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June 9, 2016

Securities and Exchange Commission
100 F St. NW
Washington, DC 20549-9303
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Re: Proposed Rule Change to Adopt NYSE Arca Equities Rule 8.900 to Permit Listing and Trading of Managed Portfolio Shares and to Permit Listing and Trading of Shares of Fifteen Issues of the Precidian ETFs Trust

File SR-NYSEARCA-2016-08

Dear Securities and Exchange Commission:

Here are my comments on this proposal:

Summary

- These products look more like closed-end funds than ETPs and, if approved, should be clearly labeled as such.

[1] All opinions are strictly my own and do not necessarily represent those of Georgetown University or anyone else for that matter.

- Arbitrage pricing will be far more difficult for these products than for normal ETPs due to their opaque nature and the inability of arbitrageurs to closely monitor execution quality when the so-called "Trusted Agents" execute trades on their behalf. The added costs and risks will lead to wider deviations of the market price from the underlying asset value.

- The selective disclosure of portfolio holdings to so-called "Trusted Agents" raises Regulation FD issues. The costly compliance burdens and risks of being a Trusted Agent will limit the pool of willing agents, further driving up the cost of their intermediation.

- These products may fare far worse than normal ETPs during times of market disruption.

- The VIIV calculations are dangerously flawed because they rely on sometimes flawed bid-ask quotes.

- IIV data are important to investors and should be made more readily available by including them in the normal quote feeds.

- SEC should take steps to reduce ETP settlement failures by encouraging ETP sponsors to use smaller sized Creation Units, waive creation fees, and lend ETP shares. Similarly, Rule 15c3-3 should be modernized to make it easier to lend fully paid shares.

I am a big fan of exchange traded products (ETPs). They provide efficient means for investors to implement a wide range of investment strategies, ranging from holding the entire market to trading very narrowly focused positions. ETPs give investors easy access to transparent portfolios that are easy to track and easy to trade. In general, my opinion is that ETP sponsors should have wide latitude to introduce new ETPs, as long as they clearly communicate what they are doing to investors. Investors themselves should have the choice as to whether the risk and rewards are appropriate for their investment situation.

The proposed funds are more like closed-end funds than ETPs and, if approved, should be labeled and treated as closed-end funds.

This proposal is for a different type of product that would be marketed as an ETP. Unlike traditional ETPs, these proposed actively managed funds would not disclose their portfolios on a daily basis. They would only be required to disclose their holdings quarterly like other closed-end funds. In order to keep the market price somewhat close to the actual portfolio value, the funds propose to disseminate every second of the trading day a "verified" intraday indicative value (VIIV) that is calculated by not one but two calculation entities. The VIIV would be based on the midpoint of the bid-ask spread of the constituent securities. The portfolios would only be disclosed to so-called "Trusted Agents" who would buy or sell the secret portfolio securities on behalf of Authorized Participants (APs) and Non-Authorized Participant Market Makers (NAPMMs). In general, normal investors like me would only get to see the portfolios on a quarterly basis.

These opaque products look more like closed-end funds than ETPS and should be labeled as closed-end funds and not ETPs. Investors expecting the usual ETP attributes of transparency, liquidity, tax efficiency and prices that track the underlying asset values will be sorely disappointed. Any approval for this product should contain strict prohibitions on any marketing that would confuse these products with traditional ETPs. The sponsor should be expected to ensure that these products are not listed as ETPs or ETFs in standard industry databases, but instead classified with other closed-end funds.

Arbitrage pricing will be far more difficult for these products than for traditional ETPs.

The funds propose to rely upon an untested arbitrage mechanism to provide liquidity and prices close to the underlying asset values. However, the actual arbitrageurs and liquidity providers will not get to see the daily portfolio holdings. They may place orders to buy and sell the underlying portfolios with so-called Trusted Agents who are privy to the secret portfolio holdings. However, this adds a layer of complexity and cost to the process. The arbitrageurs and liquidity providers will have little way of judging the execution quality of the fills that they receive.

Many arbitrageurs and market makers in ETPs indirectly hedge their ETP exposures through other instruments such as futures or even other ETPs. They will be unable to do this if they do not know what is inside the portfolio.

The use of "statistical arbitrage" or "stat-arb" is also problematic for these securities. In statistical arbitrage, traders look for securities that generally trade in the same manner. A classic example is the pair of Coke and Pepsi. As both are large global beverage companies, their stocks tend to go up and down together except when there is news about one of the companies. When the stock prices start to diverge, a stat-arb play would be to buy the stock going down and short the stock going up, expecting to profit when the pattern reverses.

Instead of hedging by trading in the underlying securities through the so-called Trusted Agent, an arbitrageur or market maker may try to hedge using stat-arb techniques. However, the proposed products are actively managed portfolios, whose characteristics may change dramatically from one day – or one minute - to the next. Indeed, the changing nature of the portfolios is one of the purported reasons for the need for secrecy. If the portfolios never changed, then even the last quarterly filing of portfolio holdings would be good enough for market making. A security that seemed to be good stat-arb hedge candidate because it was highly correlated in the past might make a very bad hedge if the underlying secret portfolio has changed. A hedge derived from an analysis of yesterday's trading data could be totally useless for hedging today because today's portfolio is different.

More difficult arbitrage implies higher transaction costs and higher deviations from the underlying values.

The increased difficulty, complexity, risk, and expense of arbitraging these proposed funds will undoubtedly result in less arbitrage activity. In order for arbs to step in, the security price has to move far enough away from the underlying asset value in order to make it profitable for the arb to act. Higher costs and risks for the arbs mean that prices will have to move further away from their underlying values before arbitrage activity can occur, leading to larger deviations from the underlying value than for traditional ETPs.

These products may fare far worse during times of market disruption than other ETPs.

ETPs experience problems during times of market disruption, such as during the Flash Crash of May 6, 2010 and the volatility of August 24, 2015. In those situations, the volatility in the main markets spilled over into ETPs, causing many arbitrageurs and liquidity providers to stop trading. This led to large dislocations in which many ETPs traded at prices far removed from their underlying asset values.

Given the opacity and complexity of the arbitrage relationship between these proposed ETPs and their underlying portfolios, it stands to reason that these products would be the first ones that the arbitrageurs and liquidity providers stop trading when the next market disruption hits. In a time of market turmoil, the arbs will understand that the fund's portfolio manager may be changing the portfolio, and that the so-called Trusted Agents through which arbs are forced to trade may not be able to execute trades in a timely manner. This will cause arbs and market makers to step away from the market, allowing prices to deviate substantially from the values of the invisible underlying assets. This will substantially harm many retail investors who unwittingly trade at such times.

This product raises Regulation FD issues.

The deliberate opaqueness of the proposed product, together with the proposed disclosure of daily fund holdings to Trusted Agents, raises serious Regulation FD issues as well.[2] The spirit of Regulation FD is

[2] Regulation FD begins to read as follows:

§ 243.100 General rule regarding selective disclosure.

(a) Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any person described in paragraph (b)(1) of this section, the issuer shall make public disclosure of that information as provided in § 243.101(e):

(1) Simultaneously, in the case of an intentional disclosure; and (2) Promptly, in the case of a non-intentional disclosure.

that material nonpublic information should be released equally to all. The selective disclosure of portfolio information only to so-called Trusted Agents who trade on behalf of their AP and NAPMM clients would appear to be a clear violation of Regulation FD. However, my understanding is that Regulation FD applies to closed-end funds but not to funds classified as open-end funds like the proposed funds at issue here.[3] However, as I have stated above, due to the opacity of the products and the likely ineffective arbitrage mechanism that will lead to larger deviations of the market price from NAV, the proposed opaque products are really more like closed-end funds and should be treated as such.

The "Trusted Agents" will have information the general market does not have, and the humans entrusted with this information will be tempted to profit from that information, either by front running fund trades or by passing the information on to their clients and friends. The ongoing difficulties that the SEC has in enforcing insider trading rules make it most unwise to create yet more valuable secret information that could corrupt humans on trading desks.

The "Trusted Agents" will have serious compliance burdens and will have to charge accordingly.

The proposal attempts to provide an untested mechanism that would maintain the secrecy of the portfolio while still allowing something approximating arbitrage to occur. In short, arbitrageurs and market makers would not have access to the undisclosed portfolio holdings and would have to go to trade through the so-called Trusted Agents.

The so-called Trusted Agents will have serious compliance burdens that may cause firms to either avoid the obligation or else charge fees commensurate to the cost – plus a markup. The so-called Trusted Agents have a duty of confidentiality, and thus will have to have policies and procedures in place to make sure that the top-secret portfolio holdings are kept confidential. They will have to set up procedures to receive the secret information, and severely restrict the employees who have access to that data. The rotation and substitution of trading desk personnel will be far more complicated than before. Similar databases of portfolio holdings that are currently public information will have to be segregated from the secret portfolio data, and the access to that data will have to be restricted and all accesses to the data

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(b)(1) Except as provided in paragraph (b)(2) of this section, paragraph (a) of this section shall apply to a disclosure made to any person outside the issuer:

(i) Who is a broker or dealer, or a person associated with a broker or dealer, as those terms are defined in Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)); …

[3] With respect to open-end funds, the Commission previously stated: " Divulging nonpublic portfolio holdings to selected third parties is permissible only when the fund has legitimate business purposes for doing so and the recipients are subject to a duty of confidentiality, including a duty not to trade on the nonpublic information" (https://www.sec.gov/rules/final/33-8408.htm) The proposal to permit selective disclosure to so-called Trusted Agents with the intent that they would trade on this information appears to be in direct conflict with the prior statement of the Commission.

(including backups) recorded and the records maintained for many years. They will have to train their employees on these procedures and document the training. They will have to monitor adherence to these procedures and document this monitoring, and maintain the documentation in an accessible place for many years. Even if the firm has sound policies and procedures, it is likely that eventually someone will fall for the temptation and seek to profit from this information, leading to expensive enforcement actions against the firm.

These burdens are likely to drive up the cost of being a Trusted Agent and severely limit the number of firms willing to take on the burden of becoming Trusted Agents. With less competition, arbitrageurs and market makers are likely to face higher fees and poorer service. In the event that there were many Trusted Agents, then the likelihood of data breaches would also increase.

The construction of the VIIV is flawed as it is based on sometimes flawed bid-ask midpoints.

The proposed price feed, the "Verified Intraday Indicative Value" (VIIV), is based on the midpoint of the bid-ask spread. While in theory the bid-ask midpoint may appear to present a better estimate of the true price of a liquid stock than the most recent trade, this is not always the case for all exchange-listed securities that are fair game for these funds. For some relatively illiquid stocks, there are times when the bids and offers are absurd, and thus the bid-ask midpoint is likewise absurd. Even one such stock in a portfolio can severely distort a VIIV based on bid-ask midpoints.

Here is an example. Suppose that the Generic Example Fund (GEF) has a nicely diversified portfolio of 50 equally weighted stocks. Assume that 49 of the 50 stocks are quoted at $19.99 bid and $20.01 asked, with a bid-ask midpoint of $20.00. However, the 50th stock is Essa Pharmaceuticals (EPIX), which as of 9:30:03 on June 1, 2016 was quoted at $.01 bid, $199,999.00 asked, an actual real-life example. This leads to a midpoint price of $99,999.51 for EPIX. The properly calculated VIIV of GEF based on bid-ask midpoints is thus (49/50)*$20.00 + (1/50)*$99,999.51 or $2,019.59. Alas, EPIX opened at $3.17 and closed at $3.20. My point is that just one bad bid or offer quote can lead to a wildly inaccurate VIIV value. The VIIV should instead be based on the last trade, but if the underlying market is closed or the underlying asset has not traded recently, then a reasonable fair value methodology should be used.

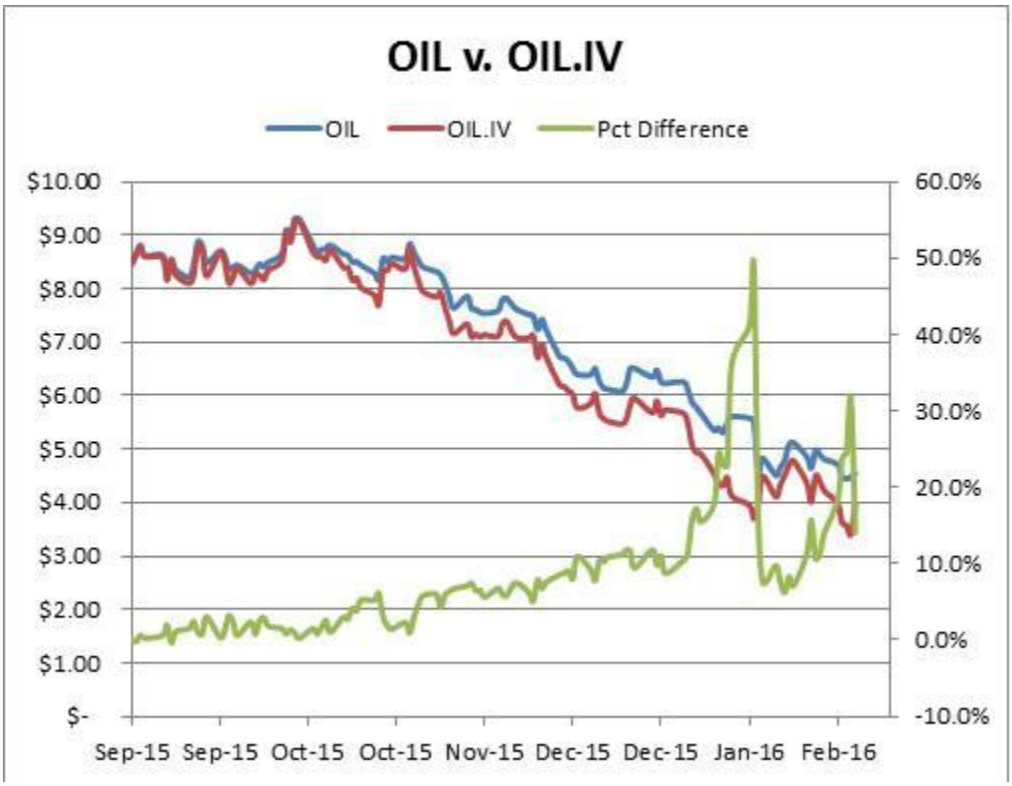
Access to IIVs is important to protect retail investors from mispricing.

Although most ETP prices closely track the values of their underlying portfolios, sometimes they do not. In order to alert investors when this is the case, it is essential that investors have easy access to the Intraday Indicative Value (IIV) data.[4] While the most sophisticated traders do not rely on the IIV, as it

[4] Although IIVs are far from perfect and can and should be improved, they are still useful. See my previous comment letter on ETPs. https://www.sec.gov/comments/s7-11-15/s71115-29.pdf.

may be up to 15 seconds old, and instead generate their own price estimates based on the most recent trades and quotes, nevertheless the IIV data can be quite useful in protecting retail investors in circumstances where the ETP price is quite different from the underlying value.

For example, the iPath GSCI Crude Oil Trust (ARCA: OIL) was selling for substantially more than its underlying value for quite some time.[5] At times this discrepancy was more than 20%, as seen in the following chart:



Unwitting investors ended up purchasing this ETP at a substantial premium to the underlying value of its assets.

Here is another example. The following is a screen shot of an Interactive Brokers quote screen from 10:15 am on June 6, 2016 showing the last trade and the IIV data for a few ETPs. Note that the NUGT is selling at a slight discount of 0.1% to its IIV. However, the inverse DUST, which is based on the same underlying index of gold mining stocks (most of which are in the US and Canada and trading during U.S. market hours), is selling at an 8.7% discount.

[5] See http://seekingalpha.com/article/3898146-overpricing-oil-etf-presents-arbitrage-opportunity for more details.

Contract	Company Name	Last	Bid	Ask
	Account	Action	Quantity	Type
NUGT	DIREXION DAILY GOLD MINERS I	96.85	96.70	96.85
NUGT.IV IN...	DIREXION GOLD MINERS BULL 3...	96.95		
DUST	DIREXION DAILY GOLD MINERS I	11.33	11.32	11.34
DUST.IV IN...	DIREXION GOLD MINERS BEAR 3...	12.41		
YANG	DIREXION DAILY FTSE CHINA BE	22.30	22.29	22.34
YANG.IV IN...	DIREXION DAILY CHINA BEAR 3X...	24.61		

This is an arbitrage big enough that even a slow retail investor like me could do it by buying the underpriced DUST and hedging by shorting NUGT. Even if a retail investor is not eager to do the arbitrage, better information about the IIV could warn investors about times when the ETP prices are out of alignment from their underlying portfolio values.

IIVs should be disseminated over the normal quote feeds.

One major defect in the ETP universe is the difficulty most investors have of obtaining real-time IIV data. Simply put, most brokerage firms do not provide this information to their customers.[6] Yahoo! Finance (unlike Google Finance) does display IIV data, but one has to know where to look. (To get an IIV on Yahoo, type ^XXX-IV where XXX is the ticker symbol.)

Although ETP sponsors generally display IIV data on their web sites, it is not clear how timely these data are. Even if such data were timely, it is awkward for individual investors to find the data when they want to trade.

My understanding is that the IIV data are not disseminated over the normal quote feeds and that there are several different data feeds with the data. It is quite cumbersome for any entity to gather these different IIV feeds together. They should all be disseminated at no extra cost over the same normal consolidated quote feeds used by the industry for standard NMS stock quotations.

[6] Two notable exceptions are Merrill Edge and Interactive Brokers, both of which make IIV data available to investors. I have not been able to find the IIV data on E-trade, TD Ameritrade, Schwab, Vanguard, Fidelity, Scottrade, or finance.google.com.

The SEC should take steps to mitigate ETP settlement failures.

The ongoing large and protracted settlement failures in ETFs are a blemish on the integrity of the U.S. equity markets. Their persistence despite the Regulation SHO Threshold List mechanism and Regulation 204's knife-edge buy-in requirements are an embarrassment to the U.S. equity markets and its regulator, the SEC. Regulation 204 cleaned up most of the settlement failures in corporate stocks, but the SEC allows the problem to continue to fester in ETPs.

This is ironic in that settlement failures are even more problematic and damaging to ETPs than to corporate stocks. Persistent settlement failures and long-term membership on the Reg SHO Threshold list are not just cosmetic problems. These protracted failures exacerbate the illiquidity facing many ETPs. Stocks experiencing protracted settlement failures and Regulation SHO treatment are hard to borrow, which means that they are difficult to short, and expensive to borrow when they can be shorted. This makes it much more difficult to short ETPs, narrowing the pool of traders willing and able to arbitrage ETPs and their underlying assets.

With fewer traders willing to conduct arbitrage and provide liquidity, there is less liquidity, higher trading costs, and the deviations between ETP prices and the underlying market values are likely to be larger and more frequent.

The higher cost and inability to borrow/short these ETPs shares with high delivery fails increases the risks to investors in short positions. I have personally and painfully been bought in on a short position in an ETF. Even though market makers currently they have until T+6 to deliver shares, they too may be hesitant to provide liquidity due to the risk of being forced to buy in because they could not borrow the shares.

The NUGT/DUST mispricing described above is a classic example of how the frictions in the stock lending market are harming retail investors who expect ETPs to closely track their underlying values. DUST is seriously mispriced relative to NUGT, which is based on the exact same underlying index of gold mining stocks. One would expect arbitrageurs to step in and purchase DUST and short NUGT. Alas, NUGT is not an easy-to-borrow stock and most retail brokerages would reject an order to sell short. (DUST is even worse and is on the Regulation SHO Threshold List.) Note that it is not the leverage in these products that is leading to the mispricing. There are many other pairs of leveraged products which do not have this level of mispricing. It is the frictions in the create/redeem process and the stock lending market that are leading to these harmful mispricings.

As it is harder and more expensive to conduct arbitrage on short-constrained ETPs, such ETPs are more likely to experience disruptions during times of market turmoil. With fewer arbitrageurs and liquidity providers able to engage in arbitrage and liquidity provision, during times of market disruption it becomes more likely that there will be no arbitrage and ETP prices will deviate substantially from underlying values, as occurred on August 24, 2015 and in the Flash Crash.

The following steps should be considered as a means of mitigating settlement failures:

- ***Reduce size of Creation Units.*** ETP issuers should be encouraged to keep the size of Creation Units, the minimum number of shares that can be created or redeemed, as small as possible, even as low as 100 shares for some ETPs. The only real constraint is a need to avoid fractional shares for a large number of constituents. Indeed, fractional shares for a small number of the smallest constituents need not be a show stopper because such small amounts can be settled in cash. As creation and redemption can only be done by Authorized Participants, there is no danger that large numbers of retail investors will bother creating or redeeming small numbers of shares.

- ***Encourage ETPs to waive fees for creating ETPs.*** There is no reason why the fees for creation/redemption need to be symmetrical. Operators of toll bridges that are hard to bypass such as the Golden Gate Bridge long ago figured out that it was much more efficient to charge twice the toll in one direction and not bother to charge in the other direction. ETP sponsors should be encouraged to do the same thing. This is in their best interest as it will encourage the creation of more shares and thus lead to more assets under management. By making it easier and cheaper to create ETP shares, there is less excuse for failing to deliver the shares.

- ***Modernize Rule 15c3-3 to make it easier to lend fully paid shares out of cash accounts.*** The well-meaning Customer Protection Rule (15c3-3) imposes numerous paperwork burdens on lending out fully paid shares. However, it is much easier to lend out shares from margin accounts with debit balances. The industry's long track record of safely lending margined shares while protecting consumers shows that the current rules on lending fully paid shares can be relaxed without harming consumers.

- ***Permit issuers to lend ETP shares.*** In a typical stock loan, the lender delivers shares and the borrower puts up cash collateral that is marked to market daily. ETP issuers should be permitted to do effectively the same thing in any amount. They should be permitted to instantly create ETP shares on demand using cash collateral, with the understanding that either the underlying shares will be delivered in a timely manner or the ETP shares will be returned. This could totally eliminate the need felt by some market makers to fail to deliver ETP shares on the standard settlement date. This would be little different than the practice that some ETPs have of permitting cash creation and redemption.

- ***Examine other means of reducing frictions in stock lending.*** As part of its reviews of market structure, the SEC should also examine securities lending to find other means of reducing unnecessary frictions in the process.

Respectfully submitted,

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