



INTERNATIONAL SECURITIES EXCHANGE

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October 4, 2012

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

Re: File No. 10-207 (MIAX Form 1 Application)

Dear Ms. Murphy:

The International Securities Exchange, LLC ("ISE") appreciates the opportunity to comment on the Form 1 Application by the Miami International Securities Exchange, LLC ("MIAX").¹ Because a Form 1 Application for registration as a national securities exchange is not filed pursuant to Section 19(b) of the Securities Exchange Act of 1934 (the "Act") and Rule 19b-4 thereunder, the MIAX Application does not contain the same level of detailed description of the purpose of the proposed rules nor a robust discussion of how such rules are consistent with the requirements of the Act. While we do not believe such detail is necessary with respect to all aspects of the Application, particularly those that are common among existing exchanges, the ISE requests that certain unique aspects of the proposed rules be clarified and that in any approval order the Commission discuss how such rules are consistent with the Act with the same level of detail that the Commission will require of existing exchanges if they were to adopt similar rules pursuant to Rule 19b-4. In particular, the ISE believes that a full discussion of proposed Rule 514 regarding priority of quotes and orders and Rule 515 regarding the processing of orders and quotes, is warranted, as there are aspects of these rules that may raise new issues not previously addressed by the Commission.

Hidden Prices

In the section entitled "Display of Orders and Quotations" in Exhibit E to the Application, MIAX represents that orders and quotes will be displayed except in four specified instances. This is followed by statements that locked or crossed markets will not be displayed, and that orders and quotes submitted to the Exchange will be displayed at the price specified by the submitting Member. However, it appears that there are additional instances, other than the four identified in the discussion, where orders or quotes may be displayed at a price that is different from (worse than) the price at which they are executable on MIAX: (i) Professional Interest and Priority Customer

¹ Exchange Act Release No. 67660 (August 16, 2012), 77 FR 50184 (August 20, 2012).

Orders marked Do Not Route (“DNR”)² that lock or cross the NBBO will be displayed one Minimum Price Variation (“MPV”) away from the current opposite side NBBO, but such orders will remain executable at a price that locks the NBBO;³ and (ii) market maker quotes and orders that would trade through the ABBO will be displayed one MPV away from the current opposite side NBBO, but such quotes or orders will remain executable at a price that locks the NBBO.⁴

The Commission has previously considered and approved non-displayed penny orders, which are limit orders that specify a one-cent price increment in a security that has an MPV that is larger than one-cent. Such orders are executable at their penny limit price, but are displayed at the next worse MPV.⁵ ISE notes that these orders were approved within the particular circumstance where the MPV limited the ability of market participants to trade in penny increments, and that such options now represent a very small percentage of total options industry volume. In contrast, MIAX proposes to handle orders and quotes in a manner that will permit non-displayed prices in the regular trading increments in all options classes. ISE and other market participants opposed the approval of hidden penny orders, as we believe such orders decrease transparency and further internalization of order flow without sufficient exposure to the marketplace. Because the MIAX proposal to handle orders and quotes in a manner that will create hidden prices on its market is much broader than what has been previously approved by the Commission, we believe this aspect of the MIAX proposal warrants specific consideration by the Commission and specific discussion of the statutory basis for approving such broad hidden interest in regular trading increments.⁶

² Proposed MIAX Rule 516(f). It is unclear whether DNR orders are continuously re-priced or only re-priced once.

³ Proposed MIAX Rule 515(c)(1)(i)(A). There is inconsistency in the language of proposed Rule 515(c)(1)(i)(A), 515(c)(1)(ii)(A), 515(c)(2), and 516(f) regarding the execution price of a resting order that has a non-displayed execution price. Proposed Rule 515(c)(1)(i)(A), 515(c)(1)(ii)(A), and 515(c)(2) specify that orders will be booked at a price that internally locks the current opposite side NBBO, and that such orders remain available for execution up to their original bid or down to their original offer. These rules also provide that incoming orders will be executed against such orders at their booked price “provided that the execution price does not violate the current NBBO.” While these rules provide for the repricing of the displayed price of these orders, it is unclear from the rules whether the non-displayed portion is also re-priced and in what circumstances the booked price would differ from the NBBO. Rule 516(f) states that any incoming order interacting with a resting DNR order “will receive the better of the best away market price or the DNR order’s limit price” and does not contain the provision “provided that the execution price does not violate the current NBBO.” Thus, ISE seeks clarification as to the non-displayed execution price of orders under these rules and confirmation that they will not be executed at a price that would trade-through the NBBO. ISE also seeks clarification regarding reference to the “away best bid/offer” in proposed Rule 516(f), as opposed to the defined terms ABBO or NBBO, and whether orders are continuously re-priced or re-priced only once pursuant to proposed Rule 515(c)(2).

⁴ Proposed MIAX Rule 515(d). ISE seeks clarification as to whether market maker quotes and orders are continuously re-priced or re-priced only once.

⁵ *E.g.*, ISE Rule 715(b)(4); proposed MIAX Rule 516(b)(4).

⁶ In this respect, we note that proposed Rule 520, which contains requirements for exposing orders before they are internalized, addresses hidden penny orders (Interpretations and Policies .03), but not the hidden prices that will result from the provisions of Rule 515(c) and (d) and the display of DNR orders.

Trade-Through Protection for Customer Orders

MIAX proposes to provide intermarket trade-through protection by routing orders to other exchanges pursuant to proposed Rule 515(c) and proposed Rule 529.⁷ However, these provisions are limited to “Priority Customer Orders” which is a subset of “Customer Orders.” When the ISE championed the creation of the “Priority Customer” category of market participants, it specifically provided that all “Customer Orders” would continue to be handled the same for the purposes of complying with the prohibition on trade throughs and locked and crossed markets contained in the Intermarket Linkage Plan and related ISE linkage rules. Because ISE did not propose to discriminate between Priority Customers and those “Customers” that are not within the definition of a Priority Customer with respect to linkage processing, the Commission was not required to analyze whether such discrimination was consistent with the provisions of the Intermarket Linkage Plan, nor whether it was appropriate and reasonable under the Act. Accordingly, the ISE believes a full discussion of this aspect of the MIAX Application is warranted.

Execution Priority and Entitlements

MIAX proposes to adopt an execution priority rule that contains two different methodologies (price-time or pro-rata based on size) with several different priority overlays and market maker entitlements. If filed pursuant to Rule 19b-4, the purpose section of the filing would contain a detailed description of how these different priority overlays would operate, perhaps with examples for clarity. Additionally, the statutory basis for each aspect of the proposed rule would be set forth by the Exchange. Due to the absence of this level of detail in the Form 1 Application, we request that the Commission seek clarification regarding the operation of proposed Rules 514 and 515, and provide a detailed discussion regarding the statutory bases for their approval.

- Allocation Priority Rule: Generally speaking, it is difficult to understand how the different combinations of the allocation methodologies (price-time or pro-rata based on size), priority overlays, and entitlements will work. While we recognize that this rule text construction is contained in the rules of other options exchanges, there is no discussion on how MIAX intends to implement these provisions. For example, if the pro-rata allocation method is applicable with both the Priority Customer Overlay and the Market Turner Overlay, and a non-priority market maker quote is the Market Turner but there are also priority quotes at the same price, how are trades allocated? Does the Market Turner get filled before Priority Customer Orders? Do Priority Customer Orders get filled before the Market Turner? If Priority Customers get filled before the Market Turner, does the Market Turner get filled before or after priority quotes at the same price? If there are no Priority Customer Orders at the best price in the above example, the incoming order is for three contracts, and the Primary Lead Market Maker has a

⁷ The ISE seeks clarification with respect to the use of the term NBBO in Rule 515 and the use of the term ABBO in Rule 529.

priority quote at that price, does the Market Turner or the Primary Lead Market Maker get priority?⁸

- **Applicability of Priority Quotes:** Rule 514(e) provides that “[i]f there is other interest at the NBBO, after all Priority Customer Orders (if any) at that price have been filled, executions at the NBBO will be first allocated to Market Maker priority quotes which have precedence over Professional Interest. . .” ISE seeks clarification as to whether market maker priority quotes have precedence over other professional interest under both the price-time methodology and the pro-rata methodology. ISE also seeks clarification as to the precedence of market maker priority quotes when executing Intermarket Sweep Orders at a price that is inferior to the NBBO.
- **Statutory Basis for Priority Quotes Precedence.** A “priority quote” is a two-sided quote pair with a width that is no greater than the maximum bid/ask differentials contained in proposed MIAX Rule 603(b)(4).⁹ ISE notes in this respect that the maximum bid/ask differential in Rule 603(b)(4) is \$5 during regular trading hours, which is the common minimum standard among the options exchanges currently. Although the text of proposed Rule 603(b)(4) is the same as ISE Rule 803(b)(4), it appears that the application is quite different: ISE market makers are subject to disciplinary action if they fail to quote within the \$5 spread requirement, whereas MIAX market makers will be rewarded with higher execution priority for meeting the minimum standard.¹⁰ ISE believes exchanges should have wide latitude for determining execution priority in their market places (particularly among professional interest), but is concerned that the Commission apply consistent standards when determining whether proposed priority advantages are consistent with the Act. For example, in the case of providing market makers enhanced allocation rights, there are heightened quotation requirements with respect to the number of series quoted (*i.e.*, 90% of the series) on all options exchanges that provide such enhanced allocations (including the proposed MIAX rule regarding Directed Lead Market Makers).¹¹ In the case of MIAX’s market

⁸ As a general matter, we believe it is increasingly important for exchange rules to clearly state how their priority rules operate. As press reports indicate, complex and non-transparent exchange priority rules can confuse investors, and, at worst, provide unfair advantages to certain market participants. See the discussion of “Hide Not Slide” orders at “For Superfast Traders, a Way to Jump to Ahead in Line,” *Wall Street Journal*, September 19, 2012; and the video “Hide Not Slide: the Sneaky Side of Wall Street,” <http://live.wsj.com/video/hide-not-slide-the-sneaky-side-of-wall-street/1BC318A7-6F26-421E-B299-C296E63A4CDA.html#!1BC318A7-6F26-421E-B299-C296E63A4CDA>. The MIAX priority rules are confusing and far from transparent. MIAX should clarify the operation of these priority overlays to provide greater transparency to the market.

⁹ Proposed MIAX Rule 517(b)(1)(i).

¹⁰ ISE believes the language of Rule 603 needs to be amended so it is clear that there is no maximum market maker quotation spread requirement during regular market hours, as it does not appear that market makers are subject to disciplinary action if their quotation spreads exceed \$5. Rather it appears that the \$5 maximum quotation spread is a minimum standard for receiving allocation priority under Rule 517(b)(1)(i).

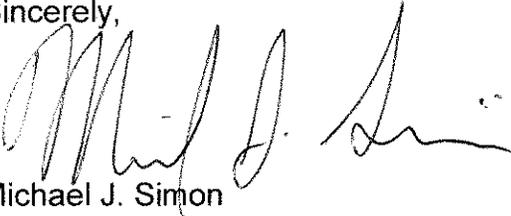
¹¹ *E.g.*, ISE Rule 804(e)(2)(iii) (providing that Preferred Competitive Market Makers maintain quotations in at least 90% of the series of any options class in which it receives Preferred Orders); proposed MIAX Rule 514(d)(4) (providing entitlements to Directed Lead Market Makers) and proposed MIAX Rule

maker priority quotes, however, the proposed "heightened" quotation requirement is simply that the market makers comply with what is the common minimum quotation spread requirement on other options exchanges. The ISE does not necessarily object to this approach, but given the relatively low threshold, we request that the Commission provide in any approval order a thorough discussion of the statutory basis for discriminating among market makers and other Professional Interest on this basis so that the existing Exchanges have a clear understanding of the Commission's analysis and the standards being applied.

* * *

As discussed above, ISE believes certain aspects of the MIAX Application require clarification. In the interest of fair competition, ISE also requests that the Commission provide in any approval order detailed analysis of the basis under the Act for approving the unique aspects of the proposed MIAX rules.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael J. Simon". The signature is fluid and cursive, with a large initial "M" and "S".

Michael J. Simon
Secretary

cc: Robert Cook, Director, Division of Trading and Markets
James Burns, Deputy Director, Division of Trading and Markets
Heather Seidel, Associate Director, Division of Trading and Markets

604(e)(2) (providing that Lead Market Makers maintain continuous two-sided quotes in 90% of the series in each of their appointed classes).