

SECURITIES AND EXCHANGE COMMISSION  
(Release No.72645; File No. SR-NYSEArca-2014-44)

July 18, 2014

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Granting Approval of Proposed Rule Change Relating to Listing and Trading Shares of First Trust Long/Short Equity ETF under NYSE Arca Equities Rule 8.600

I. Introduction

On May 21, 2014, NYSE Arca, Inc. (“Exchange” or “NYSE Arca”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to list and trade shares (“Shares”) of the First Trust Long/Short Equity ETF (“Fund”) under NYSE Arca Equities Rule 8.600. The proposed rule change was published for comment in the Federal Register on June 9, 2014.<sup>3</sup> The Commission received no comments on the proposed rule change. This order grants approval of the proposed rule change.

II. Description of Proposed Rule Change

The Exchange proposes to list and trade Shares of the Fund under NYSE Arca Equities Rule 8.600, which governs the listing and trading of Managed Fund Shares<sup>4</sup> on the Exchange.

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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. 72299 (Jun. 3, 2014), 79 FR 33018 (“Notice”).

<sup>4</sup> A Managed Fund Share is a security that represents an interest in an investment company registered under the Investment Company Act of 1940 (“1940 Act”), organized as an open-end investment company or similar entity that invests in a portfolio of securities selected by its investment adviser consistent with its investment objectives and policies. In contrast, an open-end investment company that issues Investment Company Units, listed and traded on the Exchange under NYSE Arca Equities Rule 5.2(j)(3), seeks to provide investment results that correspond generally to the price and yield performance of a specific foreign or domestic stock index, fixed income securities index, or combination thereof.

The Fund will be a series of First Trust Exchange-Traded Fund III (“Trust”),<sup>5</sup> a registered management investment company. The Fund will be an actively-managed exchange-traded fund (“ETF”) and will not seek to replicate the performance of a specified index. First Trust Advisors L.P. (“Adviser”) will be the investment adviser for the Fund.<sup>6</sup> Brown Brothers Harriman & Co. will be the administrator, accounting agent, custodian, and transfer agent for the Fund, and First Trust Portfolios L.P. will be the principal underwriter and distributor for the Fund.

The Exchange has made the following representations and statements in describing the Fund and its investment strategies, including other portfolio holdings and investment restrictions.<sup>7</sup>

#### Principal Investments of the Fund

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<sup>5</sup> The Trust is registered under the 1940 Act. According to the Exchange, on April 1, 2014, the Trust filed with the Commission an amendment to its registration statement on Form N-1A relating to the Fund (File Nos. 333-176976 and 811-22245) (“Registration Statement”). In addition, the Exchange states that the Trust has obtained certain certain exemptive relief under the 1940 Act. See Investment Company Act Release No. 28468 (Oct. 27, 2008) (File No. 812-13477).

<sup>6</sup> The Exchange represents that the Adviser is not registered as a broker-dealer, but is affiliated with First Trust Portfolios L.P., a broker dealer. The Exchange further represents that the Adviser has implemented a “fire wall” with respect to its broker-dealer affiliate regarding access to information concerning the composition and changes to the Fund’s portfolio. In addition, according to the Exchange, in the event (a) the Adviser or any sub-adviser becomes, or becomes newly affiliated with, a broker-dealer, or (b) any new adviser or sub-adviser is, or becomes affiliated with, a broker-dealer, the Adviser or any new adviser or sub-adviser, as applicable, will implement a fire wall with respect to its relevant personnel or its broker-dealer affiliate regarding access to information concerning the composition and changes to the Fund’s portfolio, and will be subject to procedures designed to prevent the use and dissemination of material, non-public information regarding such portfolio.

<sup>7</sup> The Commission notes that additional information regarding the Trust, the Fund, and the Shares, including 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 Notice and the Registration Statement, as applicable. See Notice and Registration Statement, supra notes 3 and 5, respectively.

According to the Exchange, the Fund will seek to provide investors with long-term total return. The Fund intends to pursue its investment objective by establishing long and short positions in a portfolio of Equity Securities (as defined below). Under normal market conditions,<sup>8</sup> at least 80% of the Fund's net assets will be exposed to U.S. exchange-listed equity securities of U.S. and foreign companies by investing in such securities directly and in U.S. ETFs that provide exposure to such securities.<sup>9</sup> The securities of the companies and ETFs in which the Fund will invest are referred to collectively as "Equity Securities." The Equity Securities held by the Fund may include U.S. exchange-listed equity securities of foreign issuers as well as investments in the equity securities of foreign issuers that are in the form of U.S. exchange-listed American Depositary Receipts ("ADRs") or U.S. exchange-listed Global Depositary Receipts ("GDRs," and together with ADRs, "Depositary Receipts"), as well as unsponsored ADRs.<sup>10</sup> The Equity Securities in which the Fund may invest (with the exception of unsponsored ADRs) will be listed on a U.S. national securities exchange, all of which are members of the Intermarket Surveillance Group ("ISG").

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<sup>8</sup> The term "under normal market conditions" or "under normal circumstances" includes, but is not limited to, the absence of adverse market, economic, political, or other conditions, including extreme volatility or trading halts in the equities markets or the financial markets generally; operational issues causing dissemination of inaccurate market information; or force majeure type events such as systems failure, natural or man-made disaster, act of God, armed conflict, act of terrorism, riot or labor disruption, or any similar intervening circumstance.

<sup>9</sup> For purposes of the Fund's principal investments, ETFs include Investment Company Units (as described in NYSE Arca Equities Rule 5.2(j)(3)); Portfolio Depositary Receipts (as described in NYSE Arca Equities Rule 8.100); and Managed Fund Shares (as described in NYSE Arca Equities Rule 8.600). The ETFs all will be listed and traded in the U.S. on registered exchanges. The ETFs in which the Fund may invest will primarily be equity index-based ETFs that hold substantially all of their assets in securities representing a specific equity index. While the Fund may invest in inverse ETFs, the Fund will not invest in leveraged (e.g., 2X, -2X, 3X, or -3X) ETFs.

<sup>10</sup> The Fund will not invest more than 10% of its investments in Equity Securities in unsponsored ADRs.

As indicated above, the Fund will take long and short positions in Equity Securities. As opposed to taking long positions in which an investor seeks to profit from increases in the price of a security, short selling (or “selling short”) is a technique that will be used by the Fund to try and profit from the falling price of a security. Short selling involves selling a security that has been borrowed from a third party with the intention of buying an identical security back at a later date to return to that third party.

The Adviser will select Equity Securities using an investment process that analyzes fundamental, market-related, technical and statistical attributes of Equity Securities to assess total return potential. The Adviser will then use this analysis as the basis to establish long and short positions within the Fund’s portfolio. The Exchange notes that having both long and short positions in an equity security portfolio is a common way to create returns that are independent of market moves. One advantage of a long and short portfolio is that the long and short positions may offset one another in a manner that results in a lower net exposure to the direction of the market. In addition, cash balances arising from the use of short selling typically will be held in money market instruments.<sup>11</sup>

#### Other Investments of the Fund

While the Fund, under normal circumstances,<sup>12</sup> will invest at least 80% of its net assets in Equity Securities as described above, the Fund may also invest its remaining assets in other investments as described below.

The Fund may invest a portion of its net assets in high-quality, money market instruments on an ongoing basis. The instruments in which the Fund may invest include: (1) short-term

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<sup>11</sup> Money market instruments will generally be short-term cash instruments that have a remaining maturity of 397 days or less and exhibit high quality credit profiles. These include U.S. Treasury Bills and repurchase agreements.

<sup>12</sup> See supra note 8.

obligations issued by the U.S. government; (2) negotiable certificates of deposit (“CDs”), fixed time deposits and bankers’ acceptances of U.S. and foreign banks and similar institutions; (3) commercial paper rated at the date of purchase “Prime-1” by Moody’s Investors Service, Inc. or “A-1+” or “A-1” by Standard & Poor’s Ratings Group, Inc., a division of The McGraw-Hill Companies, Inc., or, if unrated, of comparable quality as determined by the Adviser; (4) repurchase agreements (only from or to a commercial bank or a broker-dealer, and only if the purchase is scheduled to occur within seven (7) days or less); and (5) money market mutual funds. CDs are short-term negotiable obligations of commercial banks. Time deposits are non-negotiable deposits maintained in banking institutions for specified periods of time at stated interest rates. Bankers’ acceptances are time drafts drawn on commercial banks by borrowers, usually in connection with international transactions.

The Fund also may invest up to 20% of its net assets in U.S. exchange-listed equity index futures contracts. All of such equity index futures contracts will be listed on an exchange that is a member of ISG.

In certain situations or market conditions, the Fund may temporarily depart from its normal investment policies and strategies provided that the alternative is consistent with its investment objective and is in the best interest of the Fund. For example, the Fund may hold little or no short positions for extended periods, or the Fund may hold a higher than normal proportion of its net assets in cash in times of extreme market stress.

#### Investment Restrictions of the Fund

The Fund will seek to qualify for treatment as a regulated investment company under Subchapter M of the Internal Revenue Code of 1986, as amended.

In addition, as part of its non-principal strategy, the Fund may hold up to an aggregate

amount of 15% of its net assets in illiquid assets (calculated at the time of investment). The Fund will monitor its portfolio 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 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 and other illiquid assets.

The Fund will not invest 25% or more of the value of its net assets in securities of issuers in any one industry. This restriction will not apply to (a) obligations issued or guaranteed by the U.S. government, its agencies, or instrumentalities, or (b) securities of other investment companies.

### III. Discussion and Commission's Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of Section 6 of the Act<sup>13</sup> and the rules and regulations thereunder applicable to a national securities exchange.<sup>14</sup> In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>15</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 initial and continued listing criteria in NYSE Arca Equities Rule 8.600 for the Shares to be listed and traded on the Exchange.

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<sup>13</sup> 15 U.S.C. 78f.

<sup>14</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>15</sup> 15 U.S.C. 78f(b)(5).

The Commission finds that the proposal to list and trade the Shares on the Exchange is consistent with Section 11A(a)(1)(C)(iii) of the Act,<sup>16</sup> which sets forth Congress' finding that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure the availability to brokers, dealers, and investors of information with respect to quotations for, and transactions in, securities. Quotation and last-sale information for the Shares and the underlying U.S. exchange-traded Equity Securities will be available via the Consolidated Tape Association ("CTA") high-speed line. In addition, the Fund's Portfolio Indicative Value, as defined in NYSE Arca Equities Rule 8.600(c)(3), will be widely disseminated at least every fifteen seconds during the NYSE Arca Core Trading Session by one or more major market data vendors.<sup>17</sup> On a daily basis, the Adviser, on behalf of the Fund, will disclose on the Fund's website the following information regarding each portfolio holding ("Disclosed Portfolio," as defined in NYSE Arca Equities Rule 8.600(c)(2)), as applicable to the type of holding: ticker symbol, CUSIP number or other identifier, if any; a description of the holding; the identity of the security, index, or other asset or instrument underlying the holding, if any; 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. The website information will be publicly available at no charge. In addition, a basket composition file, which includes the security names and share quantities, if applicable, required to be delivered in exchange for a Fund's Shares, together with estimates and actual cash components, will be publicly disseminated daily prior to the opening of the New York Stock Exchange ("NYSE") via

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<sup>16</sup> 15 U.S.C. 78k-1(a)(1)(C)(iii).

<sup>17</sup> According to the Exchange, several major market data vendors display or make widely available Portfolio Indicative Values taken from CTA or other data feeds.

the National Securities Clearing Corporation. The NAV of the Fund will be determined as of the close of trading (normally 4:00 p.m., Eastern Time) on each day the NYSE is open for business.<sup>18</sup> Information regarding market price and trading volume of the Shares will be continually available on a real-time basis throughout the day on brokers' computer screens and other electronic services. Information regarding the previous day's closing price and trading volume information for the Shares will be published daily in the financial section of newspapers. Information regarding the Equity Securities and U.S. exchange-traded futures contracts held by the Fund will be available from the national exchanges trading such securities and futures contracts, respectively, automated quotation systems, published or other public sources, or on-line information services, such as Bloomberg or Reuters or any such future service provider. In addition, quotation information from brokers and dealers or pricing services will be available for fixed income securities, including U.S. government obligations, other money market

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<sup>18</sup> NAV will be calculated for the Fund by taking the market price of the Fund's net assets, including interest or dividends accrued but not yet collected, less all liabilities, and dividing such amount by the total number of Shares outstanding. The result, rounded to the nearest cent, will be the NAV per Share. All valuations will be subject to review by the Board of Trustees of the Trust or its delegate. According to the Exchange, equity securities (including ETFs and Depositary Receipts) listed on any exchange other than The NASDAQ Stock Market LLC ("NASDAQ") will be valued at the last sale price on the exchange on which they are principally traded on the business day as of which such value is being determined. Equity securities listed on the NASDAQ will be valued at the official closing price on the business day as of which such value is being determined. If there has been no sale on such day, or no official closing price in the case of securities traded on the NASDAQ, the securities will be valued using fair value pricing. Equity securities traded on more than one securities exchange will be valued at the last sale price or official closing price, as applicable, on the business day as of which such value is being determined at the close of the exchange representing the principal market for such securities. Exchange-traded futures contracts will be valued at the closing price in the market where such contracts are principally traded. Intra-day and closing price information regarding unsponsored ADRs will be available from major market data vendors such as Bloomberg and Reuters. Overnight repurchase agreements will be valued at cost. Term repurchase agreements (i.e., those whose maturity exceeds seven days) will be valued at the average of the bid quotations obtained daily from at least two recognized dealers.



instruments, and repurchase agreements. The Fund's website will include a form of the prospectus for the Fund and additional data relating to NAV and other applicable quantitative information for the Fund.

The Commission further believes that the proposal to list and trade the Shares is reasonably designed to promote fair disclosure of information that may be necessary to price the Shares appropriately and to prevent trading when a reasonable degree of transparency cannot be assured. The Exchange will obtain a representation from the issuer of the Shares that the NAV per Share will be calculated daily and that the NAV and the Disclosed Portfolio for the Fund will be made available to all market participants at the same time. Trading in Shares of the Fund will be halted if the circuit breaker parameters in NYSE Arca Equities Rule 7.12 have been reached or because of market conditions or for reasons that, in the view of the Exchange, make trading in the Shares inadvisable,<sup>19</sup> and trading in the Shares will be subject to NYSE Arca Equities Rule 8.600(d)(2)(D), which sets forth additional circumstances under which trading in the Shares of the Fund may be halted. The Exchange states that it has a general policy prohibiting the distribution of material, non-public information by its employees. Consistent with NYSE Arca Equities Rule 8.600(d)(2)(B)(ii), the Commission notes that the Reporting Authority must implement and maintain, or be subject to, procedures designed to prevent the use and dissemination of material, non-public information regarding the actual components of the Fund's portfolio. In addition, the Exchange states that the Adviser is affiliated with a broker-dealer and that the Adviser has implemented a fire wall with respect to its broker-dealer affiliate regarding

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<sup>19</sup> These reasons may include: (1) the extent to which trading is not occurring in the securities or the financial instruments comprising the Disclosed Portfolio of the Fund; or (2) whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present. With respect to trading halts, the Exchange may consider all relevant factors in exercising its discretion to halt or suspend trading in the Shares of the Fund.

access to information concerning the composition and changes to the Fund’s portfolio.<sup>20</sup> The Exchange represents that trading in the Shares will be subject to the existing trading surveillances, administered by the Financial Industry Regulatory Authority (“FINRA”) on behalf of the Exchange, which are designed to detect violations of Exchange rules and applicable federal securities laws.<sup>21</sup> The Exchange further 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 federal securities laws applicable to trading on the Exchange. Moreover, prior to the commencement of trading, the Exchange states that it will inform its Equity Trading Permit Holders in an Information Bulletin of the special characteristics and risks associated with trading the Shares.

The Exchange represents that the Shares are deemed to be equity securities, thus rendering trading in the Shares subject to the Exchange’s existing rules governing the trading of equity securities. In support of this proposal, the Exchange has made representations, including

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<sup>20</sup> See supra note 6. The Exchange states that an investment adviser to an open-end fund is required to be registered under the Investment Advisers Act of 1940 (“Advisers Act”). As a result, the Adviser and its related personnel are subject to the provisions of Rule 204A-1 under the Advisers Act relating to codes of ethics. This Rule requires investment advisers to adopt a code of ethics that reflects the fiduciary nature of the relationship to clients, as well as compliance with other applicable securities laws. Accordingly, procedures designed to prevent the communication and misuse of non-public information by an investment adviser must be consistent with Rule 204A-1 under the Advisers Act. In addition, Rule 206(4)-7 under the Advisers Act makes it unlawful for an investment adviser to provide investment advice to clients unless such investment adviser has (i) adopted and implemented written policies and procedures reasonably designed to prevent violation, by the investment adviser and its supervised persons, of the Advisers Act and the Commission rules adopted thereunder; (ii) implemented, at a minimum, an annual review regarding the adequacy of the policies and procedures established pursuant to subparagraph (i) above and the effectiveness of their implementation; and (iii) designated an individual (who is a supervised person) responsible for administering the policies and procedures adopted under subparagraph (i) above.

<sup>21</sup> The Exchange states that FINRA surveils trading on the Exchange pursuant to a regulatory services agreement and that the Exchange is responsible for FINRA’s performance under this regulatory services agreement.

the following:

- (1) The Shares will be subject to NYSE Arca Equities Rule 8.600, which sets forth the initial and continued listing criteria applicable to Managed Fund Shares.
- (2) The Exchange has appropriate rules to facilitate transactions in the Shares during all trading sessions.
- (3) FINRA, on behalf of the Exchange, will communicate as needed regarding trading in the Shares, underlying Equity Securities, and equity index futures contracts with other markets and other entities that are members of ISG, and FINRA, on behalf of the Exchange, may obtain trading information regarding trading in the Shares, Equity Securities, and equity index futures contracts from such markets and other entities. In addition, the Exchange may obtain information regarding trading in the Shares, underlying Equity Securities, and equity index futures contracts from markets and other entities that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.
- (4) The Equity Securities in which the Fund may invest (including Depositary Receipts, with the exception of unsponsored ADRs) will be listed on a U.S. national securities exchange, all of which are members of ISG. The Fund will not invest more than 10% of its investments in Equity Securities in unsponsored ADRs. All of the Fund's equity index futures contracts will be listed on an exchange that is a member of ISG.
- (5) Prior to the commencement of trading, the Exchange will inform its Equity Trading Permit Holders in an Information Bulletin of the special characteristics

and risks associated with trading the Shares. Specifically, the Information Bulletin will discuss the following: (a) the procedures for purchases and redemptions of Shares in creation units (and that Shares are not individually redeemable); (b) NYSE Arca Equities Rule 9.2(a), which imposes a duty of due diligence on its Equity Trading Permit Holders to learn the essential facts relating to every customer prior to trading the Shares; (c) the risks involved in trading the Shares during the Opening and Late Trading Sessions when an updated Portfolio Indicative Value will not be calculated or publicly disseminated; (d) how information regarding the Portfolio Indicative Value and Disclosed Portfolio is disseminated; (e) the requirement that Equity Trading Permit Holders deliver a prospectus to investors purchasing newly issued Shares prior to or concurrently with the confirmation of a transaction; and (f) trading information.

- (6) For initial and continued listing, the Fund will be in compliance with Rule 10A-3 under the Act,<sup>22</sup> as provided by NYSE Arca Equities Rule 5.3.
- (7) The Fund may hold up to an aggregate amount of 15% of its net assets in illiquid assets (calculated at the time of investment).
- (8) Under normal market circumstances, at least 80% of the Fund's net assets will be exposed to U.S. exchange-listed Equity Securities. While the Fund may invest in inverse ETFs, the Fund will not invest in leveraged ETFs. The Fund may invest up to 20% of its net assets in U.S. exchange-listed equity index futures contracts.
- (9) A minimum of 100,000 Shares for the Fund will be outstanding at the commencement of trading on the Exchange.

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<sup>22</sup> 17 CFR 240.10A-3.

This approval order is based on all of the Exchange's representations, including those set forth above and in the Notice, and the Exchange's description of the Fund.

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act<sup>23</sup> and the rules and regulations thereunder applicable to a national securities exchange.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>24</sup> that the proposed rule change (SR-NYSEArca-2014-44) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>25</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>23</sup> 15 U.S.C. 78f(b)(5).

<sup>24</sup> 15 U.S.C. 78s(b)(2).

<sup>25</sup> 17 CFR 200.30-3(a)(12).