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“The Future is in Futures”
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Good afternoon everyone, and thank you, Bob, for that kind introduction. I appreciate the opportunity to be here today.

A year ago, when I had just become CEO of the Chicago Mercantile Exchange, my first speech was before the FIA's Chicago Division, where I thanked everyone for the support and cooperation your two divisions gave to our exchange for the clearing processing agreement we had just achieved with the Chicago Board of Trade.

One year later, that agreement is still delivering about \$2 billion in value to our clearing firms and customers. But, this being New York and, as my good friend and colleague Mike Dawley would say, “Yeah, but what have you done for us lately?” And that, in part, is what I am here to talk about today.

By all measures, 2004 was an outstanding year for CME:

- We broke volume records in every one of our product lines.
- We facilitated a record \$463 trillion in notional value transactions in our financial markets – far more than any other centralized exchange market anywhere in the world.
- We grew our global market share at the expense of our competitors.
- We significantly consolidated clearing and settlement activity in a single clearing house with a 90 percent market share today.
- and we moved the dial dramatically from approximately 50 percent to 70 percent electronic in our total mix of trading at CME in 2004.

Our accomplishments are due to the fact that we are executing a very clear and focused strategy:

- To expand our markets through electronic trading,
- Expand access and distribution globally with 8 new hubs in Europe and Asia,
- Provide transaction processing services to third parties, and
- Grow non-organically through partnerships, joint ventures or acquisitions.

I will talk more about our strategy and plans in a moment but first I would like to offer a few personal observations about recent events in our industry, as well as

why I believe “the future is in futures” as I like to say when summarizing the financial services landscape in the next several years. You will probably notice in my remarks that I am not a very big fan of conventional wisdom since it almost always seems to be wrong as it relates to the global futures and options industry. Let me provide you with but a few examples:

- Seven years ago, most people in the industry said common clearing would never be achieved.
- Five years ago, and at the height of the so-called B2B revolution, many in the industry said the exchange model is dead.
- Three years ago, many thought the Chicago exchanges would never be largely electronic.
- One year ago, almost to the day, some thought the Chicago exchanges were not ready for competition from the formidable European exchanges and would rapidly lose market share in head-to-head product competition.

All of this, of course, has proved to be demonstrably false and underscores the fact that the tandem forces of competition, technology, deregulation and globalization have enabled CME to position itself as the preeminent leader in today’s global risk management industry. Importantly, none of this could have been accomplished without your encouragement, support and involvement so, on behalf of all of us at CME, a hearty thank you!

So, why is “the future in futures?” Why are derivatives exchanges the focal point of growth and innovation in today’s global financial markets? Those, my friends, are complicated questions for which I will try to offer reasonably simple answers. I attribute the growth in our markets to:

- Secular trends,
- Cyclical factors,
- Organic initiatives to innovate new products and technologies while expanding access and distribution, and
- Non-organic growth (consolidation if you will) that provides further trading and capital efficiencies, thereby enabling further organic business expansion.

Let’s talk first about the **secular drivers** of growth in our industry.

- After 35 years of education and experience as an industry, we have increased investor awareness/sophistication concerning the value and benefit of engaging in hedging and risk management activities using derivatives:
 - Today, market users know that ETFs and cash baskets of stock are, respectively, 60 percent and 100 percent more expensive than E-mini contracts at the CME.

- They also know that the notional value of trading, and hence, the depth of liquidity in our E-mini markets is 8 times larger than the SPDR ETF market and 3 to 4 times larger than the QQQQ ETF market.
- The strengthening of Europe's financial infrastructure and monetary union, the emergence of major new global economies like China and India, and increased global conflict in the Middle East are all driving demand for global risk management products.
- The desire to reduce bilateral credit risks, overcome counterparty credit limits on OTC activities, or simply make more efficient use of capital under the Basle Capital Accord, will continue to drive growth in exchange-traded futures and options markets with our central counterparty clearing systems.
- To provide some evidence of this, the Bank for International Settlements recently reported that notional value of OTC derivatives contracts outstanding rose to **\$197 trillion** in 2003, representing a three-year CAGR of **28 percent**. But that was outpaced by growth in the notional value of exchange-traded derivatives contracts, which reached **\$37 trillion** in 2003 – representing a three-year CAGR of **38 percent**.

In terms of **cyclical** factors, much of our growth as an industry has clearly been achieved in the absence of strong cyclical influences.

- While energy markets have experienced some volatility and foreign exchange markets have seen some increased activity due to the weakness in the dollar, the majority of our markets have seen relatively little volatility.
- For example, our E-mini stock index futures markets have continued to experience strong growth and new records of more than 1 million contracts a day, despite a continued and significant decline in equity market volatility.
- Similarly, our Eurodollar futures market has seen significant expansion and our interest rate products as a whole are now trading more than 2 million contracts a day despite insignificant interest rate volatility.

Somewhere **in between secular and cyclical** is the question of shifts in asset allocation strategies and the movement from passive long-term equity market investment strategies to dynamic trading based investment returns by hedge funds and other alternative investment managers. The quest by institutional asset managers to generate alpha returns over and above average market returns is what accounts for the dramatic growth of hedge funds and managed futures funds.

- Global hedge fund assets have grown from approximately \$50 billion in 1988 to more than \$1 trillion today.

- Managed futures have grown from \$6 billion to \$132 billion in the same period.
- Futures and options on futures offer these asset managers electronic markets that are globally accessible with low transaction or frictional costs and significant trading leverage.

In terms of **organic growth**, the picture is equally bright. Why? Derivatives are inherently more flexible than listed securities. Their utility is limited only by the creativity and imagination of those who design and use them. Today, in addition to our major product lines, we are successfully trading weather derivatives and we have introduced or will soon introduce products based on inflation and housing prices.

Further areas of emphasis for organically expanding CME's business include:

- Facilitating continued customer growth in Europe and Asia among regional banks and asset managers, hedge funds and electronic proprietary trading groups.
- Introducing electronically traded options on all of our financial futures products across equities, interest rates and foreign exchange.
- Adding significant new options trading functionality to our various trade-matching engines, enabling mass quoting and RFQ functionality among other things.
- Further expanding our already fast growing foreign exchange product line through our innovative partnership with Reuters.
- Assisting in the development of derivative markets in Asia – primarily China and India.

Non-organic growth, of course, is something that is beyond the scope of my remarks today. Suffice it to say, however, that we believe that further consolidation will occur in the U.S. and global financial markets and CME is well positioned to play a role in that consolidation process due to the following:

- CME is the largest publicly traded exchange in the world by market capitalization,
- CME's product line is the most diversified of any derivatives exchange,
- CME's proprietary technology has quickly evolved into a leading market position in terms of functionality, speed, reliability and breadth of global distribution, and
- CME's completely vertically integrated business model and dominant position in clearing and settlement allow us to provide significant efficiencies to market users, FCMs and shareholders.

Much of what I have talked about so far underscores why taking the right approach to futures industry regulation is so important, and why I want to discuss the issue of self-regulation as it pertains to the reauthorization of the Commodity Futures Modernization Act.

Simply put, we must consider whether the CFMA has set a course for the industry that should continue without significant change, or whether the Commodity Exchange Act is ripe for revision. From CME's perspective, I believe that CFMA has been an enormous success.

As many of you may recall, the exchange community traded legal certainty for OTC products and reduced barriers to entry of new exchanges for an elimination of prescriptive regulation and the freedom to innovate. And innovate we did at CME, predominantly in four areas:

- Governance, including our role as a self regulatory organization,
- Expansion of market access and distribution;
- Innovation in product offering, and
- Pursuing a business model that depends on creating shareholder value by serving our customers.

Regarding governance, we gained the right to demutualize and implement the form of governance necessary to complete a successful IPO and run an effective self-regulatory organization.

Our successful IPO subjected us to stringent corporate governance standards and listing requirements imposed by the New York Stock Exchange, public disclosure of all material aspects of our business and continuous scrutiny from analysts and institutional investors. To meet such obligations and instill confidence in our shareholders, CME has transitioned to a board of directors that is both fiercely independent of management and beyond the control of floor brokers and traders. We were the pioneer in including non-exchange members in our disciplinary processes and of insuring that our important standing board committees were led by and included significant representation of non-industry directors.

In April last year, CME became the first futures exchange to appoint a board-level committee devoted completely to self-regulatory oversight. Our Market Regulation Oversight Committee is composed entirely of non-industry directors and is directly responsible for the SRO function. We believe that this committee represents both an aggressive and appropriate step towards independence in self-regulation.

While we believe that CFMA has been a tremendous success and that significant revisions to the CEA are not necessary, nevertheless, as an industry we must find effective solutions for the following:

- The continuing massive frauds committed against retail customers in the OTC forex market.

- The unfortunate decision of the 7th Circuit Court of Appeals in *CFTC v. Zelener*. The *Zelener* case provides a road map for escaping CFTC jurisdiction and the establishment of private, unregulated retail electronic dealer markets in everything that we now think of as futures contracts.
- The continued dual regulation and lack of clear and efficient standards for trading security futures products.

Working together I am confident that we can successfully address these issues while leaving the current Commodity Exchange Act largely intact. In the interests of time, and because we will soon have the opportunity to testify before Congress along with other industry participants, I will limit any further comments on this topic.

Again, I want to thank the Law and Compliance Division of the FIA for inviting me to address you today, and I look forward to answering any questions you might have.

Thank you.