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The Right Way
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October 1, 2018

Submitted Electronically
Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Exchange-Traded Funds (File No. S7-16-18)

Dear Mr. Fields:

OppenheimerFunds, Inc., and its subsidiary OFI Advisors, LLC[1] (collectively, "OppenheimerFunds") appreciate this opportunity to comment to the U.S. Securities and Exchange Commission ("SEC") on the ETF Proposal, which if finalized, would permit exchange-traded funds ("ETFs") that satisfy certain conditions to operate without an exemptive order.[2] We commend the SEC's comprehensive efforts to level the playing field among existing ETF sponsors, to promote the efficient construction of ETF baskets and to enhance ETF transparency to investors.

OppenheimerFunds is a global asset manager that offers a range of ETFs pursuant to an exemptive order issued in 2013. Our current suite of ETFs is comprised of both domestic and international smart beta products, including single and multifactor products. We are also considering a number of index and active ETFs in various asset classes and strategies. The ETF Proposal, if adopted, will enable our firm to more efficiently manage our current ETFs and to more innovatively design and manage future ETFs.

[1] OFI Advisors, LLC, a direct, wholly owned subsidiary of OppenheimerFunds, Inc. ("OFI"), is a registered investment adviser, providing investment management services to 20 ETFs. OFI has been in the investment advisory business since 1960, and with its subsidiaries, has more than $245 billion in assets under management.
[2] *Exchange-Traded Funds*, 83 Fed. Reg. 37332 (July 31, 2018) ("ETF Proposal").

We also believe in robust protections for our investors and as such strongly support the enhanced transparency that certain aspects of the ETF Proposal will provide into ETF premiums and discounts and costs of ETF ownership.

We support comments to the ETF Proposal submitted by the Investment Company Institute ("ICI") and the Asset Management Group of SIFMA ("SIFMA AMG"). To echo many in the financial services industry, we believe that the ETF Proposal, with certain important changes, will enable the SEC to attain its objectives of creating a consistent, transparent and efficient regulatory framework for ETFs and to facilitate greater competition and innovation among ETFs. Below are our comments to the ETF Proposal.

I. We strongly support the inclusion of custom baskets in the ETF Proposal.

We applaud the SEC for proposing a rule that allows ETFs to use "custom baskets."[3] Doing so will benefit both the ETFs and their shareholders as portfolio managers will now have greater flexibility to more efficiently manage their portfolios. Custom baskets will allow portfolio managers to more efficiently track underlying indices that are comprised of a large number of constituents and where it may be difficult for an authorized participant ("AP") to deliver a creation unit that reflects a pro rata slice of the ETF's portfolio. Similarly, custom baskets will allow ETFs, upon receiving a redemption order, to deliver securities with unrealized capital gains, which will enhance the tax efficiency of these products.

II. The SEC should eliminate the condition requiring that the disclosure of portfolio holdings and basket assets be made pursuant to Article 12 of Regulation S-X.

The ETF Proposal would require an ETF to disclose prominently on its website on each business day both its portfolio holdings and a basket applicable to orders for the purchase or redemption of creation units.[4] Such information must present the description, amount, value and unrealized gain/loss in the manner prescribed within Article 12 of Regulation S-X. We believe conforming to Article 12 on a daily basis would be overly burdensome. By way of comparison, the preparation of financial statements, which include information required to be presented in accordance with Article 12 of Regulation S-X, follows a rigorous process that involves enriching data and classifying various financial instruments whose preliminary values may then be modified or adjusted for various reasons. Article 12 also requires detailed footnote disclosure of investments, as discussed below, which adds further complexity to the effort. OppenheimerFunds works closely with our fund accounting agent and other third parties to conduct this review during the 60-day period following the end of each fiscal period. Performing what is normally a 60-day process on a daily basis is impractical.

Additionally, we do not believe that much of the information required to be disclosed under Article 12 of Regulation S-X is necessary to make efficient ETF markets. For example, notes two and three of Article 12-12 require, in certain circumstances, the disclosure of information on industry, geography, reference rate and spread, depending on the type of security, none of which is needed for purposes of the ETF arbitrage mechanism.[5] Current exemptive orders

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[3] As defined in the ETF Proposal, custom baskets are those that (i) are composed of a non-representative selection of the ETF's portfolio holdings or (ii) are different baskets used in transactions on the same business day. *See* ETF Proposal at 271.
[4] *See* ETF Proposal at 274.
[5] *See* Letter from Susan Olson, General Counsel, Investment Company Institute to Brent Fields, Secretary, Securities and Exchange Commission dated Sep. 21, 2018 ("ICI Letter") at 22-23.

require ETFs to disclose the names and quantities of the instruments that will constitute the basket for a given business day. Similarly, self-indexed ETFs are required to disclose the identities and quantities of the portfolio securities and other assets that will form the basis of the calculation of the net asset value at the end of the business day. We recommend that the final rule not make any changes to these required data points because, as discussed below, they already provide the requisite transparency to ETF market participants. However, if the SEC is unwilling to keep these disclosures as they have been historically, we support the ICI's view that the disclosures follow a format similar to what is required by the exchange listing standards.[6] The exchange listing standards, which currently only apply to actively managed ETFs, could be used as the basis for portfolio holdings and basket disclosure of all ETFs. We believe adopting this approach would help achieve the SEC's goal of standardizing the manner in which portfolio holdings and baskets are presented while at the same time harmonizing the final rule with a separate disclosure requirement.

III. ETFs should be required to publish baskets only through the NSCC rather than through the website, and the SEC should clarify an ETF's obligations with respect to the published basket.

The ETF Proposal requires an ETF to publish a basket, on its website, "applicable to orders for the purchase or redemption of creation units to be priced based on the next calculation of current net asset value."[7] Currently, ETFs publish baskets, including custom baskets, through NSCC and these baskets are used by APs and market makers for purposes of calculating arbitrage opportunities to hedge their exposure to ETFs. We believe that the market participants that would use this basket information currently are able to access it either directly through the NSCC or through intermediaries. Therefore, we believe that ETFs should only be required to publish the basket through the NSCC rather than through the website.

We further ask the SEC to clarify that the published basket may be rejected by the ETF. The ETF Proposal provides that an ETF would publish a basket that it "would exchange"[8] for orders to purchase or redeem creation units. Although it is clear that ETFs will have the flexibility to deviate from the published basket and utilize custom baskets (pursuant to appropriate procedures), it is unclear whether an ETF issuer is compelled or obligated to accept the published basket or whether it may be rejected. There may be reasons that it would be necessary for an ETF to reject the published basket. For example, although the published basket would have been one that the ETF was willing to accept prior to the commencement of trading, changing market conditions during the course of the day, or the acceptance of a custom basket on an intervening trade, could cause acceptance of the published basket to be detrimental. Although we understand the importance of providing APs with transparency to the basket, we do not believe that an ETF should be obligated to accept the published basket.

IV. The SEC should revise the amended prospectus disclosure regarding bid-ask spreads to use hypothetical numerical examples.

The ETF Proposal would amend Item 3 in Form N-1A to include a series of Questions and Answers regarding ETF trading information and trading costs.[9] These Questions and Answers explain how investors can purchase ETFs, the types of costs inherent in purchasing ETFs (such as brokerage commissions, bid-ask spreads and premium/discounts) and the components of

[6] *See* ICI Letter at 23.
[7] *See* id. at 273-274.
[8] *See* id. at 104.
[9] *See* ETF Proposal at 279-280.

bid-ask spreads. We support the addition of these narrative disclosures, as we believe such disclosures will serve to educate investors on the various factors that impact purchases and sales of ETFs on the exchanges. We also support the Q&A format of the disclosures and believe that it will facilitate investors' understanding of these costs in a concise and easy to read manner.

We do not support the inclusion of the numerical information relating to median bid-ask spread and trading costs attributable to bid-ask spreads. Although we understand the SEC's goal of facilitating comparisons between ETFs, including this information may not achieve those goals for several reasons.

First, such comparisons would be possible only if accurate costs could be ascertained. Although such information is readily available through market data providers, it is often inconsistent, unverifiable and therefore unreliable. We note that median bid-ask information from different market data providers regarding the same ETF can vary significantly.

Second, providing information to investors on historical bid-ask spreads may not be representative of a potential investor's actual investment experience. As described in the ETF Proposal, bid-ask spreads represent only some of the trading costs associated with purchasing and selling ETFs.[10] Other trading costs include brokerage commissions, premium/discounts and quality of execution, among others. Providing bid-ask spread information to investors without regard to the other contributing factors of an investor's trading costs, may provide investors with an incomplete picture of the true costs of a trade. We respectfully submit that an investor's financial intermediary would be in a better position to explain the totality of these costs to the investor.

Third, historical bid-ask spread information could also be misleading to investors because it would be based on an ETF's prior year's bid-ask spread data and as such potentially stale. Therefore, if ETF prospectuses were to include median bid-ask spreads, mid-range spread costs and high-end spread costs, investors would potentially be making investment decisions based on out of date information.

If the SEC decides to move forward with numerical bid-ask spread disclosures, a more practical and consistent way to present this information would be through a hypothetical example that uses a given number of shares, bid price and ask price to demonstrate the impact of spreads. In this regard, we support the ICI Letter and believe that giving an example would avoid the potential of misleading investors and reliance on third party data.[11]

V. Information regarding what causes premiums/discounts could be difficult to discern and unhelpful to investors.

The ETF Proposal would require website disclosure of certain information regarding premiums/discounts. New information (not currently required by exemptive relief or Form N-1A) includes a line graph of historical premiums/discounts over the most recently completed calendar year and calendar quarter and, if an ETF's premium/discount is greater than 2% for more than seven consecutive trading days, a requirement to post this information on its website along with a discussion of the factors contributing to those premiums/discounts.[12] We believe premium/discount information is useful to both prospective and current ETF shareholders as it may reflect an ETF's portfolio liquidity, level of transaction costs and efficiency of the arbitrage

[10] *See* id. at 279.
[11] *See* ICI Letter at 30.
[12] *See* ETF Proposal at 274.

mechanism. We agree that a line graph would provide additional transparency to investors and may further incentivize ETF issuers to work to minimize them.

However, we do not agree that ETF issuers should be required to disclose on their websites information on the factors causing the premium/discounts. It may be more common (and expected) for ETFs that invest in certain asset classes to trade at greater premium or discounts, and such ETFs may trade at a premium or discount of over 2% multiple times during a year. The proposed disclosure under such circumstances would be repetitive and unnecessary. Conversely, there may be ETFs that unexpectedly trade at large discounts and premiums, the reasons for which would be difficult to readily discern based on available data.

Given these concerns, we believe the SEC's concerns would be addressed to the extent ETF issuers are reviewing the likelihood, magnitude and frequency of large premiums/discounts and including the requisite information in ETF prospectus risk disclosure.

VI. The SEC should include flexibility in the final ETF rule to allow ETFs to accept orders prior to the publication of the basket and portfolio holdings.

The ETF Proposal requires ETFs to disclose, before the opening of trading on the primary listing exchange, and before accepting any orders, their portfolio holdings and basket.[13] This differs from many current exemptive orders which require disclosure of the basket (as transmitted through the NSCC) and the portfolio holdings (for self-indexed funds) before the open of trading on the listing exchange.

This condition in the ETF Proposal would be problematic for orders that are submitted on the day prior to the transaction date (known as "T-1" orders). T-1 orders are typically submitted by APs between 4:00 and 5:30 PM. These orders are helpful for ETFs that hold a significant amount of non-US securities because they minimize an AP's exposure to price "slippage." For example, slippage may occur when APs must deliver to an ETF (for a creation order) cash-in-lieu of shares of non-US securities traded on foreign exchanges. Because at the time of the order, many non-US exchanges (e.g. Europe and Asia) are closed, the ETF's portfolio manager must purchase those securities the next day. To the extent there is a difference between the price at which the ETF acquires the securities and the price at which the ETF valued the securities, the AP is responsible for this slippage. To account for this uncertainty, APs will typically widen bid-ask spreads, thereby increasing costs to investors. T-1 orders allow ETFs to receive orders while local markets are still open and therefore minimize the likelihood of slippage.

For the reasons described above, we believe the final ETF rule should be amended to permit the practice of accepting T-1 orders.

VII. The SEC should adopt, in a future rulemaking, streamlined fund of funds relief.

We support the SEC's consideration of a new rulemaking relating to Section 12(d) under the Investment Company Act of 1940 to permit fund of fund arrangements without the need of exemptive relief. Although we believe it is appropriate for the ETF Proposal not to rescind the fund of funds relief already granted to ETF sponsors, we believe that such relief is outdated and

[13] *See* id. at p. 273.

overly complicated. The current exemptive orders require a number of burdensome conditions on both acquiring and acquired funds.[14] By comparison, the 2008 rule proposal (the "2008 Rule Proposal"),[15] if adopted, would have allowed funds of funds to acquire ETFs in excess of the limits found in Section 12(d)(1) of the 40 Act, and would have done so in a more streamlined manner than as stated in current exemptive orders. The 2008 Rule Proposal would have only required three of the current fund of funds conditions: (i) prohibiting an acquiring fund from controlling an acquired fund; (ii) prohibiting acquiring funds from also being acquired funds; and (iii) requiring acquiring fund fees to comply with NASD Conduct Rule 2830 (now known as FINRA Rule 2341). Additionally, acquiring funds would have been required to sell ETF shares on the listing exchange rather than submitting them for redemption. We also support, as many commented in response to the 2008 Rule Proposal, private funds' being able to rely on fund of funds relief to the same extent as registered funds, which would provide additional liquidity in the ETF marketplace. Therefore, we support a future rulemaking to adopt streamlined fund of funds relief and believe that doing so will ease compliance burdens associated with these types of fund of funds arrangements.

VIII. The SEC should include share class relief in a future rulemaking.

In order to further level the playing field among ETF sponsors, the SEC should include share class relief in a future rulemaking. Share class exemptive relief allows an investment company to launch an ETF as a separate share class rather than as a stand-alone investment vehicle. Using this relief, one investment company portfolio could include both a mutual fund share class and an ETF share class. As currently drafted, the ETF Proposal would allow ETF sponsors with this type of exemptive relief to continue to operate ETFs that rely on such orders and to launch new products based on this relief. We urge the SEC staff to further level the playing field by adopting, in a separate rulemaking, a rule allowing all ETF sponsors the benefits of this structure.

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Public comments from ICI and SIFMA AMG make many of these same points, and we respectfully request that the SEC evaluate the respective comments from these organizations carefully. These points include, among others, support of the ability to construct custom baskets, reconsideration of the application of Regulation S-X to portfolio holdings and basket disclosure, the ability to construct T-1 baskets and a different approach to disclosure surrounding bid-ask spread costs.

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[14] These include (i) making sure that any acquiring fund does not use investments in the acquired fund to influence the terms of any dealings between the acquiring fund and affiliates and the acquired fund and affiliates; (ii) requiring procedures to ensure that the acquiring fund is not basing investments in the acquired fund on consideration received by the acquiring fund or affiliates from the acquired fund or affiliates; (iii) requiring the board of the acquired fund to determine that any consideration paid to an acquiring fund or affiliates for services is fair; (iv) the acquiring fund and its affiliates cannot cause an acquired fund to purchase a security in affiliated underwritings; (v) the board of the acquired fund must have procedures designed to monitor purchases by the acquired fund in affiliated underwritings; (vi) the board of the acquiring fund must find that the acquiring fund is not paying duplicative advisory fees; (vii) and, both the acquiring fund and the acquired fund must sign a "participation agreement" requiring them to comply with the order.

[15] *See* Exchange-Traded Funds, Investment Company Act Release No. 28193 (Mar. 11, 2008) 73 FR 14618 (Mar. 18, 2008).

We thank the SEC for considering these comments, and request that it implement changes to the ETF Proposal that address our concerns. If you have questions regarding these comments, please contact either of us at the email addresses above.

Sincerely,

Sharon French
Executive Vice President
OFI Advisors, LLC

Cynthia Lo Bessette
Executive Vice President
and General Counsel
OFI Global Asset Management, Inc.

cc: The Honorable Jay Clayton, Chairman, U.S. Securities and Exchange Commission

The Honorable Kara M. Stein, Commissioner, U.S. Securities and Exchange Commission

The Honorable Robert J. Jackson Jr., Commissioner, U.S. Securities and Exchange Commission

The Honorable Hester M. Peirce, Commissioner, U.S. Securities and Exchange Commission

The Honorable Elad L. Roisman, Commissioner, U.S. Securities and Exchange Commission

Dalia Blass, Director, Division of Investment Management, U.S. Securities and Exchange Commission

Brett Redfearn, Director, Division of Trading and Markets, U.S. Securities and Exchange Commission