Journal of Economics and Business 59 (2007) 520–535

Journal of Economics & Business

Cubes to quads: The move of QQQ from AMEX to NASDAQ

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Received 27 January 2006; received in revised form 3 January 2007; accepted 26 January 2007

Abstract

We examine the microstructure effects of the QQQ ETF listing change from AMEX to NASDAQ. We find that even though the stock traded on both venues before and after the listing change, NASDAQ reaped a substantial increase in order flow for QQQ at the expense of the AMEX. The change results in a decline in trading costs, consolidation of order flow, and a less fragmented market for QQQ. We hypothesize that the avoidance of the explicit and implicit costs imposed by the Intermarket Trading System for NASDAQ traders was partly responsible for the improvement in QQQ market quality.
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JEL classification: G14; G18

Keywords: QQQ; ETF; NASDAQ

1. Introduction

On November 9, 2004, the NASDAQ Stock Market and the American Stock Exchange (AMEX) announced that the exchange-traded fund (ETF) QQQ will change its listing from AMEX to NASDAQ effective December 1, 2004. QQQ is an ETF designed to correspond to the price and yield performance of the NASDAQ-100 index, a value-weighted index comprising the 100 largest NASDAQ listed non-financial companies. As of September 30, 2004, QQQ was the most actively

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doi:10.1016/j.jeconbus.2007.01.002

traded ETF in the world and the most heavily traded listed equity in the United States.[2] As a result of the listing change, the ticker symbol for the ETF changed from QQQ to QQQQ (in this paper we use the label QQQ). QQQ continues to trade on AMEX with unlisted trading privileges.

The NASDAQ-100 Trust, the body that manages the QQQ ETF, made the decision to change listing. According to our conversations with NASDAQ personnel, the original 10-year listing agreement for the ETF was coming to an end and the NASDAQ Trust was considering alternative listing venues. The NASDAQ market argued that a listing change to NASDAQ would result in greater liquidity for the ETF.[3]

From NASDAQ's point of view, the change made a great deal of sense. From the late 1990s and early part of the 2000s, NASDAQ experienced unprecedented competition for trading volume from other emerging market places, notably ECNs. As a response to this decline in market share, the acquisition of the QQQ listing was promoted as a means of increasing trading volume on NASDAQ. In their pitch for the ETF listing, NASDAQ argued that the move would improve market quality for QQQ. But from NASDAQ's point of view, significant cost savings are associated with having the QQQ listing. First, NASDAQ market makers can avoid the fees for trades in QQQ routed via the Intermarket Trading System (ITS), as well as surcharges for orders executed on AMEX. Second, the ITS imposes indirect costs on NASDAQ dealers due to the lack of time priority and to delays inherent in the system.

Although market quality concerns motivated the listing change, it is not at all clear that the change would result in greater liquidity. In fact, after the listing change fewer exchanges could trade the QQQ, thereby resulting in a consolidation of trading and potentially less competition. Offsetting this consolidation is the benefit that NASDAQ would reap by avoiding the Intermarket Trading System after the listing change. Prior to the change, all QQQ trades made by NASDAQ market makers had to be routed through ITS; after the change, the NASDAQ market makers could trade directly with each other. Direct trade, coupled with the relatively large volume NASDAQ handles, could result in a reduction in spreads.

In addition, by listing the QQQ on NASDAQ, NASDAQ traders could reap cost savings in terms of the fees they pay to NASDAQ. First, they would not have to pay routing execution fees for trading non-NASDAQ ETFs on AMEX. These fees amounted to 0.003 cents per share for orders that do not use the AMEX specialist and an additional US$ 0.01 per share for specialist-handled orders.[4] Second, with QQQ listed on NASDAQ, NASDAQ dealers would be able to count QQQ trading volume towards the NASDAQ market center's trading volume pricing thresholds.[5] These pricing thresholds determine in part the fees paid by market makers.

The ITS imposes an indirect cost on dealers utilizing it.[6] Specifically, when an order is submitted by a NASDAQ dealer to, say AMEX, the AMEX market maker has a short period of time in which to decide whether to trade with the order or pass on it. In effect, the NASDAQ market maker has written a short-term option contract to the AMEX market maker, in that the NASDAQ market

[2] Morgan Stanley Exchange Funds Strategies: ETFs end of third quarter 2004 Review, October 12, 2004.

[3] In particular, we would like to thank Frank Hathaway, Chief Economist at NASDAQ for providing much of this information.

[4] Full details of the NASDAQ market maker fee structure can be found in the NASDAQ fee schedule. This pricing schedule is updated periodically on the NASDAQ website. We are referring to the schedule in place close to when the listing change occurred, a copy of which is available from the authors.

[5] NASDAQ (2004).

[6] Several authors examine the ITS, see, for example, Battalio (1997), Blume and Goldstein (1997), and Hendershott and Jones (2005).

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