MEMORANDUM

TO: File No. SR-NASDAQ-2012-043

FROM: Victoria Crane, Division of Trading and Markets

DATE: October 18, 2012

SUBJECT: Meeting with Representatives from NASDAQ OMX Group

On September 11, 2012, representatives from the NASDAQ OMX Group met with staff members from the Divisions of Trading and Markets and Corporation Finance. The meeting participants discussed, among other things, the proposal by The NASDAQ Stock Market LCC to allow issuers of certain exchange-traded products to pay an additional fee to the exchange, which fee (or a large portion thereof) would in turn be paid to one or more market makers for making markets in such securities.

From: Ed Knight [redacted]
Sent: Wednesday, September 19, 2012 11:58 AM
To: Cook, Robert W.
Cc: Jurij Trypupenko; Burns, James R.; Eric Noll
Subject: The Market Quality Program

Robert, I wanted to follow-up on our conversation about the pay-for market maker proposal (the so-called Market Quality Program, "MQP").

The MQP is NASDAQ's experiment in liquidity enhancement that**, if successful, will be expanded to small cap companies that need liquidity support and that can create jobs.**

We have always maintained in the MQP Filing (Filing), as well as in our commentary responses of 07/06/12 and 08/30/12 (Initial Response and Second Response), that the primary goal of the MQP is to enhance liquidity and market quality of securities that *may not naturally have liquid markets*. The MQP proposal establishes a unique liquidity-enhancing market incentive structure that is sorely needed for low-liquidity securities listed on our markets, where the reality is that approximately 80% of the volume is in the top 10%-20% of the securities. Our goal in proposing the MQP was, and is, to put forth a structured *rules-based* program that is most likely to gain Commission approval and success. In anticipation of Commission concerns we proposed the MQP as: first, **a pilot program** that allows the Commission and the exchange to evaluate the effectiveness of the MQP; and second, being applicable to a **category of securities that is not likely to be conducive to manipulation because of its unique structure, namely exchange traded funds**. ETFs have, as we have noted in our proposal and response letters, a multi-layered structure that makes it virtually impossible for a market maker to manipulate the price of an ETF product in the MQP, thereby making funds particularly good candidates for the initial MQP pilot proposal. (Filing, p. 7 of 17; Initial Response, p. 2 of 21; Second Response, p. 2 of 14). We continue to believe that ETFs represent the class of securities that may be most likely to achieve approval of the MQP proposal; and that **ETF firms and sponsors have a heightened appreciation for sophisticated product and market structure yet, at the same time, have products that could substantially benefit from the liquidity enhancement that the MQP could provide**.

Clearly, we believe that if the MQP pilot is successful it can be the model to expand to other sectors that could benefit from deeper and more liquid

markets, such as small cap companies, emerging growth companies, and lower-tier securities. Several commenters view the MQP the same way: as a liquidity enhancement vehicle that can be used for other sectors of the market that can help to stimulate economic growth. **For example, TechNet, which promotes the growth of technology and the innovation economy, stated that "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."** (TechNet letter dated June 20, 2012). And, in urging the approval of the MQP pilot proposal, Professor Stanislav Dolgopolov of the UCLA School of Law recognized the value of the MQP pilot in allowing us to learn about "the feasibility of [liquidity enhancement programs] for small cap stocks, as opposed to exchange-traded products." (Dolgopolov letter dated August 15, 2012). We agree with these commenters that the MQP can be an excellent conduit to expand to other sectors that require deep, liquid, and quality markets. (Initial Response, p. 12 of 21; Second Response pp. 6-7 of 14.) Professor James Angel of Georgetown University summed up the need for the MQP proposal eloquently, stating that "…[W]e now have a 'one size fits all' market that does a great job of trading large cap stocks like Intel and IBM. However, smaller companies have trouble attracting attention in the crowded marketplace." Professor Angel urges the Commission to permit NASDAQ and other exchanges "to engage in market structure experiments that may help the market." (Angel letter dated May 2, 2012).

Finally, we note that liquidity-enhancing market incentive programs analogous to the **MQP have been used for decades in numerous overseas markets such as NASDAQ's First North market, Oslo Stock Exchange, NYSE Euronext exchanges in Paris and Amsterdam, Tel Aviv Stock Exchange, and Deutsche Borse Xetra).** As we have demonstrated in our Filing and responses, study after study has determined that these global market incentive programs increase liquidity, reduce transactional costs, and are very beneficial to market participants. (Filing, p.4-6; Initial Response, p. 4 of 21; Second Response, pp. 2-3 of 14). We believe that our MQP proposal can bring the successful global experience to the U.S., where it is needed.