



Opening of the Treasury bill contract in 1976: Melamed with Chicago Mayor Richard Daley.

The Nerve To Imagine

Leo Melamed, the dynamic former leader of the Chicago Mercantile Exchange, taps his imagination for automated trading.

By Ivy Schmerken

Since creating the first financial futures contract on foreign currencies in 1971, Leo Melamed, chairman emeritus of the Chicago Mercantile Exchange (CME), has been changing the status quo. The same man who sparked the transformation of Chicago's hog, porkbelly and cattle markets in the 1970s into global markets for risk control is also the principal architect of Globex, the after-hours electronic trading system for futures and options that could eventually topple trading pits.

No doubt, Melamed, a successful futures trader who steals time to write

science fiction novels, taps an active imagination for some of these unconventional ideas. "He begins thinking where a lot of successful people have ended," says Barry J. Lind, chairman of Chicago's Lind-Waldock & Co., the nation's largest discount futures broker. An innovator who identifies trends way ahead of his peers, Melamed has had a profound impact on the evolution of Chicago's futures exchanges. He has been at the center of three milestones: the transference of futures from agriculture to finance; the switch from physical to cash delivery for abstract products, such as interest rate and stock indexes; and



Melamed's revolutionary ideas have shaped Chicago's financial futures markets for the past 20 years.

perhaps his most difficult project of all, wiring the world's futures and options exchanges with Globex. He is convinced that a computerized mechanism is going to drive futures markets by the end of the decade and into the 21st century.

For the past 23 years, Melamed, a charismatic leader of the CME membership, has been pioneering revolutionary concepts and challenging the obstacles put in his path. "I got lucky," jokes Melamed, 58, who has embarked on a new chapter in his career. Last December, he stepped down from his posts as chairman of the executive committee of the CME and chairman of the National Futures Association (NFA) to free up more time to devote to writing and other business projects.

Japanese Partnership. Anticipating a boom in derivatives investments by U.S. pension funds and corporations, last February he signed a deal with Mitsui Taiyo Kobe Bank (MTK), one of Japan's largest global banking organizations with \$400 billion in assets, to buy a majority interest in Dellsher Investment Co. Dellsher is a small futures commission merchant (FCM), which since 1965, has served as Melamed's trading vehicle. Pending approval by the Federal Reserve Bank, the Japanese bank

would provide its credit rating, balance sheet and global distribution network to Melamed's firm. In return, Dellsher would share its technology and teach MTK about trading futures, statistical research and risk management.

If approved, there would be three aspects to MTK/Dellsher's business: managing money for corporate accounts that want to diversify in Standard & Poor's 500 futures and Treasury bill futures; executing trades for MTK's proprietary trading activities that span the globe; and over time, developing managed funds, which are commingled futures funds. By hooking up with a Japanese firm, Dellsher also hopes to bite off a chunk of the Japanese market for derivatives, which is virtually untapped because of uncertain rules that permitted leasing companies but not banks from investing in derivatives. But recently, the Ministry of Finance and other ministries have clarified the rules, paving the way for Japanese financial institutions to invest in derivatives.

Escaping Peril. Venturing into uncharted territory is something Melamed has done all of his life. In 1939, as a six-year-old boy, Melamed escaped Nazi-occupied Poland with his parents on a speeding train bound for Lithuania and then Russia. Facing certain death again, they fled the Russians on a Japanese junk boat and sought refuge in Japan. His family immigrated to the U.S. in 1941, permanently settling in Chicago, where his parents got jobs as school teachers in Yiddish-speaking parochial schools. Melamed and his wife, Betty, settled in the northern Chicago suburbs, where they raised three children. As a child, Melamed spoke Yiddish and was fluent in Polish and English. To this day, he recites Yiddish poetry at special events and does what he can to promote the Yiddish language. This year he was awarded the human rights medal by the American Jewish Committee.

While attending law school at John Marshall Law School, in Chicago, he accidentally entered the futures in-

dustry. He thought he was applying for a job as a runner at a law firm called Merrill Lynch Pierce Fenner and Bean. Smitten by the futures industry, Melamed never left it, giving up his law practice after five years.

Inventing Currency Futures.

As a local trader on the CME and the Chicago Board of Trade (CBOT), he mainly traded porkbellies, live cattle and hogs. But in the 1970s, the system of fixed foreign exchange rates, established by the Bretton Woods Agreement, operating since 1945, was on the verge of falling apart. Melamed recognized there was a potential opportunity for foreign currency futures when the agreement collapsed in 1971. He tested his ideas on Milton Friedman, the renowned economics professor whose lectures he attended at the University of Chicago. Friedman, who would later win the Nobel prize, wrote a paper supporting Melamed's idea of transferring the mechanism of futures markets from agriculture to finance. "A blessing from a man of his ability and stature gave me courage," says Melamed.

But the whole commercial establishment was against the idea of currency futures, he recalls. Most financial institutions didn't use agricultural futures, and the image that futures projected—what with corners and squeezes—"wasn't too good," says Melamed. Oddly enough, during the 1970s, government officials grasped the concept early on, he says. George Shultz, who was then Secretary of the Treasury under President Gerald Ford, gave support to currency futures, and later Alan Greenspan, then chairman of the Council of Economic Advisors, embraced the potential role of Treasury bill futures.

Changing the Rules. Before the Eurodollar contract began trading in 1981, all commodities required physical delivery. In order to make the Eurodollar contract successful, Melamed advocated that the contract be settled in cash. "He broke all the cardinal rules of trading commodities,"



At 17, Melamed was already hitting home runs.

says Lind. In the past, contracts "had to be seasonable, storable, gradable and affected by the weather," says Lind. That limits the kinds of prod-

ucts that can be traded because some, like interest rates or stock indexes, are ideas that cannot really be physically delivered, says Melamed. Instead, like an insurance policy, financial futures are a risk management tool. "You don't want to wait until you die to collect it," he explains. "If you have a fire, you want to collect the equivalent cash value."

Melamed, along with others, promoted the idea that an investor should exchange the value for cash rather than the commodity itself. Even though Lind was a "Leo Melamed believer," the concept of not delivering something was intolerable to him. "I said, 'How can you trade something that you're not going to deliver?' and he proved everybody wrong," says Lind.

Sharpening the Mind. "He has one of the quickest minds in or out of the financial industry," says Gary Ginter, managing director of Globex Corp. Unlike some quick thinkers, however, Melamed is also careful to think deeply, says Ginter. It is rare for a person to combine both traits, he says.

As an escape from the pressures of exchange life, Melamed used to enjoy playing complex computer games, such as Tetris, a Nintendo game, and he was a life master bridge and chess player. "The more intricate, the more difficult and the more psychological [it was], the more he liked it," says Lind. Today, Melamed says he no longer has time for computer games. Asked why he liked them, he says: "Who knows what moves the mind?"

Although Melamed ostensibly left the CME "officialdom" at the end of last year, he retains his title as chairman emeritus and as chairman of the board of directors of Globex Corp., where he was instrumental in persuading cross-town rival CBOT to join the CME as a

50/50 partner. Melamed is committed to the Globex board until the system is operational. He is also involved with helping Eastern European countries set up commodities markets. Earlier

this year, he went on a junket with the CME and Chicago Board Options Exchange to open the Moscow Commodities Exchange. While Poland, Czechoslovakia and Hungary will

probably beat Russia, given the disintegration of the Soviet Union into independent republics, all need to establish market-driven economies first, and Russia needs convertibility of the ruble. "Markets cannot solve the world's problems," he says.

Writing Sci-Fi. Life is so hectic that he barely has time to sit down and write, though he has begun a sequel to his first novel. In 1987, Melamed, an avid science fiction reader, published *The Tenth Planet*, a whodunit set in outer space. It took four years to write the book during nights, weekends and winter vacations. Why bother? "I always thought I had a fairly decent imagination, and the imagination can be used in fiction better than in anything else," he says. Among his heroes are authors Larry Niven and Arthur Clarke, who wrote the original *2001 Space Odyssey* series. Melamed also felt that he could write better than many of the authors he read. "If you say that enough of the time, someone finally says to you, 'Okay, big shot, go and do it,'" says Melamed. "I couldn't refuse that sort of challenge," says the author. The plot of *The Tenth Planet* centers on the disappearance of a spaceship that goes beyond the solar system. When the starship vanishes without any trace of matter being destroyed, the reader assumes that aliens have zapped it.

Automated Trading. Globex's acceptance by regulators and traders has been stymied by similar concerns: What if a multimillion-dollar position evaporates on-line without a trace of recordkeeping? While industry skeptics have said that Globex is more in keeping with science fiction than reality, Melamed contends that computerized trading will absolutely happen in this decade. "The handwriting is on the wall," says Melamed. "Everything since I first thought about it has borne out that truth," he says. "If anything," he continues, "the U.S. led the parade, and now the parade is getting ahead of us," he says, alluding to the launch of electronic derivatives mar-

kets by overseas exchanges.

Electronic trading is inevitable, says Melamed, because foreign institutions want to trade during their daylight business hours. In the future, Chicago's trading pits will probably operate during the day, but a good portion—16 or 17 hours—of that 24-hour trading day will be driven by computer technology, he says.

Technology has affected the world beyond anything that the average citizen recognizes, says Melamed. "It has made us able to do things in ways we never dreamed of 20 years ago." Half the population is walking around with little pagers attached to their belts, he says. "What kind of world is this?" exclaims Melamed, himself an avid technology user. Whether it's the telephone or the computer screen or the combination of the two, "we're completely connected, and we live differently as a consequence of that," he says. Technology has shrunk the world, and information is conveyed instantly. That change has had its greatest impact on financial markets. "We will be totally connected; we will have a 24-hour market," predicts Melamed. While it may take several stages of getting there, it's going to get there, he insists. "That's the way the world is going to work. Whether we like it or not—that's another story," he says.

Ominous Prediction. The only thing that could stop the advance of electronic trading is if the world were to plunge into a lengthy economic recession, warns Melamed. That would stunt the growth of futures trading. Because of the enormous amount of debt accumulated by the U.S. during the 1980s, he fears that the 1990s will be the decade that must pay for it. "The U.S. is the main economic engine in the world, and if that engine is slowing down, so will the world," says Melamed. The only solution is sound economics and basic budgeting, he says. While the technological march is unstoppable, 24-hour trading is an extension of markets, and "markets are not magic formulas," he says. ◀