NYSE Files Proposed Rules for Listing of "Managed Portfolio Shares"

On January 23, 2014, NYSE Arca Equities filed a proposal with the SEC to permit the listing of "Managed Portfolio Shares," which are shares of actively managed exchange-traded funds ("ETFs") for which portfolio holdings are disclosed only quarterly. Actively managed ETFs have become increasingly popular recently,[1] and NYSE Arca's proposed rule 8.900 (the "Proposed Rule") would remove what is widely seen as a major drawback for certain actively managed strategies – the requirement for daily disclosure of portfolio holdings. Under the Proposed Rule, ETFs issuing Managed Portfolio Shares would be subject only to the same disclosure requirements (quarterly with a one-month lag) applicable to traditional mutual funds.

While a number of ETF sponsors have applied for, but not yet received, exemptive relief to create such "non-transparent" ETFs, this is the first time an exchange has filed a proposed rule to permit the listing of such ETFs.

The Proposed Rule provides that, as with traditional mutual funds, but unlike other ETFs, authorized purchasers will be able to purchase Managed Portfolio Shares for cash directly from the ETF at its NAV on any business day, and retail investors (defined as natural persons, trusts established exclusively for the benefit of natural persons or groups of related family members, or tax-deferred retirement plans where investments are selected by natural persons purchasing for their own accounts) may redeem Managed Portfolio Shares in any amount less than a "Redemption Unit" established by the ETF. This feature may lead ETFs relying on the Proposed Rule to incur higher brokerage costs, maintain higher levels of cash reserves (leading to "cash drag") and be less tax efficient than ETFs that effect purchase and redemption transactions in-kind (rather than in cash). On the other hand, it would allow retail investors who prefer to transact at the next-determined NAV to do so, while enabling them to invest in the same fund as investors who prefer intraday liquidity. The Proposed Rule provides that ETFs may recoup such brokerage and other transaction costs through transaction fees, which may not exceed 2%.

To prevent disclosure of portfolio holdings information in connection with redemptions of Redemption Units, the Proposed Rule provides for a mechanism whereby all authorized participants must agree to the establishment of a "blind trust" that will receive and liquidate in accordance with standing instructions all in-kind redemption consideration. In addition, the Proposed Rule would require investment advisers to ETFs issuing Managed Portfolio Shares to erect "fire walls" between the adviser and any affiliated broker-dealers with respect to information regarding the composition of the portfolio.

Other requirements under the Proposed Rule include a prohibition on investing in options, futures, forwards, swaps, leveraged ETFs or non-U.S. equity securities, and the dissemination of a "Portfolio Indicative Value" every 15 seconds during NYSE's core trading session that reflects an estimated intraday value of the ETF's portfolio. The Portfolio Indicative Value will be based on the most recent available sale information for each of the ETF's holdings as of the close of the prior business day.

In connection with the Proposed Rule, NYSE proposes to list and trade shares of three new Precidian Funds: ActiveShares℠ Large-Cap Fund, ActiveShares℠ Mid-Cap Fund, and ActiveShares℠ Multi-Cap Fund.

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[1] *See, e.g.,* Ropes & Gray Alert, Exemptive Relief filed for New "Exchange-Traded Managed Fund," April 12, 2013; Ropes & Gray Alert, Recent Wave of Actively Managed ETFs Overcomes Lengthy Approval Process, March 13, 2012.

If you would like to learn more about the development discussed in this Alert, please contact the Ropes & Gray attorney with whom you regularly work or any member of the Ropes & Gray investment management group listed below.

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