



DIVISION OF
TRADING AND MARKETS

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

June 2, 2022

Ms. Kris Dailey
Vice President, Risk Oversight & Operational Regulation
Financial Industry Regulatory Authority ("FINRA")
One World Financial Center
200 Liberty Street
New York, NY 10281

Re: Net Capital Treatment of Certain U.S. Treasury Exchange-Traded Funds

Dear Ms. Dailey:

Broker-dealers have inquired about the appropriate net capital treatment under Section 15(c)(3) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 15c3-1 thereunder for an exchange-traded fund ("ETF") that: (a) is an open-ended management company registered with the Commission under the Investment Company Act of 1940, as amended ("1940 Act") that issues securities redeemable at the net asset value ("NAV"); and (b) invests solely in cash and U.S. government securities that are eligible securities under paragraph (a)(11) of Rule 2a-7 under the 1940 Act, limited to U.S. Treasury floating and fixed rate bills, notes, and bonds with a remaining term to final maturity of 12 months or less, government money market funds as defined in Rule 2a-7, and/or repurchase and reverse repurchase agreements with a remaining term to final maturity of 12 months or less collateralized by U.S. Treasury securities or other government securities with a remaining term to final maturity of 12 months or less ("U.S. Treasury ETF").¹ U.S. Treasury ETFs are not money market funds as defined in Rule 2a-7 under the 1940 Act. However, broker-dealers with a long or short position in a U.S. Treasury ETF have inquired whether they can apply the haircut deduction in paragraph (c)(2)(vi)(D)(1) of Rule 15c3-1 (currently 2%) for the portion of the position that constitutes a number of shares that is eligible for redemption and the highest haircut deduction in paragraph (c)(2)(vi)(A) of Rule 15c3-1 (currently 6%) for the portion of the position not eligible for redemption. I understand the following facts are relevant to their request.²

¹ A U.S. Treasury ETF may not comply with Rule 2a-7 in that the dollar-weighted average maturity of the portfolio could be longer than that of a money market fund under Rule 2a-7.

² In a letter dated March 6, 2018, the staff of the Division of Trading and Markets advised it would not recommend enforcement action to the U.S. Securities and Exchange Commission ("Commission") under section 15(c) of the Exchange Act and Rule 15c3-1 thereunder if broker-

U.S. Treasury ETF

A broker-dealer can redeem shares of a U.S. Treasury ETF through an authorized participant. We understand that such transactions may be settled within one business day of the submission of such order in good form (i.e., T+1). Redemptions are transacted at the U.S. Treasury ETF's NAV. Each U.S. Treasury ETF's NAV will be calculated at least once per day on a day that the national securities exchange on which it trades is open. Redemptions may be settled in units of shares to be determined by each U.S. Treasury ETF, otherwise known as redemption units, by T+1, and the U.S. Treasury ETF has committed in its registration statement to permit shareholders to settle transactions within that timeframe.³ Consequently, a broker-dealer seeking to liquidate proprietary positions in shares of such a U.S. Treasury ETF through the redemption process can do so by delivering one or more redemption units of the ETF and, in return, receiving the ETF's underlying securities and/or cash by T+1.

As an alternative to the redemption processes, shares of a U.S. Treasury ETF may be purchased and sold on a national securities exchange through broker-dealers, including in amounts other than what is required by the U.S. Treasury ETF to redeem ETF shares. Shares purchased and sold in this manner will trade at market prices rather than NAV per share and, therefore, may trade at a premium or discount relative to a U.S. Treasury ETF's NAV per share. Trades executed on the exchanges currently settle in accordance with the standard settlement cycle prescribed by Rule 15c6-1 under the Exchange Act.

Net Capital Haircuts

Pursuant to Rule 15c3-1, a broker-dealer computing its net capital is required to deduct the percentages specified in paragraphs (c)(2)(vi) and (vii) of the rule (or the deductions set forth in Appendix A to Rule 15c3-1) from the market value of all securities, money market instruments, or options in the proprietary or other accounts of the broker-dealer.

Paragraph (c)(2)(vi)(A) of Rule 15c3-1 specifies haircuts for securities issued or guaranteed as to principal or interest by the United States or any agency thereof depending on the maturity, up to a maximum haircut deduction of 6% for such securities with a maturity of 25 years or more. Paragraph (c)(2)(vi)(D)(1) provides that “[i]n the case of redeemable securities of an investment company registered under the Investment Company

dealers with positions in the PowerShares Treasury Collateral Portfolio apply the haircut deduction in paragraph (c)(2)(vi)(D)(1) of Rule 15c3-1 (currently 2%) for the portion of the position eligible for redemption and the highest haircut deduction in paragraph (c)(2)(vi)(A) of Rule 15c3-1 (currently 6%) for the portion of the position not eligible for redemption. *See* letter to Invesco PowerShares Capital Management LLC from Michael A. Macchiaroli, Associate Director, Division of Trading and Markets, dated Mar. 6, 2018 (“Invesco Letter”). This letter supersedes the Invesco Letter.

³ Shares of a U.S. Treasury ETF are held in book-entry form only (shares are DTC eligible) and no physical certificates of ownership are issued.

Act of 1940, which assets consist of cash or money market instruments and which is described in [Rule 2a-7 under the 1940 Act (“Rule 2a-7”)], the deduction will be 2% of the market value of the greater of the long or short position.” Rule 2a-7, in turn, identifies the conditions that a money market fund must satisfy.

Analysis

Under paragraph (c)(2)(vi)(A)(1) of Rule 15c3-1, securities issued or guaranteed as to principal or interest by the United States or any agency thereof are currently subject to a haircut of no more than 1.5% if they mature in 12 months or less, and the haircut for these securities increases with their remaining maturity with a maximum haircut of 6%. Money market funds under Rule 2a-7 are currently subject to a haircut of 2%. In addition, as stated above, a broker-dealer, through an authorized participant, can redeem shares of a U.S. Treasury ETF that has committed to permit a T+1 settlement timeframe by exchanging a redemption unit of the U.S. Treasury ETF shares for a basket of the ETF’s underlying securities and/or cash equal to the aggregate NAV of the shares in the unit.

Based on the facts and analysis set forth above, the staff will not recommend enforcement action to the Commission under section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder if a broker-dealer elects to take the haircut deduction specified in paragraph (c)(2)(vi)(D)(1) of Rule 15c3-1 (currently 2%) on the market value of the greater of the portion of the broker-dealer’s long or short position in the size of a redemption unit (or multiple of a redemption unit) of U.S. Treasury ETF shares if the following conditions are met:

- (1) the broker-dealer is not aware of any substantial operational problem that the U.S. Treasury ETF may be experiencing;
- (2) the U.S. Treasury ETF shares can be redeemed by a broker-dealer through an authorized participant, the redemption of the U.S. Treasury ETF’s shares can be settled in exchange for a basket of the ETF’s underlying securities and/or cash by T+1, and the U.S. Treasury ETF has committed in its registration statement to permit shareholders, except in extraordinary circumstances, to settle transactions within that timeframe; and
- (3) the U.S. Treasury ETF’s shares are listed for trading on a national securities exchange and trades of such shares are settled in accordance with the standard settlement cycle prescribed by Rule 15c6-1 under the Exchange Act.⁴

Staff will not recommend enforcement action to the Commission under section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder if broker-dealers take the haircut

⁴ As an example of how to apply this haircut methodology, if the broker-dealer’s position in U.S. Treasury ETFs consists of 10,000 shares long in U.S. Treasury ETF A, 10,000 shares long in U.S. Treasury ETF B, and 10,000 shares short in U.S. Treasury ETF C, and the redemption unit for each of these three U.S. Treasury ETFs is 10,000 shares, the broker-dealer would take a 2% haircut on the 20,000 shares long and no haircut on the 10,000 shares short.

deduction in paragraph (c)(2)(vi)(A) of Rule 15c3-1 (currently 6%) on the market value of the greater of the portion of the broker-dealer's long or short position held in a size other than a redemption unit (or multiple of a redemption unit) of U.S. Treasury ETF shares if the following conditions are met:

(1) the broker-dealer is not aware of any substantial operational problem that the U.S. Treasury ETF may be experiencing; and

(2) the U.S. Treasury ETF's shares are listed for trading on a national securities exchange and trades of such shares are settled in accordance with the standard settlement cycle prescribed by Rule 15c6-1 under the Exchange Act.⁵

This staff position is based strictly on the facts and circumstances stated in the request. Any different facts or circumstances from those set forth in the request may require a different response. Furthermore, this response expresses the staff's position on enforcement action only and does not purport to express any legal conclusions on the questions presented. The staff expresses no view with respect to any other questions that the proposed activities may raise, including the applicability of any other federal, state, or foreign laws. This position is subject to modification or revocation at any time. If you have any questions regarding this letter, please email tradingandmarkets@sec.gov or call 202-551-5777.

Sincerely,

**Macchiaroli,
Michael A.**

Digitally signed by
Macchiaroli, Michael A.
Date: 2022.06.02
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Michael A. Macchiaroli
Associate Director
Division of Trading and Markets

cc: Yui Chan, FINRA

⁵ As an example of how to apply this haircut methodology, if the broker-dealer's position in U.S. Treasury ETFs consists of 5,000 shares long in U.S. Treasury ETF A, 8,000 shares long in U.S. Treasury ETF B, and 3,000 shares short in U.S. Treasury ETF C, and the redemption unit for each of these three U.S. Treasury ETFs is 10,000 shares, the broker-dealer would take a 6% haircut on the 13,000 shares long and no haircut on the 3,000 shares short. As demonstrated in the example, broker-dealers may not combine their positions in different U.S. Treasury ETFs that are each held in a size other than a redemption unit (or multiple thereof) in order to avail themselves of the 2% haircut.