

MEMO# 26217

June 5, 2012

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

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 17-12
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 15-12
ETF ADVISORY COMMITTEE No. 13-12
EQUITY MARKETS ADVISORY COMMITTEE No. 11-12 RE: DRAFT ICI LETTER ON NYSE ARCA PROPOSAL TO ESTABLISH A MARKET MAKER INCENTIVE PROGRAM

As we previously informed you, NYSE Arca has filed a proposal with the SEC 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.

Comments on the proposal are due to the SEC by Thursday, June 7; attached is ICI's draft comment letter on the proposal. If you have any comments on the draft letter, please contact the undersigned at aburstein@ici.org or by phone at 202/371-5408 by COB Wednesday, June 6.

The draft 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 draft 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 draft letter notes some of the differences between the Fixed Incentive Program and market maker incentive programs offered by other exchanges. The draft 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 draft letter provides several recommendations to address these potential conflicts of interest as well as other comments on the proposal. Most significantly:

- The draft 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 draft 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 draft 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 draft 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 draft 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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[Attachment](#)