

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-100032; File No. SR-CboeBZX-2023-062)

April 25, 2024

Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Order Disapproving a Proposed Rule Change to Amend the Initial Period After Commencement of Trading of a Series of Exchange-Traded Fund Shares on the Exchange as It Relates to the Holders of Record and/or Beneficial Holders, as Provided in Exchange Rule 14.11(l)

**I. INTRODUCTION**

On August 14, 2023, 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 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend the continued listing requirement applicable to Exchange-Traded Fund Shares (“ETF Shares”) relating to holders of record and/or beneficial holders pursuant to BZX Rule 14.11(l). The proposed rule change was published for comment in the Federal Register on September 1, 2023.<sup>3</sup>

On September 25, 2023, pursuant to Section 19(b)(2) of the Exchange Act, 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>4</sup> On November 14, 2023, the Commission instituted proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act<sup>5</sup> to determine whether to approve or disapprove the proposed rule change.<sup>6</sup> On February 13, 2024, the Commission designated a longer

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<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. 98231 (August 28, 2023), 88 FR 60516 (“Notice”).

<sup>4</sup> See Securities Exchange Act Release No. 98497, 88 FR 67397 (September 29, 2023).

<sup>5</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>6</sup> See Securities Exchange Act Release No. 98933, 88 FR 80783 (November 20, 2023) (“OIP”).

period for Commission action on the proposed rule change.<sup>7</sup> The Commission has received no comments on the proposed rule change.

This order disapproves the proposed rule change because, as discussed below, BZX has not met its burden under the Exchange Act and the Commission’s Rules of Practice to demonstrate that its proposal is consistent with the requirements of Exchange Act Section 6(b)(5), and, in particular, the requirement that the rules of a national securities exchange be designed “to prevent fraudulent and manipulative acts and practices” and “to protect investors and the public interest.”<sup>8</sup>

## **II. DESCRIPTION OF THE PROPOSAL**<sup>9</sup>

As described in detail in the Notice and OIP, a continued listing requirement under BZX Rule 14.11(l) for ETF Shares<sup>10</sup> currently provides that, following the initial 12-month period after commencement of trading on the Exchange, the Exchange will consider the suspension of trading in, and will commence delisting proceedings for, a series of ETF Shares for which there are fewer than 50 beneficial holders for 30 or more consecutive trading days (“Beneficial Holders Rule”). The Exchange is proposing to change the date after which a series of ETF

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<sup>7</sup> See Securities Exchange Act Release No. 99530, 89 FR 12891 (February 20, 2024).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> On April 29, 2020, BZX filed a proposed rule change to extend the Non-Compliance Period (as defined herein) in the Beneficial Holders Rule (as defined herein) from 12 months after commencement of trading on the Exchange to 36 months after commencement of trading on the Exchange for certain exchange-traded products, including a series of ETF Shares. See Securities Exchange Act Release No. 88795 (May 1, 2020), 85 FR 27254 (SR-CboeBZX-2020-036) (“Prior PRC Notice” or “prior proposal”). The Commission disapproved the prior proposal, finding that the Exchange failed to satisfy its burden to demonstrate that the proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder. See Securities Exchange Act Release No. 90819 (December 29, 2020), 86 FR 332 (January 5, 2021) (SR-CboeBZX-2020-036) (“Prior Disapproval Order”). In the current proposed rule change, BZX proposes the same extension of the Non-Compliance Period in the Beneficial Holders Rule from 12 months after commencement of trading on the Exchange to 36 months after commencement of trading on the Exchange, but only with respect to ETF Shares.

<sup>10</sup> BZX Rule 14.11(l)(3)(A) defines ETF Shares as shares of stock issued by an Exchange-Traded Fund. The term “Exchange-Traded Fund” has the same meaning as the term “exchange-traded fund” defined in Rule 6c-11 under the Investment Company Act of 1940. See BZX Rule 14.11(l)(3)(B).

Shares must have at least 50 beneficial holders or be subject to delisting proceedings under the Beneficial Holders Rule (“Non-Compliance Period”). Specifically, the Exchange seeks to extend the Non-Compliance Period in the Beneficial Holders Rule from 12 months after commencement of trading on the Exchange to 36 months after commencement of trading on the Exchange.

The Exchange asserts that it would be appropriate to increase the Non-Compliance Period from 12 months to 36 months because: (1) it would bring the rule more in line with the life cycle of an exchange-traded product (“ETP”);<sup>11</sup> (2) the economic and competitive structures in place in the ETP ecosystem naturally incentivize issuers to delist products rather than continuing to list products that do not garner investor interest; and (3) extending the period from 12 to 36 months will not meaningfully impact the manipulation concerns that the Beneficial Holders Rule is intended to address.

According to the Exchange, the ETP space is more competitive than it has ever been, with more than 2,000 ETPs listed on exchanges. As a result, distribution platforms have become more restrictive about the ETPs they will allow on their systems, often requiring a minimum track record (e.g., twelve months) and a minimum level of assets under management (e.g., \$100 million). Many larger entities also require a one-year track record before they will invest in an ETP. In the Exchange’s view, this has slowed the growth cycle of the average ETP, with the result that the Exchange has seen a significant number of deficiencies with respect to the Beneficial Holders Rule over the last several years. Specifically, the Exchange states that it has issued deficiency notifications to 39 ETPs for non-compliance with the Beneficial Holders Rule since 2015. Of those 39 ETPs, 30 ultimately were able to achieve compliance while undergoing the delisting process. According to the Exchange, this data shows that a 12-month threshold is an

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<sup>11</sup> A series of ETF Shares is a type of ETP.

inappropriately short time frame and only serves as a regulatory and administrative burden for issuers that must remediate if they fall out of compliance.

In addition, the Exchange believes that the economic and competitive structures in place in the ETP ecosystem naturally incentivize issuers to delist products with insufficient investor interest, and that the Beneficial Holders Rule has resulted in the forced termination of ETPs that issuers believed were still economically viable. The Exchange states that there are significant costs associated with the launch and continued operation of an ETP, and notes that the Exchange has had 148 products voluntarily delist since 2018. The Exchange also questions whether the number of beneficial holders is a meaningful measure of market interest in an ETP and believes that an ETP issuer is incentivized to have as many beneficial holders as possible.

The Exchange states that the proposal “does not create any significant change in the risk of manipulation for ETF Shares listed on the Exchange.”<sup>12</sup> The Exchange contends that a time extension to meet the requirement would present no new issues because any risk that is present during months 12 through 36 of initial listing would also be present during the first 12 months.<sup>13</sup> The Exchange also states that it has in place a robust surveillance program for ETPs that it believes is sufficient to deter and detect manipulation and other violative activity, and that the Exchange (or the Financial Industry Regulatory Authority on its behalf) communicates as needed with other members of the Intermarket Surveillance Group. The Exchange believes that its surveillance procedures will act to mitigate any manipulation concerns that arise from extending the compliance period for the Beneficial Holders Rule from 12 months to 36 months.<sup>14</sup>

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<sup>12</sup> See Notice, supra note 3, 88 FR at 60518.

<sup>13</sup> See id.

<sup>14</sup> See id.

Lastly, the Exchange takes the position that other continued listing standards (e.g., the disclosure obligations applicable under Rule 6c-11 of the Investment Company Act of 1940 for series of ETF Shares) are generally sufficient to mitigate manipulation concerns associated with ETF Shares.<sup>15</sup>

### **III. DISCUSSION AND COMMISSION FINDINGS**

The Commission must consider whether BZX’s proposal is consistent with Section 6(b)(5) of the Exchange Act, which requires, in relevant part, that the rules of a national securities exchange be designed “to prevent fraudulent and manipulative acts and practices” and “to protect investors and the public interest.”<sup>16</sup> Under the Commission’s Rules of Practice, the “burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder ... is on the self-regulatory organization [‘SRO’] that proposed the rule change.”<sup>17</sup>

The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding,<sup>18</sup> and any failure of an SRO to

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<sup>15</sup> See id.

<sup>16</sup> 15 U.S.C. 78f(b)(5). Pursuant to Section 19(b)(2) of the Exchange Act, 15 U.S.C. 78s(b)(2), the Commission must disapprove a proposed rule change filed by a national securities exchange if it does not find that the proposed rule change is consistent with the applicable requirements of the Exchange Act. Exchange Act Section 6(b)(5) states that an exchange shall not be registered as a national securities exchange unless the Commission determines that “[t]he rules of the exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by this title matters not related to the purposes of this title or the administration of the exchange.” 15 U.S.C. 78(f)(b)(5).

<sup>17</sup> Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

<sup>18</sup> See id.

provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the applicable rules and regulations.<sup>19</sup> Moreover, “unquestioning reliance” on an SRO’s representations in a proposed rule change is not sufficient to justify Commission approval of a proposed rule change.<sup>20</sup>

The Commission has consistently recognized the importance of the Beneficial Holders Rule and other similar requirements, stating that such listing standards help ensure that exchange listed securities have sufficient public float, investor base, and trading interest to provide the depth and liquidity necessary to promote fair and orderly markets.<sup>21</sup> As stated by the Exchange, the Beneficial Holders Rule is intended to ensure that trading in ETF Shares is not susceptible to manipulation.<sup>22</sup>

As discussed above, the Exchange is proposing to increase the Non-Compliance Period from 12 months to 36 months, thereby extending by two years the length of time during which ETF Shares listed on the Exchange would have no requirement to have a minimum number of beneficial holders. In support of its proposal, the Exchange states that some ETPs have had difficulty complying with the Beneficial Holders Rule,<sup>23</sup> and that the existing Beneficial Holders

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<sup>19</sup> See id.

<sup>20</sup> Susquehanna Int’l Group, LLP v. Securities and Exchange Commission, 866 F.3d 442, 447 (D.C. Cir. 2017).

<sup>21</sup> See, e.g., Securities Exchange Act Release No. 57785 (May 6, 2008), 73 FR 27597 (May 13, 2008)(SR-NYSE-2008-17) (stating that the distribution standards, which includes exchange holder requirements “... should help to ensure that the [Special Purpose Acquisition Company’s] securities have sufficient public float, investor base, and liquidity to promote fair and orderly markets”); Securities Exchange Act Release No. 86117 (June 14, 2019), 84 FR 28879 (June 20, 2018) (SR-NYSE-2018-46) (disapproving a proposal to reduce the minimum number of public holders continued listing requirement applicable to Special Purpose Acquisition Companies from 300 to 100). See also Prior Disapproval Order, supra note 9, 86 FR at 334.

<sup>22</sup> See Notice, supra note 3, 88 FR at 60518. See also Prior PRC Notice, supra note 9 **Error! Bookmark not defined.**, 85 FR at 27255.

<sup>23</sup> Although the Exchange’s proposed rule change is focused on ETF Shares, the Exchange’s discussion refers to ETPs more generally.

Rule forces the delisting of ETPs that issuers believe may still be economically viable.<sup>24</sup> However, the Exchange does not sufficiently support its assertion that compliance with the Beneficial Holders Rule is especially difficult for ETF Shares or that any such compliance difficulties have led to the delisting of economically viable ETPs. For example, BZX states that it has issued deficiency notifications to 39 series of ETPs for noncompliance with the Beneficial Holders Rule since 2015 and, of those 39 series, 30 attained compliance after issuance of the deficiency notice.<sup>25</sup> These data indicate that, at most, the Exchange delisted nine series of ETPs over eight years for non-compliance with this requirement. However, BZX has not established how many (if any) of those nine series of ETPs were ETF Shares<sup>26</sup> or that they were delisted solely for non-compliance with the Beneficial Holders Rule.<sup>27</sup>

Additionally, the Exchange does not sufficiently explain why any such compliance difficulties, or the need to remediate the applicable deficiencies, justify tripling the Non-Compliance Period for this core quantitative listing standard from one year to three years, and permitting ETF Shares to trade on the Exchange for an additional two years without the protections described above that the Beneficial Holders Rule was designed to provide. For example, the Exchange states that no new manipulation concerns would arise with a longer Non-Compliance Period than a shorter one because any risk that is present during months 12 through 36 of initial listing would also be present during the first 12 months as provided under current

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<sup>24</sup> See Notice, supra note 3, 88 FR at 60518.

<sup>25</sup> See id. at 60517.

<sup>26</sup> As noted above, ETF Shares are a subset of ETPs. See id. at 60517, n.7. Additionally, BZX does not disclose how many of those 9 delistings occurred after April 6, 2020, when the Commission approved the adoption of BZX Rule 14.11(l), which permits the listing and trading of ETF Shares on the Exchange. See Securities Exchange Act Release No. 88566 (April 6, 2020), 85 FR 20312 (April 10, 2020) (SR-CboeBZX-2019-097).

<sup>27</sup> BZX did not establish that the nine delisted issues complied with all other applicable listing requirements, and therefore were delisted only because of their non-compliance with the Beneficial Holders Rule.

rules.<sup>28</sup> However, the Exchange does not address why tripling the period during which the same regulatory risks posed by a Non-Compliance Period would be present is consistent with the Exchange Act. As discussed above, the Beneficial Holders Rule and other minimum number of holders requirements are important to ensure that trading in exchange listed securities is fair and orderly and not susceptible to manipulation, and the Exchange does not explain why it is consistent with the Exchange Act to permit ETF Shares to trade for two additional years without any of the protections of investors and the public interest provided by the Beneficial Holders Rule.

Finally, while the Exchange asserts that existing surveillances and other listing standards are sufficient to mitigate manipulation concerns, it does not offer a sufficient explanation of the basis for that view or provide supporting information or evidence to support its conclusion. Notably, although the Exchange acknowledges that the Beneficial Holders Rule is designed to ensure that trading in exchange-listed securities is not susceptible to manipulation, the Exchange does not explain how any of its specific existing surveillances or other listing requirements effectively address, in the absence of the Beneficial Holders Rule, those manipulation concerns and other regulatory risks to fair and orderly markets, investor protection and the public interest.<sup>29</sup> Accordingly, the Commission is unable to assess whether the Exchange's assertion has merit.

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<sup>28</sup> See Notice, supra note 3, 88 FR at 60518.

<sup>29</sup> The Exchange states that its surveillances focus on detecting securities trading outside of their normal patterns, followed by surveillance analysis and investigations, where appropriate, to review the behavior of all relevant parties for all relevant trading violations. The Exchange also states that it or the Financial Industry Regulatory Authority, on behalf of the Exchange, or both, communicate as needed regarding ETP trading with other markets and the Intermarket Surveillance Group member entities, and may obtain trading information in ETPs from such markets and other entities.



The Commission identified its concerns with this proposal in the OIP,<sup>30</sup> but the Exchange did not adequately respond or provide additional data addressing these concerns. As stated above, under the Commission’s Rules of Practice, the “burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder...is on the self-regulatory organization [‘SRO’] that proposed the rule change.”<sup>31</sup> The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding, and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the applicable rules and regulations.<sup>32</sup> The Commission concludes that, because BZX has not demonstrated that its proposal is designed to prevent fraudulent and manipulative acts and practices or to protect investors and the public interest, the Exchange has not met its burden to demonstrate that its proposal is consistent with Section 6(b)(5) of the Exchange Act.<sup>33</sup> For this reason, the Commission must disapprove the proposal.

#### **IV. CONCLUSION**

For the reasons set forth above, the Commission does not find, pursuant to Section 19(b)(2) of the Exchange Act, that the proposed rule change is consistent with the requirements

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<sup>30</sup> See OIP, supra note 6, 88 FR at 80784-5; see also Prior Disapproval Order, supra note 9.

<sup>31</sup> Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

<sup>32</sup> See id.

<sup>33</sup> In disapproving 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). Although the Exchange states that the regulatory and administrative burdens of the Beneficial Holders Rule makes it more difficult for smaller issuers to compete because they have limited resources to overcome legal, marketing, or other obstacles associated with this requirement (see Notice, 88 FR at 60517), as discussed above, BZX has failed to establish that its Beneficial Holders Rule is unnecessary or that smaller issuers of ETF Shares actually have been negatively impacted by it.

of the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with Section 6(b)(5) of the Exchange Act.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act, that proposed rule change SR-CboeBZX-2023-062 is disapproved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>34</sup>

**Sherry R. Haywood,**

*Assistant Secretary.*

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<sup>34</sup> 17 CFR 200.30-3(a)(12).