

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-80745; File No. SR-NASDAQ-2017-033)

May 23, 2017

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Granting Approval of a Proposed Rule Change, as Modified by Amendments No. 1 and 2, to List and Trade Shares of the First Trust California Municipal High Income ETF

I. Introduction

On March 24, 2017, The NASDAQ Stock Market LLC (“Exchange” or “Nasdaq”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to list and trade shares (“Shares”) of the First Trust California Municipal High Income ETF (“Fund”) of First Trust Exchange-Traded Fund III (“Trust”) under Nasdaq Rule 5735. The proposed rule change was published for comment in the Federal Register on April 10, 2017.<sup>3</sup> On May 12, 2017, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>4</sup> On May 16,

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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. 80369 (April 4, 2017), 82 FR 17314.

<sup>4</sup> In Amendment No. 1, which amended and replaced the proposed rule change in its entirety, the Exchange: (a) clarified the scope and definition of Municipal Securities (defined herein) and other municipal securities in which the Fund may invest; (b) represented that to the extent the Fund invests in Municipal Securities (as defined herein) that are asset-backed and mortgage-backed, those investments will not account, in the aggregate, for more than 20% of the fixed-income portion of the Fund’s portfolio; (c) stated that the Fund may invest up to 20% of its net assets in the aggregate in OTC Derivatives (as defined herein) and represented that the Fund will only enter into transactions in OTC Derivatives with counterparties that the Adviser reasonably believes are capable of performing under the applicable contract or agreement; and (d) made certain technical amendments. Because Amendment No. 1 makes clarifying changes and does not unique or novel regulatory issues, it is not subject to notice and comment. Amendment No. 1 to the proposed rule change is available at: <https://www.sec.gov/comments/sr-nasdaq-2017-033/nasdaq2017033-1749423-151718.pdf>.

2017, the Exchange filed Amendment No. 2 to the proposed rule change.<sup>5</sup> The Commission has received no comments on the proposal. The Commission is granting approval of the proposed rule change, as modified by Amendments No. 1 and 2.

## II. Exchange's Description of the Proposed Rule Change

The Exchange proposes to list and trade the Shares of the Fund under Nasdaq Rule 5735, which governs the listing and trading of Managed Fund Shares on the Exchange. The Fund will be an actively-managed exchange-traded fund ("ETF"). The Trust, which was established as a Massachusetts business trust on January 9, 2008 and is registered with the Commission as an investment company, has filed with the Commission a registration statement on Form N-1A ("Registration Statement").<sup>6</sup> First Trust Advisors L.P. will serve as the investment adviser ("Adviser") to the Fund. First Trust Portfolios L.P. will serve as the principal underwriter and distributor ("Distributor") of the Fund's Shares.<sup>7</sup> Brown Brothers Harriman & Co. will act as the administrator, accounting agent, custodian, and transfer agent to the Fund.

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<sup>5</sup> In Amendment No. 2, which partially amended the proposed rule change, as modified by Amendment No. 1, the Exchange clarified that all statements and representations made in the filing regarding (a) the description of the portfolio or reference assets, (b) limitations on portfolio holdings or reference assets, (c) dissemination and availability of the reference asset or intraday indicative values, or (d) the applicability of Exchange listing rules shall constitute continued listing requirements for listing the Shares on the Exchange. Because Amendment No. 2 does not materially alter the substance of the proposed rule change or raise unique or novel regulatory issues, it is not subject to notice and comment. Amendment No. 2 to the proposed rule change is available at: <https://www.sec.gov/comments/sr-nasdaq-2017-033/nasdaq2017033.htm>.

<sup>6</sup> See Post-Effective Amendment No. 65 to the Registration Statement for the Trust, dated March 24, 2017 (File Nos. 333-176976 and 811-22245). The Exchange represents that the Trust has obtained certain exemptive relief from the Commission under the Investment Company Act of 1940 ("1940 Act"). See Investment Company Act Release No. 30029 (April 10, 2002) (File No. 812-13795).

<sup>7</sup> The Exchange represents that, while the Adviser is not a broker dealer, it is affiliated with the Distributor, a broker dealer. The Exchange states that the Adviser has implemented and will maintain a fire wall between the Adviser and the Distributor with respect to access to information concerning the composition of, and changes to, the Fund's

The Exchange has made the following representations and statements in describing the Fund and its investment strategies, including the Fund's portfolio holdings and investment restrictions.<sup>8</sup>

A. Exchange's Description of the Fund's Principal Investments

According to the Exchange, the primary investment objective of the Fund will be to seek to provide current income that is exempt from regular federal income taxes and California income taxes, and its secondary objective will be long-term capital appreciation. Under normal market conditions,<sup>9</sup> the Fund will seek to achieve its investment objectives by investing at least

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portfolio. In the event (a) the Adviser or any sub adviser registers as a broker dealer or becomes newly affiliated with a broker dealer, or (b) any new adviser or sub adviser is a registered broker dealer or becomes affiliated with another broker dealer, it will implement and maintain a fire wall with respect to its relevant personnel and/or such broker dealer affiliate, as applicable, regarding access to information concerning the composition of, and/or changes to, the portfolio and will be subject to procedures designed to prevent the use and dissemination of material, non-public information regarding such portfolio.

<sup>8</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, Fund holdings disclosure policies, distributions, and taxes, among other information, is included in the proposed rule change, as modified by Amendments No. 1 and 2, and the Registration Statement, as applicable. See Amendments No. 1 and 2 and Registration Statement, supra notes 4, 5, and 6, respectively, and accompanying text.

<sup>9</sup> The term "under normal market conditions" for purposes of the filing, includes, but is not limited to, the absence of adverse market, economic, political or other conditions, including extreme volatility or trading halts in the fixed income 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. The Exchange represents that, on a temporary basis, including for defensive purposes, during the initial invest-up period (for purposes of this filing, i.e., the six-week period following the commencement of trading of Shares on the Exchange) and during periods of high cash inflows or outflows (for purposes of this filing, i.e., rolling periods of seven calendar days during which inflows or outflows of cash, in the aggregate, exceed 10% of the Fund's net assets as of the opening of business on the first day of such periods), the Fund may depart from its principal investment strategies; for example, it may hold a higher than normal proportion of its assets in cash.

80% of its net assets (including investment borrowings) in municipal debt securities that pay interest that is exempt from regular federal income taxes and California income taxes (collectively, "Municipal Securities").<sup>10</sup> Municipal Securities will be issued by or on behalf of the State of California or territories or possessions of the U.S. (including without limitation Puerto Rico, the U.S. Virgin Islands and Guam), and/or the political subdivisions, agencies, authorities, and other instrumentalities of such State, territories, or possessions. Municipal Securities issued by or on behalf of territories or possessions of the U.S. and/or the political subdivisions, agencies, authorities, and other instrumentalities of such territories or possessions (collectively, "Territorial Obligations") will pay interest that is exempt from regular federal income taxes and California income taxes. Under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, the Fund will invest at least 80% of its net assets in Municipal Securities that are not Territorial Obligations.

The types of Municipal Securities in which the Fund may invest include municipal lease obligations (and certificates of participation in such obligations), municipal general obligation bonds, municipal revenue bonds, municipal notes, municipal cash equivalents, private activity bonds (including, without limitation, industrial development bonds), and pre-refunded<sup>11</sup> and

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During such periods, the Fund may not be able to achieve its investment objectives. According to the Exchange, the Fund may adopt a defensive strategy when the Adviser believes securities in which the Fund normally invests have elevated risks due to political or economic factors and in other extraordinary circumstances.

<sup>10</sup> Assuming compliance with the investment requirements and limitations described herein, the Fund may invest up to 100% of its net assets in Municipal Securities that pay interest that generates income subject to the federal alternative minimum tax.

<sup>11</sup> A pre-refunded municipal bond is a municipal bond that has been refunded to a call date on or before the final maturity of principal and remains outstanding in the municipal market. The payment of principal and interest of the pre-refunded municipal bonds held by the Fund will be funded from securities in a designated escrow account that holds U.S. Treasury securities or other obligations of the U.S. government (including its agencies and instrumentalities). As the payment of principal and interest is generated from

escrowed to maturity bonds. In addition, Municipal Securities include securities issued by entities (referred to as “Municipal Entities”) whose underlying assets are municipal bonds (i.e., tender option bond trusts and custodial receipts trusts).

The Fund may invest in Municipal Securities of any maturity. However, under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, the weighted average maturity of the Fund will be less than or equal to 14 years.

Under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, the Fund will invest at least 50% of its net assets in “investment grade Municipal Securities,” which are Municipal Securities that are, at the time of investment, rated investment grade (i.e., rated Baa3/BBB- or above) by at least one nationally recognized statistical rating organization (“NRSRO”) rating such securities (or Municipal Securities that are unrated and determined by the Adviser to be of comparable quality)<sup>12</sup> (“Investment Grade Requirement”). The Fund will consider pre-refunded or escrowed to maturity bonds, regardless of rating, to be investment grade Municipal Securities. Under normal market conditions, except

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securities held in a designated escrow account, the pledge of the municipality has been fulfilled and the original pledge of revenue by the municipality is no longer in place. The escrow account securities pledged to pay the principal and interest of the pre-refunded municipal bond do not guarantee the price movement of the bond before maturity. Investment in pre-refunded municipal bonds held by the Fund may subject the Fund to interest rate risk, market risk, and credit risk. In addition, while a secondary market exists for pre-refunded municipal bonds, if the Fund sells pre-refunded municipal bonds prior to maturity, the price received may be more or less than the original cost, depending on market conditions at the time of sale.

<sup>12</sup> Comparable quality of unrated Municipal Securities will be determined by the Adviser based on fundamental credit analysis of the unrated security and comparable rated securities. On a best efforts basis, the Adviser will attempt to make a rating determination based on publicly available data. In making a “comparable quality” determination, the Adviser may consider, for example, whether the issuer of the security has issued other rated securities, the nature and provisions of the relevant security, whether the obligations under the relevant security are guaranteed by another entity and the rating of such guarantor (if any), relevant cash flows, macroeconomic analysis, and/or sector or industry analysis.

for the initial invest-up period and periods of high cash inflows or outflows, the Fund will invest no more than 50% of its net assets in Municipal Securities that are, at the time of investment, not investment grade Municipal Securities (commonly referred to as “high yield” or “junk” bonds).<sup>13</sup> If, subsequent to purchase by the Fund, a Municipal Security held by the Fund experiences a decrease in credit quality and is no longer an investment grade Municipal Security, the Fund may continue to hold the Municipal Security, and it will not cause the Fund to violate the Investment Grade Requirement; however, the Municipal Security will be taken into account for purposes of determining whether purchases of additional Municipal Securities will cause the Fund to violate the Investment Grade Requirement.

Certain representations included in this filing, described below, will meet or exceed similar requirements set forth in the generic listing standards for actively-managed ETFs (“Generic Listing Standards”). It is not anticipated that the Fund will meet the requirement that components that in the aggregate account for at least 75% of the fixed income weight of the portfolio each have a minimum original principal amount outstanding of \$100 million or more.<sup>14</sup> In general terms, as described above, the Fund will operate as an actively-managed ETF that normally invests in a portfolio of Municipal Securities and will be subject to the Investment Grade Requirement. The Adviser notes that debt issuance sizes for municipal obligations are generally smaller than for corporate obligations. Furthermore, as a general matter, municipal

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<sup>13</sup> These Municipal Securities may include Municipal Securities that are currently in default and not expected to pay the current coupon (“Distressed Municipal Securities”). The Fund may invest up to 10% of its net assets in Distressed Municipal Securities. If, subsequent to purchase by the Fund, a Municipal Security held by the Fund becomes a Distressed Municipal Security, the Fund may continue to hold the Distressed Municipal Security, and it will not cause the Fund to violate the 10% limitation; however, the Distressed Municipal Security will be taken into account for purposes of determining whether purchases of additional Municipal Securities will cause the Fund to violate such limitation.

<sup>14</sup> See Nasdaq Rule 5735(b)(1)(B)(i).

borrowers in certain industries with municipal obligations rated in the “A” and “BBB” categories (in which the Fund currently intends to significantly invest)<sup>15</sup> tend to have less outstanding debt than municipal borrowers in other municipal industries.

Therefore, under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, at least 40% (based on dollar amount invested) of the Municipal Securities in which the Fund invests<sup>16</sup> will be issued by issuers with total outstanding debt issuances that, in the aggregate, have a minimum amount of municipal debt outstanding at the time of purchase of \$50 million or more (“40/50 Requirement”). The Adviser believes that the 40/50 Requirement is appropriate in light of the Fund’s investment objectives and the manner in which the Fund intends to pursue them. Given the expected availability of Municipal Securities that will satisfy the Fund’s investment parameters and the debt issuance profiles of the corresponding issuers and borrowers, the 40/50 Requirement should both provide the Fund with flexibility to construct its portfolio and, when combined with the other representations in this filing (including certain representations set forth below pertaining to fixed income securities weightings and number of non-affiliated issuers that are based on, but more stringent than, the Generic Listing Standards), should support the potential for diversity and liquidity, thereby mitigating the Commission’s concerns about manipulation.

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<sup>15</sup> These industries include charter schools, senior living facilities (i.e., continuing care retirement communities), and special tax districts, among others. See infra note 27 and accompanying text (providing additional information regarding the Fund’s exposure to different industries). In the case of a municipal conduit financing (in general terms, the issuance of municipal securities by an issuer to finance a project to be used primarily by a third party (“conduit borrower”)), the “borrower” is the conduit borrower (i.e., the party on which a bondholder must rely for repayment). In the case of other municipal financings, the “borrower” is the issuer of the municipal securities.

<sup>16</sup> For the avoidance of doubt, in the case of Municipal Securities that are issued by Municipal Entities, the underlying municipal bonds will be taken into account.

Under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, no component fixed income security (excluding the U.S. government securities described in “Other Investments” below) will represent more than 15% of the Fund’s net assets, and the five most heavily weighted component fixed income securities in the Fund’s portfolio (excluding U.S. government securities) will not, in the aggregate, account for more than 25% of the Fund’s net assets.<sup>17</sup> Further, under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, the Fund’s portfolio of Municipal Securities will include securities from a minimum of 30 non-affiliated issuers.<sup>18</sup> Moreover, under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, component securities that in the aggregate account for at least 90% of the weight of the Fund’s portfolio of Municipal Securities will be exempted securities as defined in Section 3(a)(12) of the Act.<sup>19</sup> Additionally, to the extent the Fund invests in Municipal

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<sup>17</sup> See the Generic Listing Standards requirement set forth in Nasdaq Rule 5735(b)(1)(B)(ii), which provides that that no component fixed income security (excluding U.S. Treasury securities and government-sponsored entity (“GSE”) securities) may represent more than 30% of the fixed income weight of the portfolio, and that the five most heavily weighted component fixed income securities in the portfolio (excluding U.S. Treasury securities and GSE securities) may not in the aggregate account for more than 65% of the fixed income weight of the portfolio. In the case of Municipal Securities that are issued by Municipal Entities, the underlying municipal bonds will be taken into account.

<sup>18</sup> See the Generic Listing Standards requirement set forth in Nasdaq Rule 5735(b)(1)(B)(iii), which provides that generally an underlying portfolio (excluding exempted securities) that includes fixed income securities must include a minimum of 13 non-affiliated issuers. In the case of Municipal Securities that are issued by Municipal Entities, the underlying municipal bonds will be taken into account. Additionally, for purposes of this restriction, each separate political subdivision, agency, authority, or instrumentality of the State of California, and each guarantor, if any, will be treated as separate, non-affiliated issuers of Municipal Securities.

<sup>19</sup> See the Generic Listing Standards requirement set forth in Nasdaq Rule 5735(b)(1)(B)(iv)(d). For the avoidance of doubt, in the case of Municipal Securities that are issued by Municipal Entities, the underlying municipal bonds will be taken into account.

Securities that are mortgage-backed or asset-backed securities, such investments will not account, in the aggregate, for more than 20% of the weight of the fixed income portion of the Fund's portfolio.<sup>20</sup>

B. Exchange's Description of the Fund's Other Investments

The Fund may invest up to an aggregate of 20% of its net assets in the securities and other instruments (including cash) described in this section.

The Fund may invest in the short-term debt instruments described below, money market funds and other cash equivalents, and taxable municipal securities and other municipal securities that are not Municipal Securities, or it may hold cash.

Short-term debt instruments, which do not include Municipal Securities, are issued by issuers having a long-term debt rating of at least A-/A3 (as applicable) by S&P Global Ratings ("S&P"), Moody's Investors Service, Inc. ("Moody's") or Fitch Ratings ("Fitch") and have a maturity of one year or less. The Fund may invest in the following short-term debt instruments: (1) fixed rate and floating rate 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,<sup>21</sup> which involve purchases of debt securities; (5) bank time deposits, which are

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<sup>20</sup> See the Generic Listing Standards requirement set forth in Nasdaq Rule 5735(b)(1)(B)(v).

<sup>21</sup> The Fund intends to enter into repurchase agreements only with financial institutions and dealers believed by the Adviser to present minimal credit risks in accordance with criteria approved by the Board of Trustees of the Trust. The Adviser will review and monitor the creditworthiness of such institutions. The Adviser will monitor the value of the collateral at the time the transaction is entered into and at all times during the term of the repurchase agreement.

monies kept on deposit with banks or savings and loan associations for a stated period of time at a fixed rate of interest; and (6) commercial paper, which is short-term unsecured promissory notes.<sup>22</sup>

The Fund may (i) invest in the securities of other investment companies registered under the 1940 Act, including money market funds, ETFs,<sup>23</sup> open-end funds (other than money market funds and other ETFs), and closed-end funds and (ii) acquire short positions in the securities of the foregoing investment companies.

The Fund may (i) invest in exchange-listed options on U.S. Treasury securities, exchange-listed options on U.S. Treasury futures contracts, and exchange-listed U.S. Treasury futures contracts (collectively, “Listed Derivatives”) and (ii) acquire short positions in the Listed Derivatives. Transactions in the Listed Derivatives may allow the Fund to obtain net long or short exposures to selected interest rates. The Listed Derivatives may also be used to hedge risks, including interest rate risks and credit risks, associated with the Fund’s portfolio investments. In addition, to hedge interest rate risks associated with the Fund’s portfolio investments, the Fund may invest in over-the-counter (“OTC”) forward contracts and OTC swaps (collectively, “OTC

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<sup>22</sup> The Fund may only invest in commercial paper rated A-3 or higher by S&P, Prime-3 or higher by Moody’s, or F3 or higher by Fitch.

<sup>23</sup> An ETF is an investment company registered under the 1940 Act that holds a portfolio of securities. ETFs included in the Fund will be listed and traded in the U.S. on one or more registered exchanges. The Fund may invest in the securities of certain ETFs in excess of the limits imposed under the 1940 Act pursuant to exemptive orders obtained by such ETFs and their sponsors from the Commission. In addition, the Fund may invest in the securities of certain other investment companies in excess of the limits imposed under the 1940 Act pursuant to an exemptive order that the Trust has obtained from the Commission. See Investment Company Act Release No. 30377 (February 5, 2013) (File No. 812-13895). The ETFs in which the Fund may invest include Index Fund Shares (as described in Nasdaq Rule 5705), Portfolio Depository Receipts (as described in Nasdaq Rule 5705), and Managed Fund Shares (as described in Nasdaq Rule 5735). While the Fund may invest in inverse ETFs, the Fund will not invest in leveraged or inverse leveraged (e.g., 2X or -3X) ETFs.

Derivatives”).<sup>24</sup> The Fund will only enter into transactions in OTC Derivatives with counterparties that the Adviser reasonably believes are capable of performing under the applicable contract or agreement.<sup>25</sup> The Fund’s investments in derivative instruments will be consistent with the Fund’s investment objectives and the 1940 Act and will not be used to seek to achieve a multiple or inverse multiple of the Fund’s broad-based securities market index (as defined in Form N-1A).

C. Exchange’s Description of the Fund’s Investment Restrictions

The Fund may hold up to an aggregate amount of 15% of its net assets in illiquid assets (calculated at the time of investment), including Rule 144A securities deemed illiquid by the Adviser.<sup>26</sup> 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

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<sup>24</sup> On both an initial and continuing basis, no more than 20% of the assets in the Fund’s portfolio will be invested in the OTC Derivatives and, for purposes of calculating this limitation, the Fund’s investment in the OTC Derivatives will be calculated as the aggregate gross notional value of the OTC Derivatives.

<sup>25</sup> 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’s analysis will evaluate each approved counterparty using various methods of analysis and may consider the Adviser’s past experience with the counterparty, its known disciplinary history and its share of market participation.

<sup>26</sup> 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).

resale and other instruments that lack readily available markets as determined in accordance with Commission staff guidance.

The Fund may not invest 25% or more of the value of its total assets in securities of issuers in any one industry. This restriction does not apply to (a) municipal securities issued by governments or political subdivisions of governments, (b) obligations issued or guaranteed by the U.S. government, its agencies or instrumentalities, or (c) securities of other investment companies. In addition, under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, the Fund's investments in Municipal Securities will provide exposure (based on dollar amount invested) to at least 10 different industries<sup>27</sup> (with no more than 25% of the value of the Fund's net assets comprised of Municipal Securities that provide exposure to any single industry).<sup>28</sup>

### III. Discussion and Commission's Findings

After careful review, the Commission finds that the Exchange's proposal is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>29</sup> In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>30</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

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<sup>27</sup> The municipal industry classification system used by the Fund will divide the municipal securities universe into distinct categories that are intended to reflect either the use of proceeds generated by particular subsets of municipal securities or the collateral/sources of repayment securing/backing such municipal securities. For example, municipal bonds associated with the airport industry are issued to construct or expand an airport and/or related facilities and are secured by revenues generated from the use of the airport.

<sup>28</sup> For the avoidance of doubt, in the case of Municipal Securities that are issued by Municipal Entities, the underlying municipal bonds will be taken into account.

<sup>29</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>30</sup> 15 U.S.C. 78f(b)(5).

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 is consistent with Section 11A(a)(1)(C)(iii) of the Act,<sup>31</sup> which sets forth the finding of Congress 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 (“CTA”) plans for the Shares. Quotation and last-sale information for exchange-listed equity securities (including other ETFs and closed-end funds) will be available from the exchanges on which they are traded as well as in accordance with any applicable CTA plans. Quotation and last-sale information for U.S. exchange-listed options will be available via the Options Price Reporting Authority. One source of price information for Municipal Securities and taxable and other municipal securities will be the Electronic Municipal Market Access (“EMMA”) of the Municipal Securities Rulemaking Board (“MSRB”).<sup>32</sup> Additionally, the MSRB offers trade data subscription services that permit subscribers to obtain same-day pricing information about municipal securities transactions. Moreover, pricing information for Municipal Securities, as well as for taxable municipal securities and other municipal securities, Short-Term Debt Instruments (including short-term U.S. government securities, commercial paper, and bankers’ acceptances), repurchase

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<sup>31</sup> 15 U.S.C. 78k-1(a)(1)(C)(iii).

<sup>32</sup> Information available on EMMA includes next-day information regarding municipal securities transactions and par amounts traded. In addition, a source of price information for certain taxable municipal securities is the Trade Reporting and Compliance Engine (“TRACE”) of the Financial Industry Regulatory Authority (“FINRA”).

agreements and OTC Derivatives (including forward contracts and swaps) will be available from major broker-dealer firms and/or major market data vendors and/or Pricing Services. Pricing information for Listed Derivatives (including options on U.S. Treasury securities, options on U.S. Treasury futures contracts, and U.S. Treasury futures contracts), ETFs and closed-end funds will be available from the applicable listing exchange and from major market data vendors. Money market funds and other open-end funds (excluding ETFs) are typically priced once each business day and their prices will be available through the applicable fund's website or from major market data vendors.

The Intraday Indicative Value, available on the NASDAQ OMX Information LLC proprietary index data service,<sup>33</sup> will be based upon the current value for the components of the Disclosed Portfolio (defined below) and will be updated and widely disseminated by one or more major market data vendors and broadly displayed at least every 15 seconds during the Regular Market Session.<sup>34</sup> 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 ("Disclosed Portfolio," as defined in Nasdaq Rule 5735(c)(2))<sup>35</sup> held by the Fund that will form the basis for the Fund's calculation of

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<sup>33</sup> Currently, the NASDAQ OMX Global Index Data Service ("GIDS") is the Nasdaq 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 indexes, listed ETFs, or third-party partner indexes and ETFs.

<sup>34</sup> See Nasdaq Rule 4120(b)(4) (describing the trading sessions on the Exchange).

<sup>35</sup> 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.

NAV at the end of the business day.<sup>36</sup> The Fund's website, which will be publicly available prior to the public offering of Shares, will include a form of the prospectus for the Fund and additional data relating to NAV and other applicable quantitative information that may be downloaded.

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 disclosure of derivative positions in the Disclosed Portfolio will include sufficient information for market participants to use to value these positions intraday. Additionally, FINRA, on behalf of the Exchange, will communicate as needed regarding trading in the Shares and the exchange-listed securities and instruments held by the Fund (including closed-end funds, ETFs, and Listed Derivatives) with other markets and other entities that are members of the Intermarket Surveillance Group ("ISG"),<sup>37</sup> and FINRA may obtain trading information regarding trading in the Shares and such exchange-listed securities and instruments held by the Fund from

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<sup>36</sup> In addition to disclosing the identities and quantities of the portfolio of securities and other assets in the Disclosed Portfolio, the Fund also will disclose on a daily basis on its website the following information, 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); with respect to holdings in derivatives, the identity of the security, index or other asset upon which the derivative is based; 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 percentage weighting of the holding in the Fund's portfolio. The website information will be publicly available at no charge. The Fund's NAV will be determined as of the close of regular trading on the New York Stock Exchange ("NYSE") on each day the NYSE is open for trading.

<sup>37</sup> For a list of the current members of ISG, see [www.isgportal.org](http://www.isgportal.org). The Exchange notes that not all components of the Disclosed Portfolio may trade on markets that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement.

such markets and other entities. In addition, the Exchange may obtain information regarding trading in the Shares and the exchange-listed securities and instruments held by the Fund from markets and other entities that are members of ISG, which includes securities and futures exchanges, or with which the Exchange has in place a comprehensive surveillance sharing agreement. Moreover, FINRA, on behalf of the Exchange, will be able to access, as needed, trade information for certain fixed income securities held by the Fund reported to FINRA's TRACE.<sup>38</sup>

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 will be made available to all market participants at the same time. Nasdaq will halt 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). In addition, trading may be halted because of market conditions or for reasons that, in the view of the Exchange, make trading in the Shares inadvisable. These may include: (1) the extent to which trading is not occurring in the securities and/or the other assets constituting 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. Trading in the Shares also will be subject to Rule 5735(d)(2)(D), which sets forth circumstances under which Shares of the Fund may be halted.

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<sup>38</sup> For Municipal Securities, trade information can generally be found on the MSRB's EMMA.

The Exchange states that it has a general policy prohibiting the distribution of material, non-public information by its employees. Further, the Commission notes that the Reporting Authority<sup>39</sup> that provides the Disclosed Portfolio 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 portfolio.<sup>40</sup> In addition, the Exchange states that the Adviser is not a broker-dealer, but it is affiliated with the Distributor, a broker-dealer, and is required to implement and maintain a “fire wall” with respect to such broker-dealer affiliate regarding access to information concerning the composition of, and/or changes to, the Fund’s portfolio.<sup>41</sup> Moreover, Nasdaq Rule 5735(g) requires that personnel who make decisions on the open-end fund’s portfolio composition must be subject to procedures designed to prevent the use and dissemination of material, non-public information regarding the Fund’s portfolio.

The Exchange represents that trading in the Shares will be subject to the existing trading surveillances, administered by both the Exchange and FINRA, on behalf of the Exchange, which

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<sup>39</sup> Nasdaq Rule 5735(c)(4) defines “Reporting Authority.”

<sup>40</sup> See Nasdaq Rule 5735(d)(2)(B)(ii).

<sup>41</sup> See supra note 7. The Exchange states 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 the Advisers Act and Rule 204A-1 thereunder. 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.

are designed to detect violations of Exchange rules and applicable federal securities laws.<sup>42</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 applicable federal securities laws. Moreover, the Exchange states that, prior to the commencement of trading, it will inform its members in an Information Circular 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 the following:

- (1) The Shares will be subject to Rule 5735, 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 and the exchange-listed securities and instruments held by the Fund (including closed-end funds, ETFs, and Listed Derivatives) with other markets and other entities that are members of ISG, and FINRA may obtain trading information regarding trading in the Shares and such exchange-listed securities and instruments held by the Fund from such markets and other entities.

In addition, the Exchange may obtain information regarding trading in the Shares

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<sup>42</sup> 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.

and the exchange-listed securities and instruments held by the Fund from markets and other entities that are members of ISG, which includes securities and futures exchanges, or with which the Exchange has in place a comprehensive surveillance sharing agreement. Moreover, FINRA, on behalf of the Exchange, will be able to access, as needed, trade information for certain fixed income securities held by the Fund reported to FINRA's TRACE, and the MSRB's EMMA will be a source of price information for Municipal Securities and taxable and other municipal securities.

- (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 Intraday Indicative Value and the Disclosed Portfolio is disseminated; (d) the risks involved in trading the Shares during the Pre-Market and Post-Market Sessions when an updated 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 Act.<sup>43</sup>
- (6) Under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, the Fund will invest at least 80% of its net assets in Municipal Securities that are not Territorial Obligations.
- (7) Under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, the Fund will invest at least 50% of its net assets in investment grade Municipal Securities, and the Fund will invest no more than 50% of its net assets in Municipal Securities that are, at the time of investment, not investment grade Municipal Securities.
- (8) The Fund may not invest more than 10% of its net assets in Distressed Municipal Securities.
- (9) To the extent the Fund invests in Municipal Securities that are mortgage-backed or asset-backed securities, such investments will not account, in the aggregate, for more than 20% of the weight of the fixed income portion of the Fund's portfolio.
- (10) At least 40% (based on dollar amount invested) of the Municipal Securities in which the Fund invests will be issued by issuers with total outstanding debt issuances that, in the aggregate, have a minimum amount of municipal debt outstanding at the time of purchase of \$50 million or more.
- (11) On both an initial and continuing basis, no more than 20% of the assets in the Fund's portfolio will be invested in the OTC Derivatives and, for purposes of calculating this limitation, the Fund's investment in the OTC Derivatives will be

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<sup>43</sup> See 17 CFR 240.10A-3.

calculated as the aggregate gross notional value of the OTC Derivatives. The Fund will only enter into transactions in OTC Derivatives with counterparties that the Adviser reasonably believes are capable of performing under the applicable contract or agreement.

- (12) Under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, the Fund's investments in Municipal Securities will provide exposure (based on dollar amount invested) to at least 10 different industries (with no more than 25% of the value of the Fund's net assets comprised of Municipal Securities that provide exposure to any single industry).
- (13) ETFs included in the Fund will be listed and traded in the U.S. on one or more registered exchanges. While the Fund may invest in inverse ETFs, the Fund will not invest in leveraged or inverse leveraged (e.g., 2X or 3X) ETFs.
- (14) Under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows: no component fixed-income security (excluding the U.S. government securities described in "Other Investments") will represent more than 15% of the Fund's net assets, and the five most heavily weighted component fixed income securities in the Fund's portfolio (excluding U.S. government securities) will not, in the aggregate, account for more than 25% of the Fund's net assets. Further, under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, the Fund's portfolio of Municipal Securities will include securities from a minimum of 30 non-affiliated issuers. Moreover, under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, component

securities that in the aggregate account for at least 90% of the weight of the Fund's portfolio of Municipal Securities will be exempted securities as defined in Section 3(a)(12) of the Act.

- (15) The Fund may hold up to an aggregate amount of 15% of its net assets in illiquid assets (calculated at the time of investment), including Rule 144A securities deemed illiquid by the Adviser. 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.
- (16) The Fund's investments in derivative instruments will be consistent with the Fund's investment objectives and the 1940 Act and will not be used to seek to achieve a multiple or inverse multiple of the Fund's broad-based securities market index (as defined in Form N-1A).
- (17) A minimum of 100,000 Shares will be outstanding at the commencement of trading on the Exchange.

The Exchange represents that all statements and representations made in the filing regarding (a) the description of the portfolio or reference assets, (b) limitations on portfolio holdings or reference assets, (c) dissemination and availability of the reference asset or intraday indicative values, or (d) the applicability of Exchange listing rules shall constitute continued listing requirements for listing the Shares on the Exchange. In addition, the issuer has represented to the Exchange that it will advise the Exchange of any failure by the Fund to comply with the

continued listing requirements, and, pursuant to its obligations under Section 19(g)(1) of the Act, the Exchange will monitor for compliance with the continued listing requirements.<sup>44</sup> If the Fund is not in compliance with the applicable listing requirements, the Exchange will commence delisting procedures under the Nasdaq 5800 Series.

This order is based on all of the Exchange’s representations, including those set forth above and in Amendments No. 1 and 2. The Commission notes that the Fund and the Shares must comply with the requirements of Nasdaq Rule 5735 for the Shares to be listed and traded on the Exchange.

For the foregoing reasons, the Commission finds that the proposed rule change, as modified by Amendments No. 1 and 2, is consistent with Section 6(b)(5) of the Act<sup>45</sup> and Section 11A(a)(1)(C)(iii) of the Act<sup>46</sup> and the rules and regulations thereunder applicable to a national securities exchange.

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<sup>44</sup> The Commission notes that certain other proposals for the listing and trading of Managed Fund Shares include a representation that the exchange will “surveil” for compliance with the continued listing requirements. See, e.g., Securities Exchange Act Release No. 77499 (April 1, 2016), 81 FR 20428 (April 7, 2016) (SR-BATS-2016-04). In the context of this representation, it is the Commission’s view that “monitor” and “surveil” both mean ongoing oversight of a fund’s compliance with the continued listing requirements. Therefore, the Commission does not view “monitor” as a more or less stringent obligation than “surveil” with respect to the continued listing requirements.

<sup>45</sup> 15 U.S.C. 78f(b)(5).

<sup>46</sup> 15 U.S.C. 78k-1(a)(1)(C)(iii).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>47</sup> that the proposed rule change (SR-NASDAQ-2017-033), as modified by Amendments No. 1 and 2, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>48</sup>

Eduardo A. Aleman  
Assistant Secretary

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Id.

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17 CFR 200.30-3(a)(12).