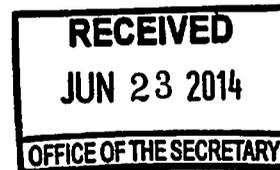


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June 23, 2014



Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: 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 ActiveSharesSM Large-Cap Fund, ActiveSharesSM Mid-Cap Fund, and ActiveSharesSM Multi-Cap Fund Pursuant to that Rule (Release Nos. 34-72255 and 34-71588; File No. SR-NYSEArca-2014-10)

Dear Ms. Murphy:

In a letter to you dated March 18, 2014 (the March Letter),¹ I stated my opposition to the proposed rule change described in the above-referenced filing and the related request by the Precidian ETF Trust and other parties for exemptive relief² from various provisions of the 1940 Act. As detailed in the March Letter, I do not believe approval of the Proposal would be in the public interest or consistent with the protection of investors.

The Exchange's Letter and My Responding Comments

In a letter dated May 14, 2014 (the NYSE Arca Letter),³ NYSE Arca, Inc. (the Exchange) responded to the March Letter, addressing various issues and concerns that I raised in the letter. The central assertions of the NYSE Arca Letter, and my responding comments, are as follows:

- NYSE Arca: Certain of the issues raised in the March Letter are not relevant to the Commission's consideration under Section 19(b) of the Exchange Act. The Exchange asserts that the concerns I expressed about the uncertain tax treatment of the Funds' in-kind redemptions, the proposed mandatory early Order Cut-off Times for direct purchases and redemptions of Shares, investor cost considerations, the scope of permissible Fund investment activities and potentially misleading and incomplete Fund disclosures should be disregarded by the Commission as not relevant to approval of the Filing.

¹ See comment letters under File No. SR-NYSEArca-2014-10. Unless otherwise noted, all capitalized terms used in this letter have the same meaning as in the March Letter. Please refer to the March Letter for my background. As stated in the March Letter, I have a retained economic interest in a product concept that may be competitive with the Shares; accordingly, my views on the Filing may be considered subject to a conflict of interest. As in the March Letter, my comments here are made in the public interest and, to the best of my ability, are not influenced by any conflict.

² See File No. 812-14116 (July 18, 2013).

³ See comment letters under File No. SR-NYSEArca-2014-10.

RESPONSE: The Exchange has a burden to demonstrate that any rule change under Section 19(b) that the Exchange proposes is consistent with the Exchange Act and the rules and regulations thereunder. Section 6(b)(5) of the Exchange Act states, in relevant part, that the “rules of the exchange [must be] designed . . . to promote just and equitable principles of trade, . . . to remove impediments to and perfect the mechanism of a free and open market . . . and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination” among market participants. To my understanding, each issue raised in the March Letter that the Exchange seeks to disregard is implicated by this statutory requirement.

Uncertain tax treatment of the Funds’ proposed in-kind redemptions: The proposed rule change provides that each Authorized Participant will be required to establish a blind trust to receive all proceeds of redemptions of Shares by the Authorized Participant. If the tax treatment of in-kind redemptions through the proposed blind trust structure is challenged by the IRS, I believe there is a high likelihood that the Funds would liquidate or seek to restructure such that they would no longer operate in accordance with the requested rule change. Whether or not the Funds’ proposed method of redeeming Shares in kind is tenable from a tax perspective strikes me as highly relevant to the Commission’s consideration of the Filing. I continue to believe it should be a condition for approval that the Applicants receive a Private Letter Ruling from the IRS affirming the proposed tax treatment of the Fund’s in-kind redemptions.

Mandatory early Order Cut-off Times for direct purchases and redemptions of Shares: Imposing a mandatory early Order Cut-off Time on redemption of Shares presents clear issues under the 1940 Act relating to the suspension of redemption rights for the period between the Order Cut-off Time and the time at which NAV is determined. Mandatory early Order Cut-off Times for direct purchases and redemptions of Shares also raise Exchange Act issues due to the potential impact on secondary market trading. If Authorized Participants cannot enter orders to purchase and redeem Shares after a designated cut-off time, how will this affect market trading later in the session? If market makers cannot transact with the Fund to offload long and short positions in Shares accumulated after the cut-off time, how could the Funds’ proposed arbitrage mechanism function effectively? I believe these considerations are important to the Commission’s evaluation of the Filing and should be addressed as a condition for approval.

Investor cost considerations: The Fund Transaction Fees, broker-dealer processing fees imposed on direct purchases and redemptions of Shares and the commissions payable on secondary market trades are the principal cost factors for investors buying and selling Shares. In the March Letter, I expressed concerns regarding whether the proposed Transaction Fees would be applied fairly and made recommendations regarding applicable limits to Transaction Fees and broker-dealer processing fees on direct purchases and redemptions of Shares.⁴ Due to their effect on transacting Fund shareholders and the potential impact on secondary market trading volumes and liquidity, I believe these considerations are relevant to whether or not the Filing should be approved.

Scope of permissible Fund investment activities: As described in the Filing,⁵ the Funds’ proposed method for seeking to ensure that market trading prices of Shares remain aligned with underlying

⁴ See March Letter at pages 19-23.

⁵ See Filing at page 10.

portfolio values will be based principally on the dissemination of PIVs at 15 second intervals throughout the Exchange's Regular Trading Session. The reliability of a Fund's PIVs will, of necessity, be limited by the availability, timeliness and accuracy of intraday valuations for the Fund's underlying holdings, which will vary significantly by holdings type. If intraday valuation information for a Fund's holdings does not support the dissemination of timely and accurate PIVs throughout the Regular Trading Session, the Fund cannot be expected to trade efficiently. There should be no argument that the nature of a Fund's holdings is highly relevant to the Commission's consideration of the Filing, due to the direct linkage to PIV reliability and market trading efficiency.⁶

Fund disclosures: The adequacy of Fund disclosures is critically important to evaluation of the Proposal under the 1940 Act and also relevant to consideration of the Filing. Efficient, informed and non-discriminatory trading in Shares requires market participants to have access to timely and accurate information regarding the Funds, including risks and special considerations in buying and selling Shares.

- *NYSE Arca: Market makers in ETFs are uniquely suited to prospectively assess the efficiency of Share trading, and no market maker would act as a Lead Market Maker in Shares unless it were comfortable it could hedge its positions.* The Exchange suggests that the willingness of market makers to serve as Lead Market Makers is important evidence the Shares will trade at acceptably tight bid-ask spreads and narrow premiums/discounts.

RESPONSE: In both the Filing and the NYSE Arca Letter, the Exchange cites statements⁷ by Lead Market Makers that they will be able to make efficient and liquid markets in Shares, provided that certain information is available, including an accurate PIV and knowledge about a Fund's means of achieving its investment objective. Contrary to the assertion in the NYSE Arca Letter, I do not question the veracity of the statements attributed to Lead Market Makers. Rather, I question two related points: (a) whether the important caveat that accurate PIVs are available will reliably be met (*see discussion under next bullet point below*) and (b) whether the terms "efficient and liquid markets" and "priced near the PIV" as used by the cited Lead Market Makers mean the same to them as what the Commission may consider a suitable standard for open-end funds issuing redeemable securities. As demonstrated in the Petajisto Study referenced in the March Letter, the trading efficiency of existing ETFs varies across a broad range, and many existing ETFs trade with quite wide bid-ask spreads and highly variable premiums/discounts. I suspect at least some of the Lead Market Makers supporting trading in those ETFs would represent that they trade "efficiently" and "near" underlying value. To clarify this point, I recommend that the Commission ask the Exchange to quantify the range of expected bid-ask spreads and premiums/discounts at which Lead Market Makers have indicated they expect the Shares to trade and to compare these expectations to accurate measures of benchmark index ETF trading performance.

⁶ In the Exemptive Application (*see page 25*), the Applicants appear to agree: "Applicants believe that the nature of the markets in the component securities underlying the investment objective and strategy of a Fund will be [the] primary determinant of premiums or discounts."

⁷ *See Filing at pages 10-11 and 41-43, and NYSE Arca Letter at pages 1-2.* In the NYSE Arca Letter, the Exchange represents that it has been informed by various Lead Market Makers that they will be able to make efficient and liquid markets in the Shares despite the absence of daily portfolio disclosure, provided that accurate PIVs and other Fund information is available. In the Filing, the Exchange represents something different: that it is the Exchange's *belief*, after consultation with various Lead Market Makers that trade ETFs, that market makers will be able to make efficient and liquid markets in the Shares. The Commission may seek to clarify from the Exchange which is the more accurate statement.

In the NYSE Arca Letter, the Exchange states that it “expects that a market maker will act as [Lead Market Maker] in the Shares and believes no market maker would accept [a Lead Market Maker] assignment if they were not entirely comfortable in their ability to hedge their positions.”⁸ While it is undoubtedly true that no market maker would serve as a Lead Market Maker or otherwise make markets in securities for which the market maker is not comfortable that it could hedge its positions, I see no connection between this statement and the assertion that the Shares can be expected to trade at consistently tight bid-ask spreads and stable premiums/discounts. Each existing ETF listed on the Exchange has a Lead Market Maker, including those that trade at wide bid-ask spreads and variable premiums/discounts. Every closed-end fund listed on the Exchange also has a Lead Market Maker, including the many closed-end funds that routinely trade at *double-digit discounts or premiums to NAV*. Contrary to the Exchange’s assertion, the mere presence of a market maker willing to serve as Lead Market Maker is hardly evidence that a particular fund will trade with bid-ask spreads and premiums/discounts consistent with the marketplace’s expectations for how ETFs should trade or the legal standard applicable to open-end investment companies issuing redeemable securities. It simply does not follow that the willingness of a market maker to serve as a Fund’s Lead Market Maker means the Shares can be expected to trade with tight bid-ask spreads and narrow premiums/discounts.

- *NYSE Arca: No direct support was provided for my contention in the March Letter that the PIVs will not be sufficiently reliable for their intended purpose.* The Exchange states that it has no reason to believe that PIVs calculated using a methodology substantially similar to that used by existing ETFs will be inherently unreliable. Accordingly, enhanced surveillance to detect PIV errors and procedures for cancelling Share trades based on erroneous PIVs should not be required.

RESPONSE: As described in the March Letter,⁹ there are numerous reasons to believe disseminating PIVs at 15 second intervals throughout the Exchange’s Core Trading Session will not provide a reliable and sufficient basis for ensuring that market trading prices of Shares maintain a close correspondence to each Share’s underlying value: (a) PIVs may not be calculated in the same manner as NAV; (b) PIVs will be based on consolidated last sale information and may reflect clearly erroneous values for securities that have not opened for trading on a particular Business Day or that are subject to an intraday interruption in trading; (c) PIVs will be calculated based on a “*commercially reasonable*” standard of care, not the higher standards that apply to a Fund’s daily NAV calculations; (d) there will be no time or scope for checking calculated PIV values before they are released *in real-time 1,560 times each Business Day*; and (e) the calculation of PIVs will require the coordinated actions of multiple parties, *none of which will guarantee the accuracy of disseminated PIVs or assume liability for damages resulting from PIV errors*. Although disseminated intraday values have been used by existing ETFs for more than two decades, in that context they have essentially no relevance to secondary market trading efficiency and limited overall utility for investors. The NYSE Arca Letter ignores the March Letter’s most telling point in this regard: “It is widely understood that market makers in existing ETFs place little or no reliance on the “official” intraday fund values disseminated every 15 seconds based on last sale prices. Instead, they use their own calculations of fund value (or valuations provided by third-party pricing services) based on the disclosed portfolio holdings and bid, offer and execution prices of the portfolio securities and other

⁸ See NYSE Arca Letter at page 2.

⁹ See March Letter at pages 10-12.

relevant pricing indicators updated continuously.”¹⁰ For the Shares, by contrast, the officially disseminated PIVs will be the foundation supporting market trading. Because Fund holdings will not be disclosed, market makers in the Shares will not be able to calculate their own independent estimates of intraday Fund values or to verify the accuracy of the Fund-disseminated PIVs.

To my knowledge, neither the Applicants nor any other parties have conducted any studies to demonstrate the reliability of the intraday values disseminated for existing ETFs based on substantially the same calculation methodology and standards as proposed for the Shares. If the Exchange is unwilling to undertake a surveillance program to detect erroneous PIVs and to establish procedures for cancelling trades based on erroneous trades, I believe it should be a condition for approval of the Filing that the Applicants demonstrate the prospective reliability of Fund PIVs through a comprehensive study of the historical accuracy of the disseminated intraday values of existing ETFs with investment profiles similar to the Funds.

- NYSE Arca: The ability of market professionals to glean information about a Fund’s holdings through time-series analysis of PIVs (and, potentially, to reverse engineer complete Fund holdings) should not be a concern because that information would be reflected in the prices at which they are willing to buy and sell Shares. The Exchange represents that the same public information will be available and accessible to market professionals and retail investors alike.

RESPONSE: As an initial matter, all investors would not have equal access to Share trading information unless, as I have recommended as a condition for approval,¹¹ the Funds provide free access to PIVs on a public website and the PIVs are available to the general public as soon as available to any party. Without this, there is not even a theoretical argument that all investors will have access to the same Fund information. As a practical matter, the asserted level playing field between market professionals and the investing public will not exist if, *as intended by the Applicants*, market makers are able to gain knowledge about a Fund’s holdings through sophisticated time-series analysis of intraday changes in the Fund’s PIVs. Although the Fund information learned by market makers from that analysis will most certainly be reflected in their bid and offer prices for Shares, I see no reason to take comfort in this. As highlighted in the current public discussion of market trading practices, dissemination of market information in a manner that facilitates unfair discrimination among market participants is inconsistent with equitable principles of trade and, therefore, the requirement of Section 6(b)(5) of the Exchange Act. As a condition for approval, I believe the Applicants should be required to explain how the information advantage being granted to market makers as an intentional element of the Funds’ method for seeking to ensure the trading efficiency of Shares is not inconsistent with the provisions of the Exchange Act.

- NYSE Arca: As proposed, the provisions of the Funds’ direct Share purchase program and Retail Redemption Facility are consistent with the requirements of the Exchange Act. The Exchange contends that my recommendations to make the Retail Redemption facility available to all shareholders, to establish the close of the Exchange’s Regular Trading Session as the deadline for submitting direct purchase and redemption orders, to limit the fees permissible for broker-dealers to charge clients to process direct purchases and redemptions of Shares, and to limit

¹⁰ See March Letter footnote 39 at page 11.

¹¹ See March Letter at page 25.

trading in Shares to broker-dealers with systems in place to accommodate direct purchase and redemptions on terms no less favorable than secondary market trading in Shares and to support best execution should not be required as conditions for approval of the Filing.

RESPONSE: The Applicants assert in the Filing that “investors may choose to purchase Shares directly from a Fund if they want to assure that they will not purchase Shares at a premium”¹² and “Retail Investors may decide to redeem their Shares for cash if they want to make sure they receive the NAV and do not want to risk selling their Shares in the secondary market at a discount.”¹³ These assertions are valid only to the extent that a Fund’s direct purchase and redemption options apply to a particular investor, are available at the particular time of day when the investor seeks to buy or sell Shares, are not negated by disproportionate fees and are backed by investor information and broker-dealer systems adequate to support informed decision-making and effective execution of direct transactions in Shares. Given the challenges to broker-dealer trade management and order processing systems introduced by the Funds’ unique dual-liquidity features,¹⁴ I believe there is a legitimate concern that, left unregulated, broker-dealers will charge significantly higher fees on direct purchases and redemptions than the commissions they charge on comparably sized secondary market trades in Shares. If broker-dealer fees on direct transactions in Shares are too high, shareholders would, in a practical sense, lose access to the Funds’ intended mechanism for ensuring continued access to liquidity at or near NAV during periods when market trading prices of Shares vary significantly from NAV. If the Commission values the Funds’ direct purchase and redemption facilities for this purpose, I do not see how it can avoid placing appropriate limits on associated broker-dealer fees and Fund Transactions Fees¹⁵ as conditions for approval. Moreover, I do not see any valid arguments for why the Funds’ proposed direct purchase and redemptions options should not apply equally to all investors and should not be available throughout each Business Day’s Regular Trading Session. The disparate redemption rights proposed to be granted to different groups of shareholders are inherently discriminatory, and therefore inconsistent with the requirements of Section 6(b)(5) of the Exchange Act.

- NYSE Arca: Market hours for trading in Shares should not be limited to the Core Trading Session because surveillance procedures will be operative during all trading sessions, and the Exchange has no reason to believe efficient markets will not prevail during all trading sessions. The Exchange asserts that market makers have indicated an ability to make efficient markets in Shares even during periods in which PIVs are not disseminated.

RESPONSE: In the Filing, the Applicants state their belief that market makers will be able to make efficient and liquid markets in Shares priced near the underlying value of Shares “as long as an accurate PIV is disseminated every 15 seconds” and other conditions are met.¹⁶ To my thinking, it strains credibility to assert that the regular dissemination of PIVs during the Core Trading Session will support efficient trading in Shares during the Opening and Late Trading Sessions, when no PIVs are being

¹² See Filing at page 9.

¹³ *ibid* at page 30.

¹⁴ See March Letter at page 20.

¹⁵ Although not addressed in the NYSE Arca Letter, I also recommended in the March Letter that the Funds should not be permitted to charge Transaction Fees on direct purchases and redemptions of Shares that exceed the associated Fund expenses incurred, taking into account the size of a specific transaction. See March Letter at pages 20-21.

¹⁶ See Filing at pages 10-11 and 41.

disseminated. During the Opening and Late Trading Sessions, how would a market maker have any idea whether Shares were trading at a premium or a discount if PIVs are not being disseminated? On what basis would a market maker construct hedge positions against Share inventory accumulated during these sessions? As stated in the March Letter,¹⁷ I see no basis for permitting Shares to trade during periods when *neither* the *contents* nor any estimates of current *values* of Fund holdings are known in the marketplace. While it may be debatable whether the Shares should be expected to trade with appropriately tight bid-ask spreads and narrow premiums/discounts during the Core Trading Session when PIVs are being disseminated (I think not), I see absolutely no basis for presuming that the Shares will trade efficiently during trading sessions in which current PIVs are not available.

- *NYSE Arca: Certain of the conditions for approval I recommended should not apply to the Funds because they do not apply to existing ETFs.* The Exchange asserts that the Funds should not be required to provide investors with free public access to real-time PIVs and other Fund trading information because these requirements do not apply to existing ETFs.

RESPONSE: The Funds would differ from all existing ETFs in three respects for which the suggested requirements for additional PIV and other Fund trading information disclosures are highly relevant: (a) the Funds would offer shareholders two distinct pathways for buying and selling Shares (*i.e.*, direct transactions and secondary market trades) and therefore should be obligated to give investors sufficient information about Share trading conditions to help them determine how *best* to buy and sell Shares; (b) the arbitrage mechanism intended to support efficient secondary market trading in Shares is *untested* and likely to be *less reliable* than the mechanism supporting efficient trading in existing ETFs, meaning that investors in the Funds should appropriately pay more attention to Share trading costs and must have access to enhanced trading information to make that possible; and (c) the arbitrage mechanism underlying trading in Shares is uniquely reliant upon PIVs, with the result that a level playing field among market participants can only be achieved if *all* Fund investors have equal access to this critical Fund data.

- *NYSE Arca: Concerns raised by me should not impact the Commission's decision to approve or disapprove the Filing because they are driven by competitive motives.*

RESPONSE: I see no basis for the Commission ignoring legitimate issues and concerns about the Proposal raised by any credible source. As noted above, my comments on the Proposal are made in the public interest and, to the best of my ability, are not influenced by any conflict.

- *NYSE Arca: The Proposal and similar concepts should be assessed on their individual merits and risks.* The Exchange asserts that investors and the marketplace can only benefit from access to a variety of products with differing structures, provided that investor protection concerns are adequately addressed.

RESPONSE: I completely agree—especially with the investor protection proviso.

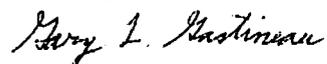
I would note that several issues and considerations that I raised in the March Letter—(a) the costs and risks to Authorized Participants of the blind trust redemption arrangement and the associated likely impact on the Shares' secondary market trading efficiency; (b) my recommendation that the

¹⁷ See March Letter at page 24.

Proposal documents be modified to include a discussion of reverse engineering risk and steps to be taken to mitigate this risk; (c) the recommendation that allowable Transaction Fees on direct purchases and redemptions of Shares be limited to estimates of associated Fund expenses, taking into account the size of a specific transaction; and (d) the recommendation that the Funds not be permitted to describe themselves as “ETFs” or “exchange-traded funds”—are not addressed in the NYSE Arca Letter. I presume that the Applicants do not wish to rebut these discussion points and recommendations, which remain standing.

In closing, I wish to thank the Commissioners and Staff of the SEC for consideration of the views and information presented.

Sincerely,



Gary L. Gastineau
President, ETF Consultants.com, Inc.