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February 27, 2013

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

Re: File No. SR-NASDAQ-2012-117
Response to Comments and Draft Amendment 1

Dear Ms. Murphy:

On January 16, 2013, the Commission issued an Order Instituting Proceedings to Determine Whether to Approve or Disapprove the above-captioned proposed rule change ("the Filing").[1] Through the Filing, The NASDAQ Stock Market LLC ("NASDAQ" or "Exchange") proposed to amend Rule 4751(f)(4) to establish a new Intraday Net Asset Value ("INAV") Pegged Order for Exchange-Traded Funds ("ETFs") where the component stocks underlying the ETFs are U.S. Component Stocks as defined by NASDAQ Rule 5705(a)(1)(C) and 5705(b)(1)(D). In response to the Order Instituting Proceedings, the Commission received just one comment letter, from the Investment Company Institute ("ICI"), in addition to the comment letter ICI filed dated November 8, 2012.[2]

Attached hereto is a draft Amendment 1 to the Filing which NASDAQ plans to file with the Commission as soon as practicable. The Draft Amendment 1 contains NASDAQ's response to the ICI comment letter, as well as four modifications to the original proposal. NASDAQ believes that the response to comments and proposed modifications fully and fairly respond to the valid comments raised by ICI, and the questions posed in the Commission's Order Instituting Proceedings.

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1 *See* Securities Exchange Act Release No. 34-68672 (Jan. 16, 2013) ("Order Instituting Proceedings to Determine Whether to approve or Disapprove Proposed Rule Change With Respect to INAV Pegged Orders for ETFs").

2 Letter from Dorothy Donohue, Deputy General Counsel, Investment Company Institute, dated February 13, 2013. ICI did not explicitly address the questions posed in the Order Instituting Proceedings.

Accordingly, NASDAQ respectfully urges the Commission to approve the proposed rule change quickly.

Respectfully submitted,

Jeffrey S. Davis
V.P. and Deputy General Counsel

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 ("Act"),[1] and Rule 19b-4 thereunder,[2] The NASDAQ Stock Market LLC ("NASDAQ" or "Exchange") is filing with the Securities and Exchange Commission ("Commission") this Amendment 1 ("Amended Proposal") to a proposed rule change to establish a new Indicative Value Pegged Order[3] for Exchange-Traded Funds ("ETFs") consisting of U.S. Component Stocks as defined by Rule 5705(a)(1)(C) and 5705(b)(1)(D) ("Original Proposal").

NASDAQ filed the Original Proposal on October 2, 2012, and it was published in the Federal Register on October 18, 2012.[4] On November 21, 2012, the Commission issued an order designating a longer period of time to act on the proposal.[5] On January 16, 2013, the Commission issued an Order Instituting Proceedings to Determine Whether to Approve or Disapprove the Original Proposal, thereby triggering a second comment opportunity.[6]

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 As set forth below in greater detail, to avoid potential investor confusion, NASDAQ is changing the name of the proposed order type from Intraday Value ("INAV") Pegged Order to Indicative Value Pegged Order.

4 *See* Securities Exchange Act Release No. 68042 (October 12, 2012), 77 FR 64167.

5 *See* Securities Exchange Act Release No. 68279 (November 21, 2012), 77 FR 70857 (November 27, 2012).

6 *See* Securities Exchange Act Release No. 34-68672 (Jan. 16, 2013) ("Order Instituting Proceedings to Determine Whether to approve or Disapprove Proposed Rule Change With Respect to INAV Pegged Orders for ETFs").

The Commission received just two comment letters, both from the Investment Company Institute ("ICI").[7] The letters are largely overlapping; the second letter raises no new issues and quotes liberally from the first. Therefore, NASDAQ will refer and respond to them collectively as "ICI Letter." NASDAQ responded to the ICI's first comment in a letter dated January 15, 2013.[8] There were no comments from any NASDAQ member or other market participant. NASDAQ's responses to those comments are set forth below.

Additionally, after considering ICI's comments and the eight questions posed by the Commission's Order Instituting Proceedings, NASDAQ has determined to amend the Original Proposal in four ways. First, to alleviate concerns that the term "Intraday Net Asset Value" or "INAV" could mislead investors about the nature of the pegging price, NASDAQ will change the name of the order type from "INAV Pegged Order" to "Indicative Value Pegged Order." Second, to further reduce the potential for investor confusion, NASDAQ will publish a broad disclosure on the NASDAQ.com and NASDAQTrader.com websites setting forth information useful to investors, including the characteristics of the order type and the risks involved in its use. Third, to reduce the potential for mis-priced orders at the sometimes-volatile start of the trading day, NASDAQ proposes to begin offering the Indicative Value Pegged Order at 9:45 a.m., rather than 9:30 a.m. Fourth, in response to ICI's speculation about execution quality, NASDAQ will convert the proposal to a one-year pilot and provide quarterly reports

7 Letters from Dorothy Donohue, Deputy General Counsel, Investment Company Institute, dated November 8, 2012 and February 13, 2013. ICI did not explicitly address the questions posed in the Order Instituting Proceedings.

8 Letter from Steven Matthews, Senior Associate General Counsel, NASDAQ OMX Group, Inc., dated January 15, 2013.

regarding the execution quality of the new order type. NASDAQ believes that the four proposed modifications and the responses to comments fully and fairly respond to the valid points raised by commenters to the Original Proposal.

The text of the proposed rule change is below. Proposed new language is underlined; deleted text is in brackets.

* * * * *

4751. Definitions

The following definitions apply to the Rule 4600 and 4750 Series for the trading of securities listed on Nasdaq or a national securities exchange other than Nasdaq.

(a) – (e) No change.

(f) The term "Order Type" shall mean the unique processing prescribed for designated orders that are eligible for entry into the System, and shall include:

(1)- (3) No change.

(4) "Pegged Orders" are orders that, after entry, have their price automatically adjusted by the System in response to changes in either the Nasdaq Market Center inside bid or offer, bids or offers in the national market system as appropriate. A Pegged Order can specify that its price will equal the inside quote on the same side of the market ("Primary Peg"), the opposite side of the market ("Market Peg"), or the midpoint of the national best bid and offer ("Midpoint Peg"). A Pegged Order may have a limit price beyond which the order shall not be executed. In addition, the Primary Peg, and Market Peg Orders may also establish their pricing relative to the appropriate bids or offers by the selection of one or more offset amounts that will adjust the price of the order by the offset amount selected. A Midpoint Peg Order is priced based upon the national best bid and offer, excluding the effect that the Midpoint Peg Order itself has on the inside bid or inside offer. Midpoint Pegged Orders will never be displayed. A Midpoint Pegged Order may be executed in sub-pennies if necessary to obtain a midpoint price. A new timestamp is created for the order each time it is automatically adjusted.

For a one-year pilot following approval, NASDAQ will offer an Indicative Value Pegged Order for use in trading Exchange Traded Funds of U.S. Component Stocks (as defined in Rule 5705), based upon changes in the indicative intraday value ("Indicative Value Peg"). The member entering an Indicative Value Pegged Order may specify that its price will equal the Indicative Value of an ETF as disseminated by the Reporting Authority (as defined in NASDAQ Rule 5705(B)) every 15 seconds, as well as a limit price beyond which the order shall not be executed. In addition, the entering member may also establish its pricing relative to the Indicative Value by the selection of one or more offset amounts that will adjust the price of the order by the offset amount selected. A new timestamp is created for the order each time it is automatically adjusted.

During the one-year Pilot Period of the Indicative Value Pegged Order, NASDAQ shall on a quarterly basis collect, analyze and publish on the NASDAQTrader.com website data regarding the execution quality of Indicative Value Pegged Orders for all Exchange Traded Funds of U.S. Component Stocks in which Indicative Value Pegged Orders are executed during the quarter. The quarterly reports shall compare the execution quality of Indicative Value Pegged Orders with the execution quality of other order types based on execution quality measures set forth in Rule 605 of Regulation NMS under the Exchange Act. The quarterly report shall also indicate how often the dissemination of underlying indicative values is interrupted and how many Indicative Value Pegged Orders are cancelled.

During the Pilot Period and to reduce the potential for investor confusion, NASDAQ shall also publish on the NASDAQTrader.com website a disclosure describing the origin, calculation, and risks associated with use of the Indicative Value to which such orders' prices are pegged.

(5) – (15) No change**.**

(g)- (i) No change**.**

* * * * *

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1. A notice of the proposed rule text amendments is attached hereto as Exhibit 4.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The Board of Directors of the Exchange approved the proposed rule change on September 24, 2012. No further action is necessary for the filing of the proposal.

Questions regarding this rule filing may be directed to Jeffrey S. Davis, Deputy General Counsel, NASDAQ OMX Group, Inc. at (301) 978-8484, or to Steve Matthews, Senior Associate General Counsel, The NASDAQ OMX Group, Inc. at (301) 978-8458 (telephone) or (301) 978-8472 (fax).

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

a. Purpose

Original Proposal. In the Original Proposal, NASDAQ proposed to amend Rule 4751(f)(4) to establish INAV Pegged Orders for use in trading U.S. Component Stock ETFs. NASDAQ opined that this new order will benefit investors and ETF

Sponsors/Issuers by improving the quality of executions in those securities. As described in the Original Proposal, the ETF INAV Pegged Order would allow firms to enter orders that are priced relative to the Intraday Net Asset Value of the fund's component securities. Once entered, an INAV Pegged Order, like existing Pegged Orders based upon the national best bid or offer ("NBBO"), will adjust in price automatically in response to changes in the INAV price. As originally proposed, an INAV Pegged Order would specify that its price will equal (or, to the extent an offset is used, be offset from) the prevailing INAV for the relevant ETF. As the INAV moves, so move INAV Pegged Orders.

ICI Comments, NASDAQ's Response, and Commission Questions. The ICI Letter states that "[w]hile we do not necessarily object to the creation of a new order type pegged to INAV, we recommend that the [Commission] request additional information from NASDAQ to further explore these questions and concerns". The ICI Letter sought additional clarity in four areas: (1) the "purpose and benefit" of the proposed new order; (2) how the new order type will operate when data feed that disseminates the indicative value is compromised; (3) how to address the potential for investor confusion regarding what the INAV value represents; and (4) how to address the potential for errors in the calculation of the INAV. NASDAQ attempted to address ICI's concerns in its response to comments dated January 15, 2013, which is summarized and augmented below.

Before turning to ICI's specific questions, however, it is important to note that if ICI's comments emanate from ICI's discomfort with the reliability and value of intraday indicative prices, this rule filing is not the proper vehicle for ICI or the Commission to address that discomfort. The Commission has for almost 20 years held that providing investors access to the intraday values underlying structured products "at least once every fifteen seconds throughout the trading day is extremely important and will provide benefits to investors in the product."[9] The Commission has orchestrated listing standards among multiple national securities exchanges that uniformly require dissemination of intraday asset values at least every 15 seconds.[10] These listing standards have enabled the listing and trading of trillions of dollars of ETFs and other structured products.[11] Were the Commission to find now that intraday values are potentially so inaccurate and confusing to investors that they cannot underpin the voluntary use the proposed pegged order, this would cast doubt on decades of Commission rulings and an enormous dollar-volume of investments and trading.[12]

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9 *See, e.g.*, Securities Exchange Act Release No 34692 (Sept. 20, 1994) ("the Commission believes that it is useful and beneficial for all investors and market participants to have access to the value of the Restructuring Companies Portfolio as frequently as possible and encourages the NYSE and Merrill Lynch to further explore the possibilities in this area, *i.e.*, calculating and disseminating the value of the portfolio at least once every 15 seconds as is done with other derivative products. ") (SR-NYSE-94-15); Securities Exchange Act Release No. 37744 (Sept. 27, 1996); 61 F.R. 52480 (Oct. 7, 1996) (SR–Amex-96-27); Securities Exchange Act Release No. 48152 (July 10, 2003); 68 F.R. 43425 (July 17, 2003) (SR–Amex– 2003–62); Securities Exchange Act Release No. 50241 (Aug. 24, 2004) (SR-Amex-2004-57).

10 *See* NASDAQ Rule 5705; NYSE Amex Rule 1000; NYSE Arca Equities Rule 5.2; Direct Edge Rule Section 14.

11 Given this widespread use of indicative intraday values for trading and investing, NASDAQ is uncertain how offering the Intraday Value Pegged Order presents any liability issue beyond those that already exist, if any. NASDAQ welcomes further input from ICI on that issue.

12 The Indicative Value Pegged Order will be available only for ETFs comprised of U.S. component securities, as opposed to international or fixed income components. NASDAQ believes that market data in U.S. component stocks is the most reliable data available anywhere in the world.

The ICI itself has historically taken the position that the intraday indicative value ("IIV") of an ETF is a useful, reliable data point for investors. For example, the 2012 INVESTMENT COMPANY FACT BOOK,[13] in describing how ETFs trade, describes the role of an ETF's intraday asset valuations:

> The price of an ETF share on a stock exchange is influenced by the forces of supply and demand. While imbalances in supply and demand can cause the price of an ETF share to deviate from its underlying value (i.e., the market value of the underlying instruments, also known as the intraday indicative value or IIV), substantial deviations tend to be short-lived for many ETFs. Two primary features of an ETF's structure promote trading of an ETF's shares at a price that approximates the ETF's underlying value: portfolio transparency and the ability for authorized participants to create or redeem ETF shares at NAV at the end of each trading day.
>
> The transparency of an ETF's holdings enables investors to observe, and attempt to profit from, discrepancies between the ETF's share price and its underlying value during the trading day. ETFs contract with third parties (typically market data vendors) to calculate an estimate of an ETF's IIV, using the portfolio information an ETF publishes daily. IIVs are disseminated at regular intervals during the trading day (typically every 15 to 60 seconds). Some market participants for whom a 15- to 60-second latency is too long will use their own computer programs to estimate the underlying value of the ETF on a more real-time basis.
>
> If the ETF is trading at a discount to its underlying value, investors may buy ETF shares and/or sell the underlying securities. The increased demand for the ETF should raise its share price and the sales of the underlying securities should lower their share prices, narrowing the gap between the ETF and its underlying value. If the ETF is trading at a premium to its underlying value, investors may choose to sell the ETF and/or buy the underlying securities. These actions should reduce the ETF share price and/or raise the price of the underlying securities, bringing the price of the ETF and the market value of its underlying securities closer together.
>
> The ability of authorized participants to create or redeem ETF shares at the end of each trading day also helps an ETF trade at market prices that approximate the underlying market value of the portfolio. When a deviation between an ETF's market price and its underlying value occurs,

13 ICI Factbook, at page 48 (available on the web at http://www.ici.org/pdf/2012_factbook.pdf).

> authorized participants may engage in trading strategies similar to those described above, and may also purchase or sell creation units directly with the ETF. For example, when an ETF is trading at a discount, authorized participants may find it profitable to buy the ETF shares and sell short the underlying securities. At the end of the day, authorized participants return ETF shares to the fund in exchange for the ETF's redemption basket of securities that they use to cover their short positions. When an ETF is trading at a premium, authorized participants may find it profitable to sell short the ETF during the day while simultaneously buying the underlying securities. At the end of the day, the authorized participant will deliver the creation basket of securities to the ETF in exchange for ETF shares that they use to cover their short sales. These actions by authorized participants, commonly described as "arbitrage opportunities," help keep the market-determined price of an ETF's shares close to its underlying value.

It is unclear, and the ICI Letter offers no explanation, why the indicative intraday value is a valid data point and price discovery mechanism for the market participants described in its Factbook but not for NASDAQ members. NASDAQ believes, consistent with the ICI Factbook, that the proposed order type can contribute to price discovery and provide additional opportunities for arbitrage that "keep the market-determined price of an ETF's shares close to its underlying value."

Purpose and Benefit of the Order. With respect to the first question – what is the purpose and proposed benefit of the Indicative Value Pegged Order – NASDAQ stated that the proposed new order is designed to provide a voluntary, alternative tool for investors to obtain high quality executions in certain ETFs. No NASDAQ member or investor is required to use the Indicative Value Pegged Order, and ETF issuers are free to endorse, oppose or remain silent on the order. NASDAQ hopes that members will test the order and consider using it to serve their customers. NASDAQ fully expects members that use the order and that benefit from using the order will continue to use it; and those not enjoying such benefits will not use it. In either case, NASDAQ members will remain free to utilize NASDAQ's other orders, including NASDAQ's Primary and Midpoint Pegged Orders which NASDAQ members have tested and determined to be reliable.

In its response, NASDAQ opined that investors could use the new order to achieve greater transparency and a fair execution price. For example, as described in Example 2 of the Original Proposal, investors can use the Intraday Pegged Value Order to reduce (or, with proper instructions, avoid) the premium to assets paid when purchasing an ETF where new shares are difficult to create. If, as ICI claims in its Factbook, the IIV creates arbitrage opportunities that help align prices, the proposed Intraday Value Pegged Order simply builds on that price discovery process. Finally, NASDAQ explained that the "published INAV represents the closest calculation of underlying value generally available, and therefore in our view forms the best proxy for fair value." As such, the INAV of an ETF is a useful benchmark against which to price orders for the ETF.

Operation of the Order When Data Feed is Compromised. With respect to the second question -- how the new order type will operate when the disseminated indicative value is compromised – NASDAQ's Letter sought to clarify that its use of the term "compromised" referred to a disruption in dissemination of the data feed containing the INAV data element, rather than an error in the calculation of the INAV itself. In that regard, NASDAQ agreed that when NASDAQ detects a technical problem in disseminating the data feed containing the INAV, NASDAQ would suspend use of the order type and cancel back to the entering parties all resting INAV Pegged Orders. In addition, NASDAQ explained that a number of protections already exist to ensure a valid data point and to communicate with market participants in the event of technology issues which impact its own systems or those systems of a third party where there is such a dependency. Finally, NASDAQ stated that where there are clearly erroneous executions, NASDAQ will process these in accordance with established policies. In response, ICI's second letter simply reiterates the same operational questions raised in its first letter.

Given ICI's lingering questions about the operation of the Indicative Value Pegged Order, NASDAQ believes it would be beneficial to explain in greater detail how the new order will operate and demonstrate that it will operate safely and effectively. First, in pricing Indicative Value Pegged Orders, NASDAQ will use the same market data that it currently uses for executing trades, routing orders, and complying with Regulation NMS and other regulatory obligations. NASDAQ takes this data exclusively from a primary listing market for ETFs, not from third-party data vendors as ICI implies. In other words, NASDAQ has already determined that the data is reliable for use in all SRO functions, and NASDAQ has already developed monitoring and surveillance tools to detect signals that call into question that reliability and processes to respond to such situations.

More specifically, as set forth in SR-NASDAQ-2011-118, NASDAQ's matching engine, router, and compliance tools today receive and utilize numerous consolidated data feeds and proprietary data feeds.[14] These data feeds contain the best bids and offers as well as the indicative values for ETFs published by all listing venues, including NASDAQ, NYSE Arca, NYSE Amex, and DirectEdge. As set forth in the cited filing,

> This determination – whether to utilize bids and offers from the network processor feed or from a direct proprietary data feed – will be made by the Exchange on a market-by-market basis based upon objective criteria about

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[14] *See* Securities Exchange Act Release No. 65159 (Aug. 18, 2011); 76 FR 53007 (Aug. 24, 2011), at footnote 7 and accompanying text.

> reliability and speed. The determination, once made, will apply to all bids and offers from an exchange; it will not be made on a stock-by-stock basis. Additionally, the determination, once made, will be valid until such time as the away exchange stops disseminating the proprietary data feed in a manner that meets NASDAQ's objective criteria (for example, when that exchange experiences operational difficulties that reduce the reliability and speed of its proprietary data feed). For exchanges that do not disseminate proprietary data feeds or whose proprietary data feeds lack sufficient reliability and speed, the Feed will continue to reflect bids and offers disseminated via the network processor feeds.

This data is used not only for NASDAQ's execution algorithm, router, and surveillance tools, but also for the Primary and Midpoint Pegged orders already existing and operating effectively under NASDAQ Rule 4751(f)(4).

In addition, the Original Proposal already addressed ICI's question about when NASDAQ will suspend use of the Indicative Value Pegged Order:

> In the event that the INAV data feed for a particular ETF were to be compromised or temporarily stopped being disseminated, the use of the INAV Pegged Order type for that ETF would be suspended (i.e. no new INAV Pegged Orders would be accepted into the system) and orders utilizing the INAV pegged functionality for that ETF already in the system, would be cancelled. The suspension of new INAV Pegged Orders would remain in effect until such time as the Exchange was confident that the integrity of the INAV data feed had been restored.

Accordingly, NASDAQ believes that ICI's concerns about the reliability of the data source are misplaced.

The Risks of Poor Executions. The ICI Letter made three broad contentions: that the indicative value may not always represent the "fair value" of the ETF; that a stale INAV can lead to poor executions; and that the INAV is susceptible to error. Based on those contentions -- each of which is misplaced to some degree -- ICI argued that the INAV is not a valid benchmark for pegging orders. We will aim to deal with each contention below.

NASDAQ and ICI now agree that, generally, the indicative value "is a good representation of fair value" and may be "the only representation of fair value currently available for individual investors." This is to be expected given the endorsement of indicative intraday values contained in ICI's Factbook, as well as the longstanding, pervasive use of indicative values by ICI's membership in marketing ETFs to ordinary investors.

Nonetheless, ICI identifies four instances when indicative intraday values may not accurately represent fair value of the ETF: (1) lightly-traded ETFs, (2) ETFs whose creation unit is a sample of a fund's portfolio, (3) following trading halts, and (4) at market open. ICI acknowledges both that the Indicative Value Pegged Order is optional, and also that "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."

NASDAQ, like ICI, is deeply concerned that ordinary investors receive the highest quality executions, and that they fully understand the risks inherent in trading ETFs and in using the proposed order. As explained in greater detail below, NASDAQ will amend the filing to ensure that both of these concerns are addressed. However, NASDAQ believes that ICI continues to misperceive the scope and breadth of marketplace protections that protect all investors today and that will protect future users of the Indicative Value Pegged Order.

First, as stated in the Original Proposal and Response to Comments, the Indicative Value Pegged Order will be bounded by the prevailing national best bid or offer ("NBBO") for the ETF. If a buy order is priced above the national best bid or a sell order is priced below the national best offer, the price of the order will be adjusted to the prevailing bid or offer. This price adjustment protects the party entering the Indicative Value Pegged Order against “trading through” the NBBO in which a worse-priced order is executed ahead of a better-priced order. Trade through protection is established by Rule 610 of Regulation NMS under the Exchange Act and it applies equally to the proposed order as well as already existing orders. Additionally, Indicative Value Pegged Orders, like NASDAQ’s existing pegged orders, will not route to away markets, further reducing the risk of price variations. To the extent the ICI is concerned about the quality of the NBBO in thinly-traded ETFs, this is an existing issue and it requires a discussion much broader than is appropriate in the context of this proposal. NASDAQ is, of course, eager to engage in any discussion that will lead to market structure and trading enhancements.

Second, to the extent ICI is concerned with the impact of market volatility on ETF valuation, NASDAQ notes that ETFs and ETF investors are already protected by multiple, market-wide trading pauses, (1) standard regulatory halts, (2) the Single Stock Circuit Breaker, and (3) the Marketwide Circuit Breaker. Each trading pause protects investors in different trading scenarios and from different manifestations of volatility; together they provide a resilient safety net against poor quality or unfair executions. These protections apply to all ETFs (in fact, ETFs were a special focus of the Single Stock Circuit Breaker), and to all order types, including the proposed Indicative Value Pegged Order. To the extent the ICI is concerned about the quality of the trading pause safety net, this again is an existing issue and it requires a discussion much broader than is appropriate in the context of this proposal.

Third, all ETFs and ETF investors are protected against poor quality executions by NASDAQ Rule 11890, which governs "clearly erroneous executions" on NASDAQ. In the wake of the May 6, 2010 trading incident, the exchanges and Commission established a uniform standard applicable to multiple trading scenarios in which clearly erroneously-priced executions can most often occur. As was the case with Single Stock Circuit Breakers, the debate about clearly erroneous trades focused on the unique characteristics of ETFs as baskets of securities, and on the corresponding needs of traders and investors for protection. Again, NASDAQ is available to discuss modifications to the handling of clearly erroneous trades; however that issue both pre-exists and transcends the current proposal.

Proposed Amendments. In addition to the above responses to comments and the questions set forth in the Commission's Order Instituting Proceedings, NASDAQ has determined to make the following four changes to the Original Proposal.

First, to the extent ICI is correct that the term "Intraday Net Asset Value" or "INAV" could mislead investors about the nature of the intraday value (as opposed to an end of day value), NASDAQ can reduce the potential for investor confusion by modifying the name of the order type from "INAV Pegged Order" to "Indicative Value Pegged Order." As stated in the Original Proposal, NASDAQ believes that the industry uses multiple synonymous terms to describe the intraday fair value of an ETF, including INAV, Intraday Indicative Value, Intraday Optimized Portfolio Value, and Intraday Portfolio Value amongst others. NASDAQ will defer to ICI's expertise in selecting the clearest terminology.

Second, to further resolution the potential for investor confusion, NASDAQ will publish a broad disclosure on the NASDAQ.com and NASDAQTrader.com websites setting forth the characteristics of the order type and the risks involved in its use. NASDAQ will work cooperatively with ICI and other interested parties to address areas of potential confusion raised in the ICI Letters and in the Commission's Order Instituting Proceedings, including but not limited to:

1) the potential for an indicative value to not accurately reflect the ETF's fair value due to the 15-second elapsed time between data dissemination or the fact that an indicative value may be based upon sampling;
2) the risks associated with using unpriced market orders when trading based on an indicative value;
3) the possibility that an order would not execute due to a failure of the data feed in an otherwise functioning market; and
4) the procedures in place for addressing erroneous executions

NASDAQ respectfully suggests, however, that given the widespread use of similar indicative values for high dollar volumes of instruments and trading, such disclosures should not be limited to NASDAQ or the proposed new order. Rather, they should become the industry standard.

Third, commenters noted the potential for mis-priced orders at the start of the trading day due to a delayed opening of component securities of the ETFs. In response, NASDAQ proposes to amend the Original Proposal to offer the order beginning at 9:45 a.m., rather than at 9:30 a.m. NASDAQ believes that the halt procedures described above adequately address the remaining halt-related risks about which ICI speculates in its Letters.

Fourth, out of an abundance of caution regarding commentors' concerns about execution quality, NASDAQ proposes to re-position the proposal as a one-year pilot and to prepare quarterly reports regarding the execution quality of the new order type. NASDAQ will analyze and publish on the NASDAQTrader.com website data regarding the comparative execution quality of trades in all Exchange Traded Funds of U.S. Component Stocks in which Indicative Value Pegged Orders are executed during the quarter. The quarterly reports will compare the execution quality of Indicative Value Pegged Orders with the execution quality of other order types based on execution quality measures set forth in Rule 605 of Regulation NMS under the Exchange Act. The quarterly report will also indicate how often the dissemination of indicative values is interrupted and how many Indicative Value Pegged Orders are cancelled. Finally, NASDAQ will cooperate with commenters in considering additional metrics to be studied.

NASDAQ believes that these proposed modifications fully and fairly respond to the valid points raised by commenters to the Original Proposal as well as the questions posed by the Commission's Order Instituting Proceedings. Furthermore, NASDAQ submits that the proposed rule change as amended is consistent with the Act and the protection of investors as set forth below.

b. Statutory Basis

The proposed rule change is consistent with Section 6(b) of the Act,[15] in general,

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15 15 U.S.C. 78f(b).

and furthers the objectives of Section 6(b)(5),[16] in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system. The Indicative Value Pegged Order will allow market participants the option to enter an order without concern about the value of the fund's portfolio being drastically different and therefore resulting in an inferior execution, as the order will be dynamically repriced/updated throughout the life of the order as the value of the underlying portfolio changes. Additionally, it provides a more intelligent form of market order. Instead of having the order execute at the prevailing price (regardless of what that price might be relative to the fund's value) the Indicative Value Pegged Order gives participants the option to collar the execution at a price that relates to the actual value of the fund's components. Whilst it is acknowledged that there is an inherent lack of execution determinism with a Pegged Order, market participants will be free to elect this order type for U.S. Component Stock ETFs where there is dynamic Indicative Value data, but they will not be limited to this option, or required to use this option. For those market participants who are more interested in securing execution certainty, a conventional market order will still be available.

The Exchange believes that the proposed change to Rule 4751(f)(4) meets the requirements of Section 6(b)(5) of the Act[17] in that it will improve the stability, quality

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16 15 U.S.C. 78f(b)(5).

17 Id.

and transparency of the national market system. In the event that the Indicative Value data feed were to be compromised or temporarily stopped being disseminated, the use of the Indicative Value Pegged Order type would also be suspended (i.e. no new Indicative Value Pegged Orders would be accepted into the system) until such time as the Exchange was confident that the integrity of the data feed had been restored and orders utilizing the pegged functionality already in the system would be cancelled. In addition, the Exchange is not aware of any circumstance where this order type could be used to manipulate the indicative value of the fund, and Nasdaq MarketWatch will perform all usual market surveillance activity on the use of the Indicative Value Pegged Order.

4. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. To the contrary, NASDAQ believes that the Indicative Value Peg Order is pro-competitive in that it will be a unique functional enhancement to the attractiveness of NASDAQ's trading venues. NASDAQ fully expects that, if successful, the Indicative Value Pegged Order will be copied by competing national securities exchanges.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

The Exchange does not consent at this time to an extension of the time period for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

1. Notice of proposed rule for publication in the Federal Register.