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THE HISTORIC MERC-BOARD OF TRADE DEAL

City 'on the world stage'

Biggest commodities market may target other exchanges

By Robert Manor
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The Chicago Mercantile Exchange and the Chicago Board of Trade won their bruising battle for a merger Monday, creating a behemoth that cements the city's status as an international center of finance.

The $11.8 billion combination of the Merc and the CBOT puts an end to decades of rivalry between the two downtown trading pits and makes Chicago home to the largest market in the world for commodities and financial instruments. This comes at a time when exchanges from Germany to Canada are growing rapidly and acquiring each other.

■ NYSE covets a piece of Chicago's action.
BUSINESS

"The derivative center will be Chicago," declared Leo Melamed, chairman emeritus of the Merc and one of the visionaries responsible for a futures market to trade financial instruments. "We are now going to be on the world stage."

The merger, first announced last October, almost didn't come together because of the surprise intervention of Atlanta-based IntercontinentalExchange Inc., an upstart that set off a bidding war for the CBOT. Although ICE didn't get its way, it forced the Merc over months of back-and-forth to come up with about $3 billion more to seal the deal.

With their final offers equal in values, CBOT shareholders finished voting Monday afternoon whether to approve the merger, leading Charles Carey, the CBOT's chairman, to announce: "Preliminary indications are this thing is going to pass overwhelmingly." While the final tally isn't due for days, enough votes had been cast early to assure a Merc victory.

A merger of the Merc and Board of Trade was once unthinkable, so different were they in cultures and so cutthroat was their competition. But in the past decade, as the rise of electronic trading broke down ideas about what could be traded and where, the industry underwent a seismic shift. Nearly all the markets, once clubby and local institutions, are now publicly traded, for-profit enterprises with global reach and 24-hour business cycles.

These changes were dramatic enough to bring the two Chicago markets together, and they almost certainly mean there will be more combinations, a trend that already spans continents.

John Lothian, editor of a newsletter that covers exchange issues, said the Chicago behemoth won't be satisfied with being simply the world's largest.

"We are in an age of consolidation," Lothian said. "They will be looking at acquiring exchanges."

The Merc traces its history to 1898, when it was known as the Chicago Butter and Egg Board. It adopted its current name in 1919. The Chicago Board of Trade was established in 1848 to trade in corn, wheat, oats and soybeans.

That elemental system of commodities trading evolved since the early 1970s into a system of trading risk and security in everything from currencies to interest rates to fluctuations in the weather, although agricultural commodities remain a major business.

For generations, the system involved people trading futures contracts face to face on giant trading floors. That continues today, but the bulk of trading has migrated to electronic platforms in which people can participate in markets such as Chicago's but never step foot here.

The CBOT is to adopt the Merc's Globex electronic system next year, while the floor traders of the Merc will migrate to the pits at the CBOT. They already shared essential back-office functions, one of the reasons why the managements of the two exchanges favored combining.

Melamed saw the future in electronic trading.

"I have been a proponent since 1987," he said. "At the time, I thought [floor trading] would be gone in five or 10 years.

"I was wrong," he said, adding that he is now leery of predicting how much longer face-to-face trading will last.

"Who is to argue with it?" he said. "If the customers want it, give it to them."

The speculation now is that after a period of integration, the Merc will go on the prowl again to bulk up its trading capacity and secure a wider variety of products to offer. Industry observers expect many of the world's exchanges eventually will be owned by a few elite holding companies. This year, for example, the New York Stock Exchange merged with Euronext, which trades derivatives throughout Europe.

"The exchange markets are going to be dominated by three or four large companies," predicted Michael Henry, senior executive of consulting firm Accenture's capital markets practice.

The Merc merger with CBOT is a bid to become one of those big players, and Henry said he expects the company to go after an overseas exchange. "They are saying, 'We want to be a major player, we want to be global,'" Henry said.

Jon Najarian, a CBOT trader, said the Merc might not have to look anywhere exotic for a purchase. The Chicago Board Options Exchange, which trades options on stocks, is a very short walk from the Chicago Board of Trade building.

Members of the CBOT have the right to a seat on the CBOE, although the options exchange has asked federal regulators to extinguish that right under the argument that after the merger, the CBOT no longer will exist.

"The CBOE is a logical fit," Najarian said.

Najarian also said he expects the Merc to go after businesses now held by ICE and the New York Mercantile Exchange. Both of those exchanges trade energy futures, a fast-growing part of the derivatives industry.

"They will be so big," Najarian said of the merged exchanges, "that they can go after anything they want."

Among the growth markets of the future are China and India, where an increasingly wealthy and sophisticated class of business people are expected to avail themselves of financial derivatives. While the two countries' governments restrict foreign ownership of exchanges, the usefulness of derivatives to businesses could be lucrative for exchanges located elsewhere.

Stuart Ellison, a trader at the CBOT for 31 years, sees the potential.

"The timing is perfect for this marriage," Ellison said. He said he was glum when he voted for the Merc's offer last week because the price was lower than ICE's, but his mood lifted when the richer offer was announced Friday.

"All of a sudden, everybody is smiling," Ellison said.

The Merc proposed to the CBOT in October, offering a deal that would eventually come to involve both stock and cash. But the competing offer by ICE appeared to have the edge for months. Then on Friday the Merc effectively matched the ICE offer, leading that exchange to give up. Merc shareholders also approved the merger.

The merged exchanges have a capital market value of about $30 billion.

Many details of the merger remain to be worked out. For example, with its two cavernous trading floors emptied, what will be done with the massive Merc building at 20 S. Wacker Drive?

"We will have an announcement about real estate later," said Merc spokesman Allan Schoenberg.

"I'm waiting for the world's largest Starbucks," he said.

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