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Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20459

Re: Proposed Rule 6c-11 Under the Investment Company Act of 1940, SEC File No. S7-15-18

Dear Mr. Fields:

Jane Street Capital, LLC (together with its affiliates, "Jane Street") respectfully submits the following comment on proposed rule 6c-11 (the "Proposed Rule") under the Investment Company Act of 1940 (the "Act"), as published in Release Nos. 33-10515; IC-33140 (the "Proposal").

Founded in 2000, Jane Street is a global market maker and registered broker-dealer. Jane Street trades across a wide range of asset classes, including equities, bonds, options, currencies, commodities and futures. In 2017, the total volume of products traded by Jane Street exceeded $5 trillion. As an electronic market maker in more than 2,100 exchange traded products, Jane Street is one of the largest market makers in U.S. ETFs and has extensive experience trading ETFs in both normal day-to-day trading situations and periods of market stress. Jane Street makes markets not only by buying or selling small numbers of shares around the bid or offer, but by standing ready to provide liquidity in large size, both on exchange and to institutions through OTC markets. On an average day, Jane Street trades over $6.5 billion of ETFs, representing approximately 9% of the global ETF volume traded. As a result, Jane Street has comprehensive familiarity with workings of the ETF market and is keenly aware of the importance of a well-functioning ETF market structure.

Jane Street commends the Commission for its thoughtful efforts to create a rule which levels the playing field for all ETF issuers and streamlines the process for new ETF approvals. In particular, the Proposal accurately notes that a well-functioning arbitrage mechanism serves a vital role in the ETF marketplace, reflects the importance of ETFs in the securities market and includes several requirements which are generally conducive to a strong arbitrage mechanism. A strong arbitrage mechanism is necessary because many retail investors purchasing an ETF implicitly rely on the ETF arbitrage mechanism to ensure that they are not paying an inflated price for an ETF's shares (or selling shares at a depressed price) and because it discourages market participants from engaging in manipulation of the ETF's share price.

In this comment, Jane Street draws on its experience trading ETFs to recommend certain changes and additions to the Proposed Rule that the Commission may consider incorporating into any final rule (the "Final Rule") in order to promote the Commission's goals of creating a consistent, transparent and efficient regulatory framework for ETFs and to facilitate greater competition and innovation among ETFs.

Summary of Comments

Jane Street provides the following comments with respect to the Proposed Rule:

- ETFs should be required to promptly and fairly disseminate certain information materially impactful on the arbitrage mechanism.
- ETFs should not be required to post portfolio holding and basket information prior to accepting creation and redemption orders.
- Jane Street supports the Proposed Rule's approach to custom baskets.
- An ETF should be required to have multiple authorized participants.
- Jane Street supports not imposing a minimum creation unit size.
- Jane Street supports the exclusion of a requirement to disseminate intraday indicative values.

Ensuring Proper Dissemination of Material Information

In a number of contexts, the Proposal asks for comments on the dissemination of material information as relates to ETFs. For example:

- "Should we amend Regulation FD to apply to ETFs given that any information that is selectively disclosed may be immediately used to trade ETF shares... on the secondary market...?" (Proposal, at 87); and
- "Should we require ETFs to file periodic reports, such as on Form 8-K? Under what circumstances should we require periodic reports? For example, should we require ETFs to file periodic reports after a market event that adversely affects the arbitrage mechanism during the trading day?" (Proposal, at 178).

Jane Street believes that fair disclosure of material non-public information is an issue of relevance to ETFs. In order to ensure a level playing field for all market participants and to promote fair and accurate secondary market pricing, the securities laws should apply to ETFs the basic precept that once material non-public information is disclosed to any market participant, the issuer must publicly disclose that information to the market at large. The key types of information which may be material to an ETF *per se* are (i) information about whether the arbitrage mechanism is functioning and (ii) certain information about portfolio holdings.

Information Regarding the Arbitrage Mechanism

Material information about whether an ETF's arbitrage mechanism is functioning properly would generally concern creation halts. As the Proposal explains, when an ETF's creation and redemption process becomes disrupted, market forces which ensure that an ETF's market price is tied to its NAV are impaired. Market participants ought to be made aware in this situation, as the market price of the ETF is more likely to materially diverge from the ETF's true value. Presently, certain exchanges require listed

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ETFs to first notify the exchange of a creation halt, and then require the issuer to publicly disclose the halt.[1] However, in Jane Street's experience, market participants sometimes learn of a creation halt only when trying to create additional units or through other communications. Jane Street recommends that the Final Rule requires an ETF to immediately disseminate news that its creation process is halted through a Form 8-K or other suitable mechanism.[2]

The Proposal also asks whether commentators generally agree that ETFs cannot "set transaction fees so high as to effectively suspend the issuance of creation units" (Proposal, at 70). Jane Street agrees that ETFs should not, and generally do not, set transaction fees at a level which would effectively suspend creations in lieu of transparently informing the market that creations are halted. Jane Street also wishes to point out that ETFs could be incentivized to set *redemption* fees at a level which would effectively work to suspend redemptions of units of the ETF in cases where suspending redemptions outright would otherwise be prohibited by the Act.

Information Regarding Portfolio Holdings

The Proposal notes that the Commission has previously stated that "divulging nonpublic portfolio holdings…is permissible only when the fund has legitimate business purposes for doing so and the recipients are subject to a duty of confidentiality, including a duty not to trade on the nonpublic information"[3] (Proposal, at 85). Jane Street would like to point out how the selective disclosure of nonpublic information regarding portfolio holdings may be relevant in the ETF context.

The Proposed Rule requires that all ETFs "disclose at the beginning of the business day the portfolio that will form the basis for the next NAV calculation" (Proposal, at 78). (Currently, many ETFs publish this information, but the Proposed Rule would require all covered ETFs to do so.) As the Proposal notes, when an ETF publishes that day's portfolio holdings, market makers typically rely on the accuracy of such information for the purpose of calculating the end-of-day NAV. From time-to-time, Jane Street has encountered situations where an ETF has published portfolio holdings containing an error. Such errors may arise for a variety of innocuous reasons, such as the occurrence of unexpected corporate actions or miscalculated dividend payments. While it is not necessary that the ETF publicly correct all errors, Jane Street recommends that funds be required to avoid *selective* disclosure; that is, if an issuer decides to inform any market participants about a portfolio publication error, the issuer should inform all market participants in a suitable public manner. Additionally, in the event that an issuer chooses to

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[1] See "Listed ETP Compliance Guidance," NYSE Regulation, January 10, 2018, available at https://www.nyse.com/publicdocs/nyse/regulation/nyse-arca/NYSE_Arca_2018_Regulatory_Reminder_Letter.pdf, page 5.

[2] Jane Street further recommends that in the event of such a creations halt, the issuer should be required to immediately notify the primary exchange on which the ETF is traded and, in turn, the exchange should be required to immediately notify market participants. Exchanges are well positioned to notify market participants of such a status change, as they regularly disseminate information regarding listed equities (e.g. short sale restrictions, volatility halts). Jane Street agrees with the Proposal that an ETF may suspend creations only in limited circumstances; however, due to the large impact that a creation halt may have on the arbitrage mechanism, Jane Street believes it appropriate for the Final Rules to address halts.

[3] The Proposal cites Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings, Investment Company Act Release No. 26418 (Apr. 20, 2004), at section II.C.

provide any additional information regarding present or future portfolio holdings beyond daily files, such information should not be selectively disclosed.

"T-1" Orders

The Proposed Rule requires that an ETF publish its basket before accepting orders for creation or redemption units. While Jane Street appreciates that the Commission included this requirement in order to "mitigate possible inefficiencies in the arbitrage mechanism that could result from delaying the publication of an ETF's basket" (Proposal, at 104), Jane Street believes such a requirement would disrupt existing market practices and could impede the arbitrage mechanism. Presently, many international ETFs which hold some component securities that do not trade during U.S. hours accept creation or redemption orders from authorized participants shortly after U.S. markets close, but before the next day's basket is published (commonly referred to as a "T-1 Order"). Market participants benefit from the ability to affirmatively agree to these trades shortly after U.S. market close, as it provides them greater flexibility to transact in the underlying securities when the relevant international markets open. Based on conversations with ETF issuers, Jane Street understands that it is operationally difficult for an issuer to publish baskets for the next day shortly after U.S. market close. However, market participants such as Jane Street are willing to place a creation or redemption order, notwithstanding the lack of a published basket, for ETFs which have baskets which are predictable. For these ETFs, market participants have found that the benefits of agreeing to an order shortly after market close outweighs the costs imposed by the lack of certainty, and they knowingly and voluntarily enter creation and redemption orders. Requiring publication of baskets prior to accepting orders would disrupt a long-standing practice successfully utilized by sophisticated market participants, and Jane Street recommends it should not be incorporated in the Final Rule.

Custom Baskets

The Proposed Rule provides an ETF with the flexibility to use "custom baskets" if the ETF has adopted written policies and procedures setting forth detailed parameters for the construction and acceptance of custom baskets. Jane Street supports the Proposed Rule's approach to the utilization of custom baskets. The Proposal correctly notes that custom baskets can be an efficient way for an ETF's portfolio manager to effect changes to the ETF's portfolio, as use of custom baskets may be less costly (from the ETF shareholder's perspective) than executing trades in the open market. As the Proposal also notes, basket flexibility is especially critical for fixed income ETFs because it may be difficult for market participants to effectively source each component of a *pro rata* basket.

Jane Street agrees that "the consistent implementation of custom basket policies and procedures would discipline the basket process and would act as a safeguard against potential cherry picking or dumping of unwanted securities by authorized participants" (Proposal, at 96). It is also worth noting that prospectus rules currently require ETFs to disclose data comparing the fund's performance relative to its benchmark (for active funds) or tracker index (for passive funds) for the prior five years.[4] Especially in the case of passive funds, these disclosure requirements should provide additional incentive for funds to implement effective policies and procedures designed to ensure that fund performance does not suffer as a result of cherry picking or dumping.

[4] See Instruction (b)(2)(iii) to Item 4 of Form N-1A.

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Internal policies and procedures designed to protect ETF shareholders will be most effective when complemented by market transparency regimes designed to ensure that authorized participants and market makers do not have access to price sensitive information about basket securities which is unavailable to funds. In that light, Jane Street notes a recent proposal put forth by the SEC Fixed Income Market Structure Advisory Committee (the "FIMSAC Proposal")[5]. If implemented, the FIMSAC Proposal would create a "pilot program" whereby market participants could delay reporting the execution of block size trades in corporate bonds exceeding certain dollar size thresholds for up to 48 hours after the trade has occurred. The FIMSAC Proposal is intended to encourage large broker-dealers to provide more block-sized liquidity in corporate bonds but, as Jane Street and others have argued[6], it also risks causing an uneven playing field because certain market participants will have access to price sensitive information regarding recent large trades that has not yet been disseminated to the market at large. When negotiating custom baskets, fixed income ETFs could, on some occasions, be susceptible to cherry-picking or dumping when facing a counterparty who has non-public information about recent large trades in potential basket components.

Jane Street believes that basket flexibility is critical to ETFs and that the custom basket elements of the Proposal should be adopted irrespective of the outcome of the FIMSAC Proposal. However, Jane Street would also recommend that the Commission consider the potential impact of the FIMSAC Proposal on ETFs in light of basket flexibility.

Establishing a Minimum Number of Authorized Participants

As noted in the Proposal, "ETFs do not sell or redeem individual shares. Instead, 'authorized participants' that have contractual arrangements with the ETF (or its distributor) purchase and redeem ETF shares directly from the ETF in blocks called 'creation units'" (Proposal, at 12). Accordingly, liquidity providers who are not authorized participants of an ETF, such as market makers, proprietary trading firms, and hedge funds, must utilize an authorized participant as their agent to create or redeem ETF shares in order to complete an arbitrage. These authorized participants serve as a vital intermediary between the liquidity providers and the fund itself. Jane Street recommends that an ETF be required to have multiple authorized participants to reduce the risk of anticompetitive behavior in this key aspect of the market.[7] An ETF's arbitrage mechanism will function best when the arbitrage is competitive, low-cost and open to all liquidity providers. As more costs or other barriers are introduced into the creation and

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[5] "Preliminary Recommendation for a Pilot Program to Study the Market Implications of Changing the Reporting Regime for Block-Size Trades in Corporate Bonds", April 9, 2018 (available at https://www.sec.gov/spotlight/fixed-income-advisory-committee/transparency-subcommittee-preliminary-recommendation-fimsa-040918.pdf).

[6] See comment letters of Jane Street Capital, LLC (May 16, 2018); Flow Traders US LLC (July 5, 2018); and Larry Harris, Kumar Venkataraman and Elisse Walter (August 21, 2018) (available at https://www.sec.gov/comments/265-30/265-30.htm).

[7] Jane Street believes that requiring either two authorized participants or three authorized participants would be a reasonable standard and not unduly burdensome on ETFs, as many ETFs already meet this standard. *See* "The Role and Activities of Authorized Participants of Exchange-Traded Funds," Investment Company Institute, March 2015, available at https://www.ici.org/pdf/ppr_15_aps_etfs.pdf ("ETFs with more than $790 million in assets have an average of nine active APs and half of these ETFs have seven or more active APs. ETFs with less than $27 million have an average of two active APs").

redemption process, the ETF's market value may experience a greater divergence from its NAV. When an ETF has a single authorized participant, this arrangement can lead to price distortions if that authorized participant effectively refuses to process creation or redemption orders from other liquidity providers at reasonable prices. This may result in excessive deviations between NAV and the secondary market price of the ETF, even when plenty of liquidity providers are present. Excessive deviations between NAV and secondary market prices can also lead to a windfall for the sole authorized participant. The windfall may occur because the authorized participant may also act a liquidity provider and complete the arbitrage opportunity while denying other liquidity providers the possibility of creating or redeeming at a reasonable price. (In contrast, since there are many liquidity providers for any given ETF and less barriers to entry with respect to being a liquidity provider, Jane Street has not tended to observe situations in which deviations between NAV and market price of an ETF existed and authorized participants were willing to process creations and redemptions, but no liquidity provider was willing to utilize arbitrage to bring market price in line with the ETF's NAV.)

In some markets outside the United States, Jane Street has observed that ETFs will often use a single authorized participant, especially for a limited period of time following the launch of the fund.[8] While this arrangement is less common in the United States, Jane Street has repeatedly encountered instances within the United States in which a fund had a single authorized participant, and the ETF traded at a premium to its NAV as a result. Jane Street believes that the Final Rule should reduce the risk of this sort of arrangement by requiring a minimum number of authorized participants.

General Comments

Below, Jane Street briefly responds to certain additional topics about which the Proposal requested comments:

- *Minimum Creation Unit Size*: Jane Street agrees that the Final Rule should not contain a minimum or maximum creation unit size, as it is appropriate for different types of ETFs to have different creation unit sizes. Jane Street agrees that ETFs have no incentive to set arbitrarily large or small creation unit sizes, and that the market is best served by allowing an issuer to choose an appropriate creation unit size. Jane Street agrees with the Proposal that "a large creation unit size could reduce the willingness or ability of … market participants... to engage" in arbitrage activities (at 65). The Proposal further states: "Conversely, a small creation unit size could discourage market making and render creation units irrelevant because the ETF could issue and redeem ETF shares much like a mutual fund" (*Id.*). Jane Street does not believe that having a small creation unit size would "discourage market making".
- *Intraday Indicative Value*: Jane Street confirms the Commission's understanding that market participants today typically calculate their own intraday values of an ETF portfolio, and do not rely on the published IIV. Jane Street agrees that the Final Rule should not require the dissemination of an ETF's IIV.

[8] As ETFs are more likely to trade at a significant discount or premium to NAV shortly after launch, arrangements which introduce additional costs to the arbitrage mechanism are particularly concerning.

Sincerely,

/s/ Frank Liu

Frank Liu
Chief Compliance Officer