Regulatory Circular RG02-28

Date: April 23, 2002

From: Department of Market Regulation

Re: Position and Exercise Limits

Contacts: Pat Cerny (312) 786-7722
Mike Felty (312) 786-7504

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Expanded Equity Hedge Exemption for Position and Exercise Limits Effective Immediately

On March 20, 2002, the Securities and Exchange Commission approved rule filing CBOE SR00-12 regarding the elimination of position and exercise limits in equity options contracts, including QQQ options, for certain qualified hedge strategies. The SEC also approved an increase of the equity hedge exemption to five (5) times the base limit when a hedge transaction includes an Over-the-Counter ("OTC")* option as detailed below:

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Key Points

- **The hedge exemption is automatic; documentation, if applicable, must be provided to the Exchange on the trade date after the exempt position is established. Please see below for details regarding the reporting of a stock hedge.**

- **Position and exercise limits will not apply to the following hedge strategies described in paragraphs (1) through (5). Hedge transactions and positions described in paragraphs (6) and (7) are subject to a position and exercise limit equal to five (5) times the standard limit:**

(1) Where each option contract is "hedged" or "covered" by 100 shares of the underlying security or securities convertible into such underlying security, or, in the case of an adjusted option contract, the same number of shares represented by the adjusted contract; (i) long call and short stock; (ii) short call and long stock; (iii) long put and long stock; (iv) short put and short stock.

(2) Reverse Conversion: A long call position accompanied by a short put position, where the long call expires with the short put, and the strike price of the long call and short put is equal, and where each long call and short put position[1] is hedged with 100 shares of short stock (or other adjusted number of shares) or a security convertible into such stock.

(3) Conversion: A short call position accompanied by a long put position where the short call expires with the long put, and the strike price of the short call and long put is

[1] For the reverse conversion, conversion and collar strategies, the option component of the transaction (i.e. 1 call and 1 put) will be counted as one (1) contract and must be hedged with 100 shares of the underlying security to qualify for the hedge exemption. For example, if an account is short 5000 GE Apr 35 calls and long 5000 GE Apr 35 puts, and long 500,000 shares of GE stock, then the calls and puts are considered one 5,000 unit position.

equal, and where each short call and long put position is hedged with 100 shares of long stock (or other adjusted number of shares) or a security convertible into such stock.

(4) Collar: A short call position accompanied by a long put position, where the short call expires with the long put, and the strike price of the short call equals or exceeds the long put, and where each short call and long put position is hedged with 100 shares of long stock (or other adjusted number of shares). Neither side of the short call, long put position can be in-the-money at the time the collar position is established.

(5) A long call position accompanied by a short put position with the same strike price and a short call position accompanied by a long put position with the same strike price, which strike price is different than that of the first pair ("box spread").

(6) A listed option position hedged on a one-for-one basis with an over-the-counter ("OTC")* option position on the same underlying security. The strike price of the listed option position and corresponding OTC option position must be within one strike of each other and no more than one expiration month apart.

(7) For those strategies described under (2), (3), and (4) above, one component of the option strategy can be an OTC* option contract guaranteed or endorsed by the firm maintaining the proprietary position or carrying the customer account.

** An OTC option contract is defined as an option contract that is not listed on a National Securities Exchange or cleared at the Options Clearing Corporation.*

Standard Position and Exercise Limit: The standard limits for unhedged equity option classes remain at 13,500, 22,500, 31,500, 60,000 or 75,000 contracts, depending on the most recent six-month trading volume of the underlying security and the total number of shares outstanding in the underlying security, as set forth in Interpretation and Policy .02 to Exchange Rule 4.11. The QQQ option class is subject to a 300,000 contract limit.

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The above described hedge exemptions are in addition to the standard limit and other exemptions available under Exchange rules, interpretations and policies.

Reporting of Stock Hedge Information: For customer and clearing firm accounts, clearing members should report stock hedge information directly to SIAC utilizing the options hedge field on the Large Options Position Report (refer to NASD Notice to Members 97-56). Because market maker stock information is already reported to the Exchange, market makers need not report their stock hedge position.

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