August 16, 2012

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 29549-1090

Re: SR-NASDAQ-2012-43; SR-NYSEArca-2012-37

Dear Ms. Murphy,

IMC Chicago, LLC d/b/a IMC Financial Markets ("IMC")[1] appreciates the opportunity to submit this comment letter regarding proposals by The NASDAQ Stock Market LLC ("NASDAQ") to establish a Market Quality Program ("MQP") and NYSE Arca, Inc. ("ARCA") to introduce a Lead Market Maker ("LMM") Issuer Incentive Program ("Fixed Incentive Program" and together with the MQP, the "Programs"). According to the proposals, NASDAQ and ARCA intend to adopt listing fees and related market maker incentive programs for certain securities on a pilot basis. For the reasons identified below, IMC respectfully recommends that the Securities & Exchange Commission ("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.

Background

IMC is an LMM on ARCA for over 150 exchange traded products ("ETPs') that collectively represent an average daily volume (ADV) of over 180 million shares. IMC is the 4th largest LMM by number of assigned products and the 2nd largest LMM by total market volume traded in those issues. IMC is also a Designated Liquidity Provider ("DLP") on NASDAQ. IMC is the 3rd largest DLP by number of products assigned and the 5th largest DLP by total market volume traded in those issues. The below table offers a recent snapshot of LMM and DLP assignments and average daily volumes in the assigned products across both ARCA and NASDAQ.

[1] IMC is a proprietary trading firm and registered broker-dealer, engaged in providing liquidity in nearly every listed equities and derivatives market in the U.S. IMC is a registered market maker in U.S. exchange listed products. As a market maker, IMC establishes two-sided markets which serve to aid investors in their effort to mitigate or transfer risk. In addition, IMC is part of a global firm, with affiliates trading in Amsterdam, Zug, Sydney, and Hong Kong.

ARCA (assignments as of 8/1/12, average daily volume ("ADV") per products[2] as of 8/13/12)

Assigned LMMs	No. of Products		Top Volume Providers	20-Day ADV
Knight Equity Markets	456		Goldman Sachs & Co.	293,228,554
Goldman Sachs & Co.	398		IMC Chicago	182,955,495
Susquehanna Capital Group	213		GETCO LLC	107,032,353
IMC Chicago	157		Sun Trading	45,731,653
Virtu Financial	32		Knight Equity Markets	41,032,141

NASDAQ (assignments and ADV per products as of 8/7/12)

Assigned DLPs	No. of Products		Top Volume Providers	20-Day ADV
Knight	44		Knight	4,344,721
Susquehanna	32		Susquehanna	2,547,689
IMC Chicago	16		Getco	670,124
Getco	2		Virtu	353,516
Deutsche Bank	1		IMC Chicago	216,070

Obligations

As an LMM on ARCA, IMC is subject to several obligations and our performance is measured by several metrics. An LMM is subject to the obligations of Market Makers set forth in NYSE Arca Rule 7.23, including maintaining continuous, two-sided trading interest in the securities it is registered to trade. In addition, LMMs must satisfy certain minimum daily performance standards pursuant to NYSE Arca Rule 7.24, including (i) percent of time at the NBBO; (ii) average displayed size; and (iii) average quoted spread. Pursuant to the Exchange's policy, LMM's are required to maintain "inside quotes" with a maximum width and minimum depth, which will vary depending on the symbol's monthly average daily share volume and price. Moreover, LMMs must contribute to providing liquidity at the NBBO on ARCA. An LMM may satisfy this requirement either by having quotes or orders at the inside price at least 15% of the trading day or by contributing quotes or orders so that an ETP will size-set the NBBO at least 25% of the trading day on ARCA. LMMs, whose orders must be displayed to be included as part of the time-at-inside calculations, are also required to be present with limit orders in the ARCA opening and closing auctions.

As a DLP on NASDAQ, IMC is similarly subject to an enhanced performance obligation in comparison to non-DLP's. Unlike ARCA, however, NASDAQ utilizes only one metric by which to judge performance—percent of time at the NBBO. Specifically, for securities with less

[2] The data referenced was derived from Bloomberg and the volumes reflect total market volume for the products and not the volume of the specific participants assigned to those products.

than 1 million shares ADV, DLPs must display orders at the NBBO at least 15% of the time. For securities with greater than 1 million shares ADV, DLPs must display orders at the NBBO at least 10% of the time.

Costs & Risks

As dedicated providers of liquidity, LMMs and DLPs are exposed to certain costs and risks associated with their market-making assignments. A low inventory turnover rate is one example. Where a product's underlying volume is low, due to poor investor reception or other issues, the rate at which the market-maker is able to turnover their inventory decreases. As a result, the risk of holding a significant inventory increases. Throughout the time this inventory is held, the MM must pay management fees and interest charges levied by its clearing firm. These costs, taken together, also amount to lost opportunity costs; in other words, capital invested by LMMs or DLPs on illiquid products may be allocated elsewhere with better returns on the investment.

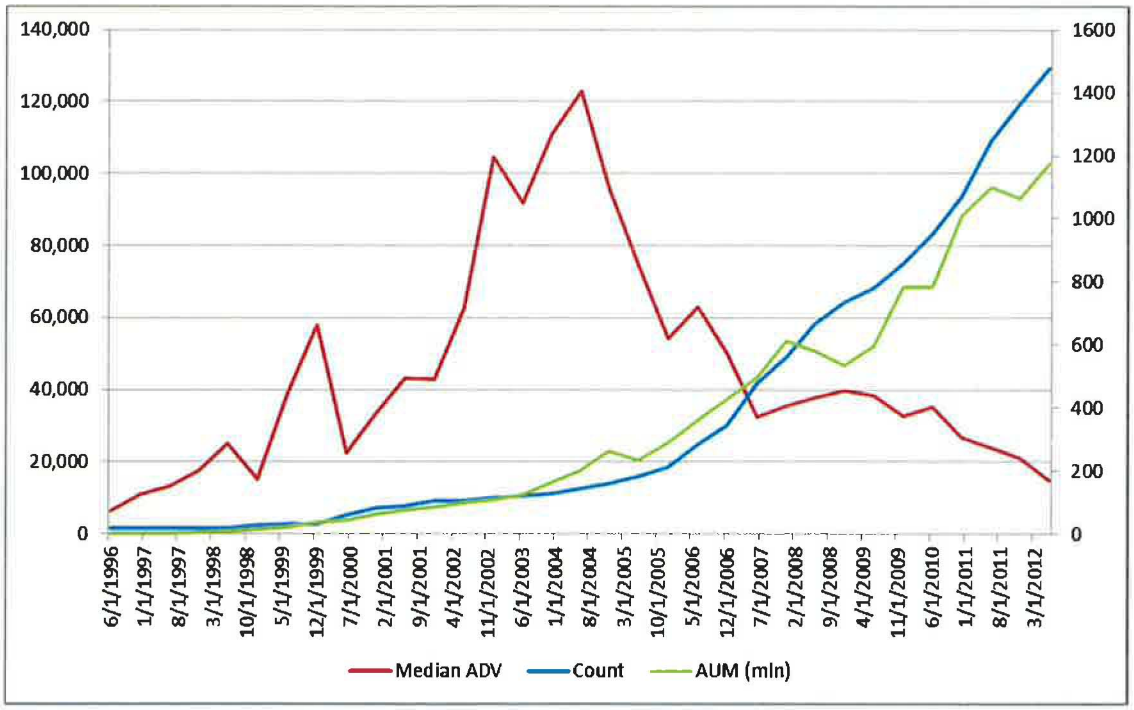
LMMs and DLPs also face costs and risks associated with the increasing complexity of exchange traded products and the underlying asset classes they represent. As a direct result of increasingly complex products, it is increasingly difficult for LMMs or DLPs to access reliable and cost effective hedges to manage their positions. This further increases the risks and costs associated with holding a position in the products for extended periods of time.

In addition, while the costs associated with trading new ETPs have risen due to increased complexity and lower turnover rates, median volumes for ETPs have dropped substantially over time. With lower volumes, the compensation that an LMM or DLP is able to earn for the median product has also dropped. This has led to a situation where the median revenue per product has sharply diverged with the median cost associated with providing continuous, high quality, two-sided quote, as is required of LMMs and DLPs. Furthermore, the risk of a material adverse event resulting from quoting increasingly complex ETPs has led to a significant increase in costs associated managing these risks. Unfortunately, there has not been a mechanism to emerge that compensates LMMs or DLPs for these increased operational costs.

Current Methods to Incentivize LMM & DLP Participation are Insufficient

As outlined above, LMMs and DLPs are required to comply with increased obligations and performance metrics. Failure to satisfy these obligations and attendant performance metrics may expose the LMM or DLP to possible disciplinary action and/or loss of its assignment(s). As a result, in order to incentivize participation in the program, in exchange for providing high quality liquidity, both ARCA and NASDAQ offer LMMs and DLPs an enhanced fee structure in the assigned products. Unfortunately, the incremental rate differences compared to the standard fees are not sufficient to cover the costs—both explicit and opportunity related—associated with being an LMM and DLP for most new products, which tend to be less liquid ETPs. Most ETPs coming to market now focus on increasingly narrow asset classes or market segments. Such products have an increased risk of a low ADV and turnover rate, thereby increasing the level of difficulty in supporting such products by means of a fee model based on traded volume.

Simultaneously, the commonality of interests between issuers and LMMs or DLPs has also begun to diverge. As a result, although issuers continue to innovate and bring new investment products to the market, less and less liquidity providers are willing to step up as LMMs and DLPs. Naturally, as a market-maker, there is a greater opportunity to profit as trading volumes in the assigned products increase. Historically, the significant growth in ETF assets under management ("AUM") has corresponded with significant growth in ETF volumes; thus, aligning the interests of both issuer and LMM / DLP. Over the past few years, however, the incentives of issuers and market-makers have decoupled. As seen in the chart below, derived from data observed on Bloomberg, while total industry AUM and number of products have been steadily climbing, the median ADV has been in a steady decline since 2005.



In addition to the growing disparity between rising aggregate AUM and declining median ADV, IMC further notes that a small percentage of ETPs account for most of the traded volume. According to our research, the largest 55 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. With volume concentrated in such a relatively small percentage of products, it is clear that the current volume-based fee incentive structure is ill equipped to incentivize market makers to undertake the potential increased costs and obligations associated with being designated an LMM or DLP in a newer products, especially when many of these focus on narrower market segments or asset classes compared to larger products. In other words, the existing volume-based fee incentive approach has proven to be unsustainable over the past few years and its insufficiency is aggravated by slow markets generally and the current ETP market in particular.

To address the deficit between costs and benefits of LMM / DLP participation, LMMs and DLPs have turned to developing portfolios of assignments with issuers in the hopes of identifying the right mix of products that in the aggregate offer the prospect of profitability or of at least breaking even. Portfolios supported by successful products with significant ADV satisfy all parties—the issuers, the LMMs and DLPs, and the exchange. LMMs and DLPs will benefit from the opportunity to cover their overall costs, the issuer is able to launch new products with the understanding that the exchange-subsidized LMM or DLP will provide support, and the exchange is able to cover these costs via incremental listing fees, increased tape revenue and higher overall net capture. Of course, in light of the incremental rebate and decremented take fee the LMM or DLP would earn/save from a successful assignment, the value of being assigned to a successful ETP within a portfolio is both significant and critical. This ad-hoc approach is effective only as long as there are products such as XLF, EEM and IWM to subsidize the issuance of new products. Unfortunately, as the market becomes increasingly saturated with new products, the average incremental benefit to the LMMs and DLPs decreases and participation may even become a negative. Furthermore, as more new issuers emerge without stables full of heavily-traded ETPs, there exists no clear way to compensate LMMs and DLPs for the service they provide.[3] As a result, the business case for either existing or new participants to the LMM or DLP programs to undertake new designations is becoming increasingly weak as the likelihood of recouping costs under the current programs becomes increasingly less likely. Indeed, we would expect many participants in these programs to reconsider their current and future levels of participation if the concerns outlined herein are not soon addressed by the Commission and exchanges.

<u>The Proposals Are Designed to Restore Incentives & Investor Opportunities</u>

The Programs offer issuers and market makers an opportunity to better align the cost of bringing products to market, while continuing to provide the benefit of a dedicated market-maker. All too often, as described above, market makers are losing capital over the course of a year, after accounting for the operational and opportunity costs associated with managing their portfolio. To avoid potential operating losses, a LMM or DLP is typically forced to choose between either dropping their assignment in a number of smaller ETPs or providing a lower service-level to their issuer. 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.

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[3] We note that some ETF issuers, who have few if any products trading in significant volume are struggling; some are actively reviewing their U.S. business while others close down.

IMC believes that ARCA's proposed Fixed Incentive Program and NASDAQ's proposed MQP each have their own merits. In fact, IMC believes that it is in the best interests of markets and investors when exchanges offer competitive and innovative proposals. We do not believe that there is only one way to structure a program designed to foster liquidity. Consequently, we believe that the Commission should be careful in avoiding the appearance of establishing a one-size-fits-all approach. Instead, IMC respectfully 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.

Program Design Differences & Their Impact

Although the Programs seek the same goal—robust markets for new or illiquid products—the impact of certain differences in their design, highlighted below, merit consideration.

- Trading Level Eligibility & Termination. ARCA does not establish a trading volume threshold for ETPs to qualify for eligibility or that would trigger termination; NASDAQ proposes that only ETPs that have an ADV of less than 2 million shares would be eligible for participation in its MQP and that this level, if sustained for three consecutive months would also trigger termination.
- Performance Standards. LMMs in products subject to ARCA's Fixed Incentive Program would be subject to the same performance standards as LMMs in products not subject to the program; market makers participating in NASDAQ's MQP would be subject to different performance standards than those applicable to non-participating market makers.
- MM Participation. Only one LMM would be assigned to each ETP in ARCA's Fixed Incentive Program and would be sole eligible for the incentive payment; multiple market makers could be assigned to an MQP security and such market makers would be compensated by NASDAQ on a pro-rata basis.
- Payment Transparency. The amount of incentive payment under ARCA's Fixed Incentive Program may vary between $10,000-$40,000, but the agreed upon amount would not be publicly disclosed; the amount of any Supplemental MQP fee may vary up to $50,000 and it will be disclosed on NASDAQ's website.

Trading Level Eligibility & Termination

IMC believes that it is critical to maintain as much flexibility as possible with respect to product eligibility and inclusion. The success of any incentive program generally, and any participating product in particular, is a facts and circumstances assessment and may in fact require continued support despite the appearance of having attained some calculable level of success. ARCA's program is appropriately designed to ensure that a product may be supported throughout its life, if the issuer so chooses. An arbitrary metric for inclusion or exclusion, on the other hand, may needlessly expose the participating product to negative and unintended consequences. For example, if after a pre-determined amount of time a product is removed from the program, the liquidity in the security could readily diminish, thereby making the cost of exiting a position more costly to the investor. In addition, certain products may require time before gaining significant traction. 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 long as issuers wish to maintain certain products in a MM supported program, they should be afforded the discretion to do so. ARCA's proposed program accomplishes this while allowing issuers to determine whether the issuer or exchange sponsored program best suits the trading profile of their product.

Performance Standards

As described above, the Programs are an attempt to recalibrate existing incentives so as to encourage meaningful market maker participation and liquidity provision. ARCA's current performance standards for LMM's, which are scalable for the characteristics of particular products, are robust and generally more stringent that those requirements set forth by NASDAQ. Unfortunately, the current incentives are failing to attract market makers and LMMs to participate because the economics no longer justify the increased risks. In other words, the costs associated with the current LMM requirements are not sufficiently addressed solely through the existing variable remuneration program. ARCA's proposal accurately reflects the current imbalance of the existing program; the performance obligations are high but the corresponding benefits to market makers are low. Conversely, NASDAQ's proposal to establish a program reflects both the value of increased performance standards (akin to ARCA's LMM program) as well as the need for an incentive mechanism to facilitate acceptance of the program's inherent obligations, costs and risks.

Moreover, products should not be viewed in isolation, but should instead be viewed as part of the overall relationship each market maker has with the product's issuer. Any payments from an issuer to the market maker, as proposed under the Programs, will make up the total compensation received by the market maker. The payment(s) offer issuers one more means of incentivizing market makers to achieve a desired service level, for all products, that is acceptable to the issuer—to the benefit of investors.

Market Maker Participation

Assigning only one eligible market maker for receipt of the incentive payment, as proposed by ARCA, maximizes the available incentive and assures accountability. NASDAQ's proposal to diffuse the incentive across 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. With one responsible LMM, an issuer may hold a single identifiable party directly accountable for a product attaining, or failing to attain its expected service levels.

Payment Transparency

IMC believes payment levels should be disclosed. We respectfully urge the Commission to require ARCA to amend its proposal so as to require ARCA to disclose payment levels in a manner consistent with NASDAQ's proposal.[4] With this proposed change, IMC believes that the design of ARCA's program—in terms of product eligibility, performance standards, and market maker eligibility—empowers issuers to obtain the highest possible service-levels.

Conclusion

For the foregoing reasons, IMC respectfully urges the Commission to approve both ARCA's proposed Fixed Incentive Program and NASDAQ's MQP on a pilot basis. Each program offers a reasonable and transparent effort 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.

Should you have any questions in connection with our comments, please feel free to contact me at 312-244-3355.

Sincerely,

Andrew Stevens
Legal Counsel

cc:

Robert W. Cook, Division of Trading and Markets
Heather Seidel, Division of Trading and Markets

[4] In terms of payments, the proposed cap at $50,000 amounts to $200 per day—not an amount that closely aligns with the operational and opportunity costs associated with LMM or DLP assignments. Going forward, we suggest that such incentives not be subject to a cap. We believe that transparency of the fees is the critical component regarding payments, as opposed to arbitrary caps.