

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 40	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - 2013 - * 12 Amendment No. (req. for Amendments *)
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Filing by Miami International Securities Exchange, LLC.  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input checked="" type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
			Rule		
Pilot <input checked="" type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	<input checked="" type="checkbox"/> 19b-4(f)(1)	<input checked="" type="checkbox"/> 19b-4(f)(4)	
			<input checked="" type="checkbox"/> 19b-4(f)(2)	<input checked="" type="checkbox"/> 19b-4(f)(5)	
			<input checked="" type="checkbox"/> 19b-4(f)(3)	<input checked="" type="checkbox"/> 19b-4(f)(6)	

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010 Section 806(e)(1) <input checked="" type="checkbox"/> Section 806(e)(2) <input checked="" type="checkbox"/>	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934 Section 3C(b)(2) <input checked="" type="checkbox"/>
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Exhibit 2 Sent As Paper Document <input checked="" type="checkbox"/>	Exhibit 3 Sent As Paper Document <input checked="" type="checkbox"/>
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**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked \*).

Proposed rule change relating to obvious errors during a Limit or Straddle state

**Contact information**

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name \* Richard      Last Name \* Rudolph  
 Title \* Senior Counsel  
 E-mail \* rrudolph@miami-holdings.com  
 Telephone \* (609) 897-1487      Fax

**Signature**

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 03/21/2013      (Title \*) Senior Counsel  
 By Richard S. Rudolph  
 (Name \*)  


NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Richard Rudolph, rrudolph@miami

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFF website.

**Form 19b-4 Information \***

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies**

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with instruction F, they shall be filed in accordance with instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

Miami International Securities Exchange, LLC (“MIAX” or “Exchange”), pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder<sup>2</sup>, proposes to amend Exchange Rule 530, Limit Up-Limit Down (“LULD”), and to amend Exchange Rule 521, Obvious and Catastrophic Errors to provide for how the Exchange proposes to treat erroneous options transactions 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”).

A notice of the proposed rule change for publication in the Federal Register is attached hereto as Exhibit 1, and a copy of the proposed rule text is attached hereto as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Chief Executive Officer of the Exchange pursuant to authority delegated by the MIAX Board of Directors on December 5, 2012. Exchange staff will advise the Board of Directors of any action taken pursuant to delegated authority. No other action by the Exchange is necessary for the filing of the proposed rule change.

Questions and comments on the proposed rule change may be directed to Richard S. Rudolph, Senior Counsel, at (609) 897-1487, or James C. Morgan, Associate Counsel, at (609) 897-1484.

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

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

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

a. Purpose

The purpose of the proposed rule change is to amend MIAX Rules 530 and 521 to provide for how the Exchange proposes to treat erroneous options transactions 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.

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. 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 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 nonexecutable, 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.

#### Obvious Error

The Exchange analyzed in detail the operation of current Exchange Rule 521 (Obvious and Catastrophic Errors) and determined that it would be undesirable to apply that Rule to options when the underlying NMS Stock has entered either a Limit or Straddle State. However, the Exchange does not believe that it should operate without any protection against erroneous transactions during these periods. Therefore, the Exchange proposes that proposed Rule 530(j) apply to erroneous transactions in options when the underlying NMS Stock has entered either a Limit or Straddle State only when an erroneous transaction is due to a verifiable disruption or malfunction of the MIAX System.

The Exchange proposes to exclude transactions executed during a Limit or Straddle State from the provisions of MIAX Rule 521, on a one-year pilot basis, beginning on the date of implementation of the Plan, except in situations where the affected trade resulted from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system, as discussed below.

Current Rule 521 provides a process by which a transaction may be busted or adjusted when the execution price of a transaction deviates from the option's theoretical price<sup>3</sup> by a certain amount.

As discussed above, during a Limit or Straddle State, options prices may deviate substantially from those available prior to or following the limit state. The Exchange believes that the application of this provision to all erroneous transactions that occur during a Limit or Straddle State would give rise to much uncertainty for market participants as there is no bright line definition of what the theoretical price should be for an option when the underlying NMS stock has an unexecutable bid or offer or both.

Determining theoretical price in such a situation would be often times very subjective as opposed to an objective determination giving rise to additional uncertainty, and Rule 521 provides that if there are no quotes from other options exchanges for comparison purposes, the theoretical price will be determined by an Exchange Official. However, given that options market makers and other industry professionals will have difficulty pricing options during Limit and Straddle States, the Exchange does not believe it would be reasonable for an Exchange Official to derive theoretical prices to be applied to transactions executed during such unusual market conditions. Accordingly, the Exchange does not believe that the approach employed

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<sup>3</sup> The Theoretical Price of an option is:

(1) If the series is traded on at least one other options exchange the last National Best Bid price with respect to an erroneous sell transaction and the last National Best Offer price with respect to an erroneous buy transaction, just prior to the trade;

(2) if there are no quotes for comparison purposes, or if the bid/ask differential of the NBBO for the affected series, just prior to the erroneous transaction, was at least two times the standard bid/ask differential as permitted for pre-opening quotes under Rule 603(b)(4), as determined by an Exchange Official; or

(3) for transactions occurring as part of the Exchange's automated opening system, the Theoretical Price shall be the first quote after the transaction(s) in question that does not reflect the erroneous transaction(s).

See Exchange Rule 521(b).



under Rule 521, which by definition depends on a reliable national best bid and offer in the option, is appropriate for all transactions that occur during a Limit or Straddle State. The Exchange believes that there is no reliable basis on which to determine the Theoretical Price of transactions that occur during a Limit or Straddle State. Accordingly, proposed Rule 530(j) will not include any provision to adjust the price of trades that occur during a Limit or Straddle State. Proposed Rule 530(j) will only apply to transactions occurring during Limit and Straddle States that resulted from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system, and thus proposed Rule 530(j) will not include the numerical tables defining Obvious and Catastrophic Errors found in Rule 521(a). Moreover, the Exchange proposes to exclude the description of conditions other than a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system that give rise to a review that are included in current Rules 521(c)(2)(v) and (vi).<sup>4</sup>

After careful consideration, the Exchange believes the application of the current rule to all transactions occurring during a Limit or Straddle State would be impracticable during Limit and Straddle States, and could produce undesirable effects.

The Exchange believes that market participants should not be able to benefit from the time frames allotted to them from the time of the affected transaction within which they may request a review of their transactions in these situations. Suspending application of Rule 521 for

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<sup>4</sup> Under these rules, which will not be incorporated into proposed Rule 530(j), parties to a trade may have a trade nullified or its price adjusted if:

(v) The trade resulted in an execution price in a series quoted no bid and for 5 seconds prior to the execution remained no bid (excluding the quote in question; bids and offers of the parties to the subject trade that are in any of the series in the same options class shall not be considered) and at least one strike price below (for calls) or above (for puts) in the same class were quoted no bid at the time of the erroneous execution (in which case the trade shall be nullified); or

(vi) The trade occurred at a price that is deemed to be an Obvious Error as defined in Paragraph (a)(1) of this Rule 521.



all transactions occurring during a Limit or Straddle State (except for erroneous transactions that resulted from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system, or due to an erroneous quote or print in the underlying NMS Stock as discussed below) would mitigate two of the undesirable aspects described above : (i) the moral hazard associated with granting a second look to trades that went against the market participant after market conditions have changed and (ii) gaming the obvious error rule to retroactively adjust market maker quotes by adjusting the execution price at a later time.

The Exchange notes that there are additional protections in place outside of Rule 521 that will continue to safeguard customers. First, SEC Rule 15c3-5 requires that, “financial risk management controls and supervisory procedures must be reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds, or that appear to be erroneous.”<sup>5</sup>

Secondly, as noted above, the Exchange will cancel unexecuted market orders in the MIAX System, and will reject market orders received during a Limit or Straddle State. Additionally, the MIAX System is designed with a built-in protection mechanism that will never trade through the NBBO price at the time of receipt of an order by more than one Minimum Price Variation (“MPV”).<sup>6</sup> Thus, Exchange functionality that filters out orders that appear to be erroneous or are at risk of execution at an erroneous price enhances the protections provided through LULD Functionality.

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<sup>5</sup> See Securities and Exchange Act Release No. 63241, 75 FR 69791 (November 15, 2010) (S7-03-10).

<sup>6</sup> This would only happen in the event that the Exchange receives an Intermarket Search Order (“ISO”) routed to the Exchange by an away market, in which the sending away market indicates that it has exhausted its efforts to trade at a better price than the Exchange’s disseminated price and that such ISO can be executed at a price that is inferior to the then-disseminated NBBO.

Reviewable Transactions

As stated above, the Exchange will review all erroneous transactions occurring during Limit and Straddle States that resulted from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system. Accordingly, the Exchange is proposing to incorporate the relevant portions of Rule 521 into proposed Rule 530(j) to establish the process for such review. The Exchange proposes to adopt Commentary .06 to Rule 521, which provides that transactions in MIAX options that overly an NMS Stock that occur during a Limit or Straddle State are not subject to review under Rule 521. The Exchange shall apply proposed Rule 530(j) to such transactions.

Proposed Rule 530(j)(1)(ii) states that trades will continue to be subject to an obvious error or catastrophic error review in a Limit or Straddle State if (A) the trade resulted from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system that caused a quote/order to trade in excess of its disseminated size (e.g. a quote/order that is frozen, because of an Exchange system error, and repeatedly traded) in which case trades in excess of the disseminated size may be nullified, or (B) the trade resulted from a verifiable disruption or malfunction of an Exchange dissemination or communication system that prevented a member from updating or canceling a quote/order for which the member is responsible where there is Exchange documentation providing that the member sought to update or cancel the quote/order; (C) the trade resulted from an erroneous print disseminated by the underlying market which is later cancelled or corrected by the underlying market where such erroneous print resulted in a trade higher or lower than the average trade in the underlying security during the time period encompassing two minutes before and after the erroneous print, by an amount at least five times greater than the average quote width for such underlying

security during the time period encompassing two minutes before and after the erroneous print. For purposes of this Rule, the average trade in the underlying security shall be determined by adding the prices of each trade during the four minute time period referenced above (excluding the trade in question) and dividing by the number of trades during such time period (excluding the trade in question); or (D) the trade resulted from an erroneous quote in the primary market for the underlying security that has a width of at least \$1.00 and that width is at least five times greater than the average quote width for such underlying security during the time period encompassing two minutes before and after the dissemination of such quote. For the purposes of this Rule, the average quote width shall be determined by adding the quote widths of sample quotations at regular 15-second intervals during the four minute time period referenced above (excluding the quote in question) and dividing by the number of quotes during such time period (excluding the quote in question).

Currently, under Rule 521(a)(1) and (2), obvious and catastrophic errors are calculated by determining a theoretical price and applying such price, based on objective standards, to ascertain whether the trade should be nullified or adjusted. While the rule contains a notification process for requesting an obvious error review, certain more substantial errors may fall under the category of a catastrophic error, for which a longer time period is permitted to request a review and for which trades can currently only be adjusted (not nullified). Trades are adjusted pursuant to an adjustment table that, in effect, assesses an adjustment penalty. By adjusting trades above or below the theoretical price, the Rule assesses a “penalty” in that the adjustment price is not as favorable as the amount the party making the error would have received had it not made the error.

Pursuant to current Rule 521(b), the theoretical price of an option is determined in one

of three ways: (1) if the series is traded on at least one other options exchange, the last National Best Bid price with respect to an erroneous sell transaction and the last National Best Offer price with respect to an erroneous buy transaction, just prior to the trade; (2) if there are no quotes for comparison purposes, or if the bid/ask differential of the National Best Bid and Offer ("NBBO") for the affected series, just prior to the erroneous transaction, was at least two times the permitted bid/ask differential under Rule 1014(c)(i)(A)(1)(a), as determined by an Exchange Official; or (3) for transactions occurring as part of the Exchange's automated opening system, the theoretical price shall be the first quote after the transaction(s) in question that does not reflect the erroneous transaction(s).

The Exchange believes that none of these three methods is appropriate during a Limit or Straddle State. Specifically, under Rule 521(b)(1), the theoretical price is determined with respect to the NBBO for an option series just prior to the trade. As discussed above, during a Limit or Straddle State, options prices may deviate substantially from those available prior to or following the State. The Exchange believes this provision would give rise to much uncertainty for market participants as there is no bright line definition of what the theoretical price should be for an option when the underlying NMS stock has an unexecutable bid or offer or both. Determining theoretical price in such a situation would be often times very subjective as opposed to an objective determination giving rise to additional uncertainty and confusion for investors. Accordingly, the Exchange does not believe that the approach employed under current Rule 521(b)(1), which by definition depends on a reliable NBBO in the option, is appropriate during a Limit or Straddle State. The Exchange believes that excluding this from proposed Rule 530(j) is appropriate because while in a Limit or Straddle State, only limit orders will be accepted by the Exchange, affirming that the participant is willing to accept an execution up to the limit price.

Further, because the Exchange system will only trade through the theoretical bid or offer if the Exchange or the participant (via an ISO order) has accessed all better priced interest away in accordance the Options Order Protection and Locked/Crossed Markets Plan, the Exchange believes potential trade reviews of executions that occurred at the participant's limit price and also in compliance with aforementioned Plan could result in uncertainty that could harm liquidity and also could create an advantage to either side of an execution depending on the future movement of the underlying stock.

The Exchange recognizes that the second method (in Rule 521(b)(2)) affords discretion to the Options Exchange Official in determining the theoretical price and thereby, ultimately, whether a trade is busted or adjusted and to what price. The Exchange has determined that it would be difficult to exercise such discretion in periods of extraordinary market volatility and in particular when the price of the underlying security is unreliable. Moreover, the theoretical price would be subjective. Thus, the Exchange has determined not to permit an obvious or catastrophic error review if there are no quotes for comparison purposes, or if the bid/ask differential of the NBBO for the affected series, just prior to the erroneous transaction, was at least two times the permitted bid/ask differential. The Exchange believes that adding certainty to the execution of orders in these situations should encourage market participants to continue to provide liquidity to the Exchange and thus promote a fair and orderly market.

The Exchange notes that current Rule 521(b)(3) applies to trades executed during openings. Because the Exchange does not intend to open an option during a Limit or Straddle State, this provision, on its face, will not apply.

For the same reasons, the Exchange is proposing that Rule 521(c)(2)(vi) not apply during a Limit or Straddle State.

In addition, the Exchange proposes that trades are not subject to an obvious error and catastrophic error review if pursuant to the provisions of Rule 521(c)(2)(vi) the trade resulted from an execution price in a series quoted no bid. A zero bid option refers to an option where the bid price is \$ 0.00. Series of options quoted zero bid are usually deep out-of-the-money series that are perceived as having little if any chance of expiring in-the-money. For this reason, relatively few transactions occur in these series and those that do are usually the result of a momentary pricing error.

Specifically, under this provision, where the trade resulted in an execution price in a series quoted no bid and for 5 seconds prior to the execution remained no bid (excluding the quote in question; bids and offers of the parties to the subject trade that are in any of the series in the same options class shall not be considered) and at least one strike price below (for calls) or above (for puts) in the same class were quoted no bid at the time of the erroneous execution (in which case the trade shall be nullified). The Exchange believes that these situations are not appropriate for an error review because they are more likely to result in a windfall to one party at the expense of another in a Limit or Straddle State, because the criteria for meeting the no-bid provision are more likely to be met in a Limit or Straddle State, and unlike normal circumstances, may not be a true reflection of the value of the series being quoted. For example, in a series quoted \$1.95-\$2.00 on multiple exchanges prior to the Limit or Straddle State, an order to B10@ \$2.00 is likely a reasonably priced trade because the buyer attempted to pay \$2.00 with a limit price. However, if that series and the series one strike below are both quoted \$0.00- \$5.00, then both the seller and the buyer at \$2.00 would have an opportunity to dispute the trade. This would create uncertainty to both parties and an advantage to one participant if the underlying stock moved significantly in their direction.

Regarding Obvious Errors, the Commission has stated previously that it “...considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the price of the executed trade indicates an ‘obvious error’ may exist, suggesting that it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In the Commission’s view, the determination of whether an ‘obvious error’ has occurred, and the adjustment or nullification of a transaction because an obvious error is considered to exist, should be based on specific and objective criteria and subject to specific and objective procedures...”<sup>7</sup>

The Exchange believes that, in some extreme situations, trade participants may not be aware of errors that result in very large losses within the time periods currently required under the rule. In this type of extreme situation, the Exchange believes its members should be given more time to seek relief so that there is a greater opportunity to mitigate very large losses and reduce the corresponding large wind-falls. However, to maintain the appropriate balance, the Exchange believes members should only be given more time when the execution price is much further away from the theoretical price than is required for Obvious Errors so that relief is only provided in extreme circumstances.

The Exchange believes that this proposal strikes the aforementioned balance. The Exchange is proposing to decline to review certain trades, which is specific and objective. Furthermore, the proposal more fairly balances the potential windfall to one market participant against the potential reconsideration of a trading decision under the guise of an error, and thereby results in more certainty during periods of extreme market volatility. Trades can nevertheless be considered erroneous under other sections of the Rule, because those continue to be an objective method of determining whether an error occurred, even during periods of extraordinary market

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<sup>7</sup> See Securities Exchange Act Release No. 49785 (May 28, 2004), 69 FR 32090 (June 8, 2004) (SR-Phlx-2003-68).



volatility. Because the Exchange intends to continue to review trades pursuant to proposed Rules 521(j)(1)(A)-(D), the Exchange believes that this continues to provide some protection to market participants.

The Exchange believes that, in addition to the built-in customer protections discussed above, it is necessary to protect investors from erroneous transactions resulting from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system.

Proposed Rule 530(j) will also include identical language to that used in current Rule 521 regarding mutual agreement by the parties to an erroneous transaction during a trading halt, *i.e.*, trades on the Exchange will be nullified when the trade occurred during a trading halt in the affected option on the Exchange, or respecting equity options (including options overlying ETFs), the trade occurred during a trading halt on the primary market for the underlying security. Proposed Rule 530(j) will also incorporate the relevant elements of Rule 521 regarding the review procedure, requests for review, and appeals from decisions to bust a trade.

The Exchange has engaged in informal discussions with its members, and has received generally favorable feedback concerning its proposed handling of Obvious Errors during Limit and Straddle States, given the aforementioned built-in protections in the MIAX System.

During the one-year pilot period beginning on the date of implementation of the Plan, the Exchange will conduct its own analysis concerning the elimination of obvious error rules during limit and straddle states and agrees to provide the Commission with relevant data to assess the impact of this proposed rule change. As part of its analysis, the Exchange will evaluate (1) the options market quality during limit and straddle states, (2) assess the character of incoming order flow and transactions during limit and straddle states, and (3) review any complaints from members and their customers concerning executions during limit and straddle states.

Additionally, the Exchange agrees to provide to the Commission data requested to evaluate the impact of the elimination of the obvious error rule, including data relevant to assessing the various analyses noted above.

b. Statutory Basis

MIAX believes that its proposed rule change is consistent with Section 6(b) of the Act<sup>8</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>9</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 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 the application of the current Obvious Error rule will be impracticable given the lack of a reliable NBBO in the options market during Limit and Straddle States, and that the resulting actions (i.e., nullified trades or adjusted prices) may not be appropriate given market conditions. This change would ensure that limit orders that are filled during a Limit or Straddle State would have certainty of execution in a manner that promotes just and equitable principles of trade, removes impediments to, and perfects the mechanism of a free and open market and a national market system. Moreover, given that options prices during brief Limit or Straddle States may deviate substantially from those available shortly following the Limit or Straddle State, the Exchange believes giving market participants time to reevaluate a

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<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

transaction would create an unreasonable adverse selection opportunity that would discourage participants from providing liquidity during Limit or Straddle States. In this respect, the Exchange notes that by rejecting market orders and cancelling pending market orders, only those orders with a limit price will be executed during a Limit or Straddle State. Therefore, on balance, the Exchange believes that removing the potential inequity of nullifying or adjusting executions occurring during Limit or Straddle States outweighs any potential benefits from applying certain provisions during such unusual market conditions.

Additionally, as discussed above, there are additional pre-trade protections in place on the MIAX System that will continue to safeguard customers.

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

MIAX 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.

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.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

6. Extension of Time Period for Commission Action

The Exchange does not consent to an extension of the time period for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

The Exchange requests accelerated effectiveness pursuant to Section 19(b)(2) of the Act<sup>10</sup> in order to ensure that the proposed rule will be effective on or before the anticipated April 8, 2013 date of implementation of the Plan.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The proposed rule change is not based on the rules of another self-regulatory organization or of the Commission.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

1. Notice of proposed rule for publication in the Federal Register.

5. Text of proposed rule change.

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<sup>10</sup> 15 U.S.C. 78s(b)(2).

**EXHIBIT 1**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34- ; File No. SR-MIAX-2013-12

March \_\_, 2013

Self-Regulatory Organizations: Notice of Filing of a Proposed Rule Change by Miami International Securities Exchange LLC Relating to Obvious Errors in Limit or Straddle States

Pursuant to the provisions of 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 22, 2013, Miami International Securities Exchange LLC (“MIAX” or “Exchange”) filed with the Securities and Exchange Commission (“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 530, Limit Up-Limit Down (“LULD”), and to amend Exchange Rule 521, Obvious and Catastrophic Errors to provide for how the Exchange proposes to treat erroneous options transactions 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 text of the proposed rule change is provided in Exhibit 5. The text of the proposed rule change is also available on the Exchange’s website at

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

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

[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 Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of the proposed rule change is to amend MIAX Rules 530 and 521 to provide for how the Exchange proposes to treat erroneous options transactions 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.

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. 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 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 nonexecutable, 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.

#### Obvious Error

The Exchange analyzed in detail the operation of current Exchange Rule 521 (Obvious and Catastrophic Errors) and determined that it would be undesirable to apply that Rule to options when the underlying NMS Stock has entered either a Limit or Straddle State. However, the Exchange does not believe that it should operate without any protection against erroneous transactions during these periods. Therefore, the Exchange proposes that proposed Rule 530(j) apply to erroneous transactions in options when the underlying NMS Stock has entered either a Limit or Straddle State only when an erroneous transaction is due to a verifiable disruption or malfunction of the MIAX System.

The Exchange proposes to exclude transactions executed during a Limit or Straddle State from the provisions of MIAX Rule 521, on a one-year pilot basis, beginning on the date of

implementation of the Plan, except in situations where the affected trade resulted from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system, as discussed below.

Current Rule 521 provides a process by which a transaction may be busted or adjusted when the execution price of a transaction deviates from the option's theoretical price<sup>3</sup> by a certain amount.

As discussed above, during a Limit or Straddle State, options prices may deviate substantially from those available prior to or following the limit state. The Exchange believes that the application of this provision to all erroneous transactions that occur during a Limit or Straddle State would give rise to much uncertainty for market participants as there is no bright line definition of what the theoretical price should be for an option when the underlying NMS stock has an unexecutable bid or offer or both.

Determining theoretical price in such a situation would be often times very subjective as opposed to an objective determination giving rise to additional uncertainty, and Rule 521 provides that if there are no quotes from other options exchanges for comparison purposes, the theoretical price will be determined by an Exchange Official. However, given that options market makers and other industry professionals will have difficulty pricing options during Limit

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<sup>3</sup> The Theoretical Price of an option is:

(1) If the series is traded on at least one other options exchange the last National Best Bid price with respect to an erroneous sell transaction and the last National Best Offer price with respect to an erroneous buy transaction, just prior to the trade;

(2) if there are no quotes for comparison purposes, or if the bid/ask differential of the NBBO for the affected series, just prior to the erroneous transaction, was at least two times the standard bid/ask differential as permitted for pre-opening quotes under Rule 603(b)(4), as determined by an Exchange Official; or

(3) for transactions occurring as part of the Exchange's automated opening system, the Theoretical Price shall be the first quote after the transaction(s) in question that does not reflect the erroneous transaction(s).

See Exchange Rule 521(b).

and Straddle States, the Exchange does not believe it would be reasonable for an Exchange Official to derive theoretical prices to be applied to transactions executed during such unusual market conditions. Accordingly, the Exchange does not believe that the approach employed under Rule 521, which by definition depends on a reliable national best bid and offer in the option, is appropriate for all transactions that occur during a Limit or Straddle State. The Exchange believes that there is no reliable basis on which to determine the Theoretical Price of transactions that occur during a Limit or Straddle State. Accordingly, proposed Rule 530(j) will not include any provision to adjust the price of trades that occur during a Limit or Straddle State. Proposed Rule 530(j) will only apply to transactions occurring during Limit and Straddle States that resulted from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system, and thus proposed Rule 530(j) will not include the numerical tables defining Obvious and Catastrophic Errors found in Rule 521(a). Moreover, the Exchange proposes to exclude the description of conditions other than a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system that give rise to a review that are included in current Rules 521(c)(2)(v) and (vi).<sup>4</sup>

After careful consideration, the Exchange believes the application of the current rule to all transactions occurring during a Limit or Straddle State would be impracticable during Limit and Straddle States, and could produce undesirable effects.

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<sup>4</sup> Under these rules, which will not be incorporated into proposed Rule 530(j), parties to a trade may have a trade nullified or its price adjusted if:

(v) The trade resulted in an execution price in a series quoted no bid and for 5 seconds prior to the execution remained no bid (excluding the quote in question; bids and offers of the parties to the subject trade that are in any of the series in the same options class shall not be considered) and at least one strike price below (for calls) or above (for puts) in the same class were quoted no bid at the time of the erroneous execution (in which case the trade shall be nullified); or

(vi) The trade occurred at a price that is deemed to be an Obvious Error as defined in Paragraph (a)(1) of this Rule 521.

The Exchange believes that market participants should not be able to benefit from the time frames allotted to them from the time of the affected transaction within which they may request a review of their transactions in these situations. Suspending application of Rule 521 for all transactions occurring during a Limit or Straddle State (except for erroneous transactions that resulted from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system, or due to an erroneous quote or print in the underlying NMS Stock as discussed below) would mitigate two of the undesirable aspects described above : (i) the moral hazard associated with granting a second look to trades that went against the market participant after market conditions have changed and (ii) gaming the obvious error rule to retroactively adjust market maker quotes by adjusting the execution price at a later time.

The Exchange notes that there are additional protections in place outside of Rule 521 that will continue to safeguard customers. First, SEC Rule 15c3-5 requires that, “financial risk management controls and supervisory procedures must be reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds, or that appear to be erroneous.”<sup>5</sup>

Secondly, as noted above, the Exchange will cancel unexecuted market orders in the MIAX System, and will reject market orders received during a Limit or Straddle State. Additionally, the MIAX System is designed with a built-in protection mechanism that will never trade through the NBBO price at the time of receipt of an order by more than one Minimum Price Variation (“MPV”).<sup>6</sup> Thus, Exchange functionality that filters out orders that appear to be

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<sup>5</sup> See Securities and Exchange Act Release No. 63241, 75 FR 69791 (November 15, 2010) (S7-03-10).

<sup>6</sup> This would only happen in the event that the Exchange receives an Intermarket Search Order (“ISO”) routed to the Exchange by an away market, in which the sending away market indicates that it has exhausted its efforts to trade at a better price than the Exchange’s disseminated price and that such ISO can be executed at a price that is inferior to the then-disseminated NBBO.

erroneous or are at risk of execution at an erroneous price enhances the protections provided through LULD Functionality.

#### Reviewable Transactions

As stated above, the Exchange will review all erroneous transactions occurring during Limit and Straddle States that resulted from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system. Accordingly, the Exchange is proposing to incorporate the relevant portions of Rule 521 into proposed Rule 530(j) to establish the process for such review. The Exchange proposes to adopt Commentary .06 to Rule 521, which provides that transactions in MIAX options that overly an NMS Stock that occur during a Limit or Straddle State are not subject to review under Rule 521. The Exchange shall apply proposed Rule 530(j) to such transactions.

Proposed Rule 530(j)(1)(ii) states that trades will continue to be subject to an obvious error or catastrophic error review in a Limit or Straddle State if (A) the trade resulted from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system that caused a quote/order to trade in excess of its disseminated size (e.g. a quote/order that is frozen, because of an Exchange system error, and repeatedly traded) in which case trades in excess of the disseminated size may be nullified, or (B) the trade resulted from a verifiable disruption or malfunction of an Exchange dissemination or communication system that prevented a member from updating or canceling a quote/order for which the member is responsible where there is Exchange documentation providing that the member sought to update or cancel the quote/order; (C) the trade resulted from an erroneous print disseminated by the underlying market which is later cancelled or corrected by the underlying market where such erroneous print resulted in a trade higher or lower than the average trade in the underlying security during the time period encompassing two minutes before and after the erroneous print,

by an amount at least five times greater than the average quote width for such underlying security during the time period encompassing two minutes before and after the erroneous print. For purposes of this Rule, the average trade in the underlying security shall be determined by adding the prices of each trade during the four minute time period referenced above (excluding the trade in question) and dividing by the number of trades during such time period (excluding the trade in question); or (D) the trade resulted from an erroneous quote in the primary market for the underlying security that has a width of at least \$1.00 and that width is at least five times greater than the average quote width for such underlying security during the time period encompassing two minutes before and after the dissemination of such quote. For the purposes of this Rule, the average quote width shall be determined by adding the quote widths of sample quotations at regular 15-second intervals during the four minute time period referenced above (excluding the quote in question) and dividing by the number of quotes during such time period (excluding the quote in question).

Currently, under Rule 521(a)(1) and (2), obvious and catastrophic errors are calculated by determining a theoretical price and applying such price, based on objective standards, to ascertain whether the trade should be nullified or adjusted. While the rule contains a notification process for requesting an obvious error review, certain more substantial errors may fall under the category of a catastrophic error, for which a longer time period is permitted to request a review and for which trades can currently only be adjusted (not nullified). Trades are adjusted pursuant to an adjustment table that, in effect, assesses an adjustment penalty. By adjusting trades above or below the theoretical price, the Rule assesses a “penalty” in that the adjustment price is not as favorable as the amount the party making the error would have received had it not made the error.

Pursuant to current Rule 521(b), the theoretical price of an option is determined in one

of three ways: (1) if the series is traded on at least one other options exchange, the last National Best Bid price with respect to an erroneous sell transaction and the last National Best Offer price with respect to an erroneous buy transaction, just prior to the trade; (2) if there are no quotes for comparison purposes, or if the bid/ask differential of the National Best Bid and Offer ("NBBO") for the affected series, just prior to the erroneous transaction, was at least two times the permitted bid/ask differential under Rule 1014(c)(i)(A)(1)(a), as determined by an Exchange Official; or (3) for transactions occurring as part of the Exchange's automated opening system, the theoretical price shall be the first quote after the transaction(s) in question that does not reflect the erroneous transaction(s).

The Exchange believes that none of these three methods is appropriate during a Limit or Straddle State. Specifically, under Rule 521(b)(1), the theoretical price is determined with respect to the NBBO for an option series just prior to the trade. As discussed above, during a Limit or Straddle State, options prices may deviate substantially from those available prior to or following the State. The Exchange believes this provision would give rise to much uncertainty for market participants as there is no bright line definition of what the theoretical price should be for an option when the underlying NMS stock has an unexecutable bid or offer or both. Determining theoretical price in such a situation would be often times very subjective as opposed to an objective determination giving rise to additional uncertainty and confusion for investors. Accordingly, the Exchange does not believe that the approach employed under current Rule 521(b)(1), which by definition depends on a reliable NBBO in the option, is appropriate during a Limit or Straddle State. The Exchange believes that excluding this from proposed Rule 530(j) is appropriate because while in a Limit or Straddle State, only limit orders will be accepted by the Exchange, affirming that the participant is willing to accept an execution up to the limit price. Further, because the Exchange system will only trade through the theoretical bid or offer if the



Exchange or the participant (via an ISO order) has accessed all better priced interest away in accordance the Options Order Protection and Locked/Crossed Markets Plan, the Exchange believes potential trade reviews of executions that occurred at the participant's limit price and also in compliance with aforementioned Plan could result in uncertainty that could harm liquidity and also could create an advantage to either side of an execution depending on the future movement of the underlying stock.

The Exchange recognizes that the second method (in Rule 521(b)(2)) affords discretion to the Options Exchange Official in determining the theoretical price and thereby, ultimately, whether a trade is busted or adjusted and to what price. The Exchange has determined that it would be difficult to exercise such discretion in periods of extraordinary market volatility and in particular when the price of the underlying security is unreliable. Moreover, the theoretical price would be subjective. Thus, the Exchange has determined not to permit an obvious or catastrophic error review if there are no quotes for comparison purposes, or if the bid/ask differential of the NBBO for the affected series, just prior to the erroneous transaction, was at least two times the permitted bid/ask differential. The Exchange believes that adding certainty to the execution of orders in these situations should encourage market participants to continue to provide liquidity to the Exchange and thus promote a fair and orderly market.

The Exchange notes that current Rule 521(b)(3) applies to trades executed during openings. Because the Exchange does not intend to open an option during a Limit or Straddle State, this provision, on its face, will not apply.

For the same reasons, the Exchange is proposing that Rule 521(c)(2)(vi) not apply during a Limit or Straddle State.

In addition, the Exchange proposes that trades are not subject to an obvious error and catastrophic error review if pursuant to the provisions of Rule 521(c)(2)(vi) the trade resulted

from an execution price in a series quoted no bid. A zero bid option refers to an option where the bid price is \$ 0.00. Series of options quoted zero bid are usually deep out-of-the-money series that are perceived as having little if any chance of expiring in-the-money. For this reason, relatively few transactions occur in these series and those that do are usually the result of a momentary pricing error.

Specifically, under this provision, where the trade resulted in an execution price in a series quoted no bid and for 5 seconds prior to the execution remained no bid (excluding the quote in question; bids and offers of the parties to the subject trade that are in any of the series in the same options class shall not be considered) and at least one strike price below (for calls) or above (for puts) in the same class were quoted no bid at the time of the erroneous execution (in which case the trade shall be nullified). The Exchange believes that these situations are not appropriate for an error review because they are more likely to result in a windfall to one party at the expense of another in a Limit or Straddle State, because the criteria for meeting the no-bid provision are more likely to be met in a Limit or Straddle State, and unlike normal circumstances, may not be a true reflection of the value of the series being quoted. For example, in a series quoted \$1.95-\$2.00 on multiple exchanges prior to the Limit or Straddle State, an order to B10@ \$2.00 is likely a reasonably priced trade because the buyer attempted to pay \$2.00 with a limit price. However, if that series and the series one strike below are both quoted \$0.00- \$5.00, then both the seller and the buyer at \$2.00 would have an opportunity to dispute the trade. This would create uncertainty to both parties and an advantage to one participant if the underlying stock moved significantly in their direction.

Regarding Obvious Errors, the Commission has stated previously that it "...considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the price of the executed trade indicates an 'obvious error' may exist, suggesting that

it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In the Commission's view, the determination of whether an 'obvious error' has occurred, and the adjustment or nullification of a transaction because an obvious error is considered to exist, should be based on specific and objective criteria and subject to specific and objective procedures..."<sup>7</sup>

The Exchange believes that, in some extreme situations, trade participants may not be aware of errors that result in very large losses within the time periods currently required under the rule. In this type of extreme situation, the Exchange believes its members should be given more time to seek relief so that there is a greater opportunity to mitigate very large losses and reduce the corresponding large wind-falls. However, to maintain the appropriate balance, the Exchange believes members should only be given more time when the execution price is much further away from the theoretical price than is required for Obvious Errors so that relief is only provided in extreme circumstances.

The Exchange believes that this proposal strikes the aforementioned balance. The Exchange is proposing to decline to review certain trades, which is specific and objective. Furthermore, the proposal more fairly balances the potential windfall to one market participant against the potential reconsideration of a trading decision under the guise of an error, and thereby results in more certainty during periods of extreme market volatility. Trades can nevertheless be considered erroneous under other sections of the Rule, because those continue to be an objective method of determining whether an error occurred, even during periods of extraordinary market volatility. Because the Exchange intends to continue to review trades pursuant to proposed Rules 521(j)(1)(A)-(D), the Exchange believes that this continues to provide some protection to market participants.

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<sup>7</sup> See Securities Exchange Act Release No. 49785 (May 28, 2004), 69 FR 32090 (June 8, 2004) (SR-Phlx-2003-68).

The Exchange believes that, in addition to the built-in customer protections discussed above, it is necessary to protect investors from erroneous transactions resulting from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system.

Proposed Rule 530(j) will also include identical language to that used in current Rule 521 regarding mutual agreement by the parties to an erroneous transaction during a trading halt, *i.e.*, trades on the Exchange will be nullified when the trade occurred during a trading halt in the affected option on the Exchange, or respecting equity options (including options overlying ETFs), the trade occurred during a trading halt on the primary market for the underlying security. Proposed Rule 530(j) will also incorporate the relevant elements of Rule 521 regarding the review procedure, requests for review, and appeals from decisions to bust a trade.

The Exchange has engaged in informal discussions with its members, and has received generally favorable feedback concerning its proposed handling of Obvious Errors during Limit and Straddle States, given the aforementioned built-in protections in the MIAX System.

During the one-year pilot period beginning on the date of implementation of the Plan, the Exchange will conduct its own analysis concerning the elimination of obvious error rules during limit and straddle states and agrees to provide the Commission with relevant data to assess the impact of this proposed rule change. As part of its analysis, the Exchange will evaluate (1) the options market quality during limit and straddle states, (2) assess the character of incoming order flow and transactions during limit and straddle states, and (3) review any complaints from members and their customers concerning executions during limit and straddle states.

Additionally, the Exchange agrees to provide to the Commission data requested to evaluate the impact of the elimination of the obvious error rule, including data relevant to assessing the various analyses noted above.

## 2. Statutory Basis

MIAX believes that its proposed rule change is consistent with Section 6(b) of the Act<sup>8</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>9</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 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 the application of the current Obvious Error rule will be impracticable given the lack of a reliable NBBO in the options market during Limit and Straddle States, and that the resulting actions (i.e., nullified trades or adjusted prices) may not be appropriate given market conditions. This change would ensure that limit orders that are filled during a Limit or Straddle State would have certainty of execution in a manner that promotes just and equitable principles of trade, removes impediments to, and perfects the mechanism of a free and open market and a national market system. Moreover, given that options prices during brief Limit or Straddle States may deviate substantially from those available shortly following the Limit or Straddle State, the Exchange believes giving market participants time to reevaluate a transaction would create an unreasonable adverse selection opportunity that would discourage participants from providing liquidity during Limit or Straddle States. In this respect, the Exchange notes that by rejecting market orders and cancelling pending market orders, only those

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<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

orders with a limit price will be executed during a Limit or Straddle State. Therefore, on balance, the Exchange believes that removing the potential inequity of nullifying or adjusting executions occurring during Limit or Straddle States outweighs any potential benefits from applying certain provisions during such unusual market conditions.

Additionally, as discussed above, there are additional pre-trade protections in place on the MIAX System that will continue to safeguard customers.

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.

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 Exchange consents, the Commission shall: (a) by order approve or

disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be 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

- Send an e-mail [to rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-MIAX-2013-12 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 Number SR-MIAX-2013-12. 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 Web site (<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-2013-12 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>10</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>10</sup> 17 CFR 200.30-3(a)(12).

## EXHIBIT 5

## MIAMI INTERNATIONAL SECURITIES EXCHANGE, LLC

## Proposed Rule Change

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It is proposed that the following provisions of the Miami International Securities Exchange Rules be amended as set forth below. [Bracketed] text indicates material to be deleted and underlined text indicates material to be added.

**Rule 521. Obvious and Catastrophic Errors.**

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**(a)-(g)** No change.

...Interpretations and Policies

.01-.05. No change

.06 Transactions in MIAX options that overly an NMS Stock that occur during a Limit or Straddle State are not subject to review under Rule 521. The Exchange shall apply Rule 530(j) to such transactions.

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**Rule 530. Limit Up-Limit Down****(a) – (i)** No change

**(j) Review of Erroneous Transactions Occurring During Limit States and Straddle States.** Once an NMS Stock has entered a Limit or Straddle State, the Exchange shall nullify a transaction in an option overlying such an NMS Stock as provided in this Rule. Rule 530(j) will be effective on a one year pilot basis beginning on the date of implementation of the Plan. The Exchange will provide the Commission with data and analysis during the duration of this pilot as requested.

(1) Absent Mutual Agreement as provided in paragraph (j)(2)(iii) below, parties to a trade may have a trade nullified if:

(i) any such party makes a documented request within the time specified in Rule 530(j)(5)(i); and

(ii) one of the conditions below is met:

(A) The trade resulted from a verifiable disruption or malfunction of an Exchange execution, dissemination, or communication system that caused a quote/order to trade in excess of its disseminated size (e.g. a quote/order that is frozen, because of an Exchange System error, and repeatedly traded) in which case trades in excess of the disseminated size may be nullified; or

(B) The trade resulted from a verifiable disruption or malfunction of an Exchange dissemination or communication system that prevented a Member from updating or canceling a quote/order for which the Member is responsible where there is Exchange documentation providing that the Member sought to update or cancel the quote/order; or

(C) The trade resulted from an erroneous print disseminated by the underlying market which is later cancelled or corrected by the underlying market where such erroneous print resulted in a trade higher or lower than the average trade in the underlying security during the time period encompassing two minutes before and after the erroneous print, by an amount at least five times greater than the average quote width for such underlying security during the time period encompassing two minutes before and after the erroneous print. For purposes of this Rule, the average trade in the underlying security shall be determined by adding the prices of each trade during the four minute time period referenced above (excluding the trade in question) and dividing by the number of trades during such time period (excluding the trade in question); or

(D) The trade resulted from an erroneous quote in the primary market for the underlying security that has a width of at least \$1.00 and that width is at least five times greater than the average quote width for such underlying security during the time period encompassing two minutes before and after the dissemination of such quote. For the purposes of this Rule, the average quote width shall be determined by adding the quote widths of sample quotations at regular 15-second intervals during the four minute time period referenced above (excluding the quote in question) and dividing by the number of quotes during such time period (excluding the quote in question);

(iii) Mutual Agreement. The determination as to whether a trade was automatically executed at an erroneous price may be made by mutual agreement of the affected parties to a particular transaction within the time periods specified in subparagraphs (j)(1)(i) or (ii) below. A trade may be nullified on the terms that all parties to a particular transaction agree. In the absence of mutual agreement by the parties, a particular trade may only be nullified as provided in this Rule.

(iv) Trading Halts. Trades on the Exchange will be nullified when:

(A) The trade occurred during a trading halt in the affected option on the Exchange; or

(B) Respecting equity options (including options overlying ETFs), the trade occurred during a trading halt on the primary market for the underlying security.

(2) Review Procedure. MIAX Regulatory Control ("MRC") shall administer the application of this Rule as follows:

(i) Notification. If a Market Maker on the Exchange believes that he/she participated in a transaction that can be nullified pursuant to section (j) of this Rule, he/she must notify MRC within fifteen minutes of the transaction. If a Member that initiated the order believes a transaction on the Exchange can be nullified pursuant to section (j) of this Rule, such Member must notify MRC within twenty minutes of the execution. Absent unusual circumstances, MRC will not grant relief under this Rule unless notification is made within the prescribed time period. Notwithstanding the foregoing, respecting transactions that occur as part of the Exchange's automated opening process, after the twenty minute notification period as described above and until 4:30 p.m. Eastern Time ("ET") on the subject trade date, where parties to the transaction are a non-broker-dealer customer and an Exchange Market Maker, the non-broker-dealer customer may request review of the subject transaction, and the transaction will nullified by an Exchange Official.

(ii) Bust. An Exchange Official will determine whether there is a trade that qualifies to be nullified as defined in this Rule.

(3) Request for Review. If a party affected by a determination made under this Rule so requests within the time permitted, the CRO will review decisions made under this Rule. A request for review under this paragraph must be made within thirty minutes after a party receives official notification of a final determination by the Exchange Official under this Rule, except that if such notification is made after 3:30 p.m. Eastern Time, either party has until 9:30 a.m. Eastern Time on the next trading day to request a review. Such a request for review must be in writing or otherwise documented. The CRO shall review the facts and render a decision on the day of the transaction, or the next trade day in the case where a request is properly made after 3:30 p.m. on the day of the transaction or where the request is properly made the next trade day.

(i) Absence of the CRO. In the absence of the CRO, the deputy CRO or designee of the CRO will be appointed to act in this capacity.

(ii) Appeal Fee. A Member seeking the CRO's review of an Exchange Official ruling shall be assessed a fee of \$250.00 for each Exchange Official ruling to be reviewed that is sustained and not overturned or modified by the CRO.

(iii) Authority of the CRO. Decisions of the CRO concerning (i) the review of Exchange Official rulings relating to the nullification of transactions, and (ii) initial requests for relief shall be final and may not be appealed to the Exchange's Board.