

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-72787; File No. SR-BATS-2014-018)

August 7, 2014

Self-Regulatory Organizations; BATS Exchange, Inc.; Notice of Filing of Proposed Rule Change to Adopt Rule 14.11(k) to Permit BATS Exchange, Inc. to List Managed Portfolio Shares and to List and Trade Shares of Certain Funds of the Spruce ETF Trust

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 4, 2014, BATS Exchange, Inc. (“Exchange” or “BATS”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to adopt new BATS Rule 14.11(k) to permit the Exchange to list Managed Portfolio Shares, which are shares of actively managed exchange-traded funds (“ETFs”) for which the portfolio is disclosed quarterly and are further described below. In addition, the Exchange proposes to list and trade shares of certain funds of the Spruce ETF Trust (the “Trust”) under the proposed BATS Rule 14.11(k). The text of the proposed rule addition is available at the Exchange’s website at <http://www.batstrading.com>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to add new BATS Rule 14.11(k) for the purpose of permitting the listing of Managed Portfolio Shares<sup>3</sup> which are securities issued by an actively managed open-end investment management company.<sup>4</sup> In addition to the above-mentioned proposed rule change, the Exchange proposes to list and trade shares of the following under proposed BATS Rule 14.11(k): Large Cap Fund, Large Cap Value Fund, Large Cap Growth Fund, Large/Mid Cap Fund, Large/Mid Cap Value Fund, Large/Mid Cap Growth Fund, Large Cap Long-Short Fund, Large Cap Value Long-Short Fund, Large Cap Growth Long-Short Fund, Large/Mid Cap

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<sup>3</sup> A Managed Portfolio Share is a security that represents an interest in an investment company registered under the Investment Act of 1940 ("15 U.S.C. 80a-1) ("1940 Act") organized as an open-end investment company or similar entity that invests in a portfolio of securities selected by its investment adviser consistent with its investment objectives and policies. In contrast, an open-end investment company that issues Index Fund Shares, listed and traded on the Exchange under BATS Rule 14.11(c), seeks to provide investment results that correspond generally to the price and yield performance of a specific foreign or domestic stock index, fixed income securities index, or combination thereof.

<sup>4</sup> The Trust, the Adviser (as defined below), and the Distributor (as defined below) have applied for certain exemptive relief under the Investment Company Act of 1940 (15 U.S.C. 80a-1) ("1940 Act") (the "Exemptive Relief Application"). See Exemptive Relief Application at <http://www.sec.gov/Archives/edgar/data/1006249/000119312511239094/d40app.htm>.

Long-Short Fund, and Large/Mid Cap Value Long-Short Fund, Large/Mid Cap Growth Long-Short Fund, and Large Cap Growth Active Insights Fund (each a “Fund” and, collectively, the “Funds”). The shares of each Fund and the shares of the Funds collectively, as applicable, are referred to herein as the “Shares.”

### Proposed Listing Rules

Proposed Rule 14.11(k)(1) provides that the Exchange will consider listing Managed Portfolio Shares that meet the criteria of Rule 14.11(k). Proposed Rule 14.11(k)(2) provides that Rule 14.11(k) is applicable only to Managed Portfolio Shares and that, except to the extent inconsistent with Rule 14.11(k), or unless the context otherwise requires, the rules and procedures of the Board of Directors shall be applicable to the trading on the Exchange of such securities. It also provides that Managed Portfolio Shares are included within the definition of “security” or “securities” as such terms are used in the Rules of the Exchange. Further, under proposed Rule 14.11(k)(2)(A) through (F), the Exchange is proposing: (i) that it will file separate proposals under Section 19(b) of the Act before the listing of Managed Portfolio Shares; (ii) that transactions in Managed Portfolio Shares will occur throughout the Exchange’s trading hours; (iii) that the minimum price variation for quoting and entry of orders in Managed Portfolio Shares is \$0.01, with the exception of securities that are priced less than \$1.00, for which the minimum price variation for order entry is \$0.0001; (iv) that the Exchange will implement written surveillance procedures for Managed Portfolio Shares; (v) that Authorized Participants redeeming Managed Portfolio Shares will each sign an agreement with the Investment Company or fund, or their authorized agents, requiring the establishment of a blind trust for the benefit of such Authorized Participant that will receive all consideration from a fund in a redemption, which blind trust will be bound not to disclose the consideration received in a

redemption except as required by law and will liquidate any securities received in a redemption in accordance with standing instructions for the Authorized Participant; and (vi) that if the investment adviser to the registered investment company (the “Investment Company”) issuing Managed Portfolio Shares is affiliated with a broker-dealer, such investment adviser shall erect a “fire wall” between the investment adviser and the broker-dealer with respect to access to information concerning the composition and/or changes to such Investment Company portfolio. Personnel who make decisions on the Investment Company’s portfolio composition must be subject to procedures designed to prevent the use and dissemination of material nonpublic information regarding the applicable Investment Company portfolio.

The Exchange is also proposing that, for purposes of Rule 14.11(k), the following terms shall, unless the context otherwise requires, have the meanings herein specified. As proposed, the term “Managed Portfolio Share” means a security that (a) is issued by an Investment Company organized as an open-end management investment company or similar entity, that invests in a portfolio of securities selected by the Investment Company’s investment adviser consistent with the Investment Company’s investment objectives and policies; (b) is issued in a predetermined Creation Unit size in exchange for a cash amount equal to the next determined Net Asset Value (“NAV”),<sup>5</sup> as described in more detail below; (c) in the event that for 10 consecutive Business Days, or such shorter period as determined by the issuer, the midpoint of the national best bid and offer at the time of the calculation of the NAV (the “Bid/Ask Price”),<sup>6</sup> for the security has a discount of 5% or greater from the NAV, the security may be redeemed for

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<sup>5</sup> Depending on the context, the term “NAV” may refer to the NAV per Share, the NAV per Creation Unit, as defined below, or the NAV of a fund.

<sup>6</sup> The Bid/Ask Price of the Funds will be determined using the midpoint of the national best bid and offer as of the time of calculation of the Fund’s NAV. The records relating to Bid/Ask Prices will be retained by the Funds and its service providers.

cash by any Beneficial Owner in any size less than a Redemption Unit for a cash amount equal to the next determined NAV for at least 15 calendar days; and (d) when aggregated in a number of shares equal to a Redemption Unit, or multiples thereof, may be redeemed at an Authorized Participant's request, which each Authorized Participant will be paid through a blind trust established for its benefit a portfolio of securities and/or cash with a value equal to the next determined NAV. The Exchange proposes that the term "Beneficial Owner" means (i) a natural person; (ii) a trust established for the benefit of a natural person or a group of related family members; or (iii) a tax deferred retirement plan where investments are selected by a natural person purchasing for its own account. As proposed, the term "Intraday Indicative Value" ("IIV") is the estimated indicative value of a Managed Portfolio Share based on all of the issuer's holdings as of the close of business on the prior business day. The Exchange proposes that the term "Creation Unit" means a specified minimum number of Managed Portfolio Shares that an Authorized Participant may purchase from the issuer for the current NAV. The Exchange proposes that the term "Redemption Unit" means a specified number of Managed Portfolio Shares that an Authorized Participant may sell to the issuer for the current NAV and which is also used for determining whether a Beneficial Owner may redeem for cash. Finally, as proposed, the term "Reporting Authority" in respect of a particular series of Managed Portfolio Shares means a reporting service designated by the issuer and acceptable to the Exchange as the official source for calculating and reporting information relating to such series, including, but not limited to, the IIV, NAV, or other information relating to the issuance, redemption or trading of Managed Portfolio Shares. A series of Managed Portfolio Shares may have more than one Reporting Authority, each having different functions.

Proposed Rule 14.11(k)(4) sets forth the proposed initial and continued listing criteria applicable to Managed Portfolio Shares. Proposed Rule 14.11(k)(4)(A)(i) and (ii) provides that all series of Managed Portfolio Shares must meet both of the following initial listing criteria: for each series, the Exchange will establish a minimum number of Managed Portfolio Shares required to be outstanding at the time of commencement of trading on the Exchange and the Exchange will obtain a representation from the issuer of each series of Managed Portfolio Shares that the NAV per share for the series will be calculated daily and that the NAV will be made available to all market participants at the same time. Proposed Rule 14.11(k)(4)(B)(i) provides that the IIV for a series of Managed Portfolio Shares will be widely disseminated by one or more major market data vendors at least every 15 seconds during Regular Trading Hours.<sup>7</sup> Proposed Rule 14.11(k)(4)(B)(ii) provides that the Exchange will consider the suspension of trading in or removal from listing of a series of Managed Portfolio Shares under any of the following circumstances: (a) if, following the initial twelve-month period after commencement of trading on the Exchange of a series of Managed Portfolio Shares, there are fewer than 50 beneficial holders of the series of Managed Portfolio Shares for 30 or more consecutive trading days; (b) if the value of the IIV is no longer calculated or made available to all market participants at the same time; (c) if the Investment Company issuing the Managed Portfolio Shares has failed to file any filings required by the Securities and Exchange Commission or if the Exchange is aware that the Investment Company is not in compliance with the conditions of any exemptive order or no-action relief granted by the Securities and Exchange Commission to the Investment Company with respect to the series of Managed Portfolio Shares; or (d) if such other event shall occur or

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<sup>7</sup> Regular Trading Hours are from 9:30 a.m. to 4:00 p.m. Eastern Time.

condition exists which, in the opinion of the Exchange, makes further dealings on the Exchange inadvisable.

As proposed, Rule 14.11(k)(4)(B)(iii) provides that if the IIV of a series of Managed Portfolio Shares is not being disseminated as required, the Exchange 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 occurred, the Exchange 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 Managed Portfolio Shares is not 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.

Proposed Rule 14.11(k)(4)(B)(iv) provides that upon termination of an Investment Company, the Exchange requires the Managed Portfolio Shares issued in connection with such entity be removed from Exchange listing. Proposed Rule 14.11(k)(4)(B)(v) provides that voting rights shall be as set forth in the applicable fund prospectus.

Proposed Rule 14.11(k)(5), which relates to limitation of Exchange liability, provides that neither the Exchange, the Reporting Authority, nor any agent of the Exchange shall have any liability for damages, claims, losses, or expenses caused by any errors, omissions or delays in calculating or disseminating any current portfolio value; the current value of the portfolio of securities or cash value required to be deposited to the open-end management investment company in connection with issuance of Managed Portfolio Shares; the amount of any dividend equivalent payment or cash distribution to holders of Managed Portfolio Shares; net asset value; or other information relating to the purchase, redemption, or trading of Managed Portfolio Shares, resulting from any negligent act or omission by the Exchange, the Reporting Authority,

or any agent of the Exchange, or any act, condition, or cause beyond the reasonable control of the Exchange, 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.

#### Features of Managed Portfolio Shares

While funds issuing Managed Portfolio Shares will be actively-managed and, to that extent, will be similar to Managed Fund Shares, Managed Portfolio Shares differ from Managed Fund Shares in the following important respects. First, in contrast to Managed Fund Shares, for which creations are generally effected through an in-kind delivery of securities and cash, creations of Managed Portfolio Shares will generally be effected through a delivery of only cash. Second, whereas Managed Fund Shares are actively-managed funds listed and traded under BATS Rule 14.11(i),<sup>8</sup> which requires a “Disclosed Portfolio” to be disseminated at least once daily,<sup>9</sup> the portfolio for an issue of Managed Portfolio Shares will be disclosed at least quarterly in accordance with normal disclosure requirements otherwise applicable to open-end investment

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<sup>8</sup> The Commission has previously approved listing and trading on the Exchange of numerous actively managed funds under Rule 14.11(i). *See, e.g.*, Securities Exchange Act Release Nos. 67894 (September 20, 2012), 77 FR 59227 (September 26, 2012) (SR-BATS-2012-033) (order approving Exchange listing and trading of the iShares Short Maturity Bond Fund); 68390 (December 10, 2012), 77 FR 74520 (December 14, 2012) (SR-BATS-2012-042) (order approving Exchange listing and trading of the iShares Sovereign Screened Global Bond Fund); 70986 (December 4, 2013), 78 FR 74212 (December 10, 2013) (SR-BATS-2013-051) (order approving Exchange listing and trading of the iShares Liquidity Income Fund); and 72099 (May 6, 2014), 78 FR 27023 (May 12, 2014) (SR-BATS-2014-007) (order approving Exchange listing and trading shares of certain funds of the ProShares Trust).

<sup>9</sup> BATS Rule 14.11(i)(3)(B) defines the term “Disclosed Portfolio” as the identities and quantities of the securities and other assets held by the Investment Company that will form the basis for the investment Company’s calculation of net asset value at the end of the business day.



companies registered under the 1940 Act.<sup>10</sup> Third, in connection with the redemption of shares in Redemption Unit size, the delivery of any portfolio securities in kind will generally be effected through a blind trust for the benefit of the redeeming Authorized Participant and the blind trust will liquidate the portfolio securities without disclosing the identity of such securities to the Authorized Participant. Fourth, where the market for the security (specifically the Bid/Ask Price) has a discount of 5% or greater from the NAV for 10 consecutive Business Days, Beneficial Owners will be able to redeem shares for cash directly from a fund for the next 15 calendar days and in any size less than a Redemption Unit at the fund's NAV.

For each series of Managed Portfolio Shares, the IIV that reflects an estimated intraday value of a fund's portfolio will be disseminated. The IIV will be based upon all of a fund's holdings as of the close of the prior business day and will be widely disseminated by one or more major market data vendors at least every 15 seconds during Regular Trading Hours. The dissemination of the IIV will allow investors to determine the estimated intra-day value of the underlying portfolio of a series of Managed Portfolio Shares on a daily basis and will provide a close estimate of that value throughout the trading day. The IIV should not be viewed as a "real-time" update of the NAV per share of each fund because the IIV may not be calculated in the same manner as the NAV, which will be computed once a day, generally at the end of the business day. Unlike the IIV, which will be based on consolidated last sale information, the NAV per share will be based on the closing price on the primary market for each portfolio

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<sup>10</sup> A mutual fund is required to file with the Commission its complete portfolio schedules for the second and fourth fiscal quarters on Form N-SAR under the 1940 Act, and is required to file its complete portfolio schedules for the first and third fiscal quarters on Form N-Q under the 1940 Act, within 60 days of the end of the quarter. Form N-Q requires funds to file the same schedules of investments that are required in annual and semi-annual reports to shareholders. These forms are available to the public on the Commission's website at [www.sec.gov](http://www.sec.gov).

security. If there is no closing price for a particular portfolio security, such as when it is subject to a trading halt, a fund may use fair value pricing. That fair value pricing will be carried over to the next day's IIV until the first trade in that stock is reported.

The Exchange, after consulting with various market makers that trade ETFs (and other products) on various exchanges, believes that market makers will be able to make efficient and liquid markets priced near the IIV even without daily disclosure of a fund's underlying portfolio as long as an accurate IIV is disseminated every 15 seconds, each fund's means of achieving its investment objective is clearly disclosed based on publicly available information, and there is typically an ability to manage inventory of Shares through creations and redemptions each day. The Exchange believes that market makers will employ risk-management techniques such as "statistical arbitrage", which is currently used throughout the financial services industry, to make efficient markets in exchange traded products as well as corporate issues.<sup>11</sup> This ability should permit market makers to make efficient markets in an issue of Managed Portfolio Shares without knowledge of a fund's underlying portfolio. The Exchange believes that the real-time dissemination of a fund's IIV, together with the knowledge of a fund's means of achieving its investment objective and the right of Authorized Participants to create and redeem shares of each

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<sup>11</sup> Statistical arbitrage enables a trader to construct an accurate proxy for another instrument, allowing it to hedge the other instrument or buy or sell the instrument when it is cheap or expensive in relation to the proxy. Statistical analysis permits traders to discover correlations based purely on trading data without regard to other fundamental drivers. These correlations are a function of differentials, over time, between one instrument or group of instruments and one or more other instruments. Once the nature of these price deviations have been quantified, a universe of securities is searched in an effort to, in the case of a hedging strategy, minimize the differential. Once a suitable hedging proxy has been identified, a trader can minimize portfolio risk by executing the hedging basket. The trader then can monitor the performance of this hedge throughout the trade period making corrections where warranted.

fund daily at the NAV, will be sufficient for market participants to value and trade shares in a manner that will not lead to significant deviations between the shares' Bid/Ask Price and NAV.

The Exchange understands that traders use statistical analysis to derive correlations between different sets of instruments to identify opportunities to buy or sell one set of instruments when it is mispriced relative to the others. For Managed Portfolio Shares, market makers will initially use the knowledge of a fund's means of achieving its investment objective, as described in the applicable fund registration statement, to construct a hedging proxy for a fund, to assist them in managing their risk in connection with trading the shares of a fund. Market makers will then conduct statistical arbitrage between their hedging proxy (for example, the Russell 1000 Index) and the shares of a fund, buying and selling one against the other over the course of the trading day. Market makers will then be able to evaluate how their proxy performed in comparison to the price of the shares of a fund, and use that analysis as well as knowledge of risk metrics, such as volatility and turnover, to enhance their proxy calculation to make it a more efficient hedge.

Market makers have indicated to the Exchange that, after the first several days of trading, there will be sufficient data to run a statistical analysis which will lead to spreads being tightened substantially around the IIV. This is similar to certain other existing exchange traded products (for example, ETFs that invest in foreign securities that do not trade during U. S. trading hours), in which spreads may be generally wider in the early days of trading and then narrow as market makers gain more confidence in their real-time hedges.

#### Description of the Shares and the Funds

BlackRock Fund Advisors is the investment adviser (“BFA” or “Adviser”) to the Funds.<sup>12</sup> State Street Bank and Trust Company is the administrator, custodian, and transfer agent for the Trust (the “Administrator,” “Custodian,” and “Transfer Agent,” respectively). BlackRock Investments, LLC (“Distributor”) serves as the distributor for the Trust. As described above, the Trust, the Adviser, and the Distributor have applied for certain exemptive relief under the 1940 Act.<sup>13</sup> The Shares will not be listed for trading on the Exchange until some point after the Exemptive Relief Application is approved and the Issuer’s registration statement is effective.

Proposed BATS Rule 14.11(k)(2)(F) provides that, if the investment adviser to the investment company issuing Managed Portfolio Shares is affiliated with a broker-dealer, such investment adviser shall erect a “fire wall” between the investment adviser and the broker-dealer with respect to access to information concerning the composition and/or changes to such investment company portfolio.<sup>14</sup> In addition, Proposed Rule 14.11(k)(2)(F) further requires that

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<sup>12</sup> BlackRock Fund Advisors is an indirect wholly owned subsidiary of BlackRock, Inc.

<sup>13</sup> See note 4, supra.

<sup>14</sup> An investment adviser to an open-end fund is required to be registered under the Investment Advisers Act of 1940 (the “Advisers Act”). As a result, the Adviser and its related personnel are subject to the provisions of Rule 204A-1 under the Advisers Act relating to codes of ethics. This Rule requires investment advisers to adopt a code of ethics that reflects the fiduciary nature of the relationship to clients as well as compliance with other applicable securities laws. Accordingly, procedures designed to prevent the communication and misuse of non-public information by an investment adviser must be consistent with Rule 204A-1 under the Advisers Act. In addition, Rule 206(4)-7 under the Advisers Act makes it unlawful for an investment adviser to provide investment advice to clients unless such investment adviser has (i) adopted and implemented written policies and procedures reasonably designed to prevent violation, by the investment adviser and its supervised persons, of the Advisers Act and the Commission rules adopted thereunder; (ii) implemented, at a minimum, an annual review regarding the adequacy of the policies and procedures established pursuant to subparagraph (i) above and the effectiveness of their implementation; and (iii) designated an individual (who is a supervised person) responsible for administering the policies and procedures adopted under subparagraph (i) above.

personnel who make decisions on the investment company's portfolio composition must be subject to procedures designed to prevent the use and dissemination of material nonpublic information regarding the applicable investment company portfolio. Proposed Rule 14.11(k)(2)(F) is identical to BATS Rule 14.11(i)(7) and similar to BATS Rules 14.11(b)(5)(A)(i) and 14.11(c)(5)(A)(i), however, Rules 14.11(k)(2)(F) and 14.11(i)(7) require the establishment of a "fire wall" between the investment adviser and the broker-dealer reflecting the applicable open-end fund's portfolio, not an underlying benchmark index, as is the case with index-based funds. The Adviser is not a registered broker-dealer, but is affiliated with multiple broker-dealers and has implemented "fire walls" with respect to such broker-dealers regarding access to information concerning the composition and/or changes to a Fund's portfolio. In addition, Adviser personnel who make decisions regarding the Fund's portfolio are subject to procedures designed to prevent the use and dissemination of material nonpublic information regarding a Fund's portfolio. In the event that (a) the Adviser becomes a broker-dealer or newly affiliated with a broker-dealer, or (b) any new adviser or sub-adviser is a broker-dealer or becomes affiliated with a broker-dealer, it will implement a fire wall with respect to its relevant personnel or such broker-dealer affiliate, as applicable, regarding access to information concerning the composition and/or changes to the portfolio, and will be subject to procedures designed to prevent the use and dissemination of material non-public information regarding such portfolio.

According to the Exemptive Relief Application, each Fund's investment objective will be long-term capital appreciation. To achieve their objective, each Fund will invest, under normal

circumstances,<sup>15</sup> at least 80% of its net assets in a portfolio of long positions (or engage in borrowings for the purpose of establishing short positions for the Long-Short funds) in U.S. equity securities.<sup>16</sup> The Funds may in some instances also invest in non-U.S. equity securities with similar market capitalization, liquidity, and risk-return profiles to the U.S. equity securities eligible for investment by the Fund where the Adviser determines that investing in the security is consistent with the Fund's investment objective. The Funds will not be money market funds and thus will not seek to maintain a stable NAV of \$1.00 per Share. In the absence of normal circumstances, a Fund may temporarily depart from its normal investment process, provided that such departure is, in the opinion of BFA, consistent with the Fund's investment objective and in the best interest of the Fund. For example, a Fund may hold a higher than normal proportion of its assets in cash in response to adverse market, economic, or political conditions.

Each Fund will hold equity securities of at least 13 non-affiliated issuers, primarily from the 1,200 largest U.S. stocks by market capitalization as determined by The Frank Russell Company annually. Generally, the Large/Mid Cap funds will select securities from a universe of approximately the 1,200 largest equity securities traded on U.S. exchanges and the Large Cap funds will select securities from a universe of approximately the 1,000 largest equity securities traded on U.S. exchanges.

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<sup>15</sup> The term "under normal circumstances" includes, but is not limited to, the absence of adverse market, economic, political, or other conditions, including extreme volatility or trading halts in the equity markets or the financial markets generally; operational issues causing dissemination of inaccurate market information; or force majeure type events such as systems failure, natural or man-made disaster, act of God, armed conflict, act of terrorism, riot, or labor disruption, or any similar intervening circumstance.

<sup>16</sup> Equity securities will include common stock, preferred stock, securities convertible into common stock and securities or other instruments whose price is linked to the value of common stock, which includes, but is not limited to, shares of other investment companies.

The Funds each intend to qualify each year as a regulated investment company (a “RIC”) under Subchapter M of the Internal Revenue Code of 1986, as amended.<sup>17</sup> The Funds will invest their respective assets, and otherwise conduct their respective operations, in a manner that is intended to satisfy the qualifying income, diversification and distribution requirements necessary to establish and maintain RIC qualification under Subchapter M.

#### Other Portfolio Holdings

A Fund may, to a limited extent (under normal circumstances, less than 20% of the Fund’s net assets), engage in transactions in futures contracts, forward contracts, options, and swaps.<sup>18</sup>

A Fund may also invest a portion of its assets in high-quality money market instruments on an ongoing basis rather than in other investments, when it would be more efficient or less expensive for the Fund to do so, or as cover for other financial instruments held by a Fund, for liquidity purposes, or to earn interest. Money market instruments (“Money Market Instruments”) in which a Fund may invest include: (1) short-term obligations issued by the U.S. government; (2) negotiable certificates of deposit (“CDs”), fixed time deposits and bankers’ acceptances of U.S. and foreign banks and similar institutions; (3) commercial paper rated at the date of purchase “Prime-1” by Moody’s Investors Service, Inc. or “A-1+” or “A-1” by Standard &

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<sup>17</sup> 26 U.S.C. 851.

<sup>18</sup> Derivatives include the following: treasury futures, equity index futures, currency futures, currency forwards, interest rate swaps, credit default swaps, total return swaps, equity index options, and single stock equity options. The derivatives, excluding currency forwards, will be exchange traded and/or centrally cleared. Derivatives are not a principal investment strategy of the Fund. Derivatives might be included in the Funds’ investments to serve the investment objectives of the Fund and each Fund’s use of derivatives may be used to enhance leverage. Such leverage, however, will never exceed 1/3 of a Fund’s total assets.

Poor's Ratings Group, Inc., a division of The McGraw-Hill Companies, Inc., or, if unrated, of comparable quality as determined by the Adviser; and (4) money market mutual funds.

### Investment Restrictions

A Fund may hold up to an aggregate amount of 15% of its net assets in illiquid assets (calculated at the time of investment) deemed illiquid by the Adviser<sup>19</sup> under the 1940 Act.<sup>20</sup> A Fund will monitor its portfolio liquidity on an ongoing basis to determine whether, in light of current circumstances, an adequate level of liquidity is being maintained, and will consider taking appropriate steps in order to maintain adequate liquidity if, through a change in values, net assets, or other circumstances, more than 15% of the Fund's net assets are held in illiquid securities. Illiquid securities include securities subject to contractual or other restrictions on

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<sup>19</sup> In reaching liquidity decisions, the Adviser may consider factors including: the frequency of trades and quotes for the security; the number of dealers wishing to purchase or sell the security and the number of other potential purchasers; dealer undertakings to make a market in the security; the nature of the security and the nature of the marketplace trades (e.g., the time needed to dispose of the security, the method of soliciting offers, and the mechanics of transfer); any legal or contractual restrictions on the ability to transfer the security or asset; significant developments involving the issuer or counterparty specifically (e.g., default, bankruptcy, etc.) or the securities markets generally; and settlement practices, registration procedures, limitations on currency conversion or repatriation, and transfer limitations (for foreign securities or other assets).

<sup>20</sup> The Commission has stated that long-standing Commission guidelines have required open-end funds to hold no more than 15% of their net assets in illiquid securities and other illiquid assets. See Investment Company Act Release No. 28193 (March 11, 2008), 73 FR 14618 (March 18, 2008), footnote 34. See also, Investment Company Act Release No. 5847 (October 21, 1969), 35 FR 19989 (December 31, 1970) (Statement Regarding "Restricted Securities"); Investment Company Act Release No. 18612 (March 12, 1992), 57 FR 9828 (March 20, 1992) (Revisions of Guidelines to Form N-1A). A fund's portfolio security is illiquid if it cannot be disposed of in the ordinary course of business within seven days at approximately the value ascribed to it by the fund. See Investment Company Act Release No. 14983 (March 12, 1986), 51 FR 9773 (March 21, 1986) (adopting amendments to Rule 2a-7 under the 1940 Act); Investment Company Act Release No. 17452 (April 23, 1990), 55 FR 17933 (April 30, 1990) (adopting Rule 144A under the Securities Act of 1933).



resale and other instruments that lack readily available markets as determined in accordance with Commission staff guidance.

A Fund will not purchase the securities of issuers conducting their principal business activity in the same industry if, immediately after the purchase and as a result thereof, the value of the Fund's investments in that industry would equal or exceed 25% of the current value of the Fund's total assets, provided that this restriction does not limit the Fund's: (i) investments in securities of other investment companies, (ii) investments in securities issued or guaranteed by the U.S. government, its agencies or instrumentalities, or (iii) investments in repurchase agreements (including reverse-repurchase agreements) collateralized by U.S. government securities.<sup>21</sup>

#### Net Asset Value

According to the Exemptive Relief Application, the NAV per Share of a Fund will be computed by dividing the value of the net assets of a Fund (i.e., the value of its total assets less total liabilities) by the total number of Shares of a Fund outstanding, rounded to the nearest cent. Expenses and fees, including, without limitation, the management, administration and distribution fees, will be accrued daily and taken into account for purposes of determining NAV. Interest and investment income on the Trust's assets accrue daily and will be included in a Fund's total assets. The NAV per Share for a Fund will be calculated by the Administrator and determined as of the close of the regular trading session on the Exchange (ordinarily 4:00 p.m., E.T.) on each day that the Exchange is open. The NAV that is published will be rounded to the nearest cent; however, for purposes of determining the price of Shares in creations and

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<sup>21</sup> The Commission has taken the position that a fund is concentrated if it invests in more than 25% of the value of its total assets in any one industry. See, e.g., Investment Company Act Release No. 9011 (October 30, 1975), 40 FR 54241 (November 21, 1975).

redemption, the NAV will be calculated to five decimal places. The Shares of the Funds will not be priced on days on which the Exchange is closed for trading.

Shares of exchange-listed equity securities, options, and investments in futures, including currency, equity index, and single stock futures, will be valued generally by using the last reported official closing or last trading price on the exchange or market on which the security or futures contract is primarily traded at the time of valuation. Swaps and currency forward contracts generally will be valued based on quotations from market makers, which may be based on quotations in the instruments themselves or quotations in the underlying assets from which they are derived, or by a pricing service in accordance with valuation procedures approved by the Fund's board of directors. Money Market Instruments will be valued by one or more pricing services. In determining the value of a Money Market Instrument, pricing services may use certain information with respect to transactions in such investments, quotations from dealers, pricing matrixes, market transactions in comparable investments, various relationships observed in the market between investments, and calculated yield measures.

When last sale prices and market quotations are not readily available, are deemed unreliable or do not reflect material events occurring between the close of local markets and the time of valuation, investments will be valued using fair value pricing as determined in good faith by the Adviser under procedures established by and under the general supervision and responsibility of the Trust's Board of Trustees. Investments that may be valued using fair value pricing include, but are not limited to: (1) securities that are not actively traded; (2) securities of an issuer that becomes bankrupt or enters into a restructuring; and (3) securities whose trading has been halted or suspended.

The frequency with which each Fund's investments will be valued using fair value pricing will primarily be a function of the types of securities and other assets in which the respective Fund will invest pursuant to its investment objective, strategies and limitations. If the Funds invest in open-end management investment companies registered under the 1940 Act they may rely on the NAVs of those companies to value the shares they hold of them. Those companies may also use fair value pricing under some circumstances.

Valuing the Funds' investments using fair value pricing involves the consideration of a number of subjective factors and thus the prices for those investments may differ from current market valuations. Accordingly, fair value pricing could result in a difference between the prices used to calculate NAV and the prices used to determine a Fund's IIV, which could result in the market prices for Shares deviating from NAV. Similarly, under certain circumstances, fair value pricing could also result in the NAV and the IIV values becoming more alike.

#### The Shares – Creation, Redemption, and Small Allotment Redemption Option

Each Fund will issue Shares through the Distributor on a continuous basis at NAV. The Exchange represents that the issuance of Shares will operate in a manner substantially similar to that of other ETFs and, in particular, certain fixed income ETFs that issue shares (as part of a creation unit) solely for settlement in cash.

Each Fund will issue Shares only at the NAV per Share next determined after an order in proper form is received. The Trust will sell and redeem Shares on each day that the Exchange is open for business (a "Business Day") and will not suspend the right of redemption or postpone the date of payment or satisfaction upon redemption for more than seven days, other than as provided by Section 22(d) of the 1940 Act. In addition to the standard redemption process, Beneficial Owners may also submit orders to redeem Shares at NAV directly to a Fund for a

limited period following circumstances in which the secondary market price for the Shares at the Valuation Time, as defined below, has deviated from NAV.

The NAV of each Fund is expected to be determined once each Business Day at a time determined by the Trust's Board of Directors ("Board"), currently anticipated to be as of the end of Regular Trading Hours on the Exchange (the "Valuation Time").

### Creation

Shares may be purchased from a Fund by any Depository Trust Company ("DTC") Participant that has signed an Authorized Participant Agreement ("AP Agreement") with the Trust, for its own account or for the account of a customer. Shares will be exchanged for cash, with settlement occurring through the continuous net settlement or a similar process. Shares may be purchased from a Fund in Creation Unit size or multiples thereof. Each Creation Unit currently consists of 25,000 Shares, however, the size of a Creation Unit is subject to change. Purchase orders for one or more Creation Units (a "Creation Order") must be placed by or through an Authorized Participant. Each Fund will establish a cut-off time ("Order Cut-Off Time") for Creation Orders in proper form. To initiate a purchase of Shares, a DTC participant must submit to the Distributor an irrevocable order to purchase such Shares after the most recent prior Valuation Time but not later than the Order Cut-Off Time. The Order Cut-Off Time for a Fund may be its Valuation Time, or may be prior to the Valuation Time if the Board determines that an earlier Order Cut-Off Time for purchase of Shares is in the best interests of Fund shareholders. It is anticipated that the Funds may adopt Order Cut-Off Times prior to their Valuation Time in order to allow the Advisor to: (1) purchase securities in accordance with the Fund's investment objective and as a result of a creation of Shares (which are made primarily in cash) prior to the market closing; (2) net creations and redemptions orders; and (3) make

arrangements for any securities borrowing transactions consistent with a Fund's investment strategy that may be necessary as a result of a creation of Shares in a manner both efficient and consistent with orderly portfolio management.

The Distributor will furnish acknowledgements to those placing purchase orders that such orders have been accepted, but the Distributor may reject any Creation Order. A Creation Order is subject to acceptance by the Trust and must be preceded or accompanied by an irrevocable commitment to deliver the requisite amount of cash. Purchases of Shares will be settled in cash for an amount equal to the applicable NAV per Share purchased plus applicable transaction fees, as discussed below. At the time of settlement, an Authorized Participant will initiate payment of the requisite cash amount, including applicable transaction costs, versus subsequent delivery of the Shares.

#### Redemption

Beneficial Owners may sell their Shares in the secondary market. Alternatively, investors that own enough Shares to constitute a Redemption Unit (currently, 25,000 Shares, subject to change) or multiples thereof may redeem those Shares by placing an order through an Authorized Participant ("AP") and in turn through the Distributor, which will act as the Trust's agent for redemption. Each Redemption Unit currently consists of 25,000 Shares, however, similar to Creation Units, the size of a Redemption Unit is subject to change. Beneficial Owners that wish to redeem Shares in less than Redemption Unit size may, in limited circumstances, redeem those Shares directly from the Funds as described below under "Small Allotment Redemption Option."

The Shares may be redeemed to a Fund in Redemption Unit size or multiples thereof as described below. Redemption orders of Redemption Units must be placed by or through an

Authorized Participant (“AP Redemption Order”). Each Fund will establish an Order Cut-Off Time for redemption orders of Redemption Units in proper form. Redemption Units of the Funds will be redeemable at their NAV per Share next determined after receipt by the Trust of an Authorized Participant redemption order request by the Trust in the manner specified below before the Order Cut-Off Time. To initiate an AP Redemption Order, an Authorized Participant must submit to the Distributor an irrevocable order to redeem such Redemption Unit after the most recent prior Valuation Time but before the Order Cut-Off Time. The Order Cut-Off Time for a Fund may be its Valuation Time, or may be prior to the Valuation Time if the Board determines that an earlier Order Cut-Off Time for redemption of Redemption Units is necessary and is in the best interests of Fund shareholders. An Order Cut-Off Time prior to Valuation Time is primarily necessary because of the redemption process for the Funds. It is contemplated that Authorized Participants will instruct the trustee of its blind trust to liquidate redemption securities in market on close orders on the date of redemption so that Authorized Participants can realize redemption proceeds as close to the Fund’s NAV on the redemption date as possible. In order to allow the Adviser sufficient time to identify the redemption securities, transfer the redemption basket of portfolio securities to the blind trusts and permit the trustee adequate time to process liquidation transactions in accordance with the Authorized Participant’s instructions, it will likely be necessary to employ an Order Cut-Off Time prior to that time to allow such actions to take place. It is anticipated that all Funds will adopt Order Cut-Off Times for redemptions prior to their Valuation Time in order to facilitate the timely identification and notice to the trustee of the blind trusts (as described below) of securities to be redeemed in-kind.

Consistent with the provisions of Section 22(e) of the 1940 Act and Rule 22e-2 thereunder, the right to redeem will not be suspended, nor payment upon redemption delayed,

except for: (1) any period during which the Exchange is closed other than customary weekend and holiday closings; (2) any period during which trading on the Exchange is restricted; (3) any period during which an emergency exists as a result of which disposal by a Fund of securities owned by it is not reasonably practicable or it is not reasonably practicable for a Fund to determine its NAV; and (4) for such other periods as the Commission may by order permit for the protection of shareholders.

Redemptions other than redemptions occurring through the Small Allotment Redemption Option, as described below, will occur primarily in-kind, although redemption payments may also be made partly or wholly in cash.<sup>22</sup> The Participant Agreement signed by each Authorized Participant will require establishment of a blind trust to receive distributions of securities in-kind upon redemption.<sup>23</sup> Each Authorized Participant will be required to appoint the Custodian as trustee of its blind trust in order to facilitate orderly processing of redemptions. While the Funds will generally distribute securities in-kind, the Adviser may determine from time to time that it is not in the Fund's best interests to distribute securities in-kind, but rather to sell securities and/or distribute cash. For example, the Adviser may distribute cash to facilitate orderly portfolio management in connection with rebalancing or transitioning a portfolio in line with its investment objective, or if there is substantially more creation than redemption activity during the period immediately preceding a redemption request, or as necessary or appropriate in accordance with applicable laws and regulations. In this manner, the Funds can use in-kind

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<sup>22</sup> It is anticipated that any portion of a Fund's NAV attributable to appreciated short positions will be paid in cash, as securities sold short are not susceptible to in-kind settlement. The value of other positions not susceptible to in-kind settlement may also be paid in cash.

<sup>23</sup> The terms of the blind trust will provide that the trust be formed under New York or Massachusetts State law; the Custodian will act as trustee of the blind trusts; and the trustee will be paid by the Authorized Participant a fee negotiated by the Adviser on behalf of Authorized Participants.

redemptions to reduce the unrealized capital gains that may, at times, exist in a Fund by distributing low cost lots of each security that a Fund needs to dispose of to maintain its desired portfolio exposures. Shareholders of a Fund would benefit from the in-kind redemptions through the reduction of the unrealized capital gains in a Fund that would otherwise have to be realized and, eventually, distributed to shareholders.

The Adviser would be free to select redemption securities that do not represent an exact slice of a Fund's portfolio in an amount equal to the Fund's NAV (inclusive of a cash balancing amount, if any) on any given day, meaning that the securities included in the redemption proceeds indirectly received by an AP may or may not be proportionate to the overall portfolio holdings of a Fund. To the extent a Fund distributes portfolio securities through an in-kind distribution to more than one blind trust for the benefit of that trust's Authorized Participant, the Fund expects to distribute a pro rata portion of the portfolio securities selected for distribution to each redeeming Authorized Participant. After receipt of an AP Redemption Order, the Custodian will typically deliver securities to the blind trust (which securities are determined by the Adviser) with a value approximately equal to the value of the NAV tendered for redemption at the Order Cut-Off Time. The Custodian will make delivery of the securities by appropriate entries on its books and records transferring ownership of the securities to the blind trust, subject to delivery of the Shares redeemed. The trustee of the blind trust will in turn liquidate, hedge or otherwise manage the securities based on instructions from the Authorized Participant.<sup>24</sup> If the

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<sup>24</sup> Because an Authorized Participant would not know the holdings of its blind trust, it is anticipated that such instructions would be generic standing instructions to the trustee. Although an Authorized Participant could, in its sole discretion, provide different standing instructions, it is expected that, in order to realize proceeds from a redemption at a value as close as possible to the redemption's NAV, all Authorized Participants will likely instruct the trustee of the blind trust to sell all securities received in kind as redemption proceeds at the close of the market on the date of redemption. For this



trustee is instructed to sell all securities received at the close on the redemption date, the trustee will pay the liquidation proceeds net of expenses plus or minus any cash balancing amount to the Authorized Participant through DTC.<sup>25</sup> The redemption securities that the blind trust receives may mirror the portfolio holdings of a Fund pro rata or, if the Adviser determines to reduce one or more portfolio exposures through an in-kind distribution, may constitute only a portion of the holdings that would not be proportionate to the overall portfolio holdings of a Fund. To the extent a Fund distributes portfolio securities through an in-kind distribution to more than one blind trust for the benefit of each blind trust's Authorized Participant, each Fund expects to distribute a pro rata portion of the portfolio securities selected for distribution to each redeeming Authorized Participant. Authorized Participants will advise the Funds of any securities they are restricted from receiving. If the Authorized Participant would receive a security that it is restricted from receiving, the Funds will deliver cash equal to the value of that security.

The Adviser might choose to select redemption securities that do not represent an exact slice of a Fund's portfolio in order to effectively implement changes to a Fund's portfolio composition, take advantage of tax strategies or address corporate actions. The Adviser represents that this freedom will benefit Beneficial Owners because the Adviser can use redemption events to liquidate unwanted positions without incurring brokerage charges or taxable gains. To address odd lots, fractional shares, tradeable sizes or other situations where

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reason, an Order Cut-Off Time prior to the Valuation Time for redemptions will be necessary so that the Adviser is able to identify securities to be redeemed in-kind to the Custodian prior to the close of the market on the redemption date.

<sup>25</sup> Under applicable provisions of the Internal Revenue Code, the Authorized Participant is expected to be deemed a "substantial owner" of the blind trust because it receives distributions from the blind trust. As a result, all income, gain or loss realized by the blind trust will be directly attributed to the Authorized Participant. In a redemption, the Authorized Participant will have a basis in the distributed securities equal to the fair market value at the time of the distribution and any gain or loss realized on the sale of those Shares will be taxable income to the Authorized Participant.

dividing securities is not practical or possible, the Adviser may make minor adjustments to the pro rata portion of portfolio securities selected for distribution to each redeeming Authorized Participant on such Business Day.

An AP Redemption Order is subject to acceptance by the Trust and must be preceded or accompanied by an irrevocable commitment to deliver the requisite number of Shares. At the time of settlement, an Authorized Participant will initiate a delivery of the Shares versus subsequent payment against the proceeds, if any, of the sale of portfolio securities distributed to the applicable blind trust plus or minus any cash balancing amounts, and less the expenses of liquidation. The Trust, on behalf of a Fund, will maintain a security interest in the assets of a blind trust and, under applicable documentation, will be entitled to such assets in the event an Authorized Participant fails to make timely delivery of redeemed Shares.

#### Small Allotment Redemption Option

Beneficial Owners may submit orders to redeem Shares at NAV directly with a Fund as described below. Beneficial Owners may submit orders to redeem Shares at NAV directly to a Fund for a limited period following circumstances in which the secondary market price for the Shares at the Valuation Time has deviated from NAV within specified parameters described below (“Small Allotment Redemption Option”).

A Beneficial Owner will be able to place an order directly to a Fund if, for 10 consecutive Business Days, the Bid/Ask Price has a discount of 5% or greater from NAV (the “Trigger Event”). Following a Trigger Event, all Beneficial Owners of a Fund will have the option, beginning on the first Business Day after a Trigger Event and ending 15 calendar days following the Trigger Event (the “Small Allotment Redemption Notice Period”), to instruct the DTC Participant through which they hold Shares to submit an order to redeem Shares directly from the

Fund (“Small Allotment Redemption Order”). Redemption proceeds in connection with any Small Allotment Redemption Option will be distributed in cash. Any Beneficial Owner may submit a Small Allotment Redemption Order during the Small Allotment Redemption Notice Period, but may only submit an amount of Shares for redemption smaller than a Redemption Unit. During the Small Allotment Redemption Notice Period, redemptions of Redemption Units by and through Authorized Participants will remain available.

On each Business Day during the Small Allotment Redemption Period, a Fund will process all Small Allotment Redemption Orders received at the NAV of the Fund next calculated following submission of the Small Allotment Redemption Order in proper form, subject to a redemption fee for administering and processing such orders, not to exceed 2% of NAV of the Shares redeemed. The date the Small Allotment Redemption Order is received in proper form will be the redemption date with respect to those Shares (the “Redemption Date”). Each Fund will establish a cut-off time for Small Allotment Redemption Orders in proper form, which may be earlier than the time of calculation of the NAV in order to facilitate the timely submission of such orders from DTC to the Transfer Agent, in its capacity as the redemption agent for the Funds, for processing the order at NAV on each applicable Redemption Date. All instructions from Beneficial Owners to their DTC Participants to submit a Small Allotment Redemption Order in proper form will be processed by the DTC Participant and submitted through DTC as long as it is received prior to the cut-off time, resulting in an aggregated redemption order received by the Transfer Agent from DTC on that Business Day. Any redemption instructions submitted by a DTC Participant on behalf of Beneficial Owners to DTC and received in proper form by the Transfer Agent/Redemption Agent shall be irrevocable. Only Small Allotment

Redemption Orders for an amount of Shares smaller than a Redemption Unit will be considered in proper form.

The date of payment upon redemption will not exceed seven days after the Redemption Date, other than as provided by Section 22(d) of the Act. The cash proceeds from any Small Allotment Redemption Order received are generally expected to be delivered through DTC to the applicable DTC Participant's account at DTC. The DTC Participant will in turn deposit the proceeds in the Beneficial Owner's account or the account of the financial institution carrying the account of the Beneficial Owner.

Upon the occurrence of a Trigger Event, a Fund will notify Beneficial Owners of the [sic] their ability to place a Small Allotment Redemption Order by (a) issuing a press release, (b) delivering notice, via the Transfer Agent and DTC, to the DTC Participant, and (c) posting information about the Small Allotment Redemption Notice Period on the Fund's website. Notice delivered through DTC will closely resemble existing DTC processes commonly used to notify beneficial shareholders with respect to corporate actions that require shareholder response or action.<sup>26</sup> Following notice to DTC of the Trigger Event, owners of record of a Fund (which are also DTC Participants) are then expected to use their standard notification procedures to disseminate the necessary information to Beneficial Owners to participate in the Small Allotment Redemption Option, in accordance with FINRA requirements and pursuant to any agreement

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<sup>26</sup> Based on the issuer of the Funds' (the "Issuer") current understanding of DTC processes for corporate actions, the Issuer expects that the Transfer/Redemption Agent will transmit files to the DTC providing the necessary information for DTC to initiate the Small Allotment Redemption Notice Period. The DTC will validate the information and will send a confirmation back to the Transfer/Redemption Agent that the Small Allotment Notice Period has commenced. The DTC will then transmit information about the commencement of the Small Allotment Notice Period to broker-dealers to notify the Beneficial Owners.

between a DTC Participant and the Beneficial Owner.<sup>27</sup> Shareholders who wish to place a Small Allotment Redemption Order should so instruct their intermediary. If the intermediary is a DTC Participant, it will notify DTC (and, through DTC, the Transfer Agent) of any Small Allotment Redemption Orders received from Beneficial Owners and deliver Shares to be redeemed to the Transfer Agent at an account maintained at DTC for such purpose.<sup>28</sup>

No more than one Small Allotment Redemption Notice Period may exist for any one Fund at any time. In the event that a Trigger Event still exists after a Small Allotment Redemption Notice Period has ended, a subsequent Small Allotment Redemption Notice Period will commence on the first Business Day following the last Business Day of the previous Small Allotment Redemption Notice Period. Any Small Allotment Redemption Order placed during the subsequent Small Allotment Redemption Notice Period will be subject to the same processes and requirements applicable to a Small Allotment Redemption Order placed during the previous Small Allotment Redemption Notice Period.

The Small Allotment Redemption Option will be subject to Board oversight. The Small Allotment Redemption Option will be included in the organizational documents or resolutions of the Funds before the commencement of operations.

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<sup>27</sup> See e.g., Financial Industry Regulatory Authority (“FINRA”) Rule 2251, which requires members to forward issuer-related materials to a beneficial owner if the member carries the account for such beneficial owner. The Issuer believes that broker-dealers that own Shares in an account at DTC will be required under such rule to forward notice of the Trigger Event and the opening of the Small Allotment Redemption Notice Period to all customers who are Beneficial Owners.

<sup>28</sup> The Issuer believes that for non-DTC Participants, a similar process will apply through their clearing firms. For example, in the case of a broker-dealer intermediary that is not a DTC Participant, the Issuer expects that the intermediary will notify its clearing firm of any Small Allotment Redemption Orders received from Beneficial Owners. The clearing firm will, in turn, notify DTC (and, through DTC, the Transfer/Redemption Agent) of the Small Allotment Redemption Orders and deliver Shares to be redeemed to the Transfer Agent at an account maintained at DTC for such purpose.

## Transactions

The Trust may impose purchase or redemption transaction fees (“Transaction Fees”) in connection with the purchase or redemption of Shares from the Funds. The exact amounts of any such Transaction Fees will be determined by the Adviser but for redemptions will not exceed 2% of NAV of the Shares being redeemed. The purpose of the Transaction Fees is to protect the continuing shareholders against possible dilutive transactional expenses, including operational processing and brokerage costs, associated with establishing and liquidating portfolio positions, including short positions, in connection with the purchase and redemption of Shares. The Adviser believes that imposing Transaction Fees will best respond to market needs and help to defray certain costs that would otherwise be borne by the Funds, such as custodian transaction fees and various other fund overhead costs and fund accounting costs.

The Adviser, in its sole discretion, may determine the Transaction Fees for the purchase or redemption of Shares, which may be increased, decreased or otherwise modified from time to time, provided that the Transaction Fees (assessed/charged) on redemption transactions may not exceed 2% of NAV of the Shares being redeemed. The currently effective creation and redemption Transaction Fees will be specified in each Fund’s most recent registration statement. Such Transaction Fees will be limited to amounts that will have been determined by the Adviser to be appropriate and will take into account transaction and operational processing costs associated with the recent purchases and sales of investments made by the Trust. In all cases, such Transaction Fees will be limited in accordance with then existing requirements of the Commission applicable to management investment companies offering redeemable securities.

Only DTC Participants that have signed an AP Agreement with the Trust and their customers will be able to acquire Shares at NAV directly from a Fund through the Distributor.

The entire required cash payment must be transferred in the manner specified by the Trust on or before the date and time specified therein. These investors and others will also be able to purchase Shares in secondary market transactions at prevailing market prices. Each Fund will reserve the right to reject any purchase order at any time.

Additional information regarding the Shares and each Fund, including investment strategies, risks, creation and redemption procedures, fees and expenses, portfolio holdings disclosure policies, distributions, taxes and reports to be distributed to beneficial owners of the Shares are proposed to be available in each Fund's registration statement or on the website for the Funds ([www.iShares.com](http://www.iShares.com)), as applicable.

#### Availability of Information

The Funds' website, which will be publicly available prior to the public offering of Shares, will include a form of the prospectus for the Funds that may be downloaded. The website will include additional quantitative information updated on a daily basis, including, for the Funds: (1) the prior business day's reported NAV, the Bid/Ask Price, daily trading volume, and a calculation of the premium and discount of the Bid/Ask Price against the NAV; and (2) data in chart format displaying the frequency distribution of discounts and premiums of the daily Bid/Ask Price against the NAV, within appropriate ranges, for each of the four previous calendar quarters. The website and information will be publicly available at no charge.

As noted above, a mutual fund is required to file with the Commission its complete portfolio schedules for the second and fourth fiscal quarters on Form NSAR under the 1940 Act, and is required to file its complete portfolio schedules for the first and third fiscal quarters on Form N-Q under the 1940 Act, within 60 calendar days from the end of the quarter. Form N-Q requires funds to file the same schedules of investments that are required in annual and semi-

annual reports to shareholders. The Trust's SAI and each Fund's shareholder reports will be available free upon request from the Trust. These documents and forms may be viewed on-screen or downloaded from the Commission's website at [www.sec.gov](http://www.sec.gov).

Daily trading volume information will be available in the financial section of newspapers, through subscription services such as Bloomberg, Thomson Reuters, and International Data Corporation, which can be accessed by authorized participants and other investors, as well as through other electronic services, including major public websites.

The IIV, which is the approximate value of each Fund's investments on a per Share basis, will be disseminated every 15 seconds during Regular Trading Hours. The IIV should not be viewed as a "real-time" update of NAV because the IIV may not be calculated in the same manner as NAV, which is computed once per day.

An independent third party calculator will calculate the IIV for each Fund during, at least, Regular Trading Hours, by dividing the "Estimated Fund Value" (as described below) as of the time of the calculation by the total number of outstanding Shares of that Fund. "Estimated Fund Value" is the sum of the estimated amount of cash held in a Fund's portfolio, the estimated amount of accrued interest owed to a Fund and the estimated value of the securities held in the Fund's portfolio, minus the estimated amount of a Fund's liabilities.

The Funds will provide the independent third party calculator with information to calculate the IIV, but the Funds will not be involved in the actual calculation of the IIV.<sup>29</sup>

Additional information regarding the Trust and the Shares, including investment strategies, risks, creation and redemption procedures, fees, portfolio holdings disclosure policies,

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<sup>29</sup> Currently, it is the Exchange's understanding that several major market data vendors display and/or make widely available IIVs published via the Consolidated Tape Association ("CTA") or other data feeds.



distributions and taxes is included in the Exemptive Relief Application. In addition, the quotations of certain of the Fund's holdings may not be updated during U.S. trading hours if such holdings do not trade in the United States or if updated prices cannot be ascertained. Price information for the exchange-listed equity securities held by the Funds will be available through major market data vendors and national securities exchanges listing and trading such securities. All equity securities held by the Funds will be listed on national securities exchanges.

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. The previous day's closing price and trading volume information for the Shares will be published daily in the financial section of newspapers. Quotation and last sale information for the Shares will be available on the facilities of the CTA.

#### Initial and Continued Listing

The Shares will be subject to BATS Rule 14.11(k), which sets forth the initial and continued listing criteria applicable to Managed Portfolio Shares. The Exchange represents that, for initial and/or continued listing, the Funds must be in compliance with Rule 10A-3 under the Act.<sup>30</sup> A minimum of 100,000 Shares will be outstanding at the commencement of trading on the Exchange. The Exchange will obtain a representation from the issuer of the Shares that the NAV per Share will be calculated daily and that the NAV will be made available to all market participants at the same time.

#### Trading Halts

With respect to trading halts, the Exchange may consider all relevant factors in exercising its discretion to halt or suspend trading in the Shares of the Funds. The Exchange will halt

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<sup>30</sup> See 17 CFR 240.10A-3.

trading in the Shares under the conditions specified in BATS Rule 11.18. Trading may be halted because of market conditions or for reasons that, in the view of the Exchange, make trading in the Shares inadvisable. These may include: (1) if the IIV applicable to a Fund's Shares is not being disseminated as required; (2) the extent to which trading is not occurring in the securities and/or the financial instruments comprising the holdings of a Fund; or (3) whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present. Trading in the Shares also will be subject to Rule 14.11(k)(4)(B)(iii), which sets forth circumstances under which Shares of the Funds may be halted.

#### Trading Rules

The Exchange deems the Shares to be equity securities, thus rendering trading in the Shares subject to the Exchange's existing rules governing the trading of equity securities. BATS will allow trading in the Shares from 8:00 a.m. until 5:00 p.m. Eastern Time. The Exchange has appropriate rules to facilitate transactions in the Shares during all trading sessions. As provided in BATS Rule 11.11(a), the minimum price variation for quoting and entry of orders in Managed Portfolio Shares traded on the Exchange is \$0.01, with the exception of securities that are priced less than \$1.00, for which the minimum price variation for order entry is \$0.0001.

#### Surveillance

The Exchange believes that its surveillance procedures are adequate to properly monitor the trading of the Shares on the Exchange during all trading sessions and to deter and detect violations of Exchange rules and the applicable federal securities laws. Trading of the Shares through the Exchange will be subject to the Exchange's surveillance procedures for derivative products. The Exchange may obtain information regarding trading in the Shares and the underlying shares in equity securities, futures, and options via the Intermarket Surveillance

Group (“ISG”), from other exchanges who are members or affiliates of the ISG, or with which the Exchange has entered into a comprehensive surveillance sharing agreement.<sup>31</sup> The Funds’ Adviser will make available to the Exchange the portfolio holdings of each Fund in order to facilitate the performance of the surveillances referred to above. The Exchange prohibits the distribution of material non-public information by its employees.

#### Information Circular

Prior to the commencement of trading, the Exchange will inform its members in an Information Circular of the special characteristics and risks associated with trading the Shares of each Fund. Specifically, the Information Circular will discuss the following: (1) the procedures for purchases and redemptions of Shares in Creation Units and Redemption Units as well as in amounts less than a Redemption Unit through Small Allotment Redemptions; (2) BATS Rule 3.7, which imposes suitability obligations on Exchange members with respect to recommending transactions in the Shares to customers; (3) how information regarding the IIV is disseminated; (4) the risks involved in trading the Shares during the Pre-Opening<sup>32</sup> and After Hours Trading Sessions<sup>33</sup> when an updated IIV will not be calculated or publicly disseminated; (5) the requirement that members deliver a prospectus to investors purchasing newly issued Shares prior to or concurrently with the confirmation of a transaction; and (6) trading information.

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<sup>31</sup> For a list of the current members and affiliate members of ISG, see [www.isgportal.com](http://www.isgportal.com). The Exchange notes that not all components of the Funds may trade on markets that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement. The Exchange also notes that all of the equity securities, futures, and options will trade on markets that are a member of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.

<sup>32</sup> The Pre-Opening Session is from 8:00 a.m. to 9:30 a.m. Eastern Time.

<sup>33</sup> The After Hours Trading Session is from 4:00 p.m. to 5:00 p.m. Eastern Time.

In addition, the Information Circular will advise members, prior to the commencement of trading, of the prospectus delivery requirements applicable to each Fund. Members purchasing Shares from the Funds for resale to investors will deliver a prospectus to such investors. The Information Circular will also discuss any exemptive, no-action, and interpretive relief granted by the Commission from any rules under the Act.

In addition, the Information Circular will reference that the Funds are subject to various fees and expenses described in the Registration Statement. The Information Circular will also disclose the trading hours of the Shares of the Funds and the applicable NAV Calculation Time for the Shares. The Information Circular will disclose that information about the Shares of the Funds will be publicly available on the Funds' website.

## 2. Statutory Basis

The Exchange believes that the proposal is consistent with Section 6(b) of the Act<sup>34</sup> in general and Section 6(b)(5) of the Act<sup>35</sup> in particular in that it is designed to prevent fraudulent and manipulative acts and practices, 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.

The Exchange believes that proposed Rule 14.11(k) is 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 in that the proposal will allow issuers to list, and market participants to invest in, a new type of exchange traded product.

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<sup>34</sup> 15 U.S.C. 78f.

<sup>35</sup> 15 U.S.C. 78f(b)(5).

The Exchange believes that the proposed rule change is designed to prevent fraudulent and manipulative acts and practices in that Managed Portfolio Shares would be listed and traded on the Exchange pursuant to the proposed Rule 14.11(k), which the Exchange believes creates sufficiently rigorous standards related to the initial listing, continued listing, and surveillance of Managed Portfolio Shares as to prevent market manipulation and fraud in such securities.

Proposed Rule 14.11(k)(4) sets forth the proposed initial and continued listing criteria applicable to Managed Portfolio Shares. Proposed Rule 14.11(k)(4)(A)(i) and (ii) provides that all series of Managed Portfolio Shares must meet both of the following initial listing criteria: for each series, the Exchange will establish a minimum number of Managed Portfolio Shares required to be outstanding at the time of commencement of trading on the Exchange and the Exchange will obtain a representation from the issuer of each series of Managed Portfolio Shares that the NAV per share for the series will be calculated daily and that the NAV will be made available to all market participants at the same time. Proposed Rule 14.11(k)(4)(B)(i) provides that the IIV for a series of Managed Portfolio Shares will be widely disseminated by one or more major market data vendors at least every 15 seconds during Regular Trading Hours. Proposed Rule 14.11(k)(4)(B)(ii) provides that the Exchange will consider the suspension of trading in or removal from listing of a series of Managed Portfolio Shares under any of the following circumstances: (a) if, following the initial twelve-month period after commencement of trading on the Exchange of a series of Managed Portfolio Shares, there are fewer than 50 beneficial holders of the series of Managed Portfolio Shares for 30 or more consecutive trading days; (b) if the value of the IIV is no longer calculated or made available to all market participants at the same time; (c) if the Investment Company issuing the Managed Portfolio Shares has failed to file any filings required by the Securities and Exchange Commission or if the Exchange is aware that

the Investment Company is not in compliance with the conditions of any exemptive order or no-action relief granted by the Securities and Exchange Commission to the Investment Company with respect to the series of Managed Portfolio Shares; or (d) if such other event shall occur or condition exists which, in the opinion of the Exchange, makes further dealings on the Exchange inadvisable.

As proposed, Rule 14.11(k)(4)(B)(iii) provides that if the IIV of a series of Managed Portfolio Shares is not being disseminated as required, the Exchange 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 occurred, the Exchange 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 Managed Portfolio Shares is not 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.

Proposed Rule 14.11(k)(2)(F) provides that, if the investment adviser to the Investment Company issuing Managed Portfolio Shares is affiliated with a broker-dealer, such investment adviser shall erect a “fire wall” between the investment adviser and the broker-dealer with respect to access to information concerning the composition and/or changes to such Investment Company portfolio. Personnel who make decisions on the Investment Company’s portfolio composition must be subject to procedures designed to prevent the use and dissemination of material nonpublic information regarding the applicable Investment Company portfolio.

With respect to the proposed listing and trading of Shares of the Funds, the Exchange believes that the proposed rule change is designed to prevent fraudulent and manipulative acts and practices in that the Shares will be listed and traded on the Exchange pursuant to the initial

listing criteria, continued listing criteria, and the surveillance procedures set forth in BATS Rule 14.11(k), which, as described above, the Exchange believes are sufficiently rigorous to prevent market manipulation and fraud in such securities. The Exchange further believes that the proposed rule change prevents fraudulent and manipulative acts and practices because the Issuer has also represented that each Fund will be subject to the following diversity and market capitalization standards, which will further help prevent fraudulent and manipulative acts in both the Funds and their respective underlying securities. Each fund will hold equity securities of at least 13 non-affiliated issuers, primarily from the 1,200 largest U.S. stocks by market capitalization as determined by The Frank Russell Company annually. Generally, the Large/Mid Cap funds will select securities from a universe of approximately the 1,200 largest equity securities traded on U.S. exchanges and the Large Cap funds will select securities from a universe of approximately the 1,000 largest equity securities traded on U.S. exchanges. A Fund will not purchase the securities of issuers conducting their principal business activity in the same industry if, immediately after the purchase and as a result thereof, the value of the Fund's investments in that industry would equal or exceed 25% of the current value of the Fund's total assets, provided that this restriction does not limit the Fund's: (i) investments in securities of other investment companies, (ii) investments in securities issued or guaranteed by the U.S. government, its agencies or instrumentalities, or (iii) investments in repurchase agreements (including reverse-repurchase agreements) collateralized by U.S. government securities.<sup>36</sup> According to the Exemptive Relief Application, each Fund's investment objective will be long-term capital appreciation. To achieve their objective, each Fund will invest, under normal circumstances, at least 80% of its net assets in a portfolio of long positions (or engage in

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<sup>36</sup> See note 21, *supra*.

borrowings for the purpose of establishing short positions for the Long-Short funds) in U.S. equity securities. The Funds may in some instances also invest in non-U.S. equity securities with similar market capitalization, liquidity, and risk-return profiles to the U.S. equity securities eligible for investment by the Fund where the Adviser determines that investing in the security is consistent with the Fund's investment objective. The Funds will not be money market funds and thus will not seek to maintain a stable NAV of \$1.00 per Share. In the absence of normal circumstances, a Fund may temporarily depart from its normal investment process, provided that such departure is, in the opinion of BFA, consistent with the Fund's investment objective and in the best interest of the Fund. For example, a Fund may hold a higher than normal proportion of its assets in cash in response to adverse market, economic, or political conditions. The Funds each intend to qualify each year as a regulated investment company (a "RIC") under Subchapter M of the Internal Revenue Code of 1986, as amended.<sup>37</sup> The Funds will invest their respective assets, and otherwise conduct their respective operations, in a manner that is intended to satisfy the qualifying income, diversification and distribution requirements necessary to establish and maintain RIC qualification under Subchapter M.

A Fund may, to a limited extent (under normal circumstances, less than 20% of the Fund's net assets), engage in transactions in futures contracts, forward contracts, options, and swaps.<sup>38</sup>

A Fund may also invest a portion of its assets in Money Market Instruments on an ongoing basis rather than in other investments, when it would be more efficient or less expensive for the Fund to do so, or as cover for other financial instruments held by a Fund, for liquidity purposes, or to earn interest.

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<sup>37</sup> 26 U.S.C. 851.

<sup>38</sup> See note 18, supra.



A Fund may hold up to an aggregate amount of 15% of its net assets in illiquid securities (calculated at the time of investment) deemed illiquid by the Adviser<sup>39</sup> under the 1940 Act.<sup>40</sup> A Fund will monitor its portfolio liquidity on an ongoing basis to determine whether, in light of current circumstances, an adequate level of liquidity is being maintained, and will consider taking appropriate steps in order to maintain adequate liquidity if, through a change in values, net assets, or other circumstances, more than 15% of the Fund's net assets are held in illiquid securities. Illiquid securities include securities subject to contractual or other restrictions on resale and other instruments that lack readily available markets as determined in accordance with Commission staff guidance

The listing and trading of such securities is subject to the rules of the exchanges on which they are listed and traded, as approved by the Commission. The Funds will primarily hold securities consisting of the 1,200 largest U.S. stocks by market capitalization as determined by The Frank Russell Company annually. To the extent that a Fund invests in futures contracts, forward contracts, options, and swaps, such investments will be consistent with the Fund's respective investment objective.<sup>41</sup>

The Exchange believes that its surveillance procedures are adequate to properly monitor the trading of the Shares on the Exchange during all trading sessions and to deter and detect violations of Exchange rules and the applicable federal securities laws. If the investment adviser to the investment company issuing Managed Portfolio Shares is affiliated with a broker-dealer, such investment adviser to the investment company shall erect a "fire wall" between the investment adviser and the broker-dealer with respect to access to information concerning the

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<sup>39</sup> See note 19, supra.

<sup>40</sup> See note 20, supra.

<sup>41</sup> See note 18, supra.

composition and/or changes to such investment company portfolio. The Adviser is not a registered broker-dealer, but is affiliated with multiple broker-dealers and has implemented “fire walls” with respect to such broker-dealers regarding access to information concerning the composition and/or changes to the Fund’s portfolio. The Exchange may obtain information regarding trading in the Shares and the underlying equity securities via the ISG, from other exchanges who are members or affiliates of the ISG, or with which the Exchange has entered into a comprehensive surveillance sharing agreement.<sup>42</sup>

The Exchange, after consulting with various market makers that trade ETFs (and other products) on various exchanges, believes that market makers will be able to make efficient and liquid markets priced near the IIV even without daily disclosure of a fund’s underlying portfolio as long as an accurate IIV is disseminated every 15 seconds, each fund’s means of achieving its investment objective is clearly disclosed based on publicly available information, and there is typically an ability to manage inventory of Shares through creations and redemptions each day. The Exchange believes that market makers will employ risk-management techniques such as “statistical arbitrage”, which is currently used throughout the financial services industry, to make efficient markets in exchange traded products as well as corporate issues. This ability should permit market makers to make efficient markets in an issue of Managed Portfolio Shares without knowledge of a fund’s underlying portfolio. The Exchange believes that the real-time dissemination of a fund’s IIV, together with the knowledge of a fund’s means of achieving its investment objective and the right of Authorized Participants to create and redeem shares of each fund daily at the NAV, will be sufficient for market participants to value and trade shares in a manner that will not lead to significant deviations between the shares’ Bid/Ask Price and NAV.

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<sup>42</sup> See note 31, supra.

The Exchange understands that traders use statistical analysis to derive correlations between different sets of instruments to identify opportunities to buy or sell one set of instruments when it is mispriced relative to the others. For Managed Portfolio Shares, market makers will initially use the knowledge of a fund's means of achieving its investment objective, as described in the proposed applicable fund registration statement, to construct a hedging proxy for a fund to assist them in managing their risk in connection with trading the shares of a fund. Market makers will then conduct statistical arbitrage between their hedging proxy (for example, the Russell 1000 Index) and the shares of a fund, buying and selling one against the other over the course of the trading day. Market makers will then be able to evaluate how their proxy performed in comparison to the price of the shares of a fund, and use that analysis as well as knowledge of risk metrics, such as volatility and turnover, to enhance their proxy calculation to make it a more efficient hedge.

Market makers have indicated to the Exchange that, after the first several days of trading, there will be sufficient data to run a statistical analysis which will lead to spreads being tightened substantially around the IIV. This is similar to certain other existing exchange traded products (for example, ETFs that invest in foreign securities that do not trade during U. S. trading hours), in which spreads may be generally wider in the early days of trading and then narrow as market makers gain more confidence in their real-time hedges.

The market makers also indicated that, as with some other new exchange traded products with full disclosure, spreads may be generally wider in the early days of trading and would tend to narrow as market makers gain more confidence in the accuracy of their hedges and their ability to adjust these hedges in real-time relative to the published IIV and gain an understanding of the applicable market risk metrics such as volatility and turnover, and as natural buyers and

sellers enter the market. Other relevant factors cited by market makers were that a fund's investment objectives are clearly disclosed in the applicable prospectus, and the existence of quarterly portfolio disclosure.

The Commission's concept release regarding "Actively Managed Exchange-Traded Funds" highlighted several issues that could impact the Commission's willingness to authorize the operation of an actively-managed ETF, including whether effective arbitrage of the ETF shares exists.<sup>43</sup> The Concept Release identifies the transparency of a fund's portfolio and the liquidity of the securities in a fund's portfolio as central to effective arbitrage. However, certain existing ETFs with portfolios of foreign securities have shown their ability to trade efficiently in the secondary market at approximately their NAV even though they do not provide opportunities for riskless arbitrage transactions during much of the trading day.<sup>44</sup> Such ETFs have been shown to have pricing characteristics very similar to ETFs that can be arbitrated in this manner. For example, index-based ETFs containing securities that trade during different trading hours than the ETF, such as ETFs that hold Asian stocks, have demonstrated efficient pricing characteristics notwithstanding the inability of market professionals to engage in "riskless arbitrage" with respect to the underlying portfolio for most, or even all, of the U.S. trading day when Asian markets are closed. Pricing for shares of such ETFs is efficient because market professionals are

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<sup>43</sup> See Investment Company Act Release No. 25258 (November 8, 2001) (the "Concept Release").

<sup>44</sup> The Exchange represents that the mechanics of arbitrage and hedging differ. Prior Rule 10a-1 and Regulation T under the Act both describe arbitrage as either buying and selling the same security in two different markets or buying and selling two different securities, one of which is convertible into the other. This is also known as a "riskless arbitrage" transaction in that the transaction is risk free since it generally consists of buying an asset at one price and simultaneously selling that same asset at a higher price, thereby generating a profit on the difference. Hedging, on the other hand, involves managing risk by purchasing or selling a security or instrument that will track or offset the value of another security or instrument. Arbitrage and hedging are both used to manage risk; however, they involve different trading strategies.

still able to hedge their positions with offsetting, correlated positions in derivative instruments during the entire trading day.

The Exchange believes that the real-time dissemination of a fund's IIV, disclosure of a fund's investment objective and principal investment strategies in its prospectus and SAI, together with the right of Authorized Participants to create and redeem each day at the NAV, will be sufficient for market participants to value and trade shares in a manner that will not lead to significant deviations between the shares' Bid/Ask Price and NAV. In addition, with respect to Shares of the Funds, the Small Allotment Redemption Option will permit Beneficial Owners holding amounts smaller than a Redemption Unit to redeem at NAV in the event that for 10 consecutive Business Days the Bid/Ask Price has a discount of 5% or greater from the NAV for at least 15 calendar days, which will permit Beneficial Owners holding amounts smaller than a Redemption Unit to redeem at NAV in the event that trading on the secondary market is consistently resulting in a negative variance between the NAV of a Fund's Shares and the secondary market price of Shares at the Valuation Time.

The pricing efficiency with respect to trading a series of Managed Portfolio Shares will not generally rest on the ability of market participants to arbitrage between the shares and a fund's portfolio, but rather on the ability of market participants to assess a fund's underlying value accurately enough throughout the trading day in order to hedge positions in shares effectively. Professional traders will buy shares that they perceive to be trading at a price less than that which will be available at a subsequent time, and sell shares they perceive to be trading at a price higher than that which will be available at a subsequent time. It is expected that, as part of their normal day-to-day trading activity, market makers assigned to shares by the Exchange, off-exchange market makers, firms that specialize in electronic trading, hedge funds

and other professionals specializing in short-term, non-fundamental trading strategies will assume the risk of being “long” or “short” shares through such trading and will hedge such risk wholly or partly by simultaneously taking positions in correlated assets<sup>45</sup> or by netting the exposure against other, offsetting trading positions – much as such firms do with existing ETFs and other single stock equities. Disclosure of a fund’s investment objective and principal investment strategies in its prospectus and SAI, along with the dissemination of the IIV every 15 seconds, should permit professional investors to engage easily in this type of hedging activity.<sup>46</sup>

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<sup>45</sup> Price correlation trading is used throughout the financial industry. It is used to discover both trading opportunities to be exploited, such as currency pairs and statistical arbitrage, as well as for risk mitigation such as dispersion trading and beta hedging. These correlations are a function of differentials, over time, between one or multiple securities pricing. Once the nature of these price deviations have been quantified, a universe of securities is searched in an effort to, in the case of a hedging strategy, minimize the differential. Once a suitable hedging basket has been identified, a trader can minimize portfolio risk by executing the hedging basket. The trader then can monitor the performance of this hedge throughout the trade period, making corrections where warranted.

<sup>46</sup> With respect to trading in Shares of the Funds, market participants manage risk in a variety of ways. It is expected that market participants will be able to determine how to trade Shares at levels approximating the IIV without taking undue risk by gaining experience with how various market factors (e.g., general market movements, sensitivity of the IIV to intraday movements in interest rates or commodity prices, etc.) affect IIV, and by finding hedges for their long or short positions in Shares using instruments correlated with such factors. The Adviser expects that market participants will initially determine the IIV’s correlation to a major large capitalization equity benchmark with active derivative contracts, such as the Russell 1000 Index, and the degree of sensitivity of the IIV to changes in that benchmark. For example, using hypothetical numbers for illustrative purposes, market participants should be able to determine quickly that price movements in the Russell 1000 Index predict movements in a Fund’s IIV 95% of the time (an acceptably high correlation) but that the IIV generally moves approximately half as much as the Russell 1000 Index with each price movement. The Exchange believes that this information is sufficient for market participants to construct a reasonable hedge – buy or sell an amount of futures, swaps or ETFs that track the Russell 1000 equal to half the opposite exposure taken with respect to Shares. Market participants will also continuously compare the intraday performance of their hedge to a Fund’s IIV. If the intraday performance of the hedge is correlated with the IIV to the expected degree, market participants will feel comfortable they are appropriately hedged and can rely on the IIV as appropriately indicative of a Fund’s performance.

With respect to trading of Shares of the Funds, the ability of market participants to buy and sell Shares at prices near the IIV is dependent upon their assessment that the IIV is a reliable, indicative real-time value for a Fund's underlying holdings. Market participants are expected to accept the IIV as a reliable, indicative real-time value because (1) the IIV will be calculated and disseminated based on a Fund's actual portfolio holdings (rather than a proxy portfolio), (2) the securities in which the Funds plan to invest are generally highly liquid and actively traded and therefore generally have accurate real time pricing available, and (3) market participants will have a daily opportunity to evaluate whether the IIV at or near the close of trading is indeed predictive of the actual NAV. Because there is less risk of variability between the current IIV and the NAV nearer to the Valuation Time, it is expected that the bid/ask spread for Shares will initially tend to be less as the market approaches the close and market participants have a very high degree of certainty that they can trade at a level that reflects the current value of a Fund's holdings. It is also expected, however, that market participants will quickly be able to determine, after gaining experience with how various market factors (e.g., general market movements, sensitivity or correlations of the IIV to intraday movements in interest rates or commodity prices, other benchmarks, etc.) affect IIV, how best to hedge long or short positions taken in Shares in a manner that will permit them to provide a Bid/Ask Price for Shares that is near to the IIV throughout the day. The ability of market participants to accurately hedge their positions should serve to minimize any divergence between the secondary market price of the Shares and the IIV, as well as create liquidity in the Shares.

The Exchange believes that the real-time dissemination of a Fund's IIV, disclosure of a fund's investment objective and principal investment strategies in its prospectus and SAI together with the ability of Authorized Participants to create and redeem each day at the NAV,

will be enough information for market participants to value and trade Shares in a manner that will not lead to significant deviations between the Shares' Bid/Ask Price and NAV. In addition, the Small Allotment Redemption Option will permit Beneficial Owners holding amounts smaller than a Redemption Unit to redeem at NAV for a period of time following circumstances in which the secondary market price for the Shares at the Valuation Time has deviated from NAV within the specified parameters described above.

In a typical index-based ETF, it is necessary for Authorized Participants to know what securities must be delivered in a creation or will be received in a redemption. For Managed Portfolio Shares, however, Authorized Participants do not need to know the securities comprising the portfolio of a Fund since creations are for cash and redemptions are handled through the blind trust mechanism. The use of cash for creations, and in-kind redemption through a blind trust, will preserve the integrity of the active investment strategy and eliminate the potential for "free riding", while still providing investors with the advantages of the ETF structure.

The proposed rule change is designed to promote just and equitable principles of trade and to protect investors and the public interest in that the Exchange will obtain a representation from the issuer of the Shares that the NAV per Share will be calculated daily and will be made available to all market participants at the same time. Investors can also obtain a fund's SAI, shareholder reports, and its Form N-CSR and Form N-SAR. A fund's SAI and shareholder reports will be available free upon request from the applicable fund, and those documents and the Form N-CSR and Form N-SAR may be viewed on-screen or downloaded from the Commission's website. In addition, a large amount of information is publicly available regarding the Funds and the Shares, thereby promoting market transparency. Moreover, the IIV



will be disseminated by one or more major market data vendors at least every 15 seconds during Regular Trading Hours. Pricing information will be available on the Fund's website including: (1) the prior business day's reported NAV, the Bid/Ask Price, daily trading volume, and a calculation of the premium and discount of the Bid/Ask Price against the NAV; and (2) data in chart format displaying the frequency distribution of discounts and premiums of the daily Bid/Ask Price against the NAV, within appropriate ranges, for each of the four previous calendar quarters. Additionally, information regarding market price and trading of the Shares will be continually available on a real-time basis throughout the day on brokers' computer screens and other electronic services, and quotation and last sale information for the Shares will be available on the facilities of the CTA. The website for the Funds will include a form of the prospectus for the Funds and additional data relating to NAV and other applicable quantitative information. Trading in Shares of the Funds will be halted under the conditions specified in BATS Rule 11.18. Trading may also be halted because of market conditions or for reasons that, in the view of the Exchange, make trading in the Shares inadvisable. Finally, trading in the Shares will be subject to BATS Rule 14.11(k)(4)(B)(iii), which sets forth circumstances under which Shares of the Funds may be halted.

The proposed rule change is designed to perfect the mechanism of a free and open market and, in general, to protect investors and the public interest in that it will facilitate the listing and trading of an additional type of actively-managed exchange-traded product that will enhance competition among market participants, to the benefit of investors and the marketplace. As noted above, the Exchange has in place surveillance procedures relating to trading in the Shares and may obtain information via ISG, from other exchanges that are members of ISG, or with which the Exchange has entered into a comprehensive surveillance sharing agreement. In

addition, as noted above, investors will have ready access to information regarding IIV and quotation and last sale information for the Shares.

For the above reasons, the Exchange believes that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purpose of the Act. The Exchange believes the proposed rule change would permit listing and trading of another type of actively managed ETF that has characteristics different from existing actively-managed and index ETFs, and would introduce additional competition among various ETF products to the benefit of investors.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

The Exchange has neither solicited nor received written comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposal 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 No. SR-BATS-2014-018 on the subject line.

##### Paper Comments:

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

All submissions should refer to File No. SR-BATS-2014-018. 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 changes 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 am and 3:00 pm. Copies of such filing will also 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 No. SR-BATS-2014-018 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>47</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>47</sup> 17 CFR 200.30-3(a)(12).