IDC Independent Directors Council

ETF Share Class Relief

An Overview for Independent Directors

November 2025

About ICI

The Investment Company Institute (ICI) the leading association representing the global asset management industry in service of individual investors. ICI members are located in North America, Europe, and Asia and manage fund assets of US$50 trillion, including mutual funds, exchange-traded funds (ETFs), UCITS, closed-end funds, unit investment trusts (UITs) and similar funds in these different jurisdictions. ICI has offices in Washington DC, Brussels, and London.

IDC is part of ICI, and leverages the research, advocacy, operational, and other resources of ICI to amplify IDC's effectiveness in its mission to serve independent directors. IDC's activities are overseen by a Governing Council of independent directors of ICI member funds and are supported by dedicated IDC staff.

About IDC

The Independent Directors Council (IDC) serves the US-registered fund independent director community. Through its mission focused on education, engagement, advocacy, and public understanding, IDC promotes excellence in fund governance for the benefit of funds and their shareholders.

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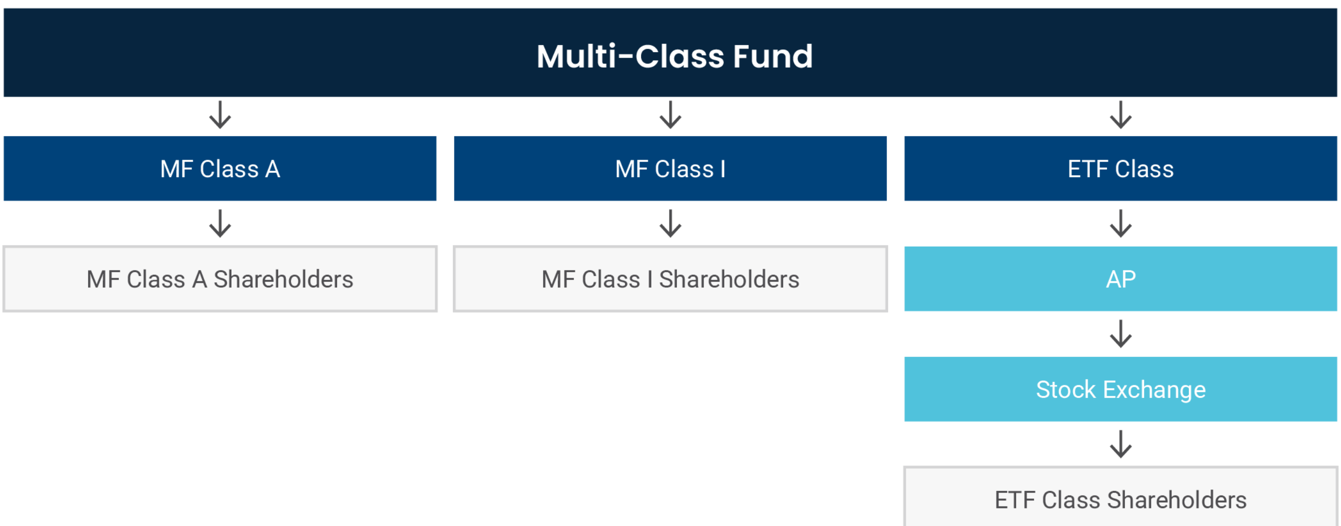
Nothing contained in this report is intended to serve as legal advice. Each investment company board should seek the advice of counsel for issues relating to its individual circumstances.

Overview

The U.S. Securities and Exchange Commission is in the process of granting exemptive relief[1] permitting open-end funds to offer a class of shares that operates as an exchange-traded fund and one or more classes of shares that operate as a mutual fund. The SEC action permitting this structure is commonly known as ETF Share Class Relief, and funds relying on the relief are referred to in this paper as Multi-Class Funds. Applicants for this relief believe that it will provide benefits to shareholders of both the mutual fund class and the ETF class, including greater investor choice, lower transaction costs, and enhanced tax efficiency.

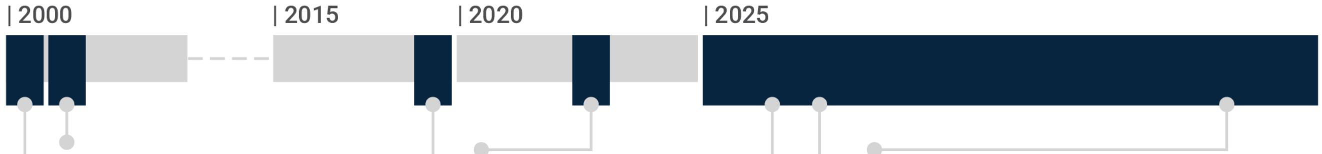
The following diagram provides a simplified illustration of the structure of a hypothetical Multi-Class Fund that offers two traditional mutual fund share classes (Class A and Class I, by way of example) and an ETF share class:



Board approval and oversight is a central component of the ETF Share Class Relief. Specifically, the board must approve various matters relating to the Multi-Class Fund structure and must receive comprehensive reporting to assist in its oversight. This paper is designed to help independent directors understand the background of the ETF Share Class Relief, the scope of the relief, and the operational challenges in bringing a Multi-Class Fund to market. The information in this paper is based on the SEC's notice published in the Federal Register on October 1, 2025, and the contents of this paper are subject to change. The paper also includes practical questions that directors, when faced with a proposal for and ongoing oversight of a Multi-Class Fund, might wish to consider based on each complex's own facts and circumstances.

Background

How We Got Here



2000
The SEC issues the first exemptive order permitting Vanguard index funds to offer ETF share classes.

2001
Vanguard receives a patent protecting the method it uses to create ETF share classes.

2019
The SEC adopts the ETF Rule, which establishes a clear and consistent framework for the operation of most ETFs, but expressly declines to extend the ETF Rule to cover the operation of a Multi-Class Fund.

2023
Vanguard's ETF share class patent expires and multiple fund sponsors file exemptive applications to permit the offering of Multi-Class Funds.

March, 2025
Acting SEC Chairman Mark Uyeda states that he directed the SEC Staff to "prioritize their careful review of the many applications filed" for ETF share class relief.

April through September, 2025
Dimensional Fund Advisors LP, et al (DFA) amends its exemptive application in a manner that appears to reflect input from the SEC Staff. Shortly thereafter, the SEC Staff informs other applicants that they would be best positioned to receive prompt exemptive relief if they amend their applications to be substantially identical to DFA's.

September, 2025
The SEC publishes a notice for ETF Share Class Relief to DFA. Orders granting the requested relief are expected to be issued to DFA and other applicants after publication of this paper.

* Specifically, the Rule 6c-11 adopting release notes that an ETF class that transacts with Authorized Participants on an in-kind basis and a mutual fund class that transacts with shareholders on a cash basis may give rise to differing costs to the portfolio. As a result, certain costs may result from transactions through one class, but all shareholders generally would bear the costs. See Rule 6c-11 adopting release at 122-123 (noting that "costs can include brokerage and other costs associated with buying and selling portfolio securities in response to mutual fund share class cash inflows and outflows, cash drag associated with holding the cash necessary to satisfy mutual fund share class redemptions, and distributable capital gains associated with portfolio transactions").

** See Acting Chairman Mark T. Uyeda, **Remarks to the 2025 ICI Investment Management Conference** (Mar. 17, 2025).

The Scope of ETF Share Class Relief

The ETF Share Class Relief would permit the following:

- Mutual funds may offer an ETF class, and ETFs may offer mutual fund classes
- Multi-Class Funds may be actively managed or track the performance of a benchmark index
- Multi-Class Funds may permit shareholders to exchange their mutual fund shares for ETF shares of the same Multi-Class Fund. Note the relief does not permit ETF class shareholders to exchange their ETF shares for mutual fund shares within the same Multi-Class Fund, except in situations where the ETF class is terminated or where the Multi-Class Fund merges into a fund with no ETF class

What benefits does the ETF Share Class Relief provide?

ETF Share Class Relief represents a new avenue for mutual funds and ETFs to sell their shares in new distribution channels, offering investors greater choice in the way they access these funds and potentially realizing cost savings to funds and their shareholders through tax efficient trading, economies of scale, reduced shareholder transaction costs, more efficient portfolio management, and less disruption from frequent trading by mutual fund shareholders.

What are the conditions of the ETF Share Class Relief?

The relief requires a Multi-Class Fund and its adviser to comply with a number of conditions designed to ensure that the fund structure is in the best interest of each class individually and the Multi-Class Fund as a whole. The most salient conditions are as follows:

- **ETF Rule**—The Multi-Class Fund must comply with the requirements of Rule 6c-11, the ETF Rule, which generally allows ETFs to operate, except that they may offer mutual fund shares that are not listed on a national securities exchange and may offer an exchange privilege from mutual fund shares to ETF Class shares. This means that a Multi-Class Fund relying on the relief is required to publish its portfolio holdings on each business day.
- **Differences in share classes**—The Multi-Class Fund must operate pursuant to a written plan required by Rule 18f-3, which allows funds to offer multiple classes of shares with different rights and obligations, so long as certain obligations are met. The relief identifies seven areas in which the ETF class and the mutual fund classes have different rights and obligations[2] and requires the board to initially and at least annually evaluate the multiple class plan and a majority of the directors and a majority of the independent directors find that the multiple class plan continues to be in the best interests of each class individually and of the fund as a whole.
- **Initial and periodic reports**—To assist the board in its initial and periodic consideration of the appropriateness of the Multi-Class Fund structure, particularly the potential for any conflicts of interest between the mutual fund and ETF share classes, the adviser must provide the board with an Initial Adviser Report and Ongoing Adviser Reports at least annually.

Among the information required in the Initial Adviser Report is:

- A discussion of the expected benefits and costs to each class and the fund overall, including, as applicable, the sources of potential cost savings and other benefits of operating a Multi-Class Fund structure and how each class will be affected by cash flows and costs associated with portfolio transactions, cash levels, distributable capital gains, and realization of any unrealized capital gains/losses or capital loss carryovers
- A discussion of how the fund's adviser intends to manage the expected costs associated with a transition to a Multi-Class Fund structure
- A discussion of the appropriateness of the fund's strategy for a Multi-Class Fund structure
- A discussion of any other potential material conflicts of interest, including any other sources of potential cross-subsidization identified by the adviser associated with operating the Multi-Class Fund

Among the information required in the Ongoing Adviser Report is:

- A discussion of any observed benefits or cost savings to the Multi-Class Fund resulting from the structure
- A discussion of any observed material conflicts between classes or observed material negative consequences to the classes resulting from the structure, including the following:
    - A discussion of how creation and redemption activity in the ETF class has affected the mutual fund class and how shareholder purchase and redemption activity in the mutual fund class has affected the ETF class during the prior year, with respect to: (i) cash levels; (ii) short- and long-term capital gains distributions; and (iii) costs associated with portfolio transactions
    - Any performance difference between the classes due to the difference in dividend payment dates
- Any other information that the board requests

Monitoring—The adviser must recommend for the board's approval an Ongoing Monitoring Process designed to help determine whether a Multi-Class Fund has encountered any issues relating to its multi-class structure, including any conflicts between the share classes.

The Ongoing Monitoring Process consists of adviser-recommended and board-approved numeric thresholds, including the calculation method for the thresholds and the time periods over which to measure the fund's performance against the numerical thresholds, with respect to the following:

- Costs associated with portfolio transactions
- Cash levels
- Capital gains distributions

If a threshold is exceeded, the adviser must:

- Notify the board within 30 days following the end of the applicable period in which the threshold was exceeded
- Explain the cause
- Recommend any remedial actions, if appropriate

Disclosure—The Multi-Class Fund must take various disclosure-related steps to ensure that investors clearly understand the structure of a Multi-Class Fund and the differences between the fund's mutual fund shares and ETF shares, including the potential that transactions through one class could generate portfolio transaction costs and tax consequences for shareholders in other classes.

Operational Challenges

Before a sponsor launches a Multi-Class Fund, it will need to evaluate certain operational challenges that arise from the important structural differences between ETFs and mutual funds. These challenges relate primarily to financial intermediary considerations, investor experience considerations, reporting requirements, exchange privileges, and technology and systems considerations.[3] Sponsors will need to assess these operational challenges when considering whether to offer a fund in reliance on the ETF Share Class Relief.

Firms that might not have developed relationships with authorized participants or market makers or might not have service providers who are deeply involved in industry preparations for ETF Share Class Relief might not be ready to rely on ETF Share Class Relief as quickly as firms that have an established infrastructure in place for matters such as ETF order management, baskets, and cash management. In addition, some mutual fund sponsors seeking to enter the ETF market by relying on ETF Share Class Relief will need to become familiar with the various legal and operational nuances of operating a registered fund whose securities trade on a securities exchange.

Potential Questions for Directors to Consider

Below are some practical questions independent directors may wish to consider in evaluating a proposal for and providing ongoing oversight of a Multi-Class Fund. This nonexclusive list of questions relates to the board's initial and periodic evaluations; board reporting topics, such as transaction costs, cash levels, capital gains distributions, and other potential conflicts of interest; and operational considerations. The questions are not intended to imply best practices or to serve as a model for boards to follow, as there is no "one size fits all" approach to board oversight. Rather, they are designed to be tailored to the unique facts and circumstances of each complex as boards consider the types of information they might seek in fulfilling their oversight responsibilities.

Initial Evaluation and Initial Adviser Report

- What are the expected benefits and costs to each class individually and the Multi-Class ETF Fund as a whole?
- Will the proposed Multi-Class Fund have access to new distribution channels for ETF or mutual fund shares? To what extent is this access expected to help the Multi-Class Fund grow?
- To what extent has the adviser engaged with intermediary platforms about adding a new share class of a fund?
- To what extent does the adviser expect the operational risk in managing a Multi-Class Fund to differ from that of separate, stand-alone mutual funds and ETFs?
- Where the adviser proposes adding an ETF class to a mutual fund, to what extent does the adviser expect in-kind creations and redemptions of the ETF shares to result in lower transaction costs and reduced tax impacts for the mutual fund shares?
- Which service providers, if any, does the fund's adviser expect to collaborate with to prepare the Initial Adviser Report and what will the arrangements with those service providers look like (including with respect to oversight)?

- Will the fund's strategy be subject to capacity constraints? If so, how does the adviser expect to manage those constraints as the fund grows?
- Where an existing mutual fund is looking to add an ETF Share Class, is daily portfolio transparency compatible with the fund's investment strategy?
- How does the adviser intend to manage the reasonably expected costs associated with the transition to a Multi-Class Fund?

Ongoing Monitoring Process

- Are there unique circumstances where additional thresholds might be appropriate?
- What is the rationale behind the adviser's proposed numerical thresholds? Are they based on a projected future state for the Multi-Class Fund, operating at scale under normal market conditions? Are the costs associated with portfolio transactions, cash levels and capital gains distributions modeled based on historical data for existing funds managed by the adviser, other similar funds in the marketplace, or both?
- To what extent do the numerical thresholds proposed by the adviser take into account projected benefits of the Multi-Class Fund structure?
- To what extent does the adviser expect the initial "ramp up" period following the launch of a Multi-Class Fund (or the introduction of a share class to an existing fund) to impact the level of threshold exceedances due to portfolio transactions or realized capital gains?
- To what extent does the fund's adviser anticipate being able to isolate fluctuations in the fund's costs associated with portfolio transactions, cash levels, and capital gains distributions that result solely from changes in market conditions as opposed to fluctuations that are the consequence, in whole or in part, of the Multi-Class Fund's structure?
- What steps, if any, has the fund's adviser taken to avoid potential "false positive" threshold exceedances during times of short-term market stress and increased market volatility?
- To what extent have different types of trading costs (e.g., brokerage expenses for equity trades, spreads on fixed income trades) contributed to the proposed methodology for calculating the costs associated with portfolio transactions?

Ongoing Adviser Reports

- What will the process be for preparing the Ongoing Adviser Report? Who in the adviser's organization or externally will be involved in the preparation of the report?
- Will new systems, policies, and/or procedures be needed to prepare the Ongoing Adviser Report?

Impact of Reasonably Expected Cash Flows and Costs Associated with Portfolio Transactions

- How does the adviser anticipate tracking fund brokerage and other trading costs on a class-by-class basis after launch or otherwise seek to distinguish trading that is primarily attributable to cash transactions by mutual fund class investors from trading that is primarily attributable to portfolio management?
- What impact does the fund's adviser expect net cash inflows and outflows in the mutual fund class to have on portfolio rebalancing or basket creation?

» Where an ETF class is proposed to be added to an existing mutual fund, is historical data available showing mutual fund shareholder trading behavior and resulting cash flows associated with frequent trading?

» Where an existing fund is proposed to become a Multi-Class Fund, is historical data available regarding the fund's portfolio turnover rate and the nature of the activity that drove that turnover? For example, to what extent has the portfolio turnover been a result of portfolio rebalancing as opposed to shareholder inflows or outflows?

Impact of Reasonably Expected Cash Levels

» Where an existing fund is proposed to become a Multi-Class Fund, what were the fund's historical cash levels? Where an existing mutual fund is proposed to add an ETF Share Class, to what extent were historical cash levels intended to meet shareholder redemptions?

» What impact does the fund's adviser expect the mutual fund class to have on the fund's cash levels, and what is the potential impact on fund performance?

» Has the adviser considered to what extent cash levels might be reduced through the use of a credit facility?

Impact of Reasonably Expected Distributable Capital Gains and Realization of Unrealized Capital Gains/Losses

» How does the fund's adviser expect to manage the tax impacts of portfolio transactions in response to mutual fund class redemption activity?

» What is the extent of any existing capital loss carry-forwards that may be used to offset any realized gains in the future?

Other Potential Considerations

» Where an existing ETF is looking to add a mutual fund share class, how might any variable fee imposed by the ETF for cash baskets affect the analysis of cross-subsidization?

» Where an existing mutual fund is looking to add an ETF share class, will any purchase or redemption fees be charged by the mutual fund with respect to transactions in mutual fund shares?

» How will the servicing costs incurred by the ETF shares and the mutual fund shares differ, if at all? If there will be differences, how will they be allocated to each class?

» Will the fund's adviser propose a unitary fee for advisory and other services across the Multi-Class Fund's share classes? What are the pros and cons of a unitary fee?

» In the case of a major market liquidity event, what steps has the adviser taken or expects to take to try to protect the Multi-Class Fund from losses that could arise from the different approaches used by the mutual fund class shares and the ETF class shares for redemptions and sales?

Operational Considerations

- Will the proposed Multi-Class Fund offer an exchange privilege and, if so, how will the exchange privilege be facilitated?
- How does the adviser intend to educate investors, financial advisers, intermediaries, service providers, and others about how the Multi-Class Fund will operate?
- Are any material amendments needed to the fund's service provider agreements in connection with the fund's proposed reliance on ETF Share Class Relief (e.g., to take into account new roles, responsibilities, and processes)?
- What efforts have been or will be taken to coordinate among the fund's service providers in connection with the fund's proposed reliance on ETF Share Class Relief, including to ensure that the applicable service providers have the software and models necessary to monitor the relative impacts of transaction costs, taxes, cash flows, and cash drag on the Multi-Class Fund's various classes?
- Do mutual fund organizational documents (e.g., declarations of trust) provide flexibility for a potential ETF class of the mutual fund to issue and redeem shares by or through authorized participants and in creation units only?
- Are any material changes to existing fund and adviser policies and procedures (for example, policies related to portfolio holdings disclosure, valuation, liquidity risk management, recordkeeping, identification of affiliated persons, codes of ethics, etc.) necessary in connection with reliance on ETF Share Class Relief?
- What will the investor experience look like for funds relying on ETF Share Class Relief, including with respect to shareholder statements and confirmations, cost-basis reporting, and direct-held account support?

Notes

1 In September 2025, the SEC issued a "notice" relating to an application for exemptive relief. The notice states that an order granting the requested relief will be issued unless the Commission orders a hearing. The public had 15 days from the date of the publication of the notice in the Federal Register to request such a hearing. The notice was published in the Federal Register on October 1, 2025. Also on October 1, the U.S. federal government shut down due to a lapse in appropriations. As of the publication date of this paper, the order has not been issued.

2 The differences are detailed in the relief and include, for example, that mutual fund shares are individually redeemable, while ETF shares generally are only redeemable in creation units; ETF shares are tradeable on an exchange, while mutual fund shares are not; and the mutual fund classes and the ETF class may declare dividends on different days.

3 See Investment Company Institute white paper on ETF Share Class Operational Considerations (Oct. 2025).