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I am very pleased to be in San Francisco. This is such a delightful city that I sometimes wish I were President of a San Francisco Commodity Exchange. But that would not be fair to Chicago, a truly great city, or to the Chicago Mercantile Exchange, an outstanding business and financial institution. I hope all of you will become exposed to them both. You will like what you see.

The times they are a changin! And changin fast, everywhere. I head an Exchange that is several decades old and steeped in agricultural tradition. We were once called the Butter and Egg Board and, along with butter and eggs, we have had futures markets in cheese, shrimp, and turkeys. You do not find any of these markets trading any more, but we do have very successful contracts in fat cattle, feeder cattle, hogs, broiler chickens, pork bellies, and lumber.

These agricultural markets are very important to us and, of course, immensely useful to the livestock and meat industry of this country. Yet, in just the past few months, they have been overtaken by the astonishingly successful financial futures markets. At our International Monetary Market, gold, foreign currency, and Treasury bill futures combined now have a higher trading volume than the traditional agricultural markets I have just named. This is all the more impressive when one realizes that financial futures markets are still less than ten years old.

It was Henry David Thoreau who said:

> In the long run men hit only what they aim at.
> Therefore, though they should fail immediately,
> they had better aim at something high.

With our International Monetary Market, we aimed high. Our timing, as it happened, could not have been better and our innovative venture into financial futures contracts in 1972 came as an appropriate response to the uncertain world in which we all now find ourselves.

I have seen firsthand what benefits these financial futures markets can offer. In my view, they represent the leading edge of financial risk management and their potential, with so many new markets to develop, is probably far greater than even the most optimistic exchange president would guess.

Last year, the International Monetary Market traded more than 10 million contracts in financial futures. In the first quarter this year, volume was 3.2 million contracts which is close to an annual rate of 13 million. But these statistics, impressive as they are, do not fully illustrate what has occurred during the past decade.

You can get a better idea from our Treasury bill contract which traded over 3 million contracts last year. That represents a daily turnover of $20 billion. Yes, $20 billion, in a contract only five years old. That is a market three times the size of the underlying cash market in Treasury bills.

Why have financial futures like Treasury bills soared so successfully? From my vantage point, it is simply, that they are, and will continue to be, an appropriate response to extremely uncertain economic conditions.

We have all shared the experience of the economic trauma of the past decade. No other decade of the century -- not even the 1930s -- had so great or so pervasive an impact upon global economic conditions as the 1970s. Inflation, energy costs, changing relationships between currencies and volatile movements in interest rates have affected everyone, everywhere in the world.

It really is no exaggeration to say that in the ten-year span beginning in 1970, an essentially new economic world came into being -- a world to which we shall be adjusting for a long time to come. It is a world which renders business forecasting extremely difficult, if not impossible.

The development of the International Monetary Market coincided with the emergence of this new economic world. Financial futures became a crucial new tool for businessmen and financial institutions to effectively manage risk.

Truly good ideas are always emulated. In keeping with the American competitive spirit, four other Exchanges in Chicago and New York now also trade financial futures. Inevitably foreign markets are being developed. Sydney, Australia, and Toronto, Montreal and Winnipeg in Canada already trade financial futures. London intends to trade gold futures this year, and interest rate and currency futures by 1982. Hong Kong is planning to add interest rate contracts to its current gold trading.

Already national and worldwide interest in financial futures corroborates their usefulness in managing risk. Soon, along with the new Exchanges will come new types of contracts. At the International Monetary Market, we ourselves are planning soon to introduce Eurodollar time deposits, domestic CDs, and a Standard and Poor's 500 stock index contract.

Let me spend a moment describing the basic functions of financial futures markets. At the International Monetary Market, we provide a marketplace whose central function is to permit the transfer of risk. One reduces risk by transferring it to another party, a party who is willing to accept it. If there is a sufficient number of traders in the marketplace, risk can be efficiently transferred and will be readily accepted. We call these liquid markets because they allow a large flow of orders to be transacted smoothly and promptly.

The second essential feature of futures markets is price discovery. Because of the structure of a financial futures marketplace -- the fixed site, the schedule of regular trading hours, and the fact that all transactions are completed publicly -- the elements of private dealing, and hence secrecy, are not present. All transactions are completed by open outcry within a designated trading pit.

Both this "auction" system of trading and the instantaneous electronic price boards that record all transactions, comprise a highly efficient mechanism for price discovery. Within a matter of seconds, participants are able to discover openly and impersonally what the price is, at any given moment, during trading hours.

This price discovery function has special importance. Because the immediate values provided by the marketplace are openly and instantaneously available, financial strategies can be planned and executed in a very short time frame.

Price dissemination is the third basic function of futures markets. Because all transactions are recorded electronically and quickly disseminated around the world, a dealer on any continent can know almost immediately what the actual trading price is. With such an effective method of price dissemination, a true "world market" becomes a reality.

This aspect of futures markets has contributed greatly to their broader use in recent years. Today's greater efficiency and economy of international telecommunications enables dealers on all continents to be participants in the futures markets and not just observers; as current on futures price movements in Hong Kong or Singapore as they are in the building in Chicago which houses the Merc. Not only can dealers in distant places base their own quotations for currency or gold on the price prevailing on a public market, they can simultaneously establish at the IMM the appropriate hedges for their own transactions.

With this continuing process of constantly incorporating new price information, risk management by institutions becomes both possible and viable. The three basic functions of risk transfer, price discovery and price dissemination inherent in futures markets create this vital process.

Allow me to clarify one often misunderstood point about futures markets. We are not forward markets. Forward transactions are executed privately between the buyer and the seller. The two parties are accountable to each other for the life of the contract, and they can create their own terms for the contract. In futures markets, we have a clearing house which assumes both positions of any transaction at the end of each trading day, creating a relationship very different from that of a typical forward transaction.

With the clearing house, a customer is not concerned about the financial performance of the party that took the opposite position during trading hours. At the end of the day, the clearing house of the Exchange takes the opposite position: It becomes the seller for every buyer, the buyer for every seller.

A futures exchange gives maximum protection for customers both in providing a forum for them to transfer risk and in the safeguards we have established for the efficient running of the marketplace. We are a haven of sorts, amidst the financial storms that have settled in for a good long duration.

We aimed high and quite accurately when we created financial futures contracts. We patterned them on the identical premises that created agricultural futures contracts, which helped make America's agricultural industry one of the most efficient in the world. For many years, some agricultural banks in the U.S. have routinely required that farm borrowers hedge their positions in the futures markets. Far from regarding futures as a means of reckless speculation or gambling, our most conservative banks have encouraged and even required hedges.

This same pattern has now emerged among our largest corporations. Within the past few years, firms such as General Telephone & Electronics, Allied Chemical, Esmark, Republic Steel, Union Carbide, Sears, DuPont, and General Electric have begun to use financial futures as part of their overall business strategy.

One of the best-known "case studies" of financial futures was provided by investment banks -- the underwriters of the October 1979 $1 billion debt issue offered by IBM. This issue was offered during the highly uncertain period leading to the Federal Reserve Board's major policy move on money supply. Interest rates moved against the debt offering, but by hedging the underwriters avoided literally millions of dollars in underwriting losses.

Since that time we have seen underwriters in the Euromarkets as well as our domestic markets also use interest futures to hedge. This means that financial futures markets are becoming increasingly international in scope, and this trend is bound to continue. Just last month the Bank of England gave the green light for the new London Futures Exchange to trade foreign currencies, sterling instruments, and a Eurodollar certificate of deposit when it opens in 1982.

We ourselves are taking this American idea to other parts of the world. In 1980 we opened a London office, and this year alone seminars are planned in about a dozen European cities and three cities in Asia (Singapore, Hong Kong, and Tokyo). We are taking the concept of financial futures trading to Europe and Asia because we are convinced that these are becoming international markets.

One aspect of financial futures that I pay special attention to is the role of government regulation. The decade of the 1970s surpassed even the New Deal Era of the 1930s in terms of the enlargement of the scope and depth of the Federal government's intervention into private business. Among other regulatory agencies established by the Congress during this period, one such agency was created specifically to oversee and regulate futures markets, the Commodity Futures Trading Commission.

Financial futures have faced -- and continue to face -- a considerable amount of jurisdictional jockeying among different governmental agencies, some of which have been trying both to impede the marketing of new financial futures and to share jurisdiction with the CFTC in oversight of such markets. We have also been impeded in our continuing effort to expand the scope of our markets.

Quite frankly, we all <u>need</u> financial futures markets. The same economic uncertainty and instability that was occurring when the IMM was in its formative stages is still with us.

Growing numbers of financial managers are coming to use financial instruments and currency futures contracts as part of their domestic and international financial management. You can be confident, I think, that those individuals responsible for managing this country's futures exchanges will help stem the tide of government intrusion in the U.S. economy. These new financial futures markets can only flourish in a market oriented environment, and we are determined to restore that environment while still maintaining public confidence in our markets.

Yes, something significant is happening in financial futures -- and those of you who have an interest in business and finance will find that learning more about how to use these markets will prove to be a productive investment of time and energy on your part.