

November 19, 2019

Non- or Semi-Transparent Active ETF Developments

2019 has been a big year for the exchange-traded fund (ETF) industry, with a series of regulatory approvals that should foster innovation and increase competition. Most recently, on November 14, 2019, the SEC issued notices for four “semi-transparent” active ETF models – the T. Rowe, Fidelity, Blue Tractor, and Natixis/NYSE applications.¹ This, of course, comes on the heels of the SEC’s approval in September of the long-anticipated ETF Rule² and the issuance of conditional exemptive relief relating to 1934 Act “class relief,”³ as well as the SEC’s May approval of the Precidian’s non-transparent active ETF exemptive application.⁴ In addition, the three ETF listing exchanges, NYSE Arca, Cboe BZX and Nasdaq, have recently proposed changes to their listing rules for most ETFs that should, if approved by the SEC, simplify and streamline the initial and continuous listing standards for ETFs relying on the ETF Rule.⁵

The “semi-transparent” models noticed for approval provide some transparency into the ETF’s holdings and baskets available to authorized participants (APs) and other market participants.⁶ While the T. Rowe, Fidelity, Blue Tractor and Natixis/NYSE models are somewhat similar in that they provide a measure of daily portfolio transparency to APs and other market participants, they differ from each other and are all markedly different from the Precidian model, which does not provide for any daily portfolio transparency to APs or other market participants. The following chart contains a brief comparison of some of the principal features of these non- and semi-transparent active ETF exemptive models.

¹See T. Rowe Price Associates, Inc. et al. (File No. 812-14214)(Nov. 15, 2019) (notice), available at <https://www.sec.gov/rules/ic/2019/ic-33685.pdf>; Fidelity Beach Street Trust et al. (File No. 812-14364) (Nov. 15, 2019) (notice), available at <https://www.sec.gov/rules/ic/2019/ic-33683.pdf>; Blue Tractor ETF Trust et al. (File No. 812-14625) (Nov. 15, 2019) (notice), available at <https://www.sec.gov/rules/ic/2019/ic-33682.pdf>; Natixis Advisors, L.P., et al. (File No. 812-14870) (Nov. 15, 2019) (notice), available at <https://www.sec.gov/rules/ic/2019/ic-33684.pdf>. It is expected that these filings will become effective approximately 25 days after publication in the Federal Register.

²Exchange-Traded Funds, Release Nos. 33-10695; IC-33646 (September 25, 2019), available at <https://www.sec.gov/rules/final/2019/33-10695.pdf> (the “Adopting Release”). The ETF Rule is discussed in a separate Ropes & Gray [Alert](#).

³Order Granting a Conditional Exemption From Exchange Act Section 11(d)(1) and Exchange Act Rules 10b-10, 15c1-5, 15c1-6 and 14e-5 for Certain Exchange Traded Funds, Release No. 34-87110 (September 25, 2019), available at <https://www.sec.gov/rules/exorders/2019/34-87110.pdf>.

⁴See, e.g., Precidian ETFs Trust, et al., 1940 Act Rel. Nos. 33440 (April 8, 2019) and 33477 (May 20, 2019) (order) (“Precidian”), available at <https://www.sec.gov/rules/ic/2019/ic-33477.pdf>.

⁵The NYSE Arca, Cboe BZX and Nasdaq proposals can be found [here](#), [here](#) and [here](#), respectively.

⁶Invesco has also submitted an exemptive application seeking approval to operate semi-transparent active ETFs, but that filing was submitted in late September and has not yet been approved by the SEC. Invesco Capital Management LLC, et al., File No. 812-15070 (Sept., 25, 2019), available at <https://www.sec.gov/Archives/edgar/data/102786/000119312519254770/d802828d40app.htm>. Ropes & Gray assisted Invesco in preparing this filing.

Model Feature	Precidian	Blue Tractor	Fidelity	Natixis/NYSE	T. Rowe
<i>Portfolio Transparency</i>	No daily disclosure of portfolio holdings to APs or other market participants.	Dynamic Portfolio shows 100% of the ETF's holdings, but only 90% of the weightings (within guardrails).	Tracking Basket optimized to fund performance and consisting of certain portfolio holdings and representative ETFs that hold securities similar to those held by the ETF.	Factor Model proxy portfolio chosen from model universe designed to perform substantially similar to actual portfolio.	High quality proxy portfolio derived from either a broad-based securities index or the ETF's recently disclosed holdings.
<i>Full Portfolio Disclosure</i>	Quarterly (60-day lag).	Quarterly (60-day lag).	Monthly (30-day lag).	Not addressed; presumed quarterly (60-day lag).	Quarterly (60-day lag).
<i>Principal Hedging Mechanism</i>	Based on verified intraday indicative value (VIIV).	Percentage of overlap between Dynamic Portfolio and ETF portfolio and guardrail amounts.	Tracking Basket and Tracking Basket overlap, plus representative ETFs and bid-ask spread info.	Proxy Portfolio holdings, overlap between Proxy Portfolio and ETF portfolio, and historical tracking error between the ETF's NAV and Proxy Portfolio value.	Proxy portfolio contents, overlap, daily deviation and tracking error of the proxy portfolio, plus other empirical measures and bid-ask spread info.
<i>Universe of Potential Investments</i>	Exchanged-listed assets that trade contemporaneously with the ETF.	Exchange-listed assets that trade contemporaneously with the ETF.	Exchange-listed assets that trade contemporaneously with the ETF.	Exchange-listed assets that trade contemporaneously with the ETF.	Exchange-listed assets that trade contemporaneously with the ETF.

<p>Board Monitoring/SEC Reporting</p>	<p><i>For the first 3 years after launch, the Adviser will promptly call a board meeting and make recommendations for appropriate remedial measures, and the board will promptly meet if:</i></p>				
	<p>For 30 or more days in any quarter or 15 days in a row, the absolute difference between either the market closing price or the Bid/Ask Price, on one hand, and NAV, on the other, exceeds 1.00% or the bid/ask spread exceeds 1.00%. In each case, the board will consider the continuing viability of the Fund, whether shareholders are being harmed, and what, if any, action would be appropriate to narrow the premium/discount or spread, as applicable. Such actions may include changing lead market makers, listing the Fund on a different Exchange, changing the size of Creation Units, changing the Fund's investment objective or strategy, or liquidating the Fund.</p>	<p>The Tracking Error exceeds 1%, or if, for 30 or more days in any quarter or 15 days in a row, the absolute difference between either the Closing Price or the Bid/Ask Price, on one hand, and NAV, on the other, exceeds 2.00% or the bid/ask spread exceeds 2.00%. In each case, the board will consider the continuing viability of the Fund, whether shareholders are being harmed, and what, if any, action would be appropriate to narrow the premium/discount or spread, or Tracking Error, as applicable. The board will then decide whether to take any such action. Such actions may include changing lead market makers, listing the Fund on a different Exchange, changing the size of Creation Units, changing the Fund's investment objective or strategy, and liquidating the Fund.</p>	<p>(1) the Tracking Error exceeds 1.00%; or (2) for 30 or more days in any quarter or 15 days in a row: (a) the absolute difference between either the Closing Price or the Bid/Ask Price, on one hand, and NAV, on the other, exceeds 2.00%; or (b) the bid/ask spread exceeds 2.00%. In each case, the board or committee will consider the continuing viability of the Fund, whether shareholders are being harmed, and what, if any, action would be appropriate to narrow the premium/discount, spread, or Tracking Error as applicable. In addition, on request, will periodically provide the SEC with certain metrics and other information.</p>	<p>(1) the Tracking Error exceeds 1%; (2) for 30 or more days in any quarter or 15 days in a row (a) the absolute difference between either the Closing Price or the Bid/Ask Price, on one hand, and NAV, on the other, exceeds 2%; or (b) the bid/ask spread exceeds 2%; or (3) as otherwise deemed necessary or appropriate by the Adviser. In each case, the board will consider the continuing viability of the Fund, whether shareholders are being harmed, and what, if any, corrective measures would be appropriate to narrow the Tracking Error, premium/discount, or bid/ask spread, as applicable. Such actions may include: (a) changing lead market makers; (b) listing the Fund on a different Exchange; (c) changing the size of Creation Units; (d) changing the Fund's investment objective or strategy; (e) publicly disclosing additional information regarding the Proxy Portfolio and/or Actual Portfolio; and (f) revising the algorithms and Model Universe used as part of the NYSE Proxy Portfolio Methodology.</p>	<p>(1) the Tracking Error exceeds 1.00%; or (2) for 30 or more days in any quarter or 15 days in a row: (a) the absolute difference between either the Closing Price or the Bid/Ask Price, on the one hand, and the Fund's NAV, on the other, exceeds a corrective action threshold set by the Adviser, which in no event will exceed 2.00%, or (b) the bid-ask spread exceeds the corrective action threshold. In each case, the board will consider the continuing viability of the Fund, whether shareholders are being harmed, and what, if any, action would be appropriate to narrow the premium/discount or spread, as applicable. The board will then decide whether to take any such action. Such actions may include changing lead market makers, listing the Fund on a different Exchange, changing the size of Creation Units, changing the construction of the Proxy Portfolio, changing the Fund's investment objective or strategy, or liquidating the Fund.</p>

<i>Indicative NAV (INAV)</i>	VIIV (every second).	N/A	N/A	N/A	Every 15 seconds.
<i>Basket Conversion “Agent”</i>	AP Representative purchases (sells) confidential basket securities on behalf of AP.	N/A	N/A	N/A	N/A

Eaton Vance has also filed an exemptive application for a non-transparent active ETF structure,⁷ but the Eaton Vance proposal differs from both the Precidian model and the various semi-transparent models.

* * * * *

These are exciting and dynamic times for the ETF industry, and Ropes & Gray is well positioned to assist ETF sponsors in navigating these significant regulatory changes and product development opportunities. Whether advising on developing basket construction and custom basket policies and procedures in response to the ETF Rule,⁸ designing new semi-transparent active ETF products or structures, or assessing the impact of recent 1934 Act relief and potential exchange listing rule changes, Ropes & Gray attorneys can help. Please contact [Ed Baer](#), [Brian McCabe](#), [Paulita Pike](#), [Jeremy Smith](#), or your regular Ropes & Gray contact with any questions.

⁷See Eaton Vance Exchange-Traded Fund Trust et al. (File No. 812-15003) (Feb. 20, 2019), available at <https://www.sec.gov/Archives/edgar/data/1076598/000094039419000345/clearhedge40app.htm>.

⁸Ropes & Gray has developed an outline that may be useful in preparing basket construction policies and procedures, as well as related custom basket policies and procedures. If you would like to receive a copy of this outline, please email custombaskets@ropesgray.com.

This alert should not be construed as legal advice or a legal opinion on any specific facts or circumstances. This alert is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. The contents are intended for general informational purposes only, and you are urged to consult your attorney concerning any particular situation and any specific legal question you may have. © 2019 Ropes & Gray LLP