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May 3, 2012

Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Re: *NASDAQ Market Quality Program (File No. SR-NASDAQ-2012-043)*

Dear Ms. Murphy:

The Investment Company Institute<sup>1</sup> is writing to respond to The NASDAQ Stock Market's proposal to add new Rule 5950 to establish the "Market Quality Program" ("MQP").<sup>2</sup> The MQP would 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.

As a preliminary matter, given the significance of the changes that the MQP would make to the interaction between an issuer of MQP Securities and a market maker of those securities and the importance, in general, of the issues raised by an issuer providing payments for market making, we are concerned about the brevity of the time period for providing comments on the proposal, *i.e.*, 21 days from publication of the proposal in the *Federal Register*. Given this short amount of time, we do not endeavor to focus our comments on the specific parameters of the program. Our general comments on the proposal, however, follow below.<sup>3</sup>

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<sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.4 trillion and serve over 90 million shareholders.

<sup>2</sup> Securities Exchange Act Release No. 66765 (April 6, 2012), 77 FR 22042 (April 12, 2012) ("Release").

<sup>3</sup> We note that NYSE Arca also has filed a proposal with the SEC to establish its own market maker incentive program; the "Lead Market Maker Issuer Incentive Program" for issuers of certain exchange-traded products listed on NYSE Arca. While there are various similarities with the NASDAQ proposal, the NYSE Arca proposal contains significant differences in the

## Market Quality Program

The Release notes that while MQP Securities may include Exchange Traded Funds (“ETFs”), Linked Securities (“LS”), and Trust Issued Receipts (“TIRs”), MQP Securities will predominantly, if not entirely, consist of ETFs. As ETF sponsors, ICI members have a strong interest in ensuring that the securities markets are highly competitive, transparent and efficient, and that the regulatory structure that governs the markets encourages liquidity, transparency, and price discovery. We have therefore long advocated for regulatory changes that would result in more efficient markets for issuers of securities, and investors in those securities.

Consistent with these goals, ICI supports the overall goal of the MQP - to incentivize market makers to make high-quality, liquid markets in ETFs. To the extent the MQP results in narrower spreads and more liquid markets for ETFs, without any associated unintended consequences for ETFs or the markets as a whole, the MQP could prove beneficial. Similarly, increased competition among market makers should be encouraged and could result in better quotes by market makers for ETFs. As the Release notes, liquid markets are critical for ETFs, particularly smaller and less frequently traded ETFs.

### *Importance of Implementing the MQP Through a Pilot Program*

At the same time, ICI recognizes that the MQP would represent a departure from the current rules precluding market makers from directly or indirectly accepting payment from an issuer of a security for acting as a market maker.<sup>4</sup> We appreciate that these rules were put in place to address concerns surrounding the payment of incentives to market makers, *i.e.*, concerns regarding investor confidence and market integrity, and whether such payments raise conflicts of interest between an issuer and the market maker for a security.

While ICI therefore supports the concept of programs that provide incentives to market makers to make better and more efficient markets, we support the establishment of the MQP at this time only through a pilot program as contemplated by the proposal. In particular, we support provisions in the proposal that will require NASDAQ to provide information to the SEC during the

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manner in which its program will operate. ICI will provide comments on the NYSE Arca proposal when it is published for public comment. We recommend, however, that as the SEC considers the issues raised by the NASDAQ proposal, it also consider the implications raised by market maker incentive programs as a whole, and the impact of the various programs on issuers, investors and the efficiency of the overall markets.

<sup>4</sup> NASDAQ Rule 2460 states that “[N]o member or person associated with a member shall accept any payment or other consideration, directly or indirectly, from an issuer of a security, or any affiliate or promoter thereof, for publishing a quotation, acting as market maker in a security, or submitting an application in connection therewith.” The proposal would provide that Rule 2460 would not be applicable to a member that is accepted into the MQP or to a person that is associated with that member for their conduct in connection with the program.

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pilot about market quality associated with the program that should assist in the comparison of ETFs before and after they are in the MQP and provide information regarding, among other things, volume metrics, number of MQP market makers in ETFs, and spread size.

ICI believes it is critical that NASDAQ and the SEC have an opportunity to evaluate the impact of the MQP on the quality of markets in ETFs prior to considering its permanent approval. An examination of the pilot program, and the payment to market makers in general, must be careful and deliberate, balancing the desire to incentivize market makers with any potential unintended consequences of the MQP on ETFs participating in the program, and on those ETFs that choose not to participate. Equally important will be the implementation of a robust surveillance program to monitor the trading of ETFs on NASDAQ during the pilot.

*Availability of MQP Pilot Program Data*

ICI supports efforts by NASDAQ to address concerns about investor confidence and market integrity that are associated with the MQP through, among other things, disclosure requirements and overall transparency built into the program. The Release is silent, however, regarding the extent of the availability of data gathered under the pilot program for ETF sponsors participating in the program. We therefore encourage NASDAQ to ensure that data surrounding the operation of the MQP is readily available to ETF sponsors participating in the program to allow them the opportunity to examine statistics on the performance of MQP market makers and to assess how much liquidity is being provided by those market makers. Such data can then be compared to and evaluated against liquidity provided by market makers and other market participants who are not participating in the program to help determine the impact of the fees paid the ETF sponsor under the program.

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If you have any questions on our comment letter, please feel free to contact me directly at (202) 371-5408.

Sincerely,

/s/ Ari Burstein

Ari Burstein  
Senior Counsel

Ms. Elizabeth M. Murphy

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cc: The Honorable Mary L. Schapiro  
The Honorable Elisse B. Walter  
The Honorable Luis A. Aguilar  
The Honorable Troy A. Paredes  
The Honorable Daniel M. Gallagher

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