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Request for Comment on Exchange Traded Products

ETPs have become a very important product in the global financial markets and continue to expand in both depth of ownership by retail and institutional investors and complexity of their investment strategies. I have a history in the ETP global marketplace dating back to 1991 and I have participated in the launch of over 400 ETPs globally. My comments to the Commission are from my perspective as an ETP consultant to issuers, ETP operations, and outsourced Chief Operating Officer for multiple ETP issuers.

I have been before the Commission on many occasions to discuss new product concepts, product attributes, exchange rules, oversight methods, and market making strategies. In the early 90's I worked with large groups within the Commission to educate the various Divisions within the SEC about the key attributes needed to move the Commission to approve the first 40 Act ETFs called WEBS. After I left Morgan Stanley, WEBS were later sold to Barclay Global Investors and rebranded as iShares. I have worked with many governments and exchanges in the global market to write, and review ETP laws and market regulations supporting ETFs. ETFs have help to advance foreign capital markets and attract foreign investments into their countries.

I believe the overall success of the U.S. ETP marketplace, consisting of Index Depository Receipts, Exchange Traded Funds [ETFs], Exchanged Traded Commodity Pools [ETCs], Exchange Traded Notes [ETNs]; Equity Linked Notes [ELNs], Paired Shares [MacroShares and AccuShares] and in the near future NextShares; is directly related to the transparency of the investments holdings, low ownership fees, reduced capital gains, efficient exchange markets, the disclosure of fund holdings, and performance against the NAV.

Unlike mutual funds, in times of market stress the investor can execute an exchange transaction or hedging transaction that can immediately increase or decrease their market exposure at a known price or difference to a known price. Exchange limit orders on an entire basket of known securities provides a level of certainty of execution that can't be achieved through the mutual fund NAV price at the close of the exchanges.

I believe the ETP recommendations made below will help to expand the acceptance an investor diversification and continue to reinforce the transparency of this marketplace in the U.S. I hope they will also serve as a guidepost for global regulators.

Investor confidence in ETPs, through the use of the inkind creation and redemption, will continues to instill within the investment community the investor confidence that assets are backing the ETP shares, [excluding ETNs and ELNs]. Additionally, the trading of ETPs on equity exchanges permits the arbitrage process to build boundaries to enforce tight trading markets.

My ETP recommendations to the Commission are as follows:

1. The Commission needs to either repeal or significantly modify rule NMS. This rule has created many of the abuses and opportunities for the ibanks and HFT traders to abuse the investing public and institutional investors.

   Many U.S. investors have lost confidence in the equity markets, the execution of their trades, and Regulation NMS continues to erode our domestic capital markets through its un-level playing field. As SROs have become public entities, their focus on quarterly earnings has driven the adoption of rules favoring the sale of investor information before it enters the execution process and the adoption of exchange rules favoring the ibanks and HFT traders over the investing public.

   The SEC must accept the responsibility for this well intentioned mess and accept the premise that Regulation NMS removed a very large level of competition represented by a exchange structures that the ibanks wanted and lobbied for with the Commission to eliminate. The specialist markets may have cost investors millions, but the current structure has given the ibanks and HFT traders billions.

   This all electronic stock market, will little or no human intervention, presents the ibanks and HFT traders the continued perfect opportunity to exploit the public and dark pool investors. Their lobby dollars have purchased the future order flow of investors. The SROs and dark pools have not added stability or investor confidence which many of their new rules and rebate programs, but have delivered volatility and a pay-to-play mentality that continues to reduce the number of investors sending orders to the exchange and holding ETPs and individual stocks in their portfolios. The flash crash and the mortgage crisis, directly related to HFT traders and ibank desks has created a level of distrust in the markets that many have found difficult to forget and are still trying to recover the wealth they loss from these two events.

2. Clear statements must be shown on listed ETP websites stating the regulatory structural under what they were issued by the SEC or Finra so that it clearly states if the ETP is an index depository receipt, commodity pool, 40 Act funds, grantor trust, 33 Act structures, etc. and it must show in bold print the minimum capital gains tax applies for each listed ETP and the tax form the investor will receive at the end of the year.

The Commission and its staff must clearly understand the structural and tax issues around each product type and insist that the issuers use these types in their marketing material as to the generic term “ETF”. Stating this within the prospectus does not go far enough to avoid the investor tax confusion.

This rule will permit investors to judge the product’s ownership risks, and investor’s future tax obligations quickly and clearly. Issuers should be required to state the Commission’s regulatory definition of each product type on their website and the major differences to a traditional 40 Act ETF.

3. ETN sponsor/issuer/marketing agents should be required to place on a designate portion of the product’s public website the three major current credit ratings of the issuing or supporting bank of the ETN. This rating must be given to the listing exchange on the launch date of the ETN and the ETN issuer must advise the public and the exchange when any one of the three major rating agencies changes their credit rating up or down. This information is crucial to the public and market makers in the ETNs and will play a role in AUM growth, decline and market spreads to investors.

4. Each Index Depository Receipt, ETF, or ETC should disclose on a dedicated website location the estimated investment capacity of the investment strategy of the ETP.

   The SEC, Finra, or other designated market participant should define how this is to be measured. Any calculation results above $50 billion USD would state “in excess of $50 billion” within the factsheet and a designated field on the ETP website. This would permit advisors and investors to immediately establish asset ownership barriers based on the investment capacity risks, as determined by a standard set of calculations for ETPs. This recommendation should be extended to mutual fund issuers as well.

   As more self-index issuers enter the ETPs marketplace investors need to understand the AUM capacity of the ETP product to determine if the investment product can handle excessive growth or declines under various market conditions.

5. All ETF issuers must be required to disclose on the product website the expected Total Expense Ratio (“TER”) for the next calendar quarter as calculated on the then current quarter-end AUM levels of the ETF.

   This process occurs between the Fund Admin and the ETF CFO at the start of each quarter in order to accrued expenses for the upcoming quarter. Too often investors are “surprised” when their ownership fees exceed the prospectus estimated expense ratio. This recommendation should be extended to the mutual fund issuers as well.

6. The website of ETP issuers should be required to publish their SEC exemptive relief/reliefs and list the ETPs issued under each of their relief/reliefs.

The exemptive relief text is often one of the most difficult documents to locate on Edgar and a PDF of this relief would benefit investors and their understanding of how ETPs work.

7. The ETP website should clearly define its' benchmark and show its' exchange symbol. For ETPs with no benchmarks their websites should clearly state “absolute return”.

8. The listing SROs should be required on their website to show each listed ETP symbol and the exchange rule under which the product is initially listed, and highlight the continued listing requirements of the issuer on a separate and clearly identifiable webpage. Too often exchanges trade ETPs under UTP privileges without adopting the proper exchange trading rules [19b4s], or ongoing surveillance mechanisms needed to enforce the 19b4s. Issuers also need to know how the exchange intends to enforce continued listing standards for any ETP so the issuer can design the proper control standards and procedures for maintenance of the ETP listing.

   Certain exchanges are known to copy and paste another competitor's exchange rules into a 19b4 request to the Commission without any fundamental understanding of the rule and what surveillance procedures will be needed to support the current and future trading of the ETP. The publication of this page will force all the exchanges to develop the necessary controls, surveillance procedures and data sources necessary to meet their rules. Issuers should be required on the product's webpage to point to the listing exchange's URL where this information is shown.

9. ETF websites should publish the daily their PCF files to the product website as .xls or .csv file. The issuers should be required to periodically display the associated IIV/IOPV across their websites during the trading day. Currently the PCF is only available to professional thru the NSCC and this would permit “involved” investor to understand what happens during rebalancing periods. Previously the PCF file was sent to the NSCC in two pieces consisting of the PLF A and PLF B components. With the new single format the PCF file the process should be easier for the custodian to product and distribute this file to the website.

   The major data venders and the exchanges have not made the IIV/IOPV easy for investors to display this information as each has adopted different symbol presentation logic for the IIV. The exchanges and major data distributors need to adopt a standard format for the symbol logic representing the IIV. The daily publication of the PCF file, which should be available to all investors and the IIV prices distribution, will facilitate the accurate investor's selection of the limit prices for their orders. It would also clearly show the downside of placing market orders on ETPs to the exchanges.

10. Several issuers in the ETF marketplace have exemptive reliefs that permit non-pro rata redemption baskets. This is beneficial to the investors during rebalancing period of the ETF. This exemptive approval should be available to all ETF issuers for the benefit of all investors.

11. It is recommended that the SEC should make it a priority over the next two years to bring transparent bond trading to the capital markets. Many new bond ETPs are expected to enter the market as yields increase and it would benefit investors if they understood the different pricing levels for round lot and odd lot bond sizes.