

To: CBOE Membership
From: Office of the Chairman and Board of Directors
Date: October 29, 2003
Subject: CBOE Innovation & Liquidity for the 21st Century

The CBOE is today announcing our plan to combine technological innovation and liquidity with the goal of guaranteeing that CBOE is the premier marketplace for listed equity options. This plan is composed of four principal initiatives:

1. The creation of a new class of CBOE members, remote Market Makers (“RMMs”), that will stream quotes into the 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 the 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 the 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.
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 the CBOE.

These initiatives are described more fully below.

REMOTE MARKET MAKERS will be a class of member market makers that choose to operate solely from off the floor. RMMs will be able to stream quotes into Hybrid classes in their market maker appointments, but they will not participate in open outcry trades. RMMs will have quoting obligations, as well as other market maker obligations. RMMs will be able to stream quotes into only one trading crowd at a time for each seat owned or leased.

FLOOR-BASED MARKET MAKERS will be able to stream quotes into Hybrid classes in their appointments without having to be physically present in the trading crowd, provided that they transact at least 80% of their total contract volume while they are present in the trading crowd. Note that market makers, like RMMs, will not participate in open outcry trades while not present on the trading floor.

E-DPMs will be a new class of competing specialists required to continuously stream quotes in a broad number of option classes. They will have other special obligations, will have to meet objective market performance standards and qualifications, and will be expected to actively promote CBOE as the marketplace of choice for all of the option classes in their appointments. E-DPMs will not be required to be physically present in the trading crowd but will stream their quotes in remotely. They will share in the current DPM participation rights and will be offered fee inducements to significantly increase volume at CBOE. They will also be required to own or lease memberships sufficient to satisfy their appointments.

CROSSING ORDERS. Order flow providers will be able to participate electronically on the other side of orders they route to the CBOE. Their participation right will be 20% for orders executed at the prevailing bid or offer and 40% for orders executed between the prevailing bid and offer.

CBOE TRANSACTION FEES will be revised to provide significant incentives to members and member firms to bring liquidity and attract order flow to CBOE. Remote participants will pay higher fees than their floor-based counterparts. Floor-based market maker fees will not be raised for transactions executed while present in the trading crowd. The Financial Planning Committee will be asked to determine the volume level at which across the board fee discounts will be implemented.

During the coming weeks we will hold several additional membership meetings, each designed to address in more detail the significant aspects of this initiative. Meetings are planned for the following dates:

Wednesday, November 5
Tuesday, November 11
Tuesday, November 18
Monday, November 24

You will be asked to endorse and approve these initiatives in a referendum to be held in early December. With your endorsement, and approval of any necessary rule filings by the SEC, we expect to implement these proposals in the first quarter of 2004.

We look forward to discussing this proposal with you.