

February 24, 2006

To: CBOE Members

From: Office of the Chairman

Re: CBOE Investment in HedgeStreet, Inc

Last fall, the Product Development Committee (PDC) recommended to the Office of the Chairman that CBOE pursue binary options products. A binary option is a contract whose final settlement price takes one of two values (zero or \$X), contingent on the value of an economic variable or the outcome of an economic event. Binary options, also called digital options, have been traded for several years on the over-the-counter market. Recently there has been significant web-based interest in these types of products. IG Index in the UK is an example which has shown strong trading volume.

In order to launch these products, CBOE was faced with a build vs. buy decision. The Exchange could develop the necessary functionality, the appropriate Internet presence, establish a clearing relationship/firm, and undertake considerable marketing expenditures. Alternatively, CBOE could enter into a strategic alliance with a firm that is already in this space. HedgeStreet, Inc. is a new, on-line, CFTC-approved exchange that trades products called "Hedgelets". These are binary contracts on economic variables and events (commodities, interest and mortgage rates, economic indicators) with maturities ranging from 1 day to 3 months. Binary Hedgelets pay \$0 or \$10 contingent on the outcome of underlying. Members pay the maximum loss for the Hedgelets at the time of entering the trade and funds are held in accounts at Union Bank of California. HedgeStreet acts as the exchange and clearinghouse with customers engaging the exchange directly as participants in the clearing organization.

PDC, OOC and the Board determined that the CBOE should pursue a strategic alliance with HedgeStreet to enter this growing new business segment. Pursuant to this direction CBOE recently closed on an agreement to acquire an equity stake in HedgeStreet. In connection with its equity stake, CBOE will also hold a seat on HedgeStreet's board. Additionally, CBOE's strategic alliance with HedgeStreet includes the provision by CBOE to HedgeStreet of system hosting services and web-based services as well as joint marketing activities and joint binary product development efforts. In return for its services, CBOE will receive service fees and share in HedgeStreet revenue originating from CBOE.com.

CBOE's equity investment is part of a larger round of equity and debt financing recently closed by HedgeStreet, with a portion also provided by Norwest Ventures Partners, a leading venture capital firm active in technology and information services. Over the course of the next year, it also anticipated that HedgeStreet will be seeking additional investors.

This strategic alliance with HedgeStreet provides CBOE with the opportunity to quickly enter the binary market with significantly less work than a go it alone approach. Binary options are one of the simplest forms of an options contract and have significant growth potential. If you have any questions regarding the CBOE-HedgeStreet strategic alliance please contact Patrick Fay at 312-786-7925 or [fayp@cboe.com](mailto:fayp@cboe.com).