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October 1, 2018

Via E-mail to: rule-comments@sec.gov

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

Re: Exchange-Traded Funds Proposal (SEC Rel. No. 33-10515; File No. S7-15-18)

Dear Mr. Fields:

I write on behalf of Franklin Resources, Inc., a global investment management organization operating as Franklin Templeton Investments ("Franklin"). Headquartered in San Mateo, California, we employ over 9,200 people and have offices in 34 countries. As of August 31, 2018, Franklin managed approximately $722.4 billion in assets. Franklin currently manages 36 exchange-traded funds ("ETFs") that are registered with the Securities and Exchange Commission ("SEC").

Franklin appreciates the opportunity to comment on the SEC's proposal to adopt new Rule 6c-11 under the Investment Company Act (the "Proposal"), which seeks to level the playing field for new and existing ETF sponsors by permitting ETFs that satisfy certain conditions to operate without having to obtain an exemptive order. We applaud the SEC's efforts through the Proposal to establish a more consistent framework for regulation of ETFs, including proposed changes that would permit index-based and actively managed open-end ETFs to operate subject to the same conditions.

We participated in the development of, and broadly endorse, the comment letters on the Proposal filed by the Investment Company Institute and the ETF Committee of the Asset Management Group of the Securities Industry and Financial Markets Association ("SIFMA") (though not necessarily each of the specific recommendations set forth in those letters).

While we generally support the objective of the Proposal, we suggest the following two key modifications below to assist the SEC in finalizing the Proposal.

<u>We believe that bid-ask spreads represent only one element of ETF trading costs, and that the SEC's disclosure proposals place too much emphasis on bid-ask spreads.</u>

The Proposal requires that each ETF, as a condition of relying on the Proposal, disclose on its website historical information regarding the median bid-ask spreads for the ETF's shares over the most recent fiscal year. The Proposal also requires that an ETF disclose in its prospectus its median bid-ask spread over the most recent fiscal year and describe how the bid-ask spread would affect an investor's return on a hypothetical $10,000 investment. ETFs would also be required to disclose mid-range and high-end spread costs.

We agree with the SEC's goal of promoting greater investor awareness of the total cost of investing in ETFs, including the impact of trading costs; however, we strongly believe that retail investors would be better served by having clear disclosure regarding the potential impact of bid-ask spreads and brokerage costs on their purchases and sales of ETF shares, rather than the proposed historical bid-ask spread information. We note that bid-ask spreads represent only one element of ETF trading costs, and that the SEC's disclosure proposals could potentially confuse investors and create misleading expectations by placing too much emphasis on historical bid-ask spreads. An investor's trading costs can include many factors outside of bid-ask spread, such as brokerage commissions, the number of shares on the bid/offer, as well as where the ETF is trading in relation to the price of its basket. These factors can have at least as much, if not more, impact on the ultimate execution costs for an investor—particularly a retail investor.

The ETF industry, including issuers, liquidity providers, exchanges, and educational websites, among others, have spent a considerable amount of time educating investors on best practices for trading ETFs, including, for example, using limit orders instead of market orders. The reason for such a focus on trading education within the industry is to highlight that ETFs have two sources of liquidity – the liquidity of the ETF itself and the liquidity of its underlying basket. Investors now know that they can trade multiples of either the average daily volume of the ETF or of the number of shares bid/offered on exchange, because of the ability of market participants to leverage the liquidity of the underlying basket. The bid/ask spread – especially for funds with lower average daily volumes – does not tell the complete story of this second source of liquidity, and thus does not provide an accurate assessment of costs.

We also believe that bid-ask spreads do not always provide accurate information of where an ETF is trading in relation to the price of its underlying basket. While, in theory, a tighter bid-ask spread should reduce the overall trading costs of an ETF for an investor on a round-trip purchase and sale, we believe other market forces, particularly for an ETF with very high average daily volume, may cause the ETF's shares to trade without consideration for the underlying value of the ETF's portfolio securities. This occurs when firms trade an ETF's shares in response to market demands to earn the bid-ask spread (i.e., the ETF trades more like a single stock than as an ETF), rather than based on the typical ETF arbitrage mechanism that is tied to the ETF's underlying basket. The benefit of a tighter bid-ask spread is significantly reduced as the ETF price moves away from the mid-point of the arbitrage band that is based on the price of the underlying basket, particularly if an investor purchases the ETF shares during periods of buying pressure, or sells the ETF shares during periods of selling pressure.

As stated earlier, we recommend clear disclosures that highlight all the factors that could impact the cost of both trading (e.g., commissions and market impact) and owning (e.g., management fee and tracking error) an ETF. The investor can then use those factors when having an informed conversation with their executing broker on the expected cost of investing in an ETF. For these reasons, we advocate for a removal of the historical bid-ask spread disclosure requirements from the Proposal.

<u>We also believe the proposed website posting of portfolio holdings and baskets in the format proscribed under Regulation S-X Article 12 will present unintended operational difficulties.</u>

We appreciate and agree with the SEC's desire to develop an industry standard format for the presentation of portfolio holdings and basket information on an ETF's website. This will help create more consistent disclosure framework for ETF sponsors. However, we believe that requiring these disclosures to be provided in accordance with Regulation S-X Article 12 ("Reg S-X") will be overly burdensome and provide little shareholder benefit. The disclosures will present unintended operational difficulties given the *daily* requirement of the website postings, as Reg S-X reporting requires additional information related to securities and derivatives that is frequently housed in separate systems from the daily accounting systems used by most ETF sponsors. Much of this data is only updated on a quarterly basis and would not be easily accessible on a daily basis. Examples of such data points include:

- Certain security level information, including whether a security is affiliated, restricted, non-income producing, or fair valued using unobservable inputs; and
- The reference rate and spread for certain variable rate securities.

We note that other SEC rules and regulations requiring Reg S-X compliant schedules provide funds with a much longer time period to compile the information, including the recently adopted Investment Company Reporting Modernization Rule, which allows funds 60 days to prepare the Reg S-X compliant schedules (Part F) of Form N-PORT. Similarly, funds are given 60 days to prepare Reg S-X compliant schedules included in Form N-CSR. We believe that the Commission's proposal could be achieved in a simpler manner, without the undesirable operational burden of Reg S-X compliant schedules, by using the portfolio composition file ("PCF") file format already in use by ETFs when submitting information to the National Securities Clearing Corporation. We believe the PCF would provide relevant information to the users, and as this file format is already standard across ETFs, will lead to a smoother, less costly implementation once the Proposal is finalized.

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We appreciate the SEC's consideration of our comments and would be pleased to respond to any questions from the SEC or its staff.

Very truly yours,

/s/ David Mann

David Mann
Head of Global ETF Capital Markets

/s/ Gaston Gardey

Vice President – Fund Administration
and Reporting

cc: The Honorable Jay Clayton
The Honorable Kara M. Stein
The Honorable Robert J. Jackson, Jr.
The Honorable Hester M. Peirce
Dalia O. Blass, Director, Division of Investment Management
Securities and Exchange Commission