A Bid to Salvage a Go-Go Legacy

Chicago's commodities guru pledges to clean up the pits

Leo Melamed had good reason to take on the role of a born-again reformer last week. Melamed, 56, guru of Chicago's go-go futures markets, was watching in dismay as federal prosecutors trampled on his legacy while they stepped up the pressure in the biggest fraud investigation ever to hit the commodities pits. The two-year FBI sting, which broke into the open in late January, intensified last week as investigators raked in evidence for a grand jury that will consider criminal indictments against dozens of brokers and traders for allegedly defrauding their customers.

Threatened with prison terms or other penalties, as many as 30 exchange members reportedly agreed to cooperate with the probe. Investigators also issued a snowstorm of subpoenas for the financial records of Chicago's 237 commodities clearinghouses. The probe, initially conducted by FBI agents posing as traders, took officials by surprise at the Chicago Mercantile Exchange and the Chicago Board of Trade. Said Melamed, chairman of the Merc's executive committee and a creator of its innovative financial instruments, in an interview with TIME: "It was a terrible shock, and it has had the expected fallout in terms of people feeling pretty bad."

Last week Melamed took an aggressively contrite stance, apparently hoping to head off or at least mitigate the regulatory scrutiny and congressional clampdown that are likely to result from the scandal. He conceded, more freely than some exchange members would like, most of the major charges. "Our view is that as long as we've got this pain, let's not ignore what is going on," Melamed told TIME. "Let's use this as an opportunity to make some fundamental changes." He announced formation of a committee to study trading practices and professed a willingness to consider profound reforms in the Merc's open-outcry method of trading. The system has been criticized as outmoded and ripe for abuse because it does not leave a complete paper trail or electronic record of a transaction.

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Melamed, who began his career at the Merc as a runner, blamed the heady growth of the exchanges over the past decade for many of their problems. Because trading volume on their floors has grown at an annual rate of 50% (average current value of daily transactions: $150 billion), the exchanges have become far more difficult to monitor. Even so, Melamed points out, the Merc has tried to enforce the rules. Last year, he said, "we caught and punished over 200 violators, enforced some 30 suspensions, imposed $1 million in fines and approved a couple of outright expulsions."

One of the areas Melamed suggested for reform is a practice known as dual trading, which allows members to trade simultaneously for their personal accounts and for customers. That system is prone to abuse: if a trader knows in advance that his clients are all buying gold or soybeans that day, it is tempting for him to buy a few personal contracts first, then profitably resell them to the customers as prices go up. Closer electronic scrutiny may also be warranted. The Merc's computers, Melamed says, could be programmed to watch for suspicious trading patterns.

Melamed sees the Chicago scandal as just part of an ethical malaise in financial markets around the world. Said he: "Whatever the reason, it's a shame, and I think it's our greatest danger." His conciliatory move this week may actually hasten reform and speed up the Government investigation by reducing the elements of conflict, as he intends. But Melamed's response recalled a bit of wisdom from a bygone era in Chicago: when surrounded by the Feds, come out with your hands up. —*By William McWhirter/Chicago*