

Information Circular IC04-03
January 16, 2004

Updates to the Chicago Board Options Exchange Membership Meetings

SEC Approval of BOX

CBOE is disappointed and concerned regarding the SEC's approval of the Boston Options Exchange (BOX) proposal to trade listed options. BOX received approval by the SEC on January 14, 2004. CBOE had made its concerns known to the SEC in comment letters filed prior to the SEC's decision. Additionally, CBOE officials visited the SEC on several occasions in order to personally discuss this issue with each SEC Commissioner, including a recent meeting with SEC Chairman William Donaldson.

CBOE has consistently contended that the BOX model, which is based on internalization, thwarts the price discovery process and promotes conflicts of interest.

In order to participate in the growing segment of internalized order flow that will surely result from the SEC's approval of the BOX, CBOE will file immediately with the SEC for the ability to trade certain orders in pennies, while quoting in nickels, as is allowed by BOX.

CBOE's comment letters to the SEC regarding the BOX filing are posted on CBOE's member website at <https://www.cboe.com/members/exchange/Special.asp>. The BOX filing and comment letters from other exchanges can be found at <http://www.sec.gov/>.

Agreement on Exercise Right

On December 17, CBOE and CBOT announced an agreement which enables CBOT Full Members to unbundle and sell their CBOE exercise right privileges. The CBOE exercise right, which was granted to CBOT Full Members when the CBOE was formed, allows a CBOT Full Member to become a CBOE member without having to purchase a membership at the CBOE.

The new agreement, which has been adopted by both the CBOT and the CBOE Board of Directors, will provide the CBOT Full Members the ability to request that the CBOT issue the exercise right privilege associated with their CBOT Full Membership. Under the terms of the agreement and the CBOT rules expected to be adopted in order to give effect to the agreement, the exercise right privilege may be unbundled and rebundled with CBOT Full Memberships and may be separately bought or sold. The agreement includes the possibility of a sale to the CBOE. However, in order to exercise and become a member of the CBOE, a CBOT Member will continue to be required to be in possession of a CBOT Full Membership and the exercise right privilege.

It is currently expected that the CBOT's restructuring proposal, which is described in a registration statement on file with the SEC, will be revised to accommodate this agreement and any related changes to the CBOT rules.

A vote of the CBOT members relating to this agreement is expected to occur early this year. In addition, before it becomes effective the proposal must be filed by CBOE with, and approved by, the SEC.

Hybrid 2.0

On December 18, the CBOE membership voted to implement the second phase of CBOE*direct*® HyTS,™ CBOE's unique hybrid trading system. Hybrid 2.0 is a new CBOE initiative, designed to combine technological innovation and liquidity with the goal of assuring that CBOE remains the premier marketplace for listed equity options. The proposal passed with 592 votes in favor, 163 votes opposed and six abstentions.

Hybrid 2.0 follows the successful implementation of CBOE*direct* HyTS, and will allow a wider range of market participants to access the Hybrid system.

The plan is composed of the following four principal components:

1. The creation of a new class of CBOE members, Remote Market Makers ("RMMs"), that will stream quotes into CBOE to enhance the liquidity base provided by market makers. As part of this initiative, floor-based CBOE Market Makers ("MMs") will be enabled to stream quotes into CBOE while they are away from the floor.
2. The creation of a new class of CBOE members, electronic Designated Primary Market Makers ("e-DPMs"), that will stream quotes into CBOE remotely to enhance the liquidity base provided by Designated Primary Market Makers (DPMs).
3. The streamlining of CBOE's current procedures to allow order flow providers to participate at a 20% or 40% rate in the orders they bring to CBOE electronically. If the order is being executed at the disseminated market, the 20% rate applies; if it is being executed between the disseminated market, the 40% rate applies.
4. A revision of CBOE's transaction fee schedule to provide incentives for members and member firms to bring substantial additional liquidity and business to CBOE.

Hybrid 2.0 is expected to be implemented during the first quarter of 2004, pending approval of the necessary rule filings by the SEC.

For more extensive information on current plans for Hybrid 2.0, members may refer to Information Circular IC03-135 and a news release titled "CBOE Further Expands Roll-Out of CBOE*direct* HyTS, Introduces Hybrid 2.0." Both documents are posted on <http://www.cboe.com/Hybrid> under the "HyTS" menu link.

Hybrid Trading Update

CBOE will have 500 classes, which account for approximately 90% of the national volume in equity options, trading on CBOE*direct* HyTS by the end of January 2004. Updated roll-out schedules are accessible at <http://www.cboe.com/Hybrid>.

Through CBOE*direct* HyTS, disseminated bid-ask spreads have tightened and displayed sizes have increased. Our initial research shows that the average quote size of all classes converted to Hybrid has doubled. In addition, during early December, CBOE was on the National Best Bid or Offer (NBBO) 67% of the time in Hybrid classes, as compared to half of the time in non-Hybrid classes.

Some of the important features of the Hybrid include: individual market makers' streaming quotes with size; open Limit Order Book for customer, firm and broker/dealer orders; and potential for price improvement by retaining the benefits inherent in a floor-based, open outcry exchange. Customers, firms and non-market maker broker/dealers have direct electronic point-and-click access to continually updated quotes with size on CBOE markets.

Market makers should contact their autoquote provider and request a Hybrid login ID. Market makers must participate in a practice session and receive quote certification by CBOE Trading Operations staff before accessing the Hybrid in live trading.

The "CBOE Hybrid Rules" are accessible on the members' website at <http://www.cboe.com/Members>. Click the "Exchange" tab once entering the site. For additional information on Hybrid, visit <http://www.cboe.com/Hybrid>.

Members with questions on Hybrid may contact the following:

Rules	Stephen Youhn, Senior Attorney, at 312.786.7416
Connectivity	Curt Schumacher, Vice President and Chief Technology Officer, at 312.786.7564
Business Issues	Anthony Montesano, Vice President, Trading Operations, at 312.786.7365 or Carol Zylus at 312.786.7174

Universal Workstation Available

In 2003, CBOE and Belzberg Technologies, Inc. entered into an agreement to co-brand the CBOE Hybrid Trading System (HyTS™) Terminal. The CBOE HyTS Terminal is provided to CBOE members and sponsored users by Electronic Brokerage Systems, an affiliate of Belzberg. The HyTS Terminal provides electronic access and order routing to U.S. options exchanges, as well as complete access to market data, streaming quotes and order management—all on a single screen. Terminal users may also obtain similar functionality for futures and stock exchanges. It also serves as a portal into CBOE*direct* HyTS.

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

CBOE Annual Election Results

On November 21, 2003, the CBOE membership elected eight individuals to the CBOE board of directors to fill expired positions.

Among the newly elected public directors is former chief of staff to the president, Samuel K. Skinner. Most recently, Mr. Skinner served as chairman and chief executive officer of USF Corporation. He also served as U.S. Secretary of Transportation, as well as senior partner in the law firm Sidley and Austin. He will serve a three-year term.

Also elected as a public director for a three-year term is Howard L. Stone, senior managing director and chairman of the management committee of American Express Tax and Business Services. Prior to holding that position, Mr. Stone served as senior partner at the Chicago-based accounting firm Altschuler, Melvoin and Glasser.

Re-elected to three-year terms were Duane R. Kullberg, former chief executive officer of Andersen Worldwide; and Susan M. Phillips, Dean of the School of Business and Public Management at The George Washington University and former Federal Reserve Board Governor.

In addition, four individuals were elected to the board as industry (member) directors and will each serve three-year terms. Stuart J. Kipnes, president and nominee of Associated Options, Inc., was newly elected to serve as an at-large director. Also elected to the board are: Mark F. Duffy, general partner of Cornerstone Partners, general partner of Isomorphism and managing general partner of Fugue, re-elected as floor director; while Thomas H. Patrick Jr., managing director of Equity Linked Trading for the Americas, Merrill Lynch & Co., Inc.; and Thomas A. Petrone, managing director of Global Equity Derivatives, Citigroup Global Markets Inc., were re-elected as off-floor directors.

In other election results, Christopher M. Wheaton, DPM designee for SLK-Hull Derivatives was elected to the Nominating Committee for a three-year term.

Three candidates were elected to the MTS Appointments Committee. CBOE members Douglas H. Edelman, market maker, Merlinone Trading, Inc.; John F. Burnside, DPM designee, Susquehanna Investment Group; and Daniel P. Carver Sr., floor broker, National Financial Services, LLC, were each elected to serve three-year terms.

Vice Chairman Appointment

At its meeting on December 10, 2003, the CBOE Board of Directors declared Edward T. Tilly CBOE vice chairman in 2004. Mr. Tilly is serving a one-year term.

An active CBOE member since 1989, Mr. Tilly is a market maker for Botta Capital Management, LLC. He was instrumental in the development and implementation of the CBOE Hybrid Trading System, CBOE*direct* HyTS. Mr. Tilly also serves on the Governance, and Equity Floor Procedure Committees, and the Corporate Structure Task Force. He also served as a member of the board of directors in 1998, 1999, 2000 and 2003. As vice chairman, he chairs the Floor Directors Committee.

As the only candidate for vice chairman in 2004, Mr. Tilly was declared vice chairman by the CBOE Board of Directors to take office on January 1, 2004, succeeding Mark F. Duffy.

New Index Product

CBOE began trading options on the Fidelity® Nasdaq Composite Index® Tracking Stock (NASDAQ ticker symbol: ONEQ, CBOE symbol: ONQ) on December 12, 2003.

ONEQ™ is an exchange traded fund that seeks to provide investment returns that closely correspond to the price and yield performance of the Nasdaq Composite Index®. Options on ONEQ can provide investors with exposure to the Nasdaq Composite Index, in one transaction, that can also offer the benefit of limited risk. Buyers of ONQ options have pre-determined risk that is limited to the amount of premium paid.

The Designated Primary Market Maker (DPM) for ONQ options is Knight Financial Products, LLC. The options trade on the March expiration cycle, with initial expiration months of January, February, March and June, and position limits of 22,500 contracts. The options will be American-style exercise and physically settled in shares of Fidelity Nasdaq Composite Index Tracking Stock. Additional information on strike prices and contract specifications can be found at <http://www.cboe.com/OptProd/OptionsonETFs.asp>.

CBOE Futures Exchange

The CBOE Futures Exchange, LLC (CFE) is a new futures exchange that is owned by CBOE. The Commodity Futures Trading Commission approved CFE as a contract market in August 2003. CFE will be a fully electronic exchange that uses CBOE*direct* as its trading platform. Launch is anticipated to be in the first quarter of 2004. VIX® futures will be the first product listed on the CBOE Futures Exchange, LLC. For more information, visit <http://www.cboe.com/VIX> and <http://www.cboe.com/CFE>.

Washington Update

Qualified Cover Calls

Issues related to the "Jumpstart Our Business Strength Act" (S. 1637) were on hold during the Congressional recess, and discussion is now resuming.

Visitors

Congresswoman Nancy Pelosi (D-CA), Democratic Leader in the U.S. House of Representatives, visited CBOE on November 17th. House Minority Leader Pelosi joined members of the PAC Executive Committee for a breakfast and toured the trading floor. While this was not our first meeting with the Leader, it was her first visit to the Exchange.

Other recent visitors include Rep. Bob Ney (R-OH), who is a member of the House Financial Services Committee/Capital Markets Subcommittee, and Rep. Jerry Weller (R-IL), a longtime friend of CBOE and member of the House Ways & Means Committee.

CBOE and OCC sponsored a trip to Chicago for staff of the Senate Banking Committee. Six staff members spent time at CBOE on December 12, touring the trading floor, learning about CBOE's technology, and discussing issues the committee is currently examining, such as market structure and regulation.

Political Action Committee

CBOE is continuing its appeal for PAC funds. All CBOE members are encouraged to contribute. Any questions regarding the PAC or procedures for donating may be directed to Christy Hanson, Civic and Governmental Affairs Representative, at 312.786.7066.

Financial Update

For the first five months of Fiscal Year 2004 (period ending November 30, 2003), CBOE reported a pre-tax profit of \$5.0 million, compared to a budgeted pre-tax loss of \$0.4 million. Continued strong volume and cost control efforts allowed CBOE to post these positive results. Volume averaged 1,149,000 contracts per day during this time period, which is higher than the 1,070,100 that CBOE averaged for Fiscal Year 2003. Working capital for the Exchange increased from \$30.1 million to \$32.5 million during the first five months of FY04 despite the acquisition of \$10 million in new equipment, mostly related to the implementation of our new Hybrid trading system. CBOE continues to be debt-free.

With December trading results now in, CBOE's positive financial results are expected to continue. CBOE averaged just over 1,230,000 contracts per day for the month. Working capital should continue to grow and CBOE profitability should stay strong.

Volume Update

Volume at CBOE for 2003 totaled 283,946,495 contracts, a rise of 6% when compared to the year-ago level. The 283 million contracts traded in 2003 represented the third highest annual volume figure in CBOE history.

Exchange Volume, Year-End and December, 2003:

Total Volume

- 2003: 283,946,495 contracts
- +6% vs. 2002 volume of 267,616,496 contracts
- December: 27,207,188 contracts
- +53% vs. year-ago (Dec 02); +18% vs. previous month (Nov 03)

Average Daily Volume

- 2003: 1,126,772 contracts
- 6% vs. 2002 average daily volume of 1,061,970 contracts
- December: 1,236,690 contracts
- +46% vs. year-ago (Dec 02); +2% vs. previous month (Nov 03)

Open Interest

- 2003: 126,320,572 contracts
- +35% vs. 2002 Open Interest of 93,472,074 contracts
- December: 126,320,572 contracts
- +35% vs. year-ago (Dec 02); -2% vs. previous month (Nov 03)

Year-End and December highlights at CBOE include:

- December's 53% increase in volume was the highest single-month gain since March 2000.
- S&P 500® Index (SPXSM) was the most actively traded index option as December volume increased 59% over December 2002 with a total of 3,761,302 contracts traded.
- In 2003, CBOE monthly volume posted increases over the year-ago levels in 8 of 12 months.
- The top 5 stock option classes traded at CBOE during 2003 were Microsoft (MSFT), Cisco Systems (CSCO), General Electric (GE), Intel Corp. (INTC) and Citigroup, Inc. (C).
- The CBOE S&P 500® BuyWrite IndexSM (BXMSM) was up 19.4% compared to its closing price in 2002. The BXM is a benchmark index that measures potential returns of a theoretical portfolio that systematically sells S&P 500 Index (SPX) call options against a portfolio of Standard and Poor's 500 Index stocks.
- During December, CBOE added an additional 146 classes to CBOEdirect HyTS.

OneChicago

On December 9, OneChicago set a new volume record as 243,198 contracts traded. The all-electronic exchange offers a total of 109 security futures products, including 94 single stock futures, futures on the DIAMONDS® Trust, and 15 futures on the Dow Jones Micro Sector Indexes.SM

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 <http://www.cboe.com/AboutCBOE/CBOEMembership.asp>, or through the CBOE Membership Department at 312.786.7449.

For additional information on products or services available at OneChicago, visit <http://www.onechicago.com> or call 312.424.8500.

Options Institute Seminars

The Options Institute is offering free seminars in locations throughout the country to CBOE customers. The seminars, which discuss the strategies and tactics involved in index trading, are targeted at investors with some basic options trading experience. Currently, seminars are scheduled in Newport Beach, California on January 27, 2004; Los Angeles, California on January 28, 2004; and in San Francisco, California on January 29, 2004.

Please refer to <http://www.cboe.com/Seminars> for more times and locations as they are announced or call Felecia Tatum at The Options Institute at 312.786.7852 for more information.

New Website Section

A new section that features legal and regulatory information has been added to CBOE's website at the following web address <http://www.cboe.com/Legal>. The goal of the new web page is to offer pertinent legal and regulatory information on a more expeditious basis and in an easily accessible form.

The new web page offers information on CBOE rule filings, information circulars, disciplinary information, and arbitration information (including awards and claim forms). CBOE also offers the CBOE Constitution and Rules free of cost to members and the public on the "Legal" web page. For more details on what will be included, visit Information Circular IC03-161 at <http://www.cboe.com/publish/InfoCir/IC03-161.pdf>.

E-mails to Members

We are instituting a major effort to encourage members to receive this and other circulars to members by e-mail as a way of reducing our costs and ensuring a speedy delivery of information to you.

CBOE members who prefer to receive the OPEN INTEREST newsletters via e-mail rather than by U.S. Mail should send their request, including member name, firm name (if applicable), and desired e-mail address to (<mailto:members@cboe.com>), or, contact the CBOE Membership Department directly, at 312.786.7449.

Coming soon: a weekly update for CBOE members that will be distributed to members via e-mail and posted on the CBOE website. Please be sure to submit your e-mail address to (<mailto:members@cboe.com>), or contact the Membership Department to begin receiving this weekly update.

Happy New Year!



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