

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-73630; File No. SR-NASDAQ-2014-038)

November 18, 2014

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Granting Approval of a Proposed Rule Change, as Modified by Amendments No. 1 and No. 2 Thereto, Relating to the Listing and Trading of the Shares of the Reality Shares NASDAQ-100 DIVS Index ETF under Nasdaq Rule 5705

I. Introduction

On April 10, 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” or “Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to list and trade shares (“Shares”) of the Reality Shares NASDAQ-100 DIVS Index ETF (“Fund”) under Rule 5705. The proposed rule change was published for comment in the Federal Register on April 30, 2014.³ On May 13, 2014, the Exchange filed Amendment No. 1 to the proposed rule change, which amended and replaced the proposed rule change in its entirety.⁴ On June 4, 2014, the Exchange filed Amendment No. 2 to the proposed rule change.⁵ On June 13, 2014, pursuant to Section 19(b)(2) of the Act,⁶ the Commission

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 72014 (Apr. 24, 2014), 79 FR 24465 (“Notice”).

⁴ In Amendment No. 1, the Exchange confirmed the hours of the three trading sessions on the Exchange, clarified the valuation of investments for purposes of calculating net asset value, clarified what information would be available on the Fund’s website, and provided additional information relating to surveillance with respect to certain assets held by the Fund. Amendment No. 1 provided clarification to the proposed rule change, and because it does not materially affect the substance of the proposed rule change or raise novel or unique regulatory issues, Amendment No. 1 is not subject to notice and comment.

⁵ The Exchange filed Amendment No. 2 to the proposal to reflect a change to the name of the Fund and the underlying index. Specifically, the Exchange replaced each reference in the proposal to the “Reality Shares NASDAQ-100 Isolated Dividend Growth ETF” (the

designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.⁷

On July 29, 2014, the Commission instituted proceedings under Section 19(b)(2)(B) of the Act⁸ to determine whether to approve or disapprove the proposed rule change.⁹ In response to the Order Instituting Proceedings, the Commission received two comment letters on the proposal.¹⁰ On October 23, 2014, the Commission designated a longer period for Commission

original name of the Fund) with a reference to the “Reality Shares NASDAQ-100 DIVS Index ETF.” Similarly, the Exchange replaced each reference in the proposal to the “Reality Shares NASDAQ-100 Isolated Dividend Growth Index” with a reference to the “Reality Shares NASDAQ-100 DIVS Index.” Amendment No. 2 is a technical amendment and is not subject to notice and comment as it does not materially affect the substance of the filing.

⁶ 15 U.S.C. 78s(b)(2).

⁷ See Securities Exchange Act Release No. 72384, 79 FR 35205 (Jun. 19, 2014). The Commission designated a longer period within which to take action on the proposed rule change and designated July 29, 2014, as the date by which it should approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule change.

⁸ 15 U.S.C. 78s(b)(2)(B).

⁹ See Securities Exchange Act Release No. 72715, 79 FR 45556 (Aug. 5, 2014) (“Order Instituting Proceedings”). Specifically, the Commission instituted proceedings to allow for additional analysis of the proposed rule change’s consistency with Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be “designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade,” and “to protect investors and the public interest.” See id.

¹⁰ See Letter from Eric R. Ervin, President, Reality Shares ETF Trust and Reality Shares Advisors, LLC, and President and CEO, Reality Shares, Inc., to Kevin M. O’Neill, Deputy Secretary, Commission, dated August 22, 2014 (“Reality Shares Letter 1”); Letter from Eric R. Ervin, President, Reality Shares ETF Trust and Reality Shares Advisors, LLC, and President and CEO, Reality Shares, Inc., to Arun Manoharan, Financial Economist, Commission, dated October 21, 2014 (“Reality Shares Letter 2”).

action on the Order Instituting Proceedings.¹¹ This order grants approval of the proposed rule change, as modified by Amendments No. 1 and No. 2 thereto.

II. Description of the Proposal, as Modified by Amendments No. 1 and No. 2 Thereto

The Exchange proposes to list and trade the Shares of the Fund under NASDAQ Rule 5705(b), which governs the listing and trading of Index Fund Shares on the Exchange.¹²

A. The Fund, Generally

The Fund is an exchange-traded fund (“ETF”) that will seek long-term capital appreciation by tracking the Reality Shares NASDAQ-100 DIVS Index (“Index”). The Index measures market expectations for dividend growth of the companies included in the NASDAQ-100 Index.¹³ The Shares of the Fund will be offered by the Reality Shares ETF Trust (“Trust”), which was established as a Delaware statutory trust on March 26, 2013. The Fund is a series of the Trust. The Exchange represents that the Trust will be registered with the Commission as an open-end management investment company.¹⁴ Reality Shares Advisors, LLC will serve as the

¹¹ See Securities Exchange Act Release No. 73418, 79 FR 64431 (Oct. 29, 2014).

¹² Index Fund Shares that are issued by an open-end investment company and listed and traded on the Exchange under NASDAQ Rule 5705 seek 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. See Rule 5705(b)(1)(A).

¹³ The NASDAQ-100 Index is an index of 100 of the largest domestic and international securities (based on market capitalization) listed on The NASDAQ Stock Market. The NASDAQ-100 Index includes companies across major industry groups, including computer hardware and software, telecommunications, retail/wholesale trade and biotechnology, and excludes securities of financial companies.

¹⁴ According to the Exchange, the Trust will be registered under the Investment Company Act of 1940 (“1940 Act”). On November 12, 2013, the Trust filed a registration statement on Form N-1A under the Securities Act of 1933 and the 1940 Act relating to the Fund, as amended by Pre-Effective Amendment Number 1, filed with the Commission on February 6, 2014 (File Nos. 333-192288 and 811-22911) (“Registration Statement”). In addition, the Exchange states that the Trust has obtained certain

investment adviser to the Fund (“Adviser”).¹⁵ ALPS Distributors, Inc. will be the principal underwriter and distributor of the Fund’s Shares. The Bank of New York Mellon will serve as administrator, custodian, and transfer agent for the Fund. The Exchange states that the Adviser is not a broker-dealer and is not affiliated with any broker-dealers.¹⁶

B. The Exchange’s Description of the Fund

The Exchange has made the following representations and statements in describing the Fund and its investment strategy, including permitted portfolio holdings and investment restrictions.¹⁷

Reality Shares NASDAQ-100 DIVS Index ETF

The Exchange states that the Index was developed by Reality Shares, Inc., the parent company of the Adviser, in conjunction with The NASDAQ OMX Group, Inc., and is maintained by Reality Shares, Inc. (“Index Provider”).¹⁸ The Index Provider is not a broker-dealer and is not affiliated with any broker-dealers.¹⁹ The Exchange states that the Index for the

exemptive relief under the 1940 Act. Investment Company Act Release No. 30678 (Aug. 27, 2013) (“Exemptive Order”). The Exchange represents that investments made by the Fund will comply with the conditions set forth in the Exemptive Order.

¹⁵ The Adviser is a wholly-owned subsidiary of the Index Provider.

¹⁶ See note 19, *infra*.

¹⁷ Additional information regarding the Trust, the Fund, and the Shares, including investment strategy, risks, creation and redemption procedures, fees, portfolio holdings disclosure policies, distributions, and taxes, among other things, is included in the Notice, Registration Statement, and Exemptive Order, as applicable. See Notice, *supra* note 3; see also Registration Statement and Exemptive Order, *supra* note 14.

¹⁸ The Index will be calculated by International Data Corporation, which is not affiliated with the Adviser, Index Provider, or The NASDAQ OMX Group, and which is not a broker-dealer or fund advisor.

¹⁹ According to the Exchange, the Adviser and the Index Provider have represented that a fire wall exists around the respective personnel who have access to information concerning changes and adjustments to the Index. The Exchange further represents that in the event (a) the Adviser, any sub-adviser, or the Index Provider becomes registered as

Fund does not meet all of the “generic” listing requirements of paragraph (b)(3)(A)(i) of Rule 5705 applicable to the listing of Index Fund Shares based upon an index of “US Component Stocks.”²⁰ Specifically, Rule 5705(b)(3)(A)(i) sets forth the requirements to be met by components of an index or portfolio of US Component Stocks. The Index will consist primarily of U.S. exchange-listed and traded options on the NASDAQ-100 Index and U.S. exchange-listed and traded options on ETFs that track the NASDAQ-100 Index.²¹ The Fund may also invest up to 20% of its total assets in other securities such as over-the-counter (“OTC”) options, futures, and forward contracts on the NASDAQ-100 Index, and OTC options, futures, and forward contracts on ETFs that track the NASDAQ-100 Index. The Exchange has represented that the Shares will conform to the initial and continued requirements of listing criteria under Rule 5705(b), except to the extent that the Index is composed of options based on U.S. Component

a broker-dealer or is newly affiliated with a broker dealer, or (b) any new adviser, sub-adviser, or Index Provider is a registered broker-dealer or becomes affiliated with a broker dealer, the Adviser, sub-adviser or Index Provider will implement a fire wall with respect to its relevant personnel or such broker dealer affiliate, as applicable, regarding access to information concerning the composition or changes to the portfolio and will be subject to procedures designed to prevent the use and dissemination of material, non-public information regarding the portfolio. The Fund does not currently intend to use a sub-adviser. See Rule 5705(b)(1)(C); Rule 5705(b)(5)(A).

²⁰ Paragraph (b)(1)(D) of Rule 5705 states that the term “U.S. Component Stock” shall mean an equity security that is registered under Sections 12(b) or 12(g) of the Exchange Act, or an American Depositary Receipt, the underlying equity security of which is registered under Sections 12(b) or 12(g) of the Act. See Rule 5705(b)(1)(D).

²¹ Paragraph (b)(3)(A)(i) of Rule 5705 states, in relevant part, that upon the initial listing of a series of Index Fund Shares pursuant to 19b-4(e) under the Act, all securities in the index or portfolio shall be U.S. Component Stocks listed on NASDAQ (including The NASDAQ Capital Market) or another national securities exchange, and shall be NMS Stocks as defined in Rule 600 of Regulation NMS under the Act. The Exchange states that each component stock of the NASDAQ-100 Index is a U.S. Component Stock that is listed on a national securities exchange and is an NMS Stock. Options, however, are excluded from the definition of NMS Stock. The Fund and the Index meet all of the requirements of the listing standards for Index Fund Shares in Rule 5705 except the requirements in 5705(b)(3)(A)(i)(a)-(e), because the Index includes options on U.S. Component Stocks.

Stocks (i.e., ETFs based on the NASDAQ-100 Index) and options on an index of U.S.

Component Stocks (i.e., the NASDAQ-100 Index).

Principal Investments of the Fund

The Fund will seek long-term capital appreciation and will seek investment results that, before fees and expenses, generally correspond to the performance of the Index. At least 80% of the Fund's total assets (exclusive of collateral held from securities lending, if any) will be invested in the component securities of the Index. The Fund will seek a correlation of 0.95 or better between its performance and the performance of its Index (a figure of 1.00 would represent perfect correlation). The Fund generally will use a representative sampling investment strategy.

The Fund will buy (i.e., hold a "long" position in) and sell (i.e., hold a "short" position in) put and call options. The strategy of taking both a long position in a security through its ex-dividend date (the last date an investor can own the security and receive dividends paid on the security) and a corresponding short position in the same security immediately thereafter is designed to allow the Fund to isolate its exposure to the growth of the level of dividends expected to be paid on such security while minimizing its exposure to changes in the trading price of such security.

The Fund will buy and sell U.S. exchange-listed options on the NASDAQ-100 Index and U.S. exchange-listed options on ETFs designed to track the NASDAQ-100 Index. A put option gives the purchaser of the option the right to sell, and the issuer of the option the obligation to buy, the underlying security or instrument on a specified date or during a specified period of time. A call option on a security gives the purchaser of the option the right to buy, and the writer of the option the obligation to sell, the underlying security or instrument on a specified date or during a specified period of time. The Fund will invest in a combination of put and call options

designed to allow the Fund to isolate its exposure to the growth of the level of expected dividends reflected in options on the NASDAQ-100 Index and options on ETFs tracking the NASDAQ-100 Index, while minimizing the Fund's exposure to changes in the trading price of such securities.

Index Methodology

The Index will be calculated using a proprietary, rules-based methodology designed to track market expectations for dividend growth conveyed in real-time using the mid-point of the bid-ask spread on NASDAQ-100 Index options and options on ETFs designed to track the NASDAQ-100 Index.²² All options included in the Index will be listed and traded on a U.S. national securities exchange. The Index will consist of a minimum of 20 components.²³

The prices of index and ETF options reflect the market trading prices of the securities included in the applicable underlying index or ETF, as well as market expectations regarding the level of dividends to be paid on such indexes or ETFs during the term of the option. The Index constituents, and, therefore, most of the Fund's portfolio holdings, will consist of multiple corresponding near-term and long-term put and call option combinations on the same reference assets (*i.e.*, options on the NASDAQ-100 Index or options on NASDAQ-100 ETFs) with the same strike price. Because option prices reflect both stock price and dividend expectations, they can be used in combination to isolate either price exposure or dividend expectations. The use of near-term and long-term put and call options combinations on the same reference asset with the same strike price, but with different maturities, is designed to gain exposure to the expected

²² The Exchange notes that there is no guarantee that either the level of overall dividends paid by such companies will grow over time, or that the Index or Fund's investment strategies will capture such growth. The Fund will include appropriate risk disclosure in its offering documents disclosing these risks, which will be available for free on the Commission's website and on the Fund's website, www.realityshares.com.

²³ See Rule 5705(b)(3).

dividends reflected in options on the NASDAQ-100 Index and options on ETFs tracking the NASDAQ-100 Index while neutralizing the impact of stock price.

Once established, this portfolio construction of options combinations will accomplish two goals. First, the use of corresponding buy or sell positions on near and long-term options at the same strike price is designed to neutralize underlying stock price movements. In other words, the corresponding “buy” and “sell” positions on the same reference asset are designed to net against each other and eliminate the impact that changes to the stock price of the reference asset would otherwise have on the value of the Index (and Fund Shares). Second, by minimizing the impact of price fluctuations through the construct of the near- and long-term contract combinations, the strategy is designed to isolate market expectations for dividends implied between expiration dates of the near-term and long-term option contracts. Over time, the Index will increase or decrease in value as the dividend spread between the near-term and long-term options combinations increases or decreases as a result of changing market expectations for dividend growth.

Other Fund Investments

While, as described above, at least 80% of the Fund’s total assets (exclusive of collateral held from securities lending, if any) will be invested in the component securities of the Index, the Fund may invest up to 20% of its total assets in other securities and financial instruments, as described below.

The Fund may invest in: (a) U.S. exchange-listed futures contracts based on the NASDAQ-100 Index and ETFs designed to track the NASDAQ-100 Index; and (b) forward contracts based on the NASDAQ-100 Index and ETFs designed to track the NASDAQ-100 Index. The Fund’s use of exchange-listed futures contracts and forward contracts is designed to allow the Fund to isolate its exposure to the growth of the level of expected dividends reflected

in options on the NASDAQ-100 Index and options on ETFs tracking the NASDAQ-100 Index, while minimizing the Fund's exposure to changes in the trading price of such securities. The Fund may also buy and sell OTC options on the NASDAQ-100 Index and on ETFs designed to track the NASDAQ-100 Index.

The Fund may enter into dividend and total return swap transactions (including equity swap transactions) based on the NASDAQ-100 Index and ETFs designed to track the NASDAQ-100 Index.²⁴ In a typical swap transaction, one party agrees to make periodic payments to another party ("counterparty") based on the change in market value or level of a specified rate, index, or asset. In return, the counterparty agrees to make periodic payments to the first party based on the return of a different specified rate, index, or asset. Swap transactions are usually done on a net basis, whereby the Fund would receive or pay only the net amount of the two payments. In a typical dividend swap transaction, the Fund would pay the swap counterparty a premium and would be entitled to receive the value of the actual dividends paid on the subject index during the term of the swap contract. In a typical total return swap, the Fund might exchange long or short exposures to the return of the underlying securities or index to isolate the value of the dividends paid on the underlying securities or index constituents. The Fund also may engage in interest rate swap transactions. In a typical interest rate swap transaction one stream of future interest payments is exchanged for another. Such transactions often take the form of an exchange of a fixed payment for a variable payment based on a future interest rate. The Fund intends to use interest rate swap transactions to manage or hedge exposure to interest rate fluctuations.

²⁴ The Fund will transact only with swap dealers that have in place an ISDA agreement with the Fund.

The Fund may invest up to 20% of its assets (exclusive of collateral held from securities lending, if any) in exchange-listed equity securities and derivative instruments (specifically, futures contracts, forward contracts, and swap transactions, as noted above)²⁵ relating to the Index and its component securities that the Adviser believes will help the Fund track the Index. For example, the Fund may buy and sell ETFs and, to a limited extent, individual large-capitalization equity securities listed and traded on a U.S. national securities exchange.

The Fund may invest in the securities of other investment companies (including money market funds) to the extent permitted under the 1940 Act.

The Fund's short positions and its investments in swaps, futures contracts, forward contracts and options based on the NASDAQ-100 Index and ETFs designed to track the NASDAQ-100 Index will be backed by investments in cash, high-quality short-term debt securities and money-market instruments in an amount equal to the Fund's maximum liability under the applicable position or contract, or will otherwise be offset in accordance with Section 18 of the 1940 Act. Short-term debt securities and money market instruments include shares of fixed income or money market mutual funds, commercial paper, certificates of deposit, bankers' acceptances, U.S. government securities (including securities issued or guaranteed by the U.S. government or its authorities, agencies, or instrumentalities), repurchase agreements,²⁶ and bonds that are rated BBB or higher. In addition to the investments described above, and in a manner

²⁵ Where practicable, the Fund intends to invest in swaps cleared through a central clearing house ("Cleared Swaps"). Currently, only certain of the interest rate swaps in which the Fund intends to invest are Cleared Swaps, while the dividend and total return swaps (including equity swaps) in which the Fund may invest are currently not Cleared Swaps.

²⁶ The Fund may enter into repurchase agreements with banks and broker-dealers. A repurchase agreement is an agreement under which securities are acquired by a fund from a securities dealer or bank subject to resale at an agreed upon price on a later date. The acquiring fund bears a risk of loss in the event that the other party to a repurchase agreement defaults on its obligations and the fund is delayed or prevented from exercising its rights to dispose of the collateral securities.

consistent with its investment objective, the Fund may invest a limited portion of its net assets in high-quality, short-term debt securities and money market instruments for cash management purposes.²⁷

The Fund will attempt to limit counterparty risk in non-cleared swap, forward, and OTC option contracts by entering into such contracts only with counterparties the Adviser believes are creditworthy and by limiting the Fund's exposure to each counterparty. The Adviser will monitor the creditworthiness of each counterparty and the Fund's exposure to each counterparty on an ongoing basis.²⁸

The Fund's investments in swaps, futures contracts, forward contracts and options will be consistent with the Fund's investment objective and with the requirements of the 1940 Act.²⁹

²⁷ The Fund may invest in shares of money market mutual funds to the extent permitted by the 1940 Act.

²⁸ The Fund will seek, where possible, to use counterparties, as applicable, whose financial status is such that the risk of default is reduced; however, the risk of losses resulting from default is still possible. The Adviser will evaluate the creditworthiness of counterparties on an ongoing basis. In addition to information provided by credit agencies, the Adviser will evaluate each approved counterparty using various methods of analysis, such as, for example, the counterparty's liquidity in the event of default, the counterparty's reputation, the Adviser's past experience with the counterparty, and the counterparty's share of market participation.

²⁹ To limit the potential risk associated with such transactions, the Fund will segregate or " earmark " assets determined to be liquid by the Adviser in accordance with procedures established by the Trust's Board of Trustees and in accordance with the 1940 Act (or, as permitted by applicable regulation, enter into certain offsetting positions) to cover its obligations arising from such transactions. These procedures have been adopted consistent with Section 18 of the 1940 Act and related Commission guidance. In addition, the Fund will include 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 derivatives, may give rise to leverage, causing the Fund to be more volatile than if it had not been leveraged. To mitigate leveraging risk, the Adviser will segregate or " earmark " liquid assets or otherwise cover the transactions that may give rise to such risk.

Investment Restrictions

To the extent the Index concentrates (i.e., holds 25% or more of its total assets) in the securities of a particular industry or group of industries, the Fund will concentrate its investments to approximately the same extent as the Index.

The Fund may hold up to an aggregate amount of 15% of its net assets in illiquid assets (calculated at the time of investment) deemed illiquid by the Adviser, consistent with Commission guidance.³⁰ 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 assets. Illiquid assets include securities subject to contractual or other restrictions on resale and other instruments that lack readily available markets as determined in accordance with Commission staff guidance.

The Fund may make secured loans of its portfolio securities; however, securities loans will not be made if, as a result, the aggregate amount of all outstanding securities loans by the Fund exceeds 33 1/3% of its total assets (including the market value of collateral received). To the extent the Fund engages in securities lending, securities loans will be made to broker-dealers that the Adviser believes to be of relatively high credit standing pursuant to agreements requiring that the loans continuously be collateralized by cash, liquid securities, or shares of other investment companies with a value at least equal to the market value of the loaned securities.

³⁰ In reaching liquidity decisions, the Adviser may consider the following factors: the frequency of trades and quotes for the security; the number of dealers wishing to purchase or sell the security and the number of other potential purchasers; dealer undertakings to make a market in the security; and the nature of the security and the nature of the marketplace in which it trades (e.g., the time needed to dispose of the security, the method of soliciting offers, and the mechanics of transfer).

The Fund will be classified as a “non-diversified” investment company under the 1940 Act. The Fund intends to qualify for and to elect treatment as a separate regulated investment company (“RIC”) under Subchapter M of the Internal Revenue Code.

The Fund’s investments will be consistent with its investment objective and will not be used to provide multiple returns of a benchmark or to produce leveraged returns.

III. Summary of Comment Letters

As noted above, the Commission received two comment letters in response to the Order Instituting Proceedings.³¹ Both comment letters, which were in favor of the proposal, sought to address certain questions, as outlined in the Order Instituting Proceedings,³² and provide additional clarification regarding the proposal.

³¹ See Reality Shares Letter 1; Reality Shares Letter 2, supra note 10.

³² In the Order Instituting Proceedings, the Commission sought comment on the following questions: (a) Because the Index is designed to reflect changes in market expectations of future dividend growth, rather than to track actual dividend growth, is the Fund’s investment strategy fundamentally based on an assumption that the options markets systemically underprice dividend growth? What are commenters’ views regarding whether investors would be able to understand the strategy, risks, potential rewards, assumptions, and expected performance of the Fund’s strategy? (b) With respect to the trading of the Shares on the Exchange, do commenters believe that the Exchange’s rules governing sales practices are adequately designed to ensure the suitability of recommendations regarding the Shares? Why or why not? If not, should the Exchange’s rules governing sales practices be enhanced? If so, in what ways? (c) How closely do commenters think the market price of the Shares will track the Fund’s intraday indicative value (“IIV”) or the intraday value of the Index? Are certain of these values likely to be more volatile than others? If so, how would this affect trading in the Shares? Are the Shares likely to trade with a significant premium or discount to IIV? What are commenters’ views of how effectively the IIV of the Fund would represent the Fund’s portfolio? What are commenters’ views of how the Shares’ market price, the Fund’s IIV, and the intraday value of the Index will relate to one another during times of market stress? and (d) Does the liquidity of the long-dated options in which the Fund will invest differ materially from that of the short-dated options in which the Fund will invest? If so, how would that affect the ability of market makers to engage in arbitrage or to hedge their positions while making a market in the Shares? Would the liquidity characteristics of the Index components or of the options in the Fund’s portfolio affect the calculation of

A. Reality Shares Letter 1

In Reality Shares Letter 1, the commenter offers its responses to the Commission's questions. The commenter responds that the Fund's investment strategy is not based on the assumption that dividend growth is underpriced by the options markets, stating that it is instead based on the expected dividend value to be paid on Nasdaq-100 securities (as implied in the price of listed Nasdaq-100 Index options over time) and the "historical high correlation between such expected dividend values and the value of actual dividends paid on Nasdaq-100 securities."³³ The commenter then explains that, as the value of actual dividends paid increases or decreases, market expectations for dividends typically move up or down in a corresponding direction and that, if the current expected dividend value of the options in the Fund's portfolio changes, the value of an investment in the Fund changes correspondingly.³⁴

The commenter asserts that the Fund's Registration Statement will sufficiently disclose to investors the key features of the Fund, including explanations of how the Fund's strategy works and how the Fund is expected to perform under various market conditions, and disclosures highlighting all material risks of investing in the Fund.³⁵ The commenter believes that these disclosures, and the disclosures in the Fund's marketing materials, will allow investors to understand the Fund's investment objective, strategy, risks, potential rewards, assumptions, and performance characteristics.³⁶ Further, the commenter believes that the Exchange's rules

the Index value, the calculation of the Fund's IIV, the calculation of the Fund's NAV, or the ability of market makers or other market participants to value the Shares? If so, how?

³³ See Reality Shares Letter 1, supra note 10, at 2-3.

³⁴ See id., at 3.

³⁵ See id., at 3-4.

³⁶ See id., at 4.

governing sales practices are sufficient to ensure the suitability of recommendations to investors regarding the Fund's Shares.³⁷

With respect to IIV, the commenter responds that it believes that the market price of the Fund Shares will closely approximate the IIV of the Fund's portfolio and the intraday value of the Fund's underlying Index.³⁸ While it believes that "the Fund's IIV and intraday Index values may reflect higher volatility than the market trading price of Fund Shares," the commenter does not expect this will have any material impact on secondary market trading of Fund Shares or arbitrage in Fund Shares.³⁹ The commenter expects that Authorized Participants and other institutional investors will quote and trade the option contracts held by the Fund in combination (by holding simultaneous long and short positions in the same put/call contracts) and that this combination tends to trade at tighter bid/ask spreads than do the individual contracts.⁴⁰ The commenter expects that Authorized Participants and other market makers will factor the price of the combination trades into their assessment of the value of Fund Shares, which will be reflected in the trading price of Fund Shares.⁴¹ The commenter explains that the Fund's IIV and the intraday Index values are based on the intraday market price of individual option contracts and do not reflect the trading price of option contracts held in combination. So, while the commenter expects the price of Fund Shares to closely approximate the Fund's IIV and the intraday values

³⁷ See id., at 5.

³⁸ See Reality Shares Letter 1, supra note 10, at 6.

³⁹ See id.

⁴⁰ See id.

⁴¹ See id., at 7.

of the Index, it also expects that the trading price of Fund shares will be less volatile than the Fund's IIV and the intraday value of the Index.⁴²

In times of market stress, the commenter believes that the Fund's Shares will trade within an acceptable spread to the Fund's IIV and the intraday value of the Index.⁴³ The commenter believes that, because the Fund's portfolio is transparent and the Index constituents are publicly disclosed, market participants will be able to assess the value of the Fund and the Index and access the securities necessary to hedge their position exposures, even during times of market stress.⁴⁴ Further, the commenter asserts that, "[b]ecause of the transparency of the Fund's portfolio and the liquidity and transparency of the underlying listed index options ... investors will continue to have the ability to buy and sell Shares in the secondary market at fair and representative prices should there be any material departure from the IIV."⁴⁵

The commenter states that the liquidity of the longer-dated option contracts in the Fund's portfolio will not differ materially from the liquidity of the shorter-dated option contracts.⁴⁶ Further, the commenter explains that the liquidity characteristics of the option contracts held by the Fund will not negatively impact the Fund's operation, the calculation of the Index value, the calculation of the Fund's IIV, or the calculation of the Fund's NAV.⁴⁷ The commenter believes that the options contracts provide "sufficient and ample liquidity ... for Authorized Participants

⁴² See id.

⁴³ See Reality Shares Letter 1, supra note 10, at 9.

⁴⁴ See id.

⁴⁵ See id., at 10.

⁴⁶ See id.

⁴⁷ See id., at 11.

and other investors to engage in efficient hedging activity, to value Fund Shares and to make markets in Fund Shares.”⁴⁸

B. Reality Shares Letter 2

In Reality Shares Letter 2, the commenter seeks to address whether the Fund’s strategy will produce positive returns for buy-and-hold investors over the longer term in light of the efficient nature of markets and the ability of astute market participants to predict dividend growth.⁴⁹ The commenter claims that the historical returns of the Fund’s strategy have been positive over long periods of time and that an investor can reasonably expect returns in the future that are non-zero and positive in the long term.⁵⁰

In support of this claim, the commenter argues that all investments, even in perfectly efficient markets, are expected to have, at minimum, a risk-free rate associated with them.⁵¹ For example, Treasury Bills (theoretically risk-free assets) are discounted by the risk-free rate in order to entice investors to purchase them.⁵² Thus, even in a perfectly efficient market such as the one for Treasury Bills, an investment in a riskless asset will produce a long-term return greater than zero.⁵³ In addition, the commenter adds that, if any uncertainty surrounds the future payoff of an investment, one would expect a risk premium to be attached to the investment.⁵⁴ This would be quantified as the amount of money by which the expected return on the asset

⁴⁸ See Reality Shares Letter 1, supra note 10, at 12.

⁴⁹ See Reality Shares Letter 2, supra note 10, at 1.

⁵⁰ See id.

⁵¹ See id.

⁵² See id.

⁵³ See id.

⁵⁴ See Reality Shares Letter 2, supra note 10, at 2.

exceeds the known return of a risk-free asset.⁵⁵ This risk premium compensates investors for the uncertainty in their investment in a risky asset.⁵⁶ If the dividend risk premium were low, one would expect the strategy to earn less than the actual growth of dividends; if dividend risk premium were high, one would expect the strategy to earn more than actual dividend growth.⁵⁷ The commenter notes that, while expected dividend returns may not match dividend growth exactly, the rate of return would (at a minimum) be expected to be equal to the risk free rate, plus the risk premium.⁵⁸

The commenter further asserts that, beyond the theoretical analogy stated above, an investment in the expected dividend implied in the options markets has historically produced positive returns and that the Fund's strategy can be expected to produce future positive long-term returns.⁵⁹ While the commenter believes that it is possible for implied dividend strategies to outperform equity returns, as well as actual dividend growth, the commenter argues that the foundation of the Fund's investment strategy is predicated on its conclusion that implied dividends carry risk and that, in an efficient market, this risk will be reflected in the form of a dividend risk premium.⁶⁰

IV. Discussion and Commission Findings

The Commission has carefully considered the proposal and the comments submitted in response to the questions raised by the Commission in the Order Instituting Proceedings. For the reasons discussed below, the Commission finds that the Exchange's proposal to list and trade the

⁵⁵ See id.

⁵⁶ See id.

⁵⁷ See id.

⁵⁸ See id.

⁵⁹ See Reality Shares Letter 2, supra note 10, at 2.

⁶⁰ See id., at 3.

Shares is consistent with the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange.⁶¹ In particular, the Commission finds that the proposed rule change, as modified by Amendments No. 1 and No. 2 thereto, is consistent with Section 6(b)(5) of the Exchange Act,⁶² 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 also finds that the proposal to list and trade the Shares on the Exchange is consistent with Section 11A(a)(1)(C)(iii) of the Exchange Act,⁶³ 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 will be available via NASDAQ proprietary quote and trade services, as well as in accordance with the Unlisted Trading Privileges and the Consolidated Tape Association plans for the Shares. The value of the Index will be published by one or more major market data vendors every 15 seconds during the Regular Market Session. Information about the Index constituents, the weighting of the constituents, the Index's methodology, and the Index's rules will be available at no charge on the Index Provider's website at www.realityshares.com. In addition, an estimated value, defined in Rule 5705(b)(3)(C) as the "Intraday Indicative Value," will be disseminated. The Intraday

⁶¹ 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).

⁶² 15 U.S.C. 78f(b)(5).

⁶³ 15 U.S.C. 78k-1(a)(1)(C)(iii).

Indicative Value, available on the NASDAQ OMX Information LLC proprietary index data service,⁶⁴ will be based upon the current value for the components of the Disclosed Portfolio (as discussed herein) and will be updated and widely disseminated and broadly displayed at least every 15 seconds during the Regular Market Session (currently 9:30 a.m. Eastern time). On each business day, before commencement of trading in Shares in the Regular Market Session on the Exchange, the Fund will disclose on its website the identities and quantities of the portfolio of securities and other assets (the “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.⁶⁵ In addition, a basket composition file, which includes the security names and quantities, as applicable, required to be delivered in exchange for the Fund’s Shares, together with estimates and actual cash components, will be publicly disseminated daily prior to the opening of NASDAQ via the National Securities Clearing Corporation. The basket will represent one Creation Unit of the Fund. The portfolio composition file will represent one Creation Unit of Shares of the Fund.

⁶⁴ Currently, the NASDAQ OMX Global Index Data Service (“GIDS”) is the NASDAQ OMX global index data feed service, offering real-time updates, daily summary messages, and access to widely followed indexes and Intraday Indicative Values for ETFs. GIDS provides investment professionals with the daily information needed to track or trade NASDAQ OMX indexes, listed ETFs, or third-party partner indexes and ETFs.

⁶⁵ Under accounting procedures to be followed by the Fund, trades made on the prior business day (“T”) will be booked and reflected in NAV on the current business day (“T+1”). Accordingly, the Fund will be able to disclose at the beginning of the business day the portfolio that will form the basis for the NAV calculation at the end of the business day. 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, 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, such as the type of swap); the identity of the security, commodity, index, 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 holdings in the Fund’s portfolio. The website information will be publicly available at no charge.

The Fund will calculate its NAV by: (i) taking the current market value of its total assets; (ii) subtracting any liabilities; and (iii) dividing that amount by the total number of Shares outstanding. The Fund will calculate NAV once each business day as of the regularly scheduled close of trading on the NYSE (normally, 4:00 p.m., Eastern Time).⁶⁶ Intra-day, executable price quotations on the securities and other assets held by the Fund will be available from major broker-dealer firms or on the exchange on which they are traded, as applicable. Intra-day price information will also be available through subscription services, such as Bloomberg, Markit, and Thomson Reuters, which can be accessed by Authorized Participants and other investors. Specifically, the intra-day, closing and settlement prices of the portfolio securities and other Fund investments, including exchange-listed equity securities (which include common stocks and ETFs), exchange-listed futures, and exchange-listed options, will be readily available from the national securities exchanges trading such securities, automated quotation systems, published or other public sources, and, with respect to OTC options, swaps, and forwards, from third party pricing sources, or on-line information services such as Bloomberg or Reuters. Price information regarding investment company securities and ETFs will be available from on-line

⁶⁶ The Trust will generally value exchange-listed securities (which include common stocks and ETFs), exchange-listed options, and options on the NASDAQ-100 Index or NASDAQ-100 ETFs at market closing prices. Market closing price is generally determined on the basis of last reported sales prices on the applicable exchange, or if no sales are reported, based on the mid-point between the last reported bid and ask. The Trust will generally value exchange-listed futures at the settlement price determined by the applicable exchange. Non-exchange-traded derivatives, including OTC options, swap transactions, and forward transactions, will normally be valued on the basis of quotations or equivalent indication of value supplied by a third-party pricing service or major market makers or dealers. Debt securities and money market instruments generally will be valued based on prices provided by third-party pricing services, which may use valuation models or matrix pricing to determine current value. Investment company securities (other than ETFs) will be valued at NAV. The Trust generally will use amortized cost to value fixed income or money market securities that have a remaining maturity of 60 days or less.

information services and from the website for the applicable investment company security. The intra-day, closing and settlement prices of debt securities and money market instruments will be readily available from published and other public sources or on-line information services. 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. The Fund's website will include a form of the prospectus for the Fund that may be downloaded and additional data relating to NAV and other applicable quantitative information.

The Commission also 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 Fund that the NAV for the Fund will be calculated daily and will be made available to all market participants at the same time. The Exchange represents that it will halt or pause trading in the Shares under the conditions specified in NASDAQ Rules 4120 and 4121, including the trading pauses under NASDAQ Rules 4120(a)(11) and (12). Trading also may be halted because of market conditions or for reasons that, in the view of the Exchange, make trading in the Shares inadvisable.⁶⁷ Trading in the Shares also will be subject to Rules 5705(b)(1)(B) and 5705(b)(9)(B), which sets forth circumstances under which Shares of the Fund may be halted. In addition, if the IIV, the Index

⁶⁷ 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. The Exchange represents that it may consider all relevant factors in exercising its discretion to halt or suspend trading in the Shares of the Fund.

Value or the value of the Index Components is not being disseminated as required, the Exchange may halt trading during the day in which the disruption occurs; if the interruption persists past the day in which it occurred, the Exchange will halt trading no later than the beginning of the trading day following the interruption.

The Exchange states that it has a general policy prohibiting the distribution of material, non-public information by its employees. The Commission notes that the Index Provider is not registered as an investment adviser or broker dealer and is not affiliated with any broker-dealers, and the Adviser is not registered as a broker-dealer and is not affiliated with any broker-dealers.⁶⁸ Prior to the commencement of trading, the Exchange will inform its members in an Information Circular of the special characteristics and risks associated with trading the Shares. The Financial Industry Regulatory Authority (“FINRA”), on behalf of the Exchange,⁶⁹ will communicate as needed regarding trading in the Shares, exchange-listed equity securities, ETFs,

⁶⁸ See supra note 19 and accompanying text. 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.

⁶⁹ The Exchange states that 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.

futures contracts, and exchange-traded options contracts with other markets and other entities that are members of the Intermarket Surveillance Group (“ISG”), and FINRA, on behalf of the Exchange, may obtain trading information regarding trading in the Shares, exchange-listed equity securities, ETFs, futures contracts, and exchange-traded options contracts from such markets and other entities. In addition, the Exchange may obtain information regarding trading in the Shares, exchange-listed equity securities, ETFs, futures contracts, and exchange-traded options contracts from markets and other entities that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.⁷⁰ All exchange-listed equity securities, ETFs, futures contracts and options held by the Fund will be traded on U.S. exchanges, all of which are members of ISG or are exchanges with which the Exchange has in place a comprehensive surveillance sharing agreement. In addition, 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.

The Exchange deems the Shares 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:

- (1) The Exchange has appropriate rules to facilitate transactions in the Shares during all trading sessions.⁷¹

⁷⁰ For a list of the current members of ISG, see www.isgportal.org. The Exchange notes that not all components of the portfolio for the Fund may trade on markets that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.

⁷¹ See NASDAQ Rule 5705(b)(7) (describing the three trading sessions on the Exchange: Regular Market Session trading will occur between 9:30 a.m. and either 4:00 p.m. or 4:15 p.m. for each series of Index Fund Shares, as specified by NASDAQ). In addition, NASDAQ may designate each series of Index Fund Shares for trading during a Pre-Market Session beginning at 4:00 a.m. and/or a Post-Market Session ending at 8:00 p.m.

- (2) The Shares will be subject to Rule 5705, which sets forth the initial and continued listing criteria applicable to Index Fund Shares.
- (3) Trading in the Shares will be subject to the existing trading surveillances, administered by both NASDAQ and also 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.
- (4) Prior to the commencement of trading, the Exchange will inform its members in an Information Circular of the special characteristics and risks associated with trading the Shares. Specifically, the Information Circular will discuss the following: (a) the procedures for purchases and redemptions of Shares in Creation Units (and that Shares are not individually redeemable); (b) NASDAQ Rule 2111A, which imposes suitability obligations on NASDAQ members with respect to recommending transactions in the Shares to customers; (c) how information regarding the Index Value and Intraday Indicative Value will be disseminated; (d) the risks involved in trading the Shares during the Pre-Market and Post-Market Sessions when an updated Index Value and Intraday Indicative Value will not be calculated or publicly disseminated; (e) the requirement that members deliver a prospectus to investors purchasing newly issued Shares prior to or concurrently with the confirmation of a transaction; and (f) trading information.

- (5) For initial and continued listing, the Fund must be in compliance with Rule 10A-3 under the Exchange Act.⁷²
- (6) At least 80% of the Fund's total assets (exclusive of collateral held from securities lending, if any) will be invested in the component securities of the Index. The Fund will seek a correlation of 0.95 or better between its performance and the performance of its Index. A figure of 1.00 would represent perfect correlation. All options included in the Index will be listed and traded on a U.S. national securities exchange.
- (7) The Fund's investments in swaps, futures contracts, forward contracts and options will be consistent with the Fund's investment objective and with the requirements of the 1940 Act. To limit the potential risk associated with such transactions, the Fund will segregate or " earmark " assets determined to be liquid by the Adviser in accordance with procedures established by the Trust's Board of Trustees and in accordance with the 1940 Act (or, as permitted by applicable regulation, enter into certain offsetting positions) to cover its obligations arising from such transactions. These procedures have been adopted consistent with Section 18 of the 1940 Act and related Commission guidance. In addition, the Fund will include 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 derivatives, may give rise to leverage, causing the Fund to be more volatile than if it had not been leveraged. To mitigate leveraging risk, the Adviser will segregate or " earmark " liquid assets or otherwise cover the transactions that may give rise

⁷² 17 CFR 240.10A-3.

to such risk. The Fund may not invest in leveraged or inverse leveraged (e.g., 2X, -2X, 3X, or -3X) ETFs or options on such ETFs. The Fund's investments will be consistent with its investment objective and will not be used to provide multiple returns of a benchmark or to produce leveraged returns.

- (8) The Fund will transact only with swap dealers that have in place an ISDA agreement with the Fund. Where practicable, the Fund intends to invest in Cleared Swaps. The Fund will attempt to limit counterparty risk in non-cleared swap, forward, and OTC option contracts by entering into such contracts only with counterparties the Adviser believes are creditworthy and by limiting the Fund's exposure to each counterparty. The Adviser will monitor the creditworthiness of each counterparty and the Fund's exposure to each counterparty on an ongoing basis. The Fund will seek, where possible, to use counterparties, as applicable, whose financial status is such that the risk of default is reduced. The Adviser will evaluate the creditworthiness of counterparties on an ongoing basis. In addition to information provided by credit agencies, the Adviser will evaluate each approved counterparty using various methods of analysis, such as, for example, the counterparty's liquidity in the event of default, the counterparty's reputation, the Adviser's past experience with the counterparty, and the counterparty's share of market participation.
- (9) The Fund may hold up to an aggregate amount of 15% of its net assets in illiquid assets (calculated at the time of investment) deemed illiquid by the Adviser, consistent with Commission guidance.

- (10) A minimum of 100,000 Shares for the Fund will be outstanding at the commencement of trading on the Exchange.
- (11) The Fund will include appropriate risk disclosure in its offering documents, which will be available on the Commission's website and on the Fund's website, www.realityshares.com.

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, as modified by Amendments No. 1 and No. 2 thereto, is consistent with Section 6(b)(5) of the Act⁷³ and the rules and regulations thereunder applicable to a national securities exchange.

⁷³ 15 U.S.C. 78f(b)(5).

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁷⁴ that the proposed rule change (SR-Nasdaq-2014-038), as modified by Amendments No. 1 and No. 2 thereto, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁷⁵

Kevin M. O'Neill
Deputy Secretary

⁷⁴ Id.

⁷⁵ 17 CFR 200.30-3(a)(12).