

Edgar Filing: CBOT HOLDINGS INC - Form 425

CBOT HOLDINGS INC
Form 425
December 12, 2006

Filed by Chicago Mercantile Exchange Holdings, Inc. pursuant
to Rule 425 under the Securities Act of 1933, as amended, and
deemed filed pursuant to Rule 14a-12 under the Securities
Exchange Act of 1934, as amended.

Subject Company: CBOT Holdings, Inc.

Subject Company's Commission File No.: 001-32650

This material is not a substitute for the prospectus/proxy statement and any other documents CME and CBOT intend to file with the Securities and Exchange Commission (SEC). Investors and security holders are urged to read such prospectus/proxy statement and any other such documents, when available, which will contain important information about the proposed transaction. The prospectus/proxy statement would be, and other documents filed or to be filed by CME and CBOT with the SEC are or will be, available free of charge at the SEC's Web site (www.sec.gov) or from Chicago Mercantile Exchange Holdings Inc., Shareholder Relations and Membership Services, 20 South Wacker Drive, Chicago, Illinois 60606, Attention: Beth Hausoul.

CME and its directors, executive officers and other employees may be deemed to be participants in the solicitation of proxies in connection with the proposed transaction. Information about CME's directors and executive officers is available in CME's proxy statement, dated March 10, 2006, for its 2006 annual meeting of stockholders. Additional information about the interests of potential participants will be included in the prospectus/proxy statement when it becomes available. This document shall not constitute an offer to sell or the solicitation of an offer to buy any securities, nor shall there be any sale of securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction. No offering of securities shall be made except by means of a prospectus meeting the requirements of Section 10 of the U.S. Securities Act of 1933, as amended.

The following is a presentation that CME plans to use in connection with the proposed merger from time to time.

* Name effective upon transaction closing.

2

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

Discussion of Forward-Looking Statements

Statements in this news release that are not historical facts are forward-looking statements. These statements are not guarantees of performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or implied in any forward-looking statements. Among the factors that might affect our performance are: increasing competition by foreign and domestic competitors, including new entrants into our markets; our ability to keep pace with technological developments, including our ability to complete the development and implementation of the enhanced functionality for our customers; our ability to continue introducing competitive new products and services on a timely, cost-effective basis, including our electronic trading capabilities, and our ability to maintain

the competitiveness of our existing products and services; our ability to adjust our fixed costs and expenses if our revenues decline; our ability to continue to realize the benefits of our transaction processing provided to third parties; our ability to maintain existing customers and attract new ones; our ability to expand and offer our products in foreign jurisdictions; changes in domestic and foreign regulations; changes in government policy, including policies relating to common or directed clearing; the costs associated with protecting our intellectual property rights and our ability to operate our business without violating the intellectual property rights of others; our ability to generate revenue from our market data that may be reduced or eliminated by the growth of electronic trading; changes in our rate per contract due to shifts in the mix of the products traded, the trading venue and the number of customers (whether the customer receives member or non-member fees or participates in one of our various incentive programs); the impact of our tiered pricing structure; the ability of our financial safeguards package to adequately protect us from the credit risk of our clearing firms; changes in price levels and volatility in the derivatives markets and in underlying fixed income, equity, foreign and commodity markets; economic, political and market conditions; our ability to accommodate increases in trading volume without degradation of performance of our systems; our ability to execute our growth strategy and maintain our growth effectively; our ability to manage the risks and control the costs associated with our acquisition, investment and alliance strategy; industry and customer

consolidation;
decreases
in
trading
and
clearing
activity;
the
imposition
of
a
transaction
tax
on
futures
and
options
on
futures
transactions;

and seasonality of the derivatives business. More detailed information about factors that may affect our performance may be found in our press release for the merger and our filings with the Securities and Exchange Commission, including our most recent Quarterly Report on Form 10-Q, which is available in the Investor Information section of the CME Web site. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.

Additional Information

This material is not a substitute for the prospectus/proxy statement and any other documents CME and CBOT intend to file with the Securities and Exchange Commission (SEC). Investors and security holders are urged to read such prospectus/proxy statement and any other documents, when available, which will contain important information about the proposed transaction. The prospectus/proxy statement, and other documents filed or to be filed by CME and CBOT with the SEC are or will be, available free of charge at the SEC's website (www.sec.gov) or from CME by directing a request to CME, 20 South Wacker Drive, Chicago, IL 60606, Attention: Shareholder Services, or from CBOT by directing a request to 141 West Jackson Boulevard, Chicago, IL 60604, Attention: Investor Relations.

CME, CBOT and their respective directors, executive officers and other employees may be deemed to be participants in the solicitation of proxies from the security holders of CME or CBOT in connection with the proposed transaction. Information about CME's directors and executive officers is available in CME's proxy statement, dated March 10, 2006, for its 2006 annual meeting of stockholders, and information about CBOT's directors and executive officers is available in CBOT's proxy statement, dated March 29, 2006, for its 2006 annual meeting of shareholders. Additional information about the interests of potential participants will be included in the prospectus/proxy statement when it becomes available. This document shall not constitute an offer to sell or the solicitation of an offer to buy any securities, nor shall it constitute any sale of securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction. No offering of securities shall be made except by means of a prospectus meeting the requirements of Section 10 of the U.S. Securities Act of 1933, as amended.

NOTE:

Unless
otherwise
noted,
all
references
to

CME
volume,
open
interest
and
rate
per
contract
information
in
the
text
of
this
document
exclude

CME's non-traditional TRAKRSSM
products, for which CME receives significantly lower clearing fees of less than one cent per contract on average, as
well as CME Auction Markets
products.

3

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

List of slides

20

Product innovation is the hallmark of derivatives

19

Technology

Innovation

-

Monthly

Globex

ADV

18

Recent

Merger

Activity

-

Stated

Rationale

16

Investment

Banks

Consortia

Involvement

15

Clearing members are global

14

Futures markets are global, not just domestic

13

Exchange-traded derivatives statistics

12

Global derivatives market shares

11

Growth of European exchange-traded derivatives

10

On-Exchange trading across markets

9

Derivatives market growth and size

8

CME/CBOT will be a platform for Innovative Growth

7

Significant User Benefits: Continuing Clearing Synergies

6

Significant User Benefits

5

CME/CBOT Merger Benefits

4

CME/CBOT merger is a landmark transaction

#

Slide

22

Potential for competitive entry and expansion

32

Recent

Merger

Activity

Stated

Rationale,

Detailed

Additional Information

31

Conclusion

30

At

Issue

-

Control

29

3

Pillars

-

Financial

Integrity

28

3

Pillars

Transparency

27

3

Pillars

-

Innovation

26

CFTC Roundtable

Notes from past comments on fungibility to the CFTC

24

Declining trading rates per contract

22

New product volume from derivatives exchanges

21

New product listings from derivatives exchanges

#

Slide

4

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

CME/CBOT merger is a landmark Transaction

Combination will establish the world's most diverse
global exchange and provide significant value to CME's
and CBOT's customers and shareholders

Solidifies combined company's status as
the premier global exchange

Expands presence in attractive derivatives markets

Positions combined company for continued growth

Creates operational and cost efficiencies for customers

\$125+ million in estimated annual cost savings expected to be achieved year two post closing

Expected to be accretive to earnings
12
18 months post close

Potential revenue opportunities

Enhances operating efficiencies
Strategically
Attractive
Financially
Compelling

5

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

CME/CBOT Merger Benefits

Well-Positioned

in Dynamic,

Competitive

Global Industry

Stronger Base

to Build Core

Derivatives

Business
Accretive
Transaction
Platform for
Product
Innovation and
Growth
Substantial
Benefits
Transaction expected to create value for shareholders of
both companies
Synergy
Opportunities
Significant User
Benefits

6

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

CME and CBOT customers will benefit from increased scale, liquidity, product diversification and functionality

Significant User Benefits

Creates operational and cost efficiencies for market users

Access to distinct products and services on an integrated platform

Broad pipeline of innovative new products and

functionality

Efficiencies through integrated systems and combined open-auction trading environment

Seamless continuation of current clearing services, which secures existing margin benefits for customers

7

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

CME/CBOT clearing agreement
Announced in April 2003
Fully operational in January 2004

Clearing agreement provides substantial savings for our
clearing firms and their customers
\$1.6 billion decrease in performance bonds for users
\$200 million decrease in security deposits for clearing firms
Combined risk capital pool and generated other operational
efficiencies
Significant User Benefits: Continuing Clearing Synergies

8

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

+

CME/CBOT will be a platform for innovative growth

The combined company provides a strong platform for bringing innovation, broader access and efficiencies to

traditional Over-The-Counter markets

CME Clearing 360

Credit Derivatives

Alternative Markets

OTC Cash FX trading

\$2 trillion in daily turnover

FXMarketSpace FX cash

and swaps clearing

Interest rates swaps

clearing

Trading and clearing for
the \$20 trillion
(outstanding) OTC credit
derivatives market

Trading and clearing of
weather, real estate, and
economic indexes
commonly traded in OTC
markets

The \$250 trillion
(outstanding) interest rate
swaps market

9

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

Derivative market growth and size

OTC derivatives markets are much larger and
growing faster than exchange-traded derivatives

\$-

\$50,000

\$100,000

\$150,000

\$200,000

\$250,000

\$300,000

Dec. 2001

Dec. 2003

Dec. 2005

Total Value Outstanding Positions (measured in notional value as of year-end)

Exchange Traded

OTC

CAGR 01-05

OTC

27%

Exchange

Traded

25%

10

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

Global Equity Market

87%

13%

Off-Exchange

On-Exchange

Average Daily Volume

Global Derivatives Market

17%

83%

On-Exchange

Off-Exchange

*Sources:Accenture (Story Waters Ahead: Stock Exchanges are Heading Towards a

Turbulent Future); BIS, NASD/TRACE, WFE
On-Exchange trading across markets
Equity markets and derivatives differ significantly -
equity exchanges compete with other equity exchanges
while derivatives exchanges compete with the larger
OTC/Off-exchange markets

11

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

Growth of European exchange-traded derivatives

Relative Volume Market Shares between the US and Europe
of Exchange-Traded Futures Products

57%

46%

0%

10%

20%

30%

40%

50%

60%

70%

80%

90%

100%

CME, CBOT, and NYMEX combined volume market share

Euronext, Eurex, LIFFE combined volume market share

12

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

Global derivative market shares

Regional Market Shares Exchange-Traded

Futures and Options on Futures

(Volume)

US Exchanges

28%

International

Exchanges

72%

Regional Market Shares Exchange-Traded

Derivatives

(Notional Value)

North America,

56%

Europe, 37%

Asia , 7%

All Other Places, 1%

Non-US exchanges have substantial market share and room for growth, given Asia's small share (in notional value)

*Source: FIA

*Source: BIS

13

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

Exchange-traded derivatives statistics

Top 20 Derivatives Contracts by Volume

In millions of contracts*

Contract

Jan-Jun 2006	Jan-Jun 2005	% Change
--------------	--------------	----------

Kospi 200 Index Options, KRX

1,208.70

1,069.42

13.0%

Eurodollar Futures, CME

244.63

207.85

17.7%

Euro-Bund Futures, Eurex

173.30

163.69

5.9%

TIIE 28-Day Interbank Rate Futures, Mexder

143.30

66.33

116.0%

Eurodollar Options, CME

140.41

92.62

51.6%

E-mini S&P 500 Index Futures, CME

129.45

100.63

28.6%

10-Year T-Note Futures, CBOT

124.92

113.55

10.0%

DJ Euro Stoxx 50 Index Futures, Eurex

108.36

66.63

62.6%

Euribor Futures, Euronext.liffe

101.78

85.10

19.6%

Euro-Bobl Futures, Eurex

92.71

84.12

10.2%

*excludes contracts based on individual equities

*Source: FIA

14

Copyright Chicago Mercantile Exchange Inc. All rights reserved.
Futures markets are global, not just domestic

Eurex/EurexUS
Currency futures
Russell 1000
Treasury futures

Euronext
Eurodollar
Japanese Government Bond

3 Month Euroyen Tibor

Nymex
Brent Crude Oil

ICE/IPE
WTI Crude Oil

CME
Nikkei 225 (Yen based)
Euroyen
E-Mini S&P Asia 50
E-Mini MSCI EAFE
Non-US dollar fx cross rates

CBOT
Bund, Bobl, Schatz

SGX
Eurodollar
Nikkei 225
Japanese Government Bond
Euroyen Tibor and Euroyen Libor
S&P CNX Nifty Index
Futures exchanges compete in domestic and
international markets

15

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

Clearing members are global

The largest clearing firms are members of many exchanges/
clearing houses -

capable of providing clearing services
globally, for many derivative products

UBS

Morgan Stanley

Merrill Lynch

Man Financial

Lehman Brothers

J.P. Morgan

HSBC

Goldman, Sachs

Fimat
Deutsche Bank
Citigroup
Bear, Stearns
Barclays
Banc of America
ABN AMRO
SFE
SGX
JSCC
Eurex
LCH
CCorp
DTCC
NYCC
NYMEX
OCC
CME
FIRM
International
Domestic
Sources World's CCP Org.; Web sites; Annual Reports
SGX -Singapore Exchange
SFE -
Sydney Futures Exchange
OCC -
Options Clearing Corporation
NYCC -
New York Board of Trade Clearing Corporation
DTCC -
Depository Trust Clearing Corporation
LCH -
London Clearing House
CCorp -
The Clearing Corporation
JSCC -
Japanese Securities Clearing Corporation

16

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

Investment Banks

Consortia Involvement

EBS

1

FXAll

BrokerTec¹

BrokerTec

Futures²

Creditex

EuroMTS

ICE

MarketAxess

Mark-it

Partners

Swapswire

TradeWeb³

Bank of America

Bear Stearns

Citibank

Credit Suisse

Deutsche Bank

Goldman

JP Morgan

Lehman Brothers

Merrill Lynch

Morgan Stanley

UBS

1 Sold to ICAP

2 Sold to Eurex

3 Sold to Thomson Corporation

Foreign Exchange

Fixed Income

17

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

Investment Banks

Consortia Involvement

Phil.

Stock

Exch.

Chicago

Stock

Exch.

ISE

Stock

Exch.

Boston

Equities

Exch.

National

Stock
Exch.
Arca'
Brut
Project
Turquoise
Bank of America
Bear Stearns
Citibank
Credit Suisse
Deutsche Bank
Goldman
JP Morgan
Lehman Brothers
Merrill Lynch
Morgan Stanley
UBS
1 Sold to NYSE
Equities

18

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

Recent Merger Activity

Stated Rationale

Exchange Transactions

Acquiror

Target

Stated Rationale

Source

CME

CBOT

Scale

Breadth of products

Cost synergies

10/17/06 CME Press Release

ICE

NYBOT

Revenue and cost synergies

Complementary customer base

New market access

Electronification of NYBOT products

9/14/06 ICE Press Release

NYSE

Euronext

Scale

Product diversity

Cost and revenue synergies

Common vision

Minimal regulatory risk

5/21/06 NYSE Press Release

NASDAQ

LSE

Creates global equity platform

Natural marketplace for international issuers

Scale

Cost synergies

3/10/06 NASDAQ Press Release

IDB Transactions

Acquiror

Target

Stated Rationale

Source

Collins Stewart

Chapdelaine

Increased North American presence

Increased credit derivative exposure

10/27/06 Collins Stewart Press Release

GFI

Amerex

Broadens product offering into energy

9/7/06 GFI Press Release

Creditex

CreditTrade

Scale

Combines electronic and voice brokerage

7/25/06 Creditex Press Release

ICAP

EBS

Cost synergies

Expands presence in FX

4/21/06 ICAP Press Release

19

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

0

200

400

600

800

1,000

1,200

1,400

1,600
1,800
2,000
2,200
2,400
2,600
2,800
3,000
3,200
3,400
3,600
3,800
4,000
4,200
4,400
4,600
4,800

Technology Innovation
Monthly CME Globex ADV
Speed
Upgrade
Remote Data Center
Implied
Spreads
Performance
Upgrade
Capacity
Upgrade
Speed Upgrade
Capacity Upgrade
Flexibility Upgrade
Reliability Upgrade
Implied Spread
Enhancements
2003
2002
2001
2006
2004
(round turns, in thousands)
Eurodollars on
CME GLOBEX
New
Initiatives
2005
CME Eurodollar
Implied Butterfly
Spreads
New equity option spreads/
RFQ functionality

CME Eurodollar
algorithm enhancement
4,022
Options Functionality
Enhancements
Nov
06

20

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

Product innovation is the hallmark of derivatives

CME innovations

Cash-settled contracts like S&P 500 Index Futures and Eurodollar futures

Mutual offset between CME and SGX

TRAKRS futures contracts with Merrill Lynch

Long-dated index futures contracts that can be held through a securities account

Goldman Sachs Commodity Index Excess Return (GSCI ER)

Long-dated index futures that are components of a trust and basis for a listed security

Rolling Spot FX futures contracts

Derivatives contract designed to mimic the FX cash market

Credit derivative futures

Recently developed event future contracts

In the OTC market

Interest Rate swaps and swaptions

Credit derivatives -

individual and indexes

Structured products like asset backed securities

21

Copyright Chicago Mercantile Exchange Inc. All rights reserved.
New product by futures exchanges listings

CME leads the pack with 106 new contracts listed 1999-2005

A listing
for these purposes is a line item on FIA Volume Reports

although one may count differently than FIA

E.g.,

FIA clusters all CME weather contracts as single line item

Source: FIA Volume Reports

106

17

21

13

26

4

10

15

Total

23

5

5

3

3

0

2

5

Options

83

12

16

10

23

4

8

10

Futures

CME

94

24

10

17

15

14

2

12

Total

35

11

3

5

7

5

1

3

Options

59
13
7
12
8
9
1
9
Futures
EUREX
38
1
3
5
4
8
3
14
Total
14
1
2
2
0
3
1
5
Options
24
0
1
3
4
5
2
9
Futures
LIFFE
31
2
5
5
5
10
4
0
Total
3
0
0

2

1

0

0

0

Options

28

2

5

3

4

10

4

0

Futures

CBOT

Total

2005

2004

2003

2002

2001

2000

1999

New product listings from derivatives exchanges

22

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

112,341,228

100,523,137

75,040,886

56,876,506

33,383,015

11,365,924

863,543

CME ex

TRAKRS

154,800,308

118,679,191

94,961,328

66,658,188
33,383,015
11,365,924
863,543

CME

22,626,167
23,121,026
26,133,088
22,408,485
23,812,255
5,727,592
2,422,103

EUREX

59,128,132
66,816,611
66,637,940
39,933,392
27,424,133
8,624,390
6,425,221

LIFFE

33,536,806
28,520,086
14,376,567
3,720,135
1,339,423
1,334,373

0

CBOT

2005
2004
2003
2002
2001
2000
1999

New product volume of representative exchanges

Source: FIA Volume Reports

New Product (Futures & Options) Volume by Exchange

0

20,000,000
40,000,000
60,000,000
80,000,000
100,000,000
120,000,000
140,000,000
160,000,000

1999
2000

2001

2002

2003

2004

2005

CBOT

LIFFE

EUREX

CME

CME ex TRAKRS

New product volume from derivatives exchanges

23

Copyright Chicago Mercantile Exchange Inc. All rights reserved.
Potential for Competitive Entry and Expansion Constrains Pricing

The threat of groups of large customers shifting trading volumes
to

alternate exchanges disciplines exchange pricing.

Select large customers account for a sizeable share of trading for major CME and CBOT
contracts and can create new exchanges for high volume contracts.

The Commodity Futures Modernization Act of 2000 simplified the regulatory approval
process.

Exchanges have entered and competed to attract liquidity.

Intercontinental Exchange (ICE) was formed by a collection of major dealers in 2000 and acquired the IPE exchange in 2001. It is now the second largest energy futures exchange.

NYSE has stated its intention to expand into futures exchange business.

Exchange and clearing facilities are readily available

Electronic platforms are available from third parties, including LIFFE's CONNECT platform and OM's Click platform.

Clearing services can be organized by a consortium of customers and are available from such third parties as Eurex Clearing AG, LCH, New York Clearing Corp., OM, Options Clearing Corp., NYMEX, and The Clearing Corporation.

Both clearing and electronic trading platforms are highly scalable and can be expanded rapidly.

CME
effectively
doubled
the
size
of
its
clearing
operation
after
taking
on
CBOT's
clearing
function.

Trading on additional commodities can be readily added to existing trading platforms.

24

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

IR Globex Futures ADV and RPC

Rolling 3 Month Avg

\$0.500

\$0.650

\$0.800

\$0.950

\$1.100
\$1.250
\$1.400
\$1.550
0
200
400
600
800
1,000
1,200
1,400
1,600
1,800
2,000

IR Globex ADV

IR Globex RPC

Declining trading rates per contracts

Notes from past comments on fungibility
to the CFTC

26

Copyright Chicago Mercantile Exchange Inc. All rights reserved.
CFTC Roundtable

In 2002 CME participated in a CFTC Roundtable
discussion of fungibility
Through a written statement submitted in August 2002
Through a presentation to the CFTC later that fall

CME's comments focused on 3 pillars
distinguishing futures exchanges that proscribed
fungibility would undermine
Innovation
Liquidity, open access and price transparency
Financial integrity

27

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

3 Pillars -

Innovation

Diversity of futures contract designs

Securities exist independently and apart from securities exchanges

stock options were standardized by Put and Call Dealers Association
before 1972 introduction of CBOE

BUT

futures are *constructed products*

that do not exist apart

from futures exchange

invoking intellectual property issues

Futures exchanges attempt to add unique value

products are

rarely generic, *e.g.*,
agencies, swaps

Innovation key to exchange value proposition and growth
Enforced or proscribed fungibility stifles new product innovation
At worst, it begs question
why innovate?

28

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

3 Pillars -

Liquidity

Liquidity and price transparency

Futures only have utility if they offer enhanced liquidity
relative to cash or derivative market solutions

But

liquidity as elusive as it is vital
Successful futures concentrate activity in open, transparent
marketplace, achieving critical mass
of liquidity

CME promotes openness and transparency

Price discovery, transparency, open market access and
competition enhanced by centralized liquidity pool

29

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

3 Pillars -

Financial Integrity

Financial Integrity

Designated Contract Markets are bound by Core Principle 11 of

the

Commodity

Futures

Modernization

Act

of

2000

to

provide

for the *financial integrity*

of its markets

A vertically integrated structure allows CME properly to

discharge that duty

CME has never experienced a default

Reliability and operating costs

A vertically integrated exchange promotes reliability with coordinated execution, clearing, settlement

30

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

At issue -

Control

Issue is actually about control of bid-offer spread

The majority of [exchange] shareholders are locals whose interest is in maintaining the grip of

open outcry

[preventing]

other forms of trading

such as *internalization or*

crossing

because of the rules requiring exposure to the floor
[or electronic order book].

Kevin Davis in CFTC testimony

Per former SEC Chairman Arthur Levitt

Internalization

substantially reduce[s] the opportunity for
investor orders to interact

[which]

may hamper price

competition, interfere with

public price discovery, and detract

from the depth and stability of the markets

Price matching dealers

take advantage of the public price

discovery process

but need not contribute to the process of

price discovery

This creates disincentives for vigorous price competition, which

could lead to wider bid-asked spreads, less depth, and higher

transaction costs

all orders could receive poorer executions

31

Copyright Chicago Mercantile Exchange Inc. All rights reserved.

Conclusion

Motivation behind fungibility and common clearing

The proponents of fungibility and common clearing seek to internalize their dealings, take the markets upstairs and exploit the profit from the bid/ask spreads.

In doing so, they will no doubt make lots of money, but there will be two fundamental casualties in their wake.

Casualties of fungibility

The first [casualty] will be in the transparency implicit in the exchange-transaction-process

Need we revisit the causes of the

Enron debacle?

The second casualty will be that of innovation. Does anyone here

remember the last innovation produced by a utility?