



## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-91236; File No. SR-NYSEArca-2020-56]

### **Self-Regulatory Organizations; NYSE Arca, Inc.; Order Disapproving a Proposed Rule Change to Amend NYSE Arca Rules 5.2-E(j)(3), 5.2-E(j)(8), 5.5-E(g)(2), 8.600-E, and 8.900-E**

March 2, 2021.

#### **I. INTRODUCTION**

On June 18, 2020, NYSE Arca, Inc. (“Exchange” or “NYSE Arca”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend certain listing requirements relating to maintaining a minimum number of beneficial holders and minimum number of shares outstanding. The proposed rule change was published for comment in the Federal Register on July 7, 2020.<sup>3</sup>

On August 17, 2020, pursuant to Section 19(b)(2) of the Exchange 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 October 2, 2020, the Commission instituted proceedings to determine whether to approve or disapprove the proposed rule change.<sup>6</sup> On December 15, 2020, the Commission

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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. 89197 (June 30, 2020), 85 FR 40720 (“Notice”).

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

<sup>5</sup> See Securities Exchange Act Release No. 89584, 85 FR 51817 (Aug. 21, 2020).

<sup>6</sup> See Securities Exchange Act Release No. 90075, 85 FR 63597 (Oct. 8, 2020) (“OIP”).

designated a longer period for Commission action on the proposed rule change.<sup>7</sup> The

Commission received one comment letter on the proposed rule change.<sup>8</sup>

This order disapproves the proposed rule change because, as discussed below, NYSE Arca 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>9</sup>

## **II. DESCRIPTION OF THE PROPOSAL**

As described in detail in the Notice and OIP, the Exchange proposes to amend the listing standards governing the listing and trading of Investment Company Units, Exchange-Traded Fund Shares, Managed Fund Shares, and Managed Portfolio Shares (collectively, “Fund Shares”).<sup>10</sup> Specifically, NYSE Arca proposes to: (1) remove the listing requirement that, following the initial twelve-month period after commencement of trading of a series of Fund Shares on the Exchange, such series have at least 50 beneficial holders (“Beneficial Holders Rule”); and (2) replace the existing minimum number of shares requirements (“Minimum Shares Outstanding Rules”)<sup>11</sup> with a

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<sup>7</sup> See Securities Exchange Act Release No. 90672, 85 FR 83135 (Dec. 21, 2020).

<sup>8</sup> The comment on the proposed rule change can be found on the Commission’s website at: <https://www.sec.gov/comments/sr-nysearca-2020-56/srnysearca202056-8163217-226939.pdf>.

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> See NYSE Arca Rules 5.2-E(j)(3) and 5.5-E(g)(2) (Investment Company Units); 5.2-E(j)(8) (Exchange-Traded Fund Shares); 8.600-E (Managed Fund Shares); and 8.900-E (Managed Portfolio Shares).

<sup>11</sup> See Commentary .01(d) to NYSE Arca Rule 5.2-E(j)(3) (requiring a minimum of 100,000 shares of a series of Investment Company Units to be outstanding at commencement of trading); NYSE Arca Rule 5.2-E(j)(8)(e)(1)(A) (requiring the Exchange to establish a minimum number of Exchange-Traded Fund Shares to be outstanding at the time of commencement of trading); NYSE Arca Rule 8.600-E(d)(1)(A) (requiring the Exchange to establish a minimum number of Managed Fund Shares to be outstanding at the time of commencement of trading); and NYSE Arca Rule 8.900-E(d)(1)(A) (requiring the Exchange to establish a minimum number of Managed Portfolio Shares to be outstanding at the time of commencement of trading).

requirement that a series of Fund Shares have at least one creation unit outstanding on an initial and continued listing basis.<sup>12</sup>

The Exchange states that Beneficial Holders Rule as it pertains to Fund Shares listed on NYSE Arca is no longer necessary. The Exchange contends that the requirements of Rule 6c-11 under the 1940 Act and, in particular, the website disclosure requirements of Rule 6c-11(c), together with the existing creation and redemption process, serve to mitigate the risks of manipulation and lack of liquidity that the Beneficial Holders Rule was intended to address.<sup>13</sup>

The Exchange also asserts that requiring at least one creation unit to be outstanding at all times, together with the enhanced disclosure requirements of Rule 6c-11 under the 1940 Act, will facilitate an effective arbitrage mechanism that, with respect to Investment Company Units, Managed Fund Shares, and Exchange-Traded Fund Shares, will provide investors with sufficient transparency into the holdings of the underlying portfolio and help ensure that the trading price in the secondary market remains in line with the net asset value-per-share of a fund's portfolio. In support of this assertion, the Exchange cites to Rule 6c-11(c)(1)(vi) under the 1940 Act, which requires additional disclosures if the premium or discount with respect to a fund's trading price in the secondary market and the net asset value-per-share of a fund's portfolio is in excess of 2% for more than seven consecutive days. NYSE Arca asserts that such enhanced disclosure would provide transparency to investors in the event there are indications of an inefficient arbitrage mechanism. With respect to Managed Portfolio Shares, while these securities do not publicly disclose their portfolio holdings daily and are not eligible to rely on Rule 6c-11 under the 1940

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<sup>12</sup> The Exchange represents that the term "creation unit" would have the same meaning as defined in Rule 6c-11(a)(1) under the Investment Company Act of 1940 ("1940 Act").

<sup>13</sup> The portfolio holdings underlying Managed Portfolio Shares must be disclosed within at least 60 days following the end of every fiscal quarter. See NYSE Arca Rule 8.900-E(c)1.d. As a result, the requirements of Rule 6c-11 upon which the Exchange relies to mitigate manipulation risk and illiquidity do not apply to Managed Portfolio Shares. See Investment Company Act Release No. 33646 (September 25, 2019), 84 FR 57162, 57163 (October 24, 2019) ("Because these non-transparent ETFs do not provide daily portfolio transparency, they would not meet the conditions of rule 6c-11").

Act, the Exchange argues that the applicable Verified Intraday Indicative Value and other information required to be disseminated in connection with the listing and trading of Managed Portfolio Shares ensures transparency of key values and information, and that such information is sufficient to support an effective arbitrage process, independent of any Beneficial Holders Rule.

The Exchange states that the arbitrage mechanism generally causes the market price and the net asset value-per-share to align, and the functioning of the arbitrage mechanism helps to ensure that the trading price in the secondary market is at fair value. The Exchange further states that the existence of the creation and redemption process, as well as the proposed requirement that at least one creation unit is always outstanding, would ensure that market participants are able to redeem Fund Shares and, thereby, allow the arbitrage mechanism to function properly. The Exchange concludes, therefore, that such arbitrage mechanism would obviate the need for a Beneficial Holders Rule to support a fair and orderly market in Fund Shares. In addition, the Exchange contends that its surveillance procedures for Fund Shares and its ability to halt trading in Fund Shares in specified circumstances provide for additional investor protections by further mitigating any abnormal trading that would affect the Fund Shares' prices.

The Commission received one comment in support of the proposal.<sup>14</sup> The commenter states that the Beneficial Holders Rule “does not appear to provide any meaningful investor-protection benefits.”<sup>15</sup> Specifically, the commenter expresses the view that the liquidity of shares of an exchange-traded fund (“ETF”) is primarily a function of the liquidity of the ETF’s underlying securities, that the marketplace taps into this liquidity through the creation and redemption and arbitrage processes, and that this mitigates potential price manipulation

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<sup>14</sup> See Letter to Secretary, Commission, from Timothy W. Cameron, Asset Management Group – Head, and Lindsey Weber Keljo, Asset Management Group – Managing Director and Associate General Counsel, SIFMA AMG (Dec. 18, 2020) (“SIFMA Letter”).

<sup>15</sup> SIFMA Letter, *id.* at 3.

concerns.<sup>16</sup> In addition, the commenter believes that the enhanced disclosure requirements of Rule 6c-11 under the 1940 Act,<sup>17</sup> including those relating to an ETF's portfolio holdings and when an ETF's premium or discount exceeds 2% for more than seven consecutive days, will help facilitate effective arbitrage. The commenter conducted a survey of its members that sought information on level of assets, number of beneficial holders, and various trading measures of newly-listed ETFs over different periods following initial listing, and concluded that the number of shareholders in an ETF does not appear to be a significant consideration in an ETF's sponsor's decision to delist and terminate an ETF and that this requirement does not appear to offer investor protection benefits.<sup>18</sup>

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

The Commission must consider whether NYSE Arca'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>19</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

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<sup>16</sup> See id.

<sup>17</sup> See id. at 3-4. The commenter also states that the Beneficial Holders Rule puts newer and smaller sponsors at an unnecessary disadvantage to larger sponsors having the enterprise-wide scale and distribution reach to gather assets in the months after launch. See id.

<sup>18</sup> See id.

<sup>19</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).

rules and regulations issued thereunder ... is on the self-regulatory organization [‘SRO’] that proposed the rule change.”<sup>20</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>21</sup> 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>22</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>23</sup>

The Commission has consistently recognized the importance of the minimum number of holders 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>24</sup> As stated by the

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<sup>20</sup> Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

<sup>21</sup> See id.

<sup>22</sup> See id.

<sup>23</sup> Susquehanna Int’l Group, LLP v. Securities and Exchange Commission, 866 F.3d 442, 447 (D.C. Cir. 2017).

<sup>24</sup> The Commission considers distribution standards, including minimum number of holders and number of shares outstanding requirements, to be important means of promoting fair and orderly markets. 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 include exchange holder and number of shares outstanding 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).

Exchange, the minimum number of holders requirement is intended to address the risks of manipulation.<sup>25</sup>

As discussed above, the Exchange is proposing to (1) remove the Beneficial Holders Rule applicable to Fund Shares listed on NYSE Arca, and (2) replace the existing Minimum Shares Outstanding Rules with a requirement that a series of Fund Shares have at least one creation unit outstanding on an initial and continued listing basis. In support of its proposal, the Exchange asserts that the requirements of Rule 6c-11 under the 1940 Act, and in particular the website disclosure requirements of Rule 6c-11(c) and, for Managed Portfolio Shares, the information required to be disseminated (including the verified intraday indicative value) in connection with the listing and trading of those Shares, together with the existing creation and redemption process and proposed requirement that at least one creation unit is always outstanding, would serve to mitigate the risks of manipulation and the lack of liquidity that the Beneficial Holders Rule was intended to address. However, the Exchange does not sufficiently support its assertions, particularly where a series of Fund Shares is permitted to have a very small number of beneficial holders. For example, the Exchange does not sufficiently address how the arbitrage mechanism will ensure Fund Shares with very few beneficial holders would be sufficiently liquid to support fair and orderly markets. The Exchange also does not discuss in sufficient detail the potential inefficiencies in the arbitrage mechanism that might occur with illiquid Fund Shares that have very few holders, and the impact that would have on the ability of the arbitrage mechanism to effectively mitigate the risks of manipulation. In addition, the Exchange does not sufficiently explain how an efficient and effective arbitrage mechanism and sufficient liquidity could result for a series of Fund Shares held only by a very few number of buy-and-hold investors and thereby mitigate manipulation risks. Further, the Exchange does not sufficiently address the

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<sup>25</sup> See Notice, *supra* note 3, 85 FR at 40722. See also SIFMA Letter, *supra* note 14, at 3 (acknowledging that the Beneficial Holders Rule was intended to address “potential price manipulation,” among other things).

impact of creation unit size on the efficiency of the arbitrage mechanism. For example, with respect to a series of illiquid Fund Shares with very few beneficial holders, the Exchange does not describe how the proposal is designed to mitigate the risks of manipulation if the creation unit size for the Fund Shares is large in comparison to the total number of Fund Shares outstanding. The Exchange provides no data or analysis to support its position, other than noting the number and size of the creation units for existing series of Fund Shares. 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 sufficiently explain why its proposed modification of these requirements is consistent with the Exchange Act.

While the Exchange also proposes to replace the existing Minimum Shares Outstanding Rules with a requirement that a series of Fund Shares have a number of shares outstanding equal to at least one creation unit, the Exchange does not sufficiently explain why this is an appropriate substitute for its existing standards. Creation unit sizes could be highly variable, since they are determined at the discretion of the issuer of Fund Shares, and the Exchange has not articulated how this new standard would effectively support fair and orderly markets, address the risks of manipulation, and otherwise be consistent with Section 6(b)(5) and other relevant provisions of the Act. The Exchange argues that requiring at least one creation unit to be outstanding at all times, together with the enhanced disclosure requirements of Rule 6c-11, would facilitate an effective arbitrage mechanism that would provide investors with sufficient transparency into the holdings of the underlying portfolio and help ensure that the trading price in the secondary market remains in line with the value per share of a fund's portfolio. The Exchange, however, fails to explain in sufficient detail how an efficient and effective arbitrage mechanism could result for an illiquid series of Fund Shares held by very few beneficial holders and with only one creation unit of Fund Shares outstanding. The Exchange also does not provide any explanation as

to how such series of Fund Shares with only a single creation unit outstanding is therefore less susceptible to manipulation risks on a continued listing basis.

Finally, while the Exchange asserts that its surveillance procedures and trading halt authority would provide for additional investor protections by further mitigating any abnormal trading that would affect the Fund Shares' prices, it does not offer any explanation of the basis for that view or provide any supporting information or evidence to support its conclusion. Notably, the Exchange does not explain how any of its specific existing surveillance procedures or administration of its trading halt authority effectively address, in the absence of the Beneficial Holders Rule<sup>26</sup> and the Minimum Shares Outstanding Rules, manipulation concerns and other regulatory risks to fair and orderly markets, investor protection, and the public interest. Accordingly, the Commission is unable to assess whether the Exchange's assertion has merit.

The Commission identified all of these concerns in the OIP, but the Exchange has not responded or provided additional data addressing these concerns.<sup>27</sup> 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-

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<sup>26</sup> See supra note 24 and accompanying text.

<sup>27</sup> See OIP, supra note 6. The commenter asserts that the creation and redemption processes, which tap into the liquidity of the underlying holdings, coupled with the enhanced disclosures mandated under Rule 6c-11 under the 1940 Act, mitigate manipulation concerns. See SIFMA Letter, supra note 14, at 3. However, neither the Exchange nor the commenter explains why arbitrage opportunities would sufficiently mitigate manipulation concerns for the full range of ETFs, including ETFs overlying a portfolio of instruments that are themselves illiquid, or where market interest in the ETF is not sufficient to attract effective arbitrage activity. While the Exchange and the commenter assert that certain disclosures under Rule 6c-11 under the 1940 Act provide investors with transparency into the holdings of the underlying portfolio and additional insight into the effectiveness of an ETF's arbitrage (see Notice, supra note 3, 85 FR at 40721; SIFMA Letter, supra note 14, at 3-4), neither the Exchange nor the commenter sufficiently explains how such disclosures might prevent manipulation. In addition, while the commenter states that its survey data showed that an ETF's number of shareholders, level of assets and liquidity tended to improve after three years of operation as compared to one year, the commenter does not assert that the survey addressed the concerns about potential manipulation that the proposal raises, as described above.

regulatory organization [‘SRO’] that proposed the rule change.’<sup>28</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>29</sup> The Commission concludes that, because NYSE Arca 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>30</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,<sup>31</sup> that the proposed rule change is consistent with the requirements 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.<sup>32</sup>

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<sup>28</sup> Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

<sup>29</sup> See id.

<sup>30</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 commenter (see SIFMA Letter, supra note 14, at 4) asserts that the current Beneficial Holders Rule puts newer and smaller sponsors at an unnecessary disadvantage to larger sponsors having the enterprise-wide scale and distribution reach to gather assets in the months after launch, neither the commenter nor the Exchange has provided data to support this conclusion.

<sup>31</sup> 15 U.S.C. 78s(b)(2).

<sup>32</sup> 15 U.S.C. 78f(b)(5).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act, that proposed rule change SR-NYSEArca-2020-56 is disapproved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>33</sup>

**J. Matthew DeLesDernier,**

*Assistant Secretary.*

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