Nasdaq

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January 27, 2017

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

Re: SR-BatsBZX-2016-60

Dear Mr. Fields:

The NASDAQ Stock Market LLC ("Nasdaq") is writing to comment on a proposal submitted to the Securities Exchange Commission ("Commission") by Bats BZX Exchange, Inc. (the "Exchange" or "BZX").[1] The Proposal would allow BZX Market Makers ("LMMs") that are assigned to certain Exchange-listed funds to receive a payment based on the consolidated average daily volume of that fund. The Commission published the notice of filing of the Proposal and, in the same document, temporarily suspended the Proposal and instituted proceedings to determine whether to approve or disapprove the Proposal.[2]

In short, Nasdaq supports market maker incentive programs for exchange traded products ("ETPs"), which promote competition among venues that list and trade ETPs, and encourage market makers to provide better quality markets for ETPs. Nasdaq also

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1 See Securities Exchange Act Release No. 79103 (October 14, 2016), 81 FR 72624 (October 20, 2016) (SR-BatsBZX-2016-60) ("Proposal").

2 Id. Proceedings to determine whether to disapprove a proposed rule change must be concluded within 180 days of the date of publication of notice of the filing of the proposed rule change, although this time may be extended for up to 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding. See 15 U.S.C. 78s(b)(2)(B).

believes that the market for the listing and trading of exchange-traded products ("ETPs") is sufficiently competitive that the market, rather than Commission staff, should determine the reasonableness of the Proposal under the Securities Exchange Act of 1934 ("Act"). Nasdaq believes that this is especially true here, since BZX is proposing to add a new payment structure for LMMs, which is inherently pro-competitive. Nonetheless, to the extent that the Commission believes that it should determine whether the proposal is consistent with the Act, Nasdaq believes that a structure whereby the requirements for a market maker are more closely aligned to the benefits a market maker may receive better promotes the goals of ETP incentive programs such as the Proposal. While Nasdaq believes that there should be some correlation between enhanced benefits and enhanced requirements, a market maker's quoting requirements must not necessarily relate to the same security for which the market maker is receiving a payment pursuant to an ETP incentive program.

Background and Discussion

Among other things, the Proposal sets forth a program through which an LMM in certain funds listed on the Exchange[3] would receive a payment from the Exchange based on the consolidated average daily volume ("CADV") of the Fund, in lieu of credits that LMMs typically receive for adding liquidity in securities in which they are the LMM. The Exchange proposed to make quarterly payments to LMMs in Funds with a CADV of 1,000,000 shares or higher. These payments would increase as the CADV of the Fund increases, up to a maximum annual payment of $400,000 to the LMM of a Fund with a CADV of 35,000,000 or more shares.[4] The Commission noted that these payments would not be accompanied by enhanced market-quality requirements for the LMM or be determined based on the actual quoting or trading activity of the LMM.[5]

In suspending the Proposal, the Commission questioned whether the Exchange adequately explained why it is consistent with the Act to make substantial additional payments to LMMs in the most-liquid ETFs, where performance incentives would seem

3 The program would apply to series of Portfolio Depository Receipts, Index Fund Shares, Trust Issued Receipts, and Managed Fund Shares listed on the Exchange ("Funds"). See Proposal, supra note 1, 81 FR at 72624.

Nasdaq notes that it proposed a similar change to its Market Quality Program in 2016, whereby market makers that were assigned to ETFs in Nasdaq's Market Quality Program would be paid by Nasdaq, if such market makers met the applicable quoting and trading requirements. See SR-NASDAQ-2016-018 (filed February 2, 2016). Although Nasdaq subsequently withdrew this filing after the Commission staff expressed concern about whether the proposal was consistent with the Act, Nasdaq anticipates re-filing this proposal in the near future.

4 81 FR at 72624-25.

5 81 FR at 72628.

least necessary to maintain market quality, without the imposition of any additional performance standards.[6] According to the Commission, it was unclear how higher payments to LMMs in the most-liquid ETFs will encourage them to become LMMs in less-liquid ETFs, particularly given that the Proposal does not obligate participants to become LMMs in any less-liquid ETFs or impose additional performance standards on them.[7] To the Commission, the connection between the proposed LMM incentives and the desired LMM behavior therefore "appears indirect and tenuous."[8]

As stated above, Nasdaq supports market maker incentive programs for ETPs, as they promote increased market quality for ETPs and competition among venues that list and trade ETPs. For this reason, Nasdaq believes that it is more appropriate for the market, rather than Commission staff, to determine the reasonableness of the Proposal. The Commission and the courts have repeatedly expressed their preference for competition over regulatory intervention in determining prices, products, and services in the securities markets. In Regulation NMS, while adopting a series of steps to improve the current market model, the Commission highlighted the importance of market forces in determining prices and self-regulatory organization revenues, and also recognized that current regulation of the market system "has been remarkably successful in promoting market competition in its broader forms that are most important to investors and listed companies."[9] Similarly, in NetCoalition v. Securities and Exchange Commission,[10] the D.C. Circuit upheld the Commission's use of a market-based approach in evaluating the fairness of market data fees against a challenge claiming that Congress mandated a cost-based approach.[11] The court recognized the SEC's finding that "competition for order flow is 'fierce'", and that '"buyers and sellers of securities, and the broker-dealers that act as their order-routing agents, have a wide range of choices of where to route orders for execution.'"[12] As such, '"no exchange can afford to take its market share percentages for granted' because 'no exchange possesses a monopoly, regulatory or otherwise, in the execution of order flow from broker dealers'...."[13]

6 Id.

7 Id.

8 Id.

9 Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37499 (June 29, 2005) ("Regulation NMS Adopting Release").

10 NetCoalition v. SEC, 615 F.3d 525 (D.C. Cir. 2010).

11 See NetCoalition, 615 F.3d at 534-35.

12 Id. at 539 (quoting Securities Exchange Act Release No. 59039 (December 2, 2008), 73 FR 74770, 74782-83 (December 9, 2008) (SR-NYSEArca-2006-21)).

13 Id.

Although the Proposal involves rebates to LMMs and associated quoting requirements, Nasdaq believes that the same analysis should apply here. The market for listing and trading ETPs is very competitive, with multiple venues competing for the opportunity to list and trade ETPs. Market participants would quickly reject a proposal that is anti-competitive or otherwise unreasonable by, for example, declining to participate in an ETP incentive program. This is especially true here, since the Proposal relates to incentive payments which make an ETP more attractive for market makers to quote and trade, and is thus inherently pro-competitive. In the interest of promoting competition and efficiency in the review of proposed rule changes, the Commission staff should therefore let the market determine whether the proposal is reasonable and not unduly burdensome on competition.

If, however, the Commission determines that it should determine whether the Proposal is consistent with the Act, Nasdaq believes that it is appropriate to align the benefits of an incentive program with specific additional requirements to qualify for those benefits. While Nasdaq believes that there should be some correlation between enhanced benefits and enhanced requirements, Nasdaq does not believe that the market maker's quoting requirements must necessarily relate to the same security for which the market maker is receiving a payment pursuant to an ETP incentive program. The purpose of ETP incentive programs for market makers is to promote trading in less-liquid ETPs, which help both launch and maintain a successful ETP. Nasdaq believes that, for example, establishing quoting requirements for a less-liquid ETP to which the market maker is assigned in order to receive a payment based on a more liquid ETP to which the market maker is assigned would better promote the ultimate purpose of ETP incentive programs such as the Proposal. Given that ETP issuers typically categorize ETPs by group rather than by individual ETPs, Nasdaq believes that such an approach would also be more consistent with industry practice.

Nasdaq appreciates the opportunity to comment on this Proposal. Please contact the undersigned should you have any questions.

Respectfully submitted,

Andrew Madar

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