Precidian Re-Files Application for Exemptive Relief to Permit Nontransparent Actively Managed Exchange-Traded Funds

On December 22, 2014, Precidian ETFs Trust (the "Trust"), Precidian Funds LLC (the "Adviser") and Foreside Fund Services, LLC (the "Distributor" and, together with the Trust and the Adviser, the "Applicants") filed an exemptive application (the "Application") under the Investment Company Act, as amended (the "1940 Act") requesting permission to operate actively managed exchange-traded funds ("ETFs") that would not be required to disclose their portfolio holdings on a daily basis.

The Application was filed approximately two months after the SEC's notice of its intention to deny a prior proposal from the same Applicants that requested similar relief. The SEC's denial of the prior proposal outlined several concerns about the Applicants' proposed ETF structure, primarily focusing on how the proposed arbitrage mechanisms fell short of the mechanisms in place for typical actively-managed ETFs and failed to provide assurance that secondary market transactions in ETF shares would occur at prices close to the current value of the ETF's shares. The SEC's denial of that proposal is discussed in a previous Ropes & Gray Alert, available here.

The Application contains several changes to the proposed ETF structure, including:

- Establishing a separate "blind trust" for each authorized participant (market makers that can buy and redeem large blocks of shares called "creation units" directly with the ETF). Each blind trust would facilitate the creation and redemption of creation units and, in order to maintain an ETF's portfolio confidentiality, would liquidate in-kind redemptions from an ETF before distributing the proceeds to the authorized participant. The Applicants argue that the use of a separate blind trust for each authorized participant would facilitate the distribution process and make for a more effective arbitrage mechanism.
- The identity of portfolio securities comprising a creation unit and a pro rata slice of each ETF's portfolio holdings would be made known to each blind trust (though kept confidential from authorized participants). Each blind trust, at the direction of its authorized participant, would be able to use this portfolio composition information to calculate its own intraday indicative value ("IIV") or construct its own statistical model to be used as a pricing indicator. The Application asserts that this would enable an authorized participant to engage in arbitrage transactions if it believes secondary market prices for ETF shares are trading at a premium or discount to the value of an ETF's underlying portfolio securities.
- A verified intraday indicative value ("VIIV") would be disseminated every 15 seconds throughout normal trading hours. In the SEC's denial of the Applicants' prior proposal, the SEC expressed doubt that the IIV disseminated by typical actively-managed ETFs could be used as a reliable pricing indicator in order to enable an effective arbitrage mechanism for the proposed ETFs. The Application describes several differences between the proposed VIIV and a typical IIV that are targeted at addressing the SEC's concerns, including:
    i. components of the VIIV would be valued at the mid-point between bid and ask quotations rather than last sale prices;[1]

[1] Since the Applicants' proposed ETFs would invest only in U.S. exchange-traded securities, the Application states that the ETFs are unlikely to use fair value pricing. In the event fair value pricing is used in calculating NAV on a particular day, the ETF's website will disclose the identity and weighting of any fair valued security in the portfolio and the price used to calculate that day's NAV and the following day's VIIV.

ii. the VIIV will include all of the ETF's accrued income and expenses and there would be procedures to ensure that any extraordinary expenses reflected in NAV on a particular day are also reflected in the VIIV; and
iii. each ETF will employ two independent sources of pricing information for the VIIV, and if a "verification agent" or computer-based monitoring system observes a material discrepancy between the two pricing feeds, the listing exchange for the ETF will be notified and have the ability to halt trading in the ETF's shares.

In addition to these changes, the Applicants no longer propose a "retail redemption option" for investors to redeem at NAV if ETF shares trade at specified discount levels from NAV for a certain period of time.

The Application is one of a number of exemptive applications filed in recent years seeking permission to use an actively-managed ETF structure that would disclose portfolio holdings only on a quarterly basis in accordance with normal disclosure requirements applicable to all open-end mutual funds. Eaton Vance recently obtained exemptive relief for nontransparent exchange-traded managed funds ("ETMFs") using a hybrid "NAV-based trading" structure. Although this structure was approved by the SEC on December 2, 2014, Eaton Vance has not yet launched an ETMF and has stated that it intends to unveil some of these products in the second quarter of 2015. The SEC's approval of Eaton Vance's ETMF structure is discussed in a previous Ropes & Gray Alert, available here.

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