SEC's exemptive relief opens up ETF market to active managers

By Philippa Aylmer

The SEC's exemptive relief granted to non-transparent ETFs is a first but significant step for active managers and a boost to the ETF industry, says Rob Owens, Managing Director of SEI's Investment Manager Services division.

On 20 May, the SEC issued the first exemptive order permitting the operation of actively managed exchange-traded funds that do not disclose their full holdings on a daily basis. Historically, exemptive orders to operate actively managed ETFs have required daily holdings disclosure. There is also the potential adoption of new Rule 6c-11 under the Investment Company Act of 1940 that would allow ETFs to operate without obtaining exemptive orders from the SEC. Currently, they do not satisfy certain requirements and as a result require exemptive relief.

"The SEC has spent the better part of a decade discussing this issue, so one would imagine that it is now getting comfortable with the methodology proposed and can see that the products and structures work as they are designed," says Owens (pictured).

Owens explains that while institutional quality active managers have been evaluating the ETF space for a long time, the main issue is transparency: "It has long been the prohibiting factor for active managers." This is particularly so regarding the issue of daily disclosure where third parties might replicate an active ETF's investment strategy or even trade ahead of the ETF.

"The long running concern has been that if you give away too much transparency there could be front-running of your product or the product line could be diminished. But not offering enough transparency makes your product unattractive in an ETF wrapper as the spreads are too wide to effectively trade."

Rob Owens, Managing Director of SEI's Investment Manager Services division

The exemptive relief and some of the other reliefs being considered will open up a vital additional distribution channel for mutual funds looking to diversify.

"It will be a boost to the ETF industry because it will no longer be restricted to traditional passive investment products and it will prompt expansion in the number and types of products available to ETF consumers."

SEI is extending its Advisors' Inner Circle (AIC) platform to incorporate ETFs within its turnkey series trust operational infrastructure. Owens explains that allowing non-transparent ETFs is an opportunity for active managers to expand their distribution capabilities. "The AIC series trust, which currently represents USD70 billion in AUM across 133 mutual funds, enables investment organisations to rapidly launch and grow mutual funds and ETFs without having to build their own fund operating infrastructure." But adds Owens, "ultimately, these changes should benefit the investor."

Asset flows remain strong in the ETF space with Morningstar reporting that asset parity between active and passive US equity funds is potentially a few months away. ■