

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-100029; File No. SR-NYSEARCA-2024-05)

April 25, 2024

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to List and Trade Shares of the COtwo Advisors Physical European Carbon Allowance Trust under NYSE Arca Rule 8.201-E (Commodity-Based Trust Shares)

I. Introduction

On January 10, 2024, NYSE Arca, Inc. (“NYSE Arca” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to list and trade shares (“Shares”) of the COtwo Advisors Physical European Carbon Allowance Trust under NYSE Arca Rule 8.201-E. The proposed rule change was published for comment in the Federal Register on January 26, 2024.³

On March 4, 2024, 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 disapprove the proposed rule change.⁵ The Commission has not received any comments on the proposed rule change. The Commission is publishing this order to institute proceedings pursuant to Section 19(b)(2)(B) of the Act⁶ to determine whether to disapprove the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 99409 (January 22, 2024), 89 FR 5273 (“Notice”).

⁴ 15 U.S.C. 78s(b)(2).

⁵ See Securities Exchange Act Release No. 99668, 89 FR 16808 (March 8, 2024). The Commission designated April 25, 2024, as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change.

⁶ 15 U.S.C. 78s(b)(2)(B).

II. Description of the Proposed Rule Change⁷

The Exchange proposes to list and trade Shares of the COTwo Advisors Physical European Carbon Allowance Trust (“Trust”)⁸ under NYSE Arca Rule 8.201-E, which governs the listing and trading of Commodity-Based Trust Shares⁹ on the Exchange. The sponsor of the Trust is COTwo Advisors LLC, a Delaware limited liability company (“Sponsor”).

Description of the Operation of the Trust

According to the Exchange, the investment objective of the Trust will be for the Shares to reflect the performance of the price of EU Carbon Emission Allowances for stationary installations (“EUAs”), less the Trust’s expenses.¹⁰ The Trust intends to achieve its objective by investing all of its assets in EUAs on a non-discretionary basis (i.e., without regard to whether the value of EUAs is rising or falling over any particular period).¹¹ The Trust will not hold any assets other than EUAs and, possibly, a very limited amount of cash to pay Trust expenses.¹²

The Trust will not invest in futures, options, options on futures, or swap contracts.¹³ The Trust will not hold or trade in commodity futures contracts, “commodity interests,” or any other

⁷ Additional information regarding the Trust and the Shares can be found in the Notice, supra note 3.

⁸ On May 12, 2023, the Trust filed with the Commission a registration statement on Form S-1 (File No. 333-271910) (“Registration Statement”) under the Securities Act of 1933. The Exchange represents that the Registration Statement is not yet effective, and the Shares will not trade on the Exchange until such time that the Registration Statement is effective. The Exchange further represents that the Trust will not be registered as an investment company under the Investment Company Act of 1940, as amended, and that the Trust is not a commodity pool for purposes of the Commodity Exchange Act, as amended. See Notice, supra note 3, 89 FR at 5274.

⁹ The Exchange represents that the Shares will satisfy the requirements of NYSE Arca Rule 8.201-E and thereby qualify for listing on the Exchange, and that the Trust relies on the exemption contained in Rule 10A-3(c)(7) regarding the application of Rule 10A-3 (17 CFR 240.10A-3) under the Act. See Notice, supra note 3, 89 FR at 5274.

¹⁰ See Notice, supra note 3, 89 FR at 5274.

¹¹ See id.

¹² See id. The Trust may also cause the Sponsor to receive EUAs from the Trust in such a quantity as may be necessary to pay the Sponsor’s annual fee. See id.

¹³ See id.

instruments regulated by the Commodity Exchange Act.¹⁴ The Trust’s cash custodian may hold cash proceeds from EUA sales to pay Trust expenses. All EUAs will be held in the Union Registry (defined below).¹⁵

The Trust will value its Shares daily based on the value of EUAs as reflected by the EUA End of Day Index value, as published by the European Energy Exchange AG (“EEX”).¹⁶ The administrator of the Trust will determine the net asset value (“NAV”) of the Trust once each Exchange trading day, which will be released after the end of the Core Trading Session, which is typically 4 p.m. New York time¹⁷ When the Trust sells or redeems its Shares, it will do so in “in-kind” transactions with authorized participants in blocks of 50,000 Shares.¹⁸

EUAs and the EUA Markets

According to the Exchange, the European Union Emissions Trading System (“EU ETS”) is a “cap and trade” system that caps the total volume of greenhouse gas emissions from installations and aircraft operators.¹⁹ The EU ETS is administered by the EU Commission, which

¹⁴ See id.

¹⁵ See id.

¹⁶ See id. at 5279. The EUA End of Day Index methodology is available at https://www.eex.com/fileadmin/EEX/Downloads/Trading/Specifications/Indices/DE/20211005_Index_Description_v010.pdf. According to the Exchange, the value of the EUA End of Day Index is calculated based on an algorithm using data regarding the prices of qualifying trades and the average bids and asks of orders that meet certain order quantity requirements. See Notice, supra note 3, 89 FR at 5276. In order for data regarding trades and orders to be used for calculating the value of the EUA End of Day Index, the trades or orders must satisfy certain requirements regarding (i) quantity of traded contracts, (ii) quantity of contracts per order, (iii) minimum duration of the cumulated valid best bid and best ask, and (iv) maximum spread per contract. The EUA End of Day Index calculation methodology depends on the number of valid trades and orders which fulfil the product-specific parameters. See id. The data used for calculating the EUA End of Day Index can also come from fair values collected in a price committee or from other price sources. See id. The EUA End of Day Index price calculated is then validated against actual market prices. See id.

¹⁷ See id. at 5279. The administrator also converts the value of Euro denominated assets into US Dollar equivalent using published foreign currency exchange prices by an independent pricing vendor. See id.

¹⁸ See id. at 5278.

¹⁹ There are two types of EU emissions allowances: (i) general allowances for stationary installations, or EUA; and (ii) allowances for the aviation sector. See id. at 5274. The Trust will not hold any assets other than EUAs and, possibly, a very limited amount of cash to pay Trust expenses. See id.

issues a predefined amount of EUAs through auctions or free allocation.²⁰ An EUA represents the right to emit one metric ton of carbon dioxide equivalent into the atmosphere by operators of stationary installations (“Covered Entities”).²¹ By the end of April each year, all Covered Entities are required to surrender EUAs equal to the total volume of actual emissions from their installation for the last calendar year.²² EU ETS operators can buy or sell EUAs to achieve EU ETS compliance.²³

In 2012, EU ETS operations were centralized into a single EU registry operated by the EU Commission (the “Union Registry”), which covers all countries participating in the EU ETS.²⁴ According to the Exchange, the Union Registry is an online database that holds accounts for all entities covered by the EU ETS as well as for participants (such as the Trust) not covered under the EU ETS.²⁵ An account must be opened in the Union Registry by a legal or natural person before being able to participate in the EU ETS and transact in EUAs.²⁶ The European Union Transaction Log (“EUTL”)²⁷ checks, records and authorizes all transactions that take place between accounts in the Union Registry to ensure that transfers are in accordance with the EU ETS rules.²⁸ The Union Registry is at all times responsible for holding all EUAs.²⁹

²⁰ See id. at 5274-75.

²¹ See id. at 5275.

²² See id.

²³ See id.

²⁴ See id.

²⁵ See id.

²⁶ See id.

²⁷ The EUTL is a central transaction log that checks and records all transactions taking place within the EU ETS. It is run by the European Commission and provides an easy access to emission trading data contained in the EUTL. See <https://www.eea.europa.eu/data-and-maps/dashboards/emissions-trading-viewer-1>.

²⁸ See Notice, supra note 3, 89 FR at 5275.

²⁹ See id.

The spot and futures markets for EUAs have existed since 2005 after the formal launch of the EU ETS on January 1, 2005.³⁰ Spot EUA contracts are traded exclusively on EEX,³¹ and futures contracts are traded on EEX, ICE Endex Markets B.V. (“ICE Endex”),³² and Nasdaq Oslo.³³ Additionally, options on EUA futures contracts are traded on EEX and ICE Endex, but not on Nasdaq Oslo.³⁴

According to the Exchange, there are currently two primary avenues for trading EUAs: a primary market and a secondary market.³⁵ The primary market involves participation in a regularly scheduled auction.³⁶ EUA auctions are held on a near-daily basis throughout the year, other than between mid-December to mid-January, when auctions are paused.³⁷ EUA auctions take place exclusively on EEX.³⁸ Prices achieved in these auctions are published on various publicly-accessible websites, including the European Commission’s primary website.³⁹ The secondary market involves transactions between buyers and sellers on regulated markets. The contracts offered for trading are the following: (1) instruments with a daily expiry, including spot

³⁰ See id.

³¹ See id. See also https://www.esma.europa.eu/sites/default/files/EEX_1.pdf; and Rules and Regulations at <https://www.eex.com/en/markets/trading-ressources/rules-and-regulations>.

³² See Notice, supra note 3, 89 FR at 5275. See also <https://www.ice.com/endex/regulation#:~:text=The%20Dutch%20Authority%20for%20Consumers.energy%20industry%20and%20wholesale%20trading>.

³³ See Notice, supra note 3, 89 FR at 5275.

³⁴ See id.

³⁵ See id.

³⁶ See id.

³⁷ See id. at 5276.

³⁸ See id.

³⁹ See id.

EUAs⁴⁰ and a single day futures contract on EUAs (“Daily EUA Future”),⁴¹ (2) futures contracts with various maturities;⁴² and (3) options on futures contracts.⁴³ There are also over-the-counter transactions, but, according to the Exchange, they comprise a negligible percentage of transactions.⁴⁴

The Exchange states that the daily EUA End of Day Index value can be expected to be substantially identical to the daily settlement price of the Daily EUA Future.⁴⁵ In support of this statement, the Exchange provided a comparison of the daily EUA End of Day Index value and the Daily EUA Future settlement price over a 45 calendar day period from October 26, 2023 through December 8, 2023.⁴⁶ Additionally, the Exchange provided a chart showing the spot prices in continuous trading on the EEX and the intra-day prices of Daily EUA Futures on ICE Endex, in EUR/tCO₂ from January 2018 to January 2022 to illustrate how the Daily EUA Future reflects the EUA spot price during the trading day.⁴⁷

Surveillance

In support of its proposal, the Exchange states that trading in the Shares will be subject to the existing trading surveillances administered by the Exchange, as well as cross-market surveillances administered by the Financial Industry Regulatory Authority Inc. (“FINRA”), on

⁴⁰ See id.

⁴¹ See id. The Daily EUA Future is exclusively traded on ICE Endex and is a deliverable contract where each person with a position open at cessation of trading is obliged to make or take delivery of EUAs upon the expiration of the contract at the end of each trading day. See id. Each Daily EUA Future represents one lot of 1,000 EUAs. See id.

⁴² See id. at 5278.

⁴³ See id.

⁴⁴ See id.

⁴⁵ See id.

⁴⁶ See id. at 5276-77.

⁴⁷ See id. at 5277.

behalf of the Exchange, which are designed to detect violations of Exchange rules and applicable federal securities laws.⁴⁸ The Exchange states that these procedures are adequate to properly monitor Exchange trading of the Shares in all trading sessions and to deter and detect violations of Exchange rules and federal securities laws applicable to trading on the Exchange.⁴⁹

The Exchange has entered into a comprehensive surveillance sharing agreement (“CSSA”) with ICE Endex.⁵⁰ The Exchange states that, pursuant to the CSSA, it will communicate as needed regarding trading in the Shares and Daily EUA Futures with ICE Endex, and may obtain trading information regarding trading in the Shares and Daily EUA Futures from ICE Endex.⁵¹

III. Proceedings to Determine Whether to Approve or Disapprove SR-NYSEARCA-2024-05 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act⁵² to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the 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.

⁴⁸ See Notice, supra note 3, 89 FR at 5280. 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. See id.

⁴⁹ See id.

⁵⁰ See id.

⁵¹ See id.

⁵² 15 U.S.C. 78s(b)(2)(B).

Pursuant to Section 19(b)(2)(B) of the Act,⁵³ 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, 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.”⁵⁴

The Commission asks that commenters address the sufficiency of the Exchange’s statements in support of the proposal, which are set forth in the Notice, in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission seeks comment on the following questions and asks commenters to submit data where appropriate to support their views:

1. Given the nature of the underlying assets held by the Trust, what are commenters’ views on whether the proposed Trust and Shares would be susceptible to manipulation? What are commenters’ views generally on whether the Exchange’s proposal is designed to prevent fraudulent and manipulative acts and practices? What are commenters’ views generally with respect to the liquidity and transparency of the EUA spot and futures markets and such markets’ susceptibility to manipulation? Are there particular features related to the EUA markets and the EUA ecosystem that raise unique concerns about whether the proposed Trust, which would hold EUAs and, possibly, a very limited amount of cash, would be susceptible to fraud or manipulation?

⁵³ Id.

⁵⁴ 15 U.S.C. 78f(b)(5).

2. According to the Exchange, EEX calculates and publishes its EUA End of Day Index on the price of spot EUAs. The value of the EUA End of Day Index is calculated based on an algorithm using data regarding the prices of qualifying trades and the average bids and asks of orders that meet certain order quantity requirements.⁵⁵ What are commenters' views on whether the EUA End of Day Index is an accurate basis to price spot EUAs for purposes of NAV calculation and valuing the Shares of the Trust?

3. The Exchange states that “[g]iven the significant size of ICE Endex, there is a reasonable likelihood that a market participant attempting to manipulate the Trust Shares would also have to trade on ICE Endex to successfully manipulate the Trust Shares.”⁵⁶ In addition, the Exchange states that “[i]t is unlikely that trading in the Trust Shares would be the predominant influence on Daily EUA Futures prices traded on ICE Endex for a number of reasons, including the significant volume in and size of the EUA daily expiry market.”⁵⁷ Based on data and analysis provided by the Exchange,⁵⁸ do commenters agree with the Exchange that ICE Endex, on which the Daily EUA Futures trade, represents a regulated market of significant size related to spot EUAs?⁵⁹ What are commenters' views on whether there is a reasonable likelihood that a person attempting to manipulate the Shares would also have to trade on ICE Endex to manipulate the Shares?⁶⁰ Do commenters agree with the Exchange that trading in the Shares would not be the predominant influence on prices in the Daily EUA Futures market?⁶¹

⁵⁵ See Notice, supra note 3, 89 FR at 5276.

⁵⁶ See id. at 5280-81.

⁵⁷ See id.

⁵⁸ See Notice, supra note 3.

⁵⁹ See Notice, supra note 3, 89 FR at 5280.

⁶⁰ See id.

⁶¹ See id.

4. The Exchange states that the “the correlation between the EUA End of Day Index value that reflects the value of the spot EUAs traded on EEX and the Daily EUA Future settlement price is nearly perfect,” and “[t]hus, on any given day, the value of an EUA purchased on EEX or an EUA received after settling a Daily EUA Future traded on ICE Endex is the same.”⁶² The Exchange concludes that “[w]hile it is possible that a potential manipulator could chose to trade only in the spot EUA market (EEX), the near-perfect correlation between the EUA End of Day Index value and the Daily EUA Future settlement price means that a price distortion in the spot EUA market would be reflected in the Daily EUA Futures market and vice versa.”⁶³ What are commenters’ views on the correlation between the EUA End of Day Index value and the Daily EUA Future settlement price? What are commenters’ views on the correlation between the spot EUA market and the ICE Endex futures market? What are commenters’ views on the extent to which a CSSA with ICE Endex would assist in detecting and deterring fraud and manipulation that impacts an exchange-traded product that holds spot EUAs, and on whether the Exchange’s correlation analysis⁶⁴ provides any evidence to this effect?

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change is consistent with Section 6(b)(5) or any other provision of the Act, or the rules and regulations thereunder.

Although there do not appear to be any issues relevant to approval or disapproval that would be

⁶² See id.

⁶³ See id.

⁶⁴ See Notice, supra note 3.

facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.⁶⁵

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change should be approved or disapproved by [INSERT DATE 21 DAYS AFTER DATE OF 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 AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's internet comment form (<https://www.sec.gov/rules/sro.shtml>);
or
- Send an email to rule-comments@sec.gov. Please include file number SR-NYSEARCA-2024-05 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-NYSEARCA-2024-05. This file number should be included on the subject line if email 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 (<https://www.sec.gov/rules/sro.shtml>).

⁶⁵ Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

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 a.m. and 3 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to file number SR-NYSEARCA-2024-05 and should be submitted on or before [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]. Rebuttal comments should be submitted by [INSERT DATE 35 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁶⁶

Sherry R. Haywood,

Assistant Secretary.

⁶⁶ 17 CFR 200.30-3(a)(57).