



8011-01P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34- 83775; File No. SR-CboeBZX-2018-018]

Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to List and Trade Shares of the Principal Morley Short Duration Index ETF Under Rule 14.11(c)(4)

August 3, 2018

I. Introduction

On April 23, 2018, Cboe BZX Exchange, Inc. (“Exchange” or “BZX”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to list and trade shares (“Shares”) of the Principal Morley Short Duration Index ETF (“Fund”). The proposed rule change was published for comment in the Federal Register on May 8, 2018.³ On June 20, 2018, 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 approve or disapprove the proposed rule change.⁴ The Commission has received no comment

¹ 15 U.S.C.78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 83152 (May 2, 2018), 83 FR 20892.

⁴ See Securities Exchange Act Release No. 83479, 83 FR 29838 (June 26, 2018). The Commission designated August 6, 2018 as the date by which the Commission shall approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change.

letters on the proposed rule change. This order institutes proceedings under Section 19(b)(2)(B) of the Act⁵ to determine whether to approve or disapprove the proposed rule change.

II. Description of the Proposed Rule Change

The Exchange proposes to list and trade the Shares pursuant to BZX Rule 14.11(c)(4), which governs the listing and trading of index fund shares based on fixed income securities indexes. The Fund would seek to provide investment results that replicate, before expenses, the performance of The ICE BofA Merrill Lynch Low Duration U.S. ABS & CMBS Equal Par Index (“Index”).⁶

A. The Exchange’s Description of the Index

The Index is designed to provide exposure to investment-grade securitized products issued in the U.S., including ABS⁷ and CMBS.⁸

To qualify for inclusion in the Index, eligible securities must be a component of The ICE BofA Merrill Lynch US ABS & CMBS Index (“Feeder Index”). Such securities are then selected and weighted based upon the Index methodology discussed below.

1. The Feeder Index’s Methodology

In order to be included in the Feeder Index, a security (whether ABS or CMBS) must meet the following criteria (“Basic Criteria”):

⁵ 15 U.S.C. 78s(b)(2)(B).

⁶ The Index value, calculated and disseminated at least once daily, as well as the components of the Index and their percentage weighting, will be available from major market data vendors.

⁷ “ABS” means fixed and floating rate debt securities secured by non-mortgage assets.

⁸ “CMBS” means fixed rate debt securities secured by first mortgages on commercial real estate.

- be rated investment-grade (based on an average of Moody's, S&P Global, and Fitch);
- have a term of at least one year remaining until final stated maturity; and have at least one month to the last expected cash flow; and
- inverse floating rate, interest only, and principal only securities are excluded.

In addition to the Basic Criteria, an ABS must meet the following criteria:

- must issue a fixed or floating rate coupon;
- must have an original deal size for the collateral group⁹ of at least \$250 million;
- must have a current outstanding deal size for the collateral group greater than or equal to 10% of the original deal size; and
- a minimum current outstanding tranche size of \$50 million for senior tranches and \$10 million current amount outstanding for mezzanine and subordinated tranches.

In addition to the Basic Criteria, a CMBS (which may include U.S. agency CMBS) must also meet the following criteria:

- must issue a fixed coupon schedule;
- must have an original deal size for the collateral group of at least \$250 million;
- must have a current outstanding deal size for the collateral group that is greater than or equal to 10% of the original deal size; and
- must have a minimum outstanding tranche size of \$50 million for senior tranches and \$10 million for mezzanine and subordinated tranches.

⁹ A collateral group describes the assets (receivables) that are held by the special purpose vehicle ("SPV") issuing the ABS securities. The collateral group provides the source of payment for the SPV's liabilities (i.e., ABS securities). Typically, an SPV will include assets greater than its liabilities as a form of credit enhancement.

2. The Index's Methodology

Securities in the Feeder Index are screened for inclusion/exclusion in the Index based on the following criteria:

- ABS related to home equity and manufactured housing are excluded;
- CMBS securities that are rated less than AAA credit quality (based on an average of Moody's, S&P Global and Fitch) are excluded;
- CMBS securities that are issued prior to December 31, 2010 are excluded; and
- Securities must have a modified duration to worst that is less than or equal to 5 years for initial inclusion in the Index, although once included, the security remains in the Index provided the remaining criteria are met.

The qualifying securities are assigned equal par amounts with a 70% allocation given to ABS securities and a 30% allocation given to CMBS securities. The Index rebalances on a monthly basis.

B. The Exchange's Description of the Fund

Under Normal Market Conditions,¹⁰ the Fund will invest at least 80% of its net assets, plus any borrowings for investment purposes, in ABS and CMBS that compose the Index at the time of purchase.

While the Fund normally will invest at least 80% of its net assets, plus any borrowings for investment purposes, in ABS and CMBS that compose the Index, as described above, the Fund may invest its remaining assets in securities not included in the Index including only the

¹⁰ The term "Normal Market Conditions" includes, but is not limited to, the absence of trading halts in the applicable financial markets generally; operational issues causing dissemination of inaccurate market information or system failures; or force majeure type events such as natural or man-made disaster, act of God, armed conflict, act of terrorism, riot or labor disruption, or any similar intervening circumstance.

following instruments: ABS and CMBS not included in the Index; cash and cash equivalents;¹¹ Treasury Securities with a maturity of three months or greater; centrally cleared, index-based credit default swaps;¹² and, to the extent permitted by the 1940 Act, other exchange-traded funds (“ETFs”).¹³

The portfolio of securities held by the Fund will be disclosed on the Fund’s website at www.PrincipalETFs.com.

C. Exchange’s Policy Discussion

The Exchange believes that while the proposed rule change does not satisfy all of the “generic” listing requirements of Rule 14.11(c)(4), in particular Rules 14.11(c)(4)(B)(i)(b)¹⁴ and

¹¹ Cash equivalents are short-term instruments with maturities of less than three months, including: (i) U.S. Government securities, including bills, notes, and bonds differing as to maturity and rates of interest, which are either issued or guaranteed by the U.S. Treasury or by U.S. Government agencies or instrumentalities; (ii) certificates of deposit issued against funds deposited in a bank or savings and loan association; (iii) bankers acceptances, which are short-term credit instruments used to finance commercial transactions; (iv) repurchase agreements and reverse repurchase agreements; (v) bank time deposits, which are monies kept on deposit with banks or savings and loan associations for a stated period of time at a fixed rate of interest; (vi) commercial paper, which are short-term unsecured promissory notes; and (vii) money market funds.

¹² Centrally cleared swaps are cleared through a central clearinghouse and, as such, the counterparty risk traditionally associated with over-the-counter swaps is eliminated.

¹³ ETFs include Index Fund Shares (as described in Rule 14.11(c)); Portfolio Depositary Receipts (as described in Rule 14.11(b)); and Managed Fund Shares (as described in Rule 14.11(i)). The ETFs all will be listed and traded in the U.S. on registered exchanges. The Fund may invest in the securities of ETFs registered under the 1940 Act consistent with the requirements of Section 12(d)(1) of the 1940 Act, or any rule, regulation or order of the Commission or interpretation thereof. The Fund will not invest in leveraged or inverse leveraged (e.g., 2X, -2X, 3X or -3X) ETFs.

¹⁴ Rule 14.11(c)(4)(B)(i)(b) requires that components that in the aggregate account for at least 75% of the weight of the index or portfolio each have a minimum original principal amount outstanding of \$100 million or more. As of February 22, 2018, only 57.9% of the weight of the Index components had a minimum original principal amount outstanding of \$100 million or more.

14.11(c)(4)(B)(i)(f),¹⁵ the policy issues that such provisions are intended to address are otherwise mitigated. The Exchange believes that Rule 14.11(c)(4)(B)(i)(b) is intended to address concerns around the size and manipulability of the Index's components. The exchange believes that these policy concerns would be mitigated by the fact that at least 90% of the weight of the Index will be comprised of securities that have a minimum par amount of \$10 million and were a constituent of an offering where the original deal size was at least \$250 million.¹⁶

The Exchange also believes that the availability of information regarding the ABS and CMBS that comprise the Index that Rule 14.11(c)(4)(B)(i)(f) is intended to address would also be mitigated by the fact that the Fund will only hold ABS and CMBS for which the bond indenture requires the public disclosure of a statement to noteholders on a no less frequent than quarterly basis.

III. Proceedings to Determine Whether to Approve or Disapprove SR-CboeBZX-2018-018 and Grounds for Disapproval under Consideration

¹⁵ Rule 14.11(c)(4)(B)(i)(f) requires that component securities that in aggregate account for at least 90% of the Fixed Income Securities portion of the weight of the index or portfolio must be either: (1) from issuers that are required to file reports pursuant to Sections 13 and 15(d) of the Act; (2) from issuers that have a worldwide market value of its outstanding common equity held by non-affiliates of \$700 million or more; (3) 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; (4) exempted securities as defined in section 3(a)(12) of the Act; or (5) from issuers that are a government of a foreign country or a political subdivision of a foreign country. According to the Exchange, as of February 22, 2018, only 68.0% of the weight of the Index components met the requirements of Rule 14.11(c)(4)(B)(i)(f).

¹⁶ The Exchange notes that similar standards have been applied to other comparable funds, and cites to Securities Exchange Act Release No. 82295 (December 12, 2017), 82 FR 60056 (December 18, 2017) (SR-NYSEArca-2017-56). Further, according to the Exchange, the Index is broad-based and currently includes 2,693 component securities. The Exchange also states that, on a continuous basis, the Index will contain at least 500 component securities and comply with the index methodology description provided above.

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act¹⁷ 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,¹⁸ the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the proposal'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, and to protect investors and the public interest.¹⁹ Specifically, in light of the Index's composition of ABS and CMBS and the proposed continued listing criteria regarding the availability of public information applicable to the Shares, the Commission seeks commenters' views on whether the information provided in the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act.

IV. Procedure: Request for Written Comments

Interested persons are invited to submit written views, data, and arguments concerning the foregoing, including whether the proposed rule change is consistent with Section 6(b)(5) or any other provision of the Act, or the rules and regulations thereunder. Although there do not

¹⁷ 15 U.S.C. 78s(b)(2)(B).

¹⁸ Id.

¹⁹ 15 U.S.C. 78f(b)(5).

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.²⁰

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].

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-CboeBZX-2018-018 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-CboeBZX-2018-018. 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

²⁰ Section 19(b)(2) of the Act, as amended by the Securities Acts 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 Acts Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

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 comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CboeBZX-2018-018 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 PUBLICATION IN THE FEDERAL REGISTER]**.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²¹

Eduardo A. Aleman,
Assistant Secretary.

²¹ 17 CFR 200.30-3(a)(57).

