

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.

Launch of Hybrid Trading System Planned for May; Proposed Rules Available

Plans to implement the CBOE Hybrid Trading System, named CBOE*direct*® HyTS™, remain on schedule with launch anticipated at the end of May 2003. 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.

The proposed rules for CBOE*direct* HyTS have been published in the **Federal Register** as of Tuesday, April 22, 2003. There is a 21-day comment period that will conclude on May 13. The beginning of the HyTS roll-out is anticipated to be scheduled for a date following May expiration. 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 the year.

The Hybrid will allow individual market makers to input their own streaming quotes, which should result in tighter markets, enhancing CBOE's competitive position. Customers will have direct point-and-click access to quotes with size on CBOE markets.

Among the many features of the CBOE*direct* HyTS model are: individual streaming quotes, point and click execution, open order limit Book, and potential for price improvement by retaining the benefits inherent in a floor-based, open outcry exchange.

The "CBOE Proposed Hybrid Rules" are posted on the members' website on the member home page at www.cboe.com. For additional information on the Hybrid, select the new "CBOE*direct* HyTS" micro-website under the "About CBOE" tab at www.cboe.com. Members can refer to Information Circular IC03-52 for information on plans for mock trading sessions.

Members with questions on the rules can also contact Stephen Youhn, Senior Attorney, at 312.786.7416. Questions on connectivity should be directed to API Client Relations at 312.786.7300. For queries regarding business issues, contact Anthony Montesano, Vice President, Trading Operations, at 312.786.7365 or Carol Zylius at 312.786.7174.

Universal WorkStation Now Available to CBOE Members

On February 27, 2003, CBOE introduced the new CBOE Hybrid Trading System (HyTS™) Terminal, a universal, multifunctional, trading solution workstation for CBOE customers. 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 serves 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. On April 22, 2003, CBOE announced it signed a definitive agreement with Belzberg Technologies, Inc. and its affiliate, Electronic Brokerage Systems, LLC.

The HyTS Terminal leverages CBOE's Hybrid Trading System and defaults 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 HyTS Terminal or who would like to schedule a demonstration, can contact Andrew Lowenthal, CBOE Director, Business Development, at 312.786.7180.

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 fully incorporates "trade-through" protections, began roll-out on Friday, April 25, 2003. Phase Two enables members to send and receive larger linkage orders that may not be eligible for automatic execution.

Payment For Order Flow

CBOE has been actively encouraging the SEC to resolve the payment for order flow issue, which continues to be prevalent in the options industry. Some exchanges, which compete with CBOE, are using payment to increase their market share. If the SEC does not ban payment for order flow, the CBOE Board of Directors is considering instituting a payment for order flow program at CBOE in order to preserve CBOE business.

The Board of Directors is considering the following options:

- 1) Re-institution of the exchange-sponsored marketing fee program that was suspended effective August 1, 2001.
- 2) A payment for order flow proposal submitted to the Board by the Equity Market Development and Market Performance Committee.
- 3) A plan that would be some combination of the above two possibilities.

Further information will be provided to members as developments occur.

Washington Update

The Boston Stock Exchange has submitted a rule filing to the SEC to operate an all-electronic options facility to be named the Boston Options Exchange (BOX). CBOE is actively encouraging members of Congress to work with the SEC to ensure that the SEC does not approve any aspects of the BOX filing that are inconsistent with the Securities Exchange Act of 1934. CBOE's main focus will be on the Senate Banking Committee, which is chaired by Senator Richard Shelby (R-AL) and the House Financial Services Committee, chaired by Representative Mike Oxley (R-OH).

Senator Charles Grassley (R-IA), chairman of the Senate Finance Committee, and Representative Bill Thomas (R-CA), chairman of the House Ways and Means Committee, are looking at offsets for the president's dividend tax cut. They will be looking at all capital gains, which raises a concern for CBOE members regarding 60/40 tax treatment. If this becomes an issue, CBOE will work aggressively with the CME and the CBOT to protect 60/40, which is extremely valuable to our members.

CBOE, as well as the other securities exchanges, recently received a letter from SEC Chairman William Donaldson requesting that CBOE review its corporate governance practices and submit a report of its findings and any proposed changes to the SEC by May 15, 2003. CBOE also received a letter from Annette Nazareth, Director of the SEC's Division of Market Regulation, providing further guidance on the issues that the SEC would like CBOE and the other securities exchanges to address in their reports requested by Chairman Donaldson. The letters from the SEC have been forwarded to the Board's Governance Committee, which is assisting in preparing the Exchange's response to the SEC.

Status of Proposed NASD Rule Changes

CBOE continues to work in cooperation with the Options Clearing Corporation, the ISE, the PCX, and the PHLX, in opposition to the National Association of Securities Dealers' (NASD) proposal to permanently impose a Trading Activities Fee ("TAF") upon listed options transactions, as proposed in their rule filing SR-NASD-2002-148 ("2002-148").

The TAF was originally submitted by the NASD as an "effective on filing" fee change (SR-NASD-2002-98). The CBOE both submitted its own comment letter in opposition to the TAF, and also joined the other SROs noted above in a joint letter in opposition. (These letters were reported in previous issues of OPEN INTEREST.) In response to these and other comments in opposition, the NASD filed a new filing that proposed to "sunset" SR-NASD-2002-98 on December 31, 2002, as well as 2002-148, which they submitted "regular way" (i.e., subject to a notice and comment period, as well as formal SEC approval). Apparently, NASD expected to secure SEC approval of 2002-148 by December 31, 2002.

The CBOE and others again wrote comment letters in opposition to 2002-148. Apparently as a result, the SEC did not approve 2002-148 by December 31, 2002, and the NASD submitted an effective-on-filing extension of the TAF through March 1, 2003.

CBOE and the other SROs continued to press our case against the TAF through a variety of means, including personal calls and visits to SEC Commissioners and their top Market Regulation staff by Chairman Brodsky and other SRO representatives. Once again, the SEC did not approve 2002-148 by the March 1, 2003 deadline, and the NASD filed another effective-on-filing extension of the TAF through April 1, 2003.

On March 18, 2003, the NASD finally submitted to the SEC a response to the various comment letters that had been received in opposition to the TAF. In summary, the NASD responded to some of CBOE's concerns by proposing to amend 2002-148 to codify exemptions from the TAF for broad and narrow-based index options, as well as for transactions by dually registered members who are trading in their specialist or market maker capacities. The latter exemption, however, does **not** extend to bona fide arbitrage or hedging transactions, such as stock transactions to hedge a position in the corresponding equity options. More fundamentally, the NASD response again refused to exempt listed options from the TAF.

The CBOE and other SROs reiterated the continuing issues with the TAF in a March 24, 2003 comment letter. In addition, the CBOE filed another comment letter of its own on March 27, 2003 to highlight one key remaining issue: that contrary to the NASD's claims, the TAF as currently proposed will often be imposed upon the option and stock transactions of non-NASD members.

Once again, the SEC did not approve 2002-148 by the April 1, 2003 deadline, and the NASD filed another effective-on-filing extension of the TAF through April 15, 2003. When that deadline also arrived without SEC approval of 2002-148, the NASD filed yet another extension through June 1, 2003 (SR-NASD-2003-73).

The CBOE will continue its work in opposition to the TAF, and this effort would be greatly assisted by additional comment letters from CBOE members and member organizations. For more information on how to submit a comment letter, or to obtain copies of the previous comment letters noted above, contact CBOE General Counsel Joanne Moffic-Silver at 312.786.7462 or Attorney Chris Hill at 312.786.7031.

Single Stock Futures

OneChicago is operating exclusively as an electronic exchange trading single stock futures, 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.

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 under the "About CBOE" tab, or by calling CBOE's Membership Department at 312.786.7449.

On April 21, 2003, Amazon.com was added to OneChicago's list of products. Volume on Amazon.com surpassed 2,000 contracts on its first day of trading. OneChicago currently trades futures on 86 single stocks and the Diamonds® ETF. On April 16, 2003, OneChicago passed the 500,000 contracts traded mark.

For additional information on products or services available at OneChicago, visit their website at www.onechicago.com or call 312.424.8500.

30th Anniversary

April 26, 2003 marked CBOE's 30th anniversary and the launch of listed options.

To commemorate the occasion, Mayor Richard M. Daley rang the opening bell during a special ceremony on April 22, 2003. CBOE staff enjoyed a complimentary continental breakfast, and CBOE members celebrated at an anniversary party, which included food and entertainment, hosted by the Exchange.

On May 2, Myron Scholes, 1997 Nobel Laureate in Economics for his role in developing the Black-Scholes options pricing model, visited the Exchange and toured the trading floor. He also addressed CBOE guests during a luncheon at The Chicago Club.

This year, CBOE hosted the 21st Annual Options Industry Conference, April 24-26, in Orlando, Florida. The 30th anniversary of options was also commemorated during the conference.

The WALL STREET JOURNAL has been running a series of articles on options in acknowledgement of the 30th anniversary.

New Products

CBOE recently listed options on three Exchange-Traded Funds:

...iShares® Lehman 1-3 Year Treasury Bond Fund (ticker symbol SHY; DPM: Knight Financial Products)

...iShares Lehman 7-10 Year Treasury Bond Fund (ticker symbol IEF; DPM: Knight Financial Products)

...iShares Lehman 20+ Year Treasury Bond Fund (ticker symbol TLT; DPM: Equitec-Structured Products)

Volume Update

Exchange-wide volume for April 2003 totaled 22,772,736 contracts (12,953,983 calls and 9,818,753 puts), up 5% versus the 21,692,523 contracts traded in April 2002. For the month of April, average daily volume was 1,084,416 contracts. At the end of April, open interest reached 92,600,581 contracts, up 25% over the close of April 2002.

Stock options volume in April 2003 totaled 13,576,433 contracts (8,638,424 calls and 4,938,009 puts), a 10% increase over the previous month's (March 2003) total of 12,395,497 contracts, but a decrease of 13% when compared to the 15,510,492 contracts traded in April 2002. For the month of April, average daily volume in stock options was 646,497 contracts. Open interest in stock options stood at 76,810,970 contracts at the end of April 2003, up 20% from the end of April 2002.

For the twelfth consecutive month, total index options volume posted gains at CBOE. In April 2003, total index options volume reached 9,193,846 contracts (4,314,077 calls and 4,879,769 puts), an increase of 49% over the April 2002 total of 6,179,582 contracts. For the month of April, average daily volume in index options totaled 437,802 contracts. At the end of April 2003, open interest in index options was 15,780,097 contracts, 58% higher than April 2002.

Upcoming Membership Meetings

CBOE general membership meetings are scheduled for Tuesday, May 13 and Wednesday, June 18, 2003. There will also be a Board of Directors meeting on June 18, and all Board members have been invited to attend the general membership meeting on that date.

As dates are subject to change, please visit the members' website at www.cboe.com for updated notification of membership meetings.

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 or contact Doug Luzzi of Internet Systems Development at 312.786.7105.