

Information Circular IC04-25
February 27, 2004

Updates to the Chicago Board Options Exchange Membership Meetings

Competitive Initiatives

Fee Cap Program

At its meeting on January 21, 2004, the CBOE Board of Directors approved a monthly cap on transaction fees charged to orders entered on behalf of a firm's proprietary trading account and orders in which the firm facilitates a customer order. The move is a competitive response to the program PHLX announced on September 1, 2003.

The CBOE fee cap went into effect February 2, 2004, and includes fees charged on firms' proprietary equity and index option orders. The cap sets a ceiling of \$75,000 per firm, per month, for all firm proprietary contracts executed at CBOE, including orders in which a firm facilitates a customer order, and applies to orders from firms whose business is primarily public customer related. For more information, please refer to the press release at <http://www.cboe.com/NewsAnnouncements> and Regulatory Bulletin RG04-16 at <http://www.cboe.com/Legal>.

Expanded Access to Posted Markets

The Equity Floor Procedure Committee has developed a proposal for allowing CBOE members and away market makers to automatically execute against posted Hybrid markets, subject to certain constraints. Watch for a Regulatory Circular to be posted soon at <http://www.cboe.com/Legal>.

CBOE Futures Exchange

CBOE Futures Exchange, LLC (CFE) will launch on Friday, March 26, 2004, pending final regulatory approval. The first product to be traded on CFE will be futures on the CBOE S&P 500® Volatility Index (VIX®). CFE received formal approval as a designated contract market from the Commodity Futures Trading Commission (CFTC) in August 2003.

CFE is a wholly-owned subsidiary of CBOE, and will operate as an all-electronic exchange using CBOE*direct* as the trading platform. The CBOE*direct*® system currently serves as the trade engine for OneChicago and CBOE's Hybrid Trading System. Trading Privilege Holder (TPH) permits will be made available to CBOE members and other eligible parties. TPH applications are available on the CBOE website at <http://www.cboe.com/CFE> or through the CBOE Membership Department. CBOE members trading on CFE will be charged reduced fees, as opposed to non-CBOE members. No transaction fees will be charged during the initial launch period. The Options Clearing Corporation (OCC) will clear all CFE trades.

VIX futures will be the first in a new family of volatility products to be offered by CBOE and CFE. Options on VIX will also soon be available, pending regulatory approval, and will be traded at CBOE.

For more information, visit <http://www.cboe.com/CFE> or contact Patrick Fay, CFE Managing Director, at 312.786.7925.

Hybrid Trading Update

By the end of February, CBOE plans to have 600 classes on Hybrid. Updated roll-out schedules are accessible at <http://www.cboe.com/Hybrid>.

Over 450 members are actively quoting on Hybrid. The hybrid system and vendors are being constantly monitored so that any problems can be quickly resolved and roll-outs can proceed as smoothly as possible.

In a recent analysis we conducted, disseminated bid/ask spreads for equity options at CBOE have tightened by 38% over the past year. During the first half of February, CBOE was on the National Best Bid or Offer (NBBO) 70% of the time in Hybrid classes, as compared to less than half of the time in non-Hybrid classes.

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.

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 Zylius at 312.786.7174

Hybrid 2.0

In December 2003, CBOE announced the second phase of the Hybrid initiative, Hybrid 2.0, which creates new classes of CBOE membership and enables a wider range of market participants to access the Hybrid System. Specifically, nationally-based specialists and market makers will now have the opportunity to quote prices and trade electronically from remote locations.

Systems development to support Hybrid 2.0 will be completed in early March. It is anticipated that Hybrid 2.0 will launch by the end of the first quarter of 2004, following SEC approval of rule filings.

Applications for e-DPMs have been received and interviews with applicants are under way. Appointments will be announced after the SEC approves the related rule filings. The Remote Market Maker (RMM) structure has been endorsed by the appropriate committees. The Equity Market Performance Committee has also approved the RMM appointment process.

The Equity Market Performance Committee has issued Information Circular IC04-16, which describes the planned establishment and configuration of Hybrid 2.0 Trading Crowds, including the creation of virtual trading crowds. IC04-16 is currently posted at <http://www.cboe.com/Legal>.

For more information on current plans for Hybrid 2.0, members may refer to <http://www.cboe.com/Hybrid>.

Index Products on Hybrid

The Index Market Performance Committee and the Index Floor Procedure Committee are working to identify a limited number of index products to list on the Hybrid system so that CBOE can evaluate the impact, benefits, limitations and capacity issues associated with trading index products on Hybrid.

The first index product to be traded on Hybrid was options on the Russell 2000[®], which began trading on Tuesday, February 24.

Exclusive Index Products

The International Securities Exchange, along with the Pacific Stock Exchange, continues to press the SEC for multiple listing of index products. CBOE, Standard & Poor's and Dow Jones have submitted comment letters to the SEC opposing any efforts to overturn exclusive licenses and intellectual property rights. See CBOE's comment letter, dated March 27, 2003, posted at <http://www.cboe.com/Legal>.

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. Features include a NBBO Options Montage, an Options Order Ticket and an Order Log. The workstation terminal also serves as a portal into CBOE *direct* HyTS.

There are 25 firms currently using the terminals and several hundred thousand contracts per month are being routed via this technology.

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. Information is also available on the website at <http://www.cboe.com/HyTS Terminal>.

SEC Concept Release

On February 3, 2004, the SEC issued a concept release, titled “Competitive Developments in the Options Markets.” The release seeks comments on practices that emerged since the expansion of multiple listing. Among the practices cited in the 56-page document are: payment for order flow, internalization, specialist guarantees, penny increments, the “self-regulatory organization” status of exchanges and regulatory arbitrage. CBOE will be submitting comments on all of these issues and answering all of the 46 questions posed within the release, during the 60-day comment period. A special membership committee has been formed to review the concept release, and is working with CBOE’s Legal Department to craft the Exchange’s response. CBOE will include comments and input from its directors as well.

Notably, the concept release praises CBOE’s Hybrid Trading System and the subsequent competition it has stimulated.

The SEC concept release is posted within the “Comments Letters” section of the Legal site at <http://www.cboe.com/Legal>.

Agreement on Exercise Right

On February 12, 2004 the CBOT membership overwhelmingly endorsed an agreement reached by CBOE and CBOT on December 17, 2003. The vote was 506 5/6 to 23 2/6. The agreement 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 CBOE was formed, allows a CBOT Full Member to become a CBOE member without having to purchase a membership at CBOE.

Under the terms of the agreement and 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 CBOE. However, in order to exercise and become a member of 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 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 CBOT rules.

Before it becomes effective, the proposal must be filed by CBOE with, and approved by, the SEC.

In light of these developments, CBOE is free to make an offer to purchase some of these exercise rights. This possibility is under study by the CBOE Board. If CBOE decides to make an offer that requires outside financing, a vote of the CBOE membership will be held prior to proceeding.

Membership Committees for 2004

The full roster of 2004 Board and Membership Committees was approved at the CBOE Board of Directors' meeting on January 21. The complete list of committees and committee members is now posted on the members' website at <https://www.cboe.com/Members>.

Strategy Implementation Committee

A new membership committee, the Strategy Implementation Committee, has been created. The Strategy Implementation Committee will foster coordination among the committees and will advise the Floor Directors Committee. The Strategy Implementation Committee includes the chairman and/or vice chairman of several of the committees of the membership. CBOE Vice Chairman Ed Tilly will chair the committee.

Financial Update

For the first six months of Fiscal Year 2004 (period ending December 31, 2003), CBOE reported a pre-tax profit of \$6.3 million, compared to a budgeted pre-tax loss of \$0.6 million. Continued strong volume and cost control efforts allowed CBOE to post these positive results. Volume averaged 1,163,300 contracts per day during this time period, which is 9% higher than the 1,070,100 contracts that CBOE averaged for Fiscal Year 2003. Working capital for the Exchange increased from \$30.1 million to \$33.6 million during the first six months of FY04 despite the acquisition of \$11.8 million in new equipment and software, mostly related to the implementation of our new Hybrid trading system. CBOE continues to be debt-free.

CBOE's positive financial results are expected to continue. We averaged over 1,700,000 contracts per day for the month of January, far surpassing our previous monthly record of 1,580,000 contracts per day set in March of 2000. As a result of this high volume, financial results should also show a significant increase in working capital combined with a sizeable profit for the month.

CBOE January 2004 Volume Breaks Records

Volume at CBOE during January 2004 set a record for the month of January as 34,102,677 contracts traded, surpassing the previous high of 30,163,186 contracts traded in January 2001. January's average daily volume of 1,705,134 contracts established a new CBOE record for highest monthly average daily volume in its history, while January 2004's volume ranked as the second-busiest month in CBOE history, trailing only the March 2000 total of 35,176,764 contracts.

Exchange Volume, January 2004

Total Volume

- 34,102,677 contracts
- +54% vs. year-ago (Jan.'03)
- +25% vs. previous month (Dec.'03)

Average Daily Volume

- 1,705,134 contracts
- +62% vs. year-ago (Jan.'03)
- +38% vs. previous month (Dec.'03)

Open Interest

- 107,707,110 contracts
- +66% vs. year-ago (Jan.'03)
- -15% vs. previous month (Dec.'03)

January volume records at CBOE included:

- Two of the top ten most-active trading days in CBOE history—including the #4 all-time day on January 16 (2,631,563 contracts) and the #7 all-time day on January 15 (2,296,450 contracts), as well as six of the top thirty most-active trading days and ten of the top fifty most-active trading days in CBOE history occurred in January.
- Monthly volume in S&P 500® Index (SPXSM) options. January 2004 volume totaled 4,075,164 contracts, an increase of 35% over the January 2003 total, surpassing the previous record of 3,859,734 contracts set in July 2002.
- Monthly volume in options on the Nasdaq-100® Index Tracking Stock (QQQ). January 2004 volume totaled 2,900,180 contracts, an increase of 40% over the January 2003 total, and exceeding the old record of 2,813,837 contracts set in March 2003.
- Monthly volume in options on the iShares® Russell 2000® Index Fund (IWM). January 2004 volume totaled 259,555 contracts traded, eclipsing the previous record of 194,146 contracts from December 2003.

OneChicago

In January 2004, 186,527 security futures contracts traded at OneChicago, a 67% increase over January 2003. In 2003, OneChicago's first complete year of trading, total volume was 1,619,194 contracts. In response to the light trading volume of single stock futures for the industry in general, and at OneChicago in particular, CBOE has appointed a new user group to educate the CBOE trading floor community about OneChicago's products and systems.

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.

Next Membership Meeting

A meeting of the membership will be held on Tuesday, March 2, 2004 at 3:30 p.m. in the Members' Lounge. The primary topic will be payment for order flow.

CBOE Lessors' Luncheon

CBOE Chairman and CEO Bill Brodsky, Vice Chairman Ed Tilly, and Chairman of the Lessor Committee Bill Power will host a Lessors' Luncheon on Friday, March 19, 2004 at the Boca Raton Resort and Club in Boca Raton, Florida. Members who are in Florida at this time of year are invited. For more information, please contact Christy Hanson, Civic and Governmental Affairs Representative, at 312.786.7066 or hansonc@cboe.com.

Simulated Trading Events

Back by popular demand, The Options Institute has scheduled "Trade Like the Pros" simulated trading events for 2004. These events, which attract many retail customers, feature hands-on simulated trading experience, education on options strategies by floor traders and an emphasis on teaching hedging and managing risk while setting up for profit. CBOE members should advise interested parties to call 1.877.THE.CBOE or visit <http://www.cboe.com/Seminars> to register. Simulated trading events are scheduled at CBOE on April 22, June 24 and October 28.

Risk Management Conference

The 20th Annual Risk Management Conference was held on Sunday, February 22 – Wednesday, February 25, 2004 at the Hyatt Coconut Point Resort and Spa located in Bonita Springs, Florida.

The Risk Management Conference was hosted by CBOE, the Chicago Board of Trade and the Chicago Mercantile Exchange. It is an educational forum where institutional end users of derivatives discuss the policies, tools and systems they use to manage risk exposures and enhance yields.

The conference was tailored to financial professionals such as pension plan sponsors, chief financial officers, portfolio managers, corporate treasury executives, mutual fund managers and investment advisors. Approximately 225 industry professionals attended.

E-mails to Members

We are instituting a major effort to encourage members to receive this and other circulars 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](mailto:members@cboe.com)), or contact the CBOE Membership Department directly at 312.786.7449.

Now available: MEMBER E-NEWS, a weekly update for CBOE members that is being distributed via e-mail only and posted on the CBOE members' website. Please be sure to submit your e-mail address to ([mailto: members@cboe.com](mailto:members@cboe.com)), or contact the Membership Department to begin receiving this weekly update.



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