SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-70007; File No. SR-MIAX-2013-21)

July 19, 2013

Self-Regulatory Organizations; Miami International Securities Exchange LLC; Order Approving Proposed Rule Change to Modify the Allocation of Directed Orders in Specific Limited Situations

I. Introduction

On May 22, 2013, Miami International Securities Exchange LLC (the “Exchange” or “MIAX”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1)1 of the Securities Exchange Act of 1934 (“Act”),2 and Rule 19b-4 thereunder,3 a proposed rule change to modify its practice of allocating Directed Orders. The proposed rule change was published for comment in the Federal Register on June 7, 2013.4 The Commission did not receive any comments on the proposal. This order approves the proposed rule change.

II. Description of the Proposal

The Exchange’s proposal amends MIAX Rule 514 to modify the allocation of Directed Orders5 to provide that a Directed Lead Market Maker (“DLMM”) will always receive a minimum participation allocation of at least one (1) contract. Specifically, the proposal ensures that the DLMM will be allocated a minimum of one contract in situations where, due to the Exchange’s allocation calculation methodology and the fact that the Exchange system rounds

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down any fractional contract size allocations, the DLMM participation entitlement allocation
would otherwise have resulted in the DLMM being allocated zero contracts.

Currently, MIAx Rule 514(h)(1) provides the formula used to calculate the DLMM
participation entitlement. The Rule provides that the DLMM participation entitlement is equal to
the greater of: (i) the proportion of the total size at the best price represented by the size of its
quote; (ii) sixty percent (60%) of the contracts to be allocated if there is only one (1) other
Market Maker quotation at the NBBO; or (iii) forty percent (40%) if there are two (2) or more
other Market Maker quotes at the NBBO. According to MIAx, the DLMM participation
entitlement algorithm works well when applied to Directed Orders of a contract size of three (3)
or more. However, as MIAx explained in the Notice,6 for Directed Orders of a contract size of
two (2) or fewer, the DLMM participation entitlement allocation may result in an allocation of
zero due to the fact that the Exchange system rounds down any fractional contract size
allocations.7 MIAx provided several examples in the Notice to illustrate how, in such instances,
a Lead Market Maker to whom the order was specifically directed does not receive a contract
allocation.

The MIAx proposal amends Rule 514(h)(1) to add a provision to ensure that DLMMs
receive at least one contract of an incoming Directed Order. Thus, under the proposed rule
change, a DLMM will be entitled to the greatest of: (i) the pro-rata share; (ii) 40% or 60% of the
incoming Directed Order (depending on the number of other Market Makers quoting along with
the DLMM, as described above); or (iii) one (1) contract. Accordingly, MIAx’s proposal will
allow the Exchange to ensure that the Electronic Exchange Member’s (“EEM”) Directed Order

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6 See Notice, supra note 4.
7 MIAx expressed its belief in the Notice that other competing exchanges may instead
round up in certain situations where there is a fractional contract size allocation. See
Notice, supra note 4.
would trade a minimum of one contract with the quote of the DLMM, when the DLMM participation entitlement applies.

III. **Discussion and Commission Findings**

The Commission has carefully reviewed the proposed rule change and finds that it consistent with the requirements of the Act. Specifically, the Commission believes it is consistent with Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be 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 mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission notes that a Directed Order is an order that an EEM enters into the MIAX system and directs to a particular Lead Market Maker. As such, EEMs have a reasonable expectation that, in most situations when the DLMM participation entitlement applies, the EEM’s Directed Order will interact and execute at least partially with the quote of the DLMM. However, under MIAX’s current rules, solely because of MIAX’s practice of rounding down

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8  15 U.S.C. 78f. In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).


10 The Commission notes, however, that there may be other situations where the DLMM may not have the opportunity to interact with the Directed Order. For example, the DLMM participation entitlement applies only to any remaining balance after Priority Customer orders have been satisfied. See MIAX Rule 514(g). MIAX Rule 100 defines “Priority Customer” as “a person or entity that (i) is not a broker or dealer in securities, and (ii) does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s).”
factional contract sizes\textsuperscript{11} and its current allocation formula, Directed Orders with a contract size of two or less may result in the DLMM being allocated zero contracts. The Commission believes that it is appropriate to allow MIAX to revise its rules to account for this limited situation and ensure that DLMMs will receive at least one contract of any order that is directed to them when the DLMM’s participation entitlement applies.\textsuperscript{12} The Commission believes that this change will allow the rule to operate as anticipated by EEMs, providing greater certainty of execution with regard to Directed Orders. Further, the proposed rule change allows MIAX to effectuate one of the purposes of the Directed Order participation entitlement; namely, to reward DLMMs for attracting order flow to the Exchange.

The Commission notes that this rule change will not impact the application of other participation entitlements. For instance, MIAX Rule 514(i)(1) provides that a PLMM may receive either the PLMM entitlement or, if applicable, the DLMM entitlement, but not both. As such, although this proposal will change the allocation for Directed Orders of two or fewer contacts, it will not, in any way, affect the small order participation guarantee for PLMMs in MIAX Rule 514(g)(2) or allow DLMMs to receive both the small order participation entitlement in that rule and the Directed Order participation entitlement in Rule 514(h). Additionally, under MIAX Rule 514(h)(4), the PLMM and DLMM participation entitlements never allow for an allocation that is greater than the quantity of contracts quoted by the PLMM or DLMM. Furthermore, the Commission notes that the proposed change will not affect Priority Customers

\textsuperscript{11} MIAX noted that other exchanges may not have the same issue with Directed Orders because their systems round up instead of down where there are fractional contract size allocations. See supra note 7.

\textsuperscript{12} See supra note 10 (concerning the possibility that a Priority Customer may have priority).
because DLMM participation entitlements may take effect only after all Priority Customer orders are satisfied.\textsuperscript{13}

For the foregoing reasons, the Commission believes that the proposed rule change is consistent with the Act.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act\textsuperscript{14} that the proposed rule change (SR-MIAX-2013-21), is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.\textsuperscript{15}

Kevin M. O’Neill
Deputy Secretary

\textsuperscript{13} See MIAX Rule 514(h).
\textsuperscript{14} 15 U.S.C. 78f(b)(2).
\textsuperscript{15} 17 CFR 200.30-3(a)(12).