

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-83594; File No. SR-CboeBZX-2018-044)

July 5, 2018

Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Notice of Filing of a Proposed Rule Change to Amend BZX Rule 14.11(c), Index Fund Shares

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> notice is hereby given that on June 21, 2018, Cboe BZX Exchange, Inc. (“Exchange” or “BZX”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange filed a proposal to amend BZX Rule 14.11(c), Index Fund Shares, to make clear that a series of Index Fund Shares meets the quantitative requirements of Rules 14.11(c)(3), (4), and (5) where either the index or portfolio holdings underlying such fund meets the quantitative requirements.

The text of the proposed rule change is available at the Exchange’s website at [www.markets.cboe.com](http://www.markets.cboe.com), at the principal office of the Exchange, 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

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

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

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 parts of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend BZX Rule 14.11(c), Index Fund Shares, to make clear that a series of Index Fund Shares meets the quantitative requirements of Rules 14.11(c)(3), (4), and (5) where either the index or portfolio holdings underlying such fund meets the quantitative requirements. More specifically, the Exchange is proposing to make clear that any instance of the phrase “index or portfolio” or “portfolio or index” in Rules 14.11(c)(3)(A), 14.11(c)(4)(A) and (B), and 14.11(c)(5) (collectively, the “Generic Listing Standards”) shall be interpreted as referring to the constituents of the underlying index or the portfolio holdings of the series of Index Fund Shares.

Practically, this proposal provides that a series of Index Fund Shares will be deemed to meet the Generic Listing Standards on a continuous basis where the underlying index meets the Generic Listing Standards or the fund's portfolio holdings meet the Generic Listing Standards. The Generic Listing Standards were designed to allow certain series of Index Fund Shares to be listed on the Exchange that, by virtue of meeting certain quantitative standards, are deemed as not being susceptible to manipulation and for which the creation and redemption process and

arbitrage mechanism will operate efficiently.<sup>3</sup> Historically, Rule 14.11(c) provided that the Generic Listing Standards did not apply on an ongoing basis and meeting such requirements was required only prior to the series of Index Fund Shares being listed on the Exchange. Because such determination occurred prior to listing on the Exchange, the index constituents constituted the best means for determining whether a series of Index Fund Shares would be susceptible to manipulation and whether the creation and redemption process and arbitrage mechanism would operate efficiently. However, the Exchange believes that after a series of Index Fund Shares is listed on the Exchange, both the index constituents and the portfolio holdings are equally viable for evaluating whether the shares are susceptible to manipulation and the efficiency of the creation and redemption process and the arbitrage mechanism.

On January 1, 2018, the Generic Listing Standards began applying on both an initial and continuous basis,<sup>4</sup> but the Adopting Order did not address the issue of whether the portfolio holdings could satisfy the Generic Listing Standards and, thus, the underlying index remains the only basis for determining whether a series of Index Fund Shares meets the Generic Listing Standards. Looking only to the index constituents to determine whether a series of Index Fund Shares can continue to be listed on the Exchange is contrary to the policy goals underlying the rules for a number of reasons, as further laid out below.

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<sup>3</sup> Series of Index Fund Shares that meet the Generic Listing Standards and the other applicable provisions of Rule 14.11(c) are allowed do list on the Exchange pursuant to Rule 19b-4(e). See 17 CFR 240.19b-4(e).

<sup>4</sup> Securities Exchange Act Release Nos. 80169 (March 7, 2017), 82 FR 13536 (March 13, 2017) (SR-BatsBZX-2016-80) (order approving the application of listing standards on a continuous basis) (the “Adopting Order”) and 81777 (September 29, 2017), 82 FR 46583 (October 5, 2017) (notice of filing and immediate effectiveness of proposed rule change to extend implementation to January 1, 2018).

First, the portfolio holdings are at least as accurate of a measure as the index constituents to evaluate whether a series of Index Fund Shares are consistent with the policy goals after such fund is already listed and trading on the Exchange. When determining whether a series of Index Fund Shares are going to be susceptible to manipulation and how efficiently the creation and redemption process and the arbitrage mechanism will operate, the Generic Listing Standards require that the underlying assets associated with a series of Index Fund Shares are sufficiently liquid, diverse, unconcentrated, and large. The portfolio holdings are arguably a better means for making this determination than the index constituents because the portfolio holdings reflect the actual assets held by the series of Index Fund Shares while the index constituents are just the assets that the series is designed to track. As such, the Exchange is proposing that where either the portfolio holdings or the index constituents meet the Generic Listing Standards, the series of Index Fund Shares should be considered to meet the Generic Listing Standards and be able to continue to be listed on the Exchange.

Second, every index is bound by its respective methodology. This process is intentionally out of the control of the issuers, whose products are ultimately required to meet the Generic Listing Standards. While it makes sense to look to the index constituents for compliance with the Generic Listing Standards on an initial basis, it becomes problematic on an ongoing basis. Where the index constituents no longer meet the Generic Listing Standards, the only way that the constituents can get back into compliance is through natural market movements, an index rebalance, a change to the index methodology, or a change of index. It is not feasible for an issuer to rely on natural market movements to bring a series of Index Fund Shares back into compliance with the Generic Listing Standards. An index rebalance may bring a series of Index Fund Shares back into compliance with the Generic Listing Standards, but it isn't guaranteed

(index providers do not generally consider the Generic Listing Standards in constructing indexes) and may not occur within the time frame of the cure periods provided under Rule 14.12 (rebalances generally occur quarterly or annually). Changes to an index methodology or changing the underlying index would require significant effort and months of notice, again putting the timeline for implementation outside of the window for the cure periods in Rule 14.12. Providing that a series of Index Fund Shares meets the Generic Listing Standards where the portfolio holdings meet the Generic Listing Standards will allow issuers with a greater degree of control over whether their products meet their ongoing listing obligations. While such portfolio holdings will still need to meet the requirements under the Investment Company Act of 1940 related to tracking the underlying index, such flexibility will allow issuers to continue to meet the Generic Listing Standards even where an underlying index narrowly fails to meet them. Further, it will provide issuers with certainty that they will be able to meet the Generic Listing Standards even where the underlying index may drift out of compliance for any number of reasons.

Finally, the generic listing standards applicable to the equity and index holdings of a series of Managed Fund Shares under Rule 14.11(i) are nearly identical to the Generic Listing Standards and are designed to mitigate the same policy concerns, but look only to portfolio holdings to determine compliance with ongoing listing obligations.<sup>5</sup> The only substantive difference between Index Fund Shares and Managed Fund Shares is that Index Fund Shares are designed to track the returns of an underlying index and Managed Fund Shares employ an actively managed portfolio that is designed to accomplish an investment objective rather than tracking an index. The Commission determined that such generic listing standards were

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<sup>5</sup> See Securities Exchange Act Release No. 78396 (July 22, 2016), 81 FR 49698 (July 28, 2016) (SR-BATS-2015-100)

consistent with the Act in the Active Generics Approval Order and the Exchange agrees with that determination and further believes that it would be consistent with the Act for compliance with the Generic Listing Standards to be evaluated based on either the series of Index Fund Shares underlying index constituents or portfolio holdings.

In sum, the Exchange believes that by allowing a series of Index Fund Shares to comply with the Generic Listing Standards where either its portfolio holdings or index constituents meet the Generic Listing Standards, the proposal would provide issuers with significant additional regulatory certainty related to a fund's ability to continue to be listed and traded on the Exchange pursuant to the Rule 19b-4(e), while simultaneously continuing to accomplish the policy goals underlying the Generic Listing Standards. The Exchange believes that this proposal would enhance competition among market participants, to the benefit of investors and the marketplace. In addition, the proposed amendments would create greater investor confidence in exchange-traded products generally because there will be a greater degree of certainty that Index Fund Shares will not be subject to regulatory action or delisting.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,<sup>6</sup> in general, and furthers the objectives of Sections 6(b)(5) of the Act,<sup>7</sup> in particular, because it is 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

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<sup>6</sup> 15 U.S.C. 78f(b).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

in securities, to remove impediments to, and perfect the mechanisms of, a free and open market and a national market system and, in general, to protect investors and the public interest and because it is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Exchange has in place surveillance procedures that are adequate to properly monitor trading in Shares in all trading sessions and to deter and detect violations of Exchange rules and applicable federal securities laws.

The Exchange believes the proposed amendments, by explicitly permitting the portfolio holdings to determine compliance with the Generic Listing Standards, would provide issuers with significant additional regulatory certainty related to a fund's ability to continue to be listed and traded on the Exchange pursuant to the Rule 19b-4(e), while simultaneously continuing to accomplish the policy goals underlying the Generic Listing Standards, which would enhance competition among market participants, to the benefit of investors and the marketplace. In addition, the proposed amendments would create greater investor confidence in exchange-traded products generally because there will be a greater degree of certainty that Index Fund Shares will not be subject to regulatory action or delisting.

The Exchange believes that looking only to the index constituents to determine whether a series of Index Fund Shares can continue to be listed on the Exchange is actually inconsistent with the policy goals underlying the Generic Listing Standards for a number of reasons, as further laid out below. First, the portfolio holdings are at least as accurate of a measure as the index constituents to evaluate whether a series of Index Fund Shares are consistent with the policy goals after such fund is already listed and trading on the Exchange. When determining whether a series of Index Fund Shares are going to be susceptible to manipulation and how

efficiently the creation and redemption process and the arbitrage mechanism will operate, the Generic Listing Standards require that the underlying assets associated with a series of Index Fund Shares are sufficiently liquid, diverse, unconcentrated, and large. The portfolio holdings are arguably a better means for making this determination than the index constituents because the portfolio holdings reflect the actual assets held by the series of Index Fund Shares while the index constituents are just the assets that the series is designed to track. As such, the Exchange is proposing that where either the portfolio holdings or the index constituents meet the Generic Listing Standards, the series of Index Fund Shares should be considered to meet the Generic Listing Standards and be able to continue to be listed on the Exchange.

Second, indexes are by design slow-moving, relatively inflexible, and generally out of the control of issuers. While it makes sense to look to the index constituents for compliance with the Generic Listing Standards on an initial basis, it becomes problematic on an ongoing basis. Where the index constituents no longer meet the Generic Listing Standards, the only way that the constituents can get back into compliance is through natural market movements, an index rebalance, a change to the index methodology, or a change of index. It is not feasible for an issuer to rely on natural market movements to bring a series of Index Fund Shares back into compliance with the Generic Listing Standards. An index rebalance may bring a series of Index Fund Shares back into compliance with the Generic Listing Standards, but it isn't guaranteed (index providers do not generally consider the Generic Listing Standards in constructing indexes) and may not occur within the time frame of the cure periods provided under Rule 14.12 (rebalances generally occur quarterly or annually). Changes to an index methodology or changing the underlying index would require significant effort and months of notice, again putting the timeline for implementation outside of the window for the cure periods in Rule 14.12.



Providing that a series of Index Fund Shares meets the Generic Listing Standards where the portfolio holdings meet the Generic Listing Standards will allow issuers with a greater degree of control over whether their products meet their ongoing listing obligations. While such portfolio holdings will still need to meet the requirements under the Investment Company Act of 1940 related to tracking the underlying index, such flexibility will allow issuers to continue to meet the Generic Listing Standards even where an underlying index narrowly fails to meet them. Further, it will provide issuers with certainty that they will be able to meet the Generic Listing Standards even where the underlying index may drift out of compliance for any number of reasons.

Finally, the generic listing standards applicable to the equity and index holdings of a series of Managed Fund Shares under Rule 14.11(i) are nearly identical to the Generic Listing Standards and are designed to mitigate the same policy concerns, but look only to portfolio holdings to determine compliance with ongoing listing obligations. The only substantive difference between Index Fund Shares and Managed Fund Shares is that Index Fund Shares are designed to track the returns of an underlying index and Managed Fund Shares employ an actively managed portfolio that is designed to accomplish an investment objective rather than tracking an index. The Commission determined that such generic listing standards were consistent with the Act in the Active Generics Approval Order and the Exchange agrees with that determination and further believes that it would be consistent with the Act for compliance with the Generic Listing Standards to be evaluated based on either the series of Index Fund Shares underlying index constituents or portfolio holdings.

In sum, the Exchange believes that by allowing a series of Index Fund Shares to comply with the Generic Listing Standards where either its portfolio holdings or index constituents meet the Generic Listing Standards, the proposal would provide issuers with significant additional

regulatory certainty related to a fund's ability to continue to be listed and traded on the Exchange pursuant to the Rule 19b-4(e), while simultaneously continuing to accomplish the policy goals underlying the Generic Listing Standards. The Exchange believes that this proposal would enhance competition among market participants, to the benefit of investors and the marketplace. In addition, the proposed amendments would create greater investor confidence in exchange-traded products generally because there will be a greater degree of certainty that Index Fund Shares will not be subject to regulatory action or delisting.

For the above reasons, the Exchange believes that the proposal 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 believes that the proposed rule change would not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change would allow the portfolio holdings for a series of Index Fund Shares to be used to determine compliance with the Generic Listing Standards in addition to the index constituents, which would enhance competition among market participants, to the benefit of investors and the marketplace.

(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. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer

period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove the proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. 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 e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CboeBZX-2018-044 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-2018-044. This file number should be included on the subject line if e-mail 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. 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-2018-044 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>8</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>8</sup> 17 CFR 200.30-3(a)(12).