

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-72141; File No. SR-NASDAQ-2014-009)

May 9, 2014

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Amendment Nos. 2 and 3 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment Nos. 1, 2, and 3 Thereto, Relating to the Means of Achieving the Investment Objectives of the First Trust Tactical High Yield ETF of First Trust Exchange-Traded Fund IV

I. Introduction

On January 22, 2014, The NASDAQ Stock Market LLC (“Exchange” or “NASDAQ”) 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 relating to the First Trust Tactical High Yield ETF (“Fund”) of First Trust Exchange-Traded Fund IV (“Trust”). The proposed rule change was published for comment in the Federal Register on February 10, 2014.<sup>3</sup> On March 11, 2014, the Exchange filed Amendment No. 1 to the proposed rule change, which amended and replaced the proposed rule change in its entirety.<sup>4</sup> On April 1, 2014, the Commission published notice to solicit comments from interested persons on the proposed rule change, as modified by Amendment No. 1 thereto, and to designate a longer period for Commission action on the proposed rule change, as modified

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<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. 71473 (Feb. 4, 2014), 79 FR 7728 (“Notice”).

<sup>4</sup> In Amendment No. 1, the Exchange: (a) clarified the types of Derivative Instruments (as defined herein) as proposed to be used by the Fund; (b) provided specific representations relating the use of these Derivative Instruments; (c) provided additional information as to the valuation of these Derivative Instruments for purposes of determining NAV (as defined herein); (d) provided additional information as to the availability of pricing for the Derivative Instruments to market participants, as well as information relating to the Derivative Instruments as part of the Disclosed Portfolio (as defined herein); and (e) provided additional details as to the Exchange’s surveillance procedures with respect to the Derivative Instruments.

by Amendment No. 1 thereto.<sup>5</sup> On May 7, 2014, the Exchange filed Amendment No. 2 to the proposed rule change, which amended and replaced the proposed rule change in its entirety.<sup>6</sup> On May 8, 2014, the Exchange filed Amendment No. 3 to the proposed rule change, which amended and replaced the proposed rule change in its entirety.<sup>7</sup> The Commission has received no comments on the proposal. The Commission is publishing this notice to solicit comments on Amendment Nos. 2 and 3 from interested persons, and is approving the proposed rule change, as modified by Amendment Nos. 1, 2, and 3 thereto, on an accelerated basis.

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<sup>5</sup> See Securities Exchange Act Release No. 71813 (March 26, 2014), 79 FR 18378. Pursuant to Section 19(b)(2) of the Act, the Commission determined that it was appropriate to designate a longer period within which to take action on the proposed rule change. Accordingly, the Commission designated May 9, 2014, as the date by which the Commission should either approve or disapprove or institute proceedings to determine whether to disapprove the proposed rule change.

<sup>6</sup> In Amendment No. 2, the Exchange: (a) provided additional information regarding the bank loans in which the Fund would invest, including information relating to the senior loan market and valuation and price availability of bank loans; (b) noted that liquidity determinations would be made in accordance with Commission guidance; (c) clarified that the Fund's investments in Derivative Instruments would be limited in all cases to 30% of the Fund's net assets, regardless of whether Derivative Instruments would be used solely for hedging purposes; (d) represented that at least 90% of the Fund's net assets invested in Derivative Instruments would trade in markets that are members of the ISG (as defined herein) or are parties to a comprehensive surveillance sharing agreement with the Exchange; (e) provided additional information relating to valuation and price availability of Derivative Instruments; and (f) clarified in detail what information the Disclosed Portfolio (as defined herein) would provide as a result of the Fund's investments in bank loans and Derivative Instruments.

<sup>7</sup> In Amendment No. 3, the Exchange: (a) clarified that at least 75% of the Fund's net assets that are invested in bank loans would be invested in tranches that have a minimum principal amount outstanding of \$100 million or more with respect to U.S. borrowers and \$200 million or more with respect to non-U.S. borrowers; (b) clarified that at least 90% of the Fund's net assets in Derivative Instruments would be invested in Derivative Instruments that trade in markets that are members of the ISG (as defined herein), which includes, among others, certain U.S. futures exchanges; and (c) replaced certain references to "securities" with "assets" for purposes of describing NAV valuation.

## II. Description of the Proposed Rule Change

The Exchange has made the following representations and statements in describing the Fund's investments, including information relating to certain proposed portfolio holdings, investment restrictions, valuation and price availability, portfolio disclosure, and surveillance, as well as other information.<sup>8</sup>

### The Fund

The Fund (formerly known as the First Trust High Yield Long/Short ETF) is an actively managed exchange-traded fund ("ETF"). The Shares are offered by the Trust, which was organized as a Massachusetts business trust on September 15, 2010. The Trust, which is registered with the Commission as an investment company, has filed a registration statement on Form N-1A ("Registration Statement") relating to the Fund.<sup>9</sup> First Trust Advisors L.P. is the investment adviser ("Adviser") to the Fund.

The Exchange proposes to reflect changes to the means of achieving the investment objectives of the Fund. Specifically, the Exchange proposes two modifications to the description

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<sup>8</sup> The Commission approved the listing and trading of shares ("Shares") of the Fund under NASDAQ Rule 5735, which governs the listing and trading of Managed Fund Shares on the Exchange. See Securities Exchange Act Release No. 68972 (Feb. 22, 2013), 78 FR 13721 (Feb. 28, 2013) (SR-NASDAQ-2012-147) ("Prior Order"). See also Securities Exchange Act Release No. 68581 (Jan. 4, 2013), 78 FR 2295 (Jan. 10, 2013) (SR-NASDAQ-2012-147) ("Prior Notice," and together with the Prior Order, collectively, "Prior Release"). The Commission notes that additional information regarding the Trust, Fund, Shares, investment strategies, risks, net asset value ("NAV") calculation, creation and redemption procedures, fees, portfolio holdings, disclosure policies, distributions, and taxes, among other information, is included in the Prior Release and the Registration Statement (as defined herein), as applicable. See id.; see also Registration Statement, infra note 10.

<sup>9</sup> See Post-Effective Amendment No. 60 to Registration Statement on Form N-1A for the Trust, dated February 28, 2014 (File Nos. 333-174332 and 811-22559). In addition, according to the Exchange, the Trust has obtained certain exemptive relief under the Investment Company Act of 1940 ("1940 Act"). See Investment Company Act Release No. 30029 (Apr. 10, 2012) (File No. 812-13795) ("Exemptive Order").

of the measures the Adviser would utilize to implement the Fund's investment objectives.<sup>10</sup> The Adviser also seeks to make the modifications described below to certain representations in the Prior Release. The Adviser represents that there is no change to the Fund's investment objectives. Except for the changes proposed herein, all other facts presented and representations made in the Prior Release remain unchanged. The Fund would continue to comply with all initial and continued listing requirements under NASDAQ Rule 5735.

#### The Fund's Investments in Bank Loans

The Exchange proposes to modify a representation reflected in the Prior Release by increasing the percentage of the Fund's net assets that may be invested in bank loans. In accordance with the Prior Release, the Fund may invest up to 15% of its net assets in "bank loans," which, as described in the Prior Release, may include loan interests that are not secured by any specific collateral of the borrower, loan interests that have a lower than first lien priority on collateral of the borrower, loans to foreign borrowers, loans in foreign currencies, and other loans with characteristics that the Adviser believes qualify as bank loans. The Fund may invest in bank loans by purchasing assignments or all or a portion of loans or loan participations from third parties. Bank loans are made by or issued to corporations primarily to finance acquisitions, refinance existing debt, support organic growth, or pay out dividends, and are typically originated by large banks and then syndicated out to institutional investors as well as to other banks. Bank loans typically bear interest at a floating rate, although some loans pay a fixed rate.

Going forward, the Exchange proposes that the Fund be permitted to invest up to 40% of its net assets in bank loans, provided that the Fund invest no more than 15% of its net assets in

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<sup>10</sup> According to the Exchange, the Adviser represents that it has managed and will continue to manage the Fund in the manner described in the Prior Release, and will not implement the changes, as described herein, until the instant proposed rule change is operative.

“junior loans” (as defined and described below), and all other bank loans in which the Fund would invest would be “senior loans” (as defined and described below). In addition, at least 75% of the Fund’s net assets that are invested in bank loans would be invested in tranches that have a minimum principal amount outstanding of \$100 million or more with respect to U.S. borrowers and \$200 million or more with respect to non-U.S. borrowers.

The term “senior loans,” as used with respect to the Fund, refers to first lien, senior, secured, floating rate bank loans. The Fund generally invests, and will continue to invest, in senior loans that the Adviser deems to be liquid with readily available prices. Although similar to high yield bonds in that they represent debt obligations of sub-investment grade corporate borrowers, senior loans differ from traditional high yield bonds in several important respects. First, senior loans are typically senior to other obligations of the borrower and secured by the assets of the borrower. Senior loans rank at the top of a borrower’s capital structure in terms of priority of payment, ahead of any subordinated debt (high yield) or the borrower’s common equity. Senior loans are also secured, as the holders of these loans have a lien on most, if not all, of the corporate borrower’s plant, property, equipment, receivables, cash balances, licenses, trademarks, etc. Furthermore, the corporate borrower of senior loans executes a credit agreement that typically restricts what it can do (debt incurrence, asset dispositions, etc.) without the lenders’ approval, and, in addition, may require the borrower to meet certain ongoing financial covenants (EBITDA, leverage tests, etc.). Finally, as noted above, senior loans are generally floating rate obligations.

Institutional investors in senior loans access the market today primarily through commingled funds or separately managed accounts. Individual investors have gained exposure to senior loans primarily through registered open-end or closed-end funds and business

development companies or occasionally through limited partnerships.<sup>11</sup> According to the Exchange, the broad senior loan market – U.S. dollar-denominated non-investment grade bank debt, including both non-institutional (revolvers and pro-rata tranches) and institutional facilities, as measured by Credit Suisse – in terms of total outstanding loans by dollar volume, is approximately \$1.5 trillion (March 31, 2014), nearly equal in size to the high yield corporate bond market in the U.S., also as measured by Credit Suisse, at \$1.4 trillion (March 31, 2014). The institutional leveraged loan market (which includes U.S. dollar-denominated non-investment grade fully-drawn institutional term loans and is a subset of the overall leveraged loan market) is approximately \$819 billion (March 31, 2014). The market for senior loans is almost exclusively comprised of non-investment grade corporate borrowers. The Loan Syndication and Trading Association (“LSTA”), a trade group sponsored by both underwriters of and institutional investors in senior bank loans, has been tracking trading volumes and bid-offer spreads for the asset class since 2007. For the month ended February 28, 2014 – a representative period – \$41 billion of senior loans changed hands representing 1,350 individual transactions. (Source: LSTA.)

The Fund currently invests, and would continue to invest, primarily in the more liquid segment of the senior loan market. The most actively traded loans generally have a tranche size outstanding (or total float of the issue) in excess of \$250 million. The borrowers of these broadly syndicated loans are typically followed by many “buy-side” and “sell-side” credit analysts who, in turn, rely on the borrower to provide transparent financial information concerning its business performance and operating results. The Adviser represents that such borrowers typically provide

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<sup>11</sup> The Adviser believes that there are currently approximately 28 closed-end funds and 60 open-end funds that invest primarily in the senior loan market, with many other funds allocating a portion of their investments to such market.

significant financial transparency to the market through the delivery of financial statements on at least a quarterly basis as required by the executed credit agreements. Additionally, bids and offers in the senior loans are available throughout the trading day on larger issues of senior loans with multiple dealer quotes available. Dealers also update their “trading runs” of senior loans throughout the day and distribute these via electronic messaging to the institutional investor community. In addition, senior loan investors can obtain information on senior loans and their borrowers from numerous public sources, including Bloomberg, FactSet, public financial statement filings (Forms 10-K and 10-Q), and sell side research analysts.

The Adviser has represented to the Exchange that the underwriters, or agent banks, that distribute, syndicate and trade senior loans are among the largest global financial institutions, including JPMorgan, Bank of America, Citigroup, Goldman Sachs, Morgan Stanley, Wells Fargo, Deutsche Bank, Barclays, Credit Suisse, and others. According to the Exchange, it is common for multiple firms to act as underwriters and market makers for a specific senior loan issue. For example, two underwriters may co-underwrite and fund a senior loan that has a \$1 billion institutional tranche. One of the underwriters, acting as syndication agent for the financing, will then draft an offering memorandum (similar to a prospectus for an initial public offering of equity securities), distribute it to potential investors, schedule management meetings with the largest loan investors and arrange a bank meeting that includes management presentations along with a question and answer session. The investor audience attends in person as well as via telephone with both live and recorded conference call options. After a syndication process, which is often two weeks in length, where investors can complete their due diligence work with access to company management and underwriter bankers to answer credit questions, investors’ commitments are collected by the underwriter. The underwriter will typically allocate

the loan to 80-120 investors within the following week, with the largest position representing 3-5% of the tranche size in a successful syndication. Banks also have senior loan trading desks that make secondary bid/ask markets in the loans after they are allocated.

Under the proposed rule change, the Fund would be permitted to invest up to 15% of its net assets (in the aggregate) in loan interests that are not secured by any specific collateral of the borrower and loan interests that have a lower than first lien priority on collateral of the borrower (collectively, “junior loans”).<sup>12</sup> Junior loans have the same characteristics as senior loans except that junior loans are not first in priority of repayment and/or may not be secured by collateral. In this respect, they are similar to a high yield bond. Accordingly, due to their subordination in the borrower’s capital structure, junior loans involve a higher degree of overall risk than senior loans of the same borrower.

According to the Exchange, this proposed change is intended to provide greater flexibility to the Adviser as it tactically allocates proceeds across the high yield debt market and across the debt capital structure of select companies. Additionally, this proposed change would provide the Adviser with increased flexibility to manage the Fund’s duration in periods of rising rates. The Adviser represents that the Fund would continue to invest 85% or more of the portfolio in securities that the Adviser deems to be sufficiently liquid at the time of investment in accordance with Commission guidance. In addition, consistent with the Prior Release, the Adviser would continue to monitor its portfolio liquidity on an ongoing basis to determine whether, in light of current circumstances, an adequate level of liquidity is being maintained.

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<sup>12</sup> As a point of clarification, under its current investment restrictions, the Fund may invest up to 15% of its net assets in junior loans; however, if the Fund invested 15% of its net assets in junior loans, it would not be able to invest in any additional bank loans.



## The Fund's Use of Derivative Instruments

The Exchange also proposes to delete a representation reflected in the Prior Release, which states that, consistent with the Exemptive Order, the Fund would not invest in options contracts, futures contracts, or swap agreements (“Derivatives Representation”).

According to the Exchange, in view of the no-action letter issued by the Commission's Division of Investment Management on December 6, 2012,<sup>13</sup> the Exchange is proposing to delete the Derivatives Representation. The Exchange proposes that, to pursue its investment objectives, the Fund be permitted to invest in U.S. exchange-traded options on futures contracts and U.S. exchange-traded futures contracts (collectively, “Derivative Instruments”). According to the Exchange, the use of Derivative Instruments may allow the Fund to seek to enhance return, to hedge some of the risks of its investments in securities, to substitute Derivative Instruments for a position in an underlying asset, to reduce transaction costs, to maintain full market exposure (which means to adjust the characteristics of its investments to more closely approximate those of the markets in which it invests), to manage cash flows, to preserve capital, or to manage its foreign currency exposures.<sup>14</sup> Under normal market conditions, no more than 30% of the value of the Fund's net assets would be invested in Derivative Instruments.<sup>15</sup> In addition, at least 90%

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<sup>13</sup> See No-Action Letter dated December 6, 2012 from Elizabeth G. Osterman, Associate Director, Office of Exemptive Applications, Division, Commission.

<sup>14</sup> According to the Exchange, the Adviser currently expects that, initially, all of the futures contracts and options on futures contracts that the Fund buys or sells would be futures and options on futures, respectively, on U.S. Treasury obligations. In particular, the Adviser contemplates that the Fund would sell futures on U.S. Treasury obligations as an alternative to engaging in short sales to gain short exposure to the U.S. Treasury market.

<sup>15</sup> According to the Exchange, the Fund would limit its direct investments in futures and options on futures to the extent necessary for the Adviser to claim the exclusion from regulation as a “commodity pool operator” with respect to the Fund under Rule 4.5 promulgated by the Commodity Futures Trading Commission (“CFTC”), as such rule may be amended from time to time. Under Rule 4.5 as currently in effect, the Fund would limit its trading activity in futures and options on futures (excluding activity for

of the Fund's net assets that would be invested in Derivative Instruments would be invested in Derivative Instruments that trade in markets that are members of the Intermarket Surveillance Group ("ISG"), which includes all U.S. national securities exchanges, certain U.S. futures exchanges, and certain foreign exchanges, or that are parties to a comprehensive surveillance sharing agreement with the Exchange.<sup>16</sup>

The Prior Release stated that the Fund's investments would not be used to enhance leverage. In view of the Exchange's proposal to permit the Fund to use Derivative Instruments, the Fund's investments in Derivative Instruments could potentially be used to enhance leverage. However, according to the Exchange, the Fund's investments in Derivative Instruments would be consistent with the Fund's investment objectives and would not be used to seek to achieve a multiple or inverse multiple of an index.

Investments in Derivative Instruments would be made in accordance with the 1940 Act and consistent with the Fund's investment objectives and policies. The Fund would comply with the regulatory requirements of the Commission to maintain assets as "cover," maintain segregated accounts, and/or make margin payments when it takes positions in Derivative Instruments involving obligations to third parties (*i.e.*, instruments other than purchase options). If the applicable guidelines prescribed under the 1940 Act so require, the Fund would earmark or set aside cash, U.S. government securities, high-grade liquid debt securities, and/or other liquid assets in a segregated custodial account in the amount prescribed. The Fund would include

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"bona fide hedging purposes," as defined by the CFTC) such that it will meet one of the following tests: (i) aggregate initial margin and premiums required to establish its futures and options on futures positions will not exceed 5% of the liquidation value of the Fund's portfolio, after taking into account unrealized profits and losses on such positions; or (ii) aggregate net notional value of its futures and options on futures positions will not exceed 100% of the liquidation value of the Fund's portfolio, after taking into account unrealized profits and losses on such positions.

<sup>16</sup> See *infra* note 20.

appropriate risk disclosure in its offering documents, including leveraging risk. Leveraging risk is the risk that certain transactions of the Fund, including the Fund's use of Derivative Instruments, may give rise to leverage, causing the Fund to be more volatile than if it had not been leveraged.<sup>17</sup>

Based on the representations above, the Exchange seeks to modify the current restriction on the Fund's use of Derivative Instruments. According to the Exchange, the Adviser believes that the ability to invest in U.S. exchange-traded options on futures contracts and U.S. exchange-traded futures contracts would provide it with additional flexibility to meet the Fund's investment objectives.

#### Valuation for Purposes of Calculating Net Asset Value

As indicated in the Prior Release, the NAV of the Fund's Shares generally is calculated once daily Monday through Friday as of the close of regular trading on the New York Stock Exchange, generally 4:00 p.m. Eastern time. The NAV per Share is calculated by dividing the Fund's net assets by the number of Shares outstanding.

For purposes of calculating NAV, the Fund's investments are valued daily at market value or, in the absence of market value with respect to any such investment, at fair value, in each case in accordance with valuation procedures (which may be revised from time to time) adopted by the Trust Board ("Valuation Procedures") and in accordance with the 1940 Act. All valuations are subject to review by the Trust Board or its delegate. A market valuation generally means a valuation (i) obtained from an exchange, an independent pricing service ("Pricing Service"), or a major market maker (or dealer) or (ii) based on a price quotation or other equivalent indication of value supplied by an exchange, a Pricing Service, or a major market

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<sup>17</sup> To mitigate leveraging risk, the Fund would segregate or " earmark " liquid assets or otherwise cover the transactions that may give rise to such risk.

maker (or dealer). The information summarized below is based on the Valuation Procedures as currently in effect; however, as noted above, the Valuation Procedures are amended from time to time and, therefore, such information is subject to change.

The Derivative Instruments held by the Fund would consist of U.S. exchange-traded futures contracts and U.S. exchange-traded options on futures contracts and, as such, would typically be valued at the closing price in the market where such instruments are principally traded.

Typically, bank loans are valued using information provided by a Pricing Service. The Pricing Service primarily uses over-the-counter pricing from dealer runs and broker quotes from indicative sheets to value the bank loans. In addition, with respect to the valuation of bank loans, as part of its review, the Adviser's pricing committee ("Pricing Committee") may, in certain limited circumstances, override a value provided by the Pricing Service. If the Pricing Service does not provide a valuation for a particular bank loan, or if the Pricing Committee overrides a value of the bank loan, the bank loan is valued using fair value pricing, as described below.

Certain assets may not be able to be priced by pre-established pricing methods. Such assets may be valued by the Trust Board or its delegate at fair value. The use of fair value pricing by the Fund is governed by the Valuation Procedures and conducted in accordance with the provisions of the 1940 Act. As a general principle, the current "fair value" of an asset is the amount that the owner might reasonably expect to receive for the asset upon its current sale. The use of fair value prices by the Fund generally results in prices used by the Fund that may differ from current market valuations or official closing prices on the applicable exchange. A variety of factors may be considered in determining the fair value of such assets.

Because foreign securities exchanges may be open on different days than the days during which an investor may purchase or sell Shares, the value of the Fund's securities may change on days when investors are not able to purchase or sell Shares. The valuations of bank loans denominated in foreign currencies are converted into U.S. dollars at the exchange rate of those currencies against the U.S. dollar as provided by a Pricing Service. The value of bank loans denominated in foreign currencies is converted into U.S. dollars at the exchange rates in effect at the time of valuation.

#### Availability of Information

As described in the Prior Release, the "Intraday Indicative Value" (defined in NASDAQ Rule 5735(c)(3)), based on the current value for the components of the Disclosed Portfolio, is updated and widely disseminated and broadly displayed at least every 15 seconds during the Regular Market session. For the purposes of determining the Intraday Indicative Value, the Fund's holdings in Derivative Instruments, which would be exchange-traded derivatives, would be valued intraday using the relevant exchange data.

The Prior Release stated that intraday, executable price quotations of the fixed income securities and other assets held by the Fund would be available from major broker-dealer firms or on the exchange on which they are traded, if applicable. The Prior Release also stated that intra-day price information would be available through subscription services, such as Bloomberg and Thomson Reuters, which can be accessed by authorized participants and other investors.

The Derivative Instruments in which the Fund proposes to invest would be U.S. exchange-traded. Accordingly, pricing information for the Derivative Instruments would be available from major broker-dealer firms, on the exchanges on which they are traded, and

through subscription services. Further, pricing information for the bank loans in which the Fund invests would continue to be available from major broker-dealer firms and subscription services.

#### Disclosed Portfolio

As described in the Prior Release, on each business day, before commencement of trading in the Regular Market Session on the Exchange, the Trust discloses on its website<sup>18</sup> the identities and quantities of the portfolio of securities and other assets (“Disclosed Portfolio”) held by the Fund that will form the basis for the Fund’s calculation of NAV at the end of the business day. The Fund’s disclosure of derivative positions in the Disclosed Portfolio would include information that market participants can use to value these positions intraday. On a daily basis, the Fund would disclose on the Fund’s website the following information regarding each portfolio holding, as applicable to the type of holding: ticker symbol, CUSIP number or other identifier, if any; a description of the holding (including the type of holding); the identity of the security or other asset or instrument underlying the holding, if any; for options, the option strike price; quantity held (as measured by, for example, par value, notional value or number of shares, contracts or units); maturity date, if any; coupon rate, if any; effective date, if any; market value of the holding; and the percentage weighting of the holding in the Fund’s portfolio.

#### Surveillance

The Exchange represents that trading in the Shares would continue to be subject to the existing trading surveillances, administered by both NASDAQ and also the Financial Industry Regulatory Authority (“FINRA”) on behalf of the Exchange, which are designed to detect

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<sup>18</sup> The Trust and the Fund have the same website ([www.ftportfolios.com](http://www.ftportfolios.com)).

violations of Exchange rules and applicable federal securities laws.<sup>19</sup> The Exchange represents that these procedures are adequate to properly monitor Exchange trading of the Shares in all trading sessions and to deter and detect violations of Exchange rules and applicable federal securities laws.

The surveillances referred to above generally focus on detecting securities trading outside their normal patterns, which could be indicative of manipulative or other violative activity. When such situations are detected, surveillance analysis follows and investigations are opened, where appropriate, to review the behavior of all relevant parties for all relevant trading violations.

FINRA, on behalf of the Exchange, will communicate as needed regarding trading in the Shares and the Derivative Instruments with other markets or other entities that are members of ISG, and FINRA may obtain trading information regarding trading in the Shares and the Derivative Instruments from such markets and other entities. In addition, the Exchange may obtain information regarding trading in the Shares and the Derivative Instruments from markets and other entities that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.<sup>20</sup> Moreover, FINRA, on behalf of the Exchange, is able to access, as needed, trade information for certain fixed income securities held by the Fund reported to FINRA's Trade Reporting and Compliance Engine ("TRACE"). In addition,

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<sup>19</sup> FINRA surveils trading on the Exchange pursuant to a regulatory services agreement. The Exchange is responsible for FINRA's performance under this regulatory services agreement.

<sup>20</sup> See [www.isgportal.org](http://www.isgportal.org) (providing a list of the current members of ISG). As stated in the Prior Release, the Exchange notes that not all components of the Disclosed Portfolio may trade on markets that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.

the Exchange also has a general policy prohibiting the distribution of material, non-public information by its employees.

### III. Discussion and Commission's Findings

After careful review, the Commission finds that the Exchange's proposal is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>21</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>22</sup> which requires, among other things, that the Exchange's rules be designed 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. The Commission notes that the Fund and the Shares must comply with the requirements of NASDAQ Rule 5735 for the Shares to continue to be listed and traded on the Exchange.

The Exchange proposes that the Fund be permitted to invest up to 40% of its net assets in bank loans. The Exchange represents that the bank loans would primarily be senior loans, which, for purposes of the Fund, refers to first lien, senior, secured, floating rate bank loans. The Fund would be permitted to invest up to 25% of its assets in these senior loans. The Commission notes that it has approved the listing and trading of shares of certain actively managed ETFs investing primarily in these senior loans.<sup>23</sup>

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<sup>21</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>22</sup> 15 U.S.C. 78f(b)(5).

<sup>23</sup> The Commission previously has approved listing and trading of Managed Fund Shares that primarily hold senior loans. See, e.g., Securities Exchange Act Release Nos. 69464 (Apr. 26, 2013), 78 FR 25774 (May 2, 2013) (SR-NASDAQ-2013-036) (order approving listing and trading of shares of the First Trust Senior Loan Fund under NASDAQ Rule 5735); and 69244 (Mar. 27, 2013), 78 FR 19766 (Apr. 2, 2013) (SR-NYSEArca-2013-



The Exchange further proposes that the Fund be able to invest up to 15% of its net assets in bank loans that are “junior loans,” which, for purposes of the Fund, refers to loan interests that are not secured by any specific collateral of the borrower and loan interests that have a lower than first lien priority on collateral of the borrower. While having many of the same characteristics as senior loans, junior loans are not first in priority of repayment and/or may not be secured by collateral. Accordingly, the Exchange states that junior loans involve a higher degree of overall risk than senior loans of the same borrower, due to their subordination in the borrower’s capital structure. The Commission notes, however, that the Fund’s investments in junior loans would be limited to 15% of its net assets.

In addition, the Exchange represents that at least 75% of the Fund’s net assets that are invested in bank loans would be invested in tranches that have a minimum principal amount outstanding of \$100 million or more with respect to U.S. borrowers and \$200 million or more with respect to non-U.S. borrowers. The Commission notes that ETFs based on fixed income component indexes are subject to a minimum principal amount outstanding that is set at the same dollar amount.<sup>24</sup> The Commission further notes that, as stated in the Prior Release, pursuant to the 1940 Act and rules thereunder, the Fund will monitor its portfolio’s liquidity on an ongoing basis to determine whether, in light of current circumstances, an adequate level of liquidity is being maintained and will consider taking appropriate steps in order to maintain adequate

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08) (order approving listing and trading of shares of the SPDR Blackstone/GSO Senior Loan ETF under NYSE Arca Equities Rule 8.600).

<sup>24</sup> See NASDAQ Rule 5705(b)(4)(A)(i) (with respect to an index or portfolio consisting of Fixed Income Securities (as such term is defined therein) underlying an ETF, components that in the aggregate account for at least 75% of the weight of the index or portfolio must have a minimum original principal amount outstanding of \$100 million or more).

liquidity if through a change in values, net assets, or other circumstances, more than 15% of the Fund's net assets are held in illiquid securities.<sup>25</sup>

The Commission believes that the restrictions placed on junior loans would not only help to mitigate the credit risks associated with junior loans, but would also help to mitigate liquidity risk associated with these loans by requiring that at least 75% of the Fund's net assets in bank loans would be invested in tranches that have a minimum principal amount outstanding of \$100 million or more with respect to U.S. borrowers and \$200 million or more with respect to non-U.S. borrowers. As a result, the Commission finds that the Exchange's proposal to permit the Fund to invest up to 40% of its assets in bank loans, including up to 15% of its assets in junior loans, is consistent with the Act.

The Exchange also proposes that the Fund, to pursue its investment objectives, be permitted to invest in Derivative Instruments. According to the Exchange, the Adviser currently expects that, initially, all of the futures contracts and options on futures contracts that the Fund buys and/or sells would be futures and options on futures, respectively, on U.S. Treasury obligations. In particular, the Adviser contemplates that the Fund would sell futures on U.S. Treasury obligations as an alternative to engaging in short sales to gain short exposure to the U.S. Treasury market. Under normal market conditions, no more than 30% of the value of the Fund's net assets would be invested in Derivative Instruments. The Exchange further represents that at least 90% of the Fund's net assets that would be invested in Derivative Instruments would be invested in Derivative Instruments that trade in markets that are members of ISG, which includes all U.S. national securities exchanges, certain U.S. futures exchanges, and certain

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<sup>25</sup> According to the Exchange, the Adviser represents that the Fund would continue to invest 85% or more of the portfolio in securities that the Adviser deems to be sufficiently liquid at the time of investment in accordance with Commission guidance. See Prior Release, supra note 8.

foreign exchanges, or are parties to a comprehensive surveillance sharing agreement with the Exchange. The Commission notes that all Derivative Instruments would be U.S. exchange-traded. The Commission finds that this aspect of the proposal is also consistent with the Act.

The Commission further notes that, with respect to information relating to bank loans and Derivative Instruments, the Exchange has made the following additional representations:

(1) As described in the Prior Release, on each business day, before commencement of trading in the Regular Market Session on the Exchange, the Trust discloses on its website the Disclosed Portfolio that will form the basis for the Fund's calculation of NAV at the end of the business day. The Fund's disclosure of derivative positions in the Disclosed Portfolio would include information that market participants can use to value these positions intraday. On a daily basis, the Fund would disclose on the Fund's website the following information regarding each portfolio holding, as applicable to the type of holding: ticker symbol, CUSIP number or other identifier, if any; a description of the holding (including the type of holding); the identity of the security or other asset or instrument underlying the holding, if any; for options, the option strike price; quantity held (as measured by, for example, par value, notional value or number of shares, contracts or units); maturity date, if any; coupon rate, if any; effective date, if any; market value of the holding; and the percentage weighting of the holding in the Fund's portfolio.

(2) In addition, as described in the Prior Release, the "Intraday Indicative Value" (defined in NASDAQ Rule 5735(c)(3)), based on the current value for the components of the Disclosed Portfolio, is updated and widely disseminated and broadly displayed at least every 15 seconds during the Regular Market session. For the purposes

of determining the Intraday Indicative Value, the Fund's holdings in Derivative Instruments, which would be exchange-traded derivatives, would be valued intraday using the relevant exchange data.

(3) The Prior Release states that intraday, executable price quotations of the fixed income securities and other assets held by the Fund would be available from major broker-dealer firms or on the exchange on which they are traded, if applicable. The Prior Release also states that intraday price information would be available through subscription services, such as Bloomberg and Thomson Reuters, which can be accessed by authorized participants and other investors. Pricing information for the Derivative Instruments would be available from major broker-dealer firms, on the exchanges on which they are traded, and through subscription services. Further, pricing information for the bank loans in which the Fund invests would continue to be available from major broker-dealer firms and subscription services.

(4) The Exchange represents that trading in the Shares would continue to be subject to the existing trading surveillances, administered by both NASDAQ and FINRA, on behalf of the Exchange, which are designed to detect violations of Exchange rules and applicable federal securities laws. The Exchange represents that these procedures are adequate to properly monitor Exchange trading of the Shares in all trading sessions and to deter and detect violations of Exchange rules and applicable federal securities laws.

FINRA, on behalf of the Exchange, will communicate as needed regarding trading in the Shares and the Derivative Instruments with other markets or other entities that are members of ISG, and FINRA may obtain trading information regarding trading in the Shares and the Derivative Instruments from such markets and other entities. In

addition, the Exchange may obtain information regarding trading in the Shares and the Derivative Instruments from markets and other entities that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement. Moreover, FINRA, on behalf of the Exchange, is able to access, as needed, trade information for certain fixed income securities held by the Fund reported to FINRA's TRACE.

In conclusion, the Commission notes that, according to the Exchange: there is no change to the Fund's investment objectives; except for the changes proposed herein, all other facts presented and representations made in the Prior Release remain unchanged; and the Fund would continue to comply with all initial and continued listing requirements under NASDAQ Rule 5735.

For the foregoing reasons, the Commission finds that the proposed rule change, as modified by Amendment Nos. 1, 2, and 3 thereto, is consistent with Section 6(b)(5) of the Act<sup>26</sup> and the rules and regulations thereunder applicable to a national securities exchange.

#### IV. Solicitation of Comments on Amendment Nos. 2 and 3

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment Nos. 2 and 3 are consistent with the Act.<sup>27</sup>

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

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<sup>26</sup> 15 U.S.C. 78f(b)(5).

<sup>27</sup> On April 1, 2014, the Commission published notice to solicit comments from interested persons on the proposed rule change, as modified by Amendment No. 1 thereto, and to designate a longer period for Commission action on the proposed rule change, as modified by Amendment No. 1 thereto. The Commission received no comments on the proposed rule change, as modified by Amendment No. 1 thereto. See supra notes 4 and 5 and accompanying text.

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2014-009 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NASDAQ-2014-009. This file number should be included on the subject line if e-mail 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 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 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-2014-009 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Accelerated Approval of Proposed Rule Change, As Modified by Amendment Nos. 1, 2, and 3

The Commission finds good cause to approve the proposed rule change, as modified by Amendment Nos. 1, 2, and 3 thereto, prior to the thirtieth day after the date of publication of notice in the Federal Register. The proposed Amendment No. 1 amended and replaced the proposed rule change in its entirety and supplemented the proposed rule change by:

(a) clarifying the types of Derivative Instruments (as defined above) proposed to be used by the Fund; (b) providing specific representations relating the use of these Derivative Instruments; (c) providing additional information as to the valuation of these Derivative Instruments for purposes of determining NAV (as defined herein); (d) providing additional information as to the availability of pricing for the Derivative Instruments to market participants, as well as information relating to the Derivative Instruments as part of the Disclosed Portfolio (as defined herein); and (e) providing additional details as to the Exchange's surveillance procedures with respect to the Derivative Instruments.<sup>28</sup>

The proposed Amendment No. 2 amended and replaced the proposed rule change, as modified by Amendment No. 1 thereto, in its entirety, and supplemented the proposed rule change by: (a) providing additional information regarding the bank loans in which the Fund would invest, including information relating to the senior loan market and valuation and price availability of bank loans; (b) noting that liquidity determinations would be made in accordance with Commission guidance; (c) clarifying that the Fund's investments in Derivative Instruments would be limited in all cases to 30% of the Fund's net assets, regardless of whether Derivative Instruments would be used solely for hedging purposes; (d) representing that at least 90% of the Fund's net assets invested in Derivative Instruments would trade in markets that are members of

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<sup>28</sup> See supra note 4 and accompanying text.

the ISG (as defined herein) or are parties to a comprehensive surveillance sharing agreement with the Exchange; (e) providing additional information relating to valuation and price availability of Derivative Instruments; and (f) clarifying in detail what information the Disclosed Portfolio (as defined herein) would provide as a result of the Fund's investments in bank loans and Derivative Instruments.<sup>29</sup>

The proposed Amendment No. 3 amended and replaced the proposed rule change, as modified by Amendment No. 2 thereto, in its entirety, and supplemented the proposed rule change by: (a) clarifying that at least 75% of the Fund's net assets that are invested in bank loans would be invested in tranches that have a minimum principal amount outstanding of \$100 million or more with respect to U.S. borrowers and \$200 million or more with respect to non-U.S. borrowers; (b) clarifying that at least 90% of the Fund's net assets in Derivative Instruments would be invested in Derivative Instruments that trade in markets that are members of the ISG (as defined herein), which includes, among others, certain U.S. futures exchanges; and (c) replacing certain references to "securities" with "assets" for purposes of describing NAV valuation.<sup>30</sup>

The Commission believes that the additional information and clarifications reflected in the proposed rule change, as modified by Amendment Nos. 1, 2 and 3 thereto, regarding the Fund's investments in bank loans and Derivative Instruments, will benefit investors and other market participants. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>31</sup> to approve the proposed rule change, as modified by Amendment Nos. 1, 2, and 3, on an accelerated basis.

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<sup>29</sup> See supra note 6 and accompanying text.

<sup>30</sup> See supra note 7 and accompanying text.

<sup>31</sup> 15 U.S.C. 78s(b)(2).



VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>32</sup> that the proposed rule change (SR-NASDAQ-2014-009), as modified by Amendment Nos. 1, 2, and 3 thereto, be, and it hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>33</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>32</sup> Id.

<sup>33</sup> 17 CFR 200.30-3(a)(12).