

(c) A short sale may be designated as a bid test exempt sale if:

(1) The sale qualifies for an exemption from the short sale bid test established in NASD rule 3350; or

(2) The short sale is by or for the account of a Primary or Competitive Market Maker and is an exempt hedge transaction in a designated Nasdaq National Market security underlying a class of stock options or included in an index underlying a class of index options to which a registered ISE market maker is appointed under Rule 803.

(d) Definitions. For purposes of paragraph (c) of this Rule:

(1) An "exempt hedge transaction" shall mean a short sale in a designated Nasdaq National Market security that was effected to hedge, and in fact serves to hedge, an existing offsetting options position or an offsetting options position that was created in one or more transactions contemporaneous with the short sale, provided that[.];

(i) In the case of a stock option, when establishing the short position the market maker receives or is eligible to receive good faith margin pursuant to Section 220.12 of Regulation T of the Federal Reserve Board for that transaction[.]; and

(ii) In the case of an index option, (A) the designated Nasdaq National Market security sold short is a component security of the index underlying such index option, (B) at least ten percent (10%) of the value of the index underlying such index option is represented by one or more designated Nasdaq National Market securities, and (C) the current aggregate value of the designated Nasdaq National Market securities sold short does not exceed the aggregate current index value of the index options position being hedged. Notwithstanding the foregoing, a transaction unrelated to normal options market making activity, such as index arbitrage or risk arbitrage that in either case is independent of a market maker's market making functions, will not be considered an "exempt hedge transaction." Once an underlying index has satisfied the ten percent (10%) test in this subparagraph (ii), the continued qualification of the index shall be reviewed as of the end of each calendar quarter, and the index shall cease to qualify if the value of the index represented by one or more designated Nasdaq National Market securities is less than eight percent (8%) at the end of any subsequent calendar quarter.

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Chapter 20

Index Rules

Rule 2000. Application of Index Rules

The Rules in this Chapter are applicable only to index options (options on indices of securities as defined below). The Rules in Chapters 1 through 19 are also applicable to the options provided for in this Chapter, unless such Rules are specifically replaced or are supplemented by Rules in this Chapter. Where the Rules in this Chapter indicate that particular indices or requirements with respect to particular indices will be "Specified," the Exchange shall file a proposed rule change with the Commission to specify such indices or requirements.

Rule 2001. Definitions

(a) The term "aggregate exercise price" means the exercise price of the options contract times the index multiplier.

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

(c) The term "A.M.-settled index option" means an index options contract for which the current index value at expiration shall be determined as provided in Rule 2009(a)(5).

(d) The term "call" means an options 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 current index value times the index multiplier.

(e) The term "current index value" with respect to a particular index options contract means the level of the underlying index reported by the reporting authority for the index, or any multiple or fraction of such reported level specified by the Exchange. The current index value with respect to a reduced-value long term options contract is one-tenth of the current index value of the related index option. The "closing index value" shall be the last index value reported on a business day.

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

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

(h) The term "index multiplier" means the amount specified in the contract by which the current index value is to be multiplied to arrive at the

value required to be delivered to the holder of a call or by the holder of a put upon valid exercise of the contract.

(i) The term "industry index" and "narrow-based index" mean an index designed to be representative of a particular industry or a group of related industries.

(j) The term "market index" and "broad-based index" mean an index designed to be representative of a stock market as a whole or of a range of companies in unrelated industries.

(k) The term "put" means an options 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 current index value times the index multiplier.

(l) The term "reporting authority" with respect to a particular index means the institution or reporting service designated by the Exchange as the official source for (1) calculating the level of the index from the reported prices of the underlying securities that are the basis of the index and (2) reporting such level. The reporting authority for each index approved for options trading on the Exchange shall be Specified (as provided in Rule 2000) in the Supplementary Material to this Rule 2001.

(m) The term "underlying security" or "underlying securities" with respect to an index options contract means any of the securities that are the basis for the calculation of the index.

Rule 2002. Designation of an Index

(a) The component securities of an index underlying an index option contract need not meet the requirements of Rule 502. Except as set forth in subparagraph (b) below, the listing of a class of index options on an industry index requires the filing of a proposed rule change to be approved by the SEC under Section 19(b) of the Exchange Act.

(b) The Exchange may trade options on a narrow-based index pursuant to Rule 19b-4(e) of the Securities Exchange Act of 1934, 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 10 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 percent of the