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OCTOBER 10, 2019

The ETF Rule: Paving the Way for Further Growth and Success

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For tens of millions of Americans, mutual funds and exchange-traded funds (ETFs) are the most convenient, cost-effective, transparent, and well-regulated tools available to meet their important financial goals. Both investment vehicles are governed by the Investment Company Act of 1940, but ETF sponsors must apply for exemptive orders from the Securities and Exchange Commission (SEC) to operate.

Of course, when the SEC started approving ETFs, it had no idea they would become one of the most popular and successful financial innovations in recent years. Nor did the Commission foresee that it would issue more than 300 individual orders during the past quarter of a century, resulting in more than 2,000 ETFs as of the end of August. And it did not realize how costly and time consuming obtaining the orders would be for ETF sponsors—or how it would ultimately have an order-based regulatory regime governing a rapidly growing and changing industry.

Though this inconsistent patchwork of orders has helped build a thriving marketplace, ETFs have long needed their own set of uniform regulations under the Investment Company Act of 1940. The SEC rightly recognized this by recently adopting Rule 6c-11—otherwise known as “the ETF rule.” The significance of this rule cannot be overstated, as it represents a critical step in the evolution of the ETF industry. The rule will enable ETFs to operate under the Investment Company Act of 1940 without having to apply for exemptive relief. In addition, the rule will harmonize, modernize, and streamline the regulation of this important industry while potentially paving the way for further innovation and growth for the benefit of investors.

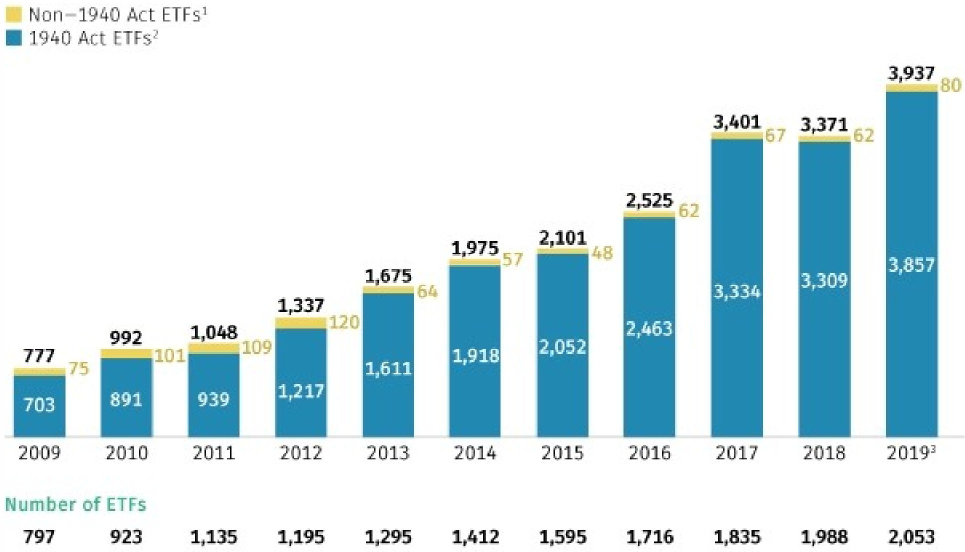
ETFs: A Robust and Growing Industry

Investors value ETFs for many reasons, but mainly because they can trade ETF shares on a stock exchange and immediately know the prices of those shares. This intraday tradability and price transparency has contributed to ETFs’ extraordinary rise.

The first US ETF launched in 1993, and ICI data show that between year-end 1993 and year-end 2008, total net assets of ETFs grew from $464 million to $531 billion. As the figure below illustrates, that growth has accelerated over the past decade. At year-end 2009, there were 797 ETFs with $777 billion in total net assets. At the end of August 2019, there were 2,053 ETFs with $3.9 trillion in total net assets.

Total Net Assets and Number of ETFs

Billions of dollars, year-end



Download an **Excel file** of this data.

[1] The funds in this category are not registered under the Investment Company Act of 1940 and invest primarily in commodities, currencies, and futures.

[2] The funds in this category are registered under the Investment Company Act of 1940.

[3] Data are as of August 31, 2019.

The ETF Rule

The SEC's new ETF rule will likely increase ETFs' growth and make it even easier for investors to benefit from these financial products. For example, allowing ETF sponsors to launch new ETFs without applying for exemptive relief will lower the barriers to entry and level the playing field for these products and their issuers. Obtaining an exemptive order was costly and could take anywhere from three to six months for even the most basic ETF. The SEC also will rescind previous exemptive orders granted to ETFs and their sponsors. Replacing this patchwork of more than 300 orders with one rule will bring much needed consistency to ETFs' regulatory framework.

Though the order regime introduced inefficiencies, the substance of the orders fostered a competitive marketplace and strong investor protections. For example, current disclosure requirements are designed to help investors understand the costs of investing in ETFs. The rule upholds these practices by requiring ETFs to show on their websites, on a daily basis, the ETF's net asset value per share, market price, and whether ETF shares are trading at a premium or discount. The rule does more than codify these disclosure requirements, though. It builds upon them by introducing a new condition: ETFs must display the median bid-ask spread over the past 30 days on their websites. By ensuring and strengthening transparency and disclosure, the ETF rule will promote even greater competition and enable ETFs to trade more efficiently, which could translate to lower trading costs for investors.

The regulated fund industry is constantly changing and growing. The previous ETF regulatory framework introduced investors to ETFs and gave rise to a $3.9 trillion industry that helps millions of Americans achieve their most important financial goals. The SEC's rule is the next step in the evolution of ETFs and will foster greater transparency, innovation, and competition, enabling more investors to realize their benefits.

For more information about ETFs, please visit our ETF Resource Center.

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