

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-87636; File No. SR-CboeBZX-2019-023)

November 27, 2019

Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1, 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

I. Introduction

On April 3, 2019, Cboe BZX Exchange, Inc. (“BZX” or “Exchange”) 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 On July 18, 2019, the Commission instituted proceedings under Section 19(b)(2)(B) of the Act⁶ to determine whether

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 85656 (April 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.

⁶ 15 U.S.C. 78s(b)(2)(B).

to approve or disapprove the proposed rule change.⁷ On October 15, 2019, the Commission extended the period for issuing an order approving or disapproving the proposed rule change.⁸ On October 31, 2019, the Exchange filed Amendment No. 1 to the proposed rule change, which amended and replaced in its entirety the original proposed rule change.⁹ The Commission has received no comment letters on the proposed rule change.

II. The Exchange’s Description of the Proposed Rule Change, as Modified by Amendment No. 1

Rule 14.11(c) permits the Exchange to list a series of Index Fund Shares based on an index or portfolio of underlying securities. Currently, Rule 14.11(c)(4)(B)(i) provides generic listing standards for Index Fund Shares based on an index or portfolio of fixed income securities. The Exchange proposes to amend the Rule to add a new subsection Rule 14.11(c)(4)(B)(ii) to provide quantitative generic listing standards for Index Fund Shares based on an index or portfolio of Municipal Securities¹⁰ that do not meet the generic listing standards under Rule 14.11(c)(4)(B)(i).¹¹

⁷ See Securities Exchange Act Release No. 86410, 84 FR 35698 (July 24, 2019).

⁸ See Securities Exchange Act Release No. 87300, 84 FR 56209 (October 21, 2019). The Commission designated December 18, 2019, as the date by which the Commission shall either approve or disapprove the proposed rule change.

⁹ In Amendment No. 1, the Exchange: (1) clarified that its proposed requirement that an underlying index or portfolio must include a minimum of 13 “non-affiliated” issuers means a minimum of 13 “unique” issuers; and (2) prohibited its generic listing of Index Fund Shares based on Municipal Securities (defined below) that seeks to provide investment results, before fees and expenses, in an amount that exceeds -300% of the percentage performance on a given day of an index of Municipal Securities. Amendment No. 1 is available at: <https://www.sec.gov/comments/sr-cboebzx-2019-023/srcboebzx2019023-6388601-198128.pdf>. In view of the Commission’s recent approval of another exchange’s substantively identical proposal, Amendment No. 1 raises no novel issues and is therefore not subject to notice and comment. See Securities Exchange Act Release Nos. 85170 (February 21, 2019), 84 FR 6451 (February 27, 2019) and 87382 (October 22, 2019), 84 FR 57789 (October 28, 2019) (SR-NYSEArca-2019-04) (“NYSE Arca Proposal”).

¹⁰ According to the proposal, the term “Municipal Securities” has the definition given to it in Section 3(a)(29) of the Act.

All other standards, however, not included in Rule 14.11(c)(4)(B)(i) applicable to series of Index Fund Shares based on an index composed of fixed income securities will continue to apply to a series of Index Fund Shares based on an index or portfolio of Municipal Securities listed pursuant to Rule 14.11(c)(4)(B)(ii). The Exchange also proposes to add language that would prohibit the listing of Shares under proposed Rule 14.11(c)(4)(B)(ii) that would seek to provide investment results, before fees and expenses, in an amount exceeding -300% of the percentage performance on a given day.

According to the Exchange, indices of Municipal Securities are able to satisfy all of the generic listing requirements applicable to fixed income indices in Rule 14.11(c)(4)(b)(i) except the requirement that component securities in an index have a minimum original principal amount outstanding of \$100 million or more. The Exchange provides that Municipal Securities are generally issued with individual maturities of relatively small size, although they generally are constituents of a much larger municipal bond offering. Therefore, Municipal Securities are unable to satisfy the Rule's requirement that "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." Notwithstanding the inability of a Municipal Securities index to meet this aspect of the generic listing standards, the Exchange notes that the Commission previously approved for listing and trading Index Fund Shares based on such indices.¹²

¹¹ The Exchange notes that its proposal is substantively identical to the NYSE Arca Proposal. See supra note 9.

¹² See Securities Exchange Act Release Nos. 84107 (September 13, 2018), 83 FR 47210 (September 18, 2018) (SR-CboeBZX-2018-070) (Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To List and Trade Shares of the iShares iBonds Dec 2025 Term Muni Bond ETF of iShares Trust Under BZX Rule 14.11(c)(4) (Index Fund Shares)); 79381 (November 22, 2016), 81 FR 86044 (November 29, 2016) (SR-BatsBZX-2016-48) (Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendments No. 1 and No. 2 Thereto, To List and Trade Shares of the

In light of the characteristics of Municipal Securities as described above, the Exchange proposes in its filing to apply existing Rule 14.11(c)(4)(b)(i) and proposed Rule 14.11(c)(4)(B)(ii) in a “waterfall” manner. Specifically, the Exchange proposes that every series of Index Fund Shares based on an index of fixed income securities and cash (including an index that contains Municipal Securities) would initially be evaluated against the generic listing standards of the existing Rule 14.11(c)(4)(b)(i). If the index underlying a series of Index Fund Shares satisfies the existing criteria of Rule 14.11(c)(4)(b)(i), the Exchange would proceed with listing the Index Fund Shares under that

iShares iBonds Dec 2023 Term Muni Bond ETF and iShares iBonds Dec 2024 Term Muni Bond ETF of the iShares U.S. ETF Trust Pursuant to BZX Rule 14.11(c)(4); 67985 (October 4, 2012), 77 FR 61804 (October 11, 2012) (SR-NYSEArca-2012-92) (order approving proposed rule change relating to the listing and trading of iShares 2018 S&P AMT-Free Municipal Series and iShares 2019 S&P AMT-Free Municipal Series under NYSE Arca Equities Rule 5.2(j)(3), Commentary .02); 67729 (August 24, 2012), 77 FR 52776 (August 30, 2012)(SR-NYSEArca-2012-92) (notice of proposed rule change relating to the listing and trading of iShares 2018 S&P AMT-Free Municipal Series and iShares 2019 S&P AMT-Free Municipal Series under NYSE Arca Equities Rule 5.2(j)(3), Commentary .02); 72523 (July 2, 2014), 79 FR 39016 (July 9, 2014) (SR-NYSEArca-2014-37) (order approving proposed rule change relating to the listing and trading of iShares 2020 S&P AMT-Free Municipal Series under NYSE Arca Equities Rule 5.2(j)(3), Commentary.02); 72172 (May 15, 2014), 79 FR 29241 (May 21, 2014) (SR-NYSEArca-2014-37) (notice of proposed rule change relating to the listing and trading of iShares 2020 S&P AMT-Free Municipal Series under NYSE Arca Equities Rule 5.2(j)(3), Commentary.02); 72464 (June 25, 2014), 79 FR 37373 (July 1, 2014) (File No. SR-NYSEArca-2014-45) (order approving proposed rule change governing the continued listing and trading of shares of the PowerShares Insured California Municipal Bond Portfolio, PowerShares Insured National Municipal Bond Portfolio, and PowerShares Insured New York Municipal Bond Portfolio); 75468 (July 16, 2015), 80 FR 43500 (July 22, 2015) (SR-NYSEArca-2015-25) (order approving proposed rule change relating to the listing and trading of iShares iBonds Dec 2021 AMT-Free Muni Bond ETF and iShares iBonds Dec2022 AMT-Free Muni Bond ETF under NYSE Arca Equities Rule 5.2(j)(3)); 74730 (April 15, 2015), 76 FR 22234 (April 21, 2015) (notice of proposed rule change relating to the listing and trading of iShares iBonds Dec 2021 AMT-Free Muni Bond ETF and iShares iBonds Dec 2022 AMT-Free Muni Bond ETF under NYSE Arca Equities Rule 5.2(j)(3), Commentary .02); 74730 75376 (July 7, 2015), 80 FR 40113 (July 13, 2015) (SR-NYSEArca-2015-18) (order approving proposed rule change relating to the listing and trading of Vanguard Tax-Exempt Bond Index Fund under NYSE Arca Equities Rule 5.2(j)(3)).

provision. However, if the index does not meet the requirements of Rule 14.11(c)(4)(b)(i) and such index contains only Municipal Securities and cash, the Exchange would apply the proposed Rule 14.11(c)(4)(B)(ii) to such index.

The Exchange believes that proposed Rule 14.11(c)(4)(B)(ii) includes many requirements that are more stringent than those applicable to an index of fixed income securities and cash under existing Rule 14.11(c)(4)(B)(i). The Exchange accordingly believes these heightened requirements would deter potential manipulation of such Municipal Securities indices, even though the indices may include securities that have smaller original principal amounts outstanding. Below is a comparison of the existing quantitative requirements for Index Fund Shares based on an index of fixed income securities (existing Rule 14.11(c)(4)(B)(i)) versus the Exchange’s proposed alternative quantitative requirements for Index Fund Shares based on an index of Municipal Securities (proposed Rule 14.11(c)(4)(B)(ii)). The Exchange proposes that the quantitative requirements described below would apply to a Municipal Securities index underlying a series of Index Fund Shares on both an initial and continued basis.

Original Principal Amount Outstanding:

Existing Requirement for Fixed Income Securities:	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.
Proposed Requirement for Municipal Securities:	Municipal Security components that in aggregate account for at least 90% of the Municipal Securities portion of the weight of the index or portfolio each shall 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.

As discussed above, 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. In recognition of these smaller offering sizes, the Exchange proposes to reduce the minimum original principal amount outstanding requirement for component securities to at least \$5 million. However, 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 that must satisfy the original principal amount outstanding requirement from 75% to 90%.

The Exchange does not believe that reducing the requirement for minimum original principal amount outstanding will make an index of Municipal Securities more susceptible to manipulation. The Exchange believes that the requirement that component securities in a fixed income index have a minimum principal amount outstanding, in concert with the other requirements of Rule 14.11(c)(4)(B)(i), is to ensure that such index is sufficiently broad-based in scope as to minimize potential manipulation of the index. However, based on empirical analysis, the Exchange does not believe that an index of Municipal Securities with lower original principal amounts outstanding is necessarily more susceptible to manipulation.¹³ According to the Exchange, in 2016, Blackrock, Inc. analyzed the potential for manipulation of Municipal Securities to affect an exchange traded fund and found that such manipulation “may be uneconomical and is unsupported in practice.”¹⁴ In addition, the Exchange believes that its proposal to require that 90% of the weight

¹³ See Letter from Samara Cohen, Managing Director, U.S. Head of iShares Capital Markets, Joanne Medero, Managing Director, Government Relations & Public Policy, and Deepa Damre, Managing Director, Legal and Compliance, BlackRock, Inc., to Brent J. Fields, Secretary, Commission, dated October 18, 2017, in support of the Exchange’s proposal to facilitate the listing and trading of Index Fund Shares listed pursuant to NYSE Arca Rule 5.2-E(j)(3) (SR-NYSEArca-2017-56).

¹⁴ See *id.* at 3 and accompanying note 11. In the letter, Blackrock states that Blackrock’s “empirical analysis indicated that: (1) given the over-the-counter dealer-centric market for municipal bonds, the bid-ask spread decreases with trade size; therefore, trading many small lots to move matrix prices is likely to be costly; (2) large trades move prices significantly and this effect is incorporated into prices quickly; for manipulation to work

of a Municipal Securities index meet the original principal amount outstanding requirement (as opposed to 75% for fixed income indices) will further deter potential manipulation by ensuring that a greater portion of the index meet this minimum size requirement.

The Exchange further notes that the Commission previously approved the listing and trading of several series of Index Fund Shares where the component securities representing at least 90% of the weight of the underlying index must 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

Maximum Weight of Component Securities:

Existing Requirement for Fixed Income Securities:	No component fixed income security (excluding Treasury Securities and GSE Securities) shall represent more than 30% of the Fixed Income Securities portion of the weight of the index or portfolio, and the five most heavily weighted component fixed income securities in the index or portfolio shall not in the aggregate account for more than 65% of the Fixed Income Securities portion of the weight of the index or portfolio.
Proposed Requirement for Municipal Securities:	No component Municipal Security shall represent more than 10% of the Municipal Securities portion of the weight of the index or portfolio, and the five most heavily weighted component Municipal Securities in the index or portfolio shall not in the aggregate account for more than 30% of the Municipal Securities portion of the weight of the index or portfolio.

by affecting bond prices, the trades must be large, implying greater dollar cost and more likelihood of detection even if markets were segmented; (3) while pricing agents apply matrix pricing techniques to value non-traded bonds, the effect is likely too small to permit price manipulation of the corresponding index or ETF; and (4) market participants will use all intraday data to come up with their own valuations independently of pricing providers; ultimately, the price of an ETF at a point in time reflects these estimates in a manner that balances supply and demand.”

¹⁵ See, e.g., Securities Exchange Act Release No. 84049 (September 6, 2018), 83 FR 46228 (September 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).

The Exchange proposes to reduce the maximum weight that any individual Municipal Security, or group of five Municipal Securities, can have in a Municipal Securities index. The current generic listing rules for Index Fund Shares based on a fixed income index permit individual component securities to account for up to 30% of the weight of such index and the top five weighted component securities to account for up to 65% of the weight of such index. The Exchange proposes to reduce these criteria to 10% for individual Municipal Securities and 30% for the top five weighted Municipal Securities in an index.

The Exchange believes that its proposal will reduce the likelihood that a Municipal Securities index underlying a series of Index Fund Shares could be subject to manipulation by ensuring that no individual Municipal Security, or group of five Municipal Securities, represents an outsized weight of a Municipal Securities index.

Diversification of Issuers:

Existing Requirement for Fixed Income Securities:	An underlying index or portfolio (excluding one consisting entirely of exempted securities) must include a minimum of 13 non-affiliated issuers.
Proposed Requirement for Municipal Securities:	An underlying index or portfolio must include a minimum of 13 unique issuers.

The current generic listing rules for Index Fund Shares based on an index of fixed income securities require that such index must include securities from at least thirteen non-affiliated¹⁶ issuers. Notably, the current Rule does not apply the issuer diversification requirement to indices consisting entirely of exempted securities. Municipal Securities are included in the definition of

¹⁶ The Exchange notes that Rule 405 under the Securities Act of 1933 defines an affiliate as a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with such person. Rule 405 defines control as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

exempted securities.¹⁷ Therefore, an index of Municipal Securities that otherwise meets the requirements of Rule 14.11(c)(4)(b)(i) would not be required to satisfy the minimum issuer diversification requirement.

Under the proposed Rule 14.11(c)(4)(b)(ii), the Exchange proposes that a Municipal Securities index be required to include securities from at least 13 unique issuers. The Exchange believes that requiring such diversification will reduce the likelihood that an index can be manipulated by ensuring that securities from a variety of issuers are represented in an index of Municipal Securities.

Number of Components:

Existing Requirement for Fixed Income Securities:	Thirteen
Proposed Requirement for Municipal Securities:	Five hundred

The current generic listing requirements for Index Fund Shares based on an index of fixed income securities do not have an explicit requirement that an index contain a minimum number of securities. However, given that such requirements also specify that an index must contain securities from at least thirteen non-affiliated issuers, there is a de facto requirement that an index of fixed income securities contain at least thirteen component securities. As described above, however, a fixed income index comprised entirely of exempted securities (including Municipal Securities) is not required to satisfy the issuer diversification requirement, thereby allowing it to have no minimum number of component securities.

Under the proposed Rule 14.11(c)(4)(b)(ii), the Exchange proposes to require that a Municipal Securities index contain at least 500 component securities. The Exchange believes that

¹⁷ See Section 3(a)(12) of the Act.

such requirement will ensure that a Municipal Securities index is sufficiently broad-based and diversified to make it less susceptible to manipulation.

In addition to these changes, the Exchange proposes to amend Rule 14.11(c)(5) to specify that the Exchange may approve a series of Index Fund Shares for listing based on a combination of indexes, including an index of Municipal Securities. To the extent that an index of Municipal Securities is included in a combination, amended Rule 14.11(c)(5) will specify that the Municipal Securities index must meet all requirements of proposed Rule 14.11(c)(4)(B)(ii). In addition, amended Rule 14.11(c)(5) will specify that requirements related to index dissemination and related continued listing standards will apply to indexes of Municipal Securities. The Exchange notes that a combination index (including one that includes an index of Municipal Securities) will not be permitted to seek to provide investment results, before fees and expenses, in an amount that exceeds -300% of the percentage performance on a given day of any index included in such combination index.

Finally, as noted above, the Exchange proposes that existing rules applicable to Index Fund Shares based on fixed income securities will continue to apply to any series of Index Fund Shares listed pursuant to proposed Rule 14.11(c)(4)(B)(ii), including: (i) index methodology and calculation;¹⁸ (ii) dissemination of information;¹⁹ (iii) initial shares outstanding;²⁰ (iv) hours of trading;²¹ (v) surveillance procedures;²² and (vi) all continued listing requirements under Rule 14.11(c)(9)(B).

III. Discussion and Commission's Findings

After careful review, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.²³ In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,²⁴ which requires, among other things, that the Exchange's rules be designed to prevent fraudulent and manipulative acts and practices, 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.

With respect to the quantitative requirements of proposed Rule 14.11(c)(4)(B)(ii), the original principal amount outstanding requirement is lower than what is currently applicable to Index Fund Shares based on an index or portfolio of fixed income securities. The Commission

¹⁸ See Rule 14.11(c)(4)(C).

¹⁹ See Rule 14.11(c)(6)(A).

²⁰ See Rule 14.11(c)(6)(B).

²¹ See Rule 14.11(c)(7).

²² See Rule 14.11(c)(6)(C).

²³ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²⁴ 15 U.S.C. 78f(b)(5).

notes, however, that the other proposed quantitative requirements (i.e., component concentration, issuer diversification, and minimum number of components) are more stringent than the existing generic listing requirements. Accordingly, the Commission believes that, taken together, the proposed criteria are sufficiently designed to prevent fraudulent and manipulative acts and practices. Specifically, the Commission believes that the proposed generic listing requirements for an index or portfolio of Municipal Securities, in aggregate, should help to ensure that an index underlying a series of Index Fund Shares will be sufficiently large, not concentrated, and diversified to prevent manipulation of that benchmark. Additionally, the Commission notes that it recently approved a proposal by another national securities exchange to adopt substantially similar generic listing standards.²⁵

The Commission also finds that the proposed amendments to Rule 14.11(c)(5) are designed to extend the requirements related to the generic listing and trading of Index Fund Shares based on a combination of two or more types of indexes to an index of Municipal Securities.

In support of its proposal, the Exchange represents the following:

- (1) Index Fund Shares listed pursuant to proposed Rule 14.11(c)(4)(B)(ii) will be subject to the existing trading surveillances, administered by the Financial Industry Regulatory Authority (“FINRA”) on behalf of the Exchange, which are designed to detect violations of Exchange rules and applicable federal securities laws.²⁶ The Exchange represents that these procedures are adequate to properly monitor Exchange trading of the Shares in all trading sessions and to deter and

²⁵ See NYSE Arca Proposal, supra note 9.

²⁶ See Amendment No. 1, supra note 9, at 14-15.

detect violations of Exchange rules and applicable federal securities laws.²⁷ FINRA, on behalf of the Exchange, will communicate as needed regarding trading in the Shares with other markets that are members of the Intermarket Surveillance Group (“ISG”) or with which the Exchange has in place a comprehensive surveillance sharing agreement.²⁸ FINRA also can access data obtained from the Municipal Securities Rulemaking Board (“MSRB”) relating to municipal bond trading activity for surveillance purposes.²⁹ FINRA, on behalf of the Exchange, is able to access, as needed, trade information for certain fixed income securities held by a Fund reported to FINRA’s Trade Reporting and Compliance Engine.³⁰

- (2) Index Fund Shares listed pursuant to the proposed generic listing rule will comply with all other requirements applicable to Index Fund Shares including, but not limited to, the applicable rules governing the trading of equity securities, trading hours, trading halts, surveillance, information barriers, and the Information Circular to members, as set forth in Exchange rules applicable to Index Fund Shares.³¹
- (3) The Exchange has in place surveillance procedures relating to trading in the Index Fund Shares and may obtain information via ISG from other exchanges that are members of ISG or with which the Exchange has entered into a comprehensive

²⁷ See id. at 15.

²⁸ See id.

²⁹ See id.

³⁰ See id.

³¹ See id. at 16.

surveillance sharing agreement.³² In addition, investors will have ready access to information regarding the intraday indicative value and quotation and last-sale information for the Index Fund Shares. Trade price and other information relating to municipal bonds is available through the MSRB's Electronic Municipal Market Access.³³

This approval order is based on all of the Exchange's representations, including those set forth above. For the foregoing reasons, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with Section 6(b)(5) of the Act³⁴ and the rules and regulations thereunder applicable to a national securities exchange.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³⁵ that the proposed rule change (SR-CboeBZX-2019-023), as modified by Amendment No. 1, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁶

Jill M. Peterson
Assistant Secretary

³² See id. at 18-19.

³³ See id. at 19.

³⁴ 15 U.S.C. 78f(b)(5).

³⁵ 15 U.S.C. 78s(b)(2).

³⁶ 17 CFR 200.30-3(a)(12).