

Exchange-Traded Fund (ETF)

Exchange-Traded Funds (“ETFs”) are typically, but not always, designed to track the performance of an index and are generally organized as open-end funds, but differ from US Mutual Funds in significant ways:

- ETFs only issue their shares in large blocks of shares that are known as "creation units" (generally 50,000 shares of an ETF).
- Creation units are purchased and redeemed by institutional investors ("authorized participants" or "APs") who are required to enter into participation agreements with the ETF's underwriter.
- Purchase and redemption of creation units are usually not effected through cash transactions. Instead, creation units are generally purchased and redeemed "in-kind" for a basket of securities.
- ETFs are listed and traded on exchanges and individual shares of creation units are often subsequently sold to other investors in the secondary market.
- SEC exemptive relief is required for an investment company to operate as an ETF.

The most common benefits of currently available ETFs are:

- Low cost
- Tax efficiency
- Liquidity
- Transparency

For more information on ETFs, see the SEI Knowledge Partnership's white paper on [ETF 2.0](#).

Investor Profile

- Only APs may transact directly in an ETF. Other investors must purchase individual shares of the ETF on a securities exchange.
- Any investor can invest in an ETF.
- There are limits based on the number of shares available until the company authorizes more share to be created.
- 401(k), other retirement plans and employee benefit plans can invest.

Regulatory Reporting Requirements

- A Prospectus (or Summary Prospectus) must be available before or at the time of sale.
- A Statement of Additional Information (“SAI”) must be available upon request and Shareholder Reports must be provided to potential shareholders at or before the time of purchase and after investment on an ongoing basis.
- ETFs are regulated under the Investment Company Act of 1940, the Securities Act of 1933 (if sold publicly), and the Securities Exchange Act of 1934.

- ETFs must meet stock exchange listing requirements and comply with applicable requirements of the Securities Exchange Act of 1934.
- Required SEC reporting includes:
 - Form N-1A
 - Form N-CSR
 - Form N-Q
 - Proxy Voting Record (Form N-PX).

Distribution, Advertising and Promotion

- ETFs may be broadly advertised and marketed to the general public.
- Advertising and marketing are subject to compliance with SEC and FINRA rules.
- FINRA requires advertising of ETF performance to show performance based both on market price and NAV.

Fund Launch Timeline and Organizer Requirements

- Formation/registration of an ETF is essentially the same as the process for launching a US Mutual Fund. However, launching an ETF requires obtaining an SEC exemptive order, which could take anywhere from six to 18 months, depending on the novelty of the product structure and SEC workload.

Fund Operational Organization Structure

- Most ETFs are registered under the Investment Company Act of 1940 and organized as a Massachusetts or Delaware business trust and seek to qualify as a regulated investment company (“RIC”); however, some are organized as unit investment trusts (“UITs”) or grantor trusts. Generally, the operation is the same as a [US Mutual Fund](#).

Initial and Ongoing Costs

- Costs are generally considered high, relative to private funds and separate accounts.

Fees and Fee Limitations

- Generally charge straight asset-based fees.
- Performance fees, even if legally permitted, are not charged given the index-based investment objective and product competition.

Taxation

- Typically the same as [US Mutual Fund](#) with regard to taxation as RIC.

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