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INVEST IN REALITY

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August 22, 2014

Deputy Secretary Kevin M. O'Neill
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. SR-NYSEArca-2014-41

Dear Deputy Secretary O'Neill:

Reality Shares, Inc., Reality Shares Advisors, LLC and the Reality Shares ETF Trust (together, "Reality Shares") respectfully submit this letter in response to the Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Change, as Modified by Amendment Nos. 1 and 4 Thereto, Relating to Listing and Trading of Shares of the Reality Shares DIVS Index ETF under NYSE Arca Equities Rule 5.2(j)(3) (the "Order").[1]

Without restating all of the detail laid out in the Order, we refer to the filings made by NYSE Arca, Inc. ("NYSE Arca" or "Exchange") with the Securities and Exchange Commission (the "Commission") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 19b-4 thereunder of a proposed rule change to list and trade shares (the "Shares" or "Fund Shares") of the Reality Shares DIVS Index ETF (the "Fund") under NYSE Arca Equities Rule 5.2(j)(3).[2] As designated in the filings, NYSE Arca proposes to list and trade Shares of the Fund under NYSE Arca Equities Rule 5.2(j)(3), which governs the listing and trading of Investment Company Units on the Exchange.

The Fund is a series of the Reality Shares ETF Trust (the "Trust"). The Trust has filed a registration statement with the Commission to be registered as an open-end management investment company under the Investment Company Act of 1940 ("1940 Act") and expects to

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[1] Securities Exchange Act Release No. 34-72714, 79 FR 45574 (Aug. 5, 2014).

[2] On April 11, 2014, NYSE Arca filed with the Commission a proposed rule change to list and trade Shares of the Fund (formerly, Reality Shares Isolated Dividend Growth Index ETF) under NYSE Arca Equities Rule 5.2(j)(3). The proposed rule change was published for comment in the Federal Register on April 30, 2014 (Securities Exchange Act Release No. 34-72015, 79 FR 24475 (Apr. 30, 2014)) (the "Notice"). On May 6, 2014, the Exchange filed Amendment No. 1 to the proposed rule change, which amended and replaced the proposed rule change in its entirety. On June 6, 2014, the Exchange filed Amendment No. 4 to the proposed rule change. On June 13, 2014, pursuant to Section 19(b)(2) of the Exchange Act, the Commission designated a longer period within which to take action on the proposed rule change and designated July 29, 2014 as the date by which it should approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change (Securities Exchange Act Release No. 34-72385, 79 FR 35205 (June 19, 2014)). The Commission received no comment letters on the proposed rule change and subsequently published the Order.

file an additional amendment in the near future.[3] The Fund seeks to track the performance of the Reality Shares DIVS Index (the "Index"). Reality Shares Advisors, LLC will serve as the investment adviser ("Adviser") to the Fund. ALPS Distributors, Inc. will be the principal underwriter and distributor of the Fund's Shares. The Bank of New York Mellon will serve as administrator, custodian, and transfer agent for the Fund.

As stated in the Order,[4] the Commission has asked that commenters address the sufficiency of the Exchange's statements in support of the proposals which are set forth in the Notice,[5] as modified by Amendment Nos. 1 and 4 to the proposed rule change as filed by the Exchange, in addition to any other comments they may wish to submit about the proposed rule change.

In response to the Commission's request for comment, we note it is our strong belief that the proposed rule change is consistent with Section 6(b)(5) of the Exchange Act, that the Exchange has sufficiently met its burden for listing of Fund Shares, and that the proposal complies with, and is otherwise consistent with, all requirements of the Exchange Act. In addition, Reality Shares hereby submits the responses below to the specific questions included in the Order. The questions are numbered and repeated below in bold type. Because the questions included in the Order contain multiple sub-questions, we have, in some instances, stated each sub-question separately and our corresponding response thereafter.

> **1. Because the Index is designed to reflect changes in market expectations of future dividend growth, rather than to track actual dividend growth, is the Fund's investment strategy fundamentally based on an assumption that the options markets systemically underprice dividend growth? What are commenters' views regarding whether investors would be able to understand the strategy, risks, potential rewards, assumptions, and expected performance of the Fund's strategy?**

<u>Response:</u>

The Fund's investment strategy is <u>not</u> fundamentally based on an assumption that the option markets systemically underprice dividend growth. To state this more simply, and similar to any asset that is underpriced, this would enhance the returns of the Fund. However, the Fund does not rely on the option markets to systemically underprice actual dividend growth as part of the

3 On November 12, 2013, the Trust filed a registration statement on Form N-1A under the Securities Act of 1933 (the "Securities Act") and under the 1940 Act relating to the Fund, as amended by Pre-Effective Amendment Number 1, filed with the Commission on February 6, 2014; Pre-Effective Amendment Number 2, filed with the Commission on May 1, 2014; and Pre-Effective Amendment Number 3, filed with the Commission on July 3, 2014 (File Nos. 333-192288 and 811-22911) (together, the "Registration Statement").

4 Securities Exchange Act Release No. 34-72714, *supra* note 1.

5 Securities Exchange Act Release No. 34-72015, *supra* note 2.

strategy for the Fund to make money**.** Rather, the Fund's investment strategy is based on (i) the aggregate value of ordinary dividends expected to be paid on S&P 500 securities as implied in the price of listed S&P 500 Index options over time (referred to as the "expected dividend value") and (ii) the historical high correlation between such expected dividend values and the value of actual dividends paid on S&P 500 securities. As the value of actual dividends paid changes up or down, market expectations for dividends typically are pulled up or down in a corresponding direction. This is reflected in the price of the option contracts in which the Fund invests. The value of an investment in the Fund is expected to increase (or decrease) if the current expected dividend value of the option contracts in the Fund's portfolio increases (or decreases). This generally will occur if the value of actual dividends paid on S&P 500 securities goes up (or down).[6]

Reality Shares believes investors will be able to understand the Fund's investment objective, strategy, risks, potential rewards, assumptions, and performance characteristics, as these will be clearly disclosed in the Fund's Registration Statement and in other Fund documents (such as Fund marketing materials). Furthermore, we note that the investment strategies used by mutual funds and ETFs have become more sophisticated in recent years as funds and ETFs have expanded into new investment categories, such as new types of fixed-income strategies, commodity strategies and other alternative investment strategies. We believe that the level of investor interest in such products indicates a potential demand for the Fund and that investors will understand the Fund and find the Fund to be a useful compliment to other investment strategies. Reality Shares believes, in light of the disclosure in the Fund's Registration Statement, investors will understand the key features of the Fund.

As an example of the types of information which will be made available to investors, the Fund's Registration Statement will describe the Fund's investment objectives and strategies in a detailed, but clear, manner. In so doing, the Registration Statement will:

- identify the primary factors that determine the value of the option contracts held by the Fund;

- explain, in both narrative and graphical form, the specific strategy used to provide exposure to changes in the dividend expectations reflected in the Fund's option contracts;

6 The Index and Fund utilize this approach because it is not possible to invest directly in dividends that are actually paid without holding an investment in the equity security paying such dividend. However, the value of an option contract on a security or index is based in part on the value of dividends expected to be paid by the security or reflected in the index. Option contracts can therefore be used in combination to provide indirect exposure to actual dividends paid while minimizing exposure to the equity securities which paid such dividends. For this reason, the Index is composed of, and the Fund invests in, option contracts in order to gain indirect exposure to the value of dividends expected to be paid on the securities in the S&P 500 Index.

- explain how the value of actual dividends drives the dividend expectations reflected in the Fund's option contracts, and, therefore, the value of the Fund; and

- contain three diagrams, with accompanying narrative explanations, showing how the value of the Fund is expected to change when the value of actual dividends rise and fall to various levels.

We note that the Registration Statement will contain both narrative and graphical explanations of how the Fund's strategy works and how the Fund is expected to perform under various market conditions. We believe that the combination of these two approaches will foster clearer understanding by investors.

In response to the Comment regarding whether investors will understand the risks of the Fund, we note that the Registration Statement for the Fund will include clear and concise disclosures highlighting all material risks of investing in the Fund, including the risks associated with a portfolio constructed of options (and other derivatives), an investment determined by dividend growth, and other pertinent risks in a manner designed to be informative to an unsophisticated retail investor. For example, the Registration Statement will include the following disclosure:

Before making an investment in the Fund you should know:

- **Unlike more traditional products, the Fund does <u>not</u> seek returns based on appreciation in the stock market price of equity securities. This means that the returns on your Fund investment are not intended to correlate to the returns of the overall stock market (for example, the value of your Fund investment may go down when overall equity markets go up, or vice versa).**
- **The Fund does <u>not</u> produce dividend income and is <u>not</u> an appropriate investment if you are seeking dividend income.**
- **The investment returns of the Fund are treated for tax purposes as capital gains or losses, as applicable. See the section of this Prospectus entitled "Taxes" for more information.**

For the reasons stated above, Reality Shares believes investors will be able to understand the Fund's investment objective, strategy, risks, potential rewards, assumptions, and performance characteristics.

2. With respect to the trading of the Shares on the Exchange, do commenters believe that the Exchange's rules governing sales practices are adequately designed to ensure the suitability of recommendations regarding the Shares? Why or why not? If not, should the Exchange's rules governing sales practices be enhanced? If so, in what ways?

Response:

We believe that the Exchange's rules governing sales practices adequately ensure the suitability of recommendations regarding the Fund's Shares. We therefore do not feel the Exchange's rules governing sales practices should be enhanced or otherwise altered for the Fund. Our conclusions are based on the following.

First, NYSE Arca Equities Rule 9.2(a) (Diligence as to Accounts) provides that an Equity Trading Permit ("ETP") Holder, before recommending a transaction in any security, must have reasonable grounds to believe that the recommendation is suitable for the customer based on any facts disclosed by the customer as to its other security holdings and as to its financial situation and needs. Further, the rule provides, with a limited exception, that prior to the execution of a transaction recommended to a non-institutional customer, the ETP Holder must make reasonable efforts to obtain information concerning the customer's financial status, tax status, investment objectives, and any other information that such ETP Holder believes would be useful to make a recommendation.

In addition, prior to the commencement of trading of Fund Shares, the Exchange will inform its ETP Holders of the suitability requirements of NYSE Arca Equities Rule 9.2(a) in an Information Bulletin ("Information Bulletin" or "Bulletin"). Specifically, ETP Holders are required to be reminded in the Information Bulletin that, in recommending transactions in these securities, they must have a reasonable basis to believe that (1) the recommendation is suitable for a customer given reasonable inquiry concerning the customer's investment objectives, financial situation, needs, and any other information known by such member, and (2) the customer can evaluate the special characteristics, and is able to bear the financial risks, of an investment in the Shares. In connection with the suitability obligation, the Information Bulletin would also provide that members must make reasonable efforts to obtain the following information: (1) the customer's financial status; (2) the customer's tax status; (3) the customer's investment objectives; and (4) such other information used or considered to be reasonable by such members or registered representatives in making recommendations to the customer.

Reality Shares therefore believes the Exchange rules and procedures governing sales practices are adequately designed to ensure the suitability of recommendations regarding the Fund's Shares.

> **3. How closely do commenters think the market price of the Shares will track the Fund's intraday indicative value ("IIV") or the intraday value of the Index? Are certain of these values likely to be more volatile than others? If so, how would this affect trading in the Shares? Are the Shares likely to trade with a significant premium or discount to IIV? What are commenters' views of how effectively the IIV of the Fund would represent the Fund's portfolio? What are commenters' views**

of how the Shares' market price, the Fund's IIV, and the intraday value of the Index will relate to one another during times of market stress?

Response:

How closely do commenters think the market price of the Shares will track the Fund's intraday indicative value ("IIV") or the intraday value of the Index? Are certain of these values likely to be more volatile than others? If so, how would this affect trading in the Shares?

Reality Shares believes the market price of the Fund Shares will closely approximate the IIV of the Fund's portfolio and the intraday value of the Fund's underlying Index. While Reality Shares believes the Fund's IIV and intraday Index values may reflect higher volatility than the market trading price of Fund Shares, it does not expect this will have any material impact on secondary market trading of Fund Shares or the ability of Authorized Participants to engage in effective arbitrage of Fund Shares.

The IIV of the Fund and the intraday values of the Index will be calculated using current market trading prices for the individual listed option contracts held by the Fund and included in the Index. These prices will be supplied by independent, third-party pricing sources and Reality Shares believes these prices represent the best available market quotes for real-time calculation and distribution of the Fund's IIV and the intraday Index values.

Reality Shares expects, however, that Authorized Participants and other institutional investors, in addition to considering the market price of these individual option contracts when valuing and trading Fund Shares, will quote and trade the option contracts held by the Fund in combination (*e.g.,* by holding simultaneous long and short positions in the same put/call contracts). When option contracts are traded in combination, they tend to trade at tighter bid/ask spreads than if such contracts are traded individually. The following simplified example comparing the quotes for an individual call option with the quotes for a call spread helps illustrates this principle. If a trader were to sell a single call option struck at $100, upon exercise the trader would be required to pay the difference between the strike price ($100) and whatever amount the stock finishes above $100. The trader is therefore subject to potentially unlimited risk. However, if a trader were to sell a $100 strike call and simultaneously buy a $110 strike call, the trader would only be subject to a total of $10 of risk. This reduction of risk by using options in combination creates a willingness on the part of market makers to quote tighter and deeper markets for the combination trade than the individual option trade. This stated relationship between option combinations and the reduction in risk is known and well documented in available literature on options pricing and theory.

For these reasons, the listed option contracts held by the Fund, when traded in combination, tend to trade with narrower bid/ask spreads than when such contracts are traded on an individual basis. Because the Fund generally trades option contracts in combination, Reality Shares expects that Authorized Participants and other market makers will factor the price of the combination trades into their assessment of the value of Fund Shares and, therefore, that the trading price of Fund Shares will reflect this assessment. As noted, the Fund's IIV and the intraday Index values are based on the intraday market price of individual option contracts and do not reflect the trading price of the option combinations. Although Reality Shares expects the trading price of Fund Shares to closely approximate the Fund's IIV and the intraday values of the Index, it also expects that the trading price of Fund shares generally will exhibit less volatility than the Fund's IIV and the intraday value of the Index for the reasons noted above.

Reality Shares does not expect that these differences will have any material impact on secondary market trading of Fund Shares or the ability of Authorized Participants to engage in effective arbitrage of Fund Shares. It is generally accepted that ETFs will trade at a secondary market price which fairly reflects the value of their underlying portfolio investments when two factors are present: "transparency" and "access." "Transparency" of a fund's underlying portfolio permits market participants to make their own assessments of the intraday value of an ETF's portfolio holdings. "Access" refers to the ability of Authorized Participants and other market participants (i) to locate the securities required to be delivered in connection with the creation of ETF shares and (ii) to be able to hedge their long or short exposure to ETF shares. Both of these factors are present with the Fund. The Fund is "transparent" in that it will disclose each business day the identities and quantities of the portfolio securities and other assets held by the Fund that will form the basis of the Fund's calculation of net asset value ("NAV") on such business day. The Fund invests in listed option contracts on the S&P 500 Index. The S&P 500 Index consists of extremely liquid, large capitalization securities which are heavily traded on national securities exchanges and elsewhere. The listed S&P 500 Index option contracts in which the Fund invests are also heavily traded and readily available. "Access" can be obtained not only through direct investment, but also through derivative contracts, such as S&P 500 Index swaps and futures. In this manner, Authorized Participants and other investors will have sufficient transparency as to the Fund's portfolio holdings to make their own assessment of the Fund's intraday value and will have sufficient "access" to hedge their positions and support secondary market trading and efficient ETF arbitrage.

In further support of the statement that Reality Shares does not expect any potential differences between the market price of Fund Shares, the Fund's IIV and intraday Index values to have a material impact on secondary market trading of Fund Shares, Reality Shares notes that it is generally accepted that publication of a fund's IIV is of limited utility to Authorized Participants and other market participants and is not necessary to support efficient ETF arbitrage. For example, as noted by a prominent ETF sponsor in its comment letter on the 2008 proposed ETF rule, “an ETF with portfolio transparency does not also require an intraday indicative value to be disseminated in order to achieve valuation clarity.”[7] Portfolio transparency is sufficient to permit Authorized Participants and other investors to determine an ETF’s current underlying portfolio value. In the same comment letter the sponsor also noted its belief that “intraday indicative values are not the most useful indicator of current portfolio value to investors.”[8] Other ETF experts have noted the inherent limitations of IIV as a pricing source since it is, by definition, based on historical trading prices (reported every 15 seconds) and does not reflect real-time bid/ask quotes.[9] Additionally, IIV is limited in usefulness as an indication of value for ETFs investing in non-U.S. markets or commodities which may not have overlapping trading hours with the U.S. or which invest in less liquid assets.[10] Despite these limitations, Reality Shares understands that these types of ETFs have generally experienced efficient arbitrage activity and have traded in the secondary market as expected.

Are the Shares likely to trade with a significant premium or discount to IIV? What are commenters’ views of how effectively the IIV of the Fund would represent the Fund’s portfolio?

The Fund’s IIV will be calculated using real-time, independent prices for the underlying portfolio securities throughout the trading day. As discussed above, Reality Shares believes the Fund’s IIV generally will closely approximate the value of Fund Shares. As a result, Reality Shares expects that Fund Shares generally will not trade at significant premiums or discounts to IIV. In this sense, Reality Shares believes the IIV will be an effective, though not exact, representation of the intraday value of the Fund’s portfolio.

As already noted, Reality Shares believes the use of IIV as a representation of an ETF’s intraday portfolio value is limited, and that portfolio transparency and access play a much more significant role in the success of the ETF arbitrage mechanism and secondary market trading than IIV. Although IIV is a tool used by some investors to help understand the approximate intraday value of ETF shares, as discussed above there are many examples of ETFs with efficient

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7 Comment Letter from Barclays Global Fund Advisers (“BGFA”) to the Commission, Investment Company Act Release No. 28193, File No. S7-07-8 (May 16, 2008) at note 43.

8 *Id.*

9 *See* David J. Abner, Visual Guide to ETFs 55 (2013) (“It has reached a point now in the markets that, because pricing is in real time and so many high-frequency traders are providing markets in ETFs, it sometimes makes more sense just to look at the automatically updating bid/ask to get an indication of ETF value, in conjunction with looking at the IV [intraday indicative value].”).

10 *Id.* (“Another concern with the IV is that it is really only close to real time for an ETF with a constituent basket that is trading at the exact same time as the fund. This leaves a giant swath of the market, those ETFs with international constituents, commodities that close earlier than 4 P.M., or illiquid bonds, where the IV is providing a value that has little relevance to the current trading price of the ETF.”).

arbitrage mechanisms and active secondary market trading that do not update their IIVs throughout the U.S. trading day (such as where an ETF invests in non-U.S. securities)[11] or where IIV is calculated based on pricing matrices, dealer quotes or securities prices which may be stale or illiquid (such as where an ETF invests in fixed-income securities). Reality Shares believes there are several successful ETFs currently trading in the market which have experienced above-average daily premiums or discounts between the market price of ETF shares and IIV, but for which the ETF shares still effectively trade in the secondary market and do not experience significantly wide premiums or discounts to NAV.

What are commenters' views of how the Shares' market price, the Fund's IIV, and the intraday value of the Index will relate to one another during times of market stress?

While it is impossible to predict how any security will behave during periods of market stress, Reality Shares believes the Fund's Shares will trade within an acceptable spread to the Fund's IIV and the intraday value of the Index during times of market stress for the following reasons:

- The listed index options included in the Fund's portfolio and the Index are extremely liquid and readily priced. Market bid/ask quotes for these option contracts (and the underlying securities included in the S&P 500 Index) are widely available and competitively quoted by most every liquidity provider operating in the securities markets. Because the Fund's portfolio is transparent and the Index constituents are publicly disclosed, Reality Shares expects that market participants will be able to assess the value of the Fund and the Index and access the securities necessary to hedge their position exposures, even during times of market stress.

- The dealers expected to make markets in Fund Shares are also market makers in the underlying listed index options, the securities underlying the S&P 500 Index and related derivative products (such as index swaps and futures). Each possesses the necessary infrastructure and securities knowledge to price, make markets, and hedge their positions in the Fund's Shares throughout the day with other financial instruments as part of a larger risk book. Reality Shares believes that, even during times of market stress, the market making community will continue to be able to accurately calculate the value and position the risk of the Fund's portfolio.

- As is the case with other ETFs, during periods of severe market stress the trading price of the Fund's Shares could materially widen from the Fund's IIV for a period of time. However, in these instances Reality Shares believes the secondary market price of

[11] In such instances IIV is updated to reflect changing currency prices only. The IIVs for these ETFs are not updated to reflect events occurring subsequent to the close of the applicable non-U.S. market which could have a material impact on the value of such ETFs' portfolio holdings and lead to intraday premiums and discounts between the IIVs and the market prices of the ETFs' shares.

the Fund Shares may be a more accurate representation of the current value of the Fund's portfolio holdings than IIV owing to the efficiency of the ETF arbitrage mechanism and the fact that IIV is based on historical, not real-time, prices.

- Because of the transparency of the Fund's portfolio and the liquidity and transparency of the underlying listed index options, Reality Shares believes investors will continue to have the ability to buy and sell Shares in the secondary market at fair and representative prices should there be any material departure from IIV.

- The Fund's IIV and the intraday Index values are currently calculated using the same third party pricing sources and therefore generally would be expected to react to market stress in the same fashion (since their underlying pricing sources would be equally impacted by market events).

4. Does the liquidity of the long-dated options in which the Fund will invest differ materially from that of the short-dated options in which the Fund will invest? If so, how would that affect the ability of market makers to engage in arbitrage or to hedge their positions while making a market in the Shares? Would the liquidity characteristics of the Index components or of the options in the Fund's portfolio affect the calculation of the Index value, the calculation of the Fund's IIV, the calculation of the Fund's NAV, or the ability of market makers or other market participants to value the Shares? If so, how?

<u>Response:</u>

Does the liquidity of the long-dated options in which the Fund will invest differ materially from that of the short-dated options in which the Fund will invest?

Although the level of open interest in the longer-dated option contracts held by the Fund is lower than the level of open interest in the shorter-dated option contracts, Reality Shares does not believe that, as a practical matter, the liquidity of the longer-dated option contracts in which the Fund will invest differs materially from the liquidity of the shorter-dated option contracts in which the Fund will invest. Open interest is only one measure of the liquidity of option contracts, and as such, the level of open interest does not paint a complete picture of total available liquidity of an option contract. The best measure of liquidity for any option contract in the market is based on the overall availability of bid/ask quotes. Reality Shares believes the readily available and highly competitive market quotes from a large number of market makers on both the longer- and shorter-dated option contracts, as well as trading liquidity in the market as measured by transacted volume for both the longer-dated and shorter-dated option contracts, indicates there is more than sufficient liquidity in both sets of contracts. Further, the fact that open interest in the shorter-dated contracts is significantly higher than open interest in the longer-dated contracts (*e.g.*, approximately $400 billion for the shorter-dated SPX options compared to approximately $55 billion for the longer-dated SPX options) does not suggest a lack of liquidity in the longer-dated positions. For comparative purposes, the open interest of $55 billion for just the individual longer-dated index options is larger than the market cap of the underlying index basket of several liquid and successful ETFs currently trading in the marketplace.

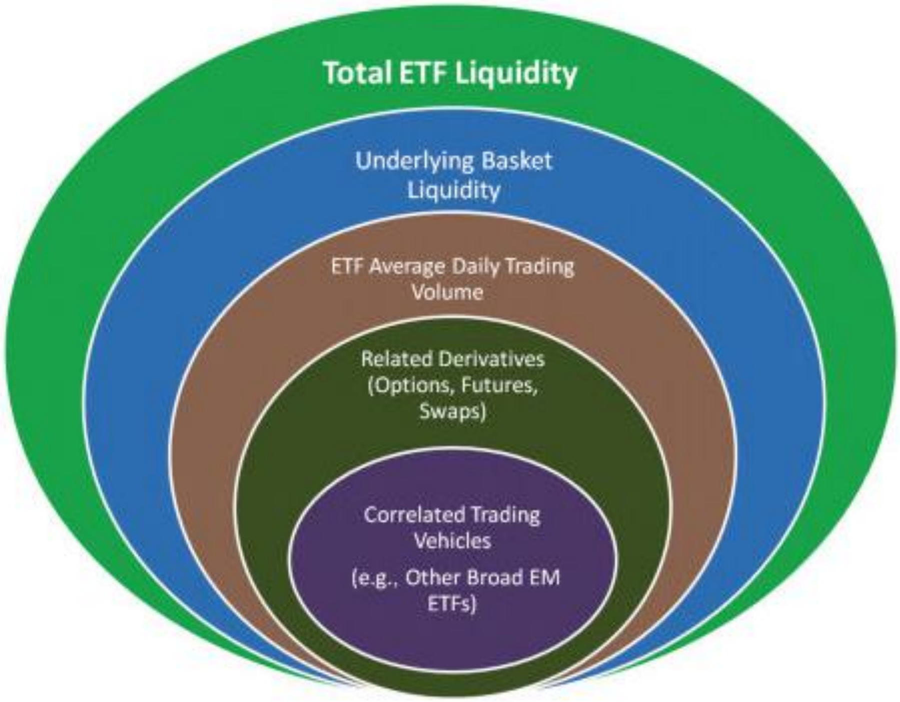
If so, how would that affect the ability of market makers to engage in arbitrage or to hedge their positions while making a market in the Shares? Would the liquidity characteristics of the Index components or of the options in the Fund's portfolio affect the calculation of the Index value, the calculation of the Fund's IIV, the calculation of the Fund's NAV, or the ability of market makers or other market participants to value the Shares? If so, how?

As already noted, the option contracts held by the Fund are extremely liquid and readily quoted. Reality Shares does not believe the liquidity characteristics of the option contracts held by the Fund will have any negative impact on the operation of the Fund, secondary market trading of the Fund's Shares, or the ability of the market makers to engage in arbitrage or hedge their positions in the Fund's Shares. Nor does Reality Shares believe the liquidity characteristics of the option contracts held by the Fund and the Index will have any negative impact on the calculation of the Index value, the calculation of the Fund's IIV, the calculation of the Fund's NAV, or the ability of the market makers or other market participants to value the Shares. In fact, we believe the liquidity characteristics of the option contracts held by the Fund will support efficient arbitrage and secondary market trading, and allow market participants to readily value Fund Shares.

The market for both the longer- and shorter-dated listed index options held by the Fund is sufficiently liquid and the pricing of these option contracts is sufficiently transparent for Authorized Participants and other investors to effectively arbitrage the Fund's Shares and underlying securities portfolio. The dealers who will be making markets in the ETF are also dealers in the underlying option securities and related derivative products. This means they have the necessary infrastructure, risk management applications (including options pricing models) and securities knowledge to price, make markets, and hedge their positions in the Fund's Shares and underlying options contracts throughout the trading day.

<u>Evaluating ETF Liquidity</u>

The liquidity of an ETF is a function of a much greater group of variables than just the current open interest or trading volume in the underlying basket. The components of total ETF liquidity include the liquidity of the underlying basket, all related derivatives based on the ETF or underlying constituents, and all correlated but different trading vehicles.



Source: David J. Abner, Visual Guide to ETFs 93 (2013).

Reality Shares believes there is sufficient and ample liquidity in the option contracts included in the Fund's portfolio for Authorized Participants and other investors to engage in efficient hedging activity, to value Fund Shares and to make markets in Fund Shares. As illustrated by the chart above, the liquidity of a fund's portfolio is a function of the liquidity of option contracts held by a fund which is, in turn, a function of the liquidity of all the related derivative products on, or related to, such contracts. These alternative sources of liquidity enable Authorized Participants and market makers to trade, create and redeem ETF shares and efficiently hedge their portfolio exposures. Generally speaking, if an ETF has multiple liquid alternate hedges in addition to the underlying basket, then it will be easier to price and provide more utility to the investor community. The following products represent additional components of liquidity which may be used in valuing the Fund and the Index:

- **Dividend Swaps** – Dividend swaps are OTC instruments that enable investors to purchase or sell the dividend paid by an underlying index over a specified period. They are based on the actual dividends paid and consequently constitute a hedge for the Fund's portfolio. The levels of liquidity in the dividend swap market are estimated to be in the order of hundreds of millions of notional dollars per day.[12]

- **Futures –** Futures are contracts between two parties to buy or sell an asset at a future date. A long future is analogous to the long combination position the Fund will be

[12] Dividend Swap Indices, Barclays Capital Research (Apr. 2008).

employing in its strategy. Therefore equity index futures contracts represent a key hedge for dealers who have positions in the Fund. As of 2013, the notional volume of total equity index futures is approximately *$3 trillion.*[13] The total open interest in S&P 500-related listed futures is approximately $360 billion.

- **Other Derivatives** – In addition to listed index options, listed ETF options will also be used by many dealers to hedge their positions in the Fund's portfolio.

ETF Option Contracts	Open Interest (USD Billions)
Shorter-Dated SPY Options	$34.4
Longer-Dated SPY Options	$7.1

- **OTC Derivatives –** OTC products such as total return swaps, whose payout is determined by the equity and dividend returns on an Index, are a key source of additional liquidity to the Fund's portfolio. The OTC derivative market for forwards, swaps, and options is estimated to be approximately $6.5 trillion as of December 2013.[14]

We believe the information presented above, combined with the information presented by the Exchange in its prior filings, provides sufficient basis for the Commission to approve the Exchange's proposal. For the reasons stated above, we believe the Fund's Registration Statement disclosure will enable retail and other investors to understand the Fund's investment objectives, strategies and risks and that many investors will find the Fund to be a useful part of their overall investment portfolio. Further, we believe we have demonstrated that there is sufficient information available about the price of the Fund's portfolio investments to allow market participants to readily value Fund Shares throughout the trading day, and that the liquidity and other characteristics of the option contracts held by the Fund will support efficient ETF arbitrage and secondary market trading. It is therefore our strong belief that the proposed rule change is consistent with Section 6(b)(5) of the Exchange Act, that the Exchange has sufficiently met its burden for listing of Fund Shares, and that the proposal complies with, and is otherwise consistent with, all requirements of the Exchange Act. We therefore believe an order approving the Exchange's proposal should be approved as soon as possible.

[13] Futures Research, Bloomberg (2014).

[14] OTC Derivatives Research, Bank of International Settlements (2014).

We appreciate the opportunity to comment on the points raised by the Commission in the Order, and we are eager to assist the Commission in any way we can to ensure that the proposal benefits investors. Please do not hesitate to contact me if you have any questions or would like additional information.

Very truly yours,

Eric Ervin
President, Reality Shares ETF Trust and Reality Shares Advisors, LLC
President and CEO, Reality Shares, Inc.