August 17, 2015

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Submitted via email: rule-comments@sec.gov

Re: Request for Comment on Exchange-Traded Products;
File Number S7-11-15

Dear Mr. Fields:

State Street Global Advisors (“SSGA”) supports the efforts of the Securities and Exchange Commission (“SEC” or “Commission”) to seek additional information regarding the listing and trading of exchange-traded products on national securities exchanges and sales of these products by broker-dealers. Recognized as an industry pioneer, State Street Corporation created the first United States listed exchange-traded fund in 1993 (SPDR S&P 500® – Ticker: SPY) and has remained on the forefront of responsible innovation, as evidenced by the introduction of many ground-breaking products, including first-to-market launches with gold, international real estate, international fixed income, and sector ETFs. SSGA manages approximately $412 billion in SPDR ETF assets worldwide (as of June 30, 2015) and is one of the largest ETF providers in the U.S. and globally.

SSGA welcomes the opportunity to provide comments regarding the Commission’s oversight of the listing and trading of ETPs on national securities exchanges. Our comments focus primarily on the arbitrage mechanism of exchange-traded funds (“ETFs”) as well as the exchange listing process. SSGA believes that the ETF arbitrage mechanism helps to ensure efficient market pricing for ETFs throughout periods of market volatility, including times of market stress. SSGA also believes that ETFs can serve as valuable price discovery tools, particularly in stressed markets. Finally, SSGA concurs with the view of the Investment Company Institute that enhanced certainty and uniformity is needed for the ETF listing process.
The ETF Arbitrage Mechanism

As noted in the Request for Comment, arbitrage mechanisms are designed to keep intraday trading prices of ETFs equal (or nearly equal) to the contemporaneous value of the underlying portfolio or reference assets. The premium or discount of an ETF’s market price to the net asset value of the ETF’s underlying basket of assets is one of the important drivers of the creation and redemption process of ETF shares. Authorized Participants (“APs”) may create or redeem ETF shares directly with the ETF, resulting in an increase or decrease in the supply of available ETF shares in the marketplace. There are a number of reasons why an AP might create or redeem ETF shares, including: arbitrage, inventory management, customer facilitation, or equity finance/stock loan. As a result of such creation and redemption activity, APs may be able to realize financial gain through arbitrage opportunities in the market.

ETF shares, like individual equity securities, trade on an exchange and can be bought and sold at any point during trading hours at their current market value. In the secondary market, market participants post bids and offers at price levels they are willing to buy or sell a particular number of shares of a given ETF. As the market price of an ETF decreases in value relative to the net asset value of the ETF’s portfolio securities, arbitrageurs have a financial incentive to: 1) purchase ETF shares in the open market; 2) redeem a Creation Unit’s worth of ETF shares directly with the ETF in exchange for an in-kind distribution of portfolio securities; and 3) sell the portfolio securities for a profit.

For example, if shares of an ETF are trading at $55.00 in the secondary market and the net asset value of the underlying basket of securities of the ETF is $54.95 per share, an inherent arbitrage opportunity exists. A real time indicator of the value of the underlying basket of securities of each ETF is published every fifteen seconds by the listing exchange and is commonly referred to as the Indicative Net Asset Value or iNAV. As a general matter, APs tend to be sophisticated financial institutions which generally maintain proprietary systems to price an ETF’s underlying holdings throughout the day. In order to realize on the arbitrage opportunity, the AP would sell (short) ETF shares at $55.00 per share and hedge its position by purchasing the corresponding underlying basket of securities for $54.95 per share, thus locking in the $0.05 per share profit. The AP then has the ability to create shares of the ETF at the end of the day with their long position in the corresponding underlying securities of the ETF. The AP would then close out its short position in the ETF using these newly created ETF shares. This example produces a $0.05 per share profit for the AP. More importantly, however, is that this process generally serves to keep premiums and discounts in check as it holds the ETF’s market price in line with the
net asset value of its underlying securities and provides liquidity in both the ETF shares as well as the underlying securities. Similarly, as the market price of an ETF increases in value relative to net asset value of the ETF’s portfolio securities, arbitrageurs have a financial incentive to: 1) aggregate the portfolio securities in an ETF’s basket; 2) purchase ETF shares directly from the ETF with a Creation Unit’s worth of the portfolio securities; and 3) sell the ETF shares for a profit.

ETFs Continue to Trade Effectively Even in Volatile Environments

In the most volatile markets over the last fifteen years, ETFs have continued to trade effectively. We have observed that ETF trading volumes increased sharply in September 2001 and in late 2008 as investors looked to ETFs for their key attributes of transparency and liquidity.

Fixed income ETFs, in particular, tend to see increased secondary market liquidity during volatile market periods. In fact, high yield fixed income ETF volume and credit spreads have shown a propensity to move in tandem during volatile times. For example, as shown in the below, when the price of oil precipitously fell in the second half of 2014, it sparked contagion fears within the markets, specifically in the high yield fixed income markets.

High Yield ETF Trading Volumes vs. High Yield Spreads

Source: SSGA, Bloomberg, Barclays as of 2/28/2015. Past performance is not a guarantee of future results.
However, during this time, the SPDR® Barclays High Yield Bond ETF (Ticker: JNK) provided a high level of market liquidity by trading as much as 19 million shares ($779 million notional) on October 10, 2014, nearly twice as much as its previous 30 day daily average. In essence, during volatile times, fixed income ETFs have provided liquidity and price discovery for market participants when the underlying fixed income markets might not be reacting as quickly. The liquidity in the secondary market, along with the creation and redemption mechanism, provides investors with the potential to transact at fair and orderly prices.

As a result of the dynamics of fixed income pricing, fixed income based ETFs generally trade at a premium to their net asset value. The reason is that the ETF will most often trade at the midpoint of the underlying basket bid/ask spread, while the net asset value is typically priced using the bid side of the market. During fear driven market environments (e.g., the 2011 U.S. debt ceiling debate; the so-called “Taper Tantrum” of May 2013; and the oil sell-off of 2014), fixed income ETFs may see their premiums diminish and begin trading at a discount to NAV. When this occurs, the discount conveys a general market sentiment and reflects the risk which market makers face selling the underlying bonds.

The net asset value of a fixed income ETF’s underlying portfolio holdings may not always be reflective of the true market price of such securities during times of stress as certain underlying securities trade infrequently. In other words, ETFs can act as a principal price discovery vehicle for what the capital markets view as fair value. ETFs can provide insights into the market’s view on correct market pricing even during periods when the underlying liquidity for an asset class is diminished. The figure below highlights the premium and discount mechanism during times of stress.
Between October 2012 and February 2015, the SPDR® Barclays Short Term High Yield Bond ETF (Ticker: SJNK) traded at an average premium of 26 basis points (0.26%). However, when negative oil related sentiment pushed credit markets lower in the second half of 2014, the premium evaporated and turned into a discount. The ETF traded below the net asset value of its underlying holdings for multiple days as the market reassessed the fair value for high yield instruments in real time. Once the primary market adjusted to the environment, the ETF reverted back to trading within its normal premium range.

Unlike equity securities, which are traded on exchanges with transparent pricing, fixed income securities are bought and sold over-the-counter in a decentralized market where certain issues do not trade on a daily basis and pricing is far less transparent to investors. Relatively illiquid fixed income securities, such as municipal bonds, may not reflect the most recent information about the security’s fundamentals because the bonds may not have traded in a considerable time period and may, in fact, incorporate stale pricing. In periods of increased market
volatility, this discrepancy can create a situation in which the ETF actually serves as a more accurate price discovery tool for the asset class. The ETF trades at a price which reflects the true fair value of its holdings based on all publicly available information about the asset class. In turn, what may appear to be a discount or premium between the market value of the ETF and the net asset value of its portfolio holdings is simply a truer reflection of the market’s pricing of the value of the underlying securities.

Since fixed income transactions occur outside of an exchange, they generally lack the transparency that ETFs offer. This opaqueness may exist for ETF market makers and dealers who transact in the underlying securities of ETFs as well. When the fixed income market sells off rapidly, dealers look to gather information on the state of the market, and one prominent and easily accessible way of doing so is through ETFs. When the ETF market price moves far enough away from a dealer’s estimate of the fair value of the its underlying portfolio securities, a dealer will look to take advantage of the arbitrage opportunity through the ETF creation/redemption process, which helps to improve the overall efficiency of the product. This mechanism is a benefit to investors and highlights how ETFs offer multiple layers of liquidity to various investor types.

Since ETFs trade on an exchange, they often offer superior price transparency, tighter bid/ask spreads and more layers of liquidity than can be found in most segments of the fixed income market. For instance, on screen liquidity for ETFs that track niche areas of the market, such as high yield, trade at spreads roughly forty times tighter than the underlying basket of constituents. Furthermore, these tight spreads are accompanied by an abundance of volume on the secondary market as shown below by JNK, which has an average 30 day trading volume of six million shares ($237 million notional).

<table>
<thead>
<tr>
<th>Market Liquidity</th>
<th>JNK</th>
<th>SJNK</th>
<th>SPGB</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUM</td>
<td>11,809</td>
<td>4,129</td>
<td>3,906</td>
</tr>
<tr>
<td>Average 30 Daily Share Volume (M)</td>
<td>6.0</td>
<td>1.7</td>
<td>1.4</td>
</tr>
<tr>
<td>Average 30 Daily $ Volume (M)</td>
<td>237.3</td>
<td>50.2</td>
<td>41.9</td>
</tr>
<tr>
<td>Average 30 Day Bid Ask Spread (bps)</td>
<td>0.03%</td>
<td>0.04%</td>
<td>0.04%</td>
</tr>
<tr>
<td>Basket Bid Ask Spread (bps)</td>
<td>1.30%</td>
<td>1.31%</td>
<td>0.40%</td>
</tr>
</tbody>
</table>

If an ETF’s market price diverges from the net asset value of its underlying holdings, the ETF structure preserves the ability of investors to transact at a known price in
difficult market environments. In fact, ETFs are often considerably less expensive to trade than their underlying holdings. Even incorporating additional expenses, such as expense ratios, potential market impact and opportunity costs, ETFs will frequently be advantageous to constructing a portfolio of individual bonds from a cost perspective.

**Primary Market Transactions in ETFs Create Liquidity**

Unique to ETFs, the “in kind” transaction in the creation/redemption process, in which shares are traded instead of cash, provides institutions with the ability to gain fast, cost efficient exposure to an ETF’s underlying securities without negative implications or added fees for existing ETF shareholders. Because investors are not affected by other shareholder redemptions, the creation/redemption process may also improve overall tax efficiency. Increased ETF trading activity and market volume typically results in a tightening of bid/ask spreads, which benefits all investors due to decreased costs of execution.

**The Current 19b-4 Process**

SSGA concurs with the view of the Investment Company Institute that the current 19b-4 process unnecessarily slows the launch of innovative ETFs, thereby depriving investors of investment options. For example, in respect of the SPDR® DoubleLine Total Return Tactical ETF (Ticker: TOTL), the NYSE ARCA began discussions with the SEC in June 2014. Discussions continued until December 30, 2014, when the proposed rule change to list and trade shares of TOTL was filed with the SEC. The proposed rule change was granted on February 20, 2015. The eight months was generally considered to be a fast 19b-4 process. In the time since the launch of TOTL, it has garnered over $1 billion in assets, evidencing a clear marketplace desire for the product. SSGA strongly supports the issuance of generic listing standards for actively managed ETFs.

SSGA appreciates the opportunity to comment on the Commission’s oversight of the listing and trading of ETPs on national securities exchanges and commends the Commission and its staff for their efforts in reviewing such oversight. Should you have any questions about our comments, please do not hesitate to contact me.
Respectfully yours,

Joshua A. Weinberg  
Vice President and Managing Counsel  
State Street Global Advisors

cc:  
The Honorable Mary Jo White, Chairman, Securities and Exchange Commission  
The Honorable Luis A. Aguilar, Commissioner, Securities and Exchange Commission  
The Honorable Daniel M. Gallagher, Commissioner, Securities and Exchange Commission  
The Honorable Michael Piwowar, Commissioner, Securities and Exchange Commission  
The Honorable Kara M. Stein, Commissioner Securities and Exchange Commission  
David Grim, Director, Division of Investment Management, Securities and Exchange Commission