

Future of Chicago as a Financial Derivatives Center: Why Chicago? (Then and Now)

Loyola University Chicago
Quinlan School of Business

Robert S. Steigerwald*
Federal Reserve Bank of Chicago
January 30, 2013

*Substantial research assistance was provided by Ivana Ruffini

The statements and opinions expressed herein are solely those of the author and not necessarily those of the Federal Reserve Bank of Chicago or the Board of Governors of the Federal Reserve System.

Why Chicago? (Then and Now)

- **OVERVIEW**

- **Chicago Then – Chicago's Place in the 19th Century Grain Market**
- **Chicago Now – Chicago's Status as a Global Financial Center**

Why Chicago? (Then and Now)

- **Chicago Then – Chicago’s Place in the 19th Century Grain Market**
 - **Key infrastructure developments and market innovations (circa 1825 to 1899)**
 - Transportation infrastructure
 - Information and communications technology
 - Grain storage and trading facilities
 - Standardization and the “fungibility” of cash grain
 - Development of “to arrive” contracts and, ultimately, commodity futures
 - Clearing and settlement arrangements

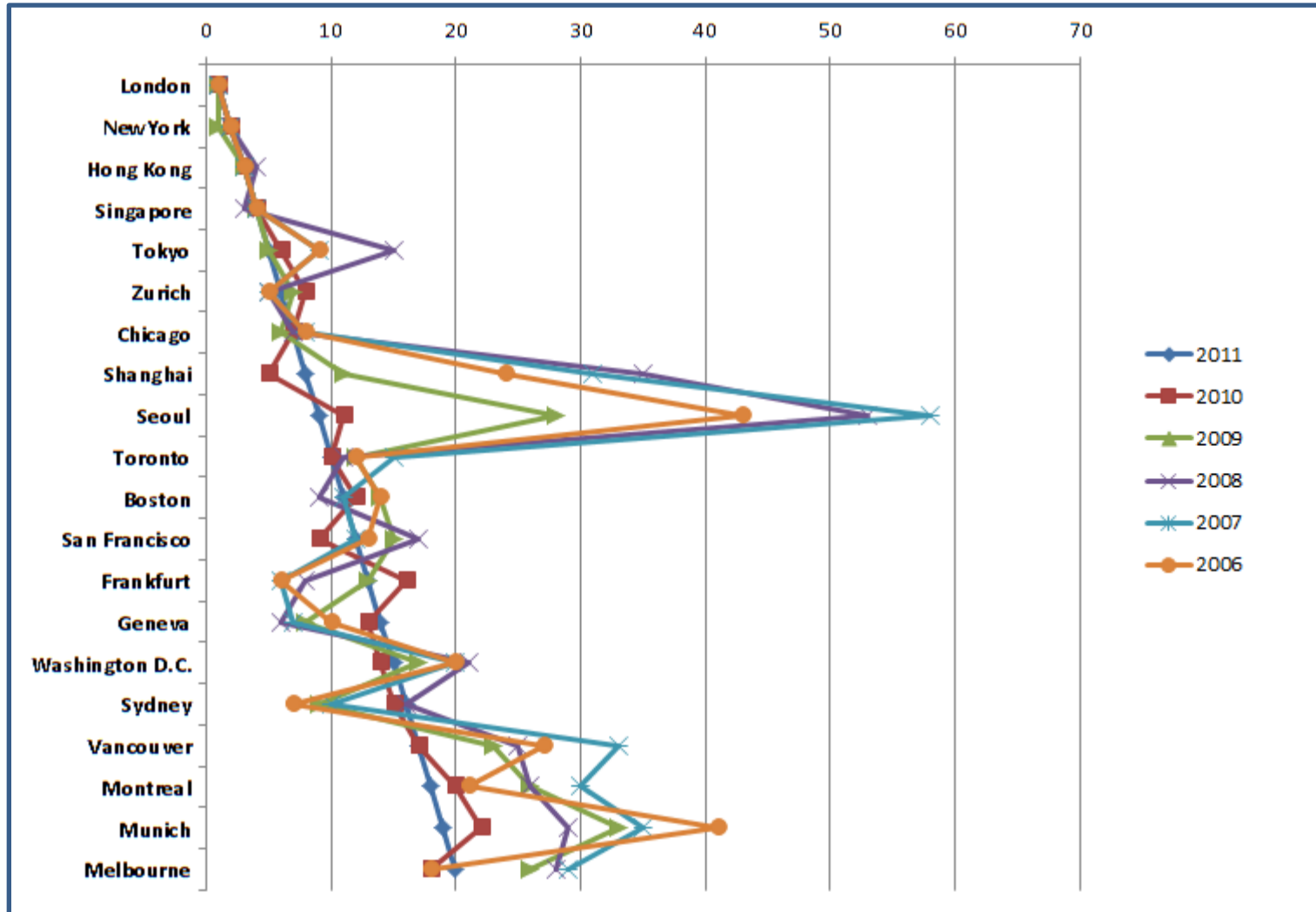
Why Chicago? (Then and Now)

- **Chicago Now – Chicago's Status as a Global Financial Center**

- **The global marketplace – financial center rankings**

1. London
2. New York
3. Hong Kong
4. Singapore
- 5. Chicago**
6. Zurich

Why Chicago? (Then and Now)



Source: Global Financial Centers Index Rankings (Published by the City of London)

Why Chicago? (Then and Now)

- **Chicago Now – Chicago’s Status as a Global Financial Center**

- **The global marketplace – derivatives clearing**
 - What is “clearing?”

“In the context of financial transactions, the ***convenience, safety and trust*** required for national and global markets to function are largely provided by ***clearing and settlement arrangements.***”

Edward J. Green, Clearing and Settling Financial Transactions Circa 2000, in Anthony M. Santomero, Staffan Viotti & Anders Vredin (eds.), *Challenges for Central Banking* (2001)

Why Chicago? (Then and Now)

- **Chicago Now – Chicago’s Status as a Global Financial Center**

- **The global marketplace – derivatives clearing**
 - What is central counterparty “clearing?”

“A central counterparty interposes itself between counterparties to contracts traded in . . . financial markets, becoming the **buyer to every seller and the seller to every buyer . . .**”

Committee on Payment and Settlement Systems (CPSS) & Technical Committee, International Organization of Securities Commissions (IOSCO), *Principles for financial market infrastructures* (April 2012)

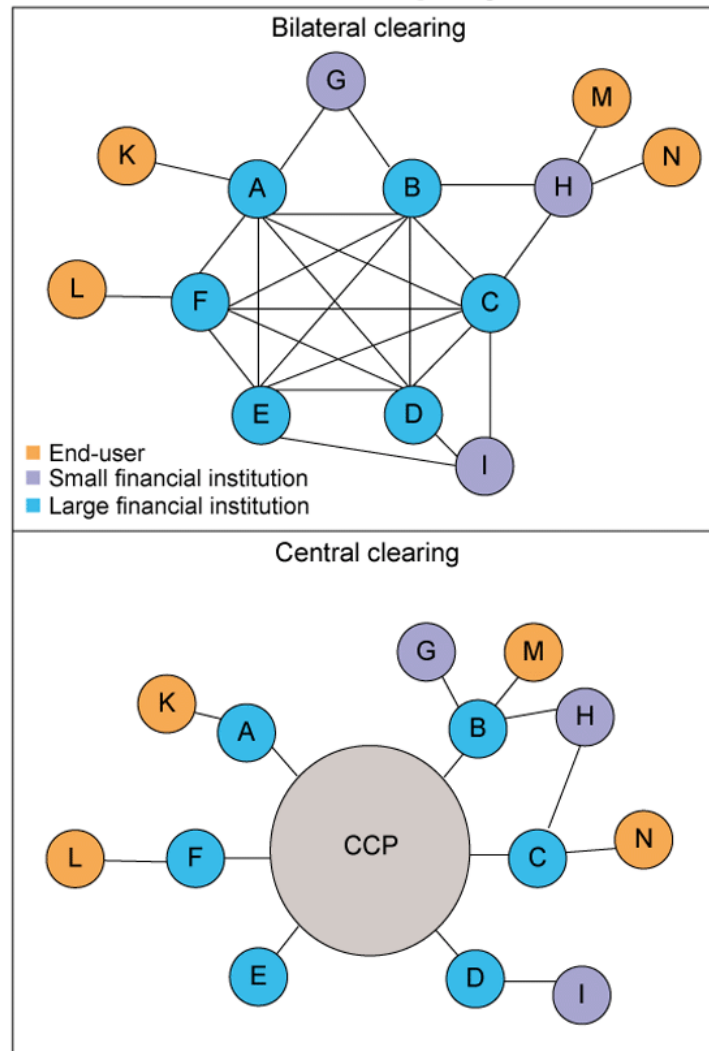
Why Chicago? (Then and Now)

- **Chicago Now – Chicago’s Status as a Global Financial Center**
 - **The global marketplace – derivatives clearing**
 - What is central counterparty “clearing?”



Why Chicago? (Then and Now)

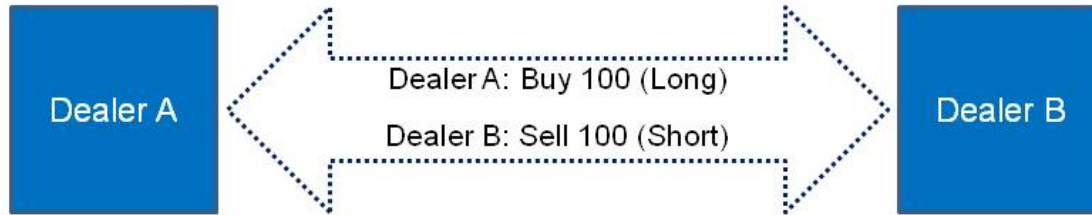
OTC Derivatives Counterparty Relationships



Source: Reserve Bank of Australia, Central Clearing of OTC Derivatives in Australia (June 2011):

<http://www.rba.gov.au/publications/consultations/201106-otc-derivatives/central-clearing-otc-derivatives.html>

Why Chicago? (Then and Now)



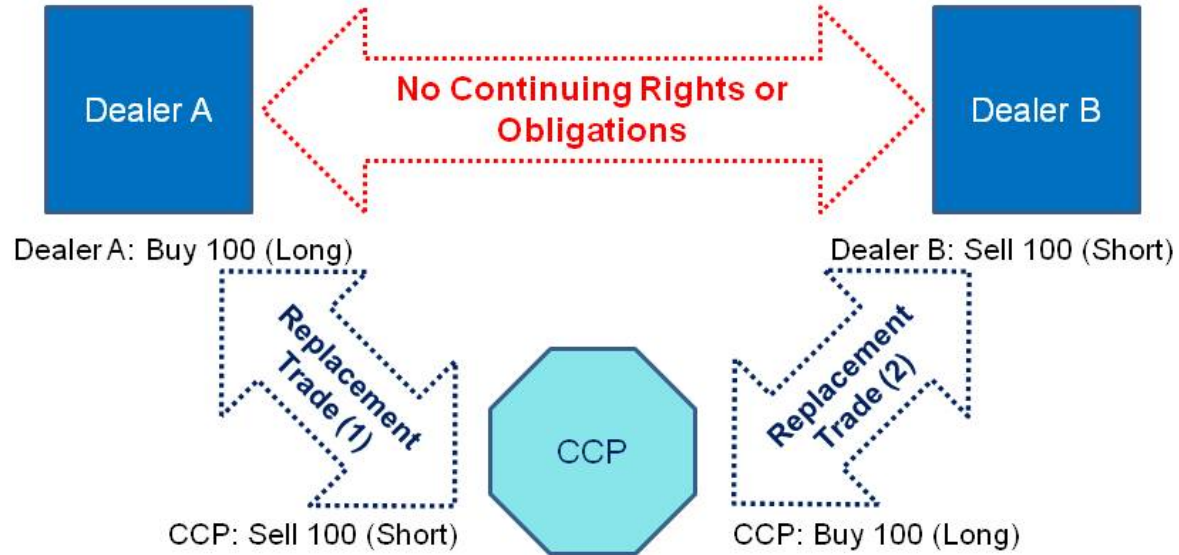
	Dealer A	CCP	Dealer B
Trade	Buy 100 (from Dealer B)		Sell 100 (to Dealer A)
Combined Position	Buy 100 (Long)		Sell 100 (Short)

Why Chicago? (Then and Now)



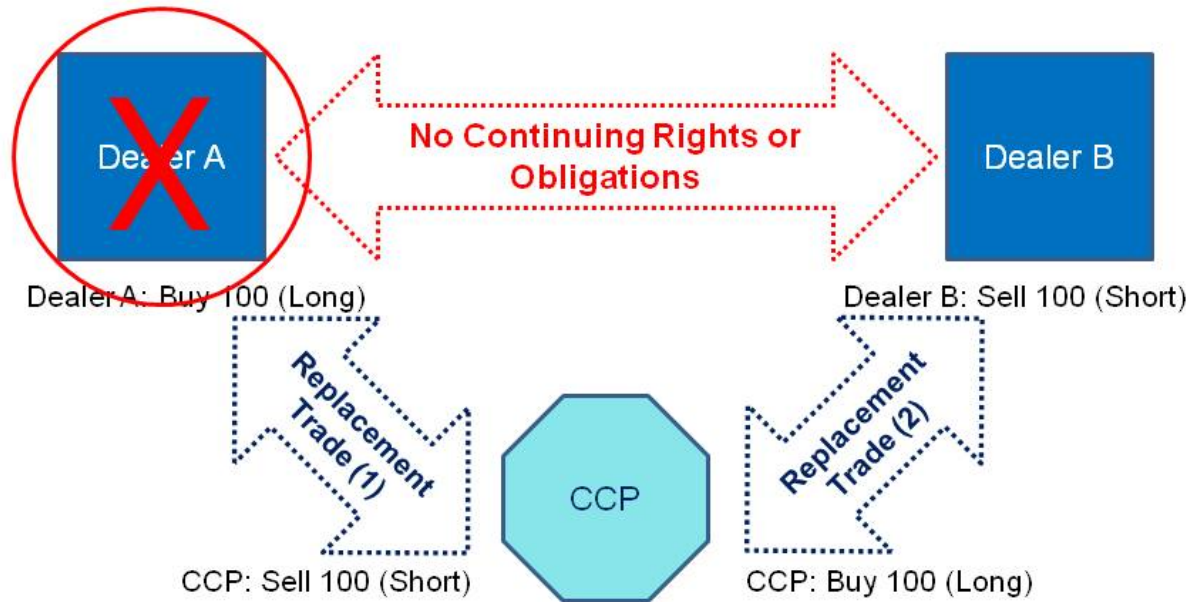
	Dealer A	CCP	Dealer B
Trade	Buy 100 (from Dealer B)		Sell 100 (to Dealer A)
Combined Position	Buy 100 (Long)		Sell 100 (Short)

Why Chicago? (Then and Now)



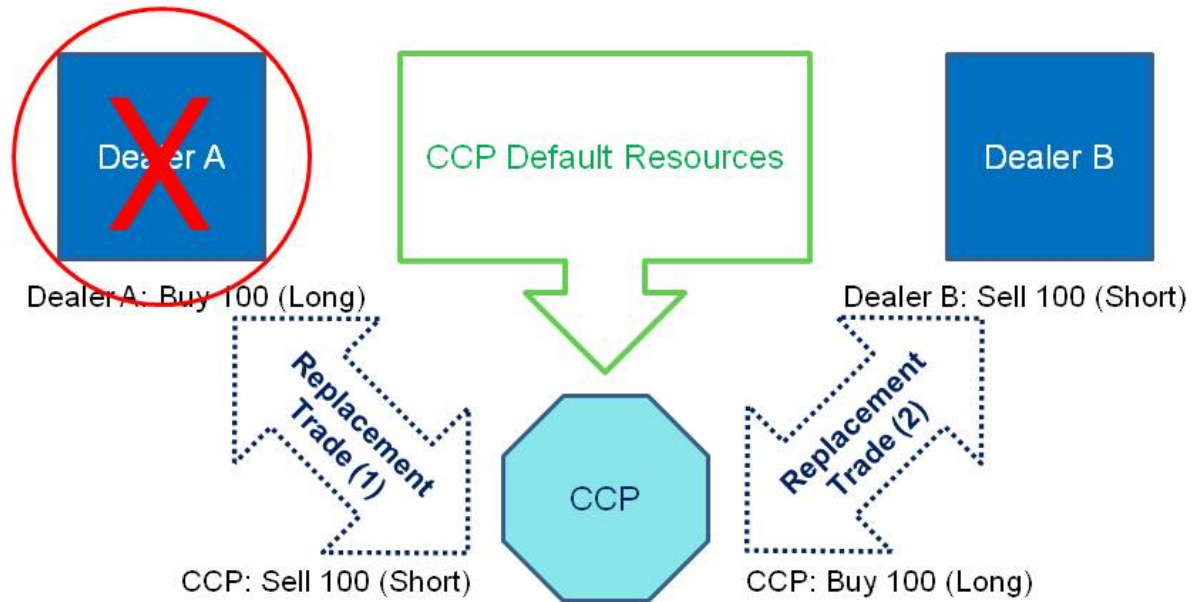
	Dealer A	CCP	Dealer B
Trade	Buy 100 (from Dealer B)		Sell 100 (to Dealer A)
Replacement Trade (1)	Buy 100 (from CCP)	Sell 100 (to Dealer A)	
Replacement Trade (2)		Buy 100 (from Dealer B)	Sell 100 (to CCP)
Combined Position	Buy 100 (Long)	Offsetting (Neutral)	Sell 100 (Short)

Why Chicago? (Then and Now)



	Dealer A	CCP	Dealer B
Trade	Buy 100 (from Dealer B)		Sell 100 (to Dealer A)
Replacement Trade (1)	Buy 100 (from CCP)	Sell 100 (to Dealer A)	
Replacement Trade (2)		Buy 100 (from Dealer B)	Sell 100 (to CCP)
Combined Position	Buy 100	Offsetting (Neutral) Buy 100 (Long)	Sell 100 (Short)

Why Chicago? (Then and Now)



	Dealer A	CCP	Dealer B
Trade	Buy 100 (from Dealer B)		Sell 100 (to Dealer A)
Replacement Trade (1)	Buy 100 (from CCP)	Sell 100 (to Dealer A)	
Replacement Trade (2)		Buy 100 (from Dealer B)	Sell 100 (to CCP)
Combined Position	Buy 100	Offsetting (Neutral)	Sell 100 (Short)
		Buy 100 (Long)	

Why Chicago? (Then and Now)

- **OVERVIEW**

- **Chicago Then – Chicago's Place in the 19th Century Grain Market**
- **Chicago Now – Chicago's Status as a Global Financial Center**

Future of Chicago as a Financial Derivatives Center: Why Chicago? (Then and Now)

Loyola University Chicago
Quinlan School of Business

Robert S. Steigerwald*
Federal Reserve Bank of Chicago
January 30, 2013

*Substantial research assistance was provided by Ivana Ruffini

The statements and opinions expressed herein are solely those of the author and not necessarily those of the Federal Reserve Bank of Chicago or the Board of Governors of the Federal Reserve System.