SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-88872; File No. SR-MIAX-2020-11)

May 14, 2020

Self-Regulatory Organizations; Miami International Securities Exchange, LLC; Notice of Filing of a Proposed Rule Change to Amend Exchange Rule 518, Complex Orders, to Adopt New Interpretation and Policy .08, Related Futures Cross ("RFC") Order Type

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934

("Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on May 11, 2020, Miami

International Securities Exchange, LLC ("MIAX Options" or the "Exchange") filed with the

Securities and Exchange Commission ("Commission") a proposed rule change as described in

Items I and II 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 518, Complex Orders.

The text of the proposed rule change is available on the Exchange's website at

http://www.miaxoptions.com/rule-filings/ at MIAX Options' 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

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[1]     15 U.S.C. 78s(b)(1).

[2]     17 CFR 240.19b-4.

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.      <u>Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change</u>

      1.      <u>Purpose</u>

The Exchange proposes to amend Exchange Rule 518, Complex Orders, to adopt a new Related Futures Cross ("RFC") order type.

In April of 2018, the Exchange adopted a proposal to list and trade on the Exchange options on the SPIKES™ Index ("SPIKES" or the "Index"), a new index that measures expected 30-day volatility of the SPDR S&P 500 ETF Trust.[3] Options on the Index are cash-settled and have European-style exercise provisions.[4]

There are currently no futures listed on the Index, therefore Members[5] of the Exchange who want to hedge a position in SPIKES options using futures have to hedge using highly correlated related instruments, such as VIX futures. While the SPIKES Index is highly correlated to the VIX Index (SPIKES is over 99% correlated to VIX), there remains some basis risk[6] between the two products. That basis risk can be exacerbated in times of extreme volatility, such as we are currently experiencing in the markets. Both the SPIKES Index and VIX Index settle on

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[3]    <u>See</u> Securities Exchange Release No. 83619 (July 11, 2018), 83 FR 32932 (July 16, 2018) (SR-MIAX-2018-14).

[4]    <u>See</u> Exchange Rule 1809(a)(4).

[5]    The term "Member" means an individual or organization approved to exercise the trading rights associated with a Trading Permit. Members are deemed "members" under the Exchange Act. <u>See</u> Exchange Rule 100.

[6]    Basis risk is the financial risk that offsetting investments in a hedging strategy will not experience price changes in entirely opposite directions from each other. This imperfect correlation between two investments creates the potential for excess gains or losses in a hedging strategy, thus adding risk to the position. James Chen, *Basis Risk*, Investopedia (June 16, 2019), https://www.investopedia.com/terms/b/basisrisk.asp.

the same day, at the market's open, but using options on two different, but highly correlated, products. The SPIKES settlement value is determined using the opening prices on the Exchange of SPY options which expire in 30 days, whereas the VIX settlement value is determined using the opening prices on the Cboe Exchange of the SPX options which expire in 30 days. While the two products (SPY and SPX) are highly correlated, there are supply and demand variances that can occur at settlement which can cause the settlement prices of the two indexes (SPIKES and VIX) to diverge. For example, the settlement which occurred on March 18, 2020 illustrates this divergence.

| Index | 3/17/20 Close | 3/18/20 Close | 3/18/20 Settlement |
|---|---|---|---|
| SPIKE | 75.51 | 77.77 | 77.64 |
| VIX | 75.91 | 76.45 | 69.76 |
| Difference (SPIKE - VIX) | -0.40 | 1.32 | 7.88 |

As illustrated above demand for SPY options expiring on April 17, 2020, was relatively neutral, however there was selling pressure in those options representing the VIX settlement, (SPX options), which caused a significant divergence in the settlement prices of the indexes.

The impact this divergence has on a hedged position can be seen in the following example.

<u>Example 1</u>

Firm A has a long position of 10,000 SPIKES call options that are deep-in-the-money.[7]
Firm A has also sold 1,000 VIX futures contracts to hedge their position.
(SPIKES options have a $100 multiplier; VIX futures have a $1,000 multiplier)

To unwind the position Firm A has two options:
1. Wait until expiration and allow both the SPIKES calls and the VIX futures to expire into cash; or
2. Unwind the position by transferring the risk from the VIX futures into SPIKES options by simultaneously:
   a. Buying back the short VIX futures position; and
   b. Selling the long SPIKES options position by selling SPIKES option combos

If Firm A chooses option 1 and allows the position to expire, Firm A assumes additional market risk by assuming the basis risk at settlement. Under this scenario if Firm A had allowed the long SPIKES options position and the short VIX futures position to expire at the March 2020 settlement, the Firm would have realized an unplanned profit of 7.88M (7.88 x 10,000 x $100). However, the settlement variance could have gone in the opposite direction and resulted in an unplanned loss for Firm A.

If Firm A chooses option 2, Firm A must use a broker to find a party to take the other side of the position (contra party), which is a hedged position in highly correlated products, with some basis risk. Since these are highly correlated indexes (SPIKE and VIX), if one were to find another participant (or participants), the optimal transaction would be to trade the 10,000 SPIKES option combos and 1,000 VIX futures as a single trade. If a contra party (Firm B) to the

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[7]      A deep in the money option has an exercise, or strike price, significantly below (for a call option) or above (for a put option) the market price of the underlying asset. James Chen, *Deep In The Money*, Investopedia (April 30, 2019), https://www.investopedia.com/terms/d/deepinthemoney.asp

trade can be located, Firm A and Firm B will have to agree to a price for the "package." Once a price is agreed upon there will have to be two trades between the parties as the products trade on two different market centers with the options trading only on the MIAX Options Exchange and the VIX futures trading only on the Cboe Futures Exchange ("CFE").

To facilitate this type of exchange, the Exchange is proposing to adopt a new order type that will permit a Member to convert their hedge in VIX futures into SPIKES options combos, a synthetic equivalent, that does not carry any basis risk (the proposed order type can also be used to exchange SPIKES options combos for a corresponding futures position in order to reduce margin and capital requirements). If both the SPIKES option combos on MIAX Options and the VIX futures on the CFE are executed as a "clean cross" Firm A is left with a long position of 10,000 SPIKES calls perfectly hedged with 10,000 short SPIKES option combos, while Firm B has a hedged position long 10,000 SPIKES options combos and a short position of 1,000 VIX futures. If the transaction is not executed as a clean cross and the options transaction is exposed to the market, there is an additional risk that a 3rd party could join the transaction on MIAX Options and purchase 5,000 SPIKES options, which would leave Firm B with a long position of 5,000 SPIKES option combos, but a short position of 1,000 VIX futures, leaving a portion of the transaction unhedged.

Therefore, the Exchange now proposes to amend Interpretations and Policies of Exchange Rule 518, to adopt new Policy .08, Related Futures Cross ("RFC") Orders. The Exchange proposes to adopt rule text that will provide that: (a) An EEM[8] may execute an RFC

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[8]     The term "Electronic Exchange Member" or "EEM" means the holder of a Trading Permit who is not a Market Maker. Electronic Exchange Members are deemed "members" under the Exchange Act. See Exchange Rule 100.

order, which is comprised of a SPIKES options combo coupled with a contra-side order or orders totaling an equal number of option combo orders, which is identified to the Exchange as being part of an exchange of option contracts for related futures positions. For purposes of RFC orders:

(1) In order to execute an RFC order an EEM must submit the RFC to the System,[9] which may execute automatically on entry without exposure.

(2) An EEM may execute an RFC order pursuant to subparagraph (1) above only if: (i) each option leg executes at a price that complies with Exchange Rule 518(c), provided that no option leg executes at the same price as a Priority Customer Order[10] in the Simple Book; (ii) each option leg executes at a price at or between the NBBO[11] for the applicable series; and (iii) the execution price is better than the price of any complex order resting in the Strategy Book,[12] unless the RFC order is a Priority Customer Order and the resting complex order is a non-Priority Customer Order, in which case the execution price may be the same as or better than the price of the resting complex order. The System cancels an RFC order if it cannot execute.

(3) An RFC order may only be entered in the standard increment applicable to the class under Rule 518(c)(1).

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[9]   The term "System" means the automated trading system used by the Exchange for the trading of securities. See Exchange Rule 100.

[10]   The term "Priority Customer" means 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). See Exchange Rule 100.

[11]   The term "NBBO" means the national best bid or offer as calculated by the Exchange based on market information received by the Exchange from OPRA. See Exchange Rule 100.

[12]   The "Strategy Book" is the Exchange's electronic book of complex orders and complex quotes. See Exchange Rule 518(a)(17).

(4) For purposes of this subparagraph (a), a SPIKES options combo is a two-legged order with one leg to purchase (sell) SPIKE calls and another leg to sell (purchase) the same number of SPIKE puts with the same expiration date and strike price.

(5) For purposes of this subparagraph (a), an exchange of option contracts for related futures positions is a transaction entered into by market participants seeking to swap option positions with related futures positions with related exposures.

(a) A related futures position is a position in a futures contract with either the same underlying as, or a high degree of price correlation to, the underlying of the option combo in the RFC order so that the execution of the option combos in the RFC order would serve as an appropriate hedge for the related future positions.

(b) In an exchange of contracts for related positions, one party(ies) must be the buyer(s) of (or the holder(s) of) the long market exposure associated with the options positions and the seller(s) of corresponding futures contracts and the other party(ies) must be the seller(s) of (or holder(s) of) the short market exposure associated with the options positions and the buyer(s) of the corresponding futures contracts.[13] The quantity of the option contracts executed as part of the RFC order must correlate to the quantity represented by the related futures position portion of the exchange.

(6) An RFC order may be executed only during Regular Trading Hours and contemporaneously with the execution of the related futures position portion of the exchange.

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[13]     As proposed, one side of the cross will consist of one party, and the other side may consist of multiple parties.

(7) The transaction involving the related futures position of the exchange must comply with all applicable rules of the designated contract market on which the futures are listed for trading.

A "clean cross" transaction which is not broken up is the optimal transaction for executing this type of transaction because it allows both components of the transaction to be executed in their entirety.[14] If the trade is exposed on the Exchange it is subject to an additional risk that it is broken up, leaving one party with an unhedged position. These types of exchanges are permitted for products listed on the Cboe Futures Exchange LLC ("CFE") pursuant to CFE Rule 414. The Exchange understands from customers that the need to reduce risk is prevalent in SPIKES based on current market conditions. The proposed rule change will provide market participants with the ability to exchange a corresponding futures position with a SPIKES options position, and also to exchange a SPIKES options position for a corresponding futures position, depending upon the position being held by the participant and the current market circumstances, provided that the transaction involving the related futures position complies with all applicable rules of the designated contract market on which the futures are listed for trading. This will allow market participants to reduce the basis risk, or better manage capital requirements, in their hedged portfolios while maintaining the same risk exposure.

The proposed rule will require that the executing EEM identify these crosses as related to an exchange for related positions. As a result, the Exchange's Regulatory Department has put in place a regulatory review plan that will permit it to ensure that any RFC orders that are executed are done in conjunction with an exchange of contract for related positions as required by the

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[14]     A Qualified Contingent Cross Order is similarly executed as a clean cross. See Exchange Rule 516(j).

proposed rule. This proposed rule is substantially based upon the functionality described in Cboe Exchange Rule 5.24(e)(1)(D).[15]

2. Statutory Basis

MIAX believes that its proposed rule change is consistent with Section 6(b) of the Act[16] in general, and furthers the objectives of Section 6(b)(5) of the Act[17] 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.

The Exchange believes that the proposed rule change will remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general protect investors and the public interest. The proposed rule change will provide market participants with the ability to exchange SPIKES options positions with corresponding futures positions, or exchange corresponding futures positions with SPIKES options positions. This will allow market participants to reduce basis risk, or better manage capital requirements, in their hedged portfolios while maintaining the same risk exposure.

The Exchange believes that the proposed rule change is consistent with the Act as it promotes just and equitable principles of trade and facilitates transactions in securities. The Exchange believes that because these orders must be executed on separate exchanges that

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[15] See Securities Exchange Release No. 88447 (March 20, 2020) 85 FR 17129 (March 26, 2020) (SR-CBOE-2020-023).

[16] 15 U.S.C. 78f(b).

[17] 15 U.S.C. 78f(b)(5).

executing these orders as a clean cross is justified as it allows them to achieve their intended purpose to reduce basis risk or better manage capital and margin requirements. Additionally, as the purpose of these trades is an exchange of risk in a hedged position, the Exchange believes it is appropriate to not expose these orders, as exposing these orders to the market introduces the risk that one side of the hedged transaction could be broken up, leaving one party with an unhedged position.

The Exchange believes that the proposed rule change, which is limited to a single class of a proprietary product listed only on the Exchange, is narrowly tailored for the specific purpose of exchanging a corresponding futures positions with a SPIKES options position, or to exchange a SPIKES options positions with a corresponding futures positions, to reduce basis risk and/or better manage capital requirements. The proposed rule change provides the Exchange with substantially the same functionality currently permitted on the Cboe Exchange.[18] The Exchange believes that this proposal does not present any novel or unique issues because at least one other exchange has a substantially similar rule.[19]

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

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

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[18]      See Cboe Exchange Rule 5.24(e)(1)(D).

[19]      Id.

competition, as the Rules of the Exchange apply equally to all Exchange Members,[20] and any

Member of the Exchange may use the RFC order type.

The Exchange does not believe the proposed rule change will impose any burden on

inter-market competition because the proposed rule change applies only to products listed on the

Exchange. Additionally, the proposed order type is intended to accommodate riskless

transactions for parties that are not seeking price improvement, but rather looking to swap risk

exposure, and therefore is not intended to have a competitive impact. Further, the proposed rule

is substantially similar to a rule on the Cboe Exchange and may promote inter-market

competition.[21]

        C.    <u>Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others</u>

Written comments were neither solicited nor received.

III.    <u>Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action</u>

Within 45 days of the date of publication of this notice in the <u>Federal Register</u> or within

such longer period up to 90 days (i) as the Commission may designate if it finds such longer

period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-

regulatory organization consents, the Commission will:

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

(B) institute proceedings to determine whether the proposed rule change should be

disapproved.

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20    The term "Member" means an individual or organization approved to exercise the trading rights associated with a Trading Permit. Members are deemed "members" under the Exchange Act. <u>See</u> Exchange Rule 100.

21    <u>See</u> <u>supra</u> note 19. [sic]

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. Please include File Number SR-MIAX-2020-11 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-MIAX-2020-11. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change.

Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MIAX-2020-11, 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.[22]

J. Matthew DeLesDernier
Assistant Secretary

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[22]     17 CFR 200.30-3(a)(12).