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

Loyola University Chicago
Quinlan School of Business

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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
  
  o Chicago Then – Chicago’s Place in the 19th Century Grain Market
  
  o 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

Source: Global Financial Centers Index Rankings (Published by the City of London)
Why Chicago? (Then and Now)

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- 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.”

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 . . . .”

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

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Why Chicago? (Then and Now)

Source: Reserve Bank of Australia, Central Clearing of OTC Derivatives in Australia (June 2011):
Why Chicago? (Then and Now)

Dealer A: Buy 100 (Long)
Dealer B: Sell 100 (Short)

<table>
<thead>
<tr>
<th>Dealer A</th>
<th>CCP</th>
<th>Dealer B</th>
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<tbody>
<tr>
<td>Trade</td>
<td>Buy 100 (from Dealer B)</td>
<td>Sell 100 (to Dealer A)</td>
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Combined Position
Buy 100 (Long)
Sell 100 (Short)
Why Chicago? (Then and Now)

Dealer A

Termination (Discharge)

Dealer B

CCP

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Dealer A: Buy 100 (Long)  
Dealer B: Sell 100 (Short)  
CCP: Sell 100 (Short)  
CCP: Buy 100 (Long)  
No Continuing Rights or Obligations

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<td>Replacement Trade (2)</td>
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Combined Position

Buy 100 (Long)
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CCP: Sell 100 (Short)
CCP: Buy 100 (Long)

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