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August 17, 2015

Via Electronic Mail (rule-comments@sec.gov)

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

Re: File No. S7-11-15: Request for Comment on Exchange-Traded Products

Dear Mr. Fields:

KCG Holdings, Inc. ("KCG")[1] submits this letter in response to the request for public comment by the Securities and Exchange Commission ("Commission") on topics related to the listing and trading of exchange-traded products ("ETPs") on national securities exchanges and sales of these products by broker-dealers. KCG appreciates the opportunity to comment and agrees with the Commission's assessment that now is an opportune time for it to revisit its oversight of the listing and trading of ETPs given the rapid recent growth of ETPs with regards to number, variety, and aggregate market capitalization.

KCG is one of the largest sources of exchange-traded fund ("ETF") liquidity in the U.S. We are a lead market maker in approximately 600 ETFs and our ETF Trading Desk provides our clients with efficient and fair executions across all ETFs by working closely with issuers and other broker-dealers. Our range and depth of ETF experience gives us considerable insight into ETF trading and valuation.

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[1] KCG is a global financial services firm that offers investors a range of services designed to address their trading needs across asset classes, product types and time zones. As an independent, electronic market maker, KCG combines advanced technology with exceptional client service to deliver greater liquidity, lower transaction costs, improve pricing, and provide execution choices. KCG is a registered market maker on numerous U.S. cash equity and options exchanges. As a market maker, KCG commits its capital to facilitate trades by buyers and sellers on exchanges, ATSs, and directly to our clients.

KCG believes the U.S. ETF market stands out based upon its cost efficiency, deep liquidity, competitive pricing, and because exchange-traded funds consistently trade close to NAV. As a result of these attributes, the U.S. is the clear leader in ETFs globally and attracts investments from all over the world into U.S. managed and traded products. In our view, the success of ETFs in the United States is largely related to the underlying equity market structure, which makes it cheaper and easier to hedge electronically than in other countries and markets. ETFs are not, however, completely free of challenges and concerns and we commend the Commission exploring and seeking to address these issues. KCG offers the following comments with respect to: (i) exchange listing standards; (ii) arbitrage and market pricing; (iii) creations and redemptions; and (iv) investor understanding.

Exchange Listing Standards

As noted in the above referenced Release,[2] exchange listing standards for ETP Securities often contain both initial listing criteria and continuing listing criteria. Initial listing criteria specify requirements that must be met when ETP Securities are first listed by an exchange and continuing listing criteria set forth requirements to be met on an ongoing basis. The Commission asks whether exchange listing standards should always contain both initial and continuing listing criteria and whether initial and continuing listing standards should be substantially identical for ETP securities.[3]

KCG generally believes exchange listing standards for ETP Securities should contain both initial listing criteria as well as continuing listing criteria to be met on an ongoing basis. KCG appreciates the efforts of ETP issuers to use the ETP structure to bring to investors historically inaccessible asset classes or investment strategies in an economical and efficient manner. Certain ETPs, however, fail to attract investor attention and are not desired by the market. Thus, we believe exchange listing standards for ETP Securities should contain continuing listing standards to allow for continued trading. Continuing listing standards should be agreed upon by market participants (exchanges, issuers, and market makers) and should require a certain amount of fund assets and include a minimum average daily trading volume. Without

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[2] Securities Exchange Act Release No. 34-75165 (June 17, 2015) 80 FR 34729 ("Release").

[3] *See* Release at 34742.

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continuing listing standards, certain ETPs that fail to generate investor interest may linger instead of being efficiently unwound and closed.

Arbitrage and Market Pricing

The Commission notes in the Release its view that the deviation between the daily closing price of ETP Securities and their NAV is relatively small when averaged across broad categories of ETP investment strategies and over time periods of several months.[4] KCG agrees with this assessment, at least with respect to ETFs, as our research indicates that almost all ETFs track close to NAV over the long term. We believe this alignment is largely due to arbitrage mechanisms provided by the creation-redemption process, which creates a constant pull towards NAV for most ETFs.

The Commission asks whether arbitrage mechanisms work better for some types or categories of ETPs, including those ETPs with less-liquid underlying or reference assets, and to what extent arbitrage mechanisms help ensure efficient market pricing during times of market stress.[5]

While ETF pricing closely tracks NAV for most ETFs, certain types of ETFs exhibit less close alignment between ETF prices and NAV. For example, NAV of bond ETFs sometimes suffer from stale prices, which in KCG's view is largely due to issues related to fixed income market structure. Unlike equities that trade on exchange electronically and where price discovery is readily available - arbitrageurs can almost always trade a live bid or offer and NAV can easily be computed – bond markets are still largely manual and many bonds do not trade every day. Price discovery difficulties in the bond market makes it much more difficult and expensive to perform arbitrage in bond ETFs, and this difficulty may be exacerbated during stressed market environments. KCG believes this dynamic can be improved through continued regulatory focus on enhancements to fixed income market structure that increase standardization of issues and encourage exchange trading of corporate and municipal bonds.

[4] *See* Release at 34739.

[5] *See* Release at 34740.

Creations and Redemptions

The Commission asks about circumstances under which an ETP issuer would suspend creations or redemptions and the effect such actions have on arbitrage mechanisms.[6]

As detailed above, KCG believes the creation-redemption process is the critical feature of ETFs in that it provides a mechanism for arbitragers to lock in profits and pull an ETF back to fair value. When ETFs cannot be created or redeemed because the creation-redemption process is suspended or restricted, it impacts the efficiency of arbitrage mechanisms and creates additional risk for arbitragers. ETF creations-redemptions may be closed or restricted for a variety of reasons: underlying markets may cease trading during a crisis; underlying markets may be closed to certain investors; or creations and redemptions may be halted by an issuer. Regardless of the reason, KCG believes the suspension or restriction of creations-redemptions is a critical issue for market participants that warrants the issuance of a news flag or, in extreme circumstances such as where ETF prices have no fundamental basis, a trading halt.

Investor Understanding

The Commission asks whether broker-dealers use the term "ETF" to describe all types of ETPs and, if so, whether this may result in investor confusion.[7]

Since 1992 when the Commission approved the listing and trading of shares of the first ETP – the SPDR S&P 500 ETF ("SPY") – investor demand for these funds has grown dramatically. As the Commission notes in the Release, there has been significant recent growth in ETP investment strategies beyond exchange-traded funds that track equity indices such as SPY. The term "ETF" has become an almost generic description for many different types of products that include a range of differing structures beyond those normally associated with a traditional exchange-

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[6] *See* Release at 34740.

[7] *See* Release at 34743.

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traded fund. We are concerned that investors, especially retail investors, may find this over-use of the term "ETF" confusing. KCG believes it is critically important that investors understand and are able to differentiate among the various types of ETPs. To that end, we believe the Commission should consider implementing an ETP classification system designed to help investors differentiate among the differing structural features, investment strategies, and risks presented by various types of exchange-traded products.

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KCG appreciates this opportunity to submit our views in response to the Commission's request for comment on ETPs. Please do not hesitate to contact me at [redacted] or [redacted] if you have questions regarding any of the comments provided in this letter.

Sincerely,

John A. McCarthy
General Counsel

cc: The Honorable Mary Jo White, Chair
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Michael S. Piwowar, Commissioner
The Honorable Kara M. Stein, Commissioner
Stephen Luparello, Director, Division of Trading and Markets
Gary Goldsholle, Deputy Director, Division of Trading and Markets
David Shillman, Associate Director, Division of Trading and Markets