

**MEMO# 26388**

August 9, 2012

# **Draft ICI Letter on SEC Order Relating to Exchange Market Maker Incentive Programs**

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 26-12  
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 28-12  
ETF ADVISORY COMMITTEE No. 29-12  
EQUITY MARKETS ADVISORY COMMITTEE No. 17-12  
SEC RULES COMMITTEE No. 49-12 RE: DRAFT ICI LETTER ON SEC ORDER RELATING TO EXCHANGE MARKET MAKER INCENTIVE PROGRAMS

The SEC has issued an order instituting proceedings to determine whether to approve or disapprove NASDAQ's and NYSE Arca's proposed market maker incentive programs, specifically the NASDAQ Market Quality Program and NYSE Arca Fixed Incentive Program.

Comments on the order are due to the SEC by Thursday, August 16; attached is ICI's draft comment letter on the order. If you have any comments on the draft letter, please contact the undersigned at [aburstein@ici.org](mailto:aburstein@ici.org) or by phone at 202/371-5408 by COB Tuesday, August 14.

The draft letter supports the overall goal of the Programs - to incentivize market makers to make high-quality, liquid markets in ETFs. The draft letter, however, recognizes that the Programs represent a departure from current rules precluding market makers from accepting payment from an issuer of a security for acting as a market maker. The draft letter therefore reiterates many of the comments and recommendations made in ICI's previous letters on the Programs. [\[1\]](#) The letter notes that the majority of ICI members believe that the SEC should approve the Programs on a pilot basis if the Programs are modified to reflect these recommendations but that some ICI members continue to oppose the Programs and believe the SEC should not approve the proposals.

## **ICI Recommendations**

The draft letter notes that while there are a number of similarities between the Programs, there also are a number of important differences in the manner in which the Programs will

operate that can raise potential conflicts of interest between a market maker and an issuer. To address these concerns, the draft letter reiterates the recommendations contained in ICI's previous letters and states that the SEC should approve the Programs only if the changes set forth in the recommendations are implemented. Most significantly, these recommendations relate to the eligibility criteria and market maker performance standards under the Fixed Incentive Program.

## **Implementing the Programs on a Pilot Basis**

The draft letter strongly supports the establishment of the Programs on a pilot basis. The draft letter states that it is critical that NASDAQ and NYSE Arca, as well as the SEC, have an opportunity to evaluate the impact of the Programs on the quality of markets in ETFs prior to considering their permanent approval, both with respect to ETFs participating in the Programs and ETFs that choose not to participate.

## **Rule 12b-1**

The draft letter notes that the SEC order contains a brief discussion of Rule 12b-1 under the Investment Company Act; specifically, that an ETF's board of directors should evaluate the fees paid under the Programs to determine that such payments would be in compliance with Rule 12b-1. The draft letter states that it is not clear that payments under the Programs are related to distribution, the subject of Rule 12b-1, and to the extent that such payments are not related to distribution, Rule 12b-1 is inapplicable.

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Senior Counsel - Securities Regulation

[Attachment](#)

### **endnotes**

[1] The letters can be found on ICI's website at <http://www.ici.org/pdf/26142.pdf> and <http://www.ici.org/pdf/26227.pdf>.

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