

**MEMO# 22427**

April 15, 2008

## **Nasdaq Modifies Incentive Program for Market Makers in ETFs**

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TO: ETF ADVISORY COMMITTEE No. 7-08    RE: NASDAQ MODIFIES INCENTIVE PROGRAM FOR MARKET MAKERS IN ETFS

A proposed rule change filed by the Nasdaq Stock Market to modify a pricing incentive program for market makers in ETFs and index-linked securities (“ILS”) has become immediately effective upon its filing with the Securities and Exchange Commission.\*

Last year, Nasdaq introduced a pricing incentive program for market makers in which a market maker in an ETF or ILS may become a “Designated Liquidity Provider” in a “Qualified Security” and receive favorable incentive pricing. A Designated Liquidity Provider must commit to maintain minimum performance standards for which the performance measurements include: (1) percent of time at the national best bid/best offer (“NBBO”); (2) percent of executions better than the NBBO; (3) average displayed size; and (4) average quoted spread. A Qualified Security is an ETF or ILS that is listed on Nasdaq, has at least one Designated Liquidity Provider, and trades at volumes below a Nasdaq-designated maximum trading volume. The incentive program requires Designated Liquidity Providers to pay \$.003 per share when accessing liquidity in Qualified Securities and, when providing liquidity, they receive a credit of \$.004 per share executed.

From the incentive program’s inception, the maximum trading volume had been set such that a security was no longer eligible to be a Qualified Security once there had been two calendar months in any three calendar-month period during which its average daily volume on Nasdaq exceeded 250,000 shares. The proposed rule change increased the maximum

volume threshold to 10,000,000 shares. Once the 10,000,000-share volume threshold is reached, the pricing for the ETF or ILS becomes consistent with pricing for other securities traded on Nasdaq. In the Release, Nasdaq states its belief that the incentive program will “encourage the development of new financial products, provide a better trading environment for investors in ETFs and ILSs, and encourage greater competition between listing venues for ETFs and ILSs.”

Heather L. Traeger  
Assistant Counsel

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