BLACKROCK®

January 29, 2018

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Submitted via email to: pubcom@finra.org

Re: FINRA Retrospective Rule Review on the Effectiveness and Efficiency of Its Payment for Market Making Rule; Regulatory Notice 17-41

Dear Ms. Mitchell,

BlackRock, Inc (together with its affiliates, "BlackRock")[1] appreciates the opportunity to respond to the FINRA Retrospective Rule Review on the Effectiveness and Efficiency of Its Payments for Market Making Rule ("Rule 5250").[2] Rule 5250 prohibits a member or associated person from accepting payment or other consideration, directly or indirectly, from an issuer or its affiliates and promoters, for publishing a quotation, acting as a market maker or submitting an application in connection therewith. The intent of Rule 5250 is to protect investors from illusory trading activity and preserve the integrity of the marketplace by ensuring that members act in an independent capacity when publishing a quotation.[3]

Blackrock supports market structure changes which foster transparency, promote stability, and protect investors, while preserving choice and competition. As an exchange-traded fund ("ETF") sponsor, BlackRock also seeks to foster liquidity and improve market quality for ETFs. Guided by these principles, Blackrock supports a review of Rule 5250 and recommends that FINRA consider whether an exemption should be made for ETFs, subject to appropriate disclosure requirements and other regulatory considerations.[4]

Markets have evolved dramatically since Rule 5250 was adopted.[5] ETF volume, which was only a small proportion of trading in 1997, has since grown to become a significant segment of the equity market. Today, ETFs on average represent approximately 30.6% of daily trading activity.[6] As a result, we believe it is worthwhile for FINRA to review the application of this rule

1 BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers, and other financial institutions, as well as individuals around the world. BlackRock is the investment adviser to the iShares family of exchange-traded funds ("ETFs"). BlackRock also advises non-US ETFs.

2 FINRA Regulatory Notice 17-41 (Nov. 28, 2017).

3 SEC Release No. 34-69398; File No. SR-FINRA-2013-020.

4 BlackRock notes that certain SEC rules and regulations will also need to be evaluated by ETF sponsors and market participants in order to rely on any potential exemption granted by FINRA under Rule 5250.

5 Rule 5250 was first codified as NASD Rule 2460 in 1997; SEC Release No. 34-38812; File No. SR-NASD-97-29. The policy was first stated in NASD Notice to Members 75-16 (Feb. 20, 1975).

6 Credit Suisse, Equity Trading Strategy, "2017 ETF Outlook: Trading Trends, Themes, and Tactics" (Jan. 19, 2017).

to ETFs in the context of its examination of Rule 5250 and consider whether Rule 5250 meets the objective of promoting healthy and effective markets across the entire equity ecosystem, particularly for ETFs.

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I. Overview of ETF Ecosystem

ETFs are investment vehicles which incorporate characteristics of both open-end and closed-end funds. Like traditional open-end mutual funds, ETF inflows and outflows are managed through an end of day process, where shares are created or redeemed at the current per share net asset value. ETFs typically publish their fund holdings in order to facilitate this primary market mechanism. Pre-approved institutions known as Authorized Participants (APs) intermediate the exchange of ETF shares for baskets of the underlying holdings on behalf of their customers, who may be broker dealers, market makers or end investors.[7]

Like closed-end funds, ETFs can also be bought or sold intraday on an exchange at market-determined prices, without requiring any activity in their underlying holdings. This trading activity is often facilitated by market makers, who provide liquidity in the ETF to offset short term imbalances of supply and demand. If an imbalance cannot be met by secondary market liquidity, market participants are incentivized to access the primary market through APs to create or redeem ETF shares in a manner which adjusts outstanding ETF supply to match market demand. A key distinction of ETFs is this arbitrage relationship which keeps ETF share prices highly aligned with the value of the underlying holdings.[8]

II. Differences between ETFs and Stocks

There are fundamental differences between ETFs and corporate stocks which serve to mitigate the underlying concerns addressed by Rule 5250. Opportunities for market maker manipulation are magnified when the primary means of price discovery is through the dissemination of quotes and trades in a security, which is generally the case for single-company stocks. However, unlike stocks, ETFs have an alternate valuation mechanism, which is defined by the intrinsic value of its underlying holdings. For the vast majority of ETFs that disclose their holdings on a daily basis, investors have ample transparency into the prices of the underlying securities owned by the ETF and can utilize this clarity to assess whether ETF quotes accurately reflect the net asset value.

Additionally, when a price discrepancy exists between the ETF share price and the value of its underlying holdings, market participants have a monetary incentive to oppose the trend by buying (selling) ETFs trading at a discount (premium) to the ETF's intrinsic value. As a result, the opportunities for manipulation in ETFs are limited because this arbitrage mechanism generally keeps ETF prices aligned with the intrinsic asset value. In fact, issuers strongly encourage this activity as they prefer to see their ETFs closely track the underlying basket rather than trade at significant discounts or premiums to fair value.

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7 BlackRock, *ViewPoint, A Primer on ETF Primary Trading and the Role of Authorized Participants* (Mar. 2017), available at https://www.blackrock.com/corporate/en-se/literature/whitepaper/viewpoint-etf-primary-trading-role-of-authorized-participants-march-2017.pdf.

8 BlackRock, *ViewPoint, Exchange Traded Products: Overview, Benefits and Myths* (Jun. 2013), available at https://www.blackrock.com/corporate/en-se/literature/whitepaper/viewpoint-etps-overview-benefits-myths-062013.pdf.

III. Revisiting Rule 5250

BlackRock believes that FINRA should re-examine Rule 5250 in the context of recent ETF growth. An exemption for ETFs may help issuers enhance market quality in their products which in turn will create a better trading experience for investors. Market makers play a crucial role in the health and market quality of an ETF. This is particularly true for newly launched or less actively-traded ETFs, which require greater investment and support by market makers. As such, policy makers should promote market structure changes that effectively increase market maker participation. Regulators have previously recognized that payments for market making may potentially "benefit investors in the form of enhanced liquidity, narrowed spreads, and reduced transaction costs."[9] In Europe, where direct payment models are permitted, our experience has shown that such programs demonstrably improve market quality. Since 2012, average spreads have steadily declined in BlackRock's European listed products with contracted market making agreements.

While exchanges currently offer indirect market maker programs, we believe that it would be worthwhile for ETF sponsors to have the option to explore more direct arrangements in addition to what is currently offered by exchanges. Intermediated incentive programs are often constrained by the exchange's model and do not provide issuers with sufficient flexibility. Direct payment models for market making could provide ETF sponsors with the ability to be more targeted in which products they support and the determination of the specific market quality metrics that drive the incentives. This would create a more competitive landscape and provide issuers with the discretion to employ additional tools to enhance market quality in their ETFs for the benefit of investors.[10]

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We commend FINRA for undertaking this retrospective analysis to ensure that Rule 5250 is meeting its intended objectives in light of market developments since the rule was adopted over two decades ago. We appreciate the opportunity to comment on this important endeavor. Please contact the undersigned if you have any questions or comments regarding BlackRock's views.

Sincerely,

Samara Cohen
Managing Director, ETF & Index Investments Global Markets

Joanne Medero
Managing Director, U.S. Head of Global Public Policy Group

Deepa Damre
Managing Director, Legal & Compliance

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9 SEC Release No. 34-69195; File No. SR-NASDAQ-2012-137.

10 It is important to note that while issuers may be able to improve market quality in normal market conditions through the use of market making incentives, these programs are not a panacea for extraordinary volatility events. BlackRock, *ViewPoint, US Equity Market Structure: Lessons from August 24* (Oct. 2015), available at https://www.blackrock.com/corporate/en-se/literature/whitepaper/viewpoint-us-equity-market-structure-october-2015.pdf.