



8011-01

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-80802; File No. SR-NASDAQ-2017-038]

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change Relating to the First Trust Municipal High Income ETF

May 26, 2017

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹, and Rule 19b-4 thereunder,² notice is hereby given that on May 16, 2017, The NASDAQ Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

Exchange’s proposed rule change relating to the First Trust Municipal High Income ETF (the “Fund”) of First Trust Exchange-Traded Fund III (the “Trust”), the shares of which have been approved by the Commission for listing and trading under Nasdaq Rule 5735 (“Managed Fund Shares”). The shares of the Fund are collectively referred to herein as the “Shares.”

The text of the proposed rule change is available on the Exchange’s Website at <http://nasdaq.cchwallstreet.com>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Commission has approved the listing and trading of Shares under Nasdaq Rule 5735, which governs the listing and trading of Managed Fund Shares on the Exchange.³ However, no Shares are currently listed and traded on the Exchange. The Exchange believes the proposed rule change reflects no significant issues not previously addressed in the Prior Release.

The Fund is an actively-managed exchange-traded fund ("ETF"). The Shares will be offered by the Trust, which was established as a Massachusetts business trust on January 9, 2008. The Trust, which is registered with the Commission as an investment company under the Investment Company Act of 1940 (the "1940 Act"), has filed a registration statement on Form N-1A ("Registration Statement") relating to the Fund with the Commission.⁴ The Fund is a series of the Trust.

³ The Commission approved Nasdaq Rule 5735 in Securities Exchange Act Release No. 57962 (June 13, 2008), 73 FR 35175 (June 20, 2008) (SR-NASDAQ-2008-039). The Commission previously approved the listing and trading of the Shares of the Fund. See Securities Exchange Act Release No. 78913 (September 23, 2016), 81 FR 69109 (October 5, 2016) (SR-NASDAQ-2016-002) ("Prior Release").

⁴ See Post-Effective Amendment No. 27 to Registration Statement on Form N-1A for the Trust, dated August 31, 2015 (File Nos. 333-176976 and 811-22245). The descriptions

The primary purpose of this proposed rule change is to modify certain representations set forth in the Prior Release. Since the Prior Release, in evaluating its ability to construct a portfolio that would both enable the Fund to pursue its investment objectives effectively and satisfy the representations set forth in the Prior Release, the Adviser determined that, based on certain factors, including regulatory and market developments with portfolio management implications, additional flexibility would be needed to launch and operate the Fund. In particular, in October 2016, the Commission adopted a new rule (i.e., Rule 22e-4 under the 1940 Act, referred to as the “Liquidity Rule”) that will generally require ETFs (as well as mutual funds) to establish liquidity risk management programs that include a number of specified elements and may significantly impact funds’ investment activities.⁵ Among other things, funds will generally be required to (a) assess, manage and periodically review their liquidity risk;⁶ (b) classify each of their portfolio investments into one of four liquidity categories based on the

of the Fund and the Shares contained herein are based, in part, on information in the Registration Statement. Before Shares are publicly offered, the Trust will file a post-effective amendment to its Registration Statement. The changes in this proposed rule change will not be implemented for the Fund until the post-effective amendment to the Registration Statement becomes effective. First Trust Advisors L.P. (the “Adviser”) represents that the Adviser will not implement the changes described herein until the instant proposed rule change is operative.

⁵ See Investment Company Act Release No. 32315 (October 13, 2016), 81 FR 82142 (November 18, 2016). Funds (except for smaller entities) will generally be required to comply with the liquidity risk management program requirements by December 1, 2018. Although funds that qualify as “in-kind ETFs” will be exempt from certain of the Liquidity Rule’s requirements, as noted in the Prior Release, the Fund is typically expected to effect creations and redemptions on a cash basis.

⁶ “Liquidity risk” means the risk that the fund could not meet requests to redeem shares issued by the fund without significant dilution of remaining investors’ interests in the fund. See Rule 22e-4(a)(11). Funds will be required to consider various factors including, for ETFs, (i) the relationship between the ETF’s portfolio liquidity and the way in which, and the prices and spreads at which, ETF shares trade, including, the efficiency of the arbitrage function and the level of active participation by market participants (including authorized participants); and (ii) the effect of the composition of baskets on the overall liquidity of the ETF’s portfolio. See Rule 22e-4(b)(1)(i)(D).

number of days in which the fund reasonably expects the investment would be convertible to cash (or sold or disposed of, as applicable) in current market conditions without significantly changing the market value of the investment (i.e., highly liquid investments, moderately liquid investments, less liquid investments, and illiquid investments); (c) determine a minimum percentage of net assets that will be invested in “highly liquid investments”⁷; and (d) limit “illiquid investments”⁸ to 15% of net assets. Additionally, the Adviser took into account that recent increases in interest rates have been accompanied by substantial outflows from mutual funds and ETFs, and that future interest rate swings may spark increased market volatility and trigger potentially dramatic inflows and outflows.⁹ To enable the Fund to operate effectively (including, in addition to pursuing its investment objectives, complying with the Liquidity Rule and responding to potential market volatility), the Adviser believes that additional portfolio management flexibility is needed and warranted. Additionally, for the reasons discussed in more detail below, the Exchange believes that the proposal is consistent with Section 6(b)(5) of the Act.

As a related matter, the Exchange notes that although the Prior Release included certain representations that were based on the generic listing standards for index-based ETFs, the

⁷ “Highly liquid investment” generally means any cash held by a fund and any investment that the fund reasonably expects to be convertible into cash in current market conditions in three business days or less without the conversion to cash significantly changing the market value of the investment. See Rule 22e-4(a)(6).

⁸ “Illiquid investment” generally means any investment that the fund reasonably expects cannot be sold or disposed of in current market conditions in seven calendar days or less without the sale or disposition significantly changing the market value of the investment. See Rule 22e-4(a)(8).

⁹ It should also be noted that the Liquidity Rule requires that in conjunction with assessing, managing and reviewing liquidity risk, a fund consider certain factors, including investment strategy and liquidity of portfolio investments during both normal and reasonably foreseeable stressed conditions. See Rule 22e-4(b)(1)(i)(A).

Exchange’s “generic listing standards” for actively-managed ETFs (the “Active ETF Generic Listing Standards”)¹⁰ were recently adopted and, with one exception, the Fund’s proposed revised representations would meet or exceed similar requirements for portfolios of fixed income securities set forth in Nasdaq Rule 5735(b)(1)(B) under the Active ETF Generic Listing Standards (“Rule 5735(b)(1)(B)”). In addition, this proposed rule change would make certain changes to the description of the Fund’s investments to achieve better consistency with the proposed new representations. Further, to provide the Adviser with greater flexibility in hedging interest rate risks associated with the Fund’s portfolio investments, this proposed rule change would expand the Fund’s ability to invest in derivatives by permitting it to invest in over-the-counter (“OTC”) forward contracts and OTC swaps, subject to a limitation that would be consistent with the limitation on investments in OTC derivatives set forth in Nasdaq Rule 5735(b)(1)(E) under the Active ETF Generic Listing Standards (“Rule 5735(b)(1)(E)”).

Changes to Representations

The Prior Release noted that the Fund would be actively managed and not tied to an index, but that under normal market conditions, on a continuous basis determined at the time of purchase, its portfolio of Municipal Securities (as defined in the Prior Release) would generally meet, as applicable, all except for two of the criteria for non-actively managed, index-based, fixed income ETFs contained in Nasdaq Rule 5705(b)(4)(A), as described therein. More specifically, the Prior Release stated that, under normal market conditions, the Fund’s portfolio of Municipal Securities would meet the requirements of: (i) Nasdaq Rule 5705(b)(4)(A)(i) (requiring that the index or portfolio consist of “Fixed Income Securities”); (ii) Nasdaq Rule 5705(b)(4)(A)(iv) (requiring that no component fixed income security (excluding Treasury

¹⁰ See Securities Exchange Act Release No. 78918 (September 23, 2016), 81 FR 67033 (September 29, 2016).

securities) represent more than 30% of the weight of the index or portfolio, and that the five highest weighted component fixed income securities do not, in the aggregate, account for more than 65% of the weight of the index or portfolio); and (iii) Nasdaq Rule 5705(b)(4)(A)(v) (requiring that an underlying index or portfolio (excluding one consisting entirely of exempted securities) include securities from a minimum of 13 non-affiliated issuers) (collectively, the “Rule 5705-Related Representations”).

Additionally, the Prior Release noted that Nasdaq Rule 5705(b)(4)(A)(iii) (relating to convertible securities) was inapplicable to the Fund’s portfolio of Municipal Securities. Further, the Prior Release provided that the Fund’s portfolio of Municipal Securities may not satisfy 5705(b)(4)(A)(vi) (requiring that component securities that in the aggregate account for at least 90% of the weight of the index or portfolio be either exempted securities or from a specified type of issuer) and that it would not generally satisfy Rule 5705(b)(4)(A)(ii) (requiring that components that in the aggregate account for at least 75% of the weight of the index or portfolio have a minimum original principal amount outstanding of \$100 million or more). However, the Prior Release stated that under normal market conditions, at least 40% (based on dollar amount invested) of the Municipal Securities in which the Fund invested would 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 \$75 million or more (the “40/75 Representation”).¹¹

¹¹ As noted in the Prior Release, the Commission has previously issued orders approving proposed rule changes relating to the listing and trading under NYSE Arca Equities Rule 5.2(j)(3), Commentary .02 (which governs the listing and trading of fixed-income index ETFs on NYSE Arca, Inc.) to various ETFs that track indexes comprised of municipal securities (including high-yield municipal index ETFs) that did not meet the analogous requirement included in Commentary .02(a)(2) to NYSE Arca Equities Rule 5.2(j)(3), but demonstrated that the portfolio of municipal securities in which the ETFs would invest would be sufficiently liquid (including Securities Exchange Act Release Nos. 75376 (July 7, 2015), 80 FR 40113 (July 13, 2015) (SR-NYSEArca-2015-18) (order approving listing

In addition to the Rule 5705-Related Representations and the 40/75 Representation, the Prior Release provided that under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows,¹² the Fund’s investments in Municipal Securities would provide exposure (based on dollar amount invested) to (a) 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) and (b) at least 15 different states (with no more than 30% of the value of the Fund’s net assets comprised of Municipal Securities that provide exposure to any single state) (collectively, the “Industry/State Representations”).

Additionally, the Prior Release stated that under normal market conditions, except for the initial

and trading of Vanguard Tax-Exempt Bond Index Fund); 71232 (January 3, 2014), 79 FR 1662 (January 9, 2014) (SR-NYSEArca-2013-118) (order approving listing and trading of Market Vectors Short High-Yield Municipal Index ETF); and 63881 (February 9, 2011), 76 FR 9065 (February 16, 2011) (SR-NYSEArca-2010-120) (order approving listing and trading of SPDR Nuveen S&P High Yield Municipal Bond ETF)). See also Securities Exchange Act Release Nos. 67985 (October 4, 2012), 77 FR 61804 (October 11, 2012) (SR-NYSEArca-2012-92) (order approving listing and trading of iShares 2018 S&P AMT-Free Municipal Series and iShares 2019 S&P AMT-Free Municipal Series); 72464 (June 25, 2014), 79 FR 37373 (July 1, 2014) (SR-NYSEArca-2014-45) (order approving continued listing and trading of PowerShares Insured California Municipal Bond Portfolio, PowerShares Insured National Municipal Bond Portfolio and PowerShares Insured New York Municipal Bond Portfolio); 72523 (July 2, 2014), 79 FR 39016 (July 9, 2014) (SR-NYSEArca-2014-37) (order approving listing and trading of iShares 2020 S&P AMT-Free Municipal Series); 75468 (July 16, 2015), 80 FR 43500 (July 22, 2015) (SR-NYSEArca-2015-25) (order approving listing and trading of iShares iBonds Dec 2021 AMT-Free Muni Bond ETF and iShares iBonds Dec 2022 AMT-Free Muni Bond ETF); 78329 (July 14, 2016), 81 FR 47217 (July 20, 2016) (SR-BatsBZX-2016-01) (order approving listing and trading of VanEck Vectors AMT-Free 6-8 Year Municipal Index ETF, VanEck Vectors AMT-Free 8-12 Year Municipal Index ETF, and VanEck Vectors AMT-Free 12-17 Year Municipal Index ETF); and 79885 (January 26, 2017), 82 FR 8963 (February 1, 2017) (SR-NYSEArca-2016-100) (order approving listing and trading of Direxion Daily Municipal Bond Taxable Bear 1X Fund).

¹² As described in the Prior Release, the term “initial invest-up period” means the six-week period following the commencement of trading of Shares on the Exchange and the term “periods of high cash inflows or outflows” means 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.

invest-up period and periods of high cash inflows or outflows, (a) with respect to 75% of the Fund's net assets, the Fund's exposure to any single borrower (based on dollar amount invested) would not exceed 3% of the value of the Fund's net assets and (b) with respect to 15% of the Fund's net assets, the Fund's exposure to any single borrower (based on dollar amount invested) would not exceed 5% of the value of the Fund's net assets (collectively, the "Borrower Exposure Representations").

The Prior Release also provided that under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows, (a) with respect to the Municipal Securities in which the Fund invested that were rated investment grade by each nationally recognized statistical rating organization ("NRSRO") rating such securities, at the time of purchase, the applicable borrower would be obligated to pay debt service on issues of municipal obligations that have an aggregate principal amount outstanding of \$100 million or more and (b) with respect to all other Municipal Securities in which the Fund invested (referred to as "Clause B Munis"), at the time of purchase of a Clause B Muni, the borrowers of all Clause B Munis held by the Fund, in the aggregate, would have a weighted average of principal municipal debt outstanding of \$50 million or more (collectively, the "Borrower Debt Representations" and, together with the Borrower Exposure Representations, the Industry/State Representations, the 40/75 Representation and the Rule 5705-Related Representations, the "Prior Representations").

As indicated above, the Adviser has reconsidered the Prior Representations and concluded that additional flexibility will be needed to launch and operate the Fund. As a result, in this proposed rule change, the Exchange is proposing that, going forward: (a) the Prior Representations, except for the Industry/State Representations, would be deleted and (b) the

representations included in the next two paragraphs (referred to as the “New Representations”) would be added. Further, the Exchange notes that the New Representations have been designed to correspond to the requirements of Rule 5735(b)(1)(B), as these are more readily adapted to the Fund (as an actively-managed ETF) than the generic listing standards for index-based ETFs upon which the Rule 5705-Related Representations were based.

Although as described below, certain of the New Representations would meet or exceed similar requirements set forth in Rule 5735(b)(1)(B), it is not anticipated that the Fund would 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 (the “Generic 100 Requirement”).¹³ In general terms, the Fund would operate as an actively-managed ETF that normally invests in a portfolio of Municipal Securities (as defined in the Prior Release, with the modification described below). The Adviser notes that debt issuance sizes for municipal obligations are generally smaller than for corporate obligations.¹⁴ Furthermore, as a general matter, municipal borrowers in certain industries in which the Fund currently intends to invest significantly¹⁵ tend to have less outstanding debt than municipal borrowers in other municipal industries. Therefore, under normal market conditions,

¹³ See Nasdaq Rule 5735(b)(1)(B)(i).

¹⁴ As indicated above in note 11, various ETFs seeking to track indexes comprised of municipal securities have previously sought and obtained approval by the Commission of proposed rule changes because they would not meet the requirement under the applicable generic listing standards that is similar to the Generic 100 Requirement.

¹⁵ These industries include charter schools, senior living facilities (i.e., continuing care retirement communities (“CCRCs”)) and special tax districts, among others. As noted in the Prior Release, 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 (the “conduit borrower”)), the “borrower” is the conduit borrower (i.e., the party on which a bondholder must rely for repayment) and in the case of other municipal financings, the “borrower” is the issuer of the municipal securities.

except for the initial invest-up period and periods of high cash inflows or outflows,¹⁶ at least 40% (based on dollar amount invested) of the Municipal Securities in which the Fund invests¹⁷ would 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 (the “40/50 Representation”). Based on its expertise and understanding of the municipal securities market and the manner in which municipal securities generally trade, the Adviser believes that, notwithstanding both the previous more stringent 40/75 Representation and the Generic 100 Requirement, the 40/50 Representation is appropriate in light of the Fund’s investment objectives and the manner in which the Fund intends to pursue them.¹⁸ Given the nature of the municipal securities market and the manner in which municipal securities generally trade, the expected availability of Municipal Securities that would satisfy the Fund’s investment parameters, and the debt issuance profiles of the corresponding issuers and borrowers, the 40/50 Representation should both provide the Fund with flexibility to construct its portfolio and, when

¹⁶ See note 12 regarding the meaning of the terms “initial invest-up period” and “periods of high cash inflows or outflows.”

¹⁷ For the avoidance of doubt, in the case of Municipal Securities that are issued by entities whose underlying assets are municipal bonds (“Municipal Entities”), the underlying municipal bonds would be taken into account.

¹⁸ The Adviser notes that individual issues of municipal securities represented by CUSIPs (i.e., the specific identifying numbers for securities) may be placed into categories according to common characteristics (such as rating, geographical region, purpose, and maturity). Municipal securities that share similar characteristics generally tend to trade similarly to one another; therefore, within these categories, issues may be considered somewhat fungible from a portfolio management perspective, allowing one CUSIP to be represented by another that shares similar characteristics for purposes of developing an investment strategy. Moreover, when municipal securities are close substitutes for one another, pricing vendors may be able to use executed trade information from similar municipal securities as pricing inputs for an individual security. This can make individual securities more liquid because valuations for a single security are generally better estimators of actual trading prices when they are informed by trades in a large group of closely related securities.

combined with the Industry/State Representations and the other New Representations included 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, as applicable, the requirements set forth in Rule 5735(b)(1)(B)), should support the potential for diversity and liquidity, thereby mitigating the Commission's concerns about manipulation.¹⁹

Under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows,²⁰ no component fixed income security (excluding the U.S. government securities described under the heading "Other Investments" in the Prior Release) would 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) would not, in the aggregate, account for more than 25% of the Fund's net assets.²¹

¹⁹ The Exchange notes that, in addition to approving the Fund in the Prior Release, the Commission has also approved for listing and trading shares of other actively-managed ETFs that principally hold municipal securities. See, e.g., Securities Exchange Act Release Nos. 60981 (November 10, 2009), 74 FR 59594 (November 18, 2009) (SR-NYSEArca-2009-79) (order approving listing and trading of PIMCO Short Term Municipal Bond Strategy Fund and PIMCO Intermediate Municipal Bond Strategy Fund); 71617 (February 26, 2014), 79 FR 12257 (March 4, 2014) (SR-NYSEArca-2013-135) (order approving listing and trading of db-X Managed Municipal Bond Fund); 71913 (April 9, 2014), 79 FR 21333 (April 15, 2014) (SR-NASDAQ-2014-019) (order approving listing and trading of First Trust Managed Municipal ETF); and 79293 (November 10, 2016), 81 FR 81189 (November 17, 2016) (SR-NYSEArca-2016-107) (order approving listing and trading of Cumberland Municipal Bond ETF).

²⁰ See note 12 regarding the meaning of the terms "initial invest-up period" and "periods of high cash inflows or outflows."

²¹ See the Active ETF Generic Listing Standards requirement set forth in Nasdaq Rule 5735(b)(1)(B)(ii), which provides 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. For the avoidance of doubt, in the case of Municipal Securities that are issued by Municipal Entities, the underlying municipal bonds would be taken into account.

Further, under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows,²² the Fund’s portfolio of Municipal Securities would include securities from a minimum of 30 non-affiliated issuers.²³ Moreover, under normal market conditions, except for the initial invest-up period and periods of high cash inflows or outflows,²⁴ component securities that in the aggregate account for at least 90% of the weight of the Fund’s portfolio of Municipal Securities would be exempted securities as defined in Section 3(a)(12) of the Act (the “Exempted Securities Representation”).²⁵ Additionally, to the extent the Fund invests in Municipal Securities that are mortgage-backed or asset-backed securities, such

²² See note 12 regarding the meaning of the terms “initial invest-up period” and “periods of high cash inflows or outflows.”

²³ For the avoidance of doubt, in the case of Municipal Securities that are issued by Municipal Entities, the underlying municipal bonds would be taken into account. Additionally, for purposes of this restriction, each state and each separate political subdivision, agency, authority, or instrumentality of such state, each multi-state agency or authority, and each guarantor, if any, would be treated as separate, non-affiliated issuers of Municipal Securities. The Active ETF Generic Listing Standards requirement set forth in Nasdaq Rule 5735(b)(1)(B)(iii) provides that generally, an underlying portfolio (excluding exempted securities) that includes fixed income securities must include a minimum of 13 non-affiliated issuers. Although not required, if the Fund’s portfolio of Municipal Securities is comprised entirely of securities that meet the definition of “municipal securities” set forth in Section 3(a)(29) of the Act, then such portfolio would also be comprised entirely of “exempted securities” as defined in Section 3(a)(12) of the Act and, therefore, the requirements of Rule 5735(b)(1)(B)(iii) would not pertain to such portfolio; see the Exempted Securities Representation below (which refers to 90% of the weight of the Fund’s portfolio of Municipal Securities).

²⁴ See note 12 regarding the meaning of the terms “initial invest-up period” and “periods of high cash inflows or outflows.”

²⁵ See the Active ETF 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 would be taken into account.

investments would not account, in the aggregate, for more than 20% of the weight of the fixed income portion of the Fund’s portfolio.²⁶

The New Representations differ from the Prior Representations and do not, in certain respects, comply with Rule 5735(b)(1)(B) (particularly with respect to the Generic 100 Requirement). However, taking into account the nature of the municipal securities market and the manner in which municipal securities generally trade, in light of the requirements that the New Representations and the Industry/State Representations would impose (e.g., concerning municipal debt outstanding, fixed income securities weightings, issuer diversification, the nature of the securities in which the Fund would invest (including representations relating to exempted securities and mortgage-backed and asset-backed securities), and exposure to industries and states), they should provide support regarding the anticipated diversity and liquidity of the Fund’s Municipal Securities portfolio and should mitigate the risks associated with manipulation, while also providing the Adviser with the necessary flexibility to operate the Fund as intended.

Changes to Description of Certain Fund Investments

The Prior Release stated that under normal market conditions, the Fund would seek to achieve its investment objectives by investing at least 80% of its net assets (including investment borrowings) in municipal debt securities that pay interest that is exempt from regular federal income taxes which are “exempted securities” under Section 3(a)(12) of the Act (collectively, “Municipal Securities”). In light of the Exempted Securities Representation, going forward, the Exchange proposes to revise the foregoing by deleting the phrase “which are ‘exempted securities’ under Section 3(a)(12) of the Act.” In addition, the Prior Release stated that the Fund “may invest up to 20% of its net assets in short-term debt instruments . . . , taxable municipal

²⁶ See the Active ETF Generic Listing Standards requirement set forth in Nasdaq Rule 5735(b)(1)(B)(v).

securities or tax-exempt municipal securities that are not exempted securities under Section 3(a)(12) under the Act, or it may hold cash.” Going forward, the Exchange proposes to revise the foregoing by replacing the phrase “taxable municipal securities or tax-exempt municipal securities that are not exempted securities under Section 3(a)(12) under the Act,” with the phrase “and taxable municipal securities and other municipal securities that are not Municipal Securities,”.

Additionally, the Prior Release stated that under normal market conditions, the Fund would invest at least 65% of its net assets in Municipal Securities that are, at the time of investment, rated below investment grade (i.e., not rated Baa3/BBB- or above) by at least one NRSRO rating such securities (or Municipal Securities that are unrated and determined by the Adviser to be of comparable quality) (the “65% Requirement”). The Prior Release also provided that the Fund could invest up to 35% of its net assets in “investment grade” Municipal Securities (meaning Municipal Securities that are, at the time of investment, rated investment grade (i.e., rated Baa3/BBB- or above) by each NRSRO rating such securities (or Municipal Securities that are unrated and determined by the Adviser to be of comparable quality)) (the “35% Limitation”). Going forward, for consistency with various other representations, the Exchange proposes to modify the beginning of the 65% Requirement by replacing the phrase “Under normal market conditions, the Fund will invest at least 65% of its net assets” with the following: “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 65% of its net assets”.²⁷ Similarly the Exchange proposes to modify the beginning of the 35% Limitation by replacing the phrase “The Fund may invest up to 35% of its net assets” with the following: “Under normal market conditions, except for the

²⁷ See note 12 regarding the meaning of the terms “initial invest-up period” and “periods of high cash inflows or outflows.”

initial invest-up period and periods of high cash inflows or outflows, the Fund may not invest more than 35% of its net assets”.²⁸

Changes to Expand Permitted Derivatives Investments

As described in the Prior Release, 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, the “Listed Derivatives”) and (ii) acquire short positions in the Listed Derivatives. No changes are being proposed with respect to the Fund’s investments in the Listed Derivatives. Going forward, however, the Exchange proposes that the Fund’s ability to invest in derivatives would be expanded to permit it to also invest in OTC forward contracts and OTC swaps (collectively, the “OTC Derivatives”) to hedge interest rate risks associated with the Fund’s portfolio investments.

On both an initial and continuing basis, no more than 20% of the assets in the Fund’s portfolio would be invested in the OTC Derivatives and, for purposes of calculating this limitation, the Fund’s investment in the OTC Derivatives would be calculated as the aggregate gross notional value of the OTC Derivatives.²⁹ The Fund would only enter into transactions in the OTC Derivatives with counterparties that the Adviser reasonably believes are capable of performing under the applicable contract or agreement.³⁰ The Fund’s investments in both Listed

²⁸

Id.

²⁹

This limitation is consistent with the limitation set forth in Rule 5735(b)(1)(E).

³⁰

The Fund would 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 would evaluate the creditworthiness of counterparties on an ongoing basis. In addition to information provided by credit agencies, the Adviser’s analysis would 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.

Derivatives and OTC Derivatives would be consistent with the Fund's investment objectives and the 1940 Act and would not be used to seek to achieve a multiple or inverse multiple of an index.

The OTC Derivatives would typically be valued using information provided by a Pricing Service (as defined in the Prior Release). Pricing information for the OTC Derivatives would be available from major broker-dealer firms and/or major market data vendors and/or Pricing Services (as defined in the Prior Release).

The Adviser represents that there would be no change to the Fund's investment objectives. Except as provided herein, all other facts presented and representations made in the Prior Release would remain unchanged. The Fund and the Shares would comply with all initial and continued listing requirements under Nasdaq Rule 5735.

2. Statutory Basis

Nasdaq believes that the proposal is consistent with Section 6(b) of the Act in general and Section 6(b)(5) of the Act, in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest. Except as provided herein, all other facts presented and representations made in the Prior Release would remain unchanged. The Fund would comply with all the initial and continued listing requirements under Nasdaq Rule 5735.

The Exchange believes that the proposed rule change is designed to prevent fraudulent and manipulative acts and practices in that the Shares would be listed and traded on the Exchange pursuant to the initial and continued listing criteria in Nasdaq Rule 5735 and, except as provided herein, all other facts presented and representations made in the Prior Release would remain unchanged. The Exchange notes that Shares have not yet been listed on the Exchange.

Consistent with the Prior Release, the Exchange represents that trading in the Shares would be subject to the existing trading surveillances, administered by both Nasdaq and also the Financial Industry Regulatory Authority (“FINRA”), on behalf of the Exchange, which are designed to detect violations of Exchange rules and applicable federal securities laws.

The proposed rule change is designed to promote just and equitable principles of trade and to protect investors and the public interest in that the Adviser represents that taking into account the nature of the municipal securities market and the manner in which municipal securities generally trade, in light of the requirements that the New Representations and the Industry/State Representations would impose (e.g., concerning municipal debt outstanding, fixed income securities weightings, issuer diversification, the nature of the securities in which the Fund would invest (including representations relating to exempted securities and mortgage-backed and asset-backed securities), and exposure to industries and states), they should provide support regarding the anticipated diversity and liquidity of the Fund’s Municipal Securities portfolio and should mitigate the risks associated with manipulation, while also providing the Adviser with the necessary flexibility to operate the Fund as intended.

With one exception, the New Representations would meet or exceed similar requirements for portfolios of fixed income securities set forth in Rule 5735(b)(1)(B). In this regard, it is not anticipated that the Fund would meet the Generic 100 Requirement. Based on its expertise and understanding of the municipal securities market and the manner in which municipal securities generally trade, the Adviser believes that, notwithstanding both the previous more stringent 40/75 Representation and the Generic 100 Requirement, the 40/50 Representation is appropriate in light of the Fund’s investment objectives and the manner in which the Fund intends to pursue them. Further, given the nature of the municipal securities market and the manner in which

municipal securities generally trade, the expected availability of Municipal Securities that would satisfy the Fund's investment parameters, and the debt issuance profiles of the corresponding issuers and borrowers, the 40/50 Representation should both provide the Fund with flexibility to construct its portfolio and, when combined with the Industry/State Representations and the other New Representations, should support the potential for diversity and liquidity, thereby mitigating the Commission's concerns about manipulation.

Further, in connection with the proposal to permit the Fund to invest in the OTC Derivatives, the Exchange notes that the ability to invest in the OTC Derivatives would provide the Adviser with additional flexibility in hedging interest rate risks associated with the Fund's portfolio investments and would be subject to a limitation that is consistent with the limitation set forth in Rule 5735(b)(1)(E). Additionally, the Fund would only enter into transactions in the OTC Derivatives with counterparties that the Adviser reasonably believes are capable of performing under the applicable contract or agreement.

In addition, a large amount of information would be publicly available regarding the Fund and the Shares, thereby promoting market transparency. Moreover, the Intraday Indicative Value (as described in the Prior Release), available on the NASDAQ OMX Information LLC proprietary index data service, would be widely disseminated by one or more major market data vendors and broadly displayed at least every 15 seconds during the Regular Market Session. On each business day, before commencement of trading in Shares in the Regular Market Session on the Exchange, the Fund would disclose on its website the Disclosed Portfolio that will form the basis for the Fund's calculation of NAV at the end of the business day.

The proposed rule change is designed to perfect the mechanism of a free and open market and, in general, to protect investors and the public interest. The Exchange notes that the Fund

does not yet have publicly offered Shares and does not yet have Shares listed and traded on the Exchange. Before Shares are publicly offered, the Trust will file a post-effective amendment to its Registration Statement. The Shares will not be publicly offered until the post-effective amendment to the Registration Statement becomes effective.

For the above reasons, Nasdaq believes the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange believes that the proposed rule change would provide the Adviser with the flexibility needed to proceed with launching the Fund, accommodating the listing and trading of Managed Fund Shares for an additional actively-managed exchange-traded product, thereby enhancing competition among market participants, to the benefit of investors and the marketplace.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will: (a) by order approve or disapprove such proposed rule change; or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with 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. Please include File Number SR-NASDAQ-2017-038 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-2017-038. 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; the

Commission does not 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-2017-038 and should be submitted on or BEFORE [INSERT DATE 21 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

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

Eduardo A. Aleman,
Assistant Secretary.

³¹ 17 CFR 200.30-3(a)(12).

