

Date: December 10, 1993

Regulatory Circular RG93-65

To: Members

From: Department of Market Surveillance

Re: Position Limit Increases and Expanded Equity  
Hedge Exemption Policy

Position and Exercise Limit Increases

The Securities and Exchange Commission (SEC) has approved revisions to Exchange Rules 4.11 and 4.12, regarding equity option position and exercise limits, and Rules 24.4A. and 24.5, regarding position and exercise limits for industry index options. Accordingly, **effective December 20, 1993** position and exercise limits in equity options will be as follows:

OLD TIER	NEW TIER
3,000 contracts	4,500 contracts
5,500 contracts	7,500 contracts
8,000 contracts	10,500 contracts

With respect to industry index options, the revised position and exercise limit tiers are as follows: 5,500 [4,000] 7,500 [6,000] and 10,500 contracts [8,000].

Index	Old Limit	New Limit
S&P Bank	8,000	10,500
S&P Chemical	4,000	5,500
S&P Health Care	6,000	7,500
S&P Insurance	6,000	7,500
S&P Retail	4,000	5,500
S&P Transportation	6,000	7,500
Computer Software	6,000	7,500
Environmental	6,000	7,500
Biotech	8,000	10,500

## Equity Option Hedge Exemption

In 1988, the SEC approved an exemption for option contracts hedged by the underlying security. The following strategies where each option contract is hedged by 100 shares qualify for such an exemption; long call and short stock, ii) short call and long stock, iii) long put and long stock iv) short put and short stock. The hedge exemption rule has been expanded so that "securities readily convertible" into the underlying security may now be used as an options hedge. Although it is not required that the security be converted prior to using the exemption, the security must be readily convertible at the time the hedge is utilized. Moreover, the convertible security must be economically equivalent and closely track the underlying security. As is currently the rule, the total exempt and non-exempt amount cannot exceed twice the established limit. The hedge exemption may be applied without prior Exchange approval, however, the Department of Market Surveillance will review each situation on a case-by-case basis to determine if the convertible security meets the aforementioned requirements.

To qualify for such an exemption, generally the security should be held in the same account as the option position. Documentation in the form of internal account statements and other literature discussing the convertible security must be supplied to the Department of Market Surveillance no later than the business day following use of the hedge exemption. Firms may continue to use the Exchange prepared form titled "Equity Hedge Exemption Reporting Form" when reporting on behalf of public customers, however, additional information detailing the terms of the convertible security must be provided.

Last, the Exchange will deem a violation of position limits to have occurred if any excess option positions are not liquidated contemporaneously with a decrease in the hedging stock or stock equivalent position. Therefore, at all times, the option position must be hedged by the appropriate underlying security or equivalent to remain exempt from position limits.

For additional information or a copy of the current position limits please contact Pat Cerny at (312) 786-7722 or Karen Charleston at (312) 786-7724 in the Department of Market Surveillance.