Information Circular IC03-80
July 10, 2003

CBOE
CHICAGO BOARD OPTIONS EXCHANGE

OPEN INTEREST

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.

CBOE*direct*® HyTS℠
The CBOE Hybrid Trading System, CBOE*direct* HyTS, was successfully launched on June 12, 2003. Initial classes converted to trading on the new system were Harmony Gold (HMY) on June 12, Pepsi (PEP) on June 13, Computer Associates (CA) and Sprint Corporation (FON) on June 24, Genzyme Corporation (GZQ) on June 25, Harley Davidson (HDI) on June 26; and Motorola, Inc. (MOT) and Krispy Kreme Donuts (KKD) on June 27. As of July 11, 2003, 22 classes will have been converted to trading on the Hybrid. Roll-out schedules are posted on the members' website at www.cboe.com as they are developed. By year-end, it is anticipated that the top classes, which account for approximately 80% of the national volume in equity options, will be on the Hybrid.

Initial reaction to the Hybrid has been very encouraging, and testing is currently being expanded. All market makers must participate in a practice session and be certified ready to quote before accessing CBOE*direct* HyTS in live trading.

Some of the features of the CBOE*direct* HyTS model are: individual market makers' streaming quotes with size; point-and-click electronic execution and open Limit Order Book for customer, firm and (non-market maker) broker/dealer orders; and potential for price improvement by retaining the benefits inherent in a floor-based, open outcry exchange. By displaying CBOE market makers' consolidated best bid and offer along with total size available at those prices, deeper, tighter markets should result, improving CBOE's competitive position. Customers, firms and (non-market maker) broker/dealers have direct electronic point-and-click access to continually updated quotes with size on CBOE markets.

The "CBOE Hybrid Rules" are posted on the members' website at www.cboe.com. Select "What's New" under the "Exchange" tab. For additional information on the Hybrid, select the "CBOE*direct* HyTS" micro-website under the "About CBOE" tab at www.cboe.com. Members should refer to Information Circular IC03-52 for information on 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 Available to CBOE Customers
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, firms and (non-market maker) broker/dealers 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.

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 also serve as the main portal to CBOE*direct* HyTS.

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.

Fiscal Year 2004 Business Plan and Budget
CBOE's budget for Fiscal Year 2004, which runs from July 1, 2003 to June 30, 2004, has been developed by the Financial Planning Committee and was approved by the Board of Directors on June 18, 2003.

CBOE used a conservative approach to projecting volume for the new fiscal year. Revenues of $151 million are projected in FY 2004, based on budgeted volume of an average of 925,000 contracts per day. CBOE will break-even at the budgeted volume level. CBOE began FY 2004 with working capital of $28 million.

There are some changes in the fee schedule in FY 2004, including:

. The Index Public Order Book Transaction Fee has been reduced from an average of $.82 to an average of $.54 per contract.

. A six-month pilot program will cap fees for large orders for customer trades in most of the indexes.

. The current Market Share Incentive Plan, which reduces equity and QQQ market maker fees for high market share, has been extended through December 31, 2003.

. Market maker fees in DJX and DIA have been increased from $.19 to $.29.

. Trading floor booth fees for non-OCC members have been reduced from $550 to $300 per month.

For more extensive information on fee changes in FY 2004, refer to Regulatory Circular RG03-47 on the members' website at www.cboe.com.

Strike Price Pilot Program
On Tuesday, June 24, 2003, CBOE announced a pilot program to list series on certain stock option classes at $1 strike price increments. CBOE initiated its program on June 24 by listing strike prices with $1 increments on AMR Corporation (AMR) and Sun Microsystems Corp. (SUNW). CBOE added Calpine Corp. (CPN), El Paso Corp. (EP) and EMC Corp. (EMC) on Wednesday, June 25, and added Motorola, Inc. (MOT) options on Thursday, June 26.

Under the pilot program, CBOE may select up to five equity classes on which $1 increment strike prices may be listed, and CBOE also may list $1 strike price series on any other classes that are selected by other exchanges pursuant to their respective pilot programs. For a class to be eligible for the pilot program, an underlying stock must close under $20 and dollar strike prices may only be from $3 to $20.

CBOE sought SEC approval to list options with tighter price intervals in an effort to better align option trading opportunities with lower priced stocks. Traditionally, options strike prices are set in $5 increments on stocks that are priced over $20 and in $2.50 increments for stocks that trade under $20, and, for certain classes, between $25 and $50.

All five options exchanges are participating in the program, and hence it is expected that there will be 25 classes subject to dollar strike prices. CBOE was the first to seek regulatory approval for this program.

NASD Trading Activities Fee Approved in Modified Form

On May 30, 2003, the SEC approved a modified version of the NASD's Trading Activities Fee (TAF) in rule filing SR-NASD-2002-148. In response to comments from CBOE and other commenters, the SEC required NASD to amend their original proposal to make it applicable to fewer transactions as follows:

. All index options and futures transactions are exempt from the TAF;

. Also exempt from the TAF are transactions in exchange listed options effected by a NASD member when NASD is not the Designated Options Examination Authority for the member. *(This particular exemption is not effective until January 1, 2004. Fees will continue to be charged until that date.)*

. Also exempt from the TAF are proprietary transactions by NASD members who are also members of an exchange, effected in their capacity as exchange specialists or market makers, that are subject to Section 11(a) of the '34 Act and Rule 11a1(t)(a). This exemption does NOT apply to bona fide arbitrage or hedge transactions;

. Also permanently approved as exempt from the TAF are transactions by a floor-based broker who is a member of both NASD and an exchange, provided the floor broker qualifies for exemption from NASD membership under Exchange Act Rule 15b9-1. (Previously, such transactions were exempted temporarily pending further consideration by the SEC.)

In addition, at the suggestion of CBOE and other commenters, the SEC's approval order:

. urges the NASD to "consider ways to take into account activity" in debt, mutual funds and variable annuities "to better allocate costs to these areas."

. notes that the NASD has agreed to file all future changes to the TAF for full notice and comment prior to approval. This should prevent NASD from raising the TAF fee rate without an opportunity for notice and comment.

For further and more detailed information on the applicability of the Trading Activity Fee, interested CBOE members should visit the NASD's website at www.nasdr.com, or contact the NASD Office of the General Counsel at 202.728.8071. Members can also obtain copies of CBOE comment letters on this issue by contacting Attorney Chris Hill at 312.786.7031.

Linkage

All multiple-listed option classes at CBOE were enabled for linkage on Tuesday, March 4, 2003. This concluded Phase One roll-out of intermarket linkage. Phase Two (the final phase), which fully incorporates "trade-through" protections, began roll-out on Friday, April 25, 2003 and was concluded on Friday, June 27. Phase Two enables members to send and receive larger linkage orders that may not be eligible for automatic execution. Questions on linkage should be directed to Timothy Watkins, Vice President, Trading Systems Support, at 312.786.7172.

LEAPS® on OEX®, XEO® and OEF

On Thursday, June 26, 2003, CBOE began listing full value 2005 LEAPS on S&P 100® Index with American style exercise (OEX), S&P 100 Index with European style exercise (XEO) and iShares® S&P 100 Index exchange-traded fund (OEF). Chicago Trading Company, LLC; Knight Financial Group; QSA-Ronin Capital, LLC; and Equitec Proprietary Markets, LLC will be the Lead Market Makers (LMMs) for the OEX, XEO and OEF full value 2005 LEAPS.

Payment for Order Flow
CBOE has been actively encouraging the SEC to resolve the payment for order flow issue, which continues to prevail in the options industry. Competing exchanges are using payment to increase their market share. The CBOE Board of Directors instituted a payment for order flow program at CBOE effective June 1, 2003 in order to retain the Exchange's ability to compete and preserve CBOE business.

Extended Hours Trading Suspended
Effective at the close of trading on Friday, May 26, 2003, CBOE suspended the Extended Hours Trading (EHT) sessions which ran from 7 a.m. to 8:15 a.m. EHT began in October, 2001, using CBOE*direct* to trade certain indexes electronically prior to the regular trading session. Suspension of the EHT sessions allows market makers, DPMs and member firms to focus their efforts on transitioning to CBOE*direct* HyTS, which is rolling-out in phases throughout 2003.

OneChicago
OneChicago, LLC and Dow Jones Indexes announced that they signed an exclusive license agreement on June 5, 2003 to list futures on 15 Dow Jones MicroSector Indexes℠, which began trading on Monday, June 23, 2003. MicroSector Indexes are narrow-based equity indexes that include five of the largest and most actively-traded stocks in each sector. These narrow-based indexes are highly correlated to their broader industries, and can give traders and other market participants an effective tool to plan sector rotation strategies.

Dow Jones MicroSector Indexes are derived from stocks and ADRs in industry groups and subgroups that comprise the Dow Jones Global Indexes. A selection list for each index is created from the top ten eligible stocks in the industry group or subgroup ranked by free-float market capitalization, dollar volume and options volume.

The initial Dow Jones MicroSector Indexes industry groups to begin trading are: Aerospace, Banks, Biotechnology, Communications Technology, Diversified Financial, Electric Utilities, Diversified Industrial, Investment Services, Major Oil Companies, Pharmaceuticals, Precious Metals, Retail, Semiconductors, Software, Technology Hardware and Equipment.

The composition of these indexes as well as historical price data and charts on the MicroSectors are available on the *OneChicago Analytics*℠ section of the OneChicago website, www.onechicago.com.

OneChicago is operating exclusively as an electronic exchange trading single stock futures and narrow-based indexes, 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.

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

Trading Futures at CBOE
The application filed with the CFTC for the CBOE Futures Exchange was recently re-activated. Approval is anticipated in mid-August 2003. The New Product Development Committee is working on futures products that would complement CBOE's current options products. Trading on the CBOE Futures Exchange might begin by the fourth quarter of 2003.

Washington Update

CBOE CEO Bill Brodsky, President Ed Joyce and General Counsel Joanne Moffic-Silver met with new SEC Chairman William Donaldson on June 20, 2003 to discuss CBOE's positions on the following issues: payment for order flow, internalization, the Boston Options Exchange application, contract rights to trade proprietary indexes, and 60/40 tax treatment for options market makers and futures traders.

The meeting was very productive and the SEC Chairman showed great interest in these issues. We are hopeful the new SEC Chairman will visit the Exchange in the near future.

Members unfamiliar with CBOE's positions on any of the issues cited should contact CBOE's Legal Department at 312.786.7462. Members may also visit the CBOE website at www.cboe.com to read CBOE comment letters on these issues.

Tax Treatment for Options and Futures Traders

On May 20, 2003, the U.S. Senate stripped its proposed repeal of 60/40 tax treatment [Code section 1256(a)(3)] in a unanimous consent agreement that altered the tax reduction bill passed by the Senate on Thursday, May 15, 2003.

It was CBOE's work in Washington that produced the first alert that the Senate had included the repeal provision. The subsequent swift action of CBOE's Washington team, along with the U.S. Securities Markets Coalition (the five U.S. options exchanges) and the Chicago futures exchanges resulted in the very prompt action by the Senate in striking a provision from a tax bill that had been adopted just days earlier.

The tax technicians at both the Treasury Department and the Joint Committee on Taxation have renewed their interest in the 60/40 issue as a possible future tax change. For this reason, CBOE will remain extremely vigilant with regard to efforts to educate Congress about the importance of this to the options industry and the threat that repeal creates to options markets and investors.

For more information on this issue, including CBOE's response, please refer to Information Circulars IC03-061 and IC03-062 posted on the members' website at www.cboe.com.

Political Action Committee

CBOE's Political Action Committee (PAC) is now conducting an annual fund-raising drive. These funds are critical at a time when there is so much at stake affecting the options industry in both the U.S. House of Representatives and in the U.S. Senate. Donations are very much needed to maintain a significant presence in Washington. Any questions regarding the PAC may be directed to Amy Zisook, Vice President, Civic and Governmental Affairs, at 312.786.7182 or Christy Hanson, Representative, Civic and Governmental Affairs, at 312.786.7066.

Volume Update

Exchange-wide volume for June 2003 totaled 25,340,487 contracts (14,659,422 calls and 10,681,065 puts), up 20% versus the 21,165,444 contracts traded in June 2002 and up 11% when compared to the previous month's (May 2003) total of 22,928,895 contracts. June was the fourth consecutive month this year that exchange-wide volume posted gains over the prior year. For the month of June, average daily volume was 1,206,690 contracts. At the end of June, open interest reached 103,788,204 contracts, 27% higher than the close of June 2002.

Stock options volume in June 2003 totaled 15,710,788 contracts (10,650,814 calls and 5,059,974 puts), a 16% increase over the 13,550,971 contracts traded in June 2002 and up 9% over the previous month's (May 2003) total of 14,380,860 contracts. For the month of June, average daily volume in stock options was 748,133 contracts. Open interest in stock options stood at 87,854,967 contracts at the end of June 2003, up 23% from the end of June 2002.

For the fourteenth consecutive month, total index options volume posted gains at CBOE. In June 2003, total index options volume reached 9,618,719 contracts (4,001,054 calls and 5,617,665 puts), an increase of 26% over the 7,611,008 contracts traded in June 2002 and 13% higher than the previous month's (May 2003) total of 8,536,530 contracts. For the month of June, average daily volume in index options totaled 458,034 contracts. At the end of June 2003, open interest in index options was 15,920,254 contracts, exceeding the June 2002 level by 55%.

CBOE BuyWrite Monthly Index℠ (BXM℠)

The CBOE BuyWrite Monthly Index (BXM) finished the first half of 2003 up 7.1%. The BXM is a benchmark index that measures potential returns of a theoretical portfolio of Standard & Poor's 500 index stocks that also systematically sells S&P 500® Index call options against the portfolio.

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.