THE COLLAPSE OF MF GLOBAL, PART 2

HEARING

BEFORE THE

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OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

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THE COLLAPSE OF MF GLOBAL, PART 2

Thursday, February 2, 2012

U.S. House of Representatives,
Subcommittee on Oversight
and Investigations,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:01 a.m., in room 2128, Rayburn House Office Building, Hon. Randy Neugebauer [chairman of the subcommittee] presiding.

Members present: Representatives Neugebauer, Pearce, Posey, Renacci, Canseco, Fincher; Capuano, Waters, Baca, Miller of North Carolina, Himes, and Carney.

Also present: Representatives Grimm and Royce.

Chairman Neugebauer. The committee will come to order.

We will have opening statements—previously agreed to be 10 minutes for each side.

Also, Mr. Grimm and Mr. Royce have joined us today. While they are not members of the subcommittee, they are members of the full Financial Services Committee. I ask unanimous consent that members of the Financial Services Committee who are not members of the subcommittee may join us today and participate in the hearing.

So, good morning. This is our second hearing on the collapse of MF Global. And the purposes of these hearings is really to try to find out exactly what happened, why a very old company ended up in bankruptcy where creditors and shareholders and, unfortunately, customers lost money.

We may have additional hearings. This investigation continues—one of the things that we hope to accomplish from this series of hearings and from the investigation that we have been conducting is to then publish a report to kind of give a timeline and also some findings of how these customers lost their money, how a company that was allowed to kind of slip through the regulatory groups that—with them being knowledgeable of some of the problems that were going on.

We are going to hear from some people today who were inside the organization, and we are going to hear today from some people who were outside in the rating agencies. We have Mr. Stockman and Mr. Roseman here today who were risk officers inside the organization.

And, again, the bottom line here is trying to figure out what happened.

Because what we have seen in other problems that we have had in the marketplace is that there are those who are saying, "Well, if we would have had Dodd-Frank in place or if we had had this regulation in place or if we had this or that, etc." And, one of the things that happens is people jump to conclusions and try to overreact to that.

What we want to do is get to the bottom of what happened here and then make a finding. And one of the things that I think we have seen is that when we look back at the 2008 crisis, a lot of people said it was the fact that we had a lack of regulation. But the truth of the matter is, had we taken the time to ascertain exactly what happened, I think what we would have found is that 2008 happened not because we didn't have enough regulations, but in many cases because maybe we had regulators who were not doing their jobs, and market behavior that was not acceptable.

And so, the purpose of this hearing—and the hearings that we have had in the past and may have in the future—is, again, as I said, to get to the bottom of the situation. And so, I will look forward to hearing from our witnesses today.

With that, I yield to my good friend, Mr. Capuano, the ranking member of the subcommittee.

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Chairman, thank you for having this hearing, and I thank the witnesses for coming today.

This is another hearing in a series of this particular issue. And I don't know who has made conclusions about what happened here at MF Global. I haven't met any thoughtful person who knows much about it who has. Everybody I know, including myself and all my colleagues on this side, are simply asking questions.

And I will tell you, for me, as a supporter of Dodd-Frank, I have no idea yet whether Dodd-Frank could have or should have addressed this issue. There is simply not enough knowledge on the table yet.

For all I know, it might be just simple basic criminality. For all I know, it may just be excessive risk. I don't know yet. And I haven't talked to anybody who has drawn a conclusion yet. So I am here to learn, if you want the truth, not to draw conclusions.

And I didn't come here either today or to the last hearing or probably the next hearing I hope we have in the not too distant future with those conclusions. That is why I am here. I have lots of different questions.

I still fear that we may be ahead of the curve, and it is a good thing to be ahead of the curve for a change. We are probably going to have a whole bunch of questions, as we did at the last hearing, that probably cannot yet be answered. But I think it is important to ask them and to continue this investigation to see not just in this one instance.

As I have said before and I will continue to say, it is always bad for any company to lose a billion dollars. But, really, if there is a criminal aspect to it—somebody just misappropriated somebody's funds—that is not what Congress does. That is the Justice Department, that is the SEC. Those are other people.

What I believe that we are here for is to see if this particular case represents any threat to the system, whether others are doing it, whether there is a hole in regulation, whether there is or if there is need for either enforcement or regulation or not.

That is what I am trying to ascertain. And hopefully, today, we will take a few more steps toward being able to do that.

With that, I yield back. Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

And now the vice chairman of the subcommittee, Mr. Fitzpatrick, is recognized for 1½ minutes.

Mr. FITZPATRICK. Thank you, Mr. Chairman.

I believe this issue requires our persistent attention because there were actually many failures that have already been exposed, among them failure of the CEO and the board to heed warnings of their own internal risk managers. Also, I believe there was a clear failure of the major credit rating agencies to identify the massive risk that MF Global had taken on.

The reason why these particular failures warrant the attention of Congress is because it affects our constituents and their money.

This morning, I received an e-mail from a constituent with a substantial amount of still-missing funds.

The NRSROs, particularly the largest three credit rating agencies are and will likely remain for some time major market movers. It is not a coincidence that when Moody's downgraded MF Global, and S&P issued its warning, MF Global collapsed soon after.

Of course, it was risky bets that caused MF Global to collapse, not the ratings, but the actions taken by Moody's and S&P, I think, hastened the result.

I expect it to be argued that the financial troubles in MF were identified as soon as possible. And the fact that their situation was so precarious validated the abrupt actions of the agencies.

However, there is a demonstrable pattern of this happening again and again; Enron, Lehman, and WorldCom caused major market disruptions. Bad companies and bad securities are being rated favorably right up until the minute the house of cards collapses.

If we can avoid these abrupt shocks to the system, our financial system will be sounder and investors will be more confident. When a situation like MF Global occurs, it is our responsibility to examine how it happened, carefully consider reforms and, most importantly, make sure it doesn't happen again.

So, Mr. Chairman, again, I appreciate your facilitating this hearing. I yield back.

Chairman NEUGEBAUER. I thank the gentleman. And now, Mr. Royce is recognized for 1½ minutes.

Mr. ROYCE. Thank you, Mr. Chairman. It has been 3 months since the initial hearing, and still, most of the questions are unanswered in terms of what happened to the $1.2 billion in customer funds.

The most pressing public policy left unaddressed in all of this is, of course, the breach in segregated customer funds. I guess the shocking part is that the rules on this have been around for 75 years, and according to the regulatory community, they are not rules that are difficult to understand. They are not rules that are particularly difficult to enforce. They are the foundation of the CFTC's customer protection regime.

So one question is, how did the CFTC fail in its most basic task here?

Despite what some have said and might say again today, I will just give this perspective from CFTC commissioner O'Malia, who said, "The perception that MF Global happened because of lack of regulation is mistaken. Both our governing statute, the Community Exchange Act, and our regulations require an intermediary, require MF Global to segregate futures customer funds.

There have also been calls for SIPC-like coverage for the futures and swaps markets. Again, I think this would be a mistake. Expanding the safety net to this vast market would be unworkable and would compound the moral hazard problem already present throughout much of our financial sector.

It does appear, however, that there are several steps which can and should be taken. The focus must be on improving market discipline and ensuring the most basic regulatory functions are met by these agencies.

And I thank you, Mr. Chairman, for holding this hearing.

Chairman NEUGEBAUER. I thank the gentleman. And Mr. Grimm is recognized for 1 minute.

Mr. GRIMM. Thank you, Mr. Chairman.

I have a little bit of a different perspective on this. There is no question that customer funds being transferred—I think it speaks for itself—never should have happened, period. The law is clear.

But on top of that, it is further compounded by one of the biggest travesties in market history. Who made a decision to allow this bankruptcy to be a SIPA bankruptcy and not under the commodities bankruptcy laws?

What we did was someone stole their money and then those customers who had their money stolen just got hit even worse, because the bankruptcy laws are going to work against them.

That is one of the biggest travesties definitely in market history and undermines the entire U.S. markets, certainly commodities and futures.

With that, I yield back.

Chairman NEUGEBAUER. I thank the gentlemen. And I believe that is all the opening statements. I remind Members that their opening statements will be made a part of the record.

Now, I will introduce our first panel today: Mr. Michael Roseman, former chief risk officer, MF Global Holdings Limited; and Mr. Michael Stockman, former global chief risk officer, MF Global Holdings Limited.

Gentlemen, before we proceed, I will ask you to raise your right hand.

[Witnesses sworn.]

Thank you. Without objection, your written statements will be made a part of the record, and you will each be recognized for a 5-minute summary of your testimony.

Mr. Roseman?

STATEMENT OF MICHAEL K. ROSEMAN, FORMER CHIEF RISK OFFICER, MF GLOBAL HOLDINGS, LTD.

Mr. ROSEMAN. Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee, my name is Michael Roseman. I was the risk officer of MF Global Group from August 2008 to January 2011. Thank you for the opportunity to testify today. I hope that my comments will help you to continue to build on your knowledge of the events that led to the collapse of MF Global.

Regarding my background, I started my professional career as an aerospace engineer after graduating from the University of Delaware as an aerospace engineer.

In 1994, I received an MBA from the Kenan-Flagler Business School at the University of North Carolina and pursued a career in financial services.

I first joined Sanwa Financial Products with responsibility for the risk analysis function. The following year, I moved to the trading team and co-managed the U.S. dollar OTC option portfolio for a number of years before returning to risk management as global head of market risk.

In 2001, I joined the Bank of Montreal as the head of U.S. risk oversight for all trading, underwriting, and investment activities in the United States and with the mandate to strengthen risk management activities and capabilities in the United States.

Then, in 2004, I joined Newedge as the chief risk officer of the Americas, again with a mandate to elevate the risk management capabilities to fully support the growing brokerage businesses.

In each of these experiences, I led and coordinated significant efforts to implement new best practice policies, systems, analytics, and controls, and supported businesses to bring both transparency to and governance of the risks across organizations.

In August of 2008, I joined MF Global as the chief risk officer (CRO) reporting to the CEO with responsibility for the risk department worldwide. I also had a mandate to elevate the risk management capabilities, support the strategic objectives, and address the risk management recommendations made by two consulting firms that had been hired by the company.

As the CRO, I provided leadership for and oversaw the adherence to the enterprise risk management framework across all categories of risk, including chairing of the monthly enterprise risk committee.

Further, I was a member of the executive management team and provided regular CRO reports to the board. Over the next 2 years, I coordinated closely with executive management and the board to implement a new comprehensive enterprise risk management framework, including establishment of new risk management committees, enterprise risk policies, and a board-approved risk appetite statement with associated delegations of authority across all categories of risk.

Among other things, I coordinated the efforts to enhance the risk systems, implement new analytics and risk measures, strengthen the 24-hour global risk monitoring, and implement comprehensive enterprise-wide controls across the organization, and with the CEO to establish a culture of sound risk management throughout the company.

As a key part of my CRO responsibility, I reviewed MF Global's firm-wide exposure to the evolving risks. I regularly presented these exposures in the context of the approved risk appetite to executive management and to the board.

Both executive management and the board received a monthly enterprise risk report that detailed firm-wide exposures against the risk appetite and approved limits. As CRO, I also presented the board limit requests from executive management, along with their associated risks.

Regarding the sovereign debt positions, MF Global had both country-level credit limits and specific sovereign limits in place to control the exposure of all activities in all countries, as well as to control specific sovereign exposures.

With respect to Italy, Spain, Portugal, Ireland, and Greece, there were sovereign limits in place to support the European brokerage activity prior to Mr. Corzine joining MF Global. These limits were well within the company's approved risk appetite, and were adjusted when conditions began to deteriorate in Greece. And I believe the positions in March 2010 were less than $500 million in total across these issuers.

In June and July of 2010, I received requests to adjust the European sovereign limits from business units. I reviewed the positions and limits in detail with the business heads and with Mr. Corzine. I expressed my cautions on the requests, outlined a potential capital risk implied by the credit default swap market along with continued political and financial uncertainty in the relevant countries.

While Mr. Corzine and I had different views on potential sovereign default risk, we agreed upon a $1 billion total limit across the named sovereigns. By mid-September, I recall that the position's limits had increased to some $1.5 billion to $2 billion.

During this time period, I expressed my increasing concerns with regard to the potential capital risk associated with the growing positions and began to express cautions on the growing liquidity risk.

Additionally, around this time, the strategy significantly increased the positions of the repo-to-maturity trades which was being evaluated, given the profitability of the transactions and the importance of generating earnings.

At this point, I indicated to Mr. Corzine that we would need to consult the board for approval of increased sovereign limits given the increased materiality of the risk as related to the board's approved risk appetite.

As such, a decision was made to consult with the board to discuss the strategy, the risks, and the sovereign limits. And subsequently, sovereign limits were presented to and approved by the board.

By late October, I recall the positions were approaching some $3.5 billion to $4 billion, and I was asked to present another request to the board on behalf of executive management to increase the total sovereign limit to $4.75 billion.

At this point, not only was I concerned with the capital risk, but given the size, I was now concerned with the liquidity risk relative to the risk appetite and taking into account the liquidity risks presented by other positions held by the company.

I again discussed my concerns about the positions and the risk scenarios with Mr. Corzine and with others. However, the risk scenarios I presented were challenged as being implausible. At the end of November 2010 board meeting, I presented the new requests, along with a detailed analysis of the potential liquidity risk stress scenarios.

These scenarios included potential variation margin requirements from price changes of the securities, as well as potential initial margin calls from the repo counterparties.

These scenarios were presented at both the individual sovereign levels, as well as the coordinated levels across all sovereigns and all repo counterparties.

I also provided an analysis of the CDS market and highlighted the significant capital risk, given the sovereign default risk associated with unresolved issues in Europe.

During this meeting, all of the risks were debated. In particular, the liquidity scenarios were debated and were challenged by some members of the board as not being plausible. Ultimately, the board approved the requests, conditioned on the limits being evaluated again in 2011, which is when I left the company.

I would be happy to answer the subcommittee's questions.

[The prepared statement of Mr. Roseman can be found on page 113 of the appendix.]

Chairman NEUGEBAUER. Thank you.

Mr. Stockman, you are now recognized.

STATEMENT OF MICHAEL G. STOCKMAN, FORMER CHIEF RISK OFFICER, MF GLOBAL HOLDINGS, LTD

Mr. STOCKMAN. Thank you, sir.

Chairman Neugebauer, Ranking Member Capuano, and distinguished members of the subcommittee, thank you for the opportunity to make this brief statement.

I am deeply saddened by the bankruptcy of MF Global and its impact on its customers, shareholders, and employees. Although I was only at the company for approximately 9 months, I hope my testimony today will help the committee in obtaining a clearer picture of what happened at MF Global during my tenure at the company.

I have worked in the financial services industry for more than 25 years. Of particular note, I served as a risk officer at UBS for over a decade, eventually rising to the position of chief risk officer for the Americas for that institution.

Since 2006, I have been a member of the MBA advisory board at the Tuck School of Business up at Dartmouth College, where I have also served as a visiting scholar in the fall of 2009.

I began interviewing for the position of chief risk officer at MF Global in the fall of 2010. During the interview process, I was informed that MF Global was in the process of transitioning its business model from a traditional commodities broker to a full-scale investment bank and that the company was seeking a new chief risk officer with the experience and skill set to assist in that transition.

In or about January 2011, MF Global offered me the position of chief risk officer and I joined the company in that capacity, reporting directly to the chief operating officer. My responsibilities included, among other things, assessing market and credit risk for the company. I provided analysis about these risks to senior management and the board, who used this information in setting the company's business strategy.

I was ably assisted in the performance of my duties by a strong staff of approximately 60 dedicated employees, located in company offices around the world, including the United States, Europe, and Asia.

Although the chief risk officer did not have formal responsibility for managing the company's liquidity risk, my staff and I performed numerous analyses measuring the company's potential liquidity needs under various stress scenarios.

My understanding is that my portfolio of responsibilities as a CRO was largely the same as my predecessor, Mr. Roseman. There has been substantial discussion about MF Global's participation in transactions involving European sovereign debt known as repo-to-maturities (RTMs).

The company's European sovereign debt trading strategy was firmly in place when I joined the company in late January 2011, as mentioned by Mr. Roseman. At that time, the board had approved a sovereign limit of $4.75 billion.

After I joined MF Global, the risk department regularly analyzed the company's sovereign RTM positions. For the first several months of my tenure, based on analyses performed by the department, I believed that the risk profile associated with the company's sovereign deposition was acceptable in light of the then-prevailing market conditions.

Among the many metrics supporting this assessment were credit ratings, credit spreads, and probabilities of default, among other things.

In addition, the risk department, under my direction, analyzed potential liquidity needs associated with these trades under stressed market conditions and had received information from other departments that the company possessed adequate liquidity sources to address such potential needs.

As the credit markets deteriorated in the summer of 2011, I came to the view that it would be prudent for the company to mitigate the increased risks associated with its European sovereign debt trading positions and to consider entering into hedging transactions to reduce the company's exposure.

In July of 2011, I initiated several discussions with senior management to express this view and explore such risk mitigation strategies. I also highlighted the increased default and liquidity risks associated with the sovereign RTMs in written and oral presentations to the board at the August 2011 board meeting.

In my view, the board and senior management were highly sophisticated. The strategy was in place, and they knew and understood how the RTMs worked. They were well aware of the increased risk caused by weakening market conditions in the summer, as highlighted in my reports to the board.

To the best of my recollection, following my presentation at the August 2011 board meeting, the board and senior management made an informed business judgment to cease adding to the company's long positions in European sovereign debt and to allow existing long positions to roll off as the underlying securities reached maturity, thereby reducing the company's exposure over time.

It is my understanding that none of the sovereign debt securities underlying the RTMs have defaulted or been restructured, and all of the securities in the RTM portfolio that reach maturity have been paid in full.

I am, of course, aware and deeply saddened about the numerous press reports of the more than one billion dollars in customer funds that are missing and unaccounted for. I have no personal knowledge of any missing funds or unreconciled customer accounts.

While at MF Global, I did not have responsibility for treasury functions such as fund transfers and the maintenance of segregated customer funds. Like everyone else, I am truly hopeful that all the missing customer funds will be located and promptly returned to their rightful owners. That concludes my statement, and I look forward to being as helpful as I can today.

[The prepared statement of Mr. Stockman can be found on page 120 of the appendix.]

Chairman NEUGEBAUER. Thank you. We will now go to questions.

Mr. Stockman, in a March 2011 memo to the board, you highlighted some of the market risk associated with the firm's European RTM trades, and under the heading of "late market risk," you identify liquidity risks that are associated with potential haircuts from MF Global's counterparties.

One scenario I think that is in that report requires that if that scenario were to play out, the company would have to come up with about 761 million additional dollars. Are you familiar with this memo?

Mr. STOCKMAN. Yes, sir.

Chairman NEUGEBAUER. Yes. And do you agree with the conclusions that you reached in that memo about the market risk and liquidity risk associated with the European RTM trades?

Mr. STOCKMAN. Yes. I think that was a fair representation of some stressed market conditions that we should analyze.

Chairman NEUGEBAUER. And then I believe in October, you produced a document which I think we called "break-the-glass" scenarios.

And I think in this particular document, you said, forget scenarios one and two; we are in a different environment now. So, you outlined additional scenarios where additional liquidity requirements would be needed, based on some additional scenarios. Is that correct?

Mr. STOCKMAN. Sir, was that in the August document?

Chairman NEUGEBAUER. No, this was, I believe, in October. It is "Stress Scenario Analysis Downgrade MF Global, Potential Impact of MF Global."

Mr. STOCKMAN. I see. The scenarios referred to in the March memo are specific to the sovereign risk. And the "break-the-glass" scenario, albeit may have some similar numerology, I am not sure that we are talking apples and oranges just yet.

Chairman NEUGEBAUER. Let me ask you, did you prepare this document, the October document?

Mr. STOCKMAN. I did not prepare that document. That was the work product of the finance and treasury group. I had a senior member of my staff assist in the preparation of that document. And while I was at the company, I actually did not see a final outcome of the document there that you are referring to.

Chairman NEUGEBAUER. So they were doing a stress scenario analysis and you are the risk management officer and you didn't see this document?

Mr. STOCKMAN. I did not see the final outcome of that document while I was at the firm.

Chairman NEUGEBAUER. So the stress scenarios that you were familiar with were the ones that were done in August. Is that correct?

Mr. STOCKMAN. Correct.

Chairman NEUGEBAUER. And you had a different scenario in your August memo than you had in your March memo. Is that correct?

Mr. STOCKMAN. Agreed. Understood, yes, sir.

Chairman NEUGEBAUER. Yes. And what was the difference?

Mr. STOCKMAN. The difference in moving from the March scenario to the August scenarios were, as the market conditions had changed over time, my risk department and myself always tried to keep pace with updating the market conditions and stress scenarios as the market conditions changed. And so what—

Mr. PEARCE. Mr. Chairman, could you have him pull the microphone just a little bit closer?

Chairman NEUGEBAUER. Okay.

Mr. STOCKMAN. I'm sorry.

Chairman NEUGEBAUER. Yes.

Mr. STOCKMAN. So the scenarios that you are referring to, scenarios one and two in March were effectively updated to incorporate more recent market conditions—and apologies for the different numerology, but the basic point was those updated scenarios were to capture some of the more recent market volatility and so forth.

Chairman NEUGEBAUER. Did you have greater concern about the liquidity and market risks in August than you had in March?

Mr. STOCKMAN. As a general matter, that is correct.

Chairman NEUGEBAUER. And did you express that to Mr. Corzine and to the board?

Mr. STOCKMAN. Yes, sir, in a series of meetings as I became more concerned; in particular, in July.

Chairman NEUGEBAUER. In that scenario that you did in August, did you still feel like the company had the ability to meet the liquidity needs, should those scenarios play out?

Mr. STOCKMAN. I apologize. Could you just ask that question again?

Chairman NEUGEBAUER. Yes. So scenarios three and four that you did in August require you spell out additional liquidity requirements should those scenarios play out. Were you able to validate that if those scenarios did play out, that there was sufficient liquidity for the firm to sustain those scenarios?

Mr. STOCKMAN. I see what you are just asking. Sure. Eventually these various discussions about either risk mitigation and, in particular, increased liquidity scenarios, were discussed and debated at the board.

So I would have to suggest—that suggests that there was full information to senior management and board members, and with the understanding that these scenarios could play out and that potential liquidity would be available.

Chairman NEUGEBAUER. Would be available. And what would—

Mr. STOCKMAN. To the best of my recollection.

Chairman NEUGEBAUER. But you didn't. You just reported, but you did not verify whether the liquidity was available. Was that not part of your responsibility?

Mr. STOCKMAN. The actual liquidity function is part of the CFO and treasury area with respect to sources of liquidity. And as it relates to the various discussions and information that I was disseminating in July, those individuals responsible for ensuring that liquidity was available saw this information and then made an informed judgment.

Chairman NEUGEBAUER. So I just want to go back here and recraft. In March, you said to the board that you were concerned, and previously, Mr. Roseman had said he was concerned about these positions. In August, you became more concerned about these positions. And then in October, the company put together a "break-the-glass" thing with much more aggressive scenarios.

And then on October the 24th, during an investor call, Mr. Corzine—this is 7 days before the bankruptcy—stated that MF Global's RTM positions have relatively little underlying principal risk and that the structure of these transactions themselves essentially eliminates market and financing risk.

Do you agree with that statement?

Mr. STOCKMAN. I apologize. Could you just run that statement by me again?

Chairman NEUGEBAUER. Mr. Corzine, on October the 24th, said in a statement with investors, a call with investors, that MF Global's RTM positions had relatively little underlying principal risk, and that the structure of these transactions themselves essentially eliminates market and financing risks.

Mr. STOCKMAN. I had no reason to doubt Mr. Corzine's comments at that point.

Chairman NEUGEBAUER. You wouldn't doubt it? Is that your testimony?

Mr. STOCKMAN. Yes.

Chairman NEUGEBAUER. And 7 days later, the company goes bankrupt? How do you justify that?

Mr. STOCKMAN. Sir, the downfall of MF Global in those final weeks was a very complex issue and contained the confluence of at least three challenging events: one, the negative earnings related to a tax write-off, tax-deferred asset write-off; second, the downgrades that were happening at that point in time; and third, the perception in the marketplace regarding the riskiness of the sovereign strategy.

All seemed to come together in a very short period of time, so that the outcome unfortunately was unpredictable as we walked through that challenging period of time.

Chairman NEUGEBAUER. I see my time has expired.

And now, Mr. Capuano is recognized for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

And I want to thank my colleagues for their indulgence—you are allowing me to run in and out. I apologize, but I have another markup down the hall at Transportation on a very important bill. So, I will be in and out all day.

Mr. Roseman, I want to ask you some questions based on your written testimony. I am just going to actually ask them in the order that they appear. On page three, you make a statement that, "over time, stakeholders, including the rating agencies, etc., etc., gained confidence in MF Global's improvements."

I have the record of both S&P's and Moody's ratings of MF Global and the only time that there was, I guess you could consider it an upgrade, was Friday, July 18, 2008, when all they did was just take away the negative outlook. They kept the triple-B rating, but all they did was take away the negative outlook. And that was actually before you took office at MF Global.

Am I missing something? Am I missing information that I should have?

Mr. ROSEMAN. During discussions with the rating agencies, with myself and others in executive management, they did continue to express their interest.

Mr. CAPUANO. But they didn't take action on ratings. They said good things, but then didn't take it into account when it came to a rating.

Mr. ROSEMAN. Then I maybe misstated in my written testimony.

Mr. CAPUANO. That is fair. Okay.

I guess from your testimony, it certainly seems as though, presuming that in June or July—I'm sorry, May of 2010, you agreed on a $1 billion nominal limit across-the-board. And yet by mid-September, only a few months later, obviously the people who ran the business had completely ignored that board approval, your agreement, and had blown through it almost to the amount of $2 billion.

And then later on, 1 month after that, they have doubled it again. There is no indication here that the board took any action in between that time, so there was an agreement at $1 billion. They ended up at $4 billion by October of 2010.

I am just curious, am I reading this correctly?

Mr. ROSEMAN. No, you are not, sir.

Mr. CAPUANO. Okay.

Mr. ROSEMAN. When the $1 billion limit was approved, that was taken under management delegation authority for risk from the board, so that approval did not have to go to the board of directors. Subsequently, any other limit increases before the $2 billion were also taken internally and approved by myself and Mr. Corzine.

They did not pose what I considered a material issue relative to risk appetite, per se.

Mr. CAPUANO. So you are saying that you and Mr. Corzine were authorized and did in fact agree to go to $2 billion?

Mr. ROSEMAN. Up to $2 billion when it became—

Mr. CAPUANO. That is mid-September 2010. What about the $4 billion by October of 2010?

Mr. ROSEMAN. Sir, when it got to some $2 billion, I don't remember the exact number, then I indicated to Mr. Corzine that we would have to approach the board of directors for approval for further increases.

Mr. CAPUANO. So he went to $4 billion without your agreement and without board approval?

Mr. ROSEMAN. No. I believe at that time, I recall going to the board and discussing the strategy and the limits to get further increases, and there were a few periods in between my written statements where there were meetings with the board's executive committee to approve the limits.

Mr. CAPUANO. So then you are suggesting—again, the written testimony is not that clear, then. You are telling me now that at no time did the investment limits exceed what was agreed to by you and/or the board?

Mr. ROSEMAN. That is my recollection, yes.

Mr. CAPUANO. Okay. That is fair enough. Your statement, in my opinion, is not that clear because if they had, I guess during that time, did anybody know you were doing that? Were you telling— I guess the board did now, obviously. Were you telling the general public? Were you telling your investors? Were you telling the credit rating agencies?

Mr. ROSEMAN. Prior to that time, within the $2 billion number, in my opinion because the risks were controlled, the positions were controlled, the maturity buckets in 3-month, 6-month, 12-month periods, it did not pose a material risk to the company.

Mr. CAPUANO. That is not what I asked. I asked: Were you telling the credit rating agencies? Were you informing your investors that you had indeed hit that number?

Mr. ROSEMAN. I am not aware of myself notifying, to answer your question specifically, the rating agencies. And I am not aware, it is possible, that others had notified them of those positions. But again, we have to keep in account the materiality of the positions and the short-datedness of the positions.

Mr. CAPUANO. So basically, you think there was nothing wrong going on up until $4 billion, when the board then approved up to what, $4.75 billion, if I am reading this correctly?

Mr. ROSEMAN. I would say my comfort level and the board's risk appetite started getting exceeded the approved-risk appetite at that time, I should clarify, got exceeded around $2 billion. That required to go back—

Mr. CAPUANO. So around $2 billion, you and the board were both getting uncomfortable?

Mr. ROSEMAN. No. It is relative to the stated-risk appetite that had been approved, given the prior strategies of the company. At that point, because the strategy was evolving, it was escalated to the board for approval of those specific limits; control the risk.

Mr. CAPUANO. I am missing something. I am asking simple questions. You are telling me the board approved up to $4 billion, and you are saying that you and the board were getting uncomfortable in the $2 billion range?

Mr. ROSEMAN. No. I specifically started becoming more uncomfortable at $2 billion, and I felt there was an excess of the approved boards-approved risk appetite statement at that point in time.

Mr. CAPUANO. And did you tell anybody that?

Mr. ROSEMAN. Yes. I presented it to the board.

Mr. CAPUANO. Did you tell the credit rating agencies that?

Mr. ROSEMAN. At that point in time, that was, I don't think an issue to bring to the credit agencies until after discussions potentially with the board.

Mr. CAPUANO. They were rating you this entire time. They had you in a pretty good watch actually. They kept either affirming or downgrading you pretty much repeatedly from 2008. I have never seen this many credit ratings of a firm by two major credit rating agencies so frequently.

It seems like every couple of months, somebody was rating you.

Mr. ROSEMAN. You have to remember to keep in context to MF Global's history.

As you know, in February of 2008, shortly after the IPO, the company suffered a wheat trading, wheat trading, rogue trading—

Mr. CAPUANO. Yes, I understand that, but I get that is a separate item. I will give you the benefit of the doubt that you addressed that issue. That is why you were hired and okay, that was a problem, but that was a minor problem you took care of it.

I am wondering going forward, as you are getting credit rating agencies in your face every couple of months, then were you telling them that you were uncomfortable at the levels they were at?

Mr. ROSEMAN. First, sir, I didn't meet with the rating agencies regularly. I wasn't the—

Mr. CAPUANO. So the credit rating agencies were rating you without talking to the risk manager?

Mr. ROSEMAN. Periodically, I would. Not every month or every 3 months, but I would say on a regular basis, maybe once or twice a year.

Mr. CAPUANO. And when you talked to them, did you tell them that you were uncomfortable?

Mr. ROSEMAN. Having said that, sir, they had up until that point in time, I firmly believe they had a strong transparency on the risk of the organization.

Mr. CAPUANO. So you told them that, gee, we are over $2 billion, I am starting to get a little nervous?

Mr. ROSEMAN. I did not say that to them.

Mr. CAPUANO. Okay, that is what I was trying to get at.

Mr. Roseman—I'm sorry, Mr. Stockman, when you took office in January of 2011, were you aware of your predecessor's concerns of the $2 billion limit?

Mr. STOCKMAN. Mr. Roseman and I did not spend a lot of time together in the overlap and as a general matter, these were a large position but I was not specifically aware of concerns at that point upon joining.

Mr. CAPUANO. So that as he was leaving, neither did he tell you nor was any documentation that you came across during your period of time that indicated, gee, once they hit $2 billion, my predecessor got a little nervous, maybe I should think about this?

Mr. STOCKMAN. I explored upon arrival a couple of board meeting minutes that covered that period from, to the best of my recollection, November, December, before I joined to try and explore a little bit what had been undertaken just before I joined and in those minutes was no specific indication of concern but it certainly did highlight the risks.

Mr. CAPUANO. So you didn't find anything that basically said that a bell went off and when you came in, there were four-and-a-half, give or take a billion, and that didn't get you nervous? You thought that was acceptable?

Mr. STOCKMAN. I am saying this a little differently, in those board memo minutes, there was an indication certainly that the risks were discussed and highlighted by Mr. Roseman and with the board and that gave me some confidence that there was a full understanding of—

Mr. CAPUANO. I apologize, I am way over my time. I appreciate the generosity of the chairman.

One last question, and I will just jump to it.

At the end, you say you have no personal knowledge of where the money is or what happened. Do you think that maybe this excessive risk and the pressure might have caused the losses that were seen in these excessive risks might have maybe encouraged some of the employees there to either bend or stretch or even possibly break rules?

Mr. STOCKMAN. Sir, I don't think so, and it would be very hard at this point in time and I hope that some point in time we really do understand the details of that situation and in particular, as it relates to these sovereign risks and the analysis that when the last chapter does come through, I think we will be able to see with a bit more clarity what in fact the—

Mr. CAPUANO. Thank you.

Mr. Chairman, thank you very much for your indulgence.

Chairman NEUGEBAUER. Thank you.

I just have one quick follow-up for Mr. Stockman. I just want to go back to this "break-the-glass" report on October the 13th and it says that this report was prepared by Treasury and Finance and Risk teams, that would be your team. Is that right?

Mr. STOCKMAN. Correct, that is what I mentioned before, a senior member from my team provided assistance on some of those scenarios.

Chairman NEUGEBAUER. So this is a plan where these people think they are about to go under, this is a "break-the-glass" deal.

You are the chief risk officer and you are not a part of this plan?

Mr. STOCKMAN. As I said, I had a senior officer doing some of the risk analysis as it relates to the production of that particular document. I was not part of the specific risk team who contributed to that and the Treasury and Finance area really drove the assessment, so yes, I had not seen the final outcome.

Chairman NEUGEBAUER. But you are aware that a document is being prepared, they are getting in the bunker and you agree with Mr. Corzine's statement on October 24th that everything is fine having knowledge that the senior management is working on a plan to go to the foxhole?

Mr. STOCKMAN. Yes, to the best of my knowledge, the "break-the-glass" scenario is really a contingency plan that would have been an intelligent thing to do and under a number of different cases, in particular for a company that was just above investment grade.

So I think that those, as I said, the "break-the-glass" scenario is something that was an intelligent contingency plan to be looking at.

Chairman NEUGEBAUER. What prompted them to do that? It wasn't hey, it is October, why don't we put together a "break-the-glass" strategy. There had to be something that caused them to think that, wouldn't you think that they needed to develop a plan like that?

Mr. STOCKMAN. To the best of my recollection it was a board request and again, I think to find out some detail as to what the request and how it was prepared, would have to be really directed towards our Finance and Treasury group who really drove that.

Chairman NEUGEBAUER. I appreciate the committee's indulgence.

Now, I yield to Mr. Fitzpatrick, the vice chairman of the subcommittee.

Mr. FITZPATRICK. Thank you, Mr. Chairman.

Mr. Stockman, you just indicated that the "break-the-glass" plan was a board request? Was there anybody within the organization who had equal concerns to indicate it was a board concern?

Mr. STOCKMAN. I'm sorry. I didn't hear the question.

Mr. FITZPATRICK. You indicated the generation of this document, "break-the-glass" around mid-October, was a board request, would that have come from within the organization at all?

Mr. STOCKMAN. To the best of my understanding, it came from the board.

Mr. FITZPATRICK. Directly from the board.

You indicated that you didn't spend much time in the transition with Mr. Roseman. Did you spend any time as you passed off the obligations of chief risk officer?

Mr. STOCKMAN. Yes.

Mr. FITZPATRICK. How much time did you spend with him?

Mr. STOCKMAN. Michael and I spent an hour together 2, 3, 4 weeks into my initial—when I first arrived and Michael was helpful in the transition as well with a series of—including a series of e-mails that I vaguely remember receiving, but I couldn't speak to exactly their—

Mr. FITZPATRICK. Mr. Roseman indicates his concern about the risk in excess of $2 billion of sovereign debt?

Mr. STOCKMAN. As a general matter, during that brief discussion that we had for an hour, to the best of my recollection, it was certainly indicated as an item of interest as it relates to the company, but I don't recall any specific discussions on concerns about sovereign risk.

Mr. FITZPATRICK. I want to go back to the October 13th "break-the-glass" scenario which you indicated in response to the chairman's question that you were not directly involved in this plan. Is that correct?

Mr. STOCKMAN. Correct.

Mr. FITZPATRICK. Now, you are the chief risk officer responsible for how many employees of the organization?

Mr. STOCKMAN. On my team, approximately 60.

Mr. FITZPATRICK. Sixty? Your office is in the same building as them?

Mr. STOCKMAN. Yes.

Mr. FITZPATRICK. Liquidity was a key concern of this plan, correct?

Mr. STOCKMAN. The first time I had an opportunity to really look at it carefully was just a day ago when it was provided to me.

Mr. FITZPATRICK. Sir, our committee obtained internal notes from S&Ps October 28th management meeting and the notes contained a discussion of MF Global's "big European exposure." The analyst who drafted these notes also writes that MF Global is scrambling for funding and it had lost its liquidity.

Now, I would like to take you to October 24th, a day right in the middle of when this "break-the-glass" plan was being drafted and implemented and just 4 days before S&P said that MF Global was scrambling for funding.

On the 24th, the MF Global CFO wrote an e-mail to S&P analysts stating, among other things, that he believed MF Global's capital and liquidity "has never been stronger," and that, "MF Global is in its strongest position ever as a public entity."

Can you reconcile those two statements for our committee?

Mr. STOCKMAN. I can't. I don't know in what context our CFO sent that note out. So I couldn't, and to the best of my recollection, I was not part of that dialogue. So I really couldn't speak to that.

Mr. FITZPATRICK. Did you speak with Mr. Steenkamp? Did you speak with him around that time?

Mr. STOCKMAN. Not on this subject, no.

Mr. FITZPATRICK. Given what you know about the liquidity challenges that MF Global was facing now on October 24th, and which the "break-the-glass" plan had foreseen, how do you think that Mr. Steenkamp could make this representation to a credit rating agency?

Mr. STOCKMAN. Yes, again, I would be speculating as to what context Mr. Steenkamp was referring to. And it would be hard for me to give you a comment as to why and what the context was for that particular note.

Mr. FITZPATRICK. Were there internal meetings between your treasury people, your risk people, and your finance people in the creation of this document?

Mr. STOCKMAN. There were.

Mr. FITZPATRICK. And were you involved in any of those meetings?

Mr. STOCKMAN. Very early on, as the treasury and finance team was pulling the document together, and as I mentioned before, subsequent—excuse me, after that point in time, a senior member of my staff assisted in the creation of that document as it relates to some of the various stress scenarios.

Mr. FITZPATRICK. Mr. Stockman, $1.2 billion of customer money is missing. I have constituents who have lost a significant amount of money. Your risk team is putting together what is essentially an Armageddon plan for the organization, and you want the committee to believe that you had no direct involvement in the creation of the plan and you never saw the plan until very recently?

Mr. STOCKMAN. Again, sir, I mentioned that a contingency plan such as that was certainly sensible. And that is—I am just giving you the stated truth of my involvement in it.

Mr. FITZPATRICK. I thank the chairman.

Chairman NEUGEBAUER. I now recognize Mr. Miller for 5 minutes.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

Mr. Stockman, in response to Mr. Capuano's questions, you said that you only spent an hour with Mr. Roseman and that the subject of his concerns about the sovereign debt positions did come up.

But you also knew that you were being hired from the outside to replace a CRO who was being asked to leave. Did you have any conversations in your interviews about why Mr. Roseman was leaving and if it had to do with his risk appetite?

Mr. STOCKMAN. In those conversations, it was a congenial meeting. We talked a little bit about—it was a congenial meeting. We talked about how the concept of my being hired was really related to the company's stated goals of transitioning from a broker, futures commissions broker, to a broker-dealer, and that my skill set had more history and was more aligned with what the firm was trying to do.

So it was really more about that as it relates to their hiring.

Mr. MILLER OF NORTH CAROLINA. And that is the reason they gave you that Mr. Roseman was being asked to leave? Did they discuss his risk appetite? Did they have a discussion with you about risk appetite for the firm, what they wanted to have for the firm?

Mr. STOCKMAN. As a general matter, yes, we talked about—if you are referring to the point of when I got to the firm, we certainly talked about stated goals going forward and the types of analysis and assessment that would have to be performed in order to accommodate that.

Mr. MILLER OF NORTH CAROLINA. According to published reports, Mr. Roseman had direct access to the CEO and to the board. And when you came in, your access was no longer to the CEO, no longer to the board, but to the COO. Did you have a discussion about that change in organization?

Mr. STOCKMAN. Yes. It made—

Mr. MILLER OF NORTH CAROLINA. Did you have any questions about whether concerns that you might have about risk would make it to the board?

Mr. STOCKMAN. No, sir, my—I reported directly to the COO and had responsibilities to report to the board from time to time on risk matters to the best of my understanding—

Mr. MILLER OF NORTH CAROLINA. Did you ask why you were no longer talking to the board?

Mr. STOCKMAN. No, sir, let me make sure I correct you on this. While I reported directly to the COO, I also had obligations to the board to report on risks and highlight risks similar to my predecessor. So I had access to the board, if that is the—

Mr. MILLER OF NORTH CAROLINA. Okay. Published reports are that your role basically consisted of helping prepare PowerPoint presentations for Jon Corzine to make to the board. Is that incorrect?

Mr. STOCKMAN. That is incorrect.

Mr. MILLER OF NORTH CAROLINA. Okay. Mr. Neugebauer read a statement that Mr. Corzine made to investors shortly before the collapse that the repo-to-maturity presented no threat to capital of any consequence. A week before the collapse, the CFO, Mr. Steenkamp, told Standard & Poor's, S&P, that MF Global was in its strongest position ever. And actually, while Moody's had downgraded MF Global to junk status 4 days earlier, at the time of the collapse, S&P still had MF Global at investment grade.

Were you consulted in any way on the representations made by Mr. Corzine or by Mr. Steenkamp?

Mr. STOCKMAN. I was not.

Mr. MILLER OF NORTH CAROLINA. Did you know those representations were being made?

Mr. STOCKMAN. Mr. Corzine's comments, I believe, were public, if I understood the quote that you were referring to. And the representation, as I mentioned before from Mr. Steenkamp, I was not involved or couldn't represent him on what the context was that he was—

Mr. MILLER OF NORTH CAROLINA. Did you pass along to anybody that you disagreed with those representations, that you thought there was, in fact, risk? Who did you tell?

Mr. STOCKMAN. Sir, as I mentioned, as far as the risk highlights and risk reporting goes, for example, at the August board meeting, there was quite a detailed representation of both verbal and a PowerPoint presented. Is that the sort of example you are referring to?

Mr. MILLER OF NORTH CAROLINA. Okay. You had an auditor, PricewaterhouseCoopers. Did they raise any concerns about the previous reporting relationship between Mr. Roseman and the CEO and the board and the change that you reported to the COO?

Did they raise any concerns with the processes that MF Global had in place for proprietary trading and account segregation? Was PricewaterhouseCoopers, did they know about all this, did they know about the changes that were made, did they know about the ending of the direct reporting to the board by the CRO?

Mr. STOCKMAN. I was not involved in any direct relationships or discussions with Pricewaterhouse.

Mr. MILLER OF NORTH CAROLINA. Are you aware of any? Did anyone tell you they talked to PricewaterhouseCoopers or that PricewaterhouseCoopers had raised any kind of concern or they had said, "It is okay with us?"

Mr. STOCKMAN. Not to my understanding.

Mr. MILLER OF NORTH CAROLINA. You know of no discussion at all, of any conversation, any communication with PricewaterhouseCoopers about the changes in the organization of MF Global, the changes in the reporting relationship between the CRO and the board or any changes or anything regarding the processes for proprietary trading and account segregation?

Mr. STOCKMAN. To the best of my recollection, I was not involved in those discussions.

Mr. MILLER OF NORTH CAROLINA. Did you have a conversation at a water cooler? Did you hear anything? Was there a rumor?

Mr. STOCKMAN. Again, I wasn't responsible for the PricewaterhouseCoopers relationship or what—

Mr. MILLER OF NORTH CAROLINA. I know that. Did you hear about it? Every organization is a rumor mill. Were there no discussions within the organization?

Did you hear from anybody whether PriceWaterhouseCoopers was okay with all of this?

Mr. STOCKMAN. Again, I come back to my original comment. To the best of my recollection, I was not aware of specific conversations regarding the items you just mentioned.

Mr. MILLER OF NORTH CAROLINA. My time has expired.

Chairman NEUGEBAUER. Now, Mr. Posey is recognized for 5 minutes.

Mr. POSEY. Thank you very much, Mr. Chairman. It appears—just trying to put the pieces of the puzzle together as simply as possible—that Mr. Roseman was a chief financial officer until he stopped telling Mr. Corzine what he wanted to hear. And so, then Mr. Stockman was hired to tell Mr. Corzine what he wanted to hear. Just saying. That is clearly how it appears so far.

I read an article, "Sold Out: MF Global Investor Protections Trampled in Private Meeting Between Government Regulators."

I would like to begin by asking Mr. Stockman just a few questions about that meeting. Do you know about the meeting with the SEC, JPMorgan, Goldman Sachs, and others?

Mr. STOCKMAN. No, sir, I wasn't involved with those meetings, if I understand which ones they were.

Mr. POSEY. Did you know about the meeting?

Mr. STOCKMAN. I was aware as a general matter, but I was not involved with those meetings.

Mr. POSEY. Do you know the names of those who were there?

Mr. STOCKMAN. I do not.

Mr. POSEY. How did you find out about the meeting?

Mr. STOCKMAN. If it is the SEC meetings that you are referring to, some of this was in the public and as a general matter—

Mr. POSEY. Rumor mill or—

Mr. STOCKMAN. I don't recall exactly where, but as I said, I was not involved with those.

Mr. POSEY. Do you know the names of anyone who was there, under oath?

Mr. STOCKMAN. Under oath, to the best of my knowledge, again, making sure I understand which meetings you are referring to, I wasn't aware of who was at those meetings.

Mr. POSEY. Clearly, the October 31st meeting, which you mentioned, was with the SEC. Do you know the names of anyone who was at that meeting? Rumored? First-hand? Second-hand? Third-hand Fifth-hand? I want to know if you know about anyone or about anyone who was at that meeting.

Mr. STOCKMAN. I do not.

Mr. POSEY. Did you find out after that meeting what transactions were made by MF Global Holdings?

Mr. STOCKMAN. No, sir.

Mr. POSEY. You don't know what decisions came out of that meeting, what they decided to do with assets, how they decided to hose the investors? You don't know any of that? You have not heard of any of that anywhere?

Mr. STOCKMAN. Sir, if you are referring to the final days of the company wind-down, is that what you are referring to?

Mr. POSEY. You are the risk manager. I am just a Congressman trying to put pieces together. You have more knowledge of this in your little finger than everybody up in this board has, and we are trying to get you to tell us a little bit, so that we may better protect the public, and maybe for the first time in 4 years have some accountability for the thieves who are plundering the public. It is important for you to be honest with us and tell us everything you know about this situation in order to do that.

Your testimony, what you knew about it, did you want say, this is all I know about it; you said, this is all I care to say about it. This meeting is very, very critical what went on at this meeting. I want to know everything that you know about that meeting, and I am not going to stop asking questions about it on record, under oath, until the chairman makes me, unless you start answering some of them.

Mr. STOCKMAN. I wouldn't be able to answer to the question in any different way, because I was not there, or involved at that meeting.

Mr. POSEY. The last question I asked you was the result of what came out of the meeting. Certainly, you knew what transpired after the meeting, didn't you? There was a decision about selling some assets, who was going to get priority of the assets. Tell me what you know about that subsequent to the meeting, please.

Mr. STOCKMAN. Subsequent to the meeting, I was not involved in the wind-down of the company or in its decision to file for bankruptcy. So I was not in the area, so to speak, when actual specific decisions were being made regarding which assets to sell in the wind-down.

Mr. POSEY. So you are saying you don't even know what decisions were made?

Mr. STOCKMAN. I am saying that I was not involved in the wind-down of the company during that period of time, when assets and decisions were being made to reduce exposure.

Mr. POSEY. Who do you think is the best person to know what went on in that meeting?

Mr. STOCKMAN. Again—

Mr. POSEY. Under oath, I know.

Mr. STOCKMAN. I am really just saying that not having been a participant or invited to the meeting that you are referring to, I think it wouldn't be hard to figure out who the attendees were. But as you asked before—

Mr. POSEY. Out of 400 million people in the United States of America, it could have been any of them; is that what you are telling me?

Mr. STOCKMAN. No, sir. I am just saying, simply saying, that not having either been invited to that meeting or a participant at that meeting, that I wouldn't know—

Mr. POSEY. And you have no clue who would have been there?

Mr. STOCKMAN. It would make sense that some senior management would have been there.

Mr. POSEY. And some names maybe?

Mr. STOCKMAN. Our senior management is—again, it is hard for me to be very specific because this particular meeting, I was neither invited nor a participant. So it is just—

Mr. POSEY. Listen. You were not a lowly clerk in that organization. You know darn good and well what is going on within that organization. And you know darn good and well who you think should have been at that meeting. I am just asking you to be honest with us and do it.

Mr. STOCKMAN. Again, I just have to keep coming back to, I could only imagine—

Mr. POSEY. Mr. Roseman, can you give me any ideas? Obviously, you needed to be replaced by this guy. But maybe you have a little bit better knowledge of how that organization works.

Mr. ROSEMAN. Clearly, I wasn't there, but in Mr. Stockman's defense, it sounds like he wasn't at the meeting. But after the fact, I am sure there was some direction that was given to individuals. I wasn't there, so I can't respond whether or not he knows what actions were given out or otherwise.

Mr. POSEY. Who do you think would have been in attendance at the meeting?

Mr. ROSEMAN. Certainly, if it were a very concerning meeting like you are suggesting, I would expect Mr. Corzine to be there. I would have expected Mr. Abelow to be there, and maybe a few other members of executive management, but at least these two individuals.

Mr. POSEY. Okay.

Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I hate to do this, gentleman, but we are going to have to—

Mr. ROSEMAN. That is speculation, though, of course.

Chairman NEUGEBAUER. —move on. Ms. Waters?

Ms. WATERS. Thank you very much, Mr. Chairman. It is clear to me what was taking place at MF Capital. And I think that this information has come out in a previous hearing or previous hearings. Mr. Corzine basically was a one-man show. He was the chairman and CEO, and he threatened the board when they got in the way of his sovereign trading. He was glad when Mr. Roseman left. He hired his own people. He did his thing.

And so, I think there is no question that Mr. Corzine violated many of the rules of the game, in terms of being the chief and prolific trader who emerges out of all of this information. My real concern is what happened to the customer assets and the loss of $1.2 billion in these customer funds? Mr. Stockman, what do you know about the decision that was made to utilize these customer funds despite the fact they were supposed to be segregated and protected?

Mr. STOCKMAN. Ma'am, in my opening statement, I noted that I have no specific knowledge of client funds or segregated funds. And as far as my job duties, they were not involved with the treasury or—

Ms. WATERS. What nonspecific knowledge do you have?

Mr. STOCKMAN. I have no specific or nonspecific knowledge of—

Ms. WATERS. So you knew nothing about any decisions that were made to use these customer funds? You know nothing about that? Is that correct?

Mr. STOCKMAN. That is correct.

Ms. WATERS. All right. Given everything that has happened, what would you do differently?

Mr. STOCKMAN. That is a terrific question. We think that when the final chapter is written, I believe, at the moment, it is a little preliminary to make specific decisions and recommendations—

Ms. WATERS. I didn't ask for recommendations. You were the risk officer. You had the responsibility of at least alerting the board of directors or somebody about what was taking place. Obviously, you didn't do it.

What would you do differently today? I don't want to talk about any recommendations. I don't want to talk about any—I simply want to know, if the position that you are in now, having been the risk officer, everybody looking at you and wondering where were you? You were absent or not absent. What would you do differently?

Mr. STOCKMAN. Ma'am, I think the absent comment—I want to challenge you on that a little bit, which is to say that myself and my risk management team, we did our job during this period. We highlighted, analyzed, assessed risks, made transparent and clear to both senior management and the board the risks that we were running at the firm.

Ms. WATERS. Who did you give this information to?

Mr. STOCKMAN. Senior management and the board. And then, informed and sophisticated business judgments were made, based on my department's assessments.

Ms. WATERS. You may have said this already—excuse me; we only have so much time. In your report to the board or the management, did you say that this company was being placed in a highly risky situation with the sovereign debt trading that Mr. Corzine was involved in?

Mr. STOCKMAN. Ma'am, for example, in the August board report, it was clearly highlighted in both written and verbal presentations to the board and senior management: number one, increased risk in the marketplace overall from the summer of volatility; number two, widening credit spreads; number three, increasing probabilities of default; number four, lowering liquidity in the marketplace; and number five, in particular, the increasing liquidity stress—

Ms. WATERS. So in essence, you felt you did your job? Is that right?

Mr. STOCKMAN. That is correct.

Ms. WATERS. And there is nothing that you would have done differently?

Mr. STOCKMAN. Ma'am, obviously, let me say with the benefit of 20–20 hindsight, there are things that we would have done differently, knowing what we know now.

Ms. WATERS. My time has expired. I yield back.

Chairman NEUGEBAUER. We thank the gentlewoman.

Mr. Renacci is recognized for 5 minutes.

Mr. RENACCI. Thank you, Mr. Chairman.

Mr. Stockman, I am over here on this side.

Mr. STOCKMAN. Okay.

Mr. RENACCI. Again, looking at all the questions you are hearing and getting, you are probably starting to understand that Mr. Roseman at least saw some issues, brought them to the board and, at the time, the board wasn't happy with the decisions he was making, so they went out and hired somebody else. And that was you.

So my question was, who recruited you? How did you come to this position?

Mr. STOCKMAN. I came to the position through a search firm and then went through an extensive interviewing process.

Mr. RENACCI. Okay. Who ended up hiring you ultimately? Mr. Corzine?

Mr. STOCKMAN. Do you mean, effectively, who made the decision?

Mr. RENACCI. Yes.

Mr. STOCKMAN. I was hired and directly reported to Mr. Abelow.

Mr. RENACCI. So, Mr. Corzine had no influence in that decision?

Mr. STOCKMAN. Oh, I am sure, as a matter of senior management, when you recruit for a senior position, I certainly interviewed with Mr. Corzine, but there was an extensive interview process with both Mr. Corzine and the board.

Mr. RENACCI. Were you asked during the interview process your opinion at any time of MF Global's appetite in taking a greater position in the European backed RTMs?

Mr. STOCKMAN. The European backed RTMs specifically, to the best of my recollection, didn't come up during the interview process which, as a general matter, wouldn't be that unusual as it relates to proprietary positions for somebody who isn't hired yet.

Mr. RENACCI. Do you believe in any way that MF Global's increased appetite, maybe during this discussion, this interview process, would have been a prerequisite of you being hired? Or do you think that was totally not a position or their decision?

Mr. STOCKMAN. Yes. I believe it was not a prerequisite and, as I mentioned, not specifically discussed. And it was really about—the interview and hiring process was really about my skill set and where the firm had its stated goals were and where it was going.

Mr. RENACCI. Okay. You said in your testimony that you noticed after you were hired, there was some concern noted, I think in the board minutes, that Mr. Roseman had addressed with the board, related to increased positions being taken in European-backed RTMs. What did you do after that? Did you just ignore that? Did you look into it? You were the risk officer. What did you do with that information?

Mr. STOCKMAN. I began, soon after I arrived at the firm, to do my own analysis. And I was assisted by my department, and that analysis included a number of features and grew more sophisticated with every month that went by during my tenure. So the analysis included a number of elements; in particular, liquidity risk.

Mr. RENACCI. You also said in your testimony that you felt their positions were acceptable. Is that correct?

Mr. STOCKMAN. Correct. In the context of the first 3 or 4 months, while market conditions were what they were, much more benign and favorable, I found that the risk and reward were acceptable. And then, as we have discussed, in July, I had a change of view.

Mr. RENACCI. So as all this was going on, as you look back through the minutes, you had no concerns about the potential outcome? You were comfortable that everything was going okay, right down to the last minute?

Mr. STOCKMAN. Sir, I highlighted the risks, as I mentioned, in very specific form and fashion. And in those early few months, as I mentioned, I found them acceptable. Market conditions changed. And so did my view.

Mr. RENACCI. My background is financial also. And I have had to deal with a lot of companies. There comes a time when you realize things are going in the wrong direction and you really start to throw up some flags. Did you ever do that? Or did you—

Mr. STOCKMAN. In July, as market conditions changed, that is when I began to recommend that the company think through carefully, not only really understanding the increased risk profile but that we consider hedging or reduction strategies.

Mr. RENACCI. Mr. Roseman, regarding the "break-the-glass" plan, are margin calls or liquidity risk the kind of risk with which a chief risk officer at MF Global might concern himself?

Mr. ROSEMAN. Certainly, liquidity risk is always a material concern. If you look at all companies that have failed, ultimately, it is generated by a liquidity risk event, or more often than not. Certainly, you need to have a very good understanding of the liquidity risk that the organization is facing, including margin calls.

Mr. RENACCI. You did throw up the red flag to Mr. Corzine a couple of times. Can you just briefly tell me what his opinion was of your red flag being thrown up?

Mr. ROSEMAN. Initially, there was certainly disagreement on the potential price risk or default risk associated with the positions in regard to capital risk. At that point in time, as I put in my written and verbal statements, there wasn't necessarily concern about liquidity risk because the firm had more than enough liquidity to handle the initial positions.

As the positions started to grow in the fall, that is when I expressed my growing concerns about the liquidity risk, and the risk department presented to me, and I presented to Mr. Corzine, plausible—what I considered potential scenarios around initial margin and variation margin.

Mr. RENACCI. Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Carney is recognized for 5 minutes.

Mr. CARNEY. Thank you, Mr. Chairman.

This is fairly complicated for me, so I just want to try to better understand some of the basics here. I would like to start a little bit where Mr. Renacci left off with you, Mr. Roseman, about when you raised the flag, and if you could explain for me what you think caused the problem here.

You started to outline it, and then the answer that you just finished with Mr. Renacci, if you could just walk me through that in as simple a way as you can, and tell me how you thought the risk management process here fell apart or didn't work right, and how it maybe should have happened.

Mr. ROSEMAN. The first thing that I think the committee needs to realize is, as Mr. Stockman stated as well, the sovereign positions and the associated risk with those positions were very well communicated, very transparent within the organization and to Mr. Corzine and to the board.

Mr. CARNEY. The risks associated with everything that was going on were clearly laid out to Mr. Corzine and the board and they decided to go forward, notwithstanding some of those understanding what the risks were.

Mr. ROSEMAN. In fairness to them, as in other events, for events that haven't occurred before, sometimes there is a difference of opinion on the view of what might happen. The challenge there, though, is if you get it wrong, then you have an event such as what happened with MF Global.

Mr. CARNEY. So in your position as global risk manager, what is your role in that conversation?

Mr. ROSEMAN. My role is to articulate my view on what the risks are to the organization. And I also ensure there is enough cushion within the company's means to support the risk and make sure that the risks that the company is taking are aligned with the strategy of the company and that is an ongoing concern.

Mr. CARNEY. So, you obviously were moved out of the position and Mr. Stockman was put in the position. Is that because management was unhappy with the advice that you were providing?

Mr. ROSEMAN. I'm sorry. You are asking why I was replaced?

Mr. CARNEY. Yes.

Mr. ROSEMAN. I am really not in a position to answer that. I would say that my views on risk certainly played a factor in the decision.

Mr. CARNEY. So regardless of that happening, what happened after you left, and where do you think the company went wrong from that point on?

Mr. ROSEMAN. In my opinion, there is a sovereign strategy in itself, but in a broader context the firm was pursuing an investment banking strategy that was clearly articulated by Mr. Corzine to the public, to shareholders, and to others. That strategy certainly required resources, capital, liquidity to fully support. It was important to manage the strategy within the means. And I do think that strategy maybe exceeded the ability of the resources.

Mr. CARNEY. Are there lessons here with respect to how systemic risk is implicated with this particular case that should concern us as members of the Financial Services Committee?

Mr. ROSEMAN. I'm sorry. Could you repeat that?

Mr. CARNEY. Are there systemic issues that we ought to be concerned about as members of this committee with respect to what happened at MF Global?

Mr. ROSEMAN. As I put in my written statement, I think one of the main takeaways is, again, firms need to be very mindful of the concentration risk that they are running and the implications of the stress scenarios related to that concentration risk. Clearly, during the mortgage crisis, it was the same. Some of the firms that failed had concentrations in the mortgage securities, and we know the outcome that occurred there.

I certainly think, again, that needs to be revisited.

Mr. CARNEY. The issue of concentration?

Mr. ROSEMAN. Concentration risks, large positions within a company that a company may hold.

Mr. CARNEY. Right. Thank you very much. I see my time has expired, so I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

Now, the gentleman from New Mexico, Mr. Pearce, is recognized for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman.

At my prayer breakfast this morning, we talked about how man doesn't live by bread alone; $1.2 billion worth of bread has been disappearing off the table out there.

Mr Stockman, what was your salary when you were hired?

Mr. STOCKMAN. My salary began at $300,000.

Mr. PEARCE. How much?

Mr. STOCKMAN. $300,000 U.S.

Mr. PEARCE. And what about you, Mr. Roseman, when you departed either ceremoniously or unceremoniously?

Mr. ROSEMAN. At $350,000.

Mr. PEARCE. $350,000. So you have chief operating officers, you have CEOs, you have a chief executive officer, you have a chief risk officer. They all begin with a "C." Does that mean anything, Mr. Stockman? In other words, it doesn't sound like you are in many of the real management meetings. You are just kind of left out of those. Am I hearing you correctly?

Mr. STOCKMAN. Sir, my responsibilities—

Mr. PEARCE. I didn't ask about your responsibilities. I said you were left out of the key meetings. You didn't know. You were answering some of the questions from the other side and you didn't know who might be at those meetings. You didn't answer Mr. Posey.

So it appears that you weren't there. When you were with other firms, did you get to sit in on senior management meetings at those other firms as a risk officer or whatever level you were?

Mr. STOCKMAN. At meetings that were appropriate to—

Mr. PEARCE. At UBS, did you get to sit in on things where they talked about the risk of the company, the future of the company?

Mr. STOCKMAN. The—

Mr. PEARCE. Just "yes" or "no" would work.

Mr. STOCKMAN. I'm sorry?

Mr. PEARCE. "Yes" or "no" would work. Did you sit in on the key meetings where the risk and the future of the company was at stake?

Mr. STOCKMAN. As chief risk officer of the Americas at UBS, I did not sit in at the highest levels.

Mr. PEARCE. You were not. Is that right? You were not?

Mr. STOCKMAN. No.

Mr. PEARCE. Okay. So Friday, October the 21st, that management team met with Moody's. Did they come back and report to you, kind of as the chief risk officer, that, "Oof, things might not be going so good over there; they are now a little bit worried about what they are seeing." Did they come back and relay that to you, the chief risk officer?

You are the head guy in charge. You are not wearing a hard hat in risk management. You are right up there with the fancy pinstriped suit guys. Did they come back and tell you anything at all about what Moody's says might be happening to you?

Mr. STOCKMAN. The key contact at Moody's was our CFO.

Mr. PEARCE. I didn't ask that. I said, did they come back and tell you anything? Kind of raise the storm flag—

Mr. STOCKMAN. Not directly to me.

Mr. PEARCE. They didn't share anything with you?

Mr. STOCKMAN. Correct.

Mr. PEARCE. Did you ever think that maybe they ran off Mr. Roseman and brought you in to be the kind of a guy who doesn't see, tell, know? Did that ever occur to you?

Mr. STOCKMAN. No, sir.

Mr. PEARCE. It didn't?

Mr. STOCKMAN. No.

Mr. PEARCE. What about off-balance sheet stuff? I am looking here at your "break-the-glass" thing, and it says, "we are going to prevent the off-balance sheet drains." When I read that—and I know I am just a suspicious character—it brings to mind Enron doing all this fancy stuff around the edges and having fast-moving traders, and they are moving all up and down and shucking and jiving and moving around.

Did it ever occur to you that maybe off-balance sheet stuff was something that you shouldn't be signing off on as a chief risk officer, the CRO, the "C" in the risk deal? Did it ever occur to you that you should maybe say something about that?

Mr. STOCKMAN. The off-balance sheet treatment, I think—

Mr. PEARCE. Would you move the microphone a little closer?

Mr. STOCKMAN. The off-balance sheet treatment that you are referring to, if you are referring to the sovereigns, was fully established prior to my—

Mr. PEARCE. I didn't ask you if it was fully established. I said, did you ever think you ought to say something about that? Is it normal where you are doing off balance sheet trading at UBS?

Mr. STOCKMAN. To the best of my recollection, there was off balance sheet trading. But if you are referring to—again, if you are referring to MF off balance sheet the—

Mr. PEARCE. Is off balance sheet legal?

Mr. STOCKMAN. That is an accounting treatment.

Mr. PEARCE. Is off balance sheet legal?

Mr. STOCKMAN. Again, I am not an accounting expert. But under—

Mr. PEARCE. But you are the one who has to certify the risk. And so, I don't care if you are an expert or not on accounting. I am asking you, as the "C,"—CRO, CEO, COO, you are one of the C's—is it legal?

Mr. STOCKMAN. To the best of my understanding, it was performed under accounting principles and—

Mr. PEARCE. Is it ethical?

Mr. STOCKMAN. That is a hard question to answer.

Mr. PEARCE. You are the "C" guy. We hired you. We hired you to be the head "C" guy. CRO. You have to say it. Nobody else in the organization is responsible for telling some risk of off balance sheet stuff. Is it ethical?

Mr. STOCKMAN. Again, ethical is as it relates to accounting treatment and how the off balance sheet statements are prepared, are guided by accounting principles and I don't have a strong view as to—

Mr. PEARCE. I get the drift. You don't have to keep going. I get the drift, and $1.2 billion worth of people got the drift. We are hiding around the corners, we are doing stuff that we don't know is legal. We certainly will not say it is ethical or unethical. And we are deeply sorry.

I read your testimony. It is the same as Mr. Corzine's. "Deeply sorry. Deeply, deeply sorry." Did you call one of these—I have a guy in my district who lost $5,000 at Christmastime. Did you call anyone? $1.2 billion divided by 5,000, that is a lot of people. Did you call one of them?

Mr. STOCKMAN. I have not, sir. And I, again, I—

Mr. PEARCE. Deeply sorry, though, you are deeply sorry?

Mr. STOCKMAN. And I—

Mr. PEARCE. I see.

Mr. STOCKMAN. —are found by—

Mr. PEARCE. Have you suggested that maybe you ought to give your pay back and put it into a scholarship fund for these kids who aren't going to go to college, or some hog farmer who is trying to make ends meet? My dad raised pigs, so I know what it is like. He is trying to pay for the next sack of feed, and you guys got up $1.2 billion and you are hiding around on the definition of whether it is legal, on whether it is ethical or unethical?

I don't think shame reaches Wall Street, but if it did, maybe you should be looking at how much you are paid and what you are paid for. Thank you.

Chairman NEUGEBAUER. I thank the gentleman. And now, Mr. Canseco.

Mr. CANSECO. Thank you, Mr. Chairman.

Mr. Stockman, one very brief question here just to follow up on some of the questions that have been asked already.

Mr. STOCKMAN. Sir, I apologize for interrupting. I wanted to just make sure that it was understood, if there was any confusion, that I did attend the Moody's meeting. I am not sure there was, but I just wanted to confirm.

Chairman NEUGEBAUER. Thank you.

Mr. CANSECO. Let me ask a question now, Mr. Stockman. When did MF Global first approach you? I know that you went through an agency. But when did you first meet? When did MF Global first approach you, either by letter or by phone call or otherwise?

Mr. STOCKMAN. To the best of my recollection, in September or October, possibly October of 2010.

Mr. CANSECO. Right. And by what means was it? Letter, phone call, e-mail?

Mr. STOCKMAN. Phone call.

Mr. CANSECO. Phone call. And did you go and visit with them shortly thereafter?

Mr. STOCKMAN. Shortly thereafter, I had a series of interviews, yes.

Mr. CANSECO. Okay. And was it your headhunter or agent who called you? Or was it someone at MF Global who called you?

Mr. STOCKMAN. This was through a search firm.

Mr. CANSECO. So your search firm called you up and said, "MF Global wants to meet with you." Is that correct?

Mr. STOCKMAN. Correct.

Mr. CANSECO. And it was in October?

Mr. STOCKMAN. To the best of my recollection—

Mr. CANSECO. Early October or late October?

Mr. STOCKMAN. I apologize. To the best of my recollection, it was in and around that period.

Mr. CANSECO. Mr. Roseman, you were told that you were no longer needed as chief risk officer of MF Global in January of 2011. Is that correct?

Mr. ROSEMAN. Yes, sir.

Mr. CANSECO. Okay. So the CRO is an important job, and I imagine that, in order to replace you, it would require at least a few months of a search process. Do you know when MF Global began to search for your replacement?

Mr. ROSEMAN. I do not, sir.

Mr. CANSECO. Okay. In what month was your biggest disagreement with Jon Corzine over liquidity risk of European sovereign RTMs?

Mr. ROSEMAN. I would say the discussion started becoming much more material in September.

Mr. CANSECO. Okay. In what month was it that you made your presentation to the board, saying that the board should not follow Mr. Corzine's advice to increase MF Global's European sovereign RTMs?

Mr. ROSEMAN. I did a full presentation in November.

Mr. CANSECO. Do you have an opinion on whether or not your presentation had anything to do with your removal?

Mr. ROSEMAN. As I said before, I am really not in a position to respond to that. but, again, I do think my views on risk would have played a part.

Mr. CANSECO. Thank you for your candor. And I thank you for your answers.

In testifying before the House Agriculture Committee, Mr. Jon Corzine said that he replaced you as chief risk officer because MF Global, "needed someone in the chief risk officer position who was more fully attuned to the broker-dealer side of our business than what Mr. Roseman's background was about." And there were other issues about how people worked with each other."

So, Mr. Roseman, you have a very impressive resume and a wide variety of experience in the financial industry. Do you believe that your background was not fully attuned to the broker-dealer side of MF Global's business?

Mr. ROSEMAN. I would fully disagree with that statement. I certainly had the experience in investment banking prior to MF Global.

Mr. CANSECO. Okay. So it is true that you have a very strong financial background and experience and a good, strong resume? You would agree with me there, right?

Mr. ROSEMAN. Yes, I appreciate you saying it that way, but I would say I certainly had a strong background.

Mr. CANSECO. All right. Thank you.

Mr. Stockman, in a letter to a subcommittee, Moody's indicated that they did not understand until August 21, 2011, that the European sovereign debt portfolio was part of MF Global's trading book. Did that surprise you, since MF Global had disclosed this exposure several months before?

Mr. STOCKMAN. Yes, I was not fully attuned to exactly the dialogue but, yes, I would find that surprising.

Mr. CANSECO. You found it surprising? Even though MF Global had disclosed the exposure several months before? So it should have been no surprise, right?

Mr. STOCKMAN. Again, I couldn't tell you exactly the context in which Moody's was making their statement, but I thought that our disclosures were both adequate and robust.

Mr. CANSECO. What was MF Global's initial response to inquiries from Moody's about the exposure?

Mr. STOCKMAN. When you say initial inquiries, can you help me with—

Mr. CANSECO. Don't parse it. What was the company, MF Global's, response to inquiries from Moody's? You are the chief risk officer.

Mr. STOCKMAN. Right. As also mentioned by my predecessor, I was not the key contact and I had very little direct contact in terms of discussions with the rating agency.

Mr. CANSECO. But let me ask you this. You are the risk officer. I don't care who you told. But when you heard about this, what response would you have given to Moody's about this, that they didn't realize that European sovereign debt was part of the trading book of MF Global?

Mr. STOCKMAN. Again, I probably would want to talk more, understand more specifically what their reference to the trading book and otherwise was, because as I mentioned before, I thought that our disclosures were both adequate—

Mr. CANSECO. And that is what your response would be, that your disclosures were adequate?

Okay. On October 13, 2011, executives at MF Global put together a "break-the-glass" presentation that outlined what MF Global would do in the event of a credit rating downgrade. That was prepared by the chief risk officer—and that would be you—the CFO, and the MF Global treasury department.

Why did MF Global find it necessary to draft a "break-the-glass" presentation?

Mr. STOCKMAN. As mentioned before, this initiative, to the best of my understanding, was at a board request. The CFO and treasurer really drove that strategy, or that analysis. And one of my senior officers helped out on creating some of the scenarios in there. So that was the genesis of that contingency plan.

Mr. CANSECO. I see that my time has expired, but I don't think you have been very candid with us. Thank you, Mr. Stockman.

Chairman NEUGEBAUER. The gentleman from Tennessee, Mr. Fincher is recognized.

Mr. FINCHER. Thank you. Thank you, Mr. Chairman.

Thank you, gentlemen.

Did you have previous relationships with any of the board members?

Mr. Stockman?

Mr. STOCKMAN. I did not have previous relationships with any of the board members, no.

Mr. FINCHER. You didn't know them at all?

Mr. STOCKMAN. No.

Mr. FINCHER. None of them?

Mr. Corzine, Governor Corzine? How long did you know him personally?

Mr. STOCKMAN. I had—I didn't—sorry. Are you asking how long I knew Mr. Corzine?

Mr. FINCHER. Personally, yes.

Mr. STOCKMAN. Personally? I didn't know Mr. Corzine personally, but I had worked at Goldman Sachs a number of years prior.

Mr. FINCHER. You said a few minutes ago that you did your job, that you reported information to the board, to Mr. Corzine, and they made the decisions.

Mr. Roseman, you also said you did your job; you reported the information.

Like my colleague, Mr. Pearce, I have a district where many, many people lost thousands of dollars—farmers, ranchers. It almost looks like they took Mr. Roseman out and replaced Mr. Roseman with a "yes man."

Does it look that way to you guys? Does it?

Mr. Roseman, would you comment at all, that you gave them information that they didn't like so they replaced you and put someone in who gave them information that they liked?

Mr. ROSEMAN. I have answered that question, actually, twice. In fairness, I have to say I am really not in a position to answer that. Others made a decision for me. I would say, again, some of my views would have played a part, I would believe.

Mr. FINCHER. Mr. Stockman?

Mr. STOCKMAN. Sir, I think as in my testimony notes, when I joined the firm, doing deep analysis on sovereign positions in particular, I found the risks acceptable and, in particular, so did the board and senior management, in terms of finding those risks acceptable.

And as market conditions changed, in particular in July, I expressed my views as it relates to wanting to recommend hedging strategies and bring the risk down. So I would have to, sort of, make a difference—excuse me—take exception to your characterization of a "yes man."

Mr. FINCHER. So, in your opinion, the money was there to cover the margins on whatever the recommendation was?

Mr. STOCKMAN. Correct, although, to be specific, our treasury and finance area would have represented that because that is their first line of business.

Mr. FINCHER. But you would know, in your position?

You would know?

Mr. STOCKMAN. Oh, no, I understood but, ultimately, our treasury and finance area is responsible for the liquidity.

Mr. FINCHER. In the notes that were produced, the member writes about his negative assessment of MF Global's risk management.

He writes that, "MF Global is betting the house, so to speak, in their current approach to risk management."

Both of you, do you agree with this assessment, and was Mr. Corzine betting the house with the European debt RTM portfolio?

Mr. STOCKMAN. As I mentioned before, through the genesis of the 9 months that I was there, the first 3 or 4 months, I would have to say the idea of betting the house was inaccurate or not a depiction that I would represent, and that as the risk profiles changed in the marketplace, that the same transparency and assessment and analysis and informed business judgments were made at that senior management level.

And let us not forget about a sophisticated board being the balance between Jon and these decisions.

Mr. ROSEMAN. I would certainly suggest that the ability of the company to handle the positions was pushed to the maximum. And as I outlined before, under adverse liquidity conditions or scenarios, it would potentially put the company in harm's way.

Mr. FINCHER. Okay. I yield back. No more questions.

Chairman NEUGEBAUER. I thank the gentleman. And now, the gentleman from California, Mr. Royce, is recognized for 5 minutes.

Mr. ROYCE. Thank you.

Mr. Roseman, let me ask you about leverage ratios, if I could. The 30–1 leverage ratio has often been cited in the financial press. And Mr. Corzine testified that he worked to deleverage the firm, as he testified to us.

Can you expand upon the effective leverage, the ratio that actually existed there at MFG while you were there and whether you believe the leverage of the firm materially changed under Mr. Corzine?

Mr. ROSEMAN. Yes, I think the important point is not only the leverage but what comprises the leverage. So a year before, almost all of the leverage that existed was extremely liquid securities and it was well presented, for example, to the rating agencies that we were holding treasuries—we were holding treasuries, agency notes, and what have you, that were very short-dated in nature.

After Mr. Corzine joined, the composition of the leverage changed. That is the important point.

Mr. ROYCE. You were there in August of 2008. He came in the spring of 2010. And as you say, that started to change. Did this window-dressing issue begin to arise as well at that time?

Mr. ROSEMAN. I would say, when we speak in terms of window-dressing, it is a pretty common practice across the street to bring the leverage down at the reporting periods. I would also say—

Mr. ROYCE. But this is 34 percent higher.

Mr. ROSEMAN. I'm sorry?

It did come down. It certainly was brought down in the quarter, and I am aware of that. The point you need to be aware of that, as well, if you can bring the leverage down, it reflects the liquidity of the positions.

So if you can quickly bring them down, that means that they don't pose a threat to the balance sheet, per se. It is the leverage you can't bring down which is the more concerning risk, which would be consistent again with what happened during the subprime crisis, as well as, again, with some of these other positions that were held by MF Global.

Mr. ROYCE. Their investments overseas in sovereign debt, I take it.

When asked about the concerns you raised, Mr. Corzine testified that, "We allowed people to speak their minds." That was his response.

Your testimony here today suggests something slightly different. You raised concerns about the positions, as you laid them out to the board, and you walked them through the risk scenarios and they were "challenged as being implausible," as you said, and shortly thereafter, you were let go.

But they were "challenged as being implausible." Can you reconcile those two representations of what was going on in the board room there?

Mr. ROSEMAN. I'm sorry. Can you repeat the first part of—

Mr. ROYCE. The first part—Mr. Corzine testified that we allowed people to speak their mind.

That was his argument about what went on. But you say when you brought up these risk scenarios, you were challenged before the board that what you were arguing was implausible was implausible, and, of course, a few months later—

Mr. ROSEMAN. I don't know if those two statements are contradictory, per se. He certainly allowed me to express my opinion in the board meetings.

Mr. ROYCE. Okay. But was there a constructive dialogue that really raised your concerns there? Were the board members—it is one thing to raise an issue. It is another to be told by the chairman of the board, "Well, that is an implausible scenario." I am trying to reconcile those two things.

Mr. ROSEMAN. Within the room, there were certainly differences of opinions within the board members on the positions themselves.

Mr. ROYCE. Yes.

Mr. ROSEMAN. So they were certainly discussed.

Mr. ROYCE. One last question. You noted the strategy pursued by Mr. Corzine didn't match the resources of MFG. Can you expand a little bit on what you mean by that? What specifically caused the failure of MF Global, in your opinion?

Mr. ROSEMAN. Since I wasn't there, I am not really familiar with all the specific positions that they added to the company subsequent to my departure, so I am probably not in the best position to respond to that.

Mr. ROYCE. Then how about to this? You noted that the strategy pursued by Mr. Corzine did not match the resources of MFG. What did you mean by that?

Mr. ROSEMAN. You certainly need sufficient capital globally. We were operating a number of different companies around the globe, which causes some challenges to moving around funds or capital to other entities. And when you employ a strategy, you have to make sure you do the analysis on the forward needs.

They were certainly raising additional capital and what have you. So there might have been other plans to raise more funds, more capital. I am not aware of it because I wasn't there. But it certainly presents the need to assess the strategy against the resources.

Mr. ROYCE. Thank you very much, Mr. Roseman.

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from New York, Mr. Grimm, is recognized for 5 minutes.

Mr. GRIMM. Thank you, Mr. Chairman.

Mr. Stockman, you have already testified that you were not privy to the meeting on October 31st where the SEC and the CFTC allegedly discussed the unwinding with other large entities of MF Global. Let me ask you this, MF Global, would you say that 98 to 99 percent of its business was commodities?

Mr. STOCKMAN. The—

Mr. GRIMM. Commodities and futures.

Mr. STOCKMAN. In terms of a revenue breakdown, I am not 100 percent sure, but I think that sounds a little bit high.

Mr. GRIMM. Over 90 percent? The vast majority of their business is commodities and futures?

Mr. STOCKMAN. If we had to spot it, maybe it was—in terms of this growing strategy, commodities and futures, maybe it could have been closer to a half. I am really speculating at this point.

Mr. GRIMM. I think you are speculating quite a bit.

My curiosity is this: You are a chief risk officer, so obviously, you know the industry pretty well. You are paid handsomely to know the industry. Is there any reason that you can think of why this would be a bankruptcy under the Securities Investment Protection Act, a SIPA bankruptcy, versus under the commodities rules? Any reason why that would be?

Mr. STOCKMAN. Sir, I understand the question. And I don't really offer much expertise in—as it relates to bankruptcy specific laws, and—

Mr. GRIMM. Okay.

Mr. STOCKMAN. —so I am not going to be able to really comment on that with any—

Mr. GRIMM. Mr. Roseman, do you have any idea why a decision would be made to do this—do you know of any precedent for this?

Mr. ROSEMAN. I don't have the expertise myself as to why it would have been—a decision would have been made or why—

Mr. GRIMM. But from your knowledge of the industry, does it seem strange to you?

Mr. ROSEMAN. It does seem strange.

Mr. GRIMM. Does it raise a red flag that something is wrong here? How long you been in the industry?

Mr. ROSEMAN. 16 years.

Mr. GRIMM. 16 years.

How about you, Mr. Stockman, how many years have you been in the industry?

Mr. STOCKMAN. 25 years.

Mr. GRIMM. 25 years.

I am not saying you are an expert on bankruptcy. I am just asking, does it raise a red flag that a company that is mostly in commodities and futures is not going under bankruptcy normally under the commodities bankruptcy but it is under the SIPA? Does that seem to raise a red flag for you? Does that seem odd or strange? Does it give you any reason to question it?

Mr. STOCKMAN. I think it is a reasonable question, and in deciding the basis on which to answer the question fully is where, unfortunately, we—

Mr. GRIMM. Okay. You don't want to answer the question. That is fine. If you don't have an opinion, you don't have an opinion.

Explain to me—I am trying to figure this out. We have two companies, right? One is the Inc., MF Global, Inc., and the other is a holding company. Is that correct?

Mr. STOCKMAN. Among others—

Mr. GRIMM. Right. But the two that we are really honing in on today, where the problems lie, I know there are a whole bunch of other things, but those are the two main entities that we are focusing on, correct?

Are you the risk officer for both?

Mr. STOCKMAN. Correct.

Mr. GRIMM. You are the risk officer for both?

Mr. STOCKMAN. Generally speaking, yes; we didn't really organize ourselves on an entity basis but rather a global basis. But—

Mr. GRIMM. So what were your responsibilities in the holding company? Because it looks like what happened—maybe I am crazy—is that the inmates were running the asylum. That is why all this happened in the first place, because we have massive leverage happening in the holding company, leverage that a chief risk officer said he had problems with the $2 billion and it went way beyond there.

Mr. Corzine didn't like the answers he was getting from Mr. Roseman, so he hired you. Leverage keeps going up, very risky, market conditions continue to change, and margin calls happen.

And when those margin calls happen, the liquidity that Mr. Roseman was worried about wasn't there, and in the final hours, in the mayhem, which we have yet to find out, but I think everyone has a good idea who transfers money from the segregated accounts, from the FCM side, over to the holding company, and that is probably where the money is or that is probably where it got lost, somehow, some way.

That is just a hypothetical. That is my hypothetical. But I am wondering, now, when you look back, if you are the chief risk officer for both, the holding company, what safeguards were in place to stop that from happening?

And before you answer that, I just want to read to you, here is the latest from MF Global that went out to customers and it says, "Your assets at MF Global are protected from multilevel safeguards, stability, separation, and protection."

As the chief risk officer for both of these entities, is this true? Is there stability, separation, and protection, to the best of your knowledge?

Mr. STOCKMAN. I have no reason to doubt that.

Mr. GRIMM. Actually, you have a great reason: $1.2 billion is missing.

Thank you very much.

Chairman NEUGEBAUER. I thank the gentleman.

What we are going to do now is—and the Chair is going to enforce this—go to a 2-minute lightning round for some members who want follow-up questions, and then we will dismiss this panel.

And so, I am going to go to Mr. Miller and recognize him for 2 minutes.

Mr. MILLER OF NORTH CAROLINA. Thank you.

Mr. Roseman had questions about risk appetite. But he also had questions about liquidity, about whether there was the money to pay a margin call, to cover a margin call if you have one.

Mr. Stockman, you talked about the limited conversation you had with Mr. Roseman. You talked earlier about the interviews that you had and the discussion of risk appetite in those interviews.

How about liquidity? Did you talk to whoever was interviewing you, did you talk to Mr. Roseman about liquidity concerns, whether you had the money or the liquid assets to meet a margin call if you got one?

Mr. STOCKMAN. Sir, as I pointed out, we analyzed the risks and stress—

Mr. MILLER OF NORTH CAROLINA. Could you start with a yes or no?

Mr. STOCKMAN. I'm sorry, then. Can you repeat the question?

Mr. MILLER OF NORTH CAROLINA. Did you have a conversation with Mr. Roseman about liquidity concerns?

Mr. STOCKMAN. We did not.

Mr. MILLER OF NORTH CAROLINA. Did you have a conversation in your interviews for the position about liquidity concerns?

Mr. STOCKMAN. During that period of time, liquidity was fully available—

Mr. MILLER OF NORTH CAROLINA. Is that a "no?" That is a "no." Okay.

At what point did you ever raise a liquidity concern in the 11 months, 10 months, however long you were there, with anyone to whom you reported? The COO?

Mr. STOCKMAN. Yes, the—

Mr. MILLER OF NORTH CAROLINA. When?

Mr. STOCKMAN. Along the way, in particular in the July time period where liquidity stress needs and actual liquidity posted for these—

Mr. MILLER OF NORTH CAROLINA. Did you make sure those concerns were passed along to the board?

Mr. STOCKMAN. Absolutely.

Mr. MILLER OF NORTH CAROLINA. Okay, were they passed along to the board?

Mr. STOCKMAN. Absolutely, it was during a presentation both verbal and written.

Mr. MILLER OF NORTH CAROLINA. Okay. Repo transactions are usually with highly liquid assets as collateral, they are usually very short term, they are usually, in fact overnight. These were repo-to-maturity transactions which basically bought the sovereign debt with 100 percent financing by using the debt itself as the collateral.

It was European debt; the world was holding their breath about whether there would be a default on European debt. It appears that the reason that these transactions held out the possibility of a substantial profit was that it was a bet against the market. The sovereign debt was beat down because the world was worried, the markets were worried about whether there would be a default.

It was 100 percent financing. There wasn't the money to make a margin call. You knew that margin call was a possibility.

What red flags were—and at the same time, Mr. Corzine and others were saying, "There is no problem here."

You said earlier that you did read Mr. Corzine's statement to investors, it was a public statement, so you knew about it. To whom did you say, whoa, no we have a lot to worry about? Did you say it to the board? Did you say it publicly? Did you say it to a regulator? Did you say it to your accountants? To your auditors? Who did you say it to?

Mr. STOCKMAN. Sir, we continued to highlight the risks internally and talked about them in great detail.

Mr. MILLER OF NORTH CAROLINA. To whom? Just internally? Just to the COO?

Mr. STOCKMAN. To all those who were involved, we continued to do our function in terms of reporting the risk and—

Mr. MILLER OF NORTH CAROLINA. And you knew with 100 percent financing with the possibility of the likelihood of margin call and no way to make a margin call and you knew that the top executives were making statements out to investors and to rating agencies that they were in a rock solid position and you just talked about it internally?

Mr. STOCKMAN. Sir, prior to the final week, the firm was meeting its margin calls and financing these positions and, ultimately, obviously the case speaks for itself what happened in that ensuing week.

Chairman NEUGEBAUER. The Chair recognizes himself.

Mr. Roseman, going back from your analysis in your time there and then kind of watching how this all played out, would MF Global be in bankruptcy today if they had not put on the sovereign debt trades?

Mr. ROSEMAN. In my opinion, they would still be here.

Chairman NEUGEBAUER. So you believe that contributed to the downfall of the company?

Mr. ROSEMAN. I believe so.

Chairman NEUGEBAUER. Mr. Stockman?

Mr. STOCKMAN. As I mentioned before, I think I would like to wait for the final chapter to be written—

Chairman NEUGEBAUER. I think just the question, if—and there may be other circumstances, but sometimes that is a domino, but if you took that particular piece of it out, if they had not had these RTMs on the books, would that company still be here today?

Mr. STOCKMAN. I think it is that confluence of events that I was talking about—

Chairman NEUGEBAUER. I didn't ask you about the confluence of events, I just asked you if, yes or no, you believe it would or would not be here?

Mr. STOCKMAN. I think it is a possibility that even with the RTM positions, we will have to wait for further details that the company could have survived.

Chairman NEUGEBAUER. It is kind of funny that when everybody discovered they had RTMs, though, that is when the company went down.

I now yield to Mr. Posey for 2 minutes.

Mr. POSEY. Thank you, Mr. Chairman.

It has been reported, Mr. Stockman, that customer assets may have gone through a transformation in which they went from a liquid state to a gaseous state; in other words, they just vaporized. In your experience, is that possible?

Mr. STOCKMAN. Sir, as I mentioned before, I have no specific knowledge of customer funds and where they may have gone.

Mr. POSEY. Listen, they pay you $350,000 a year because you have 25 years of experience in this business and you can't answer a simple question as to whether or not you think people's assets can just vaporize like there is nobody to blame? It is not God's fault, your fault, or Mr. Corzine's fault. It is nobody's fault; they just vaporize. It just happened. It is a quirk of nature.

Do you believe that is possible?

Mr. STOCKMAN. I think there is a team of experts who are really going through all the details, and in my experience I had never—

Mr. POSEY. As a $350,000-a-year expert, you don't know if it is possible for money to just vaporize? Okay, that is good.

You are fully aware of the rules requiring customer segregated accounts to be segregated, protected at all times. Was Mr. Corzine aware of those requirements?

Mr. STOCKMAN. I would be speculating, but I would imagine he would be aware of those requirements.

Mr. POSEY. How about Laurie Ferber?

Mr. STOCKMAN. And I would imagine she is, too.

Mr. POSEY. What involvement did Ms. Ferber have with your risk management and compliance functions?

Mr. STOCKMAN. Laurie didn't have significant involvement in the risk management function.

Mr. POSEY. Was she aware of MF's risk positions and the use of segregated funds?

Mr. STOCKMAN. I couldn't speak specifically to what Laurie may or may not have known.

Mr. POSEY. Did she maintain or have access to control sheets for risk positions including repos, proprietary positions, and counterparties?

Mr. STOCKMAN. I'm sorry, could you say that again?

Mr. POSEY. Did she maintain or have access to control sheets for risk positions including repos, proprietary positions and counterparties?

Mr. STOCKMAN. I don't know.

Mr. POSEY. Was J.C. Flowers a trading counterparty with MF?

Mr. STOCKMAN. I don't know.

Mr. POSEY. Since J.C. Flowers was a board member and investor, and Jon Corzine was still employed by J.C. Flowers, I am told, wouldn't that be, in your opinion as a $350,000-a-year, 25-year-experience expert, an inherent conflict of interest?

Mr. STOCKMAN. Again, I couldn't speak to specific conflicts of interest.

Mr. POSEY. Were you aware of any problems—

Chairman NEUGEBAUER. I'm sorry, the gentleman's time—we are going to have to—

I would let Members know, if you have additional questions for these witnesses, we are going to hold the record open. You may submit those questions to them in writing, and we would expect the witnesses to respond to those questions as well.

I now go to the vice chairman of the subcommittee, Mr. Fitzpatrick, for 2 minutes.

Mr. FITZPATRICK. Mr. Stockman, I want to go back to the e-mail that the CFO, Mr. Steenkamp, wrote to, I think it was S&P. On the 24th of October, he said the company was never in a stronger position, great public entity, and you indicated in response to my question that you didn't have any reason to disagree with the CFO's assessment.

And after I asked you that question, you consulted with somebody and you came back and you indicated that you were at a meeting with Moody's on the 21st of October, is that correct?

Mr. STOCKMAN. I think I want to just take half a step back. I think the answer to the question regarding Mr. Steenkamp's e-mail was that I don't know in what context he had sent that e-mail nor was I part of that e-mail chain, as far as I know.

Mr. FITZPATRICK. But in terms of context, were you in a meeting with Moody's, a different rating agency, 3 days earlier?

Mr. STOCKMAN. Yes, I was in that meeting.

Mr. FITZPATRICK. Was Mr. Steenkamp in that meeting?

Mr. STOCKMAN. He was.

Mr. FITZPATRICK. And was the firm downgraded as a result of that meeting, 3 days later?

Mr. STOCKMAN. The firm was downgraded 3 days later but I couldn't be specific as it was a result of that particular specific meeting.

Mr. FITZPATRICK. Was it a result of anything you said at that meeting? Did you say anything at the meeting?

Mr. STOCKMAN. Me personally?

Mr. FITZPATRICK. Yes.

Mr. STOCKMAN. I spoke very little, frankly.

Mr. FITZPATRICK. Did you let Moody's know that Mr. Roseman had concerns about credit risk beyond $2 billion and that you were brought in to let Mr. Corzine trade through that $2 billion number?

Mr. STOCKMAN. That characterization certainly wouldn't have come up at that meeting, no.

Mr. FITZPATRICK. Did you have an opinion as to the position of MF Global at that time separate from Mr. Steenkamp? Did you have an opinion of the firm's viability? This is now 10 days before the complete implosion of the firm and the filing of bankruptcy. Did you agree that the firm was viable and was in a strong position?

Mr. STOCKMAN. That is not my area of expertise, and I relied on our CFO and finance people to help us understand in specificity the liquidity and financial position of our company.

Chairman NEUGEBAUER. I thank the gentleman. And the final question is from Mr. Grimm from New York. You are recognized for 2 minutes.

Mr. GRIMM. Thank you. Mr. Stockman, do you think you should be held liable civilly or criminally in any way, shape or form? Just yes or no.

Mr. STOCKMAN. No, sir.

Mr. GRIMM. How about Mr. Corzine, do you think he should be held liable for anything?

Mr. STOCKMAN. That would be beyond my chance to—

Mr. GRIMM. You don't have an opinion?

Mr. STOCKMAN. I don't have an opinion.

Mr. GRIMM. Okay. Just say you don't have an opinion. Do you think it is possibly negligence, maybe even gross negligence, for a new risk officer to come in, amidst all of these things going on and only spend 1 hour with Mr. Roseman, the prior risk officer, and in that 1 hour, you didn't even speak about the risky positions?

You don't think that is a little bit negligent? You are taking over the shop as risk officer and you tell me all you spent was 1 hour and you didn't really speak about his concerns for the risks.

Mr. STOCKMAN. We spoke briefly about the sovereign risk and—

Mr. GRIMM. I think you testified earlier that you didn't speak about that.

Mr. STOCKMAN. No, as I mentioned, we spoke briefly on that—and continuing on that list of discussion was a touch on sovereign risk.

Mr. GRIMM. A touch on sovereign risk?

Mr. STOCKMAN. Yes. But more importantly, when I arrived at the firm, I did my own analysis, I performed my own—along with my team—assessment of those risks. And as you see in my written testimony, the discussion and description of those risks were fully vetted and transparent.

Mr. GRIMM. But you just also testified that 10 days prior to this, you had no reason to believe that the company wasn't viable? So you have done all of this risk analysis, but 10 days prior to the collapse, you didn't have any reason to believe it wasn't viable?

Mr. STOCKMAN. Ten days prior, I wasn't coming in to work that day.

Mr. GRIMM. Okay. Enough said. You didn't come into work that day.

Last thing, do you think this could jeopardize the entire commodities and futures markets here in the United States, that people think that if they are in segregated accounts, it can be moved over and then put into bankruptcy and everyone basically gets the shaft? Don't you think that could jeopardize our entire system here, the integrity of the U.S. markets with regard to commodities and futures? Is that a true statement?

Mr. STOCKMAN. It is my sincere hope that this all works out for the clients.

Mr. GRIMM. Mr. Roseman, do you think that it could jeopardize the integrity of the markets?

Mr. ROSEMAN. I—

Mr. GRIMM. People could lose faith in our system?

Mr. ROSEMAN. I would hope not. Hopefully, this will get reconciled and they don't lose faith.

Mr. GRIMM. Even if it gets reconciled, the point is, people were in segregated accounts, promises were made, they were told it was safe, and now the money is missing. Even if it gets returned later, I think it is safe to say that people lose faith. Thank you very much.

I yield back.

Chairman NEUGEBAUER. Thank you, gentlemen. And I thank our witnesses for your time. With that, this panel is excused, and we will call up our second panel: Mr. Craig Parmelee, managing director and lead analytical manager for North American Financial Institutions Ratings, Standard & Poor's Ratings Services; Mr. Richard Cantor, chief credit officer, Moody's Investors Services; Mr. James Gellert, chairman and chief executive officer, Rapid Ratings International Inc.

I am going to ask the three of you to please stand and raise your right hand.

[Witnesses sworn.]

Thank you. I am now going to recognize each of you for a 5-minute summary of your statement, and just to let you know, your full written statements will be made a part of the record.

Mr. Parmelee, you are recognized for 5 minutes.

TESTIMONY OF CRAIG PARMELEE, MANAGING DIRECTOR AND LEAD ANALYTICAL MANAGER FOR NORTH AMERICAN FINANCIAL INSTITUTIONS RATINGS, STANDARD & POOR'S RATINGS SERVICES

Mr. PARMELEE. Thank you. Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee, good morning. My name is Craig Parmelee. I serve as managing director and lead analytical manager for the North American Financial Institutions Team at Standard and Poor's.

I am pleased to appear before you this morning to discuss S&P's ratings on MF Global. Over the course of its long history, S&P has sought to improve transparency in capital markets by providing independent assessments of creditworthiness. At their core, S&P's credit ratings, just like our forward-looking views about the ability and willingness of issuers to meet their financial obligations in full and on time.

S&P's ratings are, thus, expressions of opinion. They are not recommendations to buy, sell or hold securities. And they are not statements of facts.

S&P first rated MF Global in May 2007. Our rating at that time was triple D plus, and remained at that level until February 2008. We then downgraded the company's rating to triple D, following its announcements regarding a loss from unauthorized trading, and based on our view that the company's high financial leverage, among other things.

In 2010, we downgraded the company yet again, this time to triple D minus, just one notch above speculative gray or non-investment grade status, and lower than the ratings of S&P's two largest competitors.

In the published reports announcing this downgrade, we stated that MF Global's new CEO, Jon Corzine, had announced a strategy to begin transitioning the firm from a traditional commodities broker to a full service investment bank. In our report, we noted that the strategy would likely result in the company taking on more proprietary trading positions, which in our view would be riskier than the company's traditional broker business.

We further stated that the company's risk management controls continued to be a work in progress. Six months later, in May 2011, MF Global disclosed for the first time that it had off balance sheet exposure to approximately $6.3 billion of European sovereign debt through so-called repurchased maturity transactions that we have all heard this morning. It has been referred to as an RTM transaction.

This disclosure caused no discernible disruption in the capital markets, perhaps because the portfolio was made up of highly rated sovereign bonds, funded through scheduled maturity in 2012, meaning that MF Global would only lose money if one or more of the sovereigns defaulted during this relatively short time period.

Following the May 2011 disclosure, S&P continued to believe that MF Global's underlying credit fundamentals supported the trading of triple D minus.

In October 2011, concerns in the market over escalation of the Eurozone credit crisis, combined with a disappointing earnings report from MF Global and other factors, were causing the firm's investors, their counterparties and others to become quickly and increasingly concerned about the firm.

Against this backdrop, S&P analysts sought to obtain additional information about the RTM portfolio, and were told by MF Global executives that the firm believed it was "in its strongest position ever as a public entity."

Not withstanding management's optimism, MF Global reported a net gap quarterly loss of $191 million the next day. This loss was surprising and frightened the markets even further.

Although Mr. Corzine stated that MF Global remained on strong footing and that its RTM portfolio presented minimal risk, the company's stock price fell by nearly 50 percent the day of the earnings announcement.

One day later, on October 26th, S&P placed MF Global's ratings on credit watch with negative implications, under review for a potential downgrade. This action reflected S&P's view that continued volatility in the capital markets and low interest rates could further harm MF Global's ability to generate capital.

As part of this action, we also noted the firm's RTM exposure and increased risk profile. The October 26th report concluded by saying that S&P might soon lower MF Global's rating to speculative or non-investment grade, depending on the firm's execution of a strategic plan which included a potential short-term sale of certain operations.

On October 31, 2011, MF Global filed for bankruptcy protection. As a result, S&P downgraded the firm's credit rating to D. In S&P's view, MF Global's collapse was not caused directly by its exposure to the RTM portfolio.

Rather, we believe MF Global's demise was driven primarily by a rapid downward spiraling of confidence among market participants and counterparties, who questioned the firm's transparency and its ability to attract and maintain investors and generate revenue.

I thank you for the opportunity to participate in this hearing. I would be happy to answer any questions that you may have.

[The prepared statement of Mr. Parmelee can be found on page 103 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Cantor, you are recognized for 5 minutes.

TESTIMONY OF RICHARD CANTOR, CHIEF CREDIT OFFICER, MOODY'S INVESTORS SERVICE

Mr. CANTOR. Mr. Chairman, members of the subcommittee, good morning.

My name is Richard Cantor. I am the chief credit officer of Moody's Investors Service. In that capacity, I lead the Credit Policy Group, and I chair the Credit Policy Committee, which are jointly responsibly for the review and approval of Moody's rating methodology.

Thank you for this opportunity to address you today.

Long before the collapse of MF Global, Moody's regarded the company as a franchise that was particularly reliant on customer and counterparty confidence. Our rating reflected our view that MF Global's credit profile had speculative characteristics compared to other rated credits.

In fact, for several years, Moody's viewed MF Global as one of the riskiest credits among all U.S. banks and securities firms. Today, I will describe the rating actions that Moody's took before MF Global's bankruptcy, which was brought on by the revelation that customer assets were missing.

But first, it would be helpful to briefly explain the meaning of Moody's credit ratings, and the additional indicators we use to communicate to the market the possible direction of those ratings.

Moody's credit ratings are forward-looking opinions that speak to relative credit risk on a multiple step scale. This means that issuers assigned a higher rating level are less likely to default than issuers assigned a lower rating level.

Some credits are expected to default at every rating level. But no one can predict which specific credit at any particular level will default. If that were possible, Moody's would simply use a two step rating scale, default or not default.

Moody's expresses its opinions to the markets not only through its ratings, but also through the publication of directional rating indicators, called "Rating Outlooks" and "Rating Reviews," and through written research.

When we announce that a credit rating has a negative rating outlook, for example, we are indicating that the issuers' rating is more likely to be downgraded than upgraded over time. Placing a rating on the review indicates that the rating is likely to change over the near term.

By 2008, Moody's viewed MF Global's creditworthiness as not particularly strong, as reflected in its Baa1 rating and its negative outlook. Moody's subsequently downgraded MF Global's credit rating to Baa2.

By the end of 2010, the Baa2 ratings had a negative outlook, again communicating downward pressure on the ratings. Moody's reassessed MF Global's credit profile last February in light of the company's weak profitability and high leverage, relative to similarly rated peers.

We affirmed the negative outlook and issued a press release identifying three areas of concern about the company's performance—earnings, leverage, and risk—which would determine Moody's next rating action over the following 4 to 6 quarters.

Two quarters later, in August of last year, Moody's once again communicated that it would like to downgrade MF Global if the company's performance did not improve in these three areas. On October 21st, Moody's analysts met with Mr. Corzine and members of his management team in advance of the company's announcement of its quarterly financial results.

During that meeting, Mr. Corzine made it clear that MF Global's repurchase-to-maturity transactions were purely proprietary trading positions. Prior to that meeting, Moody's had understood, based on discussions with management, that the company was increasing its principal trading activities primarily for the purpose of facilitating customer transactions.

MF Global also revealed to Moody's at that meeting that it would report a significant quarterly loss. As a result, MF Global's performance had deteriorated in three areas of concern that Moody's had identified last February: earnings; leverage; and risk.

On the very next business day, Moody's once again downgraded MF Global's rating, this time to Baa3, and placed it on review for a further possible downgrade.

The following day, MF Global announced a record quarterly loss, and an accelerating flight of customers and counterparties rapidly took hold. As the crisis of confidence and liquidity gathered pace over the subsequent 48 hours, Moody's downgraded its rating to Ba2 and kept the credit on review for a further possible downgrade.

When MF Global filed for bankruptcy on October 31st, Moody's downgraded the credit rating to Caa1. Moody's withdrew its ratings on MF Global altogether on November 15th.

Thank you. I look forward to answering your questions.

[The prepared statement of Mr. Cantor can be found on page 66 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Gellert, you are recognized.

TESTIMONY OF JAMES H. GELLERT, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, RAPID RATINGS INTERNATIONAL, INC.

Mr. GELLERT. On behalf of Rapid Ratings' employees, shareholders, and subscribers, I would like to thank Chairman Neugebauer, Ranking Member Capuano, and the members of the subcommittee for asking me to testify today. I am James Gellert, chairman and chief executive officer of Rapid Ratings.

It is clear by now that MF Global is a tragic story for Wall Street, Main Street, and the futures industry. Its bankruptcy follows and trends with other notable financial failures from the last 12 years in one way; agencies that were paid to provide professional opinions on credit risk failed to give sufficient warning of this firm's risk.

MF Global carried investment grade ratings from Standard & Poors from 2007 until October 31, 2001, and from Moody's and Fitch from 2007 until October 24th, 2011.

In contrast, Rapid Ratings provided 2 years of warning that MF Global was a high-risk, sub-investment grade entity. We are a user-paid, not an issuer-paid firm. We use only financial statements, no market inputs, no qualitative analysts.

We have no contact in the ratings process with management, bankers, investors or their advisers. We utilize our proprietary software-based system to rate the financial health of thousands of private and public companies, quarterly.

Our ratings have an impressive record of far outperforming the big three rating agencies. Our financial health rating system (FHR) evaluates 62 ratios from company's income statements and balance sheets.

Our zero to 100 score is the product of a highly complex modeling process that measures variations in the financial health of any company, effectively benchmarking how well it is able to withstand an internal or external shock. We are consistent and we are accurate.

Over the past 20 years, approximately 90 percent of defaults have occurred at 40 and below on our scale. At bankruptcy, we had MF Global rated at 23.

Prior to their last quarterly release, they were rated at 29. Both ratings are in our high-risk category and well below investment grade, where we have had them for over 2 years.

These ratings are the rough equivalent to CCC minus and CCC on the traditional alpha scale, or 8 to 10 ratings notches below where they sat for the big three agencies.

The FHR system is agnostic through qualitative judgements like management star power, unless their actions affect the company's financial health. Through our system, MF Global is a simple story of a firm's declining in performance since 2007 in various measures, including revenue performance, profitability, debt service management and others.

From 2007 through 2011, MF Global's revenue declined by 63 percent, from $6.1 percent to $2.2 billion. Net profit declined by 142 percent, from $190 million to negative $79 million.

In the last 16 quarters, MF Global had 10 quarters with recorded losses, and the last 4 saw losses grow by 68 percent over the prior 12 months. Its most recent quarterly report showed a record loss of $191.6 million.

Without even factoring in risky trading in Euro sovereign debt or risk controls and other things, MF Global was unmistakably in declining health. Yet Moody's, S&P, and Fitch barely moved over this period.

Why?

Number one, the issuer-paid business model is inherently conflicted, making objectivity difficult to administer consistently. Management of rated companies will try hard to get and keep the best possible ratings. If they are convincing, their ratings are better than not. If ratings analysts don't properly question what they are sold, a rating can be compromised.

Two, the big three strive for stable ratings and to look through the cycle, thus ignoring the short- to medium-term performance volatility that can capture a firm's underlying fundamentals and determine long-term success or failure.

Three, barriers to competition are still great. Despite reform efforts, NRSRO ratings are still firmly embedded all over the financial system.

Four, and finally, the big three hold little to no accountability when things go wrong. The MF Global story inevitably turns to the question of timing of ratings changes. Traditional agencies say they need to be careful when downgrading a company because they can affect market behavior.

They also rightly assert that many investors want rating stability. These are indeed real concerns. But they pale in comparison to the damage done when ratings are downgraded too late or not at all.

We do not advocate ratings volatility. We support a better ratings industry.

Congressman Fitzpatrick's recent draft bill responds to these points directly. It would require NRSROs to be accountable and stand by their ratings on a quarterly basis.

The market has no way of knowing when the big three are proactive, behind schedule or simply inattentive to maintenance of an existing rating. While we regularly out-perform the big three, we don't believe that Rapid Rating's system is simply better than others, nor that traditional ratings are always flawed.

We believe in open competition in the ratings business, so institutional investors, risk professionals and regulators can choose among options that best suit their needs. Certainly, those who had our early warnings on MF Global were far better served than those who relied exclusively on the big three, whose ratings provided none.

It is time to require more timely ratings, more accurate ratings, and more competition. We cannot simply rely on traditional agencies that promise much, only to deliver and to defend much less.

Thank you.

[The prepared statement of Mr. Gellert can be found on page 74 of the appendix.]

Chairman NEUGEBAUER. I thank the gentlemen. We will now go to questions by the panel. And the Chair recognizes himself for 5 minutes.

Mr. Cantor, in Moody's January 17th letter responding to the subcommittee, with reference to the RTM trades, they said that the analysts did not have an understanding that MF Global was exposing its own capital in amounts representing a multiple of its outstanding common equity until October 21, 2010.

But, in fact, in the 10-K filed by MF Global for the period ending March 31st, it was published. On 5/20/2011, MF Global disclosed those positions in their 10-K.

But yet Moody's didn't know about it, according to your firm's letter, until October 21, 2011. How do you explain that?

Mr. CANTOR. Of course, all financial services firms are exposing their capital at multiple levels to the assets that they hold on balance sheets. Plus, they have a variety of derivative exposures that also can be viewed as exposing their capital to multiples.

So the entirety of the sets of obligations the financial services firms enter into will be some significant multiple of its capital.

In this particular case, we were talking about a specific set of transactions which we had interpreted, based on our discussions with management in the past, as being transactions that had been undertaken with the intention to facilitate customer-based transactions, which would imply that either they were being liquidated over a short period of time, when there were customer transactions that were taking place, or they were being hedged.

They were being used in some other purpose, rather than taking these strictly proprietary trading positions.

Chairman NEUGEBAUER. I think we understood that was your response. But we talked to some other people who have looked at that 10-K. And based on bringing Mr. Corzine in, and Mr. Corzine's stated goals for this company, that they were moving, or adding to, not moving away, but adding proprietary trading, becoming a full service investment banking company.

And so a lot of folks think that would have been the note that was—either if you didn't understand it, you should have followed up. But then, as I am sure you are aware, in August, then they filed a 10-Q. And basically, did your analysts review the 10-Q filed in August?

Mr. CANTOR. I am not aware that that filing was reviewed. You are talking about the 10-Q or the 10-QA or the—

Chairman NEUGEBAUER. Then, they did a 10-Q in September, which detailed $150 million FINRA capital charge, which was related to the European RTM trades.

Did you look at that?

Mr. CANTOR. That was a one-page document. That was not, as far as I know, reviewed by the analysts at that time.

Chairman NEUGEBAUER. Would that have been a flag as an analyst in your firm, to ask, what is up with this? That we should go back and take a look at this?

Mr. CANTOR. I don't believe so. I think what that document indicated was the cash capital that was being required by MF Global's regulator was being increased, because of the different interpretations that were being given to the exposure.

It wasn't new information about the exposure, but rather its capital treatment. And the magnitude of the change in capital requirements was not a particularly significant amount from a credit perspective.

Chairman NEUGEBAUER. So do your analysts read financial newspapers?

Mr. CANTOR. Yes.

Chairman NEUGEBAUER. Okay. The Wall Street Journal had an article on October 17, 2011, that detailed that they had been asked to put up additional capital, that there was concern about the company.

Did your analysts follow up on that?

Mr. CANTOR. Yes. We had a meeting already scheduled with MF Global. And that topic would be discussed.

Chairman NEUGEBAUER. And what was the date of that meeting?

Mr. CANTOR. The date of the meeting was the 21st. I think there was prior discussion 2 days before that.

Chairman NEUGEBAUER. So, 4 days after The Wall Street Journal. You all didn't pick it up in the initial 10-K that came out in March. Subsequent 10-Ks that came out, didn't—became aware that they have been asked to put up additional capital.

So then you read The Wall Street Journal" and you decided, hey, maybe we should go over to MF Global and see what is going on?

Mr. CANTOR. No. This is the context of a regular quarterly meeting that we have with MF Global and with other major issuers in the market. And we would be reviewing in that meeting all the financial releases that had occurred in the interim, since the previous meeting.

And we would be discussing that issue, as well as others. If you will recall, there was not a lack of knowledge of the European exposure, but rather a difference of view about what that exposure entailed and how to interpret that exposure, which wasn't discussed, I believe, in either of the documents that you mentioned.

Chairman NEUGEBAUER. Obviously, S&P was able to kind of figure that out a little earlier than Moody's did. And as we hear from Mr. Gellert, they had been concerned about the company's capital inability for some time.

Mr. Gellert, I was going to ask you, the rating was 23 in your firm?

Mr. GELLERT. It was 29 going into October. And at the quarterly financial release, we downgraded it again to 23.

Chairman NEUGEBAUER. And that is on a scale from what?

Mr. GELLERT. Zero to 100.

Chairman NEUGEBAUER. Zero to 100? So, 23 is not very good.

Mr. GELLERT. It is not very good. As a matter of fact, 26 is the point on our curve where, over the last 20 years, the highest incidence of individual defaults have occurred. So anything in the 23, 26, 29 range is definitely a cause for significant concern.

Chairman NEUGEBAUER. I yield to Mr. Capuano for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Parmelee, would you agree or disagree that a triple D rating from your agency is not a really good rating?

Mr. PARMELEE. Sir, our rating was triple D minus, and it is our lowest. It is our lowest—

Mr. CAPUANO. I know what it is. Would you agree that it is not a very good rating?

Mr. PARMELEE. It is in the middle of our scale. It is our lowest investment grade rating. We have 21—

Mr. CAPUANO. Would you invest in somebody doing investment banking with a triple D rating, your personal money?

Mr. PARMELEE. Sir, it is considered to be an investment grade rating. But it is our lowest investment grade rating. That is the only point I would make.

Mr. CAPUANO. Mr. Cantor, your Baa2, pretty low?

Mr. CANTOR. There is no rating that is a good rating or a bad rating. We have a lot of issuance in the United States.

Mr. CAPUANO. Having received ratings in the past, I would not just respectfully, irrespectively disagree.

When you get that rating, you want a good one. We know the difference between a Baa and an A. You don't?

Mr. CANTOR. I meet with issuers very regularly. Some of them are extremely pleased to get their Caa1 rating, instead of a Caa2 rating, or investors are pleased if their bonds are upgraded.

Mr. CAPUANO. So you are basically tell me your ratings don't mean a thing?

Mr. CANTOR. There is a trillion dollar junk bond market, right? There is a trillion dollar market. Every day, there are junk bonds issuance, speculative rate bonds issued.

Mr. CAPUANO. So it doesn't matter what rating you rate them? Then why bother?

I don't want to go down this path. You can avoid the questions up to a point. I will get to you in a minute, because I want to follow up on the chairman's question.

Mr. Cantor, you stated in your written documents that you didn't know that they were doing proprietary trading until October 21,

2011. Do you know what that tells us, very clearly, very simply? Nobody at your firm read the 10-K.

Is that a fair conclusion, that you did not read the 185-page document in May of 2011?

Mr. CANTOR. That document was read.

Mr. CAPUANO. But you missed the fact that they were dealing proprietary?

Mr. CANTOR. We did not understand that the—

Mr. CAPUANO. So it was unclear?

Mr. CANTOR. —the size of the position was a proprietary position.

Mr. CAPUANO. That is not your statement. Your statement is you didn't know it; it was the first time you learned of it.

Honestly, because I want to go down the road of these 10-Ks.

Mr. Parmelee, you stated that the 10-K was the first time you learned of the off-balance sheet RTMs. Is that a correct statement?

Mr. PARMELEE. Yes, sir. We didn't have advance notice.

Mr. CAPUANO. Okay. Mr. Parmelee, did you know about the off balance RTMs?

Mr. PARMELEE. I learned about the off balance sheet RTMs later on. The team was aware. I didn't learn about those until probably the October timeframe.

Mr. CAPUANO. Mr. Cantor, did your company know about the off balance sheet RTMs?

Mr. CANTOR. Yes.

Mr. CAPUANO. So you did read the 10-K?

Mr. CANTOR. I said yes before.

Mr. CAPUANO. Okay. It is just kind of interesting. If you are getting a lot of money to read something, you would think that you would actually read it.

I guess the reason I am asking this is because, honestly, the off balance sheet thing bothers me to no end, and the fact that neither of you could have possibly known.

Yes, let me ask you a very quick question, Mr. Cantor. Mr. Parmelee answered it.

Did you know about the RTMs before the 10-K, the off balance sheet RTMs?

Mr. CANTOR. No.

Mr. CAPUANO. Okay. So there is no way you could have known it, which I understand. That is why they are called off balance sheet. I get that.

And the problem that I have, as I understand it, allowing these off balance sheet RTMs is perfectly okay, according to accounting rules.

Am I understanding correctly, Mr. Parmelee?

Mr. PARMELEE. Yes, sir.

Mr. CAPUANO. Mr. Cantor, do you agree that my understanding is correct?

Mr. CANTOR. I believe so.

Mr. CAPUANO. If accounting rules said—now the reason they are off balance sheet is because for some reason these things are allowed to be counted as sales, which, for all intents and purposes, is an asset.

And I don't understand when you have these RTMs, it is basically a wash. Why they are not recorded as a wash, maybe even as a liability. And in this particular case, it turns out maybe they were a liability.

So be it. But at least a wash.

If the accounting rules required them to be put on earlier statements, do you think it would have affected your ratings earlier, Mr. Parmelee?

Mr. PARMELEE. No, sir. We were aware of the—I'm sorry, you are saying after it was made public in May?

We were aware of the RTM portfolio. Our analysts read the financial statements as part of our procedures. They did in this case. They told me they did.

We believe that all the information around that portfolio was factored into our rating. And you will recall, the portfolio itself—

Mr. CAPUANO. So that when you first learned of the multi-billion dollar, off balance sheet, risky investments, wouldn't change your opinion at all?

Mr. PARMELEE. Sir, what is most relevant isn't whether or not it is off balance sheet, but what is actually in the investment itself and how much risk does it pose. Our evaluation of the risk was that, again, it was made up of five European sovereign bonds. Those tended to be very highly rated European sovereigns.

80 percent of the exposure, or roughly 80 percent—

Mr. CAPUANO. It didn't bother you at all that somebody who was supposed to be telling you everything hadn't bothered to tell you about this?

Mr. PARMELEE. Sir, we believe that transparency is a very good thing. And we would push for more transparency in financial reporting. Absolutely.

Mr. CAPUANO. But when you got the transparency, it didn't change your opinion.

Mr. PARMELEE. Once we learned about it, we factored it in, as well as other information, and believed that our rating, the triple D minus rating, continued to be appropriate.

I can comment a little bit on why we weren't so concerned relative to our rating, if you would like.

Mr. CAPUANO. Mr. Cantor, if you had known about—if your firm had known about these off balance sheet RTMs earlier, would it have affected your rating?

Mr. CANTOR. I am not sure they were present much earlier than the disclosure. But—

Mr. CAPUANO. According to all the testimony we have, they were present for months before that, and growing. As a matter of fact, the previous panel pretty much said that.

Mr. CANTOR. A few months, yes.

But, as I said, there are a number of things to consider. As the other panelists said, the inherent credit risk of those transactions was fairly modest. It was highly rated. If we were talking about an Italian rating agency with a Baa rating agency, we wouldn't even think twice.

It so happens they are holding other government securities. But the positions themselves were not inordinately risky. However, the trading strategy that they represented, that the firm was taking on a very large proprietary bet, outside of its traditional business, was a break from the strategy that we had understood they were—

Mr. CAPUANO. Let me just break in for a minute. See, again, I am a politician. And I understand fully well that transparency is critically important. I actually agree with you.

But I have to tell you, if you walk into my office and you don't tell me something, that is not transparency. And I will say the next time you walk into my office, you will not be received quite as well as you were previously.

Mr. CANTOR. I agree with you.

If we had known that—in fact, we felt that we learned something new on October 21st, that we didn't know before, in that the firm had engaged in a large proprietary bet—

Mr. CAPUANO. Had you learned it earlier, you might have changed your opinion earlier?

Mr. CANTOR. If we knew something earlier, we might have changed our opinion earlier. Sure.

Mr. CAPUANO. I guess what I am asking is if the accounting rules required more transparency in this situation, would it or could it have changed your opinion?

Mr. CANTOR. I don't think the accounting rules would have been able to reveal to us the strategy that lay behind that particular position. I think that would have required conversations with management.

I am not sure more—

Mr. CAPUANO. The same management that you now say didn't tell you that they were dealing proprietary. So what would meetings with those kinds of people really have helped?

They wouldn't have told you something else. I guess what I am getting at is, honestly, I think transparency is a critical thing in the entire marketplace. I think that is what it is all about, letting investors know.

Your ratings here in this case, in my opinion, they kind of let the world know that this was a significantly risky investment. I know you don't want to say that for whatever reason.

But that is what it tells everybody in America. And you know it. And the fact that you are now telling me that if you knew more, you wouldn't have changed your opinion, now raises questions about your opinion in the first place, to me.

That is like saying, wait a minute, I was about to give you guys credit for actually being on top of this, or in front of it. And now, I am not so sure.

One of you apparently didn't read the 10-K. And now you are telling me no matter how much information you told me, I thought it was perfectly fine.

And you know something? That is really not a good answer. And I guess we will have to pursue this a little bit further later, because I am way over my time again.

Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

And now, the vice chairman of the subcommittee, Mr. Fitzpatrick.

Mr. FITZPATRICK. Thank you, Mr. Chairman.

Follow up on Mr. Capuano's questions with the Moody's and S&P representatives, can you discuss a little bit your surveillance regime, how often? What do you look for? What do you rely on?

Talk to us about how you do it.

Mr. PARMELEE. Sure. I am happy to take that. And also following up, in this case, for us, we downgraded MF Global about 6 months before this disclosure. At the time, we pointed out the fact that we expected that the firm would be taking on more risk, including more proprietary risk.

So that was factored in.

In terms of our surveillance policies, we surveil companies on an ongoing basis. Any time there is new information that is put into the marketplace, the analysts are responsible to know what that information is, to ask follow up questions to the extent they are warranted, and to act on it.

So it is really sort of a regular daily surveillance, based on activity in the marketplace.

Mr. FITZPATRICK. Mr. Cantor?

Mr. CANTOR. We look at a lot of things on an ongoing basis, including the macroeconomic environment the firm operates in, and the sectoral environment as well. Of course, we review the financial filings. We often meet with the firm.

In the case of MF Global, I think we met with the firm 15 times in 2 years, and reviewed financial results and asked further questions.

Mr. FITZPATRICK. You indicated you met with MF Global 15 times in a couple of years. Is that specifically to review the rating?

Mr. CANTOR. Yes. There was a higher frequency of meetings there towards the end. But we would certainly meet at least on a quarterly basis.

Mr. FITZPATRICK. So it sounds like both Moody's and S&P, you stand by you ratings and the methodologies?

Mr. PARMELEE. Yes, sir.

Mr. CANTOR. Yes.

Mr. FITZPATRICK. Mr. Cantor, do you feel confident enough in those ratings to personally stand by them?

Mr. CANTOR. Yes.

Mr. FITZPATRICK. So as the chief credit officer and the managing director, would you, at any given time, say that any given rating is as precise as it could be, on the best and most up-to-date information available to your company?

Mr. CANTOR. In an ideal world, everything can be improved. And we are always seeking to improve our processes. So one of the things I hope to do is always improve the quality of our ratings over time.

Mr. FITZPATRICK. Given that the European sovereign debt holdings at MF Global were—they were disclosed as early as May of 2011, and realizing that the market did not respond at the time, but in retrospect, knowing that these holdings would lead to a downgrade that you indicated 6 months later, would you say that this was perhaps a surveillance failure?

Mr. CANTOR. I don't believe so. I think we had laid out very clearly three areas of concern for the firm. We laid out a timeline over which we would be evaluating the performance against those three benchmarks.

When we learned that the firm was not meeting those criteria that we had laid out, we took immediate action.

I think it is also important to recognize that while the firm's credit profile had deteriorated and was reflected in rating downgrades, the bankruptcy of MF Global appears to have been caused by something very different from what we are talking about right now.

It was caused by these missing funds.

Mr. FITZPATRICK. We heard from the previous panel that there was an October 21st meeting with Moody's, that the chief risk officer was there, it was kind of like a pro forma meeting, really. He wasn't asked any questions; he didn't really say anything.

Is that typical of the kind of review that would be going on at that point?

Mr. CANTOR. I don't know what was discussed particularly at the meeting. I have a copy of the presentation. All the issues that were critical for the rating action that was taken immediately I think were quite amply discussed.

Mr. FITZPATRICK. Mr. Parmelee, do you feel confident enough in the ratings of your firm of MF Global that you would personally stand by them?

Mr. PARMELEE. Yes, sir. We factored all relevant information into the ratings, and that they were an appropriate opinion of the credit quality of the firm.

Mr. FITZPATRICK. That is on an ongoing basis.

Mr. PARMELEE. Yes, sir.

Mr. FITZPATRICK. Mr. Gellert, you went to great length in your testimony to chart the ratings that your company assigned to MF Global. And you also included some description of your methodologies.

Do any of these ratings reflect the use of information that is not available to the NRSROs like Moody's and S&P and Fitch?

Mr. GELLERT. No. We generate all of our ratings based off of disclosed financials. So we are not privy to any additional information. And we have no contact with management, so we are not bouncing questions or ideas off of them.

So it is all on publicly available information.

Mr. FITZPATRICK. Thank you, Mr. Chairman.

Chairman NEUGEBAUER. Oh. Mr. Cantor, I just want to follow up on one thing you said.

You believe that the reason that MF Global went bankrupt is because of the missing money?

Mr. CANTOR. That is my understanding, that like many financial services companies in weakening financial positions and having liquidity strains, they were seeking an acquisition partner. And they were close to reaching agreement along those lines, which fell apart when customer money was missing.

Chairman NEUGEBAUER. I recognize Mr. Posey from Florida.

Mr. POSEY. Thank you, Mr. Chairman.

Just a few general accounting questions. If a company that you are rating has a commodity account, like say ExxonMobil or Tyson Foods, is the value of the cash or Treasury bills in the segregated customer account assumed to have full value?

Yes or no, each of you, please?

Mr. CANTOR. Yes.

Mr. POSEY. Yes? Only one of you has an opinion.

Mr. PARMELEE. Sir, I don't know the answer to that.

Mr. POSEY. I'm sorry?

Mr. PARMELEE. I don't know the answer to that.

Mr. POSEY. Okay. So we have an "I don't know" from Mr. Parmelee, and a "yes" from Mr. Cantor.

Mr. GELLERT. I believe the answer is yes. But fortunately, our system takes care of that and I don't need to have—

Mr. POSEY. Okay, so we have an "I don't know," a "yes," and an "I believe it is yes."

Assets in a balance sheet can appreciate or fall in value, be sold or be transferred. Do we all agree?

Let the record show you all agree.

Potentially, they could also be stolen. Do we all agree?

Mr. CANTOR. Yes.

Mr. PARMELEE. Yes, sir.

Mr. POSEY. Okay. Let the record show they all agree.

Have any of you ever heard of them being "vaporized?"

Mr. PARMELEE. No, sir.

Mr. CANTOR. No.

Mr. POSEY. No. Okay. Let the record show they all said "no."

How would you treat assets on a balance sheet if those assets had been stolen?

Or just to save time, is it correct to assume that they wouldn't be counted, because they would eventually need to be returned to their rightful owners. Do you agree with that statement?

Mr. PARMELEE. Sir, I am not sure I have ever faced that experience.

Mr. CANTOR. I think I would put stolen assets on the balance sheet as zero. But there might be a contingent potential of recovery.

Mr. GELLERT. We as well have never faced anything like that. But we would probably handle it very similarly.

Mr. POSEY. So Mr. Cantor and Mr. Gellert agree. Mr. Parmelee, you don't know.

Mr. PARMELEE. Yes, sir.

Mr. POSEY. I'm sorry?

Mr. PARMELEE. Yes, sir.

Mr. POSEY. Yes, sir, what? You don't know or you would do it like they would?

Mr. PARMELEE. I don't know, sir.

Mr. POSEY. Okay.

In your dealings with MF Global, was Laurie Ferber involved in your work? Yes or no?

Mr. PARMELEE. No, sir.

Mr. CANTOR. I am not aware.

Mr. POSEY. And you didn't have anything with MF Global. So okay, you all said "no."

She is considered to be an expert on legal issues related to commodity and derivatives trading. Would you agree, Mr. Parmelee?

Mr. PARMELEE. I don't know about Laurie Ferber's background.

Mr. POSEY. You don't know who she is?

Mr. PARMELEE. I don't know specifically about her background and her expertise. I can't speak to that.

Mr. POSEY. Okay. So somebody in her position, potentially, you feel then could have no expertise in those areas?

Mr. PARMELEE. I would assume that they would.

Mr. POSEY. Okay. Mr. Cantor?

Mr. CANTOR. I really don't know anything about her.

Mr. POSEY. Do you know who she is?

Mr. CANTOR. No, I don't.

Mr. POSEY. Okay.

Mr. Gellert?

Mr. GELLERT. Again, we have no contact with them.

Mr. POSEY. Okay. So let the record show nobody knows anything. I guess, Mr. Cantor, in rating MF Global, you assumed that they would conduct their business in accordance with all the laws and regulations, and not that they would loop their customers' segregated accounts for their own benefit.

Is that a correct assumption?

Mr. CANTOR. That is correct.

Mr. POSEY. Okay. Did you assume that the FTC and the CME were fulfilling their responsibilities to audit and verify the proper protection of those assets?

Mr. CANTOR. That is correct.

Mr. POSEY. Would you all have done the same?

Mr. PARMELEE. Yes, sir.

Mr. GELLERT. Yes.

Mr. POSEY. Did you confirm with MF auditors, PricewaterhouseCoopers, that they had verified that controls and systems were in place to prevent theft, fraud, and unauthorized transfers?

Mr. PARMELEE. No, sir. We did not speak directly to the auditors. But typically, we wouldn't expect that an auditor would be able to share information with us as a third party.

They would have a confidential relationship with their client.

Mr. CANTOR. We didn't speak to them directly. We did recognize that they had signed their opinion to the audit opinion that we did review.

Mr. POSEY. Fair enough.

Mr. GELLERT. Again, we have no contact with advisers, auditors or bankers.

Mr. POSEY. I assume you relied on SEC filings to complete your work. Are you aware that some of the 2011 filings may have been backdated and otherwise adulterated?

Mr. PARMELEE. We did rely on the SEC filings. When you say backdated and adulterated, I am not aware. So—

Mr. POSEY. Yes. I said, "may have been."

Mr. CANTOR. I have the same answer.

Mr. POSEY. Okay. But no awareness of the—okay.

And just following up on Mr. Capuano's comments, in Moody's letter to Congress, it stated that they did not learn about MF's large TRM trades until October 21st. And I am just wondering, like everyone else, how that is possible?

Mr. CANTOR. Again, we were aware of the disclosures in the 10-K. And we had read through the 10-K. So we were aware of their positions as reported.

What we became aware of on the 21st was the motivation for the positions and how they were being managed. And at that point in time, the description of that type of activity changed our view on the firm's risk appetite, which, along with the two other measures that we were tracking—earnings and leverage—led us to take the action we had intended to take if we saw that weakening performance along those metrics.

Mr. POSEY. So could anybody come close to properly assuming that just perhaps it was an oversight?

Mr. CANTOR. I don't understand what you are asking. We had talked about in all our publications of a—of taking a multi-quarter approach to evaluating along these dimensions and upon executing along that plan. We took the action that we had intended to.

Mr. POSEY. Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I now recognize the gentleman from New Mexico, Mr. Pearce.

Mr. PEARCE. Thank you, Mr. Chairman.

I guess, Mr. Parmelee, are the ratings system—is that mathematical or is subjective? How do you come up with the ratings?

Mr. PARMELEE. The ratings incorporate both qualitative and quantitative aspects to it.

Mr. PEARCE. Which way is heavier?

Mr. PARMELEE. We take a look at the underlying business. We make an assessment of the business and how risky that business is. And then, we assess the financials. And based on how risky the business is, that drives our outlook on the financials.

Mr. PEARCE. I am looking at your ratings for the firm from about 2008 through 2011, when it started having trouble, as everybody kind of got it right then.

Were your ratings higher or lower than your friends next to you there?

Mr. PARMELEE. When we made our ratings in November of 2010, that took it to a level that is lower than our two largest competitors.

Mr. PEARCE. But what was it up to in 2010? The BBB rating in 2008 to 2010, is that higher or lower?

Mr. PARMELEE. Our highest rating was double B plus over a couple of years. It went down to triple B minus, which is lower, not just lower.

Mr. PEARCE. Okay.

Who is Richard Moore?

Mr. PARMELEE. I don't know Richard Moore personally.

Mr. PEARCE. I didn't ask if you know him personally. I just asked, who is he?

Mr. PARMELEE. I know the name from a media report. But I don't know his role.

Mr. PEARCE. So you might know that he was working for Mr. Corzine and he was also on your board of directors?

Mr. PARMELEE. I didn't know that, sir. I didn't know that before the media reports came out.

Mr. PEARCE. You didn't know that? Okay.

Is it ethical, this off balance sheet trading? You heard my questions, I think, if you were sitting here for Mr. Stockman. Is that ethical?

Mr. PARMELEE. Sir, I think it is an accounting issue. And what is important isn't whether or not the trade is off balance sheet. What is important is understanding the risks that are in the trade.

But I do think, as I said earlier—

Mr. PEARCE. So you are saying that it really didn't matter that Enron was trading, oh, what, $27 billion of its $60 billion?

Mr. PARMELEE. Sir, I think transparency is important.

Mr. PEARCE. Okay. Is this firm transparent? Was MF transparent about its off balance sheet stuff?

Mr. PARMELEE. I think that MF could have been more clear to the marketplace around—

Mr. PEARCE. I am just asking yes or no, are they transparent about the off balance sheet stuff?

Mr. PARMELEE. I think they could have been more transparent than they were.

Mr. PEARCE. Were they transparent enough for you to know what was going on?

Mr. PARMELEE. Once they filed their 10-K report in May, then we knew about the off balance sheet exposure. Before that, we did not.

Mr. PEARCE. So it would have affected it if they had not been sneaky about it before, if they hadn't been—if they had been more transparent.

Mr. Gellert, why did you all, way back there in 2010, you begin to really put warning signs up. You took them down to a 29, which is the equivalent of a CCC, right?

Mr. GELLERT. That is correct.

Mr. PEARCE. Yes. So you took them down.

What was your concern back then?

Mr. GELLERT. Our concern was a combination of drops in primarily three of our six performance categories. So their sales performance was dropping dramatically. Their profitability performance was dropping dramatically, and their leveraging. So we saw significant warning signs across-the-board. We look at some of the numbers that I quoted in my opening statement. There was a dramatic change in that business over the past few years.

Mr. PEARCE. Okay.

Mr. Cantor, I would like your viewpoints on this ethical or nonethical question, about off balance sheet.

Mr. CANTOR. I don't believe it is unethical—off balance—

Mr. PEARCE. Can you speak more into the microphone?

Mr. CANTOR. I don't believe it is unethical to have off balance sheet reporting.

Mr. PEARCE. So if I filed a claim with the Federal Election Commission that declared my net worth to be different because I have some off balance sheet stuff, you wouldn't think that is unethical?

Would you take issue—would you think the Federal Election Commission would take issue with me filing stuff that is off balance sheet?

Mr. CANTOR. I won't comment on that. But I believe this exposure was disclosed in the footnotes. So it was pretty transparent.

Mr. PEARCE. Pretty transparent, except that you all didn't have a clue.

Mr. CANTOR. I don't agree with that.

Mr. PEARCE. You don't agree with that?

You are telling me that they weren't doing anything off balance sheet before you got the word, before they filed that 10?

Mr. CANTOR. Oh, you mean the months—quarters, between quarters? Again—

Mr. PEARCE. Yes. They were moving stuff in and out so they could drive the leverage up and down. Mr. Corzine could come in front of it and brag that he is bringing the leverage down in the firm, when actually what he is doing is he is selling, or whatever, the day before the filing period closes.

All of that stuff is just—you feel like it is normal, everyday activity?

Mr. CANTOR. Moody's position on MF Global was that it had weakening earnings. It had rising leverage. And it had a risk appetite that had the potential to grow, given the change in business strategy.

And all three of those things were affecting risk. The taking on of European debt positions in—at that point in time itself, was not a highly risky credit judgement.

But the decision to maintain such positions on a proprietary basis, essentially take a large side bet, even though the risks themselves were modest, was not consistent with the state business strategy, which was more minimalist in its risk intentions than had been described to us.

Mr. PEARCE. My time is kind of gone. But if I could make a comment that I am seeing where the downgrading goes way south in about a 7-day period.

You want us to believe that the performance of the company was transparent, and that there was nothing really obvious to anybody except Mr. Gellert, who somehow came up with something out of his magic formulas that you all didn't see.

And you want us to believe that. It stretches the belief capability.

Thank you very much, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

The ranking member of the subcommittee is recognized for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Cantor, just for your information, I would suggest that you go back to the 10-K—not you, but whoever the analyst was. On page 76 and on page 17, proprietary activities, it is very clearly reported. As a matter of fact, one of them is in bold.

"Collateralized financing arrangements used in connection with proprietary activities expose our company to issuer defaults and liquidity risks." That is the title of a subsection on page 17.

They go on to say later on that they may have additional margin calls, that we may not readily have.

So people read it. I don't know if they need to be retrained or something.

Mr. Parmelee, in your testimony, on page nine, near the end, you say, "We believe MF Global's demise was driven primarily by rapid downward spiraling of confidence among market participants and counterparties, who questioned the firm's transparency."

What transparency were you referring to?

Mr. PARMELEE. We think that the loss of confidence occurred because of a number of issues. One, concern in transparency around the RTM portfolio, at a time when European sovereigns were under pressure. Certainly, there was a loss that was reported. It was significant.

There were credit downgrades that had happened.

Mr. CAPUANO. No, just the transparency parts of it.

Mr. PARMELEE. The transparency related to transparency around the details of—

Mr. CAPUANO. Related to the—so you weren't concerned about it when you learned it in May, when they had never told you about it before. But now, all of a sudden, you got concerned?

Mr. PARMELEE. Sir, we think there should have been more transparency about it. That wasn't the driver of our credit watch action. We placed the ratings on credit watch on October 26th.

Mr. CAPUANO. You say here that their demise is because of the lack of transparency. And yet that lack of transparency, which you admitted earlier, was revealed to you in May.

So it took you from May until, oh, actually the day they filed for bankruptcy to actually put them below investment grade. It took you almost 6 months for that lack of transparency to, all of a sudden, be of concern.

Mr. PARMELEE. Sir, a series of events occurred, beginning in early September, that we believe undermined the confidence of—

Mr. CAPUANO. No, no. I understand that. I get all that. I know what happened in that time period.

But you said that it was mostly the lack of transparency. I happen to agree with you.

But I guess my concern is that same lack of transparency, which eventually fell apart when you finally acted—that same lack of transparency existed in May.

And I guess once somebody lies to you, doesn't that tell you something about that person or that company? That maybe they might have lied to you about something else? Or maybe they might continue to lie to you?

And yet, it took you 6 months to react to it.

Mr. PARMELEE. And we published about our concern about the transition of this company towards being an investment banking model. We talked about the expectation for higher risk.

Mr. CAPUANO. But you didn't change their rating. You didn't tell anybody in the public.

Mr. PARMELEE. We did, sir, in November.

Mr. CAPUANO. See, I don't know which one of you I should be more upset with, the one who says, it took me 6 months to get upset, or the one who says, I didn't catch it in the first place. And as soon as I figured it out, that I blew it in the first place, I got upset within a couple of days.

Both of those answers stink.

Mr. Gellert, relative to transparency, would you agree or disagree that the 10-K was pretty clear about proprietary action?

Mr. GELLERT. I haven't personally read the 10-K for that language.

But our system pulls in these numbers and processes them properly. If there is a question of transparency, to me, it is relative to the shift in the business model.

And if the business model has been—if it is the stated objective of management to change the business model, I think it is incumbent on anyone who has a relationship with management to ask the questions beyond the benefit of the doubt.

Mr. CAPUANO. You see, gentlemen, here is my problem. I was here for the Enron thing. And when Enron came along, we heard about off shore off balance sheet. A major accounting firm went out of business because of that review of their books.

When we had a crisis in 2008, our major banks talked to us about off balance sheet investments. They called them special investment vehicles, SIVs. They all had them. They all did them. And nobody knew about it, except them.

And now I am being told—or am I being told that it is okay to have off balance sheet significant investments, significantly risky investments, off the balance sheet.

Are you telling me that is okay for your rating, Mr. Parmelee, that it is perfectly acceptable to you?

Mr. PARMELEE. Sir, as I have said, if you are equating off balance sheet to a lack of transparency, I agree fully that there needs to be more transparency. There ought to be more transparency around these transactions.

Mr. CAPUANO. Mr. Cantor, would you agree that it is perfectly okay to have off balance sheet RTMs or any other investment that you are not told about?

Mr. CANTOR. I think it would be helpful to have these types of transactions on balance sheets. But I think there is already transparency. The information is in the footnote, as you identified.

So whether that is on the balance sheet or not, the information is transparent. It takes more work to—

Mr. CAPUANO. So you think everything is perfectly fine. You just basically blew it?

Mr. CANTOR. Again, you can have a lot of debt on assets on your balance sheet. You need to interpret, what are those assets? What are the risks in those assets?

Mr. CAPUANO. So you are telling me that your interpretation was completely, utterly wrong, basically, because you are telling me now that you had enough information to make a judgement.

Fine. Okay. So your judgement was wrong.

Mr. CANTOR. Again, it wasn't the only thing that was important to the rating. But one thing that was important to the rating was whether the principal positions that the firm was taking on represented a significant increase in risk appetite, or whether it was—

Mr. CAPUANO. So an excessively leveraged $6 billion bet that is off the books is fine by you?

Mr. CANTOR. Again, it is not so much that it is off the books.

Mr. CAPUANO. I have to tell you, that really runs—here is my problem: I came to this hearing prepared to give you guys credit for not being totally right about investment grade, but pretty close.

Your ratings were not that good. But what you are telling me at this hearing has just turned me around back to where I started, which is, gee, I am not so sure I can trust you guys anymore.

You think it is okay to have off balance sheet things that nobody reports.

Mr. Gellert, do you think that it is okay? Or do you want more information?

Mr. GELLERT. I think we can always use a lot more transparency. And we end up doing a lot of pro forma sensitivity modeling for our clients, when they want to run scenarios, stress testing things that are off balance sheet, to try to understand them better, and the implications on our ratings.

Mr. CAPUANO. I guess I am walking away here thinking that the major credit agencies think it is perfectly okay to have massive risky investments that are off the books, and that they don't know about, that it is okay for you to tell the public, here is our rating.

That is an incredible statement to say. And I have to tell you, I walk away—I thought today was a day we were going to kiss and make up some our past differences of opinions. But I guess it is not.

I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

I want to go back to some of the basics of the rating model that you used for MF Global.

Would you put this company, then, in the same category as Goldman Sachs? In other words, are you looking at various pieces and aspects of this business—in other words, they would be in the same business category?

Mr. CANTOR. We rate them using a general methodology, securities industry methodology. So they are broadly embraced by the sector.

Obviously, the firms are very different in scale and scope. But they are close.

Chairman NEUGEBAUER. So basically, the same parameters that you would look at Goldman Sachs, you would look at—

Mr. CANTOR. The starting points of the analysis, yes.

Chairman NEUGEBAUER. Mr. Parmelee?

Mr. PARMELEE. When we think about risk, we note that there are some comparisons in the type of risk that they take. For Goldman Sachs, Goldman Sachs is a bank holding company. We apply our bank methodology to Goldman Sachs.

We released new methodology for rating banks in November of 2011.

Chairman NEUGEBAUER. I think where I am going with this is that they were trying to emulate, using the Goldman Sachs model. And so I wondered if you were looking at them as their old business, their old business model, of a broker/dealer, and primarily in commodities?

Or were you looking at them in the sense that this is a company that is broadening their activities? They are getting into proprietary trading. And we need to look at them differently. Because it doesn't appear that you were doing that.

Mr. PARMELEE. So one important difference is, as a bank holding company, Goldman Sachs has access to the discount window and other sources of liquidity that MF would not have had. There are some comparisons.

Under our bank methodology, we break out the components of the rating. And our standalone credit rating on Goldman Sachs is triple B plus. So that would have been two notches above where MF Global was.

So there is some similarity there.

Chairman NEUGEBAUER. I think you heard the risk manager say that he was concerned that this expansion of business probably really stretched their capital. And both of your firms had this company rated basically just inside the rope for investment grade.

Didn't it concern you when you looked at that 10-K and said, okay, this is a company that is maybe marginally capitalized because one of the factors is capital. And now, they are expanding the risk of their company.

Didn't that kind of ring a bell somewhere?

Mr. PARMELEE. Sir, importantly, we did think about that. We did talk about that in our public documents. When we downgraded the company, it was many parts because of the reasons that you point out. We had pointed out, 8 months after Jon Corzine joined the firm, and he was embarking on a strategy to move towards being an investment bank.

We were concerned about the incremental risk that they would be taking on. We noted that in our November release, when we downgraded them to the triple D minus level. So that was months before the RTM portfolio was made public in the 10-K filing.

Chairman NEUGEBAUER. And so my final question is, did you, after you read the 10-K, ask MF Global for details on their off balance sheet activities?

Mr. PARMELEE. I didn't personally, sir. And I am not aware that the analysts asked that question directly.

Chairman NEUGEBAUER. Did Moody's ask, after looking at that? You now testify that you all did read it. So after you read it, did you ask them for details on those off balance sheet activities?

Mr. CANTOR. No, we did not.

Chairman NEUGEBAUER. It looks like I have run out of questioners. I am sure that is okay with the witnesses.

We appreciate you coming. I think one of the things that you probably hear from my colleagues is that we are concerned about every aspect of this. But certainly, there is a responsibility, we believe, in the ratings community to make sure that if people are going to continue to have confidence in the system, that we feel like that—and the public, more importantly, feels like that the appropriate amount of due diligence that is done on your part.

And I think today, we have some concerns about that. So we thank you, the witnesses, for being here.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

With that, this hearing is adjourned.

[Whereupon, at 1:21 p.m., the hearing was adjourned.]

A P P E N D I X

February 2, 2012

Testimony of Richard Cantor

Chief Credit Officer

Moody's Investors Service

Before the

United States House of Representatives

Committee on Financial Services

Subcommittee on Oversight and Investigations

February 2, 2012

Good morning Chairman Neugebauer, Representative Capuano and members of the Subcommittee. My name is Richard Cantor, and I am the Chief Credit Officer of Moody's Investors Service ("**Moody's**"). On behalf of my colleagues, I thank you for the opportunity to participate in today's hearing and talk to you about Moody's views on the creditworthiness of MF Global Holdings Ltd. ("**MF Global**").

In my capacity as Chief Credit Officer, I lead the Credit Policy Group and chair the Credit Policy Committee, which are jointly responsible for the review and approval of rating methodologies. The Credit Policy Group also helps develop the policies and procedures that govern the ratings process and publishes research on issuer defaults, credit losses and the performance of Moody's ratings over time.

In my statement today, I begin by addressing the nature of Moody's rating opinions and why they communicate to market participants the ***relative*** creditworthiness of an issuer or financial obligation. I then describe in detail the evolution of Moody's opinions regarding the credit risk of MF Global.

In summary, for several years Moody's has viewed MF Global as one of the riskiest credits among all US banks and securities firms. In the universe of all rated credits, MF Global was viewed as a medium credit risk, with certain speculative elements, as reflected in its Baa credit rating. Moody's had identified MF Global's franchise and earnings as weak and its business model as being particularly reliant on customer and counterparty confidence. In February 2011, Moody's warned the market that there was continued downward pressure on the rating and identified three metrics – earnings, leverage and risk – upon which we would evaluate the credit profile of the company in the following quarters. In October 2011, Moody's observed that MF Global had performed poorly against all three metrics, and accordingly took appropriate negative rating action. An erosion of confidence in MF Global quickly followed and led to an accelerating flight of customers and counterparties over the course of a few days, greatly straining the company's liquidity. MF Global, like other securities firms that have faced a confidence crisis, actively sought a strategic alternative, such as a sale of the company. When the last-minute revelation of substantial missing customer assets appeared to derail an otherwise done deal, MF Global was forced to file for bankruptcy.

I. The Relative Nature of Moody's Credit Ratings

Moody's credit ratings are forward-looking opinions that speak only to the relative credit risk of fixed income instruments: namely, their relative probability of default and the potential severity of any financial losses to creditors. Moody's credit ratings do not address any other type of risk, such as price, likelihood of prepayment or liquidity risk.[1]

A common misperception exists that credit ratings are binary – *i.e.*, "pass-fail" or "high-low" – perhaps because bonds ***ultimately*** behave in a binary manner: that is, either they default or they do not default. At the time that Moody's forms its credit opinion about any given bond, however, it is not yet known whether the bond will perform or default. It is simply not possible to predict the future with absolute precision. For that reason, Moody's has developed a non-binary rating system that reflects our view of the relative future credit risk of issuers and financial obligations.[2] It is not a "pass-fail" system that predicts which issuers or obligations will or will not default, or when they will default. Rather, Moody's rating system communicates an opinion about the probability of an issuer's or financial obligation's risk of default and loss ***relative*** to other issuers and obligations carrying higher and lower ratings.

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1 A credit rating also is not a recommendation to buy or sell a bond. For more information on the definition of a credit rating, please refer to the Moody's Investors Service Code of Professional Conduct, which is available on moodys.com, or any Moody's rating action, each of which is also available on moodys.com.

2 Moody's credit ratings are expressed according to a system of letters and numbers, on a scale that has 21 categories ranging from Aaa to C. The lowest expected credit loss is at the Aaa level, with a higher expected loss rate at the Aa levels, a yet higher expected loss rate at the A levels, and so on down through the rating scale. Moody's subdivides rating categories Aa, A, Baa, Ba, B and Caa with "numerical modifiers" of 1, 2 or 3. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of that generic rating category.

In addition to the specific rating levels assigned to an issuer or its bonds, a complete summary of Moody's credit opinion is publicly communicated through published commentary and, importantly, through Moody's rating outlooks and public rating review process. A rating outlook is expressed as positive, negative or stable, and provides an opinion regarding the likely direction of an issuer's rating over the medium term, typically 18-24 months. A negative outlook is an opinion that a downward rating action is more likely than an upward change, either as a result of a changing market environment or changes specific to the issuer. Placing a rating on review indicates that a rating is under consideration for a change in the near term. Ratings that are placed on review are said to be on Moody's "Watchlist" or "On Watch".

Moody's expects that some bonds at every level of the rating scale will default, with the forecast probability and magnitude of credit losses rising as the rating level declines. Moody's cannot predict which specific bonds within the group of bonds at a particular rating level will default. If that were possible, Moody's would have a binary credit rating system with only two rating categories: "default" and "not default". In our view, the usefulness of a rating system can be measured by the performance of the ratings over time and in the aggregate. Moody's regularly reviews the historical performance of its credit ratings and publishes its findings on its website.[3]

Moody's credit ratings are not formula-driven. In assigning our credit opinions, our analysts adhere to Moody's published credit rating methodologies. Ratings are determined by a rating committee, which is a deliberative process that

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3 Please refer to, for example, Moody's Special Comments entitled, "The Performance of Moody's Corporate Debt Ratings: September 2011 Quarterly Update" and "The Performance of Moody's Structured Finance Ratings: September 2011 Quarterly Update." The conceptual framework behind these performance reports is discussed in two Special Comments entitled, "Measuring The Performance of Corporate Bond Ratings," published in April 2003, and "Measuring The Performance Of Credit Ratings," published in November 2011. These documents and many other reports on ratings performance are available on www.moodys.com.

incorporates subjective human judgment. Other providers of credit opinions follow a similar rating process and use rating symbols intended to convey a meaning somewhat similar to Moody's rating symbols. Still other opinion providers use symbols with very different intended meanings, and others offer purely quantitative and market-based measures of credit risk. Moody's fully supports this diversity of opinion in the market, both in form and substance.

II. Moody's Credit Opinion of MF Global

By early 2008, Moody's viewed MF Global's creditworthiness as not particularly strong. It was seen as a mid-range credit with certain speculative characteristics. MF Global was one of the lowest rated credits in the US banking and securities industry.[4] This view was reflected in Moody's assignment of MF Global to the Baa rating category, which is many notches down from the highest rated credits.

In early 2009, Moody's observed a "weakening in MF Global's earnings generation ability,"[5] and expected MF Global's "revenues to continue to come under pressure over the coming quarters," given the uncertainty in financial markets. Moody's therefore downgraded MF Global's credit rating to Baa2 from Baa1.

By late 2009, Moody's observed an increase in MF Global's balance sheet leverage and accordingly assigned a negative outlook to MF Global's Baa2 rating. As noted above, a rating outlook indicates the likely direction of an issuer's next rating change over the medium term. A negative outlook communicates to the market that we see downward pressure on the issuer's credit profile.

As with all rated credits, Moody's continued to monitor and evaluate the credit profile of MF Global in 2010, including in light of the appointment of Jon Corzine as Chairman and Chief Executive Officer in March of that year. In comments

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4 Among rated US banks and securities firms in the US at the beginning of 2011, only 15% were rated lower than MF Global in 2010.

5 All quotes in this section refer to Moody's publications, each of which has been furnished to the Subcommittee.

Moody's published following Mr. Corzine's appointment, we stated that the appointment held no rating implications for MF Global, and noted that the company's negative outlook continued to reflect its high leverage and weak profitability.

Early in 2011, Moody's observed MF Global's weaker profitability and high leverage relative to similarly-rated peers, and convened a rating committee to assess its credit rating. Moody's rating announcement on February 3, 2011, affirming its Baa2 credit rating and maintaining a negative outlook, identified three factors that it expected to be primary drivers in determining its next rating action. Moody's stated that MF Global would be evaluated over the following four to six quarters on its ability to:

- Generate annual pre-tax earnings in the $200 million - $300 million range;
- Achieve balance sheet leverage in the low 20x range; and
- Maintain liquidity and risk management discipline.

Two quarters later, Moody's published a Credit Opinion[6] which stated that in Moody's view, MF Global continued to face several challenges. Moody's stated that it would most likely downgrade MF Global if revenue and pre-tax profitability did not improve significantly, or if the company failed to manage risk adequately or materially increased in its risk appetite without increasing its capital.

On Friday, October 21, 2011, Moody's analytical team met with Mr. Corzine and members of his senior management team in advance of MF Global's announcement of its Fiscal Year 2012 second quarter financial results, scheduled for the following week. The information disclosed at that meeting showed that MF

[6] A Moody's Credit Opinion is a periodically updated stand-alone research summary designed to give the reader an overview of the rationale behind a Moody's rating, the key credit strengths and weaknesses, and the outlook for what would drive the rating up or down. Credit Opinions are typically informed by Moody's most recent rating announcement concerning the issuer, and the accumulated knowledge and judgment of the analyst or analysts assigned to the issuer.

Global was not satisfying any of the three factors that Moody's had listed in its February announcement – an important benchmark in Moody's opinion of MF Global's credit risk.

During the meeting, MF Global made clear to Moody's for the first time that MF Global's repurchase-to-maturity transactions were not client-driven transactions, but instead were purely proprietary trading positions. Moody's had understood that MF Global was expanding its principal trading activity for the primary purpose of facilitating customer transactions, as opposed to generating trading profits. That understanding was developed over time through numerous meetings and discussions with MF Global management, and a review of information provided by the company and public filings.

In Moody's view, MF Global's decision to assume large credit exposures that were not client-driven and represented a multiple of the company's outstanding common equity highlighted MF Global's increased risk appetite—in the absence of a parallel increase in capital. Moody's also was told at the meeting that MF Global expected to report a significant quarterly loss and that gross leverage had increased.

On the next business day following the analysts' meeting with the company's management (that is, Monday, October 24), Moody's downgraded MF Global's credit rating to Baa3 and placed MF Global's rating on review for a possible further downgrade. As noted above, a review communicates to the market that a rating is under consideration for a change in the near term—in this case a downward change.

Following the Moody's downgrade, MF Global brought forward its quarterly earnings announcement by two days to Tuesday, October 25, and disclosed a record quarterly loss. As MF Global's crisis accelerated over the subsequent 48 hours, Moody's observed a "heightened risk of loss of client and counterparty confidence" and downgraded MF Global's rating another two notches to Ba2 on Thursday, October 27. Moody's also kept the credit on review for potential further downgrade. Moody's continued to monitor MF Global as its counterparty and customer flight gathered pace and as the company explored various strategic options. By the following Monday, October 31, MF Global had drawn down its entire credit facility, and the sudden and unexplained disappearance of significant customer assets appeared to derail any possibility of a sale of the company. With no options left, MF Global filed for bankruptcy and Moody's downgraded MF Global to Caa1.

III. Conclusion

As Moody's observed in January 2009, the MF Global franchise was particularly reliant on customer and counterparty confidence. The events of late October 2011 demonstrate that MF Global lost the confidence of many customers and counterparties over the course of a few days, despite the lack of any default or other credit event occurring on its European sovereign debt positions. Moody's repeated rating actions during that brief period reflected our opinion that the company could not meet the three specific criteria that Moody's had spelled out in February 2011 with regard to earnings, leverage and risk. Moody's withdrew its ratings of MF Global altogether on November 15, 2011 after MF Global had declared bankruptcy.

Thank you again for inviting me to testify on this important matter, and I look forward to answering your questions.

# # #

Testimony Concerning:
"The Collapse of MF Global: Part 2"

James H. Gellert
Chairman and CEO
Rapid Ratings International, Inc.

Before the
United States House of Representatives

Committee on Financial Services,
Subcommittee on Oversight and Investigations

February 2, 2012

On behalf of Rapid Ratings' employees, shareholders and subscribers, I would like to thank Chairman Neugebauer, Ranking Member Capuano and members of the Subcommittee for asking me to submit testimony for the hearing entitled *The Collapse of MF Global Part 2* before the United States House of Representatives' Committee on Financial Services, Subcommittee on Oversight and Investigations.

MF Global's failure was the latest collapse of a previously respected financial institution to catch much of the market off guard. Rapid Ratings International, Inc. (Rapid Ratings) is pleased to share our understanding of the MF Global deterioration, insight into why the Rapid Ratings Financial Health Rating (FHR™) system provided years of early warning and our conclusions as to why the traditional, issuer-paid rating agencies failed to provide similar service. Finally, we highlight the problems facing rating industry reform and explain our support for the quarterly ratings affirmations bill discussion draft released by Subcommittee member, Congressman Mike Fitzpatrick.

Introduction

Outside of the futures world MF Global may have been little known, but inside it was a very large player,[1] and its demise and aftermath constitute the most shocking event ever to occur in the futures industry. Contributing to the unfortunate story is that this was an entity perceived by many in the market as a strong credit, in part because it carried "investment grade" ratings from the "Big Three" rating firms (Standard & Poor's, Moody's and Fitch) until days prior to its failing.

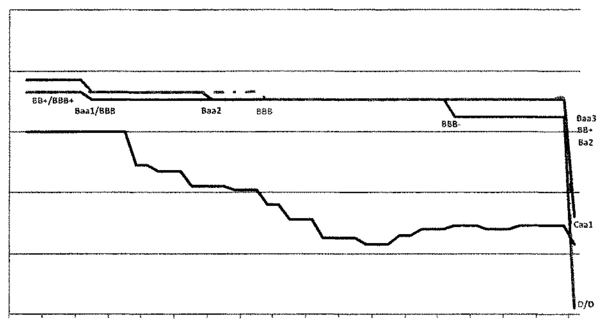
Rapid Ratings, however, had MF Global rated as a High Risk firm since June 2009. In fact, on our Financial Health Rating (FHR) scale (0/worst – 100/best), MF Global was downgraded from a 41 to a 36 on June 29, 2009, carried an FHR of 29 into October 2011, and then dropped even further to a 23 based on the quarterly figures released the week of the MF Global bankruptcy filing. While Financial Health Ratings do not have a direct translation to the alpha scales used by the Big Three, MF Global's 29 and 23 are the approximate equivalents of CCC and CCC-, that is to say, our ratings were between eight and ten alpha notches below where the Big Three agencies had MF Global rated during this period.

For context, over the last 20 years, the greatest concentration of defaults occurred at a 26 on the FHR scale and approximately 90% at 40 and below, which we consider our High Risk and Very High Risk categories. Often Rapid Ratings' FHRs are described as proxies for how well a company is able to withstand an internal or external shock. Companies with higher FHRs are

[1] MF Global was the eighth-largest U.S. futures broker, and a big player in global commodity markets. (Saphir, Ann. "MF Global Client Accounts were not protected: regulator." *The Globe and Mail* 10 Nov 2011. http://m.theglobeandmail.com/globe-investor/mf-global-client-accounts-were-not-protected-regulator/article2221277/?service=mobile)

generally stronger, more efficiently run entities with more flexibility and resiliency. Companies with lower FHRs are less healthy and have a significantly higher likelihood of failure. For more than two years (since June 29, 2009), we continuously gave significant warning to our clients that MF Global had the characteristics of a firm at high risk. And even before that our system was alerting the market of the declining health of MFG (see Figure 1).

Figure 1: Rapid Ratings, Standard & Poor's, Moody's and Fitch ratings of MF Global on the FHR™ Equivalency Scale[2]



As I will explain later, there are many reasons why our ratings were so much lower than the Big Three, but it seems difficult to justify that they maintained such high ratings on MF Global irrespective of our ratings. To the FHR system, which incorporates a global benchmarking of 62 financial ratios, MF Global is a remarkably simple story in many respects: It showed a declining performance since 2007 in various measures of revenue performance, profitability, debt service management, and working capital efficiency, and weak performance in leverage and cost structure. Between the years of 2007 and 2011, MF Global's revenue declined by 63%, from \$6.1b to \$2.2b. Its net profit declined by 142%, from \$190m to negative \$79m. In the last 16 quarters, MF Global had 10 quarters with recorded losses and the last 4 quarters saw losses grow by 68% over the previous 12 months, their most recent quarterly loss being a record at \$187m.

[2] The graph above plots S&P, Moody's and Fitch ratings based on their approximate equivalents on the Rapid Ratings FHR scale. Rapid Ratings first rated MF Global on January 27, 2009. The previous ratings are retrospective ratings using only data from that time period.

In the abstract, it is difficult to see this entity as being anything but in declining health. Yet, during the period 2007 to 2011 until the final week before MF Global's bankruptcy, Moody's ratings remained Investment Grade and only declined three notches (from A3 to Baa3), and S&P's Investment Grade ratings only declined two notches (from BBB+ to BBB-). In the five days prior to default, Moody's then downgraded two more times, to sub-investment grade Ba2 and then to Caa1 on the bankruptcy filing date.

Much has been made of the European sovereign bond trading bets made by former MF Global CEO, John Corzine. In December, Mr. Corzine testified that his bets on Euro sovereign debt were sound and ultimately would be proven correct and profitable. Nevertheless, these bets were market contrarian and exposed the firm to significantly greater risks than ever before, at a time when the firm's financial health could ill afford a shock and the market's sensitivity to financial institution risk was on high alert. The question is not whether the trades would have worked; it is whether they were appropriate in scale for this institution at this time. Many a trader has made money on contrarian bets; but this institution was historically a pure intermediary, assuming unprecedented risks in a volatile market while shifting business models with a low capital base. Thus, the firm became excessively exposed. In turn, the large rating agencies, watched by much of the market to provide signals of increased risk and vulnerability, failed to do either adequately.

Many are trying to understand why the Big Three rating firms maintained such high ratings despite the obvious evidence of declining health and increased risk-taking. Rapid Ratings incorporates no subjective factors into the FHR system, and we use only reported financial statements when rating public entities like MF Global.[3] Nevertheless, we were able to identify the risks that the Big Three did not identify, chose to disregard or deemed not to warrant material downgrades.

We are not privy to the inner workings of the Big Three's ratings analyses of MF Global. However, in their various ratings reports and announcements on MF Global over the years, repeated themes emerge. These can be categorized as concern about:

- Risk management
- Lack of revenue diversification
- Declining profitability

Despite maintaining MF Global's investment grade ratings for years with only occasional small ratings movements, the agencies finally downgraded MF Global's ratings days and hours before the bankruptcy filing, with a list of rationales for their downgrades. What were they? The same items listed above. In other words, the Big Three offered no new information in downgrading

[3] Rapid Ratings also rates thousands of private companies on behalf of clients. We use financial data provided to us by our clients or directly by the entities being rated on behalf of our clients.

MF Global. The quantum of exposures and losses may have grown, but ultimately, although the fundamentals of the credit story were known by the agencies, their warnings were inadequate until it was too late. That said, new information may suggest that at least one of the Big Three simply apparently did not pay attention to certain disclosures that may or may not have been factors in their ratings process earlier in 2011. Or perhaps the agency did not inquire about the details of the disclosures.[4]

Additionally, there are inherent conflicts of interest and other deficiencies of the Big Three's business model that appear to have contributed to the MF Global debacle. Those deficiencies are not new, rather they are the same issues that have caused examples of egregious ratings failure from Enron, to subprime-backed Collateralized Debt Obligations, to Monoline Insurers, to MF Global. The deficiencies, explored in greater depth below, are:

- The conflicts of interest in the issuer-paid ratings business model, including interaction with management like Mr. Corzine
- The failure of qualitative ratings to look at the agency's rated clients objectively on consistent, arms-length bases
- The favoring of "stable" ratings that results in infrequent ratings changes and less accuracy
- The lack of accountability for surveillance on outstanding ratings

MF Global has shaken the roots of the futures industry, but the case offers lessons far beyond this specialized portion of the capital markets. The futures industry players now understand what corporations globally have also begun to recognize: evaluating counterparty risk is more important than ever before. Doing so gives insight into the financial health and viability of broker/dealers, depository institutions, customers, suppliers, third party solutions providers and any counterparty with which they do business.

There are few silver linings to the MF Global debacle. One small positive, however, is that we have a fresh example to allow scrutiny of the traditional rating agencies' role in the capital markets, the inherent conflicts and flaws in this system, and the patently obvious need to increase their accountability for their ratings product.

While we regularly outperform the traditional agencies in providing early warnings of companies' improving or deteriorating financial health, we do not take a view that the Rapid Ratings' system is simply "better" than others, nor do we believe that traditional ratings are always flawed. Ultimately, we have different business models and rating methodologies, but

[4] On January 29, 2012, Shahien Nasiripour wrote in the *Financial Times* that "Moody's Investors Service 'did not have any understanding' that MF Global, the failed futures broker, had placed a $6.3bn proprietary bet on the debt of troubled European sovereigns until about a week before the brokerage filed for bankruptcy, despite MF Global's disclosure of the gamble some five months earlier in May." (Nasiripour, Shahien. "Ratings agencies to be quizzed over MF Global." *Financial Times* 29 Jan 2012. http://www.ft.com/intl/cms/s/0/7546a9ee-4a88-11e1-8110-00144feabdc0.html

our ratings may be used by the same clients for similar purposes. We are proponents of having an open field for competition in the ratings business so institutional investors, regulators and all other users of ratings can choose amongst options that best suit their needs. A principal strategy for creating better results in the rating industry is for regulators and legislators to remove barriers to competition. That will provide market players a more diverse selection of rating products from which to choose.

The Big Three have received unprecedented support as private sector entities for years by virtue of being embedded in the investment community's workflow practices, in federal regulations, where historically the Big Three were effectively deputized as risk management agents, in state regulations, private contracts, bank pricing grids, pension parameters, institutional investors' internal risk guidelines and on and on. Nevertheless, change can happen with effort. As legislative and regulatory reform initiatives continue, and as Congress evaluates the effectiveness of Dodd-Frank, as it did when this Subcommittee met on July 27, 2011 at a hearing entitled "Oversight of the Credit Rating Agencies Post Dodd-Frank," enhanced competition in the rating industry, greater accountability of the Big Three, and reduced reliance on ratings must be principal objectives.

As the MF Global failure and this review demonstrate, diversification of opinion, methodology and business model are all healthy for the rating industry and critical to facilitating well-rounded investment management and risk management procedures in the capital markets. Any initiative that hinders these goals and continues to support the Big Three agencies' entrenched position actively works against reducing systemic risk and improving confidence in the financial markets. Any thoughtful initiative to improve the industry should be strongly considered.

Congressman Fitzpatrick's recent bill discussion draft is timely and pertinent to MF Global. Requiring Nationally Recognized Statistical Rating Agencies ("NRSROs") to stand by their product on a quarterly basis is a positive initiative. As MF Global shows us yet again, the Big Three have a powerful place in the capital markets, yet almost no accountability when their ratings fail. They are not required to update ratings except when they feel it appropriate. They may indeed be timely on some ratings actions, but often they are not. The outside world has no way of knowing when they are being proactive, behind schedule or simply inattentive to maintenance of an existing rating. The bill's intent, we believe, is not to force ratings to change quarterly; it is to require that the agencies assure the market that they stand by their ratings quarterly. At a bare minimum, it should produce more confidence that the agencies are accountable. In some cases, like with MF Global, perhaps it would have encouraged earlier ratings changes, as agencies would be less inclined to give management benefit of the doubt, or to ignore the clear signs of a credit in decline.

Rapid Ratings' Methodology

Rapid Ratings is a user-paid firm, not an issuer-paid agency. We utilize our proprietary, software-based system to rate the financial health of thousands of public and private companies and financial institutions quarterly (in countries where quarterly financials are available). Currently, we rate over 6,500 public, and thousands of private, companies from 71 countries. We use only financial statements, no market inputs, have no qualitative analysts, and have no contact in the rating process with issuers, bankers or advisors. We are not a Nationally Recognized Statistical Rating Organization (NRSRO). We have elected not to apply for the designation, considering it more a contingent liability than an asset. Our ratings have an impressive record of far outperforming the traditional issuer-paid rating agencies in innumerable cases, and also generally outperforming the prevalent market-based default probability models.

We rate companies irrespective of whether they are bond issuers. We also do not distinguish between those companies that are issuing new securities versus those who have securities outstanding. Unlike the Big Three, we are focused on providing quarterly updated ratings, as well as the highest accuracy, breadth of coverage and speed to market to reflect the changing financial health profiles of firms we rate. The Big Three are naturally focused on primary issuance, where they traditionally get paid the majority of their fees; risk surveillance of ratings already issued is a secondary focus. This is one of the great failings of the incumbent system, and a perfect example of where a new player employing an innovative methodology can provide great value relative to the status quo.

The Financial Health Rating is a strict metric of financial and operating efficiency, derived from the in-depth study of 62 ratios across six performance categories without reference to market inputs or management explanation. The FHR measures a company's sturdiness and ability to withstand shocks from the economy, industry trends, or its own discrete misfortunes. Clients using Rapid Ratings' FHRs on MF Global were in the unique position to know, well before the bankruptcy filing, that MF Global had a weakened likelihood of surviving major reversals in its proprietary trading book, liquidity position or other shocks to the system.

Financial Health Ratings of MF Global

When MF Global filed for bankruptcy on October 31, 2011, it was the fifth largest bankruptcy of a financial institution in American history (following Lehman Brothers Holdings Inc., Washington

Mutual Inc., CIT Group Inc. and Conseco Inc.[5]), and the eighth largest bankruptcy of any institution in American history.

Many broad issues come up because of the MF Global collapse: The weaknesses in regulatory oversight of financial institutions, the deficiencies of accounting/auditing analysis, the lack of security of customer deposits, the challenge to the faith of farmers and others in using agricultural derivatives to hedge revenue fluctuations, the lack of confidence among futures market participants in counterparty financial risk, and once again, the lack of accountability of traditional rating agencies.

What Rapid Ratings' System Saw and When

See Appendix D for a timeline highlighting the events and ratings actions that preceded the collapse of MF Global.

On March 23, 2010 Mr. Corzine[6] became CEO of MF Global at the invitation of his former Goldman Sachs colleague, J. Christopher Flowers,[7] who had earlier bought 6% of the firm in 2008 by helping it finance $141 million in losses in unauthorized wheat trading.[8] Based on the FHR system, MF Global by March 2010 was already High Risk in debt service management, Very High Risk in both sales performance and overall profitability, mediocre in terms of leverage,[9] under-nourished in terms of equity-backing, and with sub-investment grade performance for both working capital efficiency (including liquidity) and cost structure. The rating changes after Q2 2010 are more marginal changes; the company took the big hits before Q3 2010 and never recovered.

Mr. Corzine's strategy of shifting business activity from futures brokerage to a full service broker-dealer in the Goldman image was risky. It included proprietary trading that involved going against growing market sentiment in Euro-zone sovereign bonds by using short-term loans in the repo market to hold long positions. This only deepened the problems of MF Global, and ultimately directly and indirectly led to the collapse of the company.[10] Had MF Global

[5] "20 Largest Public Company Financial Industry Bankruptcy Filings 1980-Present." BankruptcyData.com. Website. http://www.bankruptcydata.com/Research/Largest_Financial.pdf

[6] Former head of Goldman Sachs and former Governor of New Jersey.

[7] A wealthy former institutional banker with Goldman Sachs. Both men were considered to be well aware of the risks they were taking punting on Euro-sovereign bonds. (Cohan, William. "MF Signs Death Warrant for Short-Term Funding." *Businessweek* 15 Nov 2011. http://www.businessweek.com/news/2011-11-15/mf-signs-death-warrant-for-short-term-funding-william-d-cohan.html)

[8] Dezember, Ryan. "MF Global and Chris Flowers: A Match Made for Rescue?" *Wall Street Journal* 30 Oct 2011. http://blogs.wsj.com/deals/2011/10/30/mf-global-and-chris-flowers-a-match-made-for-rescue/

[9] MF Global's equity to assets ratio actually improved over the period 2006-2012, although leverage was excessive. The problem with MF Global's leverage was borrowing short to buy long positions in a poorly understood market combined with poor sales and profitability and hence debt service management performance, rather than over-leverage per se. However, unlike banks, U.S. brokerage firms are not subject to regulatory restrictions on leverage by federal authorities.

MF Global	2006	2007	2008	2009	2010	2011	2012
Equity/assets	1.1%	1.0%	2.6%	3.7%	2.7%	3.7%	3.3%

[10] "MF ploughed money into an off-balance-sheet maneuver known as a *repo*, or sale and repurchase agreement. A repo involves a firm borrowing money and putting up assets as collateral, assets it promises to repurchase later. Repos are a common way for firms to generate money but are not normally off-balance sheet and are instead treated as "financing" under accountancy rules. MF Global used a version of an

offered a lower risk foundation, MF Global might have been able to withstand the failure of the new business strategy. As it was, Mr. Corzine inherited an unhealthy company and made it worse by some high-stakes gambles.

From the beginning of Mr. Corzine's tenure, MF Global was behind the Financial Health Rating eight ball. The firm was suffering in various performance categories within the FHR system: on Sales Performance, on Profitability, on Debt Service Management, as well as on financial strategy (borrowing short to hold long positions) and on business strategy (trying to beat the Euro-zone bond market while avoiding massive market, counterparty and regulatory concern about the magnitude of the exposure).

Because his business strategy was poorly calculated, or had insufficient time to turnaround the firm, those three factors deteriorated and led to further decline in the Financial Health Rating of the company. This made it much more likely that his short term lenders would become restless and then desert MF Global, just as similar lenders had deserted Bear Stearns and Lehman Brothers in 2008. More specifically, the key highlights were as follows:

- MF Global's **Overall Profit performance** (using 23 ratios) had not been low or moderate risk for the last six years and exhibited persistent deterioration and then stagnation in the Very High Risk zone. During 2006 through Q1 2009, the company's profit performance slipped from a medium risk peak of 59 in 2007 to 40, bordering on High Risk. Just one year later, in Q2 2010, MF Global's overall profit performance had become Very High Risk, falling to 12. The firm's profit performance remained in the Very High Risk area until it collapsed on October 31, 2011. See **Appendix A** for one example of a profit ratio that shows sustained deterioration and weakness across the period.
- MF Global's **Debt Service Management performance** (using 3 ratios) was below average and medium risk during the period 2006 through Q1 2010. In Q2 2010, MF's debt service management performance fell 29% (or 12 rating points) to become High Risk, and did not recover. A specific example of deterioration in this area is set out in **Appendix A**.
- MF Global's **Sales performance** (using 5 ratios) was a tale of mediocrity during 2006-2007 that became a story of High Risk in Q1 2009, Very High Risk in the 2009 year end results, and no improvement afterward. An example of the deterioration in performance is presented in **Appendix A.**

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off-balance-sheet repo called a "repo-to-maturity." The repo-to-maturity involved borrowing billions of dollars backed by huge sums of sovereign debt, all of which was due to expire at the same time as the loan itself. With the collateral and the loans becoming due simultaneously, MF Global was entitled to treat the transaction as a "sale" under U.S. GAAP. This allowed the firm to move $16.5 billion off its balance sheet, most of it debt from Italy, Spain, Belgium, Portugal and Ireland." (Elias, Christopher. "MF Global and the great Wall St re-hypothecation scandal." *Reuters News & Insight* 7 Dec 2011. http://newsandinsight.thomsonreuters.com/Securities/Insight/2011/12_-_December/MF_Global_and_the_great_Wall_St_re-hypothecation_scandal/)

A key point about the FHR system is that because its early warnings had fully reflected emerging risk in 2008-2010, as the last minute shocks of the MF Global crisis emerged in October 2011 and the Big 3 ratings were making significant adjustments to move MF Global to a lower rating, Rapid Ratings' FHRs were adjusting very little. The advantage of Rapid Ratings' quarterly rating system is that it catches changes as they arise; it is not a "flatlining" metric that changes a long time after risks arise. The story of MF Global is one of a company that was weakening progressively during 2008-2010, and when Mr. Corzine's arrival brought on a new business strategy, it did not work. Given that the company was already weak, it could not recover or instil confidence in lenders for a new lease on life.

Insensitivity of Traditional Ratings

Ratings "Stability"

The ratings story of MF Global inevitably turns to questions of ratings actions and their timing. Traditional agencies will say that they need to be careful when they take action against a company because their ratings changes will affect that issuer in the marketplace. To wit, a downgrade to below investment grade will force some institutional investors that are prohibited from holding sub-investment grade paper to liquidate holdings. Enough of these forced sellers and there is downward pressure on bonds' pricing, increasing their real or perceived risk in the market, increasing borrowing cost for the issuer and potentially putting even more stress on an issuer that is already distressed, thus aggravating or intensifying the original downgrade.

This is a real concern. It should not, however, be a categorical shield from responsibility for the traditional agencies, nor an excuse for them to be inactive or to give undue benefit of the doubt to a deteriorating issuer.

As stated in the preamble to Dodd-Frank[11] Subtitle C: "In the recent financial crisis, the ratings on structured financial products have proven to be inaccurate. This inaccuracy contributed significantly to the mismanagement of risks by financial institutions and investors, which in turn adversely impacted the health of the economy in the United States and around the world. Such inaccuracy necessitates increased accountability on the part of credit rating agencies." The accuracy of Big Three ratings has long been the subject of debate. That debate is strategically important because it makes the argument that accuracy is more important than the "stability" of ratings. The traditional issuer-paid firms have used "rating stability" as a shield to deflect attention from the challenge and charge of "inaccurate ratings." Accurate ratings provide earlier warnings, stable ratings do not.

[11] United States. Cong. House of Representatives. *Dodd-Frank Wall Street Reform and Consumer Protection Act*. 111th Cong., 2nd sess. H.R. 4173. Washington: GPO, 2010. (508) http://www.gpo.gov/fdsys/pkg/BILLS-111hr4173enr/pdf/BILLS-111hr4173enr.pdf

The Big Three produce "stable" ratings by means of "rating through the cycle." The intent of rating through the cycle is to have ratings that reflect the longer-term perspective of an issuer at the conclusion of its cycle, rather than reflecting the intra-cycle conditions and performance variations of the company. The result, of course, is ratings that exhibit little or no change (flatlining) because the agency is not continually reflecting any ups and downs the issuer may experience over time. Only when the agency considers a truly material change to warrant a rerating will there be a change. Enron remaining investment grade until hours before it filed for bankruptcy, MF Global and countless other examples expose the costly Achilles heel of this methodology.

The Big Three typically defend this position by citing studies that suggest that the investment community wants ratings stability. While there are studies that document the opposite position, in fairness, many institutional investors do want to avoid volatility in rated portfolios given the inconvenience of frequent portfolio rebalancing and their ability to arbitrage stale ratings. Further, some regulators have supported the view that monitoring firms' capital adequacy frequently is too burdensome on the firms and the regulators. Unfortunately, rating through the cycle means being less sensitive to the short-and medium-term changes in a credit that make it more or less healthy at any given time but that may be early indicators of long-term change. An unwarranted low rating primarily has opportunity cost implications. An unwarranted high rating, as with MF Global, can have material real dollar cost implications for lenders, investors and counterparties. Having widespread risk benchmarking correlated to these insensitive measures has real systemic risk impact.

Within reason, some ratings changeability may benefit the market. We are not promoting volatile ratings swings, but realistic changes can benefit the market, and in the extreme, even changes that have severe consequences for an issuer may have positive overall consequences. As default approached in the last 12 months, ratings on MF Global issued by Rapid Ratings were much more stable than those offered by the Big 3. The rule should be: change ratings when warranted, affirm them quarterly and reflect emerging reality. That will offer early warnings and rating stability that already encapsulates emerging risk as a crisis draws nearer.

In the case of MF Global, S&P, Moody's and Fitch all maintained investment grade ratings on the company as it deteriorated. This was neither an early warning of inherent risks nor a reflection of emerging risks. Moody's maintained an investment grade rating (Baa2) until four days before MF Global filed for bankruptcy, at which time it had downgraded the entity to Ba2, two notches below investment grade. It is possible that the Moody's downgrade accelerated MF Global's demise. But client withdrawals (including Koch Industries) from August through October[12] and regulatory intervention by FINRA, CME and CFTC was already providing a major

[12] Prezioso, Jeanine. "Insight: Clients who fled MF Global face clawback risk." *Reuters* 11 Nov 2011. http://www.reuters.com/article/2011/11/11/us-mfglobal-clawback-f-idUSTRE7AA38A20111111

alert, albeit a late one, that MF Global was in trouble before the Big Three acted. The downgrade to below investment grade may indeed have been an event from which MF Global couldn't recover, as counterparty liquidity may have dried up as a result of the regulatory intervention and the downgrade just as collateral calls were increasing. But as we now know, MF Global was already bleeding client funds before the regulators, and rating agencies made it worse. Market whispers in the equity market were a better early warning signal than either the regulators or the Big Three rating agencies. But if the downgrades had been issued earlier, the MF Global crisis could have unfolded differently. So if the traditional agencies argue downgrades should not happen before a crisis, what good are downgrades after a crisis?

The Subcommittee should consider the cost of accepting the Big Three's argument that they did not need to downgrade earlier. What is at stake is futures market stability, consumer confidence and potentially over $1 billion in account holder funds. If Moody's or S&P had downgraded MF Global earlier, how much of segregated funds could have been saved? Assuming there was a direct cause and effect between Moody's downgrade and the death knell for MF Global, is it conceivable that an earlier precipitation of this event could have forestalled any activities that have led to capital loss for individual and institutional investors with funds that are still not located and possibly never recoverable?

A recently released working paper, *"Does the Bond Market Want Informative Credit Ratings?"* by Cornaggia and Cornaggia,[13] tackles the question as to whether market participants benefit more from relatively stable ratings utilizing traditional methodologies than from quantitatively derived ratings that are timely and accurate. Moody's Credit Ratings (MCRs) are employed as a proxy for the Big Three. Cornaggia and Cornaggia categorize the MCRs as compensated by issuers and based on qualitative analysis geared toward stability in rating levels that reflect only relative risk.

In order to test and benchmark MCRs, they select a rating system that provides contrast on multiple criteria. Cornaggia and Cornaggia write, "The Financial Health Rating (FHR) produced by Rapid Ratings (RR) is compensated by subscribers, based on quantitative models, and geared toward the timely release of information as it pertains to absolute credit risk."[14]

In the body of the working paper, MCRs are tested rigorously for information content against FHRs. The authors write, "We document that among bonds that ultimately default, RR

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13 Jess Cornaggia, PhD, is an Assistant professor at Indiana University Bloomington - Kelley School of Business. Kimberly Rodgers Cornaggia, PhD, is an Associate Professor American University - Kogod School of Business. The authors' note reads: "To support our use of Rapid Ratings as an exemplar, we note its recognition by regulators, law makers, and market participants. RR was the only non-Big-3 credit rating agency invited to speak on the ratings competition panel at the SEC Roundtable in 2009 and to testify before both congressional bodies in the run up to the most sweeping change in rating agency regulation in history." (Cornaggia J, and Cornaggia, K. *Does the Bond Market Want Informative Ratings?* 2 May 2011. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1705843&download=yes)

14 Gellert, James H. The United States of America. *Competition in the Credit Rating Industry: Are we asking the right questions and getting the right answers?* Washington: 2009. Web. 25 Jul 2011. http://www.sec.gov/comments/4-579/4579-20.pdf

downgrades the FHR to speculative grade status long before the Moody's credit rating follows suit." The data tests speak to the magnitude of these findings: They demonstrate that Rapid Ratings is 2.9 years earlier than Moody's.

One test in the study compared default frequencies among issues with investment grade ratings. The professors report a higher default frequency among issues with investment grade ratings according to the MCR compared to the FHR, writing "2.61% of defaulting firms had FHRs classified as investment grade one year prior to default." The corresponding number of defaulting firms with investment grade MCRs is 5.67%.

Cornaggia and Cornaggia contextualize these findings with respect to Moody's' stated position that stable ratings help avoid market disruptions. They postulate that gradual ratings downgrades may have disrupted the financial markets less than the huge volatility spikes and losses of investor confidence that accompanied the too-late downgrades of Enron and AIG among others, which now includes MF Global. This bolsters the position of those who have claimed that over-reliance on traditional credit agency ratings increase vulnerability to sudden market shocks. This is a critical issue. Rapid Ratings provides early warnings that the market can absorb long before a crisis, whereas the Big Three provide ratings that can compound a crisis as it reaches its climax.

The Qualitative Unknown of Management Influence

Another reason for the flatlining ratings from the Big Three is that downgrades aggravate their principal clients, the issuers, and issuers' bankers, who feed significant revenue flows to the agencies. As issuer-paid agencies, the Big Three's client was MF Global, not institutional investors. This means an issuer has unique access to the staff of its rating agencies and can present its vision of the future, explain how it is addressing weaknesses and exploiting strengths and, in the extreme, co-opt the raters.[15]

For certain the most egregious examples of this conflict have been in structured product ratings, not plain vanilla corporate ratings such as MF Global. However, it stands to reason that Mr. Corzine's star power was, at the margin, a positive influence on MF Global's ratings. How much so? We cannot tell. But in the face of the firm's clear indicators of deterioration, something powerful must have been weighing on the Big Three to justify their high ratings. In a report written by Moody's on March 23, 2010 commenting on the departure of MF Global's prior CEO and the arrival of Mr. Corzine as the new CEO, they state "Potential concerns about the unexpected nature of the leadership change are tempered by Mr. Corzine's decades of first-

[15] As reported by the *New York Times* in October 2008, documents used in a hearing of the House Committee on Oversight and Government Reform, Moody's CEO Ray McDaniel said in an internal board presentation to Moody's directors in October 2007, "Analysts and managing directors 'are continually 'pitched' by bankers, issuers, investors.' At times, he conceded, 'we drink the Kool-Aid.'" (Morgenson, Gretchen. "Credit Rating Agency Heads Grilled by Lawmakers." *New York Times* 22 Oct 2008. http://www.nytimes.com/2008/10/23/business/economy/23rating.html)

rate industry and leadership experience, as well as the reputational 'cache' and potential industry connections he would bring to MF." One can easily imagine that at least one of the Big Three gave the benefit of the doubt to MF Global's decisions and risk-taking based on their holding Mr. Corzine himself in high esteem.

Reform Initiative Addressing Ratings Accountability

After myriad examples of ratings failures over the years, a new reform initiative is addressing this topic of stale ratings, ratings "surveillance" and the accuracy of ratings over time. Subcommittee member Congressman Fitzpatrick has released a discussion draft of a "Quarterly Attestation Requirement" Bill that targets these issues. This simple yet potentially wide-reaching Bill would be the first effort to make the Big Three agencies, as well as other NRSROs, explicitly "stand by their product." We would characterize this initiative as having high potential benefit with low regulatory cost. It is motivated by the following:

- Issuer-paid ratings have lost significant credibility.
- There are potential conflicts of interest in the issuer-paid revenue model and many market participants believe ratings inflation is the result.
- The issuer-paid firms have been slow to change ratings, as clearly evidenced by MF Global.
- The principal business model of issuer-paid firms is primarily focused on issuance (in other words, where they get paid) and less on "maintenance" or surveillance ratings, where there is less money and more work.
- The SEC has a challenge to oversee ratings performance, which will become harder if there are ultimately more NRSROs.

The Quarterly Attestation Requirement proposal is both simple in concept and potentially wide reaching in its benefits: Require NRSROs to positively affirm by statement filed with the SEC that they stand by each previously issued rating, or have made whatever ratings change is appropriate given the changed quality of issuer/security, on a quarterly basis. If deemed to be too costly for the smaller NRSROs, an exemption could be granted with voluntary participation encouraged.

The **potential benefits** of this initiative are:

- **Greater transparency and timeliness:** Firms will not be able to hide behind the "our rating is good unless we say otherwise" positioning that permeates the market today. This may lead to fewer improperly aggressive/optimistic initial ratings.

- **Greater CRA commitment to their reputation:** Firms will have to properly reassure the market that their ratings have been reviewed and that the reputation of the firm is continuously at stake.
- **Greater sensitivity to risk changes:** Potentially more ratings will be changed over time as issuers' credit quality in fact changes.
- **More active market participation by investors:** More frequent communication by agencies to the market about their ratings, whether those ratings change or not, may be a good market catalyst for investors to do more research and due diligence on their own. Over time, this reduces overreliance on the NRSROs.
- **More data for the SEC:** the SEC requires more data from which to analyze rating agency performance and to provide oversight of agencies' implementation of new methodologies:
    - If there are significant discrepancies among agencies on an individual security or company rating, the SEC will have the ability to check into the accuracy of the ratings, but in a targeted way informed by NRSROs' attestation reporting. This can be accomplished without an increased burden for the SEC.
    - Additionally, in the SEC's 2011 first annual report on NRSRO oversight, the Commission identified instances of both large and small NRSROs that had reformed rating methodologies, but were slow to implement the new methods. This creates a discrepancy between the ratings they issue to the market and those their new methodology suggests are more accurate. Quarterly affirmations would compel an NRSRO to expeditiously implement new methodologies, affording the market the benefit of the theoretically improved rating insight.

Most efforts to introduce legislation to reform ratings have been wide sweeping and have covered massive ground, such as the rating components of Dodd-Frank. The Fitzpatrick Bill is a straightforward and targeted initiative that warrants significant attention and consideration.

Regulatory and Legislative Activities Affecting the Rating Industry

The more sweeping legislative and regulatory initiatives that have been put in place over the past five to six years are complex. They are also a mix of positive and counterproductive elements. Many of them are products of Dodd-Frank, the Securities and Exchange Commission's (SEC) implementing regulations and SEC rules implemented in 2009. The 2006 Credit Rating Agency Reform Act (CRA Act) is also a primary framework that instructs NRSRO criteria and activities.

Dodd-Frank does not do much to foster true competition in the market, and depending on how the SEC decides to implement its new oversight responsibilities, may even directly hinder it. The CRA Act and SEC rules also have idiosyncrasies that run counter to advancing industry reform. The problems include:

- **Material cost increases for smaller NRSROs evidenced by legal, administrative and compliance expenses, board compensation, insurance costs, and more:** These result from Dodd-Frank's emphasis on reporting requirements and legal liability for agencies, and are strong disincentives to becoming an NRSRO
- **Overreliance on NRSROs due to NRSRO references embedded in federal and state regulations, investment charters, bank agreements and others:** Dodd-Frank requires Federal agencies to remove references to NRSROs but that has yet to happen across agencies and only goes as far as the federal agencies. The problem is much deeper, and the embedding is much more prevalent beyond the federal level. There is also growing resistance from some quarters, for example banks[16]
- **Inadequate information availability under Sec Rule 17g-5:** SEC rule 17g-5 allows for an NRSRO to access the data used by another NRSRO hired to rate a structured product. This allows for unsolicited ratings and, in theory, more rating opinions in the market. But the rule only pertains to new issues, and not the information used by agencies to monitor all the outstanding ratings. Given there is *de minimis* new issuance in the structured market, this is of limited value. Also, this provision does not extend to Collateralized Loan Obligations, a still viable structured product type, because the underlying loans are out of the SEC's purview
- **Restrictive three-year qualification requirement for NRSRO application:** The CRA Act requires that a firm be providing ratings within an asset class for three years prior to applying for that asset class' NRSRO license. This effectively blocks most potential applicants from entering the business or expanding their business into a new asset class. This should be dropped or the SEC should have wide authority to waive the requirement
- **The ill-conceived Franken Amendment initiative:** Rotating agencies for structured product ratings is a flawed idea. The fundamental problems in structured product ratings going into the subprime crisis were conflicts of interest and an oligopolistic paradigm within ratings. The Franken Amendment attempts to correct this by creating further conflicts of interest in the form of a committee of conflicted parties to administer the rotation of rating agencies; it also creates a slightly broader oligopolistic paradigm by rotating among the slightly broader group of firms with their structured product NRSRO license. Given the three-year requirement detailed above, new players

[16] Braithwaite, Tom. "Banks warn rule change will hurt recovery." *Financial Times* 29 Jan 2012. http://www.ft.com/intl/cms/s/0/a84eccea-4a79-11e1-8110-00144feabdc0.html#axzz1ktXgHP90

would have a very challenging time becoming an NRSRO in structured products, making the loop of players in this asset class almost completely closed

- **An overall lack of intellectual property protection for newer rating agencies:** SEC implementation rules from Dodd-Frank may require disclosure of the IP underlying model-based ratings. Further, elements of Dodd-Frank that require agencies to disclose assumptions that can change ratings may facilitate attempts to reverse engineer model-based rating systems
- **Dangerous movement towards prescribing ratings "accuracy" criteria:** To try to increase ratings accuracy is a worthy goal, but Dodd-Frank and SEC rules could go too far by prescribing definitions for what is an accurate rating. This will ultimately lead to a homogenization of ratings, which offers new competitors fewer reasons to enter the market and greater systemic risk
- **Elimination of NRSRO's Regulation FD exemption**. Pursuant to Section 939B of Dodd-Frank, the SEC was charged with amending Reg FD to eliminate exemptions for disclosure of material nonpublic information to NRSROs. We suspect the Big Three will claim that the loss of their Reg FD exemption due to Dodd-Frank is a reason why they were lacking information to downgrade MF Global in a timely fashion. Rapid Ratings' ability to precisely and accurately identify deterioration in MF Global with only publicly available information should counter this claim.

These and other topics are explored in greater depth in Rapid Ratings' prior testimonials to Congress and the U.S. Securities and Exchange Commission:

1. "Oversight of the Credit Rating Agencies Post Dodd-Frank." 27 July 2011, United States House of Representatives Committee on Financial Services, Subcommittee on Oversight and Investigations. Testimony. http://financialservices.house.gov/UploadedFiles/072711gellert.pdf
2. "Transforming Credit Rating Agencies." 30 September 2009, United States House of Representatives Committee on Financial Services, Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises. Testimony. http://financialservices.house.gov/media/file/hearings/111/gellert_testimony_on_transforming_credit_rating_agencies_final_09302009.pdf
3. "Proposals to Enhance the Regulation of Credit Rating Agencies." 5 August 2009, United States Senate Committee on Banking, Housing and Urban Affairs. Testimony. http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=8fdc65ca-0cf8-4f65-869f-68ea727331c7
4. "Competition in the Credit Rating Industry." 15 April 2009, SEC Roundtable to Examine Oversight of Credit Rating Agencies. Presentation. http://www.sec.gov/comments/4-579/4579-20.pdf

Conclusion

MF Global's demise was a terrible development for the market, and its aftermath a tragedy. It has affected Wall Street, the entire futures industry and quite literally Main Street, leaving farmers across the country insolvent. That customer funds are still missing months after the bankruptcy filing speaks to the complexity of the problems that led to this firm's failure.

Ultimately, the story of MF Global is reasonably straightforward. A traditional and well-respected intermediary in the futures markets began to decline in its core business, and its financial health deteriorated. New management came in and began to diversify the business. In doing so, new risks were being taken with limited company capital. Instruments being traded with company capital were contrarian bets that ultimately spooked clients, regulators, shareholders and counterparty liquidity providers. These stakeholders worried about the capital base of the firm and began to require additional capital be added. All the while, the firm saw revenues deteriorating, profits turning to consecutive quarterly losses and weakening debt service management.

As a backdrop to all of this, the Big Three issuer-paid agencies, S&P, Moody's and Fitch, maintained investment grade ratings on MF Global for years. Their ratings showed very little deterioration, despite the multitude of qualitative and empirical factors that pointed to decreased health and increased risk taking at the firm. In the end, Moody's finally downgraded the firm to below investment grade, intensifying capital calls on the riskier trades. This helped precipitate the firm's final spiral and ultimate bankruptcy.

There were many qualitative factors in the MF Global story, but what stands out are the quantitative ones that Rapid Ratings' Financial Health Rating system used to provide early warnings of the firm's deteriorating financial strength: weakening Sales Performance, Profit Performance and Debt Service Management. As a user-paid, not issuer-paid, firm, we have no contact with issuers, we do not factor any management star power or story into our ratings and we rate purely based on firms' financial performance. This allows us to rate public and private companies consistently and objectively. MF Global's ratings deteriorated markedly over the past few years and our system had rated them a High Risk entity since June 2009.

Whether the Big Three didn't properly evaluate the increasing evidence (including disclosures made by the firm as far back as May 2011) or determined there actually wasn't increased risk at MF Global, they failed to give adequate warning on the brokerage's failure. Once again, the market was ill served by flatlined ratings that did not adequately reflect the risk of a company. Not only were the Big Three slow in identifying risk at MF Global, they were highly correlated in their ratings products. The similarity in their ratings further illuminates the lack of unique information value in their product.

One of the Big Three, S&P, is asserting that it only relied on public filings for information on MF Global's trading positions.[17] But this doesn't explain why it neglected to analyze the disclosure and make inquiry about the positions, their implications and on whose behalf they were made. If a hallmark of their rating methodology is qualitative analysis, where was the quality of their analysis?

The MF Global example demonstrates yet again the importance of having up-to-date ratings that are not artificially inflated or maintained. It also highlights the glaring need for greater competition in the rating industry and the need to reduce market reliance on the Big Three firms.

Accurate early warnings of companies' financial health are essential. The legislative and regulatory environment must embrace competition as a critical goal in the effort to evolve the rating industry. That means making a serious commitment to removing the barriers to new entrants including the cost of compliance for smaller rating agencies. Investment managers, risk professionals and regulators, as well as many others, deserve to have multiple opinions and analytical inputs to incorporate in their decision-making processes. Certainly those who had our early warnings on MF Global were better served than those who relied exclusively on the Big Three agencies, whose ratings provided none. We also need a commitment to quarterly ratings so that there is greater transparency and accountability in the market. These steps will help reduce the dominance of the Big Three as they continue to promise much and deliver much less.

[17] Faux, Zeke and Mattingly, Phil. "MF Global Said 'Never Been Stronger' a Week Before Failure." *Bloomberg* Jan 30 2012. http://www.bloomberg.com/news/2012-01-30/mf-global-told-s-p-it-had-never-been-stronger-one-week-before-collapse.html

Appendix A

Figure 2 below depicts the ratio net operating profit to shareholder equity, one of 23 profit ratios that demonstrate sustained deterioration and weakness in MF Global.

Figure 2: MFG's Net Operating Profit After Taxes / Shareholders' Equity Ratio: 2006-2011

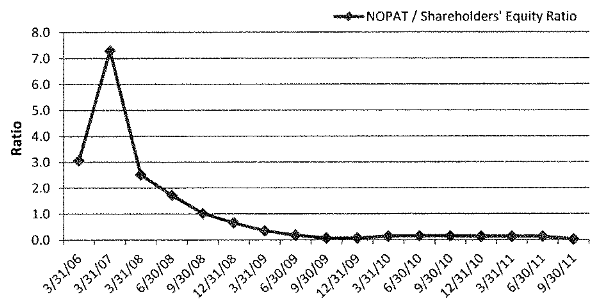
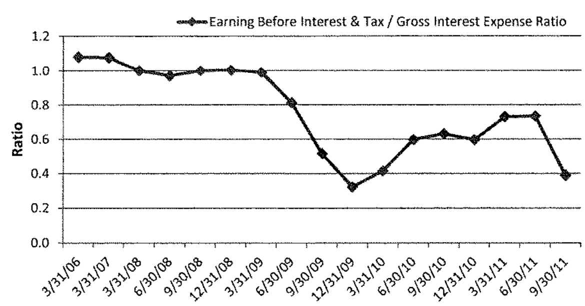


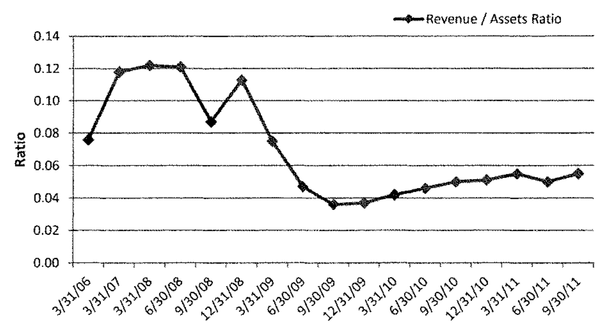
Figure 3 below presents a measure of MF Global's interest coverage ratio, one of three ratios that represent its declining Debt Service Management performance.

Figure 3: MF Global's Interest Cover Ratio: 2006-2011



An example of MF Global's deterioration in sales performance (one of five ratios) is presented in Figure 4 below.

Figure 4: MF Global's Revenue / Total Assets Ratio: 2006-2011



Appendix B

Table 1 below highlights the major events during 2007-2011 that shaped the steady decline and collapse of MF Global. Items highlighted in yellow provide a quarterly snapshot of Rapid Ratings' risk assessment of the financial health of MF Global over the course of five years. At key intervals there were major declines, and the FHR system provides reasons for those declines.

Table 1: Timeline of events leading to the collapse of MF Global (Rapid Ratings actions in yellow)

A	B	C
Date	**Event**	**Rapid Ratings Risk Assessment**
2007	Man Group sold its brokerage business, renamed MF Global, to focus on alternative investment management.[18] At that point, MF Global went public. MF Global was not a specialist in swaps, European bonds or proprietary trading, which later came to dominate its commercial activity.	FHRs from Rapid Ratings are below for each period
June 29, 2006	Rapid Ratings released a new rating for MF Global.[19] The company is not investment grade. This financial year data was issued by the new listed company, MF Global, after the Man Group divestment.	53 (12 pts below investment grade) (Medium Risk) retrospective
May 31, 2007	Both S&P (with a stable outlook) and Fitch rated MF Global as BBB+ (investment grade, three notches above junk). This was their first rating of MF Global.	53 (Medium Risk) retrospective
June 29, 2007	Rapid Ratings released a new rating for MF Global (up 7 points but still sub-investment grade).[19]	60 (Medium Risk) retrospective
July 24, 2007	Moody's issued a solid investment grade rating for MF Global (A3).	60 (Medium Risk) retrospective
Feb 28, 2008	Moody's issued a lower investment grade rating for MF Global (Baa1) – down one notch, and with a negative outlook.	60 (Medium Risk) retrospective
Feb 29, 2008	S&P rated MF Global as BBB (investment grade, two notches above junk) with a negative outlook.	60 (Medium Risk) retrospective
June 27, 2008	Moody's issued an investment grade rating for MF Global (Baa1).	60 (Medium Risk) retrospective
June 29, 2008	Rapid Ratings released a new rating for MF Global (down 11 points). *Major factors in the decline were a deteriorating profit score, which dropped by 29% over the previous quarter, and a 16% decline in sales/revenue performance.*[19]	49 (Medium Risk) retrospective

[18] "History of Man Group." Website. http://www.mangroupplc.com/assets/pdf/media/timeline.pdf
[19] Rapid Ratings first rated MF Global on January 27, 2009. The previous ratings are retrospective ratings using only data from that time period. A retrospective rating uses the financial data for the time period in question but is estimated some months or even years after the period. NO new information is used. This is a normal part of backtesting performance.

July 18, 2008	J.C. Flowers took a 6% preferred stake in MF Global three months after the firm took a $141 million charge from unauthorized wheat trading.[20, 21] On the same day, S&P removed the CreditWatch Negative designation.	49 (Medium Risk) retrospective
Aug 29, 2008	Rapid Ratings released a new rating for MF Global (down 2 points).[22]	47 (Medium Risk) retrospective
Dec 4, 2008	S&P affirmed the BBB rating but changed the outlook to negative.	42 (Medium Risk retrospective
Jan. 16, 2009	Moody's issued an investment grade rating for MF Global (Baa2, downgraded 1 notch), with a stable outlook.	42 (Medium Risk) retrospective
Jan. 27, 2009	Rapid Ratings released a new rating for MF Global (down 5 points). *There were three generic areas of deterioration. The overall profitability score declined another 12.5% over the previous quarter, sales/revenue performance declined by 26% and there was a moderate weakening in working capital efficiency (including liquidity).*	42 (Medium Risk) retrospective
Feb 25, 2009	S&P affirmed the BBB rating and reiterated its negative outlook.	42 (Medium Risk) retrospective
March 1, 2009	Rapid Ratings released a new rating for MF Global (down 1 point).	41 (Medium Risk) retrospective
April 2009	The Commodity Futures Trading Commission warned the Fed in April 2009 it had uncovered major compliance issues regarding MF Global. This problem delayed the Fed's acceptance of MF Global as a primary broker until February 2011.[23] During that interval MF Global's financial health declined further and it became a High Risk company (see column C).	41 (Medium Risk) retrospective
June 17, 2009	Fitch issued an investment grade rating for MF Global (BBB).	41 (Medium Risk) retrospective
June 29, 2009	Rapid Ratings released a new rating for MF Global (down 5 points). *There were two generic areas of deterioration. The firm's profitability score declined by 21% over the previous quarter. Sales/revenue performance dropped by 22%. MF Global became High Risk for the first time (29 rating points below investment grade) and never recovered.*	36 (High Risk)
Aug 29, 2009	Rapid Ratings released a new rating for MF Global (down another 5 points) – High Risk.	31 (High Risk)
Sep 24, 2009	S&P affirmed the BBB rating and reiterated its negative outlook.	31 (High Risk)
Nov 6,	Moody's confirmed the rating at Baa2, but lowers the outlook to negative.	31 (High Risk)

[20] Dezember, Ryan. "MF Global and Chris Flowers: A Match Made for Rescue?" *Wall Street Journal* 30 Oct 2011. http://blogs.wsj.com/deals/2011/10/30/mf-global-and-chris-flowers-a-match-made-for-rescue/

[21] *EDGAR Online – SEC Filings.* MF Global Holdings Ltd. http://google.brand.edgar-online.com/EFX_dll/EDGARpro.dll?FetchFilingHtmlSection1?SectionID=7951304-103135-117103&SessionID=HUjUFWRLX2lin47

[22] Rapid Ratings first rated MF Global on January 27, 2009. The previous ratings are retrospective ratings using only data from that time period. A retrospective rating uses the financial data for the time period in question but is estimated some months or even years after the period. NO new information is used. This is a normal part of backtesting performance.

[23] Lynch, Sarah. "A Persistent MF Global won NY Fed dealer status." *Thompson Reuters News & Insight* 15 Dec 2011. http://newsandinsight.thomsonreuters.com/Legal/News/2011/12_-_December/A_persistent_MF_Global_won_NY_Fed_dealer_status/

2009		
Nov 29, 2009	Rapid Ratings released a new rating for MF Global (down 6 points) – High Risk. *There were three generic areas of deterioration. The profitability score declined by a further 40% and sales/revenue performance dropped by another 20%. And for the first time there was a major decline in the debt service management capability of MF Global.*	25 (High Risk)
Dec 2009	The Commodities Futures Trading Commission imposed a $10 million fine on MF Global for "significant supervision violations" arising from rogue trading. MF Global was ordered to enhance its internal controls.[24]	25 (High Risk)
March 1, 2010	Rapid Ratings released a new rating for MF Global (down 2 points) – High Risk (only 3 points above Very High Risk now).	23 (High Risk)
March 23, 2010	At the invitation of JC Flowers, a former Goldman Sachs colleague, Jon Corzine joined MF Global as CEO, and proceeded to shift its focus from assisting clients with their derivatives trading to proprietary trading on behalf of MF Global. Corzine significantly increased the risk exposure of the company because of, or in spite of, MF Global's current profitability problems.	23 (High Risk)
April 2010	The Euro-zone crisis emerged as interest rates rose dramatically on bonds issued by Greece, Portugal, and Ireland. The interest rate shocks for bonds issued by Spain and Italy followed in November 2010. In 2011, the Euro-crisis escalated significantly. Corzine saw this as a big opportunity, but the market did not agree.	23 (High Risk)
June 4, 2010	Rapid Ratings released a new rating for MF Global (up 3 points) – High Risk.	26 (High Risk)
Aug 12, 2010	Rapid Ratings released a new rating for MF Global (rose 2 points) – High Risk.	28 (High Risk)
Sept. 2010	MF Global began investing in sovereign bonds of Belgium, Italy, Ireland, Portugal and Spain.	28 (High Risk)
October 2010	The Q2 2011 financials (10Q) released by MF Global explicitly state that a reduction in its long-term credit rating would have led to repayment pressure from lenders.[25]	28 (High Risk)

[24] Lynch, Sarah. "A Persistent MF Global won NY Fed dealer status." *Thompson Reuters News & Insight* 15 Dec 2011. http://newsandinsight.thomsonreuters.com/Legal/News/2011/12_-_December/A_persistent_MF_Global_won_NY_Fed_dealer_status/

[25] "Certain of the Company's derivative trading agreements contain provisions requiring the Company to post collateral according to the Company's long-term credit ratings. These terms are pursuant to bilateral agreements with certain counterparties, and could require immediate payment or ongoing overnight collateralization on derivative instruments in net liability positions. As of September 30, 2010, the aggregate fair value of derivative agreements, with credit-risk-related contingent features that were in a **net liability position was $13,668, for which the Company has posted collateral of $19,740** in accordance with trading agreements. If the Company's long term credit rating had a one-notch or two-notch reduction, as of September 30, 2010, the amount of additional collateral that could be called by counterparties for these derivative agreements would be approximately $1,901 and $2,003, respectively. As of March 31, 2010, the aggregate fair value of derivative agreements with credit-risk-related contingent features that were in a net liability position was $23,413, for which the Company has posted collateral of $29,861 in accordance with arrangements. If the Company's long term credit rating had a one-notch or two-notch reduction as of March 31, 2010, the amount of additional collateral that could be called by counterparties for these derivative agreements would be approximately $3,162." Using short term borrowing to finance long term positions had become much riskier since the collapse of Bear Stearns and Lehman Brothers in 2008. 10Q form for the quarterly period ended September 30, 2010, MF GLOBAL HOLDINGS LTD. Compare that their statement a year earlier in the Q2 2010 filing: "Certain of the Company's derivative trading agreements contain provisions requiring the Company to post collateral according to the Company's long-term credit ratings. These terms are pursuant to bilateral agreements with certain

Nov 11, 2010	Rapid Ratings released a new rating for MF Global (up one point) – High Risk.	29 (High Risk)
Nov 24, 2010	S&P downgraded MFG to BBB-, the lowest investment grade category.	29 (High Risk)
Dec 2010	PricewaterhouseCoopers encouraged MF Global to make public its euro-sovereign bond investments. By the end of the year, MF Global had invested $1.5bn in these bonds.[26]	29 (High Risk)
Feb 2, 2011	In January, the CFTC conducted a review of MF Global's candidacy for being a Primary Broker (assessing audited financial reports and tax returns in an on-site visit). This led to a Fed memo in January 2011 stating that MF Global "demonstrated a clear ability" to meet the Fed's standards.[27] The FRBNY approved MF Global as a primary dealer on Feb 2, 2011. This placed MF Global in very exclusive company.[28] What risk vetting procedures were used by the Fed in making this decision?[29] Only Primary dealers are permitted to trade directly with the Federal Reserve Bank of New York. They have an important position in the U.S. repurchase market, conducting repos in proprietary trading and helping the Fed manage monetary policy by trading in the repurchase market. This was a huge boost to MF Global's credibility and would have helped MF Global attract more customers[30] at a time when the fundamentals strongly indicated the company was High Risk.	29 (High Risk)
Feb 3, 2011	Moody's affirmed its Baa2 rating of MFG with a negative outlook.	29 (High Risk)
Feb 9, 2011	Rapid Ratings released a new rating for MF Global (down one point) – High Risk.	28 (High Risk)

counterparties and could require immediate payment or ongoing overnight collateralization on derivative instruments in net liability positions. As of September 30, 2009, the aggregate fair value of derivative agreements with credit-risk-related contingent features that were in a **net liability position was $12,271, for which the Company has posted collateral of $3,209** in the normal course of business. If the Company's long term credit rating had a one-notch or two-notch reduction as of September 30, 2009, the amount of additional collateral that could be called by counterparties for these derivative agreements would be approximately $5,779 or $8,279, respectively." *Notice the significant increase in the level of collateral required, roughly matching the beginning of Corzine's tenure as CEO and the end of his first year as CEO. There were no similar requirements incorporated in the Q2 2008 quarterly filing. This footnote provides a quick snapshot of how quickly things changed once Corzine was running MF Global.*

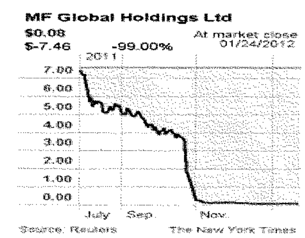
[26] Lucchetti, Aaron and Steinberg, Julie. "Corzine Rebuffed Internal Warnings on Risks." *Wall Street Journal* 6 Dec 2011. http://online.wsj.com/article/SB10001424052970204083204577080723935363452.html

[27] Lynch, Sarah. "A Persistent MF Global won NY Fed dealer status." *Thompson Reuters News & Insight* 15 Dec 2011. http://newsandinsight.thomsonreuters.com/Legal/News/2011/12 - December/A persistent MF Global won NY Fed dealer status/

[28] BNP Paribas Securities Corp.; Barclays Capital Inc.; Cantor Fitzgerald & Co.; Citigroup Global Markets Inc.; Credit Suisse Securities (USA) LLC; Daiwa Capital Markets America Inc.; Deutsche Bank Securities Inc.; Goldman, Sachs & Co.; HSBC Securities (USA) Inc.; Jefferies & Company, Inc.; J.P. Morgan Securities LLC; Merrill Lynch, Pierce, Fenner & Smith Incorporated; Mizuho Securities USA Inc.; Morgan Stanley & Co. Incorporated; Nomura Securities International, Inc.; RBC Capital Markets, LLC; RBS Securities Inc.; SG Americas Securities UBS Securities LLC. ("Fed approves MF Global and SG Americas Securities as Primary Dealers." *RepoWatch* 2 Feb 2011. http://repowatch.org/2011/02/02/fed-approves-mf-global-and-sg-americas-securities-as-primary-dealers/)

[29] This issue was raised in December 2011 by the Chairman of the House Financial Services Oversight Sub-committee, Randy Neugebauer: "We also have concerns with the apparent lack of due diligence conducted by the Federal Reserve Bank of New York in bestowing its primary dealer designation on MF Global - even as the firm consistently lost money." http://newsandinsight.thomsonreuters.com/Legal/News/2011/12_December/A_persistent_MF_Global_won_NY_Fed_dealer_status/

[30] "Fed approves MF Global and SG Americas Securities as Primary Dealers." *RepoWatch* 2 Feb 2011. http://repowatch.org/2011/02/02/fed-approves-mf-global-and-sg-americas-securities-as-primary-dealers/

March 2011	Michael Roseman, Chief Risk Officer of MF Global, opposed Corzine's strategy to invest in the euro-sovereign bond market. The Board supported Corzine. Roseman resigned as a result.[31]	28 (High Risk)
May 23, 2011	Rapid Ratings released a new rating for MF Global (1 point higher) – High Risk.	29 (High Risk)
May 2011	PricewaterhouseCoopers signed off on its annual audit of MF Global. It was paid $12 million for this service.[32] MF Global publicly revealed that it had $6.3bn invested in sovereign bonds from Belgium, Italy, Ireland Portugal and Spain. This prompted FINRA in June to require MF Global (MF Global's US subsidiary) to increase its capital reserves.[33] FINRA had questioned MF Global's use of Generally Accepted Accounting Principles (GAAP) to justify reporting its euro-sovereign bond exposure off balance sheet.[34]	29 (High Risk)
July 2011	The MF Global share price began a precipitous 4-month decline. Street talk in the equity market about MF Global risks preceded Big 3 rating agency downgrades to junk by almost 4 months. 	29 (High Risk)
Aug 8 2011	Rapid Ratings released a new rating for MF Global (unchanged).	29 (High Risk)
Aug-Oct 2011	According to Reuters, MF Global's segregated accounts (client money) "...shrank by $1.5 billion in August alone, government data showed. Another $1.8 billion fled over the following two months, according to preliminary estimates. In total, customers pulled out more than a third of their accounts in the three months leading up to MF Global's downfall, much of that in the frenzied final days, traders reckon. For instance, privately held Koch Industries -- whose businesses make it a leading commodities trader -- sent	29 (High Risk)

[31] Scott, Joelle. "Roseman and Woodford: The Foreboding Michaels of MF Global and Olympus." *Forbes* 7 Dec 2011. http://www.forbes.com/sites/corporateresolutions/2011/12/07/roseman-and-woodford-the-foreboding-michaels-of-mf-global-and-olympus/

[32] McKena, Francine. "MF Global: 99 Problems And Auditor PwC Warned About None." *Forbes* 2 Nov 2011. http://www.forbes.com/sites/francinemckenna/2011/10/31/mf-global-99-problems-and-auditor-pwc-warned-about-none/

[33] "MF Global's Big Bet...And Its Collapse." *New York Times Dealbook* 12 Dec 2011. Graphic. http://graphics8.nytimes.com/images/2011/12/12/business/dealbook/12global-graphic2/12global-graphic2-custom2.jpg

[34] Dunkley, Jamie. "US Regulators have been monitoring MF Global for months." *Telegraph* 2 Nov 2011. http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/8865899/US-regulators-have-been-monitoring-MF-Global-for-months.html

	a letter to trading partners on October 3 saying it was switching eight accounts from MF Global to Mizuho Securities USA."[35]	
Sept 30, 2011	At the end of September 2011, MF Global had a net long exposure of $6.3bn in BIIPS sovereign bonds (Belgium, Italy, Ireland, Portugal and Spain). Their average weighted maturity was December 2012, which was within the period of coverage by the European Financial Stability Facility that expires in June 2013. One of the wrinkles was that MF Global had entered into a swap arrangement financed to maturity (repo-to-maturity). Short-term loans were underpinning these long-term bond investments, and bonds were used as collateral by MF Global for the short-term loans.	29 (High Risk)
Oct 24, 2011	Moody's downgraded MF Global to Baa3, the lowest investment grade level. S&P downgrades MF Global to BBB-, the lowest investment grade level.	29 (High Risk)
Oct 24-28, 2011	Counterparties were pressuring MF Global to post more collateral on derivatives trades and likely started reducing the company's repo financing lines.[36]	29 (High Risk)
Oct 25, 2011	MF Global announced its biggest quarterly loss ($191.6 million for the previous quarter) since it went public in 2007.	29 (High Risk)
Oct 26, 2011	S&P changed the rating from BBB- with a stable outlook to BBB- with a negative outlook.	29 (High Risk)
Oct 27, 2011	Fitch Ratings downgraded the ratings of MF Global Holdings Ltd. to BB+/B from BBB/F2. The reasons it gave are instructive: "Today's rating actions reflect MF's continued challenges in establishing a sustainable level of profitability and improving its leverage profile...In addition, the firm's increase in principal and, to a lesser extent, proprietary trading activities has elevated the firm's traditional risk profile. These increased risk-taking activities have resulted in sizeable concentrated positions relative to the firm's capital base, leaving MF vulnerable to potential credit deterioration and/or significant margin calls. While Fitch notes that the firm has made some progress in rationalizing its capital structure, the firm's persistently weak earnings and leverage are no longer consistent with an investment grade financial institution."[37] *Comment by Rapid Ratings: Our models indicate that MF Global's profitability problem had started in 2008 and it showed persistent losses and deterioration since then. MF Global's ability to service its debt dropped into the High Risk zone in 2010 and stayed there.*	29 (High Risk)
Oct 27, 2011	Moody's downgraded MF Global to junk (Ba2), with the following comments: "The tactical decision to assume this outsized proprietary	

[35] Prezioso, Jeanine. "Insight: Clients who fled MF Global face clawback risk." *Reuters* 11 Nov 2011. http://www.reuters.com/article/2011/11/11/us-mfglobal-clawback-f-idUSTRE7AA38A20111111

[36] Cohan, William. "MF Signs Death Warrant for Short-Term Funding." *Businessweek* 15 Nov 2011. http://www.businessweek.com/news/2011-11-15/mf-signs-death-warrant-for-short-term-funding-william-d-cohan.html

[37] Gongloff, Mark. "MF Global Falls Again After Fitch Downgrade to Junk." *Wall Street Journal* 27 Oct 2011. http://blogs.wsj.com/marketbeat/2011/10/27/mf-global-falls-again-after-fitch-downgrade-to-junk/

	position highlights the core profitability challenges faced by MF Global, and the scope of the re-engineering challenge facing the firm's management"[38] *Comment by Rapid Ratings: The profitability problem was an old one not a new one, while the large proprietary risky positions began in March 2010 after* Mr. *Corzine came aboard.*	
Oct 29-30, 2011	The Commodity Futures Trading Commission and Interactive Brokers (Connecticut) raised questions about MF Global's capital adequacy and the location of about $1 billion in client funds. This led to Interactive Brokers aborting a potential deal to purchase MF Global.[39] According to Bloomberg, CME noticed a shortfall in MF Global's segregated client funds on Oct 31 but delayed telling the Commodity Futures Trading Commission, the CME Group's regulator, until the next day.[40]	29 (High Risk)
October 31, 2011	MF Global filed for bankruptcy.[41] The largest creditors were JPMorgan Chase ($1.2 billion, but it was syndicated) and Deutsche Bank ($325 million). Moody's downgraded MF Global to Caa1 (High Risk). Fitch and S&P downgraded MF Global to D (default). MF Global (COO Abelow) in its bankruptcy court filing blamed regulators (Commodity Futures Trading Commission, the Securities and Exchange Commission and the Financial Industry Regulatory Authority). FINRA in particular raised concerns about MF Global's US broker-dealer's need for much more capital and raised its concerns about MF Global's $6.3 billion stake in short-term debt from European sovereign bonds. This led to margin calls, downgrades and collapse, said MF Global.[42]	29 (High Risk)
Nov 1, 2011	Rapid Ratings downgraded MF Global further based on newly released financials from the previous quarter. The company continued to be High Risk through to its bankruptcy.	23 (close to Very High Risk)
Nov 4, 2011	Mr. Corzine announced his resignation from MF Global as CEO and indicated he would not seek severance payments.	
Dec 13, 2011	Mr. Corzine's testimony to the Senate Agriculture Committee: "I never gave any instructions to misuse customer money, never intended to give any instructions or authority to misuse customer funds, and I find it very hard to understand how anyone could misconstrue what I've said as a way to misuse customer money."[43] No evidence to the contrary has surfaced.	

[38] "Ahead of the Bell: Moody's Downgrades MF Global" *Businessweek* 28 Oct 2011. http://www.businessweek.com/ap/financialnews/D9QLA5PO0.htm

[39] Protess, Ben. "Regulators Investigating MF Global" *New York Times* 31 Oct 2011. http://dealbook.nytimes.com/2011/10/31/regulators-investigating-mf-global/

[40] Leising, Matthew. "CME May Face 'Liability' In MF Global Disclosure, Goldman's Harris Says." *Bloomberg* 17 Nov 2011. http://www.bloomberg.com/news/2011-11-17/cme-may-face-liability-related-to-mf-global-disclosure-goldman-sachs-says.html

[41] US broker-dealers are not protected by Chapter 11 whereby regulatory shelter from creditors is providers. Broker-dealers only have two choices in the event of severe distress: (1) liquidate all assets, or (2) takeover by another firm.

[42] Spicer, Jonathan. "MF Global collapses under euro zone bets." *MSN Money* 31 October 2011. http://money.msn.com/business-news/article.aspx?feed=OBR&date=20111031&id=14453289

[43] "USA Exchanges: CME boss seems to rebut Corzine over funds." *Economist Intelligence Unit* 14 Dec 2011. http://www.eiu.com/index.asp?layout=ib3Article&article_id=198667204&country_id=1530000153&pubtypeid=1132462498&industry_id=640001064&category_id=&rf=0

Dec 14, 2011	Jill Sommers, the leader of the CFTC review of MF Global's collapse, revealed that her team knows where the missing money went, adding, "Now it's just [a question of] finding out which ones of those transactions are legitimate and which ones of them are illegitimate."[44]	
Dec 15, 2011	Moody's withdrew its rating for MF Global.	

[44] Doering, Christopher. "Exclusive: Regulators know where MF Global funds went." *Reuters* 14 Dec 2011. http://www.reuters.com/article/2011/12/14/us-mfglobal-cftc-idUSTRE7BD20L20111214

TESTIMONY OF CRAIG PARMELEE

MANAGING DIRECTOR AND LEAD ANALYTICAL MANAGER FOR

NORTH AMERICAN FINANCIAL INSTITUTIONS RATINGS

STANDARD & POOR'S RATINGS SERVICES

BEFORE

THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

UNITED STATES HOUSE OF REPRESENTATIVES

FEBRUARY 2, 2011

Mr. Chairman, Mr. Ranking Member, Members of the Subcommittee, good morning. My name is Craig Parmelee. I serve as a Managing Director and Lead Analytical Manager for North American Financial Institutions Ratings at Standard & Poor's Ratings Services ("S&P"). I am pleased to appear before you today to discuss S&P's ratings on MF Global.

At the outset, I would like to take a moment to speak generally about our credit ratings process and to explain what ratings are and are not intended to convey.

Background Information about S&P

Over the course of its 152-year history, S&P has sought to improve transparency in capital markets by providing independent assessments of the creditworthiness of companies and securities. Investors and other market participants have repeatedly turned to S&P for our view of credit risk and we have established a long track record of providing a valuable, independent perspective. At their core, S&P's credit ratings reflect forward-looking views about the ability and willingness of issuers to meet their financial obligations in full and on time. S&P's ratings are thus expressions of opinion about the relative likelihood that certain events will, or will not, occur in the future. By the same token, S&P's ratings are not recommendations to buy, sell or hold any particular securities, and they are not statements of fact.

S&P's basic process for forming and disseminating credit ratings is well-established. Typically, ratings are the result of both quantitative and qualitative analyses of information that ratings analysts gather from issuers and other third parties. Ratings are not formed by any one analyst, but rather by committees of analysts based on the application of transparent, publicly available ratings criteria. Once a public rating is determined, S&P publishes it in real-time and for free on its Web site, www.standardandpoors.com, typically alongside a narrative providing detailed information about our underlying analysis and often citing the S&P published criteria applicable to the rating. Following publication, S&P's ratings are generally surveilled by S&P analysts and raised, lowered, or reaffirmed as appropriate based on S&P's view of the creditworthiness of the rated company or security over time.

S&P's Criteria for Rating MF Global

S&P's credit ratings on MF Global were formed and disseminated based on S&P's generally applicable policies and procedures and the application of its published criteria for rating financial institutions and brokerage companies. This criteria provides for the consideration of a number of key factors to assess creditworthiness based on S&P's opinion of a firm's business and financial risks, including its diversification, market position, confidence sensitivity, management and strategy, credit risk, market risk, funding and liquidity risks, earnings, capital and financial flexibility. Additional factors that S&P considers include the rated company's capital adequacy, asset quality, financial projections and risk management.

The specific information gathered and reviewed by S&P's analysts in connection with the ratings on MF Global included MF Global's audited financial statements, other public filings, presentations prepared by MF Global management and other information (both written and oral) deemed to be potentially relevant and useful by S&P's analysts in the ratings process. Such information included, among other things, documents describing MF Global's organizational structure, capital profile, risk management policies, and liquidity. MF Global also provided information about its strategic plans related to principal and client facilitation activities. MF Global represented to S&P that the information it provided was accurate and complete

Chronology of Rating Actions and Relevant Events

S&P's Ratings on MF Global from 2007 – 2008

On May 31, 2007, S&P published its first rating on MF Global. This initial rating was 'BBB+,' reflecting S&P's view that MF Global had a "strong franchise." The rating was accompanied by a "stable outlook" based on S&P's view that the company would continue to grow.[1]

S&P's rating remained unchanged until February 29, 2008, when it was downgraded to 'BBB' following an announcement by MF Global that it would incur a $141.5 million loss resulting from unauthorized trading by one of its employees. This downgrade was accompanied by a "CreditWatch Negative" placement, signaling that S&P could lower the rating further based on its ongoing review of the firm's risk management policies.[2] On July 18, 2008, S&P removed the CreditWatch designation based in part on MF Global's implementation of new enterprise risk management ("ERM") initiatives. At this time, however, S&P continued to view the firm's overall risk management as "weak." On December 4, 2008, S&P affirmed the 'BBB' rating but changed its outlook back to "negative," signaling the potential for another downgrade based on MF Global's lower cashflows and a decline in customer payables, among other things.

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1 An S&P rating outlook assesses the potential direction of a long-term credit rating over the intermediate term (typically six months to two years). In determining a rating outlook, consideration is given to any changes in economic and/or fundamental business conditions. Essentially, a positive outlook means that, in S&P's view, a rating may be raised, a negative outlook means it may be lowered and a stable outlook means that a rating is not likely to change during the period.

2 CreditWatch highlights S&P's opinion regarding the potential direction of a short-term or long-term rating. It focuses on identifiable events and short-term trends that cause ratings to be placed under special surveillance by Standard & Poor's analytical staff.

S&P's Ratings on MF Global in 2009

S&P reiterated its 'BBB' rating and negative outlook in reports published on February 25 and September 24, 2009. The latter report was the result of S&P's annual review of MF Global's creditworthiness. This report stated that the firm had experienced significant losses during the first two quarters of 2009 due to lower net interest income, lower trading volumes, lower margin balances and increased expenses. In this September 24 report, S&P also explained that it expected MF Global to continue experiencing lower trading volumes and reduced interest income going forward, which would likely continue to affect its revenue negatively over the upcoming quarters. The report added that, while management planned to increase efficiencies, strengthen risk management, optimize capital and establish a global governance model, S&P would nevertheless maintain its negative outlook on the rating due to the firm's generally weak profitability and various challenges faced by management, including challenges related to risk management.

November 24, 2010 Downgrade

S&P downgraded MF Global's rating on November 24, 2010, to 'BBB-'. This is just one notch above speculative, non-investment grade status and was lower than the ratings of either of S&P's two largest competitors at the time. In the published report announcing this downgrade, S&P stated that MF Global had suffered additional losses in the most recent quarter, attributable again to lower volumes, low interest rates and changes in operating strategy and client behavior. The report stated that the firm's capital levels were, in S&P's view, merely "adequate" and highlighted a number of large charges and write-downs.

The report further noted that MF Global's new CEO, Jon Corzine, had announced a strategy to begin transitioning MF Global from a relatively low-margin traditional commodities broker to a higher-margin broker-dealer, and eventually a full-service investment bank. As stated in the report, S&P understood that Mr. Corzine's strategy would involve taking on more risky proprietary trading positions, rather than merely facilitating transactions for its clients. Although senior management of MF Global informed S&P that this transition would be undertaken at a gradual pace, the November 24 report concluded that the strategy would nevertheless "increase the firm's risk profile." The report further stated that the company's ERM was still "a work in progress that needs to keep pace with the . . . market risk associated with its planned increase in principal and market-making activities."

In this respect, the November 24 report was consistent with S&P's Industry Outlook for U.S. brokerage firms — published nine months earlier in February 2010 — which had stated that "true franchise values" for brokerage firms typically come from "their intermediary role as distributors, trade facilitators, and/or advisers" and that, by contrast, "the more a broker directly provides financing for its clients or holds assets with credit or market risk, the more open it is to outsize losses and a potential downward spiraling of confidence in the firm."

MF Global's intention to pursue a new, more aggressive business plan did not cause S&P to change its usual processes and criteria for forming and disseminating credit ratings. S&P's ratings processes and criteria are generally applicable across the financial institutions and brokerage firms it rates. Thus, the same processes and criteria that underlie the ratings of MF Global were also applicable to ratings of larger firms and other brokerage institutions that may have had even more complicated strategies and business plans. The generally applicable nature of these processes and criteria is critical in allowing S&P to provide apples-to-apples analyses within industries, which ultimately improves transparency in the market.

S&P's November 24 report on MF Global concluded by warning that further downgrades were possible during implementation of MF Global's new strategy, particularly if the company were to experience material principal losses, deteriorating liquidity, or increased leverage.

MF Global's Disclosure of its Repo-to-Maturity Portfolio

MF Global's Form 10K released in May 2011 disclosed that the firm had off-balance-sheet exposure to approximately $6.3 billion of European sovereign debt through so-called re-purchase-to-maturity transactions (the "RTM" portfolio). MF Global also referred to this portfolio in a Form 10Q filed in August 2011. S&P learned of this portfolio at the same time as the general public and had no advance notice of it. Nor was S&P provided specific details about the portfolio until late October.

S&P understands that the RTM portfolio consisted of sovereign bonds funded through scheduled maturity in 2012. Accordingly, the most direct risk presented by this investment was that one or more of the relevant sovereign nations -- Ireland, Italy, Spain, Portugal, and Belgium -- would default during this relatively short time period. Disclosure of the RTM portfolio in May 2011 appeared to cause virtually no immediate reaction in the markets. In fact, in August 2011, more than six weeks after the disclosure, MF Global successfully issued hundreds of millions of dollars of bonds with relative ease, suggesting that investors continued to have confidence in the firm and its prospects. Following disclosure of the RTM portfolio, and into late October 2011, S&P continued to believe that MF Global's underlying credit fundamentals supported a credit rating of 'BBB-'.

S&P's October 26, 2011 CreditWatch Action

In October 2011, concerns over escalation of the Eurozone credit crisis, combined with a disappointing earnings report from MF Global and other factors, were causing the firm's investors, counterparties and other market participants to become quickly and increasingly concerned about the firm.

Against this backdrop, S&P analysts participated in a meeting with MF Global management on October 20, 2011, in order to obtain additional information about the firm's upcoming earnings release, its strategic plan and more detail regarding the RTM portfolio. At this time, the European sovereign investments contained in the off-balance sheet RTM portfolio continued to be investment grade rated and had short maturities and locked-in funding through the date of maturity.[3] During the October 20 meeting, MF Global executives stated that the firm believed its financial condition was strong. Four days later, on October 24, 2011, MF Global's CFO sent a follow-up e-mail to S&P's analysts stating, among other things, that he believed MF Global's "capital and liquidity has never been stronger" and that "MF Global is in its strongest position ever as [a] public entity."

On that same day, October 24, Moody's Investors Services downgraded its credit rating of MF Global to a level that corresponded to S&P's 'BBB-' rating, which had been in place since November 2010. The following day, notwithstanding management's optimism, MF Global reported a net GAAP loss of $191.6 million for the previous quarter, largely as the result of a non-cash write-down in the value of its deferred tax assets. During the investor call announcing this disappointing result, the firm's CEO, Mr. Corzine, stated that MF Global's RTM positions continued to have "relatively little underlying principal risk in the timeframe of our exposure" and that "the structure of the transactions themselves essentially eliminates market and financing

3 We note that as of the date of this submission, none of the sovereign entities contained in the off-balance sheet RTM portfolio have defaulted.

risk." Nevertheless, MF Global's stock price fell by nearly 50 percent the day of this earnings announcement, reflecting a potential crisis in confidence among investors and others.

On October 26, 2011, a committee of S&P analysts voted to place the 'BBB-' credit rating of MF Global on CreditWatch with negative implications and S&P issued a report to that effect. This action reflected S&P's view that, among other things, continued volatility in the capital markets and low interest rates could further harm MF Global's ability to generate capital. The report also discussed MF Global's RTM exposure and the firm's increased risk profile. The October 26 report concluded by stating that S&P could soon lower MF Global's rating to a speculative, non-investment grade level depending on the firm's execution of strategic plans (which included a potential short term sale of certain operations), balance sheet management, and plans for its future proprietary trading activity. Over the next several days, S&P's analysts did in fact actively consider a further downgrade based in part on MF Global's inability to execute a strategic sale.

S&P's October 31, 2011 downgrade to 'D'

On October 31, 2011, MF Global filed for bankruptcy protection. As a result, S&P downgraded the firm's credit rating to 'D'. In S&P's view, MF Global's collapse was not caused directly by its exposure to the RTM portfolio -- a fully-funded investment in sovereign debt scheduled to mature by December 2012. Rather, we believe MF Global's demise was driven primarily by a rapid, downward spiraling of confidence among market participants and counterparties who questioned the firm's transparency and its ability to attract and maintain investors and generate revenue.[4]

Conclusion

I thank you for the opportunity to participate in this hearing and I would be happy to answer any questions you may have.

[4] S&P does not purport to audit the issuers it rates and does not undertake to police issuers for fraudulent activity or misconduct. Nevertheless, S&P does evaluate the quality of information it receives and also requires issuers to provide accurate information as a condition to receiving a rating. In this case, MF Global was required to warrant that all information it provided to S&P regarding its rating contained "no untrue statement of material fact" and did not omit material facts so as to render the information misleading. When S&P does not believe that it has sufficient high-quality information, it will refuse to provide ratings, or withdraw ratings, as appropriate.

STATEMENT OF MICHAEL K. ROSEMAN
CHIEF RISK OFFICER OF MF GLOBAL HOLDINGS LTD.
FROM AUGUST 2008 TO JANUARY 2011

BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES OVERSIGHT AND INVESTIGATIONS SUBCOMMITTEE
FEBRUARY 2, 2012

Chairman Neugebauer, Ranking Member Capuano, and Members of the Subcommittee, my name is Michael Roseman, and I was the former Chief Risk Officer ("CRO") of MF Global Group from August 2008 to January 2011. Thank you for the opportunity to testify today. I hope that my comments will help you to continue to build on your knowledge of the events that led to the collapse of MF Global.

My Background

I started my professional career as an Aerospace Engineer after graduating from the University of Delaware in 1983. In 1994 , I received an MBA from the Kenan-Flagler business school at the University of North Carolina and pursued a career in financial services. After graduation I joined Sanwa Financial Products (Sanwa Bank's derivatives products subsidiary) with responsibility for the risk analysis function (product control). The following year, I moved to the trading team and co-managed the US dollar OTC option portfolio for a number of years before returning to risk management as the Global Head of Market Risk.

In 2001, after Sanwa consolidated, I joined the Bank of Montreal as the Head of US Risk Oversight for all trading, underwriting and investment activities in the United States and with the mandate to strengthen the risk management capabilities in the US. Then in 2004, I joined Newedge (formerly Fimat before its merger with Calyon Financial) as the Chief Risk Officer of the Americas, again with a mandate to elevate the risk management capabilities to fully support the growing brokerage business.

In each of these experiences, I led and coordinated significant efforts to implement new best-practice policies, systems, analytics, processes and controls in support of the businesses and to bring full transparency to, and governance of, the risks across the organizations.

MF Global Background

As I believe you are aware, in February 2008 shortly after MF Global went public in 2007, the company suffered an "unauthorized trading incident" and lost $141 million overnight. This incident significantly impacted MF Global's share price as well as customer relationships and led to two rating agency credit downgrades. The incident was immediately reviewed by two specialized consulting firms that were hired by the company to fully understand the cause of the incident and to make recommendations to the company and the Board of Directors (the "Board") as to how to prevent similar incidents from occurring in the future. After an in-depth review, the two consulting firms made a list of recommendations that were largely risk management (and compliance) oriented. The proposals reflected needed changes to fully integrate the company globally (after a number of acquisitions prior to the IPO), to strengthen the enterprise risk management governance and capabilities, and to mitigate the likelihood of future unexpected events from occurring. Specifically, these recommendations included implementing enterprise risk management policies, enhancing the risk systems, strengthening the global 24-hour risk monitoring capabilities, and hiring a global Chief Risk Officer.

In August of 2008 I left Newedge and joined MF Global as the Chief Risk Officer reporting to the CEO with responsibility for the risk department worldwide, along with a mandate to elevate the risk management capabilities to support the strategic objectives and to address the recommendations made by the two consulting firms. As the CRO I provided leadership over, and oversaw the adherence to, the enterprise risk management framework across all categories of risk including chairing the monthly Enterprise Risk Committee meetings. Further, I was a member of the Executive Management team and provided regular CRO reports to the Board.

Over the next two years I coordinated closely with Executive Management and the Board to implement a new, comprehensive enterprise risk management framework, including the establishment of new risk management committees, enterprise risk policies, and a Board-approved risk appetite statement with associated delegations of authority across all categories of risk. Among other things, I led and coordinated the efforts to enhance the risk systems, implement new analytics and risk measures, strengthen the 24-hour global risk monitoring (in the Americas, Europe, and Asia), implement comprehensive enterprise controls across the organization, and, with the CEO, established a culture of sound risk management throughout the company.

Throughout this period, I, along with others on the Executive team, regularly interacted with various stakeholders to provide transparency on the significant efforts and progress made to implement the consulting company recommendations and to strengthen MF Global's risk management capabilities. Over time, the stakeholders, including the rating agencies, regulators, insurance companies, counterparties, and customers gained confidence in MF Global's improvements. Ultimately, the two consulting firms conducted on-site reviews and reported to the Board that the recommendations were satisfactorily addressed.

Risk Appetite and Delegations

As previously stated, after I joined MF Global, the company adopted a risk appetite statement and new delegations of authority that were approved by the Board, calibrated to the existing business, supported the strategic objectives of the company, and encompassed all categories of risk, including market, credit, operational, capital, and liquidity risks. The risk appetite statement and delegations of authority were subsequently reviewed by the Board as part of the annual risk review process and also at interim Board meetings throughout the year if Executive Management requested adjustments. Additionally, there were escalation policies that were implemented in order to timely bring breaches of the approved limits to the attention of appropriate levels of management and ultimately to the Board, depending on the severity of a breach.

As a key part of my CRO responsibility, I reviewed MF Global's firm-wide exposures and evolving risks. I regularly presented the firm-wide risk exposures in the context of the approved risk appetite to Executive Management and the Board. Both Executive Management and the Board received a monthly enterprise risk report that detailed firm-wide exposures against the risk appetite and approved limits. As CRO, I also presented limit requests from Executive Management, along with their associated risks, to the Board.

Sovereigns

MF Global had both country-level credit limits and specific sovereign issuer trading limits in place to control the exposure of all activities in all countries, as well as to control specific sovereign issuer exposures. These limits took into account the risks presented by a country and MF Global's approved risk appetite, and were regularly reviewed and adjusted from time to time as country conditions or business strategies changed. The risk department distributed country level and daily issuer level risk reports that showed all exposures by country, and by sovereign issuer, against the limits and highlighted any limit breaches for escalation.

With respect to Italy, Spain, Portugal, Ireland, and Greece, there were sovereign level issuer trading limits in place to support the European brokerage activity prior to Mr. Corzine joining MF Global. These issuer limits were well within the company's approved risk appetite, were adjusted when conditions began to deteriorate in Greece, and I believe the positions in March 2010 were less than $500 million in total across these issuers.

In June/July of 2010, I received requests to adjust the European sovereign limits from business units. I reviewed the positions and limits in detail with the business heads and with Mr. Corzine. I expressed my views on the requests outlining the potential capital risk implied by the credit default swap ("CDS") market, along with the continued political and financial uncertainty in the relevant countries. While Mr. Corzine and I shared different views on the potential sovereign default risk, after taking into account the new European Financial Stability Facility ("EFSF") that was established in May 2010 and the forward funding schedule of the named sovereigns, we agreed upon a $1.0 billion total gross nominal limit across the named sovereigns. Additionally, we agreed on more specific limits by sovereign with various maturity buckets of up to 12 months to mitigate the capital risk and to keep the positions well within the EFSF's June 2013 maturity. Further, while I expressed my cautions on the potential capital risk, the liquidity risk of the positions was not considered an issue at this point given the size of the limits and the ability of the company to fund or liquidate the positions if conditions changed.

By mid-September, I recall that the positions and limits had increased to some $1.5 to $2.0 billion. During this time period, I expressed my increasing concerns with regard to the potential capital risk associated with the growing positions and began to express caution on the growing liquidity risk. Additionally, around this time the strategy to significantly increase the positions through Repo-to-Maturity ("RTM") trades was being evaluated given the profitability of the transactions and the importance of generating earnings. At this point I indicated to Mr. Corzine that we would need to consult the Board for approval for increased sovereign limits given the increasing materiality of the risks as they related to the Board's approved risk appetite. As such, the decision was made to consult with the Board to discuss the strategy, the risks, and the sovereign limits, and subsequently sovereign limits were presented to, and approved by, the Board. Prior to this, given the size of the positions and level of risk, the sovereign issuer limits had been managed under the risk delegation of authority. However, certain adjustments to country limits had been presented to the Board for approval to accommodate the sovereign trades and other transactions within a given country.

By late October, I recall that the positions were approaching $3.5 to $4.0 billion, and I was asked to present another request to the Board on behalf of Executive Management to increase the total sovereign limit to $4.75 billion. At this point, not only was I concerned with the capital risk, but given the size, I was now concerned with the liquidity risk relative to the risk appetite and taking into account the liquidity risks presented by other positions held by the company. I discussed my concerns about the positions and the risk scenarios with Mr. Corzine and others. However, the risk scenarios I presented were challenged as being implausible.

At the November 2010 Board meeting I presented the new request along with a detailed analysis of the potential liquidity risk stress scenarios. These scenarios included potential variation margin requirements from price changes of the securities, and as well as potential initial margin calls from the repo counterparties. These scenarios were presented at both the individual sovereign levels as well as at the correlated level across all sovereigns and all repo counterparties. I also provided an analysis on the CDS market, and highlighted the significant capital risk given the sovereign default risk associated with the unresolved financial issues in Europe.

During this meeting, all of the risks were debated. In particular, the liquidity scenarios were discussed and were challenged by some members of the Board as being not plausible. There was disagreement as to whether the correlated liquidity risk scenarios could occur across all counterparties and issuers at the same time. Ultimately, the Board approved the request, conditioned on the limits being evaluated again early in 2011.

My Departure

In January 2011, I was notified that I was being replaced by a new Chief Risk Officer, Michael Stockman, effectively immediately. For the next month I helped to transition my duties to Mr. Stockman prior to departing from the company in March.

Closing Comments

While I wasn't at MF Global when the events took place, and am not aware of the specifics that played out, in my opinion the events that occurred were not due to the lack of transparency of the risks, but rather the governance of concentration risks, and the resistance to certain potential stress scenarios, much the same as during the mortgage crisis, as well as the availability of sufficient capital and liquidity resources needed to fully support the company's evolving strategy.

I would be happy to answer the Committee's questions.

STATEMENT OF MICHAEL G. STOCKMAN
BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
OVERSIGHT AND INVESTIGATIONS SUBCOMMITTEE

FEBRUARY 2, 2012

Chairman Neugebauer, Ranking Member Capuano, and Distinguished Members of the Subcommittee:

Thank you for the opportunity to make this brief statement. I am deeply saddened by the bankruptcy of MF Global and its impact on customers, shareholders and employees. Although I was only with the company for approximately nine months, I hope my testimony today will assist the Committee in obtaining a clear picture of what happened at MF Global during my tenure at the company.

I have worked in the financial services industry for more than 25 years. Of particular note, I served as a risk officer at UBS for over a decade, eventually rising to the position of Chief Risk Officer for the Americas for that institution. Since 2006, I have been a member of the MBA Advisory Board of the Tuck School of Business at Dartmouth College, where I have also served as a Scholar-in-Residence.

I began interviewing for the position of Chief Risk Officer at MF Global in the fall of 2010. During the interview process, I was informed that MF Global was in the process of transitioning its business model from a traditional commodities broker to a full-scale investment bank, and that the company was seeking a new Chief Risk Officer with the experience and skill-set to assist in that transition.

In or about January 2011, MF Global offered me the position of Chief Risk Officer, and I joined the company in that capacity, reporting directly to the Chief Operating Officer. My responsibilities included, among other things, assessing market and credit risk for the company. I provided analyses about these risks to senior management and the Board, who used this information in setting the company's business strategy. I was ably assisted in the performance of my duties by a strong staff of approximately 60 dedicated employees, located in company offices around the world, including the United States, Europe and Asia. Although the Chief Risk Officer did not have formal responsibility for managing the company's liquidity risk, my staff and I performed numerous analyses measuring the company's potential liquidity needs under various stress scenarios. My understanding is that my portfolio of responsibilities as Chief Risk Officer was largely the same as that of my predecessor.

There has been substantial discussion about MF Global's participation in transactions involving European sovereign debt known as "repurchase transactions to maturity" or "RTMs". The company's European sovereign debt trading strategy was firmly in place when I joined the company in late January 2011. At that time, the Board had approved an RTM limit of $4.75 billion.

After I joined MF Global, the Risk Department regularly analyzed the company's RTM positions. For the first several months of my tenure, based on analyses performed by my department, I believed that the risk profile associated with the company's European sovereign debt position was acceptable in light of then-prevailing market conditions. Among the many metrics supporting this assessment were credit ratings, credit spreads, and probabilities of default relevant to the company's RTMs. In addition, the Risk Department, under my direction, analyzed potential liquidity needs associated with these trades under stressed market conditions, and had received information from other departments that the company possessed adequate liquidity sources to address such potential needs.

As credit markets deteriorated in the summer of 2011, I came to the view that it would be prudent for the company to mitigate the increased risks associated with its European sovereign debt trading position, and to consider entering into hedging transactions to reduce the company's exposure. In July 2011, I initiated several discussions with senior management to express this view and explore such risk mitigation strategies. I also highlighted the increased default and liquidity risks associated with the RTMs in written and oral presentations to the Board of Directors at the August 2011 Board meeting.

In my view, the Board and senior management were highly sophisticated; they knew and understood how the RTMs worked; and they were well aware of the increased risks caused by weakening market conditions, as highlighted in my reports to the Board. To the best of my recollection, following my presentation at the August 2011 Board meeting, the Board and senior management made an informed business judgment to cease adding to the company's long position in European sovereign debt and to allow existing long positions to roll off as the underlying securities reached maturity, thereby reducing the company's exposure over time. It is my understanding that none of the European sovereign debt securities underlying the RTMs has defaulted or been restructured, and all of the securities in the RTM portfolio that reached maturity have been paid in full.

I am, of course, aware of numerous press reports that more than $1 billion in customer funds are missing and unaccounted for. I have no personal knowledge of any missing funds or unreconciled customer accounts. While at MF Global, I did not have responsibility for treasury functions, such as funds transfers and the maintenance of segregated customer funds. Like everyone else, I am very hopeful that all missing customer funds will be located and promptly returned to the rightful owners.

That concludes my personal statement. I look forward to answering any questions you might have.