



RULE  
ADOPTION  
NOTICE

**RAN-02-09**  
**April 18, 2002**

**TO: All PCX Members and Member Organizations**

**FROM: Department of Regulatory Policy**

**SUBJECT: Hedge Exemptions**  
**(File No. SR-PCX-2000-45)**

On April 11, 2002, the Securities and Exchange Commission approved the PCX's rule proposal that expands the definition of a "qualified" hedged position. The amendment: (1) eliminates position and exercise limits when certain qualified hedge strategies are employed; and (2) establishes a position and exercise limit of five times the standard limit for those strategies that include an OTC option contract.

Following is the text of the approved rule change. Questions regarding this bulletin may be directed to Cindy Sink at (415) 393-7926.

**EXHIBIT A**

**Text of the Rule Change<sup>1</sup>**

**¶4769 Position Limits**

Rule 6.8(a) – No change.

*Commentary:*

.01 - .06 – No Change.

.07 Equity Hedge Exemption. The following qualified hedging transactions and positions are exempt from the established position and exercise limits prescribed under Commentary .06 above. However, for back-to-back options or where one of the option components of a qualified hedge consists of an over-the-counter ("OTC") option, then the hedge exemption is limited to five times the established position limit. For purposes of this Rule, qualified hedge strategies or positions are defined as follows:

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<sup>1</sup> New text is underscored. Deleted text is in brackets.

(a) 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.

(b) 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 is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such stock (“reverse conversion”).

(c) 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 equal, and where each short call and long put position is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such stock (“conversion”).

(d) 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 the underlying security (or other adjusted number of shares). Neither side of the short call/long put position can be in-the-money at the time the position is established (“collar”).

(e) 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 a different strike price (“box spread”).

(f) 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 (“back-to-back options”).

(g) For those strategies described under (b), (c), and (d) 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.

(h) 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.