
PART I

**Battling the Tyranny
of the Status Quo**

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CHAPTER 1

Countdown to Liftoff

“I have detected a sort of squishy rumor that you are supporting Terry Duffy for chairman.”

It was vintage Scott Gordon, chairman of the Chicago Mercantile Exchange (CME).¹ We were sitting in my office on the thirty-second floor of the Merc’s north tower. He said the words quietly as was his custom, ostensibly in total innocence of their implication. Even the phrase “squishy rumor” was a distinctively Scott Gordon usage of words intended not to be confrontational or offensive—an offhand comment between two friends about a bit of inconsequential gossip on the trading floor in 2002.

It was anything but. We were at a pivotal moment in the extraordinary history of the Chicago Mercantile Exchange. We were at another historic showdown—the corporate equivalent of the gunfight at the O.K. Corral, a confrontation replete with intrigue, conspiracy, and treachery in which the careers of many hung in the balance. We were in a battle that would determine whether past revolutionary labors and innovations would achieve a triumphant destiny for this venerable institution and make millionaires out of thousands of Chicago traders.

I liked Scott Gordon. We had been friends for many years, ever since his mentor and my close friend Leslie Rosenthal, the former chairman of the Chicago Board of Trade (CBOT), asked me if there was a job available for Gordon at my firm, Dellsher Investment Company, Inc. That was back in the 1980s. I made sure there was. It was the beginning of a career path that led Scott to be elected chairman of the CME in 1998. How strange, then, to find ourselves four years later on opposite sides of a struggle for control of the CME. But I am way ahead of the story. That’s the trouble with memory. Once you set it in motion, it is propelled like a rocket, never so much as taking a breath or stopping to reflect on the path it has followed. Memory takes far too much for granted. It presumes you know the context of each flashback it conjures and the history that conceived it.

Given the dramatic sea change that the futures industry and the CME in particular have experienced over the last 10 years, let alone the past

three decades, it is already difficult to remember in detail all the twists and turns of the history that brought the Merc to today's pinnacle, and even harder to recall some of the life-and-death issues with which we struggled, the resolution of which now seem so obvious. It is, however, imperative to record this history not only because of George Santayana's famous admonition, not only because it might provide a fascinating story, but because it is representative of the never-ending struggle between status quo and change.

In 1991—after two decades of leadership—I felt that this immigrant kid from Bialystok had done enough. Our Exchange was in very strong shape, success primarily flowing from its first-mover advantage in the introduction of financial contracts. Further, the soon-to-be-launched electronic Globex system would in my view provide the technological certainty for its future. So confident was I of the coming technological age that in November of 1991 I wrote "Tomorrow's Technological Tidal Wave," (see Chapter 11) an essay that predicted the coalescence of interactive multimedia communications systems and the dawning of an era demanding 24-hour trading capability. More to the point, in combination with its strong agricultural base, the CME represented the most diverse futures institution in the world. Its Eurodollar contract was the most actively traded futures instrument of any exchange. It had become the accepted short-term interest rate mechanism for the world of finance. Membership prices were on the rise. Volumes too were growing and the open interest, which tabulates the overnight open market positions, had risen to record proportions. As Jack Sandner, the newly installed CME chairman upon my retirement in 1991, liked to point out, the large open interest was proof that the CME had a built-in reservoir for continued growth. It was a valid observation.²

Now I thought it was time to step down and pursue some private-sector goals. I planned to launch Sakura Dellsher, a futures brokerage firm formed from a merger between my firm, Dellsher Investment Company, and the Japanese Mitsui Tayo Kobe Bank. Except that I would remain chairman of Globex for a while longer, my decision would preclude me for the first time in 22 years from leading the decisions and actions of the Merc—a move I thought represented a permanent change in the direction of my life. I was very wrong.

Few observers would argue that irrespective of what CME titles I officially held (Chairman, Special Counsel, Chairman of the Executive Committee, or Senior Policy Advisor), from the time I was first elected chairman in 1969 to my retirement in 1991, and again upon my return to the Board in 1997 as Chairman Emeritus and Senior Policy Advisor—although I had plenty of help as indicated in the acknowledgments—I was the effective leader of the Chicago Mercantile Exchange. My leadership position

remained in place (with the exception of a brief period under chief executive officer Jim McNulty), until after the Merc's initial public offering in 2002, when the new team of Terry Duffy, as chairman, and Craig Donohue, as CEO, began to take over the reins. To this date, I remain Chairman Emeritus and Chairman of the Board Strategic Steering Committee.³

Although this story could begin at any number of junctures, 1996—five years after my “retirement” and about six years before the critical conversation with Scott Gordon took place—is particularly appropriate. Just as the space shuttle is fueled with rocket propellant prior to liftoff, so did the events begun in 1996 provide fuel to the CME for its unparalleled climb to the top.⁴ However, to do justice to the pivotal events of that year, one must be conversant with the mortal conflict at the Exchange between the two opposing blocs that dominated CME politics: those who favored “open outcry” and those who supported electronic trading.

The war, and it was exactly that, unofficially began on August 28, 1987, when the CME board approved the plan submitted by its Strategic Planning Committee to create the world's first electronic trading system for futures and options. The plan, of course, needed referendum approval from the CME membership.⁵ Its working designation was PMT, which stood for Post (Pre) Market Trade, a nomenclature I purposefully selected to allay any fears that PMT might encroach on the sanctity of open outcry.⁶ The system would operate exclusively *before* and *after* regular U.S. business hours. No existing pit-traded instrument would ever need to compete with the electronic screen during the open-outcry session. It was a holy pledge that could not be changed without membership approval.

To say this was a revolutionary idea does not begin to describe the radical nature of the notion. A departure from open outcry was a watershed moment for futures markets, an event comparable in physics to, say, the splitting of the atom, or like announcing the concept of e-mail to a world that had only experienced the Pony Express. As the CME press release explained, “In a bold and far-reaching joint undertaking, the Chicago Mercantile Exchange and Reuters Holdings, PLC, entered into an agreement to create a global electronic automated transaction system for the trading of futures and futures-options.” Arguably it put the CME light-years ahead of its competition. I tried to explain this to the membership in my 1987 Annual Report titled “Embracing Reality.”

The concept embodied in PMT (Post Market Trade) is clearly an historic milestone in the development of futures trading. It embraces the realities brought about by technological advancements of recent years and takes a giant step toward unification of the world's separate financial center.

*PMT combined elements of electronic linkage with those of extended trading and integrates them with the open-outcry system. In effect, it draws the best from the present and marries it to the technology of the future. In all modesty, it put the CME light-years ahead of its competition.*⁷

The Merc's announcement served as a decisive contrast to our primary rival, the CBOT, at the time the world's largest exchange. Karsten Mahlman, the chairman of the Chicago Board of Trade, likened the CME's announcement to the development of the H-bomb, stating it could mean the end of futures markets. Indeed, the CBOT's response to the threat of international competition, announced earlier in 1987, had been predictable. Rather than encroach on open outcry, it sought to extend it by creating an open-outcry "Night Trading Session" that would operate from 6 to 11 P.M. Ostensibly, this would discourage the Asian world from creating a competitive exchange in their own time zone and bring Asian futures business to the American shore.⁸

To me, the difference in response to globalization between our two exchanges was fundamental. The CBOT leadership was bending to the political will of its traders and ignoring the wave of technology that was overtaking the world. A night market for a few hours each evening, I stated, "was like trying to hide from a tornado in a cardboard box."

Here is what the *Chicago Tribune* said:

*The Chicago Mercantile Exchange announced a revolutionary plan to capture global business through computer trading rather than resorting to night hours.*⁹

*If the proposal is approved as expected, the century-old futures industry will make a giant leap into high-tech electronics with its first major attempt at automated trading.*¹⁰

This was my statement to the CME membership in the 1988 Annual Report "The Third Milestone":

The CME believes that to blindly assume that open outcry is the perfect system for all time is to be lulled into a false sense of security and forgo any opportunities to strengthen or advance our way of doing business. Such a policy would be both foolish and dangerous and could lead to disaster. While we must always respect our heritage, we must never let ourselves be held back by its limitations. We must recognize the greater truth, that those who ignore or fear to embrace reality will quickly become history. [See Appendix 1A.]

Open outcry, of course, represented a trading regimen by which a group of traders and brokers gathered in a pit (also known as a ring) and competed for transactions by using their voices and hands to shout out the quantity and price at which they were willing to buy or sell a specific product. Until very recently, this methodology universally described and defined the markets of futures. It was a practice as old as the markets themselves, intertwined with their very birth, which, it is said, occurred in Osaka, Japan, in 1730. Feudal lords there established warehouses to store and sell rice paid to them as land tax by their villagers. In order to protect their booty from wild price fluctuations between harvests, they formed the Dojima Rice Market in the house of a wealthy rice merchant named Yodoya—ostensibly the first organized futures exchange. The merchants gathered there and with shouts and gestures negotiated the price of their “rice tickets.”

It can of course be argued that open outcry for transactions between buyers and sellers preceded the Dojima premises by a number of centuries. Ancient Phoenicians, Greeks, and Romans openly traded options against the cargoes of incoming and outgoing ships. And in the tenth and twelfth centuries, during seasonal merchant fairs in Brussels, Madrid, and elsewhere, merchants would gather to loudly and openly negotiate for the future delivery of merchandise. It was not until 1826 in England, and two decades later in the United States, that the traditional open-outcry futures market was established. In the United States, Chicago was the natural locale as it represented the great railroad center for products grown in the West to be moved to the population centers in the East. In 1848, the Chicago Board of Trade opened its doors for trading in grain—corn, wheat, soybeans—to become the world’s largest futures exchange during most of its history. Its building, erected in 1885, at LaSalle Street and Jackson Boulevard, became the symbol of Chicago’s commercial vitality. Fifty years after the CBOT’s birth, in 1898, the Chicago Butter & Egg Board was born, the precursor to the Chicago Mercantile Exchange, which was formed in 1919. In the 1960s, the CME achieved fame as the “House that Pork Bellies Built,” an exchange primarily trading in meats—cattle, hogs, and pork bellies. This long-standing commercial spirit was recorded by Carl Sandburg in his famous poem about Chicago in 1916:

*Hog Butcher for the World,
Tool Maker, Stacker of Wheat,
Player with Railroads and the Nation’s Freight Handler,
Stormy, husky, brawling,
City of the Big Shoulders.*

In 1971, while chairman of the CME, I conceived of the idea of futures contracts on foreign currencies. Toward this purpose I initiated the founding

of the International Monetary Market (IMM), the first exchange created for the express purpose of futures contracts in financial instruments. Beginning with foreign currency contracts in 1972, the IMM served to revolutionize futures markets. In 1976, the IMM merged into the CME and remains its Financial Division to this day. Over the next three decades, Chicago became known as the capital of futures markets, and financial contracts copied by every global center of finance grew to dominate the world's futures trading.

The history of futures trading in other U.S. centers is similar, with futures exchanges founded in Kansas City, Minneapolis, and New York City. Of them, the New York Mercantile Exchange (NYMEX) became the most prominent, trading in energy products and metals. In 2007, the CBOT, and in 2008, the NYMEX, were acquired by the Chicago Mercantile Exchange, to become The CME Group, today the world's largest futures exchange.

Throughout this history, until the beginning of the twenty-first century, all the trading at every U.S. futures exchange was conducted by open outcry. With such deep roots and enduring heritage, for anyone to suggest a different architecture for the execution of futures trade was not only revolutionary, it was crazy. In 1977, as chairman of the CME, I wrote an article for the *Hofstra University Law Review* in which I categorically declared that futures markets could *only* succeed within an open-outcry transaction architecture. My opinion of course was founded on the conventional wisdom of the time, the technological knowledge then available, and my experience in the Chicago trading pits. Eyeball-to-eyeball interaction, until then, provided the only successful means of generating liquidity—the continuous flow of bids and offers. In 1977, personal computers were in their infant cribs, Bill Gates had just recently left Harvard, windows were what you peered through, a mouse was a rodent, and the apple was but a fruit. Computer technology as we know it today was still science fiction. It would be another decade before computers would revolutionize the twentieth century and forever change everything.

Back then, even the mere thought of market automation was heresy. Still, I knew the idea was not new. Beginning in the early 1970s, automation became an intellectual flirtation of the National Association of Securities Dealers, Inc. (NASD). In 1971, the Nasdaq, a subsidiary of the NASD, became the world's first electronic stock market. At first, however, it was merely a computer bulletin board system and did not actually connect buyers to sellers. In 1975, the Securities and Exchange Commission (SEC) proposed the creation of an automated Central Limit Order Book for securities markets, and in 1976, it issued a formal call for automation.¹¹ In 1976, Professor Junius W. Peake together with Professor Morris Mendelson and R. Williams Jr. responded by proposing to the SEC a plan for an electronically assisted auction market for securities that would include screen-based rather than floor-based trading, auction principles for trade execution, anonymity,

price-time priority for all bids and offers, and equal global access by qualified participants—in other words, all of the salient present-day features of electronic systems.¹² It was a revolutionary concept. The idea, however, did not get very far and was attacked by the broker-dealer establishment as a system that would not work and “would destroy the finest capital market mechanism in the world.”¹³ In 1979, as a result of intensive lobbying efforts by the NYSE and market makers to preserve status quo, the SEC reversed course.¹⁴

Futures markets were not immune from these pioneering giants. In 1980, Junius Peake actually developed what in my memory was the very first electronic futures market. It was a Bermuda-based, fully automated futures exchange called INTEX. Junius Peake and I shared the same stage at the *Financial Times* conference in London in September of 1982 on the eve of the launch of the London International Financial Futures Exchange (LIFFE). He unapologetically predicted that if INTEX fulfilled an economic need it would be a success, if not “we shall fade from view.” Alas, Professor Peake was well ahead of his time and his ambitious pioneering effort failed, but his idea never faded from view. At the time, the so-called “black box” for futures markets was something never to be openly discussed. Automation was viewed as the death knell to our business, and we were bound by an unwritten holy understanding to reject such concepts outright. I recall telling him that while I admired his courage, “he did not have a ghost of a chance.” In my opinion, I stated, if someday automation came to futures markets, it could only succeed at an established futures exchange.

Luckily, I was never a captive of what Milton Friedman defined as the “tyranny of the status quo.” indeed, not too many years after my Hofstra essay, I knew that I had been sadly mistaken. Computer technology was moving at unimaginable speed, creating capabilities that in the very near future would make it realistic to consider trade execution within an electronic venue, an architecture that would make trading vastly faster, cheaper, and more efficient. And above all, it would create enormous new transaction flow on which the income of an exchange depended. Once converted, I was now bound and determined to correct my mistake and to follow John Maynard Keynes’s admonition: “When the facts change, I change.” The facts did indeed change. However, my new conviction represented one of those truisms that intellectual acceptance by itself was insufficient. It required a practical epiphany.

It was January of 1986. The markets were very active. I was standing at my Dellsher company desk station, which faced the Standard & Poor’s trading pit on the Merc trading floor, watching the army of clerks—“runners” to be exact—rush to and fro with orders to the pit at a frantic pace. It was a colorful, exciting, and boisterous scene. Normal. And remarkably inefficient. As it happened, I had just put the finishing touches on a science

fiction novel, *The Tenth Planet*,¹⁵ my first amateur attempt at fiction writing. The central character was a humanlike computer Putral, who had the incredible wherewithal to serve all the needs of an alien planetary civilization consisting of five planets and a population of 150 billion people. The nexus was striking and obvious: Life had been imitating science fiction since Jules Verne voyaged to the moon—and before that. If I could fantasize an alien computer of such amazing magnitude as Putral, would it be too much to ask of our own civilization to build a computer that could simply transmit orders to and from an electronic screen for execution—in other words, to act as an electronic pit that required no human intervention?

Convinced that technology, whether we liked it or not, would force fundamental changes to our way of life, I refused to be left in the historical trash bin of status quo obstinacy. The idea grew into an obsession—a belief that became my signal mission for the CME. I decided to utilize the Strategic Planning Committee, which I chaired, and which was charged with finding a solution to the competitive challenges of globalization, as the forum to explore everything, including electronic trading. I had carefully appointed to the committee people whom I thought would not be afraid to take on the status quo.¹⁶ In mid-1986, even before the committee's deliberations were completed, I paid a visit to Reuters Holding PLC to test the water. There I posed the critical question to Andre Mileneuve and John S. Hull, two senior executives of the giant international information company. Would Reuters undertake the mission of creating an automated global electronic transaction system for futures and options with the CME? Their affirmative response paved the way for the committee's decision.

Given today's globalized markets where electronic screens are a ubiquitous fixture on the desks of all traders in every corner of the globe, with market quotations and information flowing in continuous fashion at speeds nearly impossible to fathom, it is counterintuitive to consider a conclusion different from the one reached by the Strategic Planning Committee in 1986. However, it was a vastly different world back then, and the step we were about to take was of incalculable consequence. As I wrote in *Escape to the Futures*,¹⁷ "Just as I had done in 1972 when I entered the unknown waters of currency futures with the IMM, I was now about to ask the futures industry to follow me on yet another odyssey, over oceans, across continents, and through the immeasurable space of high technology."

Barron's printed my views:

Marriage of the computer chip to the telephone altered the world from a confederation of autonomous financial markets into one continuous marketplace. No longer is there a distinct division of three major time zones (Europe, North America, and the Far East). No longer are there

three separate markets operating independently of external pressures by maintaining their own unique market centers, products, trading hours, and clientele.

Today, news is distributed instantaneously across all time zones. When such informational flows demand market action, financial managers no longer wait for local markets to open before responding. Rather, they have the capacity to initiate immediate market positions—a capacity that has come to be known as “globalization.” With globalization, each financial center has become a direct competitor of all others, offering everyone new opportunities, challenges and perils.¹⁸

With hindsight, one can only marvel at our collective courage and pre-science. But what is vision other than imagination extended into the future? As a result, the CME became the first futures exchange in the world with the foresight to embrace an electronic solution to the coming demands of globalization. It was clearly the defining moment in the evolution of the Chicago Mercantile Exchange. More than anything else, it dramatized our leadership in futures markets and was the fundamental ingredient for the CME's current success. For me, it was also personal. Aside from creating the IMM, the world's first futures exchange for trading instruments of finance—and its introduction of currency futures—I consider the development of Globex, the CME's electronic transaction system, preeminent in my achievements on behalf of the Exchange. As I wrote to Milton Friedman at the time, “The idea is so powerful that, in my opinion, it will become the standard transaction system for all futures and options business, and most likely, the model system for securities and all other market sectors, as well.” (See Appendix 1B.)

The great man and I developed a close personal relationship over the years, beginning with his embrace of my audacious idea to launch foreign currency futures in 1972. His friendship, a privilege beyond comparison, lasted until the day I was honored to be included to deliver a eulogy at his memorial, on January 29, 2007, at the Rockefeller Chapel of the University of Chicago. (See Chapter 29.)¹⁹

It is instructive to record how much easier it is to follow than to lead. The CME's electronic announcement was followed, a year or so later, by similar announcements for electronic systems in foreign domiciles, intended either to extend existing trading hours or for the entire transaction process: In 1988 the Tokyo Stock Exchange, the Osaka Securities Exchange, the Copenhagen Stock Exchange, the Danish Options & Futures, the Swiss Options & Financial Futures Exchange (SOFFEX), and the Tokyo Grain Exchange all launched automated electronic systems. The following year, the Irish Futures and Options Exchange, the Tokyo International Financial Futures Exchange

(TIFFE), the London International Financial Futures Exchange (LIFFE), and the Sydney Futures Exchange initiated similar systems. By the end of 1991, 10 more exchanges had followed suit, including the Deutsche Terminbörse, DTB, the London Futures and Options Exchange, the Swedish Options Market (OM), the Finnish Options Market, and Mercado Español de Futuros Financieros as well as the NYMEX.

In congratulating our members on the approval of the PMT referendum, I proudly said to them, “This is our response, to the demands brought about by the technological revolution as well as to the challenges of globalization. We believe it will translate into opportunity and cost-efficiency—whether you are a banker in Tokyo, a risk manager in London, or an investor in the United States. It is a solution in synch with the markets of the future.”²⁰

It represented but the opening shot in the ensuing life-or-death battle to challenge the status quo.

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