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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-86410; File No. SR-CboeBZX-2019-023]

Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend Rule 14.11(c) (Index Fund Shares) to Adopt Generic Listing Standards for Index Fund Shares Based on an Index of Municipal Securities

July 18, 2019.

I. Introduction

On April 3, 2019, Cboe BZX Exchange, Inc. (“Exchange” or “Cboe 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 amend Cboe BZX Rule 14.11(c) to adopt generic listing standards for Index Fund Shares (“Shares”) based on an index or portfolio of municipal securities. The proposed rule change was published for comment in the Federal Register on April 22, 2019.³ On May 30, 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 85656 (Apr. 16, 2019), 84 FR 16753.

⁴ 15 U.S.C. 78s(b)(2).

⁵ See Securities Exchange Act Release No. 85966, 84 FR 26172 (June 5, 2019). The Commission designated July 21, 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.

received no comments on the proposal. The Commission is publishing this order to institute proceedings pursuant to 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

Cboe BZX Rule 14.11(c) permits the Exchange to list a series of Shares based on an index or portfolio of underlying securities. Currently, Cboe BZX Rule 14.11(c) includes generic listing standards for Shares 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 Cboe BZX Rule 14.11(c)(4). 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

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 16754. “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.” Cboe BXZ Rule 14.11(c)(4).

maturities of relatively small size, although they typically are constituents of a much larger municipal bond offering.¹⁰

A. Proposed Cboe BZX Rule 14.11(c)(4)(B)(ii)

1. Applicability

Proposed Cboe BZX Rule 14.11(c)(4)(B)(ii) provides generic listing standards for Shares based on an index or portfolio of Municipal Securities. Because existing Cboe BZX Rule 14.11(c)(4)(B)(i) also applies to Shares based on an index or portfolio of Municipal Securities, the Exchange represents that it would apply existing Cboe BZX Rule 14.11(c)(4)(B)(i) and proposed Cboe BZX Rule 14.11(c)(4)(B)(ii) in a “waterfall” manner. Specifically, the Exchange would initially evaluate every series of Shares based on an index or portfolio of Municipal Securities or Municipal Securities and cash against the generic listing standards of existing Cboe BZX Rule 14.11(c)(4)(B)(i) and would apply proposed Cboe BZX Rule 14.11(c)(4)(B)(ii) only to Shares whose index or portfolio does not meet the requirements of Cboe BZX Rule 14.11(c)(4)(B)(i).

2. Proposed Generic Listing Criteria

The Exchange asserts that Cboe BZX Rule 14.11(c)(4)(B)(ii) includes many requirements that are more stringent than those applicable under Cboe BZX Rule 14.11(c)(4)(B)(i). 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 Shares.

¹⁰ See id.

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 Cboe BZX Rule 14.11(c)(4)(B)(ii), 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 Cboe BZX Rule 14.11(c)(4)(B)(i)) will further deter potential manipulation by ensuring that a greater portion of the index or portfolio meets this minimum size requirement.¹⁴

¹¹ See supra note 10 and accompanying text.

¹² See Notice, supra note 3, 84 FR at 16754.

¹³ See id.

¹⁴ See id. at 16754-55.

The Exchange notes that the Commission has previously approved the listing and trading of several series of Shares 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 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

Cboe BZX Rule 14.11(c)(4)(B)(i), the current generic listing rules for Shares 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 Cboe BZX Rule 14.11(c)(4)(B)(ii) 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 Shares.¹⁶

c. Issuer Diversification

The current generic listing rules for Shares 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

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 16755.

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 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 Shares 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

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

¹⁸ See Notice, supra note 3, 84 FR at 16755.

¹⁹ See id.

B. Proposed Amendments to Cboe BZX Rule 14.11(c)(5)

The Exchange also proposes to amend Cboe BZX Rule 14.11(c)(5) to allow the generic listing and trading of Shares 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 Shares 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 Cboe BZX Rule 14.11(c)(4)(B)(ii). The Exchange also proposes another conforming change to Cboe BZX Rule 14.11(c)(5) 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.²⁰

III. Proceedings to Determine Whether to Approve or Disapprove SR-CboeBZX-2019-023 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act²¹ 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,

²⁰ See Notice, supra note 3, 84 FR at 16756.

²¹ 15 U.S.C. 78s(b)(2)(B).

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,²² the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the proposed rule change's consistency with Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade," and "to protect investors and the public interest."²³ 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.²⁴ 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 Shares is not susceptible to manipulation?

²²

Id.

²³

15 U.S.C. 78f(b)(5).

²⁴

C.f., Securities Exchange Act Release No. 55783 (May 17, 2007), 72 FR 29194, 29199 (May 24, 2007) (order approving generic listing standards for Shares 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...").

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, pursuant to Rule 19b-4 under the Act,²⁵ any request for an opportunity to make an oral presentation.²⁶

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,²⁷ in addition to any other comments they may wish to submit about the proposed rule change.

²⁵ 17 CFR 240.19b-4.

²⁶ 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).

²⁷ See supra note 3.

In this regard, the Commission seeks comment on the Exchange's proposed generic listing standards for Shares 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."²⁸

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-2019-023 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-2019-023. 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

²⁸ 15 U.S.C. 78f(b)(5).

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-2019-023 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.²⁹

Eduardo A. Aleman,
Deputy Secretary.

²⁹ 17 CFR 200.30-3(a)(57).

[FR Doc. 2019-15657 Filed: 7/23/2019 8:45 am; Publication Date: 7/24/2019]