



Information Circular IC05-03

DATE: January 7, 2005
TO: The Membership
FROM: Office of the Chairman
RE: Options on SPDRs

As many of you are now aware, CBOE is making preparations for the potential trading of options on SPDRs, an exchange-traded fund based on the S&P 500 Index. We want to provide the membership with some background on this possible listing.

CBOE has a longstanding license agreement with Standard & Poor's, which grants to CBOE the exclusive right to trade options based on the S&P 500 index for a specified term. During that term, S&P is prohibited from granting a license to any other exchange to trade options based upon the S&P 500 Index. It is CBOE's longstanding position that CBOE's license and the exclusivity prohibition include options on SPDRs, because SPDRs are based on and designed to track the S&P 500 Index. CBOE believes that its license with S&P protects it against licensing and trading of options on SPDRs by another exchange, which would diminish the value of CBOE's exclusive license to options products based on the S&P 500.

S&P has a different interpretation of the scope of CBOE's license as it applies to options on SPDRs. Several years ago, as a result of this dispute, CBOE and S&P entered into an agreement that provided that during the term of the agreement, S&P would not license any exchange to trade options on SPDRs. The agreement also obligates S&P to use its best efforts, including the commencement of litigation, to prevent any exchange from trading options on SPDRs without a license from S&P. Moreover, under this agreement, if another marketplace announces its intentions to trade options on SPDRs, CBOE also may prepare to trade such options, and may commence trading if S&P proves unsuccessful in preventing trading by the other marketplace.

On Monday, January 3rd, CBOE learned that ISE had made a request to The Options Clearing Corporation (OCC) that OCC issue and clear options on SPDRs without a license from S&P and, furthermore, that a special meeting of the OCC Board of Directors had been called for Wednesday, January 5th to discuss ISE's request. We were subsequently informed by OCC that, at this meeting, in reliance upon OCC's analysis that current law does not require any license to permit a marketplace to trade options on SPDRs, its Board did approve the issuance and clearance of options on SPDRs.

Since Monday, CBOE has pursued parallel paths to defend both its license rights and its competitive position. With respect to protecting our rights, CBOE has advised OCC of CBOE's rights and argued that OCC does not have the authority to issue or clear options on SPDRs for a marketplace that does not have a license.

With respect to our competitive position, CBOE has made the following preparations to trade options on SPDRs:

- CBOE has negotiated with S&P to allow S&P to license exchanges to trade options on SPDRs.
- Posts 4-9 and 4-10 have been relocated to free up a large pit with an upgraded infrastructure. Electricians are wiring the post to accommodate additional market makers and brokers.
- A SPDRs Floor Procedures Committee and charter have been approved by the Executive Committee to establish the trading platform and routing parameters for the product.
- The Committee has determined that options on SPDRs will trade on the Hybrid Trading System and has set routing parameters to assure that CBOE will be competitive in its markets and in its service offering. Current rules require that this include a DPM.
- The floor has been solicited for interest in being the DPM in options on SPDRs. The Special Product Assignment Committee interviewed 10 applicants and appointed CTC as the DPM. This appointment will be temporary as the Exchange examines the best market model for trading this product.
- Market Makers and Floor Brokers are being certified for the Hybrid trading platform so that they can access the product once it starts trading.

On Thursday, January 6th, S&P sought a temporary restraining order to prohibit ISE from trading the product and OCC from issuing or clearing the product in violation of S&P's intellectual property rights. On Thursday afternoon, we learned that S&P was successful in obtaining the temporary restraining order. Since then, we understand that S&P has entered into license agreements with other exchanges which will allow for the licensed exchanges, including CBOE, to multiply list and trade SPDR options. We will be ready to trade SPDR options as early as next week.

Obviously, the situation is extremely fluid and changing rapidly. CBOE is closely monitoring the situation. We will keep you advised of further developments.