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**Via Electronic Mail and Hand Delivery**
Ms. Jennifer Piorko Mitchell
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K Street, N.W.
Washington, D.C. 20006-1506

**Re: Regulatory Notice 17-41 (Nov. 28, 2017) -- Request for Comment**

Dear Ms. Mitchell:

We appreciate the opportunity to comment on Regulatory Notice 17-41 (Nov. 28, 2017) ("Notice 17-41"), in which the Financial Industry Regulatory Authority ("FINRA") solicited comment on a preliminary proposal to review the effectiveness and efficacy of FINRA Rule 5250. We represent one or more clients that may have an interest in FINRA's efforts in this regard.[1] As a general matter, we enthusiastically support FINRA's efforts to review its rules to determine if they are keeping pace with, and are relevant to, the dynamism and innovation of the U.S. securities markets.[2] Further, as a preliminary matter, we believe that permitting issuers to pay market makers for market-making activities arguably would be considered a significant market reform.[3] Accordingly, prudence suggests that FINRA

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1 Although our opinions regarding FINRA's preliminary proposal to review the effectiveness of Rule 5250 are informed by our regular discussions with, and representation of, Financial Services clients, the specific views expressed in this letter do not necessarily represent the views of all of our clients or all of the attorneys in our Financial Services practice.

2 FINRA previously announced a review of several of its capital formation rules in Regulatory Notice 17-14 (Apr. 2017) ("Notice 17-14"), including Rule 5250. Notice 17-14 indicated that some member firms had mentioned possible adverse effects of Rule 5250 in capital formation and its possible impediments to liquidity. Notice 17-41 followed up Notice 17-14 and sought more specific comments.

3 One significant market participant previously commented that it viewed a particular market-maker incentive program as a "significant market reform" that implicated public policy considerations requiring thought and debate. *See* Letter from Gus Sauter, Managing Director and Chief Investment Officer, Vanguard to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (May 3, 2012).

take a careful and balanced approach to its review of the rule and weigh the potential for enhanced market improvements, such as liquidity, on the one hand, against any unintended, adverse market structure impact and undisclosed or unmanaged potential conflicts of interest, on the other hand. As discussed in more detail below, we believe it is premature for industry participants to have definitive positions on FINRA's request for comment because of the lack of clear direction a proposed modification would take.

## I. BACKGROUND

### A. FINRA Rule 5250

Inasmuch as a regulatory review of Rule 5250 should be carefully considered, we believe a review of the background of the rule, and its policy purposes, is necessary to developing a framework for FINRA review, should it consider precise modifications to the rule.

Rule 5250, at its core, is an anti-manipulation rule that fundamentally seeks to eliminate conflicts of interest between issuers and market makers quoting or making a market in the issuer's securities. It reflects a longstanding position of the staff of the Securities and Exchange Commission ("SEC") prohibiting payments to market makers for their market-making activities.[4] The rule specifically prohibits member firms from accepting direct or indirect payments or other consideration from an issuer (or any affiliate of or promotor for the issuer) in connection with publishing a quotation in the issuer's securities, acting as a market maker in the issuer's securities, or for submitting any applications related to publishing quotations or making a market in the issuer's securities. Fundamentally, the prohibition was intended to order the relationship between issuers and market makers essentially as an "arm's length" one free of conflicts of interest to the fullest extent practicable. That is, the rule seeks to ensure the independence of market makers and their ability to post quotations or make markets based on objective criteria and not based on self-interest or as the result of undue influence exerted by issuers.[5]

The rule prescribes three narrowly tailored exceptions that permit a market maker to accept: (i) payment for *bona fide* services not involving market making (*e.g.*, investment banking); (ii) reimbursement of out-of-pocket administrative fees imposed at the federal, state, or self-regulatory organization level for registrations and listings of the issuer's securities; and (iii) incentives expressly permitted under final and effective rules of any national securities exchange. Before certain of the U.S. securities exchanges established conditional rules permitting market-maker payments about five years

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4 *See Monroe Securities, Inc.*, SEC No-Action Letter (pub. avail. June 4, 1973) (in declining no-action relief to a market maker seeking payment for purposes of offsetting expenses in posting market quotations and making a market, staff noted that such payments would be inadvisable).

5 *See* NASD Notice to Members 75-16 (Feb. 20, 1975) ("NTM 75-16"). In 1975, the National Association of Securities Dealers, Inc. ("NASD"), now FINRA, published its views that market-maker payments raised serious questions under, among other things, the antifraud provisions of each of the Securities Act of 1933 and the Securities Exchange Act of 1934 ("Exchange Act").

ago, as discussed below, Rule 5250 expressed the general rule, for transactions in the over-the-counter ("OTC") market and on the exchanges, that it was illegal for issuers to pay market makers for making a market in their securities.

The prohibition was codified in 1997 as NASD Conduct Rule 2460, the predecessor to what is now Rule 5250.[6] The rule remained substantively unchanged until April 2013. In 2013, the SEC approved a routine amendment to the rule in recognition of specific stock exchange programs that permitted payments to market makers in specified securities under conditions designed to manage and to disclose potential conflicts of interest.[7] For these exchange programs, FINRA amended Rule 5250 to add exception (iii) to the rule expressly permitting market makers that were exchange and FINRA members to participate in exchange-sponsored and approved incentive programs.

In light of the recent experience with the exchange programs, we believe they provide FINRA with a good starting point for evaluating any potential modifications to Rule 5250. In that regard, we briefly reviewed the exchange programs, their structure, and the extent to which they met their stated goals.

**B. U.S. Exchange Programs**

Market-maker incentive programs are relatively new in the United States. In 2013, the SEC issued orders approving pilot programs by the NASDAQ Stock Market, LLC ("NASDAQ") and NYSE Arca, Inc. ("NYSE Arca") to establish market maker-incentive programs for exchange-traded products ("ETPs").[8] The SEC approved each program as a temporary, one-year pilot program that would end after implementation, unless extended pursuant to a proposed rule change approved by the SEC pursuant to Section 19(b) of the Exchange Act and Rule 19b-4 thereunder.[9] In connection with the approval of the NASDAQ Market Quality Program and NYSE Arca ETP Incentive Program, each exchange agreed to

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6 Securities Exchange Act Release No. 38812 (July 3, 1997), 62 F.R. 37105 (July 10, 1997) (SEC order approving rule). The NASD codified the principles of NTM 75-16 in response to a court decision that viewed NTM 75-16 as an impermissible rule change not otherwise expressly countenanced by the NASD's business conduct rule. *See Bond Share & Co. v. SEC*, 39 F.3d 1451 (10th Cir. 1994).

7 *See* Securities Exchange Act Release No. 69398 (April 18, 2013), 78 F.R. 24261 (April 24, 2013) (notice of filing and immediate effectiveness of proposed amendment to Rule 5250 to conditionally permit payments to market makers, if permitted by final and effective rules of a national securities exchange).

8 *See* Securities Exchange Act Release No. 69195 (March 20, 2013), 78 F.R.18393 (March 26, 2013) (order granting approval of a rule establishing NASDAQ's Market Quality Program) (the "NASDAQ Order") and Securities Exchange Act Release No. 69706 (June 6, 2013), 78 F.R.35340 (June 12, 2013) (order granting approval of a rule establishing NYSE Arca's ETP Incentive Program) (the "NYSE Arca Order"). BATS and the CBOE also established similar incentive programs.

9 NASDAQ Order, *supra*, note 8.

submit reports analyzing the effectiveness of its program.[10] Based on a review of the public filings, it appears that NASDAQ's Market Quality Program never commenced operations during the pilot phase. NYSE Arca's ETP Incentive Program launched in September 2013, and NYSE Arca obtained three separate orders extending the program, the last of which expired July 31, 2017.[11] The SEC has not approved any incentive programs for non-ETP issuers.

The NASDAQ and NYSE Arca programs were substantially similar in that specified issuers made payments to the exchange, which, in turn, would allocate the payments among eligible market makers. The exchanges intermediated their programs, meaning they set fees, entrance and exit protocols, and payment allocations. Thus, market makers and issuers did not directly contract to set payment, performance standards, or other terms. The programs contained other safeguards that the SEC deemed important. For instance, the SEC emphasized exchange oversight of the programs, noting in the case of NASDAQ, that the exchange-traded funds ("ETFs") participating in the Market Quality Program "will be traded on [NASDAQ], which is a regulated market, pursuant to current trading and reporting rules of [NASDAQ], and pursuant to [NASDAQ's] established market surveillance and trade monitoring procedures."[12] In short, the SEC looked at the exchange market structure and its surveillance as protective safeguards against concerns that market-maker incentives could create artificial market interest in an ETF.[13]

Other safeguards in the exchange programs included disclosure of key features of the program and potential for conflicts.[14] These disclosures were designed to address the antifraud concerns originally raised in NTM 75-16.

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10 NASDAQ Order and NYSE Arca Order, *supra* note 8.

11 *See* Securities Exchange Act Release No. 72963 (Sep. 3, 2014), 79 F.R.53492 (Sep. 9, 2014) (notice of filing and immediate effectiveness of a proposal to extend NYSE Arca's ETP Incentive Program through September 4, 2015); Securities Exchange Act Release No. 75846 (Sep. 4, 2015), 80 F.R. 54646 (Sep. 10, 2015) (notice of filing and immediate effectiveness of a proposal to extend NYSE Arca's ETP Incentive Program through September 4, 2016); and Securities Exchange Act Release No. 78497 (Aug. 8, 2016), 81 F.R. 53524 (Aug. 12, 2016) (notice of filing and immediate effectiveness of a proposal to extend NYSE Arca's ETP Incentive Program through July 31, 2017).

12 *See* NASDAQ Order, *supra* note 8, at 18401.

13 *Id.* at 18399.

14 In the case of NASDAQ's Market Quality Program, all fees, participants, and participating securities would be disclosed to the public so that, going in, traders of, and investors in, ETFs could discern program participants and evaluate, at a minimum, potential conflicts of interest issues prior to trading in quoted prices. NASDAQ believed its program design was intended "to be highly transparent, with clear public notification requirements; clear entry, continuation, and termination requirements; clear market maker accountability standards; and, perhaps most importantly, clear market quality (liquidity) enhancement

In addition, the exchange programs were targeted at small ETPs and ETFs, which were believed to be most likely to benefit from enhanced liquidity and tighter bid/ask spreads provided by the multiple, competing market makers expected to participate in the programs. For instance, NASDAQ limited participation to ETFs whose shares had an average daily trading volume ("ATV") of less than 1,000,000. If the daily ATV was at, or exceeded, 1,000,000 shares for three consecutive months, the ETF would "graduate" from the program, and incentive payments would cease.[15] NASDAQ's Market Quality Program prescribed performance standards by market makers seeking payments that included meeting general standards for posting two-sided quotations and specified quantitative standards related to quoting at or inside the national best bid and offer ("NBBO"), as well as standards for the proximity of bid/ask spreads to the NBBO based on quantitative benchmarks as to time, share amount, and percentage away from the NBBO.[16]

As noted above, the Market Quality Program never commenced operations, although approved to do so. Thus, no market data would be available to FINRA in its assessment of relaxing the prohibition in Rule 5250. The NYSE Arca ETP Incentive Program did commence operations up to the expiration of an extended pilot phase, dated July 31, 2017. NYSE Arca published an assessment of the NYSE Arca ETP Incentive Program and concluded that, although some benefits were seen for certain ETPs, participation in the program was too limited, which made producing conclusive results impossible.[17] As of the publication date of the assessment, no products were participating in the program.

Each of the exchange programs was premised on the expectation that incentives in a controlled environment could promote competition among trading venues for ETFs (and other ETPs) and encourage market makers to provide better markets for these products. Promoting competition and enhanced liquidity clearly are laudable goals. To that end, we believe that any assessment of Rule 5250 must begin with a review of the exchange programs to determine if their design achieved these stated goals. If they did not, we believe FINRA should consider why they did not and what alternatives might better achieve the stated goals, balanced against maintaining market integrity, promoting competition, and reducing

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standards that benefit investors and market participants." Securities Exchange Act Release No. 68515 (Dec. 21, 2012), 77 F.R. 77141, 77142, fn. 7 (Dec. 31, 2012) ("Release 68515").

15 NASDAQ Order, *supra* note 8, at 18398. According to NASDAQ, its Market Quality Program would "benefit investors, issuers or companies, and market participants by significantly enhancing the quality of the market and trading in [specified] listed securities." Release 68515, *supra* note 14, at 77141.

16 One significant ETF market participant strongly supported objective and higher performance standards for market makers receiving payments. *See* Letter from James E. Ross, Global Head SPDR Exchange Traded Funds, State Street Global Advisors, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (Aug. 16, 2012).

17 *See* Assessment Report for NYSE Arca Incentive Program (April 28, 2017), *available at* https://www.nyse.com/publicdocs/nyse/products/etp-funds/ETP_Incentive_Program_Assessment_Report.pdf .

harmful conflicts of interest. To that end, should FINRA proceed with modifying Rule 5250, it should consider NYSE Arca's self-assessment of its ETP Incentive Program, including why it was not renewed, as well as why the Market Quality Program did not launch.

### C. Scope and Impact

Neither Notice 17-14 nor Notice 17-41 specified the scope or considered the potential market impact that revision of Rule 5250 might have. Namely, FINRA did not specify if it was considering lifting the prohibition entirely against market-maker payments or, like the exchange programs, whether payments would be conditional and based on performance standards, transparency, and other structural safeguards. Any further consideration of revising Rule 5250 should address issues of scope.

In addition, neither Notice 17-14 nor Notice 17-41 addressed the markets or issuers that potentially would be affected by a revision to Rule 5250. We have assumed that the impact of a modification of Rule 5250 would apply to unlisted securities trading in the OTC market, as well as listed securities trading off exchange. Because of potential market structure effects of changing Rule 5250 and its potentially broad effects in this respect, it appears that modifications to permit incentives to market makers is a significant market reform. If the scope would be broader than we have assumed, another consideration would be the structure of the OTC market itself and whether incentive programs in that market would be appropriate. For example, the SEC obtained comfort from NASDAQ's status as a "regulated market."[18] Arguably, the OTC market is less regulated than the exchange market, and has from time to time been susceptible to market manipulation.[19] Thus, any further consideration of revising Rule 5250 should address the markets and issuers affected, possible market structure issues, such as fragmentation, and review the reasons why approved exchange programs did not appear to achieve their stated benefits of enhanced market liquidity and tighter bid/ask spreads for small ETFs and ETPs, if these issuers are the primary or only issuers expected to be subject to any relaxed rule.

A discussion on scope and impact also would need to address market and investor safeguards. FINRA did not specify what, if any, countervailing safeguards it might consider to address antifraud and conflicts of interest concerns. We know that, aside from the exchange structure itself, NASDAQ established safeguards, such as regulatory intermediation, disclosure, quantifiable performance standards,

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[18] NASDAQ Order, *supra* note 8, at 18401.

[19] In 1992, the SEC established pursuant to a clear Congressional mandate enunciated in the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 a regulatory regime targeted at penny-stock trading because of the fraudulent practices in trading of penny stocks. *See* 17 C.F.R. §§240.15g-1 through 15g-9, as initially adopted in Securities Exchange Act Release No. 30608 (April 20, 1992), 57 F.R. 18004 (April 28, 1992). In 1971, the SEC adopted Rule 15c2-11 under its antifraud authority in Section 15(c) of the Exchange Act because of fraudulent practices of market makers posting quotations in the OTC market absent material financial information about the issuer either in possession of the market maker or the public at large. *See* Securities Exchange Act Release No. 9310 (Sept. 13, 1971) 36 F.R. 18641 (Dec. 18, 1971).

and entry and exit protocols, that the SEC concluded "should help to mitigate the conflict of interest and other concerns that the [SEC] has previously identified relating to issuers paying for market making."[20] If these structural conditions were proven to be impediments to stated goals of the Market Quality Program, FINRA should consider alternatives in an impact analysis.

A preliminary question to ask is if any of these safeguards are practical in the OTC markets. For example, the Market Quality Program was designed for NASDAQ to intermediate the issuer and market-maker relationship. The program also contained protocols of assigning issuers and market makers. Would FINRA intermediate similar relationships for OTC market-maker incentives in the same way? Would there be eligibility protocols for participation? One industry participant has argued that the market among issuers and market makers themselves is the best arbiter of incentive arrangements, such that the market would reject anti-competitive and unreasonable programs.[21] This line of argument taken to its logical conclusion would seem to support direct arrangements between issuers and market makers in the absence of regulatory intermediation.

It is our understanding that certain foreign markets permit direct arrangements, as discussed in more detail below. It is also our understanding that in these direct arrangements certain issuers are able to obtain exclusive arrangements, thus locking other issuers out of the benefits of well-performing market makers. The potential anti-competitive effects, where an issuer is able to secure exclusive arrangements, and at what price, should be thoroughly analyzed. In particular, small issuers could be harmed by substantial barriers to entry either because there are not sufficient quality market makers due to exclusive arrangements and/or the costs of competing for these quality market makers price small issuers out of the market, thus harming the very issuers that market-maker incentive programs are intended to benefit. To avoid these consequences, FINRA should consider carefully studying direct arrangements to, among other things, determine how they are structured, the extent to which issuers may be able to extract exclusive arrangements, and the prices at which these arrangements are negotiated.

A key feature of the Market Quality Program was transparency through market-level disclosures. As noted, NTM 75-16 expressed the NASD's view that market maker payments raised antifraud concerns. We believe that those concerns continue to be relevant more than four decades later, as did NASDAQ at the time it designed and sought approval for the Market Quality Program. As a result, NASDAQ sought to remedy antifraud concerns through disclosure. NASDAQ engineered the disclosure to identify the issuer and market-maker participants, the relevant securities, and the amount of payment. Is FINRA contemplating a similar marketplace disclosure regime that could disclose participants and conflicts of interest matters?

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20 NASDAQ Order, *supra* note 8, at 18401.

21 Letter from Andrew Madar, Senior Associate General Counsel, NASDAQ Stock Market, LLC, to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission (January 27, 2017).

Another issue that FINRA should consider is the effect that a change to Rule 5250 may have on other anti-manipulation rules, such as Regulation M under the Exchange Act. In particular, Rule 102 of Regulation M prohibits an issuer from, among other things, attempting to induce any person directly or indirectly to bid for or purchase a security while it is in distribution. The SEC has expressly concluded that payments to market markers would be such a prohibited, indirect inducement under Regulation M, absent an exemption.[22] Because of the SEC's position and the continuous distribution of ETFs, NASDAQ's Market Quality Program obtained an exemption from Rule 102 of Regulation M.[23] In the context of ETFs, the SEC staff has given limited relief from Rule 102 of Regulation M for ETFs, among others, but not in the context of payments to market makers, except in the case of the exchange programs.[24] If a modification of Rule 5250 is intended to permit payments to market makers trading off-exchange in ETFs in the OTC market, it appears that either issuers, on an individual basis, or FINRA, collectively, would need to obtain an exemption from Regulation M.

## II. Foreign Markets

NASDAQ favorably cited the experience of the European markets at the time it initially sought SEC approval for the Market Quality Program. It cited to, among other things, the experience of the NASDAQ OMX Nordic First North market and several studies that ostensibly correlated market-maker incentive programs with enhanced liquidity and tighter bid/ask spreads.[25] NASDAQ did not, however, make any structural comparisons of the European markets with those in the United States. It is our understanding that exclusive arrangements between issuers and market makers in Europe are not prohibited, and that "deep-pocket" issuers seek exclusive arrangements with well-performing market makers. Furthermore, we are not aware that the specific amount of incentives are limited or otherwise disclosed or that any empirical studies have been conducted to determine the anti-competitive effects, if any, of exclusive or costly arrangements. In light of the prevalence of direct arrangements, we believe inquiry of the structure and countervailing protections in the European experience would be critical to edify a review of Rule 5250.

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22 Securities Exchange Act Release No. 69196 (March 20, 2013), 78F.R. 18410 (March 26, 2013).

23 *Id.*

24 Relief from Rule 10b-6, the predecessor of Rules 101 and 102 of Regulation M, has existed for index ETFs since the early 1990s culminating in a series of industry-wide "class relief" positions, including following: *Fixed Income Exchange Traded Index Funds*, SEC No-Action Letter (pub. avail. April 9, 2007); *PowerShares Exchange Traded Fund Trust*, SEC No-Action Letter (pub. avail. Oct. 24, 2006); and *Securities Industry Association*, SEC No-Action Letter (pub. avail. Nov. 21, 2005). More recently, the staff has also addressed Regulation M in the context of actively managed ETFs. *See, e.g., PowerShares Actively Managed Exchange Traded Fund Trust*, SEC No-Action Letter (pub. avail. April 4, 2008); and *WisdomTree Trust*, SEC No-Action Letter (pub. avail, May 9, 2008).

25 *See, e.g.,* Skjeltorp, Johannes and Odegaard, Bernt Arne, *Why do Firms Pay for Market Making in Their Own Stock?* (March 2013).

In that regard, market making is a regulated activity under the revised European Markets in Financial Instruments Directive and generally qualifies the relevant market maker as an "investment firm."[26] There are generally two models of market-making agreements: (i) agreements under which the market maker receives a certain form of remuneration from the regulated market in which the market maker acts (*e.g.* in the form of rebates) and (ii) agreements where the issuer of the securities pays remuneration to the market maker. For example, certain of the trading venues in Germany, the Netherlands, and Scandinavia permit market maker incentives for providing liquidity. These incentive arrangements are pursuant to the Supplemental Directive of the European Commission setting forth minimum technical standards applicable to market-maker agreements and programs,[27] the totality of which were considered by the European Securities and Markets Authority based on open, public consultations and pursuant to a cost-benefit analysis.[28]

Notably, Article 2 of the Supplemental Directive prescribes the minimum content required of market-making agreements, including, among other things, setting performance standards (market makers "have to meet a minimum set of requirements in terms of presence, size and spread in all cases)"[29] and obligating market makers to establish surveillance and audit protocols of their market-making activities.[30] Further requirements for market makers may relate to the maximum spread of quotes, the minimum quotation value and presence requirements. The Supplemental Directive does not specify the structure or specific terms of incentive agreements other than the minimum standards set forth in Article 2 and their compliance with anti-market manipulation standards prescribed by Regulation (EU) No. 596/2014 of the European Parliament and of the Council.[31] And the content of market making agreements (at least to the extent they are made between the regulated market and the relevant market maker) does not necessarily have to be examined or approved by any national competent authorities (NCAs).[32]

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26 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU ("MiFID II").

27 *See* Commission Delegated Regulation (EU) 2017/578, supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards specifying requirements on market making agreements and schemes (June 13, 2016) ("Supplemental Directive").

28 *Id.*, at introductory comment 13.

29 Article 2, Section 1(b) and introductory reason no. 9.

30 Article 2, Section 1(c).

31 *See* Regulation (EU) 596/2014 of the European Parliament and of the Council on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC and 2004/72/EC (April 16, 2014) ("Regulation 596/2014").

32 MiFID II, supra note 26, at introductory reason 114.

Thus, the European model leaves discretion to trading venues to consider the specifics, such as the particular economics, of arrangements and to impose potentially more stringent performance standards. Market-maker incentive arrangements in Europe are subject to the minimum content and performance standards identified by Article 2 and a robust anti-market manipulation regime prescribed by The Market Abuse Regulation.[33] We believe a comparison of the structural aspects of the European model with the OTC market would be beneficial to determine the plausibility of any potential similar program for the OTC markets. This should lead to an informed analysis of the potentially positive and adverse consequences of possible modifications to Rule 5250 and ensure an appropriate implementation of a program design for SEC review.

**III. Standards for Rulemaking**

Section 15A(b)(6) of the Exchange Act prescribes the standards for FINRA's rules, namely that they must be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade ... to remove impediments to and perfect the mechanism of a free and open market and a national market system, ... to protect investors and the public interest ... " and protect against discriminatory practices among market participants.[34] The statute itself, therefore, requires a balanced approach to rulemaking. The same balanced approach was followed by the exchanges, which are subject to the same standards prescribed by Section 6(b)(5) of the Exchange Act in adopting their market-maker incentive programs.[35] If nothing else, a consideration of the record of the exchange proposals, particularly any impediments to success balanced against concerns expressed by the SEC, would be necessary to adopt any modifications to Rule 5250. In sum, we believe a filing consistent with Section 15A(b)(6) would need to consider:

- The intended scope of the revision. Any proposed changes to Rule 5250 would need to clearly identify the markets and securities intended to be affected. The proposal would need to consider: (i) the market structure, competitive, or discriminatory effects of inclusion or exclusion of markets and securities; and (ii) the reasons that justify an incentive program treating markets, securities types, and participants differently. Further, consideration should be given to the impact on small issuers that an incentive program may have, and whether the structure and costs to such a program could create insurmountable barriers to entry for small issuers.

- The reasons for permitting market-maker incentives. Any proposed changes to Rule 5250 would need to consider the apparent impediments the exchange programs had on promoting

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33 Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

34 15 U.S.C. §78o-3(b)(6).

35 15 U.S.C. §78f(b)(5)

competition, enhanced liquidity, and tighter bid/ask quotes. If the exchange programs did not attain their stated goals, what alternative design should be proposed to achieve those goals and can they be realistically implemented, while simultaneously protecting investors and the public interest?

- Safeguards intended by the program. Any proposed changes to Rule 5250 would need to consider the appropriate safeguards to mitigate potential market structure, competitive, and discriminatory effects. Are there performance standards that should be imposed to ensure that stated goals are achieved? Are there eligibility standards to consider? Should there be agreement/content standards similar to the European model? What, if any, limitations might there be to the economic or exclusivity terms in a negotiated incentive agreement? What level of transparency and disclosure should be required if payments from issuers to market makers are permitted?

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If FINRA or its staff has any questions concerning the comments above, or requires any additional information, please do not hesitate to contact the undersigned at (202) 778-9324 or Stacy L. Fuller at (202) 778-9475.

Sincerely,

C. Dirk Peterson

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