



10/25/2010

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington DC 20549-1090

**RE: SR-NASDAQ-2010-121**

**Dear Ms. Murphy:**

We are registering opposition in part to SR-NASDAQ-2010-121, a proposed rule change that clarifies some existing fees and rebates for displayed and non-displayed orders and adds a new rebate tier for Tape B securities listed principally via the NYSE-owned Amex and Arca facilities. These roughly 1,300 securities are comprised in significant proportion by ETFs and other derivative products.

We track trading patterns for dozens of public companies, applying database and software tools to historical trade-execution data on behalf of clients to help them understand price-setting forces in contemporary, complex trading environments.

First, we take no umbrage with the professional efforts of the Exchange to compete fairly in its marketplace. We respect the NASDAQ's efforts to navigate a complex environment fairly for its members, appreciate the thought that buttresses decisions to unify rebates and fees for displayed and non-displayed orders, and realize that market structure demands of the NASDAQ regular changes to keep pace with competition and fluctuating volumes.

But these changes do not account for the chilling effect of incentivized making and taking on fundamental investment in issuer securities. Issuers are a core constituency. At root, the shares of public companies support every transaction in the equity markets. Rebate tiers affect trading behavior, causing the whole trading food chain, from the buy-side, through the sales and position traders, and various OMS/EMS algorithmic constructs, to focus first on liquidity. Oftentimes, that means diminished investment and increased short-term trading. These two are not the same objectives.

We observe it in data we track for clients. Anecdotally, in 2001 about 50% of volume on a given day was "rational," or predicated on an investment thesis, the execution of which involved competing with other market forces. Today, data indicate that rational investment rarely accounts for more than 10% of daily volume for any issuer we serve. For large companies with vast liquidity, rational investment is often less than 3% of daily volume.

We have permitted a structure that discourages patient commitment to positions, and encourages volume and transactions. Naturally, speculative, rational and risk-management forces have evolved and adapted to this structure, so that all trading incorporates elements of speculation. Risk-management systems mathematically account for make-take spreads and supply/demand imbalances. Rational investment now

blends in yields from derivative securities traded around equity positions (structured products, index arbitrage). Speculative traders intermediate the objectives of both these forces, capturing rebates and fleeting spreads in multiple asset classes, and moving liquidity between market centers. These realities have overshadowed fundamental investment theses. Yet volume generated through complicated make/take schemes is in a sense an illusion – what an executive described as “confusing busy with productive.”

These conditions are not good for issuers. In offering a statutory basis for Rule Filing 121, the NASDAQ quotes 15 U.S.C. 78f, and f (b) 4, Section 6 of the Act, as follows: “...it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system which NASDAQ operates or controls.”

But it’s not equal at all. Dues and fees may be equitably distributed among members, but these incentives, especially the new rebate tier in Tape B Securities, are contrary to issuer priorities, including capital formation, linkage between share price and underlying intrinsic investment value, and transparency into trading activity.

As a Self Regulatory Organization, the NASDAQ must treat members and issuers fairly and equally. What offset have issuers been offered, in comportment with a statement of equitable allocation of reasonable dues, fees and other charges, for the fact that more traders are being incentivized to trade things that generally redact visibility and transparency into issuer trading, that may reduce the efficiency of equity trading (because derivative products often do not reflect fundamental valuation metrics), and which may serve to further weaken the tenuous tie tethering issuer financial and operating fundamentals to share prices?

It’s a sincere effort by the NASDAQ. But the first principles of the Commission’s regulatory structure are not being met. If such a risk exists, there are firm bases for the Commission to contravene:

The SEC Act of 1933 says in Section 2(b): *“Whenever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote...capital formation.”*

Section 15A of the Securities and Exchange Act of 1934 governing the predecessors to current self-regulatory organizations, also 15 U.S.C. 78f(b)5, says in paragraph b (6): *“The rules...are designed...to promote just and equitable principles of trade...to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers ....”*

We cannot rightfully degrade the interests of the issuers for the benefit of either members or the NASDAQ itself. The rules insist on fair and equal treatment for members and issuers alike. We respectfully petition the Commission to disapprove the new rebate tier in Rule 121, unless the NASDAQ can offer substantive offsets to issuers, whose interests stand to be harmed by enhanced, incentivized trading in securities other than their own.

Yours very truly,



Timothy Quast  
Managing Director