

MEMO# 26079

April 24, 2012

NASDAQ Proposal to Establish the Market Quality Program

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TO: ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 9-12
ETF ADVISORY COMMITTEE No. 9-12
EQUITY MARKETS ADVISORY COMMITTEE No. 6-12 RE: NASDAQ PROPOSAL TO ESTABLISH THE MARKET QUALITY PROGRAM

The NASDAQ Stock Market has filed a proposal with the SEC to establish the “Market Quality Program” (“MQP”) to enable market makers that enhance the market quality of certain securities listed on NASDAQ (“MQP Securities”) to qualify for a fee credit pursuant to the program. The most significant aspects of the proposal are discussed below. [\[1\]](#)

Market Quality Program

The proposed MQP is a voluntary program designed to promote market quality in MQP Securities. MQP Securities may include Exchange Traded Funds (“ETFs”), Linked Securities (“LS”), and Trust Issued Receipts (“TIRs”). According to NASDAQ, however, MQP Securities will predominantly, if not entirely, consist of ETFs. The proposal notes that because the MQP is designed to provide market quality support to smaller, less frequently traded segments of securities, an MQP Security will no longer be eligible to remain in the MQP if the security sustains an average NASDAQ daily trading volume of two million shares or more for three consecutive months.

An MQP Company, such as an ETF sponsor, must go through an application process, and NASDAQ must accept the MQP Company into the program, before an MQP Company can list a product pursuant to the program. An MQP market maker also must go through a separate application process, and NASDAQ must accept an MQP market maker into the program, before an MQP market maker can make a market in a product listed pursuant to the program.

An MQP Company seeking to participate in the MQP must pay NASDAQ an annual basic “MQP Fee” of \$50,000 per MQP Security, paid in quarterly installments. The basic MQP Fee will be allocated equally between a “Quote Share Payment” that is based on qualified quotes and a “Trade Share Payment” that is based on qualified trades.

An MQP Company also may choose to pay an annual supplemental MQP Fee per MQP Security. The basic MQP Fee and supplemental MQP Fee when combined cannot exceed \$100,000 per year. The amount of the supplemental MQP Fee, if any, will be determined by the MQP Company on an annual basis and an MQP Company will indicate the proportions between 0% and 100% in which the supplemental MQP Fee will be allocated to the Quote Share Payment and/or Trade Share Payment.

All revenue from MQP Fees (basic and supplemental) will be credited pro rata to the eligible MQP market maker in an MQP Security based on meeting certain market quality standards. Specifically, for at least 25% of the time when quotes can be entered in the regular market session as averaged over the course of a month, an MQP market maker must maintain at least 500 shares of attributable, displayed quotes or orders at the NBBO or better on the bid side and on the offer side of an MQP Security. In addition, for at least 90% of the time when quotes can be entered in the regular market session as averaged over the course of a month, a MQP market maker must maintain at least 2,500 shares of attributable, displayed posted liquidity on NASDAQ that are priced no wider than 2% away from the NBBO on the bid side and on the offer side of an MQP Security.

The proposal contains a number of disclosure requirements associated with the MQP. Specifically, NASDAQ will provide notification on its public website regarding the names of the MQP Companies and the MQP market makers that are accepted into the program; how many MQP Securities an MQP Company may have in the program; the specific names of the MQP Securities that are listed pursuant to the program; the identity of the MQP market makers in each MQP Security; and the amount of the supplemental MQP Fee, if one is established by an MQP Company, in addition to the basic MQP Fee.

At the end of the proposal, the SEC requests comment on a number of issues relating to the MQP including:

- the impact of the MQP on the operating companies that comprise the index underlying exchange-traded products and whether being included as a “component” of an exchange-traded product, such as an ETF, results in benefits to an individual operating company;
- whether the MQP would encourage tighter quoted prices and greater quoted size at the NBBO for MQP Securities and whether the MQP would result in MQP market makers quoting at better prices (and larger sizes) than they would otherwise quote without the incentives provided by the program;
- whether the MQP would raise concerns regarding investor confidence, market integrity, and member standards and whether there could be conflicts of interest between an MQP Company and the designated MQP market maker for the MQP Securities participating in the program;
- whether the MQP Company paying the MQP Fee should be the sponsor or the fund and what impact, if any, would there be on fund investors if the fund pays the MQP Fee as opposed to the sponsor;
- whether authorized participants participating in the creation and redemption of shares of MQP Securities that are also MQP market makers in those same MQP Securities should be eligible to receive MQP fee credits; and
- questions related to the public disclosure of information regarding the program.

endnotes

[1] The proposal can be found on the SEC's website at <http://www.sec.gov/rules/sro/nasdaq/2012/34-66765.pdf>. Comments on the proposal are due to the SEC no later than May 3.

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