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EVP & Corporate Secretary
General Counsel, NYSE Markets

NYSE EURONEXT

August 14, 2012

VIA E-MAIL & FED EX

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. SR-NYSEArca-2012-37 – Response to Comments

Dear Ms. Murphy:

This letter responds to the comments submitted to the Securities and Exchange Commission ("SEC" or "Commission") regarding the above-referenced rule filing, in which NYSE Arca, Inc. ("NYSE Arca" or "Exchange") proposes to create a Lead Market Maker ("LMM") Issuer Incentive Program on a pilot basis ("Pilot Program") for issuers of certain exchange-traded products ("ETPs") listed on the Exchange in order to incentivize market makers to undertake LMM assignments in certain ETPs.

As described in the rule filing, the Exchange proposes to add new NYSE Arca Equities Rule 8.800, which would govern the Pilot Program. Under the Pilot Program, certain issuers of certain ETPs could elect to pay the Exchange an Optional Incentive Fee, which would range from $10,000 to $40,000 per year. The Exchange would credit the assigned LMM with the LMM Payment, which would be equal to the Optional Incentive Fee paid by the issuer, less an Exchange administration fee. If an LMM did not meet or exceed its minimum performance standards for the ETP for a particular month, then the LMM Payment would be prorated accordingly. As is the case with all liquidity-adding credits currently payable to NYSE Arca members, LMM Payments would be paid directly by the Exchange from its general revenues.

The SEC published notice of the rule filing ("Notice") on May 11, 2012[1] and received four comment letters.[2] Additionally, the SEC subsequently published an order ("Order") instituting proceedings to

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1 Securities Exchange Act Release No. 66966 (May 11, 2012), 77 FR 29419 (May 17, 2012) (SR-NYSEArca-2012-37).

2 Letter from Gus Sauter, Managing Director and Chief Investment Officer, Vanguard, dated June 7, 2012 ("Vanguard Letter"); letter from Ari Burstein, Senior Counsel, Investment Company Institute ("ICI"), dated June 7, 2012 ("ICI Letter"); letter from John Hyland, Chief Investment Officer, United States Commodity Funds LLC ("USCF"), dated June 27, 2012 ("USCF Letter"); and letter from Joseph Cavatoni, Managing Director, and Joanne Medero, Managing Director, BlackRock, Inc., dated July 11, 2012 ("BlackRock Letter").

determine whether to approve or disapprove the proposed rule filing[3] and requested comment on certain issues identified in the Order. While some of the comments included suggestions for improving the Pilot Program, most of the commenters were generally supportive of the proposal. The Exchange's response to the comment letters as well as to the SEC's request for comment is set forth below. For the reasons set forth below, the Exchange believes that the potential benefits of the Pilot Program are significant, and the Commission should approve the Pilot Program as proposed.

RESPONSE TO COMMENT LETTERS

Several commenters recognize the benefits of offering the Pilot Program to promote more efficient and robust markets for ETPs.[4] The Exchange agrees with the comment that new ETPs may take time to establish liquidity and trading volume in the marketplace; current programs may provide an insufficient incentive to outweigh the risks, obligations and capital commitments required of the assigned market maker, known as the LMM on NYSE Arca.[5] Another commenter encourages programs that make it possible for all firms to list new securities and to receive adequate support from the market-making community.[6] By allowing innovation to occur from a source other than large issuers, the Pilot Program may provide a valuable benefit to investors, as well as alleviate regulatory concerns about various parties becoming too dominant in any financial space.[7]

All three listing venues for ETPs in the United States are currently focusing on the issue of ETP liquidity and are aggressively pursuing new, innovative approaches to incentivize market makers as ample proof of the significance of this issue and suggest the need for improvements. Further to that point, the Exchange agrees that there may be more than one effective way to improve the markets for ETPs.[8] Therefore, each of the exchanges' programs merits an opportunity to prove its ability to improve the liquidity and transparency of ETP markets. Such programs should benefit ETP shareholders, not merely subsidize market makers and liquidity providers.[9] The Exchange also notes that there is support in Congress for enhancing liquidity for small public companies.[10]

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3 Securities Exchange Act Release No. 67411 (July 11, 2012), 77 FR 42052 (July 17, 2012) (File Nos. SR-NASDAQ-2012-043 and SR-NYSEArca-2012-37).

4 BlackRock Letter, ICI Letter, and USCF Letter.

5 BlackRock Letter.

6 USCF Letter.

7 BlackRock Letter.

8 Id.

9 Id.

10 See H.R. 6127, 112th Congress (2012). The text of the bill is available at http://www.govtrack.us/congress/bills/112/hr6127/text.

Benefits to Investors

One commenter asserts that paying market makers should only be allowed if the rationale is compelling and the exception is narrowly tailored to accomplish a public policy goal, such as providing demonstrable benefits to long-term investors, and that the Exchange has not met this standard.[11] The Exchange believes that the Pilot Program's ultimate goal of improved market quality is a compelling rationale that will inevitably benefit investors and the marketplace as a whole. The Exchange also believes that the proposal is properly tailored to reach these goals with LMM performance standards that are more stringent than other current and proposed market quality programs on competing trading venues. The proposed rule change would not mandate payments to LMMs but rather would permit the practice only within the confines of the Pilot Program, leaving the decision up to the issuer as to whether it wants to participate in the Pilot Program. Under current SEC and FINRA rules, issuers are prohibited from paying market makers in certain circumstances.[12] In the Exchange's view, such compensation would not be problematic if administered by an independent third party, such as the Exchange, and overseen by the appropriate regulators. For the ETPs in the Pilot Program, the Exchange will monitor the LMM performance and only pay the quarterly payment if the LMM meets or exceeds the performance standards. Otherwise, if the LMM fails, the issuer will receive a credit back to its account.

The derivative and open-ended nature of the ETPs eligible to participate in the Pilot Program allows for transparent intrinsic intraday pricing; therefore, concerns that issuer payments to market makers may lead to market manipulation should be sufficiently dampened as to make the prohibition unnecessary in this context. The transparent nature of an ETP's portfolio composition as well as its accessibility and the elasticity of shares outstanding contribute to an arbitrage process that will lead to executions of orders priced at or near net asset values ("NAVs"). Underlying assets are disseminated daily via a portfolio composition file ("PCF") by the National Securities Clearing Corporation or the issuer's custodian. The PCF represents large notional portfolios that are packaged into "units" or blocks of shares. The typical unit size is 50,000 shares to 100,000 shares and each share represents fractional ownership of the portfolio, allowing low minimum investments to access the exposure of a large notional portfolio. ETP supply (i.e., shares outstanding) can be increased or decreased through the creation and redemption process. Clearing firms that are authorized participants are able to deliver, or take delivery of, unit-sized amounts of the underlying securities. Proprietary traders engaging in arbitrage are able to calculate the intraday NAV using the daily PCF, understand what the intrinsic per-share price is, hedge themselves using the underlying securities or correlated equivalents, and manage their positions by either creating or redeeming units. If and when the quote is priced beyond the intrinsic value of an ETP, an arbitrage opportunity can arise, and market participants will arbitrage such spread until price equilibrium is restored.

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11 Vanguard Letter.

12 See SEC Rule 102 under Regulation M and FINRA Rule 5250. The Exchange notes that H.R. 6127, supra note 10, would encourage stock exchanges to develop programs that permit their listed companies to pay market makers to support the companies' stocks and void the rules of FINRA that bar the payments.

One commenter asserts that NYSE Arca's focus is on the needs of the market makers, not the investors, and argues that NYSE Arca has provided little evidence demonstrating how the Pilot Program will benefit investors.[13] Another commenter suggests that the SEC consider issues raised by the proposed rule change and the impact it would have on investors, not just issuers.[14]
The Exchange believes that it has appropriately considered the impact on investors and that the presence of an LMM enhances market quality, thereby benefiting investors. The Exchange believes that there is ample evidence, along with logical inference, to support the assertion that the presence of an obligated and accountable liquidity provider leads to superior market quality and thus benefits long-term investors. Under the NYSE Arca market model, the term used to define the liquidity provider with the most obligations and accountability is the LMM. When there is an LMM assigned to a security listed on NYSE Arca, long-term investors trading on the Exchange in the secondary market would likely be enhanced compared to similar securities where there are no LMMs assigned.

For instance, in the second quarter of 2012, there were 570 ETPs listed on NYSE Arca that traded less than 10,000 shares consolidated average daily volume ("CADV"). Of those ETPs, 519 had LMMs while 51 did not. The average spread for the symbols with LMMs was 0.73% and the average quote size was 2,844 shares. The average spread for the symbols without LMMs was 5.62% and the average quote size was 1,075 shares. During the same time period, there were 447 ETPs listed on NYSE Arca that traded between 10,000 shares and 100,000 shares CADV. Of those ETPs, 434 had LMMs while 13 did not. The average spread for the symbols with LMMs was 0.26% and the average quote size was 4,703 shares. The average spread for those without LMMs was 0.52% and the average quote size was 3,217 shares. Exhibits 1 and 2 illustrate that these observations were consistent over longer time periods and also show that the volatility of market quality is greater for securities without LMMs. All open-ended ETPs trading over 100,000 CADV had LMMs except SPY, which has significant liquidity without the need for an LMM. Thus, enabling issuers to compensate LMMs in order to retain them in their role or attract new LMMs is in the best interest of long-term investors and public policy.[15]

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13 Vanguard Letter.

14 ICI Letter.

15 The Exchange further notes that the standard for approving a proposed rule change is not that it meet a general public policy goal with respect to just one class of investors. Rather, Section 6(b)(5) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), sets forth specific statutory standards that an exchange's proposed rule change must meet, namely that it is designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information with respect to, and facilitating transactions in, securities; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest. The Exchange included an extensive discussion of how the proposed rule change meets these standards in the rule filing. See supra note 1.

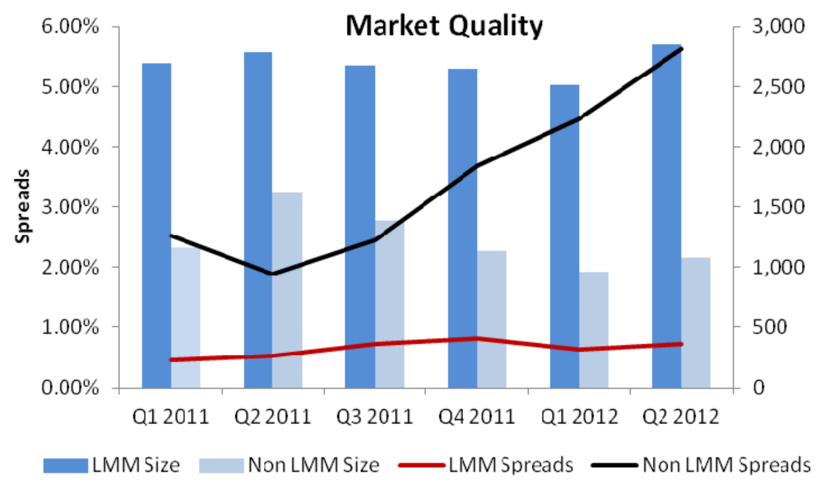

Exhibit 1: ETPs with CADV of less than 10,000 shares (2011–2012)
Source: ArcaVision.com

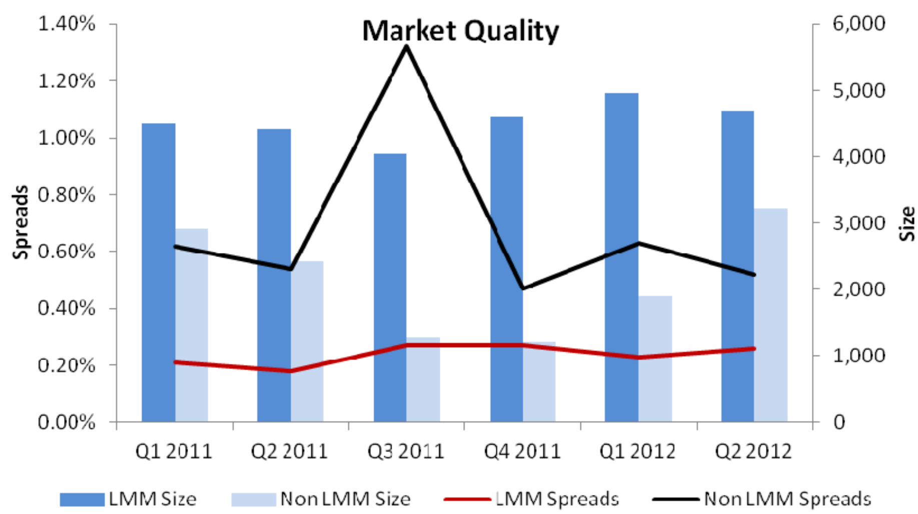

Exhibit 2: ETPs with CADV between 10,000 shares and 100,000 shares (2011–2012)
Source: ArcaVision.com

Need to Attract and Retain LMMs

One commenter also notes that more than 90% of ETPs manage to attract and retain LMMs, and thus "rolling back a long-standing investor protection principle" is not justified.[16] While the majority of ETPs

[16] Vanguard Letter.

historically have listed with the presence of LMMs, the disturbing trend, confirmed by one commenter,[17] is the increasing number of ETPs that are listing without them. Prior to 2006, no ETPs were listed without the presence of an obligated and accountable liquidity provider operating on the primary market. However, in 2010 and 2011, roughly 10% of ETPs were listed without LMMs. This represents tremendous growth and anecdotal evidence, including feedback from the liquidity provider community, suggesting that the trend will continue or worsen if there is no mechanism to appropriately remunerate capable market makers to take on the obligations and accountability that are part and parcel of LMMs' assignment. The Exchange is concerned that this would not be limited to future listings and that existing listings could also be subject to LMM withdrawals.

An intermediate goal of the Pilot Program is to increase the supply of market makers seeking to take on LMM assignments, ultimately leading to improved market quality for long-term investors in ETPs. The Exchange believes that meeting this intermediate goal would provide multiple benefits. It would ensure that a diversified pool of qualified LMM candidates from which issuers may choose exists in the present and future. It would also help to discover a competitive balance to set the fair Optional Incentive Fees within the proposed range of $10,000 to $40,000 per ETP annually, based on the risk/reward of receiving specific LMM assignments. If there are more market makers willing to take on LMM assignments, an issuer would have a better chance of ensuring that the most qualified firm is allocated the designation and that the Optional Incentive Fee would not be overly burdensome for the issuer given the expected benefits. Issuers are able to monitor the performance of LMMs as well as registered market makers and other participants that have opted into the "ArcaVision Market Maker Summary"[18] reporting mechanism. Thus, issuers would be able to compare and contrast the performance of various market makers to ensure that they are optimizing benefits vis-a-vis cost. To the extent that current NYSE Arca-enhanced rebate compensation arrangements based on traded volume are sufficient and fair, there would be no need for issuers or LMMs to participate in the Pilot Program.

Two commenters noted that the Pilot Program would permit only one LMM to receive the incentive payment, whereas the proposal offered by another exchange would include multiple market makers in its program.[19] The Exchange notes that its market structure has long included an LMM structure. The Exchange is also proposing a range of fees that is lower than the other exchange; at the lower end of that range, the incentive might not be sufficient if the fee had to be divided among multiple market makers. In any event, the Exchange believes, as noted by one commenter,[20] that there may be various ways to improve the market for ETPs, and permitting various approaches as part of pilot programs will allow the exchanges and the Commission to consider the benefits of different program features. During

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17 USCF Letter.

18 ArcaVision.com is a website offered by the Exchange to member firms and issuers for the purpose of aggregating market data statistics. The Market Maker Summary report is available to Exchange staff and issuers (for their own securities) to track the performance of certain market participants.

19 Vanguard and ICI Letters.

20 BlackRock Letter.

the Pilot Program, the Exchange will have an opportunity to consider whether a competing market maker model would be preferable.

Performance Standards

Two commenters state that the Pilot Program should impose a higher minimum performance on LMMs;[21] one commenter states that such performance standards should be transparent to issuers and investors.[22] Prior to submitting the proposed rule change, the Exchange considered the need to implement higher quote standards and determined that it would be detrimental to the previously stated goals. The current NYSE Arca LMM quote requirements are already stringent and when coupled with the volume-based incentive currently in place, potentially hinder market makers from participating in the LMM programs for select ETPs. The current quote requirements include minimum spread and size obligations based upon the average daily volume and volume-weighted average price per product. By way of comparison, similar programs on other venues simply require that market makers are at the inside quote for a certain percentage of the day and do not set minimum standards for the quality of the inside quote. NYSE Arca LMM obligations include a best bid and offer requirement (met by quoting at the inside 15% of the day or maintaining NYSE Arca as the Exchange at the inside with the most size for 25% of the day) and minimum spread and size guidelines, as well as participation requirements for opening and closing auctions. The Exchange believes that these performance standards are sufficient to create an orderly marketplace, and therefore introducing heightened requirements for the Pilot Program would be unnecessary. The Exchange further believes that it should not be required to disclose its minimum performance standards because to do so would put the Exchange and its LMMs at a competitive disadvantage when compared to other markets and their market makers.

One commenter stated that NYSE Arca should be required to publicly (and anonymously) disclose statistics on the performance of LMMs.[23] NYSE Arca discloses on its website the name of the LMM assigned to each ETP. If the Pilot Program is approved, NYSE Arca will indicate on this spreadsheet whether the security is included in the Pilot Program. In addition, NYSE Arca provides ArcaVision free of charge to the public via the website www.ArcaVision.com. ArcaVision offers a significant amount of trading data and market quality statistics for every Regulation NMS equity security traded in the United States, including all ETPs. Publicly available reports within ArcaVision, which include relevant comparative data, are the Symbol Summary, Symbol Analytics, Volume Comparison and Quotation Comparison reports, among others. In addition, users can create the reports on a per-symbol basis over a flexible time frame. They can also take advantage of predefined, accurate and up-to-date symbol sets based on type of ETP or issuer. Users can also create their own symbol lists. Lastly, as noted above, ArcaVision allows an ETP issuer to see additional information specific to its LMM and other market makers in each ETP via the "ArcaVision Market Maker Summary" reporting mechanism.

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21 Vanguard and ICI Letters.

22 ICI Letter.

23 Id.

Eligibility Criteria

Two commenters also state that specific eligibility criteria based on trading volume and/or market quality should be included in the Pilot Program.[24] Similar programs proposed by other venues include provisions to exclude securities that trade more than two million CADV or that have been listed for more than two years.[25] The impact on imposing such criteria would not be meaningful as the Exchange notes that a two-million-CADV-limit provision would exclude only approximately 6% of listed ETPs on NYSE Arca or approximately fewer than 90 of the currently listed 1,500 ETPs. Furthermore, the Exchange believes that such volume criteria are arbitrary because they do not take into account the unique characteristics of different ETPs, which may lead to varying costs to LMMs associated with quoting as well as carrying inventory. If the Exchange were to set volume thresholds for securities in order to participate in the Pilot Program while ignoring the unique attributes of the different ETPs, it is plausible that certain securities that would benefit from the Pilot Program would not be eligible and vice versa.

The Exchange also notes that sometimes it takes several years for an ETP to gain traction, and that many securities listed for longer than two years could benefit from the Pilot Program. For instance, Exhibit 3 charts the number of ETPs quoted with wide spreads based on the lengths of time they have been listed.[26] The chart illustrates that a significant number of ETPs that have been listed between two years and five years were quoted with wide spreads. The median spread during this period was 0.20%. However, 118 ETPs listed for between two years and five years had spreads greater than 0.50%. In comparison, 94 ETPs listed for less than one year, 78 ETPs listed for between one year and two years, and 12 ETPs listed for longer than five years were quoted with similarly wide spreads.

The interaction between the incentives in the Pilot Program and the current volume-based incentives make additional specific volume-based criteria unnecessary since the market maker community, through competition for LMM assignments, would naturally call for securities to be removed from the Pilot Program once volume levels were sufficient such that the current enhanced incentive rates adequately compensate the LMMs for the obligations/costs associated with assignments. As one commenter noted, the design of the Pilot Program would create a disincentive for an LMM to participate with an actively traded security.[27]

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24 Vanguard and ICI Letters.

25 See, e.g., Securities Exchange Act Release No. 66765 (April 6, 2012), 77 FR 22042 (April 12, 2012) (SR-NASDAQ-2012-043).

26 Source: ArcaVision (May 2012).

27 USCF Letter.

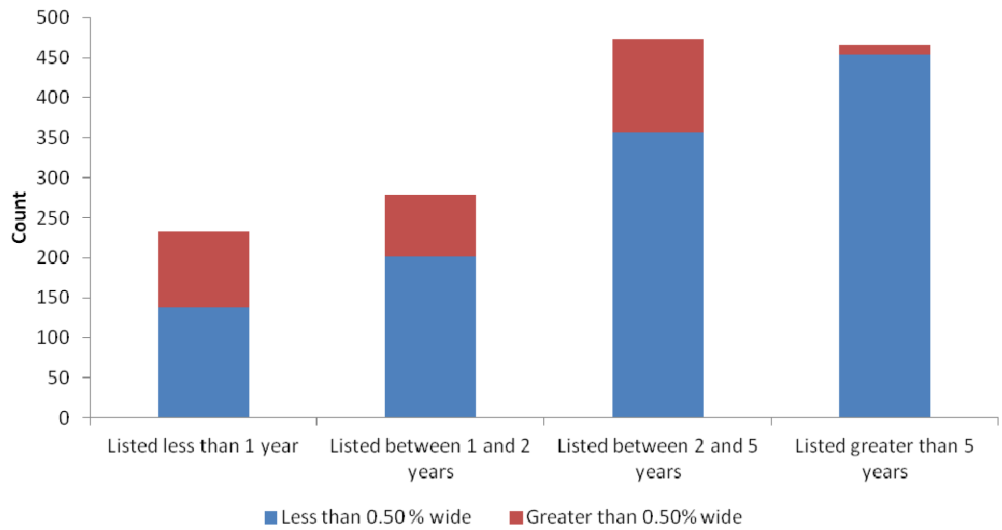

Exhibit 3

<u>Optional Incentive Fee</u>

One commenter also requested clarification regarding who would be responsible for paying the Optional Incentive Fee,[28] while another recommended that the proposed rule change be amended to require disclosure in the offering document regarding whether the shareholders or the fund sponsor would be responsible for payment.[29] To clarify, the reference to "issuer" in the proposed rule change is meant to refer to the fund sponsor. However, if the fund sponsor acting within its fiduciary duty determines that investors would benefit from narrower spreads by inclusion in the Pilot Program, the Exchange does not oppose passing through such charges to fund investors.[30] With respect to requiring disclosure in the offering document, disclosure regarding fees is already required pursuant to the securities laws and is subject to the determination of the issuers, and the requirement is unaffected by the Pilot Program.

Finally, one commenter asserts that LMMs may pressure ETP issuers to place every ETP listed on the Exchange in the Pilot Program, and therefore generate the maximum amount of Optional Incentive Fees or face the threat of the withdrawal of the LMM from making a market in that issuer's ETPs.[31] The Exchange does not believe that this would occur because there are limits to the number of securities each issuer may include in the Pilot Program at any given time.

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28 Vanguard Letter.

29 USCF Letter.

30 Fund sponsors interested in passing through these charges should consult with their counsel about the need to set up an SEC Rule 12b-1 plan.

31 ICI Letter.

RESPONSES TO SEC REQUEST FOR WRITTEN COMMENT

The SEC requested comment on a number of issues relating to the proposal, many of which have already been addressed in the Exchange's filing or in the information set forth above. A further response to certain of those issues not previously addressed is set forth below.

FINRA Rule 5250

In the Order, the Commission seeks comment on whether the Pilot Program would run afoul of the spirit of FINRA Rule 5250 ("Rule 5250"). As noted by the Commission, Rule 5250 is designed to preserve the integrity of the marketplace by ensuring that quotations accurately reflect a broker-dealer's interest in buying or selling a security and that the decision by a firm to make a market in a given security and the question of price should not be influenced by payments to members from issuers or promoters. The Exchange believes that the Pilot Program as designed is uniquely tailored to promote the beneficial purpose of improved market quality while comporting with the public policy goals of Rule 5250 and not affecting market integrity. First, the Pilot Program only applies to open-ended ETPs that are derivatively priced. Market participants can engage in arbitrage when the price of the ETP varies from the NAV to reduce temporary gaps. The opportunities for arbitrage go a long way to ensure that the ETP price reflects the true value of the underlying assets and ameliorate manipulation concerns. Second, the Pilot Program is administered by the Exchange. The Exchange collects the fees from the issuers and pays the Optional Incentive Fee pursuant to the terms of the Pilot Program only to those LMMs who meet their performance obligations as verified by the Exchange. Notwithstanding the foregoing, the Exchange reiterates that, based upon discussions with FINRA, FINRA will file an immediately effective rule change indicating that participation by LMMs and issuers in the Pilot Program would not be prohibited by Rule 5250.

Regulation M

In the Order, the Commission states that the Pilot Program violates Rule 102 of Regulation M ("Rule 102") as the increase in fees charged to an issuer would constitute an indirect attempt by the issuer of a covered security to induce a purchase or bid in a covered security during a restricted period. The Commission acknowledges that it or the staff have previously granted relief from Rule 102 to a number of ETPs ("Existing Relief"); however, it clarifies that the relief was designed to permit the ordinary operation of such ETPs and that participation in the Pilot Program is not necessary for the operation of ETPs in the same way that redemptions are necessary.[32] The crux of the Commission's findings in

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32 In granting the Existing Relief, the Commission has relied in part on the exclusion from the provisions of Rule 102 provided by paragraph (d)(4) of Rule 102 for securities issued by an open-end management investment company or unit investment trust. In granting the Existing Relief from Rule 102 to other types of ETPs, for which the (d)(4) exception is not available, the staff has relied on (i) representations that the fund in question would continuously redeem ETP shares in basket-size aggregations at their NAV and that there should be little disparity between the market price of an ETP share and the NAV per share and (ii) a finding that "[t]he creation, redemption and secondary market transactions in Shares do not appear to result in the abuses

granting the Existing Relief rests on the supposition that the prices of ETP shares closely track their per share NAVs, and given that the Pilot Program neither alters the derivative pricing nature of ETPs nor impacts the arbitrage opportunities inherent therein, the conclusion on which the Existing Relief is based remains unaffected by the Pilot Program. Additionally, the Pilot Program has also been engineered to help ameliorate the ills of price manipulation that Rule 102 was otherwise designed to prevent. As stated in the filing, the Exchange will sit between the issuer and the LMM, and the LMMs will be required to meet the performance criteria as set forth in the Exchange's current policies and procedures, which require among other things that the LMM make two-sided quotes and not just bids. In the Order, the Commission states that prohibitions against issuers' indirectly bidding/purchasing or inducements to bidding/purchasing covered securities during the restricted period exist to maintain the integrity of the trading market as an independent pricing mechanism, and such practices could fundamentally interfere with the independent market dynamics essential to the ability of investors to evaluate the terms on which securities are offered. Given that the Pilot Program will require LMMs to make two-sided markets, and given the derivatively priced nature of the ETPs, the Commission's concerns are unwarranted in this context. The Pilot Program is not intended to raise prices but rather to narrow spreads and improve market quality. Additionally, in light of the derivative nature of these ETPs, it is not expected that LMMs will quote outside of the normal quoting ranges for these products as a result of the incentive payment, but rather will quote within their normal ranges as determined by market factors; in fact, LMMs do not receive incentive payments for quoting outside the ranges established by the Exchange's policies and procedures.

<u>Rule 12b-1</u>

The Commission correctly notes in the Order that Rule 12b-1 under the Investment Company Act of 1940 ("1940 Act") prohibits investment companies registered under the 1940 Act from paying for the distribution of their shares, unless such payments are made pursuant to a plan that meets the requirements of Rule 12b-1 thereunder. The Exchange believes that the issuer payments to the Exchange and the subsequent payments by the Exchange to the LMMs under the Pilot Program are designed to promote a consistent, fair and orderly market in ETPs on the Exchange and not intended to result in a distribution-related expense. The Exchange would like to reiterate that the incentive payments are intended to encourage market participants to act as LMMs on certain ETPs, and thereby agree to be held to higher performance standards as compared to other market participants, and to ultimately lead to improved market quality in these ETPs for investors as opposed to merely trying to increase distribution in the ETP shares. If the Commission deems the payments to be distribution fees, the Commission should consider a temporary exemption in order to permit the Pilot Program to operate and to fairly evaluate the benefits that it can offer to issuers and investors.

<u>Section 11(d)(1)</u>

The Commission claims that the incentive payments under the Pilot Program are problematic vis-a-vis Section 11(d)(1) of the Exchange Act in light of the SIA Exemption, as discussed more fully in the Order.

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that Rule 10a-1 under the Exchange Act, Rules 101 and 102 of Regulation M, and Rule 200(g) of Regulation SHO were designed to prevent."

The Commission notes that the SIA Exemption provides that a broker-dealer authorized participant can only extend or maintain, or arrange for the extension or maintenance of, credit to or for customers on the ETP shares if it does not receive from the fund complex any economic incentive to promote or sell the shares. The Commission views an incentive payment as an indirect payment from the fund complex to the LMM to promote or sell the ETP shares, and thus an LMM that is also a broker-dealer authorized participant would be prohibited from extending credit to its customers. The Exchange would like to emphasize that the incentive payments are designed to increase market quality by encouraging market participants to act as market makers and quote within the normal ranges as dictated by market forces and within the parameters set in the Exchange's policies and procedures, and are not intended as payments to encourage LMMs to "push" the ETP shares. Again, if the Commission determines that the Pilot Program could be contrary to Section 11(d)(1), it should consider a temporary exemption in order to permit the Pilot Program to operate and to fairly evaluate the benefits that it can offer to issuers and investors.

Requiring ETPs to Trade Before Entering Pilot Program

The SEC requested comment as to whether an ETP should be required to trade for a period (e.g., three to six months) before being permitted to enter into the Pilot Program.[33] The Exchange does not believe that this is necessary and believes that the issuer is in the best position to determine whether and when a product should be included in the Pilot Program. The Exchange believes that the data that it currently has with respect to ETPs trading without an LMM is sufficient to provide a comparison to ETPs that are in the Pilot Program.

Public Disclosure of Amount of Fee

The SEC requested comment as to whether the Exchange should be required to disclose publicly the precise amount of the Optional Incentive Fee.[34] The Exchange notes that the range of its proposed annual Optional Incentive Fee, $10,000 to $40,000, is a narrow band and is less than the fee proposed by one competing exchange. Moreover, it would all be paid to the LMM in accordance with the procedures in the proposed rule and the ETP would be identified on the Exchange's website as participating in the Pilot Program. The Exchange believes that these elements provide adequate notice to the public about the nature of the Optional Incentive Fee.

Burden on Competition

Finally, the SEC requested comment on whether the Exchange's proposal would impose a burden on competition.[35] The Exchange believes that its proposal would not impose a burden on competition and thus meets the requirements of Section 6(b)(8) of the Act. The Exchange does not believe that the proposal would impose a burden on competition among issuers because the Pilot Program would be

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[33] See supra note 3, Question 21.

[34] See supra note 3, Question 19.

[35] See supra note 3, Question 26.

limited to ETPs and would be entirely voluntary. Moreover, a range of Optional Incentive Fees could be negotiated between the issuer and the LMM. The proposal also promotes competition among market makers to serve as the LMM. Because of the negotiation feature, and the fact that multiple market makers can compete to serve as LMM, the Pilot Program should result in setting the Optional Incentive Fee at the lowest level necessary to attract an LMM.

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In conclusion, the Exchange believes that the benefits of the proposed rule change would not be fully understood until objective observations could be made in the context of the Pilot Program. Ultimately the decision to participate is still left with the issuer, and therefore the Exchange does not think there would be any adverse impact since the Pilot Program limits the number of eligible securities per issuer. During the Pilot Program, the Exchange intends to evaluate its effectiveness prior to determining whether to make it permanent. Therefore, the Exchange asks that the Commission approve the proposed rule change on a pilot basis.

Very truly yours,

cc (via e-mail):

The Honorable Mary L. Schapiro
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
The Honorable Daniel M. Gallagher
Robert W. Cook, Director, Division of Trading and Markets
David S. Shillman, Associate Director, Division of Trading and Markets