

TALKING FINANCE

To save exchanges' future, regulatory reform needed

By LEO MELAMED



The world of futures that I encountered when I came to the Chicago Mercantile Exchange as a runner in the 1950s is long

gone. Our technology then was chalk, blackboards and the Teletype. In few places has the impact of the computer and modern information technology been more pronounced than in the financial markets.

U.S. financial exchanges, especially domestic futures markets, have been slow to grasp the full implication of these transformations, but their neglect is eclipsed by the inertia of U.S. regulators.

The consequence of this compounded inaction might very well serve to validate a recent *Chicago Tribune* editorial, which spoke of the imminent demise of Chicago—and as a result, the United States—as the capital of futures markets.

But such sweeping conclusions are premature, maybe even dead wrong.

It is now within the grasp of most financial institutions to acquire and operate trade execution systems that duplicate the trading function of exchanges. As a result, every dealer is poised to create an exchange or join and expand the

operation of an existing one.

All the while, America's traditional exchanges have been kept in a regulatory straitjacket. Antiquated rules and product restrictions have made it nearly impossible for them to compete in the altered financial landscape. Not only must they undergo a revolutionary transformation, but they also are battling for their lives in Washington, D.C.

Indeed, the new entrants are aghast that they might be subjected to Commodity Futures Trading Commission (CFTC) jurisdiction and regulation if they create their own electronic exchanges.

The efforts of new entrants to avoid a consistent, logical definition that would subject them to CFTC jurisdiction have been matched only by the efforts of Securities and Exchange Commission-regulated exchanges to keep futures markets from competing on their turf.

Seventeen years ago, the Shad-Johnson Accord resolved a jurisdictional conflict between the Securities and Exchange Commission and the CFTC.

It was not intended as a permanent barrier to innovation and growth. Today, Shad-Johnson is being used as a weapon against competition.

For instance, stock index futures—invented on futures exchanges—have matured into vital

financial management tools that enable pension funds, investment companies and others to manage the risk of adverse stock price movements.

But futures exchanges are being frozen out of this business.

Such harsh realities are driving every traditional exchange to consider a transformation of its structure. For centuries, financial exchanges have been member-owned organizations. But nearly all of them are considering a change from a non-profit, member-owned structure to a for-profit entity with publicly traded stock.

The shift toward electronic trading of stocks, futures and options changes not only the way these instruments are traded, but also their organization, governance and finances.

At the Chicago Merc, this transformation is nearly complete, and we are ready to defend our franchise.

But the hour is late. Nothing we do internally will suffice unless we also achieve regulatory reform.

While we support relief for the over-the-counter market and the opening of our markets to foreign competitors, we cannot support a package that gives relief to one segment of the derivative market at the expense of domestic exchanges.

In addition, Congress must lift the single stock futures ban and repeal Shad-Johnson this year.

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