

MEMO# 26142

May 3, 2012

ICI Letter on NASDAQ Proposal to Establish the Market Quality Program

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TO: ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 12-12
ETF ADVISORY COMMITTEE No. 10-12
EQUITY MARKETS ADVISORY COMMITTEE No. 7-12
CLOSED-END INVESTMENT COMPANY MEMBERS No. 22-12 RE: ICI LETTER ON NASDAQ
PROPOSAL TO ESTABLISH THE MARKET QUALITY PROGRAM

ICI has filed a letter with the SEC on a NASDAQ Stock Market proposal to establish the "Market Quality Program" ("MQP"), the market maker incentive program that would allow ETF sponsors to indirectly pay market makers for enhancing the market quality of ETFs, particularly less liquid and lightly traded ETFs, listed on NASDAQ.

As a preliminary matter, the letter states that given the significance of the changes that the MQP would make to the interaction between an issuer of MQP Securities, i.e., ETFs, and a market maker of those securities and the importance, in general, of the issues raised by an issuer providing payments for market making, ICI is concerned about the brevity of the time period for providing comments on the proposal, i.e., 21 days from publication of the proposal in the Federal Register. Given this short amount of time, the letter states that ICI does not endeavor to focus its comments on the specific parameters of the program.

The letter supports the overall goal of the MQP - to incentivize market makers to make high-quality, liquid markets in ETFs. To the extent the MQP results in narrower spreads and more liquid markets for ETFs, without any associated unintended consequences for ETFs or the markets as a whole, the letter states that the MQP could prove beneficial. Similarly, increased competition among market makers should be encouraged and could result in better quotes by market makers for ETFs. The letter notes that liquid markets are critical for ETFs, particularly smaller and less frequently traded ETFs.

The letter states, however, that the MQP would represent a departure from the current rules precluding market makers from directly or indirectly accepting payment from an issuer of a security for acting as a market maker. The letter therefore supports the establishment of the MQP at this time only through a pilot program as contemplated by the

proposal to allow NASDAQ and the SEC the opportunity to evaluate the impact of the program on the quality of markets in ETFs prior to considering its permanent approval.

Finally, the letter supports efforts by NASDAQ to address concerns about investor confidence and market integrity that are associated with the MQP through, among other things, disclosure requirements and overall transparency built into the program. The letter notes, however, that the Release is silent regarding the extent of the availability of data gathered under the pilot program for ETF sponsors participating in the program. The letter therefore encourages NASDAQ to ensure that data surrounding the operation of the MQP is readily available to ETF sponsors participating in the program to allow issuers the opportunity to examine statistics on the performance of MQP market makers and to assess how much liquidity is being provided by those market makers.

Ari Burstein
Senior Counsel - Securities Regulation

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