NASDAQ OMX[SM]

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Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: File No. SR-NASDAQ-2012-043; Release No. 34-66765

Dear Ms. Murphy:

This letter responds to comments received in connection with the Securities and Exchange Commission's (the "SEC" or "Commission") order instituting proceedings with respect to rule filing SR-NASDAQ-2012-043 (the "Filing"), as amended ("Second Response").[1] The Filing by NASDAQ OMX LLC ("NASDAQ" or "Exchange") would create a voluntary Market Quality Program ("MQP" or "Program"). The MQP would enable market makers that voluntarily commit to and do in fact enhance the market quality, in terms of quoted spreads and

[1] Securities Exchange Act Release No. 66765 (April 6, 2012), 77 FR 22042 (April 12, 2012)(SR-NASDAQ-2012-043)(Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Establish the Market Quality Program 2012)("Notice"). The Commission extended until July 11, 2012, the time within which it may approve or disapprove the proposed rule change or institute proceedings to determine whether the proposed rule change should be disapproved. Securities Exchange Act Release No. 67022 (May 18, 2012), 77 FR 31050 (May 24, 2012)(the "extended period"). The Exchange submitted a response to comments submitted pursuant to the Notice and extended period ("Initial Response"). Letter of Joan C. Conley, Senior Vice President and Corporate Secretary, NASDAQ OMX LLC, dated July 6, 2012. The Commission issued an order instituting proceedings to determine whether to approve or disapprove the MQP proposal at SR-Phlx-2012-043 and NYSE Arca's market maker proposal at NYSEArca-2012-37 ("Order Instituting Proceedings"). Securities Exchange Act Release No. 67411 (July 11, 2012), 77 FR 42052 (July 17, 2012)(File Nos. SR-NASDAQ-2012-043; SR-2012-NYSEArca-2012-37)(Order Instituting Proceedings To Determine Whether To Approve or Disapprove Proposed Rule Changes Relating to Market Maker Incentive Programs for Certain Exchange-Traded Products).

liquidity, of certain securities listed on the Exchange to qualify for a fee credit. These market makers would be eligible for a fee credit only to the extent that they maintain stringent quoting and liquidity standards set forth in the Program. The MQP is proposed as a one year pilot, during which time the Exchange will periodically inform the Commission about market quality within the MQP. NASDAQ believes that the MQP will benefit issuers, investors and other market participants, and contribute to the economy in general by significantly enhancing the quality of the market and trading in listed securities.

There is a vital need for the MQP in the U.S. market for products facing liquidity challenges. As noted in the Filing and in the Initial Response, the Exchange is proposing the MQP for several reasons.[2] First, to encourage narrow spreads and liquid markets where this has not occurred naturally. Second, to reward market makers that are willing to "go the extra mile" to develop liquid markets for MQP securities, and thereby benefit traders and investors by encouraging more quote competition, narrower spreads and deeper liquidity. Third, to lower transaction costs and enhance liquidity in both ETFs and their components,[3] making those securities more attractive to a broader range of investors; which, we believe, will help companies access capital to invest and grow. And fourth, to attract smaller, less developed funds, companies and investment opportunities to a regulated and transparent market and thereby serve the dual function of providing access to on-Exchange listing while expanding investment and trading opportunities to market participants and investors.

In response to the Notice, the Commission received ten favorable comment letters urging the Commission to approve the MQP.[4] As we note in our Initial Response, which is incorporated herein by reference, four of the favorable letters are penned by academicians that have personally authored research papers regarding international and European programs similar to MQP ("Market Incentive programs"),[5] or have surveyed the scholarly literature regarding these Market

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[2] Filing, p. 3 of 17; Initial Response, pp. 1-2 of 21.

[3] While Trust Issued Receipts ("TIRs") and Linked Securities ("LSs") can be listed through the MQP, the Exchange believes that the products listed pursuant to the MQP will be predominantly, if not exclusively, exchange traded funds ("ETFs"). As such, in this Second Response letter the Exchange will focus its comments on ETFs. Moreover, as the Exchange noted in its proposal, ETFs have a multi-layered structure that makes it virtually impossible for a market maker to manipulate the price (NAV) of an ETF product in the MQP; we believe this makes ETFs particularly good candidates for the initial MQP pilot. Initial Letter, p. 2 of 21. Filing, p. 7 of 17.

[4] See supra note 1.

[5] See Paying for Market Quality, Working Paper F-2006-06 by Amber Anand, Carsten Tanggaard, and Daniel G. Weaver, November 2005, Aarhus School of Business; and How Do Designated Market Makers Create Value for Small-Caps? by Albert J. Menkveld and Ting Wang, August 1, 2011. See also Why do Firms Pay for Market Making in Their Own Stock? by Johannes A. Skjeltorp, Norges Bank, and Bernt Arne Odegaard, University of Stavanger and

Incentive programs: Professor Daniel G. Weaver, Professor Amber Anand, Professor Albert J. Menkveld, and Professor James J. Angel.[6] The letters in support also include: industry groups such as the Investment Company Institute, TechNet, and Managed Funds Association;[7] a major liquidity center, Knight Capital Group;[8] and a published ETF industry author, Gary L. Gastineau.[9] The favorable comments were generally lengthy and well-supported; they also include one anonymous email submission.[10]

As we noted in our Initial Response,[11] the unfavorable comment letters were submitted during the early part of the Notice comment period and were generally short, conclusory emails; and one comment letter neither supported nor opposed the MQP proposal.[12]

Norges Bank, June 2011; Why Designate Market Makers? Affirmative Obligations and Market Quality by Hendrik Bessembinder, Jia Hao, and Michael Lemmon, June 2011; and Designated Sponsors and Bid-Ask Spreads on Xetra by Jördis Hengelbrock, October 31, 2008.
These academic works, which were cited in our MQP proposal, discuss the positive aspects of Market Incentive programs in Europe (e.g. lowered spreads and transaction costs, increased liquidity) and provide strong support for the MQP proposal. Filing, pp. 4-6.

[6] Letter from Daniel G. Weaver, Ph.D., Professor of Finance, Rutgers Business School, dated April 26, 2012. Letter from Amber Anand, Associate Professor of Finance, Syracuse University, dated April 29, 2012. Letter from Albert J. Menkveld, Associate Professor of Finance, VU University Amsterdam, dated May 2, 2012. Letter from James J. Angel, Ph.D., CFA, Associate Professor of Finance, Georgetown University, dated May 2, 2012.

[7] Letter from Ari Burstein, Senior Counsel, Investment Company Institute, dated May 3, 2012. Letter from Rey Ramsey, President and CEO, TechNet, dated June 20, 2012. Letter from Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, Managed Funds Association, dated July 3, 2012.

[8] Letter from Leonard J. Amoruso, General Counsel, Knight Capital Group, Inc., dated May 4, 2012.

[9] Letter from Gary L. Gastineau, Managing Member, ETF Consultants LLC, dated June 11, 2012. Mr. Gastineau is the author of the ETF Exchange-Traded Funds Manual, 2nd edition (Wiley, 2010).

[10] Anonymous email, Amherst, Massachusetts, dated April 18, 2012.

[11] Initial Response, p. 13 of 21.

[12] The first Vanguard comment letter neither supporting nor opposing the MQP raised several areas of concern. Our responses are at pp. 17-20 of 21 in the Initial Response. NASDAQ will discuss in detail the single unfavorable comment letter submitted pursuant to the Order Instituting Proceedings (the second Vanguard letter), which delved more deeply into the Program and its policy implications.

All But One of the Comment Letters Pursuant to the Order Instituting Proceedings Support Approval of the MQP[13]

Five comment letters were submitted in response to the Commission's Order Instituting Proceedings. Four of the comment letters support approval of the MQP. These four letters in support of the Filing include: an academic;[14] an industry group that represents ETFs;[15] and two major liquidity centers.[16]

In addition, a sixth comment letter was submitted with the same date as the Order Instituting Proceedings; this letter also supports approval of the MQP.[17] Only one comment letter – the second Vanguard letter – recommends against going forward with the MQP.[18]

We now discuss the comment letters that were submitted pursuant to the Order Instituting Proceedings.[19]

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[13] In light of the joint nature of the Order Instituting Proceedings, the comment letters refer to both SRO Programs.

[14] Letter from Stanislav Dolgopolov, Assistant Adjunct Professor, UCLA School of Law, dated August 15, 2012.

[15] Letter from Ari Burstein, Senior Counsel, Investment Company Institute ("ICI"), dated August 16, 2012.

[16] Letter from James E. Ross, State Street Global Advisors ("State Street"), dated August 16, 2012. Letter from Andrew Stevens, Legal Counsel, IMC Chicago, LLC d/b/a IMC Financial Markets ("IMC"), dated August 16, 2012.

We note that representatives of State Street and Vanguard (in conjunction with other similar firms), whose letters we discuss herein, met with various SEC staff members to discuss, among other things, the MQP and Fixed Incentive Program proposals. See http://www.sec.gov/comments/sr-nasdaq-2012-043/nasdaq2012043-18.pdf.

[17] Letter from Joseph Cavatoni, Managing Director, and Joanne Medero, Managing Director, BlackRock, Inc. ("BlackRock"), dated July 11, 2012.

[18] Letter from F. William McNabb, Chairman and Chief Executive Officer, Vanguard, dated August 16, 2012. As noted, the first Vanguard comment letter neither supported nor opposed approval of the MQP.

[19] We note that throughout this Second Response, we strive to group commenter quotations according to commenter, and cite to the appropriate comment letter in the beginning of each such grouping.

Professor Stanislav Dolgopolov of UCLA School of Law believes that the STO Proposals, and the MQP proposal in particular, should go forward and states that "this pilot-basis experimentation is still desirable."[20] In answer to the Commission's question 3 (whether the studies cited by NASDAQ and commenters supportive of the MQP were adequate and whether there are alternate studies), Professor Dolgopolov noted that one study that "…compared the market qualities of securities that did not participate in such a program to the market qualities of similar securities that participated in the same program" analyzed the introduction of designated market makers for less liquid equity securities traded on the Paris Bourse.[21] Professor Dolgopolov states that "[t]he study in fact found that the introduction of a designated market maker appears to improve market quality and company valuation relative to the control sample."

In answer to the Commission's question 8 (whether the SRO Programs represent a subsidization of ETPs that are unable to generate trading volume and should perhaps be allowed to fail, and whether the programs should have a time limit or continue indefinitely), Professor Dolgopolov notes that the term subsidy should not necessarily have a negative connotation in that "liquidity in securities market has characteristics of a public good / positive externality, and, accordingly, the function of providing liquidity has to be subsidized in certain situations in order to improve economic welfare." Professor Dolgopolov states further that "[h]istorically, market makers have often enjoyed indirect subsidies in the form of time, information, fee, order flow allocation, and other advantages in exchange for their trading obligations," and notes that "this phenomenon is also consistent with the concept of liquidity as a public good."[22] Regarding timing, Professor Dolgopolov states: "it is entirely possible that a continued subsidization of market making activities may be required at later stages - depending on the liquidity characteristics of the security in question - in order to increase economic efficiency.

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[20] Letter from Stanislav Dolgopolov ("Dolgopolov"), Assistant Adjunct Professor, UCLA School of Law, dated August 15, 2012. Professor Dolgopolov's expertise is based on several publications and ongoing research on various economic and legal issues relating to market making. Dolgopolov letter, note 2.

[21] Kumar Venkataraman & Andrew C. Waisburd, The Value of the Designated Market Maker, 42 J. FIN. & QUANT. ANALYSIS 735 (2007). This study was referenced in Professor Anand's comment letter in response to the Notice. Letter from Amber Anand, Associate Professor of Finance, Syracuse University, dated April 29, 2012.

[22] Furthermore, Professor Dolgopolov states that "perhaps a direct subsidy in the form of regular payments from an issuer / sponsor to a market maker has a clear advantage in terms of transparency - especially when this compensation flows through and is monitored by the trading venue in question." We have discussed the transparency of the MQP, and the fact that the Exchange stands between the issuer and market maker, extensively in the Filing and Initial Response.

Accordingly, a time limit on participation in a market maker incentive program might not be necessary as a hard constraint."[23]

In answer to the Commission's question 14 (whether having competing market makers under the MQP proposal or only one market maker under the Fixed Incentive Program would impact the potential benefit of those programs), Professor Dolgopolov states that although one study suggested that multiple market makers may instill free rider possibilities,[24] this should be mitigated by "the specificity of the eligibility criteria." Professor Dolgopolov believes that having just one market maker "would be detrimental to competition," but recognizes that a mechanism can be set up to reduce this. We agree, as we have noted previously and discuss in this response, that a multiple market maker system like the MQP is pro-competitive and would be advantageous to market participants.

And in answer to the Commission's question 27 (whether commenters agree with NASDAQ's and Arca's assertions as to the respective programs' potential impact on efficiency, competition, and capital formation), Professor Dolgopolov states that "Several empirical studies argue that the imposition of market making obligations in exchange for certain privileges tends to enhance market quality,[25] and *this evidence points to improvements in economic efficiency rather than mere wealth transfers* [emphasis ours]." Professor Dolgopolov believes that the SRO Proposals are likely to promote economic efficiency "[t]o the extent that the proposed market maker incentive programs promote the adoption of trading obligations that enhance liquidity [as the MQP does] and push it closer to the socially optimal level."[26] The professor notes that while "it is hard to predict the magnitude of the overall impact of the proposed programs on capital formation with respect to component securities," the pilot STO Programs are still desirable. Finally, the professor notes that implementation of the proposals (and, we believe, the MQP in particular) may allow us to learn about "the feasibility of such arrangements for small cap stocks, as opposed to exchange-traded products."[27]

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[23] We believe, as we have noted, that rather than a hard time limit the best measure is whether a product is successful from the liquidity perspective (e.g. 2 million shares ADV for 3 consecutive months), and have proposed this approach in the MQP. Initial Response, p. 14 of 21; Filing, p. 7 of 17.

[24] Dolgopolov letter, note 17.

[25] Dolgopolov letter, note 18.

[26] See p. 2 of this letter and Filing.

[27] Another commenter, TechNet, recognized the applicability of the MQP to small cap companies. Letter from Rey Ramsey, President and CEO, TechNet, dated June 20, 2012 ("Looking forward, the MQP could benefit promising tech companies that today may lack liquid, quality markets. Improving the U.S. capital markets will help foster high-growth companies that are essential to our nation's long-term competitiveness in the global economy.").

The ICI submitted a second comment letter supporting the MQP;[28] we discussed the first ICI comment letter, which supports approval of the MQP, [29] in our Initial Response. In the second comment letter ICI supports approval of the MQP on a pilot basis, reiterating that "as ETF sponsors, ICI members have a strong interest in ensuring that the securities markets are highly competitive and that the regulatory structure that governs the markets encourages liquidity, transparency, and price discovery." This is, we believe, precisely what the MQP proposal encourages. ICI continues to support the goal of the SRO Programs "to incentivize market makers to make high quality, liquid markets in ETFs." ICI specifically notes three characteristics of the MQP proposal: termination once a security is sustaining liquidity at an ATV of 2,000,000 shares or more for three consecutive months, higher performance standards for market makers participating in the MQP, and specific standards that market makers must comply with to obtain additional fees. ICI recommends additional eligibility criteria, higher performance standards, and objective performance standards for the Fixed Income Program for approval.

ICI believes that "it is critical that if the Programs are approved, they be implemented on a pilot basis." This is what we are proposing for the MQP. We agree with ICI's statement that instituting the SRO Programs as pilots would afford "NASDAQ and NYSE Arca, as well as the SEC,…an opportunity to evaluate the impact of the Programs on the quality of markets in ETFs prior to considering their permanent approval…." ICI notes its support for provisions in the proposals that will require NASDAQ and Arca "to provide information to the SEC during the pilot about market quality associated with the Programs to assist in the comparison of ETFs before and after they are in the Programs…," compare ETFs participating and not participating in the Programs, and provide information regarding overall program operation. As we have noted in the Initial Response and Filing, we have structured the MQP to supply numerous program metrics to the SEC (e.g. Rule 605 metrics; volume metrics; number of MQP Market Makers in MQP securities; spread size; and availability of shares at the NBBO).[30] Moreover, in addition to extensive metrics, we have structured the MQP to be very transparent as the program progresses through the pilot period (e.g. the Exchange's public website will contain the names of

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[28] Letter from Ari Burstein, Senior Counsel, Investment Company Institute, dated August 16, 2012. The ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts. Members of ICI manage total assets of $13.4 billion and serve more than 90 million shareholders.

[29] Letter from Ari Burstein, Senior Counsel, Investment Company Institute, dated May 3, 2012. For Exchange discussion regarding the first ICI letter, refer to Initial Response, pp. 10-11 of 21.

[30] Initial Response note 30 and related text, p. 30 (ICI support in their first comment letter for proposed MQP metrics), and p. 18 (Vanguard support in their first comment letter for proposed MQP metrics); Filing, pp. 9 and 12 of 17.

each product that has been accepted into the MQP, as well as the market makers in such product).[31]

State Street Global Advisors supports the MQP going forward on a pilot basis.[32] State Street notes that it has had the opportunity to review drafts of the second ICI comment letter, as well as the first ICI comment letter, and supports the approach suggested by the ICI in those letters.[33] Significantly, State Street notes three important characteristics that NASDAQ has clearly incorporated into the MQP: objective performance standards, liquidity and volume criteria for eligibility to receive incentive payments, and higher performance standards for market makers that choose to participate in the program.[34] State Street notes its agreement with the ICI that such characteristics "…would help address conflict of interest concerns and may provide a greater incentive for market makers to make better markets in ETFs. We believe that increasing liquidity and tighter spreads is a benefit to ETF shareholders that should be encouraged and supported."

In addition, State Street believes that Rule 12b-1 under the Act is not applicable. State Street strongly encourages that the Commission "…take this opportunity to clarify that neither MQP Fees nor Optional Incentive Fees are payments made by or on behalf of an ETF in connection with the distribution of its shares, and therefore do not represent the use of an investment company's assets to finance distribution that would be governed under Rule 12b-1." State Street in particular notes the clear NASDAQ articulation (as unequivocally maintained in the Filing and Initial Response) that "the MQP is primarily intended to establish quality markets

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[31] Initial Response, pp. 7-8 of 21 (Professor Weaver letter noting designed transparency of MQP), p. 10 of 21 (ICI support for proposed MQP transparency in their first comment letter), and pp. 14-15, 20 of 21 (Vanguard support in their first letter for transparency of proposed MQP). Filing, notes 7 and 48 and related text.

[32] Letter from James E. Ross, State Street Global Advisors, dated August 16, 2012.

[33] ICI consistently recommends that the MQP proposal be approved.

[34] "NYSE Arca should establish objective performance standards for lead market makers ("LMMs") participating in the Fixed Incentive Program… limit the type of products permitted into the Fixed Incentive Program based on liquidity levels or trading volume requirements…[and] impose higher performance standards on LMMs participating in the Fixed Incentive Program." Letter from James E. Ross, State Street Global Advisors ("State Street"), dated August 16, 2012.

for ETFs, not to increase the assets of the ETFs."[35] We agree. As we have stated in the Initial Response, and continue to maintain, our belief is that Rule 12b-1 is not implicated in the MQP.[36]

BlackRock, Inc. believes that the MQP and Fixed Incentive Program should go forward, stating that "…the exchanges' respective proposals and plans offer the opportunity for new and smaller ETPs to gain traction in the marketplace at an earlier time…[t]he ability of the exchanges to offer proper incentives to MMs who support new or less frequently traded ETPs can lead to tighter spreads, which benefits all investors."[37] BlackRock states that "… each of these three programs[38] merits an opportunity to prove its ability to improve the liquidity and transparency of ETP markets." We agree. We believe, as we have noted in the Filing and Initial Response, that the MQP provides a superior alternative that is good for all that are involved in the MQP process including issuers, market makers, other market participants that should experience increased liquidity and smaller spreads, and for the market (economy) as a whole.[39]

BlackRock clearly supports the SRO Proposals providing additional incentives to ETP market makers and liquidity providers going forward. Like other recent commenters that feel the SRO Proposals should be approved on a pilot basis (e.g. ICI, State Street), BlackRock believes that certain program characteristics are desirable. BlackRock believes that the market incentive programs should be based "…on tying financial incentives provided to ETP MMs and liquidity providers directly and clearly to metrics or standards that demonstrate improved liquidity or tighter spreads for ETPs that participate in the programs. BlackRock believes such programs should benefit ETP shareholders, not merely subsidize MMs and liquidity providers." We believe, as we have noted in the Filing and Initial Response, that the MQP as proposed does just that. The proposed MQP is set up so that a market maker in the MQP can only earn a credit in

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[35] State Street also notes NASDSAQ's argument at p. 20 of the Initial Response that payment of MQP credits is not primarily intended to result in the sale of fund shares, but rather the clear intent is to establish a quality market for products.

[36] Moreover, we agree with State Street's recommendation in note five of its comment letter that payments should be made by "…sponsors or their affiliates." We believe that a Rule 12b-1 distribution plan is not required, and in fact is contra-indicated. Initial Response, p. 20. We note that BlackRock similarly believes that ETF sponsors should pay the MQP fees. Letter from Joseph Cavatoni, Managing Director, and Joanne Medero, Managing Director, BlackRock, Inc., dated July 11, 2012.

[37] Letter from Joseph Cavatoni, Managing Director, and Joanne Medero, Managing Director, BlackRock, Inc., dated July 11, 2012.

[38] In addition to the MQP and the Fixed Income Program, the third program (which is operational, and not the subject of the Commission's Order Instituting Proceedings) is BATS' Competitive Liquidity Provider Program. Exchange Act Release No. 66307 (February 2, 2012), 77 FR 6608 (February 8, 2012)(approval order).

[39] Filing, pp. 3 and 7 of 17. Initial Response, pp. 1-3 of 21.

an MQP product in which he makes a market if he sustains liquidity requirements that are directly and clearly set forth as as transparent rules-based metrics.

IMC Chicago, LLC d/b/a IMC Financial Markets, recommends that the Commission: "…approve both ARCA's proposed Fixed Incentive Program and NASDAQ's MQP on a pilot basis. By allowing each exchange to establish competing programs, on a pilot basis, the Commission will be able to assess the merits of each approach based on data and identifiable trends."[40] In discussing the risk of market-making, IMC notes that as a liquidity provider, it faces certain market-making risks. IMC states that where a product's underlying volume is low (e.g. low turnover rate), "the risk of holding a significant inventory increases" and there is "lost opportunity cost;" in conjunction with the increasing difficulty of accessing "reliable and cost effective hedges to manage…positions."[41] IMC believes that the SRO Proposals are designed to restore investor opportunities: "The Programs are intended to recalibrate the existing incentives so as to encourage meaningful liquidity provision. Such incentives, if permitted, will foster investor choice by allowing issuers to bring new products to the market with confidence that they can provide a competitive, liquid market for investors." Furthermore, IMC believes that each of the SRO Proposals has its own merits and therefore "…urges the Commission to identify the strengths of each proposal, permit a certain amount of flexibility within which exchanges may innovate, and approve each of the Programs on a pilot basis so as to monitor and assess their effectiveness and fairness."

Regarding program termination, IMC notes that arbitrary exclusion or termination metrics may deprive investors the opportunity to invest in tighter more robust markets as these products mature or gain traction. As we have stated in our Filing and Initial Response, we believe that once an ETF product achieves the MQP termination metric (2 million shares ADV over 3 consecutive months) it is hard to imagine that it would need the MQP - or that market quality would drop off if it were no longer in the MQP. We note on page 7 of 21 of the Initial Response that Professor Weaver in his letter states that the standards proposed by the Exchange for the MQP "were sufficient," and that the 2 million ADV threshhold for program termination "…is an arbitrary number that is no better or worse than another other large number. It would be best to wait and see what happens when funds meet the threshold and are released. The number may need to be adjusted, but at this point NASDAQ's guess is no worse than any other." We believe the 2 million is reasonable and proper. [42]

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[40] Letter from Andrew Stevens, Legal Counsel, IMC Chicago, LLC d/b/a IMC Financial Markets, dated August 16, 2012.

[41] IMC notes also that according to their research, similarly to other types of investment products (e.g. equities and options), the largest 55 ETP products as measured by ADV account for approximately 80% of the aggregate ADV for all ETPs, and the largest 110 products by the same measure account for approximately 90% of the aggregate ADV for all ETPs.

[42] For our additional responses, see Initial Response.

Regarding performance standards, IMC states that NASDAQ's MQP proposal properly "…reflects both the value of increased performance standards…[and] the need for an incentive mechanism to facilitate acceptance of the program's inherent obligations, costs and risks." IMC believes that Arca's proposal, on the other hand "…reflects the current imbalance of the existing program; the performance obligations are high but the corresponding benefits to market makers are low."

Regarding market maker participation, IMC believes that the ability to have multiple market makers "...may ultimately reduce the effectiveness of the incentive as well as lessen the accountability of any one market maker for a product's failure to attain a particular service level." We do not believe so. We believe that our multiple market maker MQP proposal is pro-competitive in that it is likely to increase liquidity while tending to reduce effective spreads, which is beneficial to issuers and investors both. Simply put, a multiple market maker model should broaden the universe of market makers making a quality market and increase competition which will, we believe, increase liquidity and the number of market participants.

IMC urges the Commission to approve both SRO Proposals on a pilot basis, stating: "Each program offers a reasonable and transparent effort[43] to incentivize liquidity providers to accept the costs and burdens associated with making quality markets in new and oftentimes illiquid exchange traded products. IMC believes that by allowing each exchange to establish competing programs, on a limited pilot basis, the Commission will be able to monitor their implementation as well as identify and assess the merits of each approach."

Only One Comment Letter Pursuant to the Order Instituting Proceedings Does Not Support the MQP

In its first comment letter pursuant to the Notice, Vanguard stated that it neither supported nor opposed the MQP, and acknowledged the extensive safeguards that the Exchange has built into the MQP in an effort to address the concerns that underlie the prohibition on issuer payments to market makers.[44] Vanguard raised several areas or concern regarding the MQP,

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[43] IMC specifically notes that it is in favor of the MQP's transparent structure.

[44] Vanguard stated in its first comment letter: "among the most important of these safeguards, in Vanguard's view, are the following: a transparency requirement wherein Nasdaq will disclose on its website the identity of all ETFs and market makers participating in the Program, along with information about amounts paid to or received by these participants; objective and meaningful market quality standards that market makers must meet to [be eligible to] receive Program payments; and opportunity for multiple market makers to compete for payments on each participating ETF." Vanguard stated further: "Vanguard also applauds Nasdaq for proposing the Program as a one-year pilot, with extensive monitoring of market quality metrics during the pilot, and for basing payments not only on quote activity, but also on actual trade activity resulting from those quotes"; Vanguard questioned, however, whether these safeguards will be sufficient.

which we discussed extensively in our Initial Response,[45] and suggested that more time was needed for it to respond to the Notice.

In its second comment letter, Vanguard opposed the MQP - and the Fixed Incentive Program proposed by Arca.[46] Vanguard reiterated several concerns that it raised in its first comment letter. We have already responded to Vanguard's concerns that issuer payments have the potential to distort market forces; could lead to diminished market maker activity and/or wider spreads for ETFs that do not partake of the MQP; and could create a pay-to play environment.[47] We now respond to two additional concerns noted by Vanguard in their second letter.

First, Vanguard states that issuer-financed market maker incentive programs "…are likely to be detrimental to long-term buy-and-hold investors. Although the source of payment for both the Nasdaq and Arca Programs is the ETF sponsor, rather than the ETF, we believe it is likely that ETF sponsors would seek to recoup those costs in some way from the ETF and its shareholders." Second, Vanguard believes that "Narrow spreads primarily benefit investors engaged in frequent trading strategies, whereas higher expenses primarily hurt long-term, buy-and-hold investors." Neither of these arguments provides a basis for disapproving the Filing.

In response, we believe, first, that whether Vanguard and other ETF issuers bear the cost of the MQP Program is completely voluntary. Vanguard's assertion is completely speculative; Vanguard presents no contrary evidence that the cost of the MPQ Program will be born by Vanguard or other ETF issuers. In developing the MQP proposal and communicating broadly with industry participants about it, we have encountered no anecdotal evidence indicating that ETF sponsors will recoup MQP costs from the ETF and its shareholders.[48] In an effort to answer

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As we have noted in the Initial Response and the Filing, and as numerous commenters have opined, we continue to believe that the safeguards built into the MQP are more than sufficient to allow the proposal to go forward on a pilot basis.

[45] Initial Response, pp. 17-20 of 21.

[46] Letter from F. William McNabb, Chairman and Chief Executive Officer, dated August 16, 2012. Vanguard stated that as of July 31, 2012, it was the sponsor of 64 ETFs listed on either NASDAQ or Arca, with collective assets of approximately $215 billion.

[47] Initial Response, at pp. 17-20 of 21. For example, as we have argued, we do not believe that the MQP will distort the market; but rather will increase liquidity in the market, which is beneficial to all products and market participants, and will allow buyers (sellers) to participate– if they chose to do so - more easily and efficiently. We believe that in the end price, cost and expenses, and the ability to get in and out of the market (liquidity) are the leading investment drivers.

[48] Vanguard notes that Arca acknowledged the recoupment possibility. Vanguard second letter, note 6.

the call from the ETP and investing community at large for increased liquidity in less actively traded products, we have developed and structured the MQP to provide, we believe, a careful and acceptable balance between increased market making requirements on the one hand and incentives to market makers that are willing to accept the increased requirements (and commensurate increased risks) on the other hand - which should lead to tangible liquidity improvements that would be as valuable to issuers (sponsors) as to investors. Second, we believe that the narrowed spreads and reduced costs that should emanate will be helpful to all market participants. As we, numerous academicians and market observers, and market participants have noted, narrower spreads are advantageous to all market participants, including issuers and short and long-term investors. Third, we do not believe that the MQP is a subsidization of long-term investors by short-term investors. To the contrary, we believe that increased liquidity - which is what the proposed MQP promotes - is certainly important to the ability to invest in, and hold, a product long-term. That is, liquidity (and a quality market) is as necessary to consummate a decision to get out of a product in the future, if one wants to do so, as it is to buy the product today. If Vanguard perceives that the MQP will result in narrower spreads and that narrower spreads may not be beneficial to investors, Vanguard's appropriate response would be to refrain from participating in the voluntary MQP proposal.

Finally, in the Initial Response we note that Rep. Patrick McHenry (R-NC), a member of the House Committee on Governmental Reform and Oversight, developed legislation regarding market quality incentives entitled "Liquidity Enhancement for Small Public Companies Act" (the "Liquidity Enhancement Act"). The Liquidity Enhancement Act was co-sponsored by Rep. Scott Garrett (R-NJ), who noted that he was "…not certain that the current one-size-fits-all approach is best suited for all public issuers," and indicated that the Liquidity Enhancement Bill (as also the Schweikert tick size bill) "could be ways to provide much needed support to small businesses." [49] The Liquidity Enhancement Act, which "mirrors recent proposals by exchanges operated by Nasdaq OMX Group and NYSE Euronext",[50] was introduced on July 13, 2012, by Reps. McHenry and Garrett in the U.S. House of Representatives as H.R. 6127.

The great majority of commenters clearly recognize the current need for liquidity in the market and recommend approval of the MQP. The small number of unfavorable comments provide no basis for disapproving the Filing. We believe that the MQP will serve to increase the liquidity and market quality of products listed pursuant to the MQP and thereby enhance the overall market participant experience in respect of these products, and urge the Commission to follow the recommendations of commenters to approve the MQP proposal.

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[49] http://garrett.house.gov/press-release/garrett-chairs-subcommittee-hearing-examine-us-equity-markets.

[50] Traders Magazine Online News, June 27, 2012. The proposals referred to are NASDAQ's MQP and Arca's Fixed Incentive Program.

We appreciate the opportunity to address the Commission regarding the MQP proposal.

Respectfully submitted,

Joan C. Conley

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cc: The Hon. Mary L. Schapiro, Chairman
The Hon. Elisse B. Walter, Commissioner
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner
The Hon. Daniel M. Gallagher, Commissioner

Robert W. Cook, Director, Division of Trading and Markets
David S. Shillman, Associate Director, Division of Trading and Markets