May 6, 2022

Via Electronic Mail to pubcom@finra.org

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Request for Comment on FINRA Regulatory Notice 22-08 (Complex Products and Options) (the "*22-08 Notice*")

Dear Ms. Mitchell:

First Trust Portfolios L.P. ("*First Trust*" or "*we*") appreciates the opportunity to comment on the aforementioned 22-08 Notice. We commend FINRA for its ongoing efforts to protect investors and safeguard market integrity in a manner that facilitates vibrant capital markets.

First Trust is a registered broker-dealer and FINRA member. First Trust and its affiliate, First Trust Advisors L.P. ("*FTA*"), a federally registered investment advisor, are privately-held companies that provide a variety of investment services. FTA has collective assets under management or supervision of approximately $201.7 billion as of April 29, 2022, through unit investment trusts, exchange-traded funds, closed-end funds, mutual funds and separately-managed accounts. FTA is the supervisor of the First Trust unit investment trusts, while First Trust serves as the sponsor. First Trust is also a distributor of mutual fund shares, interval fund shares, non-affiliated third-party structured products, and exchange-traded fund ("*ETF*") creation units, including $5.8 billion of defined-outcome ETFs.

While First Trust supports FINRA's focus on complex products, we believe that FINRA should reconsider the inclusion of defined-outcome ETFs as "complex products" in the 22-08 Notice for three reasons:

1. *Significant investor protections and disclosure obligations for registered funds currently exist under federal securities laws and FINRA rules;*

2. *FINRA's proposal for enhancements will limit investor choice and have unintended consequences in the marketplace that have the potential to harm investors; and*

3. *Defined-outcome ETFs should not be categorically deemed as complex products.*

I. SIGNIFICANT INVESTOR PROTECTIONS AND DISCLOSURE OBLIGATIONS FOR REGISTERED FUNDS CURRENTLY EXIST UNDER FEDERAL SECURITIES LAWS AND FINRA RULES

U.S. securities laws, regulations and financial relationships already require disclosure that is "clear, concise and understandable for an average investor." The premise of the 22-08 Notice is that "important regulatory concerns arise when investors trade complex products without understanding their unique characteristics and risks." We agree. But for defined-outcome ETFs, existing regulatory requirements and disclosure practices, if adequately monitored and enforced, sufficiently protect retail investors.

The Securities and Exchange Commission ("*SEC*") stated as far back as 2004 that its efforts to revise disclosure documents in response to the "plain English" initiative "have certainly helped by demonstrating that even the most complex structures can be described clearly and accurately."[1]

A. FINRA Guidance on Complex Products

FINRA stated in the 22-08 Notice that complex products lack a "standard definition." In the absence of a clear definition, FINRA flagged certain investments as potentially complex products and described a complex product in relation to a retail investor's ability to decipher its risks and essential characteristics:

> *A product with features that may make it difficult for a retail investor to understand the essential characteristics of the product and its risks (including the payout structure and how the product may perform in different market and economic conditions).*[2]

More than ten years prior, FINRA provided a similar description of complex products in FINRA Regulatory Notice 12-03 (the "*12-03 Notice*"):

> *Any product with multiple features that affect its investment returns differently under various scenarios is potentially complex. This is particularly true if it would be unreasonable to expect an average retail investor to discern the existence of these features and to understand the basic manner in which these features interact to produce an investment return.*[3]

From these descriptions, one can reasonably conclude that the determination as to whether a product is complex rests on whether it is unreasonable for an average retail investor to understand the essential characteristics and risks of an investment product, as well as how its investment features interact to produce an investment return.[4]

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[1] SEC Release Nos. 33-8518; 34-50905; File No. S7-21-04, December 22, 2004, at p. 105.

[2] FINRA Regulatory Notice 22-08 (Complex Products and Options) (March 2022), hereinafter, the "*22-08 Notice*."

[3] FINRA Regulatory Notice 12-03 (Complex Products, Heightened Supervision of Complex Products) (Jan. 2012), hereinafter, the "*12-03 Notice*."

[4] The 22-08 Notice reminds members that a "broker-dealer could violate the reasonable basis portion of Reg BI's Care Obligation by not fully understanding the recommended security or investment strategy, even if the security or investment strategy could have been in the best interest of at least some retail customers." Therefore, the need for the retail investor, broker-dealer and associated person to understand a complex product is vital.

In the 22-08 Notice, FINRA explains that complex products:

> *… raise a number of regulatory and investor protection concerns. For example, if a product has features or payout structures that would be confusing to retail investors, or if it performs in unexpected ways in various market or economic conditions, investors may not fully understand the attendant risks. Moreover, depending on how a complex product is structured, some may have built-in statutory protections while others may not, and this may not be clear to the investor. Although complex products do not always translate into more investment risk, their complexity may confuse investors who may not adequately understand their features.*[5]

Based on the FINRA Notices from both 2012 and 2022, one can reason that a financial product becomes "complex" when its (1) characteristics and features, (2) behave unintuitively, and therefore, (3) cannot be easily understood by the average investor.

We recognize that a complex characteristic or product feature may remain complicated, even with proper explanation by the issuer or the recommending broker-dealer. Yet, properly explaining a complex issue can significantly mitigate, if not eliminate, the risk of retail investor misunderstanding, which appears to be FINRA's fundamental concern in the 22-08 Notice.

First Trust believes that in the case of defined-outcome ETFs, this issue is resolved via existing disclosure requirements. Defined-outcome ETFs have mandated regulatory disclosures (details provided below) to which financial service providers must refer when offering or recommending these products. These disclosures are written in simple, "plain English" language, and can be relied upon to not be "confusing to investors" by nature of the fact that disclosures, by law, must be clear, concise and understandable to an average investor.

B. Disclosures Required by U.S. Securities Laws

U.S. securities laws, regulations and agencies, as well as self-regulatory organizations, currently provide significant investor protections with regard to financial products. These protections seek to prevent investors from unknowingly investing in inappropriate financial products.

As detailed below, there already exist significant protections in place, provided via (i) SEC registration; (ii) FINRA member suitability obligations, as modified by SEC Regulation Best Interest ("*Reg BI*"); and (iii) investment adviser regulation.

These bodies require disclosures to be clear, concise and understandable to an average investor, and they also require professionals recommending financial products to understand product risks and characteristics when making recommendations. Investment strategies may require varying degrees of explanation; however, the regulatory standard remains the same: they must be understandable to an average investor and in the specific retail investor's best interest. First Trust believes that with proper supervision of the registered representatives of FINRA member firms and the enforcement of member firms' existing policies, procedures and rules, no

[5] 22-08 Notice.

additional investor protections, through classification or otherwise, are necessary for defined-outcome ETFs.

1. Protections Afforded through SEC Registration

Defined-outcome ETFs register their securities on SEC Form N-1A. As such, each fund must satisfy its registration obligations under the Securities Act of 1933, as amended (the "*Securities Act*"), and the Investment Company Act of 1940, as amended (the "*1940 Act*").[6] Shares of defined-outcome ETFs are traded on an exchange; thus, they are also subject to disclosure requirements of the Securities Exchange Act of 1934, as amended (the "*Exchange Act*").[7]

While it is beyond the scope of this comment letter to discuss each of the 1940 Act's protections, registered investment companies must comply with the rules, regulations and form requirements. For example, SEC Form N-1A specifically requires simple language that discloses the fund's fundamental characteristics and investment risks for "an average or typical investor who may not be sophisticated in legal or financial matters":

> *The requirements of Form N-1A are intended to promote effective communication between the Fund and prospective investors. A Fund's prospectus should clearly disclose the fundamental characteristics and investment risks of the Fund, using concise, straightforward, and easy to understand language. A Fund should use document design techniques that promote effective communication. The prospectus should emphasize the Fund's overall investment approach and strategy.*
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> *The prospectus disclosure requirements in Form N-1A are intended to elicit information for an average or typical investor who may not be sophisticated in legal or financial matters. The prospectus should help investors to evaluate the risks of an investment and to decide whether to invest in a Fund by providing a balanced disclosure of positive and negative factors. Disclosure in the prospectus should be designed to assist an investor in comparing and contrasting the Fund with other funds.*
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> *Responses to the Items in Form N-1A should be as simple and direct as reasonably possible and should include only as much information as is necessary to enable an average or typical investor to understand the particular characteristics of the Fund. The prospectus should avoid: including lengthy legal and technical discussions; simply restating legal or regulatory requirements to which Funds generally are subject; and disproportionately emphasizing possible investments or activities of the Fund that are not a significant part of the Fund's investment operations. Brevity is especially important in describing the practices or aspects of the Fund's operations that do not differ materially from those of other investment companies. Avoid excessive detail, technical or legal terminology, and complex language. Also avoid lengthy sentences and paragraphs that may make the prospectus difficult for*

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[6] Clifford E. Kirsch, MUTUAL FUNDS AND EXCHANGE TRADED FUNDS REGULATION (Third Edition) § 4 "Federal and State Registration Requirements" (2021).
[7] Thomas P. Lemke, et al., REGULATION OF INVESTMENT COMPANIES § 5.14 "Prospectus Disclosure Issues and Litigation" (2019).

many investors to understand and detract from its usefulness.[8]

Defined-outcome ETFs are also bound to the supplemental disclosures required by Rule 408 of the Securities Act, which subjects issuers to significant civil liabilities for misstatements and omissions.[9] Rule 421 of the Securities Act encourages issuers to use "pictures, logos, charts, graphs, or other design elements so long as the design is not misleading and the required information is clear."[10]

Moreover, we note that the Securities Act was drafted as a "Truth in Securities Act," which stresses the mechanism by which the U.S. regulates securities transactions. As Louis Brandeis emphasized, "Sunlight is said to be the best of disinfectants; electric light the most efficient policemen."[11] First Trust is concerned that moving away from this principle may be a move toward merit-based regulation.

2. Protections Afforded through Broker-Dealer Suitability and Best Interest Obligations

Broker-dealer suitability obligations are derived from both FINRA rules and federal anti-fraud statutes.[12] FINRA has issued numerous notices and guidelines describing FINRA member broker-dealers and associated persons' obligations when recommending financial products. For example, FINRA 2111, the suitability rule, requires broker-dealers and associated persons to "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile."[13]

As articulated extensively in the 22-08 Notice, Reg BI, which supersedes Rule 2111 with respect to recommendations to retail investors, addresses broker-dealer retail sales practices and recommendations, among other topics. Reg BI explicitly requires a broker-dealer to understand a recommended investment product and evaluate the "risks, rewards, and costs in light of the customer's investment profile and have a reasonable basis to believe that the recommendation is in the customer's best interest and does not place the broker-dealer's interest ahead of the retail customer's interest."[14] First Trust does not believe that classifying defined-outcome ETFs as "complex products" furthers the protections afforded to retail investors through these current obligations.

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[8] SEC Form N-1A, General Instructions, C. Preparation of the Registration Statement, 1. Administration of the Form N-1A requirements.

[9] *See* 17 CFR § 230.408 - Additional information.

[10] 17 CFR § 230.421 - Presentation of information in prospectuses.

[11] L. Brandeis, OTHER PEOPLE'S MONEY (1914).

[12] Broker-dealers may be subject to violations of Section 10(b) and Rule 10b-5 of the Exchange Act when it recommends securities that it reasonably believes are unsuitable for the investor. *See, e.g.*, *Brown v. E.F. Hutton Grp., Inc.*, 991 F.2d 1020, 1031 (2d Cir. 1993).

[13] FINRA Rule 2111(a). *See also*, *Hanly v. SEC*, 415 F.2d 589, 596 (2d Cir. 1969) ("Thus, a salesman cannot deliberately ignore that which he has a duty to know and recklessly state facts about matters of which he is ignorant. He must analyze sales literature and must not blindly accept recommendations made therein. The fact that his customers may be sophisticated and knowledgeable does not warrant a less stringent standard.")

[14] Regulation Best Interest, 17 C.F.R. § 240.15l-1 (2020). *See also* Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 86,031, 84 Fed. Reg. 33,318 (July 12, 2019).

3. Protections Afforded Through Investment Adviser Regulation

Under the Investment Advisers Act of 1940, as amended (the "*Advisers Act*"), an investment adviser is a fiduciary and owes its clients a duty of care and loyalty.[15] The duty of care requires an investment adviser to provide suitable advice to the client, based on the client's investment profile and needs. Providing advice on an investment product that is suitable for the client necessarily demands that the adviser understand a product's characteristics, features, and risks, as well as how different features interact to produce an investment return.

The SEC interprets the duty of loyalty to require an investment adviser to eliminate or make full and fair disclosure of all conflicts of interest that might incline an investment adviser, consciously or unconsciously, to render advice that is not disinterested such that a client can provide informed consent to the conflict.

First Trust believes that "plain English" disclosure, paired with the investment adviser's informed advice requirements, effectively ensures that retail investors understand their investment, regardless of product complexity, so long as the investment adviser complies with applicable securities laws and regulations.

C. FINRA Should Consider Amending Its Rules to Help Investors Better Understand Defined-Outcome ETFs

One enhancement that First Trust will suggest is for FINRA to revisit prohibitions regarding the use of hypothetical performance data to help all investors understand defined-outcome ETFs. Currently, subsection (d)(1)(F) of Rule 2210 (Communications with the Public) prohibits a member from using retail marketing materials that project performance, absent certain exceptions as set forth in Rule 2214 (Requirements for the Use of Investment Analysis Tools). We recognize and understand the danger of unchecked performance projections. First Trust's defined-outcome ETFs are designed to help reduce downside market exposure, while providing investors with some upside market participation. The defined-outcome ETFs seek to achieve a specific outcome using an options strategy, while unmistakably warning that there is no guarantee that the outcome will be achieved. A hypothetical illustration using mathematical principles of potential outcomes, which may not meet the specific requirements of Rule 2214 (Requirements for the Use of Investment Analysis Tools) – and unambiguous disclosure – would help investors better understand how the products "produce an investment return"[16] and "may perform in different market and economic conditions."[17]

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[15] *See* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Investment Advisers Act Release No. 5248, 84 Fed. Reg. 33,669, 33,670 (July 12, 2019).
[16] 12-03 Notice.
[17] 22-08 Notice.

II. FINRA's Proposal for Enhancements Will Limit Investor Choice and Have Unintended Consequences in the Marketplace That Have the Potential to Harm Investors

The 22-08 Notice and the potential to add certain product-specific rules to defined-outcome ETFs may inadvertently deprive retail investors of the use of products and strategies that currently meet the "best interest" requirement, discourage product innovation or detract from FINRA's mission of "protecting investors and safeguarding market integrity in a manner that facilitates vibrant capital markets."[18]

We understand the perceived need for the adoption of rules for specific products, such as security futures, direct participation programs and deferred variable annuities. Nevertheless, as "complex products" continue to remain difficult to define, we believe that it is best to leave the definition and retail sales practice standards to the member firm's scrutiny and supervision. First Trust is concerned that blunt, sweeping regulation can lead to unintended consequences that could ultimately cause retail investors harm.

A. Retail Investors May Lose Access to Registered Investment Products that Provide Diversification and Reduce Risk

FINRA's investor protection concerns must be balanced against the diversification and risk-abating benefits of different financial products. Investors may fail to meet their financial objectives without access to appropriate investment vehicles, even if such vehicles could be considered "complex." Although retail investors risk loss with almost all investment products, ranging from common stock to a secured note, they also risk failing to meet their financial needs. This is a cost that FINRA should not underestimate. We encourage FINRA to be cognizant of both risks in assessing whether additional regulation is warranted.

As we highlight in Section III, some of the products that FINRA has suggested being classified as "complex," such as defined-outcome ETFs, are actually risk-abating products when used properly by a registered representative and member firm. Limiting product offerings out of an abundance of caution may inadvertently increase the risk that investors fail to achieve financial goals by denying the registered representative what he or she may consider to be the best product to meet retail customers' objectives. Indeed, FINRA acknowledged this same benefit in the 22-08 Notice: "[t]he availability of complex products and options can potentially expand the investment opportunities for retail investors and, if properly understood, offer favorable investment outcomes (*e.g.*, enhancing returns, limiting losses or improving diversification)." The qualifier "properly understood" is key, and as we demonstrated in Section I, the existing regulatory requirements require fund disclosures to be understandable to the average investor.

Compounding the risk of retail investors failing to meet their financial objectives, many retail investors currently are precluded from investing in private, unregistered vehicles due to investor qualifications or minimum investment requirements, regardless of customer-specific suitability or "best interest" considerations. As proposed, retail investors may lose access to SEC-

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[18] For example, the 22-08 Notice asks whether FINRA should require retail investors to complete investor qualification tests or complete additional client onboarding forms to invest in "complex products," such as defined-outcome ETFs.

registered investment companies, irrespective of the quality of the product disclosures, again without regard to customer-specific suitability or "best interest" considerations, which may further jeopardize their long-term financial goals.

B. Brokerage Firms May Stop Offering Helpful Products and Discourage Financial Innovation

In a broader sense, financial service providers may prune their product offerings to mitigate their regulatory risk if FINRA deems large swaths of investments as "complex." Broker-dealers and registered investment advisers are concerned about the risk of enforcement actions or customer litigation or arbitration in the event of a loss. If FINRA deems a product "complex," this may cause broker-dealers and registered investment advisers to avoid the product prematurely. This is because the burden may shift to the financial adviser to overcome an assumption that all complex products are unsuitable, well beyond the requirements of reasonable basis suitability or Reg BI. Complex products could become guilty until proven innocent. With this added burden caused by a label, financial advisers will be hindered, portfolios may incur unnecessary risk, and investors may fail to meet their financial objectives.

Alternatively, investors who wish to have access to a broader selection of products may avoid their financial advisers altogether, instead opting to use self-directed platforms to ensure that they have access to products that will enable them to achieve their financial goals.[19]

III. Defined-Outcome ETFs Should Not Be Categorically Deemed as Complex Products

Although we appreciate FINRA's guidelines exemplifying complex products' features and characteristics, we encourage FINRA not to categorically deem the defined-outcome strategy as complex. First Trust wholeheartedly agrees that certain products warrant heightened scrutiny and supervisory and compliance procedures by member firms. We believe that certain defined-outcome ETFs should not be deemed complex for the several reasons outlined below.

A. FINRA Should Reasonably Conclude that Average Retail Investors Can Understand Defined-Outcome ETFs' Essential Characteristics, Risks and How Their Investment Features Interact to Produce an Investment Return

In the 22-08 Notice, FINRA indicates that defined-outcome ETFs may be deemed complex funds. In its guidance, FINRA notes:

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[19] In the 22-08 Notice, FINRA acknowledged that "Although complex products do not always translate into more investment risk, their complexity may confuse investors who may not adequately understand their features. These concerns may be heightened when a retail customer is accessing these products through a self-directed platform and without the assistance of a financial professional, who may be in a position to explain the key features and risks of the product to the retail investor." Further, the SEC recently requested comment on the broker-dealer digital engagement practices ("*DEP*") and whether certain DEPs are recommendations for purposes of Reg BI. *See* Securities Exchange Act Release No. 92766 (August 27, 2021), 86 FR 49067 (September 1, 2021) (Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices, Related Tools and Methods, and Regulatory Considerations and Potential Approaches; Information and Comments on Investment Adviser Use of Technology to Develop and Provide Investment Advice).

Defined outcome exchange-traded funds (ETFs) that offer structured retail product-type features, such as exposure to the performance of a market index or reference asset but with downside protection and an upside cap on potential gains over a specified period (typically one year). Unlike structured notes offering similar exposure but without an underlying portfolio, these defined outcome ETFs typically invest in exchange-listed options to provide the exposure.

As FINRA's description makes clear, the defining feature of a defined-outcome ETF is the potentially limited range of investment outcomes through exchange-traded options. Defined-outcome ETFs seek to achieve their investment objectives by creating "upside caps" and "downside buffers." The use of these "plain English" terms was intentional.

We believe that this use of options is straightforward, and that it is not "unreasonable to expect an average retail investor to discern the existence of [its] features and to understand the basic manner in which these features interact to produce an investment return."[20] This is especially true given the resources First Trust makes available to broker-dealers, investment advisers and investors, such as the funds' registration statements, shareholder reports, marketing materials, fund webpages, and a target outcome fund resource page that features informational guides and videos.[21]

FINRA also correctly notes that defined-outcome ETFs "provide the specified outcome if an investor buys the ETF at the beginning of the period and holds it until the end."[22]

Similar to geared ETPs with a periodic exposure reset, defined-outcome ETFs provide the specified outcome if an investor buys the ETF at the beginning of the period and holds it until the end. Otherwise, an investor's returns could deviate significantly from the specified outcome.[23]

The disclosure on First Trust's defined-outcome ETF webpages, registration statements and other marketing materials clearly states that "[t]he outcome may only be realized for an investor who holds shares on the first day of the Target Outcome Period and continues to hold them on the last day of the Target Outcome Period."[24] These disclosures also inform investors that, if they purchase a defined-outcome ETF after the target outcome period begins, they may experience a different result than had they purchased shares at the beginning of the target outcome period. Each First Trust defined-outcome ETF webpage provides information relating to the possible outcomes for an investor on a daily basis, if purchased on that date and held through the

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[20] 12-03 Notice.
[21] For the target outcome fund resource page, see https://www.ftportfolios.com/retail/etf/targetoutcomefunds.aspx.
[22] 22-08 Notice.
[23] 22-08 Notice.
[24] For example, see the fund webpage for the FT Cboe Vest U.S. Equity Deep Buffer ETF - November ("*DNOV*") at https://www.ftportfolios.com/Retail/Etf/EtfSummary.aspx?Ticker=DNOV. DNOV's registration statement further states, "If you purchase shares after the Target Outcome Period starts or sell your shares before the Target Outcome Period ends, you may receive a very different return based on the fund's current value. Investors purchasing shares of the fund after the Target Outcome Period begins can see their expected Outcome until the end of the period by visiting the Fund's website, www.ftportfolios.com/retail/etf/EtfSummary.aspx?Ticker=DNOV."

end of the target outcome period, including the fund's value relative to the cap and buffer.[25]

Further, because defined-outcome ETFs are investment management companies, they are registered with the SEC. As previously discussed, registered investment management companies are subject to a host of federal securities laws, which mandate disclosure requirements that are clear and understandable.

B. Defined-Outcome ETFs are Different From FINRA's Other Complex Product Examples

In the 22-08 Notice, FINRA highlighted defined-outcome ETFs as an investment product that may be deemed complex. FINRA has similarly singled-out other products that may be complex, such as geared funds, alternative funds,[26] structured products, principal-protected notes, commodity-linked ETPs, reverse convertibles, volatility-linked ETPs, oil-linked ETPs and funds that offer strategies employing cryptocurrency futures. We note that, unlike defined-outcome ETFs, most of these strategies are geared, illiquid, or both.

1. Defined-Outcome ETFs are not Geared Investments

First Trust encourages FINRA not to conflate defined-outcome ETFs with characteristics of "geared ETPs." According to FINRA's website, "Geared ETPs typically seek to deliver set positive or negative multiples of the performance of a given benchmark or index over a given time period such as one day or one month. Among most of the currently listed geared ETPs, positive leverage factors are 1.5x, 2x, and 3x (that is, one-and-one-half, two and three times) and inverse factors are -0.5x, -1x, -2x and -3x."[27] These geared funds are generally unbounded, meaning that they can experience unlimited upside potential, but an investor can also experience a total loss of investment. In contrast, First Trust's defined-outcome ETFs, as FINRA acknowledged in the 22-08 Notice, seek to limit the range of potential investment outcomes by providing a downside buffer on losses and an upside cap on gains. These upside caps and downside buffers are also asymmetrical, unlike geared ETPs. For example, the investment objective of the FT Cboe Vest U.S. Equity Buffer ETF - February (the "*Fund*") seeks

> *... to provide investors with returns (before fees, expenses and taxes) that match the price return of the SPDR® S&P 500® ETF Trust (the "Underlying ETF"), up to a predetermined upside cap of 14.25% (before fees, expenses and taxes) and 13.40% (after fees and expenses, excluding brokerage commissions, trading fees, taxes and extraordinary expenses not included in the Fund's management fee), while providing a buffer against the first 10% (before fees, expenses and taxes) of*

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[25] For example, *see* the "Outcome Period Performance" table for the FT Cboe Vest U.S. Equity Buffer ETF - August (FAUG) at www.ftportfolios.com/retail/etf/EtfSummary.aspx?Ticker=FAUG.

[26] Alternative funds are registered funds that seek to "accomplish their objectives through non-traditional investments and trading strategies… [that] might invest in assets such as global real estate, commodities, leveraged loans, start-up companies, and unlisted securities that offer exposure beyond traditional stocks, bonds, and cash." FINRA Investor Alert: Alternative Funds Are Not Your Typical Mutual Funds (June 11, 2013), available at www.finra.org/investors/alerts/alternative-funds-are-not-your-typical-mutual-funds?msclkid=28a986efa6d411ec98c0b90df2f96d0b).

[27] *See* FINRA's website, The Lowdown on Leveraged and Inverse Exchange-Traded Products: What are Geared ETPs?, https://www.finra.org/investors/insights/lowdown-leveraged-and-inverse-exchange-traded-products.

Underlying ETF losses, over the period from February 22, 2022 to February 17, 2023.[28]

Further, the exchange-traded options used to create the downside buffer and upside cap are matched and fully covered. In defined-outcome ETF registration statements, we explain that "any amount owed by the Fund on the written FLEX Options will be covered by payouts at expiration from the purchased FLEX Options. As a result, the FLEX Options will be fully covered and no additional collateral will be necessary during the life of the Fund."[29] In other words, unlike geared ETPs, any obligation created by a short options position held by a defined-outcome ETF cannot exceed the value of a long position in options or other assets held by the defined-outcome ETF.

We also note that FLEX Options are exchange-traded and cleared through the Options Clearing Corporation (the "*OCC*"). The OCC is the guarantor and central counterparty of the exchange, ensuring the obligations of the contracts traded on the exchange are cleared and fulfilled, protecting trading members from counterparty risk.

Therefore, First Trust believes that defined-outcome ETFs should not be designated as complex products. First Trust's defined-outcome ETFs do not possess "features that may make it difficult for a retail investor to understand the essential characteristics of the product and its risks (including the payout structure and how the product may perform in different market and economic conditions)."[30] In fact, defined-outcome ETFs are designed to provide a narrower range of potential investment outcomes than the price return of the underlying ETF. For a retail investor, this characteristic may make the defined-outcome ETF easier to understand than the underlying ETF.

2. Defined-Outcome ETFs are Registered Investment Companies Subject to Rule 22e-4 of the 1940 Act

When distinguishing defined-outcome ETFs from other products that FINRA has named as potentially complex, we again note that defined-outcome ETFs are registered investment companies subject to a host of federal securities laws, rules and regulations. One such rule is Rule 22e-4 (the "*Liquidity Rule*") of the 1940 Act, which requires open-end funds to adopt liquidity risk management programs. Accordingly, First Trust's defined-outcome ETFs have adopted and implemented a written program that is reasonably designed to assess and manage the funds' liquidity risk (*i.e.*, the risk that a fund would not be able to meet redemption requests without causing significant dilution of the interests of remaining investors). As a result, defined-outcome ETFs do not share the same liquidity profile as many of the other examples FINRA has noted as complex.

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[28] *See*, *e.g.,* the registration statement for the FT Cboe Vest U.S. Equity Buffer ETF – February, a series of the First Trust Exchange-Traded Fund VIII, dated February 22, 2022, which can be found at https://www.ftportfolios.com/Common/ContentFileLoader.aspx?ContentGUID=f8d9769d-e042-4d1a-876f-f22f783cd299.

[29] *See*, *e.g.,* the registration statement for the FT Cboe Vest U.S. Equity Deep Buffer ETF– February, a series of the First Trust Exchange-Traded Fund VIII, dated February 22, 2022, which can be found at https://www.ftportfolios.com/Common/ContentFileLoader.aspx?ContentGUID=bdb02bca-d76a-40b2-b7bc-6dd0494b7c51.

[30] 22-08 Notice.

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We thank FINRA for the opportunity to comment on the 22-08 Notice, and we express our support for your efforts to protect retail investors.

Sincerely,

Matt Farber
Assistant General Counsel
First Trust Portfolios L.P.