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SEC's Denial of Non-Transparent ETFs Means APs Can Rest Easy—For Now

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Publisher's Note—*On November 6, as this article was going to print, the Securities and Exchange Commission indicated that it will grant exemptive relief to Eaton Vance and its affiliates for the exchange-traded managed funds (ETMFs) that are discussed in this article. The December issue of Wall Street Lawyer will feature a follow-up to this article that provides further details on this new investment product and will elaborate on the potential impact of this product on authorized participants (APs).*

On October 21, the Securities and Exchange Commission (SEC) issued preliminary denials to two exemptive relief applications that softened the market's anticipation for a new investment product: non-transparent actively managed exchange-traded funds (ETFs). In responding to the applications, the SEC was substantially concerned that the pricing mechanisms proposed as an alternative to a fully transparent portfolio were insufficient to ensure that ETF shares would consistently trade at market prices equal or close to their net asset value (NAV) per share.[1] Accordingly, the SEC stated that the proposed ETF structures did not meet the standard required to grant exemptive relief. Unless the SEC grants a request for a hearing to discuss the issues set forth in its preliminary denials, the refusal of the two applications is expected to stand.

CONTINUED ON PAGE 4

Content HIGHLIGHTS

Directors Should Communicate With Shareholders
To Demonstrate Their Effectiveness, Corporate Boards Should Increase Transparency, Provide an Annual Report of Boardroom Activities and Take Charge of Their Relations with Shareholders
By John C. Wilcox....15

Audit Committee Reporting to Shareholders: 2014 Proxy Season Update Audit Committees Continue to Enhance Voluntary Disclosures
By Allie Rutherford & Ruby Sharma....20

Complete Table of Contents listed on page 2.

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CONTINUED FROM PAGE 1

As discussed in this article, if the SEC had approved the exemptive applications there would have been substantial implications for authorized participants (APs), which are the banks and broker-dealers that contract for the ability to transact directly with ETFs. Even in the wake of the SEC's denials, it seems as though non-transparent ETFs may still be the next variation in the evolution of ETFs, particularly given the creativity with respect to new product formation exemplified by the applicant firms and the market incentives to offer a pooled vehicle with the investor protections of the Investment Company Act of 1940 (1940 Act) and a non-transparent portfolio that would shield proprietary investment strategies of fund managers. The SEC was careful to state that its views on the proposals were "preliminary," which indicates that the SEC's statements could act as a roadmap to create non-transparent ETFs more likely to pass SEC muster. In addition, both of the applications that were struck down[2] proposed to use the same blind trust structure as a proxy for a transparent portfolio, but two other structures have been proposed that the SEC has not yet addressed. Accordingly, the SEC may have only bought APs more time to consider the implications of these new products to their operations and business.

Background

First, let's start with some background. Although the first non-transparent ETFs requested exemptive relief from the SEC as far back as 2007,[3] a critical mass of prominent fund shops joined the queue for regulatory approval within the last three years, increasing the likelihood that the SEC would take definitive action.[4] In recent months, fund shops also started to partner with exchanges both to convince the SEC to take action and to strategically position themselves for market share if this new line of products is permitted.[5] So what are non-transparent ETFs and what would it mean for APs if the SEC were to permit them?

Traditional ETFs are similar to both open-end funds (or mutual funds) and closed-end funds. They are like closed-end funds because their shares trade on an exchange during normal market hours. But they are also like mutual funds because their shares are in continuous distribution and can be purchased and redeemed directly from the fund. Unlike mutual funds, however, ETFs can transact directly only with banks and broker-dealers that have entered into an authorized participant agreement with the ETF's distributor —and only in large chunks of shares called "creation units" that are usually 25,000 to 100,000 shares each.

Because they do not fit squarely within either the category of open-end funds or the category of closed-end funds, ETFs are also an imperfect fit within the structure of the 1940 Act, which is the statute that was designed to regulate pooled investment structures. Accordingly, as a prerequisite to coming to market, ETFs must obtain exemptive relief from the SEC from several sections of the Investment Company Act. These exemptions typically allow ETFs, among other things, to redeem their shares in creation-unit size, to permit other funds to acquire ETF shares beyond the limits built into the Investment Company Act, and to trade their shares on exchanges at market prices instead of their NAV per share.

Because so many ETFs have launched over the years, the SEC's granting of exemptive relief has become somewhat commonplace.[6] Over time there have been variations in the exemptive orders that respond to changing market demands for different product offerings. The first fixed income ETF was launched in 2002 and the first commodity-based ETFs were launched in 2004. In 2006, leveraged and inverse index-based ETFs were permitted. In 2008, the SEC permitted the first actively managed ETFs.[7] The total number of ETFs in the United States has grown from 113 in 2002 to 1,294 as of the end of 2013, with assets growing from $102 billion to $1.67 trillion over the same period.[8] However, growth in actively managed ETFs has not exhibited the same trajectory, largely due to the condition required by the SEC in all exemptive relief that has ever been granted to date: that ETFs daily disclose their portfolio holdings.[9] Fearing that their secret

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formulas could be distilled from such disclosure requirements, many active managers have shied away from wading into the ETF space.

Exemptive relief granted by the SEC to permit a new ETF complex to come to market imposes a number of conditions on the ETF. Among other conditions, the SEC effectively requires ETF shares to trade at a market price (the price at which an ETF shares can be bought or sold on the exchange) that will closely track the ETF's NAV per share (the total asset value of the ETF's entire portfolio of underlying securities less outstanding liabilities, divided by the total number of shares outstanding). ETF shares are able to trade on the market at or near NAV per share because APs functionally provide an arbitrage pricing mechanism. If an ETF's shares are trading at a premium (*i.e.*, the market price per share is higher than the NAV per share), then one or more APs would assemble a basket of the ETF's underlying securities—a "creation basket"—and deliver it in-kind to the ETF in exchange for the shares, effectively resetting the alignment between market price and NAV per share and retaining the difference as profit. If an ETF's shares are trading at a discount (*i.e.*, the market price per share is lower than the NAV per share), then one or more APs would assemble a basket of ETF shares and redeem them back to the ETF in exchange for a basket of the underlying securities. This arbitrage pricing mechanism exists because of three elements acting in sync: (*i*) the ETF shares are traded on an exchange; (*ii*) the exchange is required to calculate and publish every 15 seconds an intraday indicative value of a basket of securities in the ETF's portfolio; and (*iii*) the ETF's portfolio is transparent. It is this last element—portfolio transparency—that the new wave of exemptive applications sought (and continues to seek) to alter, thereby removing a significant deterrent for active managers, but imposing new challenges on APs.

Proposed Structures

There are essentially three proposed non-transparent ETF structures in the current set of exemptive applications filed with the SEC. The most commonly proposed structure uses a blind trust as an intermediary between APs and the ETFs, which will be designed to maintain the confidentiality of the ETF's holdings.[10] A second proposed structure would not use a blind trust, but instead would have the ETF calculate and publish a data set that would act as a proxy for portfolio transparency and still incentivize APs to maintain a market price for ETF shares that is very close to the shares' NAV.[11] In the wake of the SEC's denial of two of the blind trust proposals, we will discuss whether these "proxy data" proposals are still viable alternatives to fully transparent portfolios. A third proposed structure would permit ETFs to trade during the day at a premium or discount to the to-be-determined end-of-day NAV, with indicative net asset values (INAV) published only every 15 minutes.[12] Under most of the proposals, an ETF's portfolio would only be disclosed quarterly and with a 60-day lag, similar to the portfolio disclosure requirements for a mutual fund.[13]

Blind Trusts

Under the blind trust proposals, APs would have been required as part of the authorized participant agreement to establish a blind trust. The terms of the blind trust would have been set forth as an exhibit to the authorized participant agreement. The AP would have been required to appoint the ETF's custodian as trustee of the blind trust, acting for the benefit of the AP. Further, the custodian, as trustee of the blind trust, would have been paid a fee by the AP, which would have been negotiated by the ETF's adviser on behalf of all APs. The custodian likely would have dictated the state law under which the trust would be formed and likely would have provided a "form of" trust agreement. For large ETF complexes, this could have resulted in the establishment of several dozen blind trusts, and it was not clear whether each AP would need a separate blind trust for each non-transparent ETF or whether a single blind trust could have been used for transactions in all of the ETFs under a single registrant by a particular AP.

Creation orders would have been effected in cash. For redemption orders, the ETF (acting

through its custodian) would have delivered in-kind portfolio securities to the AP's blind trust. In effect, because the same entity would have acted as both custodian of the ETF and trustee of the blind trust, this would have consisted of the ETF's custodian transferring the portfolio securities within its own books and records, subject to the AP's delivery of the ETF shares. As proposed, the trustee of the blind trust would have liquidated the portfolio securities delivered by the ETF and pass along the cash proceeds without disclosing the identity of the portfolio securities to the AP. APs likely would have instructed the trustee of the blind trust to liquidate portfolio securities in connection with a redemption order on the date the redemption order was placed so as to realize redemption proceeds as close as possible to the ETF's NAV on the redemption date. Because of these extra steps involved, order cut-off times likely would have been earlier than those of traditional ETFs.

Instead of instructing the trustee of the blind trust to liquidate the portfolio securities, APs could have instructed the trustee to hedge or otherwise manage the securities. APs could have worked with the trustee to design generic standing instructions that would have operated without the APs having to know the identity of the portfolio securities.

In addition to the blind trust structure, these proposals included the provision of an INAV published every 15 seconds by the exchange during the trading day, which would have been calculated by a calculation agent who would have had full insight into the ETF's portfolio. In addition, the proposed ETFs would have included a back-up mechanism pursuant to which retail investors could have redeemed shares directly back to the ETF other than in creation-unit size in certain circumstances, but subject to a 2% redemption fee and brokerage commissions incurred as a result of the transaction.

In the two recent notices denying applications for exemptive relief to create non-transparent ETFs that would use a blind trust, the SEC explained that daily portfolio transparency results in a "close tie" between an ETF's market price and its NAV per share, which serves as the "foundation for why the prices at which retail investors buy and sell ETF shares are similar to the prices at which [APs] are able to buy and redeem shares directly from the ETF at NAV."[14] The SEC stated that the proposed structures "fall far short of providing a suitable alternative" to daily portfolio transparency.[15] Supporting its conclusion, the SEC noted that ETF prospectus disclosure does not provide sufficient detail into an ETF's portfolio and that quarterly disclosures of full portfolio holdings would be largely irrelevant because of the 60-day time lag. Even more telling was the SEC's critique of INAV, which the SEC stated is calculated based on "stale data" compared to the "fractions of a second" at which market makers operate in the current market.[16] The SEC also noted that INAV is not subject to a uniform methodology of calculation and that generally no party agrees to take responsibility for its accuracy. Further, because INAV uses last available market quotations or sale prices as inputs, the SEC warned that it could be an insufficient indication of actual value for an ETF with fair- valued securities, thinly traded securities or derivative instruments, or foreign securities with significant time differences in market trading hours from the ETF's shares. The SEC stated that all of these shortcomings could be significantly pronounced during times of market stress or volatility.

Proxy Data

A second approach to non-transparent ETFs would rely not on a blind trust acting as intermediary, but instead on a steady supply of data other than portfolio holdings in order to permit APs to continue to transact in ETF shares while hedging their risk on those transactions. Unlike the blind trust proposals, which relied almost solely on INAV as a sufficient proxy for daily portfolio transparency,[17] these proxy data proposals would provide a more robust set of information to the market, although it is as yet unclear whether the SEC will consider such data to be substantial enough to ensure that an ETF's market price and NAV per share remain closely tied such that retail investors and APs

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can transact at close to the same price. There are currently two such proposals with the SEC, each of which operates under the theory that portfolio transparency is only required by the SEC because it facilitates the pricing arbitrage mechanism that keeps market prices in line with NAV, but that portfolio transparency is not a *per se* requirement for an ETF's arbitrage pricing mechanism to function efficiently. Instead of portfolio transparency, these applicant ETFs would provide alternative data sets that they claim would still permit APs to execute low-risk arbitrage trades in ETF shares.

Under the first proposal,[18] ETFs would disclose their full portfolio holdings monthly on a 30-day lag and would daily disclose a trading basket composed of recently disclosed portfolio holdings and representative ETFs. The ETFs would also disseminate an INAV every 15 seconds. The contents of the trading basket would be designed to track closely the performance of the applicable ETF. The expectation is that APs would be able to use the trading basket as a reliable hedging vehicle for the ETF. Based on the SEC's statements in its October 24 notices, it is unlikely that the SEC will give much weight to the provision of INAV and the monthly disclosure of portfolio holdings with a 30-day lag. Instead, the SEC's approval of this proposal would likely turn on the usefulness of the trading basket, namely, how closely the trading basket resembles the ETF's actual portfolio. It is possible that the SEC may only be able to get comfortable where the trading basket is so similar to the actual portfolio that there would be little benefit to the ETF's sponsor in not simply providing full portfolio transparency—which would lead us back to the market's status quo.

The second proxy data proposal is more complex. Under this proposal, in lieu of full portfolio transparency,[19] the ETFs would provide both a "high-quality pricing signal" for ETF shares and a "high-quality hedging signal" for positions in ETF shares. As proposed, the ETF's INAV per share would be a "high-quality pricing signal" because of investment limitations imposed on the ETF's portfolio. Specifically, the applicant states that at least 95% of the ETF's holdings will be traded on an exchange (and accordingly will have a market price), that at least 95% of the ETF's holdings will be traded in sync with the ETF's shares such that their prices can be continuously updated throughout the trading day, that there will be sufficient trading volume and liquidity in at least 95% of the ETF's portfolio holdings, and that the entity that calculates the INAV will know the ETF's portfolio holdings. As a result, at least 95% of such ETFs' portfolios will be invested in common stocks and exchange-traded equity securities (including fund shares), depositary receipts, short positions, exchange-traded futures, exchange-traded options, exchange-traded swaps, money market instruments, cash and cash equivalents. This highly liquid portfolio should at least partially quell the SEC's concern over the limitation of INAV in that it may not accurately value fair-valued and illiquid securities. However, these conditions substantially limit the complexity of the actively managed portfolios that could be created as a non-transparent ETF in reliance on this relief (if granted).

For a "high-quality hedging vehicle," the ETF would identify a hedge portfolio that would be designed to have low tracking error against the ETF's NAV and that would trade in sync with the ETF's shares on an exchange and with sufficient liquidity and volume. Each hedge portfolio would either be a broad-based securities index or the ETF's recently disclosed portfolio holdings. The ETF would invest at least 80% of its total assets in the same instruments as the hedge portfolio, although the ETF's adviser could change the hedge portfolio at any time. In addition, 95% of the ETF's portfolio holdings and the instruments in the hedge portfolio would be liquid and traded on an exchange.

As proposed, each ETF would also publish historical data regarding differences between the ETF's NAV and the performance of the ETF's hedge portfolio. The ETF's adviser would also manage the ETF so that its performance was sufficiently similar to that of the hedge portfolio. The ETF would also provide APs with (*i*) the daily deviation between the ETF's NAV and its hedge portfolio for a rolling one-year period; (*ii*) "tracking error," which would be the standard deviation of the daily deviation as observed over

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the prior year; and (*iii*) "empirical percentiles" of daily deviation over the prior year in one of the following levels: 99%, 95%, 90%, 75%, 50%, 25%, 10%, 5% or 1%, which effectively would give APs a confidence level in the daily deviation between the ETF's NAV and its hedge portfolio. These three metrics would be disclosed on the ETFs' public website. It is worth noting that in its response to the two blind trust applications, the SEC took little comfort in the applicants' assertions that APs would get smarter over time based on the available data. Presumably, the SEC's hesitation is that retail investors and APs could transact at significantly different prices during such learning periods, particularly if they occur during periods of market stress or volatility.

Exchange-Traded Managed Funds

The third proposed structure is currently in its fourth iteration of requested exemptive relief, which is a likely indication of substantive discussions between the ETF and the SEC Staff. As proposed, these ETFs would be called "exchange-traded managed funds" or "ETMFs."[20] Shares of ETMFs would trade on an exchange at prices directly linked to the ETMF's next-determined NAV. Specifically, the exchange on which the ETMF shares trade would adopt rules permitting purchases and sales of the shares to be executed during the trading day at the ETMF's next-determined NAV plus or minus a market-based premium or discount. Market makers would quote bids and offers as a premium or discount to NAV. At the start of each trading day, the ETMF would publish a basket of instruments to be used by APs for purchases and redemptions; however, the basket would vary from the ETMF's actual portfolio holdings as required to maintain the confidentiality of the ETMF's trading activity. Accordingly, creation and redemption transactions could include a significant cash component. In addition, an INAV would be published at least every 15 minutes (instead of 15 seconds, as is the current practice). According to the applicant, because ETMF shares would trade at prices based on an end-of-day NAV, a market maker holding shares would not be exposed to intraday market risk, which would eliminate the need for intraday hedging. Accordingly, there would be no need for transparency into the current portfolio holdings of the ETMF. For ETMFs, APs would not profit on arbitraging price differences between ETMF market price and underlying portfolio value.

Impact on APs

Each of the proposed structures for non-transparent ETFs would significantly affect the AP business by the introduction of additional costs and uncertainties.

Under the blind trust proposals, APs would have become involved in a more complex legal structure than currently required. Although market practices likely would have developed over time and new terms of authorized participant agreements and trust agreements gradually would have become more standardized, these differences could have represented significant up-front legal costs for APs as they sought to understand the new structure and map out related risks. For example, if an AP elected to provide generic instructions to the trustee to hedge the AP's risk to the ETF's portfolio, how would the AP carry those positions on its own books and evaluate these positions for purposes of its own internal risk guidelines? Who would have been liable if the trustee miscalculated the hedge or did not adjust the hedge in a timely fashion? APs likely also would have enhanced their internal policies and procedures to contemplate the new role played by the ETF custodian as the trustee to the blind trust to ensure that no improper communications occurred between personnel that could have the appearance of manipulative activity. Because transactions would have occurred on a cash-in/cash-out basis between the AP and the blind trust, there might have been less incentive for market participants to use APs to facilitate transactions on a riskless principal basis instead of signing up as APs themselves, because the blind trust effectively would have played the role that such a facilitating AP formerly played. In addition, APs likely would have received distributions from the blind trust and therefore likely would have been considered a "substantial owner" of the trust

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under the Internal Revenue Code, which could have impacted APs from a tax perspective. If any of the blind trust proposals are amended or re-proposed to include additional or more frequent data (*e.g.*, an INAV calculated and disseminated every 3 seconds), these same legal and structural issues likely would still be presented to APs.

Under the proxy data proposals, APs would continue to transact primarily on an in-kind basis and would be able to retain their current legal structures with minimal changes to authorized participant agreements, but would have to recode their internal systems to track and account for the data sets made available by the ETFs. Currently, APs have the benefit of being able to know an ETF's current portfolio holdings with full transparency. Accordingly, risk can be calculated using the APs' internal proprietary algorithms with greater certainty and can be hedged accordingly. Under the proposed proxy data structures, APs would need to distill their exposure from a series of indirect data points, which likely would have to be modified and revised over time to better reflect an AP's risk, based on its experience with the particular ETF. During these periods of "reinforcement learning," the price at which retail investors and APs transact could differ significantly. APs may also want to test the integrity of the data provided and/or seek certain representations, warranties and covenants from the ETF managers in the authorized participant agreement that would mitigate the APs' risk in the event of inaccurate or time-delayed data. The AP firms that can best use the publicly available data would have a competitive advantage.

Finally, under the ETMF proposal, the profitability of the AP business could be significantly reduced altogether and APs that decide to participate in making markets in ETMFs would still be required to evaluate available data on representative portfolios without the benefit of an INAV calculated every 15 seconds.

To conclude, the SEC's recent denial of two blind trust-model non-transparent ETF products was a noteworthy setback to the industry, but may only be a short-term setback because of the SEC's helpful provision of guidance as to what it would need to get comfortable in approving the products. In future proposals, it will become more clear whether an ETF product is possible that has a sufficiently confidential portfolio to make it attractive to asset managers with active trading strategies, but that also discloses information sufficient to ensure that market prices of the ETF's shares are close enough to NAV so that retail investors and APs are on the same footing. If this middle ground between the SEC and active managers exists, the result could be substantial growth in the number of actively managed ETFs in the marketplace because advisers would no longer be required to disclose their "secret sauce" investment strategies. However, with this non-transparency will come significant changes for APs as they will no longer be able to quickly and accurately assess the risks associated with their transactions simply by glimpsing at the ETFs' portfolios. Instead, they will have to develop more sophisticated internal metrics that assess their risk based on data made available by the ETFs, or rely on a third-party trustee to a blind trust to ensure their activities are appropriately hedged. As the fund industry goes back to the drawing board, APs have a bit of a respite to continue to consider how these new products would affect them and what they would have to do to be ready for them.

NOTES

1. Precidian ETFs Trust, et al., Notice of Application, Investment Company Act Rel. No. 31,300 (Oct. 21, 2014) and Spruce ETF Trust, et al., Notice of Application, Investment Company Act Rel. No. 31,301 (Oct. 21, 2014).
2. The applicants have a right to request a hearing, which the SEC would then either grant or deny. The SEC indicated that absent such a request, it intends to deny the requests for exemptive relief as "not necessary or appropriate in the public interest and as not consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the [1940 Act]."
3. The Vanguard Group was the first ETF issuer to request exemptive relief from the SEC for non-transparent ETFs. Guggenheim Partners has proposed the concept of non-transparent or semi-transparent ETFs with the SEC for several years. On February 12, 2007 and April 25, 2007, Vanguard Fixed Income Securities Funds, Vanguard Group Inc. and Vanguard Marketing Corp., using a patent-protected

model by which ETFs are issued as a share class of existing mutual funds, filed for permission to issue an ETF share class of fixed income funds that would be semi-transparent in that it disclosed a representative sample of portfolio holdings (File Nos. 812-13362 and 812-13378, respectively). Under Vanguard's original proposal, 40% to 50% of the securities in the representative portfolio would be actual holdings of the ETF, the representative portfolio would closely resemble the general investment characteristics of the ETF's portfolio, and the representative portfolio would be constructed by a proprietary algorithm such that there would be a 67% likelihood that the total return of the representative portfolio will be within three basis points of the ETF's total return. Given the time lapse since Vanguard's request for exemptive relief and the distinctions between its request and the more current applications filed with the SEC, we do not focus on Vanguard's structure in this article.

4. At last count, eight fund families recently filed for exemptive relief for a registered pooled investment vehicle that would have exchange-traded shares and would not have a fully transparent current portfolio. SSgA Active ETF Trust and SSgA Master Trust, along with SSgA Funds Management, Inc. and State Street Global Markets, LLC, filed an application for exemptive relief with the SEC on June 7, 2013 (File No. 812-14165-02). T. Rowe Price Equity Series, Inc. and T. Rowe Price Associates, Inc. filed an application on September 23, 2013, which was later amended on March 14, 2014 (File No. 812-14214-01). On June 5, 2014, PowerShares Actively Managed Exchange-Traded Fund Trust II, Invesco PowerShares Capital Management LLC and Invesco Distributors, Inc. filed an application with the SEC (File No. 812-14319). Capital Group ETF Trust, Capital Research and Management Company and American Funds Distributors, Inc. filed an application with the SEC on July 28, 2014 (File No. 812-14339). Fidelity Beach Street Trust and related Fidelity entities filed an application with the SEC on September 26, 2014 (File No. 812-14364).

5. At least three fund families—Eaton Vance, BlackRock and Precidian—partnered with particular exchanges, which are filing parallel requests for rulemaking to permit the listing of non-transparent ETF shares.

On September 25, 2014, January 23, 2014 and September 12, 2013, Eaton Vance ETMF Trust and Easton Vance Management filed amended applications for exemptive relief, based on an original filing on March 27, 2013 (File No. 812-14139). The September 25, 2014 filing by Eaton Vance also included a second registrant of non-transparent ETFs: Eaton Vance ETMF Trust II. On February 14, 2014, Nasdaq filed a Rule 19b-4 application with the SEC that proposed Nasdaq Rule 5745, which would permit the listing and trading of Eaton Vance's ETMFs. The SEC instituted proceedings to consider this proposal on June 9, 2014 and on September 4, 2014 the SEC designated November 7, 2014 as the day on which it will approve or disapprove of the 19b-4 filing. Since July 30, 2014, Eaton Vance has also filed registration statements for both trusts on SEC Form N-1A (File Nos. 811-22982 and 811-22983, respectively).

On August 4, 2014, BATS Exchange filed a Rule 19b-4 application with the SEC that proposed to adopt a new BATS Rule 14.11(k) that would permit the listing and trading of shares of Spruce ETF Trust (Exchange Act Rel. No. 72,787 (Aug. 7, 2014)). Spruce ETF Trust, which would include ETFs managed by BlackRock Fund Advisors and distributed by BlackRock Investments, LLC, filed an application for exemptive relief with the SEC on September 1, 2011 (File No. 812-13953), which was preliminarily denied by the SEC under the Investment Company Act on October 21, 2014 (*see supra* note 2). On September 24, 2014, the SEC extended its review period of the BATS rule proposal by 45 days to November 11, 2014 (Exchange Act Rel. No. 73,199 (Sep. 24, 2014)), but given the SEC's denial of the exemptive application, it is likely that the BATS rule proposal will either be withdrawn or disapproved by the SEC on the basis that it is currently moot.

Precidian ETFs Trust, Precidian Funds LLC and Foreside Fund Services, LLC filed an application for exemptive relief with the SEC on January 25, 2013, which was later amended on February 12, 2013 and again on July 23, 2013 (File No. 812-14166-02). Notably, Precidian ETFs Trust also filed a post-effective amendment to its registration statement pursuant to Rule 485(a) on January 22, 2014 for the addition of three non-transparent ETFs (File No. 811-22524). Although such filings automatically go effective after 75 days in the absence of action from the SEC, Precidian has filed a series of delaying amendments under Rule 485(b)(1). In parallel, NYSE Euronext originally filed a Rule 19b-4 application with the SEC on January 23, 2014 and filed a modified proposal on February 7, 2014 that proposed to adopt new NYSE Arca

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Equities Rule 8.900, which would permit the listing and trading of non-transparent ETFs. After designating a longer review period on April 7, 2014 (Exchange Act Rel. No. 71,895 (Apr. 11, 2014)) and initiating proceedings to determine whether to approve or disapprove the rule change on May 27, 2014 (Exchange Act Rel. No. 72,255 (June 2, 2014)), the SEC on August 22, 2014 further extended its review period until October 24, 2014 (Exchange Act Rel. No. 72,901 (Aug. 28, 2014)). However, citing its denial of exemptive relief under the Investment Company Act, the SEC disapproved NYSE Euronext's proposal on October 24, 2014 (Exchange Act Rel. No. 73,424 (Oct. 24, 2014)).

6. In 2008, the SEC even proposed a new rule under the Investment Company Act that would have removed the need to request exemptive relief for most ETFs. *See* Exchange-Traded Funds, Investment Company Act Rel. No. 28,193 (Mar. 18, 2008). With the recession that was occurring simultaneously with the rule proposal, the SEC never took final action on the proposal, although the Staff has periodically indicated that it remains a priority. *See e.g.*, Speech by Norm Champ, Director SEC Division of Investment Management, to the 2014 Mutual Funds and Investment Management Conference (Mar. 17, 2014) ("Lastly, we will continue to work on longstanding regulatory initiatives, including ETFs… ."). In addition, the potential role of ETFs in the May 6, 2010 "flash crash" and a significant pricing error in a handful of ETFs on March 31, 2011 may have chilled the SEC's ETF rulemaking initiative. *See e.g.*, SEC and CFTC Staffs' Report, Findings Regarding the Market Events of May 6, 2010 (Sep. 30, 2010).
7. In 2010, the SEC imposed a moratorium on exemptive relief for actively managed ETFs that use derivatives, which was later lifted in 2012.
8. Investment Company Institute, 2014 Fact Book.
9. The SEC stated in its releases denying BlackRock's and Precidian Investments' exemptive applications that the SEC "has required that a mechanism exist to ensure that ETF shares would trade at a price that is at or close to the NAV per share of the ETF," which "has been a required representation in all ETF orders since the [SEC] issued the first order." *See e.g.*, Investment Company Act Rel. No. 31,000, *supra* note 2, at n.7.
10. The exemptive applications on file from SSgA, PowerShares, BlackRock, Capital Research and Precidian proposed to follow some form of this blind trust proposal. As indicated, the SEC has denied the BlackRock and Precidian Investments proposals. It is likely that SSgA, PowerShares and Capital Research will either amend or withdraw their proposals, given their substantial similarity to the BlackRock and Precidian Investments proposals.
11. The exemptive applications on file from Fidelity and T. Rowe Price would use this "proxy data" approach.
12. To date, only Eaton Vance has applied for this approach, which may be a function of exclusive or limited ownership of intellectual property rights.
13. Mutual funds are required to disclose their holdings in full at least once quarterly, with a lag of not more than 60 days, on Form N-CSR (annual and semi-annual shareholder reports that include a schedule of portfolio holdings) and Form N-Q (quarterly reports of portfolio holdings for the first and third fiscal quarters where neither an annual nor a semi-annual report is filed). Fidelity would disclose its portfolio holdings monthly with a 30-day lag. T. Rowe Price would disclose its portfolio holdings quarterly on a 15-day lag.
14. Investment Company Act Rel. No. 31,000, *supra* note 2 at 8.
15. *Id.* at 12.
16. *Id.* at 15. The SEC noted that market makers do not rely on INAV currently and instead calculate their own NAV per share with proprietary algorithms that are based on daily portfolio transparency and which generally use INAV, "if at all, as a secondary or tertiary check… ." *Id.* at 14. The SEC was not comforted by the applicants' suggestion that APs would be able to create correlations with provided information over time and evaluate how various market factors effect INAV. *See id.* at 13.
17. Prospectus disclosure and quarterly portfolio holdings were also part of the blind trust proposals.
18. *See* Fidelity Beach Street Trust et al., *supra* note 3.
19. *See* T. Rowe Price Equity Series, Inc. et al., *supra* note 3.
20. *See* Eaton Vance ETMF Trust et al., *supra* note 4.