SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-89472; File No. SR-CboeBZX-2020-036)

August 4, 2020

Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change Relating to Rule 14.11, Other Securities, to Modify a Continued Listing Criterion for Certain Exchange-Traded Products

On April 29, 2020, 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" or "Exchange Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend one of the continued listing requirements relating to certain exchange-traded products ("ETPs") under BZX Rule 14.11. The proposed rule change was published for comment in the Federal Register on May 7, 2020.[3]

On June 16, 2020, pursuant to Section 19(b)(2) of the Act,[4] the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.[5] The Commission has received one comment letter on the proposed rule change.[6] The

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 88795 (May 1, 2020), 85 FR 27254 ("Notice").

4 15 U.S.C. 78s(b)(2).

5 See Securities Exchange Act Release No. 89076, 85 FR 37488 (June 22, 2020). The Commission designated August 5, 2020 as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change.

6 Comments on the proposed rule change can be found on the Commission's website at: https://www.sec.gov/comments/sr-cboebzx-2020-036/srcboebzx2020036.htm.

Commission is issuing this order to institute proceedings pursuant to Section 19(b)(2)(B) of the Act[7] to determine whether to approve or disapprove the proposed rule change.

I. Description of the Proposal

A continued listing requirement for certain ETPs[8] 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 under BZX Rule 14.12 for, shares of such ETPs for which there are fewer than 50 beneficial holders for 30 or more consecutive trading days ("Beneficial Holder Rule"). The Exchange is proposing to change the date after which an ETP must have at least 50 beneficial holders or be subject to delisting proceedings under BZX Rule 14.12 ("Non-Compliance Period"). Specifically, the Exchange seeks to extend the Non-Compliance Period from 12 months after commencement of trading on the Exchange to 36 months after commencement of trading on the Exchange.

A. The Exchange's Rationale

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 ETP; (2) the economic and competitive structures in place in the ETP ecosystem naturally incentivize issuers to de-list 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 continued listing standard is intended to address.

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7 15 U.S.C. 78s(b)(2)(B).

8 For purposes of the proposal, the term "ETP" means securities listed pursuant to BZX Rule 14.11(c) (Index Fund Shares), BZX Rule 14.11(i) (Managed Fund Shares), and BZX Rule 14.11(l) (Exchange-Traded Fund Shares ("ETF Shares")).

According to the Exchange, the ETP space is more competitive that it has ever been, with more than 2000 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 notes that it has issued deficiency notifications to 34 ETPs for non-compliance with the Beneficial Holders Rule in the last five years, 27 of which ultimately were able to achieve compliance while going through the delisting process.

In addition, the Exchange believes that the economic and competitive structures in place in the ETP ecosystem naturally incentivize issuers to de-list 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 69 products voluntarily delist in the last two years. 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.

Finally, the Exchange states that the proposal "does not create any significant change in the risk of manipulation for ETPs listed on the exchange." The Exchange "does not believe there is anything particularly important about the 50th Beneficial Holder that reduces the manipulation risk associated with an ETP as compared to the 49th, nor is there any manipulation concern that

arises on the 366th day after an ETP began trading on the Exchange that didn't otherwise exist on the 1st, 2nd, or 365th day."[9] 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 "these robust surveillance procedures will further act to mitigate concerns that arise from extending the compliance period for the Beneficial Holders [Rule] from 12 months to 36 months."[10] Lastly, the Exchange takes the position that other continued listing standards (e.g., with respect to the diversity, liquidity and size of an ETP's holdings or reference assets) "are generally sufficient to mitigate manipulation concerns associated with the applicable ETP."[11]

B. Comment on the Proposed Rule Change

The Commission received one comment in support of the proposal.[12] The commenter states that the beneficial owner requirement disproportionately punishes smaller companies without the resources to pay for aggressive distribution, and disincentivizes issuers from launching funds that can prove themselves purely by investment merit over the long term.[13] The commenter believes that the purpose of the beneficial holder minimum likely is to enforce some sort of minimum liquidity, and accordingly suggests alternative liquidity measures such as the

9 See Notice, supra note 3, 85 FR at 27256.

10 See id.

11 See id.

12 See Letter to Secretary, Commission, from S Phil Bak, Founder & CEO, SecLenX (May 13, 2020) ("SecLenX Letter").

13 See id. at 1.

quality of secondary markets (e.g., spreads and depth of book), the liquidity of the underlying basket, and the number of potential liquidity providers. In this commenter's view, increasing the time period to achieve the minimum number of beneficial holders is a positive step, but eliminating the requirement altogether would be far more purposeful.[14]

II. Proceedings to Determine Whether to Approve or Disapprove SR-CboeBZX-2020-036 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act[15] to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy 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.

Pursuant to Section 19(b)(2)(B) of the Act,[16] the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of and input concerning the proposed rule change's consistency with the Act and, in particular, 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, 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."[17]

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14 See id. at 2.

15 15 U.S.C. 78s(b)(2)(B).

16 Id.

17 15 U.S.C. 78f(b)(5).

The Commission has consistently recognized the importance of the minimum number of holders and other similar requirements in exchange listing standards. Among other things, 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.[18]

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 an ETP listed on the Exchange would have no requirement to have a minimum number of beneficial holders. In support of its proposal, the Exchange emphasizes that some ETPs have had difficulty complying with the Beneficial Holders Rule. The Exchange indicates that noncompliance with the Beneficial Holders Rule is increasing because the ETP market has become so competitive, and there are so many of them, that it can be difficult to acquire the requisite number of beneficial holders within the existing Non-Compliance Period. The Exchange also believes that the existing Beneficial Holders Rule forces the delisting of ETPs that may still be economically viable. With respect to regulatory considerations, the Exchange takes the position that the manipulation risk would not be materially greater if an ETP had 49 beneficial holders as opposed to 50, and that no new manipulation concerns would arise with a longer Non-Compliance Period

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18 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).

than a shorter one. The Exchange also asserts that existing surveillances and other listing standards are sufficient to mitigate manipulation concerns.

While the Exchange takes the position that the highly-competitive ETP market has made compliance with the Beneficial Holders Rule difficult, and led to the delisting of ETPs that may be economically viable, the Exchange does not explain why these compliance difficulties justify extending the Non-Compliance Period for this core quantitative listing standard for an additional two years. For example, the Exchange states that the manipulation risk is not materially greater with 49 beneficial holders than with 50, but the Exchange is proposing to require no minimum number during the Non-Compliance Period, and does not explain why the manipulation and other regulatory risks would not be greater with a very small number of beneficial holders. The Exchange also states that no new manipulation concerns would arise with a longer Non-Compliance Period than a shorter one, but does not explain 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. The Exchange takes the position that existing surveillances and other listing standards are sufficient to mitigate manipulation concerns, but does not explain in any detail the basis for this view, or the impact of its proposal on the maintenance of fair and orderly markets or other applicable Exchange Act standards.

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."[19] 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

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19 Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

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.[20]

For these reasons, the Commission believes it is appropriate to institute proceedings pursuant to Section 19(b)(2)(B) of the Act to determine whether the proposal should be approved or disapproved.

IV. Commission's Solicitation of 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.[21]

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's

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20 See id.

21 Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 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).

submission must file that rebuttal by [insert date 35 days from publication in the Federal Register]. The Commission asks that commenters address the sufficiency of the Exchange's statements in support of the proposal, which are set forth in the Notice, in addition to any other comments they may wish to submit about the proposed rule change.

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. Please include File Number SR-CboeBZX-2020-036 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-2020-036. 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-2020-036 and should be submitted by [insert date 21 days from date of publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[22]

J. Matthew DeLesDernier
Assistant Secretary

[22] 17 CFR 200.30-3(a)(57).