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Futures giants to merge

Merc to acquire Board of Trade; new exchange will dwarf rivals

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After decades of stormy courtship, Chicago's two major futures exchanges on Tuesday announced an $8 billion merger, as the stock market's hunger for their shares overcame long-standing differences.

The Chicago Mercantile Exchange, which saw its stock price soar after it went public in 2002, said it has agreed to buy its longtime rival in a deal that would put its leadership in control of the combined business.

By the middle of next year, the Merc plans to abandon its sprawling trading complex along Wacker Drive and move into the historic Board of Trade building at LaSalle Street and Jackson Boulevard.

The new exchange will have average daily trading volume approaching 9 million contracts per day, easily surpassing all of its direct competitors, with a market capitalization of more than $25 billion.

Under pressure from their profit-minded shareholders, the two Chicago institutions have put aside a legacy of mistrust and antagonism over everything from seating arrangements at social events to who has a better system for electronic trading. Now Chicago has a united front as it battles for dominance in the global financial-services business.

Some exchange veterans who were pushing in vain for a merger as long as 30 years ago said they could scarcely believe it finally happened.

"This represents the culmination of a Don Quixote impossible dream," said Leo Melamed, who led the Merc off-and-on since the 1970s.

The stock of both companies shot up, with the Board of Trade soaring $17.48, to $151.99, and the Merc $13.25, to $516.50.

Leaders of both exchanges said the Merc takeover bodes well for the city. Mayor Richard Daley, who once separated a pair of exchange leaders who had a shouting match in his City Hall office, predicted the combination will be "good for the Chicago economy."

Though the exchanges directly employ fewer than 2,200, a number expected to shrink by several hundred after merger-related layoffs, they generate tens of thousands of local jobs through their trading activity. "This is going to go a long way to make sure those jobs stay here in Chicago," said Merc Chairman Terrence Duffy, who will serve as chairman of the combined CME Group Inc.

Without the merger, the two separate organizations could find themselves at a competitive disadvantage and more vulnerable to a takeover themselves.

Melamed said the merger will preserve Chicago's stature as a global center for managing financial risk. Fellow Merc leader Jack Sandner noted, "They used to call us the hog butchers to the world. We are now the risk managers of the world."

Shouting and waving

Indeed, as stockyards and steel mills have faded from the scene, the boisterous trading pits have filled the void. Hoarse, sweaty guys shouting and waving their arms as they stand shoulder-to-shoulder in their colorful jackets have become one of Chicago's most recognizable commercial images.

Lately, the markets have been busier than ever. Every day, bankers, money managers and speculators bet on the future direction of everything from interest rates to ethanol. With a tiny down payment, they can buy and sell vast quantities of whatever they choose to trade.

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Known as "derivatives," the contracts changing hands at the Merc and Board of Trade provide the leverage that can turn small fortunes into big ones, like a stock market on steroids.

The annual incomes of top traders can exceed $10 million, though many more who roll the dice "bust out"—slang for going broke. Family and friends have taught each other the business, and folks from all walks of life have taken a shot at riches in the Chicago markets, which have survived scandals including the FBI sting in 1989 that resulted in sweeping indictments.

But derivatives have shrugged off their bad reputation in recent years as the market for them has kept expanding. Billions of dollars flow through the exchanges in a single trading session.

Both the Merc and Board of Trade got their start in corn, soybeans, butter, eggs and other agricultural commodities, and their rough-and-tumble traders still set benchmark prices for the global farm economy.

During the 1970s and '80s, the exchanges hit it big by applying the same trading formula that worked for pork bellies to bonds, foreign currencies and stock indexes.

Yet only recently have the exchanges fully embraced electronic trading, and much of Wall Street's enthusiasm for their prospects is based on computers enabling them to reach more customers globally.

Many believed a merger made strategic sense long ago. But for decades, the two home-grown businesses, so alike in many ways, were kept apart by jealousies and suspicions.

In 1980, then-Board of Trade Chairman Les Rosenthal attempted to engineer a merger with the Merc's Melamed, only to see the idea flounder because of the "we-they culture," Rosenthal recalled. "Who was top dog? Whose building would be out front? It was all silly stuff, but you couldn't get over that. The barrier has always been the culture of the two places."

The Board of Trade, formed in 1848, was for most of its history the larger, better-established and reputedly stodgier exchange, while the upstart Merc was scrappier and more willing to experiment with technology. Even the ethnic heritage of the members at each respective institution differed, with the Board of Trade leaning Irish and the Merc Jewish, though both memberships were overwhelmingly white and male.

In the late 1980s and '90s, the exchanges were limited by the entrenched interests of arm-waving floor traders who controlled their governance. Floor traders worried that electronic markets would undermine their ability to make money.

As the Chicago exchanges restricted access to their products by refusing to combine their efforts, and move trading onto computer screens, the U.S. stock market flourished and competition grew at all-electronic exchanges and over-the-counter markets.

"Both exchanges were driven by hubris, egos and historical legacies," said Patrick Arbor, a former Board of Trade chairman. "Now they're owned by investment managers demanding performance and efficiency."

The Merc, which embraced electronic trading and sold shares to the public well before the Board of Trade, has become the city's No. 1 futures exchange by far.

As Melamed observed: "The culture changed completely."

Huge financial rewards

The stock market's enthusiasm for Merc and Board of Trade shares made Tuesday's takeover possible, Rosenthal said, not least because members have reaped huge financial rewards for surrendering control.

Membership "seats" on the Board of Trade were valued at about $1.47 million each when the exchange sold shares in October 2005 at $54 each. The stock received by the owners is now worth more than $4 million, and Merc shareholders likewise have prospered handsomely as their stock has shot higher.

"The Merc has a very valuable coin of the realm in their share price," Rosenthal said. "The Board of Trade put a price on itself, and the Merc said, 'Sold!'"

Other deals could be in the offing, as trading becomes increasingly electronic and investors seek to reduce trading costs.

"The timing is perfect," said Merc Chief Executive Craig Donohue, who will continue in that post at the combined company. "We're in an increasingly competitive environment."

The Merc's deal for the Board of Trade is expected to be completed by the middle of 2007.

Tribune news services contributed to this report.