February 7, 2018

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

Re: FINRA's Regulatory Notice 17-41

Dear Ms. Mitchell:

Exponential ETFs ("Exponential" or "we") is pleased to submit this response letter to Financial Industry Regulatory Authority ("FINRA") on Regulatory Notice 17-41 regarding the effectiveness and efficiency of FINRA Rule 5250 (Payments for Market Making).

Exponential ETFs is an independent ETF issuer based in Ann Arbor, MI. Our principals have held numerous leadership positions in the ETF industry, including managing functions across market structure, capital markets, trading and ETF operations. We launched our first fund on November 1, 2016, and most recently, our third fund on November 1, 2017. As of February 6, 2018, we are managing $52 million in assets under management in our proprietary funds as well as $161 million that we manage as a sub-advisor for our partners. We have no ownership affiliations with any banks or larger asset managers. Asset Management firms, like the clients they serve, vary greatly in both size and perspective. We are submitting this comment letter because it is important in a discussion regarding the best interest of all investors that the views of the entire spectrum of asset management firms are heard.

1. We believe that it is critical that changes to market structure be considered with the impact to end-investors in mind. While exchanges, market makers and industry trade groups ultimately share the same goal (investor confidence is good for business all around), it is the issuers who are interacting with end-investors in an ongoing basis. The ETF issuers depend on the recurring revenue from investors and financial professionals, which will only result from good trading executions and experiences. As such, ETF issuers are the most incentivized to advocate on behalf of investors without conflict.

2. ETFs are derivatively priced and subject to multiple requirements that enforce transparency of pricing, including requirements to publish holdings daily, intra-day dissemination of underlying index values, dissemination of fund IOPV/iNAV in real time, and limitations on eligible securities based in part on the efficacy of the underlying pricing. As such, we do not believe that it is possible for a market maker to manipulate pricing in return for payment. Simply, if a market maker priced the bid above fair value, or the offer below fair value, market participants would trade against them and exploit the mispricing to the market maker's detriment.

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3. We recognize that there is a cost to lead market makers for providing market making services. That cost can be measured by the cost of capital tied up in "inventory" as the lead market maker sells down their shares of a fund, and it also includes the risk of pricing a security in real time. A mispricing error exposes that market maker to substantial risk. Meanwhile, non "lead" market makers can still price and trade ETFs opportunistically, but do not have the burden of ongoing quoting obligations. The offsetting incentive for a market maker to take on the "lead" designation is provided by the exchanges in the form of enhanced rebates. However, the following issues need to be considered:

    a. Lead market makers only receive enhanced rebates on the trading volume for which they themselves provide liquidity. As such, the total volume of only their participation rate – and "maker" only – is subject to enhanced rebates. Further, lead market makers only receive enhanced rebates for the volume performed on the primary listing exchange. As trading venue fragmentation increases, the volume eligible for the enhanced rebates are divided further. This has led to an incentive structure that inadequately compensates market makers for their services in the vast majority of ETFs.

    b. Incentivizing by trading volume favors funds from issuers who can outspend on distribution, creating volume which in turn compensates market makers through the current incentive structure. As such, the playing field becomes uneven.

    c. Incentivizing by trading volume favors "trading instruments" relative to buy-and-hold long term investments. We don't expect FINRA to make a judgement on which type of funds are more beneficial to investors, but it is potentially dangerous to incentivize new product offerings geared towards the former relative to the latter.

4. FINRA Rule 5250 currently prohibits payments from issuers to market makers for market making services. It must be noted, however, that many of the ETF issuers and market makers are global firms that enjoy multiple revenue lines and areas of synergies across their organizations. Asset management firms typically require trading and related services well beyond just ETF market making. As such, Rule 5250 encourages a system where services are bartered (whether spoken or unspoken), which leads to a market structure where firms that have business partnerships in place elsewhere in their organizations find themselves in a strong position to secure lead market makers. With limited market maker capacity and inadequate incentives, this may come at the expense of the investors in funds from smaller or independent issuers. The investors trading in a fund managed by a small company should have the same opportunity to enjoy competitive spreads as the investors trading in funds managed by global banks.

5. By exempting ETFs from FINRA Rule 5250, we believe that compensation for market making services will be brought into the light. We believe that a price discovery for those services will occur, and that trading firms will compete not only on price, but also on the quality of market that they provide. Ultimately, investor trading experiences will be bolstered as investors receive more consistent, transparent, and fair pricing.

We appreciate the opportunity to participate in this process and the opportunity to provide our view. We thank FINRA for its consideration and transparency of process, and we will make ourselves available should any questions arise, or information be requested.

Sincerely,

S. Phillip Bak
Chief Executive Officer
Exponential ETFs