

# ETF ROUNDUP

Welcome to the latest issue of ETF Roundup, our guide to recent legal and regulatory developments affecting the exchange-traded fund (ETF) industry. We hope you find this newsletter useful. If you have any questions, or if there are any topics you would like us to address in future issues, please email us at [etfroundup@morganlewis.com](mailto:etfroundup@morganlewis.com) or contact any of the Morgan Lewis lawyers listed on page 10.

## GENERIC LISTING STANDARDS FOR ETFS RELYING ON RULE 6C-11 APPROVED

The US Securities and Exchange Commission (SEC) has approved generic listing standards proposed by **NYSE Arca, Inc.**, **Cboe BZX Exchange, Inc.**, and **The Nasdaq Stock Market LLC** for shares of ETFs that are permitted to operate in reliance on Rule 6c-11 under the Investment Company Act of 1940 (1940 Act). The new standards streamline current procedures and are expected to reduce the timeline associated with bringing ETFs to market.

Notably, the new standards do not impose quantitative listing standards like those in the existing generic listing standards for index and actively managed ETFs, namely, standards related to the size, trading volume, concentration, and diversity of holdings of an ETF. In addition, the new standards do not require ETFs to calculate their intraday indicative values (IIV) and disseminate this information on their website every 15 seconds during regular trading hours<sup>1</sup>.

Shares of an existing ETF that have previously been approved for listing on an exchange, either pursuant to the exchange's generic listing standards or a Rule 19b-4 order, may be considered for listing under the new standards if the ETF is eligible to operate in reliance on Rule 6c-11. Once so approved for listing, the continued listing requirements applicable to the ETF's shares will be those in the new standards, i.e., the ETF will no longer have to comply with the continued listing requirements of the existing generic listing standards or Rule 19b-4 order, as applicable.

<sup>1</sup> Separately, the SEC [approved Cboe's proposal](#) to eliminate the IIV dissemination requirement from the exchange's existing listing standards for index and active ETFs.

## ISSUE 6

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The following is a summary of the new standards:

<b>Applicability</b>	<p>Only shares of ETFs that are permitted to operate in reliance on Rule 6c-11 are able to list on an exchange in reliance on the new standards. ETFs that are unable to rely on Rule 6c-11 and must apply for exemptive relief from the SEC to operate, such as leveraged ETFs, inverse ETFs, and semi-transparent active ETFs, are not able to list pursuant to the new standards and will have to list pursuant to the existing standards for index and active ETFs or apply for an order from the SEC pursuant to Rule 19b-4, as applicable.</p> <p>In the event shares of an ETF are listed pursuant to the new standards, and the ETF subsequently can no longer rely on Rule 6c-11, the shares may be listed pursuant to the existing listing standards for index and active ETFs as long as the shares meet all of the requirements of the applicable standards.</p>
<b>Initial Shares Outstanding</b>	<p>An exchange must establish a minimum number of shares of the ETF required to be outstanding at the time of commencement of trading on the exchange.<sup>2</sup></p>
<b>Initial and Continued Listing Standards for Index ETFs</b>	<p>If the index underlying an ETF is maintained by a broker-dealer or fund adviser, the broker-dealer or fund adviser shall erect and maintain a “fire wall” around the personnel who have access to information concerning changes and adjustments to the index and the index shall be calculated by a third party who is not a broker-dealer or fund adviser.</p> <p>Any advisory committee, supervisory board, or similar entity that advises a reporting authority<sup>3</sup> or that makes decisions on the index composition, methodology, and related matters of an index, must implement and maintain, or be subject to, procedures designed to prevent the use and dissemination of material non-public information regarding the index.</p>
<b>Initial and Continued Listing Standards for Active ETFs</b>	<p>If the investment adviser to an actively managed ETF is affiliated with a broker-dealer, such investment adviser shall erect and maintain a “fire wall” between the investment adviser and the broker-dealer with respect to access to information concerning the composition of and changes to the underlying portfolio.</p> <p>Personnel who make decisions regarding the ETF’s portfolio composition must be subject to procedures designed to prevent the use and dissemination of material nonpublic information regarding the portfolio.</p>

<b>Suspension of Trading or Removal</b>	<p>An exchange will consider the suspension of trading in, and will commence delisting proceedings of an ETF’s shares if:</p> <ul style="list-style-type: none"> <li>▪ The exchange becomes aware that the ETF is no longer eligible to operate in reliance on Rule 6c-11;</li> <li>▪ Following the initial 12-month period after commencement of trading of the ETF’s shares on the exchange, there are fewer than 50 beneficial holders of such shares;</li> <li>▪ Any of the other requirements set forth in the new standards are not continuously maintained; or</li> <li>▪ Such other event shall occur or condition exists that, in the opinion of the exchange, makes further dealings on the exchange inadvisable.</li> </ul>
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## NEW STRUCTURES FOR SEMI-TRANSPARENT ACTIVE ETFs APPROVED

The SEC recently issued exemptive orders to **Blue Tractor Group**, **Natixis/NYSE**, **T. Rowe Price**, and **Fidelity** approving their respective “semi-transparent” active ETF structures. The orders, which were preceded by the order issued to **Precidian Investments** in May 2019, grant necessary exemptions from the 1940 Act to permit the operation of actively managed ETFs that do not fully disclose their portfolios on a daily basis. The orders are only available to ETFs that invest in specific securities described in the application to the order, such as listed equities and futures, that principally trade during US market hours. Below, we summarize the key features of the approaches presented by each of the newly approved structures.

### Background

Prior to the issuance of the above-referenced orders, the SEC has historically required that an active ETF provide daily disclosure of the identity and weighting of its portfolio holdings. Recently adopted Rule 6c-11 also requires such daily disclosure. Like the ActiveShares® structure approved in Precidian’s order, however, the newly approved structures do not require full daily disclosure. Instead, ETFs that rely on one these orders will disclose a “proxy portfolio” designed to closely track the daily performance of an ETF’s portfolio, as well as certain other information that, together with

<sup>2</sup> In its application, Nasdaq stated that it would consider at least one creation unit outstanding at the time of listing to be sufficient for purposes of complying with this requirement. Cboe’s and NYSE Arca’s applications do not include such a statement.

<sup>3</sup> A “reporting authority” with respect to an ETF is defined as an exchange, an institution, or a reporting service designated by the exchange as the official source for calculating and reporting information relating to the ETF, including, but not limited to, any current index or portfolio value; the current value of the portfolio of any securities required to be deposited in connection with issuance of shares; the amount of any dividend equivalent payment or cash distribution to holders of shares; net asset value; and other information relating to the issuance, redemption or trading of shares.

the proxy portfolio, seek to ensure that an ETF's arbitrage mechanism is effective.<sup>4</sup>

#### **Blue Tractor Group LLC and Blue Tractor ETF Trust**

Blue Tractor's order provides for the use of a "Dynamic SSRSM Portfolio," which is created using a proprietary algorithmic process and contains all of the securities in the ETF's portfolio (and no others), but with portfolio weightings that differ from weightings of the ETF's actual portfolio. The Dynamic SSRSM Portfolio will have a minimum weighting overlap with the actual portfolio of 90%.

Additionally, the ETF will publicly disclose a "Guardrail Amount," which is the maximum possible deviation (but not the actual deviation) between the weightings of the securities in the Dynamic SSRSM Portfolio and their respective weightings in the ETF's actual portfolio. The Guardrail Amount will ensure that no individual security in the Dynamic SSRSM Portfolio will be overweighted or underweighted by more than the publicly disclosed percentage when compared to the actual weighting of each security within the ETF's actual portfolio as of the beginning of each trading day. The Guardrail Amount is designed to help market participants evaluate the risk that the performance of the Dynamic SSRSM Portfolio may deviate from the performance of an ETF's actual portfolio.

#### **Natixis Advisors, LP, Natixis ETF Trust II, and NYSE Group Inc.**

Natixis' structure provides for the use of a proxy portfolio created by applying Natixis' proprietary factor model analysis to an ETF's actual portfolio. The analysis, which considers market, fundamental, and industry/sector factors, creates a proxy portfolio that includes actual portfolio holdings in differing weights as well as additional holdings not included in the actual portfolio. Under this approach, an ETF is assigned a "model universe" comprised of securities the ETF can purchase (for example, a model universe could be the S&P 500 Index, the Russell 1000 Index, or the 3,000 largest US-listed equity securities). The results of the factor model analysis are applied to the model universe, generating a proxy portfolio, which is a small sub-set of the model universe.

Further, the ETF will disclose a proxy overlap, defined as the percentage weight overlap between the holdings of the prior business day's proxy portfolio compared to the holdings of the ETF that formed the basis for the ETF's calculation of NAV at the end of the prior business. The ETF also will disclose tracking error, defined as the standard deviation over the past three months of the daily proxy spread (i.e., the difference, in percentage terms, between the proxy portfolio per share NAV and that of the actual portfolio at the end of

the trading day). These disclosures will provide additional information to the market making community and help market participants evaluate the risk that the performance of the proxy portfolio may deviate from the performance of the actual portfolio.

#### **T. Rowe Price Associates Inc. and T. Rowe Price Equity Series Inc.**

Under T. Rowe's structure, for each ETF, the adviser will identify a proxy portfolio, which could be a broad-based securities index or the ETF's recently disclosed portfolio holdings. The proxy portfolio will be determined such that at least 80% of its total assets will overlap with the ETF's portfolio holdings. Each ETF will also disseminate an estimate NAV (INAV) to the marketplace at 15-second intervals during the core trading session of the ETF's listing exchange.

In addition, the ETF's adviser also will publish the following information: (i) the "portfolio overlap," or the percentage weight overlap between the holdings of the prior business day's proxy portfolio compared to the holdings of the ETF that formed the basis for that ETF's calculation of NAV at the end of the prior business day; (ii) the "daily deviation" between the performance of the ETF's NAV and its proxy portfolio's NAV, which will be calculated using prices as of the end of each relevant trading day and provided for the most recent one-year period; (iii) "empirical percentile" data representing the value of daily deviations (in basis points) exceeded by a specific percentage of all daily deviations over the past year; and (iv) tracking error, defined as the standard deviation over the past three months of the daily proxy spread (i.e., the difference, in percentage terms, between the proxy portfolio's per share NAV and that of the ETF at the end of the trading day). The disclosure of such information is designed to help arbitrageurs by describing the market behavior of the proxy portfolio and how it relates to the ETF's portfolio holdings, and by providing historical valuation data and analysis.

#### **Fidelity Management & Research Company, FMR Co. Inc., Fidelity Beach Street Trust, and Fidelity Distributors Corporation**

Fidelity's structure will use a "tracking basket" that consists of (i) select recently disclosed portfolio holdings; (ii) liquid US ETFs that are representative of the ETF's actual portfolio (such representative ETFs may constitute no more than 50% of the tracking basket's assets); and (iii) cash and cash equivalents. The tracking basket will be constructed utilizing a mathematical optimization process to minimize deviations in the daily returns of the tracking basket relative to the daily returns of the ETF. This process seeks to minimize tracking error, turnover cost, and basket creation cost.

<sup>4</sup> The Precidian structure takes a different approach - under this structure, creation and redemption transactions are effected through a confidential brokerage account with an agent, which will be a broker-dealer (referred to as the AP Representative), for the benefit of an authorized participant. We review this structure in a [previous issue of ETF Roundup](#).

In addition, on each business day, the ETF will publish on its website the “tracking basket weight overlap,” representing the percentage weight overlap between the holdings of the prior business day’s tracking basket compared to the holdings of the ETF that formed the basis for the ETF’s calculation of NAV at the end of the prior business day.

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## COVID-19: US REGULATORY RELIEF AND RELATED EFFECTS ON MARKETS AND PARTICIPANTS

The SEC, Financial Industry Regulatory Authority, Commodity Futures Trading Commission, and National Futures Association have each announced temporary regulatory relief for market participants whose operations may be affected by the coronavirus (COVID-19) pandemic. We have compiled a summary of such relief to date, which can be [accessed here](#).

For our clients, we have formed a multidisciplinary Coronavirus COVID-19 Task Force to help guide you through the broad scope of legal issues brought on by this public health challenge, which includes a Financial Services COVID-19 Task Force to focus on the issues specifically impacting our financial services industry clients.

We also have launched a [resource page](#) to help keep you on top of developments as they unfold. More detailed information about certain of the relief summarized below can be found in the Financial Services section of our COVID-19 resource page. If you would like to receive a daily digest of all new updates to the page, please [subscribe](#) now to receive our COVID-19 alerts.

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## SEC REQUESTS COMMENT ON FUND NAMES RULE

On March 2, 2020, the SEC issued a [request for public comment](#) on Rule 35d-1 under the 1940 Act (the Names Rule) and the framework for addressing fund names. The Names Rule generally requires that if a fund’s name suggests a particular type of investment (e.g., stock or bond), industry (e.g., utilities or healthcare), or geographic focus (e.g., Japan or Latin America), the fund must invest, under normal circumstances, at least 80% of its net assets, plus the amount of any borrowings for investment purposes, in the type of investment, industry, country, or geographic region suggested by its name.

Although the SEC and its staff have issued guidance on the Names Rule<sup>5</sup>, the SEC has not amended the rule since its adoption in 2001. Since then, the SEC staff and the industry have identified a number of challenges regarding the application of the Names Rule. The SEC is now seeking public comment to help assess whether the Names Rule is effective in prohibiting funds from using names that are materially deceptive or misleading and whether there are alternatives the SEC should consider, including repeal of the Names Rule.

In the request, the SEC details a number of challenges its staff and the industry have identified related to the Names Rule and seeks public comment on a variety of questions. Following is a discussion of certain of these challenges and questions, some of which may be particularly relevant to ETFs.

- **Index funds.** With respect to index funds, the SEC notes that such funds are subject to the Names Rule while the indexes they track are not. As a result, Names Rule issues are raised when an index fund’s name includes the name of the index it tracks, but the index constituents are not closely tied to the investment suggested by the fund’s/ index’s name. Aside from noting this, however, the request did not further discuss or address these issues or raise index fund-specific questions.
- **80% threshold.** The SEC asks whether the 80% threshold required under the Names Rule continues to be appropriate and whether a higher or lower threshold should be used. The SEC also asks whether the threshold should apply at the time of investment, as is currently the case, or whether a fund should be required to maintain that level of investment. Moving to a continuous minimum threshold rather than an at the time of investment threshold could potentially cause issues for index-based ETFs when an index constituent no longer meets the ETF’s Names Rule definition, but is not removed from the index. In such an instance, forcing an ETF to sell securities that are still included in the index in order to continue to meet the Names Rule threshold may cause the ETF to experience tracking error.
- **Use of derivatives and asset-based test.** The SEC notes that funds are increasingly using derivatives and other financial instruments that provide leverage as part of their strategies. In the request, the SEC acknowledges that an asset-based test may not be well-suited to derivative investments that provide significant exposure to a type of investment, and asks whether there are other tests that would be more appropriate. For example, the SEC asks whether the Names Rule should (i) take into account a derivative’s notional value or some other type of value other than market value or (ii) require that the type of investment suggested by a fund’s name contribute at least a minimum amount to a fund’s returns (e.g., The

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5 See, e.g., [Frequently Asked Questions about Rule 35d-1 \(Investment Company Names\)](#).



ABC Bond Fund would be expected to derive at least 80% of its returns from investments in bonds).

- **Industry classification.** The SEC asks how funds determine whether an investment is part of a particular industry. The SEC further asks, among other things, if there should be a quantifiable test based on revenues or assets to determine industry, whether there are circumstances where a company may be considered part of more than one industry, and whether the Names Rule should provide flexibility to funds that intend to focus their investments in newer industries or industries that rely on certain emerging technologies (e.g., 5G technology, artificial intelligence, or blockchain). These questions are of particular relevance to index ETFs seeking to distinguish themselves by tracking indexes of newer or emerging industries. Oftentimes these newer or emerging industries are driven by established companies where the industry does not represent a significant portion of the company's revenues or assets, or the company is considered part of a broader, more well-known industry by third-party industry classifications. Determining industry by a quantifiable test based on revenue or assets or by a third-party classification system, however, would eliminate major contributors to the newer or emerging industry that drive the industry's overall performance and that investors would expect to be included in an index tracking such industry.
- **Global or international funds.** The Names Rule currently does not apply to the use of the terms "global" or "international;" however, the SEC asks if it should apply and, if so, how. For example, the SEC asks (i) if a global or international fund should be required to invest a certain percentage of assets in a minimum number of countries or outside the United States, and (ii) how a fund should treat multinational companies with a significant presence in more than one country or region. Requirements such as these could potentially cause significant issues for ETFs tracking "global" or "international" indexes that are not subject to the Names Rule and, therefore, not subject to such requirements.
- **Short/intermediate/long-term funds.** Similar to the terms "global" or "international," the Names Rule also does not currently apply to fund names that include terms such as "short-term," "intermediate-term," or "long-term." However, the SEC asks if it should apply and, if so, how. In the "[Frequently Asked Questions about Rule 35d-1](#)" released in 2001, the SEC staff expressed its position that "a 'short-term,' 'intermediate-term,' or 'long-term' bond fund should have a dollar-weighted average maturity of, respectively, no more than 3 years, more than 3 years but less than 10 years, or more than 10 years." These maturity ranges are with respect to the average of a fund's portfolio and not each individual bond. Although the request did not suggest possibly applying these requirements to individual bonds, doing so could significantly affect the portfolios of existing funds and, in particular, fixed income

index ETFs that track indexes that are not subject to the Names Rule.

- **ESG funds.** In recent years, ESG funds (including ESG index funds) have significantly grown in popularity and have been a point of focus for the SEC and its staff. The strategies of ESG funds vary from fund to fund. For example, some ESG funds seek to specifically invest in companies exhibiting positive ESG characteristics while others seek to exclude companies exhibiting negative ESG characteristics. The SEC asks if the Names Rule should impose specific requirements on when a particular investment may be characterized as ESG and, if so, what the requirements should be. Alternatively, the SEC asks if the Names Rule should require funds using the term ESG to explain to investors what they mean by that term. Given the varied way different funds apply ESG in their strategies, any type of quantitative requirement could potentially cause issues for existing funds and impact the development of new funds in the future.
- **Ticker symbols.** Section 35(d) of the 1940 Act only applies to fund names and the use of "words" in those names (i.e., Section 35(d) does not apply to ticker symbols). The SEC notes that a fund may select a ticker symbol that is intended to convey information about how the fund invests. The SEC asks whether the Names Rule should apply to fund ticker symbols and, if so, how.

Comments on the request are due by May 5, 2020.

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## SEC PROPOSES NEW REGULATION OF FUND VALUATION

Under a [proposal](#) issued April 21, 2020, the SEC would substantially revise the regulation of fund valuation for the first time in 50 years and rescind much of the current guidance. The proposed rule would clarify the ability of independent directors to assign fair valuation responsibility to an investment adviser, but implementation could pose substantial compliance and operational burdens for fund complexes and their managers—even though the end result may not be that different from current practices. We describe the proposal in detail in our [LawFlash](#).

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## NEW METHOD FOR CERTAIN EXCHANGE-TRADED PRODUCTS TO PAY REGISTRATION FEES

On April 8, 2020, the SEC [adopted](#) reforms designed to streamline the registration, offering, and investor communications processes for business development companies and registered closed-end investment companies. In response to [industry comments](#) on the

**proposal**, the SEC extended to certain exchange-traded products (ETPs) not registered under the 1940 Act, such as commodity-backed ETPs, the ability to pay securities registration fees using the same method that mutual funds and ETFs use today.<sup>6</sup>

Specifically, the SEC adopted new Rule 456(d) under the Securities Act of 1933 (Securities Act), which will allow issuers that offer “exchange-traded vehicle securities” to elect to register an offering of an indeterminate amount of such securities and pay registration fees for such an offering on an annual net basis no later than 90 days after the end of the fiscal year when making this election.

Amended Rule 405 under the Securities Act will define the term “exchange-traded vehicle security” to mean a security:

- (A) of an issuer (i) that is not a registered investment company under the 1940 Act and (ii) the assets of which consist primarily of commodities, currencies, or derivative instruments that reference commodities or currencies, or interests in the foregoing; (B) offered or sold in a registered offering on a continuous basis pursuant to Rule 415 by or on behalf of the issuer; (C) of a class of securities that is listed for trading on a national securities exchange at or immediately after the time of effectiveness of the registration statement; and (D) which is able to be purchased or redeemed, subject to conditions or limitations as described in the registration statement for the offering of such security, by the issuer for a ratable share of the issuer’s assets (or the cash equivalent thereof) at their net asset value each business day.

The SEC also adopted Rule 457(u) under the Securities Act, which sets forth the calculation method for paying registration fees in this manner and is consistent with the fee calculation provisions of Form 24F-2. Finally, the SEC adopted Rule 424(i) pursuant to which issuers relying on Rule 456(d) will be required to file a prospectus supplement when paying registration fees on an annual net basis. Rule 424(i) will include disclosure requirements modeled after Form 24F-2.

The effective date of this aspect of the reforms is August 1, 2021.

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## SEC STAFF ISSUES DISCLOSURE GUIDANCE

In August and September 2019, respectively, the Division of Investment Management’s Disclosure Review and Accounting Office (DRAO) published **ADI 2019-08 – Improving Principal Risks Disclosure** and **ADI 2019 – 09 – Performance and Fee Issues**. In publishing the two ADIs, the staff described certain observations on fund, including ETF, disclosure filings, noting approaches that may improve such disclosures for investors.

### ADI 2019-08 – Improving Principal Risks Disclosure

Noting that some principal risk disclosures used by funds are unnecessarily long and technical, ADI 2019-08 offers the following suggestions for improving such disclosures for investors:

- **Ordering risks by importance.** Although many funds elect to list their principal risks in alphabetical order, ADI 2019-08 states that the staff strongly encourages funds to disclose risks in order of importance to draw attention to the risks that should receive the most careful consideration. The staff notes that an alphabetical approach is particularly problematic for funds that include a long list of principal risks. In acknowledging the subjective nature of ordering risks by importance, the staff states that funds are in the best position to make such determinations and that it therefore would not generally expect to comment on a fund’s ordering of risks by importance.
  - We note that Dalia Blass, director of the Division of Investment Management, has **spoken** publicly about this issue. The staff regularly raises this issue in the course of reviewing and providing comments on fund registration statements. More recently, certain staff members have indicated during the comment process that funds may prioritize the top three risk factors, followed by the remainder listed in alphabetical order. It is not certain that all staff reviewers take this approach.
- **Tailoring risk disclosures.** The staff also advises funds to tailor risk disclosures to describe how a particular fund operates rather than relying on the use of generic, standardized risk disclosures across funds in the same fund complex. ADI 2019-08 suggests that, in tailoring such disclosure, a fund should avoid including descriptions of particular risks that are not relevant to or discussed in the fund’s principal investment strategy.
- **Disclosing that a fund is not appropriate for certain investors.** The staff encourages funds to consider including in their principal risk disclosures a statement that, given its characteristics, a fund is not appropriate for certain investors. The staff notes that such a statement would allow investors to make a more informed decision consistent with their investment goals.

ADI 2019-08 also noted several additional considerations funds may take in presenting and reviewing disclosures, including a reminder to use the summary prospectus to present summarized disclosure rather than detailed information, a suggestion to disclose non-principal risks (and non-principal investment strategies) in the statement of additional information (SAI), not the prospectus, and a recommendation for a fund to periodically review its risk disclosures with a view towards ensuring that the disclosures “remain adequate” given the fund’s characteristics and the current market environment.

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6 Mutual funds and ETFs rely on Rule 24f-2 under the 1940 Act to pay registration fees in arrears and on a net basis.

## ADI 2019-09 – Performance and Fee Issues

The staff's intent in publishing ADI 2019-09 was to address certain issues it has observed relating to the presentation of performance and fee information.

- **Performance presentations.** ADI 2019-09 identifies the staff's repeated observance of certain errors in reviewing the presentation of fees in fund prospectuses. As relevant to ETFs, these errors include presenting negative performance as positive performance in both the bar chart and average annual return table and inadvertently transposing the performance of multiple benchmark indexes. The staff encourages funds to closely review their performance and fee disclosures prior to filing them with the SEC and providing them to investors, given the importance of performance information.
- **Fee presentations.** The staff also provides examples of certain mistakes some funds have recently made in their presentations of fees and expenses. Among those mistakes are incorrectly showing net expenses that exceed gross expenses in fund fee tables (the staff notes that this often occurs when a fund reflects recoupments as a positive fee waiver rather than a reduction in gross fees), failure to disclose a fund's acquired fund fees and expenses in fund fee tables, and failure to correctly calculate a fund's expense example (often due to mathematical errors, failure to reflect fee waivers for only the term of the waiver, and/or failure to include certain fee items, such as acquired fund fees and expenses). ETFs that do not utilize fee waivers due to unitary management fee arrangements should be aware of and monitor for the foregoing errors that do not relate to fee waivers.
- **Risk/return summaries in XBRL.** The staff notes the importance of ensuring that data tagged in XBRL format in the risk/return summaries is correct, reminding funds that such tagged data files carry the same liability as the related traditional format filings.

## DIRECTOR OF SEC'S DIVISION OF INVESTMENT MANAGEMENT GIVES KEYNOTE ADDRESS

On December 3, 2019, Dalia Blass, director of the SEC's Division of Investment Management gave a [keynote address](#) at the ICI Securities Law Developments Conference in Washington, DC. In her remarks, Ms. Blass discussed the division's recent efforts with respect to fund innovation, modernizing fund regulation (including the proposed derivatives rule and the division's ongoing review

of affiliated securities lending arrangements throughout the industry), and fund disclosure.

Ms. Blass reviewed developments over the last year in the ETF space, in particular, the adoption of Rule 6c-11 and the issuance of orders for semi-transparent actively managed ETFs. She noted that the division continues to review other proposals for new ETF models and encourages the industry to bring more ideas to their attention.

Finally, Ms. Blass said the division has heightened its review of disclosures made by funds tracking foreign indices, particularly those with significant exposure to emerging and frontier markets. She explained that there may be heightened risks associated with the adequacy and reliability of the information index providers use when constructing their indices because there may be less publicly available information in these markets and because these markets may involve less oversight of compliance with regulatory and reporting requirements. She further explained that there may be a marked difference in the rights and remedies available to the fund against index constituents located in emerging and frontier markets compared to those available in the United States. Ms. Blass therefore encouraged funds to consider certain questions designed to assess potential risks to the reliability of index data, index construction, and index computation.

## SEC PROPOSES REQUIREMENTS FOR FUNDS' USE OF DERIVATIVES AND OTHER TRANSACTIONS

On November 25, 2019, the SEC [proposed new rules and amendments](#) that establish requirements for the use of derivatives and other financial transactions by registered investment companies, including ETFs. The proposing release consists of three parts: (1) new Rule 18f-4 under the 1940 Act, which is designed to provide a comprehensive approach to the regulation of funds' use of derivatives and other financial transactions; (2) proposed sales practices rules designed to address investor protection concerns with respect to leveraged/inverse funds; and (3) proposed amendments to Forms N-PORT, N-LIQUID, and N-CEN. We describe the proposal in detail in our [LawFlash](#).

Of particular significance to ETF issuers is the SEC's proposed treatment of leveraged/inverse funds, summarized as follows:

### 1. Alternative requirements under proposed Rule 18f-4.

A leveraged/inverse fund<sup>7</sup> would not have to comply with the proposed VaR-based leverage risk limit under Rule 18f-4 provided the fund limits the investment results

<sup>7</sup> The proposing release defines "leveraged/inverse funds" to include funds "that seek, directly or indirectly, to provide investment returns that correspond to the performance of a market index by a specified multiple, or to provide investment returns that have an inverse relationship to the performance of a market index, over a predetermined period of time."

it seeks to 300% of the return (or inverse return) of its underlying index and discloses in its prospectus that it is not subject to Rule 18f-4's limits on leverage risk.

**2. Sales practices rules.** Proposed Rule 15l-2 under the Securities Exchange Act of 1934 and proposed Rule 211(h)-1 under the Investment Advisers Act of 1940, collectively deemed the "sales practices rules," would prohibit a broker-dealer or investment adviser from accepting or placing an order for the account of a natural person, or the non-professional legal representative of a natural person (retail investor), to buy or sell a leveraged/inverse investment vehicle unless the firm has approved the retail investor's account to engage in those transactions.

A firm would be permitted to provide this approval only if it has a reasonable basis for believing that the retail investor has such knowledge and experience in financial matters that he or she may reasonably be expected to be capable of evaluating the risks of buying and selling leveraged/inverse investment vehicles. In making this determination, the firm would be required to exercise due diligence to ascertain the essential facts relative to the retail investor, his or her financial situation, and investment objectives, including, at a minimum, the following information: (i) investment objectives and time horizon; (ii) employment status; (iii) estimated annual income from all sources; (iv) estimated net worth (exclusive of family residence); (v) estimated liquid net worth; (vi) percentage of the retail investor's estimated liquid net worth that he or she intends to invest in leveraged/inverse investment vehicles; and (vii) investment experience and knowledge regarding leveraged/inverse investment vehicles, options, stocks and bonds, commodities, and other financial instruments.

**3. Amendments to Rule 6c-11.** In light of proposed Rule 18f-4 and the sales practices rules, Rule 6c-11 would be amended to remove the exclusion of leveraged/inverse ETFs. In connection with such amendment to Rule 6c-11, exemptive orders previously issued to leveraged/inverse ETFs would be rescinded.

Comments on the proposal were due by March 24, 2020. In light of the COVID-19 pandemic, however, the SEC will not take final action before May 1 in order to allow commenters additional time if needed.

## NEW PRODUCT REGISTRATIONS

Following is a list of ETFs registered under the 1940 Act that filed a Form 8-A between January 1, 2020, and March 31, 2020. Form 8-A is filed to register a class of securities under Section 12(b) or 12(g) of the Exchange Act and is often filed in close proximity to an ETF's commencement of operations.

Date of 8-A Filing	Fund	Ticker Symbol
03/26/2020	Innovator Nasdaq-100 Power Buffer ETF™ — April	NAPR
03/26/2020	Innovator Russell 2000 Power Buffer ETF™ — April	KAPR
03/10/2020	Franklin Liberty Ultra Short Bond ETF	FTUS
03/06/2020	iShares MSCI Kuwait ETF	KWT
03/06/2020	Esoterica NextG Economy ETF	WUGI
03/03/2020	BNY Mellon US Large Cap Core Equity ETF	BKLC
03/03/2020	BNY Mellon US Mid Cap Core Equity ETF	BKMC
03/03/2020	BNY Mellon US Small Cap Core Equity ETF	BKSE
03/03/2020	BNY Mellon International Equity ETF	BKIE
03/03/2020	BNY Mellon Emerging Markets Equity ETF	BKEM
03/03/2020	BNY Mellon Core Bond ETF	BKAG
03/03/2020	BNY Mellon Short Duration Corporate Bond ETF	BKSB
03/03/2020	BNY Mellon High Yield Beta ETF	BKHY
03/02/2020	JPMorgan BetaBuilders U.S. Mid Cap Equity ETF	BBMC
02/26/2020	TrueMark Technology, AI & Deep Learning ETF	LRNZ
02/26/2020	TrueMark ESG Active Opportunities ETF	ECOZ
02/25/2020	Innovator S&P 500 Buffer ETF™ — March	BMAR
02/25/2020	Innovator S&P 500 Power Buffer ETF™ — March	PMAR
02/25/2020	Innovator S&P 500 Ultra Buffer ETF™ — March	UMAR
02/24/2020	ClearBridge Focus Value ETF*	CFCV
02/24/2020	Agility Shares Dynamic Tactical Income ETF	THY
02/24/2020	Agility Shares Managed Risk ETF	MRSK
02/24/2020	QRAFT AI-Enhanced U.S. High Dividend ETF	HDIV
02/21/2020	iShares iBonds Dec 2021 Term Treasury ETF	IBTA
02/21/2020	iShares iBonds Dec 2022 Term Treasury ETF	IBTB
02/21/2020	iShares iBonds Dec 2023 Term Treasury ETF	IBTD
02/21/2020	iShares iBonds Dec 2024 Term Treasury ETF	IBTE
02/21/2020	iShares iBonds Dec 2025 Term Treasury ETF	IBTF
02/21/2020	iShares iBonds Dec 2026 Term Treasury ETF	IBTG
02/21/2020	iShares iBonds Dec 2027 Term Treasury ETF	IBTH
02/21/2020	iShares iBonds Dec 2028 Term Treasury ETF	IBTI
02/21/2020	iShares iBonds Dec 2029 Term Treasury ETF	IBTJ
02/20/2020	Franklin Disruptive Commerce ETF	BUYZ
02/20/2020	Franklin Genomic Advancements ETF	HELX



<b>Date of 8-A Filing</b>	<b>Fund</b>	<b>Ticker Symbol</b>
02/20/2020	Franklin Intelligent Machines ETF	IQM
02/19/2020	Hartford Core Bond ETF	HCRB
02/19/2020	FT Cboe Vest U.S. Equity Buffer ETF — February	FFEB
02/19/2020	FT Cboe Vest U.S. Equity Deep Buffer ETF — February	DFEB
02/11/2020	American Century Focused Dynamic Growth ETF*	FDG
02/11/2020	American Century Focused Large Cap Value ETF*	FLV
02/10/2020	ETFMG Travel Tech ETF	AWAY
02/10/2020	Armor US Equity Index ETF	ARMR
02/10/2020	Armor International Equity Index ETF	ARMI
02/10/2020	Armor Emerging Markets Equity Index ETF	AREE
02/07/2020	LHA Market State™ Alpha Seeker™ ETF	MSVX
02/03/2020	First Trust Merger Arbitrage ETF	MARB
01/31/2020	Direxion MSCI USA ESG - Leaders vs. Laggards ETF	ESNG
01/31/2020	Direxion S&P 500® High minus Low Quality ETF	QMJ
01/31/2020	Direxion Flight to Safety Strategy ETF	FLYT
01/30/2020	Xrackers MSCI Kokusai Equity ETF	KOKU
01/28/2020	Innovator S&P 500 Buffer ETF™ — February	BFEB
01/28/2020	Innovator S&P 500 Power Buffer ETF™ — February	PFEB
01/28/2020	Innovator S&P 500 Ultra Buffer ETF™ — February	UFEB
01/24/2020	iShares ESG MSCI EM Leaders ETF	LDEM
01/16/2020	Absolute Core Strategy ETF	ABEQ
01/16/2020	CP High Yield Trend ETF	HYTR
01/15/2020	Syntax Stratified MidCap ETF	SMDY
01/15/2020	Syntax Stratified SmallCap ETF	SSLY
01/14/2020	Day Hagan/Ned Davis Research Smart Sector ETF	SSUS
01/10/2020	iShares Factors US Growth Style ETF	STLG
01/10/2020	iShares Factors US Value Style ETF	STLV
01/09/2020	Global X U.S. Preferred ETF	PFFD
01/09/2020	Global X S&P 500 Quality Dividend ETF	QDIV
01/06/2020	Pacer CSOP FTSE China A50 ETF	AFTY
01/06/2020	Leuthold Core ETF	LCR
01/06/2020	LGBTQ + ESG100 ETF	LGBT
01/03/2020	iShares U.S. Tech Breakthrough Multisector ETF	TECB

\* Semi-transparent ActiveShares® structure.

# Morgan Lewis

## PRIMARY CONTACTS

Morgan Lewis offers a deep bench of ETF lawyers who provide clients with insights into the legal, operational, and regulatory challenges facing the ETF industry. Our team draws on its understanding of US federal securities laws, derivatives, tax, and other disciplines to collaborate with clients and develop practical solutions and sophisticated products. We are proud to have been named **ETF Law Firm of the Year – 2019** by ETF.com as part of its **annual ETF Awards**, recognizing the capabilities of our team in advising ETFs.

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