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February 13, 2013

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

Re: NASDAQ Stock Market LLC Proposal With Respect to INAV Pegged Orders for
ETFs (File No. SR- NASDAQ-2012-117)

Dear Ms. Murphy:

The Investment Company Institute¹ (“ICI”) appreciates the opportunity to offer our further comments on the proposal by the NASDAQ Stock Market LLC (“NASDAQ”) to implement a new order type, pegged to intraday net asset value (“INAV”), for exchange-traded funds (“ETFs”) comprised of U.S. component stocks.²

Our initial letter on the proposal stated that “[w]hile we do not necessarily object to the creation of a new order type pegged to INAV, we recommend that the Securities and Exchange Commission (“SEC” or “Commission”) request additional information from NASDAQ to further explore [ICI]’s questions and concerns, and consider the benefits of the proposed INAV pegged order, before determining whether to approve it.”³ We appreciate NASDAQ’s written response to many of

¹ 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 \$14.2 trillion and serve over 90 million shareholders.

² See NASDAQ Stock Market LLC: Notice of Filing of Proposed Rule Change With Respect to INAV Pegged Orders for ETFs, 77 Fed. Reg. 64167 (Oct. 18, 2012).

³ Letter from Dorothy Donohue, Deputy General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, dated Nov. 8, 2012, available at <http://www.ici.org/pdf/26681.pdf> (“November 8 Letter”).

the questions posed in our November 8 Letter,⁴ as well as their participation in subsequent discussions regarding the proposed order type. After further consideration, ICI members continue to have questions and concerns about certain aspects of the proposed INAV pegged order type, particularly those surrounding the benefit of the proposal to retail investors, the utility of INAV as a reference point for pricing an ETF order, and the potential for error in calculating INAV. We also believe there is a need for robust education regarding the proposed order type, should it be approved. We recommend that the SEC explore these issues further before determining whether to approve or disapprove the proposal.

Our views are discussed in more detail below.

Purpose and Benefit of an INAV Pegged Order

Our November 8 Letter indicated that ICI members questioned the purpose and benefit to market participants of an order type pegged to INAV. The NASDAQ Letter states that NASDAQ believes the proposed order type will “serve market participants that utilize these ETFs as a vehicle to invest or trade in addition to serving the needs and interests of the Sponsors/Issuers of ETFs.” It further explains that the order type will “help investors achieve greater transparency and a fair execution price.”

ICI members that are issuers of ETFs generally did not express interest in promoting the proposed order type to potential investors in their ETFs. We recognize that potential lack of benefit, by itself, would not be a reason for the SEC to disapprove the proposed order type. Nonetheless, as discussed below, we are concerned about whether the proposed order type will in fact help investors achieve a fair execution price in all circumstances.

Questions about the Operation of the INAV Pegged Order

In our November 8 Letter, we raised a number of questions regarding the operation of the INAV pegged order in specific circumstances. Our first question related to the circumstances in which an INAV is deemed “compromised,” resulting in the suspension of the order type and cancellation of existing orders. The NASDAQ Letter clarified that use of the order type would only be suspended in the event of a “technological problem with the relevant data feed,” and that NASDAQ does not intend to identify a “compromised INAV.” It explained that in other instances where an INAV might be compromised, any orders executed will be reviewed in accordance with NASDAQ’s policies on clearly erroneous executions.

⁴ See Letter from Stephen Matthews, Senior Associate General Counsel, NASDAQ OMX, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, dated Jan. 13, 2013, available at <http://www.sec.gov/comments/sr-nasdaq-2012-117/nasdaq2012117-2.pdf> (“NASDAQ Letter”).

By offering concrete, objective criteria for suspending the order type, this clarification resolves several questions we raised about how NASDAQ would identify a “compromised” INAV. At the same time, it raises additional concerns about the result for investors in such instances. As discussed below, we continue to have doubts about the robustness of INAV as an independent measure by which to price an order, both because it is not always a good representation of an ETF’s fair value, and because of the susceptibility of INAV to error.

Further, ICI members continue to have questions about how frequently orders might be cancelled and the order type suspended due to a problem with an INAV data feed, as well as the benefit of allowing the use of an order type that may be subject to cancellation and suspension due to an independent malfunction (such as an erroneous data feed) even when the rest of the market is performing normally. Additionally, it is unclear how orders that are executed before an error is detected will be treated, and what party, if any, is liable for a poorly executed INAV pegged order due to a compromised data feed. These questions should be explored in more detail.

Concerns About Pegging Orders to INAV

ICI members continue to have concerns, expressed in our November 8 Letter, about the utility of INAV as a reference point for pricing an ETF order that fall into two categories: the constitution of INAV – that is, the extent to which it is an accurate reflection of an ETF’s fair value, and the susceptibility of INAV to error.

What INAV Represents

We agree with the NASDAQ Letter’s assertion that, for domestic equity products, the INAV is “the only representation of fair value currently available for individual investors.” We are not convinced, however, that INAV is, in all cases, “a good representation of fair value.” In our November 8 letter, we identified several instances in which INAV might not represent the fair value of the ETF, including for ETFs that do not trade frequently and those that base INAV on a creation basket that is only a sample of the full portfolio. In recent discussions two additional instances were identified: when trading in an underlying security halts (in which case an INAV will typically use the last traded price, while the fair value of the underlying security is likely fluctuating as a result of whatever caused the halt), and at market open, before trading in the basket securities has begun.

While we recognize that the proposed order type is optional, ICI members continue to be concerned that retail investors will not understand the potential weaknesses in INAV as a measure of fair value, and may utilize the order type without fully appreciating the risks. As discussed below, efforts by NASDAQ and broker-dealers offering the proposed order type to educate investors about what INAV does and does not represent should mitigate these concerns.

The Potential for Error in INAV

As we explained in our November 8 Letter, many parties participate in the calculation, publication, and dissemination of INAV, creating numerous opportunities for errors. While ETF sponsors attempt to monitor INAV and correct such errors as soon as practicable, at times INAV pegged orders may be executed before these errors are identified. ICI members have noted that INAV was never conceived of as a potential basis for pricing an order, and there are no systems for ensuring that it is sufficiently reliable for this proposed use.

The NASDAQ Letter recognized that erroneous INAVs may be disseminated, but stated that “the risk of a poor execution is mitigated by existing general safeguards in our market place,” in particular Regulation NMS, pursuant to which an order will only be filled within the prevailing bid-offer spread (or not filled at all), and in the second instance by the Exchange’s “clearly erroneous procedures.” We are not confident that investors are protected by these mechanisms in all circumstances. That is, particularly for an ETF with a wide bid/ask spread, there may be circumstances in which an execution of an INAV pegged order is sub-optimal, but does not qualify for cancellation under the “clearly erroneous” policies.

Moreover, if calculation agents and pricing vendors could be held liable by investors using INAV pegged orders for inaccuracies in INAVs, it is possible, if not likely, that firms would cease providing such services, making it impossible to disseminate INAVs, or would charge significantly more for their services, resulting in increased expenses for ETF investors. We continue to have concerns about the potential for liability associated with erroneous executions under the proposed order type.

The Need for Education About the Proposed Order Type

Many of the questions and concerns raised by ICI members about the proposed INAV pegged order relate to whether retail investors will understand the weaknesses of INAV and the potential risks associated with the order type. A strong effort to educate investors through the broker-dealers that offer the INAV pegged order type should allay these concerns. Topics for education should include: 1) the potential for INAV to not accurately reflect the ETF’s fair value; 2) the possibility that an order would not execute due to a failure of the data feed in an otherwise functioning market; and 3) the procedures in place for addressing erroneous executions. Should the proposed order type be approved, ICI urges NASDAQ and broker-dealers to make every effort to educate investors on the characteristics of INAV and the operation of the order type.

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We recommend that the SEC explore these issues further before determining whether to approve or disapprove the proposal. The ICI appreciates the SEC's attention to our comments. If you have any questions, or would like to discuss any of the matters in this letter, please contact me at 202/218-3563 or Mara Shreck at 202/326-5923.

Sincerely,

/s/ Dorothy Donohue

Dorothy Donohue
Deputy General Counsel