

Technology shakes futures

U.S. futures markets confronting globalization



The Chicago Mercantile Exchange's Leo Melamed thinks the impact of heightened international competition will be the dominant theme for U.S. futures exchanges in coming decades.

By Trudy Ring

U.S. futures markets, coming off a few tumultuous years, face a future characterized by global competition, domestic cooperation, automation and innovation.

This could produce a larger, more global and more liquid futures market, which would be to the benefit of institutional investors. The key question about any market development is "Does it bring more liquidity and other players into the marketplace that wouldn't otherwise be here?" said Jeffrey Geller, managing director of B&A Associates Inc., New York. "If it does, we all win."

Many important developments already are taking place. For example:

- Futures markets are functioning around the world, with exchanges in London, Paris, Tokyo, Sydney, Singapore and numerous other sites; the U.S. share of global futures trading has declined 20 percentage points — to 61.5% — in the past five years. In addition, futures markets are under development in the Soviet Union and Eastern Europe.

- ★ The two largest U.S. futures exchanges, the Chicago Mercantile Exchange and Chicago Board of Trade, have shown an unprecedented degree of cooperation in projects aimed at coping with foreign and off-exchange competition and improving internal operations. They are jointly developing GLOBEX, an automated, off-hours trading system that will provide links with other exchanges, as well as AUDIT, an electronic trading card that will make it easier to track members' transactions.

- The increase in automation means there likely will be a reduced role for the open-outcry trading system, although many exchange leaders and institutional investors hope open outcry will persist to some degree because of the liquidity it provides.

- Institutional investors are trying out a wider range of futures-related strategies, and pension funds are going into managed commodity futures, while more mutual funds are likely to use derivatives as regulations are relaxed. Also, institutions have access to a growing range of instruments, both exchange-traded and off-exchange.

The futures markets are continuing to deal with the concerns of the past few years — battles over

regulation, questions about futures' role in stock volatility and investigations of trading activity. Changes in leadership also are ongoing at the two largest U.S. futures exchanges.

Plus, a whole new set of challenges and — potentially — opportunities are likely to be in the forefront in the next few years.

"I believe the effect of globalization, which is upon us, is the quintessential element of the next few decades," said Leo Melamed, special counsel and chairman of the executive committee at the Chicago Mercantile Exchange.

Global competition means the U.S. exchanges will have to operate more efficiently, because many foreign markets have lower cost structures, especially in terms of regulation, said Thomas Donovan, president and chief executive officer of the Chicago Board of Trade.

The need to compete internationally has led to unprecedented cooperation between the CME and the CBOT, which together account for 80% to 90% of all U.S. futures and options-on-futures trading. The exchanges are exploring the possibility of unifying certain elements of their operations, such as clearing, technology, physical facilities and overseas marketing, said William F. O'Connor, CBOT chairman.

Mr. Melamed, who is retiring from his CME posts at year end, has agreed to stay on for certain projects, including co-chairing (with Mr. O'Connor) the committee looking at areas of consolidation. He also plans to remain active in the development of GLOBEX until it is up and running.

Regional differences become insignificant in a global economy, Mr. Melamed said. "Your neighbor down the street that used to be your competitor is now your partner. Clearly, it is to the benefit of both of you to do that."

The exchange officials stressed they're not trying to quash overseas competition; as a matter of fact, they're assisting in development of futures markets in Eastern Europe and the Soviet Union.

While challenging, the globalization of the futures markets is also exciting to market participants. "I'm very, very excited about that," said Leonard H. Wissner, chairman of Ward & Wissner Capital Management Inc., New York, on the concept of market linkages and 24-hour trading. Ward & Wissner manages \$441 million in fixed income, often enhanced with futures and options.