

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-84378; File No. SR-CboeBZX-2018-044)

October 5, 2018

Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No. 1, to Amend BZX Rule 14.11(c) (Index Fund Shares)

I. Introduction

On June 21, 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”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend BZX Rule 14.11(c) to permit either the portfolio holdings of a series of Index Fund Shares or the index underlying a series of Index Fund Shares to satisfy the listing standards under BZX Rules 14.11(c)(3), (4), and (5). The proposed rule change was published for comment in the Federal Register on July 11, 2018.<sup>3</sup> On August 23, 2018, pursuant to Section 19(b)(2) of the Act,<sup>4</sup> 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.<sup>5</sup> On September 28, 2018, the Exchange filed Amendment No. 1 to the proposed rule change, which amended and replaced the proposed rule

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 83594 (July 5, 2018), 83 FR 32158.

<sup>4</sup> 15 U.S.C. 78s(b)(2).

<sup>5</sup> See Securities Exchange Act Release No. 83919, 83 FR 44083 (August 29, 2018). The Commission designated October 9, 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.

change as originally filed.<sup>6</sup> The Commission has received no comment letters on the proposal. The Commission is publishing this notice and order to solicit comments on the proposed rule change, as modified by Amendment No. 1, from interested persons and to institute proceedings pursuant to Section 19(b)(2)(B) of the Act<sup>7</sup> to determine whether to approve or disapprove the proposed rule change, as modified by Amendment No. 1.

II. Description of the Proposal, as Modified by Amendment No. 1<sup>8</sup>

BZX Rule 14.11(c) sets forth the listing standards for Index Fund Shares. Currently, the Exchange determines whether a series of Index Fund Shares meets the initial and continued listing standards under BZX Rules 14.11(c)(3), (4), and (5) by assessing the underlying index. The Exchange now proposes to permit either the portfolio holdings of a series of Index Fund Shares or the index underlying a series of Index Fund Shares to satisfy the initial and continued listing standards under BZX Rules 14.11(c)(3), (4), and (5). As a result, the proposal would allow the Exchange to generically list a series of Index Fund Shares where the generic listing standards are satisfied by either its portfolio holdings or its underlying index.

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<sup>6</sup> In Amendment No. 1, the Exchange: (1) proposed to delete certain references to the term “portfolio” in BZX Rules 14.11(c)(1)(C), 14.11(c)(8), and 14.11(c)(9)(B)(i)(b) such that the amended provisions would apply only to the index underlying a series of Index Fund Shares; (2) represented that, to the extent that the proposal results in meaningful additional costs associated with regulatory review, the Exchange either already has or will dedicate sufficient additional resources to perform such reviews; (3) supplemented its arguments in support of the proposal; and (4) made technical and conforming changes. Amendment No. 1 is available at: <https://www.sec.gov/comments/sr-cboebzx-2018-044/srcboebzx2018044.htm>.

<sup>7</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>8</sup> For a full description of the proposal, see Amendment No. 1, supra note 6.

The Exchange also proposes to amend BZX Rules 14.11(c)(1)(C),<sup>9</sup> 14.11(c)(8),<sup>10</sup> and 14.11(c)(9)(B)(i)(b)<sup>11</sup> to eliminate certain references to the term “portfolio” such that the amended provisions would apply only to the underlying index. As proposed, all other references to “index or portfolio” or “portfolio or index” in BZX Rule 14.11(c) would mean the index underlying a series of Index Fund Shares or the portfolio holdings of a series of Index Fund Shares.

The Exchange represents that it has in place surveillance procedures that are adequate to properly monitor trading in Index Fund Shares in all trading sessions and to deter and detect violations of Exchange rules and applicable federal securities laws. In addition, the Exchange states that it does not believe that the proposal will result in any meaningful additional costs associated with regulatory review, but to the extent that it does, the Exchange either already has or will dedicate sufficient additional resources to perform such reviews.

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<sup>9</sup> BZX Rule 14.11(c)(1)(C) currently defines the term “Reporting Authority” to mean, in part, the official source for calculating and reporting information relating to a series of Index Fund Shares, including, but not limited to, any current index “or portfolio” value. The Exchange proposes to delete the term “or portfolio” from this provision.

<sup>10</sup> BZX Rule 14.11(c)(8) currently provides, in part, that the Exchange may list and trade Index Fund Shares based on one or more foreign or domestic indexes “or portfolios” and that each issue of Index Fund Shares based on each particular index “or portfolio, or combination thereof,” shall be designated as a separate series and shall be identified by a unique symbol. The Exchange proposes to delete the terms “or portfolios” and “or portfolio, or combination thereof,” from this provision.

<sup>11</sup> BZX Rule 14.11(c)(9)(B)(i)(b) currently provides, in part, that the Exchange will consider the suspension of trading in and will initiate delisting proceedings for a series of Index Fund Shares if the value of the index “or portfolio” of securities on which the series of Index Fund Shares is based is no longer calculated or available, or an interruption to the dissemination of the value of the index “or portfolio” of securities persists past the trading day in which it occurred, or the index “or portfolio” on which a series of Index Fund Shares is based is replaced with a new index “or portfolio” unless certain conditions are met. The Exchange proposes to delete the terms “or portfolio” from this provision.

III. Proceedings to Determine Whether to Approve or Disapprove SR-CboeBZX-2018-044, as Modified by Amendment No. 1, and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act<sup>12</sup> to determine whether the proposed rule change, as modified by Amendment No. 1, should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the proposal. 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, as modified by Amendment No. 1.

Pursuant to Section 19(b)(2)(B) of the Act,<sup>13</sup> 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,<sup>14</sup> 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.

As discussed above, the proposal would permit either the portfolio holdings of a series of Index Fund Shares or the index underlying a series of Index Fund Shares to satisfy the initial and continued listing standards under BZX Rules 14.11(c)(3), (4), and (5). The Exchange asserts that the proposal would provide issuers of Index Fund Shares with a greater degree of control over whether their products meet their ongoing listing obligations, and that the proposal would

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<sup>12</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>13</sup> Id.

<sup>14</sup> 15 U.S.C. 78f(b)(5).

accomplish the policy goals underlying the listing standards for Index Fund Shares.<sup>15</sup> In particular, the Exchange asserts that the index methodology for an index underlying a series of Index Fund Shares is out of the control of the issuers of the products, and that it is problematic to require an issuer to ensure that the underlying index meets listing standards on an ongoing basis.<sup>16</sup> The Exchange also asserts that, after a series of Index Fund Shares is listed on the Exchange, both the index constituents and the portfolio holdings are equally viable for evaluating whether the shares are susceptible to manipulation.<sup>17</sup> Moreover, according to the Exchange, portfolio holdings are arguably a better means for making these determinations than the underlying index because the portfolio holdings reflect the actual assets held by a series of Index Fund Shares, whereas the index constituents are just the assets that the series is designed to track.<sup>18</sup> Additionally, the Exchange states that any series of Index Fund Shares listed on the

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<sup>15</sup> See Amendment No. 1, supra note 6, at 7 and 10.

<sup>16</sup> See id. at 7. According to the Exchange, where the index constituents no longer meet the listing standards, the only ways for constituents to get back into compliance are through natural market movements, an index rebalance, a change to the index methodology, or a change of index. See id. The Exchange asserts that: (1) it is not feasible for an issuer to rely on natural market movements to bring a series of Index Fund Shares back into compliance with the listing standards; (2) an index rebalance may or may not bring a series of Index Fund Shares back into compliance, and index rebalances may not occur within the cure periods specified in BZX Rule 14.12 (i.e., up to 180 calendar days from initial notice of non-compliance with the listing standards); and (3) changing an index's methodology or changing the underlying index would require significant effort and months of notice, and therefore also may not occur within the cure periods specified in BZX Rule 14.12. See id.

<sup>17</sup> See id. at 5.

<sup>18</sup> See id. at 6. The Exchange acknowledges that allowing the portfolio holdings to satisfy the generic listing standards could raise concerns that a series of Index Fund Shares may be based on an index that does not meet the generic listing standards and therefore may be susceptible to manipulation. See id. at 9. However, the Exchange argues that, currently, a series of Index Fund Shares overlying an index that meets the generic listing standards may have portfolio holdings that could theoretically be susceptible to manipulation (and/or the creation and redemption process and the arbitrage mechanisms

Exchange must meet all requirements applicable under the Investment Company Act of 1940, including Rule 35d-1,<sup>19</sup> which requires a series of Index Fund Shares to invest at least 80% of its assets in investments connoted by the index (“80% Rule”).<sup>20</sup> According to the Exchange, the 80% Rule would provide assurance that there is significant overlap between the portfolio holdings and the underlying index.<sup>21</sup> Finally, the Exchange compares Index Fund Shares to Managed Fund Shares, and notes that the generic listing standards for Managed Fund Shares under BZX Rule 14.11(i) apply to portfolio holdings.<sup>22</sup>

The Commission asks that commenters address the sufficiency of the Exchange’s statements in support of the proposal, which are set forth in Amendment No. 1,<sup>23</sup> in addition to any other comments they may wish to submit about the proposal. In particular, the Commission seeks comment regarding whether the proposal would result in the listing and trading of Index Fund Shares that are susceptible to manipulation because they overlie indexes that do not meet the listing standards under BZX Rule 14.11(c). The Commission seeks comment regarding whether the 80% Rule or any other safeguard would help assure that, as long as the portfolio holdings meet the listing standards under BZX Rules 14.11(c)(3), (4), and (5), the Index Fund Shares would not be susceptible to manipulation. The Commission also seeks comment regarding whether the proposal sufficiently addressed manipulation risk by merely applying, without change, the current listing standards under BZX Rules 14.11(c)(3), (4), and (5) that are

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would not operate efficiently) because the portfolio holdings do not meet the generic listing standards. See id.

<sup>19</sup> 17 CFR 270.35d-1.

<sup>20</sup> See Amendment No. 1, supra note 6, at 9-10.

<sup>21</sup> See id.

<sup>22</sup> See id. at 8.

<sup>23</sup> See supra note 6.

applicable to the underlying index to the portfolio holdings of a series of Index Fund Shares.<sup>24</sup> Moreover, the Commission seeks comment regarding whether the Exchange has sufficiently justified the flexibility it seeks under the proposal, which would allow the Exchange to choose to apply the listing standards under BZX Rules 14.11(c)(3), (4), and (5) to either the portfolio holdings or the underlying index, both at the time of initial listing and at any time thereafter.<sup>25</sup> Finally, the Commission seeks comment regarding the sufficiency of the Exchange's statements in support of the deletion of certain references to the term "portfolio" in BZX Rules 14.11(c)(1)(C), 14.11(c)(8), and 14.11(c)(9)(B)(i)(b).

#### 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, as modified by Amendment No. 1, 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,<sup>26</sup> any request for an opportunity to make an oral presentation.<sup>27</sup>

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<sup>24</sup> The Commission notes that there are differences between the listing standards for Index Fund Shares under BZX Rule 14.11(c) and the listing standards for Managed Fund Shares under BZX Rule 14.11(i).

<sup>25</sup> As proposed, the Exchange could assess the portfolio holdings at one time, and assess the underlying index at another time.

<sup>26</sup> 17 CFR 240.19b-4.

<sup>27</sup> 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

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change, as modified by Amendment No. 1, 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](mailto:rule-comments@sec.gov). Please include File Number SR-CboeBZX-2018-044 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-2018-044. 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

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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).



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-2018-044 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.<sup>28</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>28</sup> 17 CFR 200.30-3(a)(12); 17 CFR 200.30-3(a)(57).