

**Updates to the Chicago Board Options Exchange Membership Meetings**

This circular is intended to keep you informed regarding the major issues affecting the Exchange, and to provide information regarding other developments at the Exchange.

**Hybrid Development and Implementation**

Plans to implement CBOE's Hybrid Trading System remain on schedule with launch anticipated in May 2003. As previously announced, the conversion to Hybrid will begin with the most active equity options classes, with the top six classes converting to Hybrid in May, followed by phased-in inclusions of other top classes over the remainder of the year. The objective is to have the top 225 classes, which account for approximately 80% of the national volume in equity options, on the Hybrid by the end of this year.

The CBOE Hybrid was designed by members and staff to incorporate the speed and efficiencies of a screen-based trading system with the liquidity and price discovery of a floor-based, open outcry marketplace. The Hybrid will meld synergies between the two, capitalize on our strengths, and create a marketplace unprecedented in the options industry.

To learn more about plans thus far for implementation of the Hybrid, refer to Information Circular IC03-009 on the members' website at [www.cboe.com](http://www.cboe.com).

**Universal WorkStation**

On February 27, 2003, CBOE announced the introduction of the CBOE Hybrid Trading System (HyTS™) Terminal, a universal, multifunctional, trading solution workstation. The CBOE HyTS Terminal provides CBOE customers with electronic access and order routing to U.S. options, futures and stock exchanges, as well as complete access to market data, streaming quotes and order management—all on a single screen. The HyTS Terminal will serve as an order management tool with position monitoring, order status and maintenance, and trade-log capabilities. CBOE has partnered with Belzberg Technologies, Inc. to provide this exclusive technology initiative.

CBOE HyTS Terminals, which are now available, also provide customer point-and-click electronic access and order entry to all CBOE equity and index products. Additionally, real-time market data, including CBOE "quotes with size" and book-depth will be available. The HyTS Terminal will leverage CBOE's Hybrid Trading System and default orders to CBOE when the CBOE market is on the national best bid and offer. HyTS Terminals will also serve as the main portal to the CBOE Hybrid Trading System when it becomes available this spring.

Members with questions regarding the Universal WorkStation or who would like to schedule a demonstration, can contact Andrew Lowenthal, CBOE Director, Business Development, at 312.786.7180.

**Automatic Execution Access Broadened**

Effective Friday, March 14, 2003, CBOE simplified and broadened access to its automatic execution systems in all equity option classes to include broker-dealers and member firms. Eligible orders now receive automatic execution for up to the disseminated size in all equity option classes via CBOE's Retail Automatic Execution System (RAES) and the Large Order Utility (LOU) system. Previously, broker-dealer orders of 20 contracts and less were eligible for automatic execution in selected equity classes.

With these changes, customers, including eligible brokers, dealers and firms, can now point-and-click on the price and size of any equity options class and instantly receive a “fill” confirmation.

Also, effective Tuesday, March 25, 2003, index orders from broker-dealers and firms may also be executed on RAES. Orders up to the following sizes are eligible: OEX, 25 (all months \$25 and under); OEF, 75; DJX and DIA, 250; RUT, 50; and SPX, 20 contracts (first three months \$40 and under). For more information on broker-dealer access to RAES for index options, please refer to Regulatory Circular RG03-20 on the members’ website at [www.cboe.com](http://www.cboe.com). Also, see the March 13, 2003 news release regarding automatic execution on [www.cboe.com](http://www.cboe.com).

### Market Share Initiatives

Over the past several months, CBOE market share in equity options has been declining. Simultaneously, index options trading volume at CBOE has flourished as investors sought protection from volatile equity markets.

The implementation of both the CBOE Hybrid Trading System and the Universal WorkStation represent two major initiatives to combat competitive pressures facing the Exchange. The implementation of the CBOE Hybrid Trading System is the major strategic objective for 2003.

In addition, several other initiatives with the intent of increasing trading volume and overall market share are currently under way.

These include:

- . Identifying and recruiting appropriate candidates for CBOE Electronic Access Firm Status (EAF). EAF status allows direct access to CBOE by brokerage firms who register as EAF firms. The vote by the membership on October 17, 2002 to create EAF was a major step toward seeking to level the competitive field with those exchanges that already provide some form of electronic access to non-member order flow providers. The rule filing to create the EAF status is currently pending at the SEC.
- . Encouraging the SEC and the U.S. Congress to resolve payment for order flow and internalization issues, both of which have been plaguing the industry and remain unresolved. On January 24, 2003, each of the options exchanges received a letter from outgoing SEC Chairman Harvey Pitt expressing concern regarding exchange-sponsored payment for order flow and internalization practices in the options industry, and asking for the exchanges’ viewpoints on these issues.

To read the letter from former Chairman Pitt as well as CBOE’s responses, see the documents titled, “SEC Letter On Payment for Order Flow and Internalization” and “January 24, 2003, Letter on Payment for Order Flow and Internalization,” on the members’ website at [www.cboe.com](http://www.cboe.com) (Information Circular IC03-11).

CBOE is opposed to payment for order flow. However, members should be aware that some competing exchanges have used payment to increase their market shares. If the SEC does not ban payment for order flow, it could become necessary for CBOE to revisit its position on this issue in order to preserve CBOE business.

- . Assessing Designated Primary Maker (DPM) performance. Several CBOE committees including the Allocation, Modified Trading System and Equity Market Development and Market Performance Committees will be reviewing each DPM’s performance, as well as considering ways to stimulate performance.
- . Implementing Market Incentive Programs for DPMs, which include financial incentives to reward increased and superior performance by DPMs.

**Linkage**

All multiple-listed option classes at CBOE were enabled for linkage on Tuesday, March 4, 2003. This concluded Phase One rollout of intermarket linkage. Phase Two (the final phase), which will fully incorporate "trade-through" protections, will be rolled out beginning Friday, April 25, 2003, and will enable members to send and receive larger linkage orders that may not be eligible for automatic execution.

The Options Institute is offering education on linkage rules and technology. For more information, refer to Regulatory Circular RG02-199 available on the members' website at [www.cboe.com](http://www.cboe.com) or contact Debra Peters, Vice President, The Options Institute, at 312.786.7395.

**Washington Update**

CEO Bill Brodsky has met with four SEC commissioners in Washington D.C. to express CBOE's concerns regarding payment for order flow, internalization and a rule filing by the Boston Stock Exchange to operate an all-electronic options facility to be named the Boston Options Exchange (BOX). CBOE believes that the current rule filing would allow BOX to function as a mechanism for internalizing trades. Bill continues to meet with many members of Congress to urge resolution of payment for order flow and internalization issues.

He also intends to meet with the new chairman of the SEC, William H. Donaldson, who was sworn in on February 18, 2003. Bill also extended an invitation to the SEC commissioners to visit CBOE.

Members should refer to Information Circular IC03-22 on the members' website at [www.cboe.com](http://www.cboe.com) to read in-depth documents regarding CBOE's positions on payment for order flow, internalization and BOX.

**Financial Update**

In the months of January and February, CBOE reported a pre-tax loss of \$730,600 and a pre-tax profit of \$162,000, respectively. Through the first eight months of Fiscal Year 2003, CBOE realized a pre-tax profit of \$13.5 million on revenues of \$110.2 million. Volume averaged 1,052,000 contracts per day in January and 976,900 contracts per day in February, and is averaging 1,045,600 contracts per day fiscal year-to-date. Working capital for the Exchange increased to \$33.5 million as of February 28.

Because of CBOE's better than budgeted volume and strong financial results, market maker fees were reduced from 24 cents per contract to 18 cents per contract on January 1. This 25% reduction in fees to DPMs and market makers saved CBOE members more than \$2 million in the last two months.

**Single Stock Futures**

OneChicago traded 79,522 contracts in March 2003. Open interest at OneChicago stood at 44,945 contracts at month's end.

OneChicago is operating exclusively as an electronic exchange, with CBOE*direct*® performing as the trade engine. Any firms not yet in the process of connecting to and testing with CBOE*direct* should contact Dan Hustad, CBOE Vice President, Market Quality and Assurance, at 312.786.7715.

Trading hours are from 8:15 a.m. to 3:00 p.m. (CST). All CBOE members with trading privileges on CBOE have member access and rights to trade on OneChicago. However, members need to have the appropriate guarantee and clearing designation forms in place prior to trading on OneChicago. Forms are available online at [www.cboe.com](http://www.cboe.com) under the "About CBOE" tab, or by calling CBOE's Membership Department at 312.786.7449.

For additional information on products or services available at OneChicago, visit their website at [www.onechicago.com](http://www.onechicago.com) or call 312.424.8500.

### **BXM Licensed**

CBOE has entered into a license agreement giving Boston-based Rampart Investment Management Company, Inc. the right to use the CBOE BuyWrite Monthly Index<sup>SM</sup> (BXM) as the strategic basis for a new options investment vehicle.

Introduced by CBOE in April 2002, the BXM is a benchmark index that measures the performance of a theoretical portfolio of long Standard & Poor's 500 Index stocks, and short S&P 500 Index call options (SPX) against the portfolio. Dividends received are included in the performance.

Rampart's implementation of the BXM Index, the *Rampart BXM Strategy*, is designed to replicate or closely approximate the CBOE BXM. It enables institutional investors to allocate assets to a buy-write strategy with a licensed investment manager.

### **Volume Update**

Exchange-wide volume for March 2003 totaled 23,041,783 contracts (12,993,031 calls and 10,048,752 puts), up 12% versus the 20,644,812 contracts traded in March 2002 and a 24% increase over the previous month's (February 2003) total of 18,606,096 contracts. For the month of March, average daily volume was 1,097,228 contracts. At the end of March, open interest reached 89,590,939 contracts, up 15% over the close of March 2002.

On Friday, March 21, 2003, CBOE experienced one of the busiest trading days in its twenty-nine year history as exchange-wide volume eclipsed the two million mark when 2,003,524 contracts (1,228,293 calls and 775,231 puts) traded.

Stock options volume in March 2003 totaled 12,395,497 contracts (7,876,054 calls and 4,519,443 puts), a 26% increase over the previous month's (February 2003) total of 9,845,570 contracts, but a decrease of 17% when compared to the 14,913,322 contracts traded in March 2002. For the month of March, average daily volume in stock options was 590,262 contracts. Open interest in stock options stood at 74,820,604 contracts at the end of March 2003, up 9% from the end of March 2002.

For the eleventh consecutive month, total index options volume posted gains at CBOE. In March 2003, total index options volume reached 10,637,781 contracts (5,111,228 calls and 5,526,553 puts), an increase of 86% over the March 2002 total of 5,729,187 contracts and a 22% increase over the previous month's (February 2003) total of 8,758,171 contracts. For the month of March, average daily volume in index options totaled 506,561 contracts. At the end of March 2003, open interest in index options was 14,760,616 contracts, 71% higher than March 2002.

March volume in the following indexes posted significant gains, when compared to March 2002:

- . S&P 500<sup>®</sup> Index<sup>SM</sup> (SPX) options: 3,364,973 contracts, up 90%
- . S&P 100<sup>®</sup> Index<sup>SM</sup> (OEX) options: 1,375,906, up 82%
- . Nasdaq-100 Index Tracking Stock<sup>SM</sup> (QQQ) options: 2,813,837 contracts, up 71%
- . Nasdaq-100 Index<sup>®</sup> (NDX) options: 91,354 contracts, up 13%
- . Dow Jones Industrial Average<sup>SM</sup> (DJX) options: 1,191,079 contracts, up 51%
- . Russell 2000<sup>®</sup> Index (RUT) options: 23,543 contracts, up 85%
- . Options on DIAMONDS (DIA): 1,059,818 contracts, up 62% (from the previous month)

**New Position Limits for DIAMONDS**

Effective as of February 24, 2003, the position and exercise limit in options on DIAMONDS (DIA) was increased at CBOE to 300,000 contracts on either side of the market, from 75,000 contracts. DIAMONDS are shares in an exchange-traded fund designed to track the performance of the Dow Jones Industrial Average (DJIA®). Options on DIAMONDS have been available at CBOE since May 2002.

**LEAPS® on OEF**

On Wednesday, March 12, 2003, CBOE began trading full value LEAPS on iShares® S&P 100® Index Fund (OEF). Chicago Trading Company, LLC; Knight Financial Group; and QSA-Ronin Capital, LLC will be the Lead Market Makers (LMMs) for OEF LEAPS.

Questions regarding OEF LEAPS may be directed to William Naus on the OEF Hotline at 312.460.1705 (8 a.m. - 3:30 p.m. Chicago time).

**New Indexes Created**

CBOE has created two new indexes: the CBOE Euro 25 Index (ticker symbol EOR) and the CBOE Asia 25 Index (ticker symbol EYR), that began trading Monday, March 31, 2003. Both the CBOE Euro 25 and Asia 25 Indexes have been designed to measure the performance of large market-capitalization companies in their respective regions, giving stock index investors more international choices. With the addition of these two indexes, CBOE now offers options on 32 stock indexes.

Both EOR and EYR are composed of 25 actively-traded American Depositary Receipts (ADRs), New York Registered Shares (NYSs) or NYSE Global Shares® (NGSs) traded on U.S. securities exchanges. Both new indexes are market-capitalization weighted indexes and will be re-balanced quarterly following the expiration of the index option contracts. January 2, 2002 is the base date for both indexes, with 100 set as the base level.

EOR and EYR options are European-style exercise, settled in cash, with position limits of 50,000 contracts on either side of the market. EOR and EYR will trade on the March expiration cycle with introductory expirations in April, May, June and September. Timber Hill was named the Designated Primary Market Maker for both indexes.

For further information, access [www.cboe.com](http://www.cboe.com) and click on "Index Options" under the "Products" tab.

**New Exchange-Traded Fund**

On March 5, 2003 CBOE listed options on iShares GS \$ InvesTop™ Corporate Bond Fund (ticker symbol LQD). Susquehanna Investment Group is the DPM in the options.

**20th Anniversary**

Tuesday, March 11, 2003 marked the 20th anniversary of index options trading at CBOE. In 1983, CBOE introduced the CBOE 100 Index, later renamed the S&P100® Index (OEX). Standard & Poor's Managing Directors of Indexes, Robert Shakotka and Eudald Canadell, visited CBOE and rang the opening bell on March 11 to commemorate the occasion.

**30th Anniversary**

April 26, 2003 marks CBOE's thirtieth anniversary and the launch of listed options.

To commemorate the occasion, Mayor Richard M. Daley will ring the opening bell during a special ceremony on April 22, 2003.

CBOE members are also invited to attend a members-only celebratory event in their honor immediately following the close of trading on April 22. The reception will be held in the lobby of the CBOE building at 400 S. LaSalle Street, and will include complimentary food, drinks and entertainment.

Members with questions can contact Janice Calvin, Media Relations Manager, at 312.786.7492.

**Options Industry Conference**

The 21st Annual Options Industry Conference, sponsored by the Options Industry Council and hosted this year by CBOE, will be held Thursday, April 24 through Saturday, April 26, 2003 at the Grand Cypress Resort in Orlando, Florida.

Register on-line at [www.optionsindustryconference.com](http://www.optionsindustryconference.com). For registration questions, problems or concerns, call the Registration Hotline at 877.752.6481.

**E-mails to Members**

CBOE members who prefer to receive the OPEN INTEREST newsletters via e-mail rather than by U.S. Mail should send their request, including their name, firm name (if applicable), and desired e-mail address to [members@cboe.com](mailto:members@cboe.com) or contact Doug Luzzi of Internet Systems Development at 312.786.7105.