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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-69234; File No. SR-MIAX-2013-15)

March 25, 2013

Self-Regulatory Organizations; Miami International Securities Exchange LLC; Notice of Filing of Proposed Rule Change Relating to Limit Up Limit Down Functionality

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup>, and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 25, 2013, Miami International Securities Exchange LLC (“MIAX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange is filing a proposal to amend Exchange Rule 530, Limit Up-Limit Down (“LULD”), to provide for how the Exchange proposes to treat option orders, market-making quoting obligations, openings, priority quotes (as defined below), systemic changes, Trading Pauses and openings following a Trading Pause in response to the Plan to Address Extraordinary Market Volatility Pursuant to Rule 608 of Regulation NMS, as it may be amended from time to time (the “Plan”). The proposed rules establish procedures to address extraordinary volatility in NMS Stocks and outlines MIAX’s LULD processing for options overlying such NMS Stocks. Rule 530, as proposed to be amended, will be effective on a one year pilot basis beginning on the date of implementation of the Plan.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

The text of the proposed rule change is provided in Exhibit 5.<sup>3</sup> The text of the proposed rule change is also available on the Exchange's website at [http://www.miaxoptions.com/filter/wotitle/rule\\_filing](http://www.miaxoptions.com/filter/wotitle/rule_filing), at MIAX's principal office, and at the Commission's Public Reference Room.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The purpose of the proposed rule change is to amend MIAX Rule 530 to provide for how the Exchange proposes to treat options orders, market-making quoting obligations, openings, priority quotes (as defined below), systemic changes, Trading Pauses, and openings following a Trading Pause in response to the Plan.

Background

Since May 6, 2010, when the markets experienced excessive volatility in an abbreviated time period, i.e., the "flash crash," the equities exchanges and The Financial Industry Regulatory Authority ("FINRA") have implemented market-wide measures designed to restore investor confidence by reducing the potential for excessive market volatility.

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<sup>3</sup> The Commission notes that Exhibit 5 is attached to the filing, not to this notice.

Among the measures adopted include pilot plans for stock-by-stock trading pauses, related changes to the equities market clearly erroneous execution rules, and more stringent equities market maker quoting requirements. On May 31, 2012, the Commission approved the Plan, as amended, on a one-year pilot basis. In addition, the Commission approved changes to the equities market-wide circuit breaker rules on a pilot basis to coincide with the pilot period for the Plan. The Plan is designed to prevent trades in individual NMS stocks from occurring outside of specified Price Bands.<sup>4</sup> The instant proposed rule change is intended to adopt MIAX rules that address the trading of options overlying NMS Stocks that are the subject of the Plan and its provisions during times of unusual volatility in the markets.

The requirements of the Plan are coupled with Trading Pauses to accommodate more fundamental price moves (as opposed to erroneous trades or momentary gaps in liquidity). All trading centers in NMS stocks, including both those operated by Participants and those operated by members of Participants, are required to establish, maintain, and enforce written policies and procedures that are reasonably designed to comply with the requirements specified in the Plan.

#### Limit State and Straddle State

As set forth in more detail in the Plan, Price Bands consisting of a Lower Price Band and an Upper Price Band for each NMS Stock are calculated by the Processors. When the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band, the Processors shall disseminate such National Best Bid (Offer) with an appropriate flag identifying it as unexecutable. When the National Best Bid (Offer) is equal to the Upper (Lower) Price Band, the Processors shall distribute such National Best Bid (Offer) with an appropriate flag identifying it as a Limit State Quotation. All trading centers in NMS stocks must maintain written policies and

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<sup>4</sup> Unless otherwise specified, capitalized terms used in this filing are based on the defined terms of the Plan.

procedures that are reasonably designed to prevent the display of offers below the Lower Price Band and bids above the Upper Price Band for NMS stocks. Notwithstanding this requirement, the Processor shall display an offer below the Lower Price Band or a bid above the Upper Price Band, but with a flag indicating that it is non-executable. Such bids or offers shall not be included in the National Best Bid or National Best Offer calculations. Trading in an NMS stock immediately enters a Limit State if the National Best Offer (Bid) equals but does not cross the Lower (Upper) Price Band. Trading for an NMS stock exits a Limit State if, within 15 seconds of entering the Limit State, all Limit State Quotations were executed or canceled in their entirety. If the market does not exit a Limit State within 15 seconds, then the Primary Listing Exchange would declare a five-minute trading pause pursuant to Section VII of the Plan, which would be applicable to all markets trading the security.

In addition, the Plan defines a Straddle State as when the National Best Bid (Offer) is below (above) the Lower (Upper) Price Band and the NMS stock is not in a Limit State. For example, assume the Lower Price Band for an NMS Stock is \$9.50 and the Upper Price Band is \$10.50, such NMS stock would be in a Straddle State if the National Best Bid were below \$9.50, and therefore non-executable, and the National Best Offer were above \$9.50 (including a National Best Offer that could be above \$10.50). If an NMS stock is in a Straddle State and trading in that stock deviates from normal trading characteristics, the Primary Listing Exchange may declare a trading pause for that NMS stock if such Trading Pause would support the Plan's goal to address extraordinary market volatility.

#### Relief from Market Maker Quoting Obligations

The Exchange proposes to adopt Rule 530(f) to address Market Maker quoting obligations during Straddle States and Limit States. Specifically, the Exchange proposes to

adopt proposed Rules 530(f)(1)(i)-(iv) to state that during such periods Market Makers will be relieved of the following obligations (collectively, “the quoting obligations”): (i) the bid/ask differential requirements set forth in Exchange Rule 603(b)(4); (ii) the minimum quote size requirement set forth in Exchange Rule 604(b)(2); (iii) the two-sided quote requirement set forth in Exchange Rule 604(c); and (iv) the continuous quote requirement set forth in Exchange Rule 604(e).

The Exchange acknowledges the effect of limited price discovery in the underlying stock on the direct relationship between an options price and the price of the underlying security. During a Limit State or Straddle State, the bid price or offer price of the underlying security will be unexecutable and the ability to hedge the purchase or sale of an option will be jeopardized. Recognizing that it may be impossible to hedge to offset the risk created by trading options, the Exchange expects that Market Makers will, as a result, modify their quoting behavior. The Exchange therefore believes it is reasonable and appropriate to relieve Market Makers from their quoting obligations as proposed during a Limit or Straddle State.

Given the uncertain effect on liquidity for affected option contracts during a Limit or Straddle State, the Exchange believes it is reasonable to relieve Market Makers from the complete suite of quoting obligations as proposed and not just the continuous quote requirements of Exchange Rule 604(e). Offering relief from Exchange Rule 604(e) provides needed flexibility to Market Makers during the affected periods of uncertain price discovery. The Exchange believes that if it does not afford relief from the remaining Market Maker quoting obligations, such as the bid-ask differential of Rule 603(b)(4), the minimum size requirement set forth in Exchange Rule 604(b)(2), the requirement to submit two-sided quotes set forth in Exchange Rule 604(c), and the continuous quoting obligations set forth in Exchange Rule 604(e), such

flexibility would be compromised. If for example, the National Best Bid or Offer (“NBBO”) has a bid/ask differential that is greater than \$5.00, a Market Maker would be compelled to improve one or both sides of the NBBO to stay within the \$5.00 bid-ask differential requirement of Rule 603(b)(4). Given the option, the Exchange believes that Market Makers would likely choose not to quote at all over assuming unwanted risk by being compelled to quote at one or both sides of the NBBO. In the interest of promoting liquidity during these periods, the Exchange believes it best to relieve Market Makers of all quoting obligations.

The Exchange will exclude the amount of time an NMS stock underlying a MIAX option is in a Limit State or Straddle State from the total amount of time in the trading day when calculating the percentage of the trading day MIAX Market Makers are required to quote. The Exchange believes that this is appropriate for the same reasons discussed above, in light of the limited price discovery in the underlying stock and the direct relationship between an options price and the price of the underlying security. During a Limit State or Straddle State, the bid price or offer price of the underlying security will be unexecutable and the ability to hedge the purchase or sale of an option will be jeopardized.

Proposed Rule 530(f)(2) states that the relief described in sub-paragraphs (f)(1)(i)-(iv) shall terminate when the Limit or Straddle State no longer exists in the affected NMS Stock.

#### Market Maker Participation Guarantees

Proposed Rule 530(f)(3) states that the provisions of Exchange Rule 514 concerning priority of quotes and orders shall remain unchanged during periods of relief from quoting obligations pursuant to proposed Rule 530(f).

Exchange Rule 514 describes, among other things, priority of quotes and orders on the Exchange, allocation methods used on the Exchange, and participation guarantees granted to

certain Market Makers. Rule 514(g) details the Primary Lead Market Maker (“PLMM”) participation guarantee and Rule 514(h) describes the Directed Lead Market Maker (“DLMM”) participation guarantee. The participation guarantees set forth in Exchange Rule 514 only apply if the affected PLMM or DLMM has submitted a priority quote at the NBBO.

The PLMM and DLMM each have a more stringent quoting obligation during normal trading conditions than other Market Makers, and the participation guarantee rewards them for these elevated quoting obligations. Although proposed Rule 530 would relieve PLMMs and DLMMs of their quoting obligations, the Exchange believes that they should continue to be entitled to receive the participation guarantee for executions in which they participate during a Limit or Straddle State.

As previously noted, the Exchange expects a Limit State and a Straddle State to have a negative impact on liquidity in the options markets, and that some Market Makers may elect not to quote at all during such times of extreme volatility. Market Makers who quote at the NBBO during these times may face greater risk in doing so given the pricing uncertainty in the underlying NMS Stock, and the Exchange believes that affording them the participation guarantees set forth in Exchange Rule 514 should serve as a reward to Market Makers who assume a higher than normal risk in quoting at the NBBO.

Moreover, the Exchange believes that the use of participation guarantees, which can be found on other options exchanges,<sup>5</sup> provides incentives for Market Makers to provide liquidity at the NBBO during Limit States and Straddle States. Accordingly, proposed Rule 530(f)(3)

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<sup>5</sup> See Phlx Rule 1014(b)(vii), CBOE Rule 6.45A(a)(ii)(2), C2 Rule 8.19, NYSE Amex Rule 964.2NY, and ISE Rule 713(e) for entitlements comparable to MIAX’s Primary Lead Market Maker participation entitlement. See Phlx Rules 1014(b)(viii) and 1080(1), CBOE Rules 8.13 and 6.45A(a)(ii)(2), C2 Rules 6.12(a)(3)(B) and 8.13, NYSE Amex Rule 964.1NY, and ISE Rules 713 and 811 for entitlements comparable to MIAX’s Directed Lead Market Maker participation entitlement.

preserves the operation of Rule 514 by continuing to grant participation entitlements for options when the underlying NMS Stock has entered either a Straddle or Limit State. The Exchange believes that rewarding Market Makers for their assumption of higher than normal risk during times of extreme market volatility and promoting and fostering liquidity through the participation guarantee will help in the maintenance of a fair and orderly market. The Exchange further believes that removing the participation guarantees from the operation of Rule 514 would have the adverse effect of motivating Market Makers to remove liquidity and further destabilize the marketplace at a time when stability and liquidity is most needed. Lastly, the Exchange notes that the participation guarantee only applies if the qualifying Market Maker participates in the execution at the NBBO.

#### Opening Process

Proposed Rule 530(g) sets forth changes in the manner in which the Exchange's System will function during Limit and Straddle States.

Proposed Rule 530(g)(1) describes the functionality of the Exchange's Opening Process<sup>6</sup> when a Straddle State or Limit State occurs before and during the Opening Process.

Proposed Rule 530(g)(1)(i) provides that Opening Process shall be delayed for options overlying an NMS Stock that is in a Straddle State or a Limit State prior to the opening of trading such overlying options and that the Opening Process shall begin when such Straddle or Limit State has ended and there is not a halt or Trading Pause in effect. The Exchange therefore will not open an option overlying an NMS Stock that is in a Limit State or Straddle State.

Proposed Rule 530(g)(1)(ii) addresses scenarios where the Exchange's Opening Process has started but not yet completed when the underlying NMS Stock enters a Straddle or Limit

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<sup>6</sup> For a complete description of the Exchange's Opening Process, see Exchange Rule 503.

State. When the affected option is in the Opening Process but trading has not begun, the Opening Process will be terminated when the underlying NMS Stock is in a Limit or Straddle State. The Opening Process will begin anew in the affected overlying options when such Limit or Straddle State has ended and there is not a halt or Trading Pause in effect. Thus, if an Opening Process is occurring, it will cease and then start the Opening Process from the beginning once the Limit or Straddle State is no longer present.

### Priority Quotes

The Exchange is proposing to adopt rules that would qualify all quotes as priority quotes<sup>7</sup> when LULD Functionality is in effect. Proposed Rule 530(g)(2)(i) states that, notwithstanding the provisions of Exchange Rule 517(b),<sup>8</sup> all quotes that result in an execution during a period in which LULD Functionality is engaged shall be deemed to be priority quotes for allocation purposes.

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<sup>7</sup> For trade allocation purposes, quotes will be considered either priority quotes (i.e., trade allocation will be in accordance with Rule 514(e), which provides priority quotes with precedence over all Professional Interest) or non-priority quotes (i.e., trade allocation will be in accordance with Rule 514(e), which also provides non-priority quotes are considered together with all other Professional Interest) based upon a Market Maker's quote width at certain times as described in the rule. See Exchange Rule 517(b).

<sup>8</sup> The Exchange is proposing to deem all quotes as priority quotes that result in an execution during a period in which LULD Functionality is engaged, notwithstanding the requirement under normal circumstances that, to be considered a priority quote at the time of execution, each of the following standards must be met: (A) the bid/ask differential of a Market Maker's two-sided quote pair must be valid width (no wider than the bid/ask differentials outlined in Rule 603(b)(4)); (B) the initial size of both of the Market Maker's bid and the offer must be in compliance with the requirements of Rule 604(b)(2); (C) the bid/ask differential of a Market Maker's two-sided quote pair must meet the priority quote width requirements defined below in subparagraph (ii) for each option; and (D) either of the following are true: (1) At the time a locking or crossing quote or order enters the System, the Market Maker's two-sided quote pair must be valid width for that option and must have been resting on the Book; or (2) Immediately prior to the time the Market Maker enters a new quote that locks or crosses the MBBO, the Market Maker must have had a valid width quote already existing (i.e., exclusive of the Market Maker's new marketable quote or update) among his two-sided quotes for that option. See Exchange Rule 517(b)(i).

The purpose of the proposed rule is to provide incentive for Market Makers to submit quotations during Limit and Straddle states by affording their quotes priority quote status, ensuring them of priority executions over professional interest when they assume the risk of quoting at or near the NBBO during times of extreme volatility.

The Exchange believes that deeming all quotes to be priority quotes should be strictly limited to the time period in which the affected underlying NMS Stock is in either a Limit or Straddle State (and LULD Functionality is thus engaged). Accordingly, proposed rule 530(g)(2)(ii) would state clearly in the Exchange's rules that, for executions occurring when LULD Functionality is not engaged, the priority status of a quote for allocation purposes shall be determined by the provisions of Rule 517(b).

As with participation guarantees as discussed above, the Exchange believes that rewarding Market Makers for their assumption of higher than normal risk during times of extreme market volatility by deeming all quotes submitted during a Limit or Straddle State to be priority quotes will help in the maintenance of a fair and orderly market. Such rewards are intended to promote and foster liquidity in the options marketplace. The Exchange further believes that, absent this and the other incentives proposed herein, Market Makers could be motivated to remove liquidity and further destabilize the marketplace at a time when stability and liquidity is most needed. The Exchange notes that the priority quote status only applies if the qualifying Market Maker participates in the execution at the NBBO.

The Exchange believes that the incentive for Market Makers to quote at the NBBO during periods of extreme volatility and the concomitant extraordinary risk assumed by Market Makers in submitting quotes at the NBBO under such conditions is consistent with the fundamental principle of customer protection incorporated in the Act. The Exchange expects

that liquidity and stability in the options markets will be compromised during a Limit or Straddle State. The participation guarantees and priority quote status described in the instant proposed rule change, taken as a whole, are intended to mitigate the anticipated diminished liquidity and stability in the options markets brought about by a Limit or Straddle State. These incentives for Market Makers to quote and to assume extraordinary risk are intended to enhance liquidity and stability during times of unusual volatility in the options marketplace, which should promote customer protection and foster stability in the marketplace as a whole.

#### Trading Pauses and Opening after a Trading Pause

Proposed Rule 530(h) provides that the Exchange will halt trading in options overlying an NMS Stock that is subject to a Trading Pause. During a Trading Pause, the Exchange System will purge all quotes in the affected option, yet maintain orders existing in the Exchange System prior to the Trading Pause. Additionally, the Exchange System will accept incoming orders and quotes, including market orders.

Proposed Rule 530(i) provides that the Exchange will open trading following a Trading Pause pursuant to the Exchange's opening procedures contained in Rule 503. Proposed Rule 530(i) further adds that, consistent with provisions of the Plan,<sup>9</sup> the Exchange may resume trading in options contracts overlying an affected NMS Stock if trading on the Primary Listing Exchange has not resumed within ten minutes of receipt of a Trading Pause and at least one exchange has resumed trading in such NMS Stock.

#### 2. Statutory Basis

MIAX believes that its proposed rule change is consistent with Section 6(b) of the Act<sup>10</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>11</sup> in particular, in that it is

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<sup>9</sup> See Section VII(B)(3) of the Plan.

<sup>10</sup> 15 U.S.C. 78f(b).

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 regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanisms of a free and open market and a national market system and, in general, to protect investors and the public interest, and it is not designed to permit unfair discrimination among customers, brokers, or dealers.

The Exchange believes that excluding the Limit and Straddle State from a Market Maker's quoting obligation calculation should promote just and equitable principles of trade by recognizing the particular risk that arises for liquidity providers who cannot hedge. Whenever an NMS stock is in a Limit or Straddle State, trading continues; however, there will not be a reliable price for a security to serve as a benchmark for the price of the option. Accordingly, the Exchange seeks to expressly remove these periods from consideration in order to enable MIAX Market Makers to provide the necessary liquidity and facilitate transactions on the Exchange.

The Exchange also believes that the proposed rules concerning MIAX LULD Functionality described herein during a Limit or Straddle State will minimize undue risk to MIAX Market Makers, and thus will lead them to continue to act as Market Makers, rather than potentially causing Market Makers to de-register. The Exchange also believes that these changes will help to protect all investors from executions in options at prices that are not based on a reliable benchmark for the price of an option during times of significant volatility.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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<sup>11</sup> 15 U.S.C. 78f(b)(5).

Specifically, the Exchange believes the proposed changes will not impose any burden on intra-market competition because it applies to all MIAX participants equally. The Exchange does not believe the proposed rules will impose any burden on inter-market competition as the proposed rules are intended to protect investors with the implementation of the Plan. In addition, the proposed changes will provide certainty of treatment and execution of options orders during periods of extraordinary market volatility.

C. 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.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.<sup>12</sup>

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<sup>12</sup> The Commission notes that the Exchange requested accelerated approval of the filing.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-MIAX-2013-15 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File No. SR-MIAX-2013-15. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be

available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-MIAX-2013-15 and should be submitted on or before [insert date 10 days from publication in the Federal Register].<sup>13</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>14</sup>

Elizabeth M. Murphy  
Secretary

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<sup>13</sup> The Commission believes that a 10-day comment period is reasonable, given the urgency of the matter. It will provide adequate time for comment.

<sup>14</sup> 17 CFR 200.30-3(a)(12).