

**MEMO# 26123**

May 1, 2012

## **Draft 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 RE: DRAFT ICI LETTER ON NASDAQ  
PROPOSAL TO ESTABLISH THE MARKET QUALITY PROGRAM

As we previously informed you, the NASDAQ Stock Market has filed a proposal with the SEC 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.

Comments on the proposal are due to the SEC no later than Thursday, May 3; attached is ICI’s draft comment letter on the proposal. If you have any comments on the draft letter, please contact the undersigned at [aburstein@ici.org](mailto:aburstein@ici.org) or by phone at 202/371-5408 by COB Wednesday, May 2.

As a preliminary matter, the draft 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 draft letter states that ICI does not endeavor to comment on the specific parameters of the program.

The draft letter supports the 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, the draft letter states that the MQP would be beneficial to the markets. Similarly, increased competition among market makers should be encouraged and could result in better quotes by market makers for ETFs. The draft letter notes that liquid markets are critical for ETFs, particularly smaller and less frequently traded ETFs.

The draft 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 draft 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 draft 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 draft 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 draft 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.

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[Attachment](#)

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