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VIA ELECTRONIC MAIL

September 28, 2018

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Proposed rule regarding Exchange-Traded Funds ("ETFs")
Investment Company Act Release No. 33-10515
File No. S7-15-18

Dear Mr. Fields:

Vanguard[1] appreciates the opportunity to comment on the Securities and Exchange Commission's ("Commission") recent release proposing a new rule governing ETFs as well as corresponding amendments to Forms N-1A, N-8B-2, and N-CEN (the "Proposing Release").[2] We support the Commission's efforts to modernize certain aspects of ETF regulation and to permit ETFs to operate without the necessity of obtaining an exemptive order from the Commission. We commend the Commission for its thoughtful consideration of proposed Rule 6c-11 (the "Proposed Rule") and recommend certain enhancements designed to better protect and inform ETF investors. Our primary comments are:

- We support the Commission's approach to modernizing the ETF regulatory framework, including the Proposed Rule's facilitation of basket flexibility, elimination of intraday indicative value ("IIV"), and elimination of creation unit size minimums;
- We recommend that the Commission consider certain alternatives to full daily portfolio holdings disclosure that more appropriately balance the relevant costs and benefits associated with such disclosure; and
- We support the Commission's efforts to better educate retail investors on the costs associated with trading ETFs and recommend modifications to simplify and streamline such disclosures for retail investors.

I. We support the Commission's approach to modernizing the ETF regulatory framework

We support the Commission's efforts to modernize the ETF regulatory framework and permit ETFs to operate without obtaining an exemptive order from the Commission. We support the many ways in

[1] Vanguard is one of the world's leading asset managers, managing over $5 trillion in assets worldwide. Vanguard offers 80 U.S. ETFs with total assets in excess of $900 billion. Vanguard's mission is to take a stand for all investors, treat them fairly, and give them the best chance for investment success.
[2] *Exchange-Traded Funds*, Investment Company Act Release No. 33-10515 (June 28, 2018).

which the Proposed Rule will simplify and enhance the regulatory framework for ETFs. First, we support the Proposed Rule's approach to permitting ETFs to use custom baskets when in the best interests of the ETF and its investors. This flexibility allows ETFs to efficiently adjust investment exposures through the creation and redemption process rather than incur the transaction costs and potential tax consequences associated with purchasing and selling portfolio holdings in the market. Custom baskets can also benefit investors by minimizing the transaction costs (*i.e.*, bid-ask spreads and/or the magnitude of premiums/discounts) associated with purchasing and selling ETF shares in the secondary market by reducing the creation/redemption costs incurred by market participants and typically passed along to ETF investors in the form of wider bid-ask spreads and/or premiums/discounts.

Second, we support the Proposed Rule's elimination of the historical requirement to disseminate an ETF's IIV, which will also minimize costs borne by the ETF that impact ETF investor returns. Although some market participants may have used IIV to evaluate arbitrage opportunities in the past, most market participants today use other sources to evaluate whether an arbitrage opportunity exists and to hedge any corresponding exposure. These other sources of data include the ETF's published basket, its last published portfolio holdings list, the index tracked by the ETF, and data from third party vendors. Market participants also rely on the correlation between the performance of an ETF's NAV and that of its index, as well as the historical correlation between the performance of an ETF's basket and that of its NAV. These tools provide market participants with the necessary information to engage in an effective and efficient arbitrage process. As a result, we believe the publication of IIV is unnecessary to facilitate a healthy arbitrage process.

Third, we support the Proposed Rule's treatment of ETF shares as "redeemable securities" within the meaning of Section 2(a)(32) of the Investment Company Act of 1940 ("1940 Act"),[3] which simplifies the regulatory complexity associated with certain provisions of the Securities Exchange Act of 1934 (the "Exchange Act").[4] We also encourage the Commission to clarify that all ETFs meeting the Proposed Rule's definition of an ETF, even those not relying on the Proposed Rule, would be eligible for treatment as "redeemable securities"[5] and to provide exemptions from other relevant rules under the Exchange Act to any ETF meeting the Proposed Rule's definition of ETF.[6]

Fourth, we support the Proposed Rule's approach to creation unit sizes and agree that ETFs should not be subject to mandated minimum creation unit sizes since ETFs are not likely to have an incentive to set very large or very small creation unit sizes that could disrupt the arbitrage mechanism. In setting creation unit sizes, we believe that ETF providers will naturally seek to balance portfolio management concerns relating to creation unit sizes (*e.g.*, tracking error) with the liquidity of the product. We agree that an ETF should have the flexibility to adjust its creation unit size when in the best interests of the ETF and its shareholders (*e.g.,* to attempt to reduce bid-ask spreads by minimizing the inventory management costs incurred by market participants that may be passed along to ETF investors).

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[3] 15 U.S.C. 80a-2 (a)(32).

[4] *See, e.g.*, Letter from James A. Brigagliano, Acting Associate Director, Securities and Exchange Commission to Stuart M. Strauss, Clifford Chance US LLP re: Class Relief for Exchange Traded Index Funds (October 24, 2006).

[5] We encourage the Commission to permit all ETFs meeting the Proposed Rule's definition of an ETF to be deemed eligible for the "redeemable securities" exceptions in 12 CFR 242.101(c)(4) and 242.102(d)(4) and 12 CFR 240.10b-17(c) in connection with secondary market transactions in ETF shares and the creation or redemption of creation units, and as falling within the "registered open-end investment company" exemption in 12 CFR 240.11d1-2.

[6] *See* 17 CFR 240.10b-10; 17 CFR 240.14e-5; 17 CFR 240.15c1-5; and 17 CFR 240.15c1-6.

Finally, we agree that it is unnecessary for the Proposed Rule to encompass ETFs structured as a share class of a fund that issues multiple classes of shares since it is not a common type of relief typically sought by ETF issuers. We believe that permitting multiple share classes within the same fund, including an ETF share class, can provide benefits to all share classes due to advantageous economies of scale. By pooling the assets of investors seeking the same investment exposure through multiple share classes, a fund may be able to lower expense ratios by allocating a fund's operational costs across a larger asset base. In addition, permitting multiple share classes within the same fund also allows all share classes to achieve investment scale more quickly and, in the case of index funds, can result in lower tracking error for all share classes due to higher degrees of index replication.

II. We recommend an alternative approach to full daily portfolio holdings disclosure

We share the Commission's view that an efficient and effective arbitrage process is important because it ensures ETF investors are treated equitably when transacting in ETF shares and that certain types of transparency can facilitate and enhance this process. However, the Proposed Rule's requirement for full daily portfolio holdings disclosure may have a small, if any, beneficial impact on the arbitrage process and could have a significant harmful impact on ETF investors. Consequently, we recommend that the Commission consider the alternatives discussed below, which we believe appropriately balance the costs and benefits associated with daily portfolio holdings disclosure.

A. Full daily portfolio holdings disclosure is superfluous and can harm investors

The Commission accurately notes in the Proposing Release that it has historically required index ETFs with unaffiliated index providers to provide daily disclosure of securities within the creation and redemption basket rather than the ETF's portfolio. Years of market experience demonstrate that a well-constructed basket with performance that closely tracks the performance of both the fund and its index promotes an efficient arbitrage process, which ensures that investors pay and receive a fair price for ETF shares. Vanguard's ETFs disclose carefully constructed baskets each day that tightly track both fund performance and their relevant index's performance, which allows market participants to estimate net asset values ("NAV") with a high degree of precision and results in ETF market prices that are very close to NAV.[7] Additional daily disclosure of an ETF's full portfolio holdings is superfluous and, as discussed below, potentially harmful to ETF investors. Additional daily disclosure of all portfolio holdings is unnecessary because it would have very little, if any, positive impact on a market participant's ability to estimate NAV, the arbitrage mechanism, and the bid-ask spread and/or the price (*i.e.*, premium or discount) at which investors transact in ETF shares on the secondary market. In our experience, a healthy, well-functioning ETF arbitrage mechanism does not require daily disclosure of full portfolio holdings.

[7] In 2017, Vanguard's domestic stock index ETFs' baskets tracked daily fund performance with an average absolute excess return of 0.4 bps (and with a standard deviation of 0.5 bps), our international stock index ETFs' baskets tracked daily fund performance with an average absolute excess return of 1.6 bps (and with a standard deviation of 2.0 bps), and our bond index ETFs' baskets tracked daily fund performance with an average absolute excess return of 1.6 bps (and with a standard deviation of 2.0 bps). In 2017, Vanguard's domestic stock index ETFs had an average absolute daily premium (absolute value of closing market price versus NAV) of 3.3 bps, our international stock index ETFs had an average absolute daily premium of 21.4 bps, and our bond index ETFs had an average absolute daily premium of 16.8 bps.

While providing little, if any, benefit to ETF investors, daily disclosure of an index ETF's full portfolio holdings can harm ETF investors by negatively impacting the prices at which the ETF trades portfolio holdings and thereby reducing investors' returns. This negative impact, and reduction in returns, arises from market participants' ability to use full daily portfolio holdings disclosure to trade ahead of index funds. The Commission recognized the potential for this negative impact when adopting funds' quarterly holdings disclosure obligations by stating "[the Commission] has determined to adopt the proposed requirement for quarterly disclosure of portfolio holdings with a 60-day delay. We are not requiring more frequent portfolio disclosure, or a shorter delay, because we take seriously concerns that frequent portfolio holdings disclosure and/or a shorter delay for the release of this information may expand the opportunities for predatory trading practices that harm fund shareholders.").[8]

Many index funds will attempt to preserve shareholder value when rebalancing due to an index change, which often means doing some trading before and/or after the effective date of an index change. This approach can benefit fund investors by reducing transaction costs and/or associated market impact of the fund's trading. Index fund managers will weigh the potential transaction cost savings against the risk of an increase in tracking error to determine an optimal trading strategy around an index change. Full daily portfolio holdings disclosure can significantly reduce the opportunity to preserve shareholder value, as other market participants will have full transparency into a fund's need to buy or sell securities. Full daily portfolio holdings disclosure can significantly reduce the ability to preserve shareholder value as some market participants will use such disclosure and the index provider's construction methodology to determine the precise amount of particular securities a fund must purchase or sell and trade ahead of the fund's transaction. This can cause the fund to pay more, or receive less, for a security than it otherwise would and thereby negatively impact fund performance, an impact that compounds over time.

We are also concerned with the proposed requirement that an ETF disclose its portfolio holdings in a manner prescribed within Article 12 of Regulation S-X,[9] which sets forth the form and content of fund financial statements. We believe that certain detailed information required by Article 12 of Regulation S-X is both unnecessary for purposes of approximating an ETF's NAV and operationally challenging for ETF issuers.[10] We suggest that the Commission revisit this proposed requirement in light of the operational burdens that would be borne by ETF sponsors to publish portfolio holdings in the manner proposed.

<u>B. We recommend an alternative approach to portfolio holdings disclosure</u>

We recommend that the Commission consider certain enhancements to the Proposed Rule's portfolio holdings disclosure requirement in light of the potential harm and limited benefit discussed above. We believe any daily portfolio holdings disclosure requirement should require ETFs to provide daily

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[8] *Shareholder Reports and Quarterly Disclosure of Registered Management Investment Companies,* Investment Company Act Release No. 26372 (Feb. 27, 2004).

[9] 17 CFR 210.12-12; 210.12-12A; 210.12-13; 210.12-13A; 210.12-13B; 210.12-13C; and 210.12-13D.

[10] For example, 17 CFR 210.12-12 requires that holdings be categorized by (i) the type of investment (such as common stocks, preferred stocks, convertible securities, fixed income securities, government securities, options purchased, warrants, loan participations and assignments, commercial paper, bankers' acceptances, certificates of deposit, short-term securities, repurchase agreements, other investment companies, and so forth); and (ii) the related industry, country, or geographic region of the investment. We also note that certain other information (*e.g.*, descriptive information about open derivatives contracts and reference indexes for variable rate securities) required within Article 12 of Regulation S-X is not currently retrieved on an automated basis such that it would be easily available for publication in connection with daily portfolio holdings disclosure.

disclosure of all portfolio holdings, except the small portion of holdings that can be used to harm ETFs and their investors. This small portion would be comprised of securities subject to sensitive trading strategies, such as those related to index changes. We believe this approach to portfolio holdings disclosure would appropriately balance the perceived benefits of daily portfolio holdings disclosure with the actual benefits of preserving shareholder value for ETF investors by avoiding disclosure of sensitive positions. This type of balance is currently contemplated in connection with Form 13F filings where Institutional Investment Managers can protect their investors from the harm caused by public disclosure of portfolio positions that are part of an ongoing program of acquisition or disposition.[11]

We also recommend that ETFs should be permitted to disseminate a list of index securities which, when combined with the disclosed portfolio holdings contemplated above, would be reasonably designed to track the fund's (and index's) performance. We estimate that this alternative approach would result in Vanguard's domestic equity index ETFs disclosing nearly 100% of their actual portfolio holdings most of the time (95%-99% during index changes) and Vanguard's bond index ETFs disclosing between 95-99% of their actual portfolio holdings most of the time (including during index changes).

We also estimate that this approach would provide an extremely reliable basis upon which one could determine an ETF's NAV. By way of example, we evaluated how our alternative approach for the Vanguard Total International Bond ETF (BNDX), over the course of a year, tracked NAV. We determined that market participants could have estimated NAV for BNDX within 0.2 basis points on average for the period from August 1, 2017 to August 30, 2018. We believe this is representative of our ability to provide disclosures designed to track fund performance for all our ETFs and generally believe that we can provide such disclosures that track fund performance within one basis point, including during volatile trading days.[12] We believe that this demonstrates that our alternative approach would be an effective way to allow market participants to estimate NAV while protecting ETF investors.

Ultimately, we agree that an efficient and effective arbitrage process, facilitated by certain types of transparency, ensures that ETF investors receive a fair price when they purchase and sell ETF shares on the secondary market. However, in mandating specific types of transparency, we urge the Commission to appropriately balance the costs and benefits associated with different types of transparency and permit flexibility for ETFs to preserve value for ETF shareholders.

III. We support the Commission's efforts to better educate retail investors on the costs associated with trading ETFs and recommend modifications to simplify and streamline such disclosures for retail investors

We support the Commission's focus on educating investors about the costs of investing in ETFs, including providing additional disclosure relating to the bid-ask spread. We have long believed in the importance of educating investors on how the bid-ask spread impacts ETF investors' returns and

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[11] *See* Form 13F Information Required of Institutional Investment Managers Pursuant to Section 13(f) of the Securities Exchange Act of 1934 and Rules Thereunder, Instructions for Confidential Treatment Requests, Section 2.

[12] For example, our alternative approach for BNDX tracked its NAV on February 5th, 2018 (a particularly volatile trading day) within 0.02 bps. In addition, our alternative approach for Vanguard Intermediate-Term Corporate Bond ETF and Vanguard Long-Term Corporate Bond ETF tracked NAV on January 31, 2018 within 0.3 bps and 0.2 bps respectively.

providing understandable disclosures to investors about the costs of investing in mutual funds and ETFs.[13] We have also long been a proponent of disclosure of actual costs associated with investing.[14] One of Vanguard's core beliefs is that costs matter and we believe it is critical for investors to understand that costs associated with investing directly impact investment returns. To this end, we believe that median bid-ask spread information from the ETF's prior fiscal year, as a data point, could be relevant for investors. However, for the reasons noted below, we believe there are significant limitations in the utility of this information for investors.

A. We offer suggested changes to the disclosures proposed to be included in Item 3 of Form N-1A

We suggest that the Commission consider making certain changes to the proposed question and answer ("Q&A") disclosures in Item 3 of Form N-1A so that they would be more understandable to retail investors. We recommend that the Commission permit ETFs to disclose the information contemplated by the first two Q&As in a narrative format (or in any other manner that the ETF believes is most useful for its investors) as opposed to a one-size-fits-all Q&A format.[15] We believe that many ETFs already include substantially similar disclosure to the proposed disclosure in the first two Q&As[16] in Item 3 and that ETF sponsors should be permitted to determine how best to present this information to ETF investors in the prospectus.

As discussed in more detail below, we believe investors would be more likely to read and understand the information being elicited in the proposed fourth Q&A if it was presented on the ETF's website in a user-friendly and standardized manner (*i.e.*, not specific to any particular ETF and including a simple hypothetical illustrating bid-ask spread costs). Investors could then use this hypothetical example to understand how the current bid-ask spread for the ETF *might* impact the cost of investment. We suggest that this hypothetical be included on the ETF's website as we believe investors would be likely to consult an ETF's website in close proximity of time to placing a trade in an ETF.[17]

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[13] *See, e.g.*, "ETFs vs. mutual funds: A Comparison" available at https://investor.vanguard.com/etf/etf-vs-mutual-fund (last visited Aug. 31, 2018); Vanguard's Plain Talk® Guide titled "Exchange traded funds" from the Vanguard Plain Talk® Library available at https://static.vgcontent.info/crp/intl/auw/docs/resources/plain-talk-guides/ptg_etfs.pdf?20180831|115721 (last visited Aug. 31, 2018).

[14] *See, e.g.,* Letter from Heidi Stam, Principal, The Vanguard Group, Inc. to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission re: Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies Release No. 33-8164, dated February 11, 2003.

[15] *See* Form N-1A, General Instructions (C)1(c) and (d) (stating "Avoid lengthy sentences and paragraphs that may make the prospectus difficult for many investors to understand and detract from its usefulness…the requirements for prospectuses included in Form N-1A will be administered by the Commission in a way that will allow variances in disclosure or presentation if appropriate for the circumstances involved while remaining consistent with the objectives of Form N-1A.").

[16] *See, e.g.*, Vanguard Extended Duration Treasury ETF Prospectus at pg. 9, dated December 21, 2017 (stating "Because secondary-market transactions occur at market prices, you may pay more (premium) or less (discount) than NAV when you buy ETF Shares and receive more or less than NAV when you sell those shares. In times of severe market disruption, the bid-ask spread and premiums/ discounts can increase significantly.").

[17] We recognize that Item 3 in Form N-1A currently requires disclosure of costs associated with a $10,000 investment in a fund for various time periods, taking into account shareholder fees and annual fund operating expenses. For the reason noted above, we believe that bid-ask spread costs associated with a hypothetical $10,000 investment in an ETF would be more useful if displayed on the ETF's website.

We also suggest that the Commission eliminate the disclosure in the proposed fifth Q&A, which includes information concerning transaction costs associated with 25 annual round-trips in an ETF. We believe this information could be confusing to the vast majority of investors, who typically buy and hold ETF investments and transact much less frequently than 25 round-trips per year. For example, Vanguard's retail brokerage clients,[18] on average, engaged in less than one round-trip per year in Vanguard ETFs for the period from July 31, 2017 to July 31, 2018.

B. <u>We recommend using a modified version of the proposed fourth Q&A as an alternative to the proposed disclosure in the third Q&A and the interactive calculator proposed to be required on an ETF's website</u>

We believe that a generic hypothetical investment scenario, such as the scenario contemplated by the fourth FAQ, would be more useful for investors than the information proposed to be disclosed in the third Q&A and would be a better alternative to the proposed interactive calculator. As noted above, we believe that such a standardized illustration of bid-ask cost would be useful for investors if it were presented on the ETF's website.

We note that actual transaction costs paid by ETF investors are influenced by a variety of factors, which would not be captured in the interactive calculator as proposed. These factors include order size, market conditions, the broker-dealer's ability to obtain price improvement on orders, the general execution quality the broker-dealer is able to obtain for orders, and the precise manner that an investor trades the ETF (*e.g.*, by placing a limit order, by trading at times other than at the open of trading when bid-ask spreads may be wider). We also note that the vast majority of Vanguard's retail brokerage clients only pay a portion of the bid-ask spread when buying and selling ETFs. For example, in 2Q 2018, Vanguard's retail brokerage clients paid less than 5% of the bid-ask spread when trading Vanguard ETFs with an effective spread/quoted spread of 1.89% taking into account market orders of up to 10,000 shares placed during market hours.[19] Approximately 97% of those market orders were executed inside the National Best Bid and Offer (NBBO) and over 94% of those orders were executed at midpoint or better (*i.e.*, no spread).

As a result, we believe that presenting median bid-ask spread information for an ETF from its prior fiscal year and providing bid-ask spread cost information through an interactive calculator could over-emphasize the potential costs an investor might pay associated with the bid-ask spread, which would be misleading since both the third Q&A and the output of the calculator would not reflect the factors noted above. In sum, we believe this information would not reflect actual costs an investor would pay when purchasing or selling an ETF. For these reasons, we suggest that a modified fourth Q&A providing generic hypothetical information on bid-ask spread costs on the ETF's website would be a more appropriate alternative than the information proposed to be included in the third Q&A and the proposed interactive calculator.

To the extent that the Commission believes it is critical for investors to compare bid-ask spread cost data across multiple ETFs,[20] we believe it would be more efficient to require ETFs to link to a third party data

[18] These include clients of Vanguard Brokerage Services, Vanguard's retail broker-dealer.
[19] Effective spread/quoted spread is a calculation measuring how much price improvement an order received. 100% effective spread/quoted spread indicates an order was executed at the bid for a sell order or at the offer for a buy order. A 0% effective spread/quoted spread indicates that an order received the midpoint between the bid and offer.
[20] *See* Proposing Release at 160 (stating "Transparency into trading costs also may promote greater comparability among ETFs and other investment products, such as mutual funds. For example, two ETFs may have very similar

source on the ETF's website rather than require each ETF sponsor to develop a calculator that would contain only bid-ask spread information relating to that sponsor's ETFs. An alternative approach would be for the Commission to provide this information through an interactive calculator that would be available on its own website. This approach would benefit ETF investors by reducing costs to ETF sponsors associated with developing and maintaining interactive calculators on separate websites. This approach would also ensure consistency in the calculation of bid-ask spreads across competing ETFs since there would be one centralized interactive calculator. We also believe that this data should only include bid-ask spreads during an ETF's regular trading on its primary listing exchange (*e.g.*, typically 9:30 am – 4:00 pm) and note that an ETF's bid-ask spread tends to be predictably wider during times of price discovery (most notably in the beginning portion of the trading day).[21]

IV. <u>We support basket flexibility</u>

We support the provisions in the Proposed Rule that would provide ETFs with flexibility in the basket construction and acceptance process. Such flexibility benefits ETF investors because it allows portfolio managers to manage ETF assets in a more efficient manner as well as reduce the ETF's arbitrage band, thereby minimizing the potential deviation between NAV and market price for ETF investors. We also support the requirement for ETFs to have robust policies and procedures designed to ensure that custom baskets are constructed in the best interests of an ETF and its shareholders. We routinely construct, and accept, custom baskets for our fixed income ETFs based on an array of relevant metrics that are carefully tailored to each ETF and collectively designed to ensure each basket is in the best interests of the ETF and its investors. We believe this type of formal process established by the ETF's investment adviser to routinely assess baskets should be a requirement for all ETFs. We will continue to ensure our custom baskets are in the best interests of our ETFs and intend to modify our current practices, as necessary, to be consistent with the custom basket requirements contemplated by the Proposed Rule for all our U.S. ETFs.[22]

With respect to the proposed requirement for an ETF to specify the titles or roles of employees of the ETF's investment adviser who are required to review custom baskets for compliance with the parameters set forth in the policies and procedures, we believe that there may be an assumption in this proposed requirement that is not reflective of certain automated review processes that an ETF's adviser may have in place to review custom baskets. For example, an ETF's adviser may choose to establish systematic risk guardrails designed to ensure custom baskets assist in index tracking in the case of an index ETF. These risk guardrails may be approved by portfolio managers and/or other personnel of the adviser with the purpose of setting limits for custom basket usage so that individual custom baskets are not each subject to manual pre- or post-review on a daily basis.

We agree with the Commission's decision not to require disclosure of every custom basket used by an ETF under the Proposed Rule. We believe that the Commission has appropriately balanced process and oversight requirements with disclosure requirements relating to custom baskets in the Proposed Rule. We do not believe that daily publication of each custom basket used by an ETF would be in the best interests of either the ETF or its shareholders. We believe that publication of custom baskets could serve to

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expense ratios, but one ETF consistently has higher bid-ask spreads, which could make the cost of that ETF significantly higher than the one with a low bid-ask spread."). As noted above, we do not believe that bid-ask spread information alone provides an accurate assessment of likely trading costs.

[21] An ETF's bid-ask spread may be wider at market open due to the price discovery process associated with the securities in its creation and redemption basket.

[22] *See* section (c)(3)(i) of the Proposed Rule.

disadvantage an ETF and its shareholders by negatively impacting the prices at which an ETF may be able to sell its holdings subject to index changes and thereby reduce shareholder returns over time. In addition, daily publication of custom baskets could harm market participants providing liquidity in the ETF by revealing the particular basket securities in which they must transact or will hold in inventory, allowing other market participants to front-run trades in such basket securities. Any costs associated with this front-running activity will likely be passed along to ETF investors in the form of wider bid-ask spreads and premiums/discounts.

We also note that index ETFs may consider various factors when constructing creation and redemption baskets, such as how a basket impacts an ETF's ability to achieve its investment objective, how a basket impacts an ETF's secondary market price, the difference between an ETF's NAV and secondary market price, and/or tax consequences. As a result, custom baskets used on a given trading day may be vastly different, including, as the Commission has noted, to account for index rebalancing or reconstitution. We therefore believe that publication of each custom basket used could potentially be confusing not only to market participants but also to the average investor.

V. We believe that ETFs should have flexibility to suspend creations in limited circumstances

We believe that the board of directors of an ETF should have the flexibility to suspend creations in the limited circumstances where doing so is in the best interests of shareholders. The Commission has historically permitted fund boards to make similar determinations. For example, the Commission permitted the board of a money market fund to make a determination to temporarily suspend redemptions with such suspension remaining in effect until the fund's board of directors, including a majority of the directors who are not interested persons of the fund, determines that the temporary suspension of redemptions is no longer in the best interests of the fund, subject to certain other conditions on the timing of restoring the right of redemption and the duration of suspensions.[23]

The suspension of creations would only be necessary to permit an ETF to continue achieving its investment objective, such as tracking an index. This could occur in unusual circumstances such as when trading markets for the index ETF's underlying securities are closed for a period of time. This could also arise in limited circumstances where an ETF is subject to investment limitations imposed by corporate issuers, regulators, or foreign governments. We believe this flexibility would allow ETF boards to protect ETF shareholders from harm, for example, from failing to closely track an ETF's index due to investment restrictions imposed by third parties. This flexibility, along with the risk that a premium or discount could develop in the ETF's shares, should be disclosed in an ETF's prospectus and an ETF should be required to promptly notify markets and investors upon exercising this flexibility.

[23] *See* 17 CFR 240.2a-7(c)(2)(i)(B).

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Vanguard appreciates the opportunity to submit these comments and would welcome further discussion with the Commission. If you have any questions or wish to discuss in greater detail, please do not hesitate to contact Brian P. Murphy at [redacted] or Lance Barrett at [redacted].

Sincerely,

Gregory Davis
Chief Investment Officer
The Vanguard Group, Inc.

cc. The Honorable Jay Clayton, Chairman
The Honorable Kara M. Stein
The Honorable Robert J. Jackson, Jr.
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
Dalia Blass, Director, Division of Investment Management