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SEC Staff Provides Industry Concentration Relief for ETFs

July 31, 2026

On July 27, 2026, the staff of the Division of Investment Management (the "*Staff*") of the Securities and Exchange Commission (the "*SEC*" or "*Commission*") issued a no-action letter[1] to the Investment Company Institute ("*ICI*") regarding the treatment of an exchange-traded fund's ("*ETF*") creation basket when the ETF passively exceeds its industry concentration limit. The Staff confirmed that it will not recommend enforcement action against an ETF that accepts certain creation baskets during such an exceedance, provided the basket composition remains within the pro rata parameters described in the letter. The letter emphasized that, in order to rely on the relief, the exceedance must be passive (*i.e.*, caused by market movements, not volitional investment decisions) and the creation basket must maintain industry weightings consistent with a pro rata basket. The relief applies to both actively-managed and index-based ETFs.

Background

The Investment Company Act of 1940 requires a registered fund to disclose its policy on concentrating investments in a particular industry or group of industries. Concentration is generally defined as investing more than 25% of a fund's net assets in a particular industry or group of industries. Funds with a policy not to concentrate in a particular industry or group of industries generally may not have more than 25% of their net assets invested in a particular industry or group of industries. Such funds are generally prohibited from making further investments in the industry once holdings exceed 25% of their net assets. A fund generally may not deviate from its concentration policy without a shareholder vote.

A "passive exceedance" of an industry occurs when market movements—rather than volitional investment decisions—cause an ETF's industry holdings to exceed 25% of net assets despite a disclosed policy not to concentrate. Unlike traditional mutual funds, ETFs issue and redeem shares through authorized participants who deliver creation baskets of securities. Because SEC guidance limits an ETF's ability to close to new investments, the manager generally cannot control creation timing, and a creation order during a passive exceedance may increase industry exposure without any affirmative decision by the manager. Prior Staff guidance on concentration was developed for traditional mutual funds and did not address ETF in-kind creation baskets during a passive exceedance.

The Relief Granted

The Staff stated that it will not recommend enforcement action to the Commission under Sections 13(a)(3) or 34(b) of the 1940 Act against an ETF that, at a time when the ETF is experiencing a passive exceedance of its disclosed concentration policy, engages in any of the following:

1. **Receives a pro rata creation basket** that includes one or more investments in the industry in which the ETF has a passive exceedance. A pro rata basket approximately reflects a pro rata representation of the ETF's portfolio holdings.

2. **Uses cash received in lieu of a basket component** (where such component represents an investment in the relevant industry) to purchase the component security up to an amount consistent with a pro rata creation basket.

3. **Receives a non-pro rata creation basket** in which the weighting of the relevant industry is consistent with the weighting of that industry in a pro rata basket.

Conditions and Scope of Reliance

Passive exceedance required. The relief is available only when the concentration exceedance is passive—that is, caused by external market movements rather than a volitional investment decision. An exceedance resulting from active portfolio decisions does not qualify.

Pro rata limits. Under Scenario 1, the ETF receives the pro rata creation basket. Under Scenario 2, the ETF may purchase the component security only up to the amount consistent with a pro rata basket. Under Scenario 3, the industry weighting in the non-pro rata basket must be consistent with weighting that would have applied in a pro rata basket.

Covered funds. The relief applies equally to actively-managed and index-based ETFs.

Standard no-action caveats. The position addresses only enforcement action, does not provide legal conclusions, and is based on the specific facts and representations in the request. It reflects the views of the Staff, not the Commission, and does not alter applicable law or create new obligations.

In practical terms, the relief allows ETFs experiencing a passive exceedance to accept in-kind creation baskets as described above without generally having to coordinate with authorized participants to alter basket composition, substitute assets, or seek costly shareholder approval to change their concentration policies. ETF sponsors should review their compliance policies and procedures to ensure that reliance on the relief is appropriately documented. In particular, sponsors seeking to rely on the no-action position should develop policies to monitor and confirm that any concentration exceedance complies with the terms of the relief (such as any exceedance was due to a passive exceedance and any creation baskets received or cash received in lieu of the creation basket component and used for additional purchases of securities in the applicable industry meet the pro rata parameters set forth in the letter). The SEC Staff also has provided oral guidance to the ICI in connection with the no-action letter reminding registrants that registration statement disclosure regarding an ETF's concentration policy should be consistent with the ETF's practices. The Staff indicated that any determinations as to the necessity or materiality of changes to an ETF's concentration policy disclosure language to reflect reliance on the no-action position should be made by registrants and their counsel.

For More Information

We are available at any time to answer questions, discuss scenarios, and provide guidance. If you would like further information concerning the matters discussed in this article, please contact a member of the Investment Management Group or visit us online at chapman.com.

1 Investment Company Institute, SEC Staff No-Action Letter (pub. avail. July 27, 2026).