

June 27, 2013

Writer's Direct Contact
202.887.1563
DLynn@mofocomDavid W. Blass
Chief Counsel and Associate Director
Division of Trading and Markets
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549**Re: Request by NASDAQ Stock Market LLC for Exemptive, Interpretive or No-Action Relief from Section 11(d)(1) of the Securities Exchange Act of 1934 and Rules 11d1-2 thereunder**

Dear Mr. Blass:

The NASDAQ Stock Market LLC (the "Exchange" or "NASDAQ"), on behalf of itself and those Market Makers¹ participating in the Exchange's Market Quality Program (the "MQP" or the "Program") who are broker-dealers (or any associated person or affiliate of such broker-dealers), requests that the Staff of the Division of Trading and Markets (the "Staff") of the Securities and Exchange Commission (the "Commission") grant exemptive, interpretive or no-action relief from the requirements of Section 11(d)(1) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and Rule 11d1-2 thereunder, in connection with certain payments from the Exchange to certain Market Makers participating in the MQP, as discussed below. For the reasons described more fully herein, we believe the proposed relief is necessary and appropriate in the public interest and is consistent with the protection of investors.

I. BACKGROUND**A. Summary of Order Granting Approval of MQP Pilot Period**

On December 7, 2012, the Exchange filed with the Commission a proposed rule change to establish the MQP on a pilot basis.² On December 20, 2012, the Exchange

¹ The term "Market Maker" has the meaning given in NASDAQ Rule 5005(a) (24). See Rule 5950(e)(3).

² See Securities Exchange Act Release No. 68378 (Dec. 6, 2012), 77 FR 74042 (Dec. 12, 2012) (SR-NASDAQ-2012-137).

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submitted Amendment No. 1 to the proposed rule change, which replaced and superseded the proposed rule change in its entirety. The proposed rule change, as modified by Amendment No. 1 thereto, was published for comment in the Federal Register on December 31, 2012.³ On February 7, 2013, the Exchange submitted Amendment No. 2 to the proposed rule change. On February 8, 2013, the Exchange withdrew Amendment No. 2 and filed Amendment No. 3 to the proposed rule change. On March 20, 2013, the Commission issued its order granting approval of the proposed rule change, as modified by Amendment Nos. 1 and 3.⁴

The Approval Order also noted the Commission's view that the incentive payments that Market Makers will receive under the Program (discussed in detail below) are indirect payments from the fund complex to the Market Maker and that those payments are compensation to promote or sell the shares of the Exchange Traded Funds ("ETF"). The Approval Order went on to note that a Market Maker that also is a Broker-Dealer AP (as defined below) for an ETF (or an associated person or an affiliate of a Broker-Dealer AP) that receives the incentives under the MQP will not be able to rely on the SIA Exemption from Section 11(d)(1) (as discussed below). In that regard, the Approval Order clarified that this does not mean that Broker-Dealer APs cannot participate in the MQP; but that they cannot rely on the SIA Exemption while doing so. The Approval Order concluded that Broker-Dealer APs that participate in the MQP will need to comply with Section 11(d)(1) of the Exchange Act, unless there is another applicable exemption.⁵

³ See Securities Exchange Act Release No. 68515 (Dec. 21, 2012), 77 FR 77141 (Dec. 31, 2012) ("Notice").

⁴ See Securities Exchange Act Release No. 69195 (March 20, 2013) (Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Granting Approval of a Proposed Rule Change, as Modified by Amendment Nos. 1 and 3 Thereto, to Establish the Market Quality Program), 78 FR 18393 (Mar. 26, 2013) ("Approval Order").

⁵ The MQP was previously proposed in NASDAQ-2012-043, which was withdrawn by the Exchange so that it could, among other things, incorporate enhancements into the Program. These enhancements to the transparency, parameters, and nature of the Program were made in response to concerns raised by Commission staff and commenters. For example, to enable Commission and Exchange staff to better evaluate the Program, the threshold to "graduate" from the Program was reduced to an average daily trading volume (consolidated trades in all U.S. markets) ("ATV") of 1 million shares or more in three consecutive months; and to negate any potential influence of issuers over Market Makers, subscribers make payments on behalf of issuers into the General Fund of the Exchange, and the Exchange may credit, out of the General Fund, only those Market Makers that meet strict market quality and liquidity standards established in the Program.

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B. Overview of NASDAQ Rule 5950 (Market Quality Program)

As set forth in more detail in NASDAQ Rule 5950 (the “Rule”),⁶ the Exchange amended its Rule 5950 to establish an MQP listing fee and related Market Maker incentive program, and to adopt interpretation IM-2460-1 to exempt the MQP from NASDAQ Rule 2460 (Payment for Market Making), on a pilot basis.⁷ The MQP will be a voluntary program, and participation in the program will be at the discretion of each MQP Company (as defined below), subject to the requirements set forth in the Rule.

1. NASDAQ Rule 5950 (Market Quality Program)

The MQP is a voluntary program designed to promote market quality in certain securities listed on the Exchange (“MQP Securities”).⁸ MQP Securities will consist of ETF securities issued by an MQP Company⁹ and listed on the Exchange pursuant to NASDAQ Rule 5705.¹⁰ In addition to the standard (non-MQP) Exchange listing fee applicable to an MQP Security set forth in the NASDAQ Rule 5000 Series (consisting of NASDAQ Rules 5000 - 5999), an MQP Company will incur a fee (“MQP Fee”), on behalf of an MQP Security, to participate in the Program.¹¹ The MQP Fee will be used for the purpose of incentivizing one or more Market Makers in the MQP Security (“MQP Market Maker”) to

⁶ See NASDAQ Rule 5950.

⁷ As discussed below, by virtue of an immediately effective rule filing, FINRA likewise exempted the MQP from its Rule 5250. See Securities Exchange Act Release No. 69398 (April 18, 2013), 78 FR 24261 (April 24, 2013) (SR-NASDAQ-2013-020) (notice of filing and immediate effectiveness).

⁸ See Rule 5950 Preamble.

⁹ The term “MQP Company” means the trust or company housing the ETF or, if the ETF is not a series of a trust or company, then the ETF itself. See Rule 5950(e)(5).

¹⁰ See Rule 5950(e)(1) (defining the term “MQP Security” to mean an ETF security issued by an MQP Company that meets all of the requirements to be listed on the Exchange pursuant to Rule 5705). The term “Exchange Traded Fund” includes Portfolio Depository Receipts and Index Fund Shares, which are defined in NASDAQ Rule 5705. See Rule 5950(e)(2).

¹¹ See Rules 5950 Preamble and 5950(b)(2). MQP Fees for MQP Securities will be paid by the Sponsors associated with the MQP Companies. See Rule 5950(e)(5). See also Rule 5950(b)(2)(C)(i) (requiring that the MQP Fee in respect of an ETF be paid by the Sponsor(s) of the ETF). The term “Sponsor” means the registered investment adviser that provides investment management services to an MQP Company or any of the adviser’s parents or subsidiaries. See Rule 5950(e)(5).

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enhance the market quality of the MQP Security.¹² Subject to the conditions set forth in the Rule, this incentive payment will be credited (“MQP Credit”) to one or more MQP Market Makers that make a high-quality market in the MQP Security pursuant to the MQP.¹³

a) Application and Withdrawal

An MQP Company that wants to have its MQP Security participate in the MQP, and a Market Maker that wants to participate in the MQP, will each be required to submit an application in the form prescribed by the Exchange.¹⁴ The Exchange can, on a Program-wide basis, limit the number of MQP Securities that any one MQP Company may have in the MQP.¹⁵ In determining whether to limit the number of MQP Securities per MQP Company, the Exchange will consider all relevant information, including whether a restriction, if any, is consistent with the goals of the MQP and in the best interest of the Exchange, the MQP Company, and investors.¹⁶ The Exchange can also, on a Program-wide basis, limit the number of MQP Market Makers permitted to register in an MQP Security.¹⁷ If such a limit is established, the Exchange will allocate available MQP Market Maker registrations in a first-come-first-served fashion based on successful completion of an MQP Market Maker application.¹⁸

¹² See Rule 5950 Preamble.

¹³ See Rule 5950 Preamble. The MQP Credit will be paid to eligible MQP Market Maker(s) based on quoting and trading activity in the MQP Security, as discussed in further detail below. See *infra* notes 43-49 and accompanying text.

¹⁴ See Rule 5950(a)(1).

¹⁵ See Rule 5950(a)(1)(A). This provision is intended to allow the Exchange, on a Program-wide basis, to limit the number of ETFs that any one MQP Company may have in the MQP. This provision would not, however, allow the Exchange to limit the number of actual shares issued by any MQP Company for a particular ETF participating in the MQP. See Approval Order, *supra* note 4, at 18394, n. 19.

¹⁶ See Rule 5950(a)(1)(B). Factors that could be considered by the Exchange include, but are not limited to, the current and expected liquidity characteristics of MQP Securities; the projected initial and continuing market quality needs of MQP Securities; and the trading characteristics of MQP Securities (e.g., quoting, trading, and volume). See Rule 5950(a)(1)(B)(i).

¹⁷ See Rule 5950(c)(3).

¹⁸ See Rule 5950(c)(3)(A).

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The Exchange will provide notification on its website regarding: (i) the acceptance of an MQP Company (on behalf of an MQP Security) and an MQP Market Maker into the MQP; (ii) the total number of MQP Securities that any one MQP Company may have in the MQP; (iii) the names of MQP Securities and the MQP Market Maker(s) in each MQP Security, and the dates that an MQP Company, on behalf of an MQP Security, commenced participation in and withdrew or was terminated from the MQP; and (iv) any limit on the number of MQP Market Makers permitted to register in an MQP Security.¹⁹

After an MQP Company, on behalf of an MQP Security, has been in the MQP for not less than two consecutive quarters but less than one year, it can voluntarily withdraw from the MQP on a quarterly basis.²⁰ An MQP Company seeking to withdraw from the MQP must notify the Exchange in writing not less than one month prior to withdrawing from the MQP. The Exchange can determine to allow an MQP Company to withdraw from the MQP earlier.²¹ In making this determination, the Exchange may take into account the volume and price movements in the MQP Security; the liquidity, size quoted, and quality of the market in the MQP Security; and any other relevant factors.²² After an MQP Company, on behalf of an MQP Security, has been in the MQP for one year or more, it can voluntarily withdraw from the MQP on a monthly basis, provided that it has notified the Exchange in writing not less than one month prior to withdrawing from the MQP.²³ After an MQP Company, on behalf of an MQP Security, has been in the MQP for one year, the MQP and all obligations and requirements of the MQP will automatically continue on an annual basis, unless: (a) the Exchange terminates the MQP by providing not less than one month prior notice of intent to terminate; (b) the MQP Company, on behalf of an MQP Security, withdraws from the MQP pursuant to the Rule; (c) the MQP Company is terminated from the MQP pursuant to Rule

¹⁹ See Rule 5950(a)(1)(C) and Rule 5950(c)(3). The Exchange also will include on its website a statement about the MQP that sets forth a general description of the MQP as implemented on a pilot basis and a fair and balanced summation of the potentially positive aspects of the MQP (e.g., enhancement of liquidity and market quality in MQP Securities) as well as the potentially negative aspects and risks of the MQP (e.g., possible lack of liquidity and negative price impact on MQP Securities that withdraw or are terminated from the MQP), and indicates how interested parties can get additional information about products in the MQP. See Rule 5950(a)(1)(C)(iv).

²⁰ See Rule 5950(a)(2)(A).

²¹ *Id.*

²² *Id.*

²³ See Rule 5950(a)(2)(B).

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5950(d);²⁴ or (d) the pilot Program is not extended or made permanent pursuant to a proposed rule change approved by the Commission under Section 19(b)²⁵ of the Exchange Act.²⁶

After an MQP Market Maker has been in the MQP for not less than one quarter, the MQP Market Maker can withdraw from the MQP on a quarterly basis. The MQP Market Maker must notify the Exchange in writing one month prior to withdrawing from the MQP.²⁷

The Exchange will provide notification on its website when it receives notification that an MQP Company, on behalf of an MQP Security, or an MQP Market Maker intends to withdraw from the MQP, including the date of actual withdrawal or termination from the MQP.²⁸

b) MQP Company Eligibility and Fee Liability

For an MQP Company, on behalf of an MQP Security, to be eligible to participate in the MQP, the following conditions must be satisfied: (i) the Exchange must have accepted the MQP Company's application in respect of the MQP Security and must have accepted the application of at least one MQP Market Maker in the same MQP Security; (ii) the MQP Security must meet all requirements to be listed on the Exchange as an ETF; (iii) the MQP Security must meet all Exchange requirements for continued listing at all times the MQP Security is in the MQP; and (iv) while an MQP Company lists an MQP Security, the MQP Company must, on a product-specific website for each product, indicate that the product is

²⁴ Rule 5950(d) states, in part, that the MQP will terminate in respect of an MQP Security under the following circumstances: (A) an MQP Security sustains an average daily trading volume (consolidated trades in all U.S. Markets) of one million shares or more for three consecutive months; (B) an MQP Company, on behalf of an MQP Security, withdraws from the MQP, is no longer eligible to be in the MQP pursuant to the Rule, or its Sponsor ceases to make MQP Fee payments to the Exchange; (C) an MQP Security is delisted or is no longer eligible for the MQP; (D) an MQP Security does not have at least one MQP Market Maker for more than one quarter; or (E) an MQP Security does not, for two consecutive quarters, have at least one MQP Market Maker that is eligible for the MQP Credit.

²⁵ 15 U.S.C. 78s(b).

²⁶ See Rule 5950(a)(3).

²⁷ See Rule 5950(a)(2)(C).

²⁸ See Rule 5950(a)(2)(D).

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in the MQP and provide the link to the Exchange's MQP website.²⁹

An MQP Company participating in the MQP will incur an annual basic MQP Fee of \$50,000 per MQP Security ("Basic MQP Fee"), which must be paid to the Exchange prospectively each quarter.³⁰ An MQP Company may also, on an annual basis, voluntarily select to incur an annual supplemental MQP Fee per MQP Security ("Supplemental MQP Fee"), which must be paid to the Exchange prospectively each quarter.³¹ The Basic MQP Fee and Supplemental MQP Fee cannot exceed \$100,000 per year when combined.³² The amount of the Supplemental MQP Fee, if any, for each MQP Security will be determined by the MQP Company initially and will remain the same for one year.³³ The Exchange will provide notification on its website regarding the amount, if any, of any Supplemental MQP Fee determined by an MQP Company per MQP Security.³⁴

The Basic MQP Fee and Supplemental MQP Fee, if any, will be in addition to the standard (non-MQP) NASDAQ listing fee applicable to the MQP Security and will not offset the standard listing fee.³⁵ The Exchange will prospectively bill each MQP Company for the quarterly MQP Fee for each MQP Security.³⁶ Basic MQP Fees and the Supplemental MQP Fees will be credited to the NASDAQ General Fund.³⁷

²⁹ See Rule 5950(b)(1).

³⁰ See Rule 5950(b)(2)(A). MQP Fees for MQP Securities will be paid by the Sponsors associated with the MQP Companies. See *supra* note 11.

³¹ See Rule 5950(b)(2)(B). As noted above, MQP Fees for MQP Securities will be paid by the Sponsors associated with the MQP Companies. See *supra* notes 11 and 30.

³² *Id.*

³³ See Rule 5950(b)(2)(B)(i).

³⁴ See Rule 5950(b)(2)(B)(ii).

³⁵ See Rule 5950(b)(2)(C).

³⁶ See Rule 5950(b)(2)(D). As discussed above, the MQP Fees for an MQP Security will be paid by the Sponsor(s) associated with the MQP Companies. See *supra* note 11.

³⁷ See Rule 5950(b)(2)(E).

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c) MQP Market Maker Eligibility and MQP Credit Distribution

The Exchange does not limit competitive Market Makers from participating in the Program. For a Market Maker to be eligible to participate in the MQP, the Exchange must have accepted the Market Maker's application in respect of an MQP Security and must have accepted the application of the MQP Company in respect of the same MQP Security.³⁸ In addition, to be eligible to receive a periodic MQP Credit out of the NASDAQ General Fund, MQP Market Makers must, when making markets in an MQP Security, meet the applicable Market Maker obligations pursuant to NASDAQ Rule 4613³⁹ and must also meet or exceed the following requirements on a monthly basis with respect to an MQP Security: (i) for at least 25% of the time when quotes can be entered in the Regular Market Session,⁴⁰ as averaged over the course of a calendar month, maintain at least 500 shares of attributable, displayed quotes or orders at the National Best Bid ("NBB") or better, and at least 500 shares of attributable, displayed quotes or orders at the National Best Offer ("NBO") or better; and (ii) for at least 90% of the time when quotes can be entered in the Regular Market Session, as averaged over the course of a month, maintain at least 2,500 shares of attributable, displayed posted liquidity on the NASDAQ Market Center⁴¹ that are priced no wider than 2% away from the NBB, and at least 2,500 shares of attributable, displayed posted liquidity on the NASDAQ Market Center that are priced no wider than 2% away from the NBO.⁴²

³⁸ See Rule 5950(c)(1)(A). The Program is competitive in that the Exchange also could accept the MQP applications of multiple MQP Market Makers in the same MQP Security, subject to any limitation on the number of MQP Market Makers established pursuant to the Rule. *Id.*

³⁹ NASDAQ Rule 4613 states that market making obligations applicable to NASDAQ members that are registered as Market Makers include, among other things, the following quotation requirements and obligations: for each security in which a member is registered as a Market Maker, the member shall be willing to buy and sell the security for its own account on a continuous basis during regular market hours and shall enter and maintain a two-sided trading interest ("Two-Sided Obligation") that is identified to NASDAQ as the interest meeting the obligation and is displayed in NASDAQ's quotation montage at all times. Interest eligible to be considered as part of a Market Maker's Two-Sided Obligation shall have a displayed quotation size of at least one normal unit of trading (or a larger multiple thereof); provided, however, that a Market Maker may augment its Two-Sided Obligation size to display limit orders priced at the same price as the Two-Sided Obligation. Unless otherwise designated, a "normal unit of trading" shall be 100 shares. After an execution against its Two-Sided Obligation, a Market Maker must ensure that additional trading interest exists in NASDAQ to satisfy its Two-Sided Obligation either by immediately entering new interest to comply with this obligation to maintain continuous two-sided quotations or by identifying existing interest on the NASDAQ book that will satisfy this obligation. See Approval Order, *supra* note 4, at 18395, n. 43.

⁴⁰ The term "Regular Market Session" has the meaning given in NASDAQ Rule 4120(b)(4)(D). See Rule 5950(e)(6).

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MQP Credits for each MQP Security will be calculated monthly and credited out of the NASDAQ General Fund quarterly on a pro rata basis to one or more eligible MQP Market Makers,⁴³ creating a competitive platform that will be available to all market participants and that will decrease the likelihood of MQP Credits concentrating in a limited number of MQP Market Makers. Each MQP Credit will be allocated 50% to a “Quote Share Payment” that is based on “Qualified Quotes,” and 50% to a “Trade Share Payment” that is based on “Qualified Trades.”⁴⁴ A “Qualified Quote” represents attributable and displayed

⁴¹ The term “NASDAQ Market Center” has the meaning given in NASDAQ Rule 4751(a). *See* Rule 5950(e)(4).

⁴² *See* Rule 5950(c)(1)(B). The Exchange provides the following examples to illustrate these market quality requirements:

Regarding the first market quality standard (25%), in an MQP Security where the NBBO is \$25.00 x \$25.10, for a minimum of 25% of the time when quotes can be entered in the Regular Market Session as averaged over the course of a month, an MQP Market Maker must maintain bids at or better than \$25.00 for at least 500 shares and must maintain offers at or better than \$25.10 for at least 500 shares. Thus, if there were 20 trading days in a given month and the MQP Market Maker met this requirement 20% of the time when quotes can be entered in the Regular Market Session for 10 trading sessions and 40% of the time when quotes can be entered in the Regular Market Session for 10 trading sessions then the MQP Market Maker would have met the requirement 30% of the time in that month.

Regarding the second market quality standard (90%), in an MQP Security where the NBBO is \$25.00 x \$25.10, for a minimum of 90% of the time when quotes can be entered in the Regular Market Session as averaged over the course of a month, an MQP Market Maker must post bids for an aggregate of 2,500 shares between \$24.50 and \$25.00, and post offers for an aggregate of 2,500 shares between \$25.10 and \$25.60. Thus, if there were 20 trading days in a given month and the MQP Market Maker met this requirement 88% of the time when quotes can be entered in the Regular Market Session for 10 trading sessions and 98% of the time when quotes can be entered in the Regular Market Session for 10 trading sessions then the MQP Market Maker would have met the requirement 93% of the time in that month.

See Approval Order, *supra* note 4, at 18396, n. 46.

⁴³ *See* Rule 5950(c)(2). If only one MQP Market Maker meets its obligations with respect to an MQP Security, the entire MQP Credit available for that MQP Security will be distributed by the Exchange to that MQP Market Maker out of the NASDAQ General Fund. If multiple MQP Market Makers satisfy their obligations with respect to an MQP Security, the available MQP Credit for the quarter will be distributed pro rata among them. *See* Approval Order, *supra* note 4, at 18396, n. 47. If no MQP Market Maker is eligible to receive an MQP Credit, the MQP Fee relating to the MQP Security will remain in the Exchange’s General Fund. *See id.*

⁴⁴ *See* Rule 5950(c)(2)(A).

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liquidity (either quotes or orders) entered by an MQP Market Maker in an MQP Security that is posted within 2% of the NBBO.⁴⁵ A “Qualified Trade” represents a liquidity-providing execution in an MQP Security by an MQP Market Maker of a Qualified Quote on the NASDAQ Market Center.⁴⁶ Quote Share Payments will be based in equal proportions on: (a) average quoted size at or better than the NBBO; and (b) average time spent quoting at or better than the NBBO.⁴⁷ Trade Share Payments will be based upon each MQP Market Maker’s share of total Qualified Trades in an MQP Security executed on the NASDAQ Market Center.⁴⁸ Quote Share Payments and Trade Share Payments will be composed of Basic MQP Fees and Supplemental MQP Fees, if any.⁴⁹

An MQP Credit will be credited quarterly to an MQP Market Maker on a pro rata basis for each month during the preceding quarter that an MQP Market Maker is eligible to receive a credit pursuant to the Rule.⁵⁰ The calculation to establish the eligibility of an MQP Market Maker will be done by the Exchange on a monthly basis.⁵¹

d) Termination of the MQP

The MQP will terminate in respect of an MQP Security under any of the following circumstances: (i) the MQP Security sustains an average daily trading volume (consolidated trades in all U.S. markets) (“ATV”) of 1,000,000 shares or more for three consecutive months; (ii) an MQP Company, on behalf of an MQP Security, withdraws from the MQP, is no longer eligible to be in the MQP, or its Sponsor ceases to make MQP Fee payments to the Exchange; (iii) the MQP Security is delisted or is no longer eligible for the MQP; (iv) the MQP Security does not have at least one MQP Market Maker for more than one quarter; or

⁴⁵ See Rule 5950(c)(2)(A)(i).

⁴⁶ See Rule 5950(c)(2)(A)(ii).

⁴⁷ See Rule 5950(c)(2)(B)(ii).

⁴⁸ See Rule 5950(c)(2)(B)(i).

⁴⁹ See Rule 5950(c)(2)(B)(iii). As discussed above, MQP Credits will be credited out of the NASDAQ General Fund. See *supra* note 43 and accompanying text.

⁵⁰ See Rule 5950(c)(2)(C).

⁵¹ *Id.* For example, if during a quarter an MQP Market Maker was eligible to receive a credit for two out of three months, the MQP Market Maker would receive a quarterly pro rata MQP Credit for those two months. *Id.*

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(v) the MQP Security does not, for two consecutive quarters, have at least one MQP Market Maker that is eligible for MQP Credit.⁵² Any MQP Credits remaining upon termination of the MQP in respect of an MQP Security will be distributed on a pro rata basis to the MQP Market Makers that made a market in the MQP Security and were eligible to receive MQP Credits pursuant to the Rule.⁵³ Termination of an MQP Company, MQP Security, or MQP Market Maker from the MQP will not preclude the Exchange from allowing re-entry into the MQP where the Exchange deems proper.⁵⁴

e) Pilot Basis

To provide the Exchange, the Commission, and other interested parties an opportunity to evaluate the impact of the MQP on the quality of markets in MQP Securities, the Exchange intends to implement the MQP as a one-year pilot program that will commence when the MQP is implemented by the Exchange's acceptance into the MQP of an MQP Company, on behalf of an MQP Security, and an MQP Market Maker(s) in the relevant MQP Security. The MQP will end one year after implementation, unless extended pursuant to a proposed rule change approved by the Commission under Section 19(b) of the Exchange Act.⁵⁵

During the pilot period, the Exchange will periodically provide information to the Commission about market quality in respect of the MQP. Specifically, the Exchange will submit monthly reports to the Commission about market quality in respect of the MQP (and will make these monthly reports public). The reports will include data and analysis with respect to MQP Securities that are in the Program, as well as data and analysis about the market quality of MQP Securities that exceed the one million ATV threshold and "graduate" from the Program pursuant to Rule 5950(d)(1)(A).⁵⁶ The reports will compare, to the extent practicable, securities before and after they are in the MQP, and will include information

⁵² See Rule 5950(d)(1).

⁵³ See Rule 5950(d)(2). As discussed above, if no Market Maker is eligible to receive MQP Credits pursuant to the Rule, the MQP Fee will remain in the Exchange's General Fund. See *supra* note 43 and accompanying text.

⁵⁴ See Rule 5950(d)(3).

⁵⁵ See Rule 5950(f).

⁵⁶ See Approval Order, *supra* note 4, at 18397, n. 60.

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regarding the MQP such as: (i) Rule 605 metrics;⁵⁷ (ii) volume metrics; (iii) the number of MQP Market Makers; (iv) spread size; and (v) the availability of shares at the NBBO.⁵⁸ These reports also will include the Exchange's analysis of the information and assessment of the efficacy of the MQP.⁵⁹ In addition, the Exchange will provide similar data and analyses to the Commission about comparable ETFs that are listed on the Exchange but that are not in the MQP, as well as any other MQP-related data and analyses requested by Commission staff for the purpose of evaluating the efficacy of the MQP.⁶⁰ The Exchange will post the monthly reports on its website.⁶¹ The first report will be submitted within sixty days after the MQP becomes operative.⁶²

2. Information Bulletin and Surveillance

The Exchange will issue to its members an information bulletin about the MQP prior to operation of the Program.⁶³

The Exchange has represented to the Commission that its surveillance procedures are adequate to properly monitor the trading of the MQP Securities on the Exchange during all trading sessions and to detect and deter violations of the Exchange's rules and applicable federal securities laws. Trading of the MQP Securities through the Exchange will be subject to FINRA's surveillance procedures for derivative products including ETFs.⁶⁴ The Exchange may obtain information through the Intermarket Surveillance Group ("ISG") from other

⁵⁷ 17 CFR 242.605.

⁵⁸ See Approval Order, *supra* note 4, at 18397, n. 62.

⁵⁹ See Approval Order, *supra* note 4, at 18397, n. 63.

⁶⁰ See Approval Order, *supra* note 4, at 18397, n. 64.

⁶¹ See Approval Order, *supra* note 4, at 18397, n. 65.

⁶² *Id.*

⁶³ See Approval Order, *supra* note 4, at 18397, n. 69.

⁶⁴ FINRA surveils trading on the Exchange pursuant to a regulatory services agreement with the Exchange. The Exchange is responsible for FINRA's performance under this regulatory services agreement. See Approval Order, *supra* note 4, at 18397, n. 70.

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exchanges that are members or affiliates of ISG and from listed MQP Companies and public and non-public data sources such as, for example, Bloomberg.

3. FINRA Rule 5250

FINRA Rule 5250, similarly to NASDAQ Rule 2460, has a prohibition against issuers making payments to FINRA members⁶⁵ for, among other things, acting as a market maker. FINRA submitted an immediately effective filing that exempts the MQP from Rule 5250⁶⁶. FINRA indicated in the filing that it did not believe that programs like the MQP should be prohibited under FINRA Rule 5250 because payments under the Program would be made as part of a transparent structure put in place by another self-regulatory organization pursuant to a rule change, which generally must be approved by the Commission following publication for public comment.

FINRA noted in the Rule 5250 proposal:

FINRA also believes the NASDAQ MQP contains several features that mitigate the concerns the Commission discussed when approving the predecessor rule to FINRA Rule 5250. For example, the terms of the NASDAQ MQP generally are ‘objective, clear, and transparent’ and includes [sic] disclosure requirements to help alert and educate potential and existing investors about the program. Specifically, and among other things, the NASDAQ program provides for Web site disclosure of certain information, including the identities of the companies, securities and market makers participating in the NASDAQ MQP, as well as the amount of the supplemental fee, if any, per security that would be in addition to the fixed basic fee. FINRA believes the level of transparency available regarding the structure of the program, participation of the parties and possible payments to market makers, provides important disclosure to investors in NASDAQ MQP securities, enabling them to identify which exchange-traded funds are and are not subject to the NASDAQ MQP. FINRA, therefore, believes it is appropriate to create an exception to Rule 5250 for payments to members expressly provided for under the rules of an exchange where the Commission

⁶⁵ Most, but not all, NASDAQ participants are FINRA members.

⁶⁶ See Securities Exchange Act Release No. 69398 (April 18, 2013), 78 FR 24261 (April 24, 2013) (SR-NASDAQ-2013-020) (notice of filing and immediate effectiveness) (the “Rule 5250 proposal”).

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has analyzed the payments and determined that the concerns Rule 5250 was designed to address have been sufficiently mitigated.⁶⁷

II. PRIOR GUIDANCE REGARDING SECTION 11(D)(1) AND RULE 11D1-2

Section 11(d)(1) of the Exchange Act generally prohibits a person who is both a broker and a dealer from extending or maintaining, or arranging for the extension or maintenance of credit, to or for a customer on any non-exempted security that is a part of a new issue in the distribution of which the broker-dealer participated as a member of a selling syndicate or group within the previous thirty days. The Commission has taken the position that shares of open-end investment companies and unit investment trusts registered under the 1940 Act, such as ETF shares, are distributed in a continuous manner, and that broker-dealers selling such securities are therefore participating in the “distribution” of a new issue for purposes of Section 11(d)(1).⁶⁸

The Staff has provided limited relief from the requirements of Section 11(d)(1) for broker-dealers trading ETF shares. In particular, Staff has confirmed that it would not recommend enforcement action against those broker-dealers that have not entered into an agreement with an ETF distributor to become authorized participants of ETF shares (“Non-AP Broker-Dealer”), but who extend or maintain or arrange for the extension or maintenance of credit to or for customers on such ETF shares in connection with such secondary market transactions in such ETF shares, provided that the Non-AP Broker-Dealer does not (and its associated persons who are natural persons do no), directly or indirectly (including through any affiliate of such Non-AP Broker-Dealer), receive from the fund complex any payment, compensation, or other economic incentive to promote or sell the shares of the ETF to persons outside the fund complex, other than non-cash compensation permitted under NASD 2830(1)(5)(A), (B) or (C).⁶⁹ In addition, the Staff, acting pursuant to delegated authority,

⁶⁷ *Id.* at 24262 (internal citations omitted).

⁶⁸ *See, e.g.*, SEC Release No. 34-6726 (Feb. 8, 1962), 27 FR 1415 (Feb. 15, 1962); SEC Release No. 34-21577 (Dec. 18, 1984), 49 FR 50174 (Dec. 27, 1984).

⁶⁹ *See, e.g.*, Letter from Catherine McGuire, Chief Counsel, Division of Trading and Markets, Securities and Exchange Commission to Securities Industry Association (Nov. 21, 2005) (“SIA Exemption”); Shares Trust (*avail.* Jul. 25, 2002); Vanguard VIPERS Small-Cap Index Fund, Total Stock Market Index Fund, Extended Stock Market Index Fund (*avail.* May 21, 2001); Country Baskets Index Fund, Inc. (*avail.* Mar. 22, 1996); American Stock Exchange (*avail.* Jan. 28, 1993). The term “AP” means an organization that has entered into an agreement with a distributor or principal underwriter of the ETF shares to become an authorized participant of the certain ETF shares.

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granted an exemption from Section 11(d)(1) and Rule 11d1-2 thereunder for broker-dealers that have entered into an agreement with an ETF's distributor to place orders with the distributor to purchase or redeem the ETF's shares ("Broker-Dealer APs").⁷⁰ The SIA Exemption allows a Broker-Dealer AP to extend or maintain credit, or arrange for the extension or maintenance of credit, to or for customers on the shares of qualifying ETFs subject to the following conditions:

(1) Neither the Broker-Dealer AP, nor any natural person associated with the Broker-Dealer AP, directly or indirectly (including through any affiliate of the Broker-Dealer AP), receive from the fund complex any payment, compensation, or other economic incentive to promote or sell the shares of the ETF to persons outside the fund complex, other than non-cash compensation permitted under NASD 2830(1)(5)(A), (B) or (C); and

(2) The Broker-Dealer AP does not extend, maintain or arrange for the extension or maintenance of credit to or for a customer on shares of the ETF before thirty days have passed from the date that the ETF's shares initially commence trading (except to the extent that such extension, maintenance or arranging of credit is otherwise permitted pursuant to Rule 11d1-1).

As stated in the Approval Order, the conditions are intended to eliminate special incentives that Broker-Dealer APs and their associated persons might otherwise have to "push" ETF shares.⁷¹

III. RATIONALE FOR RELIEF FROM SECTION 11(D)(1) AND RULE 11D1-2 THEREUNDER FOR BROKER-DEALERS INVOLVED IN THE MQP

In our view, it would be in the public interest and consistent with the investor protection objectives of the Exchange Act for the Staff, consistent with and subject to the same conditions as the SIA Exemption, to provide the relief under Section 11(d)(1) and Rule 11d1-2 for both Broker-Dealer APs and Non-AP Broker-Dealers who participate in the MQP, notwithstanding that both Broker-Dealer APs and Non-AP Broker-Dealers may receive MQP Credits as described further below.

⁷⁰ See SIA Exemption, *supra* note 69.

⁷¹ See Approval Order, *supra* note 4.

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As discussed more fully below, the MQP Credit, which is provided by the Exchange out of its General Fund only to MQP Market Makers that meet and exceed MQP market quality standards, will not act as an incentive for Broker-Dealer APs or Non-AP Broker-Dealers to “push” the MQP Securities. In addition, many features of the MQP, as described in more detail below, provide for the potential of improving the market quality of the MQP Securities that participate in the MQP, enhancing liquidity in participating MQP Securities, and decreasing the cost of investing in MQP securities, which is in the public interest and provides benefits to investors and market participants in general.

A. MQP Market Makers Do Not Have Incentives to Engage in “Share Pushing” of the Type that Section 11(d)(1) Was Intended to Address.

Section 11(d)(1) was intended to address conflicts of interest arising in circumstances in which a person acts as both a broker and a dealer. The restrictions that it imposes on the extension, maintenance, and arranging of credit in connection with a new issue of securities are designed to protect investors from “one of the greatest potential evils inherent in the combination of the broker and dealer function in the same person, by assuring that [a broker-dealer] will not induce his customers to buy on credit securities which he has undertaken to distribute to the public.”⁷² Section 11(d)(1) thus seeks to prevent broker-dealers from “share-pushing” by offering credit to customers for the purchase of newly-issued securities that the broker-dealer is distributing.

The MQP Credit received from the Exchange by MQP Market Makers does not act as an incentive for MQP Market Makers to engage in the “share-pushing” that Section 11(d)(1) was designed to address, nor does it establish any direct or indirect financial connection between MQP Market Makers and MQP Companies. First, in terms of flow of funds, the Program is constructed so that the only way that an MQP Market Maker can earn an MQP Credit – the payment of which is administered solely by the Exchange – is to maintain a quality market in terms of the spread and liquidity of an MQP Security. This is crucial. The Program does not afford any other way for an MQP Market Maker to earn an MQP Credit. If an MQP Market Maker does not earn an MQP Credit, the MQP Fee remains in NASDAQ’s General Fund. The intent behind allowing Market Makers to earn an MQP Credit if they meet market quality requirements is, like the Program itself, improvement of the quality of the secondary market for MQP Securities through enhancement of the quality of the market around or better than the NBBO – and not promotion of the sales of the securities. The MQP is clearly structured to reward only improvement to market quality.

⁷² H.R. Rep. No. 1383, 73rd Cong., 22nd Sess. at 22 (1934).

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Second, an MQP Company must go through an MQP application process, and the Exchange must accept the MQP Company into the Program, before an MQP Company can include an MQP Security in the Program. Third, an MQP Market Maker must go through a separate MQP application process, and the Exchange must accept an MQP Market Maker into the Program, before an MQP Market Maker can make a market in a product listed pursuant to the Program. NASDAQ will operate both of these application processes as an independent regulator, preventing either issuers or Market Makers from improperly influencing the ultimate outcome. Fourth, in contrast to the extensive benefits of the MQP, the participation of an MQP Company in the Program is substantially limited by design. In this regard, an MQP Company is limited to making only the following determinations regarding the Program: whether to participate in the Program; what MQP Security should be in the Program; when the MQP Security should exit the Program;⁷³ and the level of Supplemental Fees, if any, that should be applied.⁷⁴ While the Basic MQP Fee and Supplemental MQP Fee does get credited to the NASDAQ General Fund and may be used by the Exchange to credit MQP Market Makers that meet or exceed MQP market quality standards, the MQP Company can never choose a particular MQP Market Maker, nor influence how, when, or the specific amount that an MQP Market Maker receives as credit for making a market in an MQP Security; these functions are performed solely by the Exchange according to standards set forth in the Program.⁷⁵ As structured, any relationship between the MQP Credit and the MQP Companies as the source of the credit is programmatically attenuated. Coupled with the competitive nature of the platform that is designed to decrease the likelihood of MQP Credits being concentrated in a limited number of MQP Market Makers, which we believe should result in more Market Makers participating in the ETF market, and significant market quality enhancement requirements built into the Program, the Program is not expected to result in MQP Companies having any ability to pressure an MQP Market Maker to sell particular MQP Securities. Furthermore, the MQP Credit that any MQP Market Maker could potentially receive pursuant to the Program is modest⁷⁶ at best in light of additional risk

⁷³ As previously noted, however, an MQP Security that reaches the 1 million ATV threshold would “graduate” from the Program.

⁷⁴ As previously noted, because of the transparency of the Program, all of this information will be on the Exchange’s website.

⁷⁵ *Id.*

⁷⁶ Moreover, the portion of the MQP Credit that is based on actual sale of MQP Securities on the secondary market may be de minimus (e.g. substantially less than a quarter of the total credit), with the remainder of the MQP Credit attributable to purchases and quotes.

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incurred by Market Makers in maintaining a quality, liquid market around or better than the NBBO, as required by the MQP.⁷⁷ The Program would not, because of its transparency, strict rules-based standards and procedures, and intentional disassociation of issuers and Market Makers, be expected to lead to the conduct that Rule 11d1-2 is intended to prohibit. The Exchange believes that these factors, and in particular the unprecedented transparency of the MQP through a dedicated MQP web-page, will enable investors to understand the MQP and the roles of MQP Companies, MQP Market Makers and the Exchange within the Program.⁷⁸

The Exchange has designed the MQP to ensure that MQP Companies are unable to influence the selection or retention of MQP Market Makers or the amount of MQP Credit that any particular Market Marker receives from the Exchange. Due to the potential benefits of the MQP and as a result of the safeguards implemented by the Exchange, we believe the requested relief is in the public interest and consistent with the investor protection objectives of the Exchange Act. As such, the Exchange hereby requests that the Staff, consistent with and subject to same conditions as the SIA Exemption, provide relief under Section 11(d)(1) and Rule 11d1-2 for all Broker-Dealers APs and Non-AP Broker-Dealers who participate in the MQP, notwithstanding that both Broker-Dealer APs and Non-AP Broker-Dealers may receive MQP Credits as described herein.

B. The MQP Offers Potential Improvements to the Market Quality of MQP Securities that Benefit Investors

The MQP, in general, and the use of the MQP Credit, as a feature of the MQP, is designed to improve the MQP market by significantly increasing market quality by providing more market integrity and transparency and enhancing liquidity to the market.

In order to receive quarterly MQP Credit payments out of the NASDAQ General Fund, each MQP Market Maker will be required to comply with monthly quoting requirements that are higher than the standard quoting requirements applicable to Market

⁷⁷ See Notice, *supra* note 3, at 18397, n. 13: “By imposing quality quoting requirements to enhance the quality of the market for MQP Securities, the MQP will directly impact one of the ways that Market Makers manage risk in lower tier or less liquid securities (e.g. the width of bid and offer pricing).”

⁷⁸ Moreover, to further enhance the transparency of the MQP, during such time that an MQP Company lists an MQP Security, the MQP Company must, on a product-specific website for each MQP product, indicate that the product is in the MQP and provide the link to the Exchange’s MQP website. See Rule 5950(b)(1)(D).

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Makers in ETFs on the Exchange.⁷⁹ Each MQP Market Maker that complies with these heightened quoting obligations will receive a share of the MQP Credit based upon its size quoted, and time spent quoting, at or better than the NBBO, based on its liquidity-providing executions of such quotes. In addition, the Program is separately designed to incentivize MQP Market Makers to compete with each other to receive the MQP Credit payments, as the payments will be distributed based on each MQP Market Maker's average quoted size and time spent quoting at or better than the NBBO as compared to other MQP Market Makers, and its share of total Qualified Trades in an MQP Security executed on the Exchange. Thus, the MQP is designed to incentivize MQP Market Makers to quality quoting in greater quoted size, at or better than the NBBO, thereby significantly improving the market quality of the MQP Securities that participate in the MQP. This potential improved market quality could significantly benefit investors in the form of enhanced liquidity, narrowed spreads, and reduced transaction costs.

Such improvements have been garnered in market quality incentive programs that have been in existence for years in various forms and markets overseas, including on NASDAQ's First North Market. These extensively-studied programs have been very successful in enhancing liquidity at lower spreads and effective cost to investors.⁸⁰ The MQP will, we believe, be equally successful.

C. MQP as One-Year Pilot Program

The MQP is a one-year pilot program, which is significant to the present request for relief for several reasons. First, NASDAQ is implementing the pilot as an attempt to repair a gap in market structure, namely the challenge of certain small or start-up securities lacking access to quality markets with adequate liquidity. Second, the Exchange has agreed, as part of the MQP pilot, to submit periodic reports to the Commission about market quality in

⁷⁹ Specifically, with respect to the monthly quoting requirement, an MQP Market Maker must quote at least 500 shares of attributable, displayed liquidity at the NBB or NBO 25% of the time during the Regular Market Session, and at least 2,500 shares of attributable, displayed liquidity within 2% of the NBB or NBO 90% of the time during the Regular Market Session.

⁸⁰ See, e.g., *Why do Firms Pay for Market Making in Their Own Stock?* by Johannes A. Skjeltorp, Norges Bank, and Bernt Arne Odegaard, University of Stavanger and Norges Bank, June 2011; *Affirmative Obligations and Market Quality* by Hendrik Bessembinder, Jia Hao, and Michael Lemmon, June 2011; *Paying for Market Quality*, Working Paper F-2006-06 by Amber Anand, Carsten Tanggaard, and Daniel G. Weaver, November 2005, Aarhus School of Business; *How Do Designated Market Makers Create Value for Small-Caps?* by Albert J. Menkveld and Ting Wang, August 1, 2011; and *Designated Sponsors and Bid-Ask Spreads on Xetra* by Joerdis Hengelbrock, October 31, 2008.

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respect of the MQP. These reports will endeavor to compare, to the extent practicable, securities before and after they are in the MQP. The reports will provide information regarding, for example, volume metrics, number of MQP Market Makers in target securities, and spread size; and will help the Commission and NASDAQ to evaluate the efficacy of the Program. The Exchange will endeavor to provide similar data to the Commission about comparable ETFs that are listed on the Exchange that are not in the MQP. Third, the initial first year of the pilot program will provide the Exchange, the Commission, and other interested parties with an opportunity to evaluate the impact of the MQP on the quality of markets in MQP Securities. And fourth, if the Exchange desires to expand or amend the pilot program or make the MQP permanent, the Exchange will need to file a new proposed rule change with the Commission.

In order to accurately test the efficacy of the Program during the one-year pilot, the Exchange requires the involvement of qualified Broker-Dealer APs and Non-AP Broker Dealers. The Program was designed to increase liquidity in MQP Securities by incentivizing more Market Makers to participate in the Program. In addition, during the one-year pilot, it is desirable to encourage as many market participants as possible, including Market Makers, Broker-Dealers APs and Non-AP Broker-Dealers, to participate in the Program so that the Exchange can facilitate the gathering of sufficient data to allow the Staff and Exchange to effectively analyze the results. However, the Exchange believes that broker-dealers will not participate in the Program without the benefit of the relief requested herein, effectively diluting the many positive effects of this unique pilot program.⁸¹ As such, the Exchange hereby requests that the Staff, consistent with and subject to same conditions as the SIA Exemption, provide relief under Section 11(d)(1) and Rule 11d1-2 for all Broker-Dealers APs and Non-AP Broker-Dealers participating in the MQP, notwithstanding that both Broker-Dealer APs and Non-AP Broker-Dealers may receive MQP Credits as described herein.

⁸¹ In discussing the MQP with broker-dealers, we have heard that a lack of specific relief for both Broker-Dealer APs and Non-AP Broker-Dealers participating in the MQP as requested herein may present an unacceptable level of risk that may keep some market participants out of the Program.

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IV. CONCLUSION

Based on the foregoing, we respectfully request that the Staff grant the relief requested herein. The forms of relief requested are substantially similar to those actions that the Commission and the Staff have taken in similar circumstances, most notably in the SIA Exemption. If you have any questions please call me at (202) 887-1563.

Sincerely,

A handwritten signature in black ink, appearing to read "D. Lynn", written over a horizontal line.

David M. Lynn