SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74299; File No. SR-NASDAQ-2014-065)

February 18, 2015

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Approving a Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Adopt New Rule 5713 and List Paired Class Shares Issued by AccuShares® Commodities Trust I

I. Introduction

On June 11, 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")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to: (1) adopt listing standards for Paired Class Shares in new Rule 5713; and (2) list and trade Paired Class Shares ("Shares") issued by AccuShares® Commodities Trust I ("Trust") relating to the following funds pursuant to new Rule 5713: (a) AccuShares S&P GSCI® Spot Fund; (b) AccuShares S&P GSCI® Agriculture and Livestock Spot Fund; (c) AccuShares S&P GSCI® Industrial Metals Spot Fund; (d) AccuShares S&P GSCI® Crude Oil Spot Fund; (e) AccuShares S&P GSCI® Brent Oil Spot Fund; (f) AccuShares S&P GSCI® Natural Gas Spot Fund; and (g) AccuShares Spot CBOE® VIX® Fund (each individually, "Fund," and, collectively, "Funds").

The proposed rule change was published for comment in the Federal Register on June 23, 2014.[3] On August 6, 2014, pursuant to Section 19(b)(2) of the Act,[4] the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 72412 (June 17, 2014), 79 FR 35610 ("Notice").

4 15 U.S.C. 78s(b)(2).

change, or institute proceedings to determine whether to approve or disapprove the proposed rule change.[5] On September 18, 2014, the Commission instituted proceedings to determine whether to approve or disapprove the proposed rule change,[6] and on December 16, 2014, the Commission extended the deadline for Commission action until February 18, 2015.[7] The Commission received six comment letters regarding the proposal, including one from the Exchange and two from AccuShares Investment Management LLC ("Sponsor"), the sponsor of the Funds.[8] On February 10, 2015, the Exchange submitted Amendment No. 1 to the proposed rule change.[9]

This order approves the proposed rule change, as modified by Amendment No. 1 thereto.

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5 See Securities Exchange Act Release No. 72779, 79 FR 47162 (Aug. 12, 2014). The Commission designated a longer period within which to take action on the proposed rule change and designated September 19, 2014 as the date by which it should approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule change.

6 See Securities Exchange Act Release No. 73142, 79 FR 57150 (Sept. 24, 2014) ("OIP").

7 See Securities Exchange Act Release No. 73843, 79 FR 76428 (Dec. 22, 2014).

8 See Letter from Jack Fonss, CEO and Co-Founder of the Sponsor, to Kevin O'Neill, Deputy Secretary, Commission (Sept. 25, 2014) ("Sponsor Letter"); Letter from Robert E. Whaley, Valere Blair Potter Professor of Finance, Director, Financial Markets Research Center, Vanderbilt Owen Graduate School of Management, to Kevin O'Neill, Deputy Secretary, Commission (Oct. 8, 2014) ("Whaley Letter"); Letter from David B. Allen to Commission (Oct. 11, 2014) ("Allen Letter"); Letter from Mark Kassner to Commission (Oct. 13, 2014) ("Kassner Letter"); E-mail from Ned Cataldo, Chief Operating Officer and Co-Founder of the Sponsor, to Heather Seidel, Associate Director, Commission (Oct. 24, 2014) ("Sponsor E-mail"); Letter from Jurij Trypupenko, Associate General Counsel, Exchange, to Brent J. Fields, Secretary, Commission (Oct. 28, 2014) ("Exchange Letter"). All comment letters are available at: http://www.sec.gov/comments/sr-nasdaq-2014-065/nasdaq2014065.shtml.

9 In Amendment No. 1, the Exchange (a) corrected references to the entity that will be calculating and publishing the CBOE Volatility Index®, (b) deleted Commentary .05 to Rule 5713 due to its inapplicability to Paired Class Shares, and (c) made technical re-numbering changes to Rule 5713 as a result of the deletion of Commentary .05. Amendment No. 1 provided clarification to the proposed rule change, and because it does not materially affect the substance of the proposed rule change, Amendment No. 1 is not subject to notice and comment.

II. Description of the Proposal

The Exchange proposes to adopt new Rule 5713, which permits the listing of Paired Class Shares, and to list and trade Shares of the Funds.

A. General Description of Paired Class Shares[10]

Paired Class Shares will be structured with the objective of providing investors with exposure to changes in an index or other numerical variable ("Underlying Benchmark"). Paired Class Shares will be issued by a trust on behalf of a fund, and each fund will be a segregated series of that trust.[11] Paired Class Shares will have values that are based on an Underlying Benchmark where the value of the underlying benchmark reflects the value of assets, prices, price volatility, or other economic interests ("Reference Asset").[12]

The trust for each fund of Paired Class Shares will always issue and redeem Paired Class Shares in pairs of shares of opposing classes of each fund: Up Shares and Down Shares. The values of the opposing classes will move in opposite directions as the value of the fund's Underlying Benchmark varies from its starting level. Up Shares will be positively linked to the fund's Underlying Benchmark, and Down Shares will be negatively linked to the fund's Underlying Benchmark.[13] The rate of linkage or leverage of a fund's Up Shares and Down Shares performance to the performance of the fund's referenced Underlying Benchmark will be

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10 A complete description of Rule 5713 and Paired Class Shares can be found in the Notice, supra note 3.

11 See NASDAQ Rule 5713(c).

12 See id. The Exchange states that other economic interests would include, for example, currencies, interest rates, non-investable economic indices, and other measures of financial instrument value. See Notice, supra note 3, 79 FR at 35611, n.11. The Exchange will file separate proposals under Section 19(b) of the Act before listing and trading each series of Paired Class Shares. See Commentary .02 to NASDAQ Rule 5713.

13 See NASDAQ Rule 5713(c).

one-to-one.[14] Each fund will use a mathematical formula to calculate the liquidation value attributable to each of its classes of Paired Class Shares ("Class Value") and to each share of each class ("Class Value per Share").[15]

Each fund will engage in regular distributions[16] and may also engage in special distributions[17] or corrective distributions.[18] Immediately after each distribution, the fund's

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[14] See Notice, supra note 3, 79 FR at 35611.

[15] See id. The Exchange represents that the mathematical formula is based on the following factors: (1) the value of the fund's assets; (2) the allocation of that value based on changes in the level of the fund's Underlying Benchmark, which may be limited, reduced, capped, or otherwise modified according to formula or pre-set parameters; and (3) the daily accrual of gain and income or loss on the assets of the fund, less the liabilities of the fund, as such gains, income losses, and liabilities are allocated to each class of the fund. See id. at n.12.

[16] On a scheduled basis, funds would make regular distributions, paying a dividend to the class of shares that had increased in value since the last distribution. According to the Exchange, regular and special distributions will be made in the form of cash during the first six months of trading in Paired Class Shares. Thereafter, each fund will pay all or any part of any regular or special distribution in Paired Class Shares instead of cash, where further cash distributions would adversely affect the liquidity of the market for the fund's shares or impact the fund's ability to meet minimum Exchange distribution requirements. See id. at 35619 (further stating that all payments made in Paired Class Shares will be made in equal numbers of Up and Down Shares, and that, to the extent a share distribution would result in the distribution of fractional Paired Class Shares, cash in an amount equal to the value of the fractional Paired Class Shares will be distributed rather than fractional Paired Class Shares).

[17] Funds would make special distributions when movement in the Underlying Benchmark exceeded a specified rate of change since the previous distribution. Special Distributions are designed to prevent rapid movements in the Underlying Benchmark from transferring all value in the fund either to the Up Shares or to the Down Shares. See id. (describing regular and special distributions to be made in the form of cash during the first six months of trading in Paired Class Shares, and thereafter, in Paired Class Shares instead of cash).

[18] Funds would make corrective distributions when the trading price of a class of shares deviates from its class value by a specified amount for a specified period. Corrective distributions are designed to prevent the Up Shares and Down Shares from becoming locked in a persistent state of equal and opposite deviations from class value. In a

Underlying Benchmark participation or exposure will be reset, and the fund's Class Value per Share for each of its classes will be set to equal the lowest Class Value per Share of the two classes of Paired Class Shares.

Paired Class Shares of a fund will be created and redeemed in specified aggregations of equal quantities of Up Shares and Down Shares[19] at their respective Class Values per Share. Paired Class Shares can only be created or redeemed by authorized participants ("Authorized Participants").[20] Paired Class Shares creation and redemption transactions will only occur (a) for cash consideration, and (b) in equal pre-determined quantities of Up Shares and Down Shares.

B. The Exchange's Description of the Funds

The Exchange has made the following representations and statements in describing, among other things, the Funds, the corresponding Underlying Benchmarks, arbitrage, and distributions.[21]

The Shares will be offered by the Trust, which is a Delaware statutory trust.[22] Wilmington Trust, N.A., a national banking association, will serve as the trustee ("Trustee") and

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corrective distribution, a fund will issue each holder of Up Shares an equal number of Down Shares, and each holder of Down Shares an equal number of Up Shares.

19 A Creation Unit for each Fund will comprise 25,000 Up Shares and 25,000 Down Shares. See id. at 35612, n.14.

20 See id. at 35612.

21 The Commission notes that additional information regarding the Trust, the Funds, and the Shares, including risks, information relating to the Underlying Benchmarks and Reference Assets, Class Value and Class Value per Share calculations, creation and redemption procedures, trading halts and pauses, applicable Exchange trading rules, surveillance, information circulars, fees, disclosure policies, distributions, and taxes, among other information, is included in the Notice and the Registration Statement, as applicable. See Notice, supra note 3, and Registration Statement, infra note 22, respectively.

22 The Exchange states that the offer and sale of Paired Class Shares of each Fund will be registered with the Commission by means of the Trust's registration statement on Form

the investment advisor ("Investment Advisor") for each Fund. The Investment Advisor, which is chosen by the Sponsor, is responsible for investing each Fund's available cash in bills, bonds, and notes issued and guaranteed by the United States Treasury ("United States Treasury Securities") with remaining maturities of 90 days or less ("Eligible Treasuries") and over-night repurchase agreements collateralized by United States Treasury Securities ("Eligible Repos," and together with cash and Eligible Treasuries, collectively, "Eligible Assets"). State Street Bank and Trust Company ("State Street"), a Massachusetts trust company, will serve as the custodian, administrator, and transfer agent ("Custodian," "Administrator," or "Transfer Agent") for each Fund.[23]

The Underlying Benchmark of each Fund, other than the AccuShares Spot CBOE VIX Fund ("VIX Fund"), is constructed, calculated, and published by S&P® Dow Jones Indices LLC ("Index Provider").[24] The CBOE Volatility Index® ("VIX"), which is the Underlying

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S-1 under the Securities Act of 1933 ("Securities Act"). According to the Exchange, the Registration Statement was filed on March 18, 2014 and will be effective as of the date of such offer and sale. See Notice, supra note 3, 79 FR at 35615. The Commission notes that a pre-effective amendment No. 1 to the registration statement ("Registration Statement") was filed on July 17, 2014 (File No. 333-194666).

23 The Custodian will hold each Fund's securities and cash and will perform each Fund's Class Value and Class Value per Share calculations. As Administrator, State Street will, among other things, perform or supervise the performance of services necessary for the operation and administration of the Funds (other than making investment decisions or providing services provided by other service providers), including accounting and other fund administrative services. As Transfer Agent, State Street will, among other things, provide transfer agent services with respect to the creation and redemption of Creation Units. The Transfer Agent will receive from Authorized Participants creation and redemption orders and deliver acceptances and rejections of such orders to Authorized Participants as well as coordinate the transmission of such orders and instructions among the Sponsor and the Authorized Participants.

24 The Underlying Benchmarks for all of the Funds other than the VIX Fund are: (1) the S&P GSCI Spot index; (2) the S&P GSCI Agricultural and Livestock Spot index; (3) the S&P GSCI Industrial Metals Spot index; (4) the S&P GSCI Crude Oil Spot index; (5) the

Benchmark of the VIX Fund, is calculated and published by CBOE. According to the Exchange, both the Index Provider and CBOE are unaffiliated with the Trust and the Sponsor.[25] To the extent that an Underlying Benchmark is maintained by a broker-dealer or investment advisor, such broker-dealer or investment advisor will erect a "firewall" around personnel who have access to information concerning changes and adjustments to the Underlying Benchmark.[26]

As described above, the Trust will issue Shares on behalf of each Fund in offsetting pairs, where one constituent of the pair, the Up Shares, is positively linked to the Fund's Underlying Benchmark, and the other constituent, the Down Shares, is negatively linked to the Fund's Underlying Benchmark. Once created, a Fund's Paired Class Shares will trade independently of each other on the Exchange. The cash proceeds from the creation of Paired Class Shares may be held by a Fund only in Eligible Assets designed to preserve capital while earning an investment return that is consistent with the preservation of capital. Upon any redemption of a Fund's Creation Units by an Authorized Participant, the cash of the Fund will be used to pay the proceeds of the redemption to the redeeming Authorized Participant.

Each Fund engaging in a regular distribution,[27] a special distribution,[28] a corrective distribution,[29] or a net income distribution[30] will provide at least three business days' advance

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S&P GSCI Brent Crude Oil Spot index; and (6) the S&P GSCI Natural Gas Spot index, (collectively, "S&P GSCI Commodity Indices").

25 See Notice, supra note 3, 79 FR at 35615.

26 See id.

27 See supra note 16.

28 See supra note 17.

29 See supra note 18.

30 In a net income distribution, cash is distributed to investors based on income (after expenses) from the financial instruments held by the Fund.

notice (or longer advance notice as may be required by the Exchange)[31] of such an event. Each Fund engaging in a share split[32] will provide at least ten calendar days' advance notice (or longer advance notice as may be required by the Exchange) of such an event. In each instance, the Sponsor will notify the Exchange, and post a notice of such event and its details on the Sponsor's website (www.AccuShares.com). For regular distributions that occur on schedule, the Sponsor will cause a press release to be issued identifying the receiving class, the amount of cash, the amount of Paired Class Shares (if any), and any other information the Sponsor deems relevant regarding the distribution and will post this information on the Sponsor's website. With respect to special distributions, corrective distributions, and share splits, the information provided will include the relevant ex-, record, and payment dates for each such event and relevant data concerning each such event. These events will also be reported in press releases, on the Sponsor's website, and in current reports on Form 8-K as material events, as well as in the Fund's periodic reports.

C. Summary of the Comments

In the OIP, the Commission posed questions regarding the proposed rule change. Commenters responded to those questions and offered other comments as well. The comments are summarized below.

31 The Exchange states that it may determine that a longer notice is advisable in certain circumstances (e.g., an extended, or unexpected, market break).

32 Reverse share splits will be declared to maintain a positive Class Value per Share for either the Up Shares or the Down Shares of an AccuShares Fund should the Class Value per Share of either class approach zero. Reverse share splits are expected to occur in the context of special distributions and are expected to be triggered after Class Value per Share declines below a specified dollar threshold as set forth in the applicable Fund prospectus.

1. The Effect of the Distributions on the Premiums and Discounts Between the Trading Price and Class Value Per Share

In response to Commission questions about the effect of the Funds' distributions on premiums and discounts,[33] the Sponsor asserts that the presence of regular, special, and corrective distributions will aid in the reduction of premiums and discounts.[34] With regard to both regular and special distributions, the Sponsor asserts that a Fund will make these types of distributions based on the movement of the Underlying Benchmark since the last distribution date, and will then reset the index to the current market level.[35] According to the Sponsor, two positive effects relating to potential discounts or premiums from regular and special distributions are: (1) an investor will enjoy an actual distribution relating to the index move rather than having to rely on trading out of an intrinsic gain that could be subject to market lags, frictions, or a lack of realizable trading price responsiveness; and (2) the index reset will re-equate the intrinsic share prices, having the effect of further highlighting any deviations between trading prices and Class Values, and consequently all investors (not just market professionals) will more clearly observe any premium or discount, and any investor can execute a trade in response to these deviations.[36]

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33 See OIP, supra note 6, 79 FR at 57157.

34 See Sponsor Letter, supra note 8, at 4. Similarly, the Exchange states that the corrective distribution feature is designed to prevent losses that have occurred in other ETPs in the past. See Exchange Letter, supra note 8, at 22-23. See also Notice, supra note 3, 79 FR at 35611 ("Immediately after each regular, special and corrective distribution, the Fund's Underlying Benchmark participation or exposure will be reset and the Fund's Class Value per Share for each of its classes will be set to equal the lowest Class Value per Share of the two classes of Paired Class Shares.").

35 See Sponsor Letter, supra note 8, at 4.

36 See id.

The Sponsor states its view that almost all premium and discount combinations of the Up Shares and Down Shares of a Fund will be readily cured by conventional arbitrage. According to the Sponsor, the corrective distribution is an investor safety feature, above and beyond conventional arbitrage, designed to remedy those unique scenarios where the material discount amount of one Fund share is exactly equal to the material premium amount of the opposing share.[37]

The Sponsor states that the corrective distribution[38] is expected to have both a preventative effect and a curative effect relating to premiums and discounts between trading prices and Class Values per Share.[39] The Sponsor asserts that the possibility of a corrective distribution will disincentivize market participants from buying or selling shares at material premiums or discounts to the Class Values per Share.[40] Relating to the curative impact, the Sponsor states that following the corrective distribution: (1) the discount class holder, potentially stranded by low available bid prices, would have the correct aggregate value (inclusive of index movements) in a 50/50 position in the discount shares and premium shares; and (2) a premium class holder would also have the correct aggregate value (inclusive of index movements) in a 50/50 position in discount shares and premium shares.[41] The Sponsor asserts that these positions would be unaffected by a single share class premium or discount, and would be readily saleable

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37 See id.

38 A corrective distribution will result in: (1) the investors holding the share class associated with the favorable index move to realize a gain equal to the realized move in the index; and (2) all investors receiving an equal quantity of each share class of a Fund. See id. at 5.

39 See id. at 4.

40 See id.

41 See id. at 5.

at a stable and readily identifiable price (especially because the Fund is limited to holding cash equivalents).[42] Authorized Participants, the Sponsor notes, may redeem these positions in sufficient aggregate amount.[43]

One commenter, who recommends that the Commission approve the proposed rule change, asserts that the regular, special, and corrective distributions will help prevent the significant premiums and discounts that have occurred in other ETPs in recent years.[44]

Another commenter expressed concern that the structure of Paired Class Shares will result in persistent premiums and discounts that will fundamentally invalidate the premise of the products in the market, making them misleading to investors.[45] This commenter asserts that the arbitrage mechanism will not work to keep each of the products trading closely to its intrinsic value; instead, the commenter argues that the arbitrage mechanisms will, in theory, keep the sum of the discount on one class and the premium on the other at zero. The commenter states its view that it is not economically possible to maintain intrinsic value in the secondary market, and predicts that any attempt to do so will lead to massive speculation in the products until they are pushed to a breaking point, at which point less-sophisticated investors will suffer significant losses.[46] To support these conclusions, the opposing commenter provides a number of hypothetical situations involving the trading relationship between the VIX index, VIX futures,

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42 See id.

43 See id.

44 See Whaley Letter, supra note 8, at 1-2.

45 See Kassner Letter, supra note 8, at 1.

46 See id. This commenter further states that, while his assertions regarding the possibility of persistent premiums and discounts and the potential failure of an effective arbitrage mechanism for Paired Class Shares focus on the proposed VIX Fund and VIX futures, the commenter points out that the same economic principles apply to any futures. See id.

and the proposed VIX Fund.[47] According to the commenter, the core of the issue is that the products are simply not hedgeable.[48] The commenter predicts that there will be very significant arbitrage pressures attempting to exploit the "economic perversity of the products" and significant activity around prices that reflect a corrective distribution.[49]

The Exchange asserted that underlying the opposing commenter's arguments regarding ineffective arbitrage is the misunderstanding that spot levels and futures levels are equivalent and interchangeable.[50] The Exchange agrees that global markets will be broadly inter-related, including spot markets, futures markets, stock markets, and bond markets, but argues that, in the case of volatility, and VIX in particular, the spot market is not "in line" and directly comparable with VIX futures prices.[51] To support this assertion, the Exchange cites guidance from the CBOE VIX Primer Basics on the educational section of CBOE's website.[52] Additionally, the Exchange states that, contrary to the assumptions implicit in the opposing commenter's numerical examples, the Fund's creations, redemptions, and other operations are not limited by VIX futures expiration dates.[53] The Exchange asserts that, uniquely, the intrinsic Class Values of the Funds

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47 See id. at 1-3.

48 See id. at 2.

49 See id.

50 See Exchange Letter, supra note 8, at 17.

51 See id. at 18. The Exchange asserts that the willingness of market participants to trade options overlying both the spot VIX and VIX futures demonstrates that the market understands the differences between spot VIX and the range of VIX futures prices. See id. at 19.

52 See id. at 18.

53 See id. at 16, n.28, 18.

are not dependent upon successful trading, rolling, or otherwise rebalancing of securities or futures contracts.[54]

The Exchange also asserts that one part of the arbitrage process for Paired Class Shares will operate the same way as it does for all exchange-traded funds ("ETFs"); namely, a share trading above or below an intrinsic Class Value can be transacted, hedged, and traded. Paired Class Shares have an additional arbitrage mechanism, according to the Exchange: intra-fund arbitrage—through the valuation and trading of both Up and Down Shares—limits the discounts, premiums, or any combination thereof of the share classes to a value indicated by the readily determinable net asset value of the Fund's cash equivalent assets.[55] The Exchange argues that arbitrage opportunities are uniquely easy to identify because of the direct observability of the Underlying Benchmark, the direct linkage of the intrinsic Class Values to the Underlying Benchmark, and the simplicity and very limited number of the moving parts in a creation or redemption—i.e., the two Fund Share prices versus the readily determinable value of the Fund's cash equivalent assets.[56]

2. <u>The Ability of Investors to Understand the Operation of the Funds</u>

The Sponsor asserts that retail investors and other market participants will be able to understand the Fund's redemption mechanics and the types and timing of distributions.[57] Generally, the Sponsor states that the Funds' distributions are limited to scheduled dates or the

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54 <u>See</u> <u>id.</u> at 17.

55 <u>See</u> <u>id.</u>

56 <u>See</u> <u>id.</u>

57 <u>See</u> Sponsor Letter, <u>supra</u> note 8, at 6.

occurrence of large and rare underlying index moves.[58] The Sponsor asserts that movements of the underlying indexes will be easy to track using public sources and therefore concludes that investors will have the information necessary to transact in the Shares and respond to distributions.[59] In addition, the Sponsor represents that the consensus of qualified investors and market makers is that the frequency of the Funds' distributions is consistent with customary review (e.g., monitoring prices and returns) and customary reevaluation of share positions.[60]

The Sponsor states that the prospectus contains detailed examples, and the Funds' website will contain infographics describing each distribution as well as the courses of action available to investors.[61] The Sponsor also states that, except in limited and unanticipated conditions (listed in the prospectus), regular and special distributions will be made to shareholders in cash, and therefore investors will generally be making a straightforward decision with respect to deploying or maintaining received cash.[62] With respect to corrective distributions, the Sponsor states that they are a direct response to retail investor experiences in ETPs where obscure technical forces or market illiquidity have caused both large premiums and large discounts to persist.[63] The Sponsor asserts that these distributions, as a self-policing and self-

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58 See id. at 2.

59 See id.

60 See id. The Sponsor states that its opinions and views expressed in the Sponsor Letter were informed by conversations with the Exchange, prospective authorized participants, other market makers, traders, and qualified investors. See id.

61 See id. at 6.

62 See id.

63 See id.

corrections measure, are an alternative to real-time estimates of indicative portfolio values, which investors may not necessarily consider before transacting in ETP shares.[64]

The Sponsor also states that: (1) corrective distributions are expected to be rare; (2) without them, retail investors otherwise may be exposed to either paying a material premium relating to a purchase or suffering a material discount relating to a sale of Shares; (3) before receipt of a distribution, investors will see a Form 8-K, a notice from the Exchange, and a notice on the Fund's website; and (4) upon receipt of a corrective distribution, investors may take any of the following actions, all of which the Sponsor asserts are not materially different from the options available to investors upon the receipt of cash or shares from any distribution or traditional corporate action: (a) sell their entire positions for cash, (b) sell a portion of their positions for cash for a modulated exposure to the Fund index, or (c) sell part of a position and reinvest proceeds to maximize a particular market exposure.[65] According to the Sponsor, prospective investors view the corrective distribution feature as an effective balance of "newness" and "benefit" for the entire range of Fund shareholders.[66] The Sponsor states that the corrective distribution is expected to encourage more active and accurate market making and more liquidity-enhancing position-taking by Authorized Participants, all of which are more likely to actually reduce the likelihood and occurrences of a corrective distribution declaration.[67]

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64 See id.

65 See id. at 6-7.

66 Specifically, the Sponsor states that, while prospective participants with expertise in retail investing believed the corrective distribution feature to be engineered solely for the benefit of the retail investor and questioned whether institutional traders would lose profitable trading opportunities, market makers (including Authorized Participants) applauded the addition of a corrective distribution. See id. at 7. See supra note 60 (regarding with whom the Sponsor consulted).

67 See id.

The opposing commenter asserts that, because of the persistent premiums and discounts he predicts, investors would have to be extremely diligent in tracking their positions because the Up Shares might frequently turn into both Up Shares and Down Shares, which would result in inattentive investors paying fees to the issuer but not receiving any notional exposure whatsoever.[68] According to the commenter, an investor in the Shares would require extensive knowledge of the financial markets to understand why, when being required to re-enter the market after a distribution to reestablish a position, the product could be trading already at a significant premium or discount.[69] The commenter also states its view that the investor would have to have intimate knowledge of the VIX futures market to understand from where the premium or discount was actually derived.[70] The opposing commenter states that investors would likely receive Shares with the opposite economics for some distributions, and predicts that this would confuse them.[71] The commenter distinguishes regular share distributions, with which the commenter concedes investors are familiar, by stating that Share distributions would include Shares with the opposite economics and different tickers.[72] Further, the opposing commenter asserts that, unlike products that trade at or close to their intrinsic value, an investor in Shares needs to know a considerable amount of information at every point in time when investing in the product, including for example the coefficient of variation and the number of days there has been a premium or discount (in light of the corrective distribution threshold).[73] The opposing

68 See Kassner Letter, supra note 8, at 3.

69 See id.

70 See id.

71 See id.

72 See id.

73 See id. at 4.

commenter also asserts that the investor also must check his or her account every day, to see if there has been a Special Distribution, and on every Distribution Date, to see what is in his or her account (i.e., whether there is cash or a neutral basket, which may be subject to fees).[74]

3. The Ability of Investors to Understand the Funds' "Resets" to the Then-Current Reference Index Value

The Sponsor states its view that the Funds are similar to comparable ETPs in the market and that, accordingly, it expects that both retail investors and other market participants will understand the effect of resets (which will occur when regular, special, or corrective distributions are made) on their investments in a Fund.[75] The Sponsor states that in other comparable ETFs and exchange-traded notes ("ETNs") the impact of resetting comes through the re-trading of futures, options, or other contracts either daily, monthly, or on another cycle, and that this conventional resetting has transaction costs that are often difficult to isolate within the context of overall fund performance.[76] Additionally, according to the Sponsor, because the traditional method of resetting is accomplished through the trading of underlying positions at telegraphed times under prescribed fund rules, ETFs and ETNs can be disadvantaged from having to be a "price taker" in possibly adverse or challenging markets.[77] The Sponsor states that the Funds' resets allow the Funds to reduce their transaction expenses and eliminate the need to transact in underlying positions. The Sponsor also asserts that individual investors will be able to more easily track and monitor the resets of the Funds than the resetting impact in conventional funds.[78]

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74 See id.

75 See id. at 7.

76 See id.

77 See id. at 7-8.

78 See id. at 8.

A supporting commenter asserts that the Funds would deliver exact holding period returns, which he contrasts to the returns of levered and inverse funds that implicitly rebalance daily and which he asserts can be a source of confusion for retail customers.[79]

4. The Adequacy of the Exchange's Suitability Rules

The Sponsor states its view that the Exchange's rules governing sales practices adequately ensure the suitability of recommendations regarding the Shares and that enhancement is unnecessary.[80] The Sponsor states that NASDAQ Rule 2111A requires that an exchange member have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the exchange member to ascertain the customer's investment profile.[81] According to the Sponsor, a customer's investment profile would, in general, include the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, and risk tolerance.[82] The Sponsor also states that the rule explicitly covers recommended investment strategies involving securities, including recommendations to "hold" securities.[83]

The Sponsor also discusses the Exchange's information circular. Prior to the commencement of trading of Fund shares, the Exchange will inform its members through an information circular of the suitability requirements of NASDAQ Rule 2111A. Specifically the information circular will remind members that, in recommending transactions in Shares, they

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79 See Whaley Letter, supra note 8, at 2.

80 See Sponsor Letter, supra note 8, at 8, 9.

81 See id. at 8.

82 See id.

83 See id.

must: (1) have a reasonable basis to believe that (a) the recommendation is suitable for a customer given reasonable inquiry concerning the customer's investment objectives, financial situation, needs, and any other information known by such member, and (b) the customer can evaluate the special characteristics and is able to bear the financial risks of an investment in the shares; and (2) make reasonable efforts to obtain the following information: (a) the customer's age; (b) the customer's other investments; (c) the customer's financial situation and needs; (d) the customer's tax status; (e) the customer's investment objectives, experience, time horizon, liquidity needs and risk tolerance; and (f) such other information used or considered to be reasonable by such members or registered representatives in making recommendations to the customer.[84]

5. The Relationship Between the Funds' Holdings and Their Investment Objective

The Sponsor states its view that investors will understand that the Funds hold cash and cash equivalent securities, and the Cash Values per Share will be directly responsive to changes in the underlying index.[85] The Sponsor asserts that ETNs are similar to the Shares in that an ETN does not have identified "portfolio assets" and that this aspect of ETNs has been well understood.[86]

The Sponsor asserts that the Funds' structure is appropriate, and will result in certain advantages: (1) lower fund operating costs, because the Class Value per Share amounts are

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84 See id. at 8-9. In its comment letter, the Exchange repeated the Sponsor's statements regarding the Exchange's rules and information circular. See id. at 13-14.

85 See id. at 9.

86 See id. The Sponsor, however, distinguishes the Shares from ETNs in that, with ETNs, an investor is subject to the performance risk of the obligor and a market maker is subject to ETN creation and redemptions processes which are sometimes less standardized than ETF processes. See id. at 10.

directly related to an independent and readily observable index and there is no need for a Fund to incur trading costs over assets in an effort to track the index; (2) improved fund performance transparency, because the return of Shareholders will not be impacted by transactions costs that are difficult to observe and underlying assets whose pricing is opaque; (3) a higher certainty of redemption values because the Shares will be readily created and redeemed at a certain and readily determinable value, thereby eliminating the frictions often caused where (a) a potentially large number of in-kind securities are challenging to value or (b) a cash creation or redemption is based on trading illiquid securities or trading securities in a fast-moving market; and (4) direct indexing, which the Sponsor states prospective investors believe to be more easily followed through readily observable and free data services.[87]

6. Other Comments

One commenter recommends that the Commission approve the proposed rule change because, in its view, the AccuShares' products are simple and transparent, and will provide investors, institutions and retail customers alike with the returns that they want.[88] He also recommends approval of the proposed rule change because: (1) the Shares would provide exposure to spot market benchmarks that are popular to large segments of the asset management community; (2) the Up Shares and Down Shares are direct investments that track readily-observable spot market benchmarks, unlike the futures indexes, which he characterizes as complicated dynamic futures trading strategies; (3) changes in the values of the Up Shares and Down Shares would be purely mechanical and would correspond directly to the price changes in the underlying index, which is distinctly different from many current products; (4) unlike ETNs,

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[87] See id. at 9-10.

[88] See Whaley Letter, supra note 8, at 2.

investors in the Funds would have no credit risk; and (5) actively-managed products add market complexity, and the Paired Class Shares would not be actively-managed.[89]

Similarly, another commenter asserts that the Funds would be both highly relevant to a wide range of investors and highly approachable to all of them.[90] He asserts that indexes underlying the Funds are arguably better for individual investors because they are easier to follow than the indexes that underlie some existing products.[91] This commenter also asserts that the market has been clamoring for better spot market proxies since the beginning of the ETF market.[92] Further, the commenter recommends approval of the proposed rule change because the "best ETFs also help solve existing structural problems for traders and investors regarding term structure of price and/or volatility, beta to cash prices and tracking errors, and rebalancing inefficiencies…"[93]

The opposing commenter asserts that the premiums and discounts, which he predicts will result in corrective distributions that are more frequent than the Exchange has suggested, will

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89 See id. at 1-2.

90 See Allen Letter, supra note 8.

91 See id.

92 See id.

93 Id.

result in high implicit fees and large tracking errors.[94] He argues that the products are not suitable for any investor.[95]

In response, the Exchange asserts that the Daily Amount is not a charge, fee, or amount that leaves the Fund, but rather is an amount applied to both share classes.[96] The Exchange characterizes the Daily Amount as "one of the unique structural features of the Funds which leads to complete transparency of intrinsic Class Value entitlements."[97]

III. Discussion and Commission's Findings

After careful consideration, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[98] In particular, and as discussed further below, the Commission finds that the proposed rule change is consistent with: (1) the requirements of Section 6(b)(5) of the Act,[99] which requires, among other things, that the Exchange's rules be designed to promote just and equitable principles of trade; to foster cooperation and coordination with persons

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94 See Kassner Letter, supra note 8, at 3. For example, the commenter characterizes the "Daily Amount" as a fee. During any single distribution measurement period that starts with the prior distribution date and to create a balanced market for the Up Shares and Down Shares of the VIX Fund, the Class Value per Share of each Up Share of the VIX Fund will be reduced and the Class Value per Share of each Down Share of the VIX Fund will be increased by an additional daily amount, the "Daily Amount." See Notice, supra note 3, 79 FR at 35617. The opposing commenter asserts that the investors in the Up Shares of the VIX Fund will be charged will be charged 4.5% in Daily Amount charges.

95 See Kassner Letter, supra note 8, at 3.

96 See Exchange Letter, supra note 8, at 19.

97 Id. at 22.

98 In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

99 15 U.S.C. 78f(b)(5).

engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest; and (2) Section 11A(a)(1)(C)(iii) of the Act,[100] which sets forth Congress' finding that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities.

A. NASDAQ Rule 5713

NASDAQ Rule 5713 sets forth provisions regarding the listing and trading of Paired Class Shares on the Exchange. The rule defines Paired Class Shares,[101] establishes specific recordkeeping and reporting requirements for registered market makers in Paired Class Shares,[102]

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100 15 U.S.C. 78k-1(a)(1)(C)(iii).

101 See NASDAQ Rule 5713(c). The operation of Paired Class Shares is described above. See supra section II.A.

102 In accordance with NASDAQ Rule 5713(h), market makers in Paired Class Shares must file with the Exchange and keep current a list identifying all accounts for trading in the applicable securities or physical commodities included in, or options, futures or options on futures on, the Reference Asset of the Underlying Benchmark of any Paired Class Shares or any other derivatives based on such Reference Asset or based on any security or Reference Asset included in the Underlying Benchmark, which the registered market maker may have or over which it may exercise investment discretion. In addition, market makers are prohibited from trading in the applicable securities or physical commodities included in, or options, futures or options on futures on, the Reference Asset of the Underlying Benchmark of any Paired Class Shares or any other derivatives based on such Reference Asset or based on any security or Reference Asset included in the Underlying Benchmark, in an account in which a market maker, directly or indirectly, controls trading activities, or has a direct interest in the profits or losses thereof. See NASDAQ Rule 5713(h)(i). In addition, market makers in Paired Class Shares are required to make available to the Exchange any and all books, records, or other information pertaining to transactions by such entity or registered or non-registered employee affiliated with such entity for its or their own accounts for trading the applicable securities or physical commodities included in, or options, futures or options on futures on, the Reference Asset

and sets forth initial and continued listing criteria, some of which are more fully discussed below.[103] In addition, Commentary .05 to Nasdaq Rule 5713 states that the Exchange will implement written surveillance procedures for trading Paired Class Shares.[104]

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of the Underlying Benchmark of any Paired Class Shares or any other derivatives based on such Reference Asset or based on any security or Reference Asset included in the Underlying Benchmark, as may be requested by the Exchange. See NASDAQ Rule 5713(h)(ii).

103 The Commission notes that any securities listed in the future under NASDAQ Rule 5713 must be the subject of a rule filing by the Exchange under Section 19(b) of the Exchange Act—providing the Commission with the opportunity to review and to approve or disapprove that rule filing—and that all securities listed under NASDAQ Rule 5713 will be subject to the full set of bylaws and other rules and procedures of the Exchange. While Nasdaq Rule 5713(e) provides that Paired Class Shares may have values based on assets, prices, price volatility, or other economic interests, such as currencies, interest rates, non-investable economic indices, and other measures of financial instrument value, the specific products approved for listing pursuant to this order will have values based on price volatility and commodity indices. The Commission staff will consider any future proposals to list products under Nasdaq Rule 5713 with values based on these and other types of benchmarks and reference assets, evaluating the specific facts and circumstances associated with each proposal under Section 19(b) of the Exchange Act. Further, the Commission staff will continue to analyze the development of exchange-traded products and their impact on market structure and will monitor the development of the market for Paired Class Shares.

104 The Exchange stated that trading in Paired Class Shares will be subject to the existing trading surveillances, administered by both the Exchange and FINRA on behalf of the Exchange, which are designed to detect violations of Exchange rules and applicable federal securities laws. See Notice, supra note 3, 79 FR at 35621. FINRA surveils trading on the Exchange pursuant to a regulatory services agreement, and the Exchange is responsible for FINRA's performance under this regulatory services agreement. See Notice, supra note 3, 79 FR at 35621, n.51. The Exchange represented that FINRA, on behalf of the Exchange, will communicate as needed regarding trading in the Paired Class Shares and in the securities in which the Fund will invest with other markets and other entities that are members of the Intermarket Surveillance Group ("ISG") or with which the Exchange has in place a comprehensive surveillance sharing agreement. See Notice, supra note 3, 79 FR at 35621. Additionally, the Exchange represented that FINRA may obtain trading information regarding trading in the Shares from markets and other entities that are members of the ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement. See Notice, supra note 3, 79 FR at 35621. For a list of the current members of ISG, see http://www.isgportal.org/.

Pursuant to NASDAQ Rule 5713(f)(i)(B), the Exchange will obtain a representation from the Trust on behalf of each Fund that the Class Value per Share of each of its Up Shares and Down Shares will be calculated daily and that these Class Values per Share and information about the assets of the Fund will be made available to all market participants at the same time.[105] NASDAQ Rule 5713(f)(ii)(B) permits the Exchange to suspend trading in or remove from listing Paired Class Shares whose Underlying Benchmark, or a substitute or replacement Underlying Benchmark based on the same Reference Asset,[106] is no longer calculated or available on at least a 15-second delayed basis during the Regular Market Session from a major market data vendor unaffiliated with the sponsor, the custodian, the trustee of the Trust, the Fund, or NASDAQ. Further, NASDAQ Rule 5713(f)(ii)(C) permits the Exchange to suspend trading in or remove from listing Paired Class Shares whose Class Value per Share becomes no longer available on a daily basis to all market participants at the same time. NASDAQ Rule 5713(f)(ii)(D) permits the Exchange to suspend trading in or remove from listing Paired Class Shares whose Intraday Indicative Value is no longer made available on at least a 15-second delayed basis by a major market vendor during the Exchange's Regular Market Session. The Commission also notes that

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105 The Commission notes that these requirements are substantively identical to provisions applicable to other exchange-traded derivative securities products, including Managed Fund Shares under NASDAQ Rule 5735(d)(1)(B). See Securities Exchange Act Release No. 57962 (June 13, 2008), 73 FR 35175 (June 20, 2008) (SR-NASDAQ-2008-039) (approving NASDAQ listing standards applicable to Managed Fund Shares). For a specific product approved for listing under NASDAQ Rule 5735, see Securities Exchange Act Release No. 73480 (October 31, 2014), 79 FR 66022 (November 6, 2014) (SR-NASDAQ-2014-090) (approving the listing and trading of Shares of the Validea Market Legends ETF under NASDAQ Rule 5735).

106 Commentary .04 to Rule 5713 states that, prior to a substitute or replacement Underlying Benchmark being selected for the Fund, NASDAQ must file a related proposed rule change pursuant to Rule 19b-4 under the Exchange Act to continue trading the Paired Class Shares.

NASDAQ Rules 5713(f)(i)(C) and 5713(f)(ii)(E) require the establishment of information barriers concerning changes and adjustments to the Underlying Benchmark.[107]

Based on the foregoing, the Commission believes that the requirements of NASDAQ Rule 5713, taken together with other NASDAQ Rules regarding the trading of equity securities on the Exchange, are consistent with the requirement of Section 6(b)(5) of the Act that requires that the Exchange's rules be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and to promote just and equitable principles of trade and to protect investors and the public interest.

B. Issues Raised by the Opposing Commenter

1. Effectiveness of Arbitrage

In the OIP, the Commission asked for commenters' views on the effect that Paired Class Share distributions would have on premiums and discounts between the trading price of the Paired Class Shares and their respective Class Value per Share.[108]

The opposing commenter asserts that the structure of Paired Class Shares will result in significant and persistent premiums and discounts because "it is not economically possible to construct a two sided market for spot exposure that does not trade in line with VIX futures prices."[109] This commenter argues that the arbitrage mechanism of the Funds will not work to keep Up Shares and Down Shares trading close to their intrinsic value, but will instead "in theory

107 The Commission notes that these provisions are substantively identical to the firewall requirements in NASDAQ Rule 5705(b)(2)(B)(i), which governs the listing and trading of Index Fund Shares.

108 See OIP, supra note 6, 79 FR at 57157.

109 Kassner Letter, supra note 8, at 1. See also supra notes 45-48 and accompanying text.

keep the sum of the premium on one and the discount on the other at zero."[110] To support these conclusions, the opposing commenter provides a number of hypothetical situations involving the trading relationship between the VIX index, VIX futures, and the proposed VIX Fund.[111] Further, the opposing commenter argues that the "daily amount" applied to the VIX Fund—a 15 basis point amount transferred from Up Shares to Down Shares when the VIX is at 30 or below—means that investors in Up Shares will suffer a 4.5% loss over a 30-day period, even if the VIX does not move.[112] The opposing commenter also argues that, because the arbitrage mechanism will not work as described by the Exchange, multiple corrective distributions will be required per year, causing investors to incur reinvestment expenses to maintain their desired position.[113]

The Exchange argues in response that, underlying this commenter's argument is a mistaken assumption that spot levels and futures levels are equivalent and interchangeable.[114] The Exchange agrees that markets such as spot markets, futures markets, stock markets, and bond markets will be broadly inter-related, but argues that, in the case of volatility in general and VIX in particular, the spot market is not "in line" and directly comparable with VIX futures prices. The Exchange cites the willingness of market participants to trade options overlying both the spot VIX and VIX futures as evidence that the market would understand the differences between spot VIX and the range of VIX futures prices. The Exchange notes that the website of CBOE, the provider of the VIX, states, "The price of a VIX futures contract can be lower, equal

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110 Id.

111 See Kassner Letter, supra note 8.

112 Id.

113 Id. at 2-3.

114 See Exchange Letter, supra note 8, at 17.

to or higher in the 30-day forward period covered by the VIX futures contract than in the 30-day spot period covered by VIX."[115] The Exchange also notes that, unlike VIX futures, "because the shares of the Fund are both available for creation and redemption daily, the Fund provides for spot VIX positions to be created or redeemed daily, and for returns to be realized on a daily basis."[116]

Additionally, the Exchange argues that the existence of the Daily Amount applied to the VIX Fund is disclosed clearly and referenced more than 90 times in the prospectus for the VIX Fund, and the Exchange argues that the amount of the Daily Amount is closely aligned with the estimates of several market experts as to the roll cost incurred by long positions in volatility futures (e.g., VIX futures).[117] As a result, the Exchange argues, the expected premiums and discounts encountered by the VIX Fund should be substantially less that the opposing commenter predicts.[118] The Exchange also argues that the corrective distribution mechanism is designed to prevent the type of investor losses that occurred when an ETN designed to track the VIX moved substantially away from the value of the VIX.[119]

The Commission believes that the Exchange has met its burden to demonstrate that its proposal is consistent with the Act. The Exchange has reasonably explained in the Notice, the Exchange's response letter,[120] and, as to the VIX Fund, in the Registration Statement for the VIX

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115 Id. at 18.

116 Id. at 21.

117 See id. at 20-21.

118 See id. at 21.

119 See id. at 22-23.

120 See Exchange Letter, supra note 8.

Fund,[121] the methodology for the calculation of the Underlying Benchmarks and the differences between the value of the Underlying Benchmark indexes and the prices of the relevant near-month futures contracts. In particular the Exchange explains that, with respect to the VIX Fund, the purpose and derivation of the 0.15% Daily Amount by which the Up Shares will be reduced and the Down Shares increased, which, as cited by the Exchange, is consistent with price patterns historically observed when comparing VIX futures and spot prices.[122] The Exchange further notes the extent to which the Registration Statement discloses the Daily Amount transfer.[123] The Exchange has also reasonably explained the operation of the Funds; the creation and redemption process and procedures; the regular, special, and corrective distributions to be employed by the Funds; and the resulting resetting process.

In addition, with respect to arbitrage in Fund Shares, and, consistent with Section 11A(a)(1)(C)(iii) of the Act,[124] which sets forth Congress' finding that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities, the Commission notes that market information regarding the value of the Shares and of the Underlying Benchmarks will be continuously available to market participants. Quotation and last-sale information for the Shares will be available via NASDAQ proprietary quote and trade services, as well as in accordance with any UTP plans for a Fund's

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121 See Registration Statement, supra note 22.

122 See Exchange Letter, supra note 8, at 22.

123 See id.

124 15 U.S.C. 78k-1(a)(1)(C)(iii).

Shares.[125] Additionally, information regarding market price and volume of the Shares will be continually available on a real-time basis throughout the day on brokers' computer screens and other electronic services.[126] Further, information regarding the previous day's closing price and trading volume information for the Shares will be published daily in the financial section of newspapers.[127]

The value of each Fund's Underlying Benchmark, as well as information about each Fund's Underlying Benchmark constituents, the weighting of the constituents, the Underlying Benchmark's methodology, and the Underlying Benchmark's rules, will be available at no charge on the Index Provider's website at us.spindices.com or, in the case of the VIX Fund, the CBOE's Web site at www.cboe.com/VIX.[128] The value of each Fund's Underlying Benchmark also will be published by one or more major market data vendors on at least a 15-second delayed basis during the Regular Market Session.[129] An Intraday Indicative Value for each Fund will be disseminated and made available by a major market vendor, and will be updated and widely disseminated and broadly displayed on at least a 15-second delayed basis during the Regular Market Session.[130] Class Values and Class Values per Share of each Fund will be calculated by the Fund's Custodian at the end of each Regular Market Session.[131]

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125 See Notice, supra note 3, 79 FR at 35621.

126 See id.

127 See id.

128 See id.

129 See NASDAQ Rule 5713(f)(2)(B).

130 See Notice, supra note 3, 79 FR at 35622.

131 NASDAQ Rule 5713(f)(ii)(C) is designed to ensure that the Class Values and Class Values per Share of each Fund will be made available to all market participants at the same time.

Under NASDAQ Rule 5713(f)(i)(B), the Exchange will obtain a representation from the Trust on behalf of each Fund that the Class Value per Share of each of its Up Shares and Down Shares will be calculated daily and that these Class Values per Share and information about the assets of the Fund will be made available to all market participants at the same time.[132] In addition, NASDAQ Rule 5713(f)(2)(B) permits the Exchange to suspend trading in or remove from listing Paired Class Shares whose Underlying Benchmark, or a substitute or replacement Underlying Benchmark based on the same Reference Asset,[133] is no longer calculated or available on at least a 15-second delayed basis during the Regular Market Session from a major market data vendor unaffiliated with the sponsor, the custodian, the trustee of the Trust, the Fund or NASDAQ.

The Commission believes that, in light of the continuous dissemination of information about the Shares' current market prices, the Funds' Underlying Benchmarks, and the Funds' intraday estimated Class Value per Share, arbitrage opportunities will be readily identifiable to market participants. The Commission also believes that the creation and redemption process, which, under Rule 5713(c), uses a neutral basket of Up Shares and Down Shares, is reasonably designed to allow market participants to arbitrage away premiums and discounts that may

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132 The Commission notes that these requirements are substantively identical to provisions applicable to other exchange-traded derivative securities products, including Managed Fund Shares under NASDAQ Rule 5735(d)(1)(B).

133 Commentary .04 to Rule 5713 states that, prior to a substitute or replacement Underlying Benchmark being selected for the Fund, NASDAQ must file a related proposed rule change pursuant to Rule 19b-4 under the Act to continue trading the Paired Class Shares.

develop, as long as the Up Shares and Down Shares do not become locked in a persistent state of approximately equal and opposite premiums or discounts.[134]

The Commission acknowledges, however, that the normal arbitrage mechanism of the Funds will not be effective if equal and opposite premiums and discounts persist between the Up Shares and Down Shares of a Fund. Because no existing exchange-traded products use a paired-class structure, the Commission does not have a basis for comparison from which to predict how frequently such conditions are likely to occur. As noted above, however, the Funds would provide for a corrective distribution when the magnitude of the equal and opposite premiums and discounts exceeds a certain threshold.[135] The Exchange has represented that, "[e]ven if a corrective distribution is not triggered, the existence of a Fund's corrective distribution feature is expected to modify investor and Authorized Participant behavior to prevent persistent and material premium and discount conditions for Paired Class Shares from becoming locked."[136] Based on the Exchange's representation, the Commission believes that the corrective distribution mechanism is reasonably designed to limit the magnitude of such premiums and discounts and that, when triggered, it will provide investors with a market neutral position that should allow them to exit the affected Fund at Class Value. Further, the underlying value of the Funds and the extent of the premiums and discounts would not be subject to uncertainty, because, as explained

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134 Because the funds would create and redeem their shares only in equal amounts of Up Shares and Down Shares, if one class of shares traded at a premium, and the other class traded at an approximately equal discount, arbitrage using the creation or redemption process could not eliminate those price deviations. For example, if Up Shares traded at a \$0.50 premium, and down shares traded at a \$0.50 discount, the value per share of a creation unit, composed of equal amounts of each class, would be equal to the NAV of the fund (i.e., the premium would cancel out the discount).

135 See supra note 18.

136 See Notice, supra note 3, at 9, 79 FR at 35612.

above,[137] the Funds' market prices, Class Values per Share, and reference benchmark values and methodologies would be publicly available in real time. In addition, and significantly, to the extent that equal and opposite premiums and discounts persist within a Fund's threshold for a corrective distribution, all investors in the affected Fund would be subject to the same pricing conditions, and Authorized Participants would not be able to use the creation and redemption process to trade in the primary market for the shares at prices more favorable than those available to investors trading at market prices on the Exchange.

Thus, for the reasons described above, the Commission believes that the Exchange's rules are reasonably designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

2. Investor Understanding and Suitability

In the OIP, the Commission solicited comments about whether retail investors and other market participants would be able to understand the types and timing of distributions as well as the periodic resets of Paired Class Shares' exposure to their Underlying Benchmarks.[138]

The opposing commenter argues that the operational complexity of Paired Class Shares renders them unsuitable for any investor. As discussed above, this commenter argues that extreme diligence would be required of investors in tracking their positions because the Up Shares might frequently turn into both Up Shares and Down Shares, and that investors would

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137 See supra text accompanying notes 125-133.

138 See OIP, supra note 6, 79 FR at 57157.

need to know a considerable amount of information at every point in time when holding Shares.[139]

The Sponsor asserts that retail investors and other market participants will be able to understand the types and timing of fund distributions. The Sponsor states that the Registration Statement contains detailed examples, and the Funds' website will contain infographics describing each distribution, as well as the courses of action available to investors. According to the Sponsor, distributions will generally be limited to scheduled dates or the occurrence of large and rare underlying index moves, and movements of the underlying indexes will be easy to track using public sources. The Sponsor states that the consensus of qualified investors and market makers to whom it has spoken is that the frequency of the Funds' distributions is consistent with customary review (e.g., monitoring prices and returns) and customary re-evaluation of share positions. Additionally, the Sponsor states that, except in limited and unanticipated conditions which are identified in the Registration Statement, regular and special distributions will be made to shareholders in cash, and therefore investors generally will face a straightforward decision with respect to deploying or maintaining received cash. With respect to corrective distributions (in which a fund would issue each holder of Up Shares an equal number of Down Shares, and each holder of Down Shares an equal number of Up Shares), the Sponsor asserts that such distributions are expected to be rare and to encourage among Authorized Participants both more active and accurate market making and more liquidity-enhancing position-taking. The Sponsor also argues that corrective distributions, as a self-policing and self-correcting measure, are a better alternative to detailed disclosures about premiums and discounts in prospectuses, which investors may not necessarily read and which would require affirmative investor action, and the

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139 See Kassner Letter, supra note 8, at 3-4.

dissemination of real-time estimates of indicative portfolio values, which investors may not necessarily consider before transacting in other types of ETP shares. Further, the Sponsor states that prospective investors to whom it has spoken believe that the corrective distribution will benefit the entire range of shareholders.

With respect to the resets, the Sponsor states that the Funds are similar to comparable ETPs in the market and that it expects that both retail investors and other market participants will understand the effect of Paired Class Share resets on their investments.[140] The Sponsor also asserts that individual investors will be able to more easily track and monitor Paired Class Share resets than the resetting impact in other types of ETPs.

The Sponsor also argues that the Exchange's sales practice rules adequately ensure the suitability of sales recommendations regarding the Funds' Shares, citing NASDAQ Rule 2111A, which requires that an exchange member have a reasonable basis to believe that a recommended transaction or investment strategy is suitable for a given customer, based on information obtained through reasonable diligence.[141] Additionally, the Sponsor notes that, before trading in the

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140 Specifically, the Sponsor states that for comparable ETPs that seek commodity or volatility exposure through trading in derivative products, the impact of resetting comes through the "re-trading" of futures, options, or other contracts. These ETFs effect the resetting either daily, monthly, or on another cycle. This conventional resetting has transaction costs, which are often difficult to isolate within the context of overall fund performance. The Sponsor adds that, since the traditional method of resetting is accomplished through the trading of underlying positions at telegraphed times under prescribed fund rules, ETFs can be disadvantaged from having to be a "price taker" in possibly adverse or challenging markets. The Sponsor asserts that these resetting considerations in these other types of ETPs are well known by retail investors. See Sponsor Letter, supra note 8, at 7-8.

141 See id. at 8-9.

Shares begins, the Exchange will inform its members in an information circular of the special characteristics and risks associated with trading Paired Class Shares.[142]

The Commission notes that the Exchange's suitability rule, NASDAQ Rule 2111A, requires that Exchange members and associated persons of a member comply with Financial Industry Regulatory Authority ("FINRA") Rule 2111, which requires member firms and their associated persons to "have a reasonable basis to believe" that a transaction or investment strategy involving securities that they recommend is suitable for the customer. Specifically, this reasonable belief must be based on the information obtained through the reasonable diligence of the firm or associated person to ascertain the customer's investment profile. The rule requires firms and associated persons to seek to obtain information about the customer's age; other investments; financial situation and needs, which might include questions about annual income and liquid net worth; tax status, such as marginal tax rate; investment objectives, which might include generating income, funding retirement, buying a home, preserving wealth, or market speculation; investment experience; investment time horizon, such as the expected time available to achieve a particular financial goal; liquidity needs, which is the customer's need to convert investments to cash without incurring significant loss in value; and risk tolerance, which is a

[142] The Exchange has represented that the information circular will discuss (a) the procedures for purchases and redemptions of Paired Class Shares; (b) Rule 2111A, which imposes suitability obligations on Exchange members with respect to recommending transactions in Paired Class Shares to customers; (c) how information regarding the Underlying Benchmark and Intraday Indicative Value is disseminated; (d) the risks involved in trading Paired Class Shares during the Pre-Market and Post-Market sessions when an updated Underlying Benchmark and Intraday Indicative Value will not be calculated or publicly disseminated; (e) the requirement that members deliver a prospectus to investors purchasing newly issued Paired Class Shares; (g) trading information; and (h) how information regarding distributions and share splits is disseminated and the requirements of public notification of these events.

customer's willingness to risk losing some or all of the original investment in exchange for greater potential returns.

Additionally, the Commission notes that the Funds will issue specific, public notifications regarding the unique distributions that the Funds would provide. Each Fund engaging in a regular distribution,[143] a special distribution, a corrective distribution, or a net income distribution[144] will provide at least three business days' advance notice (or longer advance notice as may be required by the Exchange)[145] of such an event. Each Fund engaging in a share split will provide at least ten calendar days' advance notice (or longer advance notice as may be required by the Exchange)[146] of such an event. In each instance, the Sponsor will notify the Exchange and post a notice of the event and its details on the Sponsor's website.

The Commission further notes that the prospectus disclosures for the Funds state prominently that the Funds are not suitable for all investors, and include the following disclosures: (1) stating that the funds may not be suitable for all investors; (2) describing the

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143 With respect to regular distributions, the information provided will consist of the schedule of distributions and associated distribution dates, and a notification, as of the record date for such regular distribution, on the Sponsor's website (www.AccuShares.com) as to whether or not the regular distribution will occur. See Notice, supra note 3, 79 FR at 35620. For regular distributions that occur on schedule, the Sponsor will cause a press release to be issued identifying the receiving class, the amount of cash, the amount of Paired Class Shares (if any), and any other information the Sponsor deems relevant regarding the distribution and post such information on the Sponsor's website. See id.

144 With respect to special distributions, corrective distributions, and share splits, the information provided will include the relevant ex-, record, and payment dates for each such event and relevant data concerning each such event. In addition, notice of net income distributions for each class of a Fund, if any, will also be included in the notifications of regular, special, and corrective distributions. See id.

145 The Exchange may determine that longer notice is advisable in some circumstances (e.g., an extended, or unexpected, market break). See id. at 35620, n.46.

146 See id.

effect of distributions on an investor's exposure; and (3) stating that "Investors who do not intend to actively manage and monitor their Fund investments at least as frequently as each distribution date should not buy shares of the Fund." (Emphasis in original.)

Based on all of the foregoing, the Commission believes that the Exchange has adequately responded to the opposing commenter's concerns about investor understanding and suitability, and that the Exchange's proposal is consistent with the public interest and the protection of investors.

For the foregoing reasons, the Commission finds that the Exchange's proposal to adopt NASDAQ Rule 5713 and to list and trade the Funds pursuant to that rule is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.[147]

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[148] that the proposed rule change (SR-NASDAQ-2014-065), as modified by Amendment No. 1 thereto, be, and it hereby is, approved.

By the Commission.

Brent J. Fields
Secretary

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147 This approval order is based on all of the Exchange's representations, including those set forth above and in the Notice.

148 15 U.S.C. 78s(b)(2).