

Rule 7

General Trading Rules **[Index Options]**

Trading Sessions **[Introduction]**

Rule 7.1. [In general, the Rules of the PCX's Board of Governors applicable to the trading of stock options, in particular Rule 6, shall be applicable to the trading of index options as that term is defined below. Rule 7 supplements or replaces those rules relating to stock options where required by the nature of index options. In cases where Rule 7 is silent on an issue, the applicable section of the rules relating to stock options shall be read so as to apply to index options.] Unless otherwise ruled by the Board of Directors, the Exchange shall be open for the transaction of business daily except on Saturdays and Sundays. The hours at which trading sessions shall open and close shall be established by the Board of Directors.

Dealings upon the Exchange shall be limited to the hours during which the Exchange is open for the transaction of business. No OTP Holder or OTP Firm shall make any bid, offer or transaction upon the Floor or in the case of remote market makers through the facilities of the Exchange before the official opening of the Exchange and loans of securities may be made after those hours.

Commentary :

.01 The Board of Directors has resolved that transactions may be effected on the Options Floor of the Exchange or in the case of remote market makers through the facilities of the Exchange until 1:02 p.m. for equity options and until 1:15 for index options each business day at which time no further transactions may be made.

.02 The hours for trading options on Nasdaq-100 Index Tracking Stock will commence at 6:30 a.m. and end at 1:15 p.m. each business day, except the last trading day of each calendar month, when trading in options on Nasdaq-100 Index tracking Stock will end at 1:05 p.m.

[Definitions]

[Rule 7.1(a) The term "put" means an option contract under which the holder of the option has the right, in accordance with the terms and provisions of the option, to sell to the Clearing Corporation the index value times the index multiplier.

(b) The term "call" means an option contract under which the holder of the option has the right, in accordance with the terms of the option, to purchase from the Clearing Corporation the index value times the index multiplier.

(c) The term "index" shall mean the sum of the reported last sales on their primary market of those underlying securities which, as a group, have been designated by the Exchange as underlying an option contract, divided by the Divisor.

(d) The term "class" shall mean an option contract of the same type of option on the same group of underlying securities.

(e) The term "aggregate exercise price" shall mean the exercise price of the option contract times the index multiplier.

(f) The term "exercise price" shall mean the specified price per unit at which the index value may be purchased or sold upon the exercise of the option.

(g) The term "index multiplier" means the value designated by the Exchange by which the index is multiplied.

(h) The term "index value" in respect to a particular index shall mean the sum of the prices of the underlying securities divided by the Divisor, and as reported by the reporting authority for the index.

(i) The term "closing index value" shall be the last index value reported by the reporting authority on a business day. The reporting authority shall use the closing last sales of the underlying securities on their primary market to calculate the closing index value.

(j) The term "Divisor" shall mean that number which the sum of the reported last sales of the underlying securities are divided by to obtain the index value, as shall be designated by the Exchange pursuant to Rule 7.5.

(k) The term "underlying security" or "underlying securities" with respect to an index option contract means all of the stocks that are the basis for the calculation of the index.

(l) The term "reporting authority" in respect of a particular index means the institution or reporting service designated by the Exchange as the official source for calculating and disseminating the value of the index.

(m) The term "European-style option" means an option contract that can be exercised only on the last business day prior to the day it expires.

(n) The term "European-style index option" means an option contract on an industry or market index that can be exercised only on the last business day prior to the day it expires.

(o) The term "American-style option" means an option contract that can be exercised on any business day prior to expiration.

(p) The term "American-style index option" means an option contract on an industry or market index that can be exercised on any business day prior to expiration.

(q) The term "capped-style option" means an option contract that is automatically exercised when the cap price is reached or exceeded based upon the closing index value. If the cap price is not reached, the option can only be exercised at its expiration pursuant to the rules of the Options Clearing Corporation.

(r) The term "capped-style index option" is a capped-style option on a specific market index that is automatically exercised any time prior to its expiration when the cap price is less than or equal to the closing index value for calls or when the cap price is greater than or equal to the closing index value for puts.

(s) The term "cap-interval" means a value specified by the Exchange which, when added to the exercise price for such series (in the case of a series of calls) or subtracted from the exercise price for such series (in the case of a series of puts), results in the cap price for such series.

(t) The term "cap-price" means the exercise price plus the cap interval for a call or the exercise price minus the cap interval for a put. The cap price is assigned to the capped-style index option when listed.

(u) The term "Quarterly Index Expiration" or "QIX" means an index option contract that expires on the first business day of the month following the end of a calendar quarter.]

Holidays
[Index Multiplier]

Rule 7.2. [The index multiplier shall be 100 unless otherwise determined by the Exchange.] The Exchange will not be open for business on New Year's Day, Martin Luther King Jr. Day, Presidents' Day, Good Friday, Memorial Day, Independence Day, Labor Day, Thanksgiving Day and Christmas Day. The Board of Directors will determine whether to open the Exchange on Presidential Election Days.

When a holiday observed by the Exchange falls on a Saturday, the Exchange will not be open for business on the preceding Friday unless unusual business conditions exist, such as the ending of a monthly or yearly accounting period.

Access to Trading Facilities
[Designation of the Index
Broad-Based Index Options]

Rule 7.3(a)[(1). The underlying securities comprising the index shall be selected by the Exchange and may be revised from time to time to maintain the integrity and purpose of the index.] Non-OTP Holders or OTP Firms shall not consummate transactions on the trading floor.

(2) No single underlying security may have a weighted value greater than 50% of the index value at the time options on the index are opened for trading.

(3) An underlying security selected for inclusion in the index must meet the initial and maintenance listing standards in Rule 3.6 and Rule 3.7, if its weighted value represents 10% or more of the index value.

(4) If an index is comprised of 20 or fewer underlying securities, 50% of the index value must be derived from underlying securities meeting the initial listing standards in Rule 3.6 at the time options on the index are initially opened for trading. Thereafter, 40% of the index value must be derived from underlying securities meeting the maintenance listing standards in Rule 3.7.

(5) If an index is comprised of 21 or more underlying securities, 35% of the index value must be derived from underlying securities meeting the initial listing standards in Rule 3.6, at the time options on the index are initially opened for trading. Thereafter, 30% of the index value must be derived from underlying securities meeting the maintenance listing standards in Rule 3.7.

(6) If an index fails to meet the maintenance listing standards described in paragraphs (4) and (5), above, the Exchange shall either:

(A) withdraw approval for options on the index as provided in Rule 3.7 and Commentaries thereunder; or

(B) change the composition of the index so as to meet the initial listing standards contained in this Section.

(7) All underlying securities included in an index must be last sale reported on a real-time basis, through Consolidated Tapes A or B, or as National Market System securities (defined in SEC Rule 11Aa2-1, as amended) through the NASDAQ system.

(8) The initial and maintenance listing standards and procedures described in paragraphs (b) through (f), above, may be waived given exceptional circumstances, e.g., the structure of the companies in a particular industry.

(9) The requirement in Rule 3.6 that underlying securities be listed on a national securities exchange shall not be applicable to index option underlying securities.

(10) The requirements of Rule 7.3 shall apply unless otherwise determined by the Exchange and approved by the Securities and Exchange Commission.

Commentary:

.01 In addition to the requirements of Rule 7.3, the Exchange's Technology Index ("Index"), as designated "broad based" index, shall meet the following requirements:

(i) an average daily trading volume of at least 40,000 shares in the preceding six months for each underlying security selected for inclusion in the Index;

(ii) an average daily trading volume of at least 20,000 shares in the preceding six months for each underlying security included in the Index;

(iii) no more than 20% of the total weighting of the Index shall be represented by underlying securities that each have an average daily trading volume less than 75,000 shares in the preceding six months;

(iv) no underlying security shall represent more than 10% of the total weighting of the Index, unless such underlying security is exempted by the Exchange from this requirement. Only an underlying security that is already included in the Index shall be eligible for such an exemption. However, at no time shall any underlying security represent more than 15% of the total weighting of the Index:

(v) the five (5) heaviest weighted underlying securities shall represent no more than 25% of the total weighting of the Index; and

(vi) at least ten (10) industry sub-sectors representing a total of no less than eighty (80) underlying securities shall comprise the Index.

.02 The requirements set forth in Commentary .01 above shall be applied pursuant to semi-annual reviews of the underlying securities included in the Index.]

**[Designation of the Index
Narrow-Based Index Options]**

Rule 7.3(b). No employee, participant or person connected with or related to an OTP Holder or OTP Firm may participate in the Floor operations or transactions of any OTP Holder or OTP Firm of the PCX, unless he is registered with and approved by the Exchange prior to engaging in such activity. Such OTP Holder or OTP Firm shall be responsible for all the acts of such non-registered employee, participant, or person, while such non-registered employee, participant, or person is on the Floor of the Exchange. [The listing of a class of index options on

a new narrow-based index will be treated by the Exchange as a proposed rule change subject to filing with and approval by the Securities and Exchange Commission ("Commission") under Section 19(b) of the Exchange Act. A rule change proposing the listing of a class of index options on a new underlying index may be designated by the Exchange as constituting a stated policy, practice or interpretation with respect to the administration of this Rule 7.3(b) within the meaning of subparagraph (3)(A) of subsection 19(b) of the Exchange Act, thereby qualifying the rule change for effectiveness upon filing with the Commission if the Exchange prefiles with the Commission a draft copy of the rule change not less than one week before it is filed, and if the Exchange proposes to commence trading in the subject class of index options not earlier than 30 days after the date of filing, and if each of the following conditions is satisfied:

- (1) The options are designated as A.M.-settled index options;
- (2) The index is capitalization-weighted, price-weighted or equal dollar-weighted, and consists of ten or more component securities;
- (3) Each component security has a market capitalization of at least \$75 million, except that for each of the lowest weighted component securities in the index that in the aggregate account for no more than 10% of the weight of the index, the market capitalization is at least \$50 million;
- (4) Trading volume of each component security has been at least one million shares for each of the last six months, except that for each of the lowest weighted component securities in the index that in the aggregate account for no more than 10% of the weight of the index, trading volume has been at least 500,000 shares for each of the last six months;
- (5) In a capitalization-weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least 30% of the total number of component securities in the index each have had an average monthly trading volume of at least 2,000,000 shares over the past six months;
- (6) No single component security represents more than 25% of the weight of the index, and the five highest weighted component securities in the index do not in the aggregate account for more than 50% (60% for an index consisting of fewer than 25 component securities) of the weight of the index;
- (7) Component securities that account for at least 90% of the weight of the index and at least 80% of the total number of component securities in the index satisfy the requirements of Rule 3.6 applicable to individual underlying securities;
- (8) All component securities are "reported securities" as defined in Rule 11Aa3-1 under the Exchange Act;

(9) Non-U.S. component securities (stocks or ADRs) that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 20% of the weight of the index;

(10) The current underlying index value will be reported at least once every fifteen seconds during the time the index options are traded on the Exchange;

(11) An equal dollar-weighted index will be rebalanced at least once every calendar quarter; and

(12) If an underlying index is maintained by a broker-dealer, the index is calculated by a third party who is not a broker-dealer, and the broker-dealer has erected a "Chinese Wall" around its personnel who have access to information concerning changes in and adjustments to the index.]

**[Maintenance Requirements
Narrow-Based Index Options]**

[Rule 7.3(c). The following maintenance listing standards shall apply to each class of index options originally listed pursuant to paragraph (b) above:

(1) The conditions stated in subparagraphs (b)(1), (3), (6), (7), (8), (9), (10), (11) and (12) must continue to be satisfied, provided that the conditions stated in subparagraph (b)(6) must be satisfied only as of the first day of January and July in each year;

(2) The total number of component securities in the index may not increase or decrease by more than 33 1/3% from the number of component securities in the index at the time of its initial listing, and in no event may be less than nine component securities;

(3) Trading volume of each component security in the index must be at least 500,000 shares for each of the last six months, except that for each of the lowest weighted component securities in the index that in the aggregate account for no more than 10% of the weight of the index, trading volume must be at least 400,000 shares for each of the last six months;

(4) In a capitalization-weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least 30% of the total number of stocks in the index each have had an average monthly trading volume of at least 1,000,000 shares over the past six months.

In the event a class of index options listed on the Exchange fails to satisfy the maintenance listing standards set forth herein, the Exchange shall not open for trading any additional series of options of that class unless such failure is determined by the Exchange not to be significant and the Commission concurs in that determination, or

unless the continued listing of that class of index options has been approved by the Commission under Section 19(b)(2) of the Exchange Act.]

Deceased OTP Holder
[Dissemination of Information]

Rule 7.4(a). Upon the death of an OTP Holder, the Board of Directors may, for such period as it shall determine, allow other OTP Holders to execute orders on the facilities of the Exchange for the OTP Firm of which the deceased was an OTP Holder. [The Exchange shall assure that the index value is disseminated to the public after the close of business and from time-to-time on days on which index options are traded on the Exchange.

(b) The Exchange shall maintain, in files available to the public, information identifying the stocks whose prices are the basis for calculation of the index and the method used to determine the index value.]

Trading Halts Due to Extraordinary Market Volatility
[Adjustments in the Divisor]

Rule 7.5(a). Trading in stocks will halt on the Exchange and will not reopen for the time periods described in this paragraph (a) if the Dow Jones Industrial Average* reaches Level 1 below its closing value on the previous trading day. [The Divisor ordinarily will be adjusted in the event of a stock dividend, stock distribution, stock split or reverse split, rights offering, distribution, reorganization, recapitalization or reclassification or similar event in respect of any component stock, or in the event a stock is added to or deleted from the index, or one stock is substituted for another. The purpose of adjusting the Divisor in the context of such events is to maintain continuity of index values; the Divisor will not be revised for any other purpose.]:

- (1) before 11:00 a.m. Pacific Time, for one hour;
- (2) at or after 11:00 a.m. but before 11:30 a.m. Pacific Time, for 30 minutes.

If the Dow Jones Industrial Average reaches Level 1 below its closing value on the previous trading day at or after 11:30 a.m. Pacific Time, trading will continue on the Exchange until the close, unless the Dow Jones Industrial Average reaches Level 2 below its closing value on the previous trading day, at which time trading will be halted for the remainder of the day.

(b). Trading in stocks will halt on the Exchange and will not re-open for the time periods described in this paragraph (b) if the Dow Jones Industrial Average reaches Level 2 below its closing value on the previous trading day:

- (1) before 10:00 a.m. Pacific Time, for two hours;
- (2) at or after 10:00 a.m. but before 11:00 a.m. Pacific Time, for one hour;
- (3) at or after 11:00 a.m. Pacific Time, for the remainder of the day.

(c). If the Dow Jones Industrial Average reaches Level 3 below its closing value on the previous trading day, trading in stocks will halt on the Exchange and will not reopen for the remainder of the day.

Commentary:

.01 Levels 1, 2 and 3 will be calculated at the beginning of each calendar quarter, using the average closing value of the Dow Jones Industrial Average for the month prior to the beginning of the quarter. Level 1 will be 10% of such average closing value calculation; Level 2 will be 20% of such average closing value calculation; Level 3 will be 30% of such average closing value calculation. Each Level will be rounded to the nearest fifty points. The values of Levels 1, 2 and 3 will remain in effect until the next calculation.

.02 The restrictions in this Rule will apply whenever the Dow Jones Industrial Average reaches the trigger values notwithstanding the fact that at any given time, the calculation of the value of the average may be based on the prices of less than all of the stocks included in the average.

.03 The reopening of trading following a trading halt under this Rule will be conducted pursuant to procedures adopted by the Exchange and communicated by notice to its OTP Holders and OTP Firms.

.04 Nothing in this Rule should be construed to limit the ability of the Exchange to otherwise halt or suspend the trading in any stock or stocks traded on the Exchange pursuant to any other Exchange rule or policy.

[Position Limits for Index Options

Narrow-Based Index Options

Rule 7.6(a). In determining compliance with Rule 6.8, narrow based (industry) index option contracts shall be subject to position limits determined as follows:

- 9,000 contracts if the Exchange determines, at the time of a review conducted pursuant to paragraph (b) below, that any single stock in the group accounted, on average, for 30% or more of the index value during the 30-day period immediately preceding the review; or

- 12,000 contracts if the Exchange determines, at the time of a review conducted pursuant to paragraph (b) below, that any single stock in the group accounted, on average, for 20% or more of the index value or that any five stocks in the group together accounted, on average, for more than 50% of the index value, but that no single stock in the group accounted, on average, for 30% or more of the index value, during the 30-day period immediately preceding the review; or

- 15,000 contracts if the Exchange determines that the conditions specified above, which would require the establishment of a lower limit, have not occurred.

(b) The Exchange shall determine the appropriate position limit at the time options on an index are initially opened for trading and shall review its determination semi-annually, at the same time it reviews position and exercise limits for stock options, pursuant to Rule 6.8 and Rule 6.9. If the Exchange determines after conducting its review that a higher position limit is appropriate for an index the Exchange shall increase the limit as soon as practicable. If the Exchange determines that a lower limit is appropriate for an index, the lower limit shall take effect after the expiration of the farthest term series open for trading at the time of the Exchange's review.

(c) Option contracts on an index shall not be aggregated with option contracts on any stocks whose prices are the basis for the calculation of the index.

Broad-Based Index Options

(d) The position limit for a broad based index option shall be 15,000 contracts, except as follows:

(1) The position limit for options on the Wilshire Small Cap Index shall be 37,500 contracts on the same side of the market, with no more than 22,500 of such contracts in the series with the nearest expiration date.

(2) Quarterly Index Expirations (QIXs) on the Wilshire Small Cap Index shall be excluded from the aggregation of options on such indexes for purposes of subsection (d)(1). In determining compliance with applicable position limits, QIXs on the Wilshire Small Cap Index shall be subject to a contract limitation fixed by the Exchange, which shall not be larger than 37,500 contracts on the same side of the market. For purposes of determining compliance with this subsection (d)(2), all Wilshire Small Cap Index options (including all QIXs on the Wilshire Small Cap Index) shall be aggregated. In no event shall the aggregate of all option contracts on the Wilshire Small Cap Index exceed 37,500 contracts on the same side of the market.

(3) The position limit for options on the PCX Technology Index shall be 37,500 contracts on the same side of the market, with no more than 22,500 of such contracts in the series with the nearest expiration date.

(4) The position limit for options on the Dow Jones & Co. Taiwan Index shall be 50,000 contracts on the same side of the market, with no more than 30,000 contracts in the series with the nearest expiration date.

(5) The position limit for options on the Morgan Stanley Emerging Growth Index shall be 37,500 contracts on the same side of the market, with no more than 22,500 contracts in the series with the nearest expiration date.

(e) Capped-style index options shall be aggregated with standard option contracts on the same stock index group.

Commentary:

.01 All members and member organizations acquiring positions of 200 contracts or more in index options shall report such information to the Department of Options Surveillance. The report shall be filed in accordance with the provisions of Rule 6.6(a).

Broad-Based Index Hedge Exemption

.02 The broad-based index hedge exemption is in addition to the standard limit and other exemptions available under Exchange rules, interpretations and policies. The following procedures and criteria must be satisfied to qualify for a broad-based index hedge exemption:

(a) The account in which the exempt option positions are held (the "hedge exemption account") has received prior Exchange approval for the hedge exemption specifying the maximum number of contracts that may be exempt under this Commentary. The Exchange may grant approval on the basis of verbal representations, in which case the hedge exemption account must, within two business days (or such other time designated by the Exchange), furnish the Exchange with appropriate documentation substantiating the basis for the exemption. A hedge exemption account may apply from time to time for an increase in the maximum number of contracts exempt from the position limits.

(b) The hedge exemption account has provided all information required on Exchange-approved forms and has kept such information current.

(c) A hedge exemption account that is not carried by an Exchange Member Organization must be carried by a member of a self-regulatory organization participating in the Intermarket Surveillance Group.

(d) The hedge exemption account maintains a qualified portfolio, or will effect transactions necessary to obtain a qualified portfolio concurrent with or at or about the same time as the execution of the exempt options positions, of:

(1) a net long or short position in common stocks in at least four industry groups and contains at least twenty stocks, none of which accounts for more than fifteen percent of the value of the portfolio or in securities readily convertible, and additionally in the case of convertible bonds, economically convertible, into common stocks which would comprise a portfolio, and/or

(2) a net long or short position in index futures contracts or in options on index futures contracts, or long or short positions in index options or index

warrants, for which the underlying index is included in the same margin or cross-margin product group cleared at The Options Clearing Corporation as the index option class to which the hedge exemption applies. To remain qualified, a portfolio must at all times meet these standards notwithstanding trading activity.

(e) The exemption applies to positions in broad-based index options dealt in on the Exchange and is applicable to the unhedged value of the qualified portfolio. The unhedged value will be determined as follows:

(1) the values of the net long or short positions of all qualifying products in the portfolio are totaled;

(2) for positions in excess of the standard limit, the underlying market value

(A) of any economically equivalent opposite side of the market calls and puts in broad-based index options, and

(B) of any opposite side of the market positions in stock index futures, options on stock index futures, and any economically equivalent opposite side of the market positions, assuming no other hedges for these contracts exist, is subtracted from the qualified portfolio; and

(3) the market value of the resulting unhedged portfolio is equated to the appropriate number of exempt contracts as follows: the unhedged qualified portfolio is divided by the correspondent closing index value and the quotient is then divided by the index multiplier or 100.

(f) The hedge exemption customer shall agree to, and any Member Organization carrying an account for the customer, shall

(1) liquidate and establish option and stock positions or their equivalent in an orderly fashion; not initiate or liquidate positions in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes; and not initiate or liquidate a stock position or its equivalent with an equivalent index option position with a view toward taking advantage of any differential in price between a group of securities and an overlying stock index option.

(2) liquidate any options prior to or contemporaneously with a decrease in the hedged value of the qualified portfolio which options would thereby be rendered excessive.

(3) promptly notify the Exchange of any material change in the stock portfolio or its equivalent or stock index futures positions which materially affects the unhedged value of the qualified portfolio.

(4) abide by prevailing exercise limits allowed pursuant to Rule 7.7, without regard to the exemption provision, except in expiring series from the last business day prior to expiration until expiration.

(g) Only the following qualified hedging transactions and positions are eligible for purposes of hedging a qualified portfolio (i.e., stocks, futures, options and warrants) pursuant to this Commentary:

- (1) Long put(s) used to hedge the holding of a qualified portfolio;
- (2) Long call(s) used to hedge a short position in a qualified portfolio;
- (3) Short call(s) used to hedge the holding of a qualified portfolio; and
- (4) Short put(s) used to hedge a short position in a qualified portfolio.

The following strategies may be effected only in conjunction with a qualified stock portfolio:

(5) For non-P.M. settled, European-style index options only – a short call position accompanied by long put(s), where the short call(s) expire with the long put(s), and the strike price of the short call(s) equals or exceeds the strike price of the long put(s) (a "collar"). Neither side of the collar transaction can be in-the-money at the time the position is established. For purposes of determining compliance with Rules 6.8 and 7.6, a collar position will be treated as one (1) contract;

(6) For non-P.M. settled, European-style index options only – a long put position coupled with a short put position overlying the same broad-based index and having an equivalent underlying aggregate index value, where the short put(s) expire with the long put(s), and the strike price of the long put(s) exceeds the strike price of the short put(s) (a "debit put spread position"); and

(7) For non-P.M. settled, European-style index options only – a short call position accompanied by a debit put spread position, where the short call(s) expire with the puts and the strike price of the short call(s) equals or exceeds the strike price of the long put(s). Neither side of the short call, long put transaction can be in-the-money at the time the position is established. For purposes of determining compliance with Rules 6.8 and 7.6, the short call and long put positions will be treated as one (1) contract.

(h) Compliance.

(1) The hedge exemption account shall promptly provide to the Exchange any information requested concerning the qualified portfolio.

(2) Positions included in a qualified portfolio that serve to secure an index hedge exemption may not also be used to secure any other position limit exemption granted by the Exchange or any other self regulatory organization or futures contract market.

(3) Any member or member organization that maintains a broad-based index option position in such member's or member organization's own account or in a customer account, and has reason to believe that such position is in excess of the applicable limit, shall promptly take the action necessary to bring the position into compliance. Failure to abide by this provision shall be deemed to be a violation of Rules 6.8 and 7.6 by the member or member organization.

(4) Violation of any of the provision of Rule 7.6 and the commentaries thereunder, absent reasonable justification or excuse, shall result in withdrawal of the index hedge exemption and may form the basis for subsequent denial of an application for an index hedge exemption hereunder.

Narrow-Based Index Hedge Exemption

.03 Narrow-based (industry) index option positions may be exempt from established position limits for each option contract "hedged" by an equivalent dollar amount of the underlying component securities or securities convertible into such components; provided that, in applying such hedge, each option position to be exempted is hedged by a position in at least 75% of the number of component securities underlying the index. In addition, the underlying value of the option position may not exceed the value of the underlying portfolio. The value of the portfolio is:

(a) the total market value of the net stock position, less

(b) the value of:

(1) any offsetting calls and puts in the respective index option; and

(2) any offsetting positions in related stock index futures or options; and

(3) any economically equivalent positions.

Prior Exchange approval on the appropriate form designated by the Exchange is required. This exemption requires that both the option and stock positions be initiated and liquidated in an orderly manner. Specifically, a reduction of the option position must occur at or before the corresponding reduction in the stock portfolio position. The position in a narrow-based index option may not exceed the total of: (a) the limit established under Rule 7.6, plus (b) two times

that limit (for hedged positions). The Exchange may determine, in its discretion, to grant a hedge exemption for a number of contracts that is less than the maximum number permitted under this Commentary. The Exchange may also grant other position limit exemptions under Exchange rules, and such exemptions shall be applied in addition to any exemption provided under this Commentary.

Exercise Limits

Rule 7.7(a). In determining compliance with Rule 6.9, index option contracts shall be subject to the same exercise limit as the established position limit for that particular index option contract.

(b) Capped-style index options shall not be aggregated with standard option contracts on the same stock index group.

Terms of Option Contracts

Rule 7.8(a). The Exchange shall determine fixed point intervals of exercise prices for call and put options.

(b) The Exchange shall determine the expiration dates as provided in Rule 6.4, except that the Exchange may establish expiration dates in no more than four consecutive months.

(c) Capped-style index options.

(1) Capped-style index options on the following indexes are approved for trading on the Exchange:

(A) Wilshire Small Cap Index.

(B) PSE Technology Index.

(2) Unless modified by the Exchange, the cap interval shall be \$20.

(3) Initially, one at-the-money call and put will be listed with an expiration of up to one year in the future. Additional at-the-money series may be listed every two months with expirations up to one year in the future.

(4) Series may be added to expiration months with three or more months remaining to their expiration, if there has been a move of ten or more points in the index value.

(d) Quarterly Index Options (QIXs). The Exchange may open for trading up to eight near-term quarterly index expirations at any one time. The index multiplier for QIXs shall be

100. Unless otherwise specified, QIXs shall be p.m. settled. QIXs on the following indexes are approved for trading on the Exchange:

(1) Wilshire Small Cap Index.

(e) A.M.-Settled Index Options.

(1)(A) The last day of trading for A.M.-settled index options shall be the business day preceding the last day of trading in the underlying securities prior to expiration. The current index value at the expiration of an A.M.-settled index option shall be determined on the last day trading in the underlying securities prior- to expiration. The current index value shall be determined by reference to the reported level of such index as derived from the first reported sale (opening) prices of the underlying securities on such day. In any case where the security does not open for trading on that day, the last reported sale price of such security shall be used unless the exercise settlement amount is fixed in accordance with the Rules and By-Laws of The Options Clearing Corporation.

(B) In any case where an exercise settlement amount is fixed for any series of index options pursuant to the Rules and By-laws of The Options Clearing Corporation, the amount so fixed shall be the amount required to be paid upon exercise of options of that series notwithstanding any difference between the current index value used by The Options Clearing Corporation in fixing that amount and the index value determined pursuant to Exchange Rules or practices.

(2) The following A.M.-settled index options are approved for trading on the Exchange:

- (A) PSE Technology Index
- (B) Wilshire Small Cap Index
- (C) Dow, Jones & Co. Taiwan Index
- (D) Morgan Stanley Emerging Growth Index

Meaning of Premium Bids and Offers

Rule 7.9. Bids and offers shall be expressed in terms of dollars and cents per unit of the index (e.g. a bid of 5 1/2 would represent a bid of \$5.50 per unit).

Trading Rotations

Rule 7.10. The provisions of Rule 6.64 regarding trading rotations shall apply to index options, except as otherwise provided in Rule 7. The Order Book Official shall open first those series of a class which have the nearest expiration. Thereafter the Order Book Official shall open the remaining series in a manner he deems appropriate under the circumstances. One and one-half hours after the opening rotation, trading shall become subject to Rule 7.11, unless the Exchange determines it is in the public interest to suspend trading at an earlier time.

Trading Halts or Suspensions

Rule 7.11. Trading on the Exchange in any index option shall be halted or suspended whenever trading in underlying securities whose weighted value represents more than 20%, in the case of a broad based index, and 10% for all other indices, of the index value is halted or is suspended. Trading in an index option shall also be halted whenever the Exchange deems such action appropriate in the interests of a fair and orderly market or to protect investors. Among the factors that may be considered by the Exchange are the following:

- (i) all trading has been halted or suspended in the market that is the primary market for a plurality of the underlying stocks;
- (ii) the current calculation of the index derived from the current market prices of the stocks is not available; or
- (iii) other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present.

Trading in index options of a class or series that has been the subject of a halt or suspension by the Exchange may resume if the Exchange determines that the conditions which led to the halt or suspension are no longer present, or that the interests of a fair and orderly market are best served by a resumption of trading.

Rule 7.12. Reserved

Limitation of Liability

Rule 7.13. Each reporting authority with respect to any index underlying an option traded on the Exchange, and any affiliate of such reporting authority (together, the "Reporting Authority") does not guarantee the accuracy and/or completeness of such index or any data included therein. The Reporting Authority makes no warranty, express or implied, as to the results to be obtained by any person or any entity from the use of such index or any data included therein. The Reporting Authority makes no express or implied warranties, and expressly disclaims all warranties of merchantability and fitness for a particular purpose or use with respect to such index or any data contained therein. Without limiting any of the foregoing, in no event shall the Reporting Authority have any liability for any direct, special, punitive, indirect, or consequential damages (including lost profits), even if notified of the possibility of such damages. In addition, the Reporting Authority shall have no liability for any damages, claims, losses or expenses caused by any errors or delays in calculating or disseminating such index.

Commentary:

.01 The disclaimers set forth in Rule 7.13 shall apply to Dow Jones & Company, Inc. with respect to the Dow Jones Taiwan Stock Index and the Dow Jones Asia Pacific ex-Japan

Stock Index, and Morgan Stanley & Co. Incorporated with respect to the Morgan Stanley Emerging Growth Index, the Exchange in respect to the indexes for which it is the designated reporting authority, and any other index reporting authority in respect to any index for which it acts as such.

Rule 7.14. Reserved

Exercise of Option Contracts

Rule 7.15(a). The provisions of Rule 6.24 shall apply to index options, except as follows:

(1) With respect to all index option contracts except European-style index option contracts, Clearing Members must follow the procedures of the Clearing Corporation for tendering exercise notices. Members or Member Organizations also must follow the procedures set forth below:

(A) a memorandum to exercise any contract issued or to be issued in a customer or Market-Maker account at the Clearing Corporation must be received or prepared by the Member Organization no later than five (5) minutes after the close of trading on that day, and must be time-stamped at the time it is received or prepared. Member Organizations must accept exercise instructions until five (5) minutes after the close of trading on that day;

(B) a memorandum to exercise any contract issue or to be issued in a firm account at the Clearing Corporation must be prepared by the Member Organization no later than five (5) minutes after the close of trading on that day, and must be time-stamped at the time it is prepared;

(C) failure of any member to follow the procedures and meet the deadlines in this Section 15 may result in the assessment of fines in an amount determined by the Exchange, and further disciplinary action as may be appropriate;

(D) all memoranda of exercise instructions are subject to SEC Rules 17a-3(a)(6) and 17a-4(b); and

(E) any member or member organization that intends to submit an exercise notice for 25 or more contracts in the same series on the same business day on behalf of an individual customer, market maker or firm account must deliver an "exercise advice," on a form prescribed by the Exchange, to a place designated by the Exchange, no later than five (5) minutes after the close of trading on that day. For purposes of this rule, exercises for all accounts controlled by same individual must be aggregated.

(F) The above provisions specified in Rule 6.24(a) through Rule 6.24(e) are not applicable to expiring series on the business day prior to expiration.

(2) With respect to European-style index option contracts, no Member or Member Organization shall accept or tender to the Options Clearing Corporation an exercise notice prior to the opening of business on the day before such option contracts will expire.

Margins

Rule 7.16(a). This Rule sets forth the minimum amount of margin which must be deposited and maintained in margin accounts of customers having positions in index option contracts dealt in on a registered national securities exchange or a registered national securities association and issued by a registered clearing corporation. The Exchange may at any time impose higher margin requirements in respect of such positions when it deems such higher margin requirements to be advisable. The initial deposit of margin required under this Rule must be made promptly, pursuant to Regulation T promulgated by the Federal Reserve Board. For purposes of this Rule, the term "current market value" of an index option shall mean the total cost or net proceeds of the option transaction on the day the option was purchased or sold and at any other time shall mean the closing price of that series of options on the Exchange on any day with respect to which a determination of current market value is made.

(b) The margin requirements shall be as follows:

(i) For option contracts on a broad based index: For each put or call option contract on a broad based index carried in a short position in the account, margin must be deposited and maintained equal to at least 100% of the current market value of the contract plus 15% of the index value times the index multiplier. In each case, the amount shall be decreased by any excess of the aggregate exercise price of the option over the index value as multiplied by the index multiplier in the case of a call, or any excess of the index value as multiplied by the index multiplier over the aggregate exercise price of the option in the case of a put; provided, however, that the minimum margin required on each such option contract shall not be less than the option market value plus 10% of the index value times the index multiplier.

(ii) For all other index option contracts: For each put or call index option contract carried in a short position in the account, margin must be deposited and maintained equal to at least 100% of the current market value of the contract plus 20% of the product of the current index value times the index multiplier. In each case, the amount shall be decreased by any excess of the aggregate exercise price of the option over the current index value as multiplied by the index multiplier in the case of a call, or any excess of the current index value as multiplied by the index multiplier over the aggregate exercise price of the option in the case of a put; provided, however, that the minimum margin required on each such option contract shall not be less than the option market value plus 10% of the current index value times the index multiplier.

(c) The requirement set forth in paragraph (b) hereof is subject to the following exceptions, which in each case may be applied at the discretion of the member organization with which the account is maintained.

(1) Short option offset by long option where long option expires with or after short option. This subparagraph (c)(1) applies to accounts carrying positions in long call index options (or long put index options) which are offset by positions in short call index options (or short put index options) for the same underlying index with the same index multiplier, provided that the expiration date of the long calls (or long puts) is the same as or subsequent to the expiration date of the offsetting short calls (or short puts).

(A) When the exercise price of the long call index option (or short put index option) is greater than the exercise price of the offsetting short call index option (or long put index option) margin is required equal to the difference in aggregate exercise prices.

(B) When the exercise price of the long call index option (or short put index option) is greater than the exercise price of the offsetting short call index option (or long put index option) margin is required equal to the difference in aggregate exercise prices.

(2) Short put and short call. This subparagraph (c)(2) applies to accounts carrying positions in short put index options which are offset by positions in short call index options for the same underlying index with the same index multiplier. The margin required for such a position shall be the margin required for the short put option contract or the margin required for the short call option contract (pursuant to paragraph (b) of this Rule), whichever is greater, as determined by (b) above, plus 100% of the current market value of the other option contract.

(d) No margin is required in respect of a call option contract on a market index carried in a short position where the customer has delivered promptly, after the options are written, to the Member Organization with which such position is maintained, an Index Option Escrow Receipt in a form satisfactory to the Exchange, issued by a bank or trust company pursuant to specific authorization from the customer which certifies that the issuer of the agreement holds for the account of the customer;

- 1) cash,
- 2) cash equivalent,
- 3) one or more qualified equity securities, or

4) a combination thereof; that such deposit has an aggregate market value, at the time the option is written, of not less than 100% of the option aggregate current index

value and that the issuer will promptly pay the member organization the exercise settlement amount in the event the account is assigned an exercise notice.

(e) Option Contracts on a Capped Market Index.

(1) Cash Accounts. For each capped-style put or call option contract carried in a short position in a cash account, the customer must deposit, in an amount equal to the cap interval times the index multiplier, cash or cash equivalents as defined in Regulation T, Section 220.8(a)(3).

(2) Margin Accounts. For a capped-style put or call option contract carried in a short position in a margin account, margin must be deposited and maintained equal to at least 100% of the current market value of the contract plus 15% of the current index value multiplied by the index multiplier. In each case, the amount shall be decreased by any excess of the aggregate exercise price of the option over the current index value as multiplied by the index multiplier in the case of a call, or any excess of the current index value as multiplied by the index multiplier over the aggregate exercise price of the option in the case of a put; provided, however, that the minimum margin required on each such option contract shall not be less than (a) the option market value plus 10% of the current index value multiplied by the index multiplier or (b) the cap interval multiplied by the index multiplier, whichever is less. The maximum margin required on each such option contract shall not exceed the cap interval multiplied by the index multiplier.

Commentary:

.01 The term "aggregate current index value" means the current index value times the index multiplier; the term "aggregate exercise price" means the service price times the index multiplier; and the term "exercise settlement amount" means the difference between the aggregate exercise price and the aggregate current index value (as such terms are defined in Article XVII of the By-Laws of the Options Clearing Corporation).

.02 For purposes of paragraph (d), above, a bank or trust company is qualified to issue an Index Option Escrow Receipt if it is a corporation organized under the laws of the United States or a State thereof and is regulated and examined by federal or state authorities having regulatory authority over banks or trust companies. The issuing bank or trust company must be approved by the Options Clearing Corporation if Market Index Option Escrow Receipts are to be forwarded to the Corporation for the purpose of meeting margin requirements.

.03 A security is qualified if it is an equity security (with the exception of warrants, rights and options):

(a) traded on a national securities exchange and it substantially meets the listing standards of the New York Stock Exchange or the American Stock Exchange; or

(b) traded over-the-counter and is included on the Federal Reserve Board's list of Over-the-Counter Margin Stocks.

.04 The term "cash equivalent" is defined in Regulation T, Section 220.8(a)(3)(ii), to mean securities issued or guaranteed by the United States or its agencies, negotiable bank certificates of deposit, or banker's acceptances issued by banking institutions in the United States and payable in the United States with one year or less to maturity.

.05 When one or more securities are substituted for securities held by the bank or trust company, the substitution should not impair the value of the collateral held by the bank at the time the substitution is made.

Settlement

Rule 7.17. In accordance with the applicable Rules of the Options Clearing Corporation, the settlement of index option contracts will be by the delivery of the difference between the closing index value on the day of exercise and the exercise price times the index multiplier, denominated in United States dollars.]