

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-78918; File No. SR-NASDAQ-2016-104)

September 23, 2016

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Granting Approval of a Proposed Rule Change to Amend Nasdaq Rule 5735 to Adopt Generic Listing Standards for Managed Fund Shares

I. Introduction

On August 16, 2016, The NASDAQ Stock Market LLC (“Nasdaq” or “Exchange”) 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 amend Nasdaq Rule 5735 to, among other things, adopt generic listing standards for Managed Fund Shares. The proposed rule change was published for comment in the Federal Register on August 24, 2016.³ The Commission has received no comments on the proposed rule change. This order grants approval of the proposed rule change.

II. Description of the Proposal

Nasdaq Rule 5735 governs the listing and trading of Managed Fund Shares on the Exchange. Managed Fund Shares are issued by actively managed exchange-traded funds (“ETFs”) that do not seek to replicate the performance of a specified index of securities.

Under its current rules, the Exchange must file separate proposals under Section 19(b) of the Act before listing a new series of Managed Fund Shares.⁴ The Exchange proposes to adopt “generic” listing standards so that the Exchange may list Managed Fund Shares that satisfy the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 78616 (Aug. 18, 2016), 81 FR 57968 (“Notice”).

⁴ See Nasdaq Rule 5735(b)(1).

applicable criteria by submitting notice pursuant to Rule 19b-4(e) under the Act, rather than by filing a proposed rule change under Section 19(b) of the Act.⁵

A. Description of the Generic Listing Standards

The Exchange's listing standards establish requirements for the various types of assets that may be held in the portfolio of a generically listed, actively managed ETF ("Portfolio").

1. Equity Portfolio Components

Nasdaq Rule 5735(b)(1)(A) establishes the criteria applicable to the equity securities included in a Portfolio. Equity securities include the following securities: U.S. Component Stocks, which are defined in Nasdaq Rule 5705; Non-U.S. Component Stocks, which are defined in Nasdaq Rule 5705; Exchange Traded Derivative Securities, which are defined in Nasdaq Rule 5735(c)(6);⁶ Linked Securities, which are defined in Nasdaq Rule 5710, and each of the equivalent security types listed on another national securities exchange. Additionally, Nasdaq Rule 5735(b)(1)(A) provides that no more than 25% of the equity weight of the Portfolio can include leveraged or inverse-leveraged Exchange Traded Derivative Securities or Linked Securities and that, to the extent a Portfolio includes convertible securities, the equity securities into which such securities are converted must meet the criteria of Nasdaq Rule 5735(b)(1)(A) after converting.

⁵ See 17 CFR 240.19b-4(e). Rule 19b-4(e) permits self-regulatory organizations ("SROs") to list and trade new derivative securities products that comply with existing SRO trading rules, procedures, surveillance programs, and listing standards, without submitting a proposed rule change under Section 19(b). See Securities Exchange Act Release No. 40761 (Dec. 8, 1998), 63 FR 70952 (Dec. 22, 1998).

⁶ Nasdaq Rule 5735(c)(6) defines "Exchange Traded Derivative Securities" as: "the securities described in Nasdaq Rules 5705(a) (Portfolio Depository Receipts); 5705(b) (Index Fund Shares); 5720 (Trust Issued Receipts); 5711(d) (Commodity-Based Trust Shares); 5711(e) (Currency Trust Shares); 5711(f) (Commodity Index Trust Shares); 5711(g) (Commodity Futures Trust Shares); 5711(h) (Partnership Units); 5711(i) (Trust Units); 5735 (Managed Fund Shares); and 5711(j) (Managed Trust Securities)."

Nasdaq Rule 5735(b)(1)(A)(i) would require that U.S. Component Stocks (except as mentioned below) meet the following criteria initially and on a continuing basis:

- (1) Component stocks (excluding Exchange Traded Derivative Securities and Linked Securities) that in the aggregate account for at least 90% of the equity weight of the Portfolio (excluding Exchange Traded Derivative Securities and Linked Securities) each shall have a minimum market value of at least \$75 million;
- (2) Component stocks (excluding Exchange Traded Derivative Securities and Linked Securities) that in the aggregate account for at least 70% of the equity weight of the Portfolio (excluding Exchange Traded Derivative Securities and Linked Securities) each shall have a minimum monthly trading volume of 250,000 shares, or minimum notional volume traded per month of \$25,000,000, averaged over the previous six months;
- (3) The most heavily weighted component stock (excluding Exchange Traded Derivative Securities and Linked Securities) must not exceed 30% of the equity weight of the Portfolio, and, to the extent applicable, the five most heavily weighted component stocks (excluding Exchange Traded Derivative Securities and Linked Securities) must not exceed 65% of the equity weight of the Portfolio;
- (4) Where the equity portion of the Portfolio does not include Non-U.S. Component Stocks, the equity portion of the Portfolio shall include a minimum of 13 component stocks; provided, however, that there would be no minimum number of component stocks if (a) one or more series of Exchange Traded Derivative Securities or Linked Securities constitute, at least in part, components underlying a series of Managed Fund Shares, or (b) one or more series of Exchange Traded

Derivative Securities or Linked Securities account for 100% of the equity weight of the Portfolio of a series of Managed Fund Shares;

- (5) Except as provided in Nasdaq Rule 5735(b)(1)(A)(i), equity securities in the Portfolio must be U.S. Component Stocks listed on a national securities exchange and must be NMS Stocks as defined in Rule 600 of Regulation NMS; and
- (6) American Depositary Receipts (“ADRs”) may be exchange traded or non-exchange traded, but no more than 10% of the equity weight of the Portfolio shall consist of non-exchange traded ADRs.

Nasdaq Rule 5735(b)(1)(A)(ii) requires that Non-U.S. Component Stocks must meet the following criteria initially and on a continuing basis:

- (1) Non-U.S. Component Stocks each shall have a minimum market value of at least \$100 million;
- (2) Non-U.S. Component Stocks each shall have a minimum global monthly trading volume of 250,000 shares, or minimum global notional volume traded per month of \$25,000,000, averaged over the last six months;
- (3) The most heavily weighted Non-U.S. Component Stock shall not exceed 25% of the equity weight of the Portfolio, and, to the extent applicable, the five most heavily weighted Non-U.S. Component Stocks shall not exceed 60% of the equity weight of the Portfolio;
- (4) Where the equity portion of the Portfolio includes Non-U.S. Component Stocks, the equity portion of the Portfolio shall include a minimum of 20 component stocks; provided, however, that there shall be no minimum number of component stocks if (a) one or more series of Exchange Traded Derivative Securities or

Linked Securities constitute, at least in part, components underlying a series of Managed Fund Shares, or (b) one or more series of Exchange Traded Derivative Securities or Linked Securities account for 100% of the equity weight of the Portfolio of a series of Managed Fund Shares; and

- (5) Each Non-U.S. Component Stock shall be listed and traded on an exchange that has last-sale reporting.

2. Fixed Income Portfolio Components

Nasdaq Rule 5735(b)(1)(B) establishes criteria for fixed income securities that are included in a Portfolio. Fixed income securities are debt securities⁷ that are notes, bonds, debentures, or evidence of indebtedness that include, but are not limited to, U.S. Department of Treasury securities (“Treasury Securities”), government-sponsored entity securities (“GSE Securities”), municipal securities, trust preferred securities, supranational debt and debt of a foreign country or a subdivision thereof, investment grade and high yield corporate debt, bank loans, mortgage and asset backed securities, and commercial paper.⁸ To the extent that a Portfolio includes convertible securities, the fixed income securities into which such securities are converted shall meet the criteria of Nasdaq Rule 5735(b)(1)(B) after converting.⁹

Under Nasdaq Rule 5735(b)(1)(B), fixed income securities that are part of a Portfolio must satisfy the following criteria initially and on a continuing basis:

⁷ Debt securities include a variety of fixed income obligations, including, but not limited to, corporate debt securities, government securities, municipal securities, convertible securities, and mortgage-backed securities. Debt securities include investment-grade securities, non-investment-grade securities, and unrated securities. Debt securities also include variable and floating rate securities. See Notice, supra note 3, 81 FR at 57971, n.29.

⁸ See Nasdaq Rule 5735(b)(1)(B).

⁹ See id.

- (1) Components that in the aggregate account for at least 75% of the fixed income weight of the Portfolio must each have a minimum original principal amount outstanding of \$100 million or more;
- (2) No component fixed-income security (excluding Treasury Securities and GSE Securities) shall represent more than 30% of the fixed income weight of the Portfolio, and the five most heavily weighted fixed income securities in the Portfolio (excluding Treasury Securities and GSE Securities) shall not in the aggregate account for more than 65% of the fixed income weight of the Portfolio;
- (3) A Portfolio that includes fixed income securities (excluding exempted securities) shall include a minimum of 13 non-affiliated issuers, provided, however, that there shall be no minimum number of non-affiliated issuers required for fixed income securities if at least 70% of the weight of the Portfolio consists of equity securities as described in Nasdaq Rule 5735(b)(1)(A);
- (4) Component securities that in aggregate account for at least 90% of the fixed income weight of the Portfolio must be: (a) from issuers that are required to file reports pursuant to Sections 13 and 15(d) of the Act; (b) from issuers each of which has a worldwide market value of its outstanding common equity held by non-affiliates of \$700 million or more; (c) from issuers each of which has outstanding securities that are notes, bonds, debentures, or evidence of indebtedness having a total remaining principal amount of at least \$1 billion; (d) exempted securities as defined in Section 3(a)(12) of the Act; or (e) from issuers that are a government of a foreign country or a political subdivision of a foreign country; and

- (5) Non-agency, non-GSE, and privately issued mortgage-related and other asset-backed securities shall not account, in the aggregate, for more than 20% of the weight of the fixed income portion of the Portfolio.

3. Cash and Cash Equivalent Portfolio Components

Nasdaq Rule 5735(b)(1)(C) provides that a Portfolio may include cash and cash equivalents. Cash equivalents are defined as short-term instruments with maturities of less than three months.¹⁰ The Exchange defines short-term instruments to include the following: (1) U.S. Government securities, including bills, notes, and bonds differing as to maturity and rates of interest, which are either issued or guaranteed by the U.S. Treasury or by U.S. Government agencies or instrumentalities; (2) certificates of deposit issued against funds deposited in a bank or savings and loan association; (3) bankers' acceptances, which are short-term credit instruments used to finance commercial transactions; (4) repurchase agreements and reverse repurchase agreements; (5) bank time deposits, which are monies kept on deposit with banks or savings and loan associations for a stated period of time at a fixed rate of interest; (6) commercial paper, which are short-term unsecured promissory notes; and (7) money market funds.¹¹ The Exchange does not propose to limit to the amount of cash or cash equivalents that may be held in a Portfolio.¹²

4. Derivatives in the Portfolio

Nasdaq Rule 5735(b)(1)(D) establishes listing criteria for the portion of a Portfolio that consists of listed derivatives such as futures, options, and swaps overlying commodities,

¹⁰ See Nasdaq Rule 5735(b)(1)(C).

¹¹ See Nasdaq Rule 5735(b)(1)(C)(ii).

¹² See Nasdaq Rule 5735(b)(1)(C)(i).

currencies, financial instruments (e.g., stocks, fixed income securities, interest rates, and volatility), or a basket or index of any of the foregoing. The Exchange does not propose to limit the percentage of a Portfolio that may be composed of such holdings, provided that, in the aggregate, at least 90% of the weight of holdings in listed derivatives (calculated using the aggregate gross notional value) must, on both an initial and continuing basis, consist of futures, options, and swaps for which the Exchange may obtain information via the ISG from other members or affiliates or for which the principal market is a market with which the Exchange has a comprehensive surveillance sharing agreement (“CSSA”).¹³ Additionally, the aggregate gross notional value of listed derivatives based on any five or fewer underlying reference assets shall not exceed 65% of the weight of the Portfolio (including gross notional exposures), and the aggregate gross notional value of listed derivatives based on any single underlying reference asset shall not exceed 30% of the weight of the Portfolio (including gross notional exposures).¹⁴

Nasdaq Rule 5735(b)(1)(E) establishes a limit on over-the-counter (“OTC”) derivatives: No more than 20% of the weight of the Portfolio may be invested in OTC derivatives.¹⁵ The Exchange notes that, for purposes of calculating this limitation, a Portfolio’s investment in OTC derivatives will be calculated as the aggregate gross notional value of the OTC derivatives.

Nasdaq Rule 5735(b)(1)(E) provides that, to the extent that listed or OTC derivatives are used to gain exposure to individual equities and/or fixed income securities, or to indexes of

¹³ See Nasdaq Rule 5735(b)(1)(D)(i).

¹⁴ See Nasdaq Rule 5735(b)(1)(D)(ii).

¹⁵ OTC derivatives include: forwards, options, and swaps overlying commodities, currencies, financial instruments (e.g., stocks, fixed income securities, interest rates, and volatility), or a basket or index of any of the foregoing. See Nasdaq Rule 5735(b)(1)(E).

equities and/or fixed income securities, the aggregate gross notional value of such exposure shall meet the criteria set forth in Nasdaq Rules 5735(b)(1)(A) and 5735(b)(1)(B), respectively.

B. Other Aspects of the Proposal

1. Disclosed Portfolio

The daily dissemination of a Disclosed Portfolio¹⁶ is required under current Nasdaq Rule 5735(d)(2)(B)(i), but its contents are not specified. The Exchange proposes to amend the definition of “Disclosed Portfolio” to require that the website for each series of Managed Fund Shares listed on the Exchange, including all Managed Fund Shares currently listed and traded on the Exchange, disclose the following information in the Disclosed Portfolio, to the extent applicable: ticker symbol, CUSIP or other identifier, a description of the holding, identity of the asset upon which the derivative is based, the strike price for any options, the quantity of each security or other asset held as measured by select metrics, maturity date, coupon rate, effective date, market value, and percentage weight of the holding in the portfolio.

2. Investment Objective

The Exchange proposes to add as an initial listing criterion applicable to all Managed Fund Shares (including those that are generically listed) the requirement that Managed Fund Shares have a stated investment objective, which shall be adhered to under “Normal Market Conditions.”¹⁷ The Exchange would define “Normal Market Conditions” as circumstances including, but not limited to, the absence of: trading halts in the applicable financial markets generally; operational issues causing dissemination of inaccurate market information or systems

¹⁶ Nasdaq defines “Disclosed Portfolio” for purposes of its Managed Fund Shares listing rule as the identities and quantities of the securities and other assets held by the Investment Company that will form the basis for the Investment Company’s calculation of net asset value at the end of the business day. See Nasdaq Rule 5735(c)(2).

¹⁷ See Nasdaq Rule 5735(d)(1)(C).

failure; or force majeure type events such as natural or man-made disaster, act of God, armed conflict, act of terrorism, riot or labor disruption, or any similar intervening circumstance.¹⁸

3. Intraday Indicative Value (“IIV”)

The Exchange proposes to modify a continued listing criterion for all Managed Fund Shares to require that the IIV be widely disseminated by one or more major market data vendors at least every 15 seconds during its Regular Market Session, as defined in Nasdaq Rule 4120(b),¹⁹ rather than during all times that Managed Fund Shares trade on the Exchange.

C. Additional Representations of the Exchange Applicable to the Listing and Trading of Managed Fund Shares

In support of the proposed rule change, the Exchange represents that:

(1) Managed Fund Shares will conform to the initial and continued listing criteria under Nasdaq Rule 5735.²⁰

(2) The Exchange’s surveillance procedures are adequate to continue to properly monitor the trading of the Managed Fund Shares in all trading sessions and to deter and detect violations of Exchange rules. Specifically, the Exchange intends to utilize its existing surveillance procedures applicable to derivative products, which will include Managed Fund Shares, to monitor trading in the Managed Fund Shares.²¹

(3) Prior to the commencement of trading of a particular series of Managed Fund Shares, the Exchange will inform its Members in an information circular of the special characteristics and risks associated with trading the Managed Fund Shares, including procedures

¹⁸ See Nasdaq Rule 5735(c)(5).

¹⁹ See Nasdaq Rule 5735(d)(2)(A).

²⁰ See Notice, supra note 3, 81 FR at 57973.

²¹ See id.

for purchases and redemptions of Managed Fund Shares, suitability requirements under Nasdaq Rules 2090A and 2111A, the risks involved in trading the Managed Fund Shares during the Pre-Market and Post-Market Sessions when an updated IIV will not be calculated or publicly disseminated, information regarding the IIV and Disclosed Portfolio, prospectus delivery requirements, and other trading information. In addition, the information circular will disclose that the Managed Fund Shares are subject to various fees and expenses, as described in the registration statement, and will discuss any exemptive, no-action, and interpretive relief granted by the Commission from any rules under the Act. Finally, the information circular will disclose that the NAV for the Managed Fund Shares will be calculated after 4:00 p.m. Eastern Time each trading day.²²

(4) The issuer of a series of Managed Fund Shares will be required to comply with Rule 10A-3 under the Act for the initial and continued listing of Managed Fund Shares, as provided under the Nasdaq Rule 5600 Series.²³

(5) On a periodic basis, and no less than annually, the Exchange will review the Managed Fund Shares generically listed and traded on the Exchange under Nasdaq Rule 5735 for compliance with that rule and will provide a report to its Regulatory Oversight Committee presenting the findings of its review.

(6) On a quarterly basis, the Exchange will provide a report to the Commission staff that contains, for each ETF whose shares are generically listed and traded under Nasdaq Rule 5735(b)(1): (a) symbol and date of listing; (b) the number of active authorized participants (“APs”) and a description of any failure by either a fund or an AP to deliver promised baskets of

²² See id.

²³ See id.

shares, cash, or cash and instruments in connection with creation or redemption orders; and (c) a description of any failure by a fund to comply with Nasdaq Rule 5735.²⁴

(7) Prior to listing pursuant to amended Rule 5735(b)(1), an issuer would be required to represent to the Exchange that it will advise the Exchange of any failure by a series of Managed Fund Shares to comply with the continued listing requirements, and, pursuant to its obligations under Section 19(g)(1) of the Exchange Act, the Exchange will surveil for compliance with the continued listing requirements. If a series of Managed Fund Shares is not in compliance with the applicable listing requirements, the Exchange will commence delisting procedures under the Nasdaq Rule 5800 Series.²⁵

III. Discussion and Commission Findings

After careful review, the Commission finds that the Exchange's proposal to amend Nasdaq Rule 5735 to, among other things, adopt generic listing criteria, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.²⁶ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,²⁷ which requires, among other things, that the Exchange's rules be designed to prevent fraudulent and manipulative acts and practices, 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.

²⁴ See id.

²⁵ See id.

²⁶ 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).

²⁷ 15 U.S.C. 78f(b)(5).

The Commission notes that Nasdaq’s proposal is substantively identical to proposals that the Commission recently approved.²⁸ Accordingly, for the reasons discussed in the Prior MFS Generics Orders, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act²⁹ 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,³⁰ that the proposed rule change (SR-NASDAQ-2016-104) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³¹

Brent J. Fields
Secretary

²⁸ See Securities Exchange Act Release Nos. 78396 (Jul. 22, 2016), 81 FR 49698 (Jul. 28, 2016) (SR-BATS-2015-100); and 78397 (Jul. 22, 2016), 81 FR 49320 (Jul. 27, 2016) (SR-NYSEArca-2015-110). These releases are referred to collectively as the “Prior MFS Generics Orders.”

²⁹ 15 U.S.C. 78f(b)(5).

³⁰ 15 U.S.C. 78s(b)(2).

³¹ 17 CFR 200.30-3(a)(12).