

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57502; File No. SR-Amex-2008-18)

March 14, 2008

Self-Regulatory Organizations; American Stock Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Create a Delta Hedging Exemption from Equity Options Position Limits

Pursuant to 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 March 4, 2008, the American Stock Exchange LLC (“Amex” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been substantially prepared by Amex. The Exchange has filed the proposal as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ which renders it effective upon filing with the Commission. 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 proposes to amend Amex Rule 904 to establish a delta hedge exemption from equity options position limits. The text of the proposed rule change is available at Amex, the Commission’s Public Reference Room, and www.amex.com.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Amex included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

rule change. The text of these statements may be examined at the places specified in Item IV below. Amex has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

All options contracts listed and traded on the Exchange are subject to position and exercise limits as set forth in Amex Rules 904 and 905. Position limits restrict the number of options contracts that an investor, or a group of investors acting in concert, may own or control in one particular option class or the security or securities that underlie that option class. Similarly, exercise limits prohibit the exercise of more than a specified number of contracts on a particular instrument within five business days. The Exchange does provide various hedge exemptions to permit certain “hedged” positions greater position limits than the applicable standard position limit.⁵

Over the past several years, the Exchange as well as the other self-regulatory organizations (“SROs”) have increased in absolute terms the size of the options position and exercise limits as well as the size and scope of available exemptions for “hedged” positions.⁶ The exemptions for hedged positions generally require a one-to-one hedge (i.e., one stock option contract must be hedged by the number of shares covered by the options contract, typically 100 shares). In practice, however, many firms do not hedge their options positions in this way.

⁵ See Commentary .09 to Amex Rule 904.

⁶ See Securities Exchange Act Release Nos. 51316 (March 3, 2005), 70 FR 12251 (March 11, 2005) (SR-Amex-2005-029); 45312 (January 18, 2002), 67 FR 3752 (January 25, 2002) (SR-Amex-2001-42); and 40875 (December 31, 1998), 64 FR 1842 (January 12, 1999) (SR-Amex-98-22). See also Securities Exchange Act Release No. 45650 (March 26, 2002), 67 FR 15638 (April 2, 2002) (SR-Amex-2001-72).

Rather, these firms engage in what is known as “delta hedging,” which varies the number of shares of the underlying security used to hedge an options position based upon the relative sensitivity of the value of the option contract to a change in the price of the underlying security.⁷ The Amex believes that delta hedging is widely accepted for net capital and risk management purposes.

In 2002, the Commission approved amendments to Amex Rule 904 providing an expansion to the hedging strategies exempt from the standard position and exercise limits.⁸ In addition, in 2004, the Commission approved a proposal of the National Association of Securities Dealers, Inc. (“NASD”) providing for a delta hedging exemption from stock options position and exercise limits for positions held by affiliates of NASD members approved by the Commission as “OTC derivatives dealers.”⁹ At that time, the Commission reiterated its “support for recognizing options positions hedged on a delta neutral basis as properly exempted from position limits.”¹⁰

Proposed Delta Neutral-Based Hedge Exemption

The Exchange proposes to adopt a new exemption from equity options position and exercise limits for positions held by Amex members and certain of their affiliates that are “delta neutral”¹¹ under a “permitted pricing model” (as defined below), subject to certain conditions

⁷ For example, an option with a delta of .5 will move \$0.50 for every \$1.00 move in the underlying stock.

⁸ See supra note 6.

⁹ See Securities Exchange Act Release No. 50748 (November 29, 2004), 69 FR 70485 (December 6, 2004) (SR-NASD-2004-153).

¹⁰ Id. at 70486.

¹¹ “Delta neutral” is defined in proposed Commentary .10(a) to Rule 904 as an equity options position that has been fully hedged, in accordance with a “Permitted Pricing Model,” by a position in the underlying security or one or more instruments relating to the underlying security, for the purpose of offsetting the risk that the value of the option

(“Exemption”). The proposed Exemption would only apply to equity options, i.e. stock options and options on Exchange Traded Fund Shares. Any equity option position that is not “delta neutral” would be subject to position and exercise limits, subject to the availability of other exemptions. Only the “options contract equivalent of the net delta”¹² of a hedged options position would be subject to the appropriate position limits.

Only financial instruments relating to the security underlying an equity options position could be included in any determination of an equity options position’s net delta or whether the options position is delta neutral. In addition, members could not use the same equity or other financial instrument position in connection with more than one hedge exemption. Accordingly, a stock position used as part of a delta hedging strategy could not also serve as the basis for any other equity hedge exemption.

Permitted Pricing Model

Under this proposal, the calculation of the delta for any equity option position, and the determination of whether a particular equity option position is delta neutral, is required to be made using a “Permitted Pricing Model.” A “Permitted Pricing Model” is defined in proposed Commentary .10(e) to Rule 904 to mean the pricing model maintained and operated by The Options Clearing Corporation (“OCC”) and the pricing models used by: (1) a member or its affiliate subject to consolidated supervision by the Commission pursuant to Appendix E of Rule

position will change in response to incremental changes in the price of the security underlying the option position.

¹² “Net delta” is defined in proposed Commentary .10(b) to Rule 904 to mean “the number of shares (either long or short) required to offset the risk that the value of an equity options position will change with incremental changes in the price of the security underlying the options position, as determined in accordance with a Permitted Pricing Model.” “Options Contract Equivalent of the Net Delta” is defined in proposed Commentary .10(c) to Rule 904 to mean the net delta divided by the number of shares underlying the options contract.

15c3– 1 under the Act;¹³ (2) a financial holding company (“FHC”) or a company treated as an FHC under the Bank Holding Company Act of 1956, or its affiliate subject to consolidated holding company group supervision;¹⁴ (3) a Commission-registered OTC derivatives dealer;¹⁵ and (4) a national bank under the National Bank Act.¹⁶

¹³ Use of such pricing model would be required to be consistent with the requirements of Appendices E or G, as applicable, to Rules 15c3–1 and 15c3–4 under the Act in connection with the calculation of risk-based deductions from capital or capital allowances for market risk thereunder. See proposed Commentary .10(e)(2) to Rule 904.

¹⁴ An FHC’s affiliate that is part of the FHC’s consolidated supervised holding company group would be eligible to use this part of the Exemption. An FHC’s (or an affiliate’s) use of a proprietary model would have to be consistent with either: (i) the requirements of the Board of Governors of the Federal Reserve System, as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Board of Governors of the Federal Reserve System; or (ii) the standards published by the Basel Committee on Banking Supervision, as amended from time to time and as implemented by such company’s principal regulator, in connection with the calculation of risk-based deductions or adjustments to or allowances for the market risk capital requirements of such principal regulator applicable to such company— where “principal regulator” means a member of the Basel Committee on Banking Supervision that is the home country consolidated supervisor of such company. See proposed Commentary .10(e)(3) to Rule 904. It is important to note that the U.S. activities of entities subject to the Basel standards are overseen by the Federal Reserve Board, and the Exchange would be relying upon that oversight in extending exemptive relief to such entities.

¹⁵ An OTC derivative dealer’s use of a proprietary model would be required to be consistent with the requirements of Appendix F to Rule 15c3–1 and Rule 15c3–4 under the 1934 Act in connection with the calculation of risk-based deductions from capital for market risk thereunder. Only an OTC derivatives dealer and no other affiliated entity (including a member) would be able to rely upon this particular part of the Exemption. See proposed Commentary .10(e)(4) to Rule 904.

¹⁶ The use of a proprietary model by a national bank would be required to be consistent with the requirements of the Office of the Comptroller of the Currency, as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Office of the Comptroller of the Currency. An affiliate of a national bank (including an Exchange member) would not be permitted to rely on this part of the Exemption. See proposed Commentary .10(e)(5) to Rule 904.

Aggregation of Accounts

Members and non-member affiliates relying on the Exemption would be required to ensure that the Permitted Pricing Model applies to all positions in, or relating to, the security underlying the relevant options position that are owned or controlled by the member or its affiliates.

However, the net delta of an options position held by an entity entitled to rely on this Exemption, or by a separate and distinct trading unit of such entity, could be calculated without regard to positions in or relating to the security underlying the option held by an affiliated entity or by another trading unit within the same entity, provided that: (1) the entity demonstrates to the Exchange's satisfaction that no control relationship, as defined in Commentary .08 to Rule 904, exists between such affiliates or trading units; and (2) the entity has provided the Exchange written notice in advance that it intends to be considered separate and distinct from any affiliate, or, as applicable, which trading units within the entity are to be considered separate and distinct from each other for purposes of this Exemption.¹⁷

The Exchange has set forth in the proposed Information Circular the conditions under which it will deem no control relationship to exist between entities and between separate and distinct trading units within the same entity.

Any member or non-member affiliate relying on the Exemption would be required to designate, by prior written notice to the Exchange, each trading unit or entity whose options positions are required by Exchange rules to be aggregated with the options positions of such member or non-member affiliate relying on the Exemption for purposes of compliance with Exchange position or exercise limits.

¹⁷ See proposed Commentary .10(f) to Rule 904.

Obligations of Members and Affiliates

Any member relying on the Exemption would be required to provide a written certification to the Exchange stating that it is using a Permitted Pricing Model as defined in proposed Commentary .10(e) to Rule 904 for purposes of the Exemption. In addition, by such reliance, such member or member organization would authorize any other person carrying for such member or member organization an account, including, or with whom such member has entered into, a position in or relating to a security underlying the relevant option position to provide to the Exchange or OCC such information regarding such account or position as the Exchange or OCC may request as part of the Exchange's confirmation or verification of the accuracy of any net delta calculation under this Exemption.¹⁸

The options positions of a non-member affiliate relying on the Exemption would have to be carried by a member with whom it is affiliated. A member carrying an account that includes an equity option position for a non-member affiliate that intends to rely on the Exemption would be required to obtain from such non-member affiliate a written certification sufficient that it is using a Permitted Pricing Model as defined in the Rule for purposes of the Exemption.¹⁹

¹⁸ See proposed Commentary .10(g) to Rule 904.

¹⁹ In addition, the member or member organization would be required to obtain from such non-member affiliate a written statement confirming that such non-member affiliate: (a) is relying on the Exemption; (b) will use only a Permitted Pricing Model for purposes of calculating the net delta of the option positions for purposes of the Exemption; (c) will promptly notify the member or member organization if it ceases to rely on the Exemption; (d) authorizes the member or member organization to provide to the Exchange or the OCC such information regarding positions of the non-member affiliate as the Exchange or OCC may request as part of the Exchange's confirmation or verification of the accuracy of any "net delta" calculation under the Exemption; and (e) if the non-member affiliate is using the OCC Model, has duly executed and delivered to the Exchange such documents as the Exchange may require to be executed and delivered to the Exchange as a condition to reliance on the Exemption. See proposed Commentary .10(g)(3) to Rule 904.

Position Reporting

Under proposed Commentary .10(h) to Rule 904, each member or member organization relying on the Exemption would be required to report, in accordance with Rule 906,²⁰ (i) all equity option positions (including those that are delta neutral) that are reportable thereunder, and (ii) on its own behalf or on behalf of a designated aggregation unit pursuant to proposed Commentary .10(f) to Rule 904, for each such account that holds an equity option position subject to the Exemption in excess of the levels specified in Rule 904, the net delta and the options contract equivalent of the net delta of such position.

The Exchange and other SROs are working on modifying the Large Options Position Reporting system and/or the OCC reports to allow a member to indicate that an equity options position is being delta hedged.

Records

Under proposed Commentary .10(i) to Rule 904, each member and member organization relying on the Exemption would be required to (i) retain, and would be required to undertake reasonable efforts to ensure that any non-member affiliate of the member or member organization relying on the Exemption retains, a list of the options, securities and other instruments underlying each options position net delta calculation reported to the Exchange hereunder, and (ii) produce such information to the Exchange upon request.²¹

²⁰ Amex Rule 906 requires, among other things, that members and member organizations report to the Exchange aggregate long or short positions on the same side of the market of 200 or more contracts of any single class of options contracts dealt in on the Exchange.

²¹ A member would be authorized to report position information of its non-member affiliate pursuant to the written statement required under proposed Commentary .10(g)(3)(ii)(d).

Reliance on Federal Oversight

As provided under proposed Commentary .10(e) to Rule 904, a Permitted Pricing Model includes proprietary pricing models used by members or member organizations and affiliates that have been approved by the Commission, the Federal Reserve Board or another federal financial regulator. In adopting the proposed Exemption, the Exchange would be relying on the rigorous approval processes and ongoing oversight of a federal financial regulator. The Exchange notes that it would not be under any obligation to verify whether a member or member organization's use of a proprietary pricing model is appropriate or yielding accurate results.

The Exchange will announce the operative date of the proposed rule change in an Information Circular to be distributed no later than sixty days following the notice of filing in the Federal Register. The operative date shall be no later than thirty days following distribution of the Information Circular announcing the notice of filing in the Federal Register, or such later date as may be necessary to ensure completion of the required technology changes by the OCC and the Securities Industry Automation Corporation.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act,²² in general, and furthers the objectives of Section 6(b)(5) of the Act,²³ in particular, in that it is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and practices, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Exchange believes the proposed delta neutral-based hedge exemption from equity options position and exercise limits is appropriate in that it is based on a widely accepted

²² 15 U.S.C. 78f(b).

²³ 15 U.S.C. 78f(b)(5).

risk management method used in options trading. In addition, the Commission has previously stated its support for recognizing options positions hedged on a delta neutral basis as properly exempted from position limits.²⁴

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.

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

No written comments were either solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing rule change does not: (1) significantly affect the protection of investors or the public interest; (2) impose any significant burden on competition; and (3) become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act²⁵ and Rule 19b-4(f)(6) thereunder.²⁶

A proposed rule change filed under 19b-4(f)(6) normally may not become operative prior to 30 days after the date of filing.²⁷ However, Rule 19b-4(f)(6)(iii)²⁸ permits the Commission to

²⁴ See Securities Exchange Act Release No. 40594 (October 23, 1998), 63 FR 59362, 59380 (November 3, 1998) (S7-30-97) (adopting rules relating to OTC Derivatives Dealers).

²⁵ 15 U.S.C. 78s(b)(3)(A).

²⁶ 17 CFR 240.19b-4(f)(6).

²⁷ 17 CFR 240.19b-4(f)(6)(iii). In addition, Rule 19b-4(f)(6)(iii) requires that a self-regulatory organization submit to the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such

designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has requested that the Commission waive the 30-day operative delay. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because such waiver would allow the Exchange to implement the delta hedging exemption from equity options position limits without needless delay. The Commission notes that it recently approved a substantially similar proposal filed by the Chicago Board Options Exchange, Incorporated.²⁹ The Commission believes that Amex's proposal to create a delta hedging exemption from equity options position limits raises no new issues. For these reasons, the Commission designates the proposed rule change to be operative upon filing with the Commission.³⁰

At any time within 60 days of the filing of such proposed rule change the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors or otherwise in furtherance of the purposes of the Act.

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:

shorter time as designated by the Commission. The Exchange has satisfied the five-day pre-filing notice requirement.

²⁸ Id.

²⁹ See Securities Exchange Act Release No. 56970 (December 14, 2007), 72 FR 72428 (December 20, 2007) (SR-CBOE-2007-99).

³⁰ For the purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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-Amex-2008-18 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-Amex-2008-18. 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 Web site (<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 inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of Amex. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that

you wish to make available publicly. All submissions should refer to File Number SR-Amex-2008-18 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.³¹

Florence E. Harmon
Deputy Secretary

³¹ 17 CFR 200.30-3(a)(12).