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January 29, 2018

Via Electronic Mail (pubcom@finra.org)

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: FINRA Retrospective Rule Review on the Effectiveness and Efficiency of Its Payments for Market Making Rule (FINRA Rule 5250); Regulatory Notice 17-41

Dear Ms. Mitchell:

The Securities Industry and Financial Markets Association ("SIFMA")[1] submits this letter to the Financial Industry Regulatory Authority ("FINRA") to provide comments on FINRA's retrospective rule review on Rule 5250, which limits issuers' ability to pay market makers. SIFMA supports, and appreciates, the continued enhancement of FINRA rules through the retrospective review process. As described below, we have specific recommendations for amending Rule 5250 to allow issuers of Exchange Traded Products ("ETPs"), including Exchange Traded Funds ("ETFs"), to make direct payments to market makers. In addition, we recommend that FINRA use its retrospective rule review process to consider changes and updates to all of its rules that affect ETPs.

In response to the current request, SIFMA recommends that FINRA amend Rule 5250 to allow market makers receive payments directly from ETP issuers. Our support for allowing these payments is based on the specific nature of ETPs, which draw their market price from the market price of the ETP's component securities. As a result, market makers would not have the incentive to use issuer payments to distort ETP prices. Disconnects between the price of an ETP and the price of its component securities are quickly corrected in the market, especially by arbitrage traders. Our views in this letter are limited to ETP issuers and do not apply to corporate issuers.

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1 The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

Current Rules Allow ETPs to Indirectly Pay Market Makers

FINRA Rule 5250 generally prohibits broker-dealers from accepting payments from issuers for market-making activities[2]. The historic purpose of Rule 5250 has been to safeguard that market makers act independently and avoid influencing the price of the quote to its benefit. Prohibiting issuers from paying market-makers quelled a fear that public investors would not be able to ascertain which quotations in the market are based on actual market interest and which ones are supported by issuers or promoters from issuers paying market makers.[3] More recently, FINRA amended Rule 5250 to allow exchanges to develop programs for ETP issuers to indirectly pay market makers to incentivize liquidity.[4] That rule change improved the ETP market by enhancing liquidity, narrowing spreads, reducing transaction costs, and creating a more efficient market; particularly for new and low-volume ETPs.

More specifically, the Securities and Exchange Commission ("SEC") approved rule changes filed by NYSE Arca,[5] NASDAQ,[6] and CBOE[7] to allow the exchange to serve as a conduit for ETP issuers to indirectly pay market makers. The SEC approved these incentive programs because the trading price of an ETP closely mirrors the market value of the securities it holds to prevent market makers being able to influence the price of the quote.[8] With some variances in the specifications, NYSE Arca Equities Rule 8.800, NASDAQ Rules 5950 and 7014(f), and BATS BZX Rule 11.8, generally allow ETP issuers the option to enhance liquidity by paying an additional fee, ranging from $10,000 to $70,000, to the exchanges. As per the rules, the exchanges then use this additional revenue to pay eligible market makers rebates for posting liquidity from about $0.0033 to $0.0070 per share and $0.0001 to $0.0008 per share for certain securities if the market-maker has a designated number of ETPs assigned. To be eligible for the rebates, designated market makers must meet performance standards, set by the exchanges, such as: percent of time at NBBO, percentage of executions better than the NBBO, average displayed size, and average quote spreads.

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[2] *See* Notice to Members 75-16 (February 20, 1975); Exchange Act Release No. 38812 (July 3, 1997), 62 FR 37105.

[3] *See* Notice to Members 75-16.

[4] Order Approving a Proposed Rule Change by Financial Industry Regulatory Authority, Inc. Relating to FINRA Rule 5250 (Payments for Market Making), Exchange Act Release No. 69398, 78 Fed. Reg. 24,261 (Apr. 18, 2013).

[5] *See* Order Approving a Proposed Rule Change by NYSE Arca, Inc. To Implement a One-Year Pilot Program for Issuers of Certain Exchange-Traded Products, Exchange Act Release No. 69706, 78 Fed. Reg. 35,340 (June 6, 2013).

[6] *See* Order Approving a Proposed Rule Change by NASDAQ Stock Market LLC To Establish the Market Quality Program, Exchange Act Release No. 69195, 78 Fed Reg. 18,393 (Mar. 20, 2013); *See also* Proposed Rule Change to Amend NASDAQ's Fees Rule at 7014(f), Exchange Act Release No. 78912 (September 23, 2016).

[7] *See* Rule Change to Institute an Incentive Program for Market Makers for BATS Exchange, Inc., Exchange Act Release No. 72020 (April 25, 2014).

[8] *Id.*

ETPs Structure Promotes Price Transparency

The unique structure ETPs reduces the conflict risk of issuer payments to market makers. ETFs trade at a close proximation to the value of the component securities held by the fund. Many market participants trade ETPs regularly, and any anomaly between the ETP price and the collective prices of the component securities generally are corrected through arbitrage trading. Moreover, authorized participants of ETPs help keep the prices aligned with their intrinsic value by transferring creation units when the ETP trades on the secondary market at a premium to the value of the securities and redeeming the creation units when the ETP trades at a discount. These trading characteristics increase price transparency and mitigate the risk that issuers paying market makers will prevent public investors from ascertaining the true value of the security.

Market Makers Should be Permitted to Receive Payments Directly from ETP Issuers

Amending Rule 5250 to allow market makers to receive payments directly from ETP issuers will promote efficiency, equality, and transparency in the payments. When ETP issuers pay market makers to provide liquidity through the exchanges, there is no direct correlation in the benefit paid by the issuer to what the intended party receives. The exchange incentive programs charge the issuers a flat fee and pool the money to pay out the revenues to market makers based on a volume basis. This incentivizes market makers to provide liquidity for the heavily traded ETPs, which can harm the new and less traded ETPs. The less traded ETPs, which are the most in need of support by market makers, effectively pay market-makers assigned to other ETPs, with the most going to the heavily traded ETPs. Additionally, under the exchange programs, investors, and issuers, cannot see the payments made to each market maker. Given the high costs of making a market in securities, and the reduction of firms that act as market-makers, particularly for small issuers' securities, FINRA should allow ETP issuers to directly pay the broker-dealers acting as a market maker for its securities.

Conclusion

SIFMA greatly appreciates FINRA spending the time to review its equities rules and their impact on ETPs. Amending FINRA Rule 5250 to allow market-makers to directly receive payments from ETP issuers ensures that the ETP issuer receives the full benefit of its payment for providing liquidity. Because of the ETP trading characteristics, ETP issuers paying market makers will not affect the ETP price.

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SIFMA greatly appreciates FINRA's consideration of the issues raised above and would be pleased to discuss these comments in greater detail with FINRA Staff. If you have any questions, please contact me (at 202-962-7383 or tlazo@sifma.org).

Sincerely,

Theodore R. Lazo
Managing Director and
Associate General Counsel

cc: Racquel Russell, Associate General Counsel, Office of General Counsel
Cara Rosen, Counsel, Office of General Counsel
Shawn O'Donoghue, Economist, Office of the Chief Economist