



## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-98933; File No. SR-CboeBZX-2023-062]

### **Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend the Initial Period After Commencement of Trading of a Series of ETF Shares on the Exchange as It Relates to the Holders of Record and/or Beneficial Holders, as Provided in Exchange Rule 14.11(l)**

November 14, 2023.

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 (“Act” or “Exchange Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend the initial period after commencement of trading of a series of ETF Shares on the Exchange as it specifically relates to holders of record and/or beneficial holders under 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 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

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

rule change.<sup>5</sup> This order institutes proceedings under Section 19(b)(2)(B) of the Act<sup>6</sup> to determine whether to approve or disapprove the proposed rule change.

#### I. Description of the Proposal

A continued listing requirement for ETF Shares<sup>7</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 under BZX Rule 14.12 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”).<sup>8</sup> The Exchange is proposing to change the date after which a series of ETF Shares 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.<sup>9</sup>

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>10</sup> (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

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<sup>5</sup> See Securities Exchange Act Release No. 98497 (September 25, 2023), 88 FR 67397 (September 29, 2023) (designating November 30, 2023, as the date by which the Commission will either approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change). The Commission has received no comments on the proposed rule change.

<sup>6</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>7</sup> The term “ETF Shares” means shares of stock issued by an Exchange-Traded Fund. See BZX Rule 14.11(l)(3)(A). 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 (“1940 Act”). See BZX Rule 14.11(l)(3)(B).

<sup>8</sup> See BZX Rule 14.11(l)(4)(B)(i)(c).

<sup>9</sup> Earlier, on April 29, 2020, the Exchange filed a proposed rule change to extend the Non-Compliance Period of the Beneficial Holders Rule applicable to Index Fund Shares, Managed Fund Shares, and ETF Shares from 12 to 36 months. The Commission disapproved that proposed rule change. See Securities Exchange Act Release No. 90819 (December 29, 2020), 86 FR 332 (January 5, 2021).

<sup>10</sup> The Exchange notes that ETF Shares is a type of ETP.

will not meaningfully impact the manipulation concerns that the continued listing standard is intended to address.<sup>11</sup>

According to the Exchange, the ETP space is more competitive than it has ever been, with more than 2,000 ETPs listed on exchanges.<sup>12</sup> As a result, distribution platforms have become more restrictive about the ETPs they will allow on their systems, often requiring a minimum existing track record (e.g., at least twelve months) and a minimum level of assets under management (e.g., at least \$100 million).<sup>13</sup> Many larger entities also require a one-year track record before they will invest in an ETP.<sup>14</sup> In the Exchange's view, this has slowed the growth cycle of the average ETP and has resulted in a significant number of deficiencies with respect to satisfying the Beneficial Holders Rule over the last several years.<sup>15</sup> Specifically, the Exchange notes that it has issued deficiency notifications to 39 ETPs for non-compliance with the Beneficial Holders Rule since 2015, 30 of which ultimately were able to achieve compliance after the deficiency notice was issued.<sup>16</sup>

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.<sup>17</sup> 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.<sup>18</sup> The Exchange also questions whether the

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<sup>11</sup> See Notice, 88 FR at 60517.

<sup>12</sup> See *id.*

<sup>13</sup> See *id.*

<sup>14</sup> See *id.*

<sup>15</sup> See *id.*

<sup>16</sup> See *id.*

<sup>17</sup> See *id.* at 60518.

<sup>18</sup> See *id.*

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.<sup>19</sup>

Finally, 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>20</sup> The Exchange points out that the Beneficial Holders Rule does not apply during the first 12 months that an issue of ETF Shares is listed on the Exchange. Therefore, according to BZX, “[a]ny 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 rules.”<sup>21</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 and other entities of the Intermarket Surveillance Group.<sup>22</sup> The Exchange believes that “these robust surveillance procedures successfully mitigated manipulation concerns during an ETPs first 12 months of listing on the Exchange, during which there is currently no Beneficial Holder requirement,” and that “these surveillance procedures will act to mitigate any manipulation concerns that arise from extending the compliance period for the Beneficial Holders Rules from 12 months to 36 months.”<sup>23</sup> Lastly, the Exchange asserts that other continued listing standards (the disclosure obligations applicable under Rule 6c-11 of the 1940 Act for series of ETF Shares) “are generally sufficient to mitigate manipulation concerns associated with ETF Shares.”<sup>24</sup>

II. Proceedings to Determine Whether to Approve or Disapprove SR-CboeBZX-2023-062 and Grounds for Disapproval Under Consideration

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<sup>19</sup> See id.

<sup>20</sup> Id.

<sup>21</sup> Id.

<sup>22</sup> See id.

<sup>23</sup> Id.

<sup>24</sup> Id.

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act<sup>25</sup> 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,<sup>26</sup> 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."<sup>27</sup>

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.<sup>28</sup>

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<sup>25</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>26</sup> Id.

<sup>27</sup> 15 U.S.C. 78f(b)(5).

<sup>28</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).

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 a series of 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 emphasizes that some ETPs have had difficulty complying with the Beneficial Holders Rule. The Exchange indicates that non-compliance 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.

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. The Exchange does not explain why the manipulation and other regulatory risks would not be greater with a very small number of beneficial holders, and 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 states that no new manipulation concerns would arise with a longer Non-Compliance Period than a shorter one, and that existing surveillances and other listing standards sufficient to mitigate manipulation concerns for 12 months are sufficient for 36 months,<sup>29</sup> but does not explain in any detail the basis for this view,<sup>30</sup> or the impact of its proposal on the maintenance of fair and orderly markets or other applicable Exchange Act standards.

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<sup>29</sup> See Notice, 88 FR at 60518.

<sup>30</sup> Specifically, BZX does not discuss why it believes that existing surveillance procedures “successfully mitigated manipulation concerns” during the first 12 months after listing.

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>

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.

### III. 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, and 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>33</sup>

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<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> 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).

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change should be approved or disapproved by [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [INSERT DATE 35 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's internet comment form (<https://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-2023-062 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-2023-062. 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 (<https://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 a.m. and 3 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. Do not include personal identifiable information in submissions; you should

submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to file number SR-CboeBZX-2023-062 and should be submitted on or before [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]. Rebuttal comments should be submitted by [INSERT DATE 35 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

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)(57).