

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

No written comments were solicited or received.

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

Pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>10</sup> and Rule 19b-4(f)(2) thereunder,<sup>11</sup> the Exchange has designated this proposal as establishing or changing a due, fee, or other charge applicable to the Exchange's Members and non-members, which renders the proposed rule change effective upon filing.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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 email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-BYX-2013-001 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.
- All submissions should refer to File Number SR-BYX-2013-001. This file number should be included on the subject line if email 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 Web site (<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 change 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 Web site 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 a.m. and 3:00 p.m. Copies of such filing also will 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 Number SR-BYX-2013-001, and should be submitted on or before February 13, 2013.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>12</sup>

Kevin M. O'Neill,

Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-68672; File No. SR-NASDAQ-2012-117]

### Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Instituting Proceedings To Determine Whether To Approve or Disapprove Proposed Rule Change With Respect to INAV Pegged Orders for ETFs

January 16, 2013.

#### I. Introduction

On October 2, 2012, The NASDAQ Stock Market LLC ("NASDAQ" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), 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> a proposed rule change to amend NASDAQ Rule 4751(f)(4) to adopt a new Intraday Net Asset Value ("INAV") Pegged Order for Exchange-Traded Funds ("ETFs") where the component stocks underlying the ETFs are U.S. Component Stocks (as defined by NASDAQ Rule 5705(a)(1)(C) and

5705(b)(1)(D))<sup>3</sup> ("U.S. Component Stock ETFs"). The proposed rule change was published for comment in the **Federal Register** on October 18, 2012.<sup>4</sup> The Commission received one comment letter on the proposal.<sup>5</sup> On November 21, 2012, pursuant to Section 19(b)(2) of the Act,<sup>6</sup> the Commission designated a longer period within which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.<sup>7</sup> On January 15, 2013, the Commission received the Exchange's response to the comment letter.<sup>8</sup> This order institutes proceedings under Section 19(b)(2)(B) of the Act<sup>9</sup> to determine whether to approve or disapprove the proposed rule change.

#### II. Description of the Proposal

The Exchange proposes to amend NASDAQ Rule 4751(f)(4) to establish INAV Pegged Orders that would be available only for U.S. Component Stock ETFs. The INAV Pegged Order type would be available for all U.S. Component Stock ETFs where there is dynamic INAV data. The INAV Pegged Order would be priced relative to the INAV of the fund's underlying portfolio. According to the Exchange, the INAV is intended to approximate the fair value of the securities held in the portfolio by an ETF,<sup>10</sup> and the Exchange represents that the INAV should closely represent the value of the fund during the trading

<sup>3</sup> Rule 5705 contains NASDAQ's listing standards for ETFs (which include Portfolio Depository Receipts and Index Fund Shares).

<sup>4</sup> See Securities Exchange Act Release No. 68042 (October 12, 2012), 77 FR 64167 ("Notice").

<sup>5</sup> See Letter from Dorothy Donohue, Deputy General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Commission, dated November 8, 2012 ("ICI Letter").

<sup>6</sup> 15 U.S.C. 78s(b)(2).

<sup>7</sup> See Securities Exchange Act Release No. 68279 (November 21, 2012), 77 FR 70857 (November 27, 2012). See also Securities Exchange Act Release No. 68279A (December 4, 2012), 77 FR 73716 (December 11, 2012) (correcting certain typographical errors). The Commission determined that it was appropriate to designate a longer period within which to take action on the proposed rule change so that it has sufficient time to consider the proposed rule change. Accordingly, the Commission designated January 16, 2013 as the date by which it should approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule change.

<sup>8</sup> See Letter from Stephen Matthews, Senior Associate General Counsel, NASDAQ OMX, to Elizabeth M. Murphy, Secretary, Commission, dated January 15, 2013 ("Response Letter").

<sup>9</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>10</sup> The Exchange states that investors should note that the INAV is only an estimation of a fund's value, and this might differ from the end of day net asset value, which is more definitive and disseminated on a daily basis at the end of the trading day. See Notice, *supra* note 4, at 64169.

<sup>10</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>11</sup> 17 CFR 240.19b-4(f)(2).

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

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

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

day.<sup>11</sup> According to the Exchange, INAVs are typically calculated using the last sale prices of the fund's components.<sup>12</sup> The Exchange represents that, pursuant to NASDAQ listing rules, the INAV for NASDAQ-listed ETFs is disseminated widely to vendors and their subscribers via multiple data feeds, including UTP Level 1, NASDAQ Basic, NASDAQ Level 2, and NASDAQ TotalView, and that INAVs are typically disseminated at least once every 15 seconds during the regular market session.<sup>13</sup>

Generally, Pegged Orders are orders that, once entered, adjust in price automatically in response to changes in factors, such as the national best bid or offer, depending upon the type of Pegged Order. An INAV Pegged Order would specify that its price will equal (or, to the extent an offset is used, be offset from) the prevailing INAV for the relevant ETF. As the INAV changes, the INAV Pegged Orders would change therewith. In the event that the INAV data feed for a particular ETF were to be compromised or temporarily stopped being disseminated, the use of the INAV Pegged Order type for that ETF would be suspended (*i.e.*, no new INAV Pegged Orders would be accepted into the system) and orders utilizing the INAV Pegged Order functionality for that ETF already in the system would be cancelled. The suspension of new INAV Pegged Orders would remain in effect until such time as the Exchange was confident that the integrity of the INAV data feed had been restored.

A Pegged Order may have a limit price beyond which the order shall not be executed. In addition, certain Pegged Orders (Primary Peg and Market Peg Orders) may establish their pricing relative to the appropriate bids or offers by selecting one or more offset amounts that will adjust the price of the order by the offset amount selected. The Exchange proposes to similarly

introduce this functionality for the INAV Pegged Order type. Moreover, similar to other Pegged Orders (other than a Midpoint Peg Order), the Exchange proposes that an INAV Pegged Order may be either displayed or non-displayed. If a market participant utilizes the non-displayed order type, its order will be placed lower in the priority queue than displayed orders within each price point.

The Exchange provides the following examples to illustrate how the INAV Pegged Order type would operate (note that the price of the order updates in response to changes in the INAV):

#### Example 1

- The best bid is \$20.00 and the best offer is \$20.06 at 10:00:00 a.m. INAV is updated and published as \$20.03 at 10:00:02.
- An INAV Peg Order to buy entered at 10:00:04 would be priced at \$20.03.
- The best bid would update to \$20.03 (at approximately 10:00:04).
- The best offer would remain at \$20.06.

#### Example 2

- The best bid is \$20.00 and the best offer is \$20.06 at 10:00:00. INAV is updated and published as \$19.98 at 10:00:02.
- An INAV Peg Order to sell entered at 10:00:04 would be priced at \$19.98 and subsequently execute at \$20.00 (at approximately 10:00:04).

#### Example 3

- The best bid is \$20.00 and the best offer is \$20.10 at 10:00:00 a.m. INAV is updated and published as \$20.03 at 10:00:02.
- An INAV Peg Order to buy with a +.03 offset entered at 10:00:04 would be priced at \$20.06 (\$20.03 +.03) (at approximately 10:00:04).
- The best bid would update to \$20.06 (approximately 10:00:04).
- The best offer would remain at \$20.10.

### III. Summary of Comment Letters and the Exchange's Response

The Commission received one comment letter on the proposed rule change.<sup>14</sup> The commenter raises a number of concerns and requests a number of clarifications relating to the proposal, each of which is described below. The commenter notes that while it does not necessarily object to the creation of a new order type pegged to INAV, it believes the Commission should request additional information from the Exchange to further explore the

questions and concerns it raises, and consider the benefits and risks of the proposed INAV Pegged Order, before determining whether to approve it.<sup>15</sup>

#### A. Questions Regarding the Purpose and Benefits of the Proposal

First, the commenter states that its members have questioned the purpose and benefit to market participants of an order type pegged to INAV.<sup>16</sup> The commenter notes that in its filing the Exchange states that "ETF Sponsors routinely deal with investors that have been subject to inferior executions,"<sup>17</sup> and that the vast majority of these complaints result from people using market orders where the prevailing market price either does not correlate to the fund's value, or the quoted size does not meet the demand of the order (or both).<sup>18</sup> The commenter believes the use of limit orders generally addresses the concerns highlighted by the Exchange, and that investor confusion regarding order types likely explains the inopportune use of market orders.<sup>19</sup> The commenter further believes that educating investors on the proper use of existing order types may be preferable to the creation of another order type.<sup>20</sup> Moreover, the commenter states that the problems with execution typically occur in ETFs that would not be covered by the new order type, *i.e.*, those based on fixed income and non-US equity securities, and that most ETFs comprised of U.S. equities are very liquid and trade with fair price execution.<sup>21</sup>

In response to these comments, the Exchange states its belief that fair price executions are currently available for the highest volume, most liquid domestic equity products, but not necessarily for the majority of products which are less actively traded.<sup>22</sup> The Exchange states that the use of the INAV Pegged Order type would be entirely optional, and is meant to offer an additional tool to help investors achieve greater transparency and a fair execution price.<sup>23</sup> The Exchange further states its belief that for domestic equity products, the published INAV is the best proxy for fair value, as it represents

<sup>11</sup> See Notice, *supra* note 4, at 64168. According to the Exchange, the term "INAV," as used by the Exchange in its proposal, would be synonymous with commonly used terms such as Intraday Indicative Value (IIV), Intraday Optimized Portfolio Value (IOPV) and Intraday Portfolio Value (IPV), among others. *Id.*

<sup>12</sup> The Exchange states that INAVs can vary from the fund's market price and/or can be valued outside of the fund's prevailing bid/ask spread as a result of, among other things, the supply and demand characteristics of the fund and/or liquidity present in the marketplace. See Notice, *supra* note 4, at 64168. In addition, the Exchange states that the INAV may remain unchanged for a certain period of time if the underlying values do not change, particularly in periods of low volatility, and that the INAV may become stale as a result of a compromised data feed or disruption to the calculation and/or dissemination agent or other technology related malfunction. *Id.*

<sup>13</sup> See *id.*

<sup>14</sup> See ICI Letter, *supra* note 5.

<sup>15</sup> *Id.* at 2.

<sup>16</sup> *Id.*

<sup>17</sup> See Notice, *supra* note 4, at 64169.

<sup>18</sup> *Id.*

<sup>19</sup> See ICI Letter, *supra* note 5, at 2.

<sup>20</sup> *Id.* The commenter notes that many ETF sponsors and others have undertaken educational efforts aimed at explaining order types for investors and cites to [www.understandETFs.org](http://www.understandETFs.org), a collaborative effort by ETF providers to enhance investor understanding of ETFs, as one example. *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> See Response Letter, *supra* note 8, at 2.

<sup>23</sup> *Id.*

the closest calculation of underlying value generally available.<sup>24</sup>

#### B. Concerns Regarding Investor Understanding of INAV

The commenter states that its members are concerned about the utility of INAV as a reference point for pricing an ETF order because market participants may misunderstand INAV.<sup>25</sup> This commenter states that INAV is not a “fair value” estimate of the securities underlying the ETF, as INAV is typically calculated using the last sales price of the fund’s components.<sup>26</sup> The commenter states that, at times, particularly for securities that do not trade often, the last sale price may not be reflective of the security’s value, and unlike a fund’s end-of-day net asset value, INAV does not attempt to adjust for such variations.<sup>27</sup> Furthermore, the commenter states that INAV is not a fair value estimate of the ETF itself, as some U.S. Component Stock ETFs may trade at a consistent premium or discount, which is not taken into account in the INAV calculation.<sup>28</sup> The commenter states that where an ETF’s shares frequently trade at a premium to INAV, an INAV Pegged Order to sell at INAV would likely disadvantage the seller.<sup>29</sup> The commenter further states that, although it recognizes that the proposed order type could be used with an offset to account for this premium, it is concerned that market participants may believe INAV represents the fair market value of the ETF, and therefore reflects such nuances.<sup>30</sup>

In response, the Exchange states its belief that for domestic equity products the INAV is a good representation of fair value and the only representation of fair value currently available for individual investors.<sup>31</sup> The Exchange disagrees with the commenter that an INAV Pegged Order to sell a U.S. Component Stock ETF that trades at a consistent premium would disadvantage the seller, noting that in a scenario where an INAV Pegged Order to sell was priced below the best bid, it would only execute at the best bid, which would be at a premium to the INAV to the benefit of the investor.<sup>32</sup> The Exchange further states that, more importantly, a buyer utilizing the INAV Pegged Order type

would never execute at a premium to INAV.<sup>33</sup>

The commenter also is concerned that some market participants may not understand that INAV can be an inaccurate reflection of an ETF’s market value because it can become stale over the course of 15 seconds.<sup>34</sup> The commenter believes that establishing an order price based on data that is nearly 15 seconds old could result in poor execution.<sup>35</sup>

In response, the Exchange states that the INAV Pegged Order type should lead to a greater level of transparency as it relates to the ETF’s current value and, as a result, should increase investor confidence.<sup>36</sup> The Exchange states that the INAV is the most up-to-date data source that is publicly available, and “is a clear improvement over the current state of non-existent data as it relates to real time fund valuation.”<sup>37</sup> The Exchange states its belief that, although the INAV is only updated every 15 seconds, it is still of value and beneficial to investors as the execution will still be benchmarked against the prevailing published INAV.<sup>38</sup> The Exchange further states that if an investor is uncomfortable with the INAV Pegged Order functionality, they would not be required to use the order type.<sup>39</sup>

Further, the commenter also is concerned that investors do not understand that INAV calculations are based on the ETF’s creation basket, which in some cases does not include all of the securities in a fund’s portfolio.<sup>40</sup> The commenter notes that in such cases, ETF sponsors take great care to publish baskets that mimic the market characteristics of the full portfolio, but there may be instances in which the INAV, because it is based on the constituents of a sampled basket, deviates from the actual intra-day net asset value of the ETF.<sup>41</sup> The commenter is concerned that investors who do not understand how INAV is calculated for a particular ETF may be unaware that INAV does not always mirror the value of the full portfolio, and such investors might have chosen to submit a different type of order had they understood the limitations of INAV.<sup>42</sup>

#### C. Concerns Regarding INAV Error

The commenter also is concerned about the susceptibility of INAV to error.<sup>43</sup> The commenter states that many parties participate in the calculation, publication, and dissemination of the INAV (e.g., ETF sponsors, calculation agents, exchanges, and/or third party pricing vendors), that such a process creates opportunities for errors,<sup>44</sup> and that such errors are not infrequent.<sup>45</sup> The commenter states that ETF sponsors attempt to monitor INAV and correct such errors as soon as practicable, but at times INAV Pegged Orders would likely execute before these errors are identified.<sup>46</sup> This commenter further argues that if calculation agents and pricing vendors could be held liable by investors using INAV Pegged Orders for inaccuracies in INAVs, it is possible that firms would cease providing such services, making it impossible to disseminate INAVs, or would charge significantly more for their services, resulting in increased expenses for ETF investors.<sup>47</sup>

In its Response Letter, the Exchange agrees with the commenter that an erroneous INAV could be disseminated by a calculation agent.<sup>48</sup> However, the Exchange states its belief that the risk of a poor execution is mitigated by existing general safeguards in the market place.<sup>49</sup> The Exchange further states that an execution pursuant to an INAV Pegged Order would only ever occur within the prevailing bid-offer spread, and that, in the absence of adequate depth of market, an aggrieved party could utilize the Exchange’s existing clearly erroneous procedures.<sup>50</sup>

#### D. Clarifications About the Operation of the INAV Pegged Order

The commenter raises a number of questions and requests clarifications relating to how the INAV Pegged Order would operate. First, the commenter states that far more specificity is necessary to explain how the Exchange would suspend the use of and cancel existing INAV Pegged Orders for an ETF where the INAV data feed for such ETF stops being disseminated or is

<sup>43</sup> See ICI Letter, *supra* note 5, at 3.

<sup>44</sup> The commenter provides as examples of such errors that an ETF may report a basket inaccurately, a calculation agent may receive faulty data from a pricing vendor, or an error may be made in the calculation process. *Id.* at 5.

<sup>45</sup> *Id.* at 5.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> See Response Letter, *supra* note 8, at 3.

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> See ICI Letter, *supra* note 5, at 3–4.

<sup>26</sup> *Id.* at 4.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> See Response Letter, *supra* note 8, at 2.

<sup>32</sup> *Id.* at 3.

<sup>33</sup> *Id.*

<sup>34</sup> See ICI Letter, *supra* note 5, at 4.

<sup>35</sup> *Id.*

<sup>36</sup> See Response Letter, *supra* note 8, at 3.

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> See ICI Letter, *supra* note 5, at 4.

<sup>41</sup> *Id.* at 4–5.

<sup>42</sup> *Id.* at 5.

compromised.<sup>51</sup> The commenter believes that, most importantly, the Exchange should clarify what constitutes a “compromised” INAV, and how the Exchange would identify a compromised INAV and determine whether to suspend new orders and cancel existing ones.<sup>52</sup> The commenter also raises questions about the proposed cancellation and suspension of INAV Pegged Orders (e.g., how market participants would be notified that their orders have been cancelled due to a problem with INAV calculation), as well as about INAV Pegged Orders that may be executed based on a flawed INAV (e.g., whether such orders would be cancellable). The commenter questions the benefit of allowing or encouraging the use of an order type that may be subject to cancellation due to an independent malfunction (such as an erroneous data feed) even when the rest of the market is performing normally.<sup>53</sup>

In response to these comments, the Exchange clarifies in its Response Letter that it would only suspend use of the INAV Pegged Order type if it were to detect a technological problem with the relevant INAV data feed.<sup>54</sup> The Exchange represents that it currently utilizes a number of systems and processes aimed at detecting dissemination or latency issues with data feeds, and that it has processes in place to communicate with market participants in the event of technology issues which impact its own systems or those systems of a third party.<sup>55</sup> The Exchange states that it intends to utilize its current processes in connection with market communications relating to issues with the INAV data feed.<sup>56</sup> The Exchange further states that it will process clearly erroneous executions in accordance with established policies.<sup>57</sup>

#### IV. Proceedings To Determine Whether To Approve or Disapprove SR–NASDAQ–2012–117 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act<sup>58</sup> to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the significant legal and policy issues raised by the proposed rule change, as discussed below. Institution of

proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described in greater detail below, the Commission seeks and encourages interested persons to provide additional comment on the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,<sup>59</sup> the Commission is providing notice of the grounds for disapproval under consideration. In particular, Section 6(b)(5) of the Act<sup>60</sup> requires, among other things, that the rules of a national securities exchange be 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.

As discussed above, the Exchange’s proposal would amend NASDAQ Rule 4751(f)(4) to adopt a new INAV Pegged Order type for U.S. Component Stock ETFs. Pursuant to the proposal, an INAV Pegged Order would specify that its price will equal (or, to the extent an offset is used, be offset from) the prevailing INAV for the relevant U.S. Component Stock ETF. Once entered, the INAV Pegged Order would adjust in price automatically in response to changes in the INAV. In the event that the INAV data feed for a particular ETF were to be compromised or temporarily stopped being disseminated, the use of the INAV Pegged Order type for that ETF would be suspended until such time as the Exchange was confident that the integrity of the INAV data feed had been restored (i.e., no new INAV Pegged Orders would be accepted into the system and orders utilizing the INAV Pegged Order functionality for that ETF already in the system would be cancelled).

The Commission solicits comment on whether the proposal is consistent with the Act and whether the Exchange has met its burden in presenting a statutory analysis of how its proposal is consistent with the Act. In particular, the grounds for disapproval under consideration include whether the Exchange’s proposal is consistent with Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the

public interest.<sup>61</sup> As discussed above, one commenter has articulated a number of questions and concerns relating to the proposal. Among other things, this commenter raises concerns about investor confusion relating to what the INAV represents and what it does not represent; how INAV is calculated; and the susceptibility of the INAV to calculation errors.<sup>62</sup> In addition, the commenter requests more specificity as to how the Exchange would suspend the use of and cancel existing INAV Pegged Orders for an ETF where the INAV data feed for such ETF stops being disseminated or is compromised.<sup>63</sup> Further, the commenter is concerned that some market participants may not understand that INAV can be an inaccurate reflection of an ETF’s market value because it can become stale over the course of 15 seconds, and believes that establishing an order price based on data that is nearly 15 seconds old could result in poor execution.<sup>64</sup> As noted, the published INAV of an ETF generally is updated every 15 seconds, but the actual INAV of an ETF could change significantly during this same 15-second period. This fact pattern could potentially result in market participants’ INAV Pegged Orders being executed at prices that do not reflect an up-to-date INAV for the ETF. Investors who may use the INAV Pegged Order type may not understand this operational aspect of the order type. Moreover, the 15-second period could create opportunities for participants with access to real time calculations of the INAV for an ETF to take advantage of participants using the INAV Pegged Order type that do not have the same information. The Commission also questions whether this proposed order type could inherently be negatively biased in that INAV Pegged Orders likely would be executed when the market is moving against the investor (for example, an investor’s INAV Pegged Order to buy would be executed only when the market price of an ETF is falling).

In its Response Letter, NASDAQ argues that for U.S. Component Stock ETFs, the published INAV represents the closest and most up-to-date calculation of underlying value currently generally available, and is a

<sup>51</sup> See ICI Letter, *supra* note 5, at 3.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> See Response Letter, *supra* note 8, at 2.

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>59</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>60</sup> 15 U.S.C. 78f(b)(5).

<sup>61</sup> *Id.*

<sup>62</sup> See *supra* Section III.

<sup>63</sup> See *id.* The INAV is not a regulated measurement or calculation and is not audited by the Commission or any other regulatory or self-regulatory entity. Thus, it is unclear what party would be responsible for the integrity and accuracy of the INAV.

<sup>64</sup> See *id.*

good representation of fair value.<sup>65</sup> NASDAQ further argues that the INAV Pegged Order type will offer investors an execution tool which should lead to a greater level of transparency and result in increased investor confidence.<sup>66</sup> The Exchange argues that the commenter's concerns about poor executions resulting from erroneous or stale INAV data are mitigated because, among other things, the INAV Pegged Order type will be entirely optional, an execution would only ever occur within the prevailing bid-offer spread, and the Exchange's existing clearly erroneous procedures would be available to investors using the INAV Pegged Order type.<sup>67</sup>

After careful consideration, the Commission believes that the proposal continues to raise a number of questions, including those submitted by the commenter, as to whether the use of the proposed INAV Pegged Order type is consistent with the protection of investors and the public interest and whether it is designed to promote just and equitable principles of trade and prevent fraudulent and manipulative acts and practices. The Commission continues to evaluate the issues presented by the proposal and the specific concerns articulated by the commenter, and the Exchange's response.<sup>68</sup> In light of these issues and concerns, the Commission believes that questions remain as to whether NASDAQ's proposal is consistent with the requirements of Section 6(b)(5) of the Act, including whether the proposal is designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and protect investors and the public interest.

#### V. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the concerns identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposal is consistent with Section 6(b)(5)<sup>69</sup> or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval which would be facilitated by an oral presentation of

views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.<sup>70</sup>

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by February 13, 2013. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by February 27, 2013.

The Commission asks that commenters address the sufficiency and merit of the Exchange's statements in support of the proposal, including those contained in the Response Letter, and the statements of the commenter in response to the proposal, in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission seeks comment on the following:

1. The commenter states that market participants may misunderstand INAV as being the "fair value" estimate of the securities underlying the ETF.<sup>71</sup> In its Response Letter, the Exchange states its belief that for domestic equity products, the INAV represents the best proxy for fair value and the only representation of fair value currently available for individual investors, and is the most up-to-date real time fund valuation data source that is publicly available.<sup>72</sup> What are commenters' views as to whether the INAV represents a proxy for fair value of the assets of an ETF? What are commenters' views as to whether market participants could be confused as to what INAV represents? Could investors be confused that the INAV is not the same as the end-of-day net asset value of the ETF? Do market participants currently utilize the published INAV? If so, for what purpose do commenters utilize the published INAV? If not, why not?

2. The commenter further states that the INAV calculations are based on the ETF's creation basket, which in some cases do not represent all of the securities in a fund's portfolio; rather, the INAV would reflect baskets that mimic the market characteristics of the

full portfolio.<sup>73</sup> Do commenters agree that investors who do not understand how INAV is calculated for a particular ETF may not understand that INAV does not always mirror the value of the full portfolio of such ETF? If not, why not? Are there other aspects of the INAV that commenters believe could potentially cause confusion among investors and other market participants, particularly with respect to the operation of the proposed INAV Pegged Order? If so, what could they be?

3. The commenter states that market participants may not understand that the INAV can be an inaccurate reflection of an ETF's up-to-date market value. As noted, the published INAV of an ETF generally is updated every 15 seconds, but the actual INAV of an ETF could change significantly during this same 15-second period.<sup>74</sup> Further, the commenter states that the 15-second period could create opportunities for participants with access to real time calculations of the INAV for an ETF to take advantage of participants using the INAV Pegged Order type that do not have the same information.<sup>75</sup> As a result, the commenter asserts that establishing an order price based on data that is 15 seconds old could result in poor executions.<sup>76</sup>

In response, the Exchange states its belief that, although the INAV is only updated every 15 seconds, it is still of value and beneficial to investors as the execution will still be benchmarked against the prevailing published INAV.<sup>77</sup>

Do commenters agree with the concerns expressed by the commenter? If so, why? If not, why not? For instance, do commenters believe that the tying of the execution of an INAV Pegged Order to the published INAV, which is updated every 15 seconds, could potentially result in market participants' INAV Pegged Orders being executed at prices that do not reflect an up-to-date INAV for the ETF? Are commenters concerned that investors who may use the INAV Pegged Order type may not understand this operational aspect of the order type?

4. The Exchange states that the INAV Pegged Order type should lead to a greater level of transparency as it relates to the ETF's current value and, as a

<sup>73</sup> See ICI Letter, *supra* note 5, at 5.

<sup>74</sup> See ICI Letter, *supra* note 5, at 4.

<sup>75</sup> See *id.*

<sup>76</sup> See *id.*

<sup>77</sup> See Response Letter, *supra* note 8, at 3. The Exchange states that the INAV is the most up-to-date data source that is publicly available, and "is a clear improvement over the current state of non-existent data as it relates to real time fund valuation." *Id.*

<sup>65</sup> See Response Letter, *supra* note 8, at 2.

<sup>66</sup> *Id.* at 3.

<sup>67</sup> *Id.* at 2-3.

<sup>68</sup> See *supra* Section III.

<sup>69</sup> 15 U.S.C. 78f(b)(5).

<sup>70</sup> Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Public Law 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

<sup>71</sup> See ICI Letter, *supra* note 5, at 4.

<sup>72</sup> See Response Letter, *supra* note 8, at 2-3.

result, should increase investor confidence.<sup>78</sup> Do commenters agree with these views? If so, why? If not, why not? For example, how would use of the proposed INAV Pegged Order type lead to greater transparency as it relates to the ETF's current value?

5. The commenter states that the calculation of INAV may be susceptible to errors, based on, for example, inaccurate reporting of ETF baskets, faulty data from pricing vendors, or errors in the calculation process.<sup>79</sup> Further, the commenter asserts that such errors are not infrequent.<sup>80</sup> Do commenters agree that INAV is susceptible to calculation errors? If not, why not? If so, how so? Do commenters believe that a potential for errors in the calculation of INAV could undermine the purpose, design, and operation of the proposed INAV Pegged Order type? If so, how? If not, why not?

In its Response Letter, the Exchange states its belief that the risk of a poor execution due to an erroneous INAV is mitigated by existing general safeguards in the marketplace.<sup>81</sup> Do commenters agree with the Exchange? If so, what safeguards exist that would mitigate such a risk? If not, why not?

The Commission notes that the INAV is not a regulated measurement or calculation and is not audited by the Commission or any other regulatory or self-regulatory entity. Thus, it is unclear what party would be responsible for the integrity and accuracy of the INAV. Do commenters believe that a lack of accountability with respect to those parties responsible for the calculation of INAV could undermine the purpose, design and operation of the INAV Pegged Order? If not, why not?

6. In addition, the Commission questions whether this proposed order type could inherently be negatively biased in that INAV Pegged Orders likely would be executed when the market is moving against the investor (for example, an investor's INAV Pegged Order to buy would be executed only when the market price of an ETF is falling). Do commenters agree that the INAV Pegged Order type could be inherently biased to the detriment of the investor? If not, why not? In its Response Letter, the Exchange states that an execution pursuant to an INAV Pegged Order would only ever occur within the prevailing bid-offer spread.<sup>82</sup> Do commenters believe that this mitigates concerns relating to whether

the INAV Pegged Order type could be inherently biased to the detriment of investors? Are there other potential risks that the proposed INAV Pegged Order type could pose to investors and other market participants? If so, what could they be?

7. The commenter requests more specificity as to how the Exchange would suspend the use of and cancel existing INAV Pegged Orders for an ETF where the INAV data feed for such ETF stops being disseminated or is "compromised."<sup>83</sup> The commenter also raises questions about the proposed cancellation and suspension of INAV Pegged Orders (e.g., how market participants would be notified that their orders have been cancelled due to a problem with INAV calculation), as well as about INAV Pegged Orders that may be executed based on a flawed INAV (e.g., whether such orders would be cancellable).<sup>84</sup> In its Response Letter, the Exchange clarifies that it would only suspend the use of the INAV Pegged Order type for a particular U.S. Component Stock ETF if it were to detect a technological problem with the relevant INAV data feed, and that it would utilize its current systems and processes to detect any such problems and to communicate to market participants issues relating to the INAV data feed.<sup>85</sup> Do commenters believe the Exchange has provided sufficient detail with respect to when and how an INAV Pegged Order would be suspended and cancelled by the Exchange?

8. The commenter questions the general purpose and benefit of an INAV Pegged Order to market participants.<sup>86</sup> In particular, the commenter states that the use of limit orders generally could address concerns relating to investors, the vast majority of whom utilize market orders and who, as a result, have been subject to inferior executions.<sup>87</sup> As such, the commenter inquires as to whether the benefits of the proposed INAV Pegged Order type would outweigh the potential risks.<sup>88</sup> The Exchange states the INAV Pegged Order type should help investors achieve greater transparency and a fair execution price.<sup>89</sup> Do commenters agree with the Exchange's assertion? If so, why? If not, why not? What other benefits, if any, do commenters believe would result from the proposed INAV Pegged Order type? What are commenters' views as to how

potential benefits that they believe would result from use of the proposed INAV Pegged Order would compare to the potential risks, as noted above?

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 email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2012-117 on the subject line.

#### Paper Comments

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

All submissions should refer to File Number SR-NASDAQ-2012-117. This file number should be included on the subject line if email 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 Web site (<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 change 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 Web site 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 a.m. and 3:00 p.m. Copies of the filing also will 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 Number SR-NASDAQ-2012-117 and should be submitted on or before February 13, 2013. Rebuttal comments should be submitted by February 27, 2013.

<sup>78</sup> See ICI Letter, *supra* note 5, at 3.

<sup>79</sup> *Id.*

<sup>80</sup> See Response Letter, *supra* note 8, at 2.

<sup>81</sup> See ICI Letter, *supra* note 5, at 2.

<sup>82</sup> See *id.*

<sup>83</sup> See *id.*

<sup>84</sup> See Response Letter, *supra* note 8, at 2.

<sup>90</sup> 17 CFR 200.30-3(a)(57).

<sup>78</sup> See *id.*

<sup>79</sup> See ICI Letter, *supra* note 5, at 5.

<sup>80</sup> See *id.*

<sup>81</sup> See Response Letter, *supra* note 8, at 2.

<sup>82</sup> See Response Letter, *supra* note 8, at 3.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>90</sup>

**Kevin M. O'Neill,**  
*Deputy Secretary.*

[FR Doc. 2013-01225 Filed 1-22-13; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-68667; File No. SR-NYSEArca-2012-109]

### Self-Regulatory Organizations; NYSE Arca, Inc.; Order Granting Approval of Proposed Rule Change Relating to the Listing and Trading of Shares of the U.S. Equity High Volatility Put Write Index Fund Under NYSE Arca Equities Rule 5.2(j)(3)

January 16, 2013.

#### I. Introduction

On September 27, 2012, NYSE Arca, Inc. ("Exchange" or "NYSE Arca") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to list and trade shares ("Shares") of the U.S. Equity High Volatility Put Write Index Fund ("Fund") under NYSE Arca Equities Rule 5.2(j)(3). The proposed rule change was published in the *Federal Register* on October 18, 2012.<sup>3</sup> The Commission received no comments on the proposal. On November 29, 2012, pursuant to Section 19(b)(2) of the Act,<sup>4</sup> the Commission designated a longer period within which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.<sup>5</sup> This order grants approval of the proposed rule change.

#### II. Description of the Proposal

The Exchange proposes to list and trade the Shares of the Fund under Commentary .01 to NYSE Arca Equities

Rule 5.2(j)(3), which governs the listing and trading of Investment Company Units. The Shares will be issued by the ALPS ETF Trust ("Trust").<sup>6</sup> ALPS Advisors, Inc. will be the Fund's investment adviser ("Adviser"), and Rich Investment Solutions, LLC will be the Fund's investment sub-adviser ("Sub-Adviser"). The Adviser is affiliated with a broker-dealer and will implement and maintain procedures designed to prevent the use and dissemination of material, non-public information regarding the Fund's portfolio. The Sub-Adviser is not affiliated with a broker-dealer. In the event (a) the Sub-Adviser becomes newly affiliated with a broker-dealer, or (b) any new adviser or sub-adviser becomes affiliated with a broker-dealer, it will implement and maintain procedures designed to prevent the use and dissemination of material, non-public information regarding the Fund's portfolio.

The Bank of New York Mellon ("BNY") will serve as custodian, fund accounting agent, and transfer agent for the Fund. ALPS Distributors, Inc. will be the Fund's distributor ("Distributor"). NYSE Arca will be the "Index Provider" for the Fund. NYSE Arca is not affiliated with the Trust, the Adviser, the Sub-Adviser, or the Distributor. NYSE Arca is affiliated with a broker-dealer and will implement a fire wall and maintain procedures designed to prevent the use and dissemination of material, non-public information regarding the Index.

#### Description of the Fund

The Fund will seek investment results that correspond generally to the performance, before the Fund's fees and expenses, of the NYSE Arca U.S. Equity High Volatility Put Write Index ("Index"). The Index measures the return of a hypothetical portfolio consisting of U.S. exchange traded put options which have been sold on each of 20 stocks and a cash position calculated as described below. The 20 stocks on which options are sold ("written") are those 20 stocks from a selection of the largest capitalized (over \$5 billion in market capitalization) stocks which also have listed options and which have the highest volatility, as

determined by the Index Provider. The Sub-Adviser will seek a correlation over time of 0.95 or better between the Fund's performance and the performance of the Index. A figure of 1.00 would represent perfect correlation.

The Exchange submitted this proposed rule change because the Index for the Fund does not meet all of the "generic" listing requirements of Commentary .01(a)(A) to NYSE Arca Equities Rule 5.2(j)(3) applicable to the listing of Investment Company Units based upon an index of "US Component Stocks."<sup>7</sup> Specifically, Commentary .01(a)(A) to NYSE Arca Equities Rule 5.2(j)(3)<sup>8</sup> sets forth the requirements to be met by components of an index or portfolio of US Component Stocks. As described further below, the Index consists of U.S. exchange-traded put options. The Exchange has represented that the Shares will conform to the initial and continued listing criteria under NYSE Arca Equities Rules 5.2(j)(3) and 5.5(g)(2), except that the Index is comprised of put options, which are not NMS Stocks as defined in Rule 600 of Regulation NMS.

#### Index Methodology and Construction

The Index consists of at least 20 exchange-listed put options ("Index Components"), selected in accordance with NYSE Arca's rules-based methodology for the Index. In selecting the stocks underlying the Index Components, the Index Provider begins with the universe of all U.S. exchange-listed stocks, and then screens for those stocks that meet the following criteria: (1) Minimum market capitalization of at least \$5 billion; (2) minimum trading volume of at least 50 million shares during the preceding 6 months; (3) minimum average daily trading volume of one million shares during the preceding 6 months; (4) minimum average daily trading value of at least \$10 million during the preceding 6 months; (5) share price of \$10 or higher; (6) the availability of U.S. exchange-listed options. The Index is

<sup>7</sup> NYSE Arca Equities Rule 5.2(j)(3) provides that the term "US Component Stock" shall mean an equity security that is registered under Sections 12(b) or 12(g) of the Exchange Act or an American Depositary Receipt, the underlying equity security of which is registered under Sections 12(b) or 12(g) of the Exchange Act.

<sup>8</sup> Commentary .01(a)(A) to NYSE Arca Equities Rule 5.2(j)(3) states, in relevant part, that the components of an index of US Component Stocks, upon the initial listing of a series of Investment Company Units pursuant to Rule 19b-4(e) under the Exchange Act, shall be NMS Stocks as defined in Rule 600 of Regulation NMS under the Exchange Act. See 17 CFR 242.600(b)(47) (defining "NMS Stock" as any NMS Security other than an option).

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

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

<sup>3</sup> See Securities Exchange Act Release No. 68044 (October 12, 2012), 77 FR 64160 ("Notice").

<sup>4</sup> 15 U.S.C. 78s(b)(2).

<sup>5</sup> Securities Exchange Act Release No. 68319 (November 29, 2012), 77 FR 72429 (December 5, 2012). The Commission determined that it was appropriate to designate a longer period within which to take action on the proposed rule change so that it has sufficient time to consider the proposed rule change. Accordingly, the Commission designated January 16, 2013 as the date by which it should approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule change.

<sup>6</sup> The Trust is registered under the Investment Company Act of 1940 ("1940 Act"). On May 3, 2012, the Trust filed with the Commission an amendment to its registration statement on Form N-1A ("Registration Statement") under the Securities Act of 1933 and under the 1940 Act relating to the Fund (File Nos. 333-148826 and 811-22175). In addition, the Commission has issued an order granting certain exemptive relief to the Trust under the 1940 Act. See Investment Company Act Release No. 28262 (May 1, 2008) (File No. 812-13430).