



June 8, 2018

VIA Electronic Mail ([pubcom@finra.org](mailto:pubcom@finra.org))

Jennifer Piorko Mitchell  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington DC 2002-1506

Re: FINRA Retrospective Rule Review on the Effectiveness and Efficiency of its Payments for Market Making Rule (FINRA Rule 5250); Regulatory Notice 17-41

Dear Ms. Mitchell,

WisdomTree Asset Management, Inc. (“WisdomTree”) appreciates the opportunity to submit comments to the Financial Industry Regulatory Authority (“FINRA”) regarding FINRA’s recent retrospective rule review of FINRA Rule 5250 (“Rule 5250”) as described in Regulatory Notice 17-41.<sup>1</sup>

WisdomTree is currently the 7<sup>th</sup> largest provider of exchange traded funds (“ETFs”) in the United States and is at the forefront of ETF innovation through proprietary index development and the introduction of modern alpha into the ETF space. These strategies, among others used by WisdomTree ETFs, rely upon market makers to serve critical functions with respect to market quality, liquidity and capital market efficiency that ultimately impact an ETF shareholder’s investment experience. Considering the historical and expected growth of ETFs combined with the dynamic nature of the ETF marketplace, we appreciate FINRA’s efforts to reexamine and refine its rules, such as Rule 5250, in seeking to ensure that such rules are continuing to meet their intended objectives and evolve with ETFs and the securities markets.

Rule 5250 in substance prohibits payment from ETF issuers to market makers in exchange for their services, with limited exceptions, such as the exception for indirect payments via exchange programs established in 2013 (the “Exchange Programs”).<sup>2</sup> Rule 5250 is, at its core, an investor protection and marketplace integrity rule designed to ensure that an issuer does not seek to influence the price of the issuer’s stock by paying a market maker or otherwise create conflict of interest situations. WisdomTree believes that the potential for such issues are mitigated through the ETF structure, including due to the arbitrage mechanism, and thereby ETFs could reasonably be excluded from the prohibitions of Rule 5250. However, while WisdomTree is supportive of efforts that seek to enhance market quality, WisdomTree is particularly concerned that the potential benefits of an

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<sup>1</sup> FINRA Regulatory Notice 17-41 (Nov. 28, 2017).

<sup>2</sup> Order Approving a Proposed Rule Change by Financial Industry Regulatory Authority, Inc. Relating to FINRA Rule 5250 (Payments for Market Making), Exchange Act Release No. 69398, 78 Fed. Reg. 24,261 (APR. 18, 2013).

exemption from Rule 5250 with respect to ETFs could be outweighed by unintended consequences unless such exemption is carefully considered and tailored, including through coordination with the Division of Trading and Markets of the Securities and Exchange Commission (“SEC”).

Importantly, the Exchange Programs contained safeguards that were approved by the SEC, including disclosures, surveillance and monitoring procedures. While these Exchange Programs were not broadly utilized by ETF issuers and ultimately not continued by the exchanges, WisdomTree believes that in the event Rule 5250 were to permit payments from ETF issuers to market makers, such payments be subject to the same types of safeguards that were contained in the Exchange Programs. Allowing payments without the various safeguards would potentially create unintended negative consequences. Further, such Exchange Programs contemplated that payments to market makers may implicate the anti-fraud manipulation provisions of the Securities Exchange Act of 1934 and rules thereunder, including Rule 102 of Regulation M, and this accentuates the importance of FINRA coordinating with the SEC in obtaining Regulation M class relief related to an ETF exemption under Rule 5250 or otherwise confirming that such relief is not necessary. If such coordination with the Division of Trading and Markets of the SEC does not occur, that would leave ETF issuers with the potential need to obtain such relief individually, which could be costly, burdensome, and disjointed.

If an ETF exemption to Rule 5250 is not subject to thoughtful safeguards that dictate uniformity, objective performance standards and transparency, it is not clear what the unintended consequences to ETFs might be. By way of example: (i) could there be unlevel, material payments to market makers that differ by ETF issuer, such that the ability of an ETF to be competitive in the marketplace would be dependent on the amount of market maker payments; (ii) could market making activity for many ETFs decrease rather than increase, due to market makers facing pressure to enter into contractual or de facto exclusive relationships with ETF issuers; (iii) could unrestricted ETF issuer payments to market makers have the potential to severely distort the natural price discovery value of an ETF, otherwise distort natural market forces and/or create unrealistic expectations with respect to ETF market quality – such as in times of market stress, thereby creating a misperception by ETF investors regarding the true value of an ETF’s shares or which market quotations arise from actual interest and which result from ETF issuer payment.

Although other commentators have noted that payments to market makers have been successful in the European markets, it is important to consider that the European market structure is radically different than that of the United States. In contrast to the United States, the European markets have fragmented listing standards, quoting, and printing rules where payment for market making is largely a necessity due to the lack of natural incentive to compete in the marketplace and WisdomTree does not believe that the European marketplace provides a proper point of reference or model with respect to considering a potential ETF exemption to Rule 5250.

WisdomTree appreciates the close working relationship that it has with the market making community, particularly through WisdomTree’s Capital Markets team. WisdomTree

has been proactive in seeking even more efficient markets in WisdomTree ETFs and will continue to seek ways to be supportive of the market making function through the current tools available in the regulatory framework. Ultimately, WisdomTree does not believe that ETFs are subject to the conflicts of interest that the original Rule 5250 was intended to prevent. However, WisdomTree believes that any foray into the realm of direct payments by ETF issuers for market making services has the potential to introduce new and unintended consequences to the current system and does not believe that an exemption for ETFs with respect to Rule 5250 is advisable or warranted at this time. WisdomTree would ask that if FINRA, after close study of the prior Exchange Programs, consultation with all market participants and in close coordination with the SEC, determines nonetheless that an exemption for ETFs with respect to Rule 5250 may be warranted, that such proposed exemption be carefully tailored and issued for public comment prior to potential implementation.

Kind regards,

Anita Rausch  
Head of Capital Markets

Ryan Louvar  
General Counsel