

SEC Adopts Amendments to Form N-1A for Exchange Traded Funds

On January 13, 2009, the Securities and Exchange Commission (SEC) adopted, among other changes, amendments to Form N-1A, the registration form for open-end management investment companies (see Ropes & Gray's "[SEC Adopts Summary Prospectus Rules for Open-End Management Investment Companies](#)" from January 27, 2009). Certain of these amendments relate specifically to disclosures made by exchange traded funds that are organized as open-end management investment companies (ETFs) and are intended to (i) provide disclosure that is more relevant to retail investors who purchase and sell ETF shares in secondary market transactions on an exchange rather than directly from the ETF in large blocks of shares called "creation units" and (ii) tailor prospectus disclosure requirements to the unique features of ETFs. Our 2008 Alert, "[SEC Proposes New Rules for ETFs](#)," describes the amendments to ETF prospectus disclosure rules that were proposed by the SEC last year in connection with proposed rule 6c-11, which would permit certain ETFs to organize and operate without obtaining an exemptive order from the SEC. To date, the SEC has not taken further action with respect to proposed rule 6c-11.

Adopted Disclosure Changes

Currently, ETFs disclose in their prospectuses (i) how to buy and redeem creation units directly from the ETF and (ii) the transaction fees charged to buy or redeem such creation units. This information is useful for the few large financial institutions that typically buy and redeem creation units directly from the ETF, but is not useful for retail investors who purchase and sell ETF shares on an exchange. Under the amended Form N-1A, ETFs with creation units of 25,000 or more shares will move this disclosure to the statement of additional information, while ETFs with creation units consisting of less than 25,000 shares will continue to disclose such information in their prospectuses.

ETFs already disclose in their prospectuses (i) that, except for purchases or redemptions of creation units, ETF shares can be purchased or sold only on an exchange, (ii) that the market price at which an investor buys or sells ETF shares may differ from net asset value (NAV), (iii) that purchases and sales of ETF shares on an exchange may include brokerage fees which are not disclosed in the fee table example, and (iv) the number of ETF shares in a creation unit. The adopted amendments to Form N-1A codify these required disclosures in the form.

ETFs already disclose on their internet web sites (i) the prior business day's last determined NAV, (ii) the market closing price of the fund's shares or the midpoint of the bid-ask spread at the time of the calculation of NAV and (iii) the premium/discount to NAV. Under the amended Form N-1A, ETFs must now disclose in their prospectuses and annual reports information about the extent and frequency with which their shares have traded at a premium or discount to NAV in the past. In this regard, the SEC has adopted a new definition of "market price" that allows ETFs to use either the closing price on the principal market on which the ETF's shares trade or, if closing price does not accurately reflect the current market value of the ETF's shares at the time the fund calculates its NAV, a value within the range between the highest offer and the lowest bid at closing. An ETF may omit the premium/discount disclosure from its prospectus and annual report if the ETF (i) makes this information available on its internet web site and (ii) includes in its prospectus and annual report the web address where this information can be found.

In addition to the amendments to N-1A described above, open-end ETFs will also be subject to the newly adopted rules requiring the inclusion of a summary section at the front of the statutory prospectus and the rules related to the optional delivery of a summary prospectus in lieu of the full statutory prospectus.

Certain Proposed Disclosure Changes Were Not Adopted

ETFs will not be required, as proposed, to report returns based on the market price of ETF shares in a separate line item in their average annual return tables, in their financial highlights tables, or in a separate bar chart under Item 2 of Form N-1A. ETFs already disclose returns based on the market price of ETF shares as a condition of their exemptive orders, although such disclosure often appears towards the back of the prospectus and may use different time periods (currently, some ETFs use calendar years and others use fiscal years). The proposal, if it had been adopted, would have standardized the time periods being used, and moved the disclosure forward in the prospectus.

Index-based ETFs will also not be required, as proposed, to compare their performance to their underlying index rather than to a benchmark index.

Compliance Dates

These rule changes will become effective on March 31, 2009. All initial registration statements and post-effective amendments that are annual updates or that add new series, filed on or after January 1, 2010, must comply with these amendments. The final compliance date for filing amendments to effective registration statements to comply with the new Form N-1A requirements is January 1, 2011. Post-effective amendments filed to comply with new Form N-1A should be filed under Rule 485(a), but the SEC in appropriate circumstances will consider requests under Rule 485(b)(1)(vii) to approve filing such amendments under Rule 485(b).

View the full text of the [final rule release](#).

View the full text of the [2008 ETF proposing release](#).

If you would like to learn more about the issues raised by this alert, please contact the Ropes & Gray attorney who normally advises you.

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