

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-72255; File No. SR-NYSEArca-2014-10]

### Self-Regulatory Organizations; NYSE Arca, Inc.; Order Instituting Proceedings to Determine Whether To Approve or Disapprove Proposed Rule Change To Adopt NYSE Arca Equities Rule 8.900, Which Permits the Listing and Trading of Managed Portfolio Shares, and To List and Trade Shares of the ActiveShares<sup>SM</sup> Large-Cap Fund, ActiveShares<sup>SM</sup> Mid-Cap Fund, and ActiveShares<sup>SM</sup> Multi-Cap Fund Pursuant to That Rule

May 27, 2014.

On February 7, 2014, NYSE Arca, Inc. ("Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to adopt new NYSE Arca Equities Rule 8.900, which would govern the listing and trading of Managed Portfolio Shares, and to list and trade shares of the ActiveShares<sup>SM</sup> Large-Cap Fund, ActiveShares<sup>SM</sup> Mid-Cap Fund, and ActiveShares<sup>SM</sup> Multi-Cap Fund (collectively, "Funds") under proposed NYSE Arca Equities Rule 8.900. The proposed rule change was published for comment in the **Federal Register** on February 26, 2014.<sup>3</sup> The Commission received one comment letter on the proposed rule change.<sup>4</sup> On April 7, 2014, pursuant to Section 19(b)(2) of the Act,<sup>5</sup> the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.<sup>6</sup> The Commission received two additional comment letters on the proposed rule change, including a letter from the Exchange in support of its

proposal.<sup>7</sup> This Order institutes proceedings under Section 19(b)(2)(B) of the Act<sup>8</sup> to determine whether to approve or disapprove the proposed rule change.

#### I. Description of the Proposal

As described in the Notice, the Exchange proposes: (1) To adopt new NYSE Arca Equities Rule 8.900, which would permit the listing and trading, or trading pursuant to unlisted trading privileges ("UTP"), of Managed Portfolio Shares, which are securities issued by an actively managed open-end investment management company; and (2) to list and trade shares ("Shares") of the Funds under proposed NYSE Arca Equities Rule 8.900.<sup>9</sup> The discussion below summarizes the Exchange's proposal, details of which are described in the Notice.<sup>10</sup>

##### A. Proposed Listing Rules

The Exchange's proposal defines the term "Managed Portfolio Share" as a security that (a) is issued by a registered investment company ("Investment Company") organized as an open-end management investment company or similar entity that invests in a portfolio of securities selected by the Investment Company's investment adviser consistent with the Investment Company's investment objectives and policies; (b) is issued in any number of shares for a cash amount equal to the next determined net asset value ("NAV"); (c) may be redeemed for cash by any Retail Investor (as defined below) in any size less than a Redemption Unit (as defined below) for a cash amount equal to the next determined NAV; and (d) when aggregated in a number of shares equal to a Redemption Unit or multiples

thereof, may be redeemed at a holder's request, with payment to the holder to be made, through a blind trust established for the holder's benefit, in the form of securities, cash, or both with a value equal to the next determined NAV.

While funds issuing Managed Portfolio Shares will be actively-managed and, to that extent, will be similar to Managed Fund Shares (which are actively-managed funds listed and traded under NYSE Arca Equities Rule 8.600), Managed Portfolio Shares differ from Managed Fund Shares in the following important respects. First, in contrast to Managed Fund Shares, for which a "Disclosed Portfolio" is required to be disseminated at least once daily,<sup>11</sup> the portfolio for an issue of Managed Portfolio Shares will be disclosed once quarterly in accordance with normal disclosure requirements otherwise applicable to open-end investment companies registered under the 1940 Act.<sup>12</sup> Second, in connection with the redemption of shares in Redemption Unit<sup>13</sup> size, the in-kind delivery of any portfolio securities will generally be effected through a blind trust for the benefit of the redeeming authorized participant, and the blind trust will liquidate the portfolio securities pursuant to standing instructions from the authorized participant without disclosing the identity of those securities to the authorized participant. Third, as with traditional open-end investment companies, "Retail Investors"<sup>14</sup> will be able to redeem shares for cash directly from a fund on any day and in any size

<sup>11</sup> NYSE Arca Equities Rule 8.600(c)(2) defines the term "Disclosed Portfolio" as the identities and quantities of the securities and other assets held by the Investment Company that will form the basis for the Investment Company's calculation of net asset value at the end of the business day. NYSE Arca Equities Rule 8.600(d)(2)(B)(i) requires that the Disclosed Portfolio be disseminated at least once daily and that it be made available to all market participants at the same time.

<sup>12</sup> A mutual fund is required to file with the Commission its complete portfolio schedules for the second and fourth fiscal quarters on Form N-SAR under the 1940 Act, and is required to file its complete portfolio schedules for the first and third fiscal quarters on Form N-Q under the 1940 Act, within 60 days of the end of the quarter. Form N-Q requires funds to file the same schedules of investments that are required in annual and semi-annual reports to shareholders. These forms are available to the public on the Commission's Web site at [www.sec.gov](http://www.sec.gov).

<sup>13</sup> A "Redemption Unit" is a specified number of Managed Portfolio Shares used for determining whether a retail investor may redeem for cash.

<sup>14</sup> Under the proposal, a "Retail Investor" is defined as (i) a natural person; (ii) a trust established exclusively for the benefit of a natural person or a group of related family members; or (iii) a tax deferred retirement plan where investments are selected by a natural person purchasing for its own account.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 71588 (Feb. 20, 2014), 79 FR 10848 ("Notice"), available at <http://www.sec.gov/rules/sro/nysearca.shtml>.

<sup>4</sup> See Letter from Gary L. Gastineau, President, ETF Consultants.com, Inc., to Elizabeth M. Murphy, Secretary, Commission (Mar 18, 2014) ("Gastineau Letter").

<sup>5</sup> 15 U.S.C. 78s(b)(2).

<sup>6</sup> See Securities Exchange Act Release No. 71895, 79 FR 20285 (Apr. 11, 2014). The Commission designated a longer period within which to take action on the proposed rule change and designated May 27, 2014 as the date by which it should approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule change.

<sup>7</sup> See Letter from Dennis J. DeCore, Former Co-Head U.S. Index Arbitrage (1997-2007), Nomura Securities, to Elizabeth M. Murphy, Secretary, Commission (Apr. 8, 2014) ("DeCore Letter"); and Letter from Martha Redding, Chief Counsel and Assistant Corporate Secretary, NYSE Euronext, to Secretary, Commission (May 14, 2014) ("Response Letter"). All of the comment letters are available at <http://www.sec.gov/comments/sr-nysearca-2014-10/nysearca201410.shtml>.

<sup>8</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>9</sup> The Exchange also proposes to amend NYSE Arca Equities Rule 7.34(a)(4)(A) (Trading Sessions) to include Managed Portfolio Shares in the trading halt provision for shares traded pursuant to UTP during the Exchange's Opening Session.

<sup>10</sup> See Notice, *supra* note 3. Additional information regarding the Trust and the Shares, including investment strategies, risks, creation and redemption procedures, fees, portfolio holdings disclosure policies, distributions and taxes is available in the registration statement filed by the Trust on January 22, 2014 on Form N-1A under the Securities Act of 1933 and under the Investment Company Act of 1940 ("1940 Act") relating to the Funds (File Nos. 333-171987 and 811-22524) ("Registration Statement").

less than a Redemption Unit at the fund's NAV, as described in more detail below. Fourth, investors will be able to purchase shares either (a) in the secondary markets (e.g., the Exchange) at market prices or (b) for cash directly from a fund in any amount on any day a fund determines its NAV, as described in more detail below.

For each series of Managed Portfolio Shares, an estimated value, defined in the proposed rules as the "Portfolio Indicative Value" ("PIV"), that reflects an estimated intraday value of a fund's portfolio will be disseminated. The PIV will be based upon all of a fund's holdings as of the close of the prior business day and will be widely disseminated by one or more major market data vendors at least every 15 seconds during the Exchange's Core Trading Session (normally, 9:30 a.m. to 4:00 p.m., Eastern Time). The Exchange states that dissemination of the PIV will allow investors to determine the estimated intra-day value of the underlying portfolio of a series of Managed Portfolio Shares on a daily basis and will provide a close estimate of that value throughout the trading day. The exchange further states that the PIV should not be viewed as a "real-time" update of the NAV per share of each fund because the PIV may not be calculated in the same manner as the NAV, which will be computed once a day, generally at the end of the business day.<sup>15</sup>

The Exchange has represented that, after consulting with various Lead Market Makers that trade exchange-traded funds ("ETFs") on the Exchange, it believes that market makers will be able to make efficient and liquid markets priced near the PIV as long as an accurate PIV is disseminated every 15 seconds and as long as market makers have knowledge of a fund's means of achieving its investment objective, even without daily disclosure of a fund's underlying portfolio. The Exchange believes that market makers will employ risk-management techniques such as "statistical arbitrage" to make efficient markets in an issue of Managed Portfolio Shares without knowledge of a fund's underlying portfolio. The Exchange represents that market makers have indicated to it that, after the first few

days of trading, there will be sufficient data to run a statistical analysis that will lead to spreads being tightened substantially around the PIV. The Exchange states that this is similar to certain other existing exchange traded products (for example, ETFs that invest in foreign securities that do not trade during U.S. trading hours).

The Exchange's proposal provides that the Exchange will file separate proposals under Section 19(b) of the Act before listing and trading any series of Managed Portfolio Shares.

## B. Description of the Funds

### 1. The Funds' Investments

The portfolio for each Fund would consist primarily of stocks in the Russell 3000 Index and shares issued by other ETFs that invest primarily in shares of issuers in the Russell 3000 Index (which consists of stocks included in the Russell 1000 Index and the Russell 2000 Index).<sup>16</sup> All exchange-listed equity securities in which the Funds would invest would be listed and traded on U.S. national securities exchanges. Each Fund would target an overall net equity market exposure of between 70% and 130% of the Fund's assets. Each Fund would purchase securities that its portfolio managers believed to be undervalued and would sell short securities that the portfolio managers believed to be overvalued. Under normal market conditions,<sup>17</sup> each Fund's net long equity market exposure would not exceed 130%, and its net short equity market exposure would not exceed 30%, but the portfolio managers might at times exceed these percentages.

*The ActiveShares<sup>SM</sup> Large Cap Fund.* According to the Exchange, the Fund's investment objective would be long-term capital appreciation. Normally, the Fund would invest primarily in securities included in the Russell 1000 Index and ETFs that primarily invest in stocks in the Russell 1000 Index.

<sup>16</sup> ETFs would include Investment Company Units (as described in NYSE Arca Equities Rule 5.2(j)(3)); Portfolio Depositary Receipts (as described in NYSE Arca Equities Rule 8.100); and Managed Fund Shares (as described in NYSE Arca Equities Rule 8.600). All ETFs would be listed and traded on a U.S. national securities exchange. The Funds would invest in the securities of ETFs registered under the 1940 Act consistent with the requirements of Section 12(d)(1) of the 1940 Act, or any rule, regulation or order of the Commission or interpretation thereof.

<sup>17</sup> The terms "normally" and "under normal market conditions" would include, but not be limited to, the absence of extreme volatility or trading halts in the equity markets or the financial markets generally; operational issues causing dissemination of inaccurate market information; or force majeure events such as systems failure, natural or man-made.

*The ActiveShares<sup>SM</sup> Mid-Cap Fund.* According to the Exchange, the Fund's investment objective would be long-term capital appreciation. Normally, the Fund would invest primarily in securities that are included in the Russell 2000 Index and ETFs that primarily invest in stocks in the Russell 2000 Index.

*The ActiveShares<sup>SM</sup> Multi-Cap Fund.* According to the Exchange, the Fund's investment objective would be long-term capital appreciation. The Fund would invest primarily in securities included in the Russell 3000 Index and ETFs that primarily invest in stocks in the Russell 3000 Index.

*Other Investments.* While each Fund, under normal market conditions, would invest primarily in stocks included in the Russell 3000 Index and ETFs, as described above, each Fund would be able to invest its remaining assets in repurchase agreements and reverse repurchase agreements, high-quality money market instruments, and the securities of other investment companies to the extent allowed by law.

### 2. Creation of Shares

Each Fund would issue Shares on a continuous basis for cash at NAV, and the Exchange represents that the issuance of Shares would operate in a manner substantially similar to that of other ETFs and, in particular, to that of certain fixed-income ETFs that issue shares solely for cash. Unlike most ETFs, however, Shares would be issued in any amount rather than only in a specified block size (i.e., a Creation Unit). Only Depository Trust Company participants and their customers will be able to acquire Shares at NAV directly from a Fund.

Each Fund would establish a cut-off time ("Order Cut-Off Time") for orders, and this time could be set earlier than the time at which the fund calculates its NAV. Each Fund would reserve the right to reject any purchase order at any time. Each Fund would be able to impose a transaction fee in connection with the purchase of Shares from the Fund. This fee would be determined by the Fund's adviser, but would not exceed 2%.

### 3. Redemption of Shares by or Through Authorized Participants

Redemption orders of Redemption Units (currently 50,000 shares)<sup>18</sup> or

<sup>18</sup> Proposed Rule 8.900(c)(4) defines the term "Redemption Unit" as a specified number of Managed Portfolio Shares used for determining whether a Retail Investor may redeem for cash. Currently, the size of a Redemption Unit is 50,000 Shares, but this is subject to change.

<sup>15</sup> Unlike the PIV, which will be based on consolidated last sale information, the NAV per share will be based on the closing price on the primary market for each portfolio security. If there is no closing price for a particular portfolio security, such as when it is the subject of a trading halt, a fund will use fair value pricing. That fair value pricing will be carried over to the next day's PIV until the first trade in that stock is reported.

multiples thereof would have to be placed by or through an authorized participant. The agreement signed by each authorized participant would require the establishment of a blind trust, with the Funds' custodian as trustee, to receive distributions of portfolio securities upon redemption.<sup>19</sup> Accordingly, although redemption proceeds generally would be in the form of portfolio securities, rather than cash, the redeeming authorized participants would never know what securities they had received in exchange for their Shares.<sup>20</sup>

The Exchange has stated that it expects that an authorized participant would instruct the trustee of its blind trust to liquidate redemption securities using market-on-close orders on the date of redemption so that the authorized participant would realize redemption proceeds as close as possible to the Fund's NAV on the redemption date. To allow the Funds' adviser sufficient time to identify the redemption securities and transfer the redemption basket of portfolio securities to the blind trusts, and to permit the trustee adequate time to process liquidation transactions in accordance with the authorized participants' instructions, the Exchange expects each of the Funds to designate an Order Cut-Off Time prior to the time that its NAV is calculated. The redemption basket would consist of the same securities for all authorized participants on any given day, subject to the adviser's ability to make minor adjustments to address odd lots, fractional shares, tradable sizes, or other situations. The redemption securities that the blind trust receives may mirror the portfolio holdings of a fund *pro rata* or, if the adviser determines to reduce one or more portfolio exposures through an in-kind distribution, may constitute only a portion of the holdings that would not be proportionate to the overall portfolio holdings of a Fund.

#### 4. Redemption of Shares Through the Retail Redemption Facility

Retail Investors would be able to place orders to redeem Shares in less than Redemption Unit size by instructing their broker to redeem Shares directly from the Fund for cash at NAV (the "Retail Redemption Facility"). Each Fund would be able to

impose a transaction fee in connection with the redemption of Shares directly with the Fund. This fee would be determined by the Fund's adviser, but would not exceed 2%.

## II. Summary of the Comments Received

The Commission received one letter opposing the proposed rule change, and two letters supporting it, including one from the Exchange responding to the opposing commenter's objections. These letters are summarized below.

### A. The Gastineau Letter

This commenter opposes approval of the proposal, presenting a number of arguments.<sup>21</sup> The commenter asserts that there is a "significant risk" that the Internal Revenue Service ("IRS") will deny the purported tax benefits of the Funds' distinctive in-kind redemption program.<sup>22</sup> Therefore, the commenter recommends that approval of the proposal be conditioned on the issuer obtaining a favorable IRS determination of the tax treatment through a Private Letter Ruling.<sup>23</sup>

The commenter predicts that, compared to most existing ETFs, the Shares will probably trade with significantly wider bid-ask spreads, with more variable premiums and discounts, or with both, because of what the commenter characterizes as the unreliability of the Funds' proposed method for ensuring secondary market trading efficiency. The commenter states that the Funds would not be disclosing any holdings (except on a quarterly basis) and that the Funds' market makers would have only indirect, and likely imperfect, information about Fund holdings.<sup>24</sup> The commenter argues that effectively arbitraging the Funds will be significantly more difficult than the arbitrage for most existing foreign ETFs.<sup>25</sup> The commenter argues that there is no support for the Exchange's contention that existing ETFs holding portfolios of foreign securities, such as index-based ETFs holding Asian stocks, have demonstrated efficient pricing characteristics even though, because foreign stocks do not trade during the same hours as U.S. ETFs, the ETFs holding foreign stocks do not provide opportunities for riskless arbitrage transactions during much of the trading

day.<sup>26</sup> The commenter also cites a draft academic working paper<sup>27</sup> for the propositions that market trading efficiency varies significantly by type and size of ETF; that funds with high share trading volumes, liquid underlying holdings, and efficient arbitrage mechanisms trade with relatively tight bid-ask spreads and more stable premiums and discounts; and that funds lacking these characteristics generally traded with wider spreads and more variable premiums and discounts.

The commenter states that, for a number of reasons, the dissemination of a PIV by the Funds is likely to prove ineffective in ensuring alignment of secondary market prices for the Shares with the values of the underlying portfolios. The commenter asserts that, during periods of rapid market movement, the use of last-sale prices to calculate a PIV, coupled with the dissemination of the PIV only every 15 seconds, will mean that the PIV will be a lagging indicator of actual portfolio values.<sup>28</sup> Additionally, the commenter asserts that the PIV may reflect clearly erroneous values for securities that have not yet opened for trading on a particular business day or that are subject to an intraday interruption in trading.<sup>29</sup> The commenter also criticizes the Exchange's representation that the adviser and calculation agent will use "commercially reasonable efforts" to calculate the PIV, arguing that this is a substantially lower standard of care than that applying to NAV calculations for ETFs and mutual funds.<sup>30</sup> The commenter further asserts that no one will stand behind a Fund's PIV to ensure timeliness and accuracy.<sup>31</sup> The commenter asserts that, without a reliable PIV, the Shares cannot and will not trade acceptably in the secondary market.<sup>32</sup>

The commenter predicts that frequent PIV errors will in turn cause "erroneous share trades" to be executed.<sup>33</sup> The commenter states that the proposal does not address the treatment of erroneous share trades resulting from a faulty PIV—namely, whether PIV errors and related erroneous trades will be detected by the Exchange, whether such trades would be cancelled, and whether the Exchange would apply a materiality

<sup>19</sup> The custodian would act as trustee of the blind trusts, and the trustee will be paid by the authorized participant a fee negotiated by the funds' adviser on behalf of authorized participants.

<sup>20</sup> In contrast, an authorized participant redeeming Managed Fund Shares generally knows what securities it will receive from the fund, because these securities are disclosed on a daily basis as a "redemption basket."

<sup>21</sup> The commenter notes that he has a retained economic interest in a product that may be competitive with Managed Portfolio Shares and states that his views on the Exchange's filing "may be considered subject to a conflict of interest." Gastineau Letter, *supra* note 4, at 1, n.1.

<sup>22</sup> See *id.* at 5.

<sup>23</sup> See *id.*

<sup>24</sup> See *id.* at 8.

<sup>25</sup> See *id.* at 7, 8.

<sup>26</sup> See *id.* at 9.

<sup>27</sup> "Inefficiencies in the Pricing of Exchange-Traded Funds," Antti Petajisto, September 20, 2013, available at <http://www.petajisto.net/>.

<sup>28</sup> See Gastineau Letter, *supra* note 4, at 10.

<sup>29</sup> See *id.*

<sup>30</sup> See *id.* at 10–11.

<sup>31</sup> See *id.* at 11.

<sup>32</sup> See *id.*

<sup>33</sup> See *id.* at 13.

standard for cancellations.<sup>34</sup> The commenter argues that, as a condition of approval, the Exchange should be required to monitor the timeliness and accuracy of PIV dissemination and to implement procedures to address trades when an erroneous PIV has been disseminated.<sup>35</sup>

The commenter also predicts that the following elements of the proposed redemption arrangements would introduce additional costs and uncertainties for authorized participants:

- The Funds' custodian would have a monopoly position as the sole eligible provider of trustee services for the blind trust;
- The Funds' adviser, rather than the authorized participant, would negotiate the fees paid to the trustee;
- In contrast to existing ETFs, no authorized participant would have the potential ability to use its market knowledge and market position to enhance arbitrage profits (or offset arbitrage costs) by managing sales of the distributed securities to minimize market impact or to realize prices above the market close; and
- The Funds' custodian, who stands in for the authorized participant in the sale of distributed securities, would have no apparent incentive to sell distributed securities with low market impact or at prices above the close and would experience little or no downside from doing the opposite.

The commenter also asserts that redeeming authorized participants would be exposed to potential costs and risks associated with not being able to control disposition of significantly more concentrated redemption proceeds, and the commenter argues that these extra costs and risks associated with the blind trust arrangement will be passed through to shareholders transacting in the secondary market, reflected as wider bid-ask spreads, more volatile premiums and discounts for the Shares, or both.

The commenter posits that the lack of portfolio transparency would favor market makers and other professional traders over other market participants, such as investors, and the commenter concludes that this disparate treatment is contrary to the principle that all participants should be on an equal footing with respect to knowledge of a fund's holdings.<sup>36</sup> Notwithstanding the public dissemination of the PIV, the commenter argues that market makers and other professional traders would have a significant indirect information

advantage over other participants because of their ability to glean information about a Fund's holdings through sophisticated data analysis of changes in the PIV.<sup>37</sup> In particular, the commenter asserts that PIV disclosures might enable market makers and professional traders to uncover a Fund's holdings and trading activity, rendering the Fund susceptible to the dilutive effects of front running.<sup>38</sup> The commenter asserts that, prior to approval, the proposal should be amended to include: (1) A discussion of the steps to be taken to minimize reverse engineering risk; (2) a discussion of how the Funds propose to resolve the conflict between providing market makers with adequate information to support efficient Share trading and protecting against reverse engineering; and (3) representations that the Funds will adequately disclose reverse-engineering risk and the conflicts the Funds face in seeking to provide for efficient market trading and protection against reverse engineering.<sup>39</sup>

The commenter argues that the Commission should not grant the issuer's pending request for exemptive relief under the 1940 Act to maintain early Order Cut-Off Times for Fund redemptions, which are intended to facilitate the timely sale of distributed securities by the blind trusts that receive the proceeds of authorized participant redemptions and the efficient processing of redemptions by retail investors through the Retail Redemption Facility.<sup>40</sup>

The commenter posits that a principal purpose of including direct Share purchases and the Retail Redemption Facility in the proposal is to provide comfort to the Commission and market participants that investors will be able to transact with the Fund at or near NAV whenever secondary market trading prices of shares vary significantly from NAV.<sup>41</sup> The commenter argues that these provisions, as proposed, are inadequate for this purpose because: (1) The Retail Redemption Facility will be available only to a limited set of shareholders and will be restricted to redemptions of less than a Redemption Unit of shares; (2) the expected early Order Cut-Off Time

for direct share purchases and the Retail Redemption Facility means that an investor's ability to directly purchase or redeem shares for cash will exist for only a portion of each business day; (3) investors who directly purchase and redeem shares will be subject to transaction fees imposed by the Fund of up to 2% and may also be subject to broker-dealer processing fees; (4) self-directed investors may not have adequate information about the available liquidity options to make intelligent choices about how best to buy and sell shares; (5) broker-dealers may not have adequate information to ensure that their customers consistently receive best execution on transactions in shares, given the two distinct liquidity pathways; and (6) broker-dealers may not have or may not develop the systems capabilities necessary to support customer transactions in Funds offering both secondary market trading in shares and direct share purchases and redemptions.<sup>42</sup>

The commenter recommends that the Funds should be required to extend eligibility for the Retail Redemption Facility to all shareholders and that the Order Cut-Off Times for direct purchases of shares and redemptions under the Retail Redemption Facility be established as of the close of the Exchange's regular trading session.<sup>43</sup> The commenter recommends that the Exchange be required to limit trading in shares to broker-dealers that have represented to the Exchange that they have systems in place (a) to accommodate direct purchases and redemptions of Shares on terms no less favorable than secondary market transactions and (b) to ensure best execution of transactions in shares, considering both secondary market trading and direct purchase and redemption options.<sup>44</sup> The commenter also recommends that the broker-dealers trading shares on the Exchange should not be permitted to charge their customers processing fees on direct purchases and redemptions of shares that exceed what they charge the same customers for secondary market trades.<sup>45</sup> Further, the commenter recommends that the Funds should not be permitted to charge transaction fees on direct purchases and redemptions of shares that exceed the associated Fund

<sup>37</sup> See *id.* at 14.

<sup>38</sup> See *id.* at 15. The commenter discusses certain factors determining a fund's susceptibility to reverse engineering using intraday valuations disseminated at 15 second intervals. See *id.*

<sup>39</sup> See *id.* at 15–16.

<sup>40</sup> See *id.* at 16. The commenter alleges that the prospectus contains a number of material misstatements and omissions relating to in-kind redemptions and direct purchases and redemptions. See *id.* at 27–28.

<sup>41</sup> See *id.* at 17.

<sup>42</sup> See *id.* at 18.

<sup>43</sup> See *id.* at 20.

<sup>44</sup> See *id.*

<sup>45</sup> See *id.*

<sup>34</sup> See *id.*

<sup>35</sup> See *id.*

<sup>36</sup> See *id.* at 14–15.

expenses incurred, taking into account the size of a specific transaction.<sup>46</sup>

The commenter asserts that the Funds should: (1) Be required to limit their equity investments to U.S.-exchange-listed stocks with market caps of \$5 billion or greater (consistent with the general understanding of large- and medium-cap stocks; a universe of about 700 stocks currently); (2) not be permitted to invest in illiquid assets or debt instruments of non-U.S. issuers; and (3) not be permitted to employ investment leverage or hold short positions.<sup>47</sup>

The commenter notes that the Exchange will permit trading in the Shares between 4:00 a.m. and 8:00 p.m., but that the PIV will only be disseminated during the Core Trading Session of 9:30 a.m. to 4:00 p.m. The commenter asserts that the proposal does not adequately address the significant risk that the prices of shares bought or sold in the Opening Session (4:00 a.m. to 9:30 a.m.) and Late Trading Session (4:00 p.m. to 8:00 p.m.) will vary widely from underlying portfolio values because an updated PIVs would not be available.<sup>48</sup> Therefore, the commenter suggests that trading in shares should be limited to the Exchange's Core Trading Session.<sup>49</sup>

The commenter states that, given the importance of the PIV to the decision-making process of current and prospective Fund investors, all Fund investors should have ongoing access to current PIV values.<sup>50</sup> The commenter suggests that each Fund's current PIV be provided at no charge on a public Web site and made available to the public no later than it is made available to any other market participant.<sup>51</sup> The commenter also suggests that the following information be published on the Funds' Web site:

- *PIV Information*—Real-time PIVs updated continuously throughout the Exchange's Core Trading Session on each business day; updated daily, complete intraday PIV history for at least the 20 most recent trading days

(allowing buyers and sellers of shares to compare their executed prices to reported PIVs at the time of their trade execution); updated daily, the prior business day's closing PIV and a calculation showing the relationship of closing PIV to NAV (allowing investors to evaluate PIV to NAV

correspondence); and updated daily, a chart and tables showing the frequency distribution and range of the closing PIV-to-NAV ratios for each calendar quarter over the life of the Fund.<sup>52</sup>

- *Closing Price Premiums/*

*Discounts*—Updated daily, the prior business day's closing market price and premium or discount (expressed as a percentage) based on the relationship of the closing market price to NAV; and, updated daily, a chart showing the frequency distribution and range of daily closing price premiums and discounts (expressed as percentages) for each calendar quarter over the life of the Fund.

- *Intraday Estimated Premiums/*

*Discounts*—Updated daily, the prior business day's average, minimum, and maximum intraday estimated premiums and discounts (expressed as percentages) based on PIVs and bid-ask midpoints at each PIV publication time; and, updated daily, a chart showing the frequency distribution and range of daily average, minimum, and maximum intraday estimated premiums and discounts (expressed as percentages) for each calendar quarter over the life of the Fund.<sup>53</sup>

- *Bid-Ask Spreads*—Updated daily, the prior business day's closing bid-ask spread and average, minimum, and maximum intraday bid-ask spreads (expressed as percentages) during the Exchange's Core Trading Session; and, updated daily, a chart showing the frequency distribution and range of daily closing bid/ask spreads and intraday average, minimum, and maximum bid-ask spreads (expressed as percentages) for each calendar quarter over the life of the Fund.<sup>54</sup>

- *Fund Market Exposure and Leverage*—Updated daily, the prior business day's net long or short equity market exposure and amount of investment leverage employed, each expressed as a percentage of Fund net assets; and, updated daily, a chart showing the frequency distribution and range of the Fund's daily net market exposure and leverage percentages for each calendar quarter over the life of the Fund.<sup>55</sup>

- *Purchase and Redemption Transaction Fees*—Updated daily, transaction fees currently applicable to direct purchases of shares, redemptions through the Retail Redemption Facility, and redemption unit redemptions; and, updated daily, a chart showing the frequency distribution and range of transaction fees applicable to direct purchases of shares, redemptions through the Retail Redemption Facility, and redemption unit redemptions for each calendar quarter over the life of the Fund.<sup>56</sup>

Finally, the commenter asserts that, given the fundamental differences in how the Shares may be bought or sold, compared to other ETFs, it is not appropriate for the Funds to be advertised or marketed as ETFs.<sup>57</sup> Therefore, the commenter recommends that the Commission take appropriate steps to ensure that the Exchange, broker-dealers, and market data providers do not describe the Funds as ETFs.<sup>58</sup>

#### B. The DeCore Letter

The DeCore Letter supports the proposed rule change, asserting that investors would have access for the first time to many different types of active management strategies.<sup>59</sup> The commenter predicts that trading spreads in Managed Portfolio Shares will not be as "tight" as trading spreads in the SPY or QQQ (where futures, options, and equity portfolios can be used as a pure hedge), but that a frequent update of the intraday indicative value will allow market maker spreads to be reasonable.<sup>60</sup> The commenter asserts that Managed Portfolio Shares would have the benefit of intraday trading and of creation and redemption at closing NAV and that they would, unlike other ETFs, also offer the additional advantage of allowing investors to create or redeem directly for cash in amounts less than a creation unit.<sup>61</sup>

#### C. The Exchange's Response Letter

The Exchange asserts that the concerns of the opposing commenter are driven by competitive motives and argues that these concerns should not affect the Commission's decision to approve or disapprove the proposed rule change.<sup>62</sup> Instead, according to the Exchange, different proposals to list and trade actively managed EFTs without daily portfolio disclosure should be

<sup>46</sup> See *id.* at 20–21. The commenter does not agree with the representations made in the proposal relating to certain cost efficiencies with respect to: (1) Fund operating expenses as reflected in their total expense ratios; (2) Fund trading costs and possible cash drag on returns incurred in connection with direct purchases and redemptions of shares; (3) transaction fees imposed by the Fund on direct purchases and redemptions of shares; and (4) processing fees paid by shareholders to their broker-dealers on direct purchases and redemptions of shares. See *id.* at 21–23.

<sup>47</sup> See *id.* at 24.

<sup>48</sup> See *id.*

<sup>49</sup> See *id.*

<sup>50</sup> See *id.* at 25.

<sup>51</sup> See *id.*

<sup>52</sup> See *id.* at 26.

<sup>53</sup> See *id.*

<sup>54</sup> See *id.*

<sup>55</sup> See *id.* at 26–27.

<sup>56</sup> See *id.* at 27.

<sup>57</sup> See *id.* at 28–29.

<sup>58</sup> See *id.*

<sup>59</sup> See DeCore Letter, *supra* note 7, at 1.

<sup>60</sup> See *id.*

<sup>61</sup> See *id.* at 1–2.

<sup>62</sup> See Response Letter, *supra* note 7, at 5.

assessed on their individual merits and risks.<sup>63</sup> The Exchange also asserts that, assuming investor protection concerns are adequately addressed, investors and the marketplace can only benefit from listing and trading of a variety of products with different structures, positing that competitive forces will ultimately decide the success of failure of such initiatives.<sup>64</sup>

More specifically, the Exchange states that the opposing commenter offers no direct support for his doubts regarding the assertions by lead market makers ("LMMs") about efficient secondary market trading, and the Exchange asserts that these LMMs are uniquely suited to prospectively assess the effectiveness of arbitrage in the shares.<sup>65</sup> The Exchange reiterates that market makers have indicated that the available information regarding the Shares would be sufficient for arbitrage and hedging purposes.<sup>66</sup> Additionally, the Exchange states that, based on discussions with market makers, it expects that market makers would agree to act as LMMs in the Shares and believes that no market maker would accept an LMM assignment if it were not entirely comfortable in its ability to hedge its positions.<sup>67</sup> The Exchange also reiterates that its existing trading surveillance procedures would be applied to trading in the Shares and that such procedures are adequate to properly deter and detect violations of Exchange rules and federal securities laws applicable to trading on the Exchange.<sup>68</sup>

The Exchange agrees with the opposing commenter that an accurate PIV would be essential for trading in the Shares, but asserts that the commenter offers no support for the assertion that the PIV would be unreliable.<sup>69</sup> The Exchange reiterates that market makers have indicated that, after the first few days of trading, there would be sufficient data to run a statistical analysis that would lead to differences between the Share price of the ETF and the PIV being tightened substantially.<sup>70</sup> The Exchange states that it has no reason to believe that the PIV, which would be calculated using methodology substantially similar to that used in the calculation of all other ETF intraday indicative values, would be inherently unreliable.<sup>71</sup> The Exchange reiterates its

view that market participants would accept the PIV as a reliable, indicative real-time value because (1) the PIV would be calculated and disseminated based on a Fund's actual portfolio holdings; (2) the securities in which the Funds plan to invest are generally highly liquid and actively traded and therefore generally have accurate real-time pricing available; and (3) market participants would have a daily opportunity to evaluate whether the PIV at or near the close of trading was indeed predictive of the actual NAV.<sup>72</sup>

Responding to the opposing commenter's suggestion that the Exchange be required to institute a program to monitor the timeliness and accuracy of disseminated PIVs and to adopt appropriate procedures for the treatment of trades executed during periods when erroneous PIVs were disseminated, the Exchange reiterates that it has no reason to believe that the PIVs would be inherently unreliable, and therefore it does not propose to institute any additional monitoring programs. Instead, the Exchange states that it would rely on its existing surveillance systems to monitor trading in the Shares.<sup>73</sup> The Exchange also states that all exchanges may cancel trades only according to their respective rules and that, while its rule applicable to trade cancellations (NYSE Area Equities Rule 7.10) would apply to trading in the Shares, that rule neither addresses trade cancellations in the event erroneous PIVs are disseminated nor provides the Exchange discretion to cancel trades.<sup>74</sup>

In response to the opposing commenter's concerns about the adequacy of the risks included in the Exchange's Information Bulletin ("Bulletin")—which would provide Exchange members with key information about the Shares—and the commenter's suggestion that trading in the Shares be limited to the Core Trading Session, the Exchange states that: (1) Its surveillance procedures are operative during all trading sessions and are adequate to monitor trading in the Shares; (2) that it has no reason to discount the assertions of market makers regarding their ability to make efficient markets during all trading sessions; and (3) it will ensure that the Bulletin would adequately address the special characteristics and risks associated with trading in the Shares.<sup>75</sup>

In response to the opposing commenter's concern that market

professionals could reverse-engineer the holdings underlying the Shares and thereby obtain an advantage over retail customers, the Exchange states that the following information would be publicly available to market professionals and retail investors alike: A PIV, disseminated every 15 seconds; an NAV, disseminated daily after the close; and the national best bid and offer and last trade for the Shares, disseminated in real-time through the Consolidated Quotation System and the Consolidated Tape.<sup>76</sup> The Exchange states that, as with other ETFs, any independent view that market participants might have about the composition of the fund holdings and the value of those holdings would be included in the prices at which those participants would be willing to trade the product.<sup>77</sup>

Responding to the commenter's recommendations that the Funds extend eligibility for the Retail Redemption Facility to all shareholders, that the Order Cut-off Times for direct purchases of Shares and redemption under the Retail Redemption Facility be established as the close of the Exchange's Regular Trading Session, and that trading in the Shares be limited to broker-dealers that make certain representations to the Exchange regarding direct purchases and redemptions, the Exchange asserts that the process proposed in the Notice is consistent with the applicable provisions of the Act.<sup>78</sup>

Responding to the commenter's recommendation that the PIV be posted on each Fund's Web site in real time (along with other information), the Exchange states that such real-time Web site disclosure of an indicative value is not required of other ETFs.<sup>79</sup> The Exchange states that the PIV is designed to provide guidance regarding variances between the prior day's closing prices and intraday changes in the value of the underlying portfolio.<sup>80</sup> The pricing of the Shares themselves would be disseminated in real time through the Consolidated Quotation System, according to the Exchange.<sup>81</sup>

Finally, the Exchange argues that the opposing commenter's arguments regarding the following are not relevant to the Commission's determination, under Section 19(b) of the Act, whether the Exchange's proposal is consistent with the Act: (1) Tax treatment of in-

<sup>63</sup> See *id.*

<sup>64</sup> See *id.*

<sup>65</sup> See *id.* at 2.

<sup>66</sup> See *id.*

<sup>67</sup> See *id.*

<sup>68</sup> See *id.*

<sup>69</sup> See *id.*

<sup>70</sup> See *id.*

<sup>71</sup> See *id.*

<sup>72</sup> See *id.*

<sup>73</sup> See *id.* at 3.

<sup>74</sup> See *id.*

<sup>75</sup> See *id.*

<sup>76</sup> See *id.*

<sup>77</sup> See *id.*

<sup>78</sup> See *id.* at 4.

<sup>79</sup> See *id.*

<sup>80</sup> See *id.*

<sup>81</sup> See *id.*

kind distributions through the blind trust; (2) early Order Cut-Off Times for redemption; (3) cost considerations;<sup>82</sup> (4) the commenter's recommendation to curtail the permitted investments of the funds; and (5) prospectus disclosures.<sup>83</sup>

### III. Proceedings to Determine Whether to Approve or Disapprove SR–NYSEArca–2014–10 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act<sup>84</sup> to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change, as discussed below. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described below, the Commission seeks and encourages interested persons to provide comments on the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,<sup>85</sup> the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the proposed rule change's consistency with Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade," and "to protect investors and the public interest."<sup>86</sup>

### IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposal is consistent with Section 6(b)(5) or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval which would be facilitated

by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b–4, any request for an opportunity to make an oral presentation.<sup>87</sup>

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by June 23, 2014. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by July 7, 2014.

The Commission asks that commenters address the sufficiency of the Exchange's statements in support of the proposal, in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission seeks comment on the statements of the Exchange contained in the Notice,<sup>88</sup> the issues raised by the opposing commenter, the Exchange's responses to those issues, and any other issues raised by the listing and trading of an actively managed ETF that does not make daily public disclosure of its investment portfolio.

Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR–NYSEArca–2014–10 on the subject line.

#### Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090. All submissions should refer to File Numbers SR–NYSEArca–2014–10. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule

change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of these filings also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NYSEArca–2014–10 and should be submitted on or before June 23, 2014. Rebuttal comments should be submitted by July 7, 2014.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>89</sup>

**Kevin M. O'Neill,**

*Deputy Secretary.*

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### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–72252; File No. SR–NYSEMKT–2014–46]

#### Self-Regulatory Organizations; NYSE MKT LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Amending NYSE MKT Rule 13—Equities to Introduce a New "Retail" Modifier for Orders and to Make Related, Administrative Changes to Its Price List

May 27, 2014.

Pursuant to Section 19(b)(1) <sup>1</sup> of the Securities Exchange Act of 1934 ("Act") <sup>2</sup> and Rule 19b–4 thereunder,<sup>3</sup> notice is hereby given that, on May 13, 2014, NYSE MKT LLC ("NYSE MKT" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to

<sup>82</sup> The Exchange argues that limiting broker-dealer processing fees on direct purchases and redemptions of Shares would require Commission rulemaking. See *id.* at 4.

<sup>83</sup> See *id.* at 4–5.

<sup>84</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>85</sup> *Id.*

<sup>86</sup> 15 U.S.C. 78f(b)(5).

<sup>87</sup> Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Public Law 94–29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

<sup>88</sup> *Supra*, note 3.

<sup>89</sup> 17 CFR 200.30–3(a)(57).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 15 U.S.C. 78a.

<sup>3</sup> 17 CFR 240.19b–4.