

## SEC Requests Comment on NYSE Proposed Rule Changes that Would Allow Most Actively Managed ETFs to Forego the 19b-4 Application Process

On March 10, 2015, the SEC published a [notice](#) in the Federal Register requesting public comment on a [proposed rule change](#) from NYSE Arca, Inc. (“NYSE Arca”) that, if approved, would make it easier for actively managed exchange-traded funds (“ETFs”) to list and trade their shares (the “Notice”). Under current rules, actively managed ETFs are required to have a sponsoring exchange file a Rule 19b-4 application with the SEC and obtain SEC approval prior to listing and trading their shares. This process often takes several months and may take longer in some cases. In contrast, most index-tracking ETFs are not subject to the Rule 19b-4 application process due to an exception contained in NYSE Arca Equities Rule 5.2(j)(3). The proposed rules would apply a similar exception to actively managed ETFs through amendments to NYSE Arca Equities Rule 8.600. If the proposed rules are approved, the time required for, and costs associated with, launching an actively managed ETF would be reduced.

Rule 19b-4 under the Securities Exchange Act of 1934 requires any rule change necessary to list and trade a new derivative securities product to be approved by the SEC in advance of listing such product, unless the SEC has approved a self-regulatory organization’s (“SRO”) trading rules, procedures and listing standards for the product class, and the SRO has a surveillance program for that product class. ETFs are considered derivative securities products under this rule and, therefore, must obtain SEC approval of a Rule 19b-4 application or rely on an exception from Rule 19b-4.

NYSE Arca’s proposed rules would amend portions of NYSE Arca Equities Rule 8.600 to establish generic listing standards for actively managed ETF shares that satisfy certain criteria. The proposed rules apply to “Managed Fund Shares,” a term defined in Rule 8.600 to include actively managed ETFs. The proposed rules would amend Rule 8.600(d) to require that all Managed Fund Shares have a stated investment objective that must be adhered to under normal market conditions and a “Portfolio Indicative Value” that is widely disseminated every 15 seconds during the “core trading session,” as defined in NYSE Arca Equities Rule 7.34. In addition, the rules would add formal commentary to Rule 8.600 to establish portfolio standards that actively managed ETFs must satisfy in order to be exempt from the Rule 19b-4 application process. With respect to ETF investments in equity and fixed-income securities, the standards would mirror current requirements applicable to index-based ETFs in the commentary to NYSE Arca Equities Rule 5.2(j)(3).<sup>1</sup> However, the proposed commentary also contains standards for investments in cash and cash equivalents, derivative instruments, and illiquid securities, which are not currently addressed by Rule 5.2(j)(3).

The proposed commentary also would establish certain requirements for ETFs holding exchange-traded and over-the-counter (“OTC”) derivative instruments, but would not impose any percentage limitations on an ETF’s investments in such instruments. At least 90% of an ETF’s investments in exchange-traded futures and exchange-traded options would be required to consist of options and futures for which the principal market is a member of the Intermarket Surveillance Group or is a market with which NYSE Arca has a comprehensive surveillance sharing agreement. Moreover, an ETF’s website would be required to disclose, among other things, a description of the ETF’s holdings of both exchange-traded and OTC derivatives, each

---

<sup>1</sup> For example, a qualifying ETF’s investments in equity securities would be subject to numerous requirements relating to market capitalization, trading volume, and individual position limits, among others. Among these key requirements: (i) 90% of an ETF’s investments in stocks must be in companies with a market value of at least \$75 million; (ii) 70% of the ETF’s investments in stock must meet monthly trading volume requirements; (iii) no single position may exceed 30% of the ETF’s stock portfolio and the ETF’s top five positions together may not exceed 65% of the portfolio; and (iv) the ETF’s portfolio must generally consist of at least 13 different stocks. The requirements for a qualifying ETF’s investments in fixed-income securities are generally similar.

derivative's reference asset, a ticker symbol or other identifier, and the market value and percentage weight of the derivative in the ETF's portfolio.

Finally, the proposed commentary would set standards for an ETF's use of cash and cash equivalents and investments in illiquid securities. Actively managed ETFs could not invest more than 15% of their assets in illiquid investments, which mirrors the requirement under the Investment Company Act of 1940 and SEC guidance applicable to all open-end funds.

The Notice states that the standards for an ETF's investments in these instruments, including derivatives, are based upon previously approved Rule 19b-4 applications on behalf of other actively managed ETFs. In effect, it appears that the proposed commentary would codify the conditions that the SEC has required in prior Rule 19b-4 applications for actively managed ETFs that invest in derivatives. The SEC has requested comments on whether it is appropriate for all actively managed ETFs to be subject to these proposed generic listing standards, which have previously only been required by some actively managed ETFs' approved Rule 19b-4 applications. The SEC also requested commenters' views on whether there should be any limits on the amounts or types of derivative instruments that should be permitted investments under the proposed generic listing standards.

Streamlining the exchange-listing process by establishing generic listing standards for actively managed ETFs will add certainty and efficiency to the process of creating actively managed ETFs. The SEC requested that comments on the proposal be submitted no later than March 31, 2015.

For further information concerning this development, please contact your usual Ropes & Gray attorney or any member of the Ropes & Gray [investment management group](#).