

2020.<sup>3</sup> The Commission has received no comment letters on the proposed rule change.

Section 19(b)(2) of the Act<sup>4</sup> provides that within 45 days of the publication of notice of the filing of a proposed rule change, or within such longer period up to 90 days as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding, or as to which the self-regulatory organization consents, the Commission shall either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether the proposed rule change should be disapproved. The 45th day after publication of the notice for this proposed rule change is February 17, 2020. The Commission is extending this 45-day time period.

The Commission finds it appropriate to designate a longer period within which to take action on the proposed rule change so that it has sufficient time to consider the proposed rule change. Accordingly, the Commission, pursuant to Section 19(b)(2) of the Act,<sup>5</sup> designates April 2, 2020 as the date by which the Commission shall either approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change (File No. SR-NYSEArca-2019-96).

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>6</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-88208; File No. SR-CboeBZX-2019-097]

### Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Notice of Filing of Amendment No. 1 and Order Instituting Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No. 1, To Adopt BZX Rule 14.11(l) To Permit the Listing and Trading of Exchange-Traded Fund Shares That Are Permitted To Operate in Reliance on Rule 6c-11 Under the Investment Company Act of 1940

February 13, 2020.

On November 15, 2019, Cboe BZX Exchange, Inc. (“Exchange” or “BZX”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to, among other things, adopt BZX Rule 14.11(l) to permit the listing and trading of Exchange-Traded Fund Shares that are permitted to operate in reliance on Rule 6c-11 under the Investment Company Act of 1940. The proposed rule change was published for comment in the **Federal Register** on November 22, 2019.<sup>3</sup>

On December 17, 2019, pursuant to Section 19(b)(2) of the Act,<sup>4</sup> the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.<sup>5</sup> On February 12, 2020, the Exchange filed Amendment No. 1 to the proposed rule change, which amended and replaced the proposed rule change in its entirety.<sup>6</sup> The Commission has received no comment letters on the proposed rule change.

The Commission is publishing this notice and order to solicit comments on the proposed rule change, as modified by Amendment No. 1, from interested persons and to institute proceedings pursuant to Section 19(b)(2)(B) of the

Act<sup>7</sup> to determine whether to approve or disapprove the proposed rule change, as modified by Amendment No. 1.

#### I. The Exchange’s Description of the Proposal, as Modified by Amendment No. 1

The Exchange proposes a rule change to adopt BZX Rule 14.11(l) to permit the listing and trading of Exchange-Traded Fund Shares that are permitted to operate in reliance on Rule 6c-11 under the Investment Company Act of 1940. The Exchange is also proposing to discontinue the quarterly reports required with respect to Managed Fund Shares listed on the Exchange pursuant to the generic listing standards under Rule 14.11(i).

The text of the proposed rule change is also available on the Exchange’s website ([http://markets.cboe.com/us/equities/regulation/rule\\_filings/bzx/](http://markets.cboe.com/us/equities/regulation/rule_filings/bzx/)), at the Exchange’s Office of the Secretary, and at the Commission’s Public Reference Room.

#### II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

This Amendment No. 1 to SR-CboeBZX-2019-097 amends and replaces in its entirety the proposal as originally submitted on November 15, 2019. The Exchange submits this Amendment No. 1 in order to clarify certain points and add additional details to the proposal.

The Exchange proposes to add new Rule 14.11(l)<sup>8</sup> for the purpose of permitting the generic listing and trading, or trading pursuant to unlisted trading privileges, of Exchange-Traded

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

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

<sup>3</sup> See Securities Exchange Act Release No. 87560 (Nov. 18, 2019), 84 FR 64607.

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

<sup>5</sup> See Securities Exchange Act Release No. 87777, 84 FR 70598 (Dec. 23, 2019). The Commission designated February 20, 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.

<sup>6</sup> Amendment No. 1 is available at: <https://www.sec.gov/comments/sr-cboebzx-2019-097/sr-cboebzx2019097-6804772-208449.pdf>.

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

<sup>8</sup> The Exchange notes that it is proposing new Rule 14.11(l) because it has also proposed a new Rule 14.11(k) as part of another proposal. See Securities Exchange Act Release No. 87062 (September 23, 2019), 84 FR 51193 (September 27, 2019) (SR-CboeBZX-2019-047).

<sup>3</sup> See Securities Exchange Act Release No. 87867 (December 30, 2019), 85 FR 394.

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

<sup>5</sup> *Id.*

<sup>6</sup> 17 CFR 200.30-3(a)(31).

Fund Shares<sup>9</sup> that are permitted to operate in reliance on Rule 6c-11 (“Rule 6c-11”) under the Investment Company Act of 1940 (the “1940 Act”).<sup>10</sup> The Exchange is also proposing to make conforming changes to the Exchange’s corporate governance requirements under Rule 14.10(e) in order to accommodate the proposed listing of Exchange-Traded Fund Shares. Finally, the Exchange is proposing to discontinue the quarterly reports required with respect to Managed Fund Shares listed on the Exchange pursuant to the generic listing standards under Rule 14.11(i).

The Commission recently adopted Rule 6c-11 to permit exchange-traded funds (“ETFs”) that satisfy certain conditions to operate without obtaining an exemptive order from the Commission under the 1940 Act.<sup>11</sup> Since the first ETF was approved by the Commission in 1992, the Commission has routinely granted exemptive orders permitting ETFs to operate under the 1940 Act because there was no ETF specific rule in place and they have characteristics that distinguish them from the types of structures contemplated and included in the 1940 Act. After such an extended period operating without a specific rule set and only under exemptive relief, Rule 6c-11 is designed to provide a consistent, transparent, and efficient regulatory framework for ETFs.<sup>12</sup> Exchange listing

standards applicable to ETFs have been similarly adopted and tweaked over the years and the Exchange believes that, just as the Commission has undertaken a review of the 1940 Act as it is applicable to ETFs, it is appropriate to perform a similar holistic review and overhaul of Exchange listing rules. With this in mind, the Exchange submits this proposal to add new Rule 14.11(l) and certain corresponding rule changes because it believes that this proposal similarly promotes consistency, transparency, and efficiency surrounding the exchange listing process for ETF Shares in a manner that is consistent with the Act, as further described below. Except as otherwise provided, the Exchange would continue to enforce all governance, disclosure, and trading rules for this ETF Shares, as defined below, listed on the Exchange.

Consistent with Index Fund Shares and Managed Fund Shares listed under the generic listing standards in Rules 14.11(c) and 14.11(j), respectively, series of Exchange-Traded Fund Shares that are permitted to operate in reliance on Rule 6c-11 would be permitted to be listed and traded on the Exchange without a prior Commission approval order or notice of effectiveness pursuant to Section 19(b) of the Act.<sup>13</sup>

#### Proposed Listing Rules

Proposed Rule 14.11(l)(1) provides that the Exchange will consider for trading, whether by listing or pursuant to unlisted trading privileges, the shares of Exchange-Traded Funds (“ETF Shares”) that meet the criteria of this Rule 14.11(l).

Proposed Rule 14.11(l)(2) provides that the proposed rule would be applicable only to ETF Shares. Except to the extent inconsistent with this Rule 14.11(l), or unless the context otherwise requires, the rules and procedures of the Board of Directors shall be applicable to the trading on the Exchange of such securities. ETF Shares are included within the definition of “security” or

“securities” as such terms are used in the Rules of the Exchange.

Proposed Rule 14.11(l)(2) further provides that: (A) Transactions in ETF Shares will occur throughout the Exchange’s trading hours; (B) the minimum price variation for quoting and entry of orders in ETF Shares is \$0.01; and (C) the Exchange will implement and maintain written surveillance procedures for ETF Shares.

Proposed Rule 14.11(l)(3)(A) provides that the term “ETF Share” shall mean a share of stock issued by an Exchange-Traded Fund.

Proposed Rule 14.11(l)(3)(B) provides that the term “Exchange-Traded Fund” has the same meaning as the term “exchange-traded fund” as defined in Rule 6c-11 under the Investment Company Act of 1940.

Proposed Rule 14.11(l)(3)(C) provides that the term “Reporting Authority” in respect of a particular series of ETF Shares means the Exchange, an institution, or a reporting service designated by the Exchange or by the exchange that lists a particular series of ETF Shares (if the Exchange is trading such series pursuant to unlisted trading privileges) as the official source for calculating and reporting information relating to such series, including, but not limited to, the amount of any dividend equivalent payment or cash distribution to holders of ETF Shares, net asset value, index or portfolio value, the current value of the portfolio of securities required to be deposited to the open-end management investment company in connection with issuance of ETF Shares, or other information relating to the issuance, redemption or trading of ETF Shares. A series of ETF Shares may have more than one Reporting Authority, each having different functions.

Proposed Rule 14.11(l)(4) provides that the Exchange may approve a series of ETF Shares for listing and/or trading (including pursuant to unlisted trading privileges) on the Exchange pursuant to Rule 19b-4(e) under the Act, provided such series of ETF Shares is eligible to operate in reliance on Rule 6c-11 under the Investment Company Act of 1940 and must satisfy the requirements of this Rule 14.11(l) on an initial and continued listing basis.

Proposed Rule 14.11(l)(4)(A) provides that the requirements of Rule 6c-11 must be satisfied by a series of ETF Shares on an initial and continued listing basis. Such securities must also satisfy the following criteria on an initial and, except for paragraph (i) below, continued, listing basis. Further, proposed Rule 14.11(l)(4)(A) provides that: (i) For each series, the Exchange

<sup>9</sup> As provided below, proposed Rule 14.11(l)(3)(A) provides that the term “ETF Shares” shall mean the shares issued by a registered open-end management investment company that: (i) Is eligible to operate in reliance on Rule 6c-11 under the Investment Company Act of 1940; (ii) issues (and redeems) creation units to (and from) authorized participants in exchange for a basket and a cash balancing amount (if any); and (iii) issues shares that it intends to list or are listed on a national securities exchange and traded at market-determined prices.

<sup>10</sup> 15 U.S.C. 80a-1.

<sup>11</sup> See Release Nos. 33-10695; IC-33646; File No. S7-15-18 (Exchange-Traded Funds) (September 25, 2019), 84 FR 57162 (October 24, 2019) (the “Rule 6c-11 Release”).

<sup>12</sup> In approving the rule, the Commission stated that the “rule will modernize the regulatory framework for ETFs to reflect our more than two decades of experience with these investment products. The rule is designed to further important Commission objectives, including establishing a consistent, transparent, and efficient regulatory framework for ETFs and facilitating greater competition and innovation among ETFs.” Rule 6c-11 Release, at 57163. The Commission also stated the following regarding the rule’s impact: “We believe rule 6c-11 will establish a regulatory framework that: (1) Reduces the expense and delay currently associated with forming and operating certain ETFs unable to rely on existing orders; and (2) creates a level playing field for ETFs that can rely on the rule. As such, the rule will enable increased product competition among certain ETF providers, which can lead to lower fees for investors, encourage financial innovation, and increase investor choice in the ETF market.” Rule 6c-11 Release, at 57204.

<sup>13</sup> Rule 19b-4(e)(1) provides that the listing and trading of a new derivative securities product by a self-regulatory organization (“SRO”) is not deemed a proposed rule change, pursuant to paragraph (c)(1) of Rule 19b-4, if the Commission has approved, pursuant to Section 19(b) of the Act, the SRO’s trading rules, procedures and listing standards for the product class that would include the new derivative securities product and the SRO has a surveillance program for the product class. As contemplated by this Rule 14.11(l), the Exchange proposes new Rule 14.11(l) to establish generic listing standards for ETFs that are permitted to operate in reliance on Rule 6c-11. An ETF listed under proposed Rule 14.11(l) would therefore not need a separate proposed rule change pursuant to Rule 19b-4 before it can be listed and traded on the Exchange.

will establish a minimum number of ETF Shares required to be outstanding at the time of commencement of trading on the Exchange; (ii) if an index underlying a series of ETF Shares is maintained by a broker-dealer or fund adviser, the broker-dealer or fund adviser shall erect and maintain a “fire wall” around the personnel who have access to information concerning changes and adjustments to the index and the index shall be calculated by a third party who is not a broker-dealer or fund adviser. If the investment adviser to the investment company issuing an actively managed series of ETF Shares is affiliated with a broker-dealer, such investment adviser shall erect and maintain a “fire wall” between the investment adviser and the broker-dealer with respect to access to information concerning the composition and/or changes to such Investment Company portfolio; and (iii) any advisory committee, supervisory board, or similar entity that advises a Reporting Authority or that makes decisions on the composition, methodology, and related matters of an index underlying a series of ETF Shares, must implement and maintain, or be subject to, procedures designed to prevent the use and dissemination of material non-public information regarding the applicable index. For actively managed Exchange-Traded Funds, personnel who make decisions on the portfolio composition must be subject to procedures designed to prevent the use and dissemination of material nonpublic information regarding the applicable portfolio.

Proposed Rule 14.11(l)(4)(B) provides that each series of ETF Shares will be listed and traded on the Exchange subject to application of the Proposed Rule 14.11(l)(4)(B)(i) and (ii). Proposed Rule 14.11(l)(4)(B)(i) provides that the Exchange will consider the suspension of trading in, and will commence delisting proceedings under Rule 14.12 for, a series of ETF Shares under any of the following circumstances: (a) If the Exchange becomes aware that the issuer of the ETF Shares is no longer eligible to operate in reliance on Rule 6c-11 under the Investment Company Act of 1940; (b) if any of the other listing requirements set forth in this Rule 14.11(l) are not continuously maintained; (c) if, following the initial twelve month period after commencement of trading on the Exchange of a series of ETF Shares, there are fewer than 50 beneficial holders of the series of ETF Shares for 30 or more consecutive trading days; or (d) if such other event shall occur or

condition exists which, in the opinion of the Exchange, makes further dealings on the Exchange inadvisable. Proposed Rule 14.11(l)(4)(B)(ii) provides that upon termination of an investment company, the Exchange requires that ETF Shares issued in connection with such entity be removed from Exchange listing.

Proposed Rule 14.11(l)(5) provides that neither the Exchange, the Reporting Authority, nor any agent of the Exchange shall have any liability for damages, claims, losses or expenses caused by any errors, omissions, or delays in calculating or disseminating any current index or portfolio value; the current value of the portfolio of securities required to be deposited to the open-end management investment company in connection with issuance of ETF Shares; the amount of any dividend equivalent payment or cash distribution to holders of ETF Shares; net asset value; or other information relating to the purchase, redemption, or trading of ETF Shares, resulting from any negligent act or omission by the Exchange, the Reporting Authority, or any agent of the Exchange, or any act, condition, or cause beyond the reasonable control of the Exchange, its agent, or the Reporting Authority, including, but not limited to, an act of God; fire; flood; extraordinary weather conditions; war; insurrection; riot; strike; accident; action of government; communications or power failure; equipment or software malfunction; or any error, omission, or delay in the reports of transactions in one or more underlying securities.

Proposed Rule 14.11(l)(6) provides that the provisions of this subparagraph apply only to series of ETF Shares that are the subject of an order by the Securities and Exchange Commission exempting such series from certain prospectus delivery requirements under Section 24(d) of the Investment Company Act of 1940 and are not otherwise subject to prospectus delivery requirements under the Securities Act of 1933. The Exchange will inform its Members regarding application of this subparagraph to a particular series of ETF Shares by means of an information circular prior to commencement of trading in such series. The Exchange requires that members provide to all purchasers of a series of ETF Shares a written description of the terms and characteristics of those securities, in a form prepared by the open-end management investment company issuing such securities, not later than the time a confirmation of the first transaction in such series is delivered to such purchaser. In addition, members

shall include such a written description with any sales material relating to a series of ETF Shares that is provided to customers or the public. Any other written materials provided by a member to customers or the public making specific reference to a series of ETF Shares as an investment vehicle must include a statement in substantially the following form: “A circular describing the terms and characteristics of (the series of ETF Shares) has been prepared by the (open-end management investment company name) and is available from your broker. It is recommended that you obtain and review such circular before purchasing (the series of ETF Shares).” A member carrying an omnibus account for a non-member broker-dealer is required to inform such non-member that execution of an order to purchase a series of ETF Shares for such omnibus account will be deemed to constitute agreement by the non-member to make such written description available to its customers on the same terms as are directly applicable to members under this rule. Upon request of a customer, a member shall also provide a prospectus for the particular series of ETF Shares.

Proposed Rule 14.11(l)(7) provides that a security that has previously been approved for listing on the Exchange pursuant to the generic listing requirements specified in Rule 14.11(c) or Rule 14.11(i), or pursuant to the approval of a proposed rule change or subject to a notice of effectiveness by the Commission, may be considered for listing solely under this Rule 14.11(l) if such security is eligible to operate in reliance on Rule 6c-11 under the 1940 Act. At the time of listing of such security under this Rule 14.11(l), the continued listing requirements applicable to such previously-listed security will be those specified in paragraph (b) of this Rule 14.11(l). Any requirements for listing as specified in Rule 14.11(c) or Rule 14.11(i), or an approval order or notice of effectiveness of a separate proposed rule change, that differ from the requirements of this Rule 14.11(l) will no longer be applicable to such security.

The Exchange is also proposing to make two corresponding amendments to include ETF Shares in other Exchange rules. Specifically, the Exchange is also proposing: (i) To amend Rule 14.10(e)(1)(E) and Interpretation and Policy .13 to Rule 14.10 in order to add ETF Shares to a list of product types listed on the Exchange, including Index Fund Shares, Managed Fund Shares, and Managed Portfolio Shares, that are exempted from the Audit Committee requirements set forth in Rule

14.10(c)(3), except for the applicable requirements of SEC Rule 10A-3; and (ii) to amend Rule 14.11(c)(3)(A)(i)(a) in order to include ETF Shares in the definition of Derivative Securities Products.

#### Discussion

Proposed Rule 14.11(l) is based in large part on Rules 14.11(c) and (i) related to the listing and trading of Index Fund Shares and Managed Fund Shares on the Exchange, respectively, both of which are issued under the 1940 Act and would qualify as ETF Shares after Rule 6c-11 is effective. Rule 14.11(c) and 14.11(i) are very similar, their primary difference being that Index Fund Shares are designed to track an underlying index and Managed Fund Shares are based on an actively managed portfolio that is not designed to track an index. As such, the Exchange believes that using Rules 14.11(c) and (i) (collectively, the “Current ETF Standards”) as the basis for proposed Rule 14.11(l) is appropriate because they are generally designed to address the issues associated with ETF Shares. The only substantial differences between proposed Rule 14.11(l) and the Current ETF Standards that are not otherwise required under Rule 6c-11 are as follows: (i) Proposed Rule 14.11(l) does not include the quantitative standards applicable to a fund or an index that are included in the Current ETF Standards; and (ii) proposed Rule 14.11(l) does not include any requirements related to the dissemination of a fund’s Intraday Indicative Value.<sup>14</sup> These differences are discussed below.

#### Quantitative Standards

The Exchange believes that the proposal is designed to prevent fraudulent and manipulative acts and practices because the Exchange will perform ongoing surveillance of ETF Shares listed on the Exchange in order to ensure compliance with Rule 6c-11 and the 1940 Act on an ongoing basis. While proposed Rule 14.11(l) does not include the quantitative requirements applicable to an ETF or an ETF’s holdings or underlying index that are included in Rules 14.(c) and 14.11(i),<sup>15</sup>

<sup>14</sup> For purposes of this filing, the term “Intraday Indicative Value” or “IIV” shall mean an intraday estimate of the value of a share of each series of either Index Fund Shares or Managed Fund Shares.

<sup>15</sup> The Exchange notes that Rules 14.11(c) and (i) include certain quantitative standards related to the size, trading volume, concentration, and diversity of the holdings of a series of Index Fund Shares or Managed Fund Shares (the “Holdings Standards”) as well as related to the minimum number of beneficial holders of a fund (the “Distribution Standards”). The Exchange believes that to the

the Exchange believes that the manipulation concerns that such standards are intended to address are otherwise mitigated by a combination of the Exchange’s surveillance procedures, the Exchange’s ability to halt trading under the proposed Rule 14.11(l)(4)(B)(ii), and the Exchange’s ability to suspend trading and commence delisting proceedings under proposed Rule 14.11(l)(4)(B)(i). The Exchange will also halt trading in ETFs under the conditions specified in Rule 11.18, “Trading Halts Due to Extraordinary Market Volatility.” The Exchange also believes that such concerns are further mitigated by enhancements to the arbitrage mechanism that will come from Rule 6c-11, specifically the additional flexibility provided to issuers of ETF Shares through the use of custom baskets for creations and redemptions and the additional information made available to the public through the additional Disclosure Obligations.<sup>16</sup> The Exchange believes that the combination of these factors will act to keep ETF Shares trading near the value of their underlying holdings and further mitigate concerns around manipulation of ETF Shares on the Exchange without the inclusion of quantitative standards.<sup>17</sup> The Exchange will monitor for compliance with the 1940 Act generally as well as Rule 6c-11 specifically in order to ensure that the continued listing standards are being met. Specifically, the Exchange plans to review the website of series of ETF Shares in order to ensure that the disclosure requirements of Rule 6c-11 are being met and to review the portfolio underlying series of ETF Shares listed on the Exchange in order to ensure that certain investment requirements and limitations under the 1940 Act are being met. The Exchange will also employ numerous intraday alerts that will notify Exchange personnel of trading activity throughout the day that is potentially indicative of certain disclosures not being made accurately or the presence of other unusual conditions or circumstances that could be detrimental to the maintenance of a fair and orderly market. As a backstop to the

extent that manipulation concerns are mitigated based on the factors described herein, such concerns are mitigated both as it relates to the Holdings Standards and the Distribution Standards.

<sup>16</sup> The Exchange notes that the Commission came to a similar conclusion in several places in the Rule 6c-11 Release. See Rule 6c-11 Release at 15-18; 60-61; 69-70; 78-79; 82-84; and 95-96.

<sup>17</sup> The Exchange believes that this applies to all quantitative standards, whether applicable to the portfolio holdings of a series of ETF Shares or the distribution of the ETF Shares.

surveillances described above, the Exchange also notes that Rule 14.11(a) and proposed Rule 14.11(l)(4)(A)(ii) would require an issuer of ETF Shares to notify the Exchange of any failure to comply with Rule 6c-11 or the 1940 Act.

The Exchange may suspend trading in and commence delisting proceedings for a series of ETF Shares where such series is not in compliance with the applicable listing standards or where the Exchange believes that further dealings on the Exchange are inadvisable.<sup>18</sup>

Further, the Exchange also represents that its surveillance procedures are adequate to properly monitor the trading of the ETF Shares in all trading sessions and to deter and detect violations of Exchange rules and applicable federal securities laws. Specifically, the Exchange intends to utilize its existing surveillance procedures applicable to derivative products, which are currently applicable to Index Fund Shares and Managed Fund Shares, among other product types, to monitor trading in ETF Shares. The Exchange or the Financial Industry Regulatory Authority, Inc. (“FINRA”), on behalf of the Exchange, will communicate as needed regarding trading in ETF Shares and certain of their applicable underlying components with other markets that are members of the Intermarket Surveillance Group (“ISG”) or with which the Exchange has in place a comprehensive surveillance sharing agreement. In addition, the Exchange may obtain information regarding trading in ETF Shares and certain of their applicable underlying components from markets and other entities that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing

<sup>18</sup> Specifically, proposed Rule 14.11(l)(4)(B) provides that each series of ETF Shares will be listed and traded on the Exchange subject to application of the Proposed Rule 14.11(l)(4)(B)(i) and (ii). Proposed Rule 14.11(l)(4)(B)(i) provides that the Exchange will consider the suspension of trading in, and will commence delisting proceedings under Rule 14.12 for, a series of ETF Shares under any of the following circumstances: (a) If the Exchange becomes aware that the issuer of the ETF Shares is no longer eligible to operate in reliance on Rule 6c-11 under the Investment Company Act of 1940; (b) if any of the other listing requirements set forth in this Rule 14.11(l) are not continuously maintained; (c) if, following the initial twelve month period after commencement of trading on the Exchange of a series of ETF Shares, there are fewer than 50 beneficial holders of the series of ETF Shares for 30 or more consecutive trading days; or (d) if such other event shall occur or condition exists which, in the opinion of the Exchange, makes further dealings on the Exchange inadvisable. Proposed Rule 14.11(l)(4)(B)(ii) provides that upon termination of an investment company, the Exchange requires that ETF Shares issued in connection with such entity be removed from Exchange listing.

agreement. Additionally, FINRA, on behalf of the Exchange, is able to access, as needed, trade information for certain fixed income securities that may be held by a series of ETF Shares reported to FINRA's Trade Reporting and Compliance Engine ("TRACE"). FINRA also can access data obtained from the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access ("EMMA") system relating to municipal bond trading activity for surveillance purposes in connection with trading in a series of ETF Shares, to the extent that a series of ETF Shares holds municipal securities. Finally, as noted above, the issuer of a series of ETF Shares will be required to comply with Rule 10A-3 under the Act for the initial and continued listing of Exchange-Traded Fund Shares, as provided under Rule 14.10(e)(1)(E) and Interpretation and Policy .13 to Rule 14.10.

#### Intraday Indicative Value

As described above, proposed Rule 14.11(l) does not include any requirements related to the dissemination of an Intraday Indicative Value. Both Rule 14.11(c) and Rule 14.11(i) include the requirement that a series of Index Fund Shares and Managed Fund Shares, respectively, disseminate and update an Intraday Indicative Value at least every 15 seconds.<sup>19</sup> Historically (and theoretically), the IIV could provide valuable information about an ETF that would not otherwise be available or easily calculable. However, as consistently highlighted in the Rule 6c-11 Release, that is not reflective of the current marketplace and the Commission has expressed concerns regarding the accuracy of IIV estimates for certain ETFs. Specifically, the Commission noted that an IIV may not accurately reflect the value of an ETF that holds securities that trade less frequently as such IIV can be stale or inaccurate.<sup>20</sup> Additionally, the Commission indicated that even in circumstances when an IIV may be reliable, retail investors do not have easy access to free, publicly available IIV information.<sup>21</sup> Further, in instances when IIV may be free and publicly available, it can be delayed by up to 45 minutes.<sup>22</sup>

<sup>19</sup> See Rules 14.11(c)(3)(C), 14.11(c)(6)(A), and 14.11(c)(9)(B)(e) related to Index Fund Shares and Rules 14.11(i)(3)(C), 14.11(i)(4)(B)(i), 14.11(i)(4)(B)(iii)(b), and 14.11(i)(4)(B)(iv) related to Managed Fund Shares.

<sup>20</sup> See Rule 6c-11 Release at 62.

<sup>21</sup> See Id., at 66.

<sup>22</sup> See Id.

Aside from the fact that the disseminated IIV may provide investors with stale or misleading data, the Commission also stated that market makers and authorized participants typically calculate their own intraday value of an ETF's portfolio with proprietary algorithms that use an ETF's daily portfolio disclosure and available pricing information.<sup>23</sup> Such information allows those market participants to support the arbitrage mechanism for ETFs. Therefore, as market participants who engage in arbitrage typically calculate their own intraday value of an ETF's portfolio based on the ETF's daily portfolio disclosure and pricing information and use an IIV only as a secondary check to their own calculation,<sup>24</sup> the Commission noted that IIV was not necessary to support the arbitrage mechanism.<sup>25</sup> Given this, combined with potential shortcomings of the IIV noted above, the Commission concluded that ETFs will not be required to disseminate an IIV under Rule 6c-11.<sup>26</sup>

The Exchange generally agrees with the limitations and shortcomings of IIV described in the Rule 6c-11 Release. The Exchange further agrees with the conclusion of the Adopting Release that the "IIV is not necessary to support the arbitrage mechanism for ETFs that provide daily portfolio holdings disclosure." The transparency that comes from daily portfolio holdings disclosure as required under Rule 6c-11 provides market participants with sufficient information to facilitate the intraday valuation of ETF Shares. The Exchange notes that it is not proposing to prohibit the dissemination of an IIV for a series of ETF Shares and believes that there are certain instances in which the dissemination of an IIV could provide valuable information to the investing public. The Exchange is simply not proposing to require the dissemination of such information.

As such, the Exchange believes that it is appropriate and consistent with the Act to not include a requirement for the dissemination of an IIV for a series of ETF Shares to be listed on the Exchange.

#### Discontinuing Quarterly Reporting for Managed Fund Shares

Finally, the Exchange is proposing to eliminate certain quarterly reporting obligations related to the listing and trading of Managed Fund Shares on the Exchange. In the order approving the Exchange's proposal to adopt generic

<sup>23</sup> See Id., at 63.

<sup>24</sup> See Id., at 63.

<sup>25</sup> See Id., at 65.

<sup>26</sup> See Id., at 61.

listing standards for Managed Fund Shares,<sup>27</sup> the Commission noted that the Exchange had represented that "on a quarterly basis, the Exchange will provide a report to the Commission staff that contains, for each ETF whose shares are generically listed and traded under BATS Rule 14.11(i): (a) Symbol and date of listing; (b) the number of active authorized participants ("APs") and a description of any failure by either a fund or an AP to deliver promised baskets of shares, cash, or cash and instruments in connection with creation or redemption orders; and (c) a description of any failure by an ETF to comply with BATS Rule 14.11(i)." <sup>28</sup> This reporting requirement is not specifically enumerated in Rule 14.11(i).

The Exchange has provided such information to the Commission on a quarterly basis since the MFS Approval Order was issued in 2016. The type of information provided in the reports was created to provide a window into the creation and redemption process for Managed Fund Shares in order to ensure that the arbitrage mechanism would work as expected for products that were listed pursuant to the newly approved generic listing standards. The approval of the Rule 6c-11 collapses the distinction between index funds and active funds, which the Exchange believes represents that the Commission is generally comfortable with actively managed funds, rendering the reports unnecessary. Further, because the same general types of information provided in those reports will be made available under Rule 6c-11 directly from the issuers of such securities the Exchange also believes that it is consistent with the Act to remove this reporting obligation because it will be duplicative and no longer necessary.

#### 2. Statutory Basis

The Exchange believes that the proposal is consistent with Section 6(b) of the Act <sup>29</sup> in general and Section 6(b)(5) of the Act <sup>30</sup> in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Exchange believes that proposed Rule 14.11(l) is designed to prevent

<sup>27</sup> See Securities Exchange Act Release No. 78396 (July 22, 2016), 81 FR 49698 (July 28, 2016) (SR-BATS-2015-100) (the "MFS Approval Order").

<sup>28</sup> See MFS Approval Order at footnote 14.

<sup>29</sup> 15 U.S.C. 78f.

<sup>30</sup> 15 U.S.C. 78f(b)(5).

fraudulent and manipulative acts and practices in that the proposed rules relating to listing and trading ETF Shares on the Exchange provide specific initial and continued listing criteria required to be met by such securities. Proposed Rule 14.11(l)(4) sets forth initial and continued listing criteria applicable to ETF Shares, specifically providing that the Exchange may approve a series of ETF Shares for listing and/or trading (including pursuant to unlisted trading privileges) on the Exchange pursuant to Rule 19b-4(e) under the Act, provided such series of ETF Shares is eligible to operate in reliance on Rule 6c-11 under the Investment Company Act of 1940 and must satisfy the requirements of this Rule 14.11(l) on an initial and continued listing basis. The Exchange will submit a Form 19b-4(e) for all series of ETF Shares upon being listed pursuant to Rule 14.11(l), including those series of ETF Shares that are listed under Rule 14.11(l) pursuant to proposed Rule 14.11(l)(7).

Proposed Rule 14.11(l)(4)(B) provides that each series of ETF Shares will be listed and traded on the Exchange subject to application of the Proposed Rule 14.11(l)(4)(B)(i) and (ii). Proposed Rule 14.11(l)(4)(B)(i) provides that the Exchange will consider the suspension of trading in, and will commence delisting proceedings under Rule 14.12 for, a series of ETF Shares under any of the following circumstances: (a) if the Exchange becomes aware that the issuer of the ETF Shares is no longer eligible to operate in reliance on Rule 6c-11 under the Investment Company Act of 1940; (b) if any of the other listing requirements set forth in this Rule 14.11(l) are not continuously maintained; (c) if, following the initial twelve month period after commencement of trading on the Exchange of a series of ETF Shares, there are fewer than 50 beneficial holders of the series of ETF Shares for 30 or more consecutive trading days; or (d) if such other event shall occur or condition exists which, in the opinion of the Exchange, makes further dealings on the Exchange inadvisable. Proposed Rule 14.11(l)(4)(B)(ii) provides that upon termination of an investment company, the Exchange requires that ETF Shares issued in connection with such entity be removed from Exchange listing.

The Exchange further believes that proposed Rule 14.11(l) is designed to prevent fraudulent and manipulative acts and practices because of the robust surveillances in place on the Exchange as required under proposed Rule 14.11(l)(2)(C) along with the similarities

of proposed Rule 14.11(l) to the rules related to other securities that are already listed and traded on the Exchange and which would qualify as ETF Shares. Proposed Rule 14.11(l) is based in large part on Rules 14.11(c) and (i) related to the listing and trading of Index Fund Shares and Managed Fund Shares on the Exchange, respectively, both of which are issued under the 1940 Act and would qualify as ETF Shares after Rule 6c-11 is effective. Rule 14.11(c) and 14.11(i) are very similar, their primary difference being that Index Fund Shares are designed to track an underlying index and Managed Fund Shares are based on an actively managed portfolio that is not designed to track an index. As such, the Exchange believes that using the Current ETF Standards as the basis for proposed Rule 14.11(l) is appropriate because they are generally designed to address the issues associated with ETF Shares. The only substantial differences between proposed Rule 14.11(l) and the Current ETF Standards that are not otherwise required under Rule 6c-11 are as follows: (i) Proposed Rule 14.11(l) does not include the quantitative standards applicable to a fund or an index that are included in the Current ETF Standards; and (ii) proposed Rule 14.11(l) does not include any requirements related to the dissemination of a fund's Intraday Indicative Value.

#### Quantitative Standards

The Exchange believes that the proposal is consistent with Section 6(b)(1) of the Act<sup>31</sup> in that, in addition to being designed to prevent fraudulent and manipulative acts and practices, the Exchange has the capacity to enforce proposed Rule 14.11(l) by performing ongoing surveillance of ETF Shares listed on the Exchange in order to ensure compliance with Rule 6c-11 and the 1940 Act on an ongoing basis. While proposed Rule 14.11(l) does not include the quantitative requirements applicable to a fund and a fund's holdings or underlying index that are included in Rules 14.(c) and 14.11(i),<sup>32</sup> the Exchange believes that the manipulation concerns that such standards are intended to address are otherwise

<sup>31</sup> 15 U.S.C. 78f(b)(1).

<sup>32</sup> The Exchange notes that Rules 14.11(c) and (i) include certain quantitative standards related to the size, trading volume, concentration, and diversity of the holdings of a series of Index Fund Shares or Managed Fund Shares (the "Holdings Standards") as well as related to the minimum number of beneficial holders of a fund (the "Distribution Standards"). The Exchange believes that to the extent that manipulation concerns are mitigated based on the factors described herein, such concerns are mitigated both as it relates to the Holdings Standards and the Distribution Standards.

mitigated by a combination of the Exchange's surveillance procedures, the Exchange's ability to halt trading under the proposed Rule 14.11(l)(4)(B)(ii), and the Exchange's ability to suspend trading and commence delisting proceedings under proposed Rule 14.11(l)(4)(B)(i). The Exchange also believes that such concerns are further mitigated by enhancements to the arbitrage mechanism that will come from Rule 6c-11, specifically the additional flexibility provided to issuers of ETF Shares through the use of custom baskets for creations and redemptions and the additional information made available to the public through the additional Disclosure Obligations.<sup>33</sup> The Exchange believes that the combination of these factors will act to keep ETF Shares trading near the value of their underlying holdings and further mitigate concerns around manipulation of ETF Shares on the Exchange without the inclusion of quantitative standards.<sup>34</sup> The Exchange will monitor for compliance with Rule 6c-11 in order to ensure that the continued listing standards are being met. Specifically, the Exchange plans to review the website of series of ETF Shares in order to ensure that the disclosure requirements of Rule 6c-11 are being met and to review the portfolio underlying series of ETF Shares listed on the Exchange in order to ensure that certain investment requirements and limitations under the 1940 Act are being met. The Exchange will also employ numerous intraday alerts that will notify Exchange personnel of trading activity throughout the day that is potentially indicative of certain disclosures not being made accurately or the presence of other unusual conditions or circumstances that could be detrimental to the maintenance of a fair and orderly market. As a backstop to the surveillances described above, the Exchange also notes that Rule 14.11(a) and proposed Rule 14.11(l)(4)(A)(ii) would require an issuer of ETF Shares to notify the Exchange of any failure to comply with Rule 6c-11 or the 1940 Act.

To the extent that any of the requirements under Rule 6c-11 or the 1940 Act are not being met, the Exchange may halt trading in a series of ETF Shares as provided in proposed Rule 14.11(l)(4)(B)(ii). Further, the

<sup>33</sup> The Exchange notes that the Commission came to a similar conclusion in several places in the Rule 6c-11 Release. See Rule 6c-11 Release at 15-18; 60-61; 69-70; 78-79; 82-84; and 95-96.

<sup>34</sup> The Exchange believes that this applies to all quantitative standards, whether applicable to the portfolio holdings of a series of ETF Shares or the distribution of the ETF Shares.

Exchange may also suspend trading in and commence delisting proceedings for a series of ETF Shares where such series is not in compliance with the applicable listing standards or where the Exchange believes that further dealings on the Exchange are inadvisable.<sup>35</sup>

Further, the Exchange also represents that its surveillance procedures are adequate to properly monitor the trading of the ETF Shares in all trading sessions and to deter and detect violations of Exchange rules. Specifically, the Exchange intends to utilize its existing surveillance procedures applicable to derivative products, which are currently applicable to Index Fund Shares and Managed Fund Shares, among other product types, to monitor trading in ETF Shares. The Exchange or FINRA, on behalf of the Exchange, will communicate as needed regarding trading in ETF Shares and certain of their applicable underlying components with other markets that are members of the ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement. In addition, the Exchange may obtain information regarding trading in ETF Shares and certain of their applicable underlying components from markets and other entities that are members of ISG or with which the Exchange has in place a comprehensive surveillance sharing agreement. Additionally, FINRA, on behalf of the Exchange, is able to access, as needed, trade information for certain fixed income securities that may be held by a series of ETF Shares reported to FINRA's TRACE. FINRA also can access data obtained from the MSRB's EMMA system relating to municipal bond trading activity for surveillance purposes in connection with trading in

<sup>35</sup> Specifically, proposed Rule 14.11(l)(4)(B) provides that each series of ETF Shares will be listed and traded on the Exchange subject to application of the Proposed Rule 14.11(l)(4)(B)(i) and (ii). Proposed Rule 14.11(l)(4)(B)(i) provides that the Exchange will consider the suspension of trading in, and will commence delisting proceedings under Rule 14.12 for, a series of ETF Shares under any of the following circumstances: (a) if the Exchange becomes aware that the issuer of the ETF Shares is no longer eligible to operate in reliance on Rule 6c-11 under the Investment Company Act of 1940; (b) if any of the other listing requirements set forth in this Rule 14.11(l) are not continuously maintained; (c) if, following the initial twelve month period after commencement of trading on the Exchange of a series of ETF Shares, there are fewer than 50 beneficial holders of the series of ETF Shares for 30 or more consecutive trading days; or (d) if such other event shall occur or condition exists which, in the opinion of the Exchange, makes further dealings on the Exchange inadvisable. Proposed Rule 14.11(l)(4)(B)(ii) provides that upon termination of an investment company, the Exchange requires that ETF Shares issued in connection with such entity be removed from Exchange listing.

a series of ETF Shares, to the extent that a series of ETF Shares holds municipal securities. Finally, as noted above, the issuer of a series of ETF Shares will be required to comply with Rule 10A-3 under the Act for the initial and continued listing of Exchange-Traded Fund Shares, as provided under Rule 14.10(e)(1)(E) and Interpretation and Policy .13 to Rule 14.10.

#### Intraday Indicative Value

As described above, proposed Rule 14.11(l) does not include any requirements related to the dissemination of an Intraday Indicative Value. Both Rule 14.11(c) and Rule 14.11(i) include the requirement that a series of Index Fund Shares and Managed Fund Shares, respectively, disseminate and update an Intraday Indicative Value at least every 15 seconds.<sup>36</sup> Historically (and theoretically), the IIV could provide valuable information about an ETF that would not otherwise be available or easily calculable. However, as consistently highlighted in the Rule 6c-11 Release, that is not reflective of the current marketplace and the Commission has expressed concerns regarding the accuracy of IIV estimates for certain ETFs. Specifically, the Commission noted that an IIV may not accurately reflect the value of an ETF that holds securities that trade less frequently as such IIV can be stale or inaccurate.<sup>37</sup> Additionally, the Commission indicated that even in circumstances when an IIV may be reliable, retail investors do not have easy access to free, publicly available IIV information.<sup>38</sup> Further, in instances when IIV may be free and publicly available, it can be delayed by up to 45 minutes.<sup>39</sup>

Aside from the fact that the disseminated IIV may provide investors with stale or misleading data, the Commission also stated that market makers and authorized participants typically calculate their own intraday value of an ETF's portfolio with proprietary algorithms that use an ETF's daily portfolio disclosure and available pricing information.<sup>40</sup> Such information allows those market participants to support the arbitrage mechanism for ETFs. Therefore, as market participants who engage in arbitrage typically

<sup>36</sup> See Rules 14.11(c)(3)(C), 14.11(c)(6)(A), and 14.11(c)(9)(B)(e) related to Index Fund Shares and Rules 14.11(i)(3)(C), 14.11(i)(4)(B)(i), 14.11(i)(4)(B)(iii)(b), and 14.11(i)(4)(B)(iv) related to Managed Fund Shares.

<sup>37</sup> See Rule 6c-11 Release at 62.

<sup>38</sup> See Id., at 66.

<sup>39</sup> See Id.

<sup>40</sup> See Id., at 63.

calculate their own intraday value of an ETF's portfolio based on the ETF's daily portfolio disclosure and pricing information and use an IIV only as a secondary check to their own calculation,<sup>41</sup> the Commission noted that IIV was not necessary to support the arbitrage mechanism.<sup>42</sup> Given this, combined with potential shortcomings of the IIV noted above, the Commission concluded that ETFs will not be required to disseminate an IIV under Rule 6c-11.<sup>43</sup>

The Exchange generally agrees with the limitations and shortcomings of IIV described in the Rule 6c-11 Release. The Exchange further agrees with the conclusion of the Adopting Release that the "IIV is not necessary to support the arbitrage mechanism for ETFs that provide daily portfolio holdings disclosure." The transparency that comes from daily portfolio holdings disclosure as required under Rule 6c-11 provides market participants with sufficient information to facilitate the intraday valuation of ETF Shares. The Exchange notes that it is not proposing to prohibit the dissemination of an IIV for a series of ETF Shares and believes that there are certain instances in which the dissemination of an IIV could provide valuable information to the investing public. The Exchange is simply not proposing to require the dissemination of such information.

As such, the Exchange believes that it is appropriate and consistent with the Act to not include a requirement for the dissemination of an IIV for a series of ETF Shares to be listed on the Exchange.

The Exchange also believes that the proposed rule change is designed to promote just and equitable principles of trade and to protect investors and the public interest in that a large amount of information will be publicly available regarding the Funds and the Shares, thereby promoting market transparency. Quotation and last sale information for ETF Shares will be available via the CTA high-speed line. The website for each series of ETF Shares will include a form of the prospectus for the Fund that may be downloaded, and additional data relating to NAV and other applicable quantitative information, updated on a daily basis. Moreover, prior to the commencement of trading, the Exchange will inform its members in a circular of the special characteristics and risks associated with trading in the series of ETF Shares. As noted above, series of ETF Shares will not be required to publicly disseminate an IIV. The

<sup>41</sup> See Id., at 63.

<sup>42</sup> See Id., at 65.

<sup>43</sup> See Id., at 61.

Exchange continues to believe that this proposal is consistent with the Act and is designed to promote just and equitable principles of trade and to protect investors and the public interest because the transparency that comes from daily portfolio holdings disclosure as required under Rule 6c-11 provides market participants with sufficient information to facilitate the intraday valuation of ETF Shares, rendering the dissemination of the IIV unnecessary.

The Exchange notes that it is not proposing to prohibit the dissemination of an IIV for a series of ETF Shares and believes that there could be certain instances in which the dissemination of an IIV could provide valuable information to the investing public. The Exchange proposes to leave that decision to an issuer of ETF Shares and is simply not proposing to require the dissemination of an IIV.

Based on the foregoing discussion regarding proposed Rule 14.11(l) and its similarities to and differences between the Current ETF Standards, the Exchange believes that the proposal is consistent with the Act and is designed to prevent fraudulent and manipulative transactions and that the manipulation concerns that the quantitative standards and the IIV requirements are designed to address are otherwise mitigated by the proposal and the new Disclosure Obligations and flexibility under Rule 6c-11.

The proposed rule change is designed to perfect the mechanism of a free and open market and, in general, to protect investors and the public interest in that it will facilitate the listing and trading of ETF Shares in a manner that will enhance competition among market participants, to the benefit of investors and the marketplace. The Exchange believes that approval of this proposal will streamline current procedures, reduce the costs and timeline associated with bringing ETFs to market, and provide significantly greater regulatory certainty to potential issuers considering bringing ETF Shares to market, thereby enhancing competition among ETF issuers and reducing costs for investors.<sup>44</sup>

<sup>44</sup> In approving the rule, the Commission stated that the “rule will modernize the regulatory framework for ETFs to reflect our more than two decades of experience with these investment products. The rule is designed to further important Commission objectives, including establishing a consistent, transparent, and efficient regulatory framework for ETFs and facilitating greater competition and innovation among ETFs.” Rule 6c-11 Release, at 57163. The Commission also stated the following regarding the rule’s impact: “We believe rule 6c-11 will establish a regulatory framework that: (1) Reduces the expense and delay currently associated with forming and operating

The Exchange also believes that the corresponding change to amend Rule 14.10(e)(1)(E) and Interpretation and Policy .13 to Rule 14.10 in order to add ETF Shares to a list of product types listed on the Exchange, including Index Fund Shares, Managed Fund Shares, and Managed Portfolio Shares, that are exempted from the Audit Committee requirements set forth in Rule 14.10(c)(3), except for the applicable requirements of SEC Rule 10A-3 because it is a non-substantive change meant only to subject ETF Shares to the same corporate governance requirements currently applicable to Index Fund Shares and Managed Fund Shares. All other corporate governance requirements that ETF Shares are not specifically exempted from will otherwise apply. The Exchange also believes that the non-substantive change to amend Rule 14.11(c)(3)(A)(i)(a) in order to include ETF Shares in the definition of Derivative Securities Products is also a non-substantive change because it is just intended to add ETF Shares to a definition that includes Index Fund Shares and Managed Fund Shares in order to make sure that ETF Shares are treated consistently with Index Fund Shares and Managed Fund Shares throughout the Exchange’s rules.

Finally, the Exchange believes that eliminating the quarterly reporting requirement for Managed Fund Shares is designed to prevent fraudulent and manipulative acts and practices and, in general, to protect investors and the public interest because the report no longer serves the purpose for which it was originally intended. The type of information provided in the reports was created to provide a window into the creation and redemption process for Managed Fund Shares in order to ensure that the arbitrage mechanism would work as expected for products that were listed pursuant to the newly approved generic listing standards. In the Rule 6c-11 Release, the Commission concluded that “the arbitrage mechanism for existing actively managed ETFs has worked effectively with small deviations between market price and NAV per share.”<sup>45</sup> The Exchange generally agrees with this conclusion and, while such quarterly reports were useful when Managed Fund Shares were first able to be listed

certain ETFs unable to rely on existing orders; and (2) creates a level playing field for ETFs that can rely on the rule. As such, the rule will enable increased product competition among certain ETF providers, which can lead to lower fees for investors, encourage financial innovation, and increase investor choice in the ETF market.” Rule 6c-11 Release, at 57204

<sup>45</sup> See Rule 6c-11 Release at 23.

pursuant to generic listing standards, the Exchange believes that such a window into the creation and redemption process for Managed Fund Shares no longer provides useful information related to the prevention of manipulation or protection of investors which it was originally designed to provide. Further, because the same general types of information provided in those reports will be made available under Rule 6c-11 directly from the issuers of such securities the Exchange also believes that it is consistent with the Act to remove this reporting obligation because it will be duplicative and no longer necessary.

For the above reasons, the Exchange believes that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act.

#### *B. Self-Regulatory Organization’s Statement on Burden on Competition*

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purpose of the Act. To the contrary, the Exchange believes that the proposed rule change would enhance competition by streamlining current procedures, reducing the costs and timeline associated with bringing ETFs to market, and providing significantly greater regulatory certainty to potential issuers considering bringing ETF Shares to market, all of which the Exchange believes would enhance competition among ETF issuers and reduce costs for investors. The Exchange also believes that the proposed change would make enhance competition among ETF Shares by ensuring the application of uniform listing standards.

#### *C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

The Exchange has neither solicited nor received written comments on the proposed rule change.

### **III. Proceedings To Determine Whether To Approve or Disapprove SR-ChoeBZX-2019-097, as Modified by Amendment No. 1, and Grounds for Disapproval Under Consideration**

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act<sup>46</sup> to determine whether the proposed rule change, as modified by Amendment No. 1, should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy

<sup>46</sup> 15 U.S.C. 78s(b)(2)(B).

issues raised by the proposed rule change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described below, the Commission seeks and encourages interested persons to provide comments on the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,<sup>47</sup> the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the proposed rule change's consistency with Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade," and "to protect investors and the public interest."<sup>48</sup>

#### IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposal is consistent with Section 6(b)(5) or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.<sup>49</sup>

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by March 12, 2020. Any person who wishes to file a rebuttal to any other person's submission must file the rebuttal by March 26, 2020. The Commission asks that commenters address the sufficiency of the

Exchange's statements in support of the proposal, which are set forth in Amendment No. 1,<sup>50</sup> in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission seeks comment on the following questions and asks commenters to submit data where appropriate to support their views:

1. The Exchange's proposed generic listing requirements would require that, for the Exchange to list and trade ETF Shares, the requirements of Rule 6c-11 must be satisfied on a continued listing basis. The Exchange states that it will monitor for compliance with the 1940 Act, generally, as well as with Rule 6c-11, specifically, in order to ensure that the continued listing standards are being met. The Exchange states that it plans to review the website of series of ETF Shares to ensure that the disclosure requirements of Rule 6c-11 are being met and to review the portfolios underlying each series of ETF Shares listed on the Exchange to ensure that certain investment requirements and limitations under the 1940 Act are being met. The Exchange also states that it will employ numerous intraday alerts that will notify Exchange personnel of trading activity throughout the day that is potentially indicative of certain disclosures not being made accurately or the presence of other unusual conditions or circumstances that could be detrimental to the maintenance of a fair and orderly market. As a backstop to the surveillances, the Exchange notes that current BZX rules require, and BZX's proposed rules would require, an issuer of ETF Shares to notify the Exchange of any failure to comply with Rule 6c-11 under the 1940 Act. What are commenters' views on whether the Exchange's surveillance procedures are adequate to monitor for non-compliance with respect to the proposed continued listing requirements? Do commenters believe that the Exchange should adopt other procedures or employ additional measures to ensure that it is capable of adequately monitoring for non-compliance with the proposed listing rule?

2. Under the proposal, the Exchange describes its discretion to halt trading in ETF Shares in its proposed listing rule. For ETF Shares that are based on an underlying index, what are commenters' views on whether the Exchange should consider halting trading if there is an interruption or disruption in the calculation and dissemination of the underlying index value? What are commenters' views on whether the

Exchange should consider halting trading in the event of an interruption or disruption in the calculation and dissemination of the intraday indicative value, to the extent such value is calculated and publicly disseminated for an Exchange-Traded Fund? Do commenters believe there are other circumstances in which the Exchange ought to consider halting trading in ETF Shares listed under the proposed rule?

3. What are commenters' views on whether the proposed rule change is sufficiently clear regarding Exchange members' obligations with respect to disclosures to ETF Share purchasers? More generally, what are commenters' views on whether the proposal provides sufficient clarity for members' obligations with respect to transactions in ETF Shares on the Exchange?

Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CboeBZX-2019-097 on the subject line.

#### Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CboeBZX-2019-097. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change.

<sup>47</sup> *Id.*

<sup>48</sup> 15 U.S.C. 78f(b)(5).

<sup>49</sup> Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Public Law 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

<sup>50</sup> See *supra* note 6.

Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–CboeBZX–2019–097 and should be submitted by March 12, 2020. Rebuttal comments should be submitted by March 26, 2020.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>51</sup>

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 2020–03328 Filed 2–19–20; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–88191; File No. SR–NSCC–2019–004]

### Self-Regulatory Organizations; National Securities Clearing Corporation; Order Approving a Proposed Rule Change To Enhance National Securities Clearing Corporation's Haircut-Based Volatility Charge Applicable to Municipal Bonds

February 13, 2020.

On December 13, 2019, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b–4 thereunder,<sup>2</sup> proposed rule change SR–NSCC–2019–004 to revise NSCC’s methodology for calculating margin amounts applicable to municipal bonds.<sup>3</sup> The proposed rule change was published for comment in the **Federal Register** on January 2, 2020,<sup>4</sup> and the Commission received no comment letters regarding the changes

proposed in the proposed rule change.<sup>5</sup> For the reasons discussed below, the Commission is approving the proposed rule change.

#### I. Description of the Proposed Rule Change

The proposed rule change would revise NSCC’s Rules and Procedures (“Rules”)<sup>6</sup> to change the methodology NSCC uses for calculating the haircut-based margin charge applicable to municipal bonds.

##### A. Background

NSCC provides clearing, settlement, risk management, central counterparty services, and a guarantee of completion for virtually all broker-to-broker trades involving equity securities, corporate and municipal debt securities, and certain other securities. NSCC manages its credit exposure to its members by determining an appropriate Required Fund Deposit (*i.e.*, margin) for each member.<sup>7</sup> NSCC collects each member’s Required Fund Deposit to mitigate potential losses to NSCC associated with the liquidation of the member’s portfolio in the event of the member’s default.<sup>8</sup> The aggregate of all NSCC members’ Required Fund Deposits (together with certain other deposits required under the Rules) constitutes NSCC’s Clearing Fund, which NSCC would access should a defaulting member’s own Required Fund Deposit be insufficient to satisfy losses to NSCC caused by the liquidation of the defaulting member’s portfolio.<sup>9</sup>

Each member’s Required Fund Deposit consists of a number of applicable components, which are calculated to address specific risks that the member’s portfolio presents to NSCC.<sup>10</sup> Generally, the largest component of a member’s Required Fund Deposit is the volatility component.<sup>11</sup> The volatility component

is designed to calculate the potential losses on a portfolio over a given period of time assumed necessary to liquidate the portfolio, within a 99% confidence level.

The methodology for calculating the volatility component of the Required Fund Deposit depends on the type of security.<sup>12</sup> Specifically, for certain securities, including municipal bonds, NSCC calculates a haircut-based volatility component by multiplying the absolute value of a member’s positions in such securities by a certain percentage designated by NSCC.<sup>13</sup>

NSCC’s current methodology for designating the percentages used in calculating the haircut-based volatility component for municipal bonds involves distinguishing between municipal bonds based on tenor (*i.e.*, remaining time to maturity), municipal sector (*e.g.*, general obligation, transportation, healthcare, etc.), and credit rating.<sup>14</sup> Pursuant to that methodology, NSCC assigns each tenor-based group a percentage.<sup>15</sup> For municipal bonds rated higher than BBB+, the tenor-based percentage is the percentage NSCC uses to calculate the haircut-based volatility component.<sup>16</sup> However, for municipal bonds rated BBB+ or lower, NSCC multiplies the tenor-based percentage by a sector-based risk factor, resulting in a larger percentage for the haircut.<sup>17</sup> The additional sector-based risk factors

<sup>12</sup> For most securities (*e.g.*, equity securities), NSCC calculates the volatility component as the greater of (1) the larger of two separate calculations that utilize a parametric Value at Risk (“VaR”) model, (2) a gap risk measure calculation based on the largest non-index position in a portfolio that exceeds a concentration threshold, which addresses concentration risk that can be present in a member’s portfolio, and (3) a portfolio margin floor calculation based on the market values of the long and short positions in the portfolio, which addresses risks that might not be adequately addressed with the other volatility component calculations. *See id.*; *see also* Securities Exchange Act Release No. 82780 (February 26, 2018), 83 FR 9035 (March 2, 2018) (File No. SR–NSCC–2017–808); Securities Exchange Act Release No. 82781 (February 26, 2018), 83 FR 9042 (March 2, 2018) (File No. SR–NSCC–2017–020).

<sup>13</sup> Procedure XV, *supra* note 6.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* For example, a \$10MM short position in a municipal bond rated above BBB+ with 3 years to maturity is subject to the 2–5 years tenor-based group haircut of 5%, which applies to the absolute market value of the positions, resulting in a haircut-based volatility component of \$500,000. Notice of Filing, *supra* note 4 at 150.

<sup>17</sup> Procedure XV, *supra* note 6. For example, a \$10MM short position in a healthcare sector municipal bond rated BBB+ or lower with 3 years to maturity is subject to the 2–5 years tenor-based group haircut (5%) multiplied by the sector-based factor of 1.2, resulting in a 6% haircut-based volatility component of \$600,000. Notice of Filing, *supra* note 4 at 151.

<sup>51</sup> 17 CFR 200.30–3(a)(12) & 17 CFR 200.30–3(a)(57).

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

<sup>2</sup> 17 CFR 240.19b–4.

<sup>3</sup> NSCC also filed the proposals contained in the proposed rule change as advance notice SR–NSCC–2019–801 with the Commission pursuant to Section 806(e)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”), 12 U.S.C. 5465(e)(1), and Rule 19b–4(n)(1)(i) of the Act, 17 CFR 240.19b–4(n)(1)(i). Notice of Filing of the Advance Notice was published for comment in the **Federal Register** on January 14, 2020. Securities Exchange Act Release No. 87911 (January 8, 2020), 85 FR 2197 (January 14, 2020) (File No. SR–NSCC–2019–801).

<sup>4</sup> Securities Exchange Act Release No. 87858 (December 26, 2019), 85 FR 149 (January 2, 2020) (“Notice of Filing”).

<sup>5</sup> As the proposals contained in the proposed rule change were also filed as an advance notice, all public comments received on the proposals are considered regardless of whether the comments are submitted on the proposed rule change or the advance notice.

<sup>6</sup> Capitalized terms not defined herein are defined in NSCC’s Rules, available at [http://dtcc.com/~media/Files/Downloads/legal/rules/nscc\\_rules.pdf](http://dtcc.com/~media/Files/Downloads/legal/rules/nscc_rules.pdf).

<sup>7</sup> See Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters) of the Rules (“Procedure XV”), *supra* note 6.

<sup>8</sup> The Rules identify when NSCC may cease to act for a member and the types of actions NSCC may take. For example, NSCC may suspend a firm’s membership with NSCC or prohibit or limit a member’s access to NSCC’s services in the event that member defaults on a financial or other obligation to NSCC. See Rule 46 (Restrictions on Access to Services), *supra* note 6.

<sup>9</sup> *See id.*

<sup>10</sup> Procedure XV, *supra* note 6.

<sup>11</sup> *See id.*