

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-73562; File No. SR-NASDAQ-2014-020)

November 7, 2014

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, Relating to Listing and Trading of Exchange-Traded Managed Fund Shares

I. Introduction

On February 26, 2014, The NASDAQ Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to adopt Nasdaq Rule 5745, which would govern the listing and trading of Exchange-Traded Managed Fund Shares (“ETMF Shares” or “ETMFs”), and to amend related references under Nasdaq Rules 4120, 5615, IM-5615-4, and 5940. The proposed rule change was published for comment in the Federal Register on March 12, 2014.<sup>3</sup> The Commission initially received four comment letters on the proposal.<sup>4</sup> On April 23, 2014, pursuant to Section 19(b)(2) of the Act,<sup>5</sup> the Commission designated a longer period within which to either approve the proposed rule change, disapprove the proposed rule change, or

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<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. 71657 (Mar. 6, 2014), 79 FR 14092 (Mar. 12, 2014) (SR-NASDAQ-2014-020) (“Notice”).

<sup>4</sup> See Letters to the Commission from Christopher Davis, President, Money Management Institute, dated March 27, 2014 (“MMI Letter”); Robert Tull, President, Robert Tull & Co., dated March 31, 2014 (“Tull Letter”); Avi Nachmany, Co-Founder, Director of Research, E.V.P., Strategic Insight, dated Apr. 1, 2014 (“Strategic Insight Letter”); and Eric Noll, President and Chief Executive Officer, ConvergeX Group, LLC, dated Apr. 1, 2014 (“ConvergeX Letter”).

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

institute proceedings to determine whether to disapprove the proposed rule change.<sup>6</sup> On June 9, 2014, the Commission instituted proceedings to determine whether to approve or disapprove the proposed rule change.<sup>7</sup> In response to the Order Instituting Proceedings, the Commission received one comment letter on the proposal.<sup>8</sup> On September 4, 2014, the Commission issued a notice of designation of a longer period for Commission action on proceedings to determine whether to approve or disapprove the proposed rule change.<sup>9</sup> On September 12, 2014, the

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<sup>6</sup> See Securities Exchange Act Release No. 72007 (Apr. 23, 2014), 79 FR 24045 (Apr. 29, 2014) (SR-NASDAQ-2014-020). The Commission determined that it was appropriate to designate a longer period within which to take action on the proposed rule change so that it had sufficient time to consider the proposed rule change. Accordingly, the Commission designated June 10, 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 Securities Exchange Act Release No. 72350 (Jun. 9, 2014), 79 FR 33959 (Jun. 13, 2014) (SR-NASDAQ-2014-020) (“Order Instituting Proceedings”). In the Order Instituting Proceedings, the Commission noted, among other things, that questions remained as to whether the Exchange’s proposal is consistent with the requirements of Section 6(b)(5) of the Act, specifically whether it is designed to prevent fraudulent and manipulative acts and practices, promotes just and equitable principles of trade, and protects investors and the public interest.

<sup>8</sup> See Letter to the Commission from Thomas E. Faust, Jr., Chairman and Chief Executive Officer, on behalf of Eaton Vance Corporation and its subsidiaries Eaton Vance Management and Navigate Fund Solution LLC (collectively, “Eaton Vance”), dated July 3, 2014 (“Eaton Vance Letter”). Eaton Vance Management and the Eaton Vance ETMF Trust have, as co-applicants, filed an application with the Commission seeking relief from certain provisions of the Investment Company Act of 1940 (“1940 Act”) to permit them to offer ETMFs. The Commission published notice of this application (“Notice of Application for Exemptive Relief”) on November 6, 2014. See Investment Company Act Release No. 31333 (Nov. 6, 2014) (Eaton Vance Management, et al.; Notice of Application). Navigate Fund Solutions LLC (“Navigate”) owns patent rights and other protected intellectual property relating to ETMFs and NAV-Based Trading that it intends to license to Nasdaq to support the listing and trading of ETMFs that have themselves entered into license agreements with Navigate.

<sup>9</sup> See Securities Exchange Act Release No. 72987 (Sept. 4, 2014), 79 FR 53808 (Sept. 10, 2014) (SR-NASDAQ-2014-020).

Exchange filed Amendment No. 1 to the proposed rule change.<sup>10</sup> Thereafter, the Commission received two additional comment letters on the proposed rule change.<sup>11</sup> The Commission is publishing this notice to solicit comments from interested persons on Amendment No. 1 to the proposed rule change and is approving the proposed rule change, as modified by Amendment No. 1 thereto, on an accelerated basis.

## II. Description of the Proposal<sup>12</sup>

The Exchange proposes to adopt new Nasdaq Rule 5745 to govern the listing and trading of ETMF Shares.<sup>13</sup> At this time, Nasdaq is not proposing to list any ETMF Shares under new Nasdaq Rule 5745.<sup>14</sup> Unlike actively-managed exchange-traded funds, ETMFs will not be

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<sup>10</sup> In Amendment No.1, Nasdaq confirmed that all ETMFs listed on the Exchange will have a unique identifier associated with their ticker symbols and that, in the systems used to transmit and process transactions in ETMF Shares, an ETMF's next-determined NAV will be represented by a proxy price. Previously, the filing stated that Nasdaq expects all ETMFs listed on the Exchange to have a unique identifier associated with their ticker symbols and that Nasdaq expects an ETMF's next-determined NAV to be represented by a proxy price. Additionally, the Exchange removed references to ETMF entry and annual fees as the Exchange intends to address such fees in a separate filing.

<sup>11</sup> See Letters to the Commission from Daniel J. McCabe, Chief Executive Officer, Precidian Investments LLC ("Precidian"), dated October 30, 2014 ("Precidian Letter") and Thomas E. Faust, Jr., Chairman and Chief Executive Officer, on behalf of Eaton Vance, dated October 31, 2014 ("Eaton Vance Response Letter").

<sup>12</sup> The Commission notes that more detailed information regarding the proposal is included in the Notice. See Notice, supra note 3.

<sup>13</sup> Nasdaq intends to enter into a license agreement to allow for the listing and trading of ETMF Shares on the Exchange. The Exchange states that aspects of ETMFs and NAV-Based Trading (described below) are protected intellectual property subject to issued and pending U.S. patents held by Navigate, a wholly owned subsidiary of Eaton Vance Corporation. Nasdaq will enter into a license agreement with Navigate to allow for NAV-Based Trading on the Exchange of ETMFs that have themselves entered into license agreements with Navigate.

<sup>14</sup> Nasdaq Rule 5745(b)(1) provides that Nasdaq will file separate proposals under Section 19(b) of the Act before the listing of any specific ETMF Shares.

required under Nasdaq Rule 5745 to disclose their holdings on a daily basis.<sup>15</sup> The Exchange states that, as required for traditional open-end investment companies, ETMFs will disclose their full portfolio positions at least quarterly, with a delay (not to exceed 60 days). Nasdaq will deem ETMF Shares to be equity securities, thus rendering trading in ETMF Shares subject to Nasdaq's existing rules governing the trading of equity securities.

ETMF Shares will trade on Nasdaq using a new trading protocol called "NAV-Based Trading."<sup>16</sup> In NAV-Based Trading, as described in Nasdaq Rule 5745(b)(3), all bids, offers, and execution prices will be expressed as a premium/discount (which may be zero) to the ETMF's next-determined net asset value, or NAV<sup>17</sup> (e.g., NAV-\$0.01; NAV+\$0.01). An ETMF's NAV will be determined each business day, normally as of 4:00 p.m. Eastern Time. Executions using NAV-Based Trading will be binding at the time orders are matched on Nasdaq's facilities, with the transaction prices contingent upon the determination of the ETMF's NAV at the end of the business day.<sup>18</sup>

Member firms will utilize existing order types and interfaces to transmit ETMF Share bids and offers to Nasdaq, which will process ETMF Share trades like trades in shares of ETFs

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<sup>15</sup> Nasdaq lists actively-managed funds under Nasdaq Rule 5735, which requires the identities and quantities of the securities and other assets held by a fund to be disseminated at least once daily. See Nasdaq Rule 5735 (d)(2)(B)(i).

<sup>16</sup> Nasdaq represents that all ETMFs listed on the Exchange will have a unique identifier associated with their ticker symbols, which would indicate that their Shares are traded using NAV-Based Trading. See Amendment No. 1, supra note 10.

<sup>17</sup> As with other registered open-end investment companies, the NAV of ETMF Shares generally would be calculated daily Monday through Friday as of the close of regular trading on the New York Stock Exchange, normally 4:00 p.m. Eastern Time. NAV would be calculated by dividing the ETMF's net asset value by the number of ETMF Shares outstanding. See Notice at note 9, supra note 3.

<sup>18</sup> Because, in NAV-Based Trading, prices of executed trades are not determined until the reference NAV is calculated, buyers and sellers of ETMF Shares during the trading day will not know the final value of their purchases and sales until the end of the trading day.

and other listed securities. Nasdaq represents that an ETMF's next-determined NAV will be represented by a proxy price (e.g., 100.00) and a premium/discount of a stated amount to the next-determined NAV to be represented by the same increment/decrement from the proxy price used to denote NAV (e.g., NAV-\$0.01 would be represented as 99.99; NAV+\$0.01 as 100.01).<sup>19</sup> To avoid potential investor confusion, Nasdaq will work with member firms and providers of market data services to seek to ensure that representations of intraday bids, offers, and execution prices for ETMFs that are made available to the investing public follow the "NAV-\$0.01/NAV+\$0.01" (or similar) display format, rather than displaying proxy prices.

Nasdaq will report intraday bids, offers, and trades for ETMFs in real-time to the Consolidated Tape using the proxy price format. In addition, Nasdaq will disseminate intraday ETMF bids, offers, and trades through a proprietary exchange data feed using the NAV + \$.01 / NAV - \$.01 format.<sup>20</sup> The Exchange will also provide the member firms participating in each ETMF Share trade with a contemporaneous notice of trade execution, indicating the number of

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<sup>19</sup> See Amendment No. 1, *supra* note 10. Order transmission and processing systems currently in common use by exchanges and member firms are generally not designed to accommodate pricing arrangements, such as NAV-Based Trading, in which bids, offers, and execution prices are determined by reference to a price or value that is unknown at the time of trade execution. Compared to the alternative of building and maintaining (and requiring member firms to build and maintain) a dedicated NAV-Based Trading order transmission and processing system, the Exchange believes that the proposed approach (using, for processing purposes, a proxy price to represent next-determined NAV) offers major advantages in terms of cost, efficiency, and time to implement. To convert proxy prices used to represent intraday bids, offers, and execution prices into prices expressed in relation to the next-determined NAV, member firms would subtract from the reported proxy price (e.g., 99.99) the proxy for NAV (e.g., 100.00) and insert "NAV" in front of the calculated number expressed in dollars (e.g., 99.99 - 100.00 = -0.01, expressed as "NAV-\$0.01").

<sup>20</sup> The ETMF bid, offer, and trade information disseminated to the Consolidated Tape will be the same information disseminated through a proprietary Nasdaq data feed and will differ only in the format in which the information is provided (proxy price format on the Consolidated Tape versus NAV plus or minus format on the proprietary Nasdaq data feed).

ETMF Shares bought or sold and the executed premium/discount to NAV.<sup>21</sup>

After the Reporting Authority (defined below) calculates an ETMF's NAV and provides this information to the Exchange, Nasdaq will price each ETMF Share trade entered into during the day at the ETMF's NAV plus/minus the trade's executed premium/discount. Using the final trade price, each ETMF Share trade will then be disseminated through a proprietary exchange data feed and confirmed to the member firms participating in the trade, supplementing the previously provided information with final pricing information. After the final trade price is determined, Nasdaq will deliver the ETMF Share trading data to the National Securities Clearing Corporation ("NSCC") for clearance and settlement, following the same processes used for the clearance and settlement of trades in other exchange-traded securities.

#### Proposed Listing Rules for Exchange-Traded Managed Fund Shares

Nasdaq Rule 5745(b)(1) provides that Nasdaq will file separate proposals under Section 19(b) of the Act before the listing of any specific ETMF Shares. Nasdaq Rule 5745(b)(2) provides that transactions in ETMF Shares will occur during Nasdaq's Regular Market Session through 4:00 p.m.<sup>22</sup> Nasdaq Rule 5745(b)(3) provides that ETMF Shares will trade on Nasdaq at market-determined premiums or discounts to the next-determined NAV, and that the minimum price variation for quoting and entry of orders in ETMF Shares will be \$0.01. Nasdaq Rule 5745(b)(4) provides that Nasdaq will implement written surveillance procedures for ETMF Shares. Nasdaq Rule 5745(b)(5) provides that, for ETMF Shares based on an international or global portfolio, the statutory prospectus or the application for exemption from provisions of the

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<sup>21</sup> All orders to buy or sell an ETMF Share that are not executed on the day the order is submitted would be automatically cancelled as of the close of trading on such day.

<sup>22</sup> Nasdaq Rule 4120(b)(4) defines the Regular Market Session as the trading session from 9:30 a.m. to 4:00 p.m. or 4:15 p.m. ETMF Shares would trade until 4:00 p.m.

1940 Act for such series of ETMF Shares must state that such series must comply with the federal securities laws in accepting securities for deposit and satisfying redemptions with securities, including that the securities accepted for deposit and the securities used to satisfy redemption requests are sold in transactions that would be exempt from registration under the Securities Act of 1933 (“Securities Act”).

Definitions. Nasdaq Rule 5745(c)(1) defines the term “ETMF Share” as a security that: (1) represents an interest in a registered investment company organized as an open-end management investment company that invests in a portfolio of securities and other assets selected and managed by the ETMF’s investment adviser consistent with the ETMF’s investment objectives and policies; (2) is issued in specified aggregate unit quantities in return for a deposit of a specified portfolio of securities and/or a cash amount with a value per Share equal to the ETMF’s NAV; (3) when aggregated in the same specified unit quantities, may be redeemed in exchange for a specified portfolio of securities and/or cash with a value per Share equal to the ETMF’s NAV; and (4) is traded on Nasdaq or another national securities exchange using NAV-Based Trading, including pursuant to unlisted trading privileges.

In addition, Nasdaq Rule 5745(c)(2) defines the term “Intraday Indicative Value” (“IIV”) as the estimated indicative value of an ETMF Share based on current information regarding the value of the securities and other assets held by the ETMF. Nasdaq Rule 5745(c)(3) defines the term “Composition File” as the specified portfolio of securities and/or cash that an ETMF will accept as a deposit in issuing ETMF Shares and the specified portfolio of securities and/or cash that an ETMF will deliver in a redemption of ETMF Shares. The current Composition File will be disseminated through the NSCC once each business day before the open of trading in ETMF Shares on Nasdaq on such day. To maintain the confidentiality of current portfolio trading, an

ETMF's Composition File generally will not be a pro rata reflection of the ETMF's securities positions. Each security included in the Composition File will be a current holding of the ETMF, but the Composition File generally will not include all of the securities in the ETMF's portfolio or match the weightings of the included securities in the portfolio. The Composition File also may consist entirely of cash, in which case it would not include any of the securities in the ETMF's portfolio.

Nasdaq Rule 5745(c)(4) defines the term "Reporting Authority" as Nasdaq, an institution or a reporting service designated by Nasdaq as the official source for calculating and reporting information relating to such series of ETMF Shares, including, but not limited to, the IIV, the amount of any cash distribution to holders of ETMF Shares, NAV, the Composition File, or other information relating to the issuance, redemption, or trading of ETMF Shares. A series of ETMF Shares may have more than one Reporting Authority, each having different functions.

Initial and Continued Listing. Nasdaq Rule 5745(d) sets forth the initial and continued listing criteria applicable to ETMF Shares. Nasdaq Rule 5745(d)(1)(A) provides that, for each series of ETMF Shares, Nasdaq will establish a minimum number of ETMF Shares required to be outstanding at the time of commencement of trading. In addition, under Nasdaq Rule 5745(d)(1)(B), Nasdaq will obtain a representation from the issuer of each series of ETMF Shares that the NAV for such series will be calculated on each business day that the New York Stock Exchange is open for trading and that the NAV will be made available to all market participants at the same time. Under Nasdaq Rule 5745(d)(1)(C), the Reporting Authority that provides the Composition File must implement and maintain, or be subject to, procedures designed to prevent the use and dissemination of material, non-public information regarding the ETMF's portfolio positions and changes in positions.



Nasdaq Rule 5745(d)(2)(A) provides that each series of ETMF Shares could continue to be listed and traded if the IIV for the ETMF Shares is widely disseminated by one or more major market data vendors at intervals of not more than 15 minutes during the Regular Market Session when the ETMF Shares trade on Nasdaq. As stated in the Notice, the purpose of IIVs in NAV-Based Trading is to enable investors to determine the number of ETMF Shares to buy or sell if they want to transact in an approximate dollar amount. For this purpose, Nasdaq believes that dissemination of IIVs at intervals of not more than 15 minutes should generally be sufficient. The Exchange states that more frequent dissemination of IIVs may increase fund costs without apparent benefit and could focus unwarranted investor attention on these disclosures. Moreover, for certain strategies, more frequent IIV disclosure could provide unintended information about current portfolio trading activity to market participants who possess the requisite analytical capabilities, computation power, and motivation to reverse engineer the ETMF's portfolio positions. An ETMF will be permitted to disseminate IIVs at intervals of less than 15 minutes, but would not be required to do so to maintain trading on the Exchange.

Nasdaq Rule 5745(d)(2)(B) provides that Nasdaq will consider the suspension of trading in, or removal from listing of, a series of ETMF Shares under any of the following circumstances: (1) if, following the initial twelve-month period after commencement of trading on the Exchange of a series of ETMF Shares, there are fewer than 50 beneficial holders of the series of ETMF Shares for 30 or more consecutive trading days; (2) if the ETMF's IIV or NAV is no longer calculated or if its IIV, NAV, or Composition File is no longer available to all market participants at the same time; (3) if the ETMF has failed to submit any filings required by the Commission or if Nasdaq is aware that the ETMF is not in compliance with the conditions of any exemptive order or no-action relief granted by the Commission with respect to the series of

ETMF Shares; or (4) if such other event shall occur or condition exists which, in the opinion of Nasdaq, makes further dealings on Nasdaq inadvisable.

Nasdaq Rule 5745(d)(2)(C) provides that, if the IIV of a series of ETMF Shares is not being disseminated as required, Nasdaq may halt trading during the day in which the interruption to the dissemination of the IIV occurs. If the interruption to the dissemination of the IIV persists past the trading day in which it first occurred, Nasdaq will halt trading no later than the beginning of the trading day following the interruption. In addition, if the Exchange becomes aware that the NAV with respect to a series of ETMF Shares is not calculated on each business day that the New York Stock Exchange is open for trading and disseminated to all market participants at the same time, it will halt trading in such series until such time as the NAV is available to all market participants at the same time. If Nasdaq becomes aware that the Composition File with respect to a series of ETMF Shares is not disseminated to all market participants at the same time, it will halt trading in such series until such time as the Composition File is available to all market participants at the same time.

In addition, Nasdaq Rule 5745(d)(2)(D) provides that, upon termination of an ETMF, the ETMF Shares issued in connection with such entity must be removed from listing on Nasdaq. Nasdaq Rule 5745(d)(2)(E) provides that voting rights must be as set forth in the applicable ETMF prospectus.

Additional Provisions. Nasdaq Rule 5745(e) provides that neither Nasdaq, the Reporting Authority, nor any agent of Nasdaq shall have any liability for damages, claims, losses, or expenses caused by any errors, omissions, or delays in calculating or disseminating any of the following: the current portfolio value; the current value of the securities and other assets required to be deposited in connection with the issuance of ETMF Shares; the amount of any

dividend-equivalent payment or cash distribution to holders of ETMF Shares; NAV; the Composition File; or other information relating to the purchase, redemption, or trading of ETMF Shares, resulting from any negligent act or omission by Nasdaq, the Reporting Authority, or any agent of Nasdaq, or any act, condition, or cause beyond the reasonable control of Nasdaq, its agent, or the Reporting Authority, including, but not limited to, an act of God, fire, flood, extraordinary weather conditions, war, insurrection, riot, strike, accident, action of government, communications or power failure, equipment or software malfunction, or any error, omission, or delay in the reports of transactions in one or more underlying securities.

Nasdaq Rule 5745(f) applies only to series of ETMF Shares that are the subject of an order by the Commission exempting such series from certain prospectus delivery requirements under Section 24(d) of the 1940 Act and are not otherwise subject to prospectus delivery requirements under the Securities Act. Nasdaq will inform its members regarding application of Nasdaq Rule 5745(f) to a particular series of ETMF Shares by means of an information circular prior to commencement of trading in such series. Under the rule, Nasdaq requires that members provide to all purchasers of a series of ETMF Shares a written description of the terms and characteristics of those securities, in a form prepared by the open-end management investment company issuing such securities, not later than the time a confirmation of the first transaction in such series is delivered to such purchaser. In addition, members shall include such a written description with any sales material relating to a series of ETMF Shares that is provided to customers or the public. Any other written materials provided by a member to customers or the public making specific reference to a series of ETMF Shares as an investment vehicle must include a statement in substantially the following form: “A circular describing the terms and characteristics of (the series of ETMF Shares) has been prepared by the (open-end management

investment company name) and is available from your broker. It is recommended that you obtain and review such circular before purchasing (the series of ETMF Shares).” A member carrying an omnibus account for a non-member broker-dealer is required to inform such non-member that execution of an order to purchase a series of ETMF Shares for such omnibus account would be deemed to constitute agreement by the non-member to make such a written description available to its customers on the same terms as are directly applicable to members under this rule. Upon request of a customer, a member shall also provide a prospectus for the particular series of ETMF Shares.

Nasdaq Rule 5745(g) provides that, if the investment adviser to an ETMF issuing Shares is a registered broker-dealer or affiliated with a broker-dealer, such investment adviser shall erect a “fire wall” between the investment adviser and the broker-dealer personnel or broker-dealer affiliate, as applicable, with respect to access to information concerning the composition and/or changes to such ETMF’s portfolio holdings. Personnel who make decisions on the ETMF’s portfolio composition must be subject to procedures designed to prevent the use and dissemination of material, non-public information regarding the applicable ETMF portfolio.

#### Other Rule Changes

The Exchange is also making conforming changes to: (1) Nasdaq Rule 4120(a)(9) and (10) to add provisions applicable to ETMF Shares with respect to trading halts; (2) Nasdaq Rule 4120(b)(4)(A) and (E) to modify certain defined terms to include references to ETMF Shares; and (3) Nasdaq Rule 5615(a)(5) and IM-5615-4 to add references to ETMFs for purposes of

certain corporate governance requirements.<sup>23</sup>

### III. Summary of Comment Letters

As noted above, the Commission received a total of seven comment letters from six commenters concerning the Exchange's proposal.<sup>24</sup> Five of the commenters support the proposal, and one commenter opposes the proposal. Generally, the supporting commenters believe that ETMFs could offer investment managers and investors a tax-efficient alternative to today's mutual funds.<sup>25</sup> In addition to the benefits of tax-efficiency, some commenters state their belief that ETMFs would offer the benefits of lower costs to investors as a result of lower expenses,<sup>26</sup> and one commenter states its belief that a benefit would be transparency of ETMF transaction costs.<sup>27</sup> The same commenter also states its view that the non-disclosed nature of the ETMF portfolio would serve as a barrier to front-running of portfolio trades of actively managed funds and that the proposed ETMFs would promote renewed competition in the fund marketplace by encouraging investment managers concerned about maintaining the confidentiality of their portfolio trading to offer their leading strategies in a better performing product structure.<sup>28</sup> The opposing commenter, however, believes that ETMFs would likely not provide tax benefits and may cost more to operate than existing ETFs, because the ETMF will be

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<sup>23</sup> The Exchange also is making certain other minor technical changes to these rules unrelated to ETMFs. Specifically, the Exchange is amending Rules 4120(a)(9), (b)(4)(A), and (b)(4)(E) to include appropriate references to various derivative securities defined in Rule 5711, and to make certain other typographical corrections and clarifications.

<sup>24</sup> See supra notes 4, 8, and 11.

<sup>25</sup> See MMI Letter; Tull Letter; Strategic Insight Letter; ConvergeX Letter at 1; and Eaton Vance Letter at 2, supra notes 4 and 8.

<sup>26</sup> See Tull Letter; Strategic Insight Letter; and ConvergeX Letter at 1, supra note 4.

<sup>27</sup> See Tull Letter, supra note 4.

<sup>28</sup> Id.

forced to rebalance its portfolio every time there is a creation or redemption causing the fund to incur additional costs.<sup>29</sup> In response to the opposing commenter, Eaton Vance, the sponsor of ETMFs, states its view that the more relevant comparison for ETMFs is mutual funds and that it expects ETMFs to achieve significant performance and tax efficiency advantages over similar mutual funds by utilizing in-kind purchases and redemptions and by imposing Creation Unit transaction fees to offset the associated processing and trading costs to the fund.<sup>30</sup> The opposing commenter also states its view that NAV-Based Trading provides no discernable benefit to investors and would likely add to investor confusion because the proposal would allow the listing of products on an exchange that would not trade at current market prices.<sup>31</sup> In response, Eaton Vance acknowledges that ETMF Shares will not trade at prices determined intraday, but notes that each ETMF's registration statement, website, and any advertising or marketing materials will include prominent disclosure of this fact.<sup>32</sup> Eaton Vance further responds with its view that ETMFs provide several advantages over traditional mutual funds<sup>33</sup> and actively managed

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<sup>29</sup> See Precidian Letter at 5-6, supra note 11. Precidian states its view that the fewer securities contained in the creation or redemption basket, the worse the problem becomes.

<sup>30</sup> See Eaton Vance Response Letter at 6, supra note 11.

<sup>31</sup> See Precidian Letter at 2, supra note 11. Precidian states its belief that intraday liquidity is a foundational principle of exchanges and the secondary market as a whole.

<sup>32</sup> See Eaton Vance Response Letter at 3, supra note 11. Eaton Vance also responded to concerns about investor confusion in its first comment letter. See infra notes 43-51 and accompanying text.

<sup>33</sup> Eaton Vance believes that the potential advantages ETMFs have over mutual funds are: (a) protecting fund shareholders from the dilutive effects of other shareholders' transactions; (b) protecting fund shareholders from tax realizations in connection with other shareholders' transactions; (c) realizing savings in shareholder servicing and other fund expenses; and (d) enhancing the competitiveness of fund distribution. See Eaton Vance Response Letter at 3-4, supra note 11.

ETFs.<sup>34</sup>

In addition, several commenters state their belief about the potential positive impact the proposed ETMF product may have on arbitrage and pricing. Specifically, one commenter states its view that NAV-Based Trading for ETMFs should expand market maker opportunities as the arbitrage moves towards order management control and away from sophisticated arbitrage pricing models using real-time pricing that makes it difficult for an investor to calculate personal market entry and exit costs.<sup>35</sup> Another commenter states its view that, because ETMFs could promote competition in the fund marketplace, such competition might enable ETMFs to trade close to the underlying fund value on a consistent basis.<sup>36</sup> The opposing commenter, however, believes that market professionals will be unable to effectively hedge their ETMF positions due to a stale and possibly inaccurate IIV that is published every 15 minutes.<sup>37</sup> Eaton Vance responds to the opposing commenter by stating that the sole purpose of the IIV is to help investors determine the number of ETMF Shares to buy or sell if they want to transact in an approximate dollar amount and that market makers will never have any reason to refer to the IIV in connection with their market making function.<sup>38</sup> In response to the need for a market maker to hedge their ETMF positions, Eaton Vance asserts that a market maker holding positions in ETMF Shares is not exposed to intraday market risk, and, as such, there would be no need for

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<sup>34</sup> Eaton Vance believes that the potential advantages ETMFs have over actively managed ETFs are: (a) maintaining the confidentiality of portfolio trading activity; (b) providing trade execution cost transparency and quality control to fund investors; and (c) facilitating tight bid-ask spreads and narrow premiums/discounts in secondary market trading. See Eaton Vance Response Letter at 3-4, supra note 11.

<sup>35</sup> See Tull Letter, supra note 4.

<sup>36</sup> See ConvergEx Letter at 2, supra note 4.

<sup>37</sup> See Precidian Letter at 5, supra note 11.

<sup>38</sup> See Eaton Vance Response Letter at 5, supra note 11.

market makers to hedge their positions intraday.<sup>39</sup>

One commenter states its view that the promise of ETMFs can be realized if a “common Chassis” is adopted by multiple fund managers, who would then simultaneously educate the marketplace about the benefits of ETMFs.<sup>40</sup> The same commenter also believes that the adoption curve of ETMFs might parallel the acceleration in the use of mutual funds triggered by the introduction in the early 1990s of the Schwab’s Mutual Fund OneSource® supermarket, when numerous fund managers articulated the benefit of a common administrative platform.<sup>41</sup> The commenter concludes that ETMFs have the potential to significantly improve returns to investors in actively-managed funds, and to encourage additional investment and savings by millions of American over the coming decades.<sup>42</sup>

In response to the questions raised in the Order Instituting Proceedings regarding the ability of market participants to fully understand NAV-Based Trading and the public availability of information for ETMFs, Eaton Vance submitted a comment letter stating that the Exchange intends to provide members with a detailed explanation of NAV-Based Trading through a Trading Alert and will inform members of the special characteristics and risks associated with trading ETMF Shares in an information circular – both to be issued prior to the commencement of ETMF trading.<sup>43</sup> Additionally, Eaton Vance states that, in conjunction with the Exchange’s communications to its members, it will also educate the marketplace through its website materials and disclosures in fund prospectuses and marketing literature by focusing on the key

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<sup>39</sup> See Eaton Vance Response Letter at 6, supra note 11.

<sup>40</sup> See Strategic Insight Letter, supra note 4.

<sup>41</sup> Id.

<sup>42</sup> Id.

<sup>43</sup> See Eaton Vance Letter at 3, supra note 8.



distinctions of ETMF investing which will include: (a) how to enter orders; (b) how to use IIV to help size ETMF orders; (c) the portfolio disclosures of ETMFs; and (d) the risks of NAV-Based Trading.<sup>44</sup> Further, Eaton Vance emphasizes that it would make available an extensive library of ETMF educational materials and would maintain a website to provide a comprehensive, one-stop source of market information and investor education regarding ETMFs and NAV-Based Trading.<sup>45</sup> Eaton Vance believes that these methods will provide adequate information to support NAV-Based Trading.<sup>46</sup>

In response to the Commission's concerns regarding public availability of ETMF trading information, Eaton Vance states that NAV-Based trade prices, best bids and offers for ETMF Shares, volume of ETMF Shares traded, and other intraday trading information will be continuously available for ETMFs on a real-time basis throughout each trading day on brokers' computer terminals and electronic market data services.<sup>47</sup> In addition, Eaton Vance represents that it and Nasdaq will work with the Exchange's members and providers of market data services to ensure that representation of intraday bids, offers, and trade prices for ETMFs follow a "NAV-\$0.01/NAV+\$0.01" display format in an effort to avoid investor confusion.<sup>48</sup> Eaton Vance further states that all ETMFs listed on Nasdaq will have a unique identifier associated with their

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Id.

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See Eaton Vance Letter at 4, supra note 8.

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Id.

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Id.

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Id. The opposing commenter believes that ETMF pricing displayed in proxy prices will be confusing to investors. See Precidian Letter at 5, supra note 11. In response, Eaton Vance reiterates that it and the Exchange are working with member firms and providers of market data to ensure that representations of intraday bids, offers, and execution prices for ETMFs that are available to the public consistently follow the NAV + \$.01 / NAV - \$.01 display format. See Eaton Vance Response Letter at 5, supra note 11.

ticker symbols indicating that the Shares are trading using NAV-Based Trading.<sup>49</sup> Finally, Eaton Vance states that it will maintain a public website for ETMFs that will disclose, among other things, detailed fund information and contain links to current fund documents, including a fact sheet, summary and full prospectuses, statement of additional information, and shareholder reports for each fund.<sup>50</sup> According to Eaton Vance, this website will also display per Share, the prior trading day's NAV and the following trading information for such day: (a) intraday high, low, average, and closing prices of Shares in exchange trading; (b) the midpoint of the highest bid and lowest offer prices as of the close of exchange trading (expressed as a premium/discount to NAV); (c) the spread between highest bid and lowest offer prices as of the close of exchange trading; and (d) volume of Shares traded. Eaton Vance believes that such trading information will provide useful guidance to current buyers and sellers of Shares and accordingly believes there will be minimal risk of investor confusion.<sup>51</sup>

The opposing commenter raises several other concerns.<sup>52</sup> The opposing commenter states its belief that a market professional buying ETMF Shares from an investor would have an economic interest in providing the worst price to the investor.<sup>53</sup> In response, Eaton Vance states

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<sup>49</sup> See Eaton Vance Letter at 5, supra note 8. See also Eaton Vance Response Letter at 5, supra note 11.

<sup>50</sup> See Eaton Vance Letter at 5, supra note 8.

<sup>51</sup> Id.

<sup>52</sup> The opposing commenter states its belief that ETMFs are not redeemable securities. See Precidian Letter at 2, supra note 11. In response, Eaton Vance states that it believes ETMFs satisfy the definition of a “redeemable security” as defined in the 1940 Act, but because the shares would not be individually redeemable, Eaton Vance has requested exemptive relief under the 1940 Act. See Eaton Vance Response Letter at 2, supra note 11. Eaton Vance’s request for exemptive relief is currently before the Commission. See supra note 8.

<sup>53</sup> See Precidian Letter at 2, supra note 11.

that ETMF Shares are no different from other traded securities and that market forces exert pressure on market professionals to offer competitive prices to investors, so that a market maker who seeks to trade ETMF Shares at uncompetitive prices will not attract the volume of trading required to earn meaningful profits.<sup>54</sup> The opposing commenter also states its view that traders who accumulate large ETMF positions will be incentivized to move the NAV in their favor.<sup>55</sup> Eaton Vance responds with its view that this is “completely false,” as the amount of profit a market maker or other trader earns by trading ETMFs is not affected by movements in the NAV.<sup>56</sup> Eaton Vance argues that it doesn’t matter whether an ETMF’s NAV has moved higher or lower intraday as no level of NAV provides market makers with more profit than any other NAV.<sup>57</sup>

The opposing commenter also argues that because an ETMF’s trade price is not determined until the end of the day, there may be significant problems for brokers and investors with respect to determining the buying power of an investor’s account.<sup>58</sup> For example, the commenter argues that an investor with a cash account may not have sufficient funds in the account to cover a purchase of an ETMF entered into during the day if the ETMF’s NAV at the end of the day is higher than the investor expected.<sup>59</sup> In response, Eaton Vance states that, based on extensive discussions with multiple broker-dealers and a review of broker-dealer account funding guidelines, Eaton Vance believes that broker-dealer account control procedures are

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<sup>54</sup> See Eaton Vance Response Letter at 3, supra note 11.

<sup>55</sup> See Precidian Letter at 2, supra note 11.

<sup>56</sup> See Eaton Vance Response Letter at 3, supra note 11.

<sup>57</sup> Id. Eaton Vance’s response does not appear to take into account a trader holding a position overnight or longer. See infra notes 82-83 and accompanying text.

<sup>58</sup> See Precidian Letter at 3, supra note 11.

<sup>59</sup> See id.

adequate to accommodate trading of ETMF Shares and to mitigate the associated risks of inadequate investor account funding.<sup>60</sup> The opposing commenter further questions how brokers will be able to calculate their net capital at any point in time during the day, noting its view that a firm with ETMF positions would not be able to determine the value of its ETMF positions during the day as quotes and last-sale prices are based on a future price, and the IIV is only published at 15 minute intervals.<sup>61</sup> In response, Eaton Vance states its belief that ETMFs are likely not the only asset held by broker-dealers that does not lend itself to minute-by-minute intraday updated valuations.<sup>62</sup> Eaton Vance further states that, based on how it expects ETMF market making to function, it does not believe that market makers will hold large ETMF inventory positions and that an ETMF market maker operating within relatively tight limits of its net capital requirement may build a buffer into the valuation of its ETMF positions to ensure continued capital adequacy.<sup>63</sup>

Further, the opposing commenter states its view that inclusion of foreign stocks in an ETMF's portfolio will create problems in calculating the ETMF's NAV.<sup>64</sup> The opposing commenter argues that if a portfolio includes stocks that trade in different time zones, it may be impossible to accurately set the NAV until the foreign market opens for trading.<sup>65</sup> The opposing commenter believes that this would require the NSCC to reduce the settlement cycle for the portfolio's securities and would lessen the time that brokers can prepare confirmations, resulting

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<sup>60</sup> See Eaton Vance Response Letter at 4, supra note 11.

<sup>61</sup> See Precidian Letter at 4, supra note 11.

<sup>62</sup> See Eaton Vance Response Letter at 4, supra note 11.

<sup>63</sup> Id.

<sup>64</sup> See Precidian Letter at 3-4, supra note 11.

<sup>65</sup> See id. at 3, supra note 11.

in a delay in calculating margin calls and other time critical problems, such as stale pricing of the IIV.<sup>66</sup> In response, Eaton Vance states that mutual funds holding foreign securities routinely apply fair value pricing procedures to determine their daily NAV, and it expects ETMFs to do the same.<sup>67</sup>

Finally, the opposing commenter raises the concern that brokerage firms, vendors, the Consolidated Tape, and quote system operators will have to alter their systems to support the ETMFs' price quotations of NAV+/NAV- notations.<sup>68</sup> With regard to the Consolidated Tape, Eaton Vance does not believe that this is a valid concern, stating that ETMF trading prices and quotes will be reported in proxy price format requiring no special changes to the Consolidated Tape.<sup>69</sup> Eaton Vance further states that the process of buying and selling ETMFs will be similar to buying and selling other exchange-traded securities, with the only significant distinction being that the price limits for limit orders will be expressed relative to NAV rather than as an absolute dollar price.<sup>70</sup> Further, according to Eaton Vance, the execution, reporting, clearance, and settlement of ETMF trades will be substantially the same as for other exchange-traded securities. Separately, based on discussions with broker-dealers and providers of market data services, Eaton Vance believes that any systems modifications to accommodate ETMFs will be relatively modest and can readily be achieved in a timely manner.<sup>71</sup>

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<sup>66</sup> See id. at 4, supra note 11.

<sup>67</sup> See Eaton Vance Response Letter at 4, supra note 11.

<sup>68</sup> See Precidian Letter at 4, supra note 11.

<sup>69</sup> See Eaton Vance Response Letter at 5, supra note 11.

<sup>70</sup> See id.

<sup>71</sup> See id.

#### IV. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rule and regulations thereunder applicable to a national securities exchange.<sup>72</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>73</sup> which requires that the rules of an exchange be designed, among other things, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest. The Commission finds that Nasdaq's proposal contains adequate rules and procedures to govern the listing and trading of ETMFs on the Exchange. Except for certain requirements relating to the daily disclosure of the fund portfolio, dissemination of the IIV, and NAV-Based trading (as discussed further below), the proposed listing standards of new Nasdaq Rule 5745 are substantively identical to the provisions of Nasdaq Rule 5735, which governs the listing of Managed Fund Shares on the Exchange. Further, all securities listed under proposed Nasdaq Rule 5745 will be subject to the full panoply of Nasdaq rules and procedures that currently govern the trading of equity securities on the Exchange, except that ETMFs will trade using NAV-Based Trading.

As noted, ETMF Shares will not provide a "Disclosed Portfolio" on a daily basis.<sup>74</sup> According to the Exchange, the purpose of the daily portfolio disclosure requirement for actively-managed ETFs is to provide market makers in those products with the portfolio

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<sup>72</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>73</sup> 15 U.S.C. 78f(b)(5).

<sup>74</sup> In contrast, Nasdaq Rule 5735 requires Managed Fund Shares to disclose publicly their full portfolio positions at least once daily.

information needed to hedge the intraday market risk they assume as they take inventory positions in the ETF shares in connection with their market making activities. Nasdaq states that, in ETF trading, a condition to maintaining a tight relationship between market-based trading prices for the ETF shares and contemporaneous ETF underlying portfolio values is that market makers have sufficient information regarding portfolio positions to enable them to earn reliable arbitrage profits by entering into long (or short) positions in ETF shares and offsetting short (or long) positions in the underlying holdings (or a suitable proxy). Nasdaq states that, in ETMF trading, by contrast, a market maker will assume no intraday market risk in connection with its inventory positions in ETMF shares because all ETMF Share transaction prices are based on the next-determined NAV.<sup>75</sup> According to the Exchange, the process that connects ETMF trading prices to the NAV of the shares of ETMFs is effected at the end of each trading day when a market maker creates (redeems) Creation Units of ETMF Shares through an Authorized Participant to offset the net amount of ETMF Shares it has sold (bought) over the course of the trading day, and buys (sells) the quantity of Composition File instruments corresponding to the

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<sup>75</sup> According to the Exchange, whether an ETMF's underlying value goes up or down over the course of a trading day would not affect how much profit a market maker earns by selling (or buying) ETMF Shares in the market at a net premium (discount) to NAV, and then creating (redeeming) an offsetting number of ETMF Shares at the end of the day in transactions with the ETMF. The Exchange states that no intraday market risk means no requirement for intraday hedging, and therefore no associated requirement for portfolio disclosure to maintain a tight relationship between ETMF Share trading prices and the NAV of the ETMF.

number of Creation Units created (redeemed).<sup>76</sup>

The Exchange states that, different from actively-managed ETFs, ETMFs offer market makers a profit opportunity that does not depend on either corresponding intraday adjustments in ETMF Share and underlying portfolio positions or the use of a hedge portfolio to manage intraday market risk.<sup>77</sup> According to the Exchange, because the mechanism that underlies ETMF trading is simpler, more reliable, and exposes market makers to less risk than actively-managed ETF arbitrage, market makers should require less profit inducement to establish and maintain markets in ETMF Shares than for actively-managed ETFs, thereby enabling ETMFs to routinely trade at smaller premiums/discounts and narrower bid-ask spreads.

The Commission agrees that ETMFs will offer market makers a profit opportunity that

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<sup>76</sup> The Exchange states that an ETMF market maker that creates (redeems) a Creation Unit at the end of a trading day to offset its net intraday sales (purchases) of a Creation Unit quantity of ETMF Shares would earn profits to the extent that it either sells (buys) Shares at an aggregate premium (discount) to NAV or buys (sells) a Creation Unit-equivalent quantity of Composition File instruments at an aggregate discount (premium) to their end-of-day values, and the net amount of ETMF premium (discount) plus Composition File instruments discount (premium) exceeds the transaction fee that applies to a creation (redemption) of a Creation Unit of ETMF Shares. Nasdaq further states that this process is simplified for cash creations and redemptions, stating that an ETMF market maker that creates (or redeems) a Creation Unit in cash to offset its net intraday sales (purchases) of a Creation Unit quantity of ETMF Shares would earn profits to the extent that it sells (buys) ETMF Shares in the secondary market at an aggregate premium (discount) to NAV that exceeds the transaction fee that applies to a cash creation (redemption) of a Creation Unit of ETMF Shares.

<sup>77</sup> According to the Exchange, market makers are expected generally to seek to minimize their exposure to price risk in ETMF Shares by holding little or no overnight inventory. The Exchange states that establishing Creation Unit sizes for ETMFs that are somewhat smaller (*i.e.*, in a range of 5,000 to 50,000 Shares) than is customary for ETFs should facilitate tighter market maker inventory management. To the extent that market makers hold small positions in ETMF Shares overnight, they are expected to aggregate such holdings with other risk positions and transact at or near the market close to buy or sell offsetting positions in appropriate, broad-based hedging instruments. Nasdaq states that such hedging of overnight inventory risk on a macro basis does not require disclosure of non-Composition File portfolio positions.



does not require intraday hedging of ETMF Share price movements or changes in the value of the underlying portfolio positions. Because market makers will not need to engage in intraday hedging, the Commission believes that daily portfolio disclosure is not necessary. The Commission believes that NAV-Based Trading removes the need for market makers to hedge their ETMF positions intraday. Because all ETMF Share transaction prices are based on the next-determined NAV, a market maker will assume no intraday market risk in connection with its ETMF inventory positions and will not need to hedge the position. At the end of each day, a market maker will be able to offset its position of ETMF Shares by creating or redeeming through an authorized participant.<sup>78</sup>

The opposing commenter also raises a concern that market professionals will have an economic incentive to provide the worst price to an investor for ETMF Shares.<sup>79</sup> In response, Eaton Vance states that ETMF Shares are no different from other traded securities and that market forces exert pressure on market professionals to offer competitive prices to investors, so that a market maker who seeks to trade ETMF Shares at uncompetitive prices will not attract the volume of trading required to earn meaningful profits.<sup>80</sup> The Commission believes that competitive forces will provide incentives for market professionals to provide competitive prices to investors and that ETMFs, in this respect, are not any different than other exchange-traded securities.

The opposing commenter also raises a concern that traders who accumulate large ETMF

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<sup>78</sup> See supra notes 76 and 77 and accompanying text.

<sup>79</sup> See Precidian Letter at 2, supra note 11.

<sup>80</sup> See Eaton Vance Response Letter at 3, supra note 11.

positions will be incentivized to move the NAV in their favor.<sup>81</sup> Eaton Vance responds with its view that the amount of profit a market maker or other trader will earn by trading ETMFs will not be affected by movements in the NAV.<sup>82</sup> Eaton Vance explains that it does not matter whether an ETMF's NAV has moved higher or lower intraday, as no level of NAV provides market makers with more profit than any other NAV.<sup>83</sup> The Commission agrees with Eaton Vance's response with respect to a trader's incentives on an intraday basis because the amount of profit a trader could earn on an intraday basis will not be affected by movements in the NAV. However, traders that hold a large ETMF position overnight or longer could have an incentive to move the NAV in their favor (i.e., to move the NAV up so that they can sell their position at a profit). This, however, is not any different than the incentive a trader would have holding a large position in any exchange-traded security or mutual fund. Under the proposal, Nasdaq Rule 5745(b)(4) requires that Nasdaq implement written surveillance procedures for ETMF Shares. Exchanges routinely conduct surveillance activities to identify manipulative trading activity such as that described by the opposing commenter.<sup>84</sup> And, with an ETMF, a trader would have less ability to influence the ETMF's NAV by trading in the underlying securities because of the lack of daily portfolio disclosure.

Nasdaq Rule 5745(d)(2)(A) requires that the IIV for ETMF Shares be widely disseminated by one or more major market data vendors at intervals of not more than 15 minutes

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<sup>81</sup> See Precidian Letter at 2, supra note 11.

<sup>82</sup> See Eaton Vance Response Letter at 3, supra note 11.

<sup>83</sup> Id.

<sup>84</sup> The Commission also notes that the Exchange Act and the rules thereunder prohibit manipulative trading activity. See e.g., 15 U.S.C. 78j(b) and 17 CFR 240.10b-5.

during the Regular Market Session when the ETMF Shares trade on Nasdaq.<sup>85</sup> According to the Exchange, the purpose of IIVs in NAV-Based Trading is to enable investors to estimate the number of ETMF Shares to buy or sell if they want to transact in an approximate dollar amount. For this purpose, Nasdaq believes that dissemination of IIVs at intervals of not more than 15 minutes should generally be sufficient. An ETMF will be permitted to disseminate IIVs at intervals of less than 15 minutes, but will not be required to do so to maintain trading on the Exchange. The Commission agrees that IIV dissemination in intervals of not more than 15 minutes should be sufficient to permit investors to determine the number of ETMF Shares they want to buy or sell associated with an approximate dollar amount.

As noted above, the opposing commenter believes that market professionals will be unable to effectively hedge their ETMF positions due to a stale and possibly inaccurate IIV that is published every 15 minutes.<sup>86</sup> Eaton Vance responds to the opposing commenter by stating that the sole purpose of the IIV is to help investors determine the number of ETMF Shares roughly corresponding to a given dollar amount and that market makers will never have any reason to refer to the IIV in connection with their market making function.<sup>87</sup> In response to the need for market makers to hedge their ETMF positions, Eaton Vance asserts that market makers holding positions in ETMF Shares are not exposed to intraday market risk, and, as such, there would be no need for market makers to hedge their positions intraday.<sup>88</sup> As detailed above, ETMFs will trade intraday at prices based on NAV and, unlike ETFs, ETMFs would not provide

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<sup>85</sup> In contrast, Nasdaq Rule 5735 requires the IIV for Managed Fund Shares to be widely disseminated by one or more major market data vendors at least every 15 seconds during the time when the Managed Fund Shares trade on Nasdaq.

<sup>86</sup> See Precidian Letter at 5, supra note 11.

<sup>87</sup> See Eaton Vance Response Letter at 5, supra note 11.

<sup>88</sup> See Eaton Vance Response Letter at 6, supra note 11.

pricing signals for market intermediaries or other buyers or sellers of ETMF Shares seeking to estimate the difference between the value of the ETMF's portfolio and the price at which ETMF Shares are currently trading. As such, the Commission believes that a more frequently-disseminated IIV is not necessary for market participants to estimate the value of the ETMF's underlying portfolio for hedging purposes or the management of intraday market risk.

The Commission believes that the proposed listing standards under new Nasdaq Rule 5745 are designed to promote just and equitable principles of trade and to protect investors and the public interest. Under proposed Nasdaq Rule 5745(d)(1)(B), the Exchange will obtain a representation from the issuer of each series of ETMF Shares that the NAV per share for the series will be calculated on each business day that the New York Stock Exchange is open for trading and that the NAV per share will be made available to all market participants at the same time. In addition, under Nasdaq Rule 5745(d)(1)(C), the Reporting Authority (as defined in proposed Nasdaq Rule 5745(c)(4))<sup>89</sup> must implement and maintain or be subject to procedures designed to prevent the use and dissemination of material, non-public information regarding the ETMF's portfolio positions and changes in the positions.

Under Nasdaq Rule 5745(d)(2)(B)(ii), the Exchange will consider suspension of trading in, or removal from listing of, a series of ETMF Shares if the IIV or the NAV is no longer calculated, or if the IIV, NAV, or Composition File is no longer available to all market

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<sup>89</sup> The term "Reporting Authority" in respect of a particular series of ETMF Shares means Nasdaq, an institution, or a reporting service designated by Nasdaq as the official source for calculating and reporting information relating to such series of ETMF Shares, including, but not limited to, the IIV, the amount of any cash distribution to holders of ETMF Shares, NAV per share, and the Composition File or other information relating to the issuance, redemption, or trading of ETMF Shares. A series of ETMF Shares may have more than one Reporting Authority, each having different functions. See Nasdaq Rule 5745(c)(4).

participants at the same time. In addition, Nasdaq Rule 5745(d)(2)(C) provides additional circumstances that could result in a trading halt of ETMF Shares on the Exchange. If the IIV of a series of ETMF Shares is not being disseminated as required, Nasdaq may halt trading during the day in which the interruption to the dissemination of the IIV occurs. If the interruption to the dissemination of the IIV persists past the trading day in which it first occurred, Nasdaq will halt trading no later than the beginning of the trading day following the interruption. If Nasdaq becomes aware that the NAV per share with respect to a series of ETMF Shares is not calculated on each business day that the New York Stock Exchange is open for trading and disseminated to all market participants at the same time, it will halt trading in such series until such time as the NAV per share is available to all market participants. In addition, if Nasdaq becomes aware that the Composition File with respect to a series of ETMF Shares is not disseminated to all market participants at the same time, it will halt trading in such series until such time as the Composition File is available to all market participants.<sup>90</sup>

Further, under Nasdaq Rule 5745(g), if the investment adviser to an ETMF issuing ETMF Shares is a registered broker-dealer or is affiliated with a broker-dealer, such investment adviser must erect a “fire wall” between the investment adviser and the broker-dealer personnel or broker-dealer affiliate, as applicable, with respect to access to information concerning the composition and/or changes to such ETMF’s portfolio holdings. Nasdaq Rule 5745(g) further requires personnel who make decisions on the ETMF’s portfolio composition to be subject to procedures designed to prevent the use and dissemination of material, non-public information regarding the applicable ETMF portfolio. Lastly, Nasdaq Rule 5745(b)(4) requires that Nasdaq implement written surveillance procedures for ETMF Shares.

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<sup>90</sup> See Nasdaq Rule 5745(d)(2)(C).

As explained in more detail above, ETMFs will be traded using a novel and unique trading protocol called NAV-Based Trading. Orders to buy and sell ETMFs will be submitted to, and processed by, the Exchange in the customary manner for other exchange-traded securities, with the exception that the price limits for limit orders will be expressed relative to NAV rather than as an absolute dollar price. Further, the execution, reporting, clearance, and settlement of ETMF trades will be substantially the same as for other exchange-traded securities, except that the price of an execution will be expressed relative to NAV rather than as an absolute dollar price until the actual price is determined at the end of the day. Specifically, in NAV-Based Trading, all bids, offers, and execution prices will be expressed as a premium/discount (which may be zero) to the ETMF's next-determined NAV. Trades using NAV-Based Trading will be binding at the time orders are matched on Nasdaq's facilities, with the transaction prices contingent upon the determination of the ETMF's NAV at the end of the business day. All ETMF bids, offers, and trades will be reported intraday in real-time by the Exchange to the Consolidated Tape and separately disseminated to member firms and market data services through a proprietary Nasdaq data feed.

The opposing commenter raises several concerns about the potential for NAV-Based Trading to lead to investor confusion. Specifically, the opposing commenter believes that investors will be confused because they will not be trading at current market prices.<sup>91</sup> In addition, the opposing commenter believes that investors will be confused by the proxy price format.<sup>92</sup> The Commission believes that Nasdaq and Eaton Vance have made a number of representations regarding steps that will be taken to diminish the risk of investor confusion. For

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<sup>91</sup> See Precidian Letter at 2, supra note 11.

<sup>92</sup> See Precidian Letter at 4-5, supra note 11.

example, Nasdaq has committed to providing certain information regarding NAV-Based Trading to Nasdaq’s members and other market participants. The Exchange will provide members with a detailed explanation of NAV-Based Trading through a Trading Alert and will inform members of the special characteristics and risks associated with trading ETMF Shares in an information circular – both to be issued prior to the commencement of ETMF trading.<sup>93</sup>

Also with regard to the public availability of ETMF trading information, the Exchange represents that information regarding NAV-Based Trading prices and volumes will be continuously available for ETMFs on a real-time basis throughout each trading day on brokers’ computer terminals and through established electronic market data services.<sup>94</sup> Additionally, to avoid investor confusion, the Exchange and organizations offering ETMFs will work with the Exchange’s member firms and providers of market data services to ensure that representations of intraday bids, offers, and execution prices consistently follow an “NAV plus or minus” display format.<sup>95</sup> Further, the Commission notes that Nasdaq has represented that all ETMFs listed on the Exchange will have a unique identifier associated with their ticker symbols to clearly indicate that the Shares are traded using NAV-Based Trading.

With regard to the public availability of information on ETMFs for investors and other market participants, Eaton Vance represents that it will educate market participants about the features of ETMFs, the potential risks and benefits of investing in ETMFs, the features of NAV-Based Trading, and the distinction between IIV and NAV by posting educational materials on its

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<sup>93</sup> See Notice, supra note 3.

<sup>94</sup> Id.

<sup>95</sup> Id.

website and by including disclosure in fund prospectuses and marketing literature.<sup>96</sup> Further, Eaton Vance states that it is committed, along with distribution partners among major broker-dealers, registered investment advisors, and other fund sponsors to support and provide the marketplace with the materials, education, and training to ensure a successful ETMF investor experience.<sup>97</sup>

The Commission acknowledges the concerns expressed by the opposing commenter regarding investor understanding of how ETMFs will be priced and how they will trade.<sup>98</sup> As described above, however, the Exchange makes detailed representations regarding the education and information that will be available regarding ETMFs and the manner in which NAV-Based Trading will occur. Given all of the above representations, which are designed to address concerns about investor understanding of the products and how they will trade, the Commission believes that the proposal to allow for the listing and trading of ETMFs is consistent with the protection of investors and the public interest.

The opposing commenter also believes that NAV-Based Trading will cause all brokerage firms, vendors, the Consolidated Tape, and quotation system operators to have to significantly alter their systems.<sup>99</sup> The Commission recognizes that the implementation of NAV-Based Trading will necessitate some system modifications. Eaton Vance states its view, based on its

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<sup>96</sup> See Eaton Vance Letter at 3, supra note 8.

<sup>97</sup> See Eaton Vance Letter at 4, supra note 8.

<sup>98</sup> As noted above, the opposing commenter also stated its belief that ETMFs would likely not provide tax benefits and may cost more to operate than existing ETFs, while other commenters stated their views that ETMFs could offer investors a tax-efficient alternative to mutual funds and lower costs. See supra notes 25-30 and accompanying text. Similar to other investment decisions, investors will need to determine whether the tax-efficiency and costs are appropriate for them based on the particular facts and circumstances.

<sup>99</sup> See Precidian Letter at 5, supra note 11.



extensive discussions with broker-dealers and providers of market data services, that system modifications to accommodate the introduction of ETMF trading will be modest and can be achieved in a timely manner.<sup>100</sup> Nasdaq represents that the use of a proxy price format to facilitate NAV-Based Trading and to report intraday bids, offers, and trades for ETMFs to the Consolidated Tape will help to minimize the number of system modifications needed.<sup>101</sup> As such, the Commission notes that the Consolidated Tape should not require any changes to accommodate the trading of ETMFs. With respect to customer and brokerage order entry screens, the Commission notes that participating in ETMF trading is voluntary and only broker-dealers and market participants interested in trading ETMF Shares will need to perform any system changes.

The opposing commenter raises a concern that the pricing of ETMF Shares at the end of the day may cause funding problems for investor brokerage accounts and may cause difficulties for broker-dealers in calculating their net capital.<sup>102</sup> While the Commission recognizes that NAV-Based Trading presents certain issues for brokers to address with respect to managing their customer accounts and their net capital, the Commission does not believe that these issues are unique or insurmountable. For example, there are current order types, such as the market-on-close order type, where the final trade price is not determined until the end of the trading day, and broker-dealers have been able to implement procedures to manage their customer accounts and their net capital, despite the lack of an intraday trade price.

Finally, the opposing commenter raises a concern that inclusion of foreign stocks in an

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<sup>100</sup> See Eaton Vance Response Letter at 5, supra note 11.

<sup>101</sup> See Notice at notes 12-13 and accompanying text, supra note 3.

<sup>102</sup> See Precidian Letter at 3-4, supra note 11.

ETMF's portfolio will create problems in calculating the ETMF's NAV.<sup>103</sup> The opposing commenter states its view that, if a portfolio includes stocks that trade in different time zones, it may be impossible to accurately set the NAV until the foreign market opens for trading.<sup>104</sup> In response, Eaton Vance states that, comparable to mutual funds that contain foreign securities, ETMFs holding foreign securities would use fair value pricing procedures to determine the NAV.<sup>105</sup> The Commission agrees that ETMFs holding foreign securities would be able to use fair value pricing procedures to determine the NAV. However, the Commission notes that Nasdaq is not, at this time, proposing to list and trade any specific ETMF Shares under its ETMF listing standards and that, as required under proposed Nasdaq Rule 5745(b)(1), the Exchange must file separate proposals under Section 19(b) of the Act to list and trade ETMF Shares on Nasdaq.

The Commission further believes that the corresponding changes to other existing Nasdaq Rules appropriately accommodate the listing and trading of ETMF Shares on the Exchange and provide additional clarity regarding the applicability of Nasdaq Rules and therefore are consistent with the Act.

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rule and regulations thereunder applicable to a national securities exchange.

#### V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning

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<sup>103</sup> See Precidian Letter at 3-4, supra note 11.

<sup>104</sup> See id. at 3, supra note 11.

<sup>105</sup> See Eaton Vance Response Letter at 4, supra note 11.

the foregoing, including whether Amendment No. 1 to the proposed rule change is consistent with the Act. 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 e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2014-020 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2014-020. This file number should be included on the subject line if e-mail 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 website (<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 website 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 the filing 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-NASDAQ-2014-020 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Accelerated Approval of Proposed Rule Change, As Modified by Amendment No. 1

As discussed above, the Exchange submitted Amendment No. 1 to confirm that all ETMFs listed on the Exchange will have a unique identifier associated with their ticker symbols and that, in the systems used to transmit and process transactions in ETMF Shares, an ETMF's next-determined NAV will be represented by a proxy price.<sup>106</sup> Previously, the filing stated that Nasdaq expects all ETMFs listed on the Exchange to have a unique identifier associated with their ticker symbols and that Nasdaq expects an ETMF's next-determined NAV to be represented by a proxy price. Additionally, the Exchange removed references to ETMF entry and annual fees as the Exchange intends to address such fees in a separate filing.<sup>107</sup> The Commission believes that Amendment No. 1 provides certainty with respect to the ticker symbol and proxy price aspects of the proposed rule change. The Commission further believes that Amendment No. 1 does not materially affect the substance of the proposed rule change or raise any novel or unique regulatory issues. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>108</sup> for approving the proposed rule change, as modified by Amendment No. 1, prior to the 30<sup>th</sup> day after the date of publication of notice in the Federal Register.

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<sup>106</sup> See supra note 10.

<sup>107</sup> See id.

<sup>108</sup> 15 U.S.C. 78s(b)(2).

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>109</sup> that the proposed rule change (SR-NASDAQ-2014-020), as modified by Amendment No. 1 thereto, be, and it hereby is, approved on an accelerated basis.

By the Commission.

Kevin M. O'Neill  
Deputy Secretary

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<sup>109</sup> 15 U.S.C. 78s(b)(2).