

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-87576; File No. SR-NYSEArca-2019-14)

November 20, 2019

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Approving a Proposed Rule Change, as Modified by Amendment No. 1, Relating to the Permitted Investments of the PGIM Ultra Short Bond ETF

I. Introduction

On March 13, 2019, NYSE Arca, Inc. (“Exchange” or “NYSE Arca”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to make certain changes to the listing rule for shares (“Shares”) of the PGIM Ultra Short Bond ETF (“Fund”). The proposed rule change was published for comment in the Federal Register on April 2, 2019.³ On May 10, 2019, pursuant to Section 19(b)(2) of the Act,⁴ the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change.⁵ On June 27, 2019, the Commission instituted proceedings pursuant to Section 19(b)(2)(B) of the Act⁶ to determine whether to approve or disapprove the proposed rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 85430 (Mar. 27, 2019), 84 FR 12646 (Apr. 2, 2019) (“Notice”).

⁴ 15 U.S.C. 78s(b)(2).

⁵ See Securities Exchange Act Release No. 85829 (May 10, 2019), 84 FR 22221 (May 16, 2019). The Commission designated July 1, 2019, as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to approve or disapprove, the proposed rule change.

⁶ 15 U.S.C. 78s(b)(2)(B).

change.⁷ On September 23, 2019, the Commission designated a longer period within which to issue an order approving or disapproving the proposed rule change.⁸ On November 14, 2019, the Exchange filed Amendment No. 1 to the proposed rule change.⁹ The Commission has received no comment letters on the proposal. This order approves the proposed rule change, as modified by Amendment No. 1.

II. Description of the Proposal

A. The Fund and the Shares

PGIM Investments LLC (“Adviser”) is the investment adviser for the Fund. PGIM Fixed Income (“Subadviser”), a unit of PGIM, Inc., is the subadviser to the Fund. According to the Exchange, the investment objective of the Fund is to seek total return through a combination of current income and capital appreciation, consistent with preservation of capital. The Fund seeks to achieve its investment objective by investing primarily in a portfolio of U.S. dollar denominated short-term fixed, variable and floating rate debt instruments. Under normal market conditions,¹⁰ the Fund invests at least 80% of its net assets (plus any borrowings for investment purposes) in a portfolio of financial instruments consisting of (1) the Principal Investment Instruments (as defined in the First Prior Order); and (2) derivatives (as described in the Prior Orders) that (a) provide exposure to such Principal Investment Instruments, or (b) are used to

⁷ See Securities Exchange Act Release No. 86220, 84 FR 31868 (Jul. 3, 2019).

⁸ See Securities Exchange Act Release No. 87058, 84 FR 51210 (Sep. 27, 2019).

⁹ In Amendment No. 1, the Exchange supplemented the proposed rule change by adding additional details regarding certain of the asset backed securities in which the Fund may invest. Amendment No. 1 is available at: <https://www.sec.gov/comments/sr-nysearca-2019-14/srnysearca201914-6425213-198531.pdf>.

¹⁰ The term “normal market conditions” is defined in NYSE Arca Rule 8.600-E(c)(5).

enhance returns, manage portfolio duration, or manage the risk of securities price fluctuations, as described in the Prior Orders.¹¹

The Shares commenced trading on the Exchange on April 10, 2018, pursuant to the generic listing standards under Commentary .01 to NYSE Arca Rule 8.600-E (“Managed Fund Shares”).¹² Since then, the Exchange has proposed – and the Commission has approved – two proposed rule changes to expand the permitted investments of the Fund beyond what is permitted under the generic listing requirements.¹³ By this proposed rule change, the Exchange proposes to again amend the listing rule applicable to the Shares.

B. The Proposed Modifications to the Shares’ Listing Rule

The Exchange proposes to amend two requirements of the Shares’ current listing rule as set forth in the First Prior Order, namely the requirements that: (1) the Fund’s investments in non-U.S. Government, non-agency, non-GSE and other privately issued asset backed securities (including mortgage-backed securities) (“Private ABS/MBS”) are limited to 20% of the total

¹¹ The terms “First Prior Order” and “Prior Orders” are defined infra at note 13.

¹² A Managed Fund Share is a security that represents an interest in an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1) organized as an open-end investment company or similar entity that invests in a portfolio of securities selected by its investment adviser consistent with its investment objectives and policies. In contrast, an open-end investment company that issues Investment Company Units, listed and traded on the Exchange under NYSE Arca Rule 5.2-E(j)(3), seeks to provide investment results that correspond generally to the price and yield performance of a specific foreign or domestic stock index, fixed income securities index or combination thereof.

¹³ See Securities Exchange Act Release No. 83319 (May 24, 2018), 83 FR 25097 (May 31, 2018) (SR-NYSEArca-2018-15) (“First Prior Order”); and Securities Exchange Act Release No. 84818 (December 13, 2018) (SR-NYSEArca-2018-75) (together with the First Prior Order, “Prior Orders”).

assets of the Fund;¹⁴ and (2) the Fund may invest only 10% of its total assets in fixed income securities that do not satisfy the criteria of Commentary .01(b)(4) to NYSE Arca Rule 8.600-E.¹⁵

The Exchange proposes to modify the Fund's current limit on Private ABS/MBS by removing collateralized debt obligations ("CDOs")¹⁶ from the definition of Private ABS/MBS and by allowing the Fund to invest up to 20% of its total assets in CDOs. Therefore, the Exchange is proposing to allow up to 40% of the Fund's portfolio to be composed of what had previously been defined as Private ABS/MBS. The Exchange asserts that the ability to invest up to 20% of the Fund's portfolio in CDOs would help the Fund maintain portfolio diversification

¹⁴ At the time the proposed rule change was filed, Commentary .01(b)(5) to NYSE Arca Rule 8.600-E provided that non-agency, non-government sponsored entity and privately issued mortgage-related and other asset-backed securities components of a portfolio may not account, in the aggregate, for more than 20% of the weight *of the fixed income portion* of the portfolio. Recently, however, the Exchange amended Commentary .01(b)(5) to NYSE Arca Rule 8.600-E, and it now provides that non-agency, non-government sponsored entity and privately issued mortgage-related and other asset-backed securities components of a portfolio may not account, in the aggregate, for more than 20% of the weight of the portfolio. See Securities Exchange Act Release No. 86017 (June 3, 2019), 84 FR 26711 (June 7, 2019) (SR-NYSEArca-2019-06).

¹⁵ Commentary .01(b)(4) requires that at least 90% of *the fixed income weight* of the portfolio must be either: (a) from issuers that are required to file reports pursuant to Sections 13 and 15(d) of the Act; (b) from issuers that have a worldwide market value of its outstanding common equity held by non-affiliates of \$700 million or more; (c) from issuers that have outstanding securities that are notes, bonds debentures, or evidence of indebtedness having a total remaining principal amount of at least \$1 billion; (d) exempted securities as defined in Section 3(a)(12) of the Act; or (e) from issuers that are a government of a foreign country or a political subdivision of a foreign country.

¹⁶ The Exchange defines CDOs as collateralized loan obligations ("CLOs") and collateralized bond obligations ("CBOs"). The Exchange defines CLOs as securities issued by a trust or other special purpose entity that are collateralized by a pool of loans by U.S. banks and participations in loans by U.S. banks that are unsecured or secured by collateral other than real estate. The Exchange defines CBOs as securities issued by a trust or other special purpose entity that are backed by a diversified pool of fixed income securities issued by U.S. or foreign governmental entities or fixed income securities issued by U.S. or corporate issuers.

and would reduce manipulation risk.¹⁷ The Exchange argues that CDOs can be distinguished from asset backed securities (“ABS”) because CDOs are collateralized by bank loans or by corporate or government fixed income securities, while ABS are collateralized by consumer and other loans (including student loans) made by non-bank lenders.¹⁸ Additionally, the Exchange states that the Fund’s investments in CDOs would be subject to the Fund’s liquidity procedures, and that the Fund’s investment adviser does not expect that such investments would materially impact the liquidity of the Fund’s investments.¹⁹

With respect to the requirement that the Fund may invest only up to 10% of its total assets in fixed income securities that do not satisfy the criteria of Commentary .01(b)(4), the Exchange proposes that the Fund’s Private ABS/MBS (which may constitute up to 20% of the portfolio) and CDOs (which also may constitute up to 20% of the portfolio) would not count toward that 10% limit. As a result, up to 50% of the Fund’s fixed income securities might not satisfy the criteria in Commentary .01(b)(4). The Exchange argues that this alternative limit is appropriate because the criteria in Commentary .01(b)(4) “do not appear to be designed for structured finance vehicles such as Private ABS/MBS.”²⁰

The Exchange proposes no other changes to the Shares’ listing rule.

C. The Fund’s Investments in CDOs

In Amendment No. 1, the Exchange added information regarding the CDOs in which the Fund may invest. The Adviser and Subadviser represent that, with respect to the Fund’s investments in CDOs (which, for purposes of this filing, include CBOs and CLOs), (1) the Fund

¹⁷ See Notice, supra note 3, 84 FR at 12647-48.

¹⁸ See id. at 12647, n.12.

¹⁹ See id. at 12648.

²⁰ Id.

will invest principally in the senior-most tranches of these securities, generally with an AAA investment rating which have first claim in the capital structure and generally have less sensitivity to the credit risk of the underlying assets (e.g., bank loans or commercial real estate); and (2) CDOs/CLOs represent about one quarter of the non-agency securitized credit market and have issuances of about \$793.9 billion as of September 30, 2019.²¹ The Exchange states that the senior-most tranches provide investors with additional protections by distinguishing such investments from many of the attributes associated with the underlying assets and this credit enhancement provides the senior-most tranches “loss absorption” as credit losses from the collateral would be borne mainly by the more junior tranches.²² According to the Exchange, the relative lack of sensitivity to underlying credit exposure for senior CDO tranches allows market participants to more accurately assess current valuations, which may result in greater market liquidity.²³

The Adviser and Subadviser also represent that the senior-most CLO tranches generally make up at least 60% of the total amount issued in each securitization, and the Subadviser notes that the senior-most CLO tranches also make up most of the secondary trading volume for these securities.²⁴ According to the Exchange, most investors in these tranches are institutional and professional investors (such as asset managers, insurance companies, pensions and money-center bank treasury offices), and transparency in the underlying collateral is robust as trustees and servicers generally must report holdings on a monthly basis.²⁵ The Exchange also states that the

²¹ See Amendment No. 1, supra note 9, at 3.

²² See id.

²³ See id.

²⁴ See id.

²⁵ See id.

underlying collateral (e.g., U.S. broadly-syndicated bank loans) for CLOs is actively traded throughout the day as most of the underlying collateral held by retail mutual funds also serves as the underlying collateral for CLOs and, because mutual funds must calculate a daily price for these investments, there is more readily available information for investors to establish a market price.²⁶ According to the Exchange, the asset transparency along with the seniority of the CLO tranches tends to create more stable and predictable cash flows and, as a result, pricing can be more readily established and analyzed, including in volatile markets.²⁷ Therefore, the Exchange asserts, the senior-most CLO tranches generally trade at tighter spreads even in times of market volatility.²⁸

Additionally, the Adviser and Subadviser represent that the JPM CLO Index, which reflects recent total return performance across the CLO capital structure, provides a readily available indication of the amount of volatility (as measured by standard deviation) that CLOs have experienced and illustrates how large the “drawdown” (worst 12-month total return) has been in times of stress.²⁹ In the Exchange’s view, these two measures show significant differences in the stability of returns and the “drawdown” between the senior-most (“AAA CLO”) and the most junior tranches (“B CLO”).³⁰ Additionally, the Adviser and Subadviser represent that, like the corporate credit market, the investment grade portions of the securitized credit market are generally more liquid than lower-rated securities, with ample price discovery,

²⁶ See id.

²⁷ See id.

²⁸ See id.

²⁹ See id.

³⁰ See id. at 3-4.

while lower-rated securities are more volatile, with valuations that are more difficult to discern in times of market stress.³¹

Further, the Adviser and Subadviser represent that analysis of both data from the Trade Reporting and Compliance Engine of the Financial Industry Regulatory Authority and collateralized mortgage-backed securities (“CMBS”)/CLO spreads over time show how markets have behaved in past periods of volatility.³² The Exchange states that: (1) during the period from January 2012 through September 2019, CLO spread widening occurred during periods of broader market volatility; (2) there was a relatively high volume of CLOs trading in the secondary market, especially in the senior-most tranches; and (3) the spread moves were most pronounced in the junior tranches, while AAA CLOs did not experience a large spread move.³³

III. Discussion and Commission Findings

After careful review, the Commission finds that the Exchange’s proposal to continue listing and trading the Shares is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.³⁴ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,³⁵ which requires, among other things, that the Exchange’s rules be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

³¹ See id. at 4.

³² See id.

³³ See id.

³⁴ In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

³⁵ 15 U.S.C. 78f(b)(5).

The Exchange proposes to modify the Fund's current limit on Private ABS/MBS to allow up to 40% of the Fund's portfolio to be composed of what had previously been defined as Private ABS/MBS. The Commission notes that it has previously approved listing rules which permit other series of Managed Fund Shares to hold private asset backed and mortgage-backed securities in excess of the levels permitted under Commentary .01(b)(5).³⁶ The Commission also notes that it recently approved modifications to the listing rule of another issue of Managed Fund Shares, which included permitting that fund to hold up to 50% of its total assets in private asset-backed and mortgage-backed securities.³⁷

The Exchange also proposes to allow up to 50% of the Fund's portfolio to be composed of fixed income securities which would not satisfy the criteria in Commentary .01(b)(4), in that: (1) under the First Prior Order, the Fund may invest up to 10% of its total assets in fixed income securities that do not satisfy the criteria of Commentary .01(b)(4); and (2) the Fund's investments in Private ABS/MBS (which may constitute up to 20% of the portfolio) and CDOs (which also may constitute up to 20% of the portfolio) would not be required to satisfy the Commentary .01(b)(4) criteria. The Commission notes that it has previously approved the listing of other series of Managed Fund Shares with similar investment objectives and strategies without

³⁶ See, e.g., Securities Exchange Act Release Nos. 84047 (September 6, 2018), 83 FR 46200 (September 12, 2018) (SR-Nasdaq-2017-128) (approving the listing and trading of shares of the Western Asset Total Return ETF); and 84826 (December 14, 2018), 83 FR 65386 (December 20, 2018) (SR-NYSEArca-2018-25) (approving the continued listing and trading of shares of the Natixis Loomis Sayles Short Duration Income ETF).

³⁷ See Securities Exchange Act Release No. 87410 (October 28, 2019), 84 FR 58750 (November 1, 2019) (SR-NYSEArca-2019-33).

imposing requirements that a certain percentage of such funds' securities meet one of the criteria set forth in Commentary .01(b)(4).³⁸

For the foregoing reasons, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with Section 6(b)(5) of the Act and the rules and regulations thereunder applicable to a national securities exchange.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-NYSEArca-2019-14), as modified by Amendment No. 1, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁹

Jill M. Peterson
Assistant Secretary

³⁸ See, e.g., Securities Exchange Act Release No. 67894 (September 20, 2012), 77 FR 59227 (September 26, 2012) (SR-BATS-2012-033) (order approving the listing and trading of shares of the iShares Short Maturity Bond Fund); Securities Exchange Act Release No. 70342 (September 6, 2013), 78 FR 56256 (September 12, 2013) (SR-NYSEArca-2013-71) (order approving the listing and trading of shares of the SPDR SSgA Ultra Short Term Bond ETF, SPDR SSgA Conservative Ultra Short Term Bond ETF, and SPDR SSgA Aggressive Ultra Short Term Bond ETF).

³⁹ 17 CFR 200.30-3(a)(12).