

CHICAGO  
BOARD  
OPTIONS  
EXCHANGE  
2005  
ANNUAL  
REPORT

Fiscal Year 2005 was arguably the most successful in CBOE's distinguished 32-year history.

## A MESSAGE FROM THE OFFICE OF THE CHAIRMAN

The Chicago Board Options Exchange® (CBOE®) began Fiscal Year (FY) 2006 aggressively with a major organizational change that will significantly affect all aspects of CBOE's business going forward. On January 1, 2006, the Exchange initiated the process of converting from a membership organization to a for-profit business model, a move approved by the CBOE Board of Directors in September 2005. In a rapidly changing business environment, it is our belief that adopting a new, more agile business model will give CBOE an important competitive edge in meeting the demands of an ever-changing marketplace. In many respects, the decision to initiate this landmark transformation was the most important development in Fiscal Year 2005.

CBOE's conversion to a for-profit model ultimately will impact every area of our business, from how we make strategic decisions to how we conduct day-to-day operations. It is a change, not only to the organization itself, but also to our organizational philosophy. The move will enable us to better focus CBOE's resources and to operate more efficiently, while reaffirming the goal of maximizing value for owners as well as for customers.

The initial groundwork has already been laid. Changes to CBOE's revamped corporate model include a streamlined infrastructure and a scaled-down operating budget as part of the overall mission to create greater strategic flexibility. As we venture on, there is still much more work to be done; we are continuing to examine all phases of our operation, looking for greater efficiencies and striving to create an even better CBOE.

As we progress with this change to our organization, the Exchange remains steadfast in its commitment to continue to develop innovative products, to deliver quality service and to enhance our trading technology. Indeed, we believe a for-profit model will serve to sharpen our focus on these tenets and improve our ability to deliver them.

We look forward to a bright future where CBOE's diverse mix of products will continue to provide all facets of our customer base with versatile and efficient risk management products.

The remainder of this report highlights the significant developments, milestones, and achievements at CBOE during Fiscal Year 2005.



William J. Brodsky  
Chairman and Chief  
Executive Officer

Edward T. Tilly  
Vice Chairman

Edward J. Joyce  
President and Chief  
Operating Officer

## RECORD VOLUME AND INCREASING MARKET SHARE

Fiscal Year 2005 (January 1 to December 31, 2005) was arguably the most successful in CBOE's distinguished 32-year history. Trading volume at the Exchange soared to all-time record heights and market share increased, fortifying CBOE's bottom line and positioning the Exchange financially to initiate the important transformation of its business model.

In a fiercely competitive industry, where market share gains and losses are measured by the slimmest of margins, CBOE increased its market share of total industry volume to 31%. While its nearest competitors experienced market share declines on the year, CBOE maintained its leadership position within the U.S. options industry in 2005.

Trading volume rose to 468.2 million contracts in FY 2005 and shattered numerous records. This volume total represented the busiest year in CBOE's history for the second consecutive year and was a 30% increase over 2004's record total of 361.1 million contracts. For the year, average daily volume weighed in at nearly 1.9 million contracts.

Trading in equity options at CBOE totaled 275.6 million contracts in FY 2005, a rise of 23% over 2004's total of 224.3 million, and fell just shy of CBOE's all-time high of 278 million total contracts traded in 2000. FY 2005 was the second consecutive year that equity options volume posted a gain of at least 20%, and since 2002, equity option volume has surged 59% at CBOE.

Trading in options on broad- and sector-based indexes and exchange-traded funds (ETFs) experienced explosive growth in FY 2005 with total volume reaching 192.5 million contracts, a new record for annual index option volume at CBOE, and a jump of 41% over 2004's total of 136.7 million contracts.

*\*CBOE is already setting new volume records in 2006. As of the writing of this report, volume at CBOE on Thursday, March 16, 2006 was 5,642,589 contracts, a new record for the busiest single trading day in the Exchange's 33-year history, and the busiest day for any U.S. options exchange. March 2006 was the busiest month in CBOE history. Its record volume of 55 million contracts, an increase of 46% over March 2005, surpassed the previous monthly record of 53.9 million contracts from January 2006.*

Several of CBOE's index and ETF options logged record annual volume in 2005, including options on the Nasdaq-100 Index® (NDX®), up 80% over 2004 to 6.3 million contracts; options on the iShares Russell 2000 Index Fund (IWM), up 229% to 16.2 million; and options on the Russell 2000® Index (RUT), up 22% to 1.1 million.

Options on the S&P 500® Index (SPX<sup>SM</sup>), CBOE's most actively-traded index product, also experienced a record year in 2005 as volume soared to 71.8 million contracts, surpassing 2004, the previous high, by 45%. This record trading in CBOE's premier index product resulted, in part, from the growing popularity and increased use of the CBOE S&P 500 BuyWrite Index (BXM<sup>SM</sup>) strategy. The BXM is a benchmark index that measures the performance of a theoretical portfolio that sells covered SPX options each third Friday of the month against a portfolio of stocks in the S&P 500 Index.

In addition to the dozens of individual product volume records set, the top ten busiest single trading days in CBOE history all occurred in 2005, including April 15, CBOE's busiest day in 32 years, when over 3.9 million contracts traded.\*

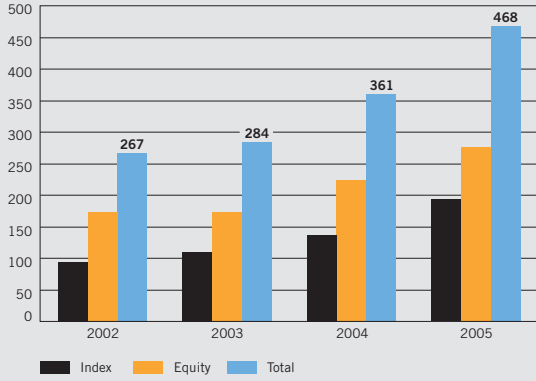
## SEAT PRICES REACH NEW ALL-TIME HIGHS

Rising seat prices during FY 2005 highlighted the increasing value of CBOE membership. After the first transaction of the year, when a seat sold for \$299,000 on January 6, 2005, CBOE seat prices began a rapid year-long ascent, rising nearly 200%. On July 18th, a seat was bought for \$755,000, eclipsing the three-quarter of a million dollar mark for the first time since March 1998. Seat prices would continue to set new record levels for the remainder of the year, culminating with the year's final seat transaction on December 20th for \$875,000,\*\* the highest price ever paid for a seat at CBOE.

*\*\*CBOE seat prices continue to climb in 2006. A CBOE seat, or membership, was bought on February 7, 2006, for the first time ever at a price of \$1,000,000. On Friday, March 24, 2006, a CBOE seat sold for an all-time high of \$1,150,000. Twelve CBOE seats were bought for at least one million dollars during the first quarter of 2006.*

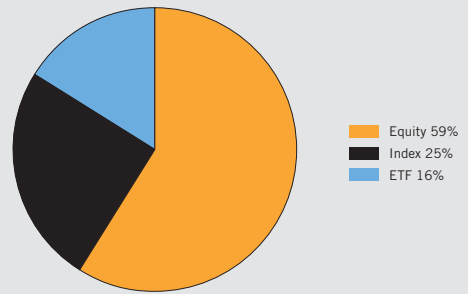
### CBOE Total Volume

In Millions



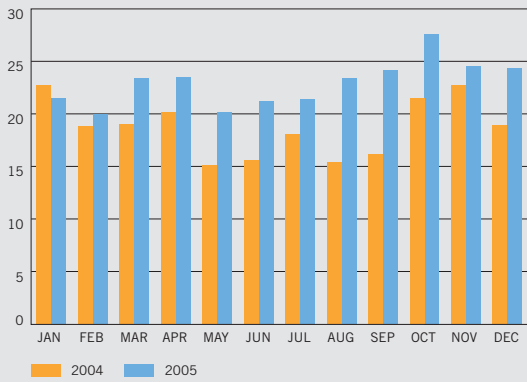
### CBOE Total Volume

By Product



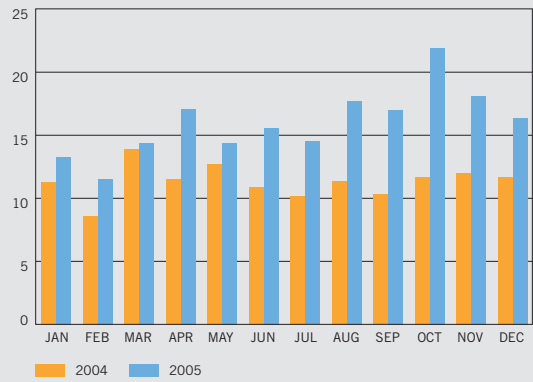
### Equity Options Volume

In Millions, 2004 v. 2005



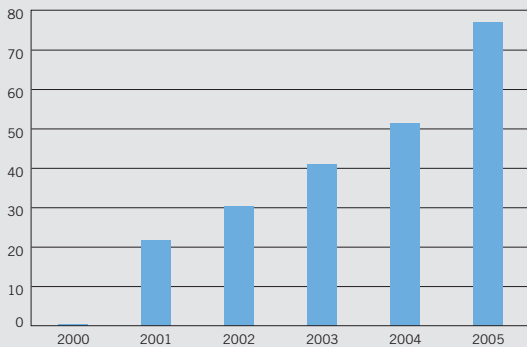
### Index Options Volume

In Millions, 2004 v. 2005



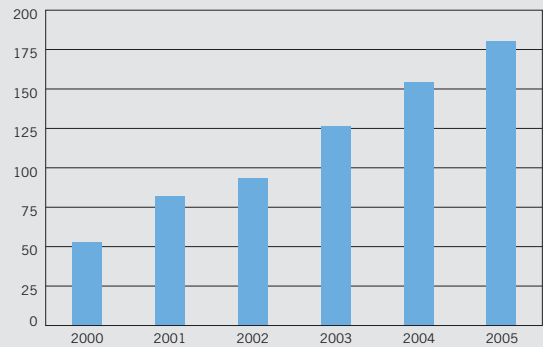
### Options on ETFs, Total Volume

In Millions



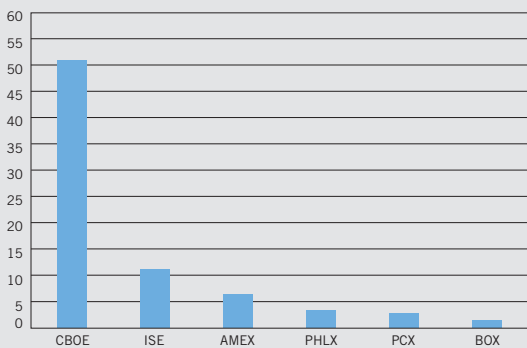
### Total Open Interest

In Millions



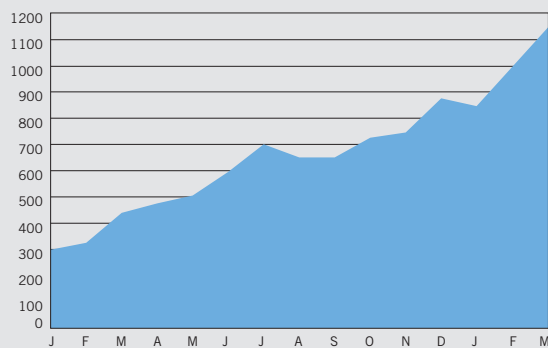
### Notional Value of 2005 Average Daily Volume

By Exchange, In Millions (estimated)



### Seat Prices

In Thousands, January 2005 to March 2006





#### **MORE NEW PRODUCT “FIRSTS” FROM CBOE**

CBOE, as it has done throughout its history, remained at the forefront of new product development in FY 2005. In an effort to attract business and broaden CBOE’s appeal to an expanding universe of customers, several innovative investment tools were introduced to the marketplace last year.

In total, 293 products were added at CBOE last year, including options on 272 individual equities, 15 cash-settled indexes, and six exchange-traded funds. At the end of 2005, the CBOE product line included options on 1,766 individual equities, 56 broad- and sector-based indexes, 61 exchange-traded funds, four interest rate products and one structured product.



*State-of-the-art technology combined with the largest pool of liquidity providers in the industry make CBOE the world's most dynamic options marketplace.*

Among the most significant products launched in FY 2005 were options on the immensely popular SPDRs Exchange-Traded Fund, based on Standard & Poor's® Depository Receipts (SPY). SPY options are now among the most actively-traded products in the industry. During FY 2005, CBOE was the leading marketplace for SPY options, trading 16.2 million contracts and generating a 38% market share from a field of primarily screen-based exchanges – a testament to CBOE's large pool of well-capitalized market makers and their ability to compete effectively with CBOE's highly-efficient Hybrid<sup>SM</sup> Trading System.

Other significant new products created and launched by CBOE in FY 2005 included Mini-S&P 500 Index options (XSP<sup>SM</sup>) which, as a smaller-sized version of CBOE's highly popular S&P 500 Index option contract, are especially attractive to retail investors; and "Weeklys<sup>SM</sup>", short-term options with a one-week life from launch to expiration, which provide cost-efficient ways to trade around specific news or events. Initial Weeklys contracts are based on the S&P 500 Index and on the S&P 100® Index, and CBOE is currently studying other potential products to be offered as Weeklys.



### **CBOE EXPANDS ITS POPULAR BUY-WRITE INDEX COMPLEX**

The CBOE S&P 500 BuyWrite Index (BXMSM), created by CBOE in 2002, was the first benchmark for measuring the performance of covered-call writing. While this buy-write strategy is not new, the BXM, for the first time, provided investors with a tool to measure the performance of this type of strategy.

Fueling the interest in the buy-write strategy is a case study done in 2004 on BXM by Ibbotson Associates. The study, commissioned by CBOE, found that the BXM had the best risk-adjusted performance of the major domestic and international equity-based indexes over the 16-year period analyzed. The Ibbotson case study has been distributed to tens of thousands of financial advisors and bankers, and was a major catalyst in generating awareness of the BXM.

Recognizing growing customer demand for additional quantifiable performance measures of the buy-write strategy, in March 2005, CBOE and Dow Jones announced the creation of the CBOE DJIA BuyWrite Index (BXDSM), based on the Dow Jones Industrial Average; and in September 2005, CBOE and the Nasdaq Stock Market® launched the CBOE NASDAQ-100 BuyWrite Index (BXNSM), based on the technology-laden Nasdaq-100 Index®.

Since the publication of the Ibbotson case study, more than \$20 billion has been raised for 40 new buy-write funds that use the BXM strategy and at least eight major brokerage firms and banks have been granted licenses to offer investment products based on one or more of the CBOE buy-write indexes. All three CBOE buy-write licenses are now generating licensing revenue for CBOE and its index partners.

### **CBOE FUTURES EXCHANGE CONCLUDES SUCCESSFUL FIRST FULL YEAR**

Launched on March 26, 2004, the CBOE Futures ExchangeSM (CFESM) is a wholly-owned subsidiary of CBOE that offers all-electronic trading of futures. At the end of CFE's first full year of trading, volume for 2005 totaled 177,046 contracts, an increase of 101% over the 88,194 contracts traded in 2004.

Through the end of 2005, CFE offered futures on 25 products, including the CBOE Volatility Index® (VIX®), CBOE DJIA® Volatility Index, CBOE S&P 500 Three-Month Variance, CBOE China Index, full- and mini-size Russell 1000® Indexes, mini-Russell 2000® Index, twelve PowerPacks® sector indexes and, most recently, six "Gas At The PumpSM" futures. Gas At The Pump futures, launched on October 28, 2005, are designed to track the retail price for regular gasoline that consumers pay at the pump throughout different regions of the U.S.

The launch of futures on the CBOE Volatility Index was a landmark CBOE achievement, giving investors, for the first time ever, a viable instrument for trading market volatility as an asset class. Until CFE launched VIX futures, the CBOE Volatility Index was a benchmark index only – with no way for investors





*The trading crowd during January expiration for options on the S&P 500 Index (SPX), CBOE's premier index product and most-actively traded contract.*

to trade it. First introduced by CBOE in 1993, VIX quickly became *the* benchmark index of market volatility and investor sentiment. Since then, VIX has been widely quoted and closely followed and is often referred to by industry observers as the market's "fear gauge." Derived from real-time S&P 500 Index option prices, VIX is designed to reflect investors' consensus view of expected near-term stock market volatility over the next 30 days.

To date, futures on the VIX have been CFE's most successful contract, generating 73% of CFE's volume in FY 2005. Not only did trading in VIX futures fuel growth at CFE, but it played a role in driving volume in CBOE's SPX options to unprecedented heights in 2005, as hedging transactions between VIX futures and SPX options is a common strategy with volatility traders.

As a complement to VIX futures, options on VIX began trading at CBOE in February 2006. Through the first several weeks of trading, average daily volume was approximately 10,000 contracts, while open interest soared to more than 200,000 contracts. The marketplace has been quick to

embrace VIX options, making them not only one of the most successful new product launches in CBOE history, but one of CBOE's most recognized products as well. With increasing popularity among investors and steadily building liquidity, VIX options show even greater promise for the future.

#### **ONECHICAGO AND THE GROWTH OF SINGLE STOCK FUTURES**

OneChicago, the joint venture exchange owned by the Chicago Board Options Exchange, Chicago Mercantile Exchange Inc. and the Chicago Board of Trade, and powered by the CBOE*direct*<sup>®</sup> trade engine, offers all-electronic trading of single stock futures and narrow-based indexes.

At year's end, OneChicago listed 208 futures on single stocks, including futures on DIAMONDS<sup>®</sup>, as well as four OneChicago Select Indexes, a series of custom-designed narrow-based security index features.

Trading volume at OneChicago at the close of 2005 totaled more than 5.5 million contracts traded, an increase of 188% over the previous year.

# The Hybrid Trading System was designed with flexibility in mind so that adaptations can be made quickly as the dynamics of the marketplace change.

## **CBOE HYBRID: A UNIQUE MARKET MODEL**

Major progressive changes were made to CBOE's Hybrid Trading System during FY 2005, resulting in the expansion of remote trading, additional product trading capabilities, greater efficiencies and faster access.

The CBOE Hybrid Trading System combines the best features of screen-based trading and floor-based markets. The ability afforded by the Hybrid Trading System for individual traders to stream live quotes and to post quotes with size allows the Exchange to better showcase the quality of markets at CBOE. The Hybrid offers customers greater liquidity and instantaneous point-and-click order execution, while still preserving the benefits of trading through open outcry. Some customers, especially when trading large or complex orders, prefer open outcry, where trades can be negotiated in an auction format among a deep pool of liquidity providers.

In an increasingly electronic world, the numbers validate CBOE's decision to integrate the open outcry component into development of a unique Hybrid market model. Ninety-two percent of the orders traded on CBOE's Hybrid Trading System are

executed electronically, accounting for 55% of the volume in those classes, while the remaining 8% of Hybrid orders and 45% of the volume are handled through the open outcry method of trading. This dichotomy illustrates the effective synergies of floor- and screen-based trading in CBOE's Hybrid trading world.

The conversion of all 1,700+ equity classes to CBOE's Hybrid Trading System was completed in January, and by the close of 2005, many of the major index classes were trading on the Hybrid as well.

Leading the new technological modifications added to the Hybrid in 2005 were enhancements to facilitate spread order capabilities, which enable seamless trading of complex or "multi-legged" orders electronically.

The Hybrid Trading System was designed with flexibility in mind so that adaptations can be made quickly as the dynamics of the marketplace change. As a result, CBOE will be able to continue to satisfy the preferences of customers for different trading venues.

*The competing market maker system coupled with the Hybrid trading environment has resulted in CBOE's quotes being the national best market more than 95% of the time.*





*Ninety-two percent of the orders traded on CBOE's Hybrid Trading System are executed electronically, accounting for 55% of the volume in those classes.*

#### **EXPANDING THE TRADING UNIVERSE THROUGH REMOTE MARKET MAKING**

As part of the evolution of CBOE's Hybrid Trading System, a new membership designation, Remote Market Maker (RMM), was adopted on April 26, 2005. The RMM program allows individual market makers or member organizations to engage in market making by streaming quotes and trading electronically at CBOE from any location, greatly expanding CBOE's universe of liquidity providers. Over fifty firms, including many new to CBOE, are participating in the RMM program. By year's end, RMMs occupied 197 memberships and accounted for nearly 20% of daily trading volume in Hybrid classes.

*The trading crowd in the S&P 100 Index (OEX) pit checks the price boards for the latest market news and information. OEX options experienced 14% growth in 2005, trading 18.7 million contracts.*

### **REMOTE TRADING SITE COMPLETED**

FY 2005 also saw CBOE finish the development of its all-electronic, and physically remote disaster recovery site. In the event that CBOE's building and trading floor become disabled, this back-up trading facility will provide CBOE with the capability to resume trading electronically on a next-day basis. Testing between the Exchange and member firms was completed in the fourth quarter of 2005 and the site became operational early in 2006. In the first phase of implementation, CBOE's exclusively listed index products have been readied, while subsequent phases will prepare additional products for trading via the site.

### **CBOE LINKS WITH CHINA'S MARKETS**

In an effort to expand CBOE's reach globally, the Exchange was pleased to enter into Memoranda of Understanding (MOUs) with five Chinese stock and derivatives exchanges – the Shanghai and Shenzhen Stock Exchanges, the Dalian and Zhengzhou Commodity Exchanges and the Shanghai Futures Exchange – during FY 2005. These links with China's emerging markets will lay the foundation for collaborative efforts between the CBOE and Chinese marketplaces, facilitate the development of channels of communication, and foster continuing relationships between the exchanges for the respective benefits of the financial services industry in the U.S. and the People's Republic of China. In the months and years to come, the MOUs will enable CBOE and our Asian counterparts to work jointly to share ideas, exchange resources and explore potential new product development.

### **PORTFOLIO MARGINING ADVOCATED**

Throughout 2005, CBOE worked closely with the U.S. Securities Market Coalition, which represents the six U.S. options exchanges, to advocate for parity in portfolio margining for stock options and single stock futures. Parity in portfolio margining, which is



strongly supported by CBOE, has been an important issue under consideration by Congress during its discussions regarding reauthorization of the futures industry regulator, the Commodity Futures Trading Commission (CFTC). Reauthorization is scheduled every five years as part of the Congressional review of the "Commodity Exchange Act." CBOE's active participation in this process played a significant part in having a parity in portfolio margining provision included in the legislation, which is currently pending on Capitol Hill. In addition, CBOE and the New York Stock Exchange have submitted rule filings to the Securities and Exchange Commission to expand portfolio margining to other products. CBOE's active participation in the legislative process, its ongoing efforts to closely monitor legislation affecting our customers, and the education of lawmakers regarding the potential impact of legislation on the options industry are very important priorities to the Exchange.



*The essence of CBOE's Hybrid Trading System: instantaneous point-and-click order execution handled in an open outcry environment.*

#### **A VISION FOR THE FUTURE**

Fiscal Year 2006 will be a pivotal year for CBOE. Through the challenges and change that await in the new year, so too, does opportunity. As competition continues to intensify, not only among existing options exchanges, but from the looming threat of new market entrants, CBOE is poised to remain the industry leader. CBOE's Hybrid Trading System has proven to be a robust and highly-efficient market model, carving a unique niche into a crowded marketplace, and moving forward, the Exchange will keep refining the system. With the conversion to a new for-profit business model, and the strategic optionality it provides, CBOE will have the agility to pursue new initiatives, while maintaining the flexibility to meet whatever challenges the future may hold. One thing that will not change, however, is CBOE's mission to continue bringing innovative investment products, cutting-edge technology and unparalleled customer service to the world's most dynamic options marketplace.

Through the challenges and change that await in the new year, so too, does opportunity.

## 2005 FINANCIAL SUMMARY

The year 2005 represents the first calendar year financial reporting period for the Exchange. Prior to 2005, the Exchange reported on a June 30 fiscal year-end basis. The process of changing our fiscal year-end included the transition step of reporting results for a six month period ended December 31, 2004 (prior period). These results are presented for comparative purposes.

The Exchange experienced a successful financial year in 2005 due to record trading volume of 1.85 million contracts per day. In the prior period, the Exchange averaged 1.4 million contracts per day. The Exchange earned net income of \$10.9 million versus \$1.2 million in the prior period.

The significant growth (32%) in 2005 trading volume versus the prior period was the main reason current year revenues were \$25.2 million (14%) higher than the prior period on an annualized basis. Fee reductions and fee caps saved our customers and members \$31.6 million in 2005 versus \$12.0 million in the prior period annualized.

Expenses were \$10.2 million higher than the prior period annualized, mainly due to employee costs (\$8.4 million) and royalty fees (\$4.0 million). Employee costs were higher in 2005 mainly due to year-end bonus awards and merit increases. Bonus awards were not paid in the six month period ended December 31, 2004. Royalty fees increased in 2005 due to significant trading volume growth in certain licensed products.

Capital spending in 2005 amounted to approximately \$21.0 million. Investments were primarily in the Systems Division related to the Hybrid Trading System and other trading floor enhancements. In addition, the Exchange contributed \$0.8 million in capital to OneChicago, LLC in 2005.

In 2005 the Exchange sold 69 (45%) of our National Stock Exchange (NSX) certificates of proprietary membership to NSX for \$5.0 million. See financial statements Note 2 for details of the Termination of Rights Agreement with NSX.

The Exchange purchased 69 Chicago Board of Trade exercise right privileges in 2005 for a total amount of \$6.9 million. See financial statements Note 9 for details of the purchase of Chicago Board of Trade exercise right privileges.

Retained earnings increased to \$120.0 million and total members' equity at December 31, 2005 was \$140.9 million. At year's end, the Exchange was debt-free with working capital of \$59.9 million.

## CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

Chicago Board Options Exchange, Incorporated and Subsidiaries

Year ended December 31, 2005 and six month period ended December 31, 2004 (in thousands)

2005

Six Month Period  
Ended Dec. 31, 2004

<b>Revenues:</b>		
Transaction fees	\$ 143,254	\$ 60,763
Other member fees	23,347	12,035
Options Price Reporting Authority income	16,749	7,885
Regulatory fees	11,835	5,730
Investment income	2,016	369
Other	5,854	2,144
<b>Total Revenues</b>	<b>203,055</b>	<b>88,926</b>
<b>Expenses:</b>		
Employee costs	74,678	33,155
Depreciation and amortization	28,349	15,950
Data processing	19,304	9,169
Outside services	18,404	8,934
Royalty fees	21,950	8,997
Travel and promotional expenses	6,796	2,869
Facilities costs	3,925	1,978
Net loss from investment in affiliates	203	1,391
Impairment of investment in affiliate and other assets	2,757	1,169
Other	6,796	2,881
<b>Total Expenses</b>	<b>183,162</b>	<b>86,493</b>
<b>Income Before Income Taxes</b>	<b>19,893</b>	<b>2,433</b>
<b>Provision for Income Taxes:</b>		
Current	9,925	(1,454)
Deferred	(927)	2,694
<b>Total Provision for Income Taxes</b>	<b>8,998</b>	<b>1,240</b>
<b>Net Income</b>	<b>10,895</b>	<b>1,193</b>
<b>Retained Earnings at Beginning of Year</b>	<b>113,906</b>	<b>112,713</b>
CBOT Exercise Rights Purchased – net of tax benefits of \$2,073	(4,827)	0
<b>Retained Earnings at End of Year</b>	<b>\$ 119,974</b>	<b>\$ 113,906</b>

## CONSOLIDATED BALANCE SHEETS

Chicago Board Options Exchange, Incorporated and Subsidiaries

December 31, 2005 and 2004 (in thousands)

2005

2004

<b>Assets</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 65,080	\$ 45,703
Investments – available for sale	0	6,000
Accounts receivable – net allowances of \$73 and \$62	21,722	16,900
Marketing fee receivable	3,634	2,840
Income taxes receivable	0	2,401
Prepaid medical benefits	2,837	1,849
Other prepaid expenses	3,534	3,767
Other current assets	663	504
<b>Total Current Assets</b>	<b>97,470</b>	<b>79,964</b>
<b>Investments in Affiliates</b>	<b>7,178</b>	<b>14,128</b>
<b>Land</b>	<b>4,914</b>	<b>4,914</b>
<b>Property and Equipment:</b>		
Building	57,609	57,609
Furniture and equipment	147,350	133,966
Less accumulated depreciation and amortization	(146,568)	(131,616)
<b>Total Property and Equipment – Net</b>	<b>58,391</b>	<b>59,959</b>
<b>Other Assets:</b>		
Software development work in progress	8,446	7,489
Data processing software and other assets (less accumulated amortization – 2005, \$51,300; 2004, \$37,903)	25,786	32,513
<b>Total Other Assets – Net</b>	<b>34,232</b>	<b>40,002</b>
<b>Total</b>	<b>\$ 202,185</b>	<b>\$ 198,967</b>

See notes to consolidated financial statements.



**CONSOLIDATED BALANCE SHEETS (CONTINUED)**

December 31, 2005 and 2004 (in thousands)	2005	2004
<b>Liabilities and Members' Equity</b>		
<b>Current Liabilities:</b>		
Accounts payable and accrued expenses	\$ 26,676	\$ 17,144
Marketing fee payable	5,622	3,491
Deferred revenue	4,493	15,846
Membership transfer and other deposits	0	572
Income taxes payable	768	0
<b>Total Current Liabilities</b>	<b>37,559</b>	<b>37,053</b>
<b>Long-term Liabilities:</b>		
Deferred income taxes	23,718	27,074
<b>Total Long-term Liabilities</b>	<b>23,718</b>	<b>27,074</b>
<b>Total Liabilities</b>	<b>61,277</b>	<b>64,127</b>
<b>Members' Equity:</b>		
Memberships	20,934	20,934
Retained earnings	119,974	113,906
<b>Total Members' Equity</b>	<b>140,908</b>	<b>134,840</b>
<b>Total</b>	<b>\$ 202,185</b>	<b>\$ 198,967</b>

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Chicago Board Options Exchange, Incorporated and Subsidiaries Year ended December 31, 2005 and six month period ended December 31, 2004 (in thousands)	2005	Six Month Period Ended Dec. 31, 2004
<b>Cash Flows from Operating Activities:</b>		
Net Income	\$ 10,895	\$ 1,193
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	28,349	15,950
Deferred income taxes	(3,356)	3,175
Equity in loss of OneChicago	2,569	1,787
Equity in income of NSX	(2,366)	(471)
Impairment of investment in affiliates and other assets	2,757	1,169
Loss on disposition of property	0	3
Changes in assets and liabilities:		
Accounts receivable	(4,822)	1,688
Marketing fee receivable	(794)	(3,491)
Net income taxes receivable	5,243	(1,135)
Prepaid medical benefits	(988)	(69)
Other prepaid expenses	233	(752)
Other current assets	(159)	220
Accounts payable and accrued expenses	9,532	665
Marketing fee payable	2,131	3,425
Deferred revenue	(11,354)	13,703
Membership transfer and other deposits	(572)	572
<b>Net Cash Flows from Operating Activities</b>	<b>37,298</b>	<b>37,632</b>
<b>Cash Flows from Investing Activities:</b>		
Sale of investments available for sale	6,000	500
Capital and other assets expenditures	(21,011)	(15,462)
Sale of NSX certificates of proprietary membership, net of fees	4,834	0
OneChicago investment	(844)	(721)
<b>Net Cash Flows from Investing Activities</b>	<b>(11,021)</b>	<b>(15,683)</b>
<b>Cash Flows from Financing Activities:</b>		
CBOT exercise right purchases	(6,900)	0
<b>Net Cash Flows from Financing Activities</b>	<b>(6,900)</b>	<b>0</b>
<b>Net Increase in Cash and Cash Equivalents</b>	<b>19,377</b>	<b>21,949</b>
<b>Cash and Cash Equivalents at Beginning of Period</b>	<b>45,703</b>	<b>23,754</b>
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$ 65,080</b>	<b>\$ 45,703</b>
<b>Supplemental Disclosure of Cash Flow Information</b>		
Cash paid for income taxes	\$ 7,525	\$ 100

See notes to consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Chicago Board Options Exchange, Incorporated and Subsidiaries

For the year ended December 31, 2005 and the six month period ended December 31, 2004

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### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Nature of Business** – The Chicago Board Options Exchange, Incorporated and Subsidiaries (“the Exchange”) is a registered securities exchange, subject to oversight by the Securities and Exchange Commission. The Exchange’s principal business is providing a marketplace for trading equity and index options.

**Basis of Presentation** – During 2004 the Exchange changed its year-end from June 30 to December 31. Accordingly, the accompanying financial statements reflect the calendar year ended December 31, 2005 and the six month period ended December 31, 2004. The consolidated financial statements include the accounts and results of operations of Chicago Board Options Exchange, Incorporated, and its wholly owned subsidiaries, Chicago Options Exchange Building Corporation, CBOE, LLC and CBOE Futures Exchange, LLC. Inter-company balances and transactions are eliminated.

**Use of Estimates** – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts of assets and liabilities, disclosures of contingent assets and liabilities, and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Revenue Recognition** – Transaction Fees revenue is considered earned upon the execution of the trade and is recognized on a trade date basis. In the event members pay for services in a lump-sum payment, revenue is recognized as services are provided. Other Member Fees revenue is recognized during the period the service is provided. The Options Price Reporting Authority (“OPRA”) income is allocated based upon the market share of the OPRA members and is received quarterly. Estimates of OPRA’s quarterly revenue are made and accrued each month. Regulatory Fees are predominately received in the month of December and are amortized monthly to coincide with the services rendered during the period July through June.

**Cash and Cash Equivalents** – Cash and cash equivalents include highly liquid investments with maturities of three months or less from the date of purchase.

**Investments** – All investments are classified as available-for-sale and are reported at cost which approximates their fair market value in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 115, “Accounting for Certain Investments in Debt and Equity Securities.”

**Accounts Receivable** – Accounts receivable consist primarily of transaction, marketing and other fees receivable from The Options Clearing Corporation (“OCC”), and the Exchange’s share of distributable revenue receivable from OPRA.

**Investments in Affiliates** – Investments in affiliates represent investments in OCC, OneChicago, LLC (“ONE”) and The National Stock Exchange (“NSX”). The investment in OCC (20% of its outstanding stock) is carried at cost because of the Exchange’s inability to exercise significant influence. The Exchange accounts for the investments in NSX (55% of its total certificates of proprietary membership) and ONE (approximately 40% of its outstanding stock) under the equity method due to the lack of effective control over the operating and financing activities of each affiliate. Investments in affiliates are reviewed to determine whether any events or changes in circumstances indicate that the investments may be other than temporarily impaired. In the event of an impairment, the Exchange would recognize a loss for the difference between the carrying amount and the estimated fair value of the equity method investment.

**Property and Equipment** – Property and equipment are carried at cost, net of accumulated depreciation. Depreciation on building, furniture and equipment is provided on the straight-line method. Estimated useful lives are 40 years for the building and five to ten years for furniture and equipment. Leasehold improvements are amortized over the lesser of their estimated useful lives or the remaining term of the applicable leases.

**Data Processing Software & Software Development Work in Progress** – Data processing software and software development work in progress are capitalized in accordance with Statement of Position 98-1 “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use” and are carried at cost. Software development work in progress is reclassified to data processing software when the software is ready for its intended use. Data processing software is amortized over five years using the straight-line method commencing with the date the software is put in service.

**Income Taxes** – Income taxes are determined using the liability method, under which deferred tax assets and liabilities are recorded based on differences between the financial accounting and tax bases of assets and liabilities.

**Deferred Revenue** – Deferred revenue represents amounts received by the Exchange for which services have not been provided.

**Fair Value of Financial Instruments** – SFAS No. 107, “Disclosures About Fair Value of Financial Instruments,” requires disclosure of the fair value of certain financial instruments. The carrying values of financial instruments included in assets and liabilities are reasonable estimates of their fair value.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### 2. INVESTMENT IN AFFILIATES

The investment in NSX is accounted for using the equity method. Condensed financial statements of NSX as of and for the year ended December 31, 2005 are as follows (in thousands):

	2005
<b>Balance Sheets</b>	
Assets	\$ 87,000
Liabilities	68,095
Members' Equity	18,905
<b>The Exchange's share of members' equity after impairment</b>	<b>\$ 6,738</b>
<hr/>	
	2005
<b>Statement of Operations</b>	
Total revenues	\$ 24,863
Total expenses	20,538
<b>Net income</b>	<b>4,325</b>
<b>The Exchange's equity in net income</b>	<b>\$ 2,366</b>

The Exchange and NSX executed a Termination of Rights Agreement (TORA) on September 27, 2004. Pursuant to the TORA, NSX will purchase 153 (94%) of the NSX certificates of proprietary membership currently owned by the Exchange. Certificates of proprietary membership will be surrendered by CBOE and NSX will pay the Exchange a total of \$11 million over a period of four years on the anniversary of the initial closing date, subject to NSX minimum working capital levels after deducting the cost of buying the certificates. The present value of the sale price is \$10.7 million. The Exchange will ultimately retain nine certificates of proprietary membership (10% of the total outstanding certificates of proprietary membership). After the sale of 153 certificates, the Exchange will account for its remaining investment in NSX on the cost basis. The initial closing transaction was held on January 18, 2005. On this date CBOE surrendered 69 certificates of proprietary membership and NSX paid \$5.0 million to CBOE. CBOE also gave up three of six seats on the NSX Board on the date of the initial closing. The Exchange's percentage of ownership of the remaining NSX outstanding certificates of proprietary membership was reduced to 54.7% after the initial closing. On March 10, 2006, the Exchange exercised its first put right under the TORA. On this date, the Exchange surrendered an additional 21 certificates of proprietary membership and NSX paid CBOE \$1.5 million. The Exchange's percentage of ownership of the remaining NSX outstanding certificates of proprietary membership was reduced to 48.3% after the March 10, 2006 exercise of its first put right.

The Exchange, the Chicago Mercantile Exchange Holdings, Inc. and the Board of Trade of the City of Chicago, Inc. are partners in ONE, a joint venture created to trade single stock futures. Certain ONE employees also have minority interests in the joint venture. ONE is a for-profit entity with its own management and board of directors, and is separately organized as a regulated exchange. The Exchange contributed \$0.8 million in capital to ONE during 2005. The Exchange had a receivable due from ONE of \$0.9 million at December 31, 2005. At December 31, 2005, the Exchange's investment in ONE was \$0.1 million after deducting our equity in ONE operating losses.

**Impairment Charge for NSX** – As is necessary under APB 18, which requires an adjustment to the carrying value of an asset when there is a decline (other than temporary) in the value of an asset that causes its current fair market value to be less than the carrying amount, the Exchange determined in the year ended December 31, 2005 that the value of its equity investment in NSX was impaired by \$2.4 million and consequently lowered the value of its investment to reflect the estimated fair market value of its ownership interest in NSX. The fair market value of the investment was based on the sale price for 153 (94% of its current investment) of the NSX certificates of proprietary membership it currently owns (see note 6). Management believes this sale price is a basis for approximating the fair value of its investment in NSX.

**Impairment Charge for Investment in Derivatech, Inc.** – The Exchange executed a stock purchase agreement with Derivatech, Inc. on February 12, 1997 for the purpose of acquiring The Options Toolbox software education code. Since that time, the investment was carried at the cost of \$315 thousand on the Exchange's balance sheet. An impairment review concluded it was prudent to recognize the full impairment of the asset in 2005.

### 3. RELATED PARTIES

The Exchange collected transaction and other fees of \$191.2 million by drawing on accounts of the Exchange's members held at OCC. The amount collected during 2005 included \$42.1 million of marketing fees (see note 8). The Exchange had a receivable due from OCC of \$15.2 million at December 31, 2005.

The Exchange incurred rebillable expenses on behalf of NSX, for expenses such as employee costs, computer equipment and office space of \$3.8 million during 2005. The Exchange had a receivable from NSX of \$931 thousand at December 31, 2005.

OPRA is a committee administered jointly by the six options exchanges and is authorized by the Securities and Exchange Commission to provide consolidated options information. This information is provided by the exchanges and is sold to outside news services and customers. OPRA's operating income is distributed among the exchanges based on their relative volume of total transactions. Operating income distributed to the Exchange was \$16.7 million during 2005. The Exchange had a receivable from OPRA of \$4.4 million at December 31, 2005.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Exchange incurred administrative expenses of \$3,600 for its affiliate, the Chicago Board Options Exchange Political Action Committee (the "Committee"), during 2005. The Committee is organized under the Federal Election Campaign Act as a voluntary, not-for-profit, unincorporated political association. The Committee is empowered to solicit and accept voluntary contributions from members and employees of the Exchange, and to contribute funds to the election campaigns of candidates for federal offices.

### 4. LEASES

The Exchange leases office space with lease terms remaining from seventeen months to twenty-five months as of December 31, 2005. Rent expenses related to leases for the year ended December 31, 2005 were \$802 thousand. Future minimum lease payments under these noncancellable operating leases are as follows at December 31, 2005 (in thousands):

2006	\$	694
2007		326
2008		10
Thereafter		0
<b>Total</b>	<b>\$</b>	<b>1,030</b>

### 5. EMPLOYEE BENEFITS

Eligible employees participate in the Chicago Board Options Exchange SMART Plan (the "SMART Plan"). The SMART Plan is a defined contribution plan, which is qualified under Internal Revenue Code Section 401(k). The Exchange contributed \$4.3 million to the SMART Plan for the year ended December 31, 2005.

Eligible employees may participate in the Supplemental Employee Retirement Plan (the "SERP") and Deferred Compensation Plan. The SERP and Deferred Compensation Plan are defined contribution plans that are nonqualified by Internal Revenue Code regulations. The Exchange contributed \$1.3 million to the SERP for the year ended December 31, 2005.

The Exchange also has a Voluntary Employees' Beneficiary Association ("VEBA"). The VEBA is a trust, qualifying under Internal Revenue Code Section 501(c)(9), created to provide certain medical, dental, severance, and short-term disability benefits to employees of the Exchange. Contributions to the trust are based on reserve levels established by Section 419(a) of the Internal Revenue Code. During the year ended December 31, 2005, the Exchange contributed \$5.6 million to the trust.

### 6. COMMITMENTS AND CONTINGENCIES

In September 2000, the Exchange reached an agreement in principle to settle a consolidated civil class action lawsuit filed against the Exchange and other U.S. options exchanges and certain market maker firms. The Exchange agreed to pay \$16.0 million, which has been paid in full and held in escrow pending approval of the settlement agreement by the U.S. District Court for the Southern District of New York. In October 2005, the Exchange and other settling parties reached a revised settlement that resolved certain disputes concerning the interpretation of certain provisions of the original settlement agreement. On February 8, 2006, the U.S. District Court preliminarily approved the revised settlement. Final approval is pending. As a result of the revised settlement, CBOE's settlement amount was reduced to \$9.3 million. On February 22, 2006 CBOE received a refund of \$7.1 million, including accrued interest. If final approval is denied, the settling parties will revert to their positions regarding the original settlement.

The Exchange is currently a party to various legal proceedings. Litigation is subject to many uncertainties, and the outcome of individual litigated matters is not predictable with assurance. After discussions with counsel, it is the opinion of management that the outcome of such matters will not have a material adverse impact on the consolidated financial position, results of operations or cash flows in the Exchange.

### 7. INCOME TAXES

A reconciliation of the statutory federal income tax rate to the effective income tax rate, for the year ended December 31, 2005 is as follows:

	2005	Six Month Period Ended Dec. 31, 2004
Statutory federal income tax rate	35.0%	34.0%
State income tax rate, net of federal income tax effect	4.8	4.8
Other permanent differences, net	5.4	12.1
<b>Effective income tax rate</b>	<b>45.2%</b>	<b>50.9%</b>

At December 31, 2005 and 2004, the net deferred income tax liability approximated (in thousands):

	2005	Six Month Period Ended Dec. 31, 2004
Deferred tax assets	\$ 6,561	\$ 7,448
Deferred tax liabilities	30,279	34,522
<b>Net deferred income tax liability</b>	<b>\$ 23,718</b>	<b>\$ 27,074</b>

Deferred income taxes arise principally from temporary differences relating to the use of accelerated depreciation methods for income tax purposes, capitalization of software, funding of the VEBA trust and undistributed earnings from the Exchange's investment in NSX.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

### 8. MARKETING FEE

Effective November 1, 2004, the Exchange re-instituted a new marketing fee program. As of December 31, 2005, amounts held by the Exchange on behalf of others included an accounts receivable balance of \$3.6 million.

### 9. PURCHASE OF CHICAGO BOARD OF TRADE (CBOT) EXERCISE RIGHT PRIVILEGES

On April 26, 2005, the Exchange initiated a purchase offer for a significant number of CBOT exercise right privileges. The exercise right privilege is a separately transferable interest representing the exercise right component of a CBOT Full Membership. The exercise right refers to the right of all CBOT Full Members to become Exchange members without the need to purchase an Exchange membership. In order to utilize the exercise right, the holder of an exercise right privilege must also hold all other rights and privileges represented by a CBOT Full Membership (including the interests issued in exchange for CBOT full memberships in the corporate restructuring of CBOT implemented effective April 22, 2005). The purchase offer was made in order to give regular members of the Exchange a greater interest in and control over the Exchange, to limit the number of members able to have access to the Exchange, and to provide the Exchange with more flexibility in managing its affairs. In May and June 2005, a total of 69 exercise right privileges were purchased at a price of \$100,000 per right. The \$6.9 million total purchase price was paid utilizing working capital reserves. This amount is reflected net of tax benefits of \$2.1 million on the consolidated statements of income and retained earnings.

### 10. DEFERRED REVENUE

Effective October 1, 2004, the Exchange instituted a fixed transaction fee program. Under the plan, Designated Primary Market Makers (DPMs) and electronic DPMs (e-DPMs) may elect to pay a fixed annual fee instead of being assessed transaction fees on a per contract basis for their DPM, e-DPM, and Remote Market Maker transactions only in equity option classes. Six DPMs participated in the 2005 fixed fee program. The prepayment of the 2005 associated transaction fees totaled \$10.5 million as of December 31, 2004, was recorded as unearned income. This amount was amortized and recorded as transaction revenues monthly during 2005. Prepayments for the 2006 fixed fee program were received in 2006.

In December 2005, the Exchange collected \$7.9 million representing annual regulatory fees amortized over the twelve-month period of July 2005 through June 2006. The amount included in unearned income as of December 31, 2005 totaled \$3.9 million.

### 11. SUBSEQUENT EVENTS

On February 3, 2006, ONE issued a capital call to the owners of ONE for a total amount of \$2.7 million. On February 10, 2006, the Exchange paid \$1.1 million to ONE, representing the Exchange's share of the capital call.

On March 15, 2006, Interactive Brokers Group LLC (IB) made a significant equity investment in ONE. IB is an electronic broker-dealer.

On February 22, 2006 the Exchange and HedgeStreet Inc. announced a strategic alliance for the joint development of new products, sharing of technology services, and marketing and support of HedgeStreet's products. Launched in 2004, HedgeStreet is a CFTC regulated exchange, a designated contract market, and a registered derivatives clearing organization. CBOE also made an equity investment in HedgeStreet.

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Members of the Chicago Board Options Exchange, Incorporated and Subsidiaries:

We have audited the accompanying consolidated balance sheets of the Chicago Board Options Exchange, Incorporated and subsidiaries (the "Exchange") as of December 31, 2005 and 2004, and the related consolidated statements of income and retained earnings and of cash flows for the year ended December 31, 2005 and for the six months ended December 31, 2004. These financial statements are the responsibility of the Exchange's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Exchange's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Exchange and its subsidiaries as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the year ended December 31, 2005 and for the six months ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

*Deloitte & Touche LLP*

Chicago, IL  
April 6, 2006

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**Edward J. Joyce**

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Adopting a new, more agile business model will give CBOE an important competitive edge in meeting the demands of an ever-changing marketplace.

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