

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-80728; File No. SR-BatsBZX-2017-26)

May 19, 2017

Self-Regulatory Organizations; Bats BZX Exchange, Inc.; Notice of Filing of a Proposed Rule Change to Amend BZX Rule 14.11, Other Securities, to Provide for the Inclusion of Cash in an Index Underlying a Series of Index Fund Shares

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 May 12, 2017, Bats BZX Exchange, Inc. (the “Exchange” or “BZX”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II 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 the Substance of the Proposed Rule Change

The Exchange filed a proposal to amend BZX Rule 14.11, Other Securities, to provide for the inclusion of cash in an index underlying a series of Index Fund Shares.

The text of the proposed rule change is available at the Exchange’s website at www.bats.com, at the principal office of the Exchange, 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 proposed rule change. The text of these statements may be examined at the places specified in

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant parts 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 amend BZX Rule 14.11(c), Index Fund Shares, to provide for the inclusion of cash in an index underlying a series of Index Fund Shares ("Shares").³ More specifically, BZX Rules 14.11(c)(3) and 14.11(c)(4) provide "generic" criteria permitting listing and trading of Shares pursuant to Rule 19b-4(e) under the Act⁴ when the underlying index or portfolio satisfies the criteria set forth in BZX Rules 14.11(c)(3) related to equity securities or 14.11(c)(4) related to fixed income securities.

The Exchange understands that certain index providers have included, or intend to include, cash as a component in indexes that also include equity or fixed income securities components. An index provider may, for example, provide a certain index weighting allocation to cash or may periodically change an allocation to cash based on the index provider's assessment of market risk associated with other asset classes in the applicable index. Accordingly, the Exchange proposes to amend BZX Rules 14.11(c)(3) and 14.11(c)(4) to explicitly permit listing and trading of Shares based on an index or portfolio that includes cash as a component.

³ Index Fund Shares are securities issued by an open-end management investment company based on a portfolio of stocks or fixed income securities or a combination thereof, that seeks to provide investment results that correspond generally to the price and yield performance or total return performance of a specified foreign or domestic stock index, fixed income securities index or combination thereof.

⁴ 17 CFR 240.19b-4(e).

BZX Rule 14.11(c)(3)(A)(i) currently provides that the component stocks of an index or portfolio of U.S. Component Stocks⁵ underlying a series of Shares must meet certain requirements related to the market cap, trading volume, weighting, diversity, and security requirements. BZX Rule 14.11(c)(3)(A)(ii) currently provides that the components of an index or portfolio underlying a series of Shares that consist of either only Non-U.S. Component Stocks⁶ or both U.S. Component Stocks and Non-U.S. Component Stocks must meet certain similar requirements related to the market cap, trading volume, weighting, diversity, and security requirements that are either equally or more restrictive than for an index or portfolio of U.S. Component Stocks. Finally, BZX Rule 14.11(c)(4)(B)(i) provides that each component of an index or portfolio that underlies a series of Shares shall meet the following criteria: the index or portfolio must consist of Fixed Income Securities⁷ as well as certain requirements related to original principal outstanding, convertible securities, weighting, diversity, and certain issuer requirements. As described below, the proposed amendments to BZX Rule 14.11(c)(3) and 14.11(c)(4) would make clear that cash is permitted to be held as an index or portfolio component and how such cash component should be treated for calculation purposes.

⁵ Pursuant to BZX Rule 14.11(c)(1)(D), the term "U.S. Component Stock" shall mean an equity security that is registered under Sections 12(b) or 12(g) of the Act, or an American Depositary Receipt, the underlying equity security of which is registered under Sections 12(b) or 12(g) of the Act.

⁶ Pursuant to BZX Rule 14.11(c)(1)(E), the term "Non-U.S. Component Stock" shall mean an equity security that (a) is not registered under Sections 12(b) or 12(g) of the Act, (b) is issued by an entity that is not organized, domiciled or incorporated in the United States, and (c) is issued by an entity that is an operating company (including Real Estate Investment Trusts (REITs) and income trust, but excluding investment trusts, unit trusts, mutual funds, and derivatives).

⁷ Pursuant to BZX Rule 14.11(c)(4), 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.

The Exchange proposes to amend BZX Rule 14.11(c)(3)(A)(i) to make clear that the components of an index or portfolio underlying a series of Shares may also include cash. In addition, the percentage weighting criteria in BZX Rule 14.11(c)(3)(A)(i)(a) through (d) each would be amended to make clear that such criteria would be applied only to the U.S. Component Stocks portion of an index or portfolio. For example, in applying the criteria in proposed BZX Rule 14.11(c)(3)(A)(i)(a),⁸ if 85% of the weight of an index consists of U.S. Component Stocks and 15% of the index weight is cash, the requirement that component stocks accounting for 90% of the weight of the index or portfolio have a minimum market value of \$75 million minimum would be applied only to the 85% portion consisting of U.S. Component Stocks.

The Exchange proposes to amend BZX Rule 14.11(c)(3)(A)(ii), which relates to international or global indexes or portfolios, in order to make clear that components of an index or portfolio underlying a series of Shares may consist of (a) only Non-U.S. Component Stocks, (b) Non-U.S. Component Stocks and cash, (c) both U.S. Component Stocks and Non-U.S. Component Stocks, or (d) U.S. Component Stocks, Non-U.S. Component Stocks and cash. In addition, the percentage weighting criteria in BZX Rule 14.11(c)(3)(A)(ii)(a) through (d) each would be amended to make clear that such criteria would be applied only to the U.S. and Non-U.S. Component Stocks portions of an index or portfolio.

As noted above, BZX Rule 14.11(c)(4) provides generic criteria applicable to listing and trading of Shares whose underlying index or portfolio includes Fixed Income Securities. The Exchange proposes to amend BZX Rule 14.11(c)(4)(B)(i)(a) to make clear that the index or

⁸ Proposed changes to BZX Rule 14.11(c)(3)(A)(i)(a) would provide that component stocks (excluding Derivative Securities Products) that in the aggregate account for at least 90% of the weight of the U.S. Component Stocks portion of the index or portfolio (excluding such Derivative Securities Products) each shall have a minimum market value of at least \$75 million.

portfolio may also include cash. In addition, the percentage weighting criteria in BZX Rule 14.11(c)(4)(B)(i)(b), BZX Rule 14.11(c)(4)(B)(i)(d), and BZX Rule 14.11(c)(4)(B)(i)(f) each would be amended to make clear that such criteria would be applied only to the Fixed Income Securities portion of an index or portfolio. For example, in applying the criteria in proposed Rule 14.11(i)(4)(B)(i)(b),⁹ if 90% of the weight of an index or portfolio consists of Fixed Income Securities and 10% of the index weight is cash, the requirement that Fixed Income Securities accounting for at least 75% of the weight of the index or portfolio have a minimum original principal amount outstanding of \$100 million would be applied only to the 90% portion of the index or portfolio that consists of Fixed Income Securities.

The Exchange notes that the Commission has previously approved Exchange rules allowing portfolios held by issues of Managed Fund Shares (actively-managed exchange-traded funds) under BZX Rule 14.11(i)(4)(C) to include cash.¹⁰ Like the provision in BZX Rule 14.11(i)(4)(C)(iii), which states that there is no limit to cash holdings by an issue of Managed Fund Shares listed under BZX Rule 14.11(i)(4)(C), there is no proposed limit to the weighting of cash in an index underlying a series of Shares. The Exchange believes this is appropriate in that cash does not, in itself, impose investment or market risk.

The Exchange believes the proposed amendments, by permitting inclusion of cash as a component of indexes underlying series of Shares, would provide issuers of Shares with additional choice in indexes permitted to underlie Shares that are permitted to list and trade on the Exchange pursuant to the Rule 19b-4(e), which would enhance competition among market

⁹ Proposed 14.11(c)(4)(B)(i)(b) would provide that Fixed Income Security components that in aggregate account for at least 75% of the Fixed Income Securities portion of the weight of the index or portfolio each shall have a minimum original principal amount outstanding of \$100 million or more.

¹⁰ See BZX Rule 14.11(i)(4)(C)(iii).

participants, to the benefit of investors and the marketplace. In addition, the proposed amendments would provide investors with greater ability to hold Shares based on underlying indexes that may accord more closely with an investor's assessment of market risk, in that some investors may view cash as a desirable component of an underlying index under certain market conditions.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,¹¹ in general, and furthers the objectives of Sections 6(b)(5) of the Act,¹² in particular, because it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to, and perfect the mechanisms of, a free and open market and a national market system and, in general, to protect investors and the public interest and because it is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Exchange has in place surveillance procedures that are adequate to properly monitor trading in Shares in all trading sessions and to deter and detect violations of Exchange rules and applicable federal securities laws.

The Exchange notes that, as described above, the percentage weighting criteria in BZX Rule 14.11(c)(3)(A)(i)(a) through (d) (U.S. index or portfolio) each would be amended to make clear that such criteria would apply only to the U.S. Component Stocks portion of an index or

¹¹ 15 U.S.C. 78f(b).

¹² 15 U.S.C. 78f(b)(5).

portfolio; BZX Rule 14.11(c)(3)(A)(ii)(a) through (d) (international or global index or portfolio) each would be amended to make clear that such criteria would be applied only to the U.S. and Non-U.S. Component Stocks portions of an index or portfolio; and the percentage weighting criteria in BZX Rule 14.11(c)(4)(B)(i)(b), (d), and (f) (fixed income index or portfolio) each would be amended to make clear that such criteria would be applied only to the Fixed Income Securities portion of an index or portfolio. Such applications of the proposed amendments would assure that the weighting requirements in Rules 14.11(c)(3) and 14.11(c)(4) would continue to be applied only to securities in an index or portfolio, and would not be diluted as a result of inclusion of a cash component. In addition, the addition of cash as a permitted component of indexes underlying Shares listed and traded on the Exchange pursuant to Rule 19b-4(e) does not raise regulatory issues because cash does not, in itself, impose investment or market risk and is not susceptible to manipulation.

The Exchange believes the proposed amendments, by explicitly permitting inclusion of cash as a component of indexes underlying series of Shares, would provide issuers of Shares with additional choice in indexes permitted to underlie Shares that are permitted to list and trade on the Exchange pursuant to the Rule 19b-4(e), which would enhance competition among market participants, to the benefit of investors and the marketplace. In addition, the proposed amendments would provide investors with greater ability to hold Shares based on underlying indexes that may accord more closely with an investor's assessment of market risk.

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

In accordance with Section 6(b)(8) of the Act,¹³ the Exchange believes that the proposed rule change would not impose any burden on competition that is not necessary or appropriate in

¹³ 15 U.S.C. 78f(b)(8).

furtherance of the purposes of the Act. The proposed rule change would explicitly permit Exchange listing and trading under Rule 19b-4(e) of Shares based on indexes that include cash as a component, which would 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 has neither solicited nor received written 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 self-regulatory organization 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-BatsBZX-2017-26 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-BatsBZX-2017-26. 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, D.C. 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should

submit only information that you wish to make available publicly. All submissions should refer to File Number SR-BatsBZX-2017-26, 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.¹⁴

Eduardo A. Aleman
Assistant Secretary

¹⁴ 17 CFR 200.30-3(a)(12).