



SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-85946; File No. SR-NYSEArca-2019-04]

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend NYSE Arca Rule 5.2-E(j)(3) and to Adopt Generic Listing Standards for Investment Company Units Based on an Index or Portfolio of Municipal Securities

May 28, 2019

I. Introduction

On February 8, 2019, NYSE Arca, Inc. (“Exchange” or “NYSE Arca”) 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 adopt generic listing standards for Investment Company Units (“Units”) based on an index or portfolio of municipal securities. The proposed rule change was published for comment in the Federal Register on February 27, 2019.³ On April 9, 2019, pursuant to Section 19(b)(2) of the Act,⁴ 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.⁵ The Commission has received no comments on the proposal. The Commission is publishing this order to institute proceedings pursuant to

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 85170 (Feb. 21, 2019), 84 FR 6451 (“Notice”).

⁴ 15 U.S.C. 78s(b)(2).

⁵ See Securities Exchange Act Release No. 85573, 84 FR 15239 (Apr. 15, 2019). The Commission designated May 28, 2019 as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to approve or disapprove, the proposed rule change.

Section 19(b)(2)(B) of the Act⁶ to determine whether to approve or disapprove the proposed rule change.

II. Summary of the Proposed Rule Change⁷

NYSE Arca Rule 5.2-E(j)(3) permits the Exchange to list a series of Units based on an index or portfolio of underlying securities. Currently, NYSE Arca Rule 5.2-E(j)(3) includes generic listing standards for Units based on an index or portfolio of equity or fixed income securities or a combination thereof. Municipal Securities⁸ are a type of fixed income security, and therefore currently the Exchange may generically list and trade securities overlying an index or portfolio of Municipal Securities provided the index or portfolio satisfies the criteria of Commentary .02 to NYSE Arca Rule 5.2-E(j)(3) (“Commentary .02”). According to the Exchange, however, indexes and portfolios of Municipal Securities typically do not satisfy the criterion that component securities in an index or portfolio that in aggregate account for at least 75% of the Fixed Income Securities portion of the weight of the index or portfolio each have a minimum original principal amount outstanding of \$100 million or more.⁹ The Exchange states that generally Municipal Securities are issued with individual maturities of relatively small size, although they typically are constituents of a much larger municipal bond offering.¹⁰

⁶ 15 U.S.C. 78s(b)(2)(B).

⁷ For a full description of the proposed rule change, see Notice, supra note 3.

⁸ The proposed rule defines the term “Municipal Securities” by incorporating the definition in Section 3(a)(29) of the Act.

⁹ See Notice, supra note 3, 84 FR at 6452. “Fixed Income Securities are debt securities that are notes, bonds, debentures or evidence of indebtedness that include, but are not limited to, U.S. Department of Treasury securities (“Treasury Securities”), government-sponsored entity securities (“GSE Securities”), municipal securities, trust preferred securities, supranational debt and debt of a foreign country or a subdivision thereof.” NYSE Arca Rule 5.2-E(j)(3), Commentary .02.

¹⁰ See id.

A. Proposed Commentary .02A to NYSE Arca Rule 5.2-E(j)(3)

1. Applicability

Proposed Commentary .02A to NYSE Arca Rule 5.2-E(j)(3) (“Commentary .02A”) provides generic listing standards for Units based on an index or portfolio of Municipal Securities. Because existing Commentary .02 also applies to Units based on an index or portfolio of Municipal Securities, the Exchange represents that it would apply existing Commentary .02 and proposed Commentary .02A in a “waterfall” manner. Specifically, the Exchange would initially evaluate every series of Units based on an index or portfolio of Municipal Securities or Municipal Securities and cash against the generic listing standards of existing Commentary .02 and would apply proposed Commentary .02A only to Units whose index or portfolio does not meet the requirements of Commentary .02.

2. Proposed Generic Listing Criteria

The Exchange asserts Commentary .02A includes many requirements that are more stringent than those applicable under Commentary .02. These heightened requirements, according to the Exchange, would deter potential manipulation of such Municipal Securities indices even though the index or portfolio may include securities that have smaller original principal amounts outstanding. The proposed quantitative requirements described below would apply on both an initial and continued basis to a Municipal Securities index or portfolio underlying a series of Units.

a. Original Principal Amount Outstanding

According to the Exchange, Municipal Securities are typically issued with individual maturities of relatively small size, although they generally are constituents of a much larger

municipal bond offering.¹¹ Accordingly, the Exchange proposes to reduce the requirement for minimum original principal amount outstanding for component securities from at least \$100 million to at least \$5 million. Further, the Exchange proposes that qualifying securities must have been issued as part of a transaction of at least \$20 million. Lastly, the Exchange proposes to increase the percentage weight of an index or portfolio that must satisfy the original principal amount outstanding requirement from 75% to 90%.

The Exchange asserts that reducing the minimum original principal amount outstanding for component securities will not make an index or portfolio more susceptible to manipulation.¹² The Exchange argues that the requirement that component securities in a Municipal Securities index or portfolio have a minimum principal amount outstanding, in concert with the other requirements of Commentary .02A, will ensure that such index or portfolio is sufficiently broad-based in scope as to minimize potential manipulation of the index or portfolio.¹³ In addition, the Exchange asserts that its proposal to require that 90% of the weight of a Municipal Securities index or portfolio meet the original principal amount outstanding requirement (as opposed to 75% for existing Commentary .02) will further deter potential manipulation by ensuring that a greater portion of the index or portfolio meets this minimum size requirement.¹⁴

The Exchange notes that the Commission has previously approved the listing and trading of several series of Units where the underlying Municipal Securities index or portfolio required that component securities representing at least 90% of the weight of the index or portfolio have a

¹¹ See supra note 10 and accompanying text.

¹² See Notice, supra note 3, 84 FR at 6452.

¹³ See id.

¹⁴ See id. at 6453.

minimum original principal amount outstanding of at least \$5 million and have been issued as part of a transaction of at least \$20 million.¹⁵

b. Component Concentration

Commentary .02, the current generic listing rules for Units based on a fixed-income index or portfolio, permits individual component securities to account for up to 30% of the weight of such index or portfolio and the top-five weighted component securities to account for up to 65% of the weight of such index or portfolio. The Exchange proposes to tighten these thresholds, proposing that under Commentary .02A an individual Municipal Security may comprise only 10% of the index or portfolio and that the five most heavily-weighted Municipal Securities in an index or portfolio may comprise only 30% of the index or portfolio. The Exchange asserts that its proposal will reduce the susceptibility to manipulation of a Municipal Securities index or portfolio underlying a series of Units.¹⁶

c. Issuer Diversification

The current generic listing rules for Units based on an index or portfolio of fixed-income securities require that an index or portfolio must include securities from at least 13 non-affiliated issuers. Notably, however, the current rules exempt indices consisting of either entirely exempted securities or exempted securities and cash from complying with this diversification requirement.¹⁷ Therefore, under the current generic listing criterion, an index or portfolio comprised of only Municipal Securities (or Municipal Securities and cash) is not required to

¹⁵ See Securities Exchange Act Release No. 84049 (Sept. 6, 2018), 83 FR 46228 (Sept. 12, 2018) (SR-NYSEArca-2018-38) (order approving, among other things, revisions to the continued listing criteria applicable to the iShares New York AMT-Free Muni Bond ETF).

¹⁶ See Notice, *supra* note 3, 84 FR at 6453.

¹⁷ Municipal Securities are included in the definition of exempted securities. See Section 3(a)(12) of the Act.

satisfy any minimum issuer diversification requirement. The Exchange proposes that an index or portfolio of Municipal Securities or Municipal Securities and cash must include securities from at least 13 non-affiliated issuers. The Exchange asserts that requiring such diversification will reduce the likelihood that an index or portfolio may be manipulated by ensuring that securities from a variety of issuers are represented in an index or portfolio of Municipal Securities.¹⁸

d. Minimum Number of Components

The current generic listing requirements for Units based on an index or portfolio of fixed-income securities do not have an explicit requirement that an index or portfolio contain a minimum number of securities. However, given that such rules require an index or portfolio to contain securities from at least thirteen non-affiliated issuers, there is an effective requirement that an index or portfolio of fixed-income securities contain at least thirteen component securities. As described above, a fixed-income index or portfolio comprised of exempted securities (including Municipal Securities) is not required to satisfy the issuer diversification test, and therefore such indices need not have a minimum number of component securities.

The Exchange proposes to require that a Municipal Securities index or portfolio contain at least 500 component securities. According to the Exchange, this proposed requirement will ensure that a Municipal Securities index or portfolio is sufficiently broad-based and diversified to make it less susceptible to manipulation.¹⁹

e. Additional Requirements

In addition to the quantitative requirements described above, the Exchange proposes to adopt additional rules related to: (1) index methodology and calculation; (2) dissemination of

¹⁸ See Notice, supra note 3, 84 FR at 6453.

¹⁹ See id.

information; (3) initial shares outstanding; (4) hours of trading; (5) surveillance procedures; and (6) disclosures.

The Exchange proposes to adopt Commentary .02A(b) to NYSE Arca Rule 5.2-E(j)(3), which requires that (i) if a Municipal Securities index is maintained by a broker-dealer or fund advisor, the broker-dealer or fund advisor shall erect and maintain a “firewall” around the personnel who have access to information concerning changes and adjustments to the index; (ii) the current index value for Units listed pursuant to proposed Commentary .02A(a) to NYSE Arca Rule 5.2-E(j)(3) will be widely disseminated by one or more major market data vendors at least once per day and, if the index value does not change during some or all of the period when trading is occurring on the NYSE Arca Marketplace, the last official calculated index value must remain available throughout NYSE Arca Marketplace trading hours; and (iii) any advisory committee, supervisory board, or similar entity that advises a Reporting Authority²⁰ or that makes decisions on the index composition, methodology, and related matters, must implement and maintain, or be subject to, procedures designed to prevent the use and dissemination of material non-public information regarding the applicable Municipal Securities index.

The Exchange proposes to adopt Commentary .02A(c) to NYSE Arca Rule 5.2-E(j)(3), which requires that one or more major market data vendors shall disseminate for each series of Units based on an index or portfolio of Municipal Securities an estimate, updated at least every 15 seconds during the Core Trading Session, of the value of a share of each series (the “Intraday Indicative Value” or “IIV”). The Intraday Indicative Value may be based, for example, upon current information regarding the required deposit of securities and cash amount to permit creation of new shares of the series or upon the index value. The Intraday Indicative Value may

²⁰ The term “Reporting Authority” has the meaning given to it in NYSE Arca Rule 5.1-E(b)(16).

be calculated by the Exchange or by an independent third party throughout the day using prices obtained from independent market data providers or other independent pricing sources such as a broker-dealer or price evaluation services. If the Intraday Indicative Value does not change during some or all of the period when trading is occurring on the Exchange, then the last official calculated Intraday Indicative Value must remain available throughout Exchange trading hours.

The Exchange proposes to adopt Commentary .02A(d) to NYSE Arca Rule 5.2-E(j)(3), which requires that a minimum of 100,000 shares of a series of Units will be required to be outstanding at commencement of trading.

The Exchange proposes to adopt Commentary .02A(e) to NYSE Arca Rule 5.2-E(j)(3), which specifies that the hours of trading for the Units will be as governed by NYSE Arca Rule 7.34-E(a).

The Exchange proposes to adopt Commentary .02A(f) to NYSE Arca Rule 5.2-E(j)(3), which specifies that Units that are listed or traded pursuant to unlisted trading privileges will be subject to the Exchange's written surveillance procedures.

Lastly, proposed Commentary .02A(g) to NYSE Arca Rule 5.2-E(j)(3) incorporates the information circular requirement of Commentary .01(g) NYSE Arca Rule 5.2-E(j)(3).

B. Proposed Amendments to Commentary .03 to NYSE Arca Rule 5.2-E(j)(3)

The Exchange also proposes to amend Commentary .03 to NYSE Arca Rule 5.2-E(j)(3) to allow the generic listing and trading of Units based on a combination of two or more types of indexes, including a combination index that includes Municipal Securities. Currently, the scope of the rule allows the Exchange to generically list Units overlying on a combination of indexes or an index or portfolio of component securities representing: (1) the U.S. or domestic equity market; (2) the international equity market; and (3) the fixed income market. To the extent that an index or portfolio of Municipal Securities is included in a combination, the proposed rule

specifies the Municipal Securities index or portfolio must satisfy all requirements of Commentary .02A to NYSE Arca Rule 5.2-E(j)(3). The Exchange also proposes other conforming changes to Commentary .03 to NYSE Arca Rule 5.2-E(j)(3) to specify that the current requirements related to index value dissemination and related continued listing standards will apply to indexes of Municipal Securities. The Exchange notes that a combination index or portfolio that includes an index or portfolio of Municipal Securities will not be permitted to seek to provide investment results in a multiple of the direct or inverse performance of such combination index or portfolio.²¹

III. Proceedings to Determine Whether to Approve or Disapprove SR-NYSEArca-2019-04 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act²² 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,²³ the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the proposed rule change's consistency with Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be "designed

²¹ See Notice, *supra* note 3, 84 FR at 6454.

²² 15 U.S.C. 78s(b)(2)(B).

²³ Id.

to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade,” and “to protect investors and the public interest.”²⁴ Specifically, the Commission seeks comment regarding the following:

1. The Exchange’s current generic listing requirement that at least 75% of the Fixed Income Securities portion of the weight of an underlying index or portfolio be comprised of components that each have a minimum original principal amount outstanding of \$100 million is designed to ensure that adequate information is available about a substantial portion of the index components.²⁵ Do the Exchange’s proposed alternative thresholds for Municipal Securities indexes or portfolios similarly ensure that adequate information is available about a majority of the index components? Should one or more alternative criteria be employed to achieve the objective of the current generic listing requirement?
2. Would the Exchange’s proposed requirements that the underlying index or portfolio of Municipal Securities include at least 500 components from at least 13 non-affiliated issuers mitigate manipulation concerns? Should one or more alternative criteria be employed to achieve diversification sufficient to mitigate manipulation concerns?
3. Taken collectively, would the proposed generic listing criteria adequately ensure that each index or portfolio of Municipal Securities underlying an issue of Investment Company Units is not susceptible to manipulation?

IV. Procedure: Request for Written Comments

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

²⁴ 15 U.S.C. 78f(b)(5).

²⁵ C.f., Securities Exchange Act Release No. 55783 (May 17, 2007), 72 FR 29194, 29199 (May 24, 2007) (order approving generic listing standards for Units based on fixed income indexes) (“The Commission believes that [the requirements of Commentary .02] are reasonably designed to ensure that a substantial portion of any underlying index or portfolio consists of securities about which information is publicly available...”).

pursuant to Rule 19b-4 under the Act,²⁶ any request for an opportunity to make an oral presentation.²⁷

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register]. The Commission asks that commenters address the sufficiency of the Exchange's statements in support of the proposal, which are set forth in Notice,²⁸ in addition to any other comments they may wish to submit about the proposed rule change.

In this regard, the Commission seeks comment on the Exchange's proposed generic listing standards for Units based on an index or portfolio of Municipal Securities. The Commission specifically seeks comment on whether the proposed requirement that an underlying index or portfolio must include a minimum of 500 component Municipal Securities is consistent with the requirement 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."²⁹

Comments may be submitted by any of the following methods:

²⁶ 17 CFR 240.19b-4.

²⁷ 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).

²⁸ See supra note 3.

²⁹ 15 U.S.C. 78f(b)(5).

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-NYSEArca-2019-04 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-NYSEArca-2019-04. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSEArca-2019-04 and should be submitted by

[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.³⁰

Eduardo A. Aleman,
Deputy Secretary.

³⁰ 17 CFR 200.30-3(a)(57).

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