

INTERVIEW

«I PREFER A SINGLE INTERNATIONAL SYSTEM TO A MULTITUDE OF MUTUAL OFF-SETS»

INTERVIEW WITH LEO MELAMED,
CHAIRMAN OF DELLSCHER INVESTMENT COMPANY.

Leo Melamed presided over the destiny of the Mercantile Exchange for many years, hoisting it to the world's leading futures market. He was the main promoter of Globex and is now withdrawing to launch his own company. In this interview he explains why he prefers an international trading system to a proliferation of mutual set offs, and expresses doubts about a future merger between the Merc and the Board of Trade.

Liffe and DTB are two potential candidates for Globex. Could it be a problem?

The Deutsche Termin Börse is undoubtedly the up-and-coming exchange in Europe at the present time. By joining Globex it would gain further international prestige. Unfortunately, negotiations with respect to its main product, the Bund contract, are tilted in favour of Liffe which realizes more volume on this contract. I would add that DTB also has another fine contract, the DAX contract, which deserves to be on Globex. If the German futures market dominates its British rival one day on the Bund contract, it would then have the possibility to replace its British rival for electronic trading. As that is not yet the case, Globex can only negotiate with Liffe.

But once Liffe gains the exclusivity, DTB will stand no chance?

Not at all. No agreement would allow that. It has always been laid down that any market accounting for more than

50 % of the volume negotiated on a particular contract has the right to be introduced on Globex. In other words, if DTB manages to overtake Liffe, it would have that freedom. It is an open door.

What about the mutual set off between Liffe and the Chicago Board of Trade?

I am the instigator of the mutual set off between the Mercantile Exchange and Simex. It is the only one in the world. Why will there be no other agreement of this type? Precisely because it is so difficult to put in place, and I am well placed to affirm that. When we at the Merc started to negotiate with Simex in 1984, we were very afraid of competition from Liffe, which was performing remarkably well with its own Eurodollar contract. For us, they represented serious competition, precisely because trading hours overlapped. We therefore thought if we could start to attract interest on our contract in Asia, it would eat into London's business. And in that case, the Merc had a chance of winning the battle. And that is exactly what happened! If the



MARCHÉS ET TECHNIQUES FINANCIÈRES

Eurodollar contract worked so well between the Merc and Simex, it was precisely because the trading hours did not at all overlap and therefore we were open almost 24 hours. This is not the case between the United States and Great Britain.

As a result, I do not see how such an agreement could be reached today, when each market is very "jealous" of its trading hours. Honestly, I do not think that a bilateral agreement could be reached anywhere else. And even if one was concluded, it would result in the opposite of Globex, which is truly an international system with individual bilateral agreements. However it seems to me that the futures industry has a greater need of a single, global system than a multitude of complicated mutual set offs.

But Globex's technology is now a little dated

Globex is not an inert system and its vocation is to be continually upgraded. For an evolutionary system like Globex, a start had to be made somewhere and I believe the present system already represents a good starting point. Certain people criticize Reuters considering it was not the best company to manage such a project.

I am in complete disagreement with those criticisms. No one approached us during those five years to tell us they could do better, and I can testify to that because I was chairing Globex Corporation throughout that period. Nobody else had the technological expertise and the willingness of Reuters to tackle such a project. I would argue that to anyone who wants to listen, and I am not paid by Reuters!

Do you think that the Arkansas Best decision and the possible introduction of a 15 cent contract on each contract would be disastrous for the American futures markets?

Both issues are very critical for our industry, because they are heading in the wrong direction and are also dangerous. However, I believe the Arkansas Best decision will be resolved favourably, because the courts and legislators will

understand that it was the wrong application by the judge.

Unfortunately, the project of a 15 cent tax on each traded contract is likely to be resolved less favourably. The present climate in Washington is tax oriented to solve the deficit problem. It is short-sighted, and could be very destructive in the long term.

Today, securities are subject to a federal tax, but not the futures markets. The reason for this difference is that a



L. Mohamed

few years ago under the Reagan administration, when Congress wanted to introduce a tax on futures contracts, we managed to convince Congress that it would be preferable to tax the industry. We therefore created the National Futures Association - NFA - believing we could better serve the interests of our markets if we taxed ourselves and took on the obligation of certain regulatory requirements. That compromise has lasted until today. But I am afraid that the new administration does not really feel bound by it. Our chances therefore are pretty slim. If we lose, the 15 cents tax on contracts in an industry, where profit margins are very tight, will have a very destructive competitive effect. International competition is vicious and the business could move elsewhere. However, on a practical basis, it will not be easy to transfer the futures industry outside America. It certainly could not happen overnight.

The futures markets seem to be suffering from a dearth of innovation

In the seventies, I launched the idea of financial futures. It was easy, because it did not exist. So anything I wanted was innovation, whether it was foreign currencies, interest rates and later stock market indices. Today innovation is far more complex, and more difficult to achieve. That is the reason why there have been no major breakthroughs in recent years, but rather an extension of existing products. The Board of Trade is presently proposing two new initiatives: an insurance contract and a pollution contract. I applaud both these initiatives, especially because they are really new. But one has to admit that they have not been a roaring success. It will be long and difficult.

As I said earlier when talking about Globex, revolutions are announced easily but are implemented only with a great deal of hard work. Only time will tell if what is launched today corresponds to a real need. Even though demand exists, one must still explain, teach etc. When I launched financial futures, it took me ten years to explain their workings to users. So yes, it is difficult to be innovative today, but that is because the primary material exists and what remains to be invented is so radically different from what we know today.

There is a project to create a single clearing system for the CME and CBOT. Is this the start to a merger between the two entities?

I continue to think that a merger between the two markets is not a realistic idea in the short term. The first step for closer relationships between the Merc and the CBOT was Globex. It was extremely important to see that the two could work together on a common project. But I must say that I am still not convinced that the two markets can overcome their rivalry and create a common clearing system. It is the thing to do to give clients a better facility and reduce costs. But the two exchanges do not always reason with long-term logic. In the short term they are always tempted to ask: if I can do it myself, why should I share it with someone else?

Interviewed by Laurence TOVI