

MEMO# 26227

June 11, 2012

ICI Letter on NYSE Arca Proposal to Establish a Market Maker Incentive Program

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 32-12
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 16-12
ETF ADVISORY COMMITTEE No. 14-12
EQUITY MARKETS ADVISORY COMMITTEE No. 12-12 RE: ICI LETTER ON NYSE ARCA
PROPOSAL TO ESTABLISH A MARKET MAKER INCENTIVE PROGRAM

ICI has filed a letter with the SEC on an NYSE Arca proposal to establish the Lead Market Maker (“LMM”) Issuer Incentive Program (“Fixed Incentive Program”) for issuers of certain exchange-traded products (“ETPs”) listed on the Exchange.

The letter supports the overall goal of the Fixed Incentive Program - to incentivize market makers to make high-quality, liquid markets in ETPs. At the same time, the letter recognizes that the Fixed Incentive Program represents a departure from current rules precluding market makers from accepting payment from an issuer for acting as a market maker and raises concerns whether payments under such programs create conflicts of interest between an issuer and the market maker for a security.

The letter notes some of the differences between the Fixed Incentive Program and market maker incentive programs offered by other exchanges. The letter states that some of these differences could raise potential conflicts of interest between an LMM and an ETP issuer. Specifically, certain elements of the proposal could provide incentives or opportunities for LMMs to pressure ETP issuers to place each and every ETP listed on the Exchange in the Program, and therefore generate the maximum amount of additional fees from an issuer, or face the threat of the withdrawal of the LMM from making a market in that issuer’s ETPs.

The letter provides several recommendations to address these potential conflicts of interest as well as other comments on the proposal. Most significantly:

- The letter recommends that NYSE Arca limit the type of ETPs permitted in the Program based on trading volume and states that it would be appropriate for an ETP to be removed from the Program once it reaches a certain liquidity level or volume

threshold.

- The letter supports the flexibility provided to issuers to choose the LMM they desire for their ETP as well as allowing issuers and LMMs to negotiate the specific additional fee. However, to address concerns regarding potential conflicts of interest, the letter recommends that NYSE Arca establish objective performance standards for LMMs participating in the Program and require that these standards be higher than the current LMM performance standards.
- The letter supports the requirement limiting the number of ETPs from a single issuer in the Program to not more than five existing ETPs to prevent any incentive for LMMs to pressure ETP issuers to place each and every ETP listed on the Exchange into the Program.
- The letter strongly supports the establishment of the Fixed Incentive Program through a pilot program and states that it is critical that NYSE Arca and the SEC have an opportunity to evaluate the impact of the Program on the quality of markets in ETPs prior to considering its permanent approval, both with respect to ETPs participating in the Program and those ETPs that choose not to participate.

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Senior Counsel - Securities Regulation

[Attachment](#)

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