Diving into ETFs

— Are you ready for a sea change?

Presented by

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Then: Don’t Go in the Water

Before 2021

- Jurisdictional debates
  - Commodity, currency or security?
- Crypto assets prohibited
  - Valuation
  - Liquidity
  - Custody
  - Market manipulation
  - Impact on arbitrage function

Now: Swim at Your Own Risk

2021 – 2024

- 2021: Bitcoin futures contracts
- 2022-2023: Litigation breakthrough
- 2023-2024: Spot ETP products
  - Bitcoin
  - Ethereum
- Regulation by Enforcement

Next: Smooth Sailing Ahead?

2025 and Beyond

- New Administration, new rules?
  - Executive Actions
  - SEC Crypto Task Force
  - Regulatory clarity
- New Initiatives
  - More crypto-related products
  - More instruments
  - Staking
  - In-kind creation and redemption

ETF Classes

- While most ETFs are “standalone” investment companies that rely on the ETF Rule, some ETF shares are issued as a class of shares of a fund with mutual fund classes.
- Vanguard obtained exemptive relief from the SEC to offer ETF shares in this manner in 2000, with additional orders to permit ETF classes in 2003 and 2007.
- Based on these orders, almost 30% of assets in the ETF market are invested through ETF classes today.
- Despite this precedent and the popularity of ETF classes, the SEC has not issued additional exemptive orders to other fund sponsors to offer ETF classes.
- Vanguard also obtained a patent on the ETF class structure, which expired in 2023.

ETF Class Relief Omitted from ETF Rule

- When the SEC adopted the ETF Rule, the SEC did not include the Section 18 relief necessary to permit ETF classes.
- In the adopting release for the ETF Rule, the SEC stated that ETF classes raise policy considerations that are different from those addressed by the rule.
- Specifically, the SEC noted that an ETF share class that transacts with APs on an in-kind basis and a mutual fund share class that transacts with shareholders on a cash basis may give rise to different costs to the portfolio.
- The SEC concluded that fund sponsors should continue to request relief through the exemptive applications process to permit the SEC to assess relevant policy considerations in the context of specific facts and circumstances.

Pending Exemptive Applications

- Beginning in 2023, numerous fund sponsors began to file exemptive applications with the SEC for ETF class relief.
- More than 50 applications now have been filed, including from some of the largest sponsors of mutual funds and ETFs.
- Most applications seek the flexibility to add ETF classes to mutual funds and mutual fund classes to ETFs.
- Applications seek relief for both actively managed and index-based strategies.
- The SEC staff has been engaged in a comment process with applicants, but none of the applications has been amended so far.

Proposed Conditions to Relief

- Applications have proposed various conditions for the requested relief:
  - Applications generally commit to comply with the Multi-Class Rule, except for specified differences.
  - ETF operations would generally comply with the ETF Rule, although a few applications propose to extend relief to semi-transparent active ETF classes.
  - Applications generally contemplate a presentation by the adviser to the Board in connection with initial approval of class structure, and some applications note specific issues that may be addressed.
  - Some applications provide for periodic Board review of the class structure, while others would permit monitoring by a committee that would only raise material issues to the Board’s attention.
  - Applications generally commit to appropriate disclosure of multi-class structure.
  - A few applications expect a Board to determine that full portfolio transparency is appropriate.
  - A few applications would require funds generally to engage in cash transactions with shareholders.

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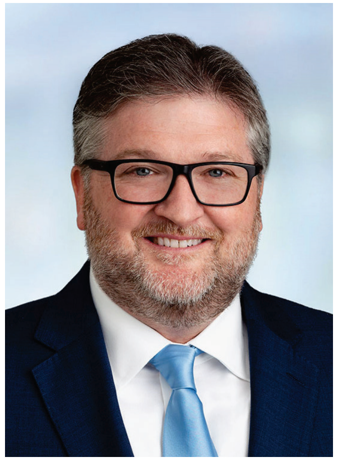

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