

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-88795; File No. SR-CboeBZX-2020-036)

May 1, 2020

Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Notice of Filing of a Proposed Rule Change to Amend Rule 14.11, Other Securities

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 29, 2020, Cboe BZX Exchange, Inc. (the “Exchange” or “BZX”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes rule changes in several places in Exchange Rule 14.11, Other Securities, to amend the initial period after commencement of trading of an ETP, as defined below, on the Exchange as it specifically relates to holders of record and/or beneficial holders. The text of the proposed rule change is provided in Exhibit 5.

The text of the proposed rule change is also available on the Exchange’s website (http://markets.cboe.com/us/equities/regulation/rule_filings/bzx/), at the Exchange’s Office of the Secretary, and at the Commission’s Public Reference Room.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The Exchange proposes to make several changes to Rule 14.11 in order to amend the continued listing standards applicable to ETPs³ listed on the Exchange. Specifically, the Exchange is proposing to amend its rules such that they would provide additional time for an ETP to meet the applicable Beneficial Holders⁴ standards in the Exchange’s listing rules (the “Beneficial Holders Rules”).⁵

Currently, the Exchange’s continued listing standards for ETPs generally require that, following the initial 12 month period after commencement of trading on the Exchange, the Exchange shall consider the suspension of trading in and will commence delisting proceedings under Rule 14.12 for an ETP for which there are fewer than 50 Beneficial Holders for 30 or more consecutive trading days. The Exchange is proposing to change the date at which an ETP would

³ For the purpose of this filing, the term ETP means securities listed pursuant to Rule 14.11(c) (Index Fund Shares), Rule 14.11(i) (Managed Fund Shares), and Rule 14.11(l) (Exchange-Traded Fund Shares (“ETF Shares”)).

⁴ As it relates to this filing, “Beneficial Holders” shall mean beneficial holders and, where applicable in a particular continued listing standard, record holders.

⁵ The Exchange notes that its Rules related to the listing and trading of other product types (that is, products that are not ETPs as defined above) have similar requirements related to Beneficial Holders which the Exchange is not proposing to eliminate at this time. Specifically, the Exchange is only proposing to amend the Beneficial Holders Rules as it pertains to Index Fund Shares, Managed Fund Shares, and ETF Shares because such product types represent the vast majority of products listed on the Exchange. The Exchange may consider proposing to amend the Beneficial Holders Rules for other product types in a future proposal.

need to have at least 50 Beneficial Holders or be subject to delisting proceedings under Rule 14.12 from 12 months after commencement of trading on the Exchange to 36 months after commencement of trading on the Exchange.

As further described below, the Exchange believes it is appropriate to increase the period of time for an ETP to comply with the applicable Beneficial Holders Rule from 12 months to 36 months because: (i) it would bring the rule more in line with the life cycle of an ETP; (ii) the economic and competitive structures in place in the ETP ecosystem naturally incentivize issuers to de-list products rather than continuing to list products that do not garner investor interest; and (iii) extending the period from 12 to 36 months will not meaningfully impact the manipulation concerns that the Beneficial Holders Rules are intended to address.

First, the ETP space is more competitive than it has ever been - with more than 2,000 ETPs listed on U.S. national securities exchanges competing for investor assets, the natural cycle for an average ETP to gain traction in the market is growing longer and longer. As more and more ETPs have come to market, many distribution platforms have become more restrictive about the ETPs that they allow on their systems, often requiring a minimum existing track record (e.g., at least 12 months) and meeting certain thresholds for assets under management (e.g., at least \$100 million) for an ETP to be added. Similarly, many larger entities are unwilling to invest in ETPs that do not have at least one calendar year track record. All of these factors have contributed to the natural slowing of the average ETP's growth cycle and, unsurprisingly, the Exchange has seen a significant number of deficiencies based on a failure to meet the applicable Beneficial Holders Rule over the last several years.⁶

⁶ The Exchange has issued deficiency notifications to 34 ETPs for non-compliance with Beneficial Holders Rules in the last five years. In addition, 22 ETPs have voluntarily delisted within their first year listed on the Exchange. While this isn't specifically

Changing the timeline for meeting the Beneficial Holders Rules from 12 months to 36 months would provide ETPs with a more reasonable runway to establish a track record and grow assets under management, both of which generally precede the accumulation of Beneficial Holders. Further, the Exchange believes that extending that runway will encourage smaller issuers to make the necessary capital expenditures to launch additional ETPs, as well as help both large and small issuers by allowing them to continue to list and promote products that they believe can succeed and that they are willing to continue paying for, all of which will help to foster competition and innovation in the ETP marketplace.⁷

Second, the economic and competitive structures in place in the ETP ecosystem naturally incentivize issuers to de-list products rather than continuing to list products that do not garner investor interest, meaning that the rule does not provide any meaningful “pruning” function for the industry. Rather, the Exchange has found that, as currently constructed, the 12 month Beneficial Holders Rules have instead resulted in the forced termination of ETPs that issuers believed were still economically viable. While some observers might argue that forced delisting of an ETP based on a failure to meet the Beneficial Holders Rule is a good way to reduce the number of ETPs in the marketplace that have not drawn meaningful market interest, the Exchange vehemently disagrees with this sentiment. First, there are significant costs associated

attributable to non-compliance with the Beneficial Holder Rules, the most likely reasons for voluntarily delisting an ETP in its first year would be either: (i) failure or anticipated failure to meet the Beneficial Holders Rules; or (ii) the issuer believing that the ETP was not economically viable.

⁷ The Exchange notes that of the 34 ETPs that received deficiency notifications for non-compliance with Beneficial Holders Rules, 27 reached compliance while going through the delisting process under Rule 14.12 and continued to list on the Exchange. As such, the 12 month threshold for the Beneficial Holders Rules had no meaningful impact on whether such ETPs could list on the Exchange and only served as regulatory and administrative burdens for issuers to manage, which the Exchange believes makes it more difficult for smaller issuers to compete.

with both the initial launch and continued operation of an ETP and the Exchange has found that the ecosystem tends to prune itself of ETPs without meaningful investor interest. In fact, the Exchange has had 69 products that have voluntarily delisted in the last two years,⁸ creating meaningful turnover in products which issuers believe are not economically viable. Second, the Exchange contests the underlying assumption that the number of Beneficial Holders is even a meaningful measure of market interest in an ETP. While a very high Beneficial Holder count would most certainly indicate an ETP's success, the absence of Beneficial Holders is not necessarily a good measure of market interest or the amount of assets held by the ETP.

Further to this point, the Beneficial Holders Rules are not rules that an ETP issuer is incentivized to cut close or exceed by the smallest amount possible. Unlike most other quantitative or disclosure based listing requirements, an ETP issuer is incentivized to have as many Beneficial Holders as possible and would almost certainly prefer that they were able to meet and exceed the applicable Beneficial Holders Rule as soon as possible after beginning trading on the Exchange. As such, extending the time period from 12 months to 36 months will not provide issuers with a longer window to intentionally keep the number of Beneficial Holders lower, but, rather, will only extend the period during which an ETP could have fewer than 50 Beneficial Holders in specific instances where an issuer is unable to meet the 50 Beneficial Holders threshold but still believes that the ETP is viable and worth the cost of continued operation. Again, it takes money and resources to launch and operate an ETP and where an issuer does not believe that an ETP is economically viable, both common sense and prior experience point to issuers delisting these products.

⁸ There are currently 357 ETPs listed on the Exchange, meaning that there's been a nearly 20% voluntary turnover of ETPs listed on the Exchange over the last two years.

Finally, the Exchange believes that making this change does not create any significant change in the risk of manipulation for ETPs listed on the Exchange for several reasons. First, the Exchange does not believe that there is anything particularly important about the 50th Beneficial Holder that reduces the manipulation risk associated with an ETP as compared to the 49th, nor is there any manipulation concern that arises on the 366th day after an ETP began trading on the Exchange that didn't otherwise exist on the 1st, 2nd, or 365th day. Rather, the Exchange believes that the rule is generally intended to ensure that products that do not have broad ownership and could be susceptible to manipulation by a few parties are not able to list on the Exchange after they've had sufficient time to diversify their ownership base. Leaving aside the issue of whether an open-ended ETP with creation and redemption processes would really be subject to manipulation by virtue of narrow ownership, the Exchange believes that, for all of the reasons explained above, 36 months is a more appropriate amount of time to consider sufficient time to diversify an ETP's ownership base.

Further to this point, the Exchange has in place a robust surveillance program for ETPs that allows it to monitor trading of ETPs during all trading sessions on the Exchange and it believes are sufficient to deter and detect violations of Exchange rules and the applicable federal securities laws. These surveillances generally focus on detecting securities trading outside of their normal patterns, which could be indicative of manipulative or other violative activity. When such situations are detected, surveillance analysis follows and investigations are opened, where appropriate, to review the behavior of all relevant parties for all relevant trading violations. Further, the Exchange or the Financial Industry Regulatory Authority ("FINRA"),⁹ on behalf of

⁹ FINRA conducts cross-market surveillances on behalf of the Exchange pursuant to a regulatory services agreement. The Exchange is responsible for FINRA's performance under this regulatory services agreement.

the Exchange, or both, communicate as needed regarding trading in ETPs with other markets and other entities that are members of the Intermarket Surveillance Group (“ISG”), and the Exchange or FINRA, on behalf of the Exchange, or both, may obtain trading information in ETPs from such markets and other entities. The Exchange believes that these robust surveillance procedures will further act to mitigate any manipulation concerns that arise from extending the compliance period for the Beneficial Holders Rules from 12 months to 36 months.

The Exchange also believes that the other continued listing standards in the Exchange’s rules or representations that constitute continued listing standards in Exchange rule filings (either the disclosure obligations applicable under Rule 6c-11 of the Investment Company Act of 1940 for series of ETF Shares or the diversity, liquidity, and size of an ETP’s holdings or reference assets applicable to Index Fund Shares and Managed Fund Shares) are generally sufficient to mitigate manipulation concerns associated with the applicable ETP. During the first 12 months of trading on the Exchange when the Beneficial Holders Rules do not apply, these disclosure and quantitative obligations, in conjunction with the Exchange’s surveillance program (as discussed above), are generally deemed sufficient to prevent any manipulation concerns in Exchange-listed ETPs. As such, the Exchange believes that extending the period from 12 months to 36 months does not significantly increase any risk of manipulation that wasn’t already generally deemed acceptable for the first 12 months that an ETP was listed. Again, the Exchange is not proposing to eliminate the Beneficial Holders Rules, but merely to extend the period for an ETP to meet the 50 Beneficial Holder requirement.

2. Statutory Basis

The Exchange believes that the proposal is consistent with Section 6(b) of the Act¹⁰ in general and Section 6(b)(5) of the Act¹¹ in particular in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

The proposed rule changes are designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest because it would prevent the premature delisting of ETPs that have not had sufficient time to build up to 50 Beneficial Holders without significantly impacting the manipulation concerns that the Beneficial Holders Rules are intended to address.

The Exchange believes it is appropriate to increase the period of time for an ETP to comply with the applicable Beneficial Holders Rule from 12 months to 36 months because: (i) it would bring the rule more in line with the life cycle of an ETP; (ii) the economic and competitive structures in place in the ETP ecosystem naturally incentivize issuers to de-list products rather than continuing to list products that do not garner investor interest; and (iii) extending the period from 12 to 36 months will not meaningfully impact the manipulation concerns that the Beneficial Holders Rules are intended to address.

First, the ETP space is more competitive than it has ever been - with more than 2,000 ETPs listed on U.S. national securities exchanges competing for investor assets, the natural cycle for an average ETP to gain traction in the market is growing longer and longer. As more and more ETPs have come to market, many distribution platforms have become more restrictive

¹⁰ 15 U.S.C. 78f.

¹¹ 15 U.S.C. 78f(b)(5).

about the ETPs that they allow on their systems, often requiring a minimum existing track record (e.g., at least 12 months) and meeting certain thresholds for assets under management (e.g., at least \$100 million) for an ETP to be added. Similarly, many larger entities are unwilling to invest in ETPs that do not have at least one calendar year track record. All of these factors have contributed to the natural slowing of the average ETP's growth cycle and, unsurprisingly, the Exchange has seen a significant number of deficiencies based on a failure to meet the applicable Beneficial Holders Rule over the last several years.¹²

Changing the timeline for meeting the Beneficial Holders Rules from 12 months to 36 months would provide ETPs with a more reasonable runway to establish a track record and grow assets under management, both of which generally precede the accumulation of Beneficial Holders. Further, the Exchange believes that extending that runway will encourage smaller issuers to make the necessary capital expenditures to launch additional ETPs, as well as help both large and small issuers by allowing them to continue to list and promote products that they believe can succeed and that they are willing to continue paying for, all of which will help to foster competition and innovation in the ETP marketplace.¹³

¹² The Exchange has issued deficiency notifications to 34 ETPs for non-compliance with Beneficial Holders Rules in the last five years. In addition, 22 ETPs have voluntarily delisted within their first year listed on the Exchange. While this isn't specifically attributable to non-compliance with the Beneficial Holder Rules, the most likely reasons for voluntarily delisting an ETP in its first year would be either: (i) failure or anticipated failure to meet the Beneficial Holders Rules; or (ii) the issuer believing that the ETP was not economically viable.

¹³ The Exchange notes that of the 34 ETPs that received deficiency notifications for non-compliance with Beneficial Holders Rules, 27 reached compliance while going through the delisting process under Rule 14.12 and continued to list on the Exchange. As such, the 12 month threshold for the Beneficial Holders Rules had no meaningful impact on whether such ETPs could list on the Exchange and only served as regulatory and administrative burdens for issuers to manage, which the Exchange believes makes it more difficult for smaller issuers to compete.

Second, the economic and competitive structures in place in the ETP ecosystem naturally incentivize issuers to de-list products rather than continuing to list products that do not garner investor interest, meaning that the rule does not provide any meaningful “pruning” function for the industry. Rather, the Exchange has found that, as currently constructed, the 12 month Beneficial Holders Rules have instead resulted in the forced termination of ETPs that issuers believed were still economically viable. While some observers might argue that forced delisting of an ETP based on a failure to meet the Beneficial Holders Rule is a good way to reduce the number of ETPs in the marketplace that have not drawn meaningful market interest, the Exchange vehemently disagrees with this sentiment. First, there are significant costs associated with both the initial launch and continued operation of an ETP and the Exchange has found that the ecosystem tends to prune itself of ETPs without meaningful investor interest. In fact, the Exchange has had 69 products that have voluntarily delisted in the last two years,¹⁴ creating meaningful turnover in products which issuers believe are not economically viable. Second, the Exchange contests the underlying assumption that the number of Beneficial Holders is even a meaningful measure of market interest in an ETP. While a very high Beneficial Holder count would most certainly indicate an ETP’s success, the absence of Beneficial Holders is not necessarily a good measure of market interest or the amount of assets held by the ETP.

Further to this point, the Beneficial Holders Rules are not rules that an ETP issuer is incentivized to cut close or exceed by the smallest amount possible. Unlike most other quantitative or disclosure based listing requirements, an ETP issuer is incentivized to have as many Beneficial Holders as possible and would almost certainly prefer that they were able to meet and exceed the applicable Beneficial Holders Rule as soon as possible after beginning

¹⁴ There are currently 357 ETPs listed on the Exchange, meaning that there’s been a nearly 20% voluntary turnover of ETPs listed on the Exchange over the last two years.

trading on the Exchange. As such, extending the time period from 12 months to 36 months will not provide issuers with a longer window to intentionally keep the number of Beneficial Holders lower, but, rather, will only extend the period during which an ETP could have fewer than 50 Beneficial Holders in specific instances where an issuer is unable to meet the 50 Beneficial Holders threshold but still believes that the ETP is viable and worth the cost of continued operation. Again, it takes money and resources to launch and operate an ETP and where an issuer does not believe that an ETP is economically viable, both common sense and prior experience point to issuers delisting these products.

Finally, the Exchange believes that making this change does not create any significant change in the risk of manipulation for ETPs listed on the Exchange for several reasons. First, the Exchange does not believe that there is anything particularly important about the 50th Beneficial Holder that reduces the manipulation risk associated with an ETP as compared to the 49th, nor is there any manipulation concern that arises on the 366th day after an ETP began trading on the Exchange that didn't otherwise exist on the 1st, 2nd, or 365th day. Rather, the Exchange believes that the rule is generally intended to ensure that products that do not have broad ownership and could be susceptible to manipulation by a few parties are not able to list on the Exchange after they've had sufficient time to diversify their ownership base. Leaving aside the issue of whether an open-ended ETP with creation and redemption processes would really be subject to manipulation by virtue of narrow ownership, the Exchange believes that, for all of the reasons explained above, 36 months is a more appropriate amount of time to consider sufficient time to diversify an ETP's ownership base.

Further to this point, the Exchange has in place a robust surveillance program for ETPs that allows it to monitor trading of ETPs during all trading sessions on the Exchange and it

believes are sufficient to deter and detect violations of Exchange rules and the applicable federal securities laws. These surveillances generally focus on detecting securities trading outside of their normal patterns, which could be indicative of manipulative or other violative activity. When such situations are detected, surveillance analysis follows and investigations are opened, where appropriate, to review the behavior of all relevant parties for all relevant trading violations. Further, the Exchange or the FINRA,¹⁵ on behalf of the Exchange, or both, communicate as needed regarding trading in ETPs with other markets and other entities that are members of the ISG, and the Exchange or FINRA, on behalf of the Exchange, or both, may obtain trading information in ETPs from such markets and other entities. The Exchange believes that these robust surveillance procedures will further act to mitigate any manipulation concerns that arise from extending the compliance period for the Beneficial Holders Rules from 12 months to 36 months.

The Exchange also believes that the other continued listing standards in the Exchange's rules or representations that constitute continued listing standards in Exchange rule filings (either the disclosure obligations applicable under Rule 6c-11 of the Investment Company Act of 1940 for series of ETF Shares or the diversity, liquidity, and size of an ETP's holdings or reference assets applicable to Index Fund Shares and Managed Fund Shares) are generally sufficient to mitigate manipulation concerns associated with the applicable ETP. During the first 12 months of trading on the Exchange when the Beneficial Holders Rules do not apply, these disclosure and quantitative obligations, in conjunction with the Exchange's surveillance program (as discussed above), are generally deemed sufficient to prevent any manipulation concerns in Exchange-listed

¹⁵ FINRA conducts cross-market surveillances on behalf of the Exchange pursuant to a regulatory services agreement. The Exchange is responsible for FINRA's performance under this regulatory services agreement.

ETPs. As such, the Exchange believes that extending the period from 12 months to 36 months will not significantly increase any risk of manipulation that wasn't already generally deemed acceptable for the first 12 months that an ETP was listed. Again, the Exchange is not proposing to eliminate the Beneficial Holders Rules, but merely to extend the period for an ETP to meet the 50 Beneficial Holder requirement.

The proposed rule change is also designed to protect investors and the public interest because the Exchange is only proposing to amend the continued listing requirement related to Beneficial Holders and all ETPs listed on the Exchange would continue to be subject to the full panoply of Exchange rules and procedures that currently govern the trading of equity securities on the Exchange.

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

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purpose of the Act. Instead, the Exchange believes that the proposed rule change would help to encourage smaller issuers to make the necessary capital expenditures to launch additional ETPs, as well as help both large and small issuers by allowing them to continue to list and promote products that they believe can succeed and that they are willing to continue paying for, which will enhance competition among market participants, to the benefit of investors and the marketplace.

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

The Exchange neither solicited nor received comments on the proposed rule change.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- A. by order approve or disapprove such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CboeBZX-2020-036 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-2020-036. 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-CboeBZX-2020-036, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁶

J. Matthew DeLesDernier
Assistant Secretary

¹⁶ 17 CFR 200.30-3(a)(12).