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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-77817; File No. SR-MIAX-2016-10)

May 12, 2016

Self-Regulatory Organizations; Miami International Securities Exchange LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend Exchange Rule 612, Aggregate Risk Manager (“ARM”)

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on April 29, 2016, Miami International Securities Exchange LLC (“MIAX” or the “Exchange”) filed with the Securities and Exchange Commission (the “Commission”) a 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 612, Aggregate Risk Manager (“ARM”).

The text of the proposed rule change is 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

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

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

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 Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend Exchange Rule 612, Aggregate Risk Manager ("ARM"), to modify the minimum Allowable Engagement Percentage (as described below) determined by Exchange Market Makers, and to codify the Exchange's existing practice of establishing default ARM settings, as described below. The Exchange is also proposing two minor technical amendments to Rule 612(a), as described below.

ARM protects MIAX Market Makers<sup>3</sup> and assists them in managing risk by limiting the number of contracts they execute in an option class on the Exchange within a specified time period that has been established by the Market Maker (a "specified time period"). MIAX Market Makers establish a percentage of their quotations (the "Allowable Engagement Percentage" or "AEP") and the specified time period for each option class in which they are appointed.<sup>4</sup> The System activates the Aggregate Risk Manager when it has determined that a Market Maker has traded a number of contracts equal to or above their AEP during the specified time period. When

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<sup>3</sup> The term "Market Maker" refers to a "Lead Market Maker," "Primary Lead Market Maker" and "Registered Market Maker" collectively. A Lead Market Maker is a Member registered with the Exchange for the purpose of making markets in securities traded on the Exchange and that is vested with the rights and responsibilities specified in Chapter VI of these Rules with respect to Lead Market Makers. A Primary Lead Market Maker is a Lead Market Maker appointed by the Exchange to act as the Primary Lead Market Maker for the purpose of making markets in securities traded on the Exchange. A Registered Market Maker is a Member registered with the Exchange for the purpose of making markets in securities traded on the Exchange, who is not a Lead Market Maker. See Exchange Rule 100.

<sup>4</sup> The Exchange's Board or designated committee appoints one Primary Lead Market Maker and other Market Makers to each options class traded on the Exchange. For a complete description of the Exchange's appointment process, see Exchange Rule 602.

an execution against a Market Maker's Standard quote<sup>5</sup> or Day eQuote (as defined below) occurs, the System looks back over the specified time period to determine whether the execution is of sufficient size to trigger the Aggregate Risk Manager. The Aggregate Risk Manager then automatically cancels and removes the Market Maker's Standard quotes and/or Day eQuotes from the Exchange's disseminated quotation in all series of that particular option class until the Market Maker sends a notification to the System of the intent to reengage quoting and submits a new revised quotation in the affected class.

Any eQuotes<sup>6</sup> other than Day eQuotes<sup>7</sup> present in the market are not cancelled by the Aggregate Risk Manager.

Currently, Exchange Rule 612(a) states that the Market Maker will establish for each option class an AEP that cannot be less than 100%.

First, the proposed amendments to Rule 612(a) would modify the existing rule to allow a Market Maker to establish an AEP at any percentage level for an option class in which such Market Maker is appointed. The Exchange believes that this change will give Market Makers the ability to better manage their risk and help them avoid trading a number of contracts that

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<sup>5</sup> A Standard quote is a quote submitted by a Market Maker that cancels and replaces the Market Maker's previous Standard quote, if any. See Exchange Rule 517(a)(1).

<sup>6</sup> An eQuote is a quote with a specific time in force that does not automatically cancel and replace a previous Standard quote or eQuote. An eQuote can be cancelled by the Market Maker at any time, or can be replaced by another eQuote that contains specific instructions to cancel an existing eQuote. See Exchange Rule 517(a)(2).

<sup>7</sup> A Day eQuote is a quote submitted by a Market Maker that does not automatically cancel or replace the Market Maker's previous Standard quote or eQuote. Day eQuotes will expire at the close of trading each trading day. See Exchange Rule 517(a)(2)(i).

exceeds the Market Maker's risk tolerance level across multiple series when multiple series are executed in rapid succession.<sup>8</sup>

The purpose of the proposed rule change is to enable individual Market Makers to enhance their risk management for an individual option class or for multiple classes as market conditions warrant, based on their own risk tolerance level and quoting behavior. Market Makers will be able to more precisely customize their risk management within the MIAX System than previously permitted, taking into account such factors as the market conditions both present and anticipated, news that may affect an option class in which they are appointed, a sudden change in the volatility of an option, and other considerations affecting their risk management, without any limitation as to the level of the AEP that will trigger the Aggregate Risk Manager. The proposed rule change will provide greater ability for Market Makers to adapt more exact and precise risk controls based on the Market Maker's risk tolerance levels.

Additionally, the Exchange proposes to amend Exchange Rule 612 to codify the Exchange's existing practice of establishing a default specified time period and a default AEP if such values are not established by a Market Maker. Currently, Exchange Rule 612(a) states that the specified time period cannot exceed 15 seconds. The proposed rule change would provide that the 15-second maximum will apply whether the specified time period is established by the Market Maker or as a default setting.

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<sup>8</sup> All of a Market Maker's quotes in each option class will be considered firm until such time as the AEP threshold has been equaled or crossed and the Market Maker's quotes are removed by the Aggregate Risk Manager in all series of that option class. Any marketable orders, or quotes that are executable against a Market Maker's disseminated quotation that are received prior to the time the Aggregate Risk Manager is engaged will be automatically executed at the disseminated price up to the Market Maker's disseminated size, regardless of whether such an execution results in executions in excess of the Market Maker's AEP. See Exchange Rule 612(c).

The proposed rule change codifies that the Exchange will establish a default specified time period and a default AEP (“default settings”) on behalf of Market Makers that have not established a specified time period and/or an AEP. The purpose of the default settings is to assist Market Makers in managing their risk in the event that they have not established a specified time period and/or an AEP in a particular appointed option and trading in such appointed option becomes active. For example, a Market Maker might not establish a specified time period or an AEP in an appointed option that has a relatively low average daily volume. If such an appointed option becomes extremely active due to news, world events or overall market changes, the default settings are in place to ensure that the Market Maker’s quotations are protected and removed from the Exchange’s disseminated quotation when the default setting threshold has been reached. The default settings benefit not only the Market Maker but the marketplace as a whole by enhancing stability and maintaining fair and orderly markets on MIAX when the settings are not established by the Market Maker, and ensure that all Exchange Market Makers are protected by ARM regardless of whether they establish ARM settings on their own. The default settings will be determined by the Exchange on an Exchange-wide basis and announced to Members via Regulatory Circular. The proposed rule change will serve to notify all market participants that the Exchange will establish the default settings for Market Makers and will apply them to all appointed option classes in which a Market Maker has not determined its specified time period or AEP. Any changes to the default settings will also be announced to Members via Regulatory Circular.

The current rule states that the specified time period cannot exceed 15 seconds. This 15-second limitation will apply to the specified time period whether it is established by a Market Maker or set by the Exchange by default; thus the proposed rule change would clarify in the rule

text that the specified time period cannot exceed 15 seconds, whether established by the Market Maker or as a default setting. Additionally, although the proposed rule states that the default AEP shall not be less than 100%, this Exchange-established default AEP setting will not limit a Market Maker's ability to establish an AEP of less than or greater than 100%. A Market Maker may establish the AEP for an appointed option class at any level. The Exchange will apply the default settings when a specified time period and/or an AEP has not been established by a Market Maker appointed in an option class. The current default specified time period setting is 1 second. The current default AEP setting is 105%. The Exchange does not propose to change the current default settings in the instant proposed rule change.

The Exchange is proposing two minor technical changes to Exchange Rule 612(a). First, the Rule currently refers to a Market Maker's "assigned" option classes. In order to maintain uniformity within Rule 612, the Exchange proposes to replace the word "assigned" with the word "appointed," as it is used later in the Rule.<sup>9</sup> Additionally, the current Rule states that "[T]he Market Maker will also establish for each option class an Allowable Engagement Percentage..." Because of the new codification of the default AEP setting established by the Exchange on behalf of a Market Maker that has not established an AEP in a given appointed class, the Exchange proposes to state that a Market Maker "may" establish an AEP, with the understanding that an AEP will be established by the Exchange on the Market Maker's behalf if not set by the Market Maker.

The Exchange will announce the implementation date of the proposed rule change by Regulatory Circular to be published no later than 60 days following the operative date of the

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<sup>9</sup> See Exchange Rule 612, Interpretations and Policies .02(a).

proposed rule. The implementation date will be no later than 60 days following the issuance of the Regulatory Circular.

## 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 designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, 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.

Market Makers are obligated to submit continuous two-sided quotations in a certain number of series in their appointed option classes for a certain percentage of each trading session,<sup>12</sup> rendering them vulnerable to risk from unusual market conditions, volatility in specific option classes, and other market events that may cause them to receive multiple, extremely rapid automatic executions before they can adjust their quotations and overall risk exposure in the market. The ability of each Market Maker to adapt their specified time period and AEP to current market conditions is a valuable tool in assisting Market Makers in risk management. The proposed rule change removes impediments to and perfects the mechanism of a free and open market by giving Market Makers the means to establish an AEP that corresponds to their ability to assume the risks inherent in quoting in a marketplace in which executions are instant and

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

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

<sup>12</sup> For a complete description of MIAX Market Maker quoting obligations, see Exchange Rule 604.

quotations must be changed rapidly to account for volatility. This protects investors and the public interest by ensuring that liquidity providers such as Exchange Market Makers are able to quote aggressively within their risk tolerance levels with respect to both price and size, resulting in narrower bid/ask differentials and deeper liquidity on the Exchange, all to the benefit and protection of investors and the public interest.

The proposed default settings further protect investors and the public interest by enhancing the risk management features provided by the Exchange on behalf of Market Makers that have not established a specified time period and/or AEP. The default settings provide Market Makers with risk management tools implemented by the Exchange in the event that a Market Maker has not determined the duration of the specified time period or the AEP for an option class in which the Market Maker is appointed.

Without adequate risk management tools in place on the Exchange, the incentive for Exchange Market Makers to quote aggressively respecting both price and size could be diminished, and could result in a concomitant reduction in the depth and liquidity they provide to the market. Such a result may undermine the quality of the markets that would otherwise be available to customers and other market participants. Accordingly, the Exchange proposes to help Market Makers better manage their risk exposure by giving them the ability to more precisely tailor their AEP to the market conditions present. This should encourage Market Makers to provide additional depth and liquidity to the Exchange's markets, thereby removing impediments to and perfecting the mechanisms of a free and open market and a national market system and, in general, protecting investors and the public interest.

Significantly, the proposed rule change removes impediments to and perfects the mechanisms of a free and open market and a national market system and, in general, protects



investors and the public interest because it codifies and enhances certain features of a risk management tool that is currently available to MIAX Market Makers. The elimination of the minimum AEP threshold requirement simply provides more alternatives to Market Makers in setting their AEP, on a class-by-class basis, without affecting their firm quote obligations. A Market Maker may set its AEP at any level (whether greater than, equal to, or less than 100%) in an appointed option, depending on that Market Maker's evaluation of its own risk tolerance level for that appointed option. The default settings serve to further enhance Market Makers' confidence in the Exchange's ability to assist them in their management of risk, and Market Makers are therefore likely to quote more aggressively in price and size, resulting in potentially narrower bid/ask differentials and deeper liquidity on the Exchange, serving to benefit and protect investors and the public interest.

The proposed rule change also promotes just and equitable principles of trade by codifying the Exchange's current practice of establishing the default settings, thus providing Exchange Market Makers with additional protection in risk management mechanisms on the Exchange. The default settings are proposed to reduce the risks associated with their Market Making obligations. Finally, the proposed rule change is designed to protect investors and the public interest by helping Market Makers prevent executions resulting from activity that exceeds their risk tolerance level under these rules as established by the Exchange and by codifying the Exchange's existing practices concerning default ARM settings.

The Exchange further notes that its proposal regarding minimum and default settings is consistent with rules that are currently in place on other exchanges.

For example, the International Securities Exchange LLC ("ISE") does not impose any minimum AEP or specified time period equivalent on its market makers, but the requirement for

ISE market makers to provide these parameters is mandatory. ISE Rule 804(g) requires its market makers to provide parameters by which the Exchange will automatically remove a market maker's quotations. ISE Rule 804(g) differs from the instant proposed rule change in that it has no default percentage or time period settings if not established by the ISE market maker.

BATS BZX Exchange, Inc. ("BATS BZX") Rule 21.16, Risk Monitor Mechanism, states that a single BATS user may configure a single counting program or multiple counting programs to govern its trading activity (i.e., on a per port basis). Just as with ARM, the BATS Risk Monitor Mechanism is based in part on a percentage based trigger (similar to the AEP), measured against the number of contracts executed as a percentage of the number of contracts outstanding within a time period designated by the Exchange ("percentage trigger"). The percentage trigger is calculated similarly to the AEP: the BATS counting program first calculates, for each series of an option class, the percentage of a User's order size in the specified class or a BATS market maker's quote size in the appointed class that is executed on each side of the market, including both displayed and non-displayed size; the counting program then sums the overall series percentages for the entire option class to calculate the percentage trigger. Like the MIAX proposal, BATS BZX Rule 21.16 has no minimum AEP equivalent or minimum specified time period. Unlike the MIAX proposal, BATS BZX does not establish default settings on behalf of its market makers.<sup>13</sup>

The Exchange notes that the proposed rule change will not relieve Exchange Market Makers of their continuous quoting obligations under Exchange Rule 604 and under Reg NMS

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<sup>13</sup> Chicago Board Options Exchange, Inc. ("CBOE") market makers may (but are not required to) establish parameters similar to the specified time period (the CBOE equivalent is a rolling time period in milliseconds) and the AEP. CBOE has no default settings. See CBOE Rule 8.18.

Rule 602.<sup>14</sup> All of a Market Maker's quotes in each option class will be considered firm until such time as the AEP threshold has been equaled or exceeded and the Market Maker's quotes are removed by the Aggregate Risk Manager in all series of that option class.<sup>15</sup>

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 that is not necessary or appropriate in furtherance of the purposes of the Act.

On the contrary, the Exchange believes that the proposed rule change will foster competition by providing Exchange Market Makers with the ability to enhance and specifically customize their use of the Exchange's risk management tools in order to compete for executions and order flow.

As to inter-market competition, the Exchange believes that the proposed rule change should promote competition because it is designed to allow Exchange Market Makers with flexibility to modify their risk exposure in order to protect them from unusual market conditions or events that may increase their exposure in the market.

For all the reasons stated, 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, and believes the proposed change will in fact enhance competition.

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.

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<sup>14</sup> 17 CFR 242.602.

<sup>15</sup> See Exchange Rule 612(c).

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

Because the foregoing proposed rule change does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate, it has become effective pursuant to 19(b)(3)(A) of the Act<sup>16</sup> and Rule 19b-4(f)(6)<sup>17</sup> thereunder.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

### 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

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<sup>16</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>17</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-MIAX-2016-10 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-MIAX-2016-10. 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 the 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 Number SR-MIAX-2016-10 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>18</sup>

Robert W. Errett  
Deputy Secretary

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<sup>18</sup> 17 CFR 200.30-3(a)(12).

