

CHICAGO MERCANTILE EXCHANGE HOLDINGS INC

Form S-3

April 07, 2003

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As filed with the Securities and Exchange Commission on April 7, 2003

Registration No. 333-

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## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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### FORM S-3

REGISTRATION STATEMENT  
UNDER  
THE SECURITIES ACT OF 1933

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## CHICAGO MERCANTILE EXCHANGE HOLDINGS INC.

(Exact name of Registrant as Specified in Its Charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**36-4459170**

(I.R.S. Employer  
Identification Number)

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**30 South Wacker Drive  
Chicago, Illinois 60606  
(312) 930-1000**

(Address, Including Zip Code, and Telephone Number,  
Including Area Code, of Registrant's Principal Executive Offices)

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**Kathleen M. Cronin, Esq.  
Corporate Secretary  
Chicago Mercantile Exchange Holdings Inc.  
30 South Wacker Drive  
Chicago, Illinois 60606  
(312) 930-1000**

(Name, Address, Including Zip Code, and Telephone Number,  
Including Area Code, of Agent for Service)

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**APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC:** As soon as practicable after the effective date of this Registration Statement.

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If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, check the following box.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box.

### CALCULATION OF REGISTRATION FEE

Title of Shares to be Registered	Amount To Be Registered	Proposed Maximum Offering Price Per Share(1)	Proposed Maximum Aggregate Offering Price(1)	Amount of Registration Fee
Class A Common Stock, par value \$.01 per share (including rights to acquire Series A Junior Participating Preferred Stock pursuant to our rights plan)	6,981,000	\$47.765	\$333,447,465	\$26,976

- (1) Estimated solely for the purpose of calculating the amount of the registration fee, pursuant to Rule 457(c) of the Securities Act of 1933, as amended, based upon the average of the high and low prices of our Class A common stock on April 2, 2003, as reported on the New York Stock Exchange.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

*PROSPECTUS (Subject to Completion)*  
*Issued April 7, 2003*

The information in this prospectus is not complete and may be changed. The selling shareholders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and the selling shareholders are not soliciting offers to buy these securities in any state where the offer or sale is not permitted.

*Shares*

**CLASS A COMMON STOCK**

*All of the shares of Class A common stock in the offering are being sold by the selling shareholders identified in this prospectus. Chicago Mercantile Exchange Holdings Inc. will not receive any of the proceeds from the sale of the shares by the selling shareholders.*

*Our Class A common stock is listed on the New York Stock Exchange under the symbol "CME." On April 2, 2003, the reported last sale price of our Class A common stock on the New York Stock Exchange was \$48.16 per share.*

*Investing in our common stock involves risks. See "Risk Factors" beginning on page 7.*

**PRICE \$ A SHARE**

	<b>Price to Public</b>	<b>Underwriting Discounts and Commissions</b>	<b>Proceeds to Selling Shareholders</b>
<i>Per Share</i>	\$	\$	\$
<i>Total</i>	\$	\$	\$
<i>The selling shareholders have granted the underwriters the right to purchase up to an additional shares to cover over-allotments.</i>			

*The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities, or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.*

*Morgan Stanley & Co. Incorporated expects to deliver the shares to purchasers on \_\_\_\_\_, 2003.*

**MORGAN STANLEY**  
**CITIGROUP**  
, 2003

**JPMORGAN**

**UBS WARBURG**  
**WILLIAM BLAIR & COMPANY**

**TABLE OF CONTENTS**

	<b>Page</b>
Prospectus Summary	1
Risk Factors	7
Special Note About Forward-Looking Statements	23
Use of Proceeds	24
Dividend Policy	24
Price Range of Our Class A Common Stock	24
Capitalization	25
Selected Financial Data	26
Management's Discussion and Analysis of Financial Condition and Results of Operations	28
Industry Overview	58
Business	62
Management	94
Certain Relationships and Related Transactions	99
Principal and Selling Shareholders	100
Description of Capital Stock	105
Shares Eligible for Future Sale	115
Material U.S. Federal Tax Consequences to Non-U.S. Shareholders	116
Underwriters	118
Legal Matters	120
Experts	120

	<u>Page</u>
Where You Can Find Additional Information	121
Documents Incorporated By Reference	121
Index to Financial Statements	F-1

Our principal executive offices are located at 30 South Wacker Drive, Chicago, Illinois 60606, and our telephone number is (312) 930-1000. In this prospectus, we refer to Chicago Mercantile Exchange Holdings Inc. as "CME Holdings" and to Chicago Mercantile Exchange Inc., a wholly owned subsidiary of CME Holdings, as "CME." The terms "we," "us" and "our" refer to CME Holdings and CME.

Unless otherwise indicated, all information in this prospectus assumes the underwriters do not exercise their over-allotment option. In this prospectus, unless otherwise indicated, we refer to our Class A, Class A-1, Class A-2, Class A-3 and Class A-4 common stock collectively as our Class A common stock, and we refer to our Class B-1, Class B-2, Class B-3 and Class B-4 common stock collectively as our Class B common stock.

You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone to provide you with information that is different. The selling shareholders are offering to sell shares of Class A common stock and seeking offers to buy shares of Class A common stock only in jurisdictions where offers and sales are permitted. The information contained or incorporated by reference in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of the Class A common stock. It is important for you to read and consider all information contained and incorporated by reference in this prospectus in making your investment decision. You should also read and consider the information in the documents to which we have referred you in the section of this prospectus entitled "Where You Can Find More Information."

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S&P®, S&P 500®, Standard & Poor's 500, S&P/BARRA Growth , S&P/BARRA Value , S&P MidCap 400 , S&P SmallCap 600 , S&P/TOPIX 150 , NASDAQ-100®, Russell 1000®, Russell 2000®, TRAKRS<sup>SM</sup>, Total Return Asset Contracts<sup>SM</sup> and other trade names, service marks, trademarks and registered trademarks that are not proprietary to us, are the property of their respective owners and are used herein under license. The FORTUNE e-50 Index is a trademark of FORTUNE, a division of Time Inc., which is licensed for use by us in connection with futures and options on futures. These products have not been passed on by FORTUNE for suitability for a particular use. The products are not sponsored, endorsed, sold or promoted by FORTUNE. FORTUNE makes no warranty and bears no liability with respect to these products. FORTUNE makes no warranty as to the accuracy and/or completeness of the Index or the data included therein or the results to be obtained by any person from the use of the Index or the data included therein.

## PROSPECTUS SUMMARY

*The following is a summary of some of the information contained in this prospectus. In addition to this summary, we urge you to read the entire prospectus carefully, especially the risks of investing in our Class A common stock discussed under "Risk Factors" and our consolidated financial statements and notes to those financial statements and other information included elsewhere and incorporated by reference in this prospectus.*

### Overview

We are the largest futures exchange in the United States and the second largest exchange in the world for the trading of futures and options on futures, as measured by 2002 annual trading volume. In 2002, our customers traded futures and options on futures contracts with a notional dollar value of \$328.6 trillion, making us the world's largest exchange by this measure. We also have the largest futures and options on futures open interest of any exchange in the world. As of December 31, 2002, our open interest record was 24.8 million contracts, set on December 12, 2002. Open interest is a widely recognized indicator of the level of customer interest in an exchange's products.

We bring together buyers and sellers of derivatives products on our open outcry trading floors, on the GLOBEX electronic trading platform and through privately negotiated transactions that we clear. We offer market participants the opportunity to trade futures contracts and options on futures on interest rates, stock indexes, foreign exchange and commodities. Our key products include Eurodollar contracts and contracts based on major U.S. stock indexes, including the S&P 500 and the NASDAQ-100. We also offer contracts for the principal foreign currencies and for a number of commodity products, including cattle, hogs and dairy. We believe several of our key products serve as global financial benchmarks. Our Eurodollar contract provides a benchmark for measuring the relative value of U.S. dollar-denominated, short-term

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fixed-income securities. Similarly, our S&P 500 Index and NASDAQ-100 Index contracts are closely linked to the benchmark indexes for U.S. equity performance.

Our products provide a means for hedging, speculation and asset allocation relating to the risks associated with interest rate sensitive instruments, equity ownership, changes in the value of foreign currency and changes in the prices of commodity products. Our customer base includes professional traders, financial institutions, institutional and individual investors and major corporations, manufacturers, producers, supranational entities and governments.

Trading on our trading floors is conducted exclusively by our members, either through open outcry or by using GLOBEX terminals located on our trading floors. Trades executed by our members can be for their own account or for the account of non-member customers. Members also conduct trading electronically through remote access to our GLOBEX platform and through privately negotiated transactions that we clear. Non-members may also access our markets through the GLOBEX electronic trading platform. Generally, member customers are charged lower fees than our non-member customers. During 2002, our members were responsible for approximately 78% of our trading volume.

Our principal source of revenue is from charges for trade execution and clearing that we assess on each contract traded on our exchange or using our clearing house. We assess clearing and transaction fees based on the product traded, the membership status of the individual executing the trade and whether the trade is executed on our open outcry trading floors, through the GLOBEX electronic trading platform or as a privately negotiated transaction. In addition to clearing and transaction fees, we derive revenue from the sale of valuable data and information regarding pricing and trading activity generated by our markets.

Our 2002 net revenues were \$453.2 million, an increase of 17.1% from the \$387.2 million recorded during 2001. In 2002, we derived \$356.4 million, or 78.6% of our net revenues, from fees associated with trading and clearing products on or through our exchange. In 2002, we derived approximately 50% of our clearing and transaction fees revenue from open outcry trading, nearly 42% from electronic trading and approximately 8% from privately negotiated transactions. Revenues from market data products totaled \$48.7 million, or 10.8% of our net revenues, in 2002. Our net income for 2002 was \$94.1 million, compared to net income of \$75.1 million during 2001.

1

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We own our clearing house and are able to guarantee, clear and settle every contract traded through our exchange. During 2002, we processed an average of approximately 554,000 clearing transactions per day. We currently have the capacity to clear more than 1.5 million transactions per day. Our systems are scalable and give us the ability to substantially increase our capacity with very little lead time. As of December 31, 2002, we acted as custodian for approximately \$27.4 billion in collateral. In 2002, we moved an average of \$1.8 billion of settlement funds through our clearing system each day. In addition, 40 exchanges and clearing organizations worldwide have adopted our Standard Portfolio Analysis of Risk, or SPAN, risk evaluation system. The New York Mercantile Exchange, or NYMEX, and Euronext N.V. also use CLEARING 21, our state-of-the-art clearing system.

CME was founded in 1898 as a not-for-profit corporation. In November 2000, we became the first U.S. financial exchange to demutualize and become a shareholder-owned corporation. As a consequence, we have adopted a for-profit approach to our business, including strategic initiatives aimed at optimizing volume, efficiency and liquidity. We posted record trading volume of 558.4 million contracts in 2002, an increase of 35.6% over 2001, which was previously our busiest year. Additionally, in December 2002, we completed our initial public offering, and our Class A common stock began trading on the New York Stock Exchange, making us the first publicly traded financial exchange in the United States.

Currently, we have or are developing strategic relationships with the leading exchanges and clearing houses in Singapore, England, France, Spain, Japan, Korea and China. These relationships are intended to extend the market reach of our global derivatives business.

We devote substantial resources to introducing new products based on new markets or securities. For example, in 2001, we formed OneChicago, LLC, our joint venture with Chicago Board Options Exchange, or CBOE, and Chicago Board of Trade, or CBOT, to trade single stock futures and futures on narrow-based stock indexes. OneChicago commenced its trading operations on November 8, 2002. We also entered into an agreement with NYMEX in 2002 to introduce smaller-sized versions of key NYMEX energy futures contracts for trading on our GLOBEX electronic trading platform. The products, based on our successful E-mini stock index contracts, are called e-miNY energy futures and clear at the NYMEX clearing house.

### **Competitive Strengths**

We have established ourselves as a premier global marketplace for financial risk management. We believe our principal competitive strengths are:

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**Highly Liquid Markets.** Our deep and liquid markets tend to attract additional customers. This further enhances our liquidity.

**Global Benchmark Products.** We believe our key Eurodollar product serves as a global financial benchmark for measuring the relative value of U.S. dollar-denominated, short-term fixed-income securities. Similarly, our stock index products are closely linked to the benchmark indexes for U.S. equity performance. As a result, our products are increasingly recognized by our customers as efficient tools for managing and hedging their interest rate and equity market risks.

**Diverse Portfolio of Products and Services.** We differentiate ourselves from our competitors by developing and offering to our customers a diverse array of products. We also offer a broad range of trade execution and clearing services.

**Wholly Owned Clearing House.** We believe our performance guarantee and capital-efficient clearing systems are major attractions of our markets. In addition, because we own our clearing house and have significant available capacity, we are able to efficiently introduce new products. We are also able to provide clearing services to other exchanges.

**Proven and Scalable Technology.** We possess fast, reliable and fully integrated trading and clearing systems. Our systems are highly scalable and designed to accommodate additional products with relatively limited modifications and low incremental costs.

2

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**Global Reach.** Our electronic trading services are available around the world approximately 23 hours a day and five days per week.

### Growth Strategy

Globalization, deregulation and advances in technology offer significant opportunities for expanding futures markets, and exchange markets generally. We intend to increase our revenues and profitability by implementing the following four strategies:

**Expand Our Current Core Business.** We intend to advance our position as a leader in the futures industry by:

*Expanding Customer Access.* We continue to expand our customer base and trading volume by broadening the access, order routing, trading and clearing solutions we offer to existing and prospective customers.

*Expanding Electronic and Other Trade Execution Choices.* Our strategy is to offer our customers a broad range of trade execution choices, including increased electronic trading, enhanced facilities for privately negotiated transactions and new links with exchanges around the world.

*Enhancing Our Market Data and Information Products.* We intend to leverage the value of our market data and information capabilities by developing enhancements to our existing information products and creating new products.

**Add New Products.** We intend to continue to introduce, either directly or through alliances with other exchanges, new products based on new markets or securities. In addition, we intend to continue working with emerging cash market trading platforms to jointly develop innovative futures products.

**Provide Transaction Processing and Other Business Services to Third Parties.** We intend to leverage our existing capacity and scalable technology and business processes to offer a broad range of services to other exchanges, clearing organizations and e-marketplaces. We believe that third parties will be attracted by our proven ability to process high volumes of transactions.

**Pursue Select Alliances and Acquisitions.** We plan to supplement our internal growth through the formation of joint ventures or alliances and select acquisitions of businesses or technologies that help us to enter new markets, provide services that we currently do not offer, open access to our markets and advance our technology.

**Corporate Information**

We were incorporated in Delaware in August 2001. Our principal executive offices are located at 30 South Wacker Drive, Chicago, Illinois 60606, and our telephone number is (312) 930-1000. Our Web site is <http://www.cme.com>. Information contained in our Web site is not incorporated by reference into this prospectus. You should not consider information contained in our Web site as part of this prospectus.

**THE OFFERING**

Class A common stock offered by the selling shareholders	shares
Common stock to be outstanding immediately after this offering:	
Class A common stock	shares
Class B common stock	3,138 shares
Use of proceeds	We will not receive any proceeds from the sale of Class A common stock in this offering by the selling shareholders.
New York Stock Exchange symbol	CME

The number of shares of our Class A common stock outstanding immediately after this offering is based on the number of shares outstanding at December 31, 2002. This number does not take into account:

67,200 shares of Class A common stock subject to restricted stock awards, which are not vested;

1,084,400 shares of Class A common stock issuable upon the exercise of outstanding stock options issued under our stock option plan, with a weighted average exercise price of \$22.32 per share; and

2,560,912 shares of Class A common stock issuable upon the exercise of the outstanding stock options issued to our chief executive officer, at a weighted average exercise price of \$21.32 per share, based on a price for our Class A common stock of \$43.66 per share, and assuming the entire option is exercised for cash and settled in Class A common stock only.

If the underwriters exercise their over-allotment option in full, the selling shareholders will sell \_\_\_\_\_ additional shares of Class A common stock and the number of shares of Class A common stock outstanding immediately after this offering will be \_\_\_\_\_.

**SUMMARY CONSOLIDATED FINANCIAL DATA**

The summary information set forth below is not necessarily indicative of the results of future operations and should be read in conjunction with "Selected Financial Data," "Management's Discussion and Analysis of Financial Condition and Results of Operations," the financial statements and related notes and other information included elsewhere and incorporated by reference in this prospectus.

Year Ended December 31,		
2000 (restated)	2001 (restated)	2002
_____	_____	_____
(in thousands, except per share amounts)		

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Year Ended December 31,

<b>Income Statement Data:(1)</b>			
Net revenues	\$	226,552	\$ 387,153 \$ 453,177
Total expenses		241,814	261,387 298,948
Limited partners' interest in earnings of PMT Limited Partnership		(1,165)	
Net income (loss)		(10,496)	75,108 94,067
Earnings (loss) per share:(2)			
Basic		(0.36)	2.61 3.24
Diluted			2.57 3.13

As of  
December 31, 2002

(in thousands)

**Balance Sheet Data:**

**Assets:**

Cash and cash equivalents(3)	\$	339,260
Proceeds from securities lending activities(4)		985,500
Cash performance bonds and security deposits(5)		1,827,991
Total current assets(6)		3,215,131
Total assets		3,355,016

**Liabilities and shareholders' equity:**

Payable under securities lending agreements(4)		985,500
Cash performance bonds and security deposits(5)		1,827,991
Total current liabilities		2,889,491
Shareholders' equity		446,139

(1) Income statement data for 2000 and 2001 have been restated to reflect the adoption of SFAS No. 123, "Accounting for Stock-Based Compensation." Prior to the restatement, net income (loss) was (\$5.9) million and \$68.3 million for 2000 and 2001, respectively. The basic loss per share was \$0.21 for 2000 and basic and diluted earnings per share were \$2.37 and \$2.33, respectively, for 2001.

(2) Earnings per share are presented as if common stock issued on December 3, 2001 as part of our reorganization into a holding company structure had been outstanding for all periods presented. For 2000, diluted loss per share is not presented, since shares issuable for stock options would have an anti-dilutive effect.

(3) Cash equivalents consist of money market mutual funds.

(4) Securities lending transactions utilize a portion of the securities that clearing firms have deposited to satisfy their proprietary performance bond requirements. Securities lending proceeds change daily. The related investment of these proceeds is short-term in nature. Investments consist principally of money market mutual funds. Securities lending activity is represented by an equal and offsetting current asset and current liability. See the section of this prospectus entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources" for a more detailed discussion of our securities lending program.

(5) Our clearing firms are subject to performance bond requirements pursuant to the rules of our exchange. These requirements can be satisfied in cash or by depositing securities, at the clearing firms' election. The deposit of cash is reflected in our financial statements while the deposit of securities is not reflected in our financial statements. The amount of cash performance bonds and security deposits that are deposited by our clearing firms may change daily as a result of changes in the number of the clearing firms' open positions and how clearing firms elect to satisfy their performance bond requirements. The balance of cash performance bonds and security deposits will also fluctuate daily based on the change in the value of positions held by clearing firms. When clearing firms deposit cash, it is held or invested by us on an overnight basis. We are required to return these funds when performance bond requirements are reduced, as these funds ultimately represent assets of the respective clearing firms. Therefore, the current asset represented by cash performance bonds and security deposits has an equal and offsetting current liability. See the section of this prospectus entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources" for a more detailed discussion of cash performance bonds and security deposits.

(6) Current assets consist of cash and cash equivalents, marketable securities, accounts receivable and other current assets in addition to cash performance bonds and security deposits and securities lending proceeds. Current assets are short-term in nature and are generally converted to cash in one year or less.



	Year Ended December 31,		
	2000	2001	2002
	(in thousands, except notional value of trading volume)		
<b>Other Data:</b>			
Total trading volume (round turns, in contracts)(7)	231,110	411,712	558,448
GLOBEX trading volume (round turns, in contracts)(7)	34,506	81,895	197,975
Open interest at period-end (contracts)	8,021	15,039	18,792
Notional value of trading volume (in trillions)	\$ 155.0	\$ 293.9	\$ 328.6

(7)

A round turn represents a matched buy and sell.

## RISK FACTORS

*You should carefully consider the risks below before making an investment decision. The risks described below are not the only ones facing our company. Additional risks not presently known to us or that we currently deem immaterial may also impair our operations.*

*Our business, financial condition or results of operations could be materially adversely affected by any of these risks. The trading price of our Class A common stock could decline due to any of these risks, and you may lose all or part of your investment.*

### Risks Related to Our Business

**Our shareholders who are members and own trading rights on our exchange, and who may have interests that differ from or conflict with those of shareholders who are not also members, currently own substantially all of our voting stock. Shareholders who own trading rights on our exchange account for 17 of the 20 directors on our board and currently control the election of all directors. Our dependence on the trading and clearing activities of our members, combined with their ability to control the election of directors, enables them to exert substantial influence over the operation of our business.**

We estimate that, immediately following this offering, our shareholders who own memberships will together own, of record, shares representing approximately % of our outstanding Class A common stock. As a result, they will, if voting in the same manner, control all matters submitted to our shareholders for approval, including electing directors and approving changes of control. As of the date of this prospectus, 17 of the 20 directors on our board own or are officers or directors of others who own memberships on our exchange. In addition, we are dependent on the revenues from the trading and clearing activities of our members. This dependence also gives them substantial influence over how we operate our business.

Many of our trading members and clearing firms derive a substantial portion of their income from their trading or clearing activities on or through our exchange. In addition, trading rights on our exchange have substantial independent value. The amount of income that members derive from their trading or clearing activities and the value of their trading rights are, in part, dependent on the fees they are charged to trade, clear and access our markets and the rules and structure of our markets. Our trading members, many of whom act as floor brokers and floor traders, benefit from trading rules, membership privileges and fee discounts that enhance their open outcry trading opportunities and profits. Our predominantly electronic trading members benefit from fee discounts and transaction fee caps that enhance their electronic trading opportunities and profits. Our clearing firms benefit from all of the foregoing, as well as decisions that increase electronic trading, which over time, will reduce their costs of doing business on our exchange. As a result, holders of our Class A common stock may not have the same economic interests as our members. In addition, our members may have differing interests among themselves depending on the role they serve in our markets, their method of trading and the products they trade. Consequently, members may advocate that we enhance and protect their clearing and trading opportunities and the value of their trading privileges over their economic interest in us represented by Class A common stock they own.

The share ownership of our members, in combination with their board representation rights and charter provision protections described in the immediately following risk factor, could be used to influence how our business is changed or developed, including how we address competition and how we seek to grow our volume and revenue and enhance shareholder value.

**Our certificate of incorporation grants special rights to holders of Class B common stock, which protect their trading rights and give them special board representation, and requires that we maintain open outcry trading until volumes are not significant.**

Under the terms of our certificate of incorporation, our Class B shareholders have the ability to protect their rights to trade on our exchange by means of special approval rights over changes to the

7

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operation of our markets. In particular, these provisions include a grant to the holders of our Class B common stock of the right to approve any changes to:

the trading floor rights;

access rights and privileges that a member has;

the number of memberships in each membership class and the related number of authorized shares of each class of Class B common stock; and

the eligibility requirements to exercise trading rights or privileges.

For a more detailed description of the approval rights of our Class B shareholders, see the section of this prospectus entitled "Description of Capital Stock." Our Class B shareholders are also entitled to elect six of the 20 directors on our board. As the transfer restrictions on shares of Class A common stock held by Class B shareholders terminate over time, Class B shareholders will continue to have these board representation rights, even if their Class A share ownership interest is very small.

Our certificate of incorporation also includes a provision requiring us to maintain open outcry floor trading on our exchange for a particular traded product as long as the open outcry market is "liquid." Our certificate of incorporation requires us to maintain a facility for conducting business, disseminating price information, clearing and delivery and to provide reasonable financial support for technology, marketing and research for open outcry markets. Our certificate of incorporation provides specific tests as to whether an open outcry market will be deemed liquid, as measured on a quarterly basis. If a market is deemed illiquid as a result of a failure to meet any of these tests, our board will determine whether or not that market will be closed.

**We only recently began operating as a for-profit company and have a limited operating history as a for-profit company. Accordingly, our historical and recent financial and business results may not be representative of what they may be in the future.**

We have only operated as a for-profit company with private ownership interests since November 13, 2000. We have a limited operating history as a for-profit business on which you can evaluate our management decisions, business strategy and financial results. As a result, our historical and recent financial and business results may not be representative of what they may be in the future. We are subject to risks, uncertainties, expenses and difficulties associated with changing and implementing our business strategy that are not typically encountered by established for-profit companies. The major U.S. futures exchanges have operated historically as mutual, membership organizations. There is little history or experience in operating an exchange as a for-profit corporation upon which we can draw. As a not-for-profit company, our business strategy and fee structure were designed to provide profit opportunities for our members. We targeted profit levels that provided sufficient levels of working capital. Today, our for-profit initiatives are designed to increase our revenues, make us profitable, optimize volume and liquidity and create operating efficiencies. These initiatives may not yield the benefits or efficiencies we expect. For example, fee increases, volume and member discounts and new access rules to our markets may not separately result in higher revenues and profits or greater volume or liquidity in our markets. As a result, we may not be able to operate effectively as a for-profit corporation. It is possible that we may incur significant operating losses in the future and that we may not be able to achieve or sustain long-term profitability.

**Our business is subject to the impact of domestic and international market and economic conditions, many of which are beyond our control and could significantly reduce our trading volumes and make our financial results more volatile.**

We generate revenues primarily from our trade execution services, clearing services and market data and information services. We expect to continue to do so for the foreseeable future. Each of these revenue

8

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sources is substantially dependent on the trading volume in our markets. Our trading volume is directly affected by U.S. domestic and international factors that are beyond our control, including:

economic, political and market conditions;

broad trends in industry and finance;

changes in levels of trading activity, price levels and price volatility in the derivatives markets and in underlying fixed-income, equity, foreign exchange and commodity markets;

legislative and regulatory changes;

competition;

changes in government monetary policies and foreign exchange rates;

consolidation in our customer base and within our industry; and

inflation.

Any one or more of these factors may contribute to reduced activity in our markets. Our recent operating results and trading volume have been favorably impacted by global and domestic economic and geopolitical uncertainty. This is because our customers have sought to hedge or manage the risks associated with volatility in the U.S. equity markets, fluctuations in interest rates and price changes in the foreign exchange and commodities markets. The future economic environment will be subject to periodic downturns, including possible recession and lower volatility in financial markets, and may not be as favorable as it has been in recent years. As a result, period-to-period comparisons of our financial results are not necessarily meaningful. Trends less favorable than those of recent periods could result in decreased trading volume, decreased capital formation and a more difficult business environment for us. Material decreases in trading volume would have a material adverse effect on our financial condition and operating results.

**Our operating results are subject to significant fluctuations due to seasonality and a number of other factors. As a result, you will not be able to rely on our operating results in any particular period as an indication of our future performance.**

A number of factors beyond our control may contribute to substantial fluctuations in our operating results particularly in our quarterly results. In the three years prior to 2001, we experienced relatively higher volume during the first and second quarters, and we generally expect that the third quarter will have lower trading volume. This trend was not evident in 2001 or 2002 in part because of the volatility of interest rates and U.S. equities in the third quarter in each of those years. As a result of seasonality and the factors described in the preceding risk factors, you will not be able to rely on our operating results in any particular period as an indication of our future performance. If we fail to meet securities analysts' expectations regarding our operating performance, the price of our Class A common stock could decline substantially.

**Our cost structure is largely fixed. If we are unable to reduce our costs if our revenues decline, our profitability will be adversely affected.**

Our cost structure is largely fixed. We base our cost structure on historical and expected levels of demand for our products and services. If demand for our products and services and our resulting revenues decline, we may not be able to adjust our cost structure on a timely basis. In that event, our profitability will be adversely affected.

**The global trend toward electronic trading may divert volume away from our open outcry trading facilities. Our revenues, profits and stock price will be adversely affected if we experience reductions in our open outcry trading volume that are not offset by increases in our electronic trading volume.**

Both newly formed organizations and established exchanges are increasingly employing trading systems that provide fast, low-cost execution of trades by matching buyers and sellers electronically. These organizations are attracting order flow away from some traditional open outcry trading markets. Many market participants believe that these electronic trading systems represent a threat to the continued viability of the open outcry method of trading. Some major European and Asian futures exchanges have closed their traditional open outcry trading facilities and replaced them entirely with electronic systems. Although we offer an electronic trading system, during 2002 approximately 50% of our revenues from clearing and transaction fees were generated by open outcry trading. Reductions in our open outcry trading volume that are not offset by increases in our electronic trading volume would have a material adverse effect on our revenue, earnings and stock price.

**The success of our markets will depend on our ability to complete development of and successfully implement electronic marketplaces that have the functionality, performance, reliability, speed and liquidity required by customers.**

The future success of our business depends in large part on our ability to create interactive electronic marketplaces in a wide range of derivatives products that have the required functionality, performance, reliability, speed and liquidity to attract and retain customers. A significant portion of our current overall volume is generated through electronic trading of our E-mini S&P 500 and E-mini NASDAQ-100 products. However, during 2002, approximately 63% of our volume and approximately 50% of our clearing and transaction fees revenue was generated through our open outcry trading facilities. Most of that open outcry volume is related to trading in Eurodollar contracts. Until recently, our electronic functionality has not been capable of accommodating the complex trading strategies typically used for trading our Eurodollar contracts. As a result, our electronic trading facilities for these products have met with limited success. We recently implemented a new electronic system upgrade called Eagle. This software is designed to provide the required functionality to replicate electronically some of the trading strategies used by open outcry Eurodollar traders. We are currently developing additional functionality to accommodate more Eurodollar trading strategies. We may not complete the development of or successfully implement the required electronic functionality for our Eurodollar marketplace. Moreover, our Eurodollar customers may not accept our electronic trading systems. In either event, our ability to increase our electronic Eurodollar trading volume would be adversely affected. In addition, if we are unable to develop our electronic trading systems to include other products and markets, or if our electronic marketplaces do not have the required functionality, performance, reliability, speed and liquidity, we may not be able to compete successfully in a new environment that we expect to be increasingly dominated by electronic trading.

**We maintain the simultaneous operation of open outcry trading and electronic trade execution facilities, which may, over time, prove to be inefficient and costly and ultimately adversely affect our profitability.**

Currently, we maintain both open outcry trade execution facilities and electronic trade execution facilities. For some products, we maintain side-by-side trading facilities for both open outcry and electronic trading. We are obligated, through the inclusion of provisions in our certificate of incorporation, to maintain the operation of our open outcry trading facilities until the trading volumes in them are not significant. If we continue to operate both trading facilities for the same product, liquidity of markets on each may be less than the liquidity of competing markets on a unified trading platform. In addition, it may be expensive to continue operating two trading systems for the same product. We may incur substantial expenses and experience delays because of our efforts to create trading links between the separate trading platforms to facilitate trading on both systems. Any loss of efficiency or increase in time to market of new or improved products could be detrimental to our business. In addition, we may expend resources on the

maintenance of our open outcry facilities that could be more efficiently used to develop our capacity and reduce our costs in the increasingly competitive market for electronic trading facilities.

**The development of our electronic trading facilities exposes us to risks inherent in operating in the new and evolving market for electronic transaction services. If we do not successfully develop our electronic trading facilities, or if our customers do not accept them,**

**our revenues, profits and stock price will be adversely affected.**

We must further develop our electronic trading facilities to remain competitive. As a result, we will continue to be subject to risks, expenses and uncertainties encountered in the rapidly evolving market for electronic transaction services. These risks include our failure or inability to:

provide reliable and cost-effective services to our customers;

develop, in a timely manner, the required functionality to support electronic trading in some of our key products in a manner that is competitive with the functionality supported by other electronic markets;

match fees of our competitors that offer only electronic trading facilities;

increase the number of trading and order routing terminals capable of sending orders to our floor and to our electronic trading system;

attract independent software vendors to write front-end software that will effectively access our electronic trading system and automated order routing system;

respond to technological developments or service offerings by competitors; and

generate sufficient revenue to justify the substantial capital investment we have made and will continue to make to develop our electronic trading facilities.

If we do not successfully develop our electronic trading facilities, or our current or potential customers do not accept them, our revenues, profits and stock price will be adversely affected.

**Our market data fees may be reduced or eliminated by the growth of electronic trading and electronic order entry systems. If we are unable to offset that reduction through terminal usage fees or transaction fees, we will experience a reduction in revenue.**

Electronic trading systems do not usually impose separate charges for supplying market data to trading terminals. If we do not separately charge for market data supplied to trading terminals, and trading terminals with access to our markets become widely available, we would lose quote fee revenue from those who have access to trading terminals. We will experience a reduction in our revenues if we are unable to recover that lost quote fee revenue through terminal usage fees or transaction fees.

**Our change to a for-profit company may cause members to seek alternative trading venues and products and negatively impact the liquidity of our markets and our trading volume.**

The trading activities of our members accounted for approximately 78% of our trading volume during 2002. When we became a for-profit company, we changed the role of our members in the operation of our business. We eliminated many member-dominated committees or converted them into advisory bodies. We gave our professional staff greater decision-making responsibilities. Subject to the oversight of our board of directors, our management is charged with making decisions that are designed to enhance shareholder value, which may lead to decisions or outcomes with which our members disagree. These changes may make us less attractive to our members and encourage them to conduct their business at, or seek membership in, another exchange or to trade in equivalent products among themselves on a private, bilateral basis. A material decrease in member trading activity would negatively impact liquidity and trading volume in our products and reduce our revenues. A loss or material reduction in the number of our

clearing firms and the capital they provide to guarantee their trades and the trades of their customers would also diminish the strength and attractiveness of our clearing house and our markets.

Despite our governance changes, our dependence on our members gives them substantial influence over how we operate our business. Members could use their ownership of Class A and Class B common stock, and ability to elect our board of directors, to change or modify our policies or business practices with which they do not agree.

**Our trading volume, and consequently our revenues and profits, would be adversely affected if we are unable to retain our current customers or attract new customers to our exchange.**

The success of our business depends, in part, on our ability to maintain and increase our trading volume. To do so, we must maintain and expand our product offerings, our customer base and our trade execution alternatives. Our success also depends on our ability to offer competitive prices and services in an increasingly price sensitive business. In addition, our success depends on our ability to increase the base of individual customers who trade our products. We cannot assure you that we will be able to continue to expand our product lines, or that we will be able to retain our current customers or attract new customers. We also cannot assure you that we will not lose customers to low-cost competitors with comparable or superior products, services or trade execution facilities. If we fail to expand our product offerings or execution facilities, or lose a substantial number of our current customers, or are unable to attract new customers, our business will be adversely affected.

**We face intense competition from other companies, including some of our members. If we are not able to successfully compete, our business will not survive.**

The derivatives, securities and financial services industries are highly competitive. We expect that competition will intensify in the future. Our current and prospective competitors, both domestically and around the world, are numerous. They include securities and securities option exchanges, futures exchanges, over-the-counter, or OTC, markets, clearing organizations, market data and information vendors, electronic communications networks, crossing systems and similar entities, consortia of large customers, consortia of some of our clearing firms and electronic brokerage and dealing facilities. We believe we may also face competition from large computer software companies and media and technology companies. The number of businesses providing Internet-related financial services is rapidly growing. Other companies have entered into or are forming joint ventures or consortia to provide services similar to those provided by us. Others may become competitive with us through acquisitions. Recent changes in federal law allow institutions that have been major participants on our exchange to trade the same or similar products among themselves without utilizing any exchange or trading system. Many of our competitors and potential competitors have greater financial, marketing, technological and personnel resources than we do. These factors may enable them to develop similar products, to provide lower transaction costs and better execution to their customers and to carry out their business strategies more quickly and efficiently than we can. In addition, our competitors may:

respond more quickly to competitive pressures due to their corporate governance structures, which may be more flexible and efficient than our corporate governance structure;

develop products that are preferred by our customers;

develop risk transfer products that compete with our products;

price their products and services more competitively;

develop and expand their network infrastructure and service offerings more efficiently;

utilize better, more user-friendly and more reliable technology;

take greater advantage of acquisitions, alliances and other opportunities;

more effectively market, promote and sell their products and services;

better leverage existing relationships with customers and alliance partners or exploit better recognized brand names to market and sell their services; and

exploit regulatory disparities between traditional, regulated exchanges and alternative markets that benefit from a reduced regulatory burden and lower-cost business model.

If our products, markets and services are not competitive, our business, financial condition and operating results will be materially harmed. In addition, even if new entrants do not significantly erode our market share, we may be required to reduce our fees significantly to remain competitive, which could have a material adverse effect on our profitability. For more information concerning the competitive nature of our industry and the challenges we face, see the section of this prospectus entitled "Business Competition."

**The enactment of the Commodity Futures Modernization Act will increase competition and enable many of our customers to trade futures contracts other than on exchanges. These events could result in lower trading volume, revenue and profits.**

Our industry has been subject to several fundamental regulatory changes, including changes in the statute under which we have operated since 1974. The Commodity Exchange Act generally required all futures contracts to be executed on an exchange that has been approved by the Commodity Futures Trading Commission, or CFTC. The exchange trading requirement was modified by CFTC regulations and interpretations to permit privately negotiated swap contracts to be transacted in the OTC market. The CFTC exemption under which the OTC derivatives market operated precluded the OTC market from using exchange-like electronic transaction systems and clearing facilities. These barriers to competition from the OTC market were largely repealed by the Commodity Futures Modernization Act. It is possible that the chief beneficiaries of the Commodity Futures Modernization Act will be OTC dealers and competitors that operate or intend to open electronic trading facilities or to conduct their futures business directly among themselves on a bilateral basis. The customers who may access these trading facilities or engage in bilateral private transactions are the same customers who account for a substantial portion of our trading volume. The Commodity Futures Modernization Act also permits banks, broker-dealers and some of their affiliates to engage in foreign exchange futures transactions for or with retail customers without being subject to regulation under the Commodity Exchange Act.

The Commodity Futures Modernization Act also permits bank clearing organizations and clearing organizations regulated by the Securities and Exchange Commission, or SEC, to clear a broad array of derivatives products in addition to the products that these clearing organizations have traditionally cleared. This allocation of jurisdiction may be advantageous to competing clearing organizations and result in a lower volume of trading cleared through our clearing house.

**If we are not able to keep up with rapid technological changes, our business will be materially harmed.**

To remain competitive, we must continue to improve the responsiveness, functionality, accessibility and other features of our software, network distribution systems and technologies. The markets in which we compete are characterized by rapidly changing technology, changes in customer demand and uses of our products and services, frequent product and service introductions embodying new technologies and the emergence of new industry standards and practices that could render our existing technology and systems obsolete. Our future success will depend in part on our ability to anticipate and adapt to technological advancements and changing standards in a timely, cost-efficient and competitive manner. We cannot assure you that we will successfully implement new technologies or adapt our technology to customer and competitive requirements or emerging industry standards.

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**Any significant decline in the trading volume of our Eurodollar, S&P 500 or NASDAQ-100 futures and options on futures contracts or in privately negotiated foreign exchange transactions using our clearing house would adversely affect our revenues and profitability.**

We are substantially dependent on trading volume from three product offerings for a significant portion of our clearing and transaction fees revenues and profits. The clearing and transaction fees revenues attributable to transactions in our Eurodollar contracts, our S&P 500 and NASDAQ-100 contracts, and privately negotiated foreign exchange transactions using our clearing house were approximately 47%, 10%, 2% and 10%, respectively, of our total clearing and transaction fees revenues during 2001 and approximately 40%, 9%, 2% and 7%, respectively, during 2002. Any significant decline in our trading volume in any of these products would negatively impact our business, financial condition and operating results.

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We believe our Eurodollar product serves as a global financial benchmark, but we cannot assure you that, in the future, other products will not become preferred alternatives to the Eurodollar contract as a means of managing or speculating on interest rate risk. We also cannot assure you that competitors will not enter the Eurodollar market, or that our members will not trade Eurodollars in privately negotiated bilateral transactions without the use of our clearing house. In either of these events, our trading volume, revenues and profitability would be adversely affected.

Our rights to the Standard & Poor's and NASDAQ products were obtained through licensing arrangements. Our license agreement with Standard & Poor's provides that the S&P 500 Index futures products will be exclusive until December 31, 2008 and non-exclusive from December 31, 2008 until December 31, 2013.

Our license with NASDAQ will be exclusive for each calendar year until expiration, provided the aggregate average daily trading volume in NASDAQ-100 futures contracts and options on NASDAQ-100 futures contracts remains above 5,000 contracts per day. The agreement terminates in April 2006, subject to our mutual agreement to extend the agreement. The agreement does not preclude NASDAQ from allowing NASDAQ-100 futures contracts to be traded on a market owned by NASDAQ or some of its affiliates.

We cannot assure you that either of our Standard & Poor's or NASDAQ license agreements will be renewed when they terminate. In addition, we cannot assure you that others will not succeed in creating stock index futures based on information similar to that which we have obtained by license or that market participants will not increasingly use alternative instruments, including securities and options based on the S&P and NASDAQ indexes, to manage or speculate on U.S. stock risks. We also cannot assure you that NASDAQ will not directly or indirectly offer competitive futures contracts. Currently, NASDAQ LIFFE Markets, or NQLX, offers futures contracts based on an exchange-traded fund called QQQ, which may compete with our NASDAQ-100 futures contracts. Any of these events could have an adverse effect on our trading volume, revenues and profits.

**Some of our largest clearing firms have indicated their belief that clearing facilities should not be owned or controlled by exchanges and should be operated as utilities and not for profit. These clearing firms are seeking legislative or regulatory changes that would, if adopted, enable them to use alternative clearing services for positions established on our exchange. Even if they are not successful, these factors may cause them to limit or stop the use of our markets.**

Some of our largest clearing firms, which are significant customers and intermediaries in our products, have increasingly stressed the importance to them of centralizing clearing of futures contracts and options on futures in order to maximize the efficient use of their capital, exercise greater control over their value at risk and extract greater operating leverage from clearing activities. Many clearing firms have expressed the view that clearing firms should control the governance of clearing houses or that clearing houses should be operated as utilities rather than as for-profit enterprises. Some of these firms, along with the Futures Industry Association, are attempting to cause legislative or regulatory changes to be adopted that would

facilitate mechanisms or policies that allow market participants to transfer positions from an exchange-owned clearing house to a clearing house owned and controlled by clearing firms. Our strategic business plan is to operate a vertically integrated transaction execution and clearing and settlement business. If these legislative or regulatory changes are adopted, our strategy and business plan may lead clearing firms to establish, or seek to use, alternative clearing houses for clearing positions established on our exchange. Even if they are not successful in their efforts, the factors described above may cause clearing firms to limit or stop the use of our products and markets. If any of these events occur, our revenues and profits would be adversely affected.

**Our clearing house operations expose us to substantial credit risk of third parties. Our financial condition will be adversely affected in the event of a significant default.**

Our clearing house acts as the counterparty to all trades consummated on or through our exchange. As a result, we are exposed to significant credit risk of third parties, including our clearing firms. We are also exposed, indirectly, to the credit risk of customers of our clearing firms. These parties may default on their obligations due to bankruptcy, lack of liquidity, operational failure or other reasons. A substantial part of our working capital is at risk if a clearing firm defaults on its obligations to our clearing house and its margin and security deposits are insufficient to meet its obligations. Although we have policies and procedures to help assure that our clearing firms can satisfy their obligations, these policies and procedures may not succeed in detecting problems or preventing defaults. We also have in place various measures intended to enable us to cover any default and maintain liquidity. However, we cannot assure you that these measures will be sufficient to protect us from a default or that we will not be materially and adversely affected in the event of a significant default. For a more detailed discussion of our clearing house operations, see the section of this prospectus entitled "Business Clearing."



**If we experience systems failures or capacity constraints, our ability to conduct our operations would be materially harmed and we could be subjected to significant costs and liabilities.**

We are heavily dependent on the capacity and reliability of the computer and communications systems and software supporting our operations. We receive and/or process a large portion of our trade orders through electronic means, such as through public and private communications networks. Our systems, or those of our third party providers, may fail or operate slowly, causing one or more of the following to occur:

unanticipated disruptions in service to our customers;

slower response times;

delays in our customers' trade execution;

failed settlement of trades;

incomplete or inaccurate accounting, recording or processing of trades;

financial losses;

litigation or other customer claims; and

regulatory sanctions.

We cannot assure you that we will not experience systems failures from power or telecommunications failure, acts of God, war or terrorism, human error, natural disasters, fire, sabotage, hardware or software malfunctions or defects, computer viruses, acts of vandalism or similar events. If any of our systems do not operate properly or are disabled, including as a result of system failure, customer error or misuse of our systems, we could suffer financial loss, liability to customers, regulatory intervention or reputational damage that could affect demand by current and potential users of our market.

From time to time, we have experienced system errors and failures that have resulted in some customers being unable to connect to our electronic trading platform or erroneous reporting, such as transactions that were not authorized by any customer or reporting of filled orders as cancelled. In September 2002, we experienced a hardware failure that resulted in a temporary suspension of trading on our GLOBEX platform. The impact of these events has not been material.

Our status as a CFTC registrant requires that our trade execution and communications systems be able to handle anticipated present and future peak trading volume. Heavy use of our computer systems during peak trading times or at times of unusual market volatility could cause our systems to operate slowly or even to fail for periods of time. We constantly monitor system loads and performance and regularly implement system upgrades to handle estimated increases in trading volume. However, we cannot assure you that our estimates of future trading volume will be accurate or that our systems will always be able to accommodate actual trading volume without failure or degradation of performance. For example, in June and July 2002, the volume on our GLOBEX electronic trading platform repeatedly exceeded one million contracts in a single day. During the initial period of increased GLOBEX trading volume, there were instances of connectivity problems or erroneous reports that affected some users of the platform. System failure or degradation could lead our customers to file formal complaints with industry regulatory organizations, file lawsuits against us or cease doing business with us or could lead the CFTC or other regulators to initiate inquiries or proceedings for failure to comply with applicable laws and regulations.

We will need to continue to upgrade and expand our systems as our business grows. Although many of our systems are designed to accommodate additional volume without redesign or replacement, we will need to continue to make significant investments in additional

hardware and software to accommodate increased volume. The inability of our systems to accommodate an increasing volume of transactions could constrain our ability to expand our businesses and could cause us to lose business.

**We depend on third party suppliers and service providers for a number of services that are important to our business. An interruption or cessation of an important supply or service by any third party could have a material adverse effect on our business.**

We depend on a number of suppliers, such as banking, clearing and settlement organizations, telephone companies, online service providers, data processors, and software and hardware vendors for elements of our trading, clearing and other systems, as well as communications and networking equipment, computer hardware and software and related support and maintenance. We cannot assure you that any of these providers will be able to continue to provide these services in an efficient, cost-effective manner or that they will be able to adequately expand their services to meet our needs. An interruption in or the cessation of an important supply or service by any third party and our inability to make alternative arrangements in a timely manner, or at all, would result in lost revenue and higher costs.

**Our networks and those of our third party service providers may be vulnerable to security risks, which could result in wrongful use of our information or cause interruptions in our operations that cause us to lose customers and trading volume and result in significant liabilities. We could also be required to incur significant expense to protect our systems.**

We expect the secure transmission of confidential information over public networks to continue to be a critical element of our operations. Our networks and those of our third party service providers, our members and our customers may be vulnerable to unauthorized access, computer viruses and other security problems. Persons who circumvent security measures could wrongfully use our information or cause interruptions or malfunctions in our operations. Any of these events could cause us to lose customers or trading volume. We may be required to expend significant resources to protect against the threat of security breaches or to alleviate problems, including reputational harm and litigation, caused by breaches. Although we intend to continue to implement industry-standard security measures, these measures may prove to be inadequate and result in system failures and delays that could cause us to lose customers, experience lower trading volume and incur significant liabilities.

**We operate in a heavily regulated environment that imposes significant costs and competitive burdens on our business.**

Although the Commodity Futures Modernization Act significantly reduced our regulatory burdens, we remain extensively regulated by the CFTC. Our international operations may be subject to similar regulations in specific jurisdictions. We have registered in the United Kingdom as a recognized foreign exchange. We may be required to register or become subject to regulation in other jurisdictions in order to accept business from customers in those jurisdictions.

Many aspects of our operations are subject to oversight and regulation by the CFTC. Our activities relating to single stock and narrow-based stock index futures products will also be subject to oversight by the SEC. Our operations are subject to ongoing review and oversight, including:

the security and soundness of our order routing and trading systems;

record keeping and record retention procedures;

the licensing of our members and many of their employees; and

the conduct of our directors, officers, employees and affiliates.

If we fail to comply with applicable laws, rules or regulations, we may be subject to censure, fines, cease-and-desist orders, suspension of our business, removal of personnel or other sanctions, including revocation of our designation as a contract market. Changes in laws, regulations or governmental policies could have a material adverse effect on the way we conduct our business.

The CFTC has broad powers to investigate and enforce compliance and punish non-compliance with its rules and regulations. We cannot assure you that we and/or our directors, officers and employees will be able to fully comply with these rules and regulations. We also cannot

assure you that we will not be subject to claims or actions by the CFTC or other agencies.

Demutualization and utilization of electronic trading systems by traders from remote locations will, among other developments, impact our ability to continue the traditional forms of "self-regulation" that have been an integral part of the CFTC regulatory program. The CFTC is reviewing that impact, and it is unclear at this time whether the CFTC will make modifications to its regulations that will have an adverse effect on the way we conduct our business.

From time to time, it is proposed in Congress that federal financial markets regulators should be consolidated, including a possible merger between the CFTC and the SEC. While those proposals have not been adopted to date, the perceived convergence of product lines offered on the securities and commodity exchanges could make adoption more likely. To the extent the regulatory environment following such consolidation is less beneficial for us, our business could be negatively affected.

From time to time, the President's budget includes a proposal that a transaction tax be imposed on futures and options on futures transactions. While those proposals have not been adopted to date, except for a per-contract fee imposed under the Securities Exchange Act of 1934 on single stock futures and futures on narrow-based stock indexes, the imposition of any such tax would increase the cost of using our products and, consequently, could adversely impact our trading volumes, revenues and profits.

**Our compliance and risk management methods might not be effective and may result in outcomes that could adversely affect our reputation, financial condition and operating results.**

Generally, the CFTC has broad enforcement powers to censure, fine, issue cease-and-desist orders, prohibit us from engaging in some of our businesses or suspend or revoke our designation as a contract market or the registration of any of our officers or employees who violate applicable laws or regulations. Our ability to comply with applicable laws and rules is largely dependent on our establishment and maintenance of compliance, audit and reporting systems, as well as our ability to attract and retain qualified compliance and other risk management personnel. We face the risk of significant intervention by

regulatory authorities, including extensive examination and surveillance activity. In the case of non-compliance or alleged non-compliance with applicable laws or regulations, we could be subject to investigations and judicial or administrative proceedings that may result in substantial penalties or civil lawsuits, including by customers, for damages, which can be significant. Any of these outcomes would adversely affect our reputation, financial condition and operating results. In extreme cases, these outcomes could adversely affect our ability to conduct our business.

Our policies and procedures to identify, monitor and manage our risks may not be fully effective. Some of our risk management methods depend upon evaluation of information regarding markets, customers or other matters that are publicly available or otherwise accessible by us. That information may not in all cases be accurate, complete, up-to-date or properly evaluated. Management of operational, legal and regulatory risk requires, among other things, policies and procedures to record properly and verify a large number of transactions and events. We cannot assure you that our policies and procedures will always be effective or that we will always be successful in monitoring or evaluating the risks to which we are or may be exposed.

**As a financial services provider, we are subject to significant litigation risk and potential securities law liability.**

Many aspects of our business involve substantial liability risks. While we enjoy governmental immunity for some of our market-related activities, we could be exposed to substantial liability under federal and state laws and court decisions, as well as rules and regulations promulgated by the SEC and the CFTC. These risks include, among others, potential liability from disputes over terms of a trade, the claim that a system failure or delay caused monetary losses to a customer, that we entered into an unauthorized transaction or that we provided materially false or misleading statements in connection with a transaction. Dissatisfied customers frequently make claims regarding quality of trade execution, improperly settled trades, mismanagement or even fraud against their service providers. We may become subject to these claims as the result of failures or malfunctions of our systems and services we provide. We could incur significant legal expenses defending claims, even those without merit. In addition, an adverse resolution of any future lawsuit or claim against us could have a material adverse effect on our business.

**We could be harmed by employee misconduct or errors that are difficult to detect and deter.**

There have been a number of highly publicized cases involving fraud or other misconduct by employees of financial services firms in recent years. Misconduct by our employees, including employees of GFX Corporation, our wholly owned subsidiary that engages in proprietary trading in foreign exchange and Eurodollar futures, could include hiding unauthorized activities from us, improper or unauthorized activities on

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behalf of customers or improper use of confidential information. Employee misconduct could subject us to financial losses or regulatory sanctions and seriously harm our reputation. It is not always possible to deter employee misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases. Our employees also may commit errors that could subject us to financial claims for negligence, or otherwise, as well as regulatory actions.

**Our acquisition, investment and alliance strategy involves risks. If we are unable to effectively manage these risks, our business will be materially harmed.**

To achieve our strategic objectives, in the future we may seek to acquire or invest in other companies, businesses or technologies. Acquisitions entail numerous risks, including the following:

difficulties in the assimilation of acquired businesses or technologies;

diversion of management's attention from other business concerns;

assumption of unknown material liabilities;

failure to achieve financial or operating objectives; and

18

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potential loss of customers or key employees of acquired companies.

We may not be able to integrate successfully any operations, personnel, services or products that we have acquired or may acquire in the future.

We also may se