

# **SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 230**

**[Release No. 33-10428; File No. S7-06-17]**

**RIN 3235-AM07**

## **COVERED SECURITIES PURSUANT TO SECTION 18 OF THE SECURITIES ACT OF 1933**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** The Securities and Exchange Commission (“SEC” or “Commission”) is adopting an amendment to Rule 146 under Section 18 of the Securities Act of 1933, as amended (“Securities Act”), to designate certain securities listed, or authorized for listing, on Investors Exchange LLC (“IEX” or “Exchange”) as covered securities for purposes of Section 18(b) of the Securities Act. Covered securities under Section 18(b) of the Securities Act are exempt from state law registration requirements. The Commission also is amending Rule 146 to reflect name changes of certain exchanges referenced in the Rule.

**EFFECTIVE DATE:** November 29, 2017.

**FOR FURTHER INFORMATION CONTACT:** Richard Holley III, Assistant Director; Edward Cho, Special Counsel; or Michael Ogershok, Attorney-Adviser, Office of Market Supervision, at (202) 551-5777, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

### **SUPPLEMENTARY INFORMATION:**

#### **I. Introduction**

In 1996, Congress amended Section 18 of the Securities Act to exempt from state

registration requirements securities listed, or authorized for listing, on the New York Stock Exchange LLC (“NYSE”), the American Stock Exchange LLC (“Amex”) (now known as NYSE American LLC),<sup>1</sup> or the National Market System of The NASDAQ Stock Market LLC (“Nasdaq/NGM”)<sup>2</sup> (collectively, the “Named Markets”), or any national securities exchange designated by the Commission to have substantially similar listing standards to those of the Named Markets (“Designated Markets”).<sup>3</sup> More specifically, Section 18(a) of the Securities Act provides that “no law, rule, regulation, or order, or other administrative action of any State . . . requiring, or with respect to, registration or qualification of securities . . . shall directly or indirectly apply to a security that – (A) is a covered security.”<sup>4</sup> Covered securities are defined in Section 18(b)(1) of the Securities Act to include those securities listed, or authorized for listing,

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<sup>1</sup> On October 1, 2008, NYSE Euronext acquired The Amex Membership Corporation (“AMC”) pursuant to an Agreement and Plan of Merger, dated January 17, 2008 (“Merger”). In connection with the Merger, NYSE Amex’s predecessor, Amex, a subsidiary of AMC, became a subsidiary of NYSE Euronext called NYSE Alternext US LLC (“NYSE Alternext”). See Securities Exchange Act Release No. 58673 (September 29, 2008), 73 FR 57707 (October 3, 2008) (SR-NYSE-2008-60 and SR-Amex 2008-62) (approving the Merger). In 2009, NYSE Alternext changed its name to NYSE Amex LLC (“NYSE Amex”). See Securities Exchange Act Release No. 59575 (March 13, 2009), 74 FR 11803 (March 19, 2009) (SR-NYSEALTR-2009-24) (approving the name change). In 2012, NYSE Amex changed its name from NYSE Amex LLC to NYSE MKT LLC (“NYSE MKT”). See Securities Exchange Act Release No. 67037 (May 21, 2012), 77 FR 31415 (May 25, 2012) (SR-NYSEAmex-2012-32) (publishing notice of the name change to NYSE MKT LLC). As of July 24, 2017, NYSE MKT changed its name from NYSE MKT LLC to NYSE American LLC (“NYSE American”). See Securities Exchange Act Release No. 80283 (March 21, 2017), 82 FR 15244 (March 27, 2017) (SR-NYSEMKT-2017-14).

<sup>2</sup> As of July 1, 2006, the National Market System of The NASDAQ Stock Market LLC is known as the Nasdaq Global Market (“NGM”). See Securities Exchange Act Release Nos. 53799 (May 12, 2006), 71 FR 29195 (May 19, 2006) and 54071 (June 29, 2006), 71 FR 38922 (July 10, 2006).

<sup>3</sup> See National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (October 11, 1996).

<sup>4</sup> 15 U.S.C. 77r(a).

on the Named Markets, or securities listed, or authorized for listing, on a national securities exchange (or tier or segment thereof) that has listing standards that the Commission determines by rule are “substantially similar” to those of the Named Markets (“Covered Securities”).<sup>5</sup>

Pursuant to Section 18(b)(1)(B) of the Securities Act, the Commission adopted Rule 146.<sup>6</sup> Rule 146(b) lists those national securities exchanges, or segments or tiers thereof, that the

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<sup>5</sup> 15 U.S.C. 77r(b)(1)(A) and (B). In addition, securities of the same issuer that are equal in seniority or senior to a security listed on a Named Market or national securities exchange designated by the Commission as having substantially similar listing standards to a Named Market are Covered Securities for purposes of Section 18(b) of the Securities Act. See 15 U.S.C. 77r(b)(1)(C).

<sup>6</sup> See Securities Exchange Act Release No. 39542 (January 13, 1998), 63 FR 3032 (January 21, 1998) (determining that the listing standards of the Chicago Board Options Exchange, Incorporated (“CBOE”), the Pacific Exchange, Inc. (now known as NYSE Arca, Inc.), and the Philadelphia Stock Exchange, Inc. (“Phlx”) (now known as NASDAQ PHLX LLC) were substantially similar to those of the Named Markets). The Commission notes that, on July 24, 2008, The NASDAQ OMX Group, Inc. acquired Phlx and renamed it “NASDAQ OMX PHLX LLC,” and NASDAQ OMX PHLX LLC subsequently changed its name to “NASDAQ PHLX LLC.” See Securities Exchange Act Release Nos. 58179 (July 17, 2008), 73 FR 42874 (July 23, 2008) (SR-Phlx-2008-31); 58183 (July 17, 2008), 73 FR 42850 (July 23, 2008) (SR-NASDAQ-2008-035); 62783 (August 27, 2010), 75 FR 54204 (September 3, 2010) (SR-Phlx-2010-104); and 76654 (December 15, 2015), 80 FR 79396 (December 21, 2015) (SR-Phlx-2015-105). In 2004, the Commission amended Rule 146(b) to designate options listed on the International Securities Exchange, Inc. (“ISE”) as Covered Securities for purposes of Section 18(b) of the Securities Act. See Securities Act Release No. 8442 (July 14, 2004), 69 FR 43295 (July 20, 2004). The Commission notes that, in March 2017, ISE changed its name from International Securities Exchange, LLC to “Nasdaq ISE, LLC.” See Securities Exchange Act Release No. 80325 (March 29, 2017), 82 FR 16445 (April 4, 2017) (SR-ISE-2017-25) (publishing notice of the name change to Nasdaq ISE, LLC). In 2007, the Commission amended Rule 146(b) to designate securities listed on the Nasdaq Capital Market (“NCM”) as Covered Securities for purposes of Section 18(b) of the Securities Act. See Securities Act Release No. 8791 (April 18, 2007), 72 FR 20410 (April 24, 2007) (File No. S7-18-06). In 2012, the Commission amended Rule 146(b) to designate securities listed on Tiers I and II of BATS Exchange, Inc. (“BATS”) as Covered Securities for purposes of Section 18(b) of the Securities Act. See Securities Act Release No. 9295 (January 20, 2012), 77 FR 3590 (January 25, 2012). The Commission notes that, in March 2016, BATS changed its name from BATS Exchange, Inc. to “Bats BZX Exchange, Inc.” See Securities Exchange Act Release No. 77307

Commission has determined to have listing standards substantially similar to those of the Named Markets and thus securities listed on such exchanges are deemed Covered Securities.<sup>7</sup> IEX has petitioned the Commission to amend Rule 146(b) to designate certain securities listed, or authorized for listing, on IEX as Covered Securities for purposes of Section 18(b) of the Securities Act.<sup>8</sup>

In July 2017, the Commission proposed to amend Rule 146(b) to designate certain securities listed, or authorized for listing, on IEX as Covered Securities for purposes of Section 18(b) of the Securities Act.<sup>9</sup> The Commission also proposed to amend Rule 146 to reflect name changes of certain exchanges referenced in the Rule. The Commission received one comment letter,<sup>10</sup> which supported amending Rule 146(b) to designate certain securities listed, or authorized for listing, on IEX as Covered Securities.

The Commission has determined that IEX's listing standards are substantially similar to the listing standards of the Named Markets. Accordingly, the Commission today is amending Rule 146(b) to designate securities listed, or authorized for listing, on IEX as Covered Securities under Section 18(b)(1) of the Securities Act.<sup>11</sup> Amending Rule 146(b) to include these securities as Covered Securities will exempt those securities from state registration requirements as set

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(March 7, 2016), 81 FR 12996 (March 11, 2016) (SR-BATS-2016-25) (publishing notice of the name change to Bats BZX Exchange, Inc.).

<sup>7</sup> 17 CFR 230.146(b).

<sup>8</sup> See Letter from Sophia Lee, General Counsel, IEX, to Brent J. Fields, Secretary, Commission, dated September 22, 2016 (“IEX Petition”).

<sup>9</sup> See Securities Act Release No. 10390 (July 14, 2017), 82 FR 33839 (July 21, 2017) (“Proposing Release”).

<sup>10</sup> See Letter from Karl T. Muth, Lecturer in Economics and Public Policy, Northwestern University, and Lecturer in Law, Pritzker School of Law, Northwestern University, to Commission, dated July 21, 2017 (“Muth Letter”).

<sup>11</sup> 15 U.S.C. 77r(b)(1).

forth under Section 18(a) of the Securities Act.<sup>12</sup> The Commission also is adopting, as proposed, updated references in the Rule.

## **II. Amendment to Rule 146(b) to Include IEX Securities**

Under Section 18(b)(1)(B) of the Securities Act,<sup>13</sup> the Commission has the authority to determine that the listing standards of an exchange, or tier or segment thereof, are substantially similar with those of the NYSE, NYSE American, or Nasdaq/NGM. The Commission initially compared IEX's listing standards with those of Nasdaq/NGM.<sup>14</sup> Where the listing standards in a particular category were not substantially similar to the standards of Nasdaq/NGM, the Commission compared IEX's standards to NYSE and NYSE American.<sup>15</sup> In addition, as it has done previously, the Commission interpreted the "substantially similar" standard to require listing standards at least as comprehensive as those of the Named Markets.<sup>16</sup> If IEX's listing standards were higher than those of the Named Markets, then the Commission would still determine that IEX's listing standards are substantially similar to those of the Named Markets.<sup>17</sup> Finally, the Commission notes that differences in language or approach would not necessarily lead to a determination that IEX's listing standards are not substantially similar to those of any Named Market.<sup>18</sup>

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<sup>12</sup> 15 U.S.C. 77r(a).

<sup>13</sup> 15 U.S.C. 77r(b)(1)(B).

<sup>14</sup> See infra note 20.

<sup>15</sup> This approach is consistent with the approach that the Commission has previously taken. See, e.g., Securities Act Release No. 7494 (January 13, 1998), 63 FR 3032 (January 21, 1998) (File No. S7-17-97).

<sup>16</sup> See id.

<sup>17</sup> See Securities Act Release No. 8791, supra note 6.

<sup>18</sup> See id.

The Commission included in the Proposing Release its preliminary view that IEX's quantitative and qualitative listing standards were substantially similar to the listing standards for a Named Market. The Commission received no comments on its views.<sup>19</sup> The Commission has reviewed IEX's listing standards for securities to be listed and traded on IEX and, for the reasons discussed below, has determined that IEX's listing standards are substantially similar to those of a Named Market as required by Section 18(b)(1)(B).<sup>20</sup> Accordingly, the Commission is amending Rule 146(b) to include securities listed, or authorized for listing, on IEX.

A. IEX Quantitative Listing Standards

The Commission continues to believe that IEX's initial and continued quantitative listing standards for its securities are substantively identical to, and thus substantially similar to, the initial and continued quantitative listing standards for securities listed on Nasdaq/NGM.<sup>21</sup> Accordingly, because IEX's initial and continued quantitative listing standards are substantively

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<sup>19</sup> See Proposing Release, supra note 9, at 33841-42. See also id. at 33842 (discussing various other types of securities and exchange-traded derivative securities products).

<sup>20</sup> See infra notes 21-29 and accompanying text (discussing the quantitative and qualitative listing standards); and infra notes 30-31 and accompanying text (discussing various other types of securities and exchange-traded derivative securities products). See also generally IEX Rules Chapters 14 (IEX Listing Rules) and 16 (Other Securities). See also Securities Exchange Act Release No. 75925 (September 15, 2015), 80 FR 57261 (September 22, 2015) (File No. 10-222) (Notice of Filing of Application of IEX). In making its determination of substantial similarity, as discussed below, the Commission compared IEX's quantitative listing standards with Nasdaq/NGM's quantitative listing standards; IEX's qualitative listing standards with Nasdaq/NGM's qualitative listing standards and, with respect to the rules relating to the listing application process and internal audit function, with NYSE's and NYSE American's applicable qualitative listing standards; and IEX's listing standards for other securities, including portfolio depository receipts, index fund shares, and managed fund shares, with Nasdaq/NGM's corresponding listing standards.

<sup>21</sup> See Proposing Release, supra note 9, at 33841. Quantitative listing standards relate to, among other things, the requirements for bid price, number of publicly held shares, number of shareholders, market value of publicly held shares, and market capitalization.

identical to those of Nasdaq/NGM, the Commission has determined that IEX's initial and continued quantitative listing standards are substantially similar to those of a Named Market.<sup>22</sup>

B. IEX Qualitative Listing Standards

The Commission continues to believe that IEX's initial and continued qualitative listing standards for its securities are substantively identical to, and thus substantially similar to, the qualitative listing standards for securities listed on Nasdaq/NGM,<sup>23</sup> with the exception of IEX Rule 14.201 (Confidential Pre-Application Review of Eligibility) (which the Commission preliminarily believed was substantially similar to rules of NYSE and NYSE American) and IEX Rule 14.414 (Internal Audit Function) (which the Commission preliminarily believed was substantially similar to a rule of NYSE).<sup>24</sup>

Accordingly, because IEX's initial and continued qualitative listing standards are substantively identical to those of Nasdaq/NGM, the Commission has determined that IEX's initial and continued qualitative listing standards are substantially similar to the qualitative listing standards for securities listed on Nasdaq/NGM, which is a Named Market,<sup>25</sup> with the exception

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<sup>22</sup> Compare IEX Rules 14.300 series with Nasdaq/NGM Rule 5300 and 5400 series (providing for identical rules concerning initial listing and maintenance standards for units, primary equity securities, preferred stock and secondary classes of common stock, rights, warrants, and convertible debt on IEX and Nasdaq/NGM).

<sup>23</sup> Qualitative listing standards relate to, among other things, the number of independent directors required, conflicts of interest, composition of the audit committee, executive compensation, shareholder meeting requirements, voting rights, quorum, code of conduct, proxies, shareholder approval of certain corporate actions, and the annual and interim reports requirements.

<sup>24</sup> See Proposing Release, supra note 9, at 33841-42.

<sup>25</sup> Compare IEX Rules 14.200 and 14.400 series with Nasdaq/NGM Rules 5200 and 5600 series (providing for virtually identical rules concerning procedures and prerequisites for initial and continued listing, obligations of security issuers, the application and qualification process, and corporate governance standards on IEX and Nasdaq/NGM).

of (a) IEX Rule 14.201 (Confidential Pre-Application Review of Eligibility), discussed below, which is substantially similar to rules of other Named Markets, namely NYSE and NYSE American, and (b) IEX Rule 14.414 (Internal Audit Function), also discussed below, which is substantially similar to a rule of NYSE.

With respect to the standards relating to the listing and delisting of companies, including prerequisites for initial and continued listing on IEX, obligations of security issuers listed on IEX, as well as rules describing the application and qualification process, IEX's listing rules for securities are virtually identical to, and thus substantially similar to, those of Nasdaq/NGM.<sup>26</sup> IEX Rule 14.201, which specifically relates to confidential pre-application review for listing eligibility, is substantially similar to the corresponding rules of NYSE and NYSE American.<sup>27</sup>

The Commission also notes that IEX's corporate governance standards in connection with securities to be listed and traded on IEX are virtually identical to, and thus substantially

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<sup>26</sup> Compare IEX Rule 14.200 series with Nasdaq/NGM Rule 5200 series (providing for virtually identical rules concerning procedures and prerequisites for initial and continued listing, obligations of security issuers, and the application and qualification process).

<sup>27</sup> See IEX Rule 14.201; NYSE Listed Company Manual Sections 101 and 104; and NYSE American Company Guide Section 201. IEX Rule 14.201 requires a company seeking the initial listing of one or more classes of securities to participate in a free, confidential pre-application eligibility review to determine whether the company meets the applicable listing criteria and, if, upon completion of this review, IEX determines that a company is eligible for listing, IEX will notify that company in writing that it has been cleared to submit an original listing application. The Commission notes that, while IEX Rule 14.201 is substantially similar to the equivalent NYSE and NYSE American rules (all of which relate to the confidential pre-application review for eligibility for companies seeking to list on the Exchange), IEX's rule contains an additional, heightened provision stating that a company deemed eligible for listing will be provided with written notification valid for nine months that it has been cleared to submit an original listing application. See IEX Rule 14.201. See also NYSE Listed Company Manual Sections 101 and 104; NYSE American Company Guide Section 201. IEX represents that an issuer that does not clear the pre-application eligibility review process or receive a timely response as part of that process on IEX after the confidential pre-application eligibility review would be permitted to appeal such determination under the procedures set forth in IEX Rule series 9.500. See IEX Petition, supra note 8, at 5.



similar to, the current rules of Nasdaq/NGM and NYSE.<sup>28</sup> IEX Rule 14.414, specifically concerning the internal audit function for a listed issuer, is substantially similar to the corresponding rule of NYSE.<sup>29</sup> Therefore, the Commission has determined that IEX's qualitative listing standards are substantially similar to those of a Named Market.

C. Other Securities, Including Securities of Exchange-Traded Funds and Other Exchange-Traded Derivative Securities Products

The Commission compared IEX's listing standards for other types of securities, including, for example, portfolio depository receipts; index fund shares; securities linked to the performance of indexes, commodities, and currencies; index-linked exchangeable notes; partnership units; trust units; and managed fund shares,<sup>30</sup> to Nasdaq/NGM's standards. The Commission continues to believe that IEX's standards for these other types of securities are virtually identical to the corresponding Nasdaq/NGM standards.<sup>31</sup> Accordingly, because IEX's

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<sup>28</sup> Compare IEX Rule 14.400 series (Corporate Governance Requirements) with Nasdaq/NGM Rule 5600 series (Corporate Governance Requirements).

<sup>29</sup> Compare NYSE Listed Company Manual Section 303A.07(c) (requiring listed companies to maintain an internal audit function to provide management and the audit committee with ongoing assessments of the listed company's risk management processes and system of internal control) with IEX Rule 14.414.

<sup>30</sup> Compare IEX Rules Chapter 16 (Other Securities) with Nasdaq/NGM Rule 5700 series (Other Securities). See also IEX Rule 16.105(a) (Portfolio Depository Receipts); Rule 16.105(b) (Index Fund Shares); Rule 16.110 (Securities Linked to the Performance of Indexes and Commodities (Including Currencies)); Rule 16.111(a) (Index-Linked Exchangeable Notes); Rule 16.111(b) (Equity Gold Shares); Rule 16.111(c) (Trust Certificates); Rule 16.111(d) (Commodity-Based Trust Shares); Rule 16.111(e) (Currency Trust Shares); Rule 16.111(f) (Commodity Index Trust Shares); Rule 16.111(g) (Commodity Futures Trust Shares); Rule 16.111(h) (Partnership Units); Rule 16.111(i) (Trust Units); Rule 16.111(j) (Managed Trust Securities); Rule 16.113 (Paired Class Shares); Rule 16.115 (Selected Equity-linked Debt Securities ("SEEDS")); Rule 16.120 (Trust Issued Receipts); Rule 16.125 (Index Warrants); Rule 16.130 (Listing Requirements for Securities Not Otherwise Specified (Other Securities)); and Rule 16.135 (Managed Funds Shares).

<sup>31</sup> See Proposing Release, supra note 9, at 33842.

initial and continued listing standards for these other securities are substantively identical to those of Nasdaq/NGM, the Commission has determined that IEX's standards for these other securities are substantially similar to those of a Named Market.

D. Other Amendments

Finally, the Commission is amending Rule 146(b) as proposed to reflect the following name changes, on which the Commission did not receive any comments:

- Paragraphs (b)(1) and (b)(2) of Rule 146 use the term “NYSE Amex” to refer to the national securities exchange formerly known as the American Stock Exchange LLC. As noted above, in 2012, NYSE Amex changed its name from NYSE Amex LLC to NYSE MKT LLC, and, in July 2017, NYSE MKT LLC changed its name to NYSE American LLC.<sup>32</sup> Accordingly, the Commission is making a conforming change to Rule 146(b).
- Paragraph (b)(1) of Rule 146 refers to “Tier I of the NASDAQ OMX PHLX LLC.” As noted above, in December 2015, NASDAQ OMX PHLX LLC changed its name to NASDAQ PHLX LLC.<sup>33</sup> Accordingly, the Commission is making a conforming change to Rule 146(b).
- Paragraph (b)(1) of Rule 146 refers to “Tier I and Tier II of BATS Exchange, Inc.” As noted above, in March 2016, BATS Exchange, Inc. changed its name to Bats BZX Exchange, Inc.<sup>34</sup> Accordingly, the Commission is making a conforming change to Rule 146(b).

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<sup>32</sup> See supra note 1.

<sup>33</sup> See supra note 6.

<sup>34</sup> See id.

- Paragraph (b)(1) of Rule 146 refers to “Options listed on the International Securities Exchange, LLC.” As noted above, in March 2017, the International Securities Exchange, LLC changed its name to Nasdaq ISE, LLC.<sup>35</sup> Accordingly, the Commission is making a conforming change to Rule 146(b).

### **III. Paperwork Reduction Act**

The Paperwork Reduction Act of 1995 does not apply because the amendment to Rule 146(b) does not impose recordkeeping or information collection requirements or other collection of information, which require the approval of the Office of Management and Budget under 44 U.S.C. 3501 et seq.

### **IV. Economic Analysis**

The Commission is sensitive to the economic consequences of its rules, including the benefits, costs, and effects on efficiency, competition, and capital formation. As noted above, the Commission has determined that the overall listing standards for securities to be listed and traded on IEX are substantially similar to those of a Named Market. As such, the Commission is adopting amendments to Rule 146 under Section 18 of the Securities Act, to designate securities listed, or authorized for listing, on IEX as Covered Securities. The following analysis considers the economic effects that may result from the amendment.

Where possible, the Commission has quantified the economic effects of the amendment; however, as explained further below, the Commission is unable to quantify all of the economic effects because it lacks the information necessary to provide reasonable estimates. In some cases, quantification depends heavily on factors outside of the control of the Commission, particularly due to the flexibility that an issuer has when choosing if and where to list its

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<sup>35</sup> See id.

securities and the flexibility of a registered national securities exchange to tailor its policies and rules to the nature of its business and technology. These factors make it difficult to quantify the changes in market share of Named and Designated Markets that may result from the amendment. In addition, the incumbent Named and Designated Markets and IEX each may react to the amendments with respect to listing fees and services. These reactions are also difficult to quantify or predict, which further complicates quantification of changes to market share, and also makes quantification of the economic effects of the amendment difficult. Therefore, some of the discussions below are qualitative in nature. In the Proposing Release the Commission solicited comment on its economic analysis, including costs and benefits and potential impacts on efficiency, competition, and capital formation, and encouraged commenters to provide specific estimates or data. The Commission did not receive any comment on, or data regarding, its estimates. The Commission received one comment letter that was generally supportive of the proposed rule amendment.<sup>36</sup>

A. Baseline

The Commission compared the economic effects of the amendment, including benefits, costs, and effects on efficiency, competition, and capital formation, to a baseline that consists of the existing regulatory framework and market structure.

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<sup>36</sup> See Muth Letter, supra note 10 (“The removal of state-by-state heterogeneity, including through 18(b) inclusion, is one way to decrease friction both at the offering stage and on the secondary market. That IEX securities would enjoy this freedom from the encumbrances of state-level registration requirements is unobjectionable in the short-term and likely beneficial to both securities issuers and consumers in the long-term (and, indirectly, beneficial to brokers in securities of this kind).”).

## 1. Regulatory Framework and Affected Parties

The listing standards of Named and Designated Markets are quantitative and qualitative requirements that issuers must satisfy before they may list on these markets. Securities listed on a Named or Designated Market are Covered Securities, which are exempt from complying with state securities law registration and qualification requirements. As mentioned above,<sup>37</sup> subsequent to its exchange registration, IEX petitioned the Commission to amend Rule 146(b) to provide that the listing standards for securities listed, or authorized for listing, on IEX are substantially similar to those of the Named Markets.

Pursuant to unlisted trading privileges, a national securities exchange such as IEX currently can trade securities that are listed on other exchanges.<sup>38</sup> While IEX may offer to list securities for trading, currently, those securities would not be Covered Securities if they chose to list on IEX in the absence of this amendment to Rule 146. Issuers of securities that are not Covered Securities must comply with state securities law registration and qualification requirements, which generally require the issuer to register such securities in each state or jurisdiction in which the issuer will offer or sell its securities. State registration and qualification requirements generally vary across the 54 U.S. jurisdictions, comprising the 50 states, the District of Columbia, and the three U.S. territories of Puerto Rico, the Virgin Islands, and Guam.<sup>39</sup> These requirements typically include: (i) filing state administrative forms and other paperwork necessary for compliance with state registration requirements; (ii) adherence to

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<sup>37</sup> See supra note 8 and accompanying text.

<sup>38</sup> See 15 U.S.C. 781(f) and Rule 12f-2.

<sup>39</sup> See Office of Investor Education and Advocacy, “Blue Sky Laws” (2014), available at <https://www.sec.gov/fast-answers/answers-blueskyhtm.html>.

disclosure standards; and (iii) in some states, requirements based upon the merits of the offering or issuer.<sup>40</sup>

The Commission lacks comprehensive, independent data to precisely estimate the total time, registration, and compliance costs associated with state registration and qualification. Moreover, those total costs may vary widely for issuers depending upon the number of states in which an issuer elects to register. To provide some information about potential costs for state registration, Table 1 below lists examples of Blue Sky registration filing fees for several states.

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<sup>40</sup> See, e.g., Stuart R. Cohn, Securities Counseling for Small and Emerging Companies § 12:8 (2016) (describing merit review as “the authority of state administrators to deny, suspend or revoke an offering because the administrator believes that the offering has substantive weaknesses in structure, financial strength or fairness to investors”). Typical elements of merit review include: offering expenses, including underwriter’s compensation, issuer capitalization requirements, dilution, financial condition of the issuer, cheap stock held by insiders, types of offering (e.g., blind pool offerings), the quantity of securities subject to options and warrants, loans to insiders, and the price at which the securities will be offered. See id. The North American Securities Administrators Association (NASAA), an association of state and provincial securities regulators composed of the securities administrators from each state, Mexico, and 13 Canadian provinces, has issued guidelines intended to provide uniformity among state merit review standards. See NASAA Statements of Policy, available at <http://www.nasaa.org/regulatory-activity/statements-of-policy/>. Some exchange listing standards impose merit regulation on issuers.

Table 1: Examples of Blue Sky Registration Filing Fees<sup>41</sup>

State	Filing Fee
California	\$200 plus 1/5 of 1 percent of the aggregate value of the securities proposed to be sold, with a maximum fee of \$2,500.
Florida	\$1,000
Illinois	1/20 of 1 percent of the aggregate offering in Illinois, with a minimum fee of \$500 and a maximum fee of \$2,500
New York	Based on total offerings: \$500,000 or less: \$300 More than \$500,000: \$1,200
Texas	\$100 filing fee, plus examination fee of 1/10 of 1 percent of the aggregate amount of securities sold in Texas

The issuer of a non-Covered Security in multiple jurisdictions would have more compliance obligations than the issuer of a Covered Security, including the potential for considerable additional costs and legal fees associated with reviews of offering-related materials at the state level.<sup>42</sup> Additionally, as discussed above, many state securities regulators also review securities offerings based upon the merits of the offering and/or the issuer of the securities, which can further increase an issuer’s compliance obligations and associated costs.<sup>43</sup> In addition, the Commission notes that on a separate matter, the Commission received an estimate that an issuer

<sup>41</sup> See CA Corp Code § 25608(e) for California filing fees; [http://www.leg.state.fl.us/Statutes/index.cfm?App\\_mode=Display\\_Statute&Search\\_String=&URL=0500-0599/0517/Sections/0517.081.html](http://www.leg.state.fl.us/Statutes/index.cfm?App_mode=Display_Statute&Search_String=&URL=0500-0599/0517/Sections/0517.081.html) for Florida filing fees; <http://www.cyberdriveillinois.com/departments/securities/sellingsec.html> for Illinois filing fees; <https://ag.ny.gov/investor-protection/broker-dealer-and-securities-registration-information-sheet> for New York filing fees; and <https://www.ssb.texas.gov/texas-securities-act-board-rules/fee-schedule#one> for Texas filing fees.

<sup>42</sup> See Proposing Release, *supra* note 9, at 33843 (citing Securities Act Release No. 9741 (March 25, 2015), 80 FR 21806 (April 20, 2015) (Amendments for Small and Additional Issues Exemptions under the Securities Act (Regulation A)), at Section II.H.3 (“Regulation A Release”).

<sup>43</sup> See *id.*

seeking state registration in 50 states would incur \$50,000 to \$70,000 in filing fees and \$80,000 to \$100,000 in legal fees.<sup>44</sup>

In addition, the Commission believes that the state registration and qualification requirements applicable to non-Covered Securities also impose costs on broker-dealers. Specifically, broker-dealers may incur costs to ensure that they are complying with applicable state laws governing non-Covered Securities in each state in which they are transacting in those securities on behalf of their customers or providing advice or other information to customers related to those securities. For example, broker-dealers can incur costs associated with maintaining a compliance program to verify an issuer's state registration status and comply with any state requirements applicable to broker-dealers that transact in non-Covered Securities, which could vary depending on where the customer resides and where the transaction occurs. In addition, the types and content of communications broker-dealers may have with their customers regarding non-Covered securities may be subject to regulation under Blue Sky laws, thus broker-dealers may incur costs to ensure they are compliant with such requirements in each state in which they advise customers.<sup>45</sup> While some portion of these costs may be passed on to a broker-dealer's customers – i.e., the investors that transact through the broker-dealer in non-Covered

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<sup>44</sup> See *id.* at 33843 & n.43 (citing Regulation A Release, *supra* note 42; Letter from Michael L. Zuppone, Paul Hastings LLP, to Commission, dated November 26, 2013, at 2 (further noting the “significant costs and uncertainties associated with ‘Blue Sky’ law compliance”); and Regulation A Release, *supra* note 42, at n.1024 and accompanying text). As noted in the Proposing Release, the commenter did not address whether these estimated costs vary by the size of the offering. Also, the Commission notes that the estimate concerns the initial costs associated with registration. The Commission believes that the ongoing costs of compliance that the issuer bears will be lower than these initial costs. See *id.*

<sup>45</sup> See *id.* at 33844 & n.45 (citing Letter from Daniel Zinn, General Counsel, OTC Markets Group Inc., to Elizabeth M. Murphy, Secretary, Commission, dated March 24, 2014, at 4 (describing the commenter's views of the impact of Blue Sky laws on broker-dealers)).



Securities – through commissions or transaction fees, the Commission believes that the compliance costs associated with Blue Sky requirements may lead some broker-dealers to only offer their services for Covered Securities.<sup>46</sup> However, the Commission lacks the data necessary to quantify the costs that broker-dealers and their customers face.

The amendment to Rule 146 that the Commission is adopting to make IEX a Designated Market will impact several parties, including (i) issuers that currently list their securities on a Named or Designated Market; (ii) issuers with securities not currently listed on any incumbent Named or Designated Market but who might list on IEX, or on an incumbent Named or Designated Market, as a result of the competition from IEX if IEX enters the listing market; and (iii) issuers with securities not currently listed on any incumbent Named or Designated Market and that would eventually list on a Named or Designated Market, regardless of IEX’s entry into the market. Given that issuers that meet the listing standards of IEX are likely to meet the listing standards of other Named or Designated Markets, the number of issuers that will list on a Named or Designated Market solely as a result of the amendment (i.e., those in category (ii) above) may be small. In addition, the amendment will affect IEX, as it will now be able to list Covered Securities, as can the Named and Designated Markets with which IEX now will be able to compete for listings.<sup>47</sup> The impacts on each of these affected parties are discussed in more detail below.

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<sup>46</sup> As noted in the Proposing Release, a commenter also stated that broker-dealers may have increased “rescission risk” for failing to comply with each jurisdiction’s Blue Sky requirements, which OTC Markets argues “may chill some broker-dealers’ willingness to allow their customers to transact in those securities at all, including securities of SEC reporting companies.” See id. at 33844 & n.46.

<sup>47</sup> The Commission believes that the amendment also may indirectly impact exchanges that are not Named or Designated Markets as well as other trading venues for both covered and non-covered securities as explained below.

## 2. Current Practices in the Market for Listings

Issuers of public securities make several considerations when deciding on which exchange to list their securities. These considerations include, among other things, the visibility and publicity provided by the exchange, the exchange's listing services and fees, and the exchange's listing standards. The Named and Designated Markets may provide issuers of Covered Securities with additional visibility over that of securities traded over the counter, which may, in turn, increase the pool of potential investors for an issuer and thereby improve an issuer's access to capital. In addition, the Named and Designated Markets provide listing services for their listed issuers, which can include monitoring, communication, and regulatory compliance services. These services may help issuers by reducing the cost of raising capital and the costs associated with going or remaining public. However, many issuers that list for the first time do so as part of an initial public offering, which can include considerations not related to listing on an exchange, such as SEC reporting obligations, as well as legal, accounting, and other expenses (both for the initial offering and the ongoing requirements of remaining public). In addition, issuers also consider the benefits of going public, such as increased access to capital and providing investors with a signal of an issuer's ability to meet obligations that apply to public companies (e.g., reporting requirements). Commonly, the decision of which exchange to list on is made concurrently with the decision about whether or not to go public.

Issuers must pay listing fees and meet listing standards to list on a Named or Designated Market. Listing fees may include an initial application fee, as well as an ongoing annual fee, and may vary by the number of shares in the initial offering or be fixed. However, listing fees typically represent a small portion of the overall cost of an initial public offering or the ongoing

costs of remaining public,<sup>48</sup> and thus may not be a significant factor that issuers consider when deciding (i) whether to list on a Named or Designated Market, and (ii) if so, on which Named or Designated market to list. Listing exchanges also impose listing standards on issuers, which can include corporate governance standards as well as quantitative requirements, such as minimum income, market capitalization, and operating history requirements.<sup>49</sup> While an exchange’s listing standards may prevent potential issuers who do not meet those standards from listing on the exchange, the stringency of an exchange’s listing standards may provide a valuable signal to investors about the quality of issuers that are able to list, which may improve the issuers’ access to capital.<sup>50</sup>

### 3. Competitive Landscape

The amendment to Rule 146 will affect the market for listing services, in which the Named and Designated Markets compete to provide listing services to issuers, or potential issuers, of Covered Securities because, as explained in detail below, the amendment will permit IEX to compete in this market. In addition, the Commission believes that the amendment can

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<sup>48</sup> Listing fees for equity securities can range from \$55,000 (NYSE American) to \$295,000 (NYSE). See NYSE MKT Company Guide at Sec. 140, available at [http://wallstreet.cch.com/MKTtools/PlatformViewer.asp?SelectedNode=chp\\_1\\_1\\_1&manual=/MKT/CompanyGuide/mkt-company-guide/](http://wallstreet.cch.com/MKTtools/PlatformViewer.asp?SelectedNode=chp_1_1_1&manual=/MKT/CompanyGuide/mkt-company-guide/); and NYSE Listed Company Manual at 902.02, available at [http://nysemanual.nyse.com/LCMTtools/bookmark.asp?id=sx-ruling-nyse-policymanual\\_902.02&manual=/lcm/sections/lcm-sections/](http://nysemanual.nyse.com/LCMTtools/bookmark.asp?id=sx-ruling-nyse-policymanual_902.02&manual=/lcm/sections/lcm-sections/). See also *supra* notes 41-46 and accompanying text (discussing the overall costs of state securities registration). See also Proskauer Rose LLP, 2016 IPO Study, at 52, available at <http://www.proskauer.com/files/uploads/Proskauer-2016-IPO-Study.pdf> (examining 258 IPOs from 2013 to 2015 and finding that the average total IPO expense, excluding underwriting fees, was \$4.15 million).

<sup>49</sup> The Commission views the term “listing exchange” as equivalent to the term “Named or Designated Market” for purposes of this release.

<sup>50</sup> See *infra* Section IV.A.3, for further discussion of listing standards and signaling to investors.

also affect the market for trading services because the listing status and listing designation of securities (i.e., whether a security is a Covered Security and where it is listed) are related to where and how the securities trade. In this section, the Commission discusses competition among Named and Designated Markets for listings, as well as competition among the various trading platforms (including Named and Designated Markets) for trading services.

(a) Competition for Listings

Listing exchanges compete with each other for listings in many ways, including, but not limited to, listing fees, listing standards, and listing services. When issuers select a listing exchange, they consider the listing fees and the costs of compliance with listing standards on any given exchange, as well as the quality of listing services and any relevant reputational benefits, among other things, each exchange may offer. Although issuers may incur costs to meet an exchange's listing standards, high listing standards may also yield benefits as they may serve as a positive signal to investors of an issuer's ability to satisfy high qualitative and quantitative listing requirements. Investors may interpret the reputation of a listing exchange and high listing standards as a credible signal of the quality of the listed securities on that exchange.<sup>51</sup>

Currently, there are three Named Markets under Section 18(b)(1)(A) of the Securities Act: NYSE, NYSE American, and Nasdaq/NGM. In addition, there are currently six Designated Markets: (i) Tier I of the NYSE Arca, Inc.; (ii) Tier I of the NASDAQ OMX PHLX LLC; (iii) CBOE; (iv) options listed on ISE; (v) The Nasdaq Capital Market; and (vi) Tier I and Tier II of BATS. As of June 2, 2017, the Commission estimates that NYSE listed 3,172 equity

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<sup>51</sup> See, e.g., Thomas J. Chemmanur & Paolo Fulghieri, Competition and Cooperation Among Exchanges: A Theory of Cross-listing and Endogenous Listing Standards, 82 J. Fin. Econ. 455-89 (2006), available at <http://www.sciencedirect.com/science/article/pii/S0304405X06001139>.

securities, Nasdaq listed 3,183 equity securities, NYSE Arca listed 1,529 equity securities, NYSE American listed 359 equity securities, and BATS listed 176 equity securities.<sup>52</sup>

While the number of equities listed on each exchange relative to the total number of equities listed on all exchanges is informative about overall competition for listings among the exchanges, the market shares for recent equity issue listings may provide a better picture of the nature of competition between exchanges and the size of the new listings market. Table 2 identifies the number of new equity issue listings from 2008 to 2016.<sup>53</sup>

Table 2: New Equity Listings in Named and Designated Markets, 2008-2016

	NYSE	Nasdaq	NYSE American	NYSE ARCA	BATS
2008	68	142	53	68	0
2009	76	115	33	20	0
2010	141	156	31	12	0
2011	130	132	34	14	0
2012	148	135	19	9	17
2013	178	201	26	13	6
2014	178	278	23	12	5
2015	101	220	15	13	31
2016	81	163	5	12	85

As shown in Table 2, two listing exchanges – NYSE and Nasdaq – captured 71% of all new equity listings on Named and Designated Markets in 2016, which is evidence of a highly

<sup>52</sup> These figures of listed equities include equity securities reported to a securities information processor. The estimates also include multiple securities from the same issuer, which means the total number of securities may differ from the total number of issuers potentially affected by this rulemaking. Listing information is from the master files of the daily trade and quotation data (“TAQ Data”).

<sup>53</sup> The listings data for NYSE, Nasdaq, NYSE American, and NYSE Arca were taken from Compustat Merged © 2016 Center for Research in Securities Prices (“CRSP”), The University of Chicago Booth School of Business. As CRSP does not have BATS listings data, BATS listings are from TAQ Data. See *supra* note 52.

concentrated listing market.<sup>54</sup> In addition, when BATS entered the market in 2012, it gained only 17 new listings, which was 5.2% of all new equity listings in 2012. This small number of new listings suggests that the number of currently unlisted issuers that would list with a new Designated Market is likely to be small.<sup>55</sup>

A highly concentrated market may be the result of barriers to entry, which limit competition, and can include economies of scale, reputation, legal barriers to entry, and network externalities. These barriers to entry may adversely affect a new listing exchange's ability to compete with incumbent exchanges for listings. New listing exchanges do not enjoy the economies of scale of large listing exchanges. Listing exchanges may exhibit economies of scale because an exchange with a large number of listings can spread the fixed costs of listing equities over a greater number of issuers. The larger these fixed costs are, the greater will be the scale economies of larger listing exchanges. New listing exchanges face reputational barriers to entry because they may not be able to quickly establish a strong reputation for high quality listings. This lack of reputation may discourage issuers from listing on an entrant exchange, as well as discourage investors from investing in an issuer that lists on an entrant exchange, which may further reinforce the reputational barriers to entry.

Legal barriers to entry also can apply because exchanges are self-regulatory organizations overseen by the Commission. The governing statute and regulations establish legal barriers to

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<sup>54</sup> The Herfindahl-Hirschman Index (HHI) measure for listing exchanges is 0.321, calculated as the sum of squared market shares, or  $(2,552/7,217)^2 + (2,863/7,217)^2 + (1,377/7,217)^2 + (339/7,217)^2 + (86/7,217)^2 = 0.321$ . See Campbell McConnell, Stanley Brue & Sean Flynn, *Microeconomics: Principles, Problems, & Policies* 218, 219, 225, 226 (2014). An HHI close to 0 indicates low concentration while an HHI of 1 indicates total concentration or monopoly.

<sup>55</sup> See *infra* Section IV.B.2, for further discussion about how this may affect currently unlisted issuers.

entry for an entity that seeks to register as an exchange, as well as additional legal barriers for an exchange to become a Designated Market. Specifically, the process by which the Commission designates an exchange as a Designated Market imposes a legal barrier to entry on the ability of an exchange to effectively compete for the listing business of Covered Securities.

In addition, the market for listings exhibits positive network externalities: issuers may prefer to be listed on exchanges where other similar issuers are listed because of increased visibility. This indicates that, all else being equal, issuers may tend to favor listing their securities on large exchanges (in terms of listings) over smaller ones.

Issuers also may face costs associated with moving their listing from one exchange to another. These switching costs will not only include the fixed costs associated with listing on a new exchange (such as the exchange's application fee, and the legal and accounting expenses associated with ensuring that the issuer satisfies the listing standards of the new exchange) but also will include the costs associated with communicating with investors about the move to the new exchange. Thus, an issuer that is considering moving from one exchange to another would compare the relatively lower annual listing fee of its current exchange with the relatively high costs of moving its listing to a new exchange, which places the new exchange at a disadvantage and creates a barrier to entry for a potential entrant. Even if an entrant exchange prices its listing fees and services for new issuers competitively compared to the incumbent exchanges, the costs for an issuer to switch its listing to a new exchange may dissuade an issuer from switching and thereby prevent the entrant from gaining market share.

Table 3 shows estimates of the probability that an issuer would change its listing exchange in a given year, based on issuer switching behavior for equities over the period 2008 to 2016. As an example, if an equity security was listed on NYSE in a given year, there was a

99.33% chance that it would still be listed on NYSE the following year, but a 0.04% chance it would be listed on Amex the following year, a 0.34% chance it would be listed on Nasdaq the following year, and a 0.08% chance it would be listed on NYSE Arca the following year. More generally, equities listed on NYSE and Nasdaq in a given year had a greater than 99% chance of remaining listed on that exchange the following year. This result suggests that issuers are unlikely to switch their listings away from the two exchanges with the highest market shares.

Table 3: Conditional Probability of Transition for Listings, 2008-2016.<sup>56</sup>

<u>Original Exchange</u>	<u>Status in the Following Year</u>					
	NYSE	NYSE American	Nasdaq	NYSE Arca	BATS	Not Trading <sup>57</sup>
NYSE	99.33%	0.04%	0.34%	0.08%	0.00%	0.20%
NYSE Amer.	1.80%	93.47%	2.80%	1.39%	0.00%	0.54%
Nasdaq	0.38%	0.07%	99.11%	0.01%	0.00%	0.42%
NYSE Arca	1.50%	0.47%	1.13%	90.81%	0.00%	6.10%
BATS	0.00%	0.00%	0.00%	0.00%	94.40%	5.60%

(b) Competition for Trading Services

Trading in Covered Securities is segmented from trading in those securities that are not listed on a Named or Designated Market (i.e., non-Covered Securities). Non-Covered Securities trade only on over-the-counter (“OTC”) markets, which consist of alternative trading systems (“ATs”) that trade unlisted securities and broker-dealers who internalize orders. Covered Securities, on the other hand, may trade on the registered national securities exchanges or off-exchange either on the 35 ATs or through broker-dealers that internalize orders. The market to

<sup>56</sup> The listings data for NYSE, Nasdaq, NYSE American, and NYSE Arca were taken from CRSP. BATS listings are from TAQ Data. See *supra* note 52.

<sup>57</sup> For the exchanges in the CRSP data (NYSE, NYSE American, Nasdaq, and NYSE Arca), this category (Not Trading) includes listings that were halted, suspended, not trading, or whose listing status was not known in the following year. For the exchange from the TAQ data (BATS), this column includes listings that were not in the TAQ master file in the following year.



trade Covered Securities on either the Named and Designated Markets or the other trading platforms is more liquid than the OTC trading of non-Covered Securities because, among other things, OTC markets have higher search costs associated with finding buyers and sellers.<sup>58</sup> Further, because Covered Securities are exempt from state securities registration laws, the costs associated with complying with state securities registration laws are lower for broker-dealers that trade Covered Securities on behalf of their customers, as compared to trading non-covered securities.

Exchanges, ATSS, and broker-dealers compete to attract order flow in Covered Securities by offering better trading services or innovative trading mechanisms. Attracting order flow can generate revenue in the form of transaction fees or data revenue.<sup>59</sup>

The ability of listing exchanges, however, to successfully use innovative trading services to attract listings has declined over the past decade.<sup>60</sup> During this time, the number of competitors in the market for trading services has increased, resulting in fragmentation in the market and a decline in the market share of trading at listing exchanges. For example, since the third quarter of 2009, the number of ATSS that reported transactions in NMS stocks has

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<sup>58</sup> See, e.g., Ulf Brüggemann, Aditya Kaul, Christian Leuz & Ingrid M. Werner, The Twilight Zone: OTC Regulatory Regimes and Market Quality, (Nat'l Bureau of Econ. Research, Working Paper No. 19358, 2013), available at <https://ideas.repec.org/p/nbr/nberwo/19358.html>.

<sup>59</sup> For example, market data fees collected by the three industry networks are allocated proportionally among the exchanges based, in part, on each exchange's share of the overall transaction volume. See Securities Exchange Act Release No. 61358 (January 14, 2010), 75 FR 3594, 3600-01 (January 21, 2010) (Concept Release on Equity Market Structure) (Commission concept release discussing the revenues and expenses from data fees at that point in time).

<sup>60</sup> See James Angel, Lawrence Harris & Chester Spatt, Equity Trading in the 21st Century: An Update (2013), available at <http://www.q-group.org/wp-content/uploads/2014/01/Equity-Trading-in-the-21st-Century-An-Update-FINAL1.pdf>.

increased from 32 to 34,<sup>61</sup> while the share volume of Covered Securities executed on ATSS has increased from 7.9% to 13.0%.<sup>62</sup> In contrast, the two listing exchanges with the greatest number of issues listed, NYSE and Nasdaq, each experienced a sharp decline in the market share of trading volume in the securities they list. The market share of the NYSE in NYSE-listed stocks fell from approximately 80% in 2005 to 20% in 2013; Nasdaq's market share of Nasdaq-listed stocks fell by approximately half, from 50% in 2005 to 25% in 2013.<sup>63</sup> Despite these changes, listing exchanges still currently enjoy a larger trading market share in their listed securities.<sup>64</sup>

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<sup>61</sup> Data compiled from Forms ATS and Form ATS-R submitted to the Commission as of June 2017 show that 35 ATSS have noted that they expect to trade NMS stocks. However, only 34 ATSS had observable transactions in NMS stocks since the third quarter of 2009.

<sup>62</sup> See 17 CFR 242.600(b)(47) (definition of NMS Stock) (“NMS stock means any NMS security other than an option.”) and 17 CFR 242.600(46) (definition of NMS security) (“NMS security means any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options.”). The estimates of ATSS that trade NMS stocks and ATS trade volume share was developed using weekly summaries of trade volume collected from ATSS pursuant to FINRA Rule 4552. See also Securities Exchange Act Release No. 76474 (November 18, 2015), 80 FR 80998, 81109 (December 28, 2015) (Regulation of NMS Stock Alternative Trading Systems). The estimates in this release were developed in the same manner as in the cited release. See also OTC (ATS & Non-ATS) Transparency, FINRA, <http://www.finra.org/Industry/Compliance/MarketTransparency/ATS/>.

<sup>63</sup> See Angel, Harris & Spatt, supra note 60, at 20-21.

<sup>64</sup> For the purposes of this rulemaking, staff examined TAQ Data for the time period of November through December 2014. Staff observed that exchanges tend to enjoy more than 15% higher market share in the securities they list compared to the securities they do not list, on average, and they tend to enjoy about 20% higher market share in the securities they list compared to the market share of others' trading in those securities, on average.

B. Impact on Efficiency, Competition, and Capital Formation

Securities Act Section 2(b)<sup>65</sup> requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

1. Efficiency

By listing on IEX, security issuers that otherwise would have not listed their securities on a Named or Designated Market will be able to avoid the duplicative costs of securities registration in multiple jurisdictions. In this way, the amendment will reduce the impediments to listing on exchanges, which in turn can improve market efficiency. To the extent that the amendment results in increased listing activity, then it may improve the allocative efficiency of securities markets by allowing investors to better diversify financial risks by investing in newly-listed securities.

However, these two impacts may be mitigated by the extent to which issuers are unable to list on a Named or Designated Market because, for example, they do not satisfy listing standards or cannot afford the attendant costs of doing so. An issuer must be an SEC reporting company to list on a national securities exchange.<sup>66</sup> Therefore, to the extent that an issuer is not already an SEC reporting company, it may face increased disclosure costs in order to be eligible to be listed on a national securities exchange. Moreover, issuers that are able to meet the listing standards of IEX are likely to be able to meet the listing standards of other Named or Designated Markets; accordingly, the entry of IEX will not necessarily increase the pool of securities eligible

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<sup>65</sup> See 15 U.S.C. 77b(b).

<sup>66</sup> See 15 U.S.C. 78l(b).

for listing. As a result, the Commission believes that the number of issuers that would not have listed at all in the absence of an amendment, but will now list on IEX, is likely to be small.<sup>67</sup>

## 2. Capital Formation

Whether IEX entering the listing market promotes capital formation depends on the extent to which issuers previously unable or unwilling to list on a Named or Designated Market subsequently do so. Some issuers may, as a result of improved services and/or decreased fees stemming from the increased competition between listing exchanges, be induced to list on an exchange where, in the absence of the amendment, they would not have done so. If so, then the entrance of IEX can provide issuers with lower cost access to capital.

As noted in Section IV.A, one reason issuers list on a Named or Designated Market is improved access to capital. Listing on a Named or Designated Market may improve access to capital in several ways, which can promote capital formation. First, listing on a Named or Designated Market may credibly signal to investors that a firm is of higher quality because firms that list on these exchanges must meet the exchange's minimum standards for governance and disclosure. Like listed issuers on the Named and Designated Markets, IEX's listed issuers might benefit from the signal of quality that comes from listing on a Named or Designated Market. The reputational benefits that come from listing on a Named or Designated Market may make investors more willing to invest in such issuers, which may improve the issuers' access to capital, and promote capital formation.

Second, an issuer listing on a Named or Designated Market may experience enhanced liquidity that facilitates capital formation. Investors may demand a liquidity premium (greater returns) when investing in illiquid securities to compensate for the risks associated with the lack

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<sup>67</sup> See supra Section IV.A.3.a (for further discussion).

of liquidity. Any liquidity risk premium raises the costs issuers incur when issuing new securities. Listing on a Named or Designated Market may result in more liquid trading relative to OTC trading because of potential frictions to liquidity imposed by OTC search costs.<sup>68</sup> Therefore, if the amendment induces additional issuers to list, the enhanced liquidity can facilitate capital formation by reducing the cost that the issuers of those securities would otherwise incur (e.g., through their ability to issue securities at a higher offering price compared to a non-listed issuance) when issuing new securities. Additionally, listing on a Named or Designated Market may enhance liquidity and promote access to capital (and thereby promote capital formation) by reducing the costs of trading incurred by broker-dealers, which potentially are shared with investors. Broker-dealers incur costs to trade non-Covered Securities when ensuring their compliance with state securities laws in multiple jurisdictions,<sup>69</sup> which are potentially shared with investors. Thus, the amendment may reduce investors' transaction costs to trade securities that list on a Named or Designated Market as a result of the amendment.<sup>70</sup> Consequently, investors in securities that list on IEX as a result of the amendment will have easier access to invest in those securities and to further diversify their investment portfolios, which may promote capital formation by improving allocative efficiency.<sup>71</sup>

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<sup>68</sup> See supra Section IV.A.3.b. See also Darrell Duffie, Nicolae Garleanu & Lasse Heje Pedersen, Over-the-Counter Markets, 73 *Econometrica* 1815 (2005).

<sup>69</sup> See supra Section IV.A.3.b.

<sup>70</sup> See supra Section IV.A.1.

<sup>71</sup> See, e.g., John Heaton & Deborah J. Lucas, Evaluating the Effects of Incomplete Markets on Risk Sharing and Asset Pricing, 104 *J. Pol. Econ.* 443 (1996).

### 3. Competition

The amendment to Rule 146(b) will likely increase competition among the Named and Designated Markets that compete to list securities. By determining that IEX has “substantially similar” listing standards to the Named and other Designated Markets, the amendment permits IEX to compete with other Named and Designated Markets to list securities that are exempt from state registration requirements. As discussed above, the Named and Designated Markets compete with each other in many ways, including listing standards, listing fees, and listing services. In addition to permitting IEX to compete to list securities as a Designated Market, the additional competition from IEX’s entry into the listing market will also provide incumbent listing markets with incentives to change how they compete with each other.<sup>72</sup>

Generally, there are two ways that increased competition can affect how listing markets compete with each other. First, it can affect how Named or Designated Markets compete to provide better services and value for listing issuers. If an additional entrant competes by providing better listing and monitoring services or lower costs for issuers, incumbent listing exchanges may decide to follow suit. For example, listing markets could reduce fees, improve services, or reduce compliance burdens associated with their listing standards.<sup>73</sup>

The Named and Designated Markets also may compete to provide better services by increasing their level of specialization with respect to securities listings. As noted below, as in

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<sup>72</sup> See, e.g., Thierry Foucault & Christine A. Parlour, Competition for Listing, 35 *Rand J. Econ.* 329 (2004) (describing how, in equilibrium, competing exchanges obtain positive expected profits by offering different execution costs and different listing fees). See also supra note 60 and accompanying text.

<sup>73</sup> See infra note 75 (discussing the filing requirements under the Securities Exchange Act of 1934 (“Exchange Act”) necessary for any revision to exchange listing standards and noting that such listing standards and changes to such listing standards are subject to the requirements of the Exchange Act and the rules and regulations thereunder).

the case of BATS, some Named and Designated Markets may develop reputations for specializing in specific types of issues by catering to specific types of issuers. An increase in competitive pressures may cause the Named and Designated Markets to increase the degree to which they cater to specific types of issuers. Specialization may reduce the cost of providing listing services or may promote innovation in the provision of listing services. To the extent that specialization improves the services provided to issuers or reduces the costs of these services, this competitive response may improve the efficiency of the market for listing services.

Second, the reputation of a Named or Designated Market for strict listing standards may be informative to an investor and serve as a signal of the quality of an issuer.<sup>74</sup> Issuers that are able to meet the listing standards of a Named or Designated Market can signal their ability to do so by listing on those exchanges. However, because complying with these listing standards may be costly for issuers, issuers weigh the benefits of signaling their higher quality (through their ability to meet the stronger listing standards of the Named or Designated Market) against the costs of compliance with these standards.

The impact of increased competition on listing standards is uncertain. The Named and Designated Markets may respond to increased competition by strengthening listing standards to provide additional signaling and attract investors to the issuers the exchanges list. Alternatively, the Named and Designated Markets can instead respond to increased competition by proposing

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<sup>74</sup> See Stewart C. Myers & Nicholas S. Majluf, Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have, 13 J. Fin. Econ. 187 (1984), available at <http://www.sciencedirect.com/science/article/pii/0304405X84900230>, for a discussion of the role of asymmetric information in corporate finance. See also Nathalie Dierkens, Information Asymmetry and Equity Issues, 26 J. Fin. & Quantitative Analysis 181 (1991), available at [www.jstor.org/stable/2331264](http://www.jstor.org/stable/2331264), for empirical evidence of asymmetric information in the equity issue process.

to weaken their listing standards to attract additional listings. The exchanges' opposing incentives to cater to these two groups of market participants make predicting the impact of increased competition on listing standards difficult.

The Named and Designated Markets' ability to lower listing standards is constrained by two factors (1) any proposed listing standards or proposed changes to existing listing standards must be filed with the Commission pursuant to Section 19(b) of the Exchange Act and must meet statutory and rule requirements to become effective;<sup>75</sup> and (2) an exchange with listing standards that are not substantially similar to those of a Named Market may lose its status as a Designated Market.<sup>76</sup> The requirement that the listing standards of a Designated Market be substantially similar to those of a Named Market means that the listing standards of the Named Markets serve as a lower bound for the extent to which competition may pressure listing exchanges to attempt to weaken their listing standards.

Some of the features of the market for listings that currently inhibit competition may mitigate the effects of the amendment on competition. Specifically, some of the barriers to entry discussed in the baseline – economies of scale and network externalities – may make it difficult for IEX to effectively compete with incumbent exchanges for listings.<sup>77</sup> For example, if a new entrant does not attract enough initial listings, the fixed cost of operations may make it difficult to keep its listing fees competitive. In addition, a new entrant may not have established a sufficient reputation as a listing exchange to credibly certify the quality of its new issues. Thus,

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<sup>75</sup> Any revision to exchange listing standards must be filed in accordance with Section 19(b) of the Exchange Act and Rule 19b-4 thereunder and is subject to the requirements of the Exchange Act and the rules and regulations thereunder. See 15 U.S.C. 78s(b) and 17 CFR 240.19b-4.

<sup>76</sup> See 17 CFR 230.146(b)(2).

<sup>77</sup> See supra Section IV.A.



the structure of the market for listings may mitigate some of the potential effects of increased competition between Named and Designated Markets.

The most recent example of an entrant into the market for listings is BATS, which became a Designated Market in 2012.<sup>78</sup> Table 2 in Section IV.A.3.a shows that the number of new listings on BATS decreased each year until 2015 but has increased recently. While the growth in new listings by BATS may be indicative of the barriers to entry that entrants such as IEX will face, circumstances specific to BATS may have impacted its ability during that period to attract listings.<sup>79</sup>

Table 3 in Section IV.A.3.a shows that almost none of the new listings on BATS arrived as transfers from another exchange; rather most of those listings were the initial listing for each issuer. This evidence could indicate that switching costs may also have had an impact on BATS' ability to gain market share, and may be a factor for IEX, as well. Moreover, the vast majority of BATS-listed securities are exchange-traded products, which is consistent with the idea that, despite barriers to entry, BATS was able to enter the market by competing for one segment of the market and specializing in listing exchange-traded products.

### C. Analysis of Benefits and Costs

The amendment to Rule 146(b) making IEX a Designated Market allows securities listed, or authorized for listing, on IEX to be designated as Covered Securities under Rule 146(b)(1) under the Securities Act. As described above, Covered Securities are exempt from

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<sup>78</sup> See Securities Act Release No. 9295 (January 20, 2012), 77 FR 3590 (January 25, 2012).

<sup>79</sup> As BATS noted in its registration statement filed with the Commission on December 15, 2015, “[O]n March 23, 2012, we experienced a serious technical failure on BZX, forcing us to cancel our planned IPO. . . . These technical failures damaged our reputation and resulted in increased regulatory scrutiny of the event by the SEC and other governmental authorities.”

state law registration requirements.<sup>80</sup> In this section, the Commission discusses the benefits and costs of the amendment, which stem from: (i) the exemption from Blue Sky laws provided to any issuers that would not list in the absence of the amendment; and (ii) the entry of IEX into the market for listings as a Designated Market.

As noted above, the Commission is unable to quantify all of the economic effects of the amendment because it lacks the information necessary to provide reasonable estimates.

#### 1. Benefits of the Amendment

The amendment will provide benefits, flowing from the exemption from Blue Sky laws, to issuers that do not currently list on an existing Named or Designated Market but choose to list on IEX.<sup>81</sup> Specifically, the amendment will permit these issuers to avoid the potentially duplicative costs of complying with multiple state securities regulations. As noted above, these duplicative costs can include both a fixed cost of registration and ongoing compliance costs. Because an unlisted issuer needs to register in each of the jurisdictions in which its securities will be bought or sold, any issuers that list as a result of the amendment will save these registration costs. To the extent that IEX attracts previously unlisted issuers, IEX will benefit as a result of revenue from listing fees, trading fees, and data fees generated by additional issuers. In addition, absent the amendment, the heterogeneity in state securities regulations generates ongoing costs

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<sup>80</sup> Rule 146 and Section 18 have no effect on Federal registration requirements, which are addressed by Section 5 of the Exchange Act. See 15 U.S.C. 78e. Section 18 of the Securities Act states that no law, rule, regulation, or order, or other administrative action of any State or any political subdivision thereof requiring, or with respect to, registration or qualification of securities, or registration or qualification of securities transactions, shall directly or indirectly apply to a covered security. See 15 U.S.C. 77r(a)(1)(A).

<sup>81</sup> Data to estimate the number of such issuers does not exist, but the Commission believes that the numbers of such issuers is likely to be small, as any issuers that can meet the listing standards of IEX are likely to be able to meet the listing standards of the incumbent Named or Designated Markets.

for broker-dealers and investors transacting in multiple jurisdictions.<sup>82</sup> However, the overall magnitude of these benefits depends on the number of currently unlisted issuers that choose to list on IEX as a result of the amendment, and the Commission believes this number is likely to be small because any unlisted issuer able to meet the listing standards of IEX is likely to be able to meet the listing standards of the other Named and Designated Markets.<sup>83</sup>

More generally, by making IEX a Designated Market, the amendment will benefit IEX by allowing it to compete in the listing market for Covered Securities on a more level playing field with similarly situated national securities exchanges.<sup>84</sup> Specifically, being able to list Covered Securities will allow IEX more effectively to compete with the incumbent Named and Designated Markets that also are able to offer Covered Securities status. This will also benefit issuers that choose to list securities on a Named or Designated Market by providing them with another alternative venue on which to list. Furthermore, adding IEX as an entrant into this market will increase the number of competitors in the market for listings. To the extent that the existing Named and Designated Markets respond to this increased competition by reducing listing fees or improving listing services, as discussed above, currently listed issuers and their investors may benefit from the improved quality of listing services, reduced listing fees or reduced compliance costs. In addition, to the extent that the entry of IEX increases the

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<sup>82</sup> See supra Sections IV.A.1 and IV.B.1.

<sup>83</sup> See Table 2, supra Section IV.A.3.a, and accompanying text.

<sup>84</sup> The Commission acknowledges that this benefit to IEX may come at the expense of the existing Named and Designated Markets, who may lose a portion of their current share to a new entrant. See infra Section IV.D.

specialization of incumbent Named and Designated Markets, issuers may benefit from listing services that are more tailored to their needs.<sup>85</sup>

Last, if issuers list on a Named or Designated Market as a result of the amendment, this listing may impact the trading of those issuers' securities on markets that are not Named or Designated Markets. As noted in the baseline, securities that list on a Named or Designated Market may also trade on exchanges that are not Named or Designated Markets, which may bring those exchanges additional revenue from trades.<sup>86</sup> To the extent IEX's entry into the market increases the number of issuers listing on a Named or Designated Market, exchanges that are not Named or Designated Markets may benefit from trading revenue from trading more Covered Securities, even though these exchanges do not directly compete with IEX or the Named or Designated Markets for listings business.

## 2. Costs of the Amendment

For unlisted issuers that choose to list on IEX as a result of the amendment, listing on IEX may entail compliance costs arising from new reporting obligations from IEX's listing standards. In addition, if unlisted issuers choose to list on IEX as a result of the amendment, investors may also face costs from the loss of state oversight for the securities listed by these issuers. The Commission notes that the overall magnitude of costs associated with the loss of state oversight depends on the number of unlisted issuers that choose to list as a result of the amendment. The Commission believes this number is likely to be small, or non-existent, for the reasons noted above.<sup>87</sup> Furthermore, the Commission notes that these issuers would only choose

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<sup>85</sup> See supra Section IV.B.3.

<sup>86</sup> See supra Section IV.A.1.

<sup>87</sup> See Table 2, supra Section IV.A.3.a, and accompanying text.

to list on IEX and bear these costs if they decided that the benefits of listing on IEX justified the costs.

The Commission believes that any costs to investors from a loss of state oversight for such issuers will be mitigated by (i) federal regulations and oversight of IEX and the other Named and Designated Markets, and (ii) the requirement for issuers to meet the exchanges' listing standards. Indeed, Congress, in Section 18 of the Securities Act, has already determined that federal regulation is sufficient for those issuers that meet the high listing standards of a Named or Designated Market. Furthermore, the Commission believes that regulatory protections offered by exchanges for trading in Covered Securities conducted on their facilities (e.g., market surveillance, investigation and enforcement) will mitigate the potential costs of a loss of state oversight for unlisted issuers that list on IEX.

Issuers that currently list on an existing Named or Designated Market that would switch to IEX would not experience potential costs from a loss of state oversight or compliance costs arising from new reporting obligations, because they currently are not subject to state oversight and are subject to the reporting requirements by virtue of being an SEC reporting company (a condition to their listing on a current Named or Designated Market). However, any previously listed issuers that decide to change their listing from another Named or Designated Market to IEX will incur costs to switch their listing.<sup>88</sup> Still, the Commission notes that issuers can choose whether or not to incur this cost and likely would do so only if the benefits of switching their listing exceed their switching costs.

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<sup>88</sup> See supra Section IV.A.3.a, for a discussion of the sources of switching costs.

D. Other Effects of the Amendment

Some of the effects of the amendment to Rule 146 on IEX, incumbent Named and Designated Markets, and issuers involve transfers from one party to another. For example, the listing fees collected by IEX from previously-listed issuers may come from a reduction in the listing fees collected by other Named or Designated Markets. Issuers that list on Named and Designated Markets may also enjoy savings from listing fee reductions as a result of increased listing exchange competition, which would also come from a reduction in listing fees collected by Named or Designated Markets.

Additionally, as a result of changes to competition in the market for listings, the volume of trading across trading venues may shift, to the advantage of some venues and to the detriment of others. Changes to the Named or Designated Markets' shares of the market for listings may affect the distribution of trading volumes across Named and Designated Markets, as well as other trading venues. Commission staff estimates that an exchange captures an average share of volume in the securities listed by that exchange that is about 20% higher than the market share of other exchanges trading the same securities.<sup>89</sup> This result suggests that even if the number of listed securities does not change, changes to listings driven by increased competition may alter the market share of trading distributed across each venue by about 20% of the volume in such securities. Any shifts in the market share of trading can result in gains and losses in transaction fees collected and the share of data fees split between exchanges. Although these gains and

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<sup>89</sup> See supra note 64. Using TAQ data, Commission staff estimates that listing exchanges have around 28.8% of the dollar volume in the securities they list compared to other exchanges' average of about 3.3% of the dollar volume. Staff observed that each listing exchange enjoys a higher market share of dollar volume in its listed securities than any other exchange trading the listing exchange's listed securities. Staff also observed that these differences were not only economically large, but that they were also statistically significant.

losses are relevant potential economic effects of the amendment, the Commission does not consider these transfers to be a benefit or cost of the amendment, but rather a consequence of increased competition.<sup>90</sup>

## **V. Regulatory Flexibility Act Certification**

The Commission certified, pursuant to Section 605(b) of the Regulatory Flexibility Act,<sup>91</sup> that the amendment to Rule 146 would not have a significant economic impact on a substantial number of small entities. This certification was included in the Proposing Release.<sup>92</sup> The Commission solicited comments on the certification. No comments on the certification were received.

## **VI. Statutory Authority and Text of the Rule**

The Commission is adopting an amendment to Rule 146 pursuant to the Securities Act of 1933,<sup>93</sup> particularly Sections 18(b)(1)(B) and 19(a).<sup>94</sup>

### **List of Subjects in 17 CFR Part 230**

Securities.

For the reasons set forth in the preamble, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

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<sup>90</sup> In light of the relevant statutory language and in the context of this particular rulemaking, the Commission does not believe that there are reasonable alternatives to this proposal to designate securities listed on IEX as Covered Securities.

<sup>91</sup> 5 U.S.C. 605(b).

<sup>92</sup> See Proposing Release, supra note 9, at 33850-51.

<sup>93</sup> 15 U.S.C. 77a et seq.

<sup>94</sup> 15 U.S.C. 77r(b)(1)(B) and 77s(a).

**PART 230 – GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933**

1. The authority citation for Part 230 continues to read, in part, as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78o-7 note, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, and Pub. L. 112-106, sec. 201(a), sec. 401, 126 Stat. 313 (2012), unless otherwise noted.

\* \* \* \* \*

2. Section 230.146 is amended by revising paragraphs (b)(1) and (b)(2) to read as follows:

**§ 230.146 Rules under section 18 of the Act.**

\* \* \* \* \*

(b) \* \* \*

(1) For purposes of Section 18(b) of the Act (15 U.S.C. 77r), the Commission finds that the following national securities exchanges, or segments or tiers thereof, have listing standards that are substantially similar to those of the New York Stock Exchange (“NYSE”), the NYSE American LLC (“NYSE American”), or the National Market System of the Nasdaq Stock Market (“Nasdaq/NGM”), and that securities listed, or authorized for listing, on such exchanges shall be deemed covered securities:

- (i) Tier I of the NYSE Arca, Inc.;
- (ii) Tier I of the NASDAQ PHLX LLC;
- (iii) The Chicago Board Options Exchange, Incorporated;
- (iv) Options listed on Nasdaq ISE, LLC;
- (v) The Nasdaq Capital Market;
- (vi) Tier I and Tier II of Bats BZX Exchange, Inc.; and



(vii) Investors Exchange LLC.

(2) The designation of securities in paragraphs (b)(1)(i) through (vii) of this section as covered securities is conditioned on such exchanges' listing standards (or segments or tiers thereof) continuing to be substantially similar to those of the NYSE, NYSE American, or Nasdaq/NGM.

By the Commission.

Dated: October 24, 2017

Lynn M. Powalski  
Deputy Secretary