FROM THE DESK OF

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Vanessa A. Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-2026-24 Request for Comment on Novel ETFs

Dear Secretary Countryman,

I submit these comments in response to the Commission's request for public input on novel exchange-traded funds. Evidence presented here will show that before the Commission turns its attention to the requested approval of a long lineup of exotic and arcane ETF products, it should first better understand the impact of the established, liquid, large-cap equity ETFs that today undermine price discovery, distort the price signals on which company managements rely, and mislead investors. Data herein illustrates that reputed liquid large cap ETFs already impair the fair and orderly markets the Commission is charged with protecting.

The data we present below from happenings in the markets during August 2026 are both alarming and indicative of a breakdown in orderly markets. Patterns of nearly identical price movements between a concentrated large-cap ETF of roughly 65 companies and a much broader mid- and small-cap ETF of roughly 120 companies would not be possible if investors were primarily buying individual stocks on the basis of company-specific business models, risks, and prospects.

Yet that is exactly what the data show. Daily correlations of approximately 0.99 over a full year, the year-to-date period, and a violent multi-week rally demonstrate that company-specific information is being systematically subverted. Price discovery and capital allocation are, for significant stretches of time, being reduced to a charade — even inside mainstream products widely regarded as liquid.

This is the practical realization of the mechanism identified in the Nobel Prize-winning work of Joseph Stiglitz (with Sanford Grossman). When

mechanical forces compress the residual variation that should reward the production of costly company-specific information, an information asymmetry is created and entrenched. Electronic market makers, arbitrageurs, and high-speed traders who intermediate the ETF complex sit at the center of that asymmetry.

They profit from the flows that drain independent price discovery from the underlying companies. The result is a market structure that increasingly serves intermediation rather than the efficient allocation of capital on the basis of real economic value at the company level.The evidence is measurable, persistent, and already visible in established large-cap ETFs.

Expanding the product set into more novel and exotic wrappers under current rules will not merely be risky — it will be destructive.

I. Evidence from Established, Liquid, Large-Cap ETFs
The problem is visible in one of the most established and liquid equity ETF complexes — gold miners.

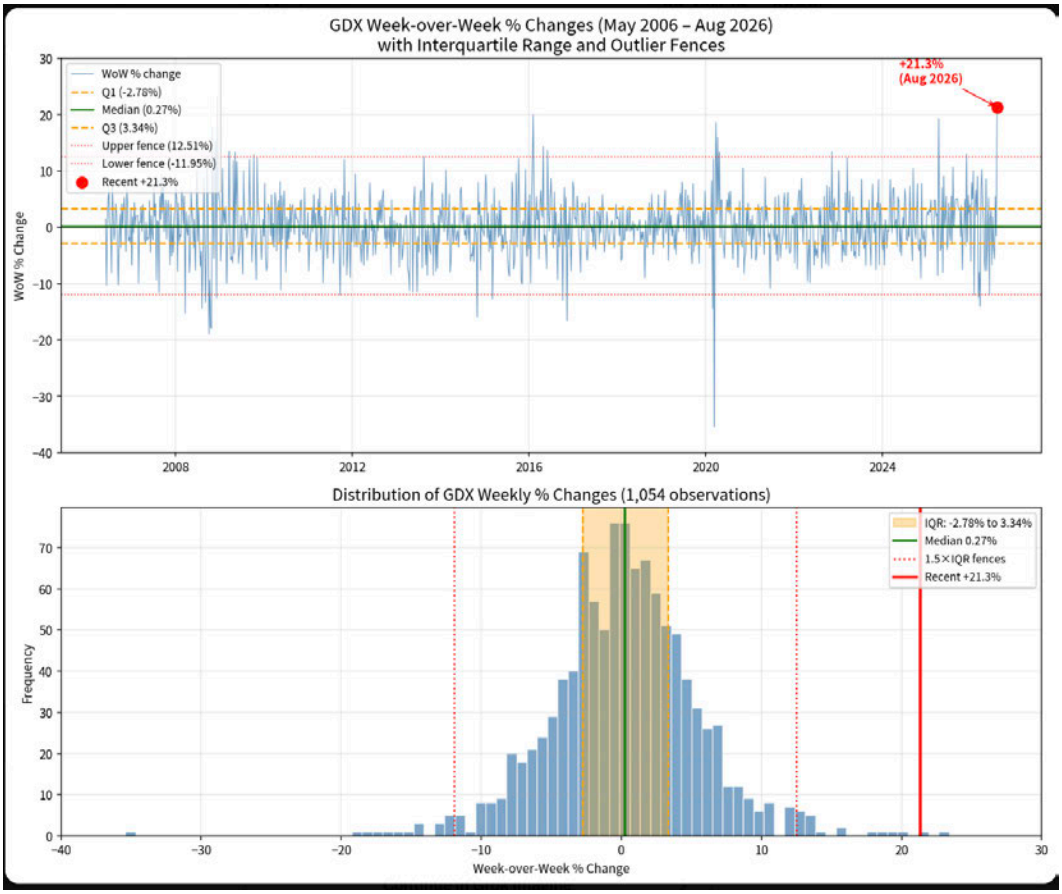
For context, the two primary ETFs examined are:

ETF	Primary Cap Focus	Number of Holdings	Details
GDX (VanEck Gold Miners)	**Large-cap**	~60–70	Tracks larger, more established ("senior") gold miners. Weighted average market cap is typically in the $30–40 billion range. Roughly 70%+ of the portfolio is in large-cap companies (>$10B).
GDXJ (VanEck Junior Gold Miners)	**Small- to mid-cap**	~115–125	Explicitly targets smaller "junior" gold (and some silver) miners. Weighted average market cap is usually around $7–8 billion. It has a clear small/mid-cap orientation with meaningful exposure to smaller companies.

1. The VanEck Gold Miners ETF (GDX) — a large cap, reputedly liquid, and diversified basket of 65 companies — recorded a +21.3% week-over-week gain.

Under standard parametric risk models that assume normal distributions and typical realized volatility for a diversified gold-miner ETF (approximately 40% annualized), a move of this magnitude registers as roughly a 3.8-standard-deviation event. That corresponds to an expected frequency of approximately 1 in 15,000 weeks, or roughly once every 300 years.

In practical risk-management terms, most firms monitoring trading and portfolio risk would treat an outcome this far into the tail of expected outcomes as effectively impossible for purposes of board-level risk reporting. The fact that a diversified ETF delivered such a move is itself evidence that ordinary company-fundamental diffusion was not the primary driver.

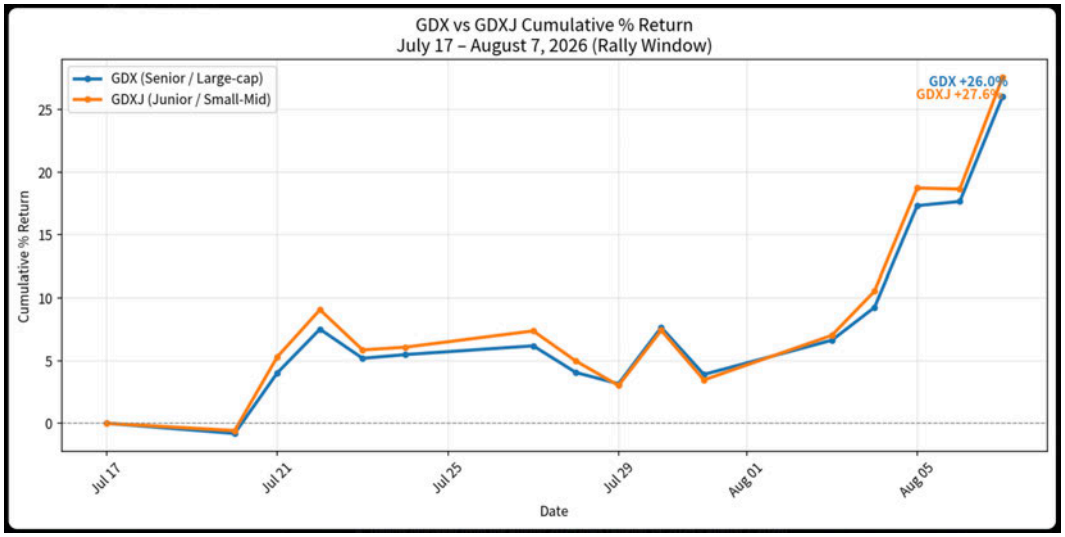


2. The recent rally window (July 17 – August 7, 2026)
In the multi-week advance that followed:

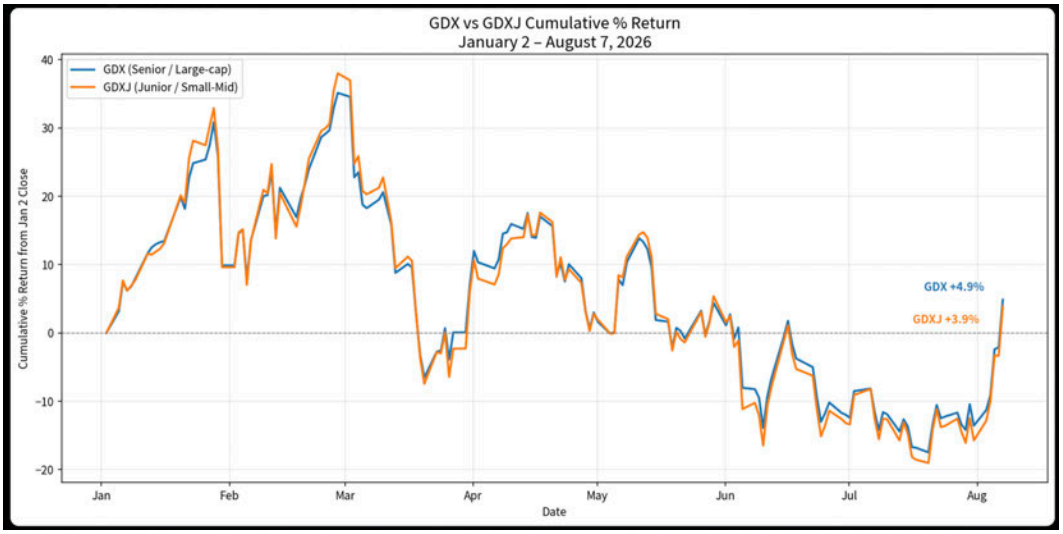
- GDX (senior / large-cap, approximately 60–70 holdings): +26.0%
- GDXJ (junior / small-to-mid-cap, approximately 115–125 holdings): +27.6%

Daily-return correlation: 0.991

Two baskets with fundamentally different risk profiles rose almost in lockstep. The difference in total return was only 1.6 percentage points.



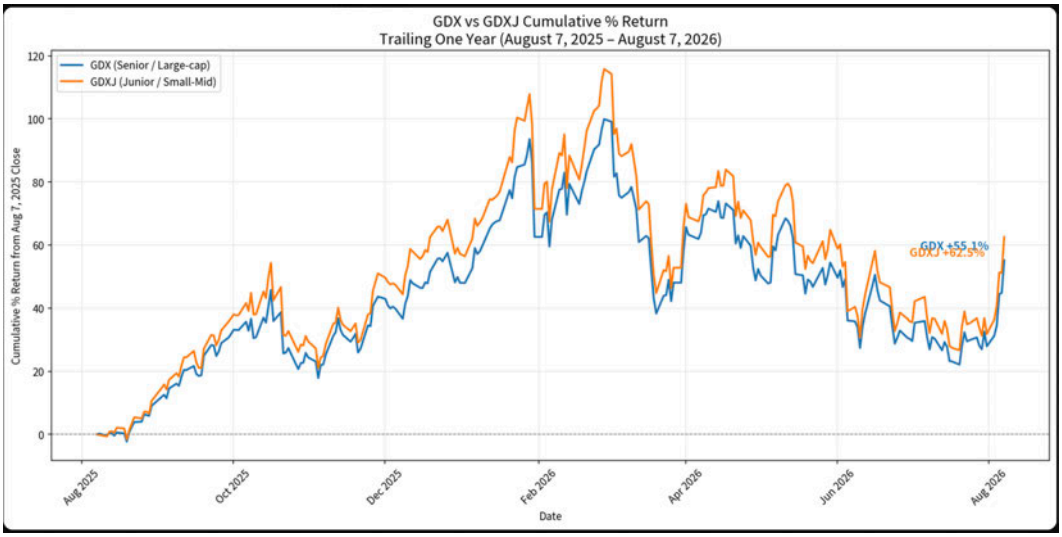
3. Year-to-date (January 2 – August 7, 2026)



Daily-return correlation across 149 trading days: 0.991

4. Trailing one-year (August 7, 2025 – August 7, 2026)
Daily-return correlation across 251 trading days: 0.9899

- GDX: +55.1%
- GDXJ: +62.5%



What these numbers mean:

A sustained daily correlation of approximately 0.99 means the two ETFs move in near-perfect lockstep. This is not what company fundamentals should produce.

GDX holds a concentrated basket of larger, more established senior gold miners. GDXJ holds a much broader basket of smaller junior miners. These groups differ in number of holdings, average company size and liquidity, operating and exploration risk, sensitivity to financing conditions, and the frequency of company-specific news.

Under normal fundamental price discovery, the daily correlation between a senior-miner ETF and a junior-miner ETF should typically fall in the range of 0.80 to 0.92. In quieter markets it is often 0.75–0.88. Even in strong directional gold moves it rarely remains above 0.94 for long.

Sustained readings of 0.97–0.99 across hundreds of trading days sit in the extreme statistical tail.A 0.99 correlation leaves almost no room for independent, company-specific behavior. The residual variation that should reflect the distinct risks and news of senior versus junior miners has been compressed to nearly zero.

What is actually setting prices:
What is driving the near-term path is mechanical flow: ETF creation and redemption, index-weight trading, and the options and derivatives activity that hedges into those vehicles. The underlying stocks are being moved as a package. Company-specific information is displaced. The residual that is supposed to reward fundamental research is being compressed.

At this level of uniformity, price discovery and capital allocation are reduced to a charade for significant stretches of time — even inside the more liquid, established, large-cap corners of the ETF complex.

The extreme co-movement creates and entrenches an information asymmetry that benefits the electronic market makers, arbitrageurs, and high-speed traders who intermediate the ETF complex.

II. Implications for Price Discovery, Research, and Corporate Governance

A fair and orderly market requires that prices primarily reflect company-specific information. When established, liquid, large-cap ETF wrappers become the dominant short-term pricing mechanism, they do not merely influence that information — they subvert it. Like the "great vampire squid" Matt Taibbi made famous as a symbol of Wall Street excess in 2009, these products wrap their tentacles around the constituent stocks and systematically drain the independent price discovery and residual risk that should belong to each company.

The private incentive to produce costly company-specific research is reduced. Investors are rationally told that choosing between the senior and junior packages is close to a coin flip and that taking individual company risk adds limited incremental value.

The damage does not stop with the suppression of independent research. The same mechanical co-movement simultaneously disables the market's primary mechanism for holding corporate management accountable.

When two differently constructed baskets of companies post daily correlations of approximately 0.99 for a full year, the share prices of well-run companies and poorly-run companies rise and fall together. Superior managers and mediocre or reckless managers experience nearly identical equity outcomes. Stock-based compensation, option grants, and performance equity lose much of their ability to differentiate. The cost of capital becomes far less sensitive to the quality of capital allocation, risk management, operating discipline, or long-term stewardship inside the firm.

At the same time, financial advisors respond rationally to the data. When senior-miner and junior-miner ETFs move in near-lockstep for months on end, the logical advice to clients becomes: "Just own the ETF. There is little point taking company-specific manager risk."

That advice further reduces the float and the analytical attention available for discriminating between good and bad stewards.The result is a double failure of capital allocation:

- On the investor side, the incentive to produce company-specific information is compressed.
- On the corporate side, the market's ability to reward prudent, competent management and to discipline the opposite is severely impaired.

Bad managers are not punished by lower valuations or a higher cost of capital. Prescient, risk-oriented, efficient managers are not rewarded. Over time this weakens the feedback loop that is supposed to improve the quality of public companies. Mechanical pricing that treats companies as interchangeable package components does not merely distort short-term prices; it erodes the governance mechanism that public markets are supposed to provide.

This impairment is already visible inside mainstream, liquid, large-cap products. Expanding the set of novel, exotic, leveraged, or complex ETF wrappers under current rules is therefore not merely dangerous. It is destructive.

III. Longer-Standing Diagnosis

These concerns are not new. In 2010, Robert E. Litan and I published Choking the Recovery: Why New Growth Companies Aren't Going Public and Unrecognized Risks of Future Market Disruptions (Kauffman Foundation). We warned that the rapid proliferation of ETFs was altering the role of equity markets in capital formation, creating liquidity illusions, elevating correlations, and introducing under-appreciated risks to price discovery. Subsequent Senate testimony in 2011 reinforced the same themes. Fifteen years later, the core diagnosis has been confirmed by the data.

IV. Recommendations

Before approving additional novel or exotic ETF structures, the Commission should strengthen the regulatory framework governing all equity-based ETFs. The following steps build on the 2010 analysis and update it for current realities. They favor prudent standards and appropriate costs that restore balance, rather than outright bans.

1. Underlying Liquidity Screens
   Require meaningful, standardized minimum liquidity and float criteria for securities included in ETF baskets, with concentration limits for less-liquid names.
2. Constraints on ETF Price Movement
   In 2010 we recommended that Self-Regulatory Organizations require a circuit-breaker time-out whenever an ETF moves more than 5 percent in the preceding five minutes. That recommendation remains necessary. Rapid ETF moves transmit mechanical

pressure into the underlying stocks and should be interrupted before they further subvert company-level price discovery.

3. Limit on Aggregate ETF Ownership of Free Float
   No more than 50 percent of a company's free float should be held in the aggregate across all ETFs.Once that threshold is reached, any further increase in ETF ownership should be possible only through the purchase of newly issued shares directly from the company (via an effective shelf registration or equivalent mechanism). The purpose of this rule is not to help companies raise capital opportunistically. It is to stop the further erosion of the residual free float that still carries company-specific price signals. When ETFs already control half or more of the free float, additional mechanical buying and selling increasingly rob managements and investors of the very price information they need to allocate capital and evaluate performance. Preserving a meaningful residual float is therefore an act of protecting the company's ability to receive useful market signals.Common objections do not withstand scrutiny:
   - "This interferes with normal ETF creation and redemption." Only after the 50% threshold is crossed. Below that level, ordinary secondary-market creation and redemption continue without restriction. The constraint is triggered solely when ETF ownership has already become dominant enough to distort price discovery.
   - "Companies may not want to issue equity." Then ETF ownership simply cannot increase further. That is the intended outcome. The company retains the decision whether additional shares are created. The alternative — allowing mechanical demand to keep consuming the remaining free float — continues to degrade the price signals the company itself relies upon.
   - "Tracking error will rise." Yes. Higher tracking error in these circumstances is acceptable and informative. It forces the market to confront the reality of concentrated ownership and limited residual float instead of papering over that reality with frictionless mechanical flows.This mechanism favors prudent standards and appropriate economic costs that restore balance. It protects the residual float necessary for company-specific price discovery and prevents the further subversion of the signals on which both managements and investors depend.
4. Enhanced Basket Transparency
   Mandate clear disclosure of the liquidity profile of the underlying basket, not merely the trading volume of the ETF itself.
5. Creation/Redemption Safeguards
   Strengthen rules governing creation and redemption when the underlying securities cannot absorb the associated volume without material price dislocation. Hard caps on short interest tied to the creation process remain relevant.

6. Options on ETFs
   Options activity on equity ETFs amplifies the mechanical transmission of flows into the underlying stocks. Market-maker hedging of ETF options contributes directly to the extreme co-movement documented above. The Commission should examine whether existing position limits, margin requirements, and listing standards for options on equity ETFs are adequate when the underlying basket contains securities whose liquidity is materially lower than that of the ETF itself. In particular, the Commission should consider:
   - Tighter position limits or enhanced margin requirements for options on ETFs whose baskets include significant weight in lower-float or lower-ADV names;
   - Greater scrutiny of very short-dated (including zero-days-to-expiration) options on equity ETFs; and
   - Improved public disclosure of aggregate options open interest relative to the liquidity of both the ETF and its underlying basket.The goal is not to ban options on ETFs, but to ensure that the hedging activity they generate does not further subvert company-specific price discovery. Prudent standards and appropriate costs can restore better balance.
7. Prevention of End-Runs via Total Return Swaps and Similar Synthetics
   The Commission should make explicit that banks and broker-dealers may not use total return swaps, contracts for difference, or similar synthetic instruments to circumvent rules designed to protect fair and orderly markets, position limits, or the free-float and ownership constraints recommended above. Recent events, including the rapid, leverage-driven unwind of the hedge fund Situational Awareness in late July 2026 — which news reports indicated relied heavily on synthetic exposure — demonstrate that these instruments can concentrate risk and transmit sudden liquidation pressure into the underlying equities while remaining partially opaque to the market and to regulators. Allowing such end-runs would render any reforms to ETF ownership, creation/redemption, or options standards incomplete.The Commission should therefore require that economic exposure obtained through total return swaps or equivalent synthetics be aggregated with direct holdings for purposes of ownership thresholds, position limits, and risk monitoring, and should ensure that prime brokers and swap counterparties cannot structure around the safeguards intended to preserve orderly markets and company-specific price discovery.
8. Capital Formation as a Threshold Criterion
   New ETF products should be evaluated explicitly against their impact on the quality of price discovery, the incentive to produce company-specific information, and the market's ability to reward or

discipline corporate management. Products that further subvert these functions should face a high burden of justification.

V. **Conclusion**

The evidence from established, liquid, large-cap ETFs shows that mechanical flows are already subverting company-specific price discovery, the incentive to produce fundamental research, and the market's ability to hold management accountable. This is not a peripheral issue. It strikes at the core economic purpose of public equity markets.

Until these structural problems are addressed, the further expansion of novel and exotic ETF wrappers will be destructive to capital formation. I urge the Commission to treat the existing effects of ETF flows on underlying price discovery as a threshold question that must be resolved before accelerating the approval of more complex products.I appreciate the opportunity to comment and am available to discuss these points further.

Respectfully submitted, Harold S. Bradley

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