

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-81120; File No. SR-NASDAQ-2017-062)

July 11, 2017

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Nasdaq Rule 5705(b) to Provide for the Inclusion of Cash in an Index or Portfolio Underlying a Series of Index Fund Shares

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 30, 2017, The NASDAQ Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend Nasdaq Rule 5705(b) to provide for the inclusion of cash in an index or portfolio underlying a series of Index Fund Shares. This filing is substantively identical to a NYSE Arca, Inc. filing previously approved by the Commission (SR-NYSEArca-2017-30, as amended).³

The text of the proposed rule change is available on the Exchange’s Website at <http://nasdaq.cchwallstreet.com>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 80777 (May 25, 2017), 82 FR 25378 (June 1, 2017) (SR-NYSEArca-2017-30).

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend Nasdaq Rule 5705(b)(3) and 5705(b)(4) to provide for the inclusion of cash in an index or portfolio underlying a series of Index Fund Shares.⁴ Nasdaq Rule 5705(b) provides “generic” criteria permitting listing and trading of Index Fund Shares pursuant to Rule 19b-4(e) under the Act⁵ when the underlying index or portfolio satisfies the criteria set forth in Nasdaq Rule 5705(b).

The Exchange understands that certain index providers have included, or intend to include, cash as a component in indexes or portfolios that also include equity or fixed income securities components. An index provider may, for example, provide a certain index weighting allocation to cash or may periodically change an allocation to cash based on the index provider’s assessment of market risk associated with other asset classes in the applicable index.⁶

⁴ See Nasdaq Rule 5705(b)(1)(A) and (B).

⁵ 17 CFR 240.19b-4(e).

⁶ The Exchange notes that shares of the following exchange-traded funds based on indexes or portfolios that include cash as a component are currently listed and traded on the BATS BZX Exchange, Inc.: QuantX Risk Managed Growth ETF; QuantX Risk Managed Multi-Asset Income ETF; QuantX Risk Managed Multi-Asset Total Return ETF; and QuantX Risk Managed Real Return ETF.

Accordingly, the Exchange proposes to amend Nasdaq Rule 5705(b)(3) and 5705(b)(4) to permit listing and trading of Index Fund Shares based on an index or portfolio that includes cash as a component. While open-end investment companies, like mutual funds, will generally hold an amount of cash, Nasdaq Rule 5705(b) currently provides that components of an index or portfolio underlying a series of Index Fund Shares consist of securities—namely, U.S. Component Stocks, Non-U.S. Component Stocks, Fixed Income Securities or a combination thereof. As described below, the proposed amendments to Nasdaq Rule 5705(b)(3) and 5705(b)(4) would permit inclusion of cash as an index or portfolio component.

Currently, Nasdaq Rule 5705(b)(3)(A)(i) provides that an underlying index or portfolio of U.S. Component Stocks⁷ must meet specified criteria. The Exchange proposes to amend Nasdaq Rule 5705(b)(3) to provide that the components of an index or portfolio underlying a series of Index Fund Shares may also include cash. In addition, the percentage weighting criteria in Nasdaq Rule 5705(b)(3)(A)(i)a. – d. each would be amended to make clear that such criteria would be applied only to the U.S. Component Stocks portion of an index or portfolio. For example, in applying the criteria in proposed Nasdaq Rule 5705(b)(3)(A)(i)a.,⁸ if 85% of the weight of an index consists of U.S. Component Stocks and 15% of the index weight is cash, the requirement that component stocks accounting for 90% of the weight of the index or portfolio

⁷ Nasdaq Rule 5705(b)(1)(D) defines “U.S. Component Stock” as an equity security that is registered under Sections 12(b) or 12(g) of the Act or an American Depositary Receipt, the underlying equity security of which is registered under Sections 12(b) or 12(g) of the Act.

⁸ Nasdaq Rule 5705(b)(3)(A)(i)a. would provide that component stocks (excluding Derivative Securities Products) that in the aggregate account for at least 90% of the weight of the U.S. Component Stocks portion of the index or portfolio (excluding such Derivative Securities Products) each shall have a minimum market value of at least \$75 million.

each have a minimum market value of \$75 million minimum would be applied only to the 85% portion consisting of U.S. Component Stocks.

Nasdaq Rule 5705(b)(3)(A)(ii), which relates to international or global indexes or portfolios, would be amended to provide that components of an index or portfolio underlying a series of Index Fund Shares may consist of (a) only Non-U.S. Component Stocks, (b) Non-U.S. Component Stocks and cash, (c) both U.S. Component Stocks and Non-U.S. Component Stocks, or (d) U.S. Component Stocks, Non-U.S. Component Stocks and cash. In addition, the percentage weighting criteria in Nasdaq Rule 5705(b)(3)(A)(ii)a. – d. each would be amended to make clear that such criteria would be applied only to the U.S. and Non-U.S. Component Stocks portions of an index or portfolio.

Nasdaq Rule 5705(b)(4) provides generic criteria applicable to listing and trading of Index Fund Shares whose underlying index or portfolio includes Fixed Income Securities.⁹ Currently, Nasdaq Rule 5705(b)(4)(A)(i) provides that an underlying index or portfolio must consist of Fixed Income Securities. The Exchange proposes to amend Nasdaq Rule 5705(b)(4)(A)(i) to provide that the index or portfolio may also include cash. In addition, the percentage weighting criteria in Nasdaq Rule 5705(b)(4)(A)(ii), 5705(b)(4)(A)(iv) and 5705(b)(4)(A)(vi) each would be amended to make clear that such criteria would be applied only to the Fixed Income Securities portion of an index or portfolio. For example, in applying the criteria in proposed Nasdaq Rule 5705(b)(4)(A)(ii),¹⁰ if 90% of the weight of an index or

⁹ As defined in Nasdaq Rule 5705(b)(4), Fixed Income Securities are debt securities that are notes, bonds, debentures or evidence of indebtedness that include, but are not limited to, U.S. Department of Treasury securities (“Treasury Securities”), government-sponsored entity securities (“GSE Securities”), municipal securities, trust preferred securities, supranational debt and debt of a foreign country or a subdivision thereof.

¹⁰ Nasdaq Rule 5705(b)(4)(A)(ii) would provide that Fixed Income Security components that in aggregate account for at least 75% of the Fixed Income Securities portion of the

portfolio consists of Fixed Income Securities and 10% of the index weight is cash, the requirement that Fixed Income Securities accounting for at least 75% of the weight of the index or portfolio each have a minimum original principal amount outstanding of \$100 million would be applied only to the 90% portion consisting of Fixed Income Securities.

The Exchange notes that the Commission has previously approved Exchange rules allowing portfolios held by issues of Managed Fund Shares (actively managed exchange-traded funds) under Nasdaq Rule 5735 to include cash.¹¹ Like the provision in Nasdaq Rule 5735, which states that there is no limit to cash holdings by an issue of Managed Fund Shares listed under the rule, there is no proposed limit to the weighting of cash in an index or portfolio underlying a series of Index Fund Shares. The Exchange believes this is appropriate in that cash does not, in itself, impose investment or market risk.

The Exchange believes the proposed amendments, by permitting inclusion of cash as a component of indexes or portfolios underlying series of Index Fund Shares, would provide issuers of Index Fund Shares with additional choice in indexes or portfolios permitted to underlie Index Fund Shares that are permitted to list and trade on the Exchange pursuant to Rule 19b-4(e), which would enhance competition among market participants, to the benefit of investors and the marketplace. In addition, the proposed amendments would provide investors with greater ability to hold Index Fund Shares based on underlying indexes or portfolios that may accord more closely with an investor's assessment of market risk, in that some investors may view cash as a desirable component of an underlying index or portfolio under certain market conditions.

weight of the index or portfolio each shall have a minimum original principal amount outstanding of \$100 million or more.

¹¹ See Nasdaq Rule 5735.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,¹² in general, and furthers the objectives of Section 6(b)(5) of the Act,¹³ in particular, because it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to, and perfect the mechanisms of, a free and open market and a national market system and, in general, to protect investors and the public interest and because it is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Exchange has in place surveillance procedures that are adequate to properly monitor trading in Index Fund Shares in all trading sessions and to deter and detect violations of Exchange rules and applicable federal securities laws.

The Exchange notes that, as described above, the percentage weighting criteria in Nasdaq Rule 5705(b)(3)(A)(i)a. – d. and Nasdaq Rule 5705(b)(3)(A)(ii)a. – d. each would be amended to make clear that such criteria would be applied only to the U.S. and Non-U.S. Component Stocks portions of an index or portfolio. The percentage weighting criteria in Nasdaq Rule 5705(b)(4)(A)(ii), 5705(b)(4)(A)(iv) and 5705(b)(4)(A)(vi) each would be amended to make clear that such criteria would be applied only to the Fixed Income Securities portion of an index or portfolio. Such applications of the proposed amendments would assure that the weighting requirements in Nasdaq Rule 5705(b)(3) and 5705(b)(4) would continue to be applied only to securities in an index or portfolio, and would not be diluted as a result of inclusion of a cash component. In addition, the addition of cash as a permitted component of indexes or portfolios

¹² 15 U.S.C. 78f(b).

¹³ 15 U.S.C. 78f(b)(5).

underlying Index Fund Shares listed and traded on the Exchange pursuant to Rule 19b-4(e) does not raise regulatory issues because cash does not, in itself, impose investment or market risk and is generally not susceptible to manipulation.

The Exchange believes the proposed amendments, by permitting inclusion of cash as a component of indexes or portfolios underlying series of Index Fund Shares, would provide issuers of Index Fund Shares with additional choice in indexes or portfolios permitted to underlie Index Fund Shares that are permitted to list and trade on the Exchange pursuant to Rule 19b-4(e), which would enhance competition among market participants, to the benefit of investors and the marketplace. In addition, the proposed amendments would provide investors with greater ability to hold Index Fund Shares based on underlying indexes or portfolios that may accord more closely with an investor's assessment of market risk.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change would permit Exchange listing and trading under Rule 19b-4(e) of Index Fund Shares based on indexes or portfolios that include cash as a component, which would enhance competition among market participants, to the benefit of investors and the marketplace. Additionally, since the Commission has already approved a substantively identical filing by NYSE Arca, Inc.¹⁴ this filing may serve to enhance competition among the exchanges.

¹⁴ Supra note 3.

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

No written comments were either solicited or received.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁵ and Rule 19b-4(f)(6) thereunder.¹⁶

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii)¹⁷ permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that the proposal may become operative immediately upon filing. As noted above, the Exchange believes that the proposed rule change would provide additional choices to issuers of Index Fund Shares and investors in Index Fund Shares. The Exchange also noted that the Commission has approved a substantively identical proposal by NYSE Arca, Inc.,¹⁸ and this proposed rule change may enhance competition between the exchanges. The Commission believes that waiver of the 30-day operative delay is consistent with the protection of investors

¹⁵ 15 U.S.C. 78s(b)(3)(A).

¹⁶ 17 CFR 240.19b-4(f)(6). As required under Rule 19b-4(f)(6)(iii), the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and the text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

¹⁷ 17 CFR 240.19b-4(f)(6)(iii).

¹⁸ See supra note 3.

and the public interest. Therefore, the Commission hereby waives the 30-day operative delay and designates the proposed rule change to be operative upon filing.¹⁹

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. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule change should be approved or disapproved.

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 e-mail to rule-comments@sec.gov. Please include File Number SR-NASDAQ-2017-062 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NASDAQ-2017-062. This file number should be included on the subject line if e-mail is used. To help the Commission process and review

¹⁹ For purposes only of waiving the 30-day operative delay, the Commission has also considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<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 website 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 will also 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-2017-062 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁰

Jill M. Peterson
Assistant Secretary

²⁰ 17 CFR 200.30-3(a)(12).