

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-83007; File No. SR-NASDAQ-2017-128)

April 6, 2018

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to List and Trade Shares of the Western Asset Total Return ETF

On December 20, 2017, The Nasdaq Stock Market LLC (“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 Western Asset Total Return ETF (“Fund”), a series of Legg Mason ETF Investment Trust (“Trust”), under Nasdaq Rule 5735 (Managed Fund Shares). The proposed rule change was published for comment in the Federal Register on January 9, 2018.<sup>3</sup> On February 21, 2018, pursuant to Section 19(b)(2) of the Act,<sup>4</sup> the Commission 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.<sup>5</sup> The Commission has received no comments on the proposed rule change. This order institutes proceedings under Section 19(b)(2)(B) of the Act<sup>6</sup> to determine whether to approve or disapprove the proposed rule change.

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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. 82439 (Jan. 3, 2018), 83 FR 1062 (“Notice”).

<sup>4</sup> 15 U.S.C. 78s(b)(2).

<sup>5</sup> See Securities Exchange Act Release No. 82757, 83 FR 8532 (Feb. 27, 2018). The Commission designated April 9, 2018, as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change.

<sup>6</sup> 15 U.S.C. 78s(b)(2)(B).

I. Summary of the Exchange’s Description of the Proposed Rule Change<sup>7</sup>

The Exchange proposes to list and trade Shares of the Fund under Nasdaq Rule 5735, which governs the listing and trading of Managed Fund Shares on the Exchange. The Shares will be offered by the Trust, which is registered with the Commission as an investment company under the Investment Company Act of 1940 (“1940 Act”). The Fund will be a series of the Trust.<sup>8</sup>

Legg Mason Partners Fund Advisor, LLC will be the investment manager (“Manager”) to the Fund. Western Asset Management Company will serve as the sub-adviser to the Fund (“Sub-Adviser”) and Western Asset Management Company Limited in London, Western Asset Management Company Pte. Ltd. in Singapore, and Western Asset Management Company Ltd in Japan will each serve as sub-sub-advisers to the Fund (collectively, “Sub-Sub-Advisers” and each, a “Sub-Sub-Adviser”).<sup>9</sup> Legg Mason Investor Services, LLC (“Distributor”) will be the distributor of the Fund’s Shares. The Manager, each of the Sub-Advisers, and the Distributor are wholly-owned subsidiaries of Legg Mason, Inc. (“Legg Mason”). The Exchange states that an entity that is not affiliated with Legg Mason, and which is named in the Registration Statement, will act as the administrator, accounting agent, custodian, and transfer agent to the Fund.<sup>10</sup>

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<sup>7</sup> For a complete description of the Exchange’s proposal, see the Notice, supra note 3.

<sup>8</sup> The Trust filed a registration statement on Form N-1A with the Commission with respect to the Fund but withdrew it on February 14, 2018. See Post-Effective Amendment No. 27 to the Registration Statement on Form N-1A for the Trust (File Nos. 333-206784 and 811-23096) as filed on August 8, 2017 (“Registration Statement”) and Request for Withdrawal of Post-Effective Amendments Nos. 27, 31, 33, 35, 36 and 38 to the Trust’s Registration Statement filed on Form N-1A as filed on February 14, 2018.

<sup>9</sup> References to “Sub-Adviser” or “Sub-Advisers” hereinafter include the Sub-Adviser and each applicable Sub-Sub-Adviser.

<sup>10</sup> According to the Exchange, none of the Manager or any of the Sub-Advisers is a broker-dealer, but each is affiliated with the Distributor, a broker-dealer. The Exchange

The Fund will be an actively managed exchange-traded fund (“ETF”). According to the Exchange, the investment objective of the Fund will be to seek to maximize total return, consistent with prudent investment management and liquidity needs. Although the Fund may invest in securities and Debt (as defined below) of any maturity, the Fund will normally maintain an average effective duration within 35% of the average duration of the U.S. bond market as a whole (generally, this bond market range is 2.5 to 7 years) as estimated by the Sub-Adviser.<sup>11</sup>

A. Principal Investments

According to the Exchange, under Normal Market Conditions,<sup>12</sup> the Fund will seek to achieve its investment objective by investing at least 80% of its net assets in a portfolio

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states that each of the Manager and the Sub-Advisers has implemented and will maintain a fire wall with respect to its broker-dealer affiliate regarding access to information concerning the composition of and/or changes to the portfolio prior to implementation. In addition, personnel who make decisions on the Fund’s portfolio composition will be subject to procedures designed to prevent the use and dissemination of material non-public information regarding the Fund’s portfolio. In the event (i) the Manager or any of the Sub-Advisers registers as a broker-dealer or becomes newly affiliated with a broker-dealer, or (ii) any new manager or sub adviser to the Fund 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 prior to implementation and will be subject to procedures designed to prevent the use and dissemination of material non-public information regarding the portfolio.

<sup>11</sup> The Exchange states that the average effective duration of the Fund may fall outside of its expected range due to market movements, and that if this happens, the Sub-Advisers will take action to bring the Fund’s average effective duration back within its expected range within a reasonable period of time.

<sup>12</sup> The term “Normal Market Conditions” has the meaning set forth in Nasdaq Rule 5735(c)(5). In addition, the Exchange states that the Fund may vary from ordinary parameters on a temporary basis, including for defensive purposes, during the initial invest-up period (*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 (*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). In those situations, the Fund may depart from its principal investment strategies and may, for example, hold a higher than normal proportion of its

comprised of (i) U.S. or foreign fixed income securities (as described below); (ii) U.S. or foreign Debt (as described below); (iii) ETFs<sup>13</sup> that provide exposure to such U.S. or foreign fixed income securities, Debt, or other Principal Investments (as described below); (iv) derivatives<sup>14</sup>

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assets in cash and cash equivalents. During such periods, the Fund may not be able to achieve its investment objective. The Fund may also adopt a defensive strategy and hold a significant portion of its assets in cash and cash equivalents when the Manager or any Sub-Adviser believes securities, Debt, and other instruments in which the Fund normally invests have elevated risks due to political or economic factors, heightened market volatility or in other extraordinary circumstances that do not constitute “Normal Market Conditions.”

<sup>13</sup> The Exchange states that the ETFs in which the Fund may invest include Index Fund Shares (as described in Nasdaq Rule 5705(b)), Portfolio Depositary Receipts (as described in Nasdaq Rule 5705(a)), and Managed Fund Shares (as described in Nasdaq Rule 5735). According to the Exchange, the Fund will not invest in ETFs that are not registered as investment companies under the 1940 Act. The ETFs held by the Fund will invest in fixed income securities, Debt, and money-market instruments to which the Fund seeks exposure. The Exchange represents that all such ETFs will trade on markets that are members of the Intermarket Surveillance Group (“ISG”) or exchanges that are parties to a comprehensive surveillance sharing agreement with the Exchange. In addition, the Exchange states that the Fund will not invest in leveraged, inverse, or inverse leveraged ETFs.

<sup>14</sup> The Exchange states that derivatives will include: (i) swaps and security-based swaps, futures, options, options on futures, and swaptions that are traded on an exchange, trading facility, swap execution facility or alternative trading system (a) that is a member of the ISG, which includes all U.S. national securities exchanges and most futures exchanges, (b) that is subject to a comprehensive surveillance sharing agreement with the Exchange, or (c) that is not an ISG member and with which the Exchange does not have a comprehensive surveillance sharing agreement (“Exchange-Traded Derivatives”); and (ii) swaps and security-based swaps, options, options on futures, swaptions, forwards, and similar instruments that are traded in the over-the-counter (“OTC”) market and are either centrally cleared or cleared bilaterally (“OTC Derivatives”). Specifically, the Exchange states that derivatives that the Fund may enter into include: (A) OTC deliverable and non-deliverable foreign exchange forward contracts; (B) exchange-listed futures contracts on securities (including Treasury Securities and foreign government securities), commodities, indices, interest rates, financial rates, and currencies; (C) exchange-listed or OTC options or swaptions (i.e., options to enter into a swap) on securities, commodities, indices, interest rates, financial rates, currencies, and futures contracts; and (D) exchange-listed or OTC swaps (including total return swaps) on securities, commodities, indices, interest rates, financial rates, currencies, and debt, and credit default swaps on single names, basket, and indices (both as protection seller and as protection buyer).

that (a) provide exposure to such U.S. or foreign fixed income securities, Debt, and other Principal Investments, (b) are used to risk manage the Fund's holdings,<sup>15</sup> or (c) are used to enhance returns, such as through covered call strategies; (v) U.S. or foreign equity securities of any type acquired in reorganizations of issuers of fixed income securities or Debt held by the Fund ("Work Out Securities");<sup>16</sup> (vi) U.S. or foreign non-convertible preferred securities (other than trust preferred securities, which the Fund may invest in but which are treated as fixed income securities under Nasdaq Rule 5735(b)(1)(B)) ("Non-Convertible Preferred Securities");<sup>17</sup> (vii) warrants<sup>18</sup> on U.S. or foreign fixed income securities; (viii) warrants on U.S. or foreign equity securities that are attached to, accompany, or are purchased alongside investments in U.S. or foreign fixed income securities issued by the issuer of the warrants ("Equity-Related Warrants");<sup>19</sup> (ix) cash and cash equivalents;<sup>20</sup> and (x) foreign currencies (collectively, the

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<sup>15</sup> According to the Exchange, the risk management uses of derivatives will include managing (i) investment-related risks; (ii) risks due to fluctuations in securities prices, interest rates, or currency exchanges rates; (iii) risks due to the credit-worthiness of an issuer; and (iv) the effective duration of the Fund's portfolio.

<sup>16</sup> According to the Exchange, Work Out Securities will generally be traded in the OTC market or may be listed on an exchange that may or may not be an ISG member.

<sup>17</sup> According to the Exchange, Non-Convertible Preferred Securities may be listed on either an ISG member exchange (or an exchange with which the Exchange has a comprehensive surveillance sharing agreement) or a non-ISG member exchange, or be unlisted and trade in the OTC market.

<sup>18</sup> The Exchange states that the Fund may hold warrants that provide the right to purchase fixed income securities or equity securities, and such warrants may be traded in the OTC market or may be listed on an exchange, including an exchange that is not an ISG member. According to the Exchange, the Fund expects that most of the warrants it holds will be attached to related fixed income securities.

<sup>19</sup> According to the Exchange, the Fund's interests in Equity-Related Warrants will be similar to the Fund's interest in Work Out Securities in that they reflect interests in equity securities that are held solely in connection with investments in fixed income securities.

<sup>20</sup> According to the Exchange, cash equivalents consist of the following, all of which have maturities of less than three months: U.S. government securities; certificates of deposit

“Principal Investments;” and the equity elements of the Principal Investments, which consist of ETFs that provide exposure to fixed income securities, Debt, or other Principal Investments; Work Out Securities; Non-Convertible Preferred Securities; and Equity-Related Warrants, collectively referred to as “Principal Investment Equities”).

The Exchange states that fixed income securities may consist of the following: (i) U.S. or foreign corporate debt securities, including notes, bonds, debentures, trust preferred securities, and commercial paper issued by corporations, trusts, limited partnerships, limited liability companies, and other types of non-governmental legal entities; (ii) U.S. government securities, including obligations of, or securities guaranteed by, the U.S. government, its agencies, or government-sponsored entities (“GSEs”); (iii) sovereign debt securities, including fixed income securities issued by governments, agencies, or instrumentalities and their political subdivisions; securities issued by government-owned, controlled, or sponsored entities; interests in entities organized and operated for the purpose of restructuring the investment instruments issued by such entities; Brady Bonds; and fixed income securities issued by supranational entities such as the World Bank; (iv) U.S. or foreign mortgage-backed securities (“MBS”); (v) U.S. or foreign asset-backed securities (“ABS”),<sup>21</sup> (vi) municipal securities, which include general obligation

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issued against funds deposited in a bank or savings and loan association; bankers’ acceptances; repurchase agreements and reverse repurchase agreements; and bank time deposits. In addition, cash equivalents consist of money market funds registered under the 1940 Act and money market funds that are not registered under the 1940 Act but that comply with Rule 2a-7 under the 1940 Act (together, “Money Market Funds”), money market ETFs, and commercial paper having maturities of 360 days or less.

<sup>21</sup> According to the Exchange, the MBS and ABS in which the Fund will invest make periodic payments of interest and/or principal on underlying pools of mortgages, government securities, or, in the case of ABS, loans, leases, and receivables other than real estate. The Fund may also invest in stripped ABS or MBS, which represent the right to receive either payments of principal or payments of interest on real estate receivables, in the case of MBS, or non-real estate receivables, in the case of ABS.

bonds, revenue bonds, housing authority bonds, private activity bonds, industrial development bonds, residual interest bonds, tender option bonds, tax and revenue anticipation notes, bond anticipation notes, tax-exempt commercial paper, municipal leases, participation certificates and custodial receipts; (vii) zero coupon securities; (viii) pay-in-kind securities; (ix) deferred interest securities; (x) U.S. or foreign structured notes and indexed securities, including securities that have demand, tender or put features, or interest rate reset features; and (xi) U.S. or foreign inflation-indexed or inflation-protected securities, which include, among others, U.S. Treasury Inflation Protected Securities. The securities may pay fixed, variable, or floating rates of interest or, in the case of instruments such as zero coupon bonds, do not pay current interest but are issued at a discount from their face values.

The Exchange states that the Fund may invest in debt instruments (“Debt”) that may be deemed not to be “securities,” as defined in the Act, which will be comprised primarily of the following: (i) U.S. or foreign bank loans and participations in bank loans; (ii) U.S. or foreign loans by non-bank lenders and participations in such loans; (iii) U.S. or foreign loans on real estate secured by mortgages and participations (without guarantees by a GSE); and (iv) participations in U.S. or foreign loans and/or other extensions of credit, such as guarantees, made by governmental entities or financial institutions. Debt may be partially or fully secured by collateral supporting the payment of interest and principal, or unsecured and/or subordinated to other instruments. Debt may relate to financings for highly-leveraged borrowers. The Fund may acquire an interest in Debt by purchasing participations in and/or assignments of portions of loans from third parties or by investing in pools of loans, such as collateralized debt obligations.

With respect to fixed income securities and Debt, the Fund may invest in restricted instruments, such as Rule 144A and Regulation S securities, which are subject to resale

restrictions that limit purchasers to qualified institutional buyers, as defined in Rule 144A under the Securities Act of 1933, as amended (“Securities Act”) or non-U.S. persons, within the meaning of Regulation S under the Securities Act.

The Exchange states that, as a result of the Fund’s use of derivatives and to serve as collateral, the Fund may also hold significant amounts of Treasury Securities, cash, and cash equivalents and, in the case of derivatives that are payable in a foreign currency, the foreign currency in which the derivatives are payable.

The Exchange states that the Fund may, without limitation, enter into repurchase arrangements and borrowing and reverse repurchase arrangements, purchase and sale contracts, buybacks and dollar rolls,<sup>22</sup> and spot currency transactions. The Fund may also, subject to required margin and without limitation, purchase securities and other instruments under when-issued, delayed delivery, to be announced or forward commitment transactions, where the securities or instruments will not be delivered or paid for immediately.

#### B. Other Investments

According to the Exchange, under Normal Market Conditions, the Fund will seek its investment objective by investing at least 80% of its net assets in a portfolio of the Principal Investments. The Fund may invest its remaining assets exclusively in: (i) U.S. or foreign exchange-listed or OTC convertible fixed income securities; and (ii) OTC Derivatives and Exchange-Traded Derivatives that do not satisfy the Fund’s primary uses for derivatives, which

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<sup>22</sup> According to the Exchange, the Fund may enter into a forward roll transaction (also referred to as a mortgage dollar roll) with the intention of entering into an offsetting transaction whereby, rather than accepting delivery of the security on the specified date, the Fund sells the security and agrees to repurchase a similar security at a later time.

are to (A) provide exposure to such U.S. or foreign fixed income securities, Debt and other Principal Investments, (B) risk manage the Fund's holdings, and (C) enhance returns.

C. Investment Restrictions

According to the Exchange, the Fund may invest up to 30% of its assets in Non-Convertible Preferred Securities, Equity-Related Warrants, and Work Out Securities. The Fund will not invest in equity securities other than Principal Investment Equities. Principal Investment Equities consist of (i) Non-Convertible Preferred Securities, Equity-Related Warrants, and Work Out Securities, which are limited to 30% of the Fund's assets in the aggregate, and (ii) shares of ETFs that provide exposure to fixed income securities, Debt, or other Principal Investments, which are subject to no limits.

The Exchange states that while the Fund will invest principally in fixed income securities and Debt that are, at the time of purchase, investment grade, the Fund may invest up to 30% of its net assets in below investment grade fixed income securities and Debt. For these purposes, "investment grade" is defined as investments with a rating at the time of purchase in one of the four highest rating categories of at least one nationally recognized statistical ratings organization ("NRSRO").<sup>23</sup>

According to the Exchange, the Fund may invest in fixed income securities, equity securities, or Debt issued by both U.S. and non-U.S. issuers (including issuers in emerging markets). However, the Fund will not invest: (i) more than 30% of its total assets directly in fixed income securities, equity securities, or Debt of non-U.S. issuers; or (ii) more than 25% of

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<sup>23</sup> The Exchange states that unrated fixed income securities or Debt may be considered investment grade if, at the time of purchase, and under Normal Market Conditions, the applicable Sub-Adviser determines that such securities are of comparable quality based on a fundamental credit analysis of the unrated security or Debt instrument and comparable NRSRO-rated securities.

its total assets directly in non-U.S. dollar denominated fixed income securities, equity securities, or Debt.<sup>24</sup>

The Exchange states that the Fund may invest a substantial portion of its net assets in ABS and MBS. However, the Fund will not invest more than 30% of the fixed income portion of the Fund's portfolio in non-agency, non-GSE, and privately-issued mortgage-related and other asset-backed securities ("Private ABS/MBS").

According to the Exchange, the Fund may not concentrate its investments (i.e., invest more than 25% of the value of its total assets) in securities of issuers in any one industry. The Exchange states that this restriction will be interpreted to permit investment without limit in the following: obligations issued or guaranteed by the U.S. government, its agencies or instrumentalities; securities of state, territory, possession, or municipal governments and their authorities, agencies, instrumentalities, or political subdivisions; and repurchase agreements collateralized by any such obligations.

In addition, the Exchange states that 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 Manager or the Sub-Advisers.<sup>25</sup> The Fund will monitor its

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<sup>24</sup> The Exchange states that, for purposes of these concentration limits only, derivatives, warrants, and ETFs traded on U.S. exchanges that provide indirect exposure to fixed income securities, equity securities, or Debt (as applicable) of non-U.S. issuers or to fixed income securities, equity securities, or Debt (as applicable) denominated in currencies other than U.S. dollars will not be counted in calculating the Fund's holdings in non-U.S. issuers or in non-U.S. dollar denominated securities or Debt.

<sup>25</sup> In reaching liquidity decisions, the Manager or Sub-Advisers (as applicable) 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).

portfolio liquidity on an ongoing basis to determine whether, in light of current circumstances, an adequate level of liquidity is being maintained and will consider taking appropriate steps in order to maintain adequate liquidity if, through a change in values, net assets, or other circumstances, more than 15% of the Fund's net assets are held in illiquid securities or other illiquid assets.

According to the Exchange, the Fund's investments in derivatives will be consistent with the Fund's investment objective and will not be used for the purpose of seeking leveraged returns or performance that is the multiple or inverse multiple of a benchmark (although derivatives have embedded leverage). Although the Fund will be permitted to borrow as permitted under the 1940 Act, it will not be operated as a "leveraged ETF," (i.e., it will not be operated in a manner designed to seek a multiple or inverse multiple of the performance of an underlying reference index).

The Exchange states that under Normal Market Conditions, the Fund will satisfy the following requirements, on a continuous basis measured at the time of purchase: (i) component securities that in the aggregate account for at least 75% of the fixed income weight of the Fund's portfolio each will have a minimum original principal amount outstanding of \$100 million or more; (ii) no fixed income security held in the portfolio (excluding Treasury Securities and GSE Securities)<sup>26</sup> will represent more than 30% of the fixed income weight of the Fund's portfolio, and the five most heavily weighted portfolio securities (excluding Treasury Securities and GSE Securities) will not in the aggregate account for more than 65% of the fixed income weight of the Fund's portfolio; (iii) the Fund's portfolio (excluding exempted securities) will include a minimum of 13 non-affiliated issuers; (iv) at least 75% of the investments in securities issued by

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<sup>26</sup> The terms "Treasury Securities" and "GSE Securities" as used herein have the meanings set forth in Nasdaq Rule 5735(b)(1)(B).

emerging market issuers will have a minimum original principal amount outstanding of \$200 million or more; and (v) at least 75% of investments in bank loans or corporate loan assets<sup>27</sup> will be in senior loans with an initial deal size of \$100 million or greater.

D. Application of Generic Listing Requirements

The Exchange states that it submitted the proposed rule change because the Fund will not meet all of the “generic” listing requirements of Nasdaq Rule 5735(b)(1). The Exchange states that the Fund will meet all such requirements except those described below,<sup>28</sup> and the Exchange has proposed that the Fund will comply with certain alternative limits described below.

- (i) The Fund will not comply with the requirements in Nasdaq Rule 5735(b)(1) to use the aggregate gross notional value of derivatives when calculating the weight of such derivatives or the exposure that such derivatives provide to underlying reference assets, including the requirements in Rules 5735(b)(1)(D)(i) and (ii),<sup>29</sup>

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<sup>27</sup> These include senior loans, syndicated bank loans, junior loans, bridge loans, unfunded commitments, revolvers, and participation interests.

<sup>28</sup> The Exchange notes that the Fund will comply with the applicable requirements of Nasdaq Rule 5735(b)(1) with respect to all commercial paper held by the Fund. In addition, in accordance with Nasdaq Rule 5735(b)(1)(B), to the extent that the Fund holds securities that convert into fixed income securities, the fixed income securities into which any such securities are converted will meet the criteria of Nasdaq Rule 5735(b)(1)(B) after converting.

<sup>29</sup> Rules 5735(b)(1)(D)(i) and (ii) impose certain limitations on investments in listed derivatives, and require that, for purposes of calculating such limitations, a portfolio's investment in listed derivatives will be calculated as the aggregate gross notional value of the listed derivatives.

5735(b)(1)(E),<sup>30</sup> and 5735(b)(1)(F).<sup>31</sup> Instead, the Exchange proposed that for the purposes of any applicable requirements under Nasdaq Rule 5735(b)(1), and any alternative requirements proposed by the Exchange, the Fund will use the mark-to-market value or exposure of its derivatives in calculating the weight of such derivatives or the exposure that such derivatives provide to their reference assets.

- (ii) The Fund will not comply with the requirement in Nasdaq Rule 5735(b)(1)(B)(v) that Private ABS/MBS in the Fund's portfolio account, in the aggregate, for no more than 20% of the weight of the fixed income portion of the Fund's portfolio. Instead, the Exchange proposed that the Fund will limit its holdings in Private ABS/MBS to no more than 30% of the weight of the fixed income portion of the Fund's portfolio. The Exchange states that, for purposes of this requirement, the weight of the Fund's exposure to Private ABS/MBS referenced indirectly through investments in derivatives held by the Fund will be calculated based on the mark-to-market value or exposure of such derivatives.
- (iii) The Fund will not comply with the requirement in Nasdaq Rule 5735(b)(1)(B)(iv) that component securities that in aggregate account for at least 90% of the fixed income weight of the portfolio must be either: (a) from issuers that are required

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<sup>30</sup> Rule 5735(b)(1)(E) imposes a 20% limitation on investments in OTC derivatives and requires that, for purposes of calculating such limitation, a portfolio's investments in OTC derivatives will be calculated as the aggregate gross notional value of the OTC derivatives.

<sup>31</sup> Rule 5735(b)(1)(F) requires that, to the extent listed or OTC derivatives are used to gain exposure to individual equities and/or fixed income securities, or to indexes of equities and/or indexes of fixed income securities, the aggregate gross notional value of such exposure shall meet the criteria set forth in Rule 5735(b)(1)(A) (which contains generic listing standards for the equity components of the portfolio) and 5735(b)(1)(B) (which contains generic listing standards for the fixed income components of the portfolio), respectively.

to file reports pursuant to Sections 13 and 15(d) of the Act; (b) from issuers that have a worldwide market value of its outstanding common equity held by non-affiliates of \$700 million or more; (c) from issuers that have 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. Instead, the Exchange proposed that the fixed income portion of the portfolio other than Private ABS/MBS will comply with the 90% requirement in Rule 5735(b)(1)(B)(iv), and that Private ABS/MBS held by the Fund will not comply with such requirement. The Exchange states that, for purposes of this requirement, the weight of the Fund's exposure to any fixed income securities referenced in derivatives held by the Fund will be calculated based on the mark-to-market value or exposure of such derivatives.

- (iv) The Fund will not comply with the requirements in Nasdaq Rule 5735(b)(1)(A)<sup>32</sup> with respect to the Fund's investments in Non-Convertible Preferred Securities,

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<sup>32</sup> Rule 5735(b)(1)(A)(i) requires that U.S. Component Stocks (as such term is defined in Nasdaq Rule 5705) of the equity portion of the portfolio meet the following criteria initially and on a continuing basis (subject to certain exclusions for Exchange Traded Derivative Securities and Linked Securities, as such terms are defined in Nasdaq Rules 5735(c)(6) and 5710, respectively): (a) component stocks that in the aggregate account for at least 90% of the equity weight of the portfolio each shall have a minimum market value of at least \$75 million; (b) component stocks that in the aggregate account for at least 70% of the equity weight of the portfolio 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 last six months; (c) the most heavily weighted component stock shall not exceed 30% of the equity weight of the portfolio, and, to the extent applicable, the five most heavily weighted component stocks shall not exceed 65% of the

Work Out Securities, and Equity-Related Warrants. Instead, the Exchange proposed that (a) the Fund's investments in equity securities other than Non-Convertible Preferred Securities, Work Out Securities, and Equity-Related Warrants will comply with the requirements in Nasdaq Rule 5735(b)(1)(A);<sup>33</sup> and (b) the aggregate weight of the Fund's investments in Non-Convertible Preferred Securities, Work Out Securities, and Equity-Related Warrants will not exceed 30% of the Fund's net assets.

- (v) The Fund will not comply with the requirement in Nasdaq Rule 5735(b)(1)(E) that, on both an initial and continuing basis, no more than 20% of the assets in the Fund's portfolio may be invested in over-the-counter derivatives. Instead, the

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equity weight of the portfolio; (d) 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; and (e) except for non-exchange traded American Depositary Receipts (which may consist of up to 10% of the equity weight of the portfolio), equity securities in the portfolio shall be U.S. Component Stocks listed on a national securities exchange and shall be NMS Stocks as defined in Rule 600 of Regulation NMS under the Act. Further, Rule 5735(b)(1)(A)(ii) requires that Non-U.S. Component Stocks (as such term is defined in Nasdaq Rule 5705) of the equity portion of the portfolio meet the following criteria initially and on a continuing basis: (a) Non-U.S. Component Stocks each shall have a minimum market value of at least \$100 million; (b) 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; (c) 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; (d) 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 (subject to certain exclusions for Exchange Traded Derivative Securities and Linked Securities); and (e) each Non-U.S. Component Stock shall be listed and traded on an exchange that has last-sale reporting.

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According to the Exchange, the other equity securities that the Fund will invest in will consist of ETFs (including money market ETFs) that provide exposure to fixed income securities, Debt, and other Principal Investments, and the weight of such ETFs in the Fund's portfolio will not be limited.

Exchange proposed that: (a) there be no limit on the Fund's investments in "Interest Rate Derivatives"<sup>34</sup> and "Currency Derivatives"<sup>35</sup> entered into with broker-dealers, banks, and other financial intermediaries; and (b) the aggregate weight of the Fund's investments in all other OTC Derivatives (excluding Interest Rate Derivatives and Currency Derivatives) will not exceed 10% of the Fund's net assets (calculated based on the mark-to-market value or exposure of such other OTC Derivatives).

- (vi) The Fund will not comply with the requirement in Nasdaq Rule 5735(b)(1)(D)(i) that, in the aggregate, at least 90% of the weight of the Fund's holdings in futures, exchange-traded options, and listed swaps shall, 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 of the ISG, or for which the principal market is a market with which the Exchange has a comprehensive surveillance sharing agreement. Instead, the Exchange proposed that no more than 10% of the net assets of the Fund will be invested in Exchange-Traded Derivatives whose principal market is not a member of ISG or is a market with which the Exchange does not have a comprehensive surveillance sharing agreement. The Exchange states that, for purposes of this 10% limit, the weight

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<sup>34</sup> The Exchange states that "Interest Rate Derivatives" are comprised of interest rate swaps, swaptions (*i.e.*, options on interest rate swaps), rate options, and other similar derivatives, and may be Exchange-Traded Derivatives or OTC Derivatives.

<sup>35</sup> The Exchange states that "Currency Derivatives" are comprised of deliverable and non-deliverable currency forwards, swaps and options on currencies, and similar currency or foreign exchange derivatives, and may be Exchange-Traded Derivatives or OTC Derivatives.

of such Exchange-Traded Derivatives will be calculated based on the mark-to-market value or exposure of such Exchange-Traded Derivatives.

- (vii) The Fund will not comply with the requirement in Nasdaq Rule 5735(b)(1)(D)(ii) that 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 Fund's 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 Fund's portfolio (including gross notional exposures). Instead, the Exchange proposed that (a) the Fund's investments in futures and options contracts (including options on futures) referencing Eurodollars and sovereign debt issued by the United States (i.e., Treasury Securities) and other "Group of Seven" countries<sup>36</sup> that are listed on an exchange that is an ISG member or an exchange with which the Exchange has a comprehensive surveillance sharing agreement ("Eurodollar and G-7 Sovereign Futures and Options") will not be subject to the requirements in Nasdaq Rule 5735(b)(1)(D)(ii); and (b) the Fund's investments in Exchange-Traded Derivatives other than Eurodollar and G-7 Sovereign Futures and Options will comply with the concentration requirements in Nasdaq Rule 5735(b)(1)(D)(ii) (for purposes of this requirement, the weight of the applicable Exchange-Traded Derivatives will be calculated based on the mark-to-market value or exposure of such Exchange-Traded Derivatives).

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<sup>36</sup> The "Group of Seven" (or "G-7") countries consist of the United States, Canada, France, Germany, Italy, Japan, and the United Kingdom.

II. Proceedings to Determine Whether to Approve or Disapprove SR-NASDAQ-2017-128 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act<sup>37</sup> to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described below, the Commission seeks and encourages interested persons to provide comments on the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,<sup>38</sup> the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting 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, ...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."<sup>39</sup>

III. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written

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<sup>37</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>38</sup> Id.

<sup>39</sup> 15 U.S.C. 78f(b)(5).

views of interested persons concerning whether the proposal is consistent with Section 6(b)(5) or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.<sup>40</sup>

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register]. The Commission asks that commenters address the sufficiency of the Exchange's statements in support of the proposal, which are set forth in the Notice,<sup>41</sup> in addition to any other comments they may wish to submit about the proposed rule change. Specifically, the Commission seeks comment on the statements of the Exchange contained in the Notice and any other issues raised by the proposed rule change.

In this regard, the Commission specifically seeks comment on the proposed cutoff time for redemption requests and creation orders. In the Notice, the Exchange states that all redemption requests and creation orders for creation units of the Fund must be received by the Distributor within one hour after the closing time of the regular trading session on the Exchange (ordinarily between 4:00 p.m., E.T. and 5:00 p.m., E.T.) in order to receive the net asset value

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<sup>40</sup> Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

<sup>41</sup> See Notice supra note 3.

(“NAV”) on the next business day immediately following the date the order was placed.<sup>42</sup> The Exchange also states that the Fund will cause to be published, through the National Securities Clearing Corporation, on each business day, prior to the opening of trading on the Exchange (currently, 9:30 a.m., E.T.), the identity and the required number (as applicable) of deposit/redemption securities and the amount of cash applicable to creation orders and redemption requests received in proper form.<sup>43</sup> Based on this description, the Commission notes that market participants that submit redemption requests or creation orders on a given business day will not know the contents of the deposit/redemption securities that will be applicable to their request until the following business day and will receive the following business day’s NAV. Accordingly, the Commission seeks comment on how the proposed cutoff time for redemption requests and creation orders would affect the opportunity for an effective and efficient arbitrage process and whether the proposed cutoff time is consistent with the maintenance of fair and orderly markets and the requirements of Section 6(b)(5) of the Act.

In addition, the Commission specifically seeks comment on whether the proposed portfolio composition, including the limitations thereon, is sufficient to support a determination that the proposal is consistent with the Act. For example, as discussed above, the Exchange notes that the Fund will not meet the requirement in Nasdaq Rule 5735(b)(1)(B)(v) that Private ABS/MBS, in the aggregate, account for no more than 20% of the weight of the fixed income portion of the Fund’s portfolio. Instead, the Exchange proposes to limit the Fund’s investments in Private ABS/MBS to 30% of the weight of the fixed income portion of its portfolio. In addition, the Exchange states that the Fund’s investments in Non-Convertible Preferred

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<sup>42</sup> See Notice, supra note 3, at 1072.

<sup>43</sup> See id.

Securities, Work Out Securities, and Equity-Related Warrants, which may constitute up to 30% of the Fund's net assets, will not comply with the generic listing requirements for portfolio investments in equity securities set forth in Nasdaq Rule 5735(b)(1)(A). The Commission seeks commenters' views on these aspects of the proposal, and whether the Exchange's statements and representations support a determination that the listing and trading of the Shares would be consistent with Section 6(b)(5) of the Act.

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2017-128 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NASDAQ-2017-128. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F

Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASDAQ-2017-128 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>44</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>44</sup> 17 CFR 200.30-3(a)(57).