LEO MELAMED

THE FATHER OF FINANCIAL FUTURES

Leo Melamed is without a doubt one of the most colorful characters in finance. Never without a trenchant opinion or a good story, the chairman emeritus of the Chicago Mercantile Exchange has been a moving force in financial futures since he introduced foreign currency futures in 1972.

But Melamed is no ivory tower operator. He's been a floor trader since 1960 and now runs Sakura Dellsher, a global futures joint venture between the Japanese bank Sakura and Dellsher Investment Co., a futures commission merchant established by Melamed in 1965. Melamed's days wouldn't be complete without a trip to the trading floor and a bit of hands-on activity.

Melamed took a rather circuitous route to his position as the grand old man of financial futures. He trained as a lawyer, picking up a runner's job on the Merc for a bit of extra cash while in school. He worked his way up the ranks on the exchange, but in the interest of security—"I had a wife and child"—Melamed continued to practice law until 1965. "I wasn't a very good trader during that period—I'd gone broke twice in the process," he concedes. "In the back of my mind I knew that I didn't have the discipline to be successful part-time. Very few part-time traders who do it as a hobby make it. So in 1965 I made the decision to treat it as a profession, a full-time business, and find out if I had any real talent."

As it turned out, Melamed had plenty of talent. More important, his legal training gave him an instant insight to what was lacking at the Merc. "Futures were the distant black sheep in the family of finance," he recalls. "For good reason. The Merc was a jungle with no rules, a place where innocents were fleeced routinely." He took over leadership of the exchange in 1967 and began the long process of establishing a body

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of rules and regulations for the running of the exchange.

He cites three points of pride in bringing the Merc into the modern world. "We wrote rules and we proved that we meant to enforce these rules," he says. Thus the Merc changed from the so-called "Whorehouse of LaSalle Street" to a free-market exchange with credibility.

"During the early 1960's a group of us at the Merc looked around us and saw stagnating markets and stagnating people who didn't have a lot of new ideas," recalls Barry Lind, a partner at Lind Waldock. "We, however, had plenty of new ideas and we wrestled power from the establishment. Leo led that process."

"Leo's greatest strength is being able to recognize secondary reactions," adds Brian Monieson, chairman of GNP Commodities, and former chairman of the Chicago Mercantile Exchange. "He can predict the reaction to a reaction. In the Chicago riots of 1968, everyone predicted that Chicago's mayor would take tremendous abuse and criticism from the press. But Leo also correctly predicted a secondary reaction: there would be a very positive, secondary reaction for Daley from the people who were silent during the protests. This ability to analyze the reaction is what impressed me most about him."

With credibility came an explosion in interest in the Merc's products. "As the floor became crowded, we had to think about expansion," says Melamed. He masterminded the Merc's1973 interim move to 444 West Jackson and the 1984 relocation to its spacious premises on West Madison at the Chicago River.

Melamed's fondest memory is the development of the International Monetary Market, the offshoot of the Merc that in 1973 started trading the world's first financial futures—foreign exchange futures. "I was very conscious that an exchange needed a diversity of products to survive. My first experience had been trading eggs, which in the early 1960s, before 24-hour egg production, was a seasonal business. When 24-hour production came in, there was no need for egg futures; there was no volatility in the price. You can't survive as an exchange on one product," he says.

In thinking about the prospects for diversification and the Merc, he lit on foreign currencies, for several reasons. "I watched the sterling crisis, the dollar crisis, the breakdown of Bretton Woods. And I was reading the economist Milton Friedman on the value of a floating rate exchange system. Then a friend mentioned a corporate hedging transaction that had made his company money. When I tried to do a similar transaction, I was told by the commercial bank that I approached that I needed a commercial interest to hedge currency. I didn't have such an interest, so I couldn't do the deal. So I saw the possibilities for a new kind of product on the exchange," says Melamed.

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With a paper written by Friedman endorsing the concept, Melamed hit the road, criss-crossing the country and the globe proselytizing on the beauty of foreign currency futures. He met a hostile response, but persevered. "The timing was perfect. After we launched the foreign currency contracts, inflation hit and the oil crisis. It was a perfect opportunity to make money," says Melamed.

This early foray into financial futures was followed by many others at the Merc, but Melamed remains a bit sentimental about the foreign exchange futures. "I've traded them all—T-bills, eurodollars, the S&P index. But the best is currency futures," he says.

The next big landmark for Melamed was the evolution of financial futures to cash settlement. "Without cash settlement, which evolved out of the eurodollar contract that was developed in the late 1970s, the rest of the derivatives business just couldn't have happened," says Melamed.

At the time the Commodities Futures Trading Commission required physical settlement of all futures contracts. With eurodollars, of course, there isn't anything to produce at the end of the day. Melamed was instrumental in convincing the CFTC that the idea of cash settlement wasn't the same as pure gambling. "With that development, the sky was the limit. It spawned the derivatives world because most products have no deliverable in physical form," says Melamed.

As far as the future is concerned, Melamed has no doubt that technology is the leading force in futures and derivatives. "There are too many exchanges today," he predicts. "Some will go out of business and should because of technology. Even in the open outcry environment, technology will be used to keep this type of trading viable. Even in 1987, when I led the fight for GLOBEX, I said that the black box ought not be feared."

Is he disappointed that GLOBEX hasn't made the impact once hoped? "It's grown slower than I would have hoped," he admits. "But part of that is the political problem between the Merc and the CBOT. Electronic exchanges will continue to allow traders in different time zones access to the volume and liquidity of other contracts. But rather than destroy local markets, it will drive local markets to develop local products."