EXCHANGES

A HUE AND CRY IN THE PITS

Commodities traders fear that an electronic system will wipe them off the floor

PHOTOGRAPH BY SCOTT OLSON/REUTERS; PHOTO ILLUSTRATION BY DAVID RUDES/BW

At the Chicago Board of Trade these days, there's a palpable sense of fear and loathing in the huge bond pit. It's not because business at the world's largest futures exchange is bad. Indeed, the financial crisis in Asia has the thousands of shouting, hand-waving traders executing record numbers of transactions this year.

The fear is of the future. On Sept. 8, Cantor Fitzgerald, the world's largest bond broker—and a member of the CBOT—plans to begin electronic trading in futures contracts on U.S. Treasury bonds and notes. The contracts represent about 50% of the CBOT's total trading volume. "We're going to offer the same service for about 75% less," says Howard Lutnick, Cantor's CEO.

Based on the experience of exchanges outside the U.S., the "open outcry" method of trading futures contracts pioneered in Chicago could soon be replaced by markets in cyberspace. That could profoundly affect the 150,000 people who work for the Chicago exchanges. "We've been amazed at the rapid acceleration of [electronic trading] in the last six months," says Patrick H. Arbor, chairman of the CBOT. The Chicago Mercantile Exchange has lost much of its currency business to electronic rivals and may soon face competition on its Eurodollar contract, which accounts for 48% of its volume.

QUICK WINNER. The experience of European exchanges is sobering. Last year, Matif, the French futures exchange, began trading its contracts on an electronic network at the same time as traders were buying and selling on the exchange floor. In that head-to-head battle, the open outcry pit lasted all of two weeks. Matif is now all-electronic. Even more unsettling is the experience of LIFFE, the London futures exchange. After losing its largest contract, the German bund, to the electronic Deutsche Terminbörse (now Eurex Deutschland), LIFFE announced plans to launch an electronic platform that will run concurrently with its floor. Many believe the London floor will disappear.

> In Chicago, the price of an exchange seat has plunged close to 50% in the past year

The Commodity Futures Trading Commission has yet to give regulatory approval to Cantor's plan, but few in the industry doubt that it will, despite lobbying by CBOT and other exchanges. Already, Cantor has more than 20,000 computer terminals on the desktops of bond traders, who are also bond futures traders. "There's going to be a lot of dislocation and a lot of angst," says Arthur W. Hahn, a Chicago lawyer with Katten Muchin & Zavis, who has represented the LIFFE exchange.

For years, Chicago's futures exchanges have argued that their open outcry systems were the most liquid markets in the world and immune to cheaper electronic trading systems. But Hahn points out they "have been working in a monopoly environment. In the new world, there's going to be real competition."

A MONSTER? The CBOT, where the price of an exchange seat has plunged nearly 50% in the past year, is at least hedging against a possible electronic future. On Aug. 18, members voted to operate the exchange's overnight electronic network, Project A, during the daytime as well. "We're making a preemptive strike on any entity which might emerge as our competitor," says Arbor. The electronic trading will begin on Sept. 18. That's fine, says Lutnick. "They've signaled the demise of the pit in Chicago."

That's what traders, brokers, runners, and clerks in the bond pits fear. Jacob J. Morowitz, head of USA Trading, which clears trades for about 400 local traders at the CBOT and Merc, says that the exchange should be enhancing the open outcry system, not replacing it. "They could be creating a monster."

Whether the monster turns out to be a predator or a savior remains to be seen. But it's clear that fear and loathing in the pits will persist.

By Andrew Osterland in Chicago