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THE COLLAPSE OF MF GLOBAL, PART 1

HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

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THE COLLAPSE OF MF GLOBAL, PART 1

Thursday, December 15, 2011

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 1:08 p.m., in room HVC–210, Capitol Visitor Center, Hon. Randy Neugebauer [chairman of the subcommittee] presiding.

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

Ex officio present: Representative Frank.

Also present: Representatives Hensarling, Royce, Garrett, Luetkemeyer, Huizenga, Dold, Grimm; Green and Perlmutter.

Chairman NEUGEBAUER. The subcommittee will come to order. I remind Members that we previously agreed there will be 10 minutes of opening statements on each side. I ask unanimous consent that members who are on the Financial Services Committee—but not on the Oversight Subcommittee—who have joined us today will be entitled to participate: Mr. Hensarling, Mr. Royce, Mr. Garrett, Mr. Luetkemeyer, Mr. Huizenga, Mr. Dold, Mr. Grimm, Mr. Green, and Mr. Perlmutter.

Without objection, it is so ordered.

What we are going to try to do is do the Members' opening statements. We may have an opportunity for the witnesses to give their opening statements. But we are told that somewhere around 1:30, we may have a series of votes. We think there are three or four votes in that series. We were going to try to continue the hearing during that period, but it looks like that would be difficult to do since there are three or four votes. So I think the best thing for the committee to do, unless the ranking member has a different idea, is for us to adjourn briefly, go make those votes, and then come back.

I also ask unanimous consent that if any other members of the Financial Services Committee arrive, they be allowed to be a part of the hearing as well. At this time, I will now recognize myself for an opening statement. This is a very important hearing. We are here to find out exactly what happened at MF Global and with their bankruptcy.

I think we want to accomplish three things in this hearing. Number one, we are very alarmed, and a lot of people are alarmed that we still have customers' funds that are missing. And that number

jumps around anywhere from over $1 billion to a number less than that. It is very disturbing. This is very historic that these funds, segregated funds—I think it is the first time since the law was put in place that segregated funds have caused customers to suffer a loss.

The second thing that we want to look at is, well, was there regulatory failure during this process? This is an entity that has a number of regulators. And we know that some regulators showed early concerns about what was going on in this organization. Others were caught by surprise. That is a very disturbing fact.

The third thing that we want to look into is the corporate behavior within this organization during this time. What we know is that during the period of time where these transactions, these positions were put on the books, there were people within the organization who were saying that these were risky and in fact, if the market went a different way, that could actually take this firm down. And in fact, that is exactly what happened.

This is all important because as we look at trying to put this puzzle together, what we need to ascertain is where the failures were. Because there will be those who will call to say, we needed more regulations. I would remind you that we had Sarbanes-Oxley and Dodd-Frank in place, and this event actually happened anyway. So when we look at the regulatory side, we need to see if we had regulators who weren't communicating, regulators who weren't doing their job, exactly what was the reason that some of these regulators were caught by surprise.

I think the other thing is internally, when we look inside the corporate structure of this company, what we saw was that one person had an extreme amount of authority, Mr. Corzine. He was the chairman of the board. He was the CEO of the company and, according to some people that we have interviewed, one of the principal traders of this company. And so, therefore, there was no real barrier or firewall for protecting the investors and the customers of this company. So I hope that we will have a very robust hearing today. And we look forward to hopefully finding some of the answers to some of these unanswered questions.

With that, I now yield to the ranking member, Mr. Capuano.

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Chairman, I know that the obvious question everyone wants to know is, where is the money? I don't expect that we will be able to get an answer today or any day. There are other people who are in a better position and more intelligent than we are to be able to chase that down. But there are an awful lot of questions left here for me, as far as I am concerned.

First of all, I would like to talk about some of the conflicting statements that have come out over the last couple of days, the last week or so with different hearings. Different people have said different things. I just want to know what the truth is. I particularly am interested to know whether there is anyone else out there who has similar exposure doing either the same things or different things. Does anybody know about it? And does anybody care? I say that because the more I look into this, the more I am coming to a, not a conclusion, but at least a suspicion that there may well have been very little here that was technically illegal. I have read

through the testimony. The word "misuse" has been used a lot. But to me, that is a legal statement, not a statement as to where we want to go, where we want to be.

There are still a lot of questions of what was allowed, should it have been allowed? Is it now closed off for future people going forward? There are all kinds of things here that I think we need to talk about. We need to ask what the ratings agencies were doing. We need to ask what the auditors were doing, whether we have too many regulators. The last I heard, MF Global was subject to 20 different regulators. That is ridiculous.

I am not afraid of regulation, but that can't possibly work. It does nothing but allow for forum shopping. It does nothing but allow somebody to point fingers at someone: "It wasn't my job; it was his job or her job." We have a significant degree of self-regulation in this particular case. I think it is a fair question of whether self-regulation is still applicable in today's world. It was one thing in the 1880s; it is another thing today. So for me, again, where the money is, that is going to be the headlines. That is what everybody wants to know. And I don't think we are going to find out. But I hope that this is the first of a series of hearings over the next several months, because I just can't imagine we will be able to get the answers to the real questions I have today. But hopefully, we will be able to do so in the future. With that, Mr. Chairman, I will yield back.

Chairman NEUGEBAUER. I thank the gentleman.

The vice chairman of the subcommittee, Mr. Fitzpatrick, is recognized for 2 minutes.

Mr. FITZPATRICK. Thank you, Mr. Chairman.

What we are here to examine today is not simply a headline in a financial newspaper. The collapse of MF Global was one of the largest bankruptcies in our Nation's history. This failure has changed lives, impacted businesses, and most certainly will cost American jobs.

I look forward to hearing today's testimony. I also look forward to reviewing the actions of the relevant regulatory agencies: Did they provide proper oversight? And what could they have done to prevent the extensive risk-taking that apparently occurred at MF Global, reportedly against the advice of its own chief risk officer. Once again, the confidence in our financial markets has been shaken.

But the biggest frustration of all is that these are real people who have lost real money. This is something more than a loss on a balance sheet. They are farmers. They are regular everyday people, including constituents of mine in Bucks County, Pennsylvania, who have been harmed. The trustee continues to work with regulators on identifying the various transfers and trying to locate missing funds. I certainly hope that is true. The victims need to be made whole. And anyone who acted improperly certainly needs to be punished.

My hope is that today's hearing helps to ensure that this doesn't happen to another family in Bucks County, or in the heartland, or anywhere in the United States. People are tired of opening their newspapers and reading stories about failures on Wall Street and failures of our regulators to identify and catch problems. I share

the frustration that many Americans feel reading stories about a major financial institution failing. And I sympathize with the hard-working Americans whose lives have been negatively impacted by the flaws in the Federal Government's regulatory regime. There was a breakdown in corporate leadership, which I think has been acknowledged in some of the previous hearings. Clearly, there was also a failure in our regulatory structure. Multiple agencies had jurisdiction in this case, and there was a lack of communication and coordination that might have identified the problem sooner. I expect that this hearing will help us to continue to bear out the facts of what happened at MF Global, and allow us to implement the necessary reforms.

Finally, Mr. Chairman, I hope that as we identify these problems, it helps us to map out a way forward that restores confidence in our financial markets, especially as our regulatory system undergoes its largest restructuring in over 80 years. And I look forward to the testimony.

Thank you for calling the hearing, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

And now, the ranking member of the full committee, Mr. Frank.

Mr. FRANK. Thank you, Mr. Chairman.

This is an interesting switch. For some time now, I have been hearing my Republican colleagues complain about overregulation and interference with the private sector. Today, we are hearing complaints about underregulation and insufficient interference with the private sector.

The facts are clear that whatever was done incompetently, incorrectly, perhaps dishonestly—although no one has established that yet—was done in the private sector. The complaint is that the public sector didn't do enough regulation.

It is true that the financial reform bill is now in place. But it was signed into law in July of 2010. We have not yet seen its full implementation. In fact, one very important rule that is relevant to trying to deal with the problems here was just adopted earlier this month.

And the way in which it was held up is relevant. The Chairman of the Commodity Futures Trading Commission (CFTC), Chairman Gensler, who I think does a very good job, couldn't get the third vote he needed. This was not the first time. We had the same problem with regard to the anti-speculation rule.

And I say that because this Commission structure, which can lead to delay in the adoption of important rules, is exactly what my Republican colleagues want to engraft onto the consumer bureau, hoping, I believe, for similar results: much less effective action.

But let's go back to the whole question of regulation. Members have said, well, the regulators didn't do a good enough job. This is partly because the extent to which we can expect our regulators to rely on volunteer help is limited. The regulators are not the Salvation Army.

What we have are my Republican colleagues consistently resisting the funding that the Commodities Futures Trading Commission, the primary regulator—and while people have said there were too many regulators, there was clearly a primary responsibility on the CFTC. I don't think regulatory diversity was the serious prob-

lem here. What we have is a significant lack of funding for the CFTC. These are complicated matters. They require intelligent people to do this.

The President asked for $308 million, $117 million to be funded through a user fee, that is, the President wanted the additional money to come from those in the business. But my Republican colleagues decided to defend the financial interests of those in the business and rejected that so that it all comes from the taxpayer. So, first, they make sure that we don't get money from the industry, and it all comes from the taxpayer. Then, they use the fact that because of them it is all coming from the taxpayer as a reason not to fund it adequately because they say the taxpayer can't afford it. Although $100 million extra from the taxpayers, from people who support the wars in Afghanistan, Iraq, Moonshots and everything else, is somewhat hard for me to accept too seriously.

Let me ask you how much time I have left, Mr. Chairman?

Chairman NEUGEBAUER. The gentleman's time has expired.

The ranking member of the subcommittee has yielded you additional time.

Mr. FRANK. Thank you.

They are inadequately funded. The Republican Appropriations Committee this year voted them $172 million, less than they have in the current year. That is for the next fiscal year. The Democratic appropriators did help to get it up to $205 million, but $55 million is kept from personnel and put only into IT, over the objection of the CFTC. So the CFTC has been hampered.

I also believe that a law that has been in effect only a little over a year, not fully a year when some of these events started, is not an adequate test of the law. A fully funded CFTC, able to adopt regulations, would do the job. And I think my Republican colleagues have this dilemma. They are opposed to regulation in general. They are now saying, the regulation should be better. But I invite people to do a little content analysis, in which we are told that these regulators are interfering with our private enterprise. You cannot logically and sensibly be for regulation in the particular when you have opposed regulation in general and in fact have disabled the regulators from doing it.

And then, there is one other question I want to raise, and that is the self-regulatory model. Much of this was self-regulatory model followed. And I have been skeptical of some proposals we have had to increase that. I want to talk particularly about the CME. And I have a great deal of regard for people at the CME. It is a very well-run organization. When we drafted the legislation, I was interested in their input. But I do want to raise a question as to whether or not there is a conflict of interest. The National Association of Securities Dealers, which FINRA is the self-regulator for the securities part, they spun off the regulatory agency from the people running the exchange.

At CME, no such spinoff has taken place. And I don't mean to suggest in the slightest that there was any conscious softening by CME. I have too much regard for the people there to believe that. But human beings are human beings. And I believe one of the things we have to look at is if you are going to have an SRO, should it be spun off in the way that FINRA was spun off from the

National Association of Securities Dealers in that exchange? Should we ask for a similar degree of spinoff if the CME and people in that area are also going to be an SRO?

Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman. And now the gentleman from California, Mr. Royce, for 1 minute.

Mr. ROYCE. Yes. It is not that Republicans are opposed to regulation in general.

We are opposed to incompetent regulation. We are opposed to the kind of regulation that would not allow, for example, the systemic risk regulation of the GSEs. So what Republicans want to see is competent regulation, including over at the CFTC. Customer segregation rules have been around in this country for 75 years. And these rules are not convoluted. They are rather easy to understand and to enforce. Yet, the CFTC failed. And why this happened is one of the many questions we hope to get answered here today.

Another concern we have is what happened at MF Global in terms of the $1.2 billion in missing funds. And on top of that, the concern that we have in terms of why the Federal Reserve would grant to this organization the status that it was given in terms of primary dealer, given the weak credit rating, the bleeding of cash, the $137 million that it was lost the year prior by the firm, the 80 regulatory actions taken against it since 1997. Is the Democrat answer for regulation leading us to a situation where political pull and political interference intercedes and prevents the rule of law and prevents the right kinds of decisions being made by the New York Fed because of the connections of people politically? Those are some of the questions we want answered.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Baca is recognized.

Mr. FRANK. Would the gentleman yield for 10 seconds?

Mr. BACA. Yes.

Mr. FRANK. I would just say to the gentleman from California, he said that Republicans are for GSE reform. That leaves me to question why in the 11 months of this Congress, they haven't done it. Of course, the answer may be for the same reason they didn't do it in the 12 years before that. My Republican colleagues are all for GSE reform when they are in the Minority, but when they are in the Majority, somehow they can't seem to do it.

Mr. ROYCE. Reclaiming my time, you and I have debated this issue—

Mr. BACA. Excuse me, it is my time.

I had yielded time to him.

Chairman NEUGEBAUER. I think we need to separate the time here.

Mr. BACA. Getting between the rings here.

Chairman NEUGEBAUER. Mr. Baca, you are recognized.

Mr. BACA. Thank you very much, Mr. Chairman, and Ranking Member Capuano, for calling this hearing.

I also want to thank the witness, Governor, Senator, Mr. Corzine, for being here.

I have to say I wish it was under better circumstances, and you wish it was under better circumstances. But with $1.2 million in

customer funds completely missing, I think it is clear to everyone why we are here today.

Where is the money? Where did it go and why? We want answers. Over the past 5 years, the American people have had their share of disappointment with the financial system. There has not been enough oversight and accountability. And that is why the Frank-Dodd legislation came into existence, to make sure that we had a lot more oversight and accountability.

And it seems like now we want to do away with a lot of the accountability and oversight, yet we want to get back to these answers. That is why I really believe that we should continue to have the oversight and the funding that is there. From the near economic collapse to the massive frauds like the one orchestrated by Bernie Madoff now to the failure of MF Global, it is clear that the need for improvement in oversight and accountability still remains.

And at the heart of it, that is what is so troubling to Members of Congress and the American public. Not the regulators or executives who dropped the ball in their responsibilities—and I state not the regulators or the executives who dropped the ball in their responsibilities—but that the American public, innocent investors are left with the check.

I do think it is curious that at a time when we are seeing a need to increase oversight and enforcement, as displayed in this case, some of my colleagues are intent on defunding some of our regulators who are charged with these same goals. And it is very curious in terms of why is it at a time that we need to have more? Today, I am hopeful that we will get the answers.

This is the third congressional hearing on this matter. And I don't think anyone has been overly impressed with what has happened at the previous two.

I am hoping that can change today. Again, I want to thank the chairman and the ranking member for calling this hearing. I thank the witnesses for being here.

And I yield back the balance of my time.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Texas, Mr. Canseco, will be recognized for 1½ minutes.

Mr. CANSECO. Thank you, Mr. Chairman, for calling this meeting.

Companies go bankrupt in the United States every day. And while I do not believe it is the role of Congress to examine every bankruptcy that occurs in the private sector, the case of MF Global is an exception.

Given that MF Global's bankruptcy is the 8th largest in the United States' history, it is hard for Congress to not ask, what happened? It is extremely important for this committee to examine the consequences for the financial sector of MF Global's bankruptcy, as well as the impacts on end users, such as farmers and ranchers, who access futures markets in order to hedge their risks.

There are also several questions that MF Global's bankruptcy raises that need to be answered. First, MF Global received a number of regulatory sanctions throughout the years, yet was still allowed to dramatically increase its risks, notably in its exposure to European sovereign debt.

The most important question that needs to be answered, however, is what happened to $1.2 billion of client money that has gone missing and nobody seems to know what happened to it? The first time customers have suffered losses from the improper handling of customer funds by a clearing member, the case of MF Global shows not just a failure of company management, which I would say demonstrates as much concern for its risk as did the captain of the Titanic, but also a profound failure in our regulatory structure that needs to be addressed.

Nine years ago, we were told that Sarbanes-Oxley would put an end to accounting gimmickry. And last year, we were told that Dodd-Frank would lead to regulatory coordination that would make our financial system safer and sounder. Despite the massive increase in the government's authority, neither of these promises held in the case of MF Global. And yet, the private sector continues to pay the enormous regulatory tab of these two bills. I look forward to hearing from our witnesses today just how this breakdown happened and what can be done to fix it.

Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from New York, Mr. Grimm, is recognized for 2 minutes.

Mr. GRIMM. Thank you, Chairman Neugebauer.

I appreciate you calling this meeting. As unfortunate as it is, really, to have a need for this hearing, I am eager to hear exactly and explicitly how the events that led to the collapse of MF Global actually transpired.

I am anxious to know exactly who was involved in commingling funds if that occurred. Who gave the order for such approved transfers? Who else was involved in that approval? Who actually executed this apparent illegal transfer?

Moreover, details about and insight into what happened and what appears to be an institution that did not have a strong internal compliance control, but rather possibly had a CEO who controlled most aspects of the firm, ranging from trading strategy, essentially betting the farm on European sovereign debt, to possibly ignoring chief risk officers' repeated warnings, and also to possibly having a controlling influence over the board of directors. Therefore, I look forward to hearing with some specificity the answers to the questions that other committees and the media have not been able to extract. Although many reports and investigations—aspects of the investigation I have had the opportunity to read, I would rather not assume any facts, none of this case, but rather, I would like to learn it firsthand, to be educated today as much as we can about the entire truth. And the one person that I believe can shed as much light on this is our witness today, Mr. John Corzine.

And with that, I yield back the balance of my time.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentlelady from New York, Ms. Hayworth, is recognized for 30 seconds.

Dr. HAYWORTH. Thank you, Mr. Chairman.

Governor Corzine, Mr. Abelow, I serve the Hudson Valley of New York, and I know former partners at Goldman Sachs who know both of you and respect you greatly.

I don't imagine that anything we will ask at this hearing will be new to you. I do have the strong impression that someone at MF Global knows what happened. And I hope merely that in the fullness of time, you will apply your talents and your minds to enlightening us as to how we can prevent something like this collapse from ever happening again. And I thank you for your testimony today.

Chairman NEUGEBAUER. I thank the gentlewoman.

And now the gentleman from New York, Mr. King, is recognized for 1 minute.

Mr. KING. Thank you, Mr. Chairman. Thank you for bringing the witnesses here today, for holding this hearing. Senator Corzine, it is good to see you again, although it is unfortunate that it has to be under these circumstances.

As my colleague Mr. Grimm said, this hearing today addresses the most serious questions both about management and about the extent to which we have control, we have jurisdiction. The fact that $1.2 billion can be missing and not accounted for, the fact that at a time when every taxpayer is trying to account for every penny, we can have persons such as yourself, Governor Corzine, who made your reputation in this field. This is your world, not mine. And yet you not being able to account for the money raises the most serious questions. I don't know if they will be answered today. They really haven't been answered up to now. There have been some differences in the testimony.

But I think it is important to keep our eye also on the innocent people out there being hurt. I have a constituent of mine, Tariq Zahir, who is the managing member of a commodity trading advisory company in my district. Right now, he is himself on the verge of losing his business because of the actions that were taken by MF Global.

And Mr. Chairman, I would, if I could just submit this statement for the record from my constituent, Mr. Tariq Zahir, managing member of Tyche Capital Advisors LLC in New York, to put a human face on the suffering this has caused. And hopefully, we will find out what happened, why it happened, and how to prevent it from ever happening again. With that, I yield back.

Chairman NEUGEBAUER. Without objection, it is so ordered.

I remind all Members that your opening statements will be made a part of the record.

Without objection, I would like to enter into the record materials sent to the committee from the Chicago Mercantile Exchange.

Without objection, it is so ordered.

Now, I am going to introduce our first panel, the Honorable John Corzine, former chief executive officer of MF Global; and Mr. Bradley Abelow, chief operating officer, MF Global.

Gentlemen, I want to remind you that your written statements will be made a part of the record. And we ask you to summarize that testimony in 5 minutes.

Before you do that, I would ask both of you to please stand. I am going to ask you to raise your right hand.

[Witnesses sworn.]

Chairman NEUGEBAUER. Please be seated.

As I stated, your written statements will be made a part of the record.

You are recognized for 5 minutes. Mr. Corzine, you are recognized.

STATEMENT OF THE HONORABLE JON S. CORZINE, FORMER CHIEF EXECUTIVE OFFICER, MF GLOBAL

Mr. CORZINE. Thank you, Chairman Neugebauer, Ranking Member Capuano, and distinguished members of the subcommittee. Let me begin with the fact that, as I have said at each of the congressional hearings, every day I think about the fact that MF Global bankruptcy has been devastating to people's lives.

Chairman NEUGEBAUER. Mr. Corzine, I am going to interrupt you. Is your button on?

Mr. CORZINE. It is, sir.

Chairman NEUGEBAUER. Okay. You may need to talk just a little bit louder.

Mr. CORZINE. I recognize that my concerns about their anguish—are you hearing me now, Mr. Chairman?

Chairman NEUGEBAUER. Yes, sir.

Mr. CORZINE. I recognize that my concerns about the anguish of those affected provide no solace for their losses and hardship, whether those hurt are customers, employees, or investors. As the chief executive officer of MF Global, I truly apologize to all those affected.

As you know, I have provided a written statement to the subcommittee, and I have previously testified before the House and Senate Committees on Agriculture. I am here to answer your questions as well.

Before I do, I wish to make a few additional points in light of my earlier testimony. First, I have been repeatedly asked over the last week whether I directed or authorized the improper use of customer funds. I have tried to answer those questions to the best of my ability.

But once again, let me be clear, I never gave any instruction to misuse customers funds, I never intended anyone at MF Global to misuse customer funds, and I don't believe that anything I said could reasonably have been interpreted as an instruction to misuse customer funds.

And as I have repeatedly stated, I was stunned on Sunday night to learn that there was a problem with many hundreds of millions of dollars of customer funds.

Second, after I testified on Tuesday, Mr. Duffy of the CME suggested he recently learned that someone heard someone else say that they understood that I knew that customer funds may have been improperly loaned to the MF Global affiliate in Europe during the last days of the firm's operation. I don't know the source of the suggestion.

Let me be clear: While the last few days of MF Global were chaotic, I did not instruct anyone to lend customer funds to MF Global or any of its affiliates, nor was I told that anyone had done so.

Third, Mr. Duffy's comments may relate to the overdraft situation at JPMorgan Chase, about which I have previously testified. I became aware of that situation on the morning of Friday, October

28th. At that time, I was trying to sell billions of dollars of securities to JPMorgan Chase in order to reduce our balance sheet and generate liquidity. JPMorgan Chase told me that they would not engage in those transactions until overdrafts in London were cleaned up. I contacted the firm's back office in Chicago and others, and asked them to resolve this issue, which I understood they did.

Later on Friday, JPMorgan Chase contacted me again and said they needed assurances that the transfer of funds did not violate CFTC rules. Since I had no personal knowledge of the issue, I asked senior people in the back office and the legal department to become directly involved in responding to JPMorgan Chase's request. The back office in Chicago explicitly confirmed to me that the funds were properly transferred. And I understood that JPMorgan Chase was satisfied, since they executed billions of dollars of trades with MF Global.

Fourth, while I obviously share many of the same questions that you have about what went wrong at MF Global regarding our controls on segregated accounts, I did not have such concerns prior to Sunday night. During my tenure, we hired many people, employed dozens and dozens of highly regarded and highly trained professionals in the area of risk, finance, compliance, legal, internal audit, and back office operations. We also retained prominent outside auditors, consultants, and attorneys, to make sure MF Global operated lawfully.

Indeed, we were subject to reviews, audits, and inspections by internal and external auditors, consultants, and regulators. To the best of my recollection, none came to me with any major issues or concerns about the quality of our people, systems, or procedures.

Finally, before I respond to your questions, I want to offer two apologies. First, I want to apologize to the subcommittee in advance. Because I have not been able to review many relevant records, I cannot be as helpful to the subcommittee as I would like to be.

And second, and frankly more important, I want to again apologize to our customers, our employees, and our investors. My pain and embarrassment do not blind me to the fact that they bear the brunt of the impact of the firm's bankruptcy.

I look forward to the questions.

[The prepared statement of Mr. Corzine can be found on page 126 of the appendix.]

Chairman NEUGEBAUER. Thank you.

Now, Mr. Abelow, you are recognized for 5 minutes.

STATEMENT OF BRADLEY ABELOW, CHIEF OPERATING OFFICER, MF GLOBAL

Mr. ABELOW. Thank you, Mr. Chairman, Ranking Member Capuano, and members of the subcommittee. The bankruptcy of MF Global was a tragedy for our customers, our employees, and our shareholders. For many of our customers, including many of your constituents, who have still been unable to retrieve funds that are rightfully theirs, it has imposed extreme financial hardship.

More than 2,500 employees have already lost or will soon lose their jobs through no fault of their own. Shareholders have seen the value of their investments reduced to almost nothing overnight.

As the president and chief operating officer of MF Global Holdings, I am deeply sorry for the hardship they have all endured. While I know nothing I say can ease their pain, I hope that through my testimony today, I can help this committee understand what happened at MF Global and how we are attempting to unwind the company in a manner that provides maximum value for all parties.

I joined MF Global in September of 2010 as the chief operating officer. I was given the additional title of president in March of 2011 and served in that capacity through the bankruptcy filing this October. After the filing, the firm's board asked me to remain in my position to work with the various trustees and administrators to close the firm's operations, which I have attempted to do over the last 6 weeks.

From my perspective, based on what I was able to observe at the time, there were a number of factors that led to MF Global's demise. First, it appeared that by mid-October of this year, the market had become increasingly concerned with the firm's exposure to European sovereign debt.

Second, beginning in late October, the ratings agencies rapidly and repeatedly downgraded the firm's credit ratings.

Third, the company reported disappointing earnings on October 25th.

The combination of those three events increased concern about exposure to European sovereign debt; a series of ratings downgrades and disappointing earnings created an extremely negative perception in the market, resulting in a large number of the firm's trading and financing counterparts pulling away from MF, which dramatically reduced the firm's liquidity.

That reduction in liquidity, a classic run on the bank, led MF Global to attempt to sell all or part of the firm in order to provide liquidity and protect the interests of our employees, shareholders, creditors, and customers.

When those efforts failed, MF Global filed for bankruptcy on October 31st.

I know this committee is interested in finding out what amount of segregated client funds went missing in the final days, how it happened, and where those funds are and what might eventually be returned to the firm's clients. I am deeply troubled by the fact that customer funds are missing. And I can assure you that I share your interest and the public's interest in finding out exactly what happened.

At this time, however, I do not know the answers to those questions. They are being investigated by the trustees who have taken over management of MF Global and have control over its records and accounts, and a host of regulatory and investigative agencies.

While I do not know what they have found, I do know that all of the parties are working hard to find answers. And I hope they are able to get to the bottom of the issue as soon as possible.

Since the company filed for bankruptcy, I have focused every day on minimizing the effect on customers and employees. There is no way to turn back time and undo all the damage caused by the collapse of MF Global. But in the last 6 weeks, I have worked day and night to reduce costs and maximize the remaining value in the

business. Because MF Global was a global firm, with operations on exchanges in more than 70 countries, there are separate entities with separate systems and books around the world. And I have worked to foster cooperation and communication among those entities. There are a number of different parties now responsible for unwinding the firm's operations. It has been an enormous effort to coordinate with them to generate the maximum possible recovery of assets. While it is only a small measure, given the number of people who have lost their jobs, I am also doing whatever I can to help former employees find new employment.

I believe it is important to examine the issues that led to MF Global's demise. The firm has attempted to be as open and transparent as possible. I hope I can provide some assistance to the committee today in its investigation. As I said, there is no way to undo the damage that has been done by MF Global's bankruptcy. But it is my hope that efforts such as this one to gather facts and provide a clear picture of what occurred will assist policymakers, regulators, and participants in the financial service industry in avoiding such tragic events in the future.

I look forward to answering your questions.

[The prepared statement of Mr. Abelow can be found on page 88 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

And we will now go to the question-and-answer period.

Mr. Corzine, you made some efforts today to kind of clarify some of your previous testimony and indicated that this will be your third time to testify.

We have been collecting a lot of information and talking to a lot of different people. And I want to maybe see if some of these facts will help you with your recollection. It appears, in the early morning hours of October 31st, MF Global's treasurer and the CFO of the global North American operations informed the CME that deficiency in customer accounts, not an accounting error, but roughly $700 million in customer segregated funds had been moved to the broker-dealer side of the business to meet the liquidity needs of the firm. Were you aware of that transfer?

Mr. CORZINE. I am aware of the phone conversation with regulators that I think you are speaking to at roughly 2 or 2:30 on that morning of the 31st. I am not aware that we used the terms that you used.

I am aware that we made very clear that there was an unreconciled imbalance in segregated funds. And frankly, I thought the number was higher than the $700 million also.

Chairman NEUGEBAUER. I think in that same meeting, it was represented that a $175 million loan advance was made to the global, MF Global UK. Were you aware of that loan?

Mr. CORZINE. Mr. Chairman, I am not aware of that conversation as a part of that meeting. And it is possible for two things. First of all, we were operating very late in the day, and after many, many days. I would also say that I stepped in and out of that meeting on a regular basis, both to consult with counsel and also speak to the board. So that may have been said.

I don't have a recollection of that.

Chairman NEUGEBAUER. Yes.

Two hours later, in a separate conference call, it was represented that you knew about the loans from customer segregated accounts. The CFO of MF Global's North American operations stated in a conference call that, "Mr. Corzine knows about the loan."

Mr. CORZINE. Mr. Chairman, as I said very clearly in my opening remarks, I did not in any way know about the use of customer funds on any loan or transfer.

Chairman NEUGEBAUER. Mr. Corzine, you knew you were having liquidity problems. Is that correct?

Mr. CORZINE. We knew we were in a difficult position.

Chairman NEUGEBAUER. Yes. And did you say, we have to fix this? We have to find the money?

Mr. CORZINE. I think I am responding, you are quoting back to me something that I said at the time when the CFO of the global entity informed I think a group of us, in which Mr. Abelow and I were both a party to, that there was an unreconciled difference with our segregated accounts.

Chairman NEUGEBAUER. And so, I think one of the things that is perplexing, Mr. Corzine, you have been with Goldman Sachs, you have been governor, you have been a Senator, your recollection of these events, or your lack of recollection is somewhat puzzling to a lot of us. Because you had to know that things were not going well and that these positions were unraveling. And you, all of a sudden, just find out that there is money missing from customers' accounts? You are the CEO of the company. You are the chairman of the board. How is it that all of a sudden, these people acted out of your instruction to make these transfers?

Mr. CORZINE. Mr. Chairman, we had policies, procedures, and I believe qualified personnel who had the responsibility to make sure that customer funds were protected.

Chairman NEUGEBAUER. Were these competent people?

Mr. CORZINE. From every element of the information that I had gained up to this point, and I think I put that in my oral statement, there was no reason that I could think of that they weren't competent. I relied upon them.

Chairman NEUGEBAUER. The thing I am troubled by, Mr. Corzine, is when you look at how this company got to this point, basically you had a chief risk officer who was telling you that these trades could cause a liquidity crisis for this firm. You were repeatedly told that. And yet, you disregarded that. And in fact, that gentleman was then replaced, and the positions doubled from then. So when you talk to me about how you had procedures in place to protect the interests of the company, yet in many ways there was no firewall built in place for the transactions that you were actually the primary trader on. So I am having a hard time believing that you were relying on a firewall when basically you were operating without a firewall.

Mr. CORZINE. Mr. Chairman, the issue with regard to trading positions was fully vetted with our board of directors, with risk officers, both the one you spoke about and his successor, with regard to the nature of the risks that were a part of those positions. And they were authorized by the board.

That is different than the clearance and settlement and money transfer aspects, which there are controls that I think, in my writ-

ten testimony, I say I had little experience nor little involvement in, in my time at MF Global.

Chairman NEUGEBAUER. I hear what you are saying, that may be different functions, but I think it is indicative of the corporate culture that if people were taking money and sending it around without your authorization, without—you have the chief financial officer, the treasurer of the company, they don't know about money being transferred around? That is a little perplexing to me.

Mr. CORZINE. Mr. Chairman, I know that we had policies, procedures, and people in place.

Chairman NEUGEBAUER. Obviously, they were not being followed or—that is what we are all trying to figure out is if you had competent people in place, you had the top people here saying that we took money out of customer accounts, and we have people saying that you knew that they had taken money out of—

Mr. CORZINE. First of all, as I said in my opening statement, I don't know how to respond to something that somebody said to somebody else to somebody else who is unidentified and I can't speak to.

I do know that I never authorized anyone to use customer funds, to make a loan or a transfer of funds. I never intended to. Nor do I think I said anything that could have been construed to do that.

Chairman NEUGEBAUER. I now yield to the ranking member of the subcommittee. And after the ranking member's questions, we will recess for votes.

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Corzine, I am going to take you at your word that you never gave instructions to misuse customer money, because again, that would be somebody else who makes that decision, whether that is accurate or not. But I am going to take you at your word. My concern is exactly, how did you get to 40 to 1 leverage in the first place? Whose money was it?

Mr. CORZINE. As I think I have conveyed in my written testimony, we were bringing down the leverage.

Mr. CAPUANO. But how did you get to 40 to 1?

Mr. CORZINE. First of all, that was the number we were at before I joined MF Global. And I think, as you will see if you look at the reporting on the quarterly filings, we were closer to 30 to 1 or even sometimes in the 20s.

Mr. CAPUANO. I know where you were, and I know you were coming down, but you were still in the 30 to 1 ratio when you left the firm as well. Whose money was it? Somebody had to loan this money to you.

Mr. CORZINE. There were many—

Mr. CAPUANO. Or to your predecessors.

Mr. CORZINE. There are many different ways that a firm goes about financing itself. Probably the most important element with regard to how those kinds of leverage numbers can be produced is through repurchase agreements.

Mr. CAPUANO. There we go. In-house repos for the most part. Is that accurate?

Mr. CORZINE. More of it was likely done with repurchase agreements from the broker-dealer side of the firm with clients, where proprietary positions that the firm had—

Mr. CAPUANO. Repos to maturity?

Mr. CORZINE. Not repos to maturity, repos of inventory positions that the firm—

Mr. CAPUANO. But even for a repo, I guess what I am getting at, as I understand, and this really is not just MF Global, as I understand it, under the rules of the CFTC a week ago, or 2 weeks ago, whatever it was, everybody talks about segregated funds, that somehow the customers' money is locked away never to be touched. Yet under the CFTC rules, for 10 years, or 8½ years, that is not true.

For all intents and purposes, as long as you went through a few steps and put a piece of paper on the books that said, "I promise I will pay you back, and here is the piece of collateral that I claim to be right," you actually could legally, under recently passed rules, basically invade those funds of customers and not break any rules doing so. Is that an unfair statement?

Mr. CORZINE. It is not an unfair statement.

Mr. CAPUANO. That is what I wanted to know.

Mr. CORZINE. I would say that—

Mr. CAPUANO. I am not suggesting that you were doing anything other than what everybody else was doing.

Mr. CORZINE. Rule 1.25 set out by the CFTC designates or identifies specific securities—

Mr. CAPUANO. And that is what I am suggesting. You were doing exactly what 1.25 said you could do. I am not blaming you for that. The rules said you could do it. But by doing that, I guess the next question is, okay, you do a repo, you move customer money out, perfectly legally under then current rules. And then, as I understand it, you moved that money to the U.K. And the U.K. would then put it on the street for additional repurchase. Now, again, I am kind of jumping around here because I am trying to follow this as everybody else. And I am not suggesting up until this point that anything wrong or illegal or against the rules was done. Is that a fair way to put this?

Mr. CORZINE. I would be speculating if I tried to say that money produced by repo, legitimate 1.25 collateral was moved to London. It could very well have just been the financing vehicle for the securities themselves.

Mr. CAPUANO. It is my understanding the reason it would be moved to London, and again, I want to be very clear—I am not suggesting you did anything different than anyone else, which I am going to get to in a minute, that it goes to London because the rules in England are significantly different than here. You were allowed to take larger risk. You were allowed to do different things with those repos.

Mr. CORZINE. To the best of my recollection, that is not what we were doing.

Mr. CAPUANO. That is not what you were doing. But I guess, let me ask it another way then. To the best of your knowledge, were you doing anything differently than most people in your business were doing?

Mr. CORZINE. Congressman, that is a very broad question. We clearly had repos to maturity in our broker-dealer on European sovereigns that seemed to be different than some of the other

firms. But the kind of repo financing, general repo financing, match books, are relatively common—

Mr. CAPUANO. Relatively common. Bingo. Hence the problem. And by the way, am I wrong to think that the CFTC, for all intents and purposes, has just shut down this relatively common approach towards borrowing customers' money?

Mr. CORZINE. Congressman, I believe they have narrowed the available assets—

Mr. CAPUANO. So that you can't use foreign debts and you can't use in-house—

Mr. CORZINE. You were not able to use foreign debt before, unless there were deposits of foreign currencies—

Mr. CAPUANO. One of the reasons why the money would be moved offshore because those rules are different there. So I guess what I am trying to get at, as I said earlier, if you did anything wrong, the criminal investigators will find that, I won't. I am trying to find out, and my concern is the things that you were doing, that is, you by your own statement said nobody intended to misuse anything, again, I am taking you at your word on that, the things you were doing are relatively common in the industry. The 30-to-1 ratio is relatively common in the industry. The regulators didn't find a serious problem with it, just a little bit of a problem.

You are talking more than $6 billion, $16 to $17 billion of exposure there, and the regulators told you to put $200 million, a mere pittance. So you were doing at the time, at least as I read it, pretty much what everybody else was doing. I guess my question is—which I know you won't be able to answer—who else was doing this? And how much is at stake? Because if it happened to you and you did nothing wrong, then it could happen to anyone tomorrow, and maybe up until this point, they are not doing anything wrong. And that is the problem to me. I am less interested in one company, though, again, you have customers who were seriously hurt, than I am in the system, and whether there is a systemic risk. And if one company does it, that may not be a systemic risk. But if everyone is doing it, and the regulators allow it, and the people who are enforcing those regulators think it is normal, the credit rating agencies think it is normal, the accountants come up with rules to be able to have a loan basically booked as a sale, that opens up this whole thing to a massive mess. And by the way, the company that you were looking at to buy your company at the end, aren't they deeply involved in the same types of activities?

Mr. CORZINE. Sir, I could not respond to that. I don't know their balance sheet.

Mr. CAPUANO. So you were going to sell the company to a company you didn't know anything about?

Mr. CORZINE. There would be a period of due diligence after there was an agreement if it were a standard merger agreement.

Mr. CAPUANO. I think my time has expired.

Thank you, Mr. Corzine.

Chairman NEUGEBAUER. Thank you.

And now, the committee will recess until the votes are over. And we will reconvene probably in about 30 minutes.

[recess]

Chairman NEUGEBAUER. The committee will come back to order. Some people thought this might be somewhat of a heated session, and it has turned out to be very hot in here. We apologize for that, but we have some folks hopefully working on the air conditioning or the temperature as well.

We will now resume the question-and-answer period. The vice chairman of the subcommittee, Mr. Fitzpatrick, is recognized for 5 minutes.

Mr. FITZPATRICK. Thank you, Mr. Chairman.

Mr Corzine, we asked the Federal Reserve Bank of New York whether you had ever called them to talk about MF Global, and they reported that there were a number of calls made during the week of October 24, 2011. For instance, on October 26th, you made two calls to the New York Federal Reserve Bank and spoke with a Mr. Dudley.

On October 27th, you made five calls to the New York Fed and discussed the situation of MF Global with Mr. Dudley. And on the 28th, there were more calls to the New York Fed.

What was the substance, or what came up during those conversations? What was the purpose of making the calls?

Mr. CORZINE. Congressman, first of all, I was called by Mr. Dudley, I think, preceding that first series of calls that you identified, to keep the Federal Reserve posted on how we saw our liquidity position, how our clients were reacting to us, and what other steps we were taking, given the stress that was being exhibited in the marketplace.

Mr. FITZPATRICK. So you identify stress in the marketplace, is it safe to assume that, at that point in time, you were discussing that MF Global was in trouble?

Mr. CORZINE. We weren't discussing that we were in trouble. We were discussing how we were managing our liquidity position and what kinds of steps we were taking in that context.

Mr. FITZPATRICK. Was MF Global in trouble at that point?

Mr. CORZINE. In my view, we were having stressful conditions in the market, but I thought we were going to be able to manage those.

Mr. FITZPATRICK. On October 24th, your assistant controller called the Chicago Mercantile Exchange and told CME that MF Global was in trouble, that you were going to be downgraded and that you were going to report losses.

There is a press release—I think it is dated October 25th, and it may be on the screens in front of the Members—about your second quarter earnings. And in that press report, you said, "Over the course of the past year, we have seen opportunities in short-dated European sovereign credit markets and built a fully financed letter of maturity portfolio that we actively manage. We remain confident that we have the resources and expertise to continue to successfully manage these exposures to what we believe will be a positive conclusion in December of 2012."

So my question, Mr. Corzine, is, why do you make a public statement about your confidence that MF Global has "the resources and expertise to continue to successfully manage that situation," when your company previously told the CME that you were going to be downgraded, and when the very next day, you were in frequent

communication with the New York Fed about MF Global's position as a going concern?

Mr. CORZINE. Congressman, the conversations with the New York Fed were stimulated by a call from them to us to keep them posted. So that would not have been in contemplation of this statement.

And while a downgrade is not comforting news for an organization, it is not indicative that we were approaching bankruptcy or that we were in the kind of stress that I think one would have described the situation on by Friday.

Mr. FITZPATRICK. Your company, in fact, filed a Chapter 11 bankruptcy on October 31st, 6 days later, correct?

Mr. CORZINE. That is true, sir.

Mr. FITZPATRICK. Your own securities filings are clear that downgrades are a huge risk factor and would lead to margin calls and liquidity problems for the organization. And yet, knowing that you were going to be downgraded, you still made a public statement to the effect that all is well.

Why did you do this, and how can you reconcile private remarks about trouble at MF Global with your public statements on October 25th?

Mr. CORZINE. Sir, I think the statement you are giving to me to review deals specifically with the repo-to-maturity portfolio and that we would be able to manage that, and we thought we had the capacity, including the morning of the 25th, we were actually liquidating some of those RTM positions.

Mr. FITZPATRICK. But you thought, on the 25th, you could manage successfully to a successful conclusion in December 2012, and 6 days later, you filed for Chapter 11 bankruptcy?

Mr. CORZINE. We thought we would have to take adjustments to deal with the realities of the downgrade and the potential reactions of the marketplace, but that was what we were alluding to. We had the capacity to manage that. We thought we did.

Mr. FITZPATRICK. So when was the first time the potential of a Chapter 11 bankruptcy was discussed with the board at MF Global? Was it before October 25th?

Mr. CORZINE. To my recollection, there was no discussion of bankruptcy before October 25th.

Mr. FITZPATRICK. Okay, I have nothing further.

Thank you.

Chairman NEUGEBAUER. Mr. Baca is recognized for 5 minutes.

Mr. BACA. Thank you very much. Mr. Corzine, we all want to make sure that someone didn't have an early Christmas, and we want to find out where this money went, especially $1.2 billion, where it has gone.

You said that you had internal and external controls in place to ensure the security of the customer funds. Can you elaborate on the functions of these controls?

Mr. CORZINE. There are arrangements, Congressman, in our Treasury operations area which have, to the best of my knowledge, thresholds of how money can move, size of amounts of money that can move. There are cross checks with Treasury functions that are responsible for making sure liquidity is in place.

So all of those, starting with the CFO, global level, moving to a global treasurer, to regional organizational structures where money could move, all of those had checks and balances in them to the extent that any of the respective internal audits and external audits and reviews of those procedures were in place. I had reason to believe the people, the policies and procedures would work.

Mr. BACA. Thank you.

Were any of these controls approved or signed on by any of your regulators?

Mr. CORZINE. I would have to actually have that question answered by the regulators. We know that we are subject to their periodic review and all of the various venues and self-regulatory organizations and others periodically check the policies and procedures and the actions.

And to my knowledge, at least up until that evening of October 30th, I am not aware of where we had major challenges to that by the regulators.

Mr. BACA. Maybe we need to find out. But to your knowledge, is there a common control that other firms have in place?

Mr. CORZINE. Congressman, I am not familiar with other firms, and actually, some of the day-to-day specifics is not my experience, and detailed knowledge even of our own organization, other than the kind of description that I tried to give to you.

Mr. BACA. Okay, to your knowledge, were your counter partners engaging in the same purchase agreement with other entities similar to MF Global?

Mr. CORZINE. As I responded to the ranking member's question, I think repurchase agreements, broadly spoken, are fairly common. Repurchase agreements to maturity are relatively common for U.S. Treasury securities, agencies, and corporates, although I don't have specific knowledge about what other companies have. I think the repo-to-maturity concept applied to Euro sovereigns is somewhat different.

Mr. BACA. Okay. In your opinion, had MF Global not run into the problems it did, would this level of finance and participation have continued, or would there have been changes in regulations, criteria or procedures to make sure that hopefully we didn't have this. You didn't have a crystal ball, but if we had a crystal ball, you probably would have changed everything, is that correct?

Mr. CORZINE. Not unlike what I responded to Congressman Fitzgerald. We were adjusting our positions given the changing perspectives that credit agencies were bringing and the availability of credit.

And so we would have, we were adjusting our balance sheet and our off-balance-sheet items to produce greater liquidity and less exposure to liquidity calls, if you would, post the downgrade.

Mr. BACA. Okay, thank you, I know that my time is running out, so I appreciate your response, thanks.

I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

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

Mr. KING. Thank you, Mr. Chairman.

Senator Corzine, as I mentioned earlier, this is really your world, not ours. And if you could just go through this with me.

When you came to MF Global, you pretty much dramatically or intended to dramatically change its business model, make it more like Goldman Sachs, which would inherently involve more risk, which there is nothing wrong with, per se, but because of the increased risk, what new compliance procedures did you put in place when you came to MF Global, and can you tell me how many personnel that involved, what the cost was, and how closely you followed the implementation of those new compliance procedures?

Mr. CORZINE. Congressman, first, I would say that I was not trying to recreate Goldman Sachs, although we wanted to be a broker-dealer.

Mr. KING. But more like Goldman Sachs than what MF Global traditionally had been.

Mr. CORZINE. It was clear, and I think I have tried to outline that in quite some detail in my written statement that we wanted to be in principal broker dealing activities to serve clients, and that there was some proprietary element that we would take that typically hadn't been done before, that is true.

And it is actually in that area that the biggest issue, I think, developed over a course of time with the initial chief risk officer because the experience of that individual had been more on the commodities side of the business, or the FCM customer credit area, a concern not only of myself but of the board. And we wanted to look for someone and did a search, a personnel search, to try to find someone who could bring the kind of experience.

Mr. KING. But if you are changing the business model to any extent, doesn't it require more than just getting a new risk officer? Did you put procedures in place yourself? Did you have any frame of reference to yourself as to what you wanted in place and how that would be done?

Mr. CORZINE. We had to have different compliance supervision. We expanded our compliance positions. We actually had some serious concerns.

Mr. KING. Can you tell me how many?

Mr. CORZINE. Clearly, we had concerns in Asia.

Mr. KING. Concerns—you said you brought in new personnel, I think.

Mr. CORZINE. We brought new personnel to bear on our compliance functions.

Mr. KING. Is that hiring new people?

Mr. CORZINE. New people.

Mr. KING. Do you have any idea what the number is?

Mr. CORZINE. I will have trouble giving you the exact statistics because I don't—it was numbers, and as I said in my oral remark, there were dozens and dozens of people dedicated to this. We made changes, upgraded.

We also installed a new technology—

Mr. KING. But you can't say, you can't say whether it was dozens and dozens of new personnel or just reprogram of old personnel?

Mr. CORZINE. No, no, there were new people added.

Mr. KING. Do you have any idea what that cost was?

Mr. CORZINE. Congressman, without being able to look at my records, I would be speculating.

Mr. KING. Okay, you testified you first became aware of the missing customer funds on October 30th, the day before MF Global declared bankruptcy. Now had MF Global not been in the middle of trying to sell itself to another commodities broker, when do you think, as CEO, you would have become aware of the missing funds?

Mr. CORZINE. Congressman, we are on premises basically 24/7 for the previous few days, so I probably, as soon as anyone had known that, it would have been elevated because all of this or most of this—

Mr. KING. But if this crisis had not come about, would you have known—if the crisis did not become as critical as it did, would you have any knowledge at all of the funds—

Mr. CORZINE. In the normal course of events, I probably would have been informed early on the morning of the 31st.

Mr. KING. Okay. You have repeatedly said that you don't know where the missing funds are. If I were a lawyer in a civil case, and I was trying to recover those funds for a client, and I hired you as an expert witness, what would your expert testimony be as to where you think those funds would be, based on your years of experience in the business?

Mr. CORZINE. Congressman, I have tried to lay out in my written testimony some places where I would look, where movements of money in large positions had moved, I think I cited $1.3 billion—

Mr. KING. Between October 30th and now, you have not been able to narrow it down at all?

Mr. CORZINE. Congressman, I have not had access to any records. I have made testimony to what I think I would have at least considered, but I don't have any specific knowledge and I—

Mr. KING. My time has expired. Basically, I was going to say, just based on the knowledge you had, if you could have somehow used, the use of expertise and your experience at MF Global, to somehow deduce where the funds may be.

With that, I yield back. My time has expired.

Chairman NEUGEBAUER. I thank the gentleman.

With that, Mr. Miller is recognized for 5 minutes.

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

The transaction that seems to have caused all the trouble was the $6.3 billion purchase of European sovereign debt that was purchased through the repo market or financed through the repo market, is that correct?

Mr. CORZINE. The European sovereign position was?

Mr. MILLER OF NORTH CAROLINA. Yes.

Mr. CORZINE. Financed to maturity through repurchase.

Mr. MILLER OF NORTH CAROLINA. But it was purchased through the repo market, the repo—

Mr. CORZINE. The original sovereigns' position, the underlying debt of those particular sovereigns, was purchased in the market, and there was a repurchase agreement arrived at roughly the same time as the purchase of the underlying securities, and they were put together. So repo to maturity.

Mr. MILLER OF NORTH CAROLINA. Under the securities, the securities were their own collateral, is that correct?

Mr. CORZINE. The securities were collateral for the repurchase agreement.

Mr. MILLER OF NORTH CAROLINA. Were there any client assets used as collateral for that purchase?

Mr. CORZINE. To my knowledge, none.

Mr. MILLER OF NORTH CAROLINA. The amount of the transaction was 5 times your book value, but all of the security was actually from the sovereign debt that you were purchasing through the repo market?

Mr. CORZINE. There are initial margin requirements for financing.

Mr. MILLER OF NORTH CAROLINA. Right.

Mr. CORZINE. And then variation margin periodically that you have to put up—

Mr. MILLER OF NORTH CAROLINA. Okay. Your client contracts do allow you to use client assets as collateral to purchase securities for your own account, though, that is right, isn't it?

Mr. CORZINE. Very specific kinds of securities. That is what Rule 1.25, Congressman specifies. European sovereigns, except in those cases where there are deposits of European currencies, are—

Mr. MILLER OF NORTH CAROLINA. Okay. In the last 2 weeks, the last month before MF Global's bankruptcy, did you pledge any client assets as security for any lending to MF Global?

Mr. CORZINE. Could I ask you to repeat the question? I apologize.

Mr. MILLER OF NORTH CAROLINA. In the last days of MF Global's existence before bankruptcy, did you use any client assets as collateral for any purchases of securities or any loans to MF Global?

Mr. CORZINE. Congressman, on an ongoing basis, you would use client funds for 1.25 eligible securities, yes.

Mr. MILLER OF NORTH CAROLINA. Okay, were any—let me ask the other side, then, I think Mr. Capuano's question got at this, did you borrow money from client funds using repo transactions? Where client funds had cash, did you use repo transactions to put—

Mr. CORZINE. Over the normal course of business, securities that qualified as 1.25 eligible could be financed with those client funds, but there are very strict rules on that, and we observed those.

Mr. MILLER OF NORTH CAROLINA. Okay, were any assets that were pledged as collateral liquidated?

Mr. CORZINE. Taken in the last days, this is one of the reasons I responded to Congressman King's question, we sold $1.3 billion worth of commercial paper, which was 1.25 eligible, and I certainly—I am not trying to answer his question while I am answering yours—but as those were liquidated, that money should have been put back into segregated accounts, and that would be one of those places that I would look very carefully.

Mr. MILLER OF NORTH CAROLINA. Were any of the assets that you used for repo transactions with your own clients, as allowed by the CFTC rule, assets that you had as collateral for other transactions with another party?

Mr. CORZINE. To my recollection, I can't think of any.

Mr. MILLER OF NORTH CAROLINA. Mr. Abelow, can you?

Mr. ABELOW. Congressman, the daily activity of funding the firm was not something that fell under my control, and so I am not intimately familiar with those structures.

Mr. MILLER OF NORTH CAROLINA. Were any, I am sorry, were any of the assets that were in client accounts as part of repo transactions liquidated, taken as collateral by anybody?

Mr. CORZINE. To the best of my recollection, any of those kinds of transactions were done according to the rules as we would have known them, and there was a whole set of people, policies, and procedures on how that should have been executed.

Chairman NEUGEBAUER. I thank the gentleman.

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

Mr. PEARCE. Thank you, Mr. Chairman.

Thank you, Mr. Corzine, and Mr. Abelow.

I am fascinated about the continuing response that, "Day to day is not my responsibility. It is not my experience."

In 2003, you offered an amendment to Defense Appropriations to hold the Bush Administration accountable, with a comment that the credibility gets weakened each day we fail to have a full accounting of the facts about what happened, facts such as who knew what, that certain information was false. When did they know it? Why was it expunged from one Administration's speech and not the other.

And then we hear today, "Oh, I am sorry, I didn't know about the $117 million loan. I didn't know about the window dressing, seven quarters consecutively, five in my time."

You have a question—window dressing, in a Wall Street Journal article, it says that you just lowered debt right before the reporting period and then you bounce it back up right after so that it looks better. It is not technically illegal, but it sure looks better. It is misleading, but it looks better, and it is not your day-to-day experience.

Where did you spend the last—what hotel are you at here in the city?

Mr. CORZINE. The Ritz-Carlton.

Mr. PEARCE. At the Ritz-Carlton, did I hear that correctly?

Mr. CORZINE. Yes, sir.

Mr. PEARCE. How many of the 36,000 clients who were defrauded have you called personally? One?

Mr. CORZINE. None. I have called none.

Mr. PEARCE. Mr. Abelow, have you called anyone? I see both of you have real anxiety and sorrow, sadness, I think is the word, for the people who were hurt. We have a guy coming in here, with a $600 million net worth. Have you created a scholarship for any of the families who have been disadvantaged? Just to help them out with maybe their college funds? Yes or no?

Mr. CORZINE. Congressman, the answer is no.

Mr. PEARCE. I am sorry?

Mr. CORZINE. The answer is no.

Mr. PEARCE. No.

Mr. Abelow?

Mr. ABELOW. No, sir.

Mr. PEARCE. "But we are so sorry. We are desperately sorry. We want to apologize, at the beginning and end of the transaction."

Mr. Corzine, you said that there were no warning signs, and yet, I have three warning signs here from Mr. Roseman, saying that we were pretty concerned. He even took his concerns to the board of directors, did you not—I know it wasn't your day-to-day responsibility, but did you ever communicate with the board of directors? Did they tell you, Mr. Roseman, the risk manager, came and said, whoa, we are doing some things that kind of frighten me?

In fact, the testimony that other people have brought was that Mr. Roseman may have left the company under duress. Yes, he left voluntarily, and he was replaced by a guy who also, as risk manager, was raising questions about what was going on, and yet I think I heard you say that you had never heard any questions about anything that was going on at the company from internal sources.

Mr. CORZINE. Congressman, I don't think I said that with respect to risk management—

Mr. PEARCE. So you were aware? You were aware Mr. Roseman was deeply concerned with risk management things, and you didn't have to go through standard risk management practices. You could go straight to the board and you could buy and sell in your client, in your portfolio, without going through risk management, one of the basic things of internal controls.

Mr. CORZINE. Congressman, risk limits were set at the board. The risk manager observed those and where we stood relative to those and would have reported to the board if we broke those limits.

Mr. PEARCE. The risk manager was right on those concerns, and somebody else was wrong. Who made the decision that you were not going to concern yourselves with the risk manager's concerns about where you stood?

Mr. CORZINE. No one was uninterested or wasn't willing to listen to the risk manager present his case to the board.

Mr. PEARCE. No, I didn't say no one is disinterested; they just ignored his advice.

We have "rainmaker," I hear the term "rainmaker" used a lot in your presence. We have rainmakers out in the dusty, barren sand hills of New Mexico. They drive around in pickup trucks with 55-gallon drums brought out of the oil field, cleaned up. Pour a few chemicals in, light them up, create rain. It is not much different than what they do on Wall Street.

Thank you, sir.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Florida, Mr. Posey, is recognized for 5 minutes.

Mr. POSEY. Thank you, Mr. Chairman.

Mr. Corzine, who advised you that the transfers were legal?

Mr. CORZINE. The overdrafts that I addressed on Friday, as I put in my oral statement, I directed my inquiry to whether they were proper to senior people back in our Chicago office.

Mr. POSEY. Would that be Laurie Ferber?

Mr. CORZINE. Ultimately, Laurie Ferber was aware that we had questions about this, and I referred that also to her, she is our gen-

eral counsel. But the assurance that I received was from our back office people in Chicago.

Mr. POSEY. Can you give me a couple of names?

Mr. CORZINE. The woman that I spoke to was a Ms. Edith O'Brien.

Mr. POSEY. But Laurie Ferber agreed it was legal, too?

Mr. CORZINE. Ms. Ferber was looking at the letter that was requested by JPMorgan to ensure that we were CFTC-compliant.

Mr. POSEY. And she said you were?

Mr. CORZINE. Once I submitted the letter that I was supposed to sign, I did not hear back from Ms. Ferber. As I suggested in my opening remarks, I had explicit statements that we were using proper funds, both orally and in writing, to the best of my knowledge. Since I don't have all my records, I don't have that, but I believe I have it in writing. And I conveyed that to JPMorgan. And JPMorgan asked later, at a later period of time, for confirmation that we were using CFTC compliant funds, and that is when I spoke with Ms. Ferber.

Mr. POSEY. And what was her response?

Mr. CORZINE. She took the issue, and was reviewing the letter, and I never heard anything back about it.

Mr. POSEY. So you asked if it was legal to do this, and she never answered you?

Mr. CORZINE. I had confirmation from the people that we relied upon—

Mr. POSEY. Back office people.

Mr. CORZINE. People in the Treasury function that we relied upon.

Mr. POSEY. Okay. Have any of your assets or your passport been frozen?

Mr. CORZINE. No, sir.

Mr. POSEY. Do you agree with the assertion of the Wall Street Journal that JPMorgan Chase and Soros benefited from the fall of MF Global?

Mr. CORZINE. I only read the article, and I have no idea.

Mr. POSEY. You have no idea?

Mr. CORZINE. No.

Mr. POSEY. Did you sell them stuff? Do they generally make money when you sell them stuff or they broker stuff for you?

Mr. CORZINE. I was not involved in those sales.

Mr. POSEY. Okay. Do you think there is anything in Dodd-Frank that would have prevented this?

Mr. CORZINE. I am really not in a position to speculate about that.

Mr. POSEY. Do you have an opinion, just a personal opinion? I am just curious. We have heard a lot of talk here. If we had had Dodd-Frank, this would have never happened, and I don't see it. I just wonder if you saw anything in Dodd-Frank that would have stopped this from happening? This is bad behavior. Somebody basically stole essentially out of an escrow account. You can have all the regulation in the world if somebody is going to steal somebody else's money—but unless the regulators catch you, if they get off their bus and do their job and catch you, it is not going to make any difference.

The only way this bad behavior, I am getting on another subject, but this is going to be changed by putting people in prison eventually.

Mr. Abelow, are you still employed by MF Global?

Mr. ABELOW. I am employed by MF Global Holdings, the holding company, not MF Global Inc., the entity in which—the regulated entity.

Mr. POSEY. Were you ever employed by the regulated entity?

Mr. ABELOW. I was employed by MF Global Holdings, of which the regulated entity was a subsidiary.

Mr. POSEY. So is that a yes?

Mr. ABELOW. I believe that I was employed by MF Global Holdings as a technical matter. That is who I got my paycheck from, sir.

Mr. POSEY. What do you think should be done differently? If we could roll back the clock, what do you think could be done differently that would prohibit this from happening?

Mr. ABELOW. Congressman, I am waiting to see the results of the investigation, and I assume that when we do and when you do, that you, together with regulators, will be better informed and able to take a view as to what can be done.

At the moment, absent the information as to what happened, I am not sure how to answer the question.

Mr. POSEY. Mr. Corzine, same question.

Mr. CORZINE. I think this will be fact-dependent, Congressman.

Mr. POSEY. Thank you.

My time has expired. Thank you, Mr. Chairman.

Mr. Chairman, I yield back. My time has expired.

Chairman NEUGEBAUER. Thank you, just a quick follow up.

Mr. Corzine, did you say you signed the letter for JPMorgan before it was verified that those funds were, and you just told them to go check it out?

Mr. CORZINE. Mr. Chairman, I did not sign the letter.

Chairman NEUGEBAUER. Okay, thank you.

I now recognize the gentleman from Ohio, Mr. Renacci, for 5 minutes.

Mr. RENACCI. Thank you, Mr. Chairman.

Mr. Corzine, MF Global had a history of compliance, failures, internal control problems, incomplete disclosures. With all of that, when you took over, did you make any effort to look at enhancing internal controls in the company?

Mr. CORZINE. As I responded, I think, to Mr. King or Congressman King, we had broadened out our compliance activities. We brought in consultants.

Mr. RENACCI. So you were trying to enhance internal controls?

Mr. CORZINE. Yes.

Mr. RENACCI. So you do understand internal controls?

Mr. CORZINE. As a CEO, you have to sign the Sarbanes-Oxley verification that you have policies and procedures and people in place.

Mr. RENACCI. And you have to understand internal controls to sign that; correct?

Mr. CORZINE. You have to have the assurance that you can rely on those things that happen.

Mr. RENACCI. Right.

Mr. CORZINE. And you need to be able to have those tested by auditors and others.

Mr. RENACCI. I agree, so you have to be able to understand it to sign it; otherwise, you wouldn't be able to sign that, correct?

Mr. CORZINE. You do, but you can't be as detailed, as experienced and in the execution of that as someone who might have a specialty on some of those areas.

Mr. RENACCI. I understand. As part of your internal control procedures, who made the decision to allow you complete authority over trades which only the board of directors could block? That is a pretty significant internal control issue.

Mr. CORZINE. Any of the trades that I think you are speaking to, the European sovereign trades that were repo-ed to maturity, were in the context of limits established after debate and discussion at the boards.

Mr. RENACCI. But you do agree the board was the only one, the board of which you were chairman, was the only one, the group that could block your trades?

Mr. CORZINE. They certainly could have blocked them up to the limits unless we got authority to go beyond those limits, which we did.

Mr. RENACCI. But they were the only ones that could block it, yes or no? There was nobody in the company who could block those trades. The board could block them.

Mr. CORZINE. The board could block them, yes, sir.

Mr. RENACCI. Right. So no matter what anybody said below that—and I go back to Mr. Pearce's questions for you, Mr. Roseman raised serious concerns. Mr. Stockman raised serious concerns—and it is another interesting thing on internal controls, when Mr. Stockman took over, someone took away his authority to determine the liquidated risks of trade you were making. Who did that, was that you, or was that the board, or was that the board based on your recommendation?

Mr. CORZINE. Congressman, I am not aware of anyone taking away authority from Mr. Stockman and, in fact, I would think that we broadened his authorities.

Mr. RENACCI. But clearly, he had no authority to stop you from making trades because everything rolled back up to the board. He could, when he went to the board, they didn't really, it was up to the board to stop you from making some of these trades?

Mr. CORZINE. Mr. Stockman, like Mr. Roseman, had access to the board, reported to the board, could have and did have individual meetings with the board members, and had full ability to state his position, his concerns, his comfort.

Mr. RENACCI. Comfort, right. Of course, you were chairman of the board, so I think I read somewhere at one point in time, you told the board you were considering leaving because they were just coming down on—

Mr. CORZINE. Congressman, to my recollection, that is not the fact.

Mr. RENACCI. Okay. You indicated earlier that these types of situations were consistent with other companies similar, and would you say that type of internal control was similar, that other compa-

nies similar, similar, would only have the board of directors be able to overrule them? Yes or no?

Mr. CORZINE. Congressman, I don't really want to speculate, and I don't really know.

Mr. RENACCI. Okay. We talked about the significance of internal controls of financial reporting given through the Sarbanes-Oxley certifications. Did you sign those on March 31st, June 30th, and September 30th?

Mr. CORZINE. I signed them on, actually, I think the timeframe is later than that when the—-

Mr. RENACCI. Right.

Mr. CORZINE. When the auditors came back with—

Mr. RENACCI. Did you believe that MF Global had sufficient internal controls over financial reporting given the breach of segregated funds that occurred subsequent to that? Did you believe that when you signed those?

Mr. CORZINE. When I signed those agreements or those certifications, I believed we had the policy and procedures and people in place. And, as I have said, there are no significant notices, either from regulators or others, that I would notice with regard to those controls.

Mr. RENACCI. So you believe that you were being truthful with your auditors when you signed the Sarbanes-Oxley certifications and assured investors and regulators of the adequacy of internal controls over financial reporting. You believed that when you signed them?

Mr. CORZINE. Yes, sir.

Mr. RENACCI. Thank you, my time is up.

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

Mr. CANSECO. Thank you, Mr. Chairman.

Thank you, Mr. Corzine, for being here. Back in July of 2002, while you were serving in the Senate, you made a statement regarding financial regulation, and you said, "We need real reform, and we need it now. We do not need the rhetoric. We need to be able to restore the confidence the American people want to see, move away from the era of Enron and WorldCom and get to an era where we have markets that are balanced and fair, where they have the checks and balances in them to give people the confidence that when they make an investment, that investment is what they thought. It is when they entered into it."

Unfortunately, the bill which you were then speaking in strong support of was the Sarbanes-Oxley bill, which has cost the private sector billions of dollars to comply with and is a direct cause of the lack of public offerings in recent years.

Yet even with all the provisions of Sarbanes-Oxley, $1.2 billion of customer money could supposedly just vanish into thin air at MF Global. A lot of this money belongs to hardworking farmers and ranchers across the country who trusted MF Global and the customer segregation laws that have been in place for years.

The farmers and ranchers whose assets are frozen, or lost, are no different than the rank and file workers at Enron who lost some or all of their retirement savings. They are all innocent victims of failed corporate management and failed regulation, and certainly,

the investments that customers made in MF Global aren't what they thought they were.

So, a question to you, you had specific responsibilities in your role as mandated by Sarbanes-Oxley law. Yet, according to your testimony, you seem to have made little or no effort to acquaint yourself with the firm's primary business. Were you failing as a CEO to perform the due diligence as required by law?

Mr. CORZINE. Congressman, we have a whole staff of individuals and checks that are performed to make sure that senior management has knowledge of deficiencies and elements of our control systems that would have been reported, not only to me, but to the audit committee before we would sign those Sarbanes-Oxley certifications.

Mr. CANSECO. Let me ask you this, because I have limited time here. You as CEO have a responsibility to monitor the internal controls at MF Global. Who at the company was responsible for ensuring that customer accounts were segregated?

Mr. CORZINE. There was a team of people in our Chicago office, led by the North American CFO and people on that staff who had the oversight of the functions of the segregated accounts.

Mr. CANSECO. And you know who they are?

Mr. CORZINE. I do.

Mr. CANSECO. Let me move on a little bit here to a different line of questioning. MF Global's Web site states, "MF Global is a well capitalized and diversified intermediary with a strong, conservatively managed balance sheet. We take measured principal risk to support client activity and offer financing to facilitate client transactions. Because of our financial strength and comprehensive risk management, clients can have confidence that they are trading with a strong counterparty."

So, please tell us, Mr. Corzine, in your own words, what the following terms mean. First, "well capitalized."

Mr. CORZINE. "Well capitalized" means that we were meeting our regulatory requirements, that we had capital that would allow us to believe that our positions were sustainable for the timeframe that we were to hold them.

Mr. CANSECO. Second, "diversified intermediary."

Mr. CORZINE. "Diversified" would mean that we were in more than one business, that we had different ways that we could approach producing revenues.

Mr. CANSECO. Third, "strong, conservatively managed balance sheet."

Mr. CORZINE. As you know, we were, or as I suggested in my written statement, that we were actively reducing the leverage, and we were in the midst of looking for a strategic sale or partnership with regard to our FCM so that it would come down even more dramatically.

Mr. CANSECO. All right, and finally, "measured principal risk."

Mr. CORZINE. The measured principal risk has to do with how we look, how, generally, people are required to report their risk, its valuation at risk, and those numbers were really quite small by comparison of any of our competitors and didn't grow under my watch.

Mr. CANSECO. All right. I see that my time is just about to expire, so let me ask you this, where were Sarbanes-Oxley and Dodd-Frank in preventing the collapse of MF Global? Could they have prevented it?

Mr. CORZINE. I don't know that I can answer that question, Congressman.

Mr. CANSECO. Do you have an opinion?

Mr. CORZINE. I believe that when you have internal controls, and they work the way they are supposed to, you have the right people, policies, and procedures in place, which we believe we did, they should have prevented the kind of problem that we had.

Mr. CANSECO. So, obviously, Dodd-Frank and Sarbanes-Oxley couldn't help you and couldn't have helped MF Global survive. Thank you very much, and I yield back the balance of my time.

Chairman NEUGEBAUER. I thank the gentleman, and now the gentleman from Colorado, Mr. Perlmutter, is recognized for 5 minutes.

Mr. PERLMUTTER. Thanks, Mr. Chairman, and I guess that sort of gets to where I want to start. There is an old adage: Desperate people do desperate things, desperate companies do desperate things.

So, in these final days, just some basic questions and maybe you have answered these, who were your top three secured creditors, say a week in advance of the bankruptcy? And I am asking both gentlemen.

Mr. CORZINE. Secured creditors, probably JPMorgan, which ran a secured credit facility for us.

Mr. PERLMUTTER. Okay.

Mr. CORZINE. And there were a number of banks in that, most of the major financial institutions.

Mr. PERLMUTTER. And did they cash their collateral in that last week?

Mr. CORZINE. I have no knowledge on whether they did or they didn't. They continued to allow us to fund against that secured facility.

Mr. PERLMUTTER. I guess my question is, over the course of the last week, how did the company get so upside down?

Mr. CORZINE. I think, as I have stated in my written testimony, the downgrade, the reported loss and the concern that was expressed by the rating agencies, in particular, with regard to this sovereign position created a fairly negative environment for investors and people who were making judgments about the company.

Mr. PERLMUTTER. Look, there are going to be plenty of courts to look at this, from the bankruptcy court to who knows what else. So, I am with Mr. Capuano. I am trying to figure out, in times where there really is a run on the bank, where there really is desperation, ordinary protocols sometimes go out the door.

Now, whether there needs to be a third party who holds the money in trust, kind of slows down the whole process in good times, but definitely slows it down in bad times, is that something that would have helped here to protect folks who seem to have lost their investment?

Mr. CORZINE. If segregated accounts were held outside, it might have. I don't want to speculate on that. The depositories now hold

some of the customer funds, and they are already held outside the firm. Some are; some aren't.

Mr. PERLMUTTER. Mr. Canseco's questions, though, he was focusing on Sarbanes-Oxley, he was focusing on Dodd-Frank, we have the 33 Act, we have the 44 Act, we have all sorts of things, but the thing we don't have is some specific requirement, in my opinion, and maybe I am wrong, that there be a segregated account.

That may be too harsh on the system, and it won't operate very efficiently, but in this instance, it would have potentially blocked or been a firewall to slow down the movement of the money. And so I am just trying to figure out, as Mr. Capuano was, how could we have prevented this, because in those last days it was, in your word, "chaotic."

Mr. CORZINE. Congressman, until the facts are peeled back on literally thousands of transactions, I am moving into a speculative forum, and I could be misleading.

Mr. PERLMUTTER. Okay. Mr. Abelow, do you have any response to that, because we are here as legislators. I am not here to judge what happened.

I am just trying to hear—a lot of people lost a lot of money and I am trying to figure out, is there a way that could be—we could deal with it in terms of the law to stop this from happening?

Mr. ABELOW. Congressman, at the risk of repeating myself and the Governor, I think that we will, in the fullness of time, when we understand exactly what happened, we will be, you will be and the regulators will be better positioned to identify what additional safeguards, if any, would prevent whatever happened from happening again.

Mr. PERLMUTTER. Okay.

Thank you, I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentlewoman from New York, Ms. Hayworth, is recognized for 5 minutes.

Dr. HAYWORTH. Governor Corzine, on page 18 of your written testimony, you state you were not an expert on the complicated rules and regulations governing the various operating businesses that comprise MF Global, that you had little experience or expertise in those operational aspects of the business.

Now, on page 4, when you are describing your initial tenure at MF Global, you do say that you initiated, obviously, you had a strategic review with the Boston Consulting Group, very well respected, and you looked into obviously a range of businesses and determined that you would take MF Global from being a fairly stodgy 230-year-old brokerage firm and 3-to-5-year plan that you would ultimately convert it into an investment bank, which obviously carries more risk but more potential profitability, one presumes. That is why you would have done that, although I don't mean to impute motives.

But if it had remained simply a broker, obviously, presumably, we wouldn't all be here.

But I am just, you can understand the discrepancy, and you can understand from your, again—I have spoken with former colleagues of yours who have the highest respect for your gifts. It is hard to imagine. And we have found ourselves in this sort of situa-

tion, unfortunately, all too frequently in the recent past, where there is a highly talented man or woman who experiences or leads an organization that unfortunately comes to grief in one way or another, and then there is a contention of ignorance.

So, I am wondering how we resolve those things, and how can any awareness in that way or any perception in that way help us to prevent this kind of event from happening in the future?

Mr. CORZINE. It is a challenging question, Congresswoman. I believe that the vigorous application of the checks and balances that come from things like Sarbanes-Oxley's review of internal controls are a positive ingredient to bring some sense of security to those that look at organizations externally, certainly give one a greater sense that the financial numbers are what they are supposed to be.

It is absolutely essential that leaders within an organization set a culture that people attend to those terms and conditions of operating within the spirit and letter of the law. Until that evening, as it relates to customer funds, I believed we were doing that.

Dr. HAYWORTH. Do you think, sir, that there might have been excessive deference toward your position given that you had had a rather stellar career, to say the least?

Mr. CORZINE. Sometimes, the kind of career that I had had might not bring deference.

Dr. HAYWORTH. I assume you are talking about the political side. Don't forget your audience.

Mr. CORZINE. But I leave it to your conclusion. It is a risk when someone new comes into an organization.

Dr. HAYWORTH. I wonder, as I listen, because we try to come up with—the 111th Congress passed a massive law that was meant to try prevent tragedy, and yet we find ourselves at risk of suffocating the very mechanisms that create growth and jobs.

And what I think we need is better tools that will allow the effective application of the laws that existed prior to Dodd-Frank. Would you say better tools might help us, better analytics?

Mr. CORZINE. Better analytics always help. More information, more transparency, in my view, are positive, and certainly, better analytics are important.

Dr. HAYWORTH. I yield back.

Mr. Chairman, thank you.

Chairman NEUGEBAUER. I thank the gentlewoman.

And now, the gentleman from Tennessee, Mr. Fincher, is recognized for 5 minutes.

Mr. FINCHER. Thank you, Mr. Chairman.

Thank you, Senator, Governor for coming here today.

I represent a very heavily agricultural district back in Tennessee. A lot of constituents had money tied up in MF Global, and they are calling me and asking me, what happened? What is going on? If you were a customer of MF Global—I have just a couple of statements, a couple of questions, and then I will let you comment. If you were a customer of MF Global, would you accept the story that you are telling that you simply don't know where the funds are, that $1.2 billion is unaccounted for, and the CEO and the COO and the CFO of this firm simply don't know where the money is and can't help find it, because they quit and don't have access to the

records? Should hardworking farmers and ranchers who have their money tied up accept this, and would you?

Mr. CORZINE. If I were one of those customers, I would be very frustrated and angry. I would expect that we will get the answers to this as the multiple investigations that are looking at all of the facts lay those out. And people, according to what I have heard, have almost a 24/7 approach to those investigations. I am sure it is frustrating, but it needs to be resolved with facts, not speculation.

Mr. FINCHER. Why did you resign?

Mr. CORZINE. I was asked to resign by implication.

Mr. FINCHER. You repeatedly state that you are unable to answer specific questions because you do not have access to the books. Why not help the investigators find this money? And can you point to any instances where you have assisted in the ongoing search for these funds after you left?

Mr. CORZINE. I have not, other than my testimony, which I am sure has been reviewed.

Mr. FINCHER. Who had the right to approve transfer of money between firm accounts?

Mr. CORZINE. As I said in my testimony, it was in our Treasury function. And there are checks and balances on that. There are Treasury operations where people physically move securities and cash, and there are people who do the financing part, operate and interface with banks in the repurchase markets and other things.

Mr. FINCHER. Would it be safe to say that maybe the reason, and just in layman's terms, if you will, that you were just, MF Global was just shorting the market and couldn't cover the margins, and that is why the money is gone?

Mr. CORZINE. Congressman, to my recollection, on the evening of October 27th, there were substantial hundreds of millions of dollars in cash and free collateral that should have allowed us to meet margin calls.

Mr. FINCHER. Do you think any laws have been broken here?

Mr. CORZINE. Congressman, I would be speculating, because I don't know the facts. And I think it is fact-dependent.

Mr. ABELOW. I do not know, sir. I have not—I don't have access to the ongoing investigations and what they have uncovered to date.

Mr. FINCHER. It is just really, to commonsense business people, farmers who take risks—and I am a farmer—every day trying to deal with all sorts of variables, to have some stability and presence knowing that their capital is safe, and then to have these hearings—and I have watched the Senate and then the House Agriculture Committees, and then today—and it just, no answers, it is just beating around the bush so to speak, as we say back in Tennessee, no clarity, no one knows anything, everybody has done something, and it is really a shame. I am sure we will get to the bottom of it; someone will. But I hope no laws have been broken here, because this is really a disservice to a lot of American farmers. Thank you, gentlemen.

Chairman NEUGEBAUER. I thank the gentleman.

And now, the gentleman from California, Mr. Royce, is recognized for 5 minutes.

Mr. ROYCE. Thank you. Mr. Corzine, you took the helm of MF Global in March of 2010. But a couple of months prior to that, you lobbied or argued before the New York Fed on behalf of MF Global, seeking to become a primary dealer. It has been noted that you believed that this status was a critical part in shifting MF Global toward a Goldman-like institution, a mini-Goldman, I think was the wording. Can you explain why that was the case?

Mr. CORZINE. Congressman, I did join MF Global in the last few days of March of 2010. And I did not, previous to that time, meet with the Federal Reserve on MF Global or on any matter, or anyone else with regard to an MF Global matter.

Mr. ROYCE. So the reports about joining the select club as primary dealers, you did not play a role in that, you did not envision that as an advantage and suggest that and try to—go ahead, sir.

Mr. CORZINE. After I joined MF Global, I certainly continued the pursuit, which had actually begun I think as much as a year and a quarter before I had joined, believed that it was important for us in a development of our business. We were active market makers in U.S. Treasury and agency securities before I came to MF Global. It is part of my own history at some place I actually had expertise. And we certainly did not step back from seeking that recognition after I came.

Mr. ROYCE. At the time of your approval as a primary dealer at MF Global, the institution had a weak credit rating, MF Global was bleeding cash, the losses in the prior year, I believe, were $137 million. There was a history of compliance failure, at least 80 regulatory actions taken against it since 1997. Looking at that period in the spring of 2010, does it make sense to you that MF Global was approved to be a primary dealer by the New York Fed?

Mr. CORZINE. Congressman, we were approved in, if I am not mistaken, in 2011, either January or February, I can't remember the specific date. But it was a 2011 approval.

Mr. ROYCE. Would you have approved an institution with those problems?

Mr. CORZINE. I would have, as we did, make the case that we were a meaningful provider of liquidity to the underwriting of U.S. Treasury debt, that we were providing liquidity to our clients through the repurchase agreement markets, that we had insights because we were active in futures markets around the globe that could be important to the capital markets desk about what was happening in markets.

Mr. ROYCE. At the same time, if you were in the shoes of the New York Fed, and you had been through Bear Stearns, leveraged at 30 to 1, if you had been through Lehman at 30 to 1, and arguably the leverage here of your firm was 40 to 1, I guess I am asking, do you think you got special treatment because of your connections in terms of this decision to give this designation to MF Global given some of the concerns out in the financial press about the institution?

Mr. CORZINE. Congressman, I don't believe we got special treatment. We never asked for special treatment.

Mr. ROYCE. Then let me ask you about CFTC, because, as you know, Mr. Gensler has recused himself from the case because of your past relationship. Do you believe MF Global, specifically the

segregation of customer funds, was properly overseen by the CFTC? And do you believe that your firm might have been given special treatment because of your connection to Mr. Gensler, who has now recused himself?

Mr. CORZINE. I do not believe we were given special treatment. And I need to understand as we—as I have communicated to the committee, that when we know the issues that caused this element, then I think you can make better judgments about whether the CFTC or anyone else actually, including internally, we performed our responsibilities.

Mr. ROYCE. My time has expired, Mr. Chairman. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

And now, the gentleman from New Jersey, Mr. Garrett, is recognized for 5 minutes.

Mr. GARRETT. I thank the chairman, and I thank you, Governor, for being here.

Governor, you go to great lengths in your testimony to explain that in your opinion, none of the firm's European sovereign debt trade ever lost money. I understand that. But obviously, you would also had to have known that the downgrades and other concerns could lead to margin calls, which is what occurred, and a loss of liquidity risk as well. And I think you allude to this in your testimony. So the question then becomes, isn't it your job, as CEO and chief risk officer, and I believe your testimony or one of your statements someplace was, "I consider one of my most important jobs to be chief risk officer," isn't one of your jobs then to take this seriously? Isn't this also really what got AIG, for example, which you talk about all the time, in trouble? Is it maybe that the bets were appropriate bets, all things considered, but it is the liquidity and the potential for downgrades that had to be considered and in this case were not?

Mr. CORZINE. Congressman, it is not that they weren't considered, but they probably weren't measured, certainly after the fact, to the degree that they should have been factored in.

Mr. GARRETT. I see. In the course of extensive interviews, we have learned from your former chief risk officer, Michael Roseman, that he expressed significant concerns with the liquidity risks associated with the growing repo market that you have already talked about tied to European sovereign debt. He said liquidity risks associated with these risks that we just talked about might ultimately sink the firm. First of all, do you think that he was right in that sense?

Mr. CORZINE. First, Congressman, I believe that, by my recollection, that Mr. Roseman's chief concern was the default risk, or restructuring risk, as opposed to liquidity risk. Mr. Stockman was much more focused on the liquidity risk than I think Mr. Roseman was.

Mr. GARRETT. Was Mr. Stockman correct then, in that sense?

Mr. CORZINE. The facts speak for themselves.

Mr. GARRETT. Mr. Roseman apparently was uncomfortable with position limits. And you were talking about the process as far as going to the board for that. He was concerned apparently when they were set at $2 billion. I understand that you had to go to the board at least twice to approve limits above that level. And as the

position went above that level, eventually, it went to $4 billion in late October of last year. I guess at that point in time, according to Mr. Roseman, you sought to draw a proverbial line in the sand against any other increases and made that presentation to the board in November of 2010. Is that a correct assessment of what he was trying to do?

Mr. CORZINE. I am not certain of the timeline, but I do—

Mr. GARRETT. Generally.

Mr. CORZINE. I accept that Mr. Roseman did not want to increase this. I would add that it was in the context of not only sovereigns, but other activities that we did in those countries with private investors and other credit arrangements.

Mr. GARRETT. Gotcha. The board apparently, after those concerns, ultimately agreed to put a hard cap at $4.5 billion and revisit the position in February or March of this year. Mr. Roseman eventually was replaced in early January of this year. The question then is, when did you begin, if it was you, your search to replace him? Was it at this time of his departure or prior?

Mr. CORZINE. This is to the best of my recollection—

Mr. GARRETT. Sure.

Mr. CORZINE. —we started a search sometime around the first of February.

Mr. GARRETT. Immediately or sometime after his departure?

Mr. CORZINE. Mr. Roseman and I had a conversation about whether there were other things that he might want to do, and would we want to have additional folks, and would he help us in a transition.

Mr. GARRETT. Okay. Now, you mentioned Mr. Stockman before, and he was more concerned about the liquidity risk aspect of it. But it was under him, I guess, then, that the board decided to go past that $4.5 billion cap that just previously had been set on a previous review date in February or March. How did it happen that they went once again above the limit they had set upon themselves, or for the company I should say?

Mr. CORZINE. I would, to my recollection, suggest that I went and asked for specific sovereign authority on individual countries.

Mr. GARRETT. Okay.

Mr. CORZINE. And to my recollection, the board was more comfortable with some sovereigns than they were others, ones that had higher ratings and were more comfortable having larger size—

Mr. GARRETT. So, collectively, they decided that they could go beyond that?

Mr. CORZINE. My request actually was for smaller size, but to take into consideration what the European community had put in place to back up Ireland and Portugal.

Mr. GARRETT. If the Chair would allow just one last question then. In the interview—see if this is correct in my understanding of the interview with Mr. Stockman—he mentioned that he did not have liquidity risk in his portfolio. First of all, is that correct? And if that is correct, why was that decision made to take out of his portfolio of responsibility?

Mr. CORZINE. Congressman, I really—I don't know how to respond to that. Liquidity risk was certainly something that we con-

stantly depended upon our risk department to address. Whether he had limit authority, I can't speak to it.

Mr. GARRETT. Thank you. I will yield back to the Chair with that.

Chairman NEUGEBAUER. I thank the gentleman.

And now, the gentleman from New York, Mr. Grimm, is recognized for 5 minutes.

Mr. GRIMM. Thank you, Mr. Chairman.

Mr. Corzine, you just testified a moment ago, my colleague, Mr. Royce, asked you a question, and you responded in part, at some place I actually had expertise. And I assume you were talking about at your time at Goldman.

Mr. CORZINE. Congressman, I grew up in the government securities business, and I was responding to the fact that Mr. Royce raised this issue about the primary dealership. And this had been something that I probably had spent 15 years, had been very, very active in that marketplace.

Mr. GRIMM. Okay. But you would say that as the CEO at MF Global, you had some expertise. Is that correct?

Mr. CORZINE. Certainly with regard to the government securities markets.

Mr. GRIMM. Okay. And you were asked a little bit about your deference. Do you think you could have gotten any special treatment because of deference because of the positions that you have held? And I just want to note that you were granted a 3-year extension of your employment agreement in 2011. And two of the reasons they cited were success in securing primary dealer status and improving the posture with regulators, the company posture with regulators. Do you think that would definitely have something to do with maybe some deference to who you are and your status? I mean, plausibly?

Mr. CORZINE. Congressman, it is plausible. But I think what—

Mr. GRIMM. That is all I needed to know. Thank you very much.

Let me ask this: You mentioned before in your statements that you actually came in when the leverage was about 40 to 1, and brought it down to say 30 to 1. Is that correct?

Mr. CORZINE. Yes, sir.

Mr. GRIMM. Okay. Mr. Pearce started to hit on it, but he didn't let you answer the question, so I am going to let you answer the question. When you analyze the records for seven quarters in a row, you run up your leverage right after the quarter ends. So you delever right before the filings for seven quarters in a row. That I am sure you know is known as window dressing. But let's go through that. These are the repos 105, I believe. Right? These are 105? Or—

Mr. CORZINE. To my knowledge, Congressman, there were no repo 105s executed at MF Global.

Mr. GRIMM. There weren't. Okay. Then what repos did you use? Is it not true that after each filing, for seven quarters in a row, the leverage went dramatically up?

Mr. CORZINE. Congressman, because our systems were not as strong as we would like them to be, we only netted positions at the close of a quarter. That is if you were long in a security in one account and shorted in another—

Mr. GRIMM. Thank you for the explanation, but ultimately if I look at your seven quarter filings in a row, at the end of each filing, your leverage is one place, and then right after that filing, your leverage is much higher. Regardless of why, is that a factual statement or not?

Mr. CORZINE. I can't actually answer that question.

Mr. GRIMM. Okay. Maybe the CFO can answer that question. Would a strict analysis of someone who knows nothing, say like me, who is not involved in MF Global, if I look at your quarterly filings, is that statistically a fact, regardless of why?

Mr. ABELOW. Congressman, the CFO isn't here today. I apologize.

Mr. GRIMM. I am sorry. You are the acting president?

Mr. ABELOW. I was the president. And I don't have those records with me, so I can't verify. I was not at the company seven quarters ago. And I don't know what happened the day before or the day after.

Mr. GRIMM. Okay. And Mr. Corzine, you don't recall seven quarters in a row? There was an article about this. So I am assuming it was brought to your attention. It was written in—I am sure you read the article.

Mr. CORZINE. Congressman, I am not familiar with the article.

Mr. GRIMM. You are not familiar with that article?

Mr. CORZINE. I am not familiar with that article.

Mr. GRIMM. Okay. Outstanding. Let me ask you this. I think there are millions of people who are familiar with that article. I am going to just say, I don't believe that answer, Mr. Corzine. If I am the CEO of a company and a major national newspaper writes an article about my company alleging that I did something that is unethical, window dressing, maybe not illegal but unethical, I would know about it. I can't believe that no one said to you, called you and said, "Hey, you see that article they wrote about you?" I get that now as a Member of Congress: "Hey, did you see that article they wrote about you?" You don't know about that article. You just testified under oath you did not know about this article.

Mr. CORZINE. I don't know the date.

Mr. GRIMM. Fair enough. That is your testimony.

Mr. CORZINE. I don't know the date or what newspaper.

Mr. GRIMM. The Wall Street Journal. It is a small little tablet. You testified before about unreconciled differences in segregated accounts. Unreconciled differences. I am not a CEO. I haven't been a Senator. What is "unreconciled differences?" Does that mean there is money missing in the account?

Mr. CORZINE. It means that there are not the assets that were supposed to be held against the segregated dollars that we were responsible for.

Mr. GRIMM. And do you reconcile every day at the end of the day?

Mr. CORZINE. Absolutely.

Mr. GRIMM. Every day broker-dealer and so on?

Mr. CORZINE. Have to submit to the CFTC that you are in reconciliation.

Mr. GRIMM. So unreconciled difference means something is missing?

Mr. CORZINE. Either that or—

Mr. GRIMM. No. I mean in your case, not in the abstract. We are talking about MF Global, the company you were in charge of. What did that mean, "unreconciled differences?"

Mr. CORZINE. We were not in balance in our segregated accounts.

Mr. GRIMM. Not in balance? What does that mean, "not in balance?"

Mr. CORZINE. It could mean we didn't have control of collateral, it could mean we had money that moved that shouldn't have moved.

Mr. GRIMM. You had money that moved that shouldn't have moved. Who other than you, is it the Treasury Department within that has the authority to move that money?

Mr. CORZINE. Yes, sir.

Mr. GRIMM. My time has expired.

Chairman NEUGEBAUER. I thank the gentleman.

Now the gentleman from Michigan, Mr. Huizenga, is recognized for 5 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman.

And I am, frankly, intensely interested where my friend from New York was going. So if it is all right, I am going to give you 30 seconds of my time so you can quickly finish that up.

Mr. GRIMM. Thank you. I appreciate that.

At the end of each day, you just testified that they reconciled. Prior to this time that we are talking about now, the demise, the explosion here, were you ever—did you ever have unreconciled differences in your account.

Mr. CORZINE. Not to my knowledge.

Mr. GRIMM. Never. Okay. That is good to hear. What is the first thing that would happen when they found out that there was something out of balance, something was unreconciled? Would you get a call, as the CEO, from treasury?

Mr. CORZINE. If it was a serious imbalance, yes.

Mr. GRIMM. And is that what happened, you got a call?

Mr. CORZINE. There was work trying to reconcile this, and I know this after the fact, not before the fact, on that Sunday.

Mr. GRIMM. But this is a serious unbalance, this is a pretty serious difference, correct?

Mr. CORZINE. From only what I have been able to discover afterwards from reading some of the press reports—

Mr. GRIMM. Okay. So as soon as they found out, treasury found out that it was unreconciled, did they call you or not?

Mr. CORZINE. I was notified on Sunday evening—

Mr. GRIMM. Okay. So they didn't call you, they did not call you then when they—when they closed the books at the end of the business day, it was not reconciled, but they did not call you.

Mr. CORZINE. It was normal operating procedure to have the calculation done the following business day, which was Friday to Monday. And so folks were working on this reconciliation through the weekend. I think there was a—

Mr. GRIMM. Who ultimately notified you then that there were unreconciled differences?

Mr. CORZINE. The CFO.

Mr. GRIMM. The CFO.

Mr. HUIZENGA. I would like to reclaim my time at this point. It quickly turned into 10 minutes. Kind of along that line, do you recall making this statement: "Our positions and the judgment about risk mediation steps are my personal responsibility." That is according to Bloomberg regarding an October 25th conference call regarding these quarterly losses and the debt downgrade. You then saw a 67 percent loss in value there. Do you recall making that statement?

Mr. CORZINE. I recall something of that nature made.

Mr. HUIZENGA. Okay. That was the quote in the article.

And I am just curious, we all get here, you sat on this side of the microphone, I am sure you are wishing you weren't sitting on that side of the microphone today, but are you a hands-on kind of guy, a detailed kind of guy?

Mr. CORZINE. In markets and clients' activities, I think most people would—

Mr. HUIZENGA. But in general life? Because I know I am here and I like asking questions. I like knowing about what is going on. Are you a control freak type, or are you the, hey, we will let things kind of play out and see what happens?

Mr. CORZINE. When it comes to the things that I understand and have expertise in, I am very hands on.

Mr. HUIZENGA. Okay. It seems to me that in the things that you have done in life, you have maybe had to strike a balance. I know I do. I have to know some details; I have to know about details on legislation. Do I know about every detail about every piece of legislation? Probably not, but I have people who follow that, and I have to go get it when a constituent asks. That is fair, right? I don't think we are expecting you to know everything that every single employee is possibly doing during the day. But I think what my friend from New York is getting at is when you have some major issues like this, it would seem that responsibility lies in your office. That is what you said on October 25th.

I can tell you, having some personal experience with attorneys and real estate brokers—I am a former REALTOR® myself—when you start commingling funds, when you start pulling funds that don't belong to you to go do things, no matter how valiant, no matter how beneficial to you personally or the firm or whatever else, people lose their law licenses; people lose their brokerage licenses. I think that is why you are seeing such frustration, anger, and hostility at this.

My phone started blowing up November 1st and late on October 31st by people whom I had no idea in my district, whom I couldn't even fathom had some sort of connection to MF Global, but they did, predominantly through the agricultural community. And it just seems to me that when you are claiming not to know details about some major, major issues that have been brought up here, it just doesn't ring true. It just doesn't ring like it is heartfelt.

And Mr. Abelow, I know both of you were employed by the Global Holdings. I am assuming that this isn't the only asset that Global Holdings had. I know you have operations in Canada, and Hong Kong, and England, and a number of places around the world. Correct?

Mr. CORZINE. Yes, sir.

Mr. HUIZENGA. And are they all much like this structure, a separate entity operating in these other countries?

Mr. CORZINE. Each country has its own regulatory structure, each country has its own finance structure. And there is cooperation across the global—

Mr. HUIZENGA. And you communicate on a regular basis with those other entities?

Mr. CORZINE. Yes, sir.

Mr. HUIZENGA. And that seems to maybe get at, and I know my time is almost up here, but it seems like I think that is some of the concern is we are seeing this money get passed around. The fiduciary element feels like it is lost. Now, it might be there legally technically, but I can tell you as someone who had a fiduciary responsibility as a REALTOR® and a developer, and having those dollars come in, this certainly doesn't feel or look like you were caring for those other people's money the way that you should have, and certainly were expected to. One last question: Did you have personal dollars yourself in those segregated fund accounts?

Mr. CORZINE. I did not.

Mr. HUIZENGA. You did not. So this was not any of your own money. You were just out with everybody else's money. It was other clients.

Mr. CORZINE. I didn't have a futures account, didn't trade for my own account. I thought it would be a conflict to be an active trader for my own purposes while I was leading a company.

Mr. HUIZENGA. But you certainly were active in trading personally, correct?

Mr. CORZINE. No. I bought shares in MF Global, which I think I have reported in my written statement.

Mr. HUIZENGA. Yes. But you weren't involved in the day to day choosing where things were going to be going?

Mr. CORZINE. There were things that I traded through—we set up a very complex compliance structure, extra supervision, to make sure that when I executed a trade, first of all, I didn't write a ticket, but somebody else did, that they were both observed and those procedures were followed.

Mr. HUIZENGA. I know my time is up, but Governor Corzine, you have thousands of hardworking people around this country who feel cheated. And frankly, it is hard not to disagree with them. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Dold is recognized for 5 minutes.

Mr. DOLD. I thank the chairman. And certainly I want to thank the Governor. I appreciate your appearance and testimony here today and at other House committees and Senate committees as well. I am particularly interested in this issue. For the first time in 150 years, the Chicago Mercantile Exchange had customer funds missing. I represent the Northern District of Illinois and the 10th District, and I probably have more traders in my district than perhaps any other district in the country.

So my first question for you is, when we look at the $1.2 billion missing, did you have any communications, whether in person, by telephone, by email, or text message, or any other means that specifically contemplated, addressed, or approved sending segregated

customer funds to serve as loans to, collateral for, or liquidity for broker-dealers whether or not they were MF Global affiliates or nonaffiliates?

Mr. CORZINE. I believe the answer to that is no.

Mr. DOLD. So today here, before this committee, you are saying that—

Mr. CORZINE. I believe that—

Mr. DOLD. I am just clarifying.

Mr. CORZINE. —the moving of customer funds I never authorized, I never intended to authorize, nor do I think anyone could misconstrue anything I said that would authorize the moving of customer funds in an improper way. And so I don't—you put a lot of—

Mr. DOLD. Let me try to be more specific then, and not put so many of those caveats in there, because it was really trying to get to the point of certainly in today's technology, did you receive any emails where you may have been CC'd that talked about moving customer funds?

Mr. CORZINE. To my knowledge, and I haven't been able to review all my records—

Mr. DOLD. This is a pretty big deal, so I assume it would stick out.

Mr. CORZINE. If someone sent me a memorandum, or an email, or a PDF off of an email that suggested we use customer funds, I wouldn't have authorized it.

Mr. DOLD. And you do not—at this point in time, you are saying that you do not remember receiving any of those?

Mr. CORZINE. At this moment, I don't recollect receiving any of those.

Mr. DOLD. If segregated customer funds were used for MF Global's purposes, wouldn't you expect U.S. Treasuries or similar securities to be placed in the segregated accounts as a substitute for customer funds?

Mr. CORZINE. That would be how the rule 1.25 requirements would work, on that basis.

Mr. DOLD. Now, I do have just a couple more questions. You talked before about being notified that there was an imbalance. Correct? Just moments ago?

Mr. CORZINE. Yes. Yes, sir.

Mr. DOLD. Okay. Did any customer statements ever show that there was an imbalance in their account?

Mr. CORZINE. Congressman, I can't answer that question. I don't know the answer to that.

Mr. DOLD. My understanding is that no customer ever received a statement—do you have any knowledge of that? No customer ever received a statement that their account was in imbalance?

Mr. ABELOW. I don't know about that. Again, that I learned, as the Governor has stated, I learned on the evening of the 30th that there was an imbalance in customer funds. I don't know if any statements went out subsequent to that date to customers because the filing for bankruptcy was the next morning.

Mr. DOLD. Governor, you talked before about having the right people and the right policies in place. And I understand that is important. Do you know Stephen Grady, Dennis Klejna, or Joseph Murphy?

Mr. CORZINE. The first two gentlemen I know.

Mr. DOLD. Okay. And the reason I bring up those names specifically is I think they were involved with the Refco bankruptcy, where a number of folks went to jail, and I think there were some significant fines paid in connection with related Justice Department consent orders. Do you know how they were connected to MF Global and what role they played in the weeks leading up to the bankruptcy?

Mr. CORZINE. Mr. Grady was responsible for trying to bring about this joint venture or the sale of our FCM. He was actively involved in those negotiations and framing that activity in the days that led up to the bankruptcy and well before that.

Mr. Klejna, Dennis, I couldn't always pronounce his name, was in our general counsel's office. I think he had previously served with the CFTC.

Mr. DOLD. Were you aware of their roles with Refco?

Mr. CORZINE. I was aware they were a part of the Refco acquisition that preceded my joining MF Global.

Mr. DOLD. Any background checks, anything along those lines that would have highlighted the fact that they were involved and had some issues potentially with some fines through the Justice Department?

Mr. CORZINE. I am not aware of those.

Mr. DOLD. Mr. Chairman, my time has expired.

Chairman NEUGEBAUER. I thank the gentleman. I have consulted with the ranking member, and we are going to have what I would call a lightning round. And if we could ask Members to keep those questions maybe to one question, or short questions so that we can move through that process. And I now recognize the ranking member.

Mr. CAPUANO. I thank the chairman.

Mr. Corzine, just one question, a ballpark, I would never hold you to exact numbers. It wouldn't be fair. Approximately a week before the bankruptcy, a week, 10 days, whatever, do you know who the biggest creditor of MF Global was? And the creditor could be either a customer or somebody who was on the counterparty through a repo or any other instrument.

Mr. CORZINE. I am glad you say that. I couldn't give you specifics. I would suspect it was JPMorgan, but I don't know it. They were our clearing bank. They were also responsible for our unsecured lending facility, and also responsible for our secured lending facility.

Mr. CAPUANO. Would you have a ballpark idea how much that might be? And again, I am not trying to nail you on it. Just a ballpark.

Mr. CORZINE. Well, 10 days before the bankruptcy, we hadn't drawn on any of those facilities.

Mr. CAPUANO. Okay.

Mr. Abelow, the same question for you now, not 10 days before, but now, who is your biggest creditor? Again, with the same caveats.

Mr. ABELOW. I apologize. I simply don't know.

Mr. CAPUANO. Okay. Thank you.

Chairman NEUGEBAUER. Mr. Corzine, you testified in the House Agriculture Committee hearing last week that it would be inappropriate for you to promote the designation as a primary dealer. In fact, you said it probably would have been criticized by the Fed if you did so. Is that a fair assessment?

Mr. CORZINE. As I recall what I said, that is—and I would believe that using it as an advertising tool would be—

Chairman NEUGEBAUER. On February 2nd, you sent out a press release stating, "Being designated a primary dealer by the Federal Reserve in New York is consistent with our global strategy of expanding our broker-dealer activities as we seek to serve our clients with broader execution services and greater market insight and ideas." Would you say that was promoting your—

Mr. CORZINE. That was just part of the announcement that we were recognized. We had to say something. And I don't believe that is implying a Good Housekeeping Seal from the Federal Reserve.

Chairman NEUGEBAUER. In fact, the board, in a proxy statement, said, "In granting Corzine a 3-year extension of his employment agreement in 2011, the board compensation committee noted that his performance had been exemplary since joining the firm over a year ago. The board also noted that Corzine's accomplishment in near-term building blocks, including significant improvements in the reputation of the firm as demonstrated by its ability to hire quality officials, the company's success in securing primary dealer status, its growing client balances, and improving posture with the regulators."

So it seems that was a big deal.

Mr. CORZINE. Internally, there is no question that people felt good about having that designation. But it was not something that we advertised or promoted to our clients. There were many clients who will not do business with people who are not designated primary dealers. And so, the mere fact that designation exists is a good thing, which I think the board was trying to recognize.

Chairman NEUGEBAUER. Did that give you borrowing power at lower—having that dealer status, did that allow you to access credit at a cheaper rate?

Mr. CORZINE. If it did, I am not aware of it. There are—the more lenders there are, the more likely it is that you will have marginally better rates. But we didn't see a meaningful element in that.

And as you know, Mr. Chairman, we are at very low interest rates in the short-term markets today anyway. And I don't think those were impacted by that.

Chairman NEUGEBAUER. Thank you.

Mr. Perlmutter?

Mr. PERLMUTTER. Thanks. I guess my questions are similar to Mr. Capuano's as to who got paid and who didn't get paid here. Just as simple as that. Secured creditors. I am just trying to figure out what happened in that week advance. Because if you hadn't drawn on the facilities 10 days in advance of this thing, everything kind of cratered in the last 10 days.

So did the secure creditors come in and sweep these accounts and then assets that you thought were assets just sort of evaporated because sovereign debt went down? And that has a question mark at the end.

Mr. CORZINE. Congressman, I said this and I meant it sincerely, I apologize, I don't have the information to that. And those are the kinds of things that you would have to go through the records. I don't know whether that happened or it didn't happen.

Mr. PERLMUTTER. Okay. I guess at some point, SIPC placed MF Global in bankruptcy, and then that froze everything. And this will all, the story will be told, as you have said, over the course of the next few years. But I look back at CME, I look back at all of the regulations and laws we have in place, and I am trying to figure out today how—is there something that needs to be improved in Dodd-Frank or Sarbanes-Oxley or the 1933 Act where some firewalls need to be built? And I guess until we really know this whole story, we won't know, because it seems like there, especially with CME, there should have been a lot of protections.

Mr. CORZINE. Congressman, I believe we need the facts to be determined so that we can figure out where the mistakes were, what was the cause of the problem.

Mr. PERLMUTTER. Okay.

I yield back. Thank you, Mr. Chairman.

Chairman NEUGEBAUER. Thank you.

And the gentleman from New Mexico, Mr. Pearce, is recognized.

Mr. PEARCE. Thank you, Mr. Chairman.

Governor, what was your pay when you were working with MF?

Mr. CORZINE. I was—I started out with a salary of $1.5 million, and I think it was in the second year down to about $750,000 a year.

Mr. PEARCE. Any performance bonuses on top of that?

Mr. CORZINE. I had a guarantee when I joined the firm, which I took less than the guarantee. I don't—

Mr. PEARCE. How much of a guarantee?

Mr. CORZINE. I don't quite remember, sir.

Mr. PEARCE. Just approximately.

Mr. CORZINE. I think it was a million and a half. It could have been a million and three-quarters.

Mr. PEARCE. Mr. Abelow, how about you?

Mr. ABELOW. Congressman, my total compensation in the time that I was at MF was a guaranteed amount of approximately $3 million.

Mr. PEARCE. Okay. I think, Mr. Corzine, that you had testified to Mr. Neugebauer that you didn't know anything about the $117 million loan when he was asking his first questions. Is that correct, that there is some loan that—

Mr. CORZINE. As I said, I don't know of any loan that was backed by customer funds. I wouldn't have authorized it. And as I said in my oral testimony, there were questions raised by JPMorgan about the transfer of funds from New York to London accounts, I don't know whether they were loans or I know it was based on the issues of overdrafts. I had oral confirmation from the people in Chicago. And as I said, I believe I have written confirmation from the people in Chicago that it was appropriately funded.

Mr. PEARCE. You testified to Mr. Grimm's questions that you didn't know about the window dressing, the article that appeared in the Wall Street Journal on November the 4th of this year. They were kind of walking back through. If you didn't know about that,

kind of what level did things have to get to before you were notified? In other words, all these people below you scurrying around and putting things in place and taking things out, and you the CEO, you didn't have day-to-day knowledge, and it is not your background, not your expertise. What does a CEO actually—when do they have to come to you and say—what level does it have to reach before they notify you? I find this compensation package and your day-to-day knowledge not very thorough, frankly, in this testimony. And so what was the threshold at which they had to come to you?

Mr. CORZINE. Congressman, with regard to being out of balance with client funds, they would have to come on a much, much smaller scale than the hundreds of millions that I heard about on Sunday.

Mr. PEARCE. Yes. So the fact that we are sitting over here on this side of the desk and there is $1.2 billion missing and you have no day-to-day knowledge of it is just incredible. It is just incredible.

I yield back, Mr. Chairman. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from Florida, Mr. Posey, is recognized.

Mr. POSEY. Thank you, Mr. Chairman.

Mr. Pearce, although he said he did not read that article that Mr. Grimm was holding up, 3 minutes later in an answer, he said when he read articles about that problem. So one of us is confused there I think.

Mr. Corzine, you stated that after, I think you used the term "significant imbalances" were discovered on October 31st, no statements were sent out. I am looking at a statement dated November 7th. It indicates no imbalances whatsoever. And there are others besides the one I am holding in my hand here. How can that be?

Mr. CORZINE. Congressman, I am not trying to avoid the question, but I left the firm on November 3rd. And I would not know what was included in those statements even if I had access to my records.

Mr. POSEY. Okay. I am not saying that it is your fault, my fault, his fault, her fault, God's fault, nobody's fault. But isn't it clear that somebody is lying to the clients if they send out a statement that says there are no imbalances when, in fact, it is a week after I think you used the term "significant imbalances" were discovered?

Mr. CORZINE. Congressman, I don't know how that confirmation or that notification was sent. So it would be hard for me to categorize it.

Mr. POSEY. It is a statement like they send out every single month. They have been getting the same statements for years. Just like all the others. That is how it was sent out. It is obviously a standard procedure, a standard policy.

Mr. Abelow, can you shed any light on this?

Mr. ABELOW. Sir, I don't know what statement you have in front of you. I haven't seen it before.

Mr. POSEY. You have never seen one of your customers' statements before? You don't know what they look like?

Mr. ABELOW. Sir, you are referencing a statement on a specific date which I have not seen.

Mr. POSEY. But it is the same style statement every day. Do you change your statements every month?

Mr. ABELOW. Congressman, as I stated earlier, the operating company, the regulated company MF Global Incorporated, was placed under an SIPC trustee on, I believe, October 31st. So a statement subsequent to that date I wouldn't have any information about.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. POSEY. Slippery when dry.

Chairman NEUGEBAUER. The gentleman from Texas, Mr. Canseco, is recognized.

Mr. CANSECO. Thank you, Mr. Chairman.

Just a couple of follow-up questions. Mr. Corzine, how much of the shortfall is due to slippage in collateral transfers, and how much was seized by creditors through margin calls after the firm was technically bankrupt?

Mr. CORZINE. Congressman, I don't know the answer to that question. And I would have to do a real analysis with people who knew how to read the thousands of pages. That is what I presume that the investigators are doing at this moment.

Mr. CANSECO. Any venturing, any opinion one way or the other?

Mr. CORZINE. Congressman, I am as interested in the answer to that as you are.

Mr. CANSECO. Thank you. Let me go to your Web site that proclaimed to the public in October, now this is October of this year, that MF Global has an extremely liquid and high-quality balance sheet that consists primarily of client payables and short-term Treasuries and agencies, slash, contains minimal level three trading assets. Now, if those statements are true, then how did MF Global go bankrupt and lose over $1 billion in customer funds in less than a month after that statement was made?

Mr. CORZINE. Congressman, I think that statement is consistent with how our balance sheet looked. I think that once there is a loss of confidence, the financing techniques that I think we have talked about here today, repurchase agreements, and the need to put up additional margin calls, can put extreme pressure on a financial institution. It should not have put so much financial pressure that anyone would have improperly used customer funds.

Mr. CANSECO. Okay. Fair enough.

Now, Mr. Abelow, there are news reports stating that Mr. Corzine had a personal trading account as CEO of MF Global. In fact, it is reported that he was making trades from his BlackBerry in the middle of meetings. Now, in your expert opinion, is it proper for a CEO of such a large company as MF Global to be engaging in such transactions?

Mr. ABELOW. Congressman, I have no frame of reference. I haven't worked directly for a CEO of a similar firm before.

Mr. CANSECO. Okay. Were customers or investors of MF Global ever made aware that the CEO of the company was spending so much time trading? You don't know whether he was out there trading or doing things for clients or for his own account?

Mr. ABELOW. I am not aware of any specific question or disclosure related to how the chairman of the company spent his time.

Mr. CANSECO. Thank you.

I yield back the balance of my time.

Chairman NEUGEBAUER. Mr. Dold is recognized.

Mr. DOLD. Thank you, Mr. Chairman.

I appreciate the second lightning round. I wanted to just get back into something that my colleague Mr. Renacci was talking about when he was going over kind of the role, I would say the unique role that the board played at MF Global in terms of trying to be involved in terms of risk and being able to—the request to take on additional risk. Do you know of any other firm that operated like that?

Mr. CORZINE. I believe that delegations of authority on risk flow from boards in most major financial institutions.

Mr. DOLD. But how about day to day-type operations? My understanding was—

Mr. CORZINE. If there were major exposures, which certainly the euro sovereign RTM positions were a major exposure, then it would, in most companies, flow, I believe, to a board. Certainly as a CEO, I would want my board to be aware of the kinds of things that would be of risk to the company.

Mr. DOLD. Can you just give me some sort of an idea about what their qualifications were? Were they engaged former traders? Were there former management in terms of futures and equities that sat on the board?

Mr. CORZINE. There were—the lead director was a former senior officer at Merrill Lynch, which has an FCM, and is very active in futures markets. There was a gentleman in London who was a senior member of the management team at ICAP, which is also another significant futures and options player. There is—

Mr. DOLD. I think we can establish that there were some folks who were on the board.

Mr. CORZINE. Yes.

Mr. DOLD. I guess my point is it seemed to me when you were talking to Mr. Renacci that you were talking about having to go to the board to overrule certain things or to get additional risk and retention even outside of the monumental ones that you were talking about with the European sovereign debt. Maybe I am misinterpreting that.

Mr. CORZINE. There were requests to the board, certainly from time to time starting after December, as the position grew. And sometimes, the board said no.

Mr. DOLD. Okay. Governor, I just want to follow up with one last thing that Mr. Posey was talking about, and then I will yield back. The statements that went out—you said, "I have no idea how the statements went out." The statement that he just held up in front of us, I assume that is a statement, that general looking statement is a statement that you have seen before.

Mr. CORZINE. Yes, sir.

Mr. DOLD. How about you, sir?

Mr. ABELOW. I didn't see it, so I will assume that it was a normal course statement.

Mr. DOLD. Okay, a normal course statement. The long and the short of it is you basically said you don't know how it would have gone out on November 7th because you had left just days prior.

Had you still been there, would that statement have still said the same thing or would there have shown—

Mr. CORZINE. We are an operating business, and if we are sending out nonfactual information, something would have had to be done. But we would have had to correct that imbalance. We would have had to go more than just reconcile, we would have to had customer funds properly segregated.

Mr. DOLD. So are you saying that, if indeed, this did go out and no customer statements were augmented, that there was some impropriety that was going on after you left?

Mr. CORZINE. Congressman, I don't want to speculate about that. I can't believe that the trustee, who has a very high reputation, is doing—at least from my following of the information, trying to do everything he can to return customer funds to the clients. I would have to think that is an oversight or somebody forgot to turn off the computer.

Mr. DOLD. One last thing. Did MF Global use an off-the-shelf risk-management program or was it proprietary?

Mr. CORZINE. To the best of my recollection, we had multiple risk management systems for different product lines.

Mr. DOLD. Off the shelf or proprietary?

Mr. CORZINE. Many of them were off the shelf, some were proprietary, and they all folded into the global risk management activities in our risk department.

Mr. DOLD. Thank you.

Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

And I thank the panel. There are no further questions from the Members. This panel is dismissed. We will call up the second panel now.

Before the second panel gets too comfortable, I would ask you to stand please, and raise your right hand.

[Witnesses sworn.]

Chairman NEUGEBAUER. On our second panel, we have: Dan Berkovitz, General Counsel, Commodity Futures Trading Commission; Robert Cook, Director, Division of Trading and Markets, U.S. Securities and Exchange Commission; Terrence Duffy, executive chairman, CME Group Inc.; Richard Ketchum, president, chairman, and chief executive officer, Financial Industry Regulatory Authority; James Kobak, chief counsel to James Giddens, Bankruptcy Trustee for MF Global Inc.; and Thomas Baxter, general counsel, Federal Reserve Bank of New York.

I would just remind all of you that your full written statements will be made a part of the record. We ask you to summarize your testimony in 5 minutes.

Mr. Berkovitz, you are recognized for 5 minutes.

STATEMENT OF DAN M. BERKOVITZ, GENERAL COUNSEL, COMMODITY FUTURES TRADING COMMISSION (CFTC)

Mr. BERKOVITZ. Good afternoon, Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee. Thank you for the opportunity to testify.

Chairman NEUGEBAUER. Mr. Berkovitz, would you make sure your button is on.

Mr. BERKOVITZ. Is that better?

Chairman NEUGEBAUER. Much better.

Mr. BERKOVITZ. Good afternoon. The Commission's highest priority at this time is returning money to MF Global customers as quickly as possible. We are working around the clock to determine what happened to and to locate all of the customer funds.

The MF Global Bankruptcy Trustee, with the assistance of the CFTC, has transferred nearly all positions of customers trading on U.S. markets and soon will have transferred approximately $4.2 billion of customer property. Commodity customers will have quickly received approximately 72 percent of their account values.

In FCM bankruptcies, commodity customers have priority in customer property. This includes segregated property, property that may have been illegally removed from segregation and is still within the debtor's estate, and property that was illegally removed but has clawed back into the debtor's estate by the trustee.

If the customer property is insufficient to satisfy in full all the claims of the customers, part 190 of the Commission's regulations allows other property of the debtor's estate to be classified as customer property to make up any shortfall. A parent or affiliated entity, however, generally would not be a debtor unless customer funds could be traced to that entity.

FCMs such as MF Global are subject to the Commission's financial and reporting requirements. Frontline oversight is carried out by designated self-regulatory organizations, such as the National Futures Association or the Chicago Mercantile Exchange.

DSRO responsibilities include establishing and enforcing rules to ensure the financial integrity of STMs and the protection of customer funds. DSROs are required to examine each FCM every 9 to 15 months. Each FCM must submit to the Commission and to its SRO an annual financial report, certified by an independent public accountant. Annual reports are reviewed by the staff of the Commission's Division of Swap Dealer and Intermediary Oversight (DSIO) as well as the SROs.

FCMs are also required to file monthly unaudited financial reports. Each report must include a statement of financial condition and a statement of segregated funds. The DSROs conduct a primary review of the monthly financial statements. The CFTC staff conducts limited scope examinations of FCMs, either as part of the assessment of the DSRO's examination function or on a for-cost basis. These examinations generally focus on specific issues at the firm and may include capital and segregation reviews.

With respect to the protection of customer funds, by statute, an FCM must treat all money, security, and properties received from a customer to margin for the trades or contracts of that customer as belonging to that customer. All customer money, securities, and property must be separately accounted for and segregated from the FCM's proprietary funds. Funds deposited by one customer to margin for secure trades may not be used for another.

An FCM must notify the Commission immediately of any occurrence of undersegregation and of significant margin calls or whenever its capital drops below minimum requirements.

Section 4(d) of the Commodity Exchange Act permits FCMs to invest customer segregated funds in obligation to the United States,

obligations fully guaranteed as to principal and interest by the United States and municipal securities. Commission regulation 1.25 permits additional types of investments.

On December 5th, the Commission voted unanimously to amend regulation 1.25 to impose new restrictions on these types of investments. Under the revised rule, permitted investments are those identified by statute, as well as certificates of deposit and money market mutual funds, commercial paper, and corporate notes or bonds that are fully guaranteed by the United States under the Temporary Liquidity Guarantee Program. The new rule also includes various concentration limites on investments.

All FCM investments made with customer funds under regulation 1.25 must be kept by the FCM in the customer accounts. Further, when investing customer funds, the value of the customer's segregated account must remain intact at all times.

Thank you. I would be happy to answer any questions.

[The prepared statement of Mr. Berkovitz can be found on page 107 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Cook?

STATEMENT OF ROBERT COOK, DIRECTOR, DIVISION OF TRADING AND MARKETS, U.S. SECURITIES AND EXCHANGE COMMISSION (SEC)

Mr. COOK. Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee, my name is Robert Cook, and I am the Director of the Division of Trading and Markets at the Securities and Exchange Commission. Thank you for the opportunity to testify on behalf of the Securities and Exchange Commission concerning the collapse of MF Global.

The bankruptcy of this firm and the apparent shortfall in segregated accounts of futures customers has resulted in serious hardship for many MF Global customers.

We are committed to working with the trustee and our fellow regulators to help return customer assets, as well as to investigate any potential violations of law that may have contributed to customer losses.

MF Global's regulated U.S. subsidiary, MF Global Inc., or MFGI, was duly registered with the CFTC as a futures Commission merchant and with the SEC as a broker-dealer. As of October 31st, MFGI had approximately 36,000 futures customers and approximately 330 custodial accounts for nonaffiliated securities customers.

MFGI was also the member of several futures self-regulatory organizations, or SROs and securities to SROs. For securities activities, the frontline supervision of a broker-dealer is performed by the SROs of which the broker-dealer is a member, in this case FINRA and various securities exchanges.

There has been significant attention given to the repo-to-maturity transactions entered into by the firm on European sovereign debt. In the summer of 2011, SRO staff identified these transactions based on an analysis of MSGI's financial statement and questioned whether the firm was recognizing them appropriately for purposes of its net capital computation.

The firm believed that the transactions should be subject to lesser capital charges than the SRO staff. The SRO staff, in consultation with and supported by SEC staff, ultimately required the firm to take the higher capital charges and to report the net capital deficiency for the month of July.

Several months later, after reporting a substantial net loss with its stock, and with its stock and credit rating under pressure, MFGI entered the weekend of October 29th to 30th engaged in negotiations with various parties regarding potential strategic transactions, such as the sale of the firm's customer business to another firm.

I participated in communications with the firm management during this period, together with other SEC staff and at times other regulators. My recollection is that the CFTC's request for more information about firm's computations for its segregation accounts for futures customers was one of the issues discussed with the firm on Sunday, October 30th.

When the firm subsequently reported early in the morning on Monday a significant deficiency in those accounts and that negotiations for a strategic transaction had ceased, firm management attempted to explain to regulators how the deficiency had occurred and whether it could be remedied. After consultation with the CFTC, we determined together that the safest and most prudent course of action to protect customer accounts and assets was to initiate a liquidation proceeding under SIPA. A referral was made to SIPA that morning.

Since then, we have been working with SIPC and the trustee to return securities and funds to the securities customers of MFGI. Last Friday, the court approved the sale and transfer of approximately 338 accounts held for nonaffiliated customers of MFGI. The trustee estimates that the initial transfer will restore 100 percent of the net equity for more than 80 percent of these securities customers.

The SEC has a set of rules designed to protect customer property by prohibiting broker-dealers from using customer funds and securities to support the proprietary positions. The rule requires broker-dealers that hold securities or cash for customers maintain physical possession or control over the securities that customers have paid for in full.

Alternatively, if a customer has a margin loan, the customer protection will strictly limit the amount of securities that can be used for the broker-dealer for financing purposes. As to cash, the broker-dealer must also maintain a reserve in an account for the benefit of customers in an amount that exceeds the net funds attributable to customer positions. These funds cannot be invested in any instrument that is not guaranteed by the full faith and credit of the U.S. Government.

Together, with the applicable SEC capital requirements and SIPC protections, this regime is meant ensure that if a broker-dealer fails, customer securities and funds will be readily available to return to those customers. The SEC will continue to work to identify further improvements to his customer protection regime.

Thank you again for inviting me here today, and I look forward to answering your questions.

[The prepared statement of Mr. Cook can be found on page 115 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman. Mr. Duffy?

STATEMENT OF TERRENCE A. DUFFY, EXECUTIVE CHAIRMAN, CME GROUP INC.

Mr. DUFFY. Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee, I am Terry Duffy, executive chairman of the CME Group. Let me start by saying the actions of Mr. Corzine's firm, MF Global, have put a lot of market users in a tragic position.

At CME Group, our efforts, with respect to the unprecedented loss of customer segregated funds caused by MF Global, have been to assist these customers and minimize market disruptions.

My testimony summarizes reports from our staff, who were on site at MF Global along with the CFTC in the days immediately preceding its bankruptcy. My written testimony expands on the introductory statement and includes substantial background material. By the middle of the week of October 24th, MF Global had announced poor earnings and was downgraded by several credit rating firms.

Sparking rumors that it would sell its brokerage business, CME was the designated self-regulatory organization for MF Global with responsibility for auditing its futures business.

On Thursday, October 27th, two of our auditors went to MF Global's Chicago offices to review MF Global's daily segregation report for the close of business on Wednesday, October 26th.

Wednesday's segregation report, which is not available until Thursday, showed full compliance. Our auditors asked for the material necessary to check the numbers on the report against the general ledger and third-party sources and began the process of tying out the numbers for Wednesday's report.

That substantial review process of the Wednesday segregation report continued on Thursday and Friday. The MF Global segregation report for Thursday, October 27th, which was delivered to CME on Friday the 28th, also stated that MF Global remained in full compliance with segregation requirements.

In fact, it showed that the firm held $200 million in excess of segregated funds. On Sunday, the CFTC informed us that they were aware of a draft segregation report for the close of business for Friday, October 28th, which showed a more than $900 million shortfall in required segregation. CFTC and CME staff and auditors returned to the firm on Sunday, October 30th, and were informed by MF Global employees that the discrepancy was caused by "an accounting error."

Our auditors worked with the CFTC, and devoted the rest of the day and night on Sunday to find the so-called accounting error. No such error was ever found. Instead, at about 2 a.m., on Monday morning, October 31st, MF Global informed both the CFTC and CME at approximately the same time that the shortfall was real and the customer segregated firms had been transferred out of segregation to the firm's broker-dealer accounts.

After receiving this information, CME remained at MF Global while MF Global attempted to identify funds that could be trans-

ferred into segregation to reduce or eliminate the deficiency. A CME auditor also participated in a phone call with senior MF Global employees wherein one employee indicated that Mr. Corzine knew about the loans that had been made from the customer segregated accounts. CME Group has provided this information and the names of the individuals to the Department of Justice and the CFTC who are investigating these matters.

On Monday, October 31st, the day the SIPC trustee took over MF Global, MF Global revised its segregation report from Thursday, October 27th, indicating that the alleged $200 million in excess segregated funds should have been reported as a deficiency of $200 million. The shortfall in segregation on Thursday, October 27th, was hidden by the inaccurate report, a telling sign that regulators were being kept in the dark. It remains to be seen whether this failure to disclose permitted additional segregated funds to be improperly transferred.

Throughout this time, the firm and its employees were under the direction and control of MF Global's management. Transfers of customer funds effectuated by MF Global management for the benefit of MF Global constitutes a very serious violation of our rules and of CFTC regulations. We met our obligations to all other clearing firms and their customers. Also, at all times, we held $1 billion in excess of the required amount of customer segregated funds on behalf of MF Global's customers.

All of CME Group's efforts have been directed towards speeding recovery and access to their trading accounts, transferring their positions and providing the trustee with a $550 million guarantee from CME Group to encourage him to quickly release customer funds that were securely held at CME clearing. No other exchange or clearing entity in the United States or abroad has done the same as CME group has done. The FederalFly mandated customer segregation program has been in place since 1936.

In that time, prior to the MF Global failure, no customer has ever lost its segregated funds because of the failure of a clearing member of the CME. Moving forward, we intend to work with Congress, regulators, and the industry leaders to strengthen safeguard systems at the firm level.

I thank you very much for your time and attention, and I look forward to your questions, sir.

[The prepared statement of Mr. Duffy can be found on page 148 of the appendix.]

Mr. CANSECO [presiding]. Thank you, Mr. Duffy.

Now, we will go to Mr. Richard Ketchum, president and CEO of the Financial Industry Regulatory Authority. Thank you.

STATEMENT OF RICHARD G. KETCHUM, PRESIDENT, CHAIRMAN, AND CHIEF EXECUTIVE OFFICER, FINANCIAL INDUSTRY REGULATORY AUTHORITY (FINRA)

Mr. KETCHUM. Thank you, Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee. Thank you for the opportunity to testify today.

My name is Richard Ketchum, and I am chairman and CEO of the Financial Industry Regulatory Authority, or FINRA. When a firm like MF Global fails, there is always value in reviewing the

events leading to that failure and examining where rules and processes may be improved. I commend the subcommittee for having this hearing to do just that.

With respect to oversight of MF Global's financial and operational compliance with the securities laws, which is most relevant to today's hearing, FINRA shares oversight responsibilities for the Chicago Board Options Exchange and the SEC.

For broker-dealers that are members of multiple SROs, the SEC assigns a designated examining authority, or DEA, to examine for, among other things, the firm's compliance with the Commission's net capital and customer protection rules. For MF Global, that DEA is CBOE.

When FINRA is not the DEA for one of its regulated broker-dealers, we work closely with the DEA and routinely analyze the firm's FOCUS report filings and annual audited financial statements as part of our ongoing oversight of the firm. While that monitoring focuses on a broad range of issues, it is particularly relevant to note that our financial surveillance team placed a heightened focus on exposure to European sovereign debt, beginning in the spring of 2010. During April and May, our staff began surveying firms as to their positions in European sovereign debt as part of our monitoring in this area.

In a review of MF Global's audited financial statements filed with FINRA on May 31 of this year, our staff raised questions about a footnote disclosure regarding the firm's repo-to-maturity portfolio. During discussions with the firm, FINRA learned that a significant portion of that portfolio was collateralized by approximately $7.6 billion in European sovereign debt. According to U.S. GAAP, RTMs, or repos to maturity, are afforded sale treatment and therefore not recognized on the balance sheet.

Notwithstanding that accounting position, the firm remains subject to credit risk throughout the life of the repo. Beginning in mid-June, FINRA, along with CBOE, had discussions with the firm regarding the proper treatment of the RTM portfolio. Our view was that while recording the repos as sales was consistent with GAAP, they should not be treated as such for purposes of the capital rule, given the market and credit risk those positions carried. As such, we asserted that capital needed to be reserved against the RTM position.

FINRA and CBOE also had discussions with the SEC about our concerns. The SEC agreed with our assertion that the firm should be holding capital against these positions. The firm fought this interpretation throughout the summer, appealing directly to the SEC before eventually conceding in late August.

MF Global infused additional capital and made regulatory filings on August 31st and September 1st that notified regulators of the identified capital deficiency and the change in net capital treatment of the RTM portfolio. Following this, FINRA added MF Global to alert reporting, a heightened monitoring process whereby we require firms to provide weekly information, including net capital and reserve formula computations.

During the week of October 24th, as MF Global's equity price declined and its credit rating was cut, FINRA increased the level of surveillance over the firm. At the end of that week, FINRA was on

site at the firm with the SEC as it became clear that MF Global was unlikely to continue to be a viable, stand-alone business. Our primary goal was to gain an understanding of the custodial locations for customer securities and to work closely with potential acquirers in the hope of avoiding SIPC liquidation. As has been widely reported, the discrepancy discovered in the segregated funds on the futures side of the firm ended those discussions.

While FINRA believes that the financial security rules of the SEC, combined with SIPC, create a good structure for protecting customer funds, firm failures provide opportunities for review and analysis of where improvements may be warranted. FINRA has two proposed rules that we believe would assist us in our work to monitor the financial status of firms.

One of the proposals would expedite the liquidation of a firm and, most importantly, the transfer of customer assets. Firms would need to contractually require their clearing banks and custodians to provide transaction feeds to the firm, regulators, and SIPC after the commencement of liquidation. The rule would also require carrying or clearing firms to maintain current records in a central location. The other proposed rule would require FINRA-regulated firms to file additional financial or operational schedules or reports as we deem necessary to supplement the FOCUS report.

FINRA shares your commitment to reviewing MF Global's collapse. We will review our own rules and procedures, but would also be pleased to participate in a coordinated review with our fellow regulators to provide a broader assessment of where current processes may be enhanced.

Again, thank you for the opportunity to share our views. I would be happy to answer any questions you may have.

[The prepared statement of Mr. Ketchum can be found on page 153 of the appendix.]

Mr. CANSECO. Thank you, Mr. Ketchum.

Now, we proceed to Mr. James Kobak, chief counsel to Mr. James Giddens, Bankruptcy Trustee for MF Global.

STATEMENT OF JAMES B. KOBAK, JR., CHIEF COUNSEL TO JAMES GIDDENS, BANKRUPTCY TRUSTEE FOR MF GLOBAL, INC.

Mr. KOBAK. Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee, thank you for inviting me to testify today about efforts to identify, preserve, and return assets to the former customers of MF Global Inc.

My name is James B. Kobak, Jr. I am lead counsel to James Giddens, the court-appointed trustee for MF Global Inc. under the Securities Investor Protection Act. I would like to provide an update on the actions we are taking to protect the former customers of MFGI.

The trustee appreciates the interest of this committee and the direct encouragement for Members of Congress to return assets to customers of MF Global Inc. as quickly as possible, consistent with the law. We share that sense of urgency.

The Office of the Trustee has been working closely and continuously with the Securities Investor Protection Corporation, the

CFTC, and the SEC and has been receiving invaluable assistance on transfers from the CME.

By statute, the trustee is the customers' advocate. His staff includes legal experts, consultants, and forensic accountants. We take very seriously our obligation to protect customers of the failed firm. We are focused on returning assets as quickly as possible but in a manner that is fair and consistent with the applicable provisions of the Securities Investor Protection Act, the Bankruptcy Code, and the relevant CFTC regulations. Every distribution we have made has been approved by the bankruptcy court. We are distributing as much as we can as soon as we can within the law.

I am very pleased to report that distributions to nearly all of the approximately 36,000 former retail customers with U.S. futures positions, whether farmers, day traders or institutional investors, have been made within weeks of the bankruptcy filing. We are now in the process of implementing a third bulk distribution that will bring the total amount of customer distributions to more than $4 billion.

The order approving that distribution was entered by the bankruptcy court on Monday. The first distributions in this bulk transfer were made yesterday. I believe they should be appearing in customers' accounts as of today and total $1.7 billion. The remainder should be completed within 2 to 4 weeks.

With this third transfer, retail commodities customers with U.S. positions will have received approximately 72 percent of the value of their accounts. We have also moved ahead with the court-approved transfer of MF Global Inc.'s approximately 330 nonaffiliate securities accounts. This will return between 60 percent and 100 percent of the assets in those accounts.

At the same time, the customer claims process, which will assure that everyone is treated fairly in accordance with the law, is also up and running. Claim forms have been sent by mail and forms are available on our Web site. Claims are being filed and reviewed as we speak. And as we meet here today, some claims have already been determined and allowed.

As part of his statutorily mandated duty, the trustee is also investigating the extent of the apparent shortfall in customer funds. The Department of Justice, the CFTC, and the SEC are also conducting investigations. We are coordinating with those investigations.

Our investigation, however, is not a law enforcement investigation. It is primarily focused on identifying and recovering funds for customers.

To understand the apparent segregation and compliance shortfalls, it is important to remember that there are three categories of segregated customer assets at MF Global Inc: first, there are customers with U.S. futures positions, which are primarily under the jurisdiction of the CME; second, there are U.S. customers with substantial foreign futures positions; and third, there are securities customers.

At this time, we don't know with certainty the amount of the potential segregation and compliance shortfalls, but our best estimate of the figure remains that it is not less than $1.2 billion across all three categories of customer assets that I have just described.

We arrive at this estimate by comparing the actual assets we believe are available or have collected from depositories with an estimate of the claims. The full amount of the shortfall cannot be known with certainty until the claims process is complete.

No matter the final amount of the shortfall, this is, as the chairman has described it, completely unacceptable, and as the trustee characterized it in his testimony Tuesday, an appalling situation. The ultimate shortfall will likely be significant, and this will substantially impact the trustees' ability to make a 100 percent distribution to former customers in the immediate term.

Exhaustive efforts to collect funds from U.S. depositories continue. Assets located in foreign depositories, however, are now under the control of foreign bankruptcy trustees and administrators. We have been and will continue to pursue these assets vigorously, but recovery may be more uncertain and may take more time.

Mr. Chairman, Mr. Ranking Member and members of the committee, thank you for the opportunity to testify here today.

[The prepared statement of Mr. Kobak can be found on page 159 of the appendix.]

Mr. CANSECO. Thank you, Mr. Kobak.

And now, we go to Mr. Thomas Baxter, general counsel, Federal Reserve Bank of New York.

Mr. Baxter.

STATEMENT OF THOMAS C. BAXTER, JR., GENERAL COUNSEL, FEDERAL RESERVE BANK OF NEW YORK

Mr. BAXTER. Good afternoon Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee. Thank you for inviting me to appear here today.

I am Tom Baxter, general counsel of the Federal Reserve Bank of New York, and I will speak about the New York Fed's relationship with its primary dealers and, more specifically, our relationship with a former primary dealer, MF Global Inc.

Let me start with a short summary of the New York Fed's relationship with the regulated institutions that we designate as primary dealers. Our relationship with this group of 21 firms is a counterparty relationship, not a supervisory relationship.

We are not a supervisor. Primary dealers serve as trading counterparties in the transactions that the New York Fed undertakes to implement monetary policy. As such, primary dealers are required to participate consistently as counterparties to the New York Fed in purchases and in sales of Treasury and agency securities.

Primary dealers are also expected to provide the New York Fed's trading desk with market information and analysis that is helpful in the formulation and implementation of monetary policy and to participate in the New York Fed's auctions of U.S. Government securities on behalf of our Treasury.

In evaluating whether a particular firm may be designated as a primary dealer, the New York Fed considers whether the firm has the experience and capability to meet the New York Fed's unique requirements, which are different from the needs of other market participants.

As a result, the New York Fed has repeatedly and publicly stated that the designation of a firm as a primary dealer should not be regarded as a kind of Good Housekeeping Seal of Approval. And we have cautioned market participants that they should not take the primary dealer designation as a substitute for their own counterparty due diligence.

Now, I will turn to the specific issues concerning MF Global. First, concerns have been raised about the New York Fed's application process for primary dealers. More specifically, the question has been asked as to how MF Global became a primary dealer.

The application process for primary dealers is governed by our primary dealer policy, which is published on our public Web site. The rigorous application process is designed to assist us in obtaining dealers who will satisfy our highly specialized needs.

MF Global first expressed interest in becoming a primary dealer in December 2008. It was not until February of 2011, more than 2 years later and hardly in a rush to judgment, that we designated MF Global as a primary dealer. In considering MF Global's application to become a primary dealer, we followed our primary dealer policy to the letter.

As my written testimony explains in detail, the substantial record evidence fully supported the New York Fed's decision to designate MF Global as a primary dealer.

Second, I would like to briefly address questions that have been asked about the prompt and progressive actions that the New York Fed took in late October 2011 as MF Global's financial condition deteriorated abruptly and quickly.

First, we mitigated exposure by excluding MF Global from certain primary dealer operations.

Second, to protect us against potential exposure to MF Global, we asked MF Global to execute an agreement to post margin to the New York Fed, and it did post margin.

Third, the New York Fed informed MF Global that MF Global was suspended from conducting new business as a primary dealer.

Through these actions, we protected the taxpayer interest and we sustained no loss.

On October 31st, following the initiation of a proceeding by the Securities Investor Protection Corporation, the New York Fed terminated MF Global's status as a primary dealer. We also returned excess margin we had received from MF Global to the SIPC trustee in accordance with the trustee's directions.

Let me finish by thanking the subcommittee for holding this hearing. The New York Fed joins this subcommittee and its members in sharing concern for those customers of MF Global who have sustained losses as a result of the firm's collapse. We at the New York Fed stand ready to assist the MF Global trustee and the Congress in their important roles in this matter.

I am pleased to answer any questions you may have.

[The prepared statement of Mr. Baxter can be found on page 91 of the appendix.]

Mr. CANSECO. Thank you, Mr. Baxter.

And thank you, gentlemen, for being here today.

At this time, I will yield itself 5 minutes for questions.

And I would like to begin by hearing from the CFTC and the SEC about regulatory coordination in the wake of Dodd-Frank. One of the big selling points of that bill was that regulators would work together, particularly through the FSOC, and in doing so, we would be able to avoid problems like the one we have at MF Global.

So, Mr. Cook, last March the SEC began looking into the so-called window dressing of quarterly statements by MF Global, and it was known by that point that the company had significant exposure to the European debt crisis. At this point, what kind of communication was going on between the SEC and other agencies?

And there's a second part to my question. Was Secretary Geithner or FSOC notified and involved in the MF Global situation?

Mr. COOK. Mr. Chairman, I am—I think the timeframe you are referring to, there may have been some ongoing review by our Division of Corporation Finance of some of the filings that were being made in the ordinary course. I'm not directly familiar with what questions they were raising; I think there were regular reviews of the filings. I'm not aware of any communications with other regulators at that time.

Mr. CANSECO. Mr. Berkovitz, do you have any—

Mr. BERKOVITZ. I would add that typically there is consultation and coordination between the two agencies on these types of matters. If there is not something that would raise red flags, though, then it wouldn't necessarily be communication.

Mr. CANSECO. Was any communication sent to the Secretary Geithner or the FSOC?

Mr. BERKOVITZ. I couldn't answer that in full, but I'm not aware of any. Throughout this period, I think that you are referring to in the review of the reports, that we had in the information that we obtained from our review of MF Global, as well as looking at the reports from the self-regulatory organization, we had not received any red flags that would be a major issue at that time.

Mr. CANSECO. The Dodd-Frank statute states that one of the objectives of the FSOC is to facilitate information-sharing and coordination among member agencies.

There were obvious problems at MF Global. Was FSOC doing its job here, do you know, Mr. Berkovitz?

Mr. BERKOVITZ. I am from the CFTC.

Mr. CANSECO. Right.

Mr. BERKOVITZ. I would say, again, during that time period, based on the information that we had in terms of the money and the segregation accounts, that with respect to the issues that we look at with respect to MF Global, the protection of customer funds, how they were protecting customer funds, the daily reports that we were getting, the monthly reports that we had and that we had been obtaining from the self-regulatory organization from CME had not raised any red flags regarding the treatment of customer funds.

So, in the normal course of business, absent red flags, it wouldn't necessarily rise to something that the FSOC would have been notified of.

Mr. COOK. If I could add, sir, when I was addressing your earlier comment, I was thinking of the earlier time period I think you had started your question with. When it became clear that there were

serious concerns with MF Global, there was a lot of discussion among various regulators. We were talking with the CFTC, the Fed Reserve Bank of New York, and the Treasury Department during that week about, and leading into the weekend about what was going on.

FSOC has been talking about, and I don't want to speak for FSOC, but—

Mr. CANSECO. You are a board member of FSOC?

Mr. COOK. Our chairman is one of the members.

Mr. CANSECO. Yes, all right.

And you, Mr. Berkovitz, you're a member of FSOC, right?

Mr. BERKOVITZ. The chairman of the CFTC is a member of the FSOC.

Mr. COOK. FSOC had included exposure to European sovereign debt as one of the risk factors in its recent report assessing systemic risk, and obviously, after the bankruptcy filing, there was a call of FSOC on that day to discuss what the implications might be of this, of the bankruptcy.

Mr. CANSECO. Mr. Ketchum, do you have any comments on that. You are also a member of—or your organization is a member of FSOC?

Mr. KETCHUM. No, we're not. To the best of my knowledge, no self-regulatory agency is a member of FSOC.

Mr. CANSECO. All right. So you have no comment on that.

There were obvious problems with MF Global. Do any of you have an opinion of whether or not FSOC was doing its job here?

Mr. COOK. Sir, my view is that—my understanding that FSOC was really created primarily as a way to help monitor systemic risk, identify where there may be systemic risk and to deal with it. While the bankruptcy of MF Global is obviously a significant event and has caused enormous hardship for many individuals, it's not clear to me that it fell within the framework of a systemic risk.

That being said, I think some of the discussions post—on that call after the bankruptcy, there was a—it was recognized that this is an opportunity to learn lessons about what we—how we—the regulatory structure works and whether there's any opportunities for further improvement.

Mr. CANSECO. Let me ask you something, the purpose of the FSOC is also to facilitate information-sharing and coordination among the member agencies and other Federal and State agencies regarding domestic financial service policy development, rulemaking, examinations, reporting requirements, and enforcement actions, and these are the duties of the FSOC.

So both of your organizations were duty bound to exchange information. And was that not happening with regard to what you were hearing from MF Global at the time?

Mr. BERKOVITZ. We had exchanged information. We were in communication with the SEC, and our staff was in communication with FINRA as well. Through this period, up until the last several days that have been described, the daily segregation reports, the monthly reports, the reports that we were getting from our DSRO had not indicated there were issues with the customer segregated funds.

The absence of information coming to us from the reports from MF Global, from the DSRO, from our own review, and in the absence of information, this wouldn't be something that necessarily we would pass on to the FSOC, as Mr. Cook stated.

Mr. CANSECO. Thank you very much, gentlemen.

I now yield 5 minutes to Mr. Capuano, the ranking member.

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Chairman, I'm going to try to stick to the issues at hand. If you want to talk to FSOC, let's get them in here. I think it's a fair question to ask what they are going to do from this point forward, but they were put together for systemic risk. And this may or may not get to that point, but I don't think anybody has suggested yet that it is.

So, in the meantime, Mr. Kobak, I would like to start with you. I understand and totally 100 percent agree that your first and primary responsibility is to the customers. But for the sake of discussion, I also presume that as a bankruptcy trustee, you were collecting information on all creditors, not just customers, is that a fair assumption?

Mr. KOBAK. That's correct. Our primary emphasis at this point is on customers, both on the securities and commodities side.

Mr. CAPUANO. I understand that.

Mr. KOBAK. But we certainly have to do our duty for everyone.

Mr. CAPUANO. But let's assume for the sake of discussion that all customers—and I'm not suggesting that they can—but for the sake of this discussion, let's assume that they can get to 100 percent of them. After the customers are paid, who is the largest creditor, to your knowledge, at the moment?

Mr. KOBAK. I believe the largest creditor is probably JPMorgan. They were creditor of the holding company but also of us.

Mr. CAPUANO. Do you have any idea—and again, I'm not trying to be—

Mr. KOBAK. I know there was a very large revolving loan. I know they were the clearing bank. I'm not exactly sure what amount.

Mr. CAPUANO. Millions, 500 million, a billion?

Mr. KOBAK. Hundreds of millions.

Mr. CAPUANO. Hundreds of millions. Okay, so it's a regulated bank at the other end of this. Because the reason I ask is, as I understand it, when everything is said and done, where the collateral might come from, that's fine, we'll get into that in a minute with the CFTC.

But in the final analysis, somebody had to loan money to get tie 30-40-1 ratio, and it appears on a very cursory review, that money had to come from the outside, and it probably came—I won't say probably—but at least in this case a significant amount of it came from a regulated entity. Is that a fair statement?

Mr. KOBAK. I really don't know, Congressman. We haven't been there. We haven't really done an analysis.

Mr. CAPUANO. I'm not trying to jump ahead. I guess I'm jumping ahead because that's what I have to do today. I think it's—I personally think that's where it's going to end up.

Mr. Kobak, have you looked at the auditors or have you looked at the credit rating agencies, have you looked at any of the other regulated agencies with the presumption being at some point, you

are going to have to go at everybody to try to get money from any place you can that is due to this company from anybody who might not have done their job? Have you started to look at them yet?

Mr. KOBAK. Step one has really been to look at the accounts to see if we can identify what the transactions were. I think as Mr. Corzine was suggesting today, another part of that is probably looking at money that should have been coming in to see whether it all got there. That's what we have been concentrating on today. We certainly will do the other things.

Mr. CAPUANO. Mr. Baxter, do you know if the Fed has started looking at any of their regulated entities that might have been on the other side of these agreements?

Mr. BAXTER. You know, ranking member, that I can't talk about specific regulated institutions.

Mr. CAPUANO. I'm not asking you to.

Mr. BAXTER. But the answer to your question generically is we were looking at certain institutions, banking institutions, before the bankruptcy, and we have continued to look at them after the bankruptcy.

Mr. CAPUANO. Because I will tell you that eventually, I, myself, am going to want to go to ask questions. I'm not expecting you to know the answers today. But to make this mess, there had to be two parties. One party might have been MF Global, maybe or maybe not doing something wrong, but there had to be another party. And if it's another regulated entity out there giving loans in incredibly risky situations, this unfortunately sounds all too familiar, which I know it's too early yet, but I just want to make sure that the Fed is aware that I, for one, am going to want to go down that road when the time is appropriate.

Mr. Berkovitz, for the CFTC, you just last week I think it was, I might be a week off, changed regulation 1.25. But that regulation, that change has been pending since May of 2009. That's 2 years it was officially put out there in October of 2010, but you have been dealing with this for 2 years.

Do you think that maybe you kind of waited a little too long?

Mr. BERKOVITZ. Congressman, the Commission, as you noted, published an advance notice of public rulemaking in May of 2009. We took the comments, the public comments we received on whether we should—

Mr. CAPUANO. How many public comments did you get?

Mr. BERKOVITZ. I think there were maybe—

Mr. CAPUANO. Twelve.

Mr. BERKOVITZ. Fifteen or something like that.

Mr. CAPUANO. So 12, so it was not hundreds of thousands of public comments.

Mr. BERKOVITZ. That's correct. And we issued a notice of proposed rulemaking in October of 2010 at that time. Subsequently—

Mr. CAPUANO. I understand that, but do you think that maybe you should have acted a little quicker? The only reason I ask is because clearly, this is the way that MF Global went through it. Whether they did it right or not, it's clearly the incredible doors that were open by the CFTC through 1.25 to allow them to repo and double repo and hyper repo everything there was involved.

Now from what I see, and again, I'm still catching up here, it looks like you finally closed the door. And the truth is the fact that you closed the door a week after the bankruptcy raises even more red flags that you knew that there was an open door, and you knew you should have closed it earlier. And so I guess the question is, if you had closed it earlier, we wouldn't be sitting here today.

Mr. BERKOVITZ. All right, so I would like to clarify in terms of what regulation 1.25, the types of transactions it would allow and the types of transactions it does not cover. Regulation 1.25 covers—

Mr. CAPUANO. So are you saying that MF Global has violated regulation 1.25?

Mr. BERKOVITZ. No, Congressman, I'm saying that 1.25 covers what investment of customer funds may be, customer funds.

Mr. CAPUANO. I understand. That's why we're trying to get back to customers, 1.25 is the regulation that for all intents and purposes enforces the so-called segregation of customer funds. But obviously, they weren't segregated, otherwise we wouldn't be looking for them. So, and as I understand it, everything I have read so far has indicated that MF Global went through 1.25, possibly legally, maybe not, not sure yet, to get at those funds in a way that was allowed by the CFTC.

Now, whether they did it illegally is fine, but at least some of it, that door was open. And now that it's closed, the fact that you closed it so quickly after the bankruptcy, certainly indicates to me that was the problem. And you have have now closed the barn door after the horse is gone, which is fine. So, for me, I would like to know what changed, why all of a sudden? Did somebody on the board change their vote?

Mr. BERKOVITZ. Congressman, we, as I was describing, this has been a process.

Mr. CAPUANO. I understand the process, Mr. Berkovitz. Why wasn't it passed before the bankruptcy? You didn't have the votes?

Mr. BERKOVITZ. The Commission was considering it through the summer.

Mr. CAPUANO. All of a sudden, they woke up on December 4th and said, "Oh, my God, we have to pass this today?"

Mr. BERKOVITZ. There were a number of outstanding issues in the rule that the Commission was—

Mr. CAPUANO. Do you realize how much this smells? This is like a dead fish sitting on the table to me. Because you—with the way you are implying it is that if this had never happened, somehow miraculously, on December 4th, they would have passed the change anyway, which, of course, is virtually impossible for me to believe since it had been hanging out there for 2 years.

Mr. BERKOVITZ. There is nothing in the change or in 1.25 prior to the change which would have permitted a person to take customer out of segregated funds. The prohibition—

Mr. CAPUANO. I am familiar with what 1.25 does. But I also understand what doors it opened up. It allowed them to be in sovereign debt. It allowed in-house repos, and you have now closed those doors, which I think is fine. As a matter of fact, as I understand it, Mr. Cook, you never opened those doors at the SEC, is that a fair statement, in-house repos and invading customers'—

Mr. COOK. The reserve account on the security side needs to be invested in cash or Treasuries.

Mr. CAPUANO. You didn't have this door open for the SEC side?

Mr. COOK. I'm not—I don't know exactly everything they permitted.

Mr. CAPUANO. Okay. That's—

Mr. BERKOVITZ. If I could clarify, what 1.25 allowed before it was amended—

Mr. CAPUANO. Mr. Berkovitz, I know what 1.25 did, but I also know how it was used, and that's why the door was closed. You clearly saw it as an open door, and I think that's fine, because it was, and I'm glad you closed it.

But I have to tell you, it seems as though you were sitting on your hands for a year-and-a-half when you knew you should have shut the door. You knew there was a problem. Had you acted precipitously, we wouldn't be here today because MF Global wouldn't have been able to do this. That's the way I read it, and I wouldn't mind hearing a follow up at a later time, but have limited time here. I think I am already over my limited time, so I think I'm done even though I'll be back.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Berkovitz, Commissioner Sommers told the Senate Agriculture Committee on Tuesday, "We have a very good idea at this point what happened to the money."

What happened?

Mr. BERKOVITZ. Congressman, I think what Commissioner Summers was referring to was we have a very good idea of the initial transfers out of the segregation account.

We have a lot of information about initially where that money went within the company. What we are continuing to look at, we are continuing to examine, is what was the nature of those transactions, what was the underlying purpose of those transactions, to what extent were they legitimate transactions, to what extent were they not legitimate transactions, and then, from there, what happened to those funds? So there are several other steps that we are looking at very, very closely to try and trace exactly where all that money went.

Chairman NEUGEBAUER. Was there one particular entity that got a lion's share of those transfers in the last day and hour?

Mr. BERKOVITZ. I can't speak to that. That's where we're continuing to try to trace these funds, and that's an ongoing process that I can't really speak to. It's also part of our investigation. But we are, that is one of the questions that we are trying to track down.

Chairman NEUGEBAUER. Thank you.

Mr. Duffy, you heard Mr. Corzine testify today. When asked about a $175 million transfer that may have been classified as a loan to a U.K. subsidiary, and he denied actually knowing about those transactions, do you agree with that testimony?

Mr. DUFFY. I can only tell the committee, which I told in the Senate, what I have been told. This committee asked for an explicit timeline of everything that CME Group knew, and we documented that and submitted it for the record. I think you submitted it earlier.

In there, it had references of our employees who were on calls where the other employees of MF Global said Mr. Corzine was aware of the loans of the $175 million to the European subsidiaries. So that is what I know about it, sir.

Chairman NEUGEBAUER. Okay. And when you, I assume you all have been doing some postmortem of what went on as you're trying to help, be a part of recovering those funds?

Mr. DUFFY. We are not, sir, we are not allowed to do an investigation. The CFTC has asked us not to.

Chairman NEUGEBAUER. Okay. So your hands are off it at this particular point.

Mr. DUFFY. Our focus, as I said in my testimony, was CME Group put up $550 million to help the trustee put moneys back into the small farmers and ranchers, and that's what we have done, sir.

Chairman NEUGEBAUER. Thank you, sir.

I think my friend from Texas—yes, I want to follow up on the testimony, I think the line of questioning about that interagency coordination. And I know that the SEC initiated some actions back in the summer, I believe, to require this entity to put up additional collateral; is that correct, Mr. Cook?

Mr. COOK. Yes, sir, I just amplified that was initiated really by the front-line supervisors of FINRA and the CBOE, who initially identified the issue and then consulted with us and that resulted—

Chairman NEUGEBAUER. When did you first get concerned about this issue with this entity?

Mr. COOK. This particular issue was raised by FINRA and the CBOE, I think in the June, July timeframe. And there were a number of conversations during that timeframe.

Chairman NEUGEBAUER. Mr. Berkovitz, when was kind of the first indication to the CFTC that there was a problem in MF Global?

Mr. BERKOVITZ. It was the weekend, obviously—let me back up, the week of the 24th of October, after the downgrades, the ratings downgrades, the earnings statements, we became concerned about the protection of customer accounts and customer funds, so we sent people on site. I believe, it was the 27th of October.

Chairman NEUGEBAUER. This was about 90 days later, and it was about the last week of the game.

Mr. COOK. Sir, if I might just amplify it, because I think you were talking about the bankruptcy in the week beforehand. The capital charge issue that came up in August was one that was discussed to clarify what are the facts, understand what are the issues and to ultimately reach a final determination where the firm was told they needed to take the charge. At the time, I understand the SEC staff did inform the CFTC staff about the issue that a capital charge was going to be taken. Under the normal rules, when someone has to take a capital charge of this nature in a way that suggested their capital charges earlier were inadequate, they have to file a notice to their regulators, which I believe they did, which would be to us and to the FINRA and to the CFTC. And then they were forced to restate their report, their financial report, which would then be filed with us and the CFTC all in the August, early September timeframe.

Chairman NEUGEBAUER. I want to go back to what you just said, Mr. Berkovitz, though you didn't acknowledge that August date. You said we became aware the problem was in the first week—

Mr. BERKOVITZ. I think I answered a different question than the one you asked, and I apologize for that. Mr. Cook is correct, we were told about the capital issue in early August, when we were informed of the issue and the resolution of that issue at that time. So we were aware of that in the early August timeframe.

Chairman NEUGEBAUER. Okay. I thank the gentleman.

Mr. Perlmutter?

Mr. PERLMUTTER. Thanks, Mr. Chairman.

It will be interesting, as the weeks and months go by and all of these facts really do unfold, because there are several sort of major things that I am concerned about. And I would like to first just sort of understand the process. Mr. Ketchum, you said we need to be able to get our hands on this quicker. But if I am not mistaken, the SIPC steps in and they can freeze everything by filing a bankruptcy. That is how we protect customers of broker-dealers.

Mr. KETCHUM. Congressman, the ultimate protection for customers of broker-dealers when there is a bankruptcy and liquidation is SIPC and the trustee, and should be. In many circumstances where a firm is in financial trouble, the regulators working with the firm are able to identify either transfer accounts or the sale of the firm, which avoids having customer accounts frozen and avoids the variety of impacts that come from SIPC liquidation. So we try to avoid that whenever we can.

Mr. PERLMUTTER. That is sort of the last straw.

Mr. KETCHUM. Absolutely.

Mr. PERLMUTTER. Okay. But in advance of that, you are saying you would like to be able to have some authority to force a sale or to protect—because it sounded to me like you are getting weekly sort of updates, and you guys got nervous a week or two in advance of the trustee stepping in and closing the company.

Mr. KETCHUM. We, of course, as you recall from my testimony and from Mr. Cook's earlier, we became concerned over the positions after the quarterly statement at the end of May, and made the initial request with CBOE for additional capital to meet the capital requirements we thought applied. With the support of the SEC, that finally occurred in August.

We continued to monitor the firm. As time went on, the position didn't change. What changed over time was the gradual public recognition of the size of the position in foreign sovereign debt that the firm had, and with that, the ratings impact and the eventual withdrawal of liquidity support to put the firm into its spin in the last week.

So we were very concerned about that. It was entirely working together with the other self-regulatory organizations and with the SEC. No, I don't think it is a matter of additional authority. It simply is the concern when you have a firm that takes a very substantial position.

Mr. PERLMUTTER. In hindsight, somebody should have put them into bankruptcy a week before this. Maybe we would have saved that $900 million that seems to be floating around. Really, I am just trying to understand this because I am very concerned. This

feels like deja vu all over again to me. Okay? And, Mr. Duffy, you and I have had conversations about CME and about how this would be the first time that money was lost from segregated accounts. I was counting on you guys sort of in this. And I appreciate that the CME has put up $550 million, which is towards the assistance to the customers. How does this happen? You clear twice a day. You see who has money and who doesn't.

Mr. DUFFY. It is very disturbing, sir. You and I have had many conversations. And I think one of the reasons you saw my testimony the way it was, it was a timeline to show that we were getting falsified segregation reports. And as we tied the segregation report out from Wednesday going into Thursday, Friday, the money was there as of Wednesday for the most part, 80 to 90 percent tied out. So something happened on Thursday or Friday. We were doing everything possible to do it. We have 50 auditors; we spend $11 million a year doing this. We audit every firm each and every year. We do spot audits. We do surprise audits. We have done things to make sure our system never fails. Our system has never failed in 75 years. In our opinion, someone has violated the law here. And it is hard to have a cop on every street.

Mr. PERLMUTTER. If somebody—if there is an embezzlement, a fraud, whatever, we have to just deal with it. The FBI is in this. But I was hoping that the system with that was in place, especially through—

Mr. DUFFY. The system didn't fail, sir.

Mr. PERLMUTTER. All right. So as this unfolds, I want to see that.

Mr. DUFFY. I am trying to show that in my testimony.

Mr. PERLMUTTER. Now, I would like to turn my question to Mr. Baxter, because here you have this primary dealer, MF Global. I don't remember if Lehman Brothers was a primary dealer. I think it was. In monitoring these guys who are doing deals with you, you started getting nervous. You cut them off in earlier October. Mr. Ketchum was nervous about things over the course of the summer through August. Maybe the books were getting cooked. We have two regulators over there. And finally, the bankruptcy trustee comes in, boom, locks it down, is able to return $4 billion, which is 72 percent as of today.

I am curious, and this is where Mr. Capuano was going, did the banks come in—and if they did, they were doing their job—and sweep all the cash that then left the customers holding the bag?

Mr. BAXTER. Let me review some of the—

Mr. PERLMUTTER. I said a lot there. I apologize.

Mr. BAXTER. And I hope I don't replicate that.

Let me review some of the activities of the New York Fed during the week of October 24th, which was the week preceding the bankruptcy. It started with a downgrade on Monday, the 24th. The next day, there was a large loss declared by MF Global. And already in the market there were rumors—and not only rumors, they were confirmed—about the large position taken in sovereign debt by MF Global.

What those three things did, Congressman, is they acted together to generate a loss of confidence that started a run on MF Global. And the run that went on MF Global really went on the funding side. And MF Global funded itself in the repo market the same way

that Bear Stearns funded itself in March of 2008. You will recall, Congressman, that the run began on March 11th, and by March 14th, Bear Stearns had no liquidity.

Mr. PERLMUTTER. Right.

Mr. BAXTER. Similarly with Lehman, which you mentioned, the run began on September 9, 2008, and, again, it began on the repo side of the book, and by September 12th, that Friday, the Lehman Brothers broker-dealer was out of liquidity.

So a part of what you see happening here relates to the funding and relates to funding assets that are not liquid. So what you see happening is the run starts abruptly, and it is vicious in its downward spiral on these firms. So consequently, when we saw what was happening early in the week on October 24th, on October 26th, I called my counterparts at the Commission, and one of my colleagues called counterparts at the CFTC, and said, given what we have seen in other recent experience, we think that we ought to be picking up the pace with respect to our crisis management with respect to MF Global. So with respect to the earlier questions about communication among the governmental entities, including the Fed, there was, I think, good communication that we had a crisis on our hands.

Now, turning for just a minute to the other piece of this question, which relates to the secured parties and the unsecured parties, I want to make three points, Congressman, because we were one of those secured parties that protected themselves and protected the American taxpayer.

Mr. PERLMUTTER. You said you had extra margin.

Mr. BAXTER. Yes. And I want to make three points of what we did. And by making these points, I don't want to in any way come across as insensitive to those who lost money by reason of this bankruptcy. But for the purpose of this hearing today, I think there are three important points as to why we avoided a loss.

First, our margin account was on our books, and we controlled it. It wasn't on the books of MF Global. All right? Second point, we received margin in the form of cash, and the proceeds came in, in a wire transfer of funds. And there was absolutely no evidence, in looking at that $4.2 million wire transfer, that it in any way connected to any customer funds. Third point, and perhaps the most important, we had an express representation in writing from MF Global that the property transferred to us as margin was MF Global's own property. If that representation turns out to be false, a Federal criminal offense has been committed.

Mr. PERLMUTTER. And the gentleman sitting next to you will come and collect that money.

So with that, I would yield back.

Chairman NEUGEBAUER. I thank the gentleman.

I recognize the gentleman from Florida, Mr. Posey.

Mr. POSEY. Thank you very much, Mr. Chairman.

First for Mr. Kobak, both you and Mr. Giddens in your previous testimony, I believe, stated that no matter the exact size of the shortfall, speaking of segregated funds, its probable size is significant and will substantially affect the trustee's ability to make a 100 percent distribution to former MF Global, Inc., customers. Is that still your opinion today?

Mr. KOBAK. Yes, it is, unfortunately.

Mr. POSEY. And thank you for just the yes-or-no answers. They are very rare around here, and we really do appreciate it.

I know that you do not want to speculate while your investigation is still under way, but based on Mr. Duffy's testimony and other reports, it seems highly probable that customer funds were transferred out of segregated accounts and commingled with MF's own funds—I don't think anybody is doubting that at this point—probably to meet margin calls on European bond positions. Does that—

Mr. KOBAK. That is certainly something we are looking into.

Mr. POSEY. Okay. Assuming for the moment that is, in fact, what happened, it would mean that the missing customer funds will never be found in some overlooked or unreported account somewhere, as had been hoped for by many customers when they first discovered that a substantial sum of money was missing from their accounts, because if the money was being used to back those bond positions, we know that those bonds were sold in mid-November, correct?

Mr. KOBAK. That is our suspicion as well. It doesn't mean we are not looking at it carefully. We stay up late at night thinking of—

Mr. POSEY. We take "yes" for an answer around here. Thank you.

According to a detailed report in the Wall Street Journal, those bonds were sold at a loss, and at an additional discount or bargain price, so to speak, to buyers that included JPMorgan Chase and George Soros. Have you seen the reports in the Wall Street Journal?

Mr. KOBAK. I have looked quickly at the Wall Street Journal, yes.

Mr. POSEY. All right. Thank you.

I know you are not responsible for dealing with the bankruptcy proceedings for MF Global, but is it true that once the wall has been breached between customer segregated funds and corporate funds, the money could have been moved via a whole range of intracompany transactions, internal repos, etc., to virtually any part of MF Global or to the counterparties who were financing those bond positions?

Mr. KOBAK. If the question is, is it possible, I believe it is possible. Whether it happened or not, we don't know. That is what we are looking at.

Mr. POSEY. "Possible" is fine.

It strikes me that what we have here is a situation where the segregated funds belonging to MF Global, including the honest, hardworking families in my district's money, were misappropriated to support a way too big speculative bet by Mr. Corzine and the board at MF Global. Since the bet was closed at a loss in a transaction that I believe needs to be investigated further, we could be looking at an absurd and totally unjust situation in which money has been taken from customers' pockets only to find its way into the pockets of big bankers and hedge fund managers.

I know that you need time to do your work, and you have no right to interfere with the bankruptcy proceedings. That is the responsibility of the Judiciary Branch, obviously. But if this committee can find a way to help reverse the travesty, obviously that

is what we want to do. And that is in large part why we are here right now. It is just essential, obviously, to protect the sanctity of segregated accounts if we are ever going to restore confidence to the commodity markets and the U.S. markets in the future.

Final question: Mr. Capuano poses a really, really interesting question. Let me just frame this a little bit differently. Is it true that JPMorgan was one of the main depository banks for customers' segregated bank accounts?

Mr. KOBAK. I believe it was a depository, but any funds that they—I am not actually sure it was a customer bank. And we have gotten from virtually all the domestic depositories the funds they were holding. It is really the foreign funds that are our problem.

Mr. POSEY. Okay. And they were also the providers of the main line of credit to MF Global, over a billion dollars?

Mr. KOBAK. There was a substantial line of credit, I think, to the holding company, and I think it was on behalf of a syndicate of banks. But JPMorgan, I believe, was the lead of that syndicate.

Mr. POSEY. Okay. And they would probably be unable to recover all of those loans if customers were made whole.

Mr. KOBAK. I don't know whether that is true or not at this time.

Mr. POSEY. Possible?

Mr. KOBAK. It is possible.

Mr. POSEY. Probable?

Mr. KOBAK. I would say possible.

Mr. POSEY. All right. We will settle on possible.

JPMorgan and Soros purchased the MF bonds in mid-November; is that correct?

Mr. KOBAK. That is what I read in the paper.

Mr. POSEY. That is what the article says. By then, everyone in the world was well aware of a missing $1.2 billion in customer funds, correct?

Mr. KOBAK. I certainly was aware of it. I assume others were.

Mr. POSEY. Okay. Do you think they should be concerned about the possibility of buying stolen goods?

Mr. KOBAK. I really don't know what the circumstances of those sales were.

Mr. POSEY. Mr. Baxter, do you? Yes or no would work.

Mr. BAXTER. There are provisions in law for a bona fide purchaser, and those transactions, which I don't remember as vividly as perhaps I wish I did, Jim, and you may help, but I think the bankruptcy court might have approved some of those transactions. And I assume the bankruptcy court would not have approved transactions if the bankruptcy court felt they were violative of law.

Mr. POSEY. Mr. Ketchum?

Mr. KETCHUM. I know no more with respect to the liquidation, Congressman, than that. I do have some recollection that there was approval of those transactions from reading the story, but I know nothing more directly.

Mr. POSEY. Okay. Mr. Duffy?

Mr. DUFFY. I have no other knowledge other than what I read in the paper also, sir.

Mr. POSEY. Mr. Cook?

Mr. COOK. I have nothing further, sir.

Mr. POSEY. Mr. Berkovitz?

Mr. BERKOVITZ. I can't really comment on where the money, where the transactions really may have gone. We are trying to trace these, and we are trying to get the money back.

Mr. POSEY. Do you think it would be reasonable for customers to expect some clawback? Starting with Mr. Baxter.

Mr. BAXTER. Again, there are protections in law for transferees who are bona fide purchasers and have no knowledge that the property they are acquiring has in any way tainted in title or otherwise. And I don't know the facts, Congressman, as to what the purchasers may or may not have known.

Mr. POSEY. If the purchase had been made after everyone was aware you have $1.2 billion missing, I think even the most extraordinarily naive person would say there is $1.2 billion missing here somewhere, I wonder why I am getting such a bargain on this.

Mr. BAXTER. And perhaps Mr. Kobak is more familiar to answer this than I am, but we have worked in a couple of bankruptcies together, and oftentimes it is important to be able to liquify some assets, particularly if the market is declining and those assets are losing value. So you shouldn't jump to the conclusion, Congressman, that a sale is necessarily bad for the bankruptcy estate. It wasn't for some of the estates that I acted as liquidator for, and I suspect that Jim would agree with me on this.

Mr. POSEY. And again, I am trying to think of customers first, just like the customer advocate is supposed to think of customers first. And I can't help, as far removed as it is—I can't help but be reminded of Madoff, and I can't help but be reminded of how effective the clawback has been for some of those poor people who were exploited by Madoff. And I am just trying to get an idea if there is a possibility here. Maybe there is not. But it was just an interesting concept brought forth.

Could I get a response from any of those others? I think they are all going to plead ignorance on this, but—

Chairman NEUGEBAUER. There will be lightning answers here, please.

Mr. KOBAK. Okay. I don't know if I would call them clawbacks. There are legal theories that you avoid transfers, you can attack transactions. That is what we are going to look into. I am not sure if the transaction you are talking about is specifically our transaction, but it is certainly something we will be looking into. But we have to find a basis, a cause of action. If we find it, I can assure you we will pursue it very diligently.

Mr. POSEY. Okay.

Mr. KETCHUM. I neither have the facts nor the bankruptcy expertise to be able to speculate, Congressman.

Mr. DUFFY. I don't have the expertise, but I will say one thing. I think that if customer segregated funds are the ones that are missing, they do not have SIPC protection or other things of that nature, I believe that they should be first in line in any circumstance whatsoever to get this money back.

Mr. POSEY. Thank you, Mr. Duffy. I do, too.

Mr. COOK. I don't have the specific facts, and I am not a bankruptcy expert. I think your original question was would it be reasonable for a customer to look for clawback? And I think if I were a customer, I would want every possible avenue to be pursued vig-

orously. I don't know whether there is—I don't know the technical details of the law here to be able to know whether there is hope that would occur here.

Mr. BERKOVITZ. We are absolutely committed to getting customer money back to the customers.

Mr. POSEY. Thank you.

Thank you, Mr. Chairman.

I yield back, and I thank you for the extra time.

Chairman NEUGEBAUER. Mr. Miller is recognized.

Mr. MILLER OF NORTH CAROLINA. Thank you. I want to make another try at the questions that I asked earlier of the first panel, without satisfactory results, maybe because of my questioning, maybe because of their answering.

As I understand it, MF Global bought more than $7 billion of European sovereign debt, which was 100 percent financed through the repo market. The sovereign debt itself was the collateral, which is pretty stunning. Mr. Capuano earlier asked how they got to 40-to-1 leverage. Maybe that was how. But at some point, the lenders figured out that was maybe not such a good idea, either because of the debt, or the sovereign debt that was pledged as collateral, or because of MF Global, and they issued a margin call, and then there began a mad scramble to come up with the money. They sold assets. And then I think Mr. Baxter, and before that Mr. Abelow, said that what happened was a classic run like used to happen to a depository institutions, if you know the movie, "It's a Wonderful Life." The other lenders decided that they maybe needed a little more security, too, and it went downhill from there.

But in the mad scramble, the question is what happened to the money or to the assets that were in clients' segregated accounts? The reality is that segregated accounts get used all the time. It is supposed to be segregated, yes, but they can get at those accounts. A Reuters article a week ago set out verbatim a paragraph in MF Global's client contract: "Consent to loaner pledge. You hereby grant us the right, in accordance with applicable law, to borrow, pledge, repledge, transfer, hypothecate, rehypothecate," and on and on. Mr. Corzine said, yes, but there were limits to that under CFTC.

But the question is—I guess for Mr. Berkovitz—was it legal? Was there a legal way for MF Global, under the CFTC rules that existed at the time, to use assets in client accounts as security for any kind of short-term loan for MF Global? And whether it was legal or not, is there a reason to think that might have happened?

Mr. BERKOVITZ. I can't speak to what MF Global did or what they didn't do. That is the matter that we are currently looking into. What I can say is under our regulations, the customer funds remain the property of the customer, and they can't be pledged to—on behalf of the company as security for a loan or something like that.

Mr. MILLER OF NORTH CAROLINA. It could not legally have been done?

Mr. BERKOVITZ. Correct.

Mr. MILLER OF NORTH CAROLINA. And you cannot speak to whether there is reason to think—any evidence that did, in fact, happen.

Mr. BERKOVITZ. I can't speak to anything that they may or may not have done factually.

Mr. MILLER OF NORTH CAROLINA. Okay. And then, several Members have asked questions about whether there was a way to structure the transaction so they could, in fact, borrow funds in clients' accounts, whether through internal repo or whatever. Was there, in fact, a legal way with the CFTC rule that was in effect at the time for them to borrow from their own clients?

Mr. BERKOVITZ. Under the regulation 1.25 in effect at the time, they could have done an internal repurchase agreement. But the customer segregated funds would have to remain intact and whole at all times. The value of the customer funds would have to be preserved. They could not reduce the value of those funds or take customer funds.

Mr. MILLER OF NORTH CAROLINA. They could borrow from them and offer something as collateral?

Mr. BERKOVITZ. I wouldn't say "borrow from."

Mr. MILLER OF NORTH CAROLINA. It is a repo transaction.

Mr. BERKOVITZ. It is a repo transaction where they are putting something of equal value back into the customer account.

Mr. MILLER OF NORTH CAROLINA. Okay. And was the thing of equal value, was there a way that they could have created an instrument on their loan that would have been permissible collateral for repo transactions?

Mr. BERKOVITZ. They would only have been able to do that with permissible investments under the regulation. They could only use a repo transaction with permissible investments.

Mr. MILLER OF NORTH CAROLINA. And can you speak to whether there is reason to think something like that happened?

Mr. BERKOVITZ. I can't speak factually to that.

Mr. MILLER OF NORTH CAROLINA. Okay. Again, a couple of people have used the term "run on the banks." That used to happen to depository institutions all the time, and then we had safety and soundness regulations, and then we had deposit insurance. It hasn't happened in 70 years really. Before the financial crisis, we had a repo market, a shadow banking system that was equal in size to all bank deposits. Stunning amounts of money were sloshing around every night. Bear Stearns was borrowing $40 billion a night in the repo market. There was a run on Bear Stearns, there was a run on Lehman, there was a run on the entire financial system in that week after that Lehman collapse. Now, it has happened again.

Is there reason to think that maybe this completely unregulated shadow banking system that actually no one in Congress knows much of anything about, but seems to create a remarkable instability for our entire financial system, that maybe we ought to pay attention to that; there ought to be some limitation on how many times a given asset can be made collateral, and then collateral again, and then collateral again, or there should be some required haircut so there is a limitation on how much can be borrowed? Is there some reason to think there should be some limitation, or should this just go on the way it has over the last 3 or 4 years?

Mr. Duffy, do you want to answer a question?

Mr. DUFFY. I won't answer on behalf of CME. I will answer it on behalf of myself.

I absolutely think you are correct. I think there needs to be some reining in of this type of activity. One of the things that Mr. Corzine kept saying was he was bringing leverage ratios down from 37 to 30. He failed to say that he also took the debt from $1 billion to $6.3 billion, too. So there are a couple of other things in there. I do believe, and this is me speaking personally, that these leverage ratios need to be adjusted.

Mr. MILLER OF NORTH CAROLINA. Okay. Actually, I think all of you were equally qualified to speak to this, but, Mr. Berkovitz, how about you?

Mr. BERKOVITZ. I can't really speak to the issue on shadow banking, although I would note that under Dodd-Frank, there are a number of additional measures to reduce systemic risk, to increase transparency in the marketplace for a variety of swap transactions. But I can't really speak to questions of shadow banking.

Mr. MILLER OF NORTH CAROLINA. Mr. Baxter? New York Fed is deeply involved in all this stuff.

Mr. BAXTER. Thank you, Congressman.

One additional point I would note in terms of references to banks, banks also fund short term with respect to deposits, and they fund longer-term assets like loans. But banks, of course, have access to the liquidity facilities of the Federal Reserve.

Mr. MILLER OF NORTH CAROLINA. Right.

Mr. BAXTER. The shadow banking system, which consists of nonbanks primarily, broker-dealers, they do not have access to the discount window at the Federal Reserve. And as you may recall, one of the changes effected in Dodd-Frank is some of the provisions that we used—and I am speaking here about Section 13, subdivision 3 of the Federal Reserve Act to lend to broker-dealers—that provision was changed to make it much more difficult for the Fed ever to loan to a single company that was facing insolvency, or a single company for the purpose of taking assets off the balance sheet like we did with respect to Bear Stearns.

So that is one point I would make to you right off the bat, is there is a difference, because the banking system has access to the liquidity facilities of the central bank, whereas the shadow banking system generally does not. Now, that is a generalization. There are some exceptions.

Second point: Just by way of historical reference, you mentioned Lehman. You may also remember that the week after Lehman, there were several prominent investment banks, and I won't name names because I shouldn't, that became—

Mr. MILLER OF NORTH CAROLINA. There weren't that many.

Mr. BAXTER. —that became bank holding companies.

Mr. MILLER OF NORTH CAROLINA. Right.

Mr. BAXTER. And again, the reason for that relates to this structural feature of having access to the liquidity facilities at the central bank.

Mr. MILLER OF NORTH CAROLINA. Mr. Chairman, I know, but one more question along my earlier lines about the way that a transaction could have been structured to borrow money from client segregated accounts. Could MF Global have issued any kind of instru-

ment on their own, a bond, commercial paper, whatever, that would have been an asset that they could have used in an internal repo and borrowed the client's funds?

Mr. BERKOVITZ. I won't speak to MF Global, but I will just speak—hypothetically speaking, you could put a corporate—a highly rated corporate bond could be a subject of a repo.

Mr. MILLER OF NORTH CAROLINA. Your own corporate bond?

Mr. BERKOVITZ. You couldn't put your own bond in. You could not put your own bond in.

Mr. MILLER OF NORTH CAROLINA. Okay. All right.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Ohio, Mr. Renacci, is recognized.

Mr. RENACCI. Thank you, Mr. Chairman.

Mr. Baxter, MF Global's application to become a primary dealer with the Federal Reserve Bank of New York was approved despite the firm's history of compliance failures, internal control problems, and incomplete disclosures to regulators. Apparently, compliance problems and poor recordkeeping continued at MF Global until the firm's collapse. If the New York Fed had a surveillance provision for primary dealers in place, do you think weaknesses in MF Global's books would have been caught?

Mr. BAXTER. The first point, Congressman, is we were not acting as MF Global's supervisor; we were acting as MF Global's counterparty. And as MF Global's counterparty, we were concerned about our financial risk, and we were concerned about our reputational risk. That is why it took the application of MF Global more than 2 years to be approved.

And with respect to reputational risk specifically, one of the concerns arose from the enforcement action that the CFTC did in December of 2009 against MF Global. And under our policy, the institution facing a material enforcement action goes into a kind of penalty box period for a period of a year. We put that MF Global application through that full 1-year penalty box. We checked to make sure it had remediated the enforcement problems that resulted in the 2009 action, and there were no new problems during that 1-year penalty box period. And as a result of that, in February of 2011, so more than a year from the date of the enforcement action, we decided to approve the designation of MF Global as our counterparty.

Mr. RENACCI. What was that date again? I am sorry?

Mr. BAXTER. It was February 2011.

Mr. RENACCI. Okay. And was there any review past that? Was there any surveillance past that?

Mr. BAXTER. Past that, we continued to receive weekly FR 2004 reports from MF Global. We continued to receive the monthly FOCUS reports from MF Global. We continued to meet regularly with MF Global staff. And most importantly, we were transacting business on behalf of the government with MF Global and looking at their trading activity done through us.

Mr. RENACCI. And in those reports you were receiving, subsequent to that, were you seeing any weakness in MF Global?

Mr. BAXTER. What happened after the date we approved it, so February of 2011, is these repo-to-maturity trades in European sovereign debt were put on. To the credit of FINRA, FINRA discovered

those in the summer of 2011. They were reported to us by MF Global in late July of 2011. And we were looking at the situation at MF Global throughout that period.

Now, we have two particular capital requirements for primary dealers. One is a minimum capital requirement of $150 million. That was always satisfied. The other is that our primary dealers need to satisfy the SEC net capital rules. And after the experience through the summer of 2011, MF Global brought itself into compliance with the SEC net capital rules. So there was no problem under our policy, which we apply evenhandedly across all 21 dealers.

Mr. RENACCI. I noticed you used the word "counterparts." And I guess I would question why it is necessary for the Federal Reserve Board of New York to designate a select firm of group of firms as primary dealers if the New York Fed maintains that its primary dealers are only counterparts?

Mr. BAXTER. We impose specific burdens on the 21 institutions that we designate as primary dealers: one, they have to participate in our trades in the open market to implement monetary policy; two, they have to provide us with market intelligence related to our monetary policy function; three, they have to participate in every auction we conduct on behalf of the Treasury for U.S. Treasury securities; and four, they have to be ready to make markets for us for the $3 trillion in assets we have under management for foreign central banks and monetary authorities, dollar reserves. So there are burdens that every one of the primary dealers has to agree to.

And so, not every primary dealer can experience those burdens, and there are situations, Congressman, where primary dealers withdraw and can no longer satisfy our very specific requirements. But they are our requirements. They are our requirements because of the types of counterparty activities we engage in. And they assure that the primary dealers that are designated meet the needs of the Fed and the United States.

Mr. RENACCI. Last but not least, do you monitor any of the communications released by the primary dealers which reference their status as primary dealers? Given the market perceptions about primary dealers, wouldn't it be wise for the Federal Reserve Bank of New York to compel all primary dealers referencing their primary dealer status in oral or written communication to explicitly disclose that a primary dealer designation does not constitute an endorsement by the Federal Reserve?

Mr. BAXTER. I hear that suggestion, Congressman. And, on our Web site, we publish prominently that the primary dealer designation should not be regarded as a substitute for counterparty due diligence. But I hear your suggestion that maybe we should do more and monitor what all of the 21 are saying. Now, that is a significant burden on us, but maybe it is a burden we need to undertake. So I will take that under advisement, sir.

Mr. RENACCI. All right. Thank you. I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

So we are going to do a lightning round. I don't know who our timekeeper is here, but we are going to do a 2-minute round. So I ask the Members to pick the question they want to ask, and I would ask our panel to be brief in their answers.

With that, I recognize the ranking member, Mr. Capuano, for 2 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

I don't need a response to this, Mr. Berkovitz, but this is a CRS report dated November 28, 2011, on MF Global. And in a footnote on page 2, which is ridiculous it is this small, they are talking about segregated accounts can't be commingled. But they also cite Section 4(d)(f)(3)(a) that has an exception permitting commingling "for convenience."

I don't expect you to answer that today, but I would like to hear from you at some point in the future as to exactly how big of a loophole that might be. Not today. Another time. But it certainly raises questions. And I ask it really only because I have such high regard for the CRS, if they put something in there, it raises my concern.

I guess for the entire panel, I don't expect that you will be familiar with an article, but I haven't read a news article as often, as frequently I have read this one. I have read it 3 times now—actually 4 times, very slowly, because it is very difficult. It is above where I am capable of understanding. But it is a Reuters article entitled, "MF Global and the Great Wall Street Rehypothecation Scandal." It was published on December 7th by a Christopher Elias out of the U.K. And I am not going to suggest anything here is accurate, but I would like you all to go back and take a look at this later on, and I would love to have some of your comments on this to see what you think he says.

The reason I mention it is it goes through a long explanation, which I have to admit I have a hard time following—this is above my pay grade, but I am trying—is that—on some really serious questions. I will read you one paragraph near the end. After he talks about rehypothecation, which, I have to be honest, I am still struggling exactly what that is, but it is basically loans on loans, "With collateral being rehypothecated to a factor of four, according to IMF's estimates, the actual capital backing banks' rehypothecation transactions may be as little as 25 percent. This churning of collateral means that the rehypothecated transactions have created enormous amounts of liquidity, much of which has no real asset backing."

Now, I have to be honest, that sentence reads like something I read not too long ago about mortgages, and it concerns me deeply. And he goes on in the next page listing big companies that, in his estimation, have taken advantage of weak collateral rules, incredible leverage by pledging and repledging collateral. And he lists JPMorgan as having sold or repledged $410 billion of collateral received under customer margin loans, derivative transactions, securities borrowed, and reverse purchase agreements; Morgan Stanley at $410 billion; and interestingly enough, Interactive Brokers at $8 billion. They are the ones you were trying to sell MF Global to.

And again, I am not trying to bushwhack you, but I would really love you each to take a good look at this and let me know what you think about this article and why you think I shouldn't be concerned. And I would specifically ask that those of you who are on the FSOC bring this article back to the FSOC and ask them, because again, the FSOC, in my estimation, was created very clearly,

unequivocally, to make sure that there was no systemic risk. This article raises concerns it may be there, and nobody is watching. So I look forward to your responses.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Ketchum, I wanted to go back to something. In late September of 2010, I think you all did a call-around asking firms if they had sovereign debt exposure in Europe. And can you tell me what the response from MF Global was in that September 30th call-around?

Mr. KETCHUM. Mr. Chairman, I don't recall whether it was in the September 30th call-around or sometime shortly thereafter, but the response was they had no positions in European sovereign debt.

Chairman NEUGEBAUER. And it subsequently turned out they did have exposure.

Mr. KETCHUM. To be most generous to them, it could be that they interpreted the fact that it was a repo-to-maturity and not required to be reported as an asset for accounting purposes that they didn't view it as a position. But that certainly wouldn't have been what we expected. They had credit and market risk, and they should have responded and explained it to us.

Chairman NEUGEBAUER. Did you ever have any—once you discovered later on, and I think you discovered in March or—

Mr. KETCHUM. We discovered it at the end of May.

Chairman NEUGEBAUER. End of May. Did you bring that to their attention that you were concerned that they had not previously disclosed that?

Mr. KETCHUM. I believe my staff did raise it with them. I don't know the details. I would be glad to get back to you on it. But we are concerned with it. They should have been far more forthright than they were.

Chairman NEUGEBAUER. And so is there—one of the things we want to do is when we get through with all of this, we want to do something productive with it. We want to make sure that we make the system better, but at the same time, we don't make the system more onerous. So we want to be careful here. But I think it appears to me down the road that disclosure of these kinds of transactions, that would need to be a little bit clearer, and some guidelines of reporting those, because obviously what Mr. Corzine thought was a risk-free transaction turned out to be an extremely risky transaction.

Mr. KETCHUM. I absolutely agree with you, Mr. Chairman. I think it should be looked at both, frankly, from a GAAP accounting standpoint, and indeed that is one of the reasons why we have a rule before the SEC that would give us the authority to require much more extended disclosure than exists in our present FOCUS—or the SEC's present FOCUS forms.

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from Colorado.

Mr. PERLMUTTER. I appreciate everybody's testimony today. This is going to be something we are all going to be looking at for a while, to know exactly when you force a sale or merger, demand more capital, close the institution, because you want to allow companies to operate if they can. But here, we have other people's

money, and that is why we have this ability for the SIPC to just come in and shut the doors and preserve what exists.

So I just have a question for the SEC and for those of you who look at this, because when we went through this type of thing before, there was a lot of short selling going on, there was a lot of rumor mongering going on, there was a lot of driving a company that is sort of wounded into the ground. And so I would—as part of all your investigation, I would really like to know that was going on, and who benefited by it, if it is possible to check something like that out, because we have seen it in the past, and it really hurts the system. And I would just ask you to do that.

And I have a million questions, so I am not going to ask any more, and I am just going to wish you all happy holidays.

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from Florida, Mr. Posey, is recognized for 2 minutes.

Mr. POSEY. Thank you very much, Mr. Chairman.

Mr. Duffy, I believe in a Senate hearing you were asked to basically butt out of any investigation. Could you elaborate on that a little bit?

Mr. DUFFY. Only to what I know, sir.

We were told that the CFTC had asked us not to get involved in an investigation; that they were going to proceed with the investigation, so we were no longer a part of the investigation. So you would have to ask them why. I don't know.

Mr. POSEY. Do any of you have any interest in pursuing an investigation of your own? Other than just being observers about what you read in the newspaper or what somebody tells you, did anyone else beside Mr. Duffy attempt to pursue your own investigation? Just anybody raise your hand if you did.

Good. I would like to hear about it. I would like to hear from all of you.

Mr. Chairman, if I can have time.

Mr. Kobak?

Mr. KOBAK. Part of our statutory duties, as I said in my remarks, is to do a thorough and independent investigation. We are doing that. We are trying to coordinate it with the other investigations that are going on.

Mr. POSEY. But you weren't asked to butt out?

Mr. KOBAK. No.

Mr. POSEY. Okay. Mr. Ketchum?

Mr. KETCHUM. We weren't asked to butt out. We provided support to the trustee, and we understood that the SEC and the CFTC were both investigating this. It was not a matter of butting out, but of allowing the agency to do their work.

Mr. COOK. Yes, sir. We are looking at many things related to this.

Mr. POSEY. You haven't been asked to butt out?

Mr. COOK. No, sir.

Mr. POSEY. Mr. Berkovitz?

Mr. BERKOVITZ. We are investigating what happened to the funds.

Mr. POSEY. Everybody is investigating, and Mr. Duffy is the only guy who was asked to butt out. Does anybody have any idea why

that could be? Nobody has any idea why Mr. Duffy's organization is the only one that was asked not to do so?

Mr. DUFFY. Just so it is clear, sir, all the information I have testified on is information we have gathered in our own internal interviews prior to us being asked not to investigate further. So that is what I have testified.

Mr. POSEY. Did they tell you why? I find that incredulous.

Mr. DUFFY. I guess you would have to ask the CFTC why. I don't know.

Mr. POSEY. Why?

Mr. BERKOVITZ. I am not familiar with what has been referred to, but even if I were, I couldn't talk about it.

Mr. POSEY. With the Chair's permission, and I am sure everyone left on this panel would be intensely interested in knowing that at the earliest possible moment you are able to tell us, why you would ask Mr. Duffy not to participate in an internal investigation. And I hope you will write that down and not forget it. At the earliest possible time that you feel ethically, morally, or legally able to tell us why you would tell him not to conduct an internal investigation, not to discover any facts on his own that he possibly could, we greatly would look forward to having your explanation on that.

Chairman NEUGEBAUER. I thank the gentleman for his questioning.

The gentleman from Texas, Mr. Canseco.

Mr. CANSECO. Thank you, Mr. Chairman.

I just have a very brief question, because most of the questions have already been asked.

So, Mr. Duffy, MF Global had a very spotty compliance record and paid about $87 million in fines to regulators in 2007. Was there anything in MF Global's past that would give CME concern about the segregation of customer funds at the company?

Mr. DUFFY. No. Again, we do random audits. We audit each and every one of our firms every year, as we are required to do. We do spot audits. We get daily segregation reports. We do third-party tie-outs. They have had some disciplinary actions, I think they were fairly de minimis, throughout the years. But when they took over after Refco failed, we never took them off daily reporting. Most firms don't have to report daily. It comes a day or so later. And we have continued to keep a close watch on all of our firms, including MF Global.

Mr. CANSECO. Thank you very much. I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

And I apologize to the gentleman, Mr. Miller, for skipping over him. So you are recognized.

Mr. MILLER OF NORTH CAROLINA. That is fine, Mr. Chairman. I will just accept double the time.

The only proposal that I can recall in Dodd-Frank that got at the repo market, which was a huge part of the financial crisis, was a proposal from the FDIC and Sheila Bair to limit how much could be paid, or to give the FDIC discretion in receivership to pay less than 100 percent of secured transactions, which was obviously aimed at the repo market. But all the debate in Congress was about mortgages on office buildings, which made me think that Congress does not really understand the shadow banking system

and the repo market. And someone really needs to, because this is very important.

And it is also very much the case that the industry does not want us to understand it, because if we did understand it, we might start to pay attention and figure out how much of a risk it really posed to us.

I have a couple of questions about proposals that have been made to limit repo transactions. One is, and I mentioned it earlier, to limit the number of times a given collateral—Mr. Capuano used the term "rehypothecation," and then he admitted he wasn't exactly sure what that meant, but it is the same collateral being used as—the same instrument, the same asset being used for collateral for multiple transactions. Should that be used ad infinitum like double mirrors, where you just see forever, or should there be some limit on the number of times a given asset can be hypothecated?

Mr. Duffy?

Mr. DUFFY. As I said earlier, sir, I do believe that there needs to be a limit on how much any particular security can be leveraged out. So, if it is 20 times over, and we are all looking to get the same security back at the same time, and there are 20 of us looking for one thing, 19 of us are going to have a problem. So I do believe that there needs to be some kind of limit to that type of behavior.

Mr. MILLER OF NORTH CAROLINA. Anyone else? Okay.

Mr. COOK. Sir, I would just add I think there are a lot of complicated issues there. Repos are a very valuable financing tool in the markets. And I think, frankly, repos-to-maturity may have their purpose. I am not here to defend them, but they do cut down certain risks. They potentially create others.

I think you are raising an important question. I know the ranking member has asked us to look at this article. I have looked at it, and I look forward to discussing it further. But I think it is hard to say—there is a difference between leverage and allowing rehypothecation.

Mr. MILLER OF NORTH CAROLINA. Then let us go to leverage. It is pretty stunning that MF Global was able to have 100 percent financing of their purchase of sovereign debt, more than $7 billion in sovereign debt, through the repo market. Should there be essentially a margin requirement? Should there be some requirement of a haircut to limit the vulnerability to the repo system?

And I understand the immediate need right now for liquidity, and imposing anything immediately would have a problem in the world economy given where things are. But if we ever pull out of where we are, should there be a limit on—should there be a required haircut or essentially a margin requirement? Mr. Cook?

Mr. COOK. I believe that was, in fact, the effect of requiring them to take a capital charge—through the discussions with FINRA and the SEC, take the capital charge for these positions. I think the question, the broader question of leverage is a very important one. I think there are a number of policy issues we need to think through there. There are different types of leverage. And so, you can have two firms that have the same degree of leverage, but very different risks. And I think the question of how we approach that

is an important one to think about further. I don't want to use up your time answering that question.

Mr. MILLER OF NORTH CAROLINA. Anyone else? I am now past my time.

Mr. KETCHUM. I would just underline what Mr. Cook said. I think you raise a very important issue from the standpoint of viewing leverage, particularly with respect to assumptions in most of the financial oversight, from banking to securities firms, with regard to matched book leverage that is built in. But the exposure to that leverage varies dramatically by asset quality and dramatically by the nature and the maturities of that matched book.

So I think you raise an important issue that all of us should go back and review, but I think Mr. Cook is right, there is also a great deal of an exceptionally critical part of financing that is built into the repo market.

Mr. MILLER OF NORTH CAROLINA. One last question, at the chairman's indulgence. Sheila Bair's argument for her haircut on the repo market is that there needs to be some market discipline. There was none; that lenders in the repo market were making their decisions based entirely upon the collateral. When Bear Stearns was obviously listing in the water, Lehman was listing in the water, everyone knew they were in deep trouble, and the result of the favored position of repo transactions was that when the FDIC finally arrived, there was just this smoking crater in the ground instead of an institution that actually may have had some franchise value and had some assets.

Do you think there is any discipline in the repo market? And what can be done to create some discipline in the repo market?

Mr. COOK. I will take a stab, sir. It is, again, a complicated question.

I think in some respects, Lehman and Bear are examples where counterparties looked beyond the collateral, because those entities, as I understand it, were not able to finance themselves even using Treasuries. So there is a discipline in that sense. But that is also part of the challenge is if you become highly dependent on financing yourself, including using very high-quality collateral, and there is some reputational issue that is out there, then you have a significant liquidity problem.

I think one way to come at your question—I am sure there are many—is to think about the appropriate capital treatment of these transactions, whether they are being properly addressed through capital charges.

Chairman NEUGEBAUER. I thank the gentleman. Good questions.

The Chair notes that some Members may have additional questions for the 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.

We thank this panel. I would remind members of the committee that we believe that additional hearings on this issue are warranted, and we are going to look at credit rating agencies, and some of the accounting practices that have been discussed today, risk management, internal controls. Some of those issues we think are important. And I think the ultimate product that we want to

deliver when we get all of the information back that we requested, and get reports back from the various people who are looking at that, is for this committee to publish a finding and let that finding then be a part of the record. And we can then ascertain if there are additional things we can do, in working with the industry, to make sure that we make whatever fine-tuning adjustments that need to be made to make sure that we do not have to have another hearing like this in the future.

We thank the panel. You have been very patient. I know it has been a long day. And so, go ahead and take the rest of the day off.

With that, this committee is adjourned.

[Whereupon, at 6:25 p.m., the hearing was adjourned.]

A P P E N D I X

December 15, 2011

Statement of Bradley Abelow

United States House of Representatives Committee on Financial Services, Subcommittee on Oversight and Investigations

December 15, 2011

The bankruptcy of MF Global was a tragedy for our customers, our employees and our shareholders. For many of our customers, including many of your constituents who have still been unable to retrieve funds that are rightfully theirs, it has imposed extreme financial hardship. More than 2,500 employees have either already lost or will soon lose their jobs through no fault of their own. Shareholders have seen the value of their investments reduced to almost nothing overnight.

As the President and Chief Operating Officer of MF Global Holdings, I am deeply sorry for the hardship they have all endured. While I know nothing I say can ease their pain, I hope that through my testimony today, I can help this committee understand what happened at MF Global and how we are attempting to unwind the company in a manner that provides maximum value for all parties.

I joined MF Global in September 2010 as COO. I was given the additional title of President in March 2011 and served in that capacity through the bankruptcy filing this October. After the filing, the firm's board asked me to remain in my position to work with the various trustees and administrators to close the firm's operations, which I have attempted to do over the last six weeks.

From my perspective, based on what I was able to observe at the time, there were a number of factors that led to MF Global's demise. First, it appeared that by

mid-October of this year the market had become increasingly concerned with the firm's exposure to European sovereign debt. Second, beginning in late October, the ratings agencies rapidly and repeatedly downgraded the firm's credit rating. Third, the company reported disappointing earnings on October 25. The combination of those three events – increased concern about exposure to European sovereign debt, a series of ratings downgrades, and disappointing earnings – created an extremely negative perception in the market resulting in a large number of the firm's trading and financing counterparts pulling away from MF, which dramatically reduced the firm's liquidity. That reduction in liquidity – a classic run on the bank – led MF Global to attempt to sell all or part of the firm in order to provide liquidity and protect the interests of our employees, shareholders, creditors and customers. When those efforts failed, MF Global filed for bankruptcy on October 31.

I know this committee is interested in finding out what amount of segregated client funds went missing in the final days, how it happened, where those funds are, and what might eventually be returned to the firm's clients. I am deeply troubled by the fact that customer funds are missing, and I can assure you that I share your interest, and the public's interest, in finding out exactly what happened. At this time, however, I do not know the answers to those questions. They are being investigated by the trustees, who have taken over management of MF Global and have control over its records and accounts, and a host of regulatory and investigative agencies. While I do not know what they have found, I do know that all of the parties are working hard to find answers, and I hope they are able to get to the bottom of the issue as soon as possible.

Since the company filed for bankruptcy, I have focused every day on minimizing the effect on customers and employees. There is no way to turn back time and undo all of the damage caused by the collapse of MF Global, but in the last six weeks, I have worked day and night to reduce costs and maximize the remaining value in the business.

Because MF Global was a global firm, with operations on exchanges in more than 70 countries, there are separate entities with separate systems and books around the world, and I have worked to foster cooperation and communication among those entities. There are a number of different parties now responsible for unwinding the firm's operations and it has been an enormous effort to coordinate with them to generate the maximum possible recovery of assets.

And while it is only a small measure given the number of people who have lost their jobs, I am doing whatever I can to help former employees find new employment.

I believe it is important to examine the issues that led to MF Global's demise, and the firm has attempted to be as open and transparent as possible. I hope I can provide some assistance to the committee in its investigation today.

As I said, there is no way to undo the damage that has been done by MF Global's bankruptcy. But it is my hope that efforts such as this one to gather facts and provide a clear picture of what occurred will assist policymakers, regulators and participants in the financial services industry in avoiding such tragic events in the future. I look forward to answering your questions.

Testimony

of

Thomas C. Baxter, Jr.

General Counsel

Federal Reserve Bank of New York

before the

Subcommittee on Oversight and Investigations

Committee on Financial Services

U.S. House of Representatives

December 15, 2011

I. Introduction

Chairman Neugebauer, Ranking Member Capuano, and members of the Subcommittee, on behalf of the Federal Reserve Bank of New York (the "New York Fed"), I appreciate the opportunity to discuss the New York Fed's relationship generally with institutions with whom the New York Fed undertakes most monetary policy operations, known as primary dealers, and more specifically, our relationship with a former primary dealer, MF Global, Inc. Primary dealers serve as key counterparties to the New York Fed in its implementation of monetary policy and provide an important backbone for the government securities market. The "primary dealer" designation is conferred on those regulated institutions that we consider suitable business counterparties.

I recognize that questions are being asked about why the New York Fed designated MF Global as a primary dealer. As I will discuss, that decision came more than two years after MF Global initially approached the New York Fed about becoming a primary dealer. We made our decision after the firm went through a rigorous and careful application process, during which MF Global met all of our requirements. On October 31, 2011, we ended our counterparty relationship with MF Global and terminated its primary dealer status. We share the Subcommittee's concern for the customers of MF Global who have experienced losses as a result of the firm's bankruptcy, and have offered our assistance to the trustee upon whom the injured customers are relying. Through prompt and progressive action, the New York Fed protected its counterparty position and the interests of the American taxpayer, and we have sustained no loss.

II. The New York Fed's Relationship with Primary Dealers

Being a "primary dealer" means that a specific broker dealer or bank has been determined to be eligible to transact certain types of business with the New York Fed. It does not mean that

the New York Fed has undertaken supervisory functions over the designated primary dealer. Primary dealers serve as trading counterparties in the New York Fed's implementation of monetary policy. A primary dealer is required to participate consistently as a counterparty to the New York Fed in our execution of open market operations. These operations are done to implement the domestic policy directives of the Federal Open Market Committee ("FOMC"). Typically, the directives are satisfied by purchasing or selling U.S. government or agency securities, either outright or through repurchase agreements ("repo" or "reverse repo"). More recently, the FOMC directed the New York Fed to purchase agency mortgage backed securities ("ABMS") to satisfy the FOMC's dual mandate.

Primary dealers also provide the New York Fed's trading desk with market information and analysis that is helpful in the formulation and implementation of monetary policy. Dealers are also required to participate when the New York Fed, as fiscal agent of the Treasury, auctions U.S. government securities, and the dealer is obliged to participate in all auctions. Finally, the New York Fed holds more than $3 trillion in reserves for foreign central banks and monetary authorities. A primary dealer is required to make reasonable markets for the New York Fed when it invests these official reserves.

In evaluating whether a particular firm may be designated as a primary dealer, the New York Fed will consider whether the firm has the experience and capability to meet the New York Fed's business requirements. A firm must meet particular capital requirements, demonstrate that it has sizable and sustained performance in business areas relevant to a primary dealer (namely, U.S. Treasury auction participation and cash and repo market activity in U.S. Treasuries), and a compliance program specifically related to its trading activities with respect to the cash and repo markets in U.S. Treasuries and any other markets in which the New York Fed transacts. The

functionality considered important to meet the unique business needs of the New York Fed may be different from the generic needs of other market participants. Consequently, the New York Fed has repeatedly and publicly stated that the designation of a firm as a primary dealer should not be regarded as a kind of "Good Housekeeping" seal of approval, and we have cautioned market participants that they should not take the primary dealer designation as a substitute for their own counterparty due diligence.

In January 2010, the Federal Reserve announced a revised Policy for the Administration of Relationships with Primary Dealers (the "Primary Dealer Policy" or the "Policy"). The revised Policy, like the policy it superseded, sets out the business standards and technical requirements for primary dealers. While the nature of the New York Fed's relationship with its primary dealers had not changed, the previous policy, which dated back to 1992, needed to be refreshed. This need arose from dramatic changes that had taken place in the financial services industry during the last two decades. The revised Policy reflects greater emphasis on compliance and corporate governance. A primary dealer is now required to have compliance professionals dedicated to the business lines relevant to the primary dealer functions and activities at the firm. Furthermore, under the revised policy, the New York Fed will not designate as a primary dealer any firm that is, or recently has been (within the last year), subject to litigation or regulatory action or investigation that the New York Fed determines is material or otherwise relevant to the primary dealer relationship. The New York Fed instituted this "waiting period" so that it could evaluate whether the issue raised by the action or investigation had been sufficiently remediated by the firm.

The revised Policy, not surprisingly given the passage of time, raises the capital requirements for primary dealers. Now, a broker-dealer applicant must have at least $150

million in regulatory net capital as computed in accordance with the SEC's net capital rule, while a bank applicant must meet the minimum Tier I and Tier II capital standards under the applicable Basel Accord and have at least $150 million of Tier I capital as defined in the applicable Basel Accord. The New York Fed considered raising the capital requirement even higher but decided not to do so because of the exclusive effect the higher capital requirement would have on smaller firms.

In addition to establishing business standards for primary dealers, the revised Policy governs the application process for a prospective dealer (an "applicant"). In Part I of the application process, an applicant must submit a letter outlining its ability to meet the business standards set forth in the Primary Dealer Policy and its satisfaction of the new capital requirements. Each applicant is required to list its volume of activity in the last year (the "seasoning requirement") in the business areas relevant to the primary dealer relationship, including auction participation, cash market activity in U.S. government and agency securities, and repo and reverse repo activity in the same markets. The applicant must also describe how becoming a primary dealer fits with its current business and long-term business plan and provide an organizational chart showing a detailed ownership chain from the applicant to the ultimate parent company that lists the jurisdiction of formation for each entity in the chain.

If the New York Fed makes the discretionary determination that the applicant warrants further consideration, the revised Policy provides that the New York Fed will issue an information request ("Part II") seeking additional information concerning corporate governance, financial condition, regulation, the existing compliance regime, internal controls, and customer base. After submission of the Part II information, an applicant can expect at least six months of formal consideration by the New York Fed.

III. The New York Fed's Relationship with MF Global

A. The Application Process

In December 2008, Donald Galante, Head of Finance, Trading, and Fixed Income Sales at MF Global, contacted a Senior Vice President in the New York Fed's Markets Group to inquire about the possibility of MF Global's broker dealer becoming a primary dealer. In early January 2009, representatives of MF Global, including Mr. Galante and the then-Chief Executive Officer of the firm, Bernard Dan, met with officials of the New York Fed's Markets Group. At the meeting, MF Global expressed its strong interest in becoming a primary dealer and provided the New York Fed with background information about the firm. On January 9, 2009, MF Global sent a formal letter requesting that the New York Fed consider MF Global as a prospective primary dealer. In the months immediately following its letter requesting consideration, MF Global started providing the New York Fed's trading desks with market color. The firm also began to participate directly in Treasury auctions, and to provide the New York Fed with mock-FR2004 reports.[1] Through these activities, the New York Fed had an opportunity to evaluate, on certain measures, how MF Global might perform as a primary dealer. At the same time that it was interacting with the New York Fed's Markets Group, MF Global also provided its financials for review by our Credit Risk Management area, and with information on its regulatory framework for review by our lawyers and compliance personnel.

In March 2009, after reviewing some of the materials MF Global provided, the New York Fed learned that the parent company of MF Global's U.S. broker dealer was domiciled in

[1] Primary dealers are required to provide the New York Fed with information on a form called the "FR2004." The FR2004 reports weekly data on primary dealers' outright positions, transactions, and financing and fails in Treasury and other marketable debt securities.

Bermuda. New York Fed lawyers advised MF Global that, under the Primary Dealers Act,[2] which Congress passed in 1988, the Board of Governors would be required to conduct a so-called "country study" of Bermuda before MF Global could be considered for designation as a primary dealer. In a country study, the Federal Reserve must consider whether the country of incorporation would permit equal access by U.S. firms to its markets. If not, the application must be denied. The requirement is designed to foster competitive equality across countries. MF Global responded that it would change the corporate domicile of the parent company from Bermuda to Delaware. This change was effected in January 2010.

In April 2009, lawyers and compliance personnel at the New York Fed reached out to the CFTC, one of MF Global's Federal supervisors.[3] In a conference call, the CFTC informed the New York Fed that while it took comfort from certain management changes made by MF Global, there remained several significant control issues. As a result, the CFTC ordered MF Global to overhaul its internal control structure with the assistance of an outside consultant. The CFTC explained that, after the consultant completed its work, the CFTC would review and assess the results of MF Global's efforts in this area. New York Fed staff decided to wait for the CFTC's assessment before taking a view on the firm's suitability as a primary dealer. MF Global was advised in May 2009 that it would not be considered for designation as a primary dealer for at least six months because of its pending compliance issues.

During the months following the decision to proceed more deliberately with MF Global's application, representatives of MF Global periodically contacted New York Fed officials to

[2] 22 U.S.C. § 5341-42.

[3] In addition to the Federal supervisors, MF Global was supervised by certain designated self regulatory organizations ("DSRO"). On the futures side, the Chicago Mercantile Exchange serves as the DSRO. On the securities side, FINRA serves as the DSRO.

discuss relevant matters, including a pending CFTC investigation into certain trading irregularities at the firm and the legal issue concerning MF Global's corporate domicile in Bermuda. Also during this time period, the New York Fed was finalizing its revised Primary Dealer Policy. The New York Fed was considering including a provision in that Policy that would impose, subject to the New York Fed's discretion, a "waiting period" of one year for a primary dealer applicant that was facing relevant and material litigation, regulatory action, or investigation. When MF Global learned that such a provision was under consideration, it sought a meeting with William Dudley (who had become President of the New York Fed in January 2009) to discuss the impact the provision might have on its prospects for becoming a primary dealer. The New York Fed declined MF Global's meeting request.

In the fall of 2009, MF Global asked the New York Fed to re-open the application process that had been suspended earlier in the year during the pendency of the consultant's report. The New York Fed refused to take this step and informed MF Global that, putting aside the issues unique to MF Global, no primary dealer designations would be made until the revised Primary Dealer Policy was finalized. On December 17, 2009, before the revision, the CFTC announced a settlement with MF Global and issued a Consent Order Instituting Proceedings and Imposing Remedial Sanctions ("Order") for violations of the Commodities Exchange Act.

The CFTC had found four principal failings in MF's control environment. Over the course of several years, the firm had failed to: (i) supervise a trader's activities; (ii) transmit accurate prices in natural gas options positions; (iii) prepare proper and accurate trading cards; and (iv) maintain written records in at least one client file. The CFTC imposed a number of sanctions including a civil money penalty of $10 million. MF Global also agreed to engage

Promontory Financial Group to conduct two independent reviews of the firm's compliance infrastructure.

On January 11, 2010, the New York Fed revised its Primary Dealer Policy. The Policy included the following provision:

> The New York Fed will not designate as a primary dealer any firm that is, or recently has been (within the last year) subject to litigation or regulatory action or investigation that the New York Fed determines material or otherwise relevant to the potential primary dealer relationship. In making such determination, the New York Fed will consider, among other things, whether and how any such matters have been resolved or addressed and the applicant's history of such matters and will consult with the appropriate regulators for their views.

On the day the revised Policy was announced, the media reported that MF Global's CEO, Mr. Dan, had publicly expressed his hope that MF Global would become a primary dealer early in 2010.

On January 13, 2010, MF Global submitted Part I of its formal application to become a primary dealer. On January 22, 2010, MF Global submitted the more extensive information required by Part II of the primary dealer application. In response, on January 26, 2010, the New York Fed informed MF Global that under the New York Fed's revised Primary Dealer Policy, MF Global could not be designated a primary dealer until at least December 17, 2010 – one year after the CFTC Order was issued. MF Global responded the next day with a letter from Mr. Dan arguing that the CFTC action was not material or relevant to MF Global's primary dealer application, and asking the New York Fed to exercise its discretion to approve MF Global's application prior to the expiration of the one year period.

Within days of our receipt of Mr. Dan's letter, I received a telephone call from MF Global's outside counsel, Sullivan & Cromwell, who requested a meeting to allow MF Global to

present its case as to why the one year waiting period was unfair. On behalf of the New York Fed, I agreed to allow MF Global an opportunity to be heard on the issue.

In late February 2010, MF Global and its outside counsel met with the New York Fed and had the opportunity to advocate why the CFTC enforcement action should not cause the New York Fed to delay designating MF Global as a primary dealer. In response to MF Global's representations about the impact the delay could have on the firm, my colleagues and I explained that MF Global's application would be evaluated in accordance with the New York Fed's revised Policy, and that we were at the beginning of a review period that they should expect would take at least six months. We also advised MF Global that they should not have an expectation that the outcome of our review would automatically result in MF Global's being designated a primary dealer. Having made the decision to publicize its application for primary dealer status, MF Global needed to accept the possible negative consequences that might result from either a delay or a denial. Following the meeting with MF Global, lawyers in the New York Fed's Legal Group conducted a materiality analysis of the CFTC Order and concluded that the Order was material and that any approval of MF Global's application to become a primary dealer should be deferred until at least December 2010.

On March 23, 2010, I was informed by MF Global's General Counsel that Mr. Dan would be resigning as CEO and that Jon Corzine would be taking his place. In mid-April, MF Global's Head of Fixed Income Trading contacted an official in the New York Fed's Markets Group to request a courtesy meeting with the New York Fed to introduce Mr. Corzine as MF Global's new CEO. I, together with several of my colleagues, attended this meeting, which took place on June 1, 2010.

During the meeting, Mr. Corzine provided an update on MF Global's business plans, emphasizing the enhancement of its credit structure, by, for example, raising additional capital in the form of $150 million in equity. The New York Fed staff updated the MF Global representatives on the status of MF Global's primary dealer application, and noted that we were in the midst of our formal review period. We emphasized that due diligence was continuing across the business, legal, compliance, and credit dimensions of the review process, and again reminded MF Global that the minimum time period for application review was six months after formal review had commenced. We again noted the requirement in the Policy that the New York Fed would not designate an applicant as a primary dealer if the applicant had been a respondent in an enforcement action within the last year that the New York Fed deemed material and relevant to the primary dealer relationship.

In the months following the June 1 meeting, New York Fed staff continued the process of gathering and evaluating data and information relevant to MF Global's application. MF Global had submitted a large volume of materials including, but not limited to, audited financial reports (with notes) from the previous three years as well as its most recent quarterly financial statements, copies of its tax returns, and policies and procedures relating to its compliance and ethics programs. With the consent of MF Global, the CFTC provided the New York Fed with its three most recent examination reports. In addition to the materials provided by MF Global as part of its application, the New York Fed staff in the credit, legal, and compliance areas made several requests to MF Global for additional information necessary to their evaluation of MF Global's application.

In early November 2010, the New York Fed staff visited the offices of MF Global and conducted an on-site review. Our requests at this point were heavily focused on credit issues

arising out of the financial and liquidity position of the broker dealer relative to the corporate entity at large. The New York Fed's principal concern was with the broker dealer because that legal entity would be our counterparty. MF Global responded to all of the additional information requests by mid-November.

A final assessment meeting on MF Global's application took place in December 2010. On January 21, 2011, Richard Dzina, a Senior Vice President in the New York Fed's Markets Group, circulated a memorandum concluding that MF Global had demonstrated a clear ability to meet each of the requirements for primary dealers set forth in the New York Fed's Primary Dealer Policy. Specifically, the memorandum stated that MF Global had demonstrated activity levels in the various markets in which the New York Fed's domestic trading desk transacts that suggested that MF Global had the capacity to provide sizeable, sustained performance in operations in Treasury repo and cash markets. The memorandum also noted that MF Global appeared capable of making markets for the New York Fed when the New York Fed transacts on behalf of its foreign official account holders. Based on auction awards during the application process, MF Global ranked in the third quintile of the then existing dealer population and ranked in the middle of the existing dealer population based upon Treasury cash and repo volume. The memorandum recommended that MF Global's application to become a primary dealer be approved. The New York Fed's legal, compliance and credit areas had no objections to the recommendation. I acted on behalf of the New York Fed's legal function. Brian Sack, Executive Vice President of the New York Fed's Markets Group, accepted Mr. Dzina's recommendation. On February 2, 2011, the New York Fed announced that MF Global had been designated a primary dealer, along with another applicant.

B. The Termination of MF Global as a Primary Dealer

We exercised counterparty due diligence over MF Global from February 2011 until October of 2011, when its financial condition deteriorated abruptly and quickly. As noted, we were not the supervisor of MF Global; that role remained with the CFTC and the SEC. From October 24, 2011 until October 31, 2011, the New York Fed took a series of prompt and progressive actions with respect to MF Global that were designed to protect our position as counterparty and to safeguard the interests of the taxpayer.

On October 24, 2011, Moody's downgraded its credit rating for MF Global Holdings Ltd (the primary dealer's parent) from Baa2 to Baa3. On October 25, MF Global Holdings disclosed its largest quarterly earnings loss ever. Mr. Dzina reported the downgrade to the New York Fed's Chief Risk Officer. Later, on October 25, the New York Fed's President requested an analysis of what a bankruptcy of MF Global might mean for U.S. markets. We actively communicated with MF Global to assess whether MF Global had the ability to perform on its commitments with the New York Fed. On October 26, 2011, I telephoned the Regional Administrator of the SEC in New York, and a member of the Commission's staff in Washington, DC, to ensure that the SEC was aware of the gravity of the situation. Members of my legal staff contacted the CFTC for the same reason. We learned that the SEC and the CFTC planned to go into MF Global on October 27, 2011, and we understand that they did.

A review of the New York Fed's counterparty exposure led us to take a series of actions. First, the New York Fed mitigated exposure by excluding MF Global from certain primary dealer operations. Second, as a result of our review of exposure to MF Global, we focused on a series of seven AMBS trades with MF Global, which were still outstanding as forward settling transactions. These trades subjected the New York Fed to exposure to MF Global if the firm became insolvent prior to the settlement date and the market price had moved in the New York

Fed's favor. In such circumstances, the New York Fed would have to replace these trades by buying the securities at a higher rate. To protect against this exposure, the New York Fed asked MF Global to execute an Annex to the Master Securities Forward Transaction Agreement (the "MSFTA"), an agreement that MF Global and the New York Fed executed when MF Global became a primary dealer. The Annex would require MF Global to post margin to the New York Fed. The margin, which was calculated daily and subject to daily call, would protect the New York Fed from credit risk exposure arising from the unsettled trades. Following the execution of the Annex, MF Global posted the initial margin in the afternoon of October 28. Later in the day, the New York Fed made another margin call pursuant to the Annex that would be due on Monday, October 31, at 10 a.m. Third, by the close of markets on Friday, October 28, the future of MF Global was in doubt. Consequently, at approximately 6:00pm on that day, the New York Fed informed MF Global that MF Global was suspended from conducting new business with the New York Fed as a primary dealer (but trades that had not yet settled were still open).

Over the course of the prior week and the weekend, the New York Fed participated in calls with various agencies that regulated or otherwise oversaw MF Global, including the SEC, the CFTC, and the U.K. Financial Services Authority, to monitor the events with respect to MF Global's attempts to stabilize its liquidity situation and sell the firm or its assets.

As we all now know, late on October 30, 2011, the prospects for a sale of MF Global dissipated. Before the markets opened on Monday, October 31, the New York Fed publicly announced that it had suspended MF Global from conducting new business as a primary dealer (the decision that it had informed the firm about on Friday evening). Later that morning, MF Global failed to meet the New York Fed's margin call by the prescribed time of 10:00am. As a result, the New York Fed declared an event of default under the MSFTA, and issued a notice of

termination of outstanding unsettled AMBS trades. The New York Fed subsequently entered the market, executed replacement trades for the terminated trades with MF Global, and served MF Global with a notice of calculation of loss (based on the cost of those replacement trades and other costs). The New York Fed then exercised its contractual right under the MSFTA to set off the calculated loss against the margin provided to the New York Fed by MF Global.[4] Through these actions, the New York Fed protected its position as counterparty and safeguarded the interest of the taxpayer. To be clear, the New York Fed sustained no loss from its relationship with MF Global.

During the afternoon of October 31, the Securities Investors Protection Corporation ("SIPC") applied to the United States District Court for the Southern District of New York for the appointment of a trustee to oversee the orderly wind-down of MF Global. Immediately following that filing, the New York Fed terminated MF Global's status as a primary dealer. The New York Fed ultimately returned the excess margin to the SIPC trustee, in accordance with the trustee's instructions.

IV. Conclusion

To conclude, the New York Fed designated MF Global as a primary dealer to meet our highly specialized needs, and we followed our Primary Dealer policy to the letter without fear or favor. In our role as counterparty, we took prompt and progressive actions to protect the New York Fed and the taxpayer from loss, and we succeeded in this endeavor. The New York Fed is deeply concerned about MF Global's customers who have sustained losses as a result of MF Global's collapse. We have pledged our assistance and cooperation to the trustee, whenever we

[4] The set off amount was calculated as the amount of unrealized appreciation on the securities from the trade date through the time of the replacement of the trades plus legal fees related to the termination and replacement transactions.

can be helpful, and we hope that our testimony is useful to the Committee in its oversight activities.

Testimony Before the U.S. House of Representatives Subcommittee on Oversight and Investigations of the Committee on Financial Services

General Counsel Dan M. Berkovitz, Commodity Futures Trading Commission

December 15, 2011

Good afternoon Chairman Neugebauer, Ranking Member Capuano, and members of the Subcommittee. I am Dan Berkovitz, the General Counsel at the Commodity Futures Trading Commission. Thank you for the opportunity to testify today regarding MF Global. The Commission is acutely aware of the impact MF Global's bankruptcy has had on customers, who have found themselves without access to their funds through no fault of their own. Our highest priority at this time is returning money that belongs to the customers back to them as quickly as possible. The Commission is working diligently to determine what happened to and locate the missing customer funds. The Commission has dozens of dedicated staff in Chicago, New York, and Washington working on these issues.

My testimony today will provide an update on the efforts to return customer money through the bankruptcy proceeding and an overview of the Commission's regulation of futures commission merchants (FCMs), including MF Global, with particular focus on the regulations for the protection of customer funds. I am unable to discuss matters today that might compromise any ongoing investigations.

Efforts to Return MF Global Customer Money

On October 31, the Securities Investor Protection Corporation (SIPC), with the support of the CFTC and consent of MF Global, initiated a liquidation proceeding under the Securities Investors Protection Act of 1970 (SIPA) to protect the customers of MF Global. In FCM bankruptcies, commodity customers have, pursuant to Section 766(h) of the Bankruptcy Code,

priority in customer property. This includes, without limitation, segregated property, property that was illegally removed from segregation and is still within the debtor's estate, and property that was illegally removed from segregation and is no longer within the debtor's estate, but is clawed-back into the debtor's estate by the Trustee. If the customer property as I just described is insufficient to satisfy in full all the claims of customers, Part 190 of the Commission's regulations allows other property of the debtor's estate to be classified as customer property to make up any shortfall. A parent or affiliated entity, however, generally would not be a "debtor" unless customer funds could be traced to that entity.

Within the first weeks of the MF Global bankruptcy, the Trustee for MF Global, with the encouragement and assistance of the CFTC, transferred nearly all positions of customers trading on U.S. commodity futures markets, and transferred approximately $2 billion of customer property. On December 9, the Bankruptcy Court granted a motion to transfer an additional $2.2 billion back to customers. When this additional transfer goes forward, commodity customers should have received approximately seventy-two percent of their account values as reflected in the books and records of MF Global.

Oversight of FCMs

An FCM is an entity that (1) solicits or accepts orders for the purchase or sale of commodity future contracts; and (2) accepts money, securities, or property to margin, guarantee, or secure any resulting trades.

Because FCMs hold customer money, they are subject to minimum financial and reporting requirements pursuant to the Commodity Exchange Act (CEA or Act) and Commission Regulations. Front line oversight of these requirements is carried out by designated self-regulatory organizations (DSROs), such as the National Futures Association or the Chicago

Mercantile Exchange (CME). The CME is the DSRO for all FCMs that are members of its derivatives clearing organization. Section 5(d)(11) of the Act, or Core Principle 11 for Designated Contract Markets, provides that a DCM shall establish and enforce rules to ensure the financial integrity of FCMs and the protection of customer funds. The Commission's Application Guidance for Core Principle 11 requires that every FCM be examined by its DSRO once every 9 to 15 months.

Each examination must include a review of the FCM's compliance with capital and customer funds segregation requirements. The examination includes a review of the depository acknowledgement letters and the account titles of segregated accounts, verification of account balances, and a review to assess whether investment of customer funds is done in accordance with Commission Regulations (1.25).

Commission Regulation 1.10 requires that each FCM submit to the Commission and to each self-regulatory organization (SRO) of which the FCM is a member, an annual financial report, certified by an independent public accountant. The report must include a Commission designed statement of computation of the minimum capital requirement and a statement of segregation of customer assets. Auditors must test internal controls to identify, and report to the Commission, any "material inadequacy" that could reasonably be expected to: inhibit a registrant from completing transactions or promptly discharging responsibilities to customers or other creditors; result in material financial loss; result in material misstatement of financial statements or schedules; or result in violation of the Commission's segregation, secured amount, recordkeeping or financial reporting requirements. The annual reports are reviewed by staff of the Commission's Division of Swaps and Intermediary Oversight (DSIO) as well as the SROs.

In addition to the audited annual report requirement, each FCM is also required by Regulation 1.10 to file monthly unaudited financial reports with the Commission and with each SRO of which the FCM is a member. The CFTC's financial report is Form 1-FR-FCM. An FCM that is also a registered broker or dealer may instead file the Focus Report required of broker dealers by the SEC. Both the CFTC and the SEC financial forms include a statement of financial condition and a statement of segregated funds. The monthly form must be signed by either the Chief Executive Officer or the Chief Financial Officer.

The DSRO of a particular FCM is responsible for the primary review of the FCM monthly financial statements. The Reports are received by the Commission electronically and are subject to automated edit checks. A review of the edit checks is performed by staff of DSIO. FCMs are required to be in compliance with the minimum capital requirements at all times, but are normally only required to prepare and maintain a formal computation once a month.

DSIO staff conducts limited scope examinations of FCMs either as part of the assessment of the DSRO's examination function or on a "for cause" basis. DSIO has approximately 45 staff who work on the examinations for all intermediaries, including FCMs. Their FCM reviews generally focus on specific issues at the firm, and may include capital and segregation reviews.

The assessments of the DSRO's examination function consist of reviews to determine whether DSROs are conducting their examinations in accordance with the Commission's Application Guidance for Core Principle 11.

Customer Protection Rules for FCMs

When a customer opens a trading account at an FCM, the FCM must provide a risk disclosure statement regarding market risk, volatility, and leverage. The risk disclosure must

contain the following statement: "You should consult your broker concerning the nature of the protections available to safeguard funds or property deposited in your account."

Under the Commodity Exchange Act, an FCM must treat all money securities and property received from a customer as margin for the trades or contracts of that customer as belonging to that customer. Furthermore, all customer money, securities, and property must be separately accounted for and segregated from the FCM's proprietary funds. The FCM cannot use funds deposited by one customer to margin or secure trades for another customer.

Commission Regulation 1.20 requires that accounts holding segregated funds be titled specifically to identify the contents of the account as separate from the ownership of the FCM. In addition, FCMs must obtain letters from their depositories acknowledging that the funds deposited in those accounts are customer funds and must be treated as such under the CEA—i.e., such depositories are prohibited from treating them as belonging to the FCM or any person other than the customer.

Commission Regulation 1.12 requires FCMs to notify the Commission immediately of any occurrence of under-segregation. FCMs also must notify the Commission of significant margin calls (such as a margin call to a customer which could put fellow customers at risk if the margin call was not made and an adequate buffer or "excess segregation" was not in segregated accounts).

Each customer posts margin to support futures positions. Often, a customer will maintain an account balance in excess of initial margin required. The additional funds provide a buffer so a customer can place trades without posting additional margin, and lessen the likelihood of repeated margin calls or liquidation of positions if margin calls are not timely met. In addition to customers depositing additional margin, in practice, FCMs typically maintain significant

amounts of their capital as "excess segregated funds." By doing this, one customer's deficit due to market moves or unmet margin calls is covered by the FCM's buffer and does not result in one customer's funds being exposed to the credit risk of another customer. FCMs are not obligated to provide excess segregated funds, but generally do so to assure their compliance with the legal obligation at all times to have sufficient funds in segregated accounts to cover all liabilities to customers.

A customer may withdraw excess margin funds or use such funds as the customer deems appropriate. This includes using the funds for non-futures related transactions with the FCM. If the excess funds held by the FCM are used in a manner directed by the customer such that the funds are not maintained in a futures segregated account, the funds would not have the protections afforded segregated customer funds under the Bankruptcy Code and Part 190 of the Commission's Regulations.

Investment of Customer Funds

An FCM is authorized to invest funds that are in customer segregated accounts by Section 4d of the Commodity Exchange Act and Commission Regulation 1.25. These provisions list the types of investments that FCMs can make with customer funds. Section 4d states that customer segregated funds may be invested in obligations of the United States, obligations fully guaranteed as to principal and interest by the United States, and municipal securities. Pursuant to Section 4(c) of the CEA, in December 2000 the Commission expanded the list of permitted investments by amending Regulation 1.25 to permit investments in government sponsored enterprise debt securities, bank certificates of deposit, commercial paper, corporate notes, general obligations of a sovereign nation (only where the FCM holds customer funds in that sovereign nation's currency), and money market mutual funds. In February 2004, the

Commission adopted amendments to Commission Regulation 1.25 regarding repurchase agreements using customer-deposited securities and time-to-maturity requirements for securities deposited in connection with certain collateral management programs of DCOs. In May2005, the Commission adopted additional amendments regarding standards for investing in instruments with embedded derivatives, requirements for adjustable rate securities, concentration limits on reverse repurchase agreements, transactions by FCMs that are also registered as securities brokers or dealers, rating standards and registration requirements of money market mutual funds, an auditability standard for investment records, and other technical changes.

On December 5, 2011, the Commission adopted a new final Regulation 1.25. The new Regulation 1.25 continues to permit investment in obligations of the United States, obligations fully guaranteed as to principal and interest by the United States, municipal securities, United States agency obligations, certificates of deposit, commercial paper and corporate notes or bonds fully guaranteed by the United States under the Temporary Liquidity Guarantee Program administered by the Federal Deposit Insurance Corporation, and money market mutual funds. The new Regulation 1.25 does not allow customer segregated funds to be used in the following types of investments or transactions that were previously permitted: foreign sovereign debt, internal and inter-affiliate repurchase transactions, and commercial paper and corporate notes and bonds not guaranteed by the United States under the Temporary Liquidity Guarantee Program. The new rule also imposes asset-based and issuer-based concentration limits on various investments.

The Commission has been, and continues to be, mindful that customer segregated funds must be invested in a manner that minimizes their exposure to credit, liquidity, and market risks. This preserves the availability of the funds to customers and DCOs and enables the investments

to be quickly converted to cash at a predictable value. Regulation 1.25 provides that customer funds are to be invested "consistent with the objectives of preserving principal and maintaining liquidity."

While an FCM is permitted to invest customer funds, it is important to note that if an FCM does so, the value of the customer segregated account must remain intact at all times. In other words, when an FCM invests customer funds, that actual investment, or collateral equal in value to the investment, must remain in the customer segregated account at all times. If customer funds are transferred out of the segregated account to be invested by the FCM, the FCM must make a simultaneous transfer of assets into the segregated account. An FCM cannot take money out of the segregated account, invest it, and then return the money to the segregated account at some later time.

Conclusion

The Commission continues to focus on returning MF Global customer funds, in addition to determining how and why the funds went missing. Thank you for the opportunity to address the Subcommittee. I'd be happy to answer any questions you may have.

Testimony on the "Collapse of MF Global"

Robert Cook
Director, Division of Trading and Markets
U.S. Securities and Exchange Commission

Before the
Subcommittee on Oversight and Investigations
Committee on Financial Services
United States House of Representatives

Thursday, December 15, 2011

Chairman Neugebauer, Ranking Member Capuano, members of the Subcommittee:

My name is Robert Cook, and I am the Director of the Division of Trading and Markets at the Securities and Exchange Commission ("SEC"). Thank you for the opportunity to testify on behalf of the SEC concerning the collapse of MF Global.

The bankruptcy of MF Global has resulted in serious hardship for many of its customers, who have experienced significant delays and uncertainty with respect to their ability to access their own assets. More broadly, the firm's collapse and the apparent shortfall in the segregated accounts of futures customers highlight the need for financial firms and regulators to remain vigilant in ensuring that customer assets are appropriately protected and made readily available to customers whenever they may be needed.

To that end, the SEC and its staff are working with the trustee, our fellow financial regulators, and other authorities to facilitate the prompt identification and return of MF Global customer assets, and to investigate and pursue any potential violations of law that may have contributed to customer losses. While the examination and review of the causes and implications of the collapse of MF Global are ongoing, I would like to provide the Subcommittee with an overview of the regulation of MF Global's SEC-registered broker-dealer subsidiary prior to the

bankruptcy, the key events leading up to the bankruptcy, the status of approximately 330 securities accounts in the liquidation proceedings, the securities customer protection regime, and recent efforts to further improve that regime.

Regulation of MF Global Prior to its Bankruptcy

MF Global Holdings Ltd. (together with its subsidiaries, "MF Global") was a publicly traded holding company that conducted financial activities through a number of subsidiaries located in various countries. MF Global Inc. ("MFGI"), an indirect subsidiary of the holding company, was dually registered with the Commodity Futures Trading Commission ("CFTC") as a futures commission merchant ("FCM") and with the SEC as a broker-dealer. As of October 31, MFGI had approximately 36,000 futures customers[1] and approximately 330 custodial accounts for non-affiliated securities customers.[2] MFGI also was authorized by the Federal Reserve Bank of New York to act as a primary dealer in the U.S. Treasury markets. Another affiliate, MF Global UK Limited, was regulated by the U.K. Financial Services Authority ("FSA"). There was no consolidated supervisor of MF Global.

The "front-line" supervisory function for the securities activities of broker-dealers is performed by the self-regulatory organizations ("SROs") of which a broker-dealer is a member, i.e., the Financial Industry Regulatory Authority ("FINRA") and the various securities exchanges. Where a broker-dealer is a member of multiple SROs, one SRO is the "designated examining authority" ("DEA") responsible for examining the securities component of the firm's

[1] Expedited Motion to Approve Further Transactions and Distributions for MF Global Inc. United States Commodity Futures Customers (Nov.29, 2011).

[2] The approximately 330 securities accounts are those custodial accounts that had positive net equity on October 31 and exclude accounts of affiliates and firm insiders. Motion of James W. Giddens, Trustee for the Liquidation of MF Global Inc., for an Order Authorizing the Sale, Transfer, and Assignment of Certain Customer Securities Accounts (Nov. 30, 2011) ("Trustee Securities Account Transfer Motion").

financial and operational programs, including its compliance with the SEC's capital and customer protection requirements. In the case of MFGI, the DEA was the Chicago Board Options Exchange ("CBOE"), although FINRA was also closely involved in the oversight of MFGI's broker-dealer activities. The futures activities of financial firms, including related segregation requirements, are overseen by the CFTC and the futures SROs, in this case the National Futures Association and the Chicago Mercantile Exchange.

The SEC oversees the regulatory functions of securities SROs and regularly communicates and coordinates with them on examinations and other matters. In its SRO role, CBOE conducted examinations of MFGI for compliance with financial responsibility rules. FINRA conducted examinations for compliance with other issues, such as sales practice requirements. In addition, the SEC's national examination program conducts its own risk-based examinations of SEC-registered broker-dealers. Unlike some other regulators of financial firms, the SEC does not have an "on site" presence at any broker-dealer and generally does not have examination staff dedicated solely to particular broker-dealers.

Key Events Leading Up to the Bankruptcy

Although the investigation of the causes of MFGI's collapse is ongoing, we can highlight our current understanding of several key events leading up to its failure.[3]

Capital Treatment of Repo-to-Maturity Transactions

[3] The events described in this testimony are based on the SEC staff's current recollection and information, including information from third parties that is currently unconfirmed. The SEC staff's knowledge of the facts surrounding the bankruptcy of MF Global continues to develop, and accordingly the description of events herein is subject to change.

During 2010, MFGI reportedly started acquiring significant proprietary positions in European sovereign debt, which were financed using an instrument called a "repo-to-maturity" ("RTM").[4] By August 2011, MFGI had accumulated several billion dollars of European sovereign debt positions using RTM transactions.[5]

In the summer of 2011, based on analysis of MFGI's financial statements, FINRA and CBOE staffs raised questions with MFGI about whether the firm was properly recognizing its RTM positions for purposes of its regulatory net capital computations. The net capital rules of the SEC required MFGI to maintain certain minimum amounts of liquid capital based on its business activities (similar to the capital rules of the CFTC). After consulting with the SEC staff, the SRO staff informed MFGI that under the SEC rule it must take capital charges for the European sovereign positions as if they were on the firm's balance sheet, notwithstanding the fact that the bonds had been "sold" pursuant to the RTM transactions.

In August, representatives of MFGI contacted SEC staff in Washington, D.C., to request a meeting to present the firm's view that the RTM positions should be subject to lesser capital charges than those determined by the SRO and SEC staffs. On August 15, 2011, members of the SEC staff met with representatives of MF Global, including its Chief Executive Officer, Jon S. Corzine. After further consultations, FINRA staff informed MFGI on or around August 24 that the staffs' collective view had not changed.

There were also discussions with MFGI regarding: (1) whether MFGI needed to provide a formal net capital deficiency notice under SEC Rule 17a-11, which generally requires broker-dealers to provide a "hindsight notice" of any deficiency in their compliance with the SEC's

[4] An RTM is a form of a repurchase agreement. A repurchase agreement generally involves the sale of a bond – here, European sovereign bonds – coupled with an agreement to repurchase the bond at a later date at a fixed price. In an RTM transaction, the repurchase date is the same date as the maturity date for the bonds that were sold.

[5] Notes to Statement of Financial Condition (Mar. 31, 2011), note 4.

financial responsibility rules; and (2) whether MFGI needed to restate and refile its "FOCUS" report for July 2011, which could result in the net capital deficiency becoming public.[6] Pursuant to Rule 17a-11, once the deficiency was identified, the firm was required to file the "hindsight notice" and on August 25, filed the deficiency notice. After consultation with the SEC staff, the SRO staff also required the firm to file an amended FOCUS report for July 2011. On August 31, MFGI amended its FOCUS report for July to reflect the required capital charges, reporting a "hindsight" capital deficiency of approximately $150 million as of July 31, 2011. At the holding company level, MF Global reported the change in capital treatment at MFGI in an amendment to MF Global's public filings on September 1.[7]

Bankruptcy of MF Global

During the week of October 17, press reports noted that regulators had directed MF Global to increase capital at MFGI due to concerns about MFGI's capital treatment of its RTM positions. On Tuesday, October 25, MF Global announced quarterly earnings, reporting a net loss of $192 million for the three months ending September 30. Its stock price declined close to 50% that day, and continued to decline over the week. During this same week, certain credit rating agencies downgraded the firm's credit rating or put it on negative watch. According to MF Global, during this time certain counterparties and customers were reducing their exposures to MFGI, and MFGI was undertaking significant efforts to reduce the size of its balance sheet.

SEC staff commenced a continuous on-site presence at MFGI's New York office beginning on October 27 to monitor the situation, and to engage with senior management

[6] FOCUS reports (Financial and Operational Combined Uniform Single Reports) are filed by broker-dealers with their DEA pursuant to SEC Rule 17a-5.

[7] See MF Global 10-Q/A (filed Sept. 1, 2011).

regarding the steps that were being taken by the firm. On Friday, October 28, MF Global management reported on developments to Chairman Mary Schapiro and SEC staff, including myself. According to the firm, it was in discussions with various parties regarding potential strategic transactions, such as the sale of the firm, the sale of the RTM positions, and the sale of the firm's customer business. We continued to receive updates from our on-site staff and from calls with firm management on Saturday and Sunday. By Sunday afternoon, MF Global reported that the firm was close to concluding a strategic transaction with a potential purchaser of the customer business of MFGI in a transaction that would provide customers with continued access to their accounts. The SEC staff worked closely with the CFTC and FSA to review the key transaction terms to determine that they provided adequate customer protection. However, MF Global subsequently reported in the early morning hours of October 31 that MFGI had identified a significant deficiency in its segregated accounts for futures customers, and that the acquisition negotiations had terminated.

At that point, after considering MFGI's financial condition and available alternatives, the SEC staff determined in consultation with the CFTC that the safest and most prudent course of action to protect customer accounts and assets was to initiate a liquidation proceeding under the Securities Investor Protection Act ("SIPA").[8] A referral was made to the Securities Investor Protection Corporation ("SIPC") on the morning of Monday, October 31, 2011. On that same day, the U.S. District Court for the Southern District of New York entered an order granting the application of SIPC to commence a liquidation of MFGI under SIPA and appointing James W. Giddens as trustee for the liquidation. Also on October 31, MF Global Holdings Ltd. separately filed a voluntary bankruptcy petition in the U.S. Bankruptcy Court for the Southern District of

[8] SEC-CFTC Statement on MF Global, Oct. 31, 2011, *available at* http://sec.gov/news/press/2011/2011-230.htm.

New York, and MF Global U.K. Limited entered administration proceedings in the United Kingdom.

MFGI Liquidation and the Status of Securities Customers

The preferred method of returning securities customer assets in a SIPA liquidation generally is to transfer those assets in bulk to another solvent broker-dealer. This approach typically provides customers with access to their securities and funds more quickly than the claims process. Accordingly, shortly after the initiation of the SIPA proceeding, the trustee solicited from other broker-dealers interest in taking over MFGI's securities customer accounts. Based on the available expressions of interest, the trustee on November 30 filed an expedited motion seeking authorization to sell and transfer substantially all securities custody accounts to another broker-dealer. This sale and transfer would cover approximately 330 accounts held for non-affiliated securities customers of MFGI. The proposed transaction was approved by the Bankruptcy Court last Friday, December 9, and the trustee has commenced the transfer process.

Securities customers will be able to trade their securities and use their funds as soon as the transfer is complete. Moreover, each customer will have the option of maintaining securities accounts at the receiving broker-dealer or moving the account to a different broker-dealer selected by the customer. The trustee estimates that this initial transfer will restore 100% of the net equity for more than 80% of these securities customers and that the remaining securities customers will receive at least 60% of their net equity plus an amount up to the limit of the protection afforded by SIPC (up to $500,000).[9] Customers who do not receive 100% of their net equity through this initial transfer may be able to receive additional funds, up to the aggregate

[9] Trustee Securities Account Transfer Motion, supra note 2.

amount of their net equity, if the trustee determines that there is customer property available for that purpose.

Throughout this process, the SEC staff has been working closely with the trustee and SIPC, seeking to make the securities customers of MFGI whole and to expedite the return of their assets. We appreciate the efforts of SIPC and the trustee in seeking to provide securities customers access to their funds and securities as quickly as possible, and we will continue to support those efforts.

Securities Customer Protection Regime

MFGI acted as a "carrying" firm for a small number of securities customers, meaning that it held their funds and securities. MFGI also had additional securities customers for which it executed purchases and sales of securities but did not hold funds and securities – rather, such securities were held at other custodians that settled transactions executed through MFGI on a "delivery versus payment" basis.

As a broker-dealer registered with the SEC, MFGI was subject to the SEC's customer protection rule. This rule requires that each broker-dealer that holds securities or cash for customers take two primary steps to safeguard customer property. These steps are designed to protect customer property by prohibiting broker-dealers from using customer funds and securities to support their proprietary positions or expenses. Together with the applicable SEC capital requirements, this regime also is meant to ensure that, if the broker-dealer fails, segregated securities and funds will be readily available to be returned to the customers.

The first step required under the customer protection rule is that the broker-dealer must maintain physical possession or control over securities that customers have paid for in full. This

means that if a customer has fully paid for his or her securities, they cannot be used by the broker-dealer in its business – for example, they cannot be pledged as collateral to finance the firm's own trades or to raise funds for the firm to invest. Further, if a customer has a margin loan, the customer protection rule strictly limits the amount of securities that can be used by the broker-dealer for financing purposes. The goal in both cases is to require broker-dealers to hold customer securities in a manner that allows those securities to be readily available to customers, either on demand or upon the liquidation of the firm.

The second step required under the customer protection rule is that the broker-dealer must maintain a reserve in an account at a bank for the benefit of customers in an amount that exceeds the net funds attributable to customer positions. These funds cannot be invested in any instrument that is not guaranteed, as to principal and interest, by the full faith and credit of the U.S. government. The amount owed to customers must be computed pursuant to a prescribed formula, normally on a weekly basis. A broker-dealer cannot make a withdrawal from the reserve account until the next computation, and then only if the computation indicates that there is an excess amount in reserve – greater than what is required to be maintained under the rule. In essence, this requirement complements the protection afforded to fully paid securities held at a broker-dealer by requiring the firm to maintain a reserve of funds or U.S. government guaranteed securities equal to its net cash obligations attributable to customer positions.

A broker-dealer that complies with the customer protection rule – isolating customer funds and securities through these steps and separating them from the firm's proprietary business – should be in a position to return all the securities and funds it owes to customers if it falls into financial difficulty. If a broker-dealer cannot return all the securities and funds owed to customers, SIPC has the responsibility to institute a proceeding under SIPA to liquidate the

broker-dealer. Under SIPA, all securities customers share *pro rata* in the available securities customer property before any other types of creditors of the broker-dealer. If the available securities customer property is insufficient to return 100% of the amount owed to securities customers, SIPC may advance up to $500,000 per customer (of which $250,000 can be used to make up a cash shortfall).

Recent Efforts to Improve the Securities Customer Protection Regime

The securities customer protection regime, including the SEC's rules and oversight, along with the SROs' rules and oversight and SIPC protection, has generally worked well for customers over time. While our near-term focus has been on working with SIPC and the trustee to return securities and funds to affected customers of MFGI, the SEC will continue to strive to identify further enhancements to its customer protection regime.

For instance, in June 2011 the SEC proposed amendments to the broker-dealer financial reporting rule in order to strengthen the audits of broker-dealers, including their practices for maintaining custody of customer assets, as well as to enhance the SEC's oversight of the way broker-dealers handle their customers' securities and funds. Specifically, the proposal would:

- Enhance the current requirement that a broker-dealer undergo an annual audit by a public accounting firm registered with the Public Company Accounting Oversight Board by requiring the accounting firm to examine the broker-dealer's compliance, and internal controls over compliance, with SEC net capital and custody requirements.
- Facilitate inspections of a broker-dealer's custody practices by allowing regulators access to the work papers of the broker-dealer's auditor and the ability to discuss any findings with relevant accounting firm personnel.

- Require that a broker-dealer file with the SEC a new "Form Custody" every quarter. This form would contain more detailed information about how broker-dealers maintain custody of customer assets in order to further facilitate verification by examiners that customer assets are being properly protected.

The SEC staff is evaluating the comments received in response to the proposal and preparing a recommendation to the Commission.

The SEC also continues to work with the SROs to help strengthen broker-dealer financial responsibility requirements. For example, also in June, the SEC approved a FINRA rule filing to establish registration, qualification, examination, and continuing education requirements for certain operations – or "back office" – personnel, including those who handle customer assets. In addition, just last month the SEC published for comment a FINRA proposal to require each member firm to file certain additional financial or operational schedules or reports to supplement existing filing requirements. FINRA believes this proposal would make income and expense data more transparent, which would in turn improve the oversight of broker-dealers. The SEC staff is currently reviewing the comments received on the proposal.

Conclusion

In conclusion, the failure of MF Global has resulted in a significant hardship for the firm's customers. While the causes of the failure of MF Global are still under investigation, the SEC and its staff are working with our fellow financial regulators and other authorities to facilitate the prompt identification and return of all customer assets.

I would be pleased to answer any questions you may have.

STATEMENT OF JON S. CORZINE
BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
OVERSIGHT AND INVESTIGATIONS SUBCOMMITTEE

DECEMBER 15, 2011

Chairman Neugebauer, Ranking Member Capuano and Distinguished Members of the Subcommittee:

Recognizing the enormous impact on many peoples' lives resulting from the events surrounding the MF Global bankruptcy, I appear at today's hearing with great sadness. My sadness, of course, pales in comparison to the losses and hardships that customers, employees and investors have suffered as a result of MF Global's bankruptcy. Their plight weighs on my mind every day – every hour. And, as the chief executive officer of MF Global at the time of its bankruptcy, I apologize to all those affected.

Before I address what happened, I must make clear that since my departure from MF Global on November 3, 2011, I have had limited access to many relevant documents, including internal communications and account statements, and even my own notes, all of which are essential to my being able to testify accurately about the chaotic, sleepless nights preceding the declaration of bankruptcy. Furthermore, even when I was at MF Global, my involvement in the firm's clearing, settlement and payment mechanisms, and accounting was limited.

The Members should also understand that the Subcommittee turned down my request to testify voluntarily in January. I had hoped that, by that time, I would have obtained and reviewed relevant records so that I could be more helpful to the Subcommittee.

As a consequence of my situation, not every fact of which I am or may have been aware that may be relevant to your inquiry is contained in this statement. While I intend to be responsive to the best of my ability today, without adequate time and materials to prepare, I may

be unable to respond to various questions members might pose. Other questions, given my specific role in the company, will be questions for which I simply have no personal knowledge. Many of your questions may well be ones I myself have.

Considering the circumstances, many people in my situation would almost certainly invoke their constitutional right to remain silent -- a fundamental right that exists for the purpose of protecting the innocent. Nonetheless, as a former United States Senator who recognizes the importance of congressional oversight, and recognizing my position as former chief executive officer in these terrible circumstances, I believe it is appropriate that I attempt to respond to your inquiries.

My Background

I was born in 1947 and raised in the rural community of Taylorville, Illinois. After high school graduation in 1965, I attended the University of Illinois, from which I graduated in 1969. In the summer of 1969, I joined the United States Marine Corps Reserve, in which I served until 1975. In 1970, I enrolled in the University of Chicago Business School. I took classes at night while working at a bank during the day, and I and received my MBA in 1973.

In 1975, after working for a short time for a regional bank in Ohio, I took a job as a bond trader at the investment banking firm Goldman Sachs in New York. I remained at Goldman Sachs until January 1999, rising to the position of Senior Partner.

In 2000, I was elected to serve in the United States Senate representing New Jersey. I served in the Senate until January 2006, when I became the Governor of New Jersey. I was elected to one term as Governor, serving from January 2006 to January 2010.

Approximately three months after I left the governorship, I was recruited to become the chief executive officer of MF Global, whose prior chief executive had resigned abruptly after serving for 17 months. Prior to being approached about this position, I had no involvement with

MF Global, and my only financial tie to it was extremely remote – I was an investor in the private equity fund J.C. Flowers, which had an investment in MF Global and a seat on the board of directors. My connection to J.C. Flowers led to my introduction to MF Global.

MF Global Before I Joined

Before I joined the company in late March 2010, MF Global was primarily a brokerage which provided execution and clearing services for products traded in derivative markets on exchanges around the world. MF Global was primarily a voice-based broker, which means that it took and placed orders largely over the telephone and had not yet made significant use of electronic trading technology. As stated in MF Global's annual Form 10-K filing for the fiscal year ended March 31, 2009, the company's revenues derived principally from commission fees generated from execution and clearing services and from interest income on cash held in customer accounts.[1]

By 2010, however, online brokerages and high-frequency traders had begun exerting downward pressure on commissions. Interest rates were at historic lows and were expected to remain so for an "extended period," according to Federal Reserve policy statements. As a consequence of these developments among others, revenues were in decline. MF Global was accordingly experiencing substantial losses. The firm had reported losses in five consecutive quarters before I arrived, including the final quarter of the fiscal year ended March 31, 2010 (just as I was arriving),[2] and it had lost money in each of the previous three years, including the fiscal year that ended on March 31, 2010, for which the company posted a net loss to common shareholders of $167.7 million.[3] (MF Global's fiscal year ran from April 1 to March 31; the fiscal year ended on March 31, 2010 was MF Global's 2010 fiscal year.)

I took the job at MF Global even though the company was in a weak financial position because it had several positive attributes such as memberships on multiple derivative exchanges

around the globe, solid market shares on those exchanges, and an extensive set of client relationships. I saw the possibility of taking part in the transformation of a challenged company by restructuring existing businesses and capturing opportunities available in the post-2008 financial environment.

Upon my arrival at MF Global, management and the board initiated a strategic review of our business. We engaged an outside consultant, the Boston Consulting Group, to help the firm define a business strategy that would lead it to profitability. Management, the board of directors, and the consultant came to the common conclusion that MF Global had to change its business strategy and diversify its revenues.

The new business plan provided, in substance, that MF Global would evolve into a broker-dealer, and ultimately into an investment bank, which would provide broker, dealer, underwriting, advisory and investment management services. The implementation of the plan was expected to take three to five years. This new strategic plan was communicated to the public.[4]

During my tenure as chief executive officer, MF Global made both structural and personnel changes in an effort to implement the strategic plan. One of the first priorities was to reduce the level of compensation as a percentage of MF Global's revenues. The company was paying over 60% of its revenues to its employees, and sought to reduce this figure. Many employment contracts were restructured to increase the amount of pay that was dependent on MF Global's performance. My own pay was structured to include a substantial component determined by MF Global's performance, as discussed below.

Before my tenure at MF Global, Promontory Financial Group ("Promontory"), a prominent financial consulting firm run by Eugene Ludwig, the former United States

Comptroller of the Currency, had been retained pursuant to a settlement with the CFTC to review and assess MF Global's implementation of the settlement.[5] During my tenure, we retained Promontory to review various of MF Global's compliance systems.

I was hopeful about the prospects for the company, and I invested in it personally. Much of my compensation was in the form of options to purchase stock, which would have value only if the company prospered. When the company made a public equity offering in June 2010, I purchased almost $2.5 million worth of stock. In 2011, I bought approximately $500,000 more stock in the company.[6]

MF Global's Leverage

One of the recurrent themes in the media has been that MF Global took on too much risk during my tenure, in particular the amount of leverage that MF Global bore at the time of its bankruptcy. In fact, MF Global reduced leverage. In the quarter ended March 31, 2010, MF Global's leverage was 37.3. During my tenure, it was consistently around 30.[7]

The RTMs

A. Description of RTMs

There has been extensive comment about a series of positions entered into by MF Global that involved "repurchase transactions to maturity," known colloquially as "RTMs." I would like to address those here.

As relevant here, repurchase transactions (also known as "repos") worked roughly as follows: MF Global would purchase a debt security (such as sovereign debt) from a seller and would sell the same security to another party (the "Counterparty"), with an agreement to repurchase the security from the Counterparty at a later date. The agreement between MF Global and the Counterparty to sell and buy back the debt security was the repurchase agreement, and it

served, in effect, as a loan from the Counterparty to MF Global. The Counterparty would hold the debt security as collateral for the loan.

An RTM is a particular kind of repurchase transaction in which the purchaser (MF Global) agrees to buy back the underlying debt security on its maturity date.

The economic benefit of RTMs to MF Global was the difference (or "spread") between (a) the interest rate paid by the issuer of the debt security to MF Global, and (b) the repurchase rate (referred to as the "financing rate") paid by MF Global to the Counterparty. It is my understanding – and I do not claim to be an accountant – that under the applicable accounting principles, MF Global was required to recognize its profit immediately in RTMs, and the asset (the debt security) and the liability (the money owed to the Counterparty) must be "de-recognized," i.e., removed from MF Global's balance sheet. I want to note here that I believe that accounting issues with respect to the RTMs would have been reviewed by MF Global's internal auditors, outside auditors (PricewaterhouseCoopers), and its audit committee.

B. Risks Related to RTMs

Financing the purchase of debt with RTMs allowed MF Global to reduce certain kinds of risk. Because RTMs financed MF Global's purchase of the debt security to the security's maturity, the RTMs eliminated the risk (referred to as "financing risk") that at some point during the life of the security MF Global would not be able to find additional financing for the security, and would therefore be forced to sell the security, potentially at a loss. Elimination of the financing risk meant that MF Global's market risk (arising from the fluctuation of the price of the underlying debt security) was significantly reduced.

MF Global retained, however, the risk that the debt securities might default or be restructured. If the debt securities defaulted or were restructured, then MF Global would not be

paid in full at their maturity, even though MF Global would still have the obligation to buy back the debt securities from the Counterparty in full (at par).

Also, the clearing house through which the repurchase transaction was executed (typically, the London Clearing House, or "LCH") could demand that MF Global increase its margin. It might do so for at least two reasons: (a) if it determined that MF Global itself was not credit-worthy, or (b) if it determined that the underlying debt security – which was the collateral for the loan from the Counterparty to MF Global – decreased in value. The possibility of such margin calls from LCH meant that MF Global retained liquidity risk.[8]

To mitigate some of the risk of the RTMs, on some occasions MF Global took short positions in the underlying debt securities or in similar securities.[9]

C. The Decision To Engage In RTMs Involving European Sovereign Debt

Even before I joined MF Global, the firm traded European sovereign debt securities. For instance, for the year ending March 31, 2010, the company reported that it was carrying over $9 billion in foreign government securities, including both foreign securities owned outright and those sold to counterparties under repurchase agreements.[10] The company also reported that it had used RTM agreements to purchase some securities, although not specifically foreign government debt.[11]

In the summer of 2010, I met with MF Global's senior traders to discuss ways to improve the company's profitability. One of the ideas discussed was for MF Global to purchase European sovereign debt using RTMs. Such transactions were attractive for the reasons stated above – the reduction of finance risk and market risk – and the spread on the European sovereign debt securities appeared to be favorable. MF Global could engage in RTMs with these securities much as it had already done with other securities. Through these discussions, I became an advocate of purchasing European sovereign debt using RTMs.

At the time that MF Global entered into the transactions, I believed that its investments in short-term European debt securities were prudent. MF Global invested in RTMs with respect to the debt of Belgium, Italy, Spain, Ireland and Portugal. The first three of these – Italy, Spain and Belgium – were rated AA or better when MF Global invested in them. Even today, they are all at least A rated, and some of them are AA rated.[12] All of the sovereign debt of these three countries that MF Global held in RTMs matured no later than December 2012. Ireland and Portugal were lower rated, but for most of the time that MF Global held these securities they were backed by financing offered through the European Financial Stability Facility (EFSF) and the IMF, which made it highly likely that Ireland and Portugal would be able to roll over their outstanding debt before June 2013, when the funding facility expired. All of the sovereign Irish and Portuguese debt that MF Global held in RTMs matured no later than June 2012. Furthermore, because the European debt instruments that MF Global purchased did not all mature at the same time, there was an additional level of risk mitigation. As time went on and as the instruments matured, MF Global's risk would decrease.

D. Participants In The Decision To Engage In RTMs Involving European Sovereign Debt

MF Global's involvement in RTMs involving European sovereign debt securities was the subject of internal discussions with the company's traders, senior managers, and the board of directors.

The RTM transactions were reported to the board of directors. There were discussions at board meetings, at which the transactions were described, analyzed and debated. Although some people complain that boards of directors are "rubber stamps" for the decisions of company management, MF Global's board was not a rubber stamp. The members of the board of directors were independent and sophisticated, and they asked hard questions and raised concerns about the

RTMs. All of the members had been on the board of directors before I joined MF Global. The board met without management on some occasions, and it is my understanding that the RTM portfolio was a topic of discussion during at least some of those meetings.

The directors approved sovereign risk limits up to which MF Global could invest in the RTM trades. Ultimately, the limits were specified on a country-by-country basis. MF Global attempted to adhere to those limits, and generally did so. On a few occasions, however, the chief risk officer reported that the firm had exceeded its limits with respect to a particular country. I recall, for example, one occasion on which the limit was exceeded because the Euro gained value against the dollar, and the risk limits were set in dollars. On the occasions on which the firm exceeded the country limits, it nonetheless remained within the overall limit and took appropriate steps (such as entering a reverse-RTM or shorting the same security) to bring its level of exposure back within the country limits. At the time of the bankruptcy, MF Global was within the risk limits set by the board of directors.

I accept responsibility for the RTM trades that MF Global engaged in from the time that I arrived at MF Global until my departure, on November 3, 2011, and I strongly advocated the trading strategy that I have described here. It is important to recognize, however, that MF Global's involvement in RTM trades was disclosed to the board of directors, the senior officers of the company, the company's accountants and numerous outsiders.

E. The Public Disclosures Of The RTMs

The RTM trades were also publicly disclosed, both in the periodic financial statements and in other public statements, including press releases and earnings calls.

MF Global's annual filing (Form 10-K), dated May 20, 2011, for the fiscal year ended March 31, 2011, stated that MF Global invested in the sovereign debt of Italy, Spain, Belgium, Portugal and Ireland, and that the final maturity for any of these securities was no later than

December 2012, which, it noted, was "prior to the expiration of the European Financial Stability Facility."[13] The filing also reported that "[a]t March 31, 2011 securities . . . sold under agreements to repurchase of $14,520,341[,000] at contract value, were de-recognized, of which 52.6% were collateralized with European sovereign debt."[14]

On July 28, 2011, the company announced its results for the first quarter of fiscal year 2012 (which ended on June 30, 2011), and its disclosures about the RTMs were again extensive. Its filing (Form 10-Q) stated that as of June 30, 2011, "securities purchased under agreements to repurchase of $16,548,450[,000] . . . were de-recognized, of which 69.3% . . . were collateralized with European sovereign debt, consisting of Italy, Spain, Belgium, Portugal and Ireland."[15] The Form 10-Q also stated that the net notional value of the Italian, Spanish, Belgian, Irish and Portuguese sovereign debt securities that MF Global held was $6.4 billion.[16] In a conference call that MF Global held on July 28 to announce its results, the RTMs collateralized with European sovereign debt were discussed.[17]

F. The Fate Of The RTMs

As of today, none of the foreign debt securities that MF Global used in the RTM trades has defaulted or been restructured. All of those securities that reached maturity while they were part of the RTM position paid in full.

Communications With Regulators

A. FINRA's Position Regarding The Capital Treatment Of The RTMs Involving European Sovereign Debt Securities

In approximately the first week of August 2011, I recall becoming aware that officials from FINRA were considering whether to require that MF Global modify its capital treatment under SEC Rule 15c3-1 of the RTMs involving European sovereign debt instruments. I believe that FINRA officials may have raised this issue with others at MF Global earlier than August

2011, but to the best of my recollection, I did not focus on the issue until approximately early August. I had not met with FINRA officials, to the best of my recollection, although I spoke briefly at a meeting at MF Global's offices on or about June 14, 2011, that was attended by officials from the SEC, the CFTC, FINRA and perhaps other regulators. I believe that I spoke about RTMs at that meeting. I believe that other members of the management of MF Global spoke at that meeting about several topics, although I did not attend those others members' presentations.

On or about August 15, 2011, I went with others from MF Global to the SEC in Washington to question FINRA's interpretation of SEC Rule 15c3-1. We met with Michael Macchiaroli, the Associate Director in the Division of Trading and Markets, and others from the SEC, and presented our argument that the capital treatment of the RTMs involving European sovereign debt securities should not be changed in the way that FINRA proposed. Some days after the meeting, MF Global was apprised by FINRA that FINRA would not change its position. I thereafter made a telephone call to Mr. Macchiaroli who told me, in substance, that there was no further appeal and that MF Global had to comply with FINRA's direction. He noted, however, that other companies in similar positions had sent letters of objection to the SEC, although he was clear that such a letter would make no difference to FINRA's or the SEC's position.

Although MF Global disagreed with FINRA's position, the firm promptly complied with the demand that its United States subsidiary increase its net capital. On September 1, 2011, we made a Form 10-Q/A public filing disclosing FINRA's ruling. It stated:

> As previously disclosed, the Company is required to maintain specific minimum levels of regulatory capital in its operating subsidiaries that conduct its futures and securities business, which levels its regulators monitor closely. The Company was recently informed by the Financial Industry Regulatory Authority, or FINRA, that its regulated

> U.S. operating subsidiary, MF Global Inc., is required to modify its capital treatment of certain repurchase transactions to maturity collateralized with European sovereign debt and thus increase its required net capital pursuant to SEC Rule 15c3-1. MF Global Inc. has increased its net capital and currently has net capital sufficient to exceed both the required minimum level and FINRA's early-warning notification level. ...[18]

B. My Communications Regarding Proposed CFTC Rules Changes

Sometime in late 2010 or early 2011, the CFTC proposed certain changes in 17 C.F.R. §1.25 ("Rule 1.25"). As far as I understand, roughly speaking, Rule 1.25 outlines the permissible investments and uses for customer funds, as that term is defined in the CFTC Rules and Regulations, held by a Futures Commission Merchant ("FCM").

The proposed rule change was the topic of substantial discussion among regulated entities, industry organizations, associations, committees and even designated self-regulatory organizations. I understand that there were numerous letters received by the CFTC opposing various aspects of the proposed rule change.[19] MF Global submitted a letter, along with Newedge, which was one of the largest FCMs in the United States, opposing the proposed amendments to the rule.

The proposed rule change was also the topic of the conference call in which I took part on July 20, 2011, in which CFTC Chairman Gary Gensler participated. As best as I can recall, there were others from MF Global who took part in the conference call, and the CFTC's own records state that in addition to CFTC Chairman Gensler, four other officials from the CFTC were on the call. According to the CFTC's records, I was not the only representative of the industry that had calls with members of the CFTC, including Chairman Gensler, regarding the proposed changes.

The principal topic of discussion was whether Rule 1.25 should be changed to prevent FCMs from engaging in repurchase transactions with related broker-dealers. As I understood it, the then-current version of Rule 1.25 permitted such transactions but the proposed version would

not, or would somehow limit such transactions. Consistent with the letter that we had submitted with Newedge, I argued, in substance, that such transactions should continue to be permitted because such transactions could be beneficial to the FCMs.

On the same afternoon, I spoke with another CFTC commissioner, Mr. Bart Chilton, to discuss the same matter. Mr. Chilton, who, according to the CFTC's records was accompanied by another CFTC official, listened to the arguments. I was joined on the phone by the general counsel for MF Global.

Later, I came to understand that the CFTC deferred consideration of the new rule.

C. Further Contacts

From the time that I joined MF Global through October 30, 2011, to the best of my recollection, I spoke with Chairman Gensler on only limited occasions. In addition to those contacts set forth above, I had a meeting with him in or about May 5, 2010, and I also met with him in or about December 2010. Those meetings were at the CFTC in Washington, and on those occasions there were other officials from the CFTC present.

In addition, Chairman Gensler and I had a few brief interactions at which there was, to the best of my recollection, no private discussions about the CFTC's regulation or oversight of MF Global. For example:

(a) He was a guest lecturer on government regulation at my class at Princeton on or about November 22, 2010. When he spoke at Princeton, there was another person from the CFTC present, and we did not discuss professional matters, except in the context of the class.

(b) I also attended a conference that was sponsored by the investment firm of Sandler & O'Neill on or about June 9, 2011. Chairman Gensler was there, as were others from the CFTC. I gave a presentation about MF Global at the conference, and Chairman Gensler gave the luncheon speech. I do not recall that I discussed any business with Chairman Gensler other than

a question that I put to him before the full audience during a question and answer session following his presentation. To the best of my recollection, the question was about proposed changes to Rule 1.25.

(c) In addition, on or about September 14, 2011, Chairman Gensler and I attended the wedding celebration of mutual friends. On that occasion, Chairman Gensler was not accompanied by anyone from the CFTC, but, again, we did not discuss business or regulatory matters so far as I recall.

On various occasions during my tenure at MF Global, I met or communicated with others at the CFTC about a variety of issues.

Until my final days at MF Global, to the best of my recollection, I never spoke about business with Chairwoman Shapiro of the SEC, another of our regulators, or any other SEC Commissioner. (I may have greeted Chairwoman Shapiro at a conference.) During the days preceding the filing of the MF Global bankruptcy, there were a number of conference calls with various regulators, and I now believe Ms. Shapiro was on at least one, and perhaps more than one, of the calls in which I also participated. There were typically several people on the conference calls during those final days. During my tenure at MF Global, to the best of my recollection, I never communicated with Secretary of the Treasury, Timothy Geithner.

During my tenure at MF Global, to the best of my recollection, I never spoke with the President of the New York Federal Reserve William Dudley until approximately the week preceding the bankruptcy of MF Global, other than on one occasion (on or about April 13, 2011) when he and I attended a speech at Princeton by Chairman Bernanke of the Federal Reserve. To the best of my recollection, Mr. Dudley and I greeted each other on that occasion, but did not engage in substantive conversation. During my tenure at MF Global, to the best of my

recollection, I did not speak with any governor of the Federal Reserve other than to greet Chairman Bernanke after his presentation at Princeton.

The Events Of October 2011

The late summer and fall of 2011 were extraordinarily difficult times in the financial markets for almost all market participants. Like many comparable firms, MF Global was experiencing poor earnings principally on account of diminished revenues, and highly correlated volatility in many markets.

On October 17, 2011, the *Wall Street Journal* published an article that described the FINRA ruling that MF Global had disclosed on September 1. Other news stories followed, and some of MF Global's counterparties decided to reduce their exposure to the company, requiring some adjustment in our financing. MF Global's stock began to perform relatively poorly.

On or about October 21 and 22, 2011 – in anticipation of a disappointing earnings announcement, and concerned that the ratings agencies would downgrade MF Global – I and several of my colleagues made presentations to the ratings agencies to put the earnings announcement in context. The firm customarily made presentations to the ratings agencies shortly before the firm's quarterly earnings announcements.

On Monday, October 24, 2011, Moody's cut MF Global's rating from Baa2 to Baa3, followed by another downgrade to Ba2, on October 27. Fitch followed suit, cutting the company's rating from BBB to BB+. On October 26, S&P placed MF Global on its "credit watch negative" list, although it did not downgrade its rating below investment grade.

MF Global announced its quarterly earnings on October 25, 2011. The announcement was made two days ahead of schedule so that the firm could get full information to the public in light of Moody's downgrade. The announcement revealed that MF Global had lost $191.6 million in the quarter that ended September 30, 2011.

In light of the attention that has been given to RTMs, and the press reports that attributed MF Global's loss to RTMs involving European debt securities, it is important to make clear here that the loss was *not* related to those positions. The lion's share of the quarterly loss was a write-off of approximately $119.4 million that reflected a valuation adjustment against a deferred tax asset. That asset had been created by years of (non-RTM) tax losses cumulated (mostly before I arrived at MF Global) in the firm's United States and Japanese subsidiaries, which had allowed MF Global to recognize as an asset potential tax benefits – equal to $119.4 million – in future years. Under applicable accounting rules, by the second quarter of MF Global's 2011 fiscal year (i.e., the quarter ending September 30, 2011) the firm was no longer permitted to recognize those tax benefits as assets, and therefore, with the advice and knowledge of its external auditor, it recognized a loss in that amount.

In addition, approximately $16.1 million of the quarterly loss resulted from the retirement of debt arising out of MF Global's purchase of certain of its 9% senior notes due 2038. Another approximately $10.0 million was for "restructuring charges," which included the closure of our Japanese securities business. The remainder was miscellaneous matters including reserves for litigation, much of it arising out of events before I arrived at MF Global. Approximately $18 million was operating losses (again, not related to the RTMs).

Shortly following the earnings announcement and the ratings downgrades, some clients and counterparties withdrew their business from the firm; others required increased margins. The firm's stock traded at sharply higher volumes and lower prices.

During the week of October 24-28, 2011, MF Global undertook extraordinary steps to ensure that it was able to honor customers' requests to withdraw funds or collateral. To the best of my recollection, during that week the firm unwound hundreds of millions of dollars worth of

RTMs, and sold the underlying sovereign debt instruments; it also sought to draw down its revolver loans from a consortium of banks led by J.P. Morgan. On October 27, MF Global sold, to the best of my recollection, $1.3 billion in commercial paper instruments for same-day settlement, and over $300 million in corporate securities, also for same-day settlement. The next day, I believe that MF Global sold approximately $4.5 billion in United States agency securities. Over the course of the week, MF Global reduced the size of its match book by, to the best of my recollection, approximately $10 billion. Despite our best efforts to sell assets and generate liquidity, the marketplace lost confidence in the firm.

The firm was in regular contact with its regulators, including the CFTC, the Federal Reserve Bank of New York, the SEC and the U.K's Financial Services Authority, and the Chicago Mercantile Exchange (CME), the firm's designated self-regulatory organization.

The firm was also engaged in efforts to sell the FCM part of its business. It had been contemplating, for some time prior to the week of October 24, a strategic partnership involving the FCM business. On or about Tuesday, October 25, the firm retained an investment bank, Evercore, to explore selling that business. By the next day, MF Global instructed Evercore also to explore selling the entire firm. MF Global was in negotiations to sell the firm through the weekend of October 29-30. The sale did not take place when it was discovered that customer accounts could not be reconciled at that time.

The Unreconciled Accounts

Obviously on the forefront of everyone's mind – including mine – are the varying reports that customer accounts have not been reconciled. I was stunned when I was told on Sunday, October 30, 2011, that MF Global could not account for many hundreds of millions of dollars of client money. I remain deeply concerned about the impact that the unreconciled and frozen funds have had on MF Global's customers and others.

As the chief executive officer of MF Global, I ultimately had overall responsibility for the firm. I did not, however, generally involve myself in the mechanics of the clearing and settlement of trades, or in the movement of cash and collateral. Nor was I an expert on the complicated rules and regulations governing the various different operating businesses that comprised MF Global. I had little expertise or experience in those operational aspects of the business.

Again, I want to emphasize that, since my resignation from MF Global on November 3, 2011, I have not had access to the information that I would need to understand what happened. It is extremely difficult for me to reconstruct the events that occurred during the chaotic days and the last hours leading up to the bankruptcy filing.

I simply do not know where the money is, or why the accounts have not been reconciled to date. I do not know which accounts are unreconciled or whether the unreconciled accounts were or were not subject to the segregation rules. Moreover, there were an extraordinary number of transactions during MF Global's last few days, and I do not know, for example, whether there were operational errors at MF Global or elsewhere, or whether banks and counterparties have held onto funds that should rightfully have been returned to MF Global. I am sure that the trustee in bankruptcy, the SIPC receiver, and the regulators are working to answer these questions and to understand precisely what happened during the firm's last days and hours.

As the chief executive officer of MF Global, I tried to exercise my best judgment on behalf of MF Global's customers, employees and shareholders. Once again, let me go back to where I started: I sincerely apologize, both personally and on behalf of the company, to our customers, our employees and our investors, who are bearing the brunt of the impact of the firm's bankruptcy.

That concludes my prepared statement. I am willing to answer the Subcommittee's questions.

[1] See FY 2009 Form 10-K (for fiscal year ended March 31, 2009) (filed on June 10, 2009), at pp. 3-4 ("Description of Business").

[2]

Quarter	Profit/(Loss)	Source
4Q 2010	($96.5 million)	News Release, "MF Global Reports Fourth Quarter and Fiscal Year 2010 Results," May 20, 2010, at p. 1 (filed with Form 8-K on May 20, 2010)
3Q 2010	($22.3 million)	News Release, "MF Global Reports Third Quarter 2010 Results," Feb. 4, 2010, at p. 1 (filed with Form 8-K on Feb. 4, 2010).
2Q 2010	($16.0 million)	News Release, "MF Global Reports Second Quarter 2010 Results," Nov. 5, 2009, at p. 1 (filed with Form 8-K on Nov. 5, 2009).
1Q 2010	($32.8 million)	News Release, "MF Global Reports First Quarter 2010 Results," Aug. 6, 2009, at p. 1 (filed with Form 8-K on Aug. 6, 2009).
4Q 2009	($119.4 million)	News Release, "MF Global Reports Fourth Quarter and Fiscal Year 2009 Results," May 21, 2009, at p. 7 (Consolidated & Combined Statements of Operations) (filed with Form 8-K on May 21, 2009).

[3]

Quarter	Profit/(Loss)	Source
FY 2010	($167.7 million)	News Release, "MF Global Reports Fourth Quarter and Fiscal Year 2010 Results," May 20, 2010, at p. 1 (filed with Form 8-K on May 20, 2010).
FY 2009	($69.2 million)	News Release, "MF Global Reports Fourth Quarter and Fiscal Year 2009 Results," May 21, 2009, at p. 7 (Consolidated & Combined Statements of Operations) (filed with Form 8-K on May 21, 2009).
FY 2008	($71.1 million)	News Release, "MF Global Reports Record Fourth Quarter and Fiscal Year 2008 Results," May 20, 2008, at p. 1 (filed with Form 8-K on May 20, 2008)

[4] See, e.g., FY 2011 Form 10-K filing (for fiscal year ended March 31, 2011) (filed May 20, 2011), at p. 6 ("Growth Strategy"); id. at 15.

[5] In February 2008, MF Global suffered a loss of $141.0 million, following an unauthorized trading incident involving wheat futures ("Dooley Trading Incident"). Criminal charges were brought against the trader, Evan Dooley. MF Global, among other things, entered into a settlement with the CFTC, under which the company agreed to specific undertakings relating to risk management, including the engagement of an independent outside consultant (Promontory). See FY 2010 Form 10-K (for fiscal year ended Mar. 31, 2010) (filed May 28, 2010), at p. 35.

[6] My Equity Acquisitions in MF Global

04/07/2010	Granted 2,500,000 stock options (granted as part of my initial compensation)
06/03/2010	Bought 352,100 common shares at $7.10, in a public offering
05/20/2011	Granted 1,600,000 stock options (granted at the time of my contract extension)
06/09-11/2011	Bought 36,100 common shares at between $6.85 and $6.92, on the market
08/08/2011	Bought 33,960 common shares at $5.71 and $5.91, on the market
08/10/2011	Bought 1,000 common shares at $5.41, on the market
08/18/2011	Bought 18,800 common shares at $5.25, on the market

I never sold any shares or options.

[7] Leverage is calculated by dividing (a) the reported total assets, by the sum of (b) total equity and (c) preferred shares. The relevant data can be found in MF Global's consolidated balance sheets, which are contained in the firm's quarterly (Form 10-Q) or annual (Form 10-K) financial statements.

[8] These risks were described in, for example, MF Global's Form 10-Q for the period ending June 30, 2011 (filed August 3, 2011), at p. 76:

> Under the Company's repurchase agreements, including those repurchase agreements accounted for as sales, its counterparties may require the Company to post additional margin at any time, as a means for securing its ability to repurchase the underlying collateral during the term of the repurchase agreement. Accordingly, repurchase agreements create liquidity risk for the Company because if the value of the collateral underlying the repurchase agreement decreases, whether because of market conditions or because there are issuer-specific concerns with respect to the collateral, the Company will be required to post additional margin, which the Company may not readily have. If the value of the collateral were permanently impaired (for example, if the issuer of the collateral defaults on its obligations), the Company would be required to repurchase the collateral at the contracted-for purchase price upon the expiration of the repurchase agreement, causing the Company to recognize a loss. Also, margin funds that are posted by the Company cannot be used by it for other purposes, which may limit the Company's ability to deploy its capital in an optimal manner or to effectively implement its growth strategy. For information about these exposures and forward purchase commitments, see "—Off Balance Sheet Arrangements and Risk" and "Item 3. Quantitative and Qualitative Disclosures about Market Risk—Disclosures about Market Risk—Risk Management."

[9] See, e.g., FY 2011 Form 10-K, at p. 78 ("From time to time, and in addition to short positions in our non-trading book, we also take short positions in our trading book to mitigate our issuer credit risk further.").

[10] See Notes 5 & 7 to Consolidated & Combined Financial Statements, FY 2010 Form 10-K, at p. 112-13.

[11] See id. at pp. 100, 112 (describing accounting treatment of RTMs).

[12] The current ratings are as follows:

Belgium:	AA negative (S&P)	AA+ negative (Fitch)	Aa1 possible downgrade (Moody's)
Italy:	A negative (S&P)	A+ negative (Fitch)	A2 negative (Moody's)
Spain:	AA- negative (S&P)	AA- negative (Fitch)	A1 negative (Moody's).

The credit ratings above were obtained from the websites of the three major credit rating agencies on December 6, 2011. See http://www.standardandpoors.com/ratings/en/us/; www.fitchratings.com; www.moodys.com.

[13] FY 2011 Form 10-K, at pp. 77-78; see also id. at pp. 99-100.

[14] Id. at p. 100.

[15] Note 3, to Consolidated & Combined Financial Statements, 1Q FY 2012 Form 10-Q, at pp. 13-14 (filed Aug. 3, 2011).

[16] Id. at p. 90 (table).

[17] Earnings call, "MF Global Holdings' CEO Discusses F1Q2012 Results," July 28, 2011, at p. 4.

[18] "Additional Information," Q1 FY 2012 Form 10-Q/A, at p. 2.

[19] The CFTC received over 30 comment letters related to topics covered by the proposed changes. Many of these letters commented on the same proposed changes on which MF Global commented. As examples, both the CME and the Futures Industry Association ("FIA") in conjunction with the International Swaps and Derivatives Association ("ISDA"), Inc. challenged, among other things, the proposed amendments regarding permissible investments and internal repurchase transactions. The comments provided by the CME, FIA and ISDA advocated that an FCM should be permitted to invest in certain types of foreign sovereign debt and also advocated that FCMs should be able to engage in repurchase transactions and reverse repurchase transactions with affiliates and to engage in in-house transactions. Both JP Morgan Futures, Inc. and Morgan Stanley took similar positions.

TESTIMONY
OF
TERRENCE A. DUFFY
EXECUTIVE CHAIRMAN
CME GROUP INC.
BEFORE THE
HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT & INVESTIGATIONS
DECEMBER 15, 2011

Subcommittee Chairman Neugebauer, Ranking Member Capuano, members of the subcommittee, thank you for the opportunity to testify on the events surrounding the recent collapse of futures commission merchant ("FCM") and broker-dealer ("BD") MF Global, Inc. ("MFG"). I am Terry Duffy, Executive Chairman of CME Group ("CME Group" or "CME"), which is the world's largest and most diverse derivatives marketplace. CME Group includes four separate exchanges — Chicago Mercantile Exchange Inc. the Board of Trade of the City of Chicago, Inc., the New York Mercantile Exchange, Inc. and the Commodity Exchange, Inc. (together "CME Group Exchanges"). The CME Group Exchanges offer the widest range of benchmark products available across all major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products. CME also includes CME Clearing, a derivatives clearing organization and one of the largest central counterparty clearing services in the world; it provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter ("OTC") derivatives transactions through CME Clearing and CME ClearPort®.

Introduction

As the Subcommittee knows, on the morning of October 31, the Securities Investor Protection Corporation ("SIPC") filed a petition with a Federal District Court in New York to place the futures commission merchant/broker-dealer arm of MFG into bankruptcy, which was immediately granted by the court. While over the course of our exchanges' histories clearing members have filed for bankruptcy protection or been placed into bankruptcy involuntarily, the MFG bankruptcy is unprecedented in that it is the first time (i) there has been a shortfall in customer segregated funds held by one of our clearing members as result of the clearing member's improper handling of customer funds and (ii) our clearing house was unable to transfer all customer positions and property in an FCM bankruptcy due to missing customer funds in a segregated customer account under the control of the FCM. Indeed, this is the first time in the industry's history that a customer has suffered a loss as a result of a clearing members' improper handling of customer funds.[1]

MFG's customers' funds held by CME clearing house were securely held; in fact, we held $1 billion in excess funds on behalf of those customers. Our number one priority is and has been to return to every MFG customer its rightful property. Our ability to do that, however, is limited. Since MFG was placed into bankruptcy, as a matter of law, the bankruptcy trustee has been in control of the process and all decisions regarding MFG assets and the money, securities and property of its customers. Indeed, we have worked diligently with the bankruptcy trustee to transfer MFG customer accounts to other FCMs along

[1] As recent examples, in both *Refco* and *Lehman*, which had large FCM operations, while non-commodities customers of Refco and Lehman were significantly impacted by the bankruptcy proceedings, the regulated commodity customer accounts were transferred to new FCMs without any disruption. We had no reason to believe this situation would be any different at MFG until the segregation shortfall was discovered.

with a portion of the customers' collateral on deposit with CME Clearing. To date, CME Group with the bankruptcy trustee's permission has successfully transferred all (approximately 15,000) MFG customer accounts to other FCMs. The portion of customer collateral transferred to the new FCMs to margin customer positions was a decision by the bankruptcy trustee and outside the control of CME Group. CME Group continues to take steps and work with the bankruptcy trustee to facilitate the release of additional available customer funds.

There are ongoing investigations by the Department of Justice, the FBI, the CFTC, and the SEC into the events surrounding the MFG bankruptcy, including efforts to locate the missing segregated customer property and determining who was responsible for permitting the removal of that customer property from MFG's segregated accounts. Although we do not yet have these details, and are affirmatively prohibited from publicly divulging information obtained in connection with these federal investigations, I would like to share with you what CME Group does know and can share. To this end, I will briefly address the timeline of events in the days leading up to MFG's bankruptcy and the efforts to return to MFG's customers property that is rightfully theirs. Before I do that, I would like to provide the Subcommittee with some background information regarding the clearing model in the futures industry, including the role and obligations of FCMs and derivatives clearing houses.

The Futures Commission Merchant

An FCM is an individual or organization that (i) solicits or accepts orders to buy or sell futures contracts or options on futures contracts and (ii) accepts money or other assets from customers to support such orders. As such, FCMs are agents or intermediaries for their customers. Among other things, the Commodity Exchange Act ("CEA"), which is the main statute governing the FCM's legal obligations, expressly states that all money and other property of any customer received to margin or guarantee a derivative contract cleared though a derivatives clearing organization belongs to the customer and may not be commingled with the FCM's own trading accounts.

With respect to ensuring that such customer collateral received by the FCM is segregated, the CEA, applicable regulations of the Commodity Futures Trading Commission ("CFTC") and our clearing house rules require that money and other customer property must be separately accounted for and may not be commingled with the funds of the FCM or be used to margin, secure, or guarantee any trades or contracts of any person other than the person for whom the same are held. Additionally, CME Clearing has rules on its books directly addressing FCMs' obligations in this regard.

In practice, an FCM maintains a number of customer segregated accounts at custodians approved by the CFTC. As a customer establishes positions, the FCM transfers collateral from one of its customer segregated accounts to a customer segregated account maintained and controlled by the clearing house. In many cases, the FCM collects margin from its customers in excess of what is required by the clearing house to support the customer positions cleared through the clearing house; this "excess margin" is held in an account controlled by the FCM for the benefit of its customers.

Derivatives Clearing Houses

A clearing house acts as the seller to every buyer and buyer to every seller of every cleared contract. Twice a day it pays winners and collects from losers so that debt is eliminated from the system and systemic risk is minimized. When a firm fails to pay its losses, the clearing house must still pay the firms with profitable positions. The Guaranty Fund is one of the principal means to make such payments possible.

Each clearing member contributes assets and agrees to pay an assessment, based on its risk profile, for the sole purpose of covering any loss suffered by the clearing house when it makes good on its commitment to honor its contracts despite the default of another clearing member. This guaranty is designed to protect against systemic risk that could arise if the default of one clearing member leads to the failure of other clearing members. It is worth noting that the assets in and committed to the Guaranty Fund do not belong to the CME, they belong to the clearing members who have contributed them.

Nearly 65 different U.S. FCMs hold approximately $155 billion in U.S. customer collateral and nearly $40 billion in collateral held for trading on foreign exchanges — much of which is not placed with regulated clearing houses. As of March 2011, the total amount of customer funds held by the top 30 FCMs was more than $163 billion. No clearing house, however large, could effectively or economically guarantee all such funds and all such activity.

CME also was the designated self-regulatory organization ("DSRO") for MFG. As MFG's DSRO, CME was responsible for, among other things, conducting periodic audits of MFG's FCM-arm and sharing any and all information with the other regulatory bodies of which the firm is a member. CME conducted audits of MFG pursuant to standards and procedures established by the Joint Audit Committee ("JAC")[2] and reported such results to the CFTC. CME conducted audits of MFG, and all firms for which it was the DSRO, at least once every 9-15 months. The last audit was as of the close of business on January 31, 2011. This regulatory audit began subsequent to the audit date and was completed with a report date of August 4, 2011.

Nothing is more important to CME Group than protecting customer funds and this is exactly what our audits are designed to ensure. We reviewed the manner in which segregated funds were invested and required certain modifications which were immediately implemented. All other audit points were relatively minor and were immediately corrected. During this same period, MFG's accounting and management controls were also reviewed by its CPA, which certified its books and records as of March 31, 2011, and by securities regulators, who required certain accounting treatment changes.

The Days Preceding MFG's Bankruptcy

During the week of October 24, 2011, MF Global announced losses and suffered credit rating downgrades, which sparked rumors of its efforts to sell its brokerage business. On Thursday, October 27th, two of our auditors made an unannounced appearance at MFG's Chicago offices to review the daily segregation report for the close of business on October 26th — the report stated that segregation was intact. Our auditors asked for the material necessary to reconcile the numbers on the segregation report to the general ledger and to third party sources. These procedures continued through Friday evening. At the time they left the office they had noted only immaterial discrepancies and we saw no indication that segregated funds were missing as of Wednesday October 26th. The segregation report for October 27th, which we received on the afternoon of the 28th, asserted that the firm remained in full compliance with segregation requirements.

Our auditors returned on Sunday, October 30th because we learned from the CFTC that the draft segregation report for Friday, October 28th, which had been provided to the CFTC that day, showed a $900 million dollar shortfall in segregation caused by an "accounting error." Our auditors, working with

[2] The JAC is a representative committee of U.S. futures exchanges and regulatory organizations which participate in a joint audit and financial surveillance program that has been approved and is overseen by the CFTC. The purpose of the joint program is to coordinate among the participants numerous audit and financial surveillance procedures over registered futures industry entities.

the CFTC, devoted the rest of the day and night Sunday to find the so-called accounting error. No such error was ever found. Instead, at about 2 am Monday morning, MFG informed the CFTC and CME that customer money had been transferred out of segregation to firm accounts. After receiving this information, CME remained at MF Global while MF Global attempted to identify funds that could be transferred into segregation to reduce or eliminate the deficiency. A CME auditor also participated in a phone call with senior MF Global employees wherein one employee indicated that Mr. Corzine knew about loans that had been made from the customer segregated accounts. CME Group has provided this information and the names of these individuals to the Department of Justice and the CFTC who are investigating these matters.

Transfers of customer funds for the benefit of the firm constitute serious violations of our rules and of the Commodity Exchange Act. MFG was taken over by a SIPC Trustee on Monday. However, before the SIPC Trustee stepped in Monday, the segregation report for Thursday, October 27th, which had shown not only full segregation compliance but also $200 million in excess segregated funds, was corrected by MFG to show a deficiency of $200 million in segregated funds. Apparently based on MFG's segregation reports, additional transfers out of segregation occurred on Friday.

MFG's Bankruptcy, the Trustee and CME Group's Guarantee to the Trustee

As previously noted, prior to MFG's bankruptcy, a shortfall was discovered in the customer segregated funds held at MFG. For this reason, unlike prior bankruptcies by FCMs, customer positions and property were not able to be ported to another solvent clearing firm. Since MFG was placed into bankruptcy, as a matter of law, the SIPC Trustee has been in control of the process and all decisions regarding MFG assets and the money, securities and property of its customers. The Trustee is holding and/or has control of a substantial pool of customer property, but must be cautious about making a distribution before he completes all of his forensic work.

At the time it was placed into bankruptcy, MFG should have had about $5.5 billion in customer segregated money, securities and property, but only held $5 billion. Approximately $2.7 billion of the $5 billion had been transferred to clearing houses in the form of collateral necessary to support positions held by MFG customers. Approximately $2.3 billion of the $5 billion in customer segregated funds was subject to MFG's sole control because those funds were not needed to collateralize open positions on any exchange or clearing house. Approximately $2.5 billion was securely-held by CME Clearing. Of that amount, CME Clearing held nearly $1 billion of so-called excess collateral on behalf of MFG customers.

The information available suggests that there might be a shortfall in segregated funds, which currently could be between 13% and 19% of segregated funds, if the information proves correct. The Trustee must also consider that the shortfall may be even greater and that if he distributes based on that assumption and it turns out to be incorrect, some customers might get better treatment than others, in contravention of the Bankruptcy Code and CFTC Regulations.

To encourage the Trustee to make a prompt distribution of property to customers, CME Group made a $550 million guarantee to the Trustee. The guarantee is not a payment made to customers, but rather a pledge of funding to the Trustee to provide him the flexibility to return more customer assets to customers now. In the event that an interim distribution by the Trustee gives customers more cash than they would have been entitled to in the claims process under the Bankruptcy Code and CFTC regulations, CME Group has proposed that our guarantee would be used to make the customer segregation asset pool whole for the amount of any over-distribution, up to $550 million. As a result of the guarantee, we believe the Trustee should be protected if he decides now to distribute to every customer at least 75% of its account value. We believe these extraordinary measures are needed because an interim distribution by the Trustee could be delayed even further without them.

On November 29, the Trustee filed a motion with the Bankruptcy Court seeking permission to make a third interim distribution of customer funds in the coming weeks. Though details of the timing and amount of the distributions are still being worked out, the Trustee has stated that CME Group's financial guarantee will enable him to return more than 2/3 of the value of frozen customer segregated accounts, up to an additional $2.1 billion, in roughly two to four weeks. The Trustee has stated that this distribution will include trapped account balances, dishonored checks and distributions with respect to warehouse receipts and other customer property at MFG. Beginning next week, another $2.0 billion-plus is expected to be released in reliance on our guarantee.

Separately, CME Group also announced that CME Trust would make its $50 million in assets available to CME Group market participants that suffered losses due to MFG's improper handling of funds held at the firm level. The CME Trust was established in 1969 to provide financial protection to customers in the event a CME Group member firm was unable to meet its obligations to customers. CME Trust is providing virtually all of its capital, $50 million, to CME Group market participants suffer losses as a result of MFG's improper handling of customer funds at the firm level. Unlike the $550 million CME Group guarantee, which is a limited guarantee in connection with the goal of accelerating interim distributions by the Trustee, the $50 million from the CME Trust will cover CME Group customer losses due to MFG's misuse of customer funds. We note that there also are civil and criminal penalties for misusing segregated funds as MFG did here, which, if recovered, would be used to address the current shortfall.

Conclusion

Our audit and spot check of MFG were performed at the highest professional level; the transfer of segregated funds out of the appropriate accounts was disguised from all regulators. CME Group has and continues to take extraordinary measures to minimize the impact that this unprecedented event has had on the futures industry and its participants. MFG appears to have broken a number of rules and obligations to protect customer collateral resulting in customer losses.

Nothing is more important to CME Group than protecting customers. CME has worked diligently to permit customers to liquidate positions, transfer accounts and recover a significant portion of the value of their accounts. We provided the Trustee comfort with a $550 million guarantee, so that he could expedite the release of funds to customers without loss to the bankruptcy estate. Customers, however, are justifiably frustrated that they do not yet have access to their own money.

Some might conclude that the system failed because of this one instance when customers have been injured despite the prescribed system of segregation. Regulatory failures happen, unfortunately. Banks fail and the FDIC provides sometimes inadequate protection to depositors. The taxpayers get tapped. Securities firms fail and SIPC is irrelevant to any large account holders. The laws prohibit Ponzi schemes, yet hundreds are detected every year after the public has been robbed and the money evaporated. Insider trading happens every day. Enron explodes, Lehman fails. Insurance companies fail and policy holders lose. While it is clear that action is necessary to restore customer confidence and protect against future failures, the fact is that MFG broke rules by moving customer segregated funds out of an account over which it had control. A firm failed to comply with applicable rules, but that does not mean the segregation system is a failed system. To be clear, the customer segregation regime in the futures industry was not the cause of the losses that customers are suffering from today.

We look forward to working with the industry, regulators and Congress to explore potential improvements to increase security of customer funds held by FCMs and restore confidence in the futures industry.

Testimony of

Richard G. Ketchum
Chairman and CEO
Financial Industry Regulatory Authority

Before the Subcommittee on Oversight and Investigations
Committee on Financial Services

U.S. House of Representatives

December 15, 2011

Chairman Neugebauer, Ranking Member Capuano and Members of the Subcommittee:

I am Richard Ketchum, Chairman and CEO of the Financial Industry Regulatory Authority, or FINRA. On behalf of FINRA, I would like to thank you for the opportunity to testify today.

When a firm like MF Global fails, there is always value in reviewing the events leading to that failure and examining where rules and processes might be improved. I commend the Subcommittee for having this hearing to do just that. Clearly the continued impact of MF Global's failure on customers who cannot access their funds is of great concern, and every possible step should be taken to transfer and restore those accounts as quickly as possible.

Like many other financial firms today, MF Global's operations included multiple business lines, engaging multiple regulatory schemes and crossing national boundaries. We and the other regulators here today will explain our roles in overseeing the various parts of the firm. We all share the goal of restoring funds to customers. While FINRA's role in that process is limited at this stage, we are committed to continuing to provide assistance wherever we can.

FINRA

FINRA is the largest independent regulator for all securities firms doing business in the United States, and, through its comprehensive regulatory oversight programs, regulates both the firms and professionals that sell securities in the United States and the U.S. securities markets. FINRA oversees approximately 4,500 brokerage firms, 163,000 branch offices and 636,000 registered securities representatives. FINRA touches virtually every aspect of the securities business—from registering industry participants to examining securities firms; writing rules and enforcing those rules and the federal securities laws; informing and educating the investing

public; providing trade reporting and other industry utilities and administering the largest dispute resolution forum for investors and registered firms.

In 2010, FINRA brought 1,310 disciplinary actions, collected fines totaling $42.2 million and ordered the payment of almost $6.2 million in restitution to harmed investors. FINRA expelled 14 firms from the securities industry, barred 288 individuals and suspended 428 from association with FINRA-regulated firms. Last year, FINRA conducted approximately 2,600 cycle examinations and 7,300 cause examinations.

One of our regulatory programs that is particularly relevant to today's hearing is our financial and operational surveillance. Through this program, FINRA reviews FOCUS (Financial and Operational Combined Uniform Single) reports that broker-dealers file on a monthly basis as required by the Securities and Exchange Commission (SEC). These reports detail a firm's financial and operational conditions and allow FINRA to closely monitor a firm's net capital position and profitability for signs of potential problems.

FINRA's activities are overseen by the SEC, which approves all FINRA rules and has oversight authority over FINRA operations.

Oversight of MF Global

Like many financial firms today that operate simultaneously in multiple channels, MF Global was not solely a broker-dealer, but also a futures commission merchant or FCM. As such, multiple government regulators and self-regulatory organizations (SROs), including FINRA, had a role in overseeing various parts of the firm's operations.

With respect to oversight of MF Global's financial and operational compliance, which is most relevant to today's hearing, FINRA shares oversight responsibilities with the Chicago Board Options Exchange (CBOE) and the SEC, especially in terms of the firm's compliance with the net capital rule. For broker-dealers that are members of multiple SROs, the SEC assigns a Designated Examining Authority, or DEA, to examine the firm's financial and operational programs, including the firm's compliance with the Commission's net capital and customer protection rules. For MF Global, that DEA is the CBOE. As such, CBOE conducted the regular examinations of the firm for capital compliance.

There are two primary SEC rules for which financial examinations evaluate compliance, the net capital and customer protection rules. The primary purpose of the SEC's net capital rule, 15c3-1, is to protect customers and creditors of a registered broker-dealer from monetary losses and delays that can occur if that broker-dealer fails. It requires firms to maintain sufficient liquid assets to satisfy customer and creditor claims. It accomplishes this by requiring brokerage firms to maintain net capital in excess of certain minimum amounts. A firm's net capital takes into account net worth, reduced by illiquid assets and various deductions to account for market and credit risk. This amount is measured against the minimum amount of net capital a firm is required to maintain, which depends on its size and business. The net capital rule is intended to provide an extra buffer of protection, beyond rules requiring segregation of customer funds, so that if a firm cannot continue business and needs to liquidate, resources will be available for them to do so.

The SEC's customer protection rule, 15c3-3, has two components, reserve formula computation and possession or control, and was designed to ensure the safety of customers' assets. The objective of the reserve formula computation is to protect the customer funds in the event the broker-dealer becomes financially insolvent. Possession or control requires that the broker-dealer obtain prompt possession or control of customers' fully paid for and excess margin securities, ensure that customers' assets held by a broker-dealer are properly safeguarded against unauthorized use and separate firm and customer related business.

Fewer than 20 FINRA-regulated broker-dealers have a DEA other than FINRA, but in those cases, we work closely and cooperatively with the DEA when questions or issues arise. Even when we are not the DEA for one of our regulated broker-dealers, FINRA monitors and analyzes the firm's FOCUS report filings and annual audited financial statements as part of our ongoing oversight of the firm. That was the case with MF Global.

While that monitoring focuses on a broad range of issues, it is particularly relevant to note that our financial surveillance team placed a heightened focus on exposure to European sovereign debt beginning in spring 2010. During April and May, our staff began surveying firms as to their positions in European sovereign debt as part of our ongoing monitoring of regulated firms.

In response to our outreach on this issue, MF Global indicated in late September 2010 that the firm did not have any such positions. We later learned that the firm began entering into transactions that carried European debt exposure in mid-September 2010. While the firm's response was consistent with GAAP accounting rules that repo-to-maturity (RTM) transactions are treated as a sale for accounting purposes, the lack of a complete response delayed us in detecting the firm's exposure.

MF Global's Exposure to European Sovereign Debt

In a routine review of MF Global's audited financial statements filed with FINRA on May 31 of this year, our staff raised questions about a footnote disclosure regarding the firm's RTM portfolio. RTMs are essentially transactions whereby the maturity date of a firm's bond position held in its inventory matches the maturity date of the repo. During the course of discussions with the firm, FINRA learned that a significant portion of that portfolio was collateralized by approximately $7.6 billion in European sovereign debt. According to U.S. GAAP, RTMs are afforded sale treatment and therefore not recognized on the balance sheet. Notwithstanding that accounting position, the firm remained subject to market and credit risk throughout the life of the repo.

Beginning in mid-June, FINRA had detailed discussions with the firm, in which CBOE also participated, regarding the proper treatment of the RTM portfolio and we asserted that not enough capital was reserved against the RTM. While the SEC has issued guidance clarifying that RTMs collateralized by U.S. Treasury debt do not require capital to be reserved, there is no such relief for RTMs collateralized by debt of non-U.S. governments. We researched whether the firm retained default risk on the positions, and concluded that it did. Our view was that while recording the RTMs as sales was consistent with GAAP, they should not be treated as such for purposes of the capital rule given the market and credit risk those positions carried. As a result, we asserted that capital needed to be reserved against the RTM.

FINRA and CBOE also had discussions with the SEC about our concerns that the firm was not holding capital against its RTM portfolio. The SEC agreed with our assertion that the firm

should be holding capital against the positions. The firm fought this interpretation throughout the summer, appealing directly to the SEC, before eventually conceding in late August.

The firm infused additional capital and filed an amended July FOCUS report on August 31 to report a $150 million capital deficiency in July. The firm also provided notification, pursuant to SEC Rule 17a-11, of its capital deficiency to the SEC, CBOE and FINRA as well as to the Commodity Futures Trading Commission (CFTC), pursuant to CFTC Rule 1.12. The net capital deficiency in the amended July FOCUS report was reported on the CFTC's website. In addition, on September 1, the firm amended its Form 10-Q filing with the SEC to identify the change in net capital treatment of the RTM portfolio.

In September, FINRA added MF Global to "alert reporting," a heightened monitoring process whereby we require firms to provide weekly information on net capital, inventory, profit and loss as well as reserve formula computations.

On October 19, the Intermarket Financial Surveillance Group (IFSG), which is comprised of securities and futures regulators and self-regulatory organizations, had its annual meeting. The IFSG was established in 1989 in order to enhance the coordination and monitoring efforts of both securities and commodities regulators. Through an information sharing agreement, SROs provide each other with financial surveillance data and related information on an as-needed basis. In addition, SRO representatives meet annually to discuss relevant capital and customer protection issues. Exposure to European sovereign debt was one of the topics at the October meeting and FINRA raised MF Global's positions during the discussions.

During the week of October 24, as MF Global's equity price declined and its credit rating was cut, FINRA increased the level of surveillance over the firm. We requested detailed information about the firm's balance sheet and liquidity; we received updates about the loss of lending counterparties and customers; and we spoke to clearing organizations about the margin required to settle trades. At the end of that week, FINRA was on site at the firm, with the SEC, as it became clear that MF Global was unlikely to continue to be a viable standalone business. Our primary goal was to gain an understanding of the custodial locations for customer securities and to work closely with potential acquirers in hopes of avoiding SIPC liquidation. As has been widely reported, the discrepancy discovered in the segregated funds on the futures side of the firm ended those discussions.

MF Global Bankruptcy and Liquidation Proceeding

On October 31, 2011, MF Global Holdings, Ltd. and MF Global, Inc. filed for bankruptcy and entered into SIPC liquidation. Since that time, FINRA has provided assistance as requested by the SEC and the trustee.

On November 4, 2011, FINRA assisted the trustee in alerting broker-dealer firms via email that the trustee was accepting proposals for the transfer of approximately 450 customer securities accounts of MF Global to another member of SIPC.

We have also assisted the trustee by providing information about other broker-dealers to which MF Global securities customer accounts may be transferred.

Proposed Rules to Enhance Financial Surveillance and Expedite the Return of Customer Funds and Securities in the Event of Liquidation

While FINRA believes that financial oversight rules of the SEC, combined with SIPC, create a good structure for protecting customer funds, firm failures provide opportunities for review and analysis of where improvements may be warranted. FINRA has proposed two rules that we believe would assist us in our work to monitor the financial status of firms. One of the proposals, approved by FINRA's Board in September of this year, would expedite the liquidation of a firm and most importantly, the transfer of customer assets. This rule is focused on enabling a more orderly resolution when a firm must cease operations. Specifically, it would require firms to contractually require their clearing banks and custodians to continue providing transaction feeds to the firm after the commencement of liquidation avoiding the recent reconciliation problems experienced by MF Global in its final days of business.

The rule would require the clearing agencies and custodians to provide read-only access to the firm's records to the regulators and SIPC, with the goal of providing a more timely transfer of customer assets. The rule would also require carrying or clearing firms regulated by FINRA to maintain and keep current certain records in a central location to facilitate a more rapid and orderly transfer of customer accounts to another broker-dealer as well as a more orderly liquidation in the event the firm can no longer continue to operate.

The other proposed rule, approved by FINRA's Board in July 2010, would require that FINRA-regulated firms file additional financial or operational schedules or reports as we deem necessary to supplement the FOCUS report. The rule would provide FINRA with the framework to request more specific information regarding, among other things, the generation of revenues and allocation of expenses by business segment or product line, the sources of trading gains and losses, the types and amounts of fees earned and the nature and extent of participation in securities offerings. As part of the rule filing, we have proposed a supplemental statement of income to the FOCUS reports, in order to capture more granular detail of a firm's revenue and expense information.

We are also working to develop an off balance sheet schedule, which could highlight exposures to regulators on a more timely basis.

We believe these proposals would enhance our ability to closely oversee the financial operations of firms we regulate and to more quickly and efficiently assist in transfers or liquidations when firms must close their doors.

Conclusion

FINRA will continue to work with our fellow regulators and Congress as the liquidation process for MF Global proceeds. We share your commitment to reviewing the events involved in the firm's collapse, relevant rules and coordination with other regulators to identify the lessons learned and potential policy or procedural adjustments that may be warranted.

We realize that it is critical to continually evaluate the customer protection regime to ensure that it is designed as well as it can be to ensure prompt restoration of customer funds in the event of a firm collapse. To that end, we would be glad to participate in a broader review, in coordination with the SEC, CFTC, self-regulatory organizations and others to provide an overall assessment of where current rules and processes may need enhancements.

Again, I appreciate the opportunity to testify today. I would be happy to answer any questions you may have.

Testimony of James B. Kobak, Jr.
Counsel for the Trustee for the Securities Investor Protection Act Liquidation of MF Global Inc.
Committee on Financial Services of the U.S. House of Representatives
Subcommittee on Oversight and Investigations
December 15, 2011

Chairman Neugebauer, Ranking Member Capuano and Members of the Committee: Thank you for inviting me to testify today about efforts to identify, preserve and return assets to former customers of MF Global Inc. My name is James B. Kobak, Jr. I am a partner at the law firm Hughes Hubbard and Reed and lead counsel to James Giddens, the court-appointed Trustee for the Securities Investor Protection Act (SIPA) liquidation of the failed broker-dealer, MF Global Inc. On behalf of the Trustee, I would like to provide an update on the actions his office is taking to protect MF Global Inc. customers.

Introduction

On October 31, 2011, Mr. Giddens was appointed as the independent Trustee for the liquidation of MF Global Inc. by the United States District Court for the Southern District of New York, on recommendation from the Securities Investor Protection Corporation, or SIPC. As empowered by the Securities Investor Protection Act of 1970, when a brokerage firm must be liquidated due to bankruptcy or other financial difficulties, SIPC uses a court-appointed Trustee to, within certain limits, return customers' property as quickly as possible.

A different Trustee has been appointed to oversee the bankruptcy proceedings of MF Global Holdings Ltd. As counsel for the Trustee liquidating MF Global Inc., I do not have obligations to the MF Global holding company, nor do I have firsthand knowledge about the events that transpired prior to MF Global's bankruptcy.

The Trustee is the customers' advocate. His statutory mandate is to preserve and recover MF Global Inc. customer assets so that they can be returned to the rightful owners and to maximize the estate for all stakeholders. The Trustee's staff, which includes legal experts, consultants and forensic accountants, is singularly focused on looking after the interests of customers and returning assets to them as quickly as possible and in a way that is fair and consistent with the law.

The Trustee appreciates the interest of this Committee and other Members of Congress and has been working closely and continuously with SIPC, Commissioner Jill Sommers and the Commodity Futures Trading Commission, Chairperson Mary Schapiro and the Securities and Exchange Commission, along with the staffs of their respective organizations, and the Chicago Mercantile Exchange.

Distributions to nearly all of the approximately 36,000 former MF Global Inc. retail customers, whether farmers, day traders, or institutional investors, have been made within weeks of the bankruptcy filing. Through expedited court filings approved by the Bankruptcy Court, we are now in the process of completing a third transfer that will bring the total distribution to customers to more than $4 billion. The customer claims process, which we asked the Bankruptcy Court to authorize us to establish on an expedited basis, is also up and running. Claims forms are on our website and have been sent by mail, and claims review is underway.

The Trustee's goal remains to pay MF Global Inc.'s former retail commodities and securities customers 100% of the amounts in their accounts as promptly as permitted by governing regulations. Ultimate distributions are, of course, dependent upon assets available and there is no assurance of a 100% return.

Exhaustive efforts to collect funds from US depositories continue. However, complicating matters, assets located in foreign depositories for customers that traded in foreign futures are now under the control of foreign bankruptcy trustees or administrators. While the Trustee will pursue them vigorously, experience dictates that recovery of these foreign assets may be more uncertain and may take more time.

The Office of the Trustee has made every effort to communicate directly and frequently with customers. Our website includes updates, court filings, claims forms and claims filing instructions, including a section addressing the common questions being asked by customers in calls or other communications to the Trustee's staff. The Trustee's staff is answering customer calls and emails and holding meetings with customer groups and counsel. In the month of November, the call center handled more than 8,500 calls, and more than 60,000 individuals accessed our website on more than 222,000 occasions.

If your constituents have any questions, I encourage them to visit MFGlobalTrustee.com, e-mail the Trustee's staff at MFGITrustee@hugheshubbard.com, or call our call center at 1-888-236-0808.

The Trustee and everyone working with him understands the frustration of many former MF Global Inc. customers, some of whom you have heard from directly. When a broker-dealer fails under the unprecedented circumstances surrounding MF Global's demise, the liquidation is necessarily complex. The Trustee's office has been working tirelessly with speed and diligence to identify ways to return assets to customers to the full extent of our ability under the applicable provisions of SIPA, the Bankruptcy Code and CFTC regulations.

Customer Distributions

Commodities Accounts

Returning assets to the approximately 36,000 former MF Global Inc. retail commodities customers, who held millions of US futures positions, has been accomplished thus far through three Bankruptcy Court-approved bulk transfers. Once the Court-approved bulk transfers are completed, more than $4 billion will have been distributed back to these former commodities customers with US futures positions.

Approximately $2 billion was distributed to former MF Global Inc. retail commodities customers through the first two bulk transfers, which are substantially complete. The first transfer was approved by the Court just two days after the appointment of the Trustee and implementation began immediately. The first bulk transfer involved those accounts with open commodities positions – a total of more than 3 million positions with a notional value in excess of $100 billion. This transfer was implemented immediately to avoid automatic liquidation of the open positions per CFTC regulations, which would have disadvantaged customers and created instability in the futures market. The second bulk transfer totaled approximately $500 million in customer assets and involved accounts with cash-only accounts.

A third bulk transfer was approved by the Bankruptcy Court last week, and it will allow the distribution of an additional $2.2 billion, which should result in former MF Global Inc. retail commodities customers with US futures positions receiving approximately 72% of their property. The implementation of this third bulk transfer is now underway, with completion of the process expected in two to four weeks.

The Trustee appreciates the exhaustive efforts of the CME and other derivative clearing organizations, which have made the bulk transfers possible. The Trustee also appreciate the CME's offer of a $550 million guarantee, which will be available for the benefit of commodity customers should it ultimately be determined that any customer has received more than a pro rata share of the final distribution.

Securities Accounts

Last week, the Bankruptcy Court approved an expedited motion seeking authorization to sell and transfer substantially all retail securities accounts to Perrin, Holden & Davenport Capital Corp. This transfer of approximately 330 accounts will allow former MF Global Inc. retail securities customers to receive all or a majority of the net equity in their accounts. Securities customers should receive 60% or more of their account value, and 85% of the securities customers may receive the full 100% because of a SIPC guarantee.

We appreciate the ongoing support and partnership of SIPC. The staff of SIPC has been an invaluable resource for the Trustee's office as we work to protect customers and return assets as quickly as possible. SIPC will play a vital role in the return of securities customer assets.

Claims Process

The Bankruptcy Court approved the customer claims process on an expedited basis on November 22, 2011. Consistent with SIPA principles and in the interest of an orderly and efficient claims process, separate, parallel customer claims processes have been established for MF Global Inc.'s commodity futures customers, securities customers, and general creditors, respectively.

Former MF Global Inc. commodity futures customers will file their claims against the segregated and secured funds for commodity customers. They will receive a prorated distribution from two subsets of customer funds: one for US positions traded through US clearing houses (so-called Rule 4(d) segregated funds), and another for foreign positions (so-called Rule 30.7 secured funds). The foreign secured funds are now largely under the control of foreign bankruptcy trustees or administrators, and the Trustee will use all means available to gain control of those assets held by foreign entities for the return to US customers. At this time, we do not have control of most of these assets and it is not known when, or if, the assets will become available to the Trustee's office. If commodity customer claims are not satisfied from the segregated commodity account estate, the remaining claim will automatically go against the general creditors' estate.

Security customers will file their claims against the separate fund of customer property segregated for security customers under SEC rules. Deficiencies will be covered to the limit of SIPC, which is $500,000 for the valid claims of each securities customer, including up to $250,000 for claims for cash deposited for the purpose of purchasing securities. Remaining deficiencies in security customer claims, if they exist, will automatically go against the general creditors' estate. Many of these claims should have been satisfied through the Court-approved transfer of securities accounts to Perrin, Holden & Davenport Capital Corp.

General creditors' prepetition claims can only be satisfied from the general creditors' estate – not from the customer estates.

The clear regulatory intent of SIPA is the protection of customer property. Consistent with SIPA, the Trustee has the authority to seek recovery of assets removed from customer property funds to the extent a cause of action exists against those who wrongfully removed the funds. In addition, the Trustee may also seek Bankruptcy Court approval to allocate existing funds from the other sources to the funds of customer property for distribution to customers to the extent of regulatory shortfalls and under certain conditions and circumstances.

Claims have already started to be filed and reviewed. The Trustee's office is committed to processing them promptly and to supporting a customer-friendly claims process. More than 75,000 claims forms have been mailed to customers, and PDF claims forms have been available on the Trustee's website since November 23, 2011. Detailed instructions and deadlines are also available on the website, and the Trustee and his staff have been meeting with customer groups and counsel about the process.

Investigation and "Shortfall"

As part of the Trustee's statutorily-mandated duty, he is investigating the extent of and reasons for any shortfall in customer funds. An investigative team, consisting of counsel experienced in broker-dealer liquidations and expert consultants and forensic accountants from both Deloitte and Ernst & Young, continues in close coordination with the Department of Justice, the CFTC, the SEC, SIPC, and others.

The investigation is ongoing, and we are not yet in a position to make any definitive conclusions. The Trustee's office does not know at this time, with certainty, the extent of the potential segregation and compliance shortfalls, but our best estimate is that the figure could be as much as $1.2 billion or more. The Trustee's investigation into shortfalls involves all customer accounts. The full amount of any shortfall will not be known with certainty until the claims process is completed. These are preliminary numbers that may well change, and the Trustee will update these numbers as appropriate. He felt obligated to share preliminary numbers and explain their uncertainty to the public to dampen assumptions that some smaller amount of the shortfall was known with certainty and could not be larger. It is our hope that, for the benefit of customers, the number will come down. No matter the exact amount of the shortfall, however, its probable size is significant and will substantially affect the Trustee's ability to make a 100% distribution to former MF Global Inc. customers.

The investigation will also address broader topics, including the demise of MF Global Inc. and the events and transactions that preceded it. The Trustee has requested and has been granted subpoena power to aid in the investigation. The Bankruptcy Court has written an opinion supporting the Trustee's view of the importance of maintaining the independence of that investigation and denying participation in it by the representatives of the holding company or former management whose conduct is an important subject of the investigation. At the same time, the Trustee is coordinating his investigation with those being conducted for law enforcement purposes by the SEC, the CFTC, and US Attorneys. He expects to make an interim report on the investigation to the Court at an appropriate time, and on completion of the investigation, the Trustee expects to make the final report public.

Conclusion

Thank you Chairman Neugebauer, Ranking Member Capuano and Members of the Committee for the opportunity to be here on behalf of the Trustee and to submit this testimony for the full record of the hearing. You can be assured that all of us working with the Trustee are fully committed to returning customers' property as quickly as possible in a fair and equitable manner that complies with the law.

APPENDIX – TIMELINE OF TRUSTEE'S MOTIONS ON BEHALF OF CUSTOMERS AND COURT APPROVALS

- **October 31, 2011** – Court appointment of the Trustee for the SIPA Liquidation of MF Global Inc. at approximately 5:00 pm EST.
- **November 2, 2011** – Trustee files emergency motion seeking approval of the bulk transfer of customer commodity open positions and a percentage of the collateral associated with those positions.
- **November 2, 2011** – Court holds a hearing and approves Trustee's motion for the bulk transfer of open positions and collateral.
- **November 4, 2011** – Court holds a hearing on an expedited basis and confirms Trustee's authority to issue subpoenas as part of his duty to conduct an investigation. The Court denies a motion to participate in the investigation by representatives of the holding company and subsequently issues an opinion emphasizing the importance of the independence of the Trustee's investigation.
- **November 7, 2011** – Trustee files motion seeking establishment of procedures to return misdirected wires.
- **November 15, 2011** – Trustee files application seeking approval of an expedited claims process.
- **November 15, 2011** – Trustee files motion seeking approval of the bulk transfer of 60% of the cash attributable to commodities accounts holding only unencumbered cash, or cash equivalents, on October 31, 2011.
- **November 17, 2011** – Court holds a hearing and approves Trustee's motion for the bulk transfer of cash-only accounts.
- **November 22, 2011** – Court holds a hearing and approves Trustee's expedited claims process.
- **November 22, 2011** – Court holds a hearing and approves procedures for return of post-bankruptcy misdirected wires.
- **November 29, 2011** – Trustee files motion seeking approval of the bulk transfer to restore approximately two-thirds or more of US segregated customer property pro rata to all former MF Global Inc. commodities customers with US positions.
- **November 30, 2011** – Trustee files motion seeking authorization to sell and transfer substantially all retail securities accounts to Perrin, Holden & Davenport Capital Corp.
- **December 9, 2011 –** Court holds a hearing and approves Trustee's motion for a third bulk transfer to former commodities customers with US positions.
- **December 9, 2011** – Court holds a hearing and approves Trustee's motion to sell and transfer substantially all retail securities accounts to Perrin, Holden & Davenport Capital Corp.
- **December 12, 2011** – Trustee files statement with Court outlining controlling legal principles and his position on issues of how customer claims will be determined and treated in the claims process.

CME Group

Kathleen M. Cronin
Managing Director
General Counsel and Corporate Secretary

December 13, 2011

Via Electronic Mail

The Honorable Randy Neugebauer
Chairman, Subcommittee on Oversight and Investigations
United States House of Representatives,
Committee on Financial Services
Washington D.C., 20515

RE: Request for Information Regarding Collapse of MF Global

Dear Chairman Neugebauer:

We write in response to your December 5, 2011 letter requesting that CME Group ("CME") provide certain information to help the Subcommittee understand our supervision of MF Global.

With respect to request 1, you have asked us to provide a detailed description of any concerns CME has had over the last five years regarding MF Global's record-keeping, internal controls, risk management, segregation of client funds, the number and performance of compliance staff, or any other compliance-related issue. You also ask for all documents related to those concerns. Providing a comprehensive response to this request, and compiling the related documents, would take considerable time. However, we do want to share with you what we currently know about issues raised during our regular audits of MF Global, as well as significant disciplinary actions against MF Global by CME's Market Regulation Department. CME issued the following audit reports for MF Global: (1) June 27, 2007 (as of December 31, 2006); (2) August 4, 2008 (as of January 31, 2008); (3) June 25, 2009 (as of December 31, 2008); (4) August 2, 2010 (as of January 31, 2010); and (5) August 4, 2011 (as of January 31, 2011). We understand that you will seek to obtain copies of those reports directly from the CFTC. As a result of those audits, CME issued a warning letter in 2007, and fined MF Global $25,000 in both 2008 and 2009, for violating CME Rule 930.D for allowing customers to trade without maintaining sufficient performance bonds. Following the 2011 audit, CME issued a warning letter to MF Global because certain customer segregated funds were not readily marketable or highly liquid, and other investments were not properly rated. The identified issues had no impact on excess segregated funds or excess net capital, and CME was informed by the firm that they were quickly remedied as required. In addition to the issues raised in the audits, in the last three years CME Group's exchanges took two significant disciplinary actions against MF Global, as a result of investigations by its Market Regulation Department. In December, 2008, CBOT fined MF Global $400,000 for failing to supervise employees and certain trade practice violations, including pre-execution communications. In December 2009, CBOT fined MF Global $495,000 for violations of CBOT rules in connection with trading by one of MF Global's associated persons in the CBOT wheat market. The NFA summaries of these disciplinary actions are attached. They are also included along with others we have been able to identify to date in the attached spreadsheet. Information related to these actions can also be found on the NFA website: www.nfa.futures.org.

With respect to requests 2 and 3, we enclose a chronology of matters that occurred during the week of October 24-31 related to MF Global's collapse. Specifically, the chronology represents CME's current timeline of our supervisory and auditing activities of MF Global. The chronology also summarizes communications among CME staff and between CME and the CFTC, SEC, NFA, FINRA and CBOE related to MF Global during the October 24-31 timeframe. Given the number of CME employees involved in this matter and the volume of communications related to MF Global during that busy week, CME's review of documents and collection of information concerning the events of October 24-31 is an ongoing process that we do not expect to be completed for weeks. We are also in the process of providing information and producing non-privileged documents in our position to the governmental authorities that are conducting the investigation of what occurred. We offer the above-referenced chronology, though it is not comprehensive or hour-by-hour because of the volume of information that would have to be processed to do so, in order to provide useful information to the

Subcommittee in advance of its hearing on December 15. We note for the Subcommittee that our understanding of what occurred the week October 24-31 likely will evolve and could change as we continue our review of documents and collection of data.

We look forward to continuing to work with you to help in any way we can with the Subcommittee's examination of the issues surrounding the collapse of MF Global.

Very truly yours,

Kathleen M Cronin

Kathleen M. Cronin

cc: The Honorable Michael Capuano
Terrence A. Duffy
Linda Dallas Rich

Case Summary

MF GLOBAL INC **CBOT CBOT-07-ETI-06-BC** **NFA ID: 0266826**

Respondent/Effective Date Summary

NFA ID	Respondent	Effective Date
0266826	MF GLOBAL INC	12/12/2008

Rule Summary

NFA ID	Respondent	Rule Type
0266826	MF GLOBAL INC	• CBOT9B.13 - TRADING AGAINST CUSTOMER ORDERS AND CROSSING ORDERS • CBOT480.10 - EMPLOYER SUPERVISION OF EMPLOYEES

Committee Summary

NFA ID	Respondent	Committee
0266826	MF GLOBAL INC	• BUSINESS CONDUCT COMMITTEE

Action Summary

NFA ID	Respondent	Action Types
0266826	MF GLOBAL INC	• TRADE PRACTICE

Penalty/Event Summary

NFA ID	Respondent	Penalty/Event	Event Date
0266826	MF GLOBAL INC	• OTHER-SEE NARRATIVE OR DESCRIPTION IN NOTICE • CEASE AND DESIST	

Narrative Summary

Narrative for 0266826 - MF GLOBAL INC

FINDINGS: Pursuant to an offer of settlement in which MF Global, Inc., a clearing member of the Chicago Board of Trade ("CBOT"), neither admitted nor denied the findings, on December 10, 2008, a Panel of the CBOT Business Conduct Committee decided that there was a reasonable basis to support the following findings.

1. CBOT 06-ETE-08-BC

On a number of occasions in 2006 and 2007, MF Global employees engaged in impermissible pre-execution communications in connection with trades executed on the e-cbot electronic trading platform and withheld customer orders that were executable in the market for the purpose of soliciting and brokering contra-orders. MF Global failed to properly supervise its employees in connection with these trades.

The Panel found that in so doing MF Global violated legacy CBOT Rule 504.00 and Regulations 480.10 and 9B.13.

2. CBOT 07-ETI-06-BC

On a number of occasions in 2006 and 2007, MF Global employees crossed orders on the e-cbot electronic trading platform without allowing for the minimum required exposure period between the entry of the orders.

The Panel found that in so doing MF Global violated legacy CBOT Regulations 480.10 and 9B.13.

3. CBOT 07-73207-BC

On April 17, 2007, MF Global employees entered a customer order on the e-cbot electronic trading platform that involved pre-execution communications.

The Panel found that in so doing MF Global violated legacy CBOT Regulation 9B.13(c).

PENALTY: In accordance with the settlement offer, the Panel:

1. fined MF Global $400,000;

2. ordered MF Global to cease and desist from engaging in the type of conduct described above as addressed in current CBOT Rules 529, 533, 539 and 432W.

3. ordered MF Global, in consultation with the CME Group Market Regulation staff, to enhance its training program covering trading practices for all employees engaged in the entry of orders for electronic and open outcry execution in all CME Group products. The enhanced training program for employees engaged in the solicitation or entry of orders for electronic execution in CME Group interest rate products must include in-person training regarding relevant CME Group electronic trading rules. MF Global must certify and maintain signed individual acknowledgements that the aforementioned employees have completed the respective program. The training program must be completed no more than six months from the effective date of this decision and must be followed by an annual systematic training program for all employees engaged in the entry of electronic and open outcry orders in all CME Group products, which is verifiable to the Exchange.

4. ordered MF Global to immediately enhance its supervisory procedures that shall include regular on-site reviews of electronic trading practices at its New York and Chicago locations and its affiliate's London location as well as periodic reviews of telephone recordings and electronic communications for a period of two years following the date of this decision. MF Global shall report to Market Regulation the scope and results of such reviews on a quarterly basis.

(The foregoing penalty covered three cases involving MF Global. In addition to this case, the penalty also covers findings against MF Global in case number CBOT-06-ETE-08-BC and CBOT-07-73207-BC. See those case numbers for the particular findings that were made in those respective cases.)

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Case Summary

MF GLOBAL INC **CBOT 08-00119-BC** **NFA ID: 0266826**

Respondent/Effective Date Summary

NFA ID	Respondent	Effective Date
0266826	MF GLOBAL INC	12/10/2009

Rule Summary

NFA ID	Respondent	Rule Type
0266826	MF GLOBAL INC	• CBOT576 - IDENTIFICATION OF GLOBEX TERMINAL OPERATORS • CBOT432(Y) - GENERAL OFFENSES • CBOT432(W) - GENERAL OFFENSES

Committee Summary

NFA ID	Respondent	Committee
0266826	MF GLOBAL INC	• BUSINESS CONDUCT COMMITTEE

Action Summary

NFA ID	Respondent	Action Types
0266826	MF GLOBAL INC	• GENERAL CONDUCT • TRADE PRACTICE • OFFICE RECORDKEEPING

Penalty/Event Summary

NFA ID	Respondent	Penalty/Event	Event Date
0266826	MF GLOBAL INC	• FINE $495000 • CEASE AND DESIST	

Narrative Summary

Narrative for 0266826 - MF GLOBAL INC

FINDINGS: Pursuant to an offer of settlement in which MF Global Inc., a clearing member of Chicago Board of Trade ("CBOT"), neither admitted nor denied the findings, on December 8, 2009, a Panel of the CBOT Business Conduct Committee found that on February 26-27, 2008, a MF Global associated person in one of its branch offices engaged in undetected overnight trading in wheat futures and other CBOT futures contracts. The associated person accumulated an extremely large short position in the May 2008 CBOT wheat futures contract despite the fact that he entered the trading session with a debit balance in his account. MF Global personnel failed to detect or prevent the associated person's excessive trading. In addition, MF Global failed to provide appropriate supervisory training to its branch office and to adequately enforce its own supervisory and risk management policies and procedures by its branch office supervisors. MF Global's personnel failed to enforce its supervisory and risk management policies and procedures, as well as detect or prevent excessive trading during that time period. Finally, MF Global failed to maintain proper Tag50 registration of Globex terminal operators.

The Panel found that in so doing MF Global violated CBOT Rules 432.W., 432.Y., and 576.

PENALTY: In determining an appropriate sanction, the Panel took into consideration that MF Global has entered into a settlement agreement with the Commodity Futures Trading Commission ("CFTC") in order to resolve related proceedings against the firm. After considering that and all the issues discussed above, it took the following actions:

1. ordered MF Global to cease and desist from engaging in the type of conduct described above;

2. ordered MF Global to (i) provide CME Group's Market Regulation Department with written policies and procedures for complying with Rule 576 by March 31, 2010, and (ii), in consultation with the Market Regulation Department, enact improved processes and procedures for abiding by the requirements of Rule 576 (a follow up Tag50 audit will be conducted by June 30, 2010);

3. ordered MF Global to satisfy all the "Undertakings" identified in its settlement with the CFTC in matter No. 10-03;

4. file simultaneously with the Market Regulation Department any written reports requested by, and filed with, the CFTC concerning the satisfaction of the "Undertakings" identified in its settlement with the CFTC in Matter No. 10-03; and

5. fined MF Global $495,000.

EFFECTIVE December 10, 2009

DATE:

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	Case Number	Respondent	Sanction	Rules	Summary	Effective
1	CBOT 06-INV-16	Man Financial, Inc.	$75,000	9B.06 and 9B.13	Legacy CBOT Floor Governors Committee found that MFG engaged in pre-execution communications and executed cross trades in violation of Reg. 9B.13 (trading against customer orders and crossing orders). Related to 16 transactions not enough exposure; 8 transactions involving pre-execution communication. FGC found that MFG failed to supervise its employees' compliance with Exchange regulations with regard to 9B.06 (e-cbot user IDs).	1/3/2007
2	CBOT 06-RFT-021	MF Global Inc.	$1,000	332.08	Firm failed to make all trade data submissions in a correct manner	1/22/2007
3	CME 06-27946-CTRA	MF Global Inc.	$1,000	536.D.	One of MF Global's sub-firm's (XFA) Order Type Indicator exception rate for floor orders exceeded 10% threshold	1/26/2007
4	CME 06-27937-CTRA	MF Global Inc.	$1,000	536.D.	One of MF Global's sub-firm's (XFA) Order Type Indicator exception rate for floor orders exceeded 10% threshold	1/26/2007
5	CME 07-28018-CTRT	MF Global Inc.	$5,000	536.A.6	Timestamp exception percentage exceeded the 7% threshold. Third violation in 3 months.	1/29/2007
6	CME 06-27936-CTRA	MF Global Inc.	$1,000	536.D	Flashed order indicator exception rate exceeded 10% threshold.	2/6/2007
7	CME 07-28135-CTRT	MF Global Inc.	$10,000	536.A.6	Timestamp exception percentage exceeded 7% threshold. This was its fourth violation in 12 months.	2/26/2007
8	CEI 06-10	MF Global Inc.	$1,500, C&D	4.97	Failed to properly time stamp its branch order tickets for September 2005 in violation of COMEX Division Rule 104.97 (Written Record of Transactions)	5/2/2007
9	CME 05-25654-BC; CME 05-26105-BC	MF Global Inc.	$35,000	433.B., 536.A.	Between August and November 2005, MFG failed to accurately timestamp 20 of its Eurodollar options customer orders when received and/or when confirmed, in violation of Rule 536.A.6.a (recordkeeping - customer orders), a minor offense. In failing to follow its own internal review procedures applicable to its order entry and confirmation process, MFG violated Rule 433.B. (uncommercial conduct), a minor offense	8/22/2007
10	CME 07-02409-CTRA	MF Global Inc.	$1,000	536.D.	Sequenced card pick-up exception rate for floor orders exceeded 20% threshold	12/20/2007
11	CBOT 07-MSR-23B	MF Global Inc.	$2,500	331.08	Exchange for Related Position that did not have a bona fide cash component	12/21/2007
12	CME 07-02407-CTRA	MF Global Inc.	$2,000	536.D.	Pick-up exception rate for verbal orders exceeded 20% threshold and order type indicator exception rate exceeded 10% threshold.	12/27/2007
13	CME 07-02413-CTRA	MF Global Inc.	$1,000	536.D.	Order type indicator exception rate for floor orders exceeded the 10% threshold	12/31/2007
14	CME 07-02551	MF Global Inc.	$5,000	536.A.6	Timestamp exception rate exceeded 7% threshold	1/7/2008
15	CME 07-02410-CTRA	MF Global Inc.	$3,500	536.D.	XFA Division of MFG order type indicator exception rate and pick-up exception rate for floor orders exceeded 10% threshold	1/7/2008
16	CME 07-02416-CTRA	MF Global Inc.	$2,000	536.D.	Hammer Division of MFG pick-up exception rate for sequenced trading cards exceeded the 20% threshold and for floor exception rate exceeded the 10% threshold	1/9/2008
17	CBOT 07-RFT-54	MF Global Inc.	$2,500	536.F.	Data entry exception rate exceeded 8% threshold	1/31/2008

	Case Number	Respondent	Sanction	Rules	Summary	Effective
18	CME 08-03011-CTRT	MF Global Inc.	$1,500	536.A.1.	Timestamp exception percentage exceeded the 7% threshold	2/27/2008
19	CME 08-03895-CTRT	MF Global Inc.	$1,500	536.A.1.	Timestamp exception rate was 8% or greater, which exceeded the allowable level	6/30/2008
20	CME 08-04866-CTRT	MF Global Inc.	$1,500	536.A.1.	Timestamp exception rate was 8% or greater, which exceeded the allowable level.	10/31/2008
21	CME 08-CH-0803	MF Global Inc.	$25,000	930.D.	Clearing House Risk found MFG violated 930.D. (acceptance of orders)	11/11/2008
22	CBOT 06-ETI-08-BC; CBOT 07-ETI-06-BC; CBOT 07-73207-BC	MF Global Inc.	$400,000, C&D, Monitored Supervision and Training	480.10, 98.13, 504.00	Failure to Supervise, Preexecution Communications, Crossing Orders, Withholding Orders, Disclosing Orders, Acts Detrimental to Welfare of Exchange	12/12/2008
23	CME 09-05365-CTRA	MF Global Inc.	$2,500	536.F.	Data entry error rate exceeded the 10% threshold on nine dates between July 7, 2008 and September 19, 2008	2/20/2009
24	CME 09-05376-CTRA	MF Global Inc.	$2,500	536.F.	Violated CTR dat entry error rate on December 11 and 12, 2008, by exceeding the 10% error level.	4/28/2009
25	CBOT 09-03225-CTRA	MF Global Inc.	$2,500	536.F.	Violated CTR data entry error rate by exceeding the 10% error level. First violation in 24 months.	5/22/2009
26	CEI 09-04	MF Global Inc.	$15,000, C&D	8.55(A)(23)	Between December 1, 2004 and August 11, 2006, MFG division Pioneer Futures failed to properly supervise a clerk, Jeffrey Rowland (who was separately fined $120,000), who entered 662 fictitional cross-trades and misallocated 28 cross-trades.	8/7/2009
27	CBOT 08-00119-BC	MF Global Inc.	C/D; amend policies and procedures; satisfy undertakings; pay fine $495,000	432.(W), 432.(Y), 576	Failed to Detect and Prevent AP in Branch Office From Entereing Excessive Trades; Failed to Supervise Branch; Failed to Enforce Risk Management Policies; Failed to Maintain Tag50 Registration	12/10/2009
28	CME 09-CH-0903	MF Global Inc.	$25,000	930.D. - Performance bond requirements - acceptance of orders	Certain accounts examined that were not maintaining sufficient performance bond or in debit for an unreasonable period of time continued to trade.	11/03/09
29	CME 09-05687-BC	MF Global Inc.	$5,000	538	MFG reported to the exchange the execution of an EFP where the corresponding cash component was a spot transaction that was not a bona fide transaction.	12/10/09
30	CBOT 10-04957-CTRA	MF Global Inc.	$5,000	536.F.	Violated CTR data entry error rate on March 17 and 18, 2010, by exceeding the 10% error level. Second violation in 24 months.	3/4/2011
31	CME 10-07243-CTRA	MF Global Inc.	$5,000	536.F.	Violated CTR data entry error rate on March 17 and 18, 2010, by exceeding the 10% error level. Second violation in 24 months.	3/4/2011

Kathleen M. Cronin
Managing Director
General Counsel and Corporate Secretary

December 13, 2011

Via Electronic Mail

The Honorable Randy Neugebauer
Chairman, Subcommittee on Oversight and Investigations
United States House of Representatives,
Committee on Financial Services
Washington D.C., 20515

RE: Request for Information Regarding Collapse of MF Global

Dear Chairman Neugebauer:

We write in response to your December 5, 2011 letter requesting that CME Group ("CME") provide certain information to help the Subcommittee understand our supervision of MF Global.

With respect to request 1, you have asked us to provide a detailed description of any concerns CME has had over the last five years regarding MF Global's record-keeping, internal controls, risk management, segregation of client funds, the number and performance of compliance staff, or any other compliance-related issue. You also ask for all documents related to those concerns. Providing a comprehensive response to this request, and compiling the related documents, would take considerable time. However, we do want to share with you what we currently know about issues raised during our regular audits of MF Global, as well as significant disciplinary actions against MF Global by CME's Market Regulation Department. CME issued the following audit reports for MF Global: (1) June 27, 2007 (as of December 31, 2006); (2) August 4, 2008 (as of January 31, 2008); (3) June 25, 2009 (as of December 31, 2008); (4) August 2, 2010 (as of January 31, 2010); and (5) August 4, 2011 (as of January 31, 2011). We understand that you will seek to obtain copies of those reports directly from the CFTC. As a result of those audits, CME issued a warning letter in 2007, and fined MF Global $25,000 in both 2008 and 2009, for violating CME Rule 930.D for allowing customers to trade without maintaining sufficient performance bonds. Following the 2011 audit, CME issued a warning letter to MF Global because certain customer segregated funds were not readily marketable or highly liquid, and other investments were not properly rated. The identified issues had no impact on excess segregated funds or excess net capital, and CME was informed by the firm that they were quickly remedied as required. In addition to the issues raised in the audits, in the last three years CME Group's exchanges took two significant disciplinary actions against MF Global, as a result of investigations by its Market Regulation Department. In December, 2008, CBOT fined MF Global $400,000 for failing to supervise employees and certain trade practice violations, including pre-execution communications. In December 2009, CBOT fined MF Global $495,000 for violations of CBOT rules in connection with trading by one of MF Global's associated persons in the CBOT wheat market. The NFA summaries of these disciplinary actions are attached. They are also included along with others we have been able to identify to date in the attached spreadsheet. Information related to these actions can also be found on the NFA website: www.nfa.futures.org.

With respect to requests 2 and 3, we enclose a chronology of matters that occurred during the week of October 24-31 related to MF Global's collapse. Specifically, the chronology represents CME's current timeline of our supervisory and auditing activities of MF Global. The chronology also summarizes communications among CME staff and between CME and the CFTC, SEC, NFA, FINRA and CBOE related to MF Global during the October 24-31 timeframe. Given the number of CME employees involved in this matter and the volume of communications related to MF Global during that busy week, CME's review of documents and collection of information concerning the events of October 24-31 is an ongoing process that we do not expect to be completed for weeks. We are also in the process of providing information and producing non-privileged documents in our position to the governmental authorities that are conducting the investigation of what occurred. We offer the above-referenced chronology, though it is not comprehensive or hour-by-hour because of the volume of information that would have to be processed to do so, in order to provide useful information to the

Subcommittee in advance of its hearing on December 15. We note for the Subcommittee that our understanding of what occurred the week October 24-31 likely will evolve and could change as we continue our review of documents and collection of data.

We look forward to continuing to work with you to help in any way we can with the Subcommittee's examination of the issues surrounding the collapse of MF Global.

Very truly yours,

Kathleen M Cronin

Kathleen M. Cronin

cc: The Honorable Michael Capuano
Terrence A. Duffy
Linda Dallas Rich

CME
MF Global Chronology[1]
Week of October 24-31, 2011

DATE	EVENT
October 24, 2011	Mike Procajlo ("Procajlo") speaks with Mike Bolan ("Bolan"), MF Global, Inc.'s ("MFGI") Assistant Controller. Bolan gives Procajlo a heads-up that a downgrade is forthcoming and that the earnings call for MF Global Holdings, Ltd. ("MFGH"), scheduled for Thursday, which is expected to report losses, is being moved up to Tuesday.
	Moody's downgrades MFGH and MFGI.
October 25, 2011	Procajlo speaks with Bolan via phone; Bolan confirms there has not been a customer run on the bank since the downgrade news.
	CME senior management, including Kim Taylor ("Taylor"), Terry Duffy ("Duffy"), and Craig Donohue ("Donohue") are in Florida at the Global Financial Leadership Conference. Taylor is advised by an MFGI customer of rumors circulating about problems at MF Global ("MFG" with respect to information not given as specific to a particular entity) stemming from OTC activity.
	11 a.m.: Taylor speaks with Laurie Ferber ("Ferber"), the General Counsel of MFGH, and Steve Monieson, another MFG employee, who tell Taylor that the rumor about problems at MFG stemming from OTC activity is not accurate. Procajlo speaks with Bolan about OTC questions.
	11 a.m.: Taylor, Donohue, and Duffy seek and obtain Jon Corzine's phone number. They do not recall speaking with Corzine.
	11:54 a.m.: Procajlo emails Grace Vogel at FINRA to see if FINRA has any additional concerns or is imposing any additional requirements in light of the downgrade news.
	1:30 p.m.: Taylor speaks with Ferber again, who informs Taylor that MFG does not have any large losses attributable to OTC activity.
	2 p.m.: CME Audit Department members, including Procajlo and Anne Bagan ("Bagan"), as well as CME Risk Department members, including

[1] All times are approximate based on individuals' best recollection and/or our ability to reconstruct the events using the available documents that have been reviewed. All times are stated in U.S. Central time.

	Dale Michaels ("Michaels"), Amy McCormick ("McCormick") and Bryan McBlaine ("McBlaine"), speak with Bolan about MFGH's earnings release and Moody's downgrade. MFGH's net losses reported were $192M. The CME employees ask about MFGH's liquidity resources. Bolan confirms that any further downgrades will only trigger covenants related to interest rates. Bolan also confirms the firm is well-capitalized and states that MFGI has not seen customers looking to transfer.
	7 p.m.: At this point, CME is taking the following steps to monitor the situation: (1) keeping MFGI on daily financial reporting; (2) monitoring MFGI's positions, exposure, and customer transfer/segregated funds balance changes for signs of a significant loss of customer confidence; (3) drafting a "good standing" press release to have ready if necessary; (4) establishing a process to ensure customers looking for information get answers to their questions; (5) establishing an industry call process to ensure information flows to other affected clearing houses and regulators; and (6) considering whether other financial measures are in order, in coordination with other regulatory bodies.
October 26, 2011	**4 p.m.:** CME arranges an industry call regarding the MFG situation.
	6 p.m.: Taylor, Bagan, Tim Doar ("Doar") and possibly other CME personnel participate in a conference call with Ferber and Henri Steenkamp ("Steenkamp"), the CFO of MFGH. Ferber and Steenkamp give Taylor and Doar the sense that MFGI is actively engaged in conversations with their customers in an attempt to preserve the business.
	7:45 p.m.: Taylor emails Ferber regarding CME helping "to ensure a good outcome for MF and your customers. You and your clients are important to us, and the clients' continued protection is paramount."
October 27, 2011	MFGI and MFGH are downgraded to junk this day.
	Members of CME's Risk Department – Michaels and Suzanne Sprague ("Sprague") – as well as Scott Malcolm ("Malcolm") from CME's Audit Department – meet with MFGI in New York (planned earlier in the week) to do a risk review, the purpose of which is to talk with the firm about their liquidity and assess the situation. At the time, CME is starting to have concerns that MFGI's liquidity is drying up. Michaels, Sprague, and Malcolm meet with a number of individuals from MFGI, including Stephen Hood ("Hood"), MFGI's Market Risk Manager, Dennis Klejna, MFGI's Compliance Officer, the CRO Michael Stockman,

	and the CFO (Steenkamp). Edith O'Brien ("O'Brien"), MFGI's treasurer, may have been on the phone. At the conclusion of the meeting, CME continued to have concerns regarding MFGI's liquidity and the ability of the company to continue normal operations without a sale of all or part of the business, notwithstanding MFGI's assurances.
	10 a.m.: Procajlo emails Bolan, who is at MFGI in New York, for a copy of the liquidity analysis being prepared by MFGI's broker-dealer side. Bolan responds saying the analysis will be ready later that day. Procajlo never receives the analysis.
	1 p.m.: CME decides to send members of the Audit Department out to MFGI in Chicago. Silmar Ramirez ("Ramirez") and Jason Guch ("Guch") arrive at MFGI and request documents to tie out the Daily Statement of Segregation Requirement and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges ("seg. statement") for the close of business as of 10/26. They start working on tying out the 10/26 seg. statement, which shows excess segregated funds of $116,164,132. In addition to tying out the 10/26 seg. statement, another purpose of their presence is to have CME people at MFGI to assist in obtaining information quickly if necessary.
	The CFTC – Melissa Hendrickson ("Hendrickson"), Lisa Marlow ("Marlow"), and Tamara Durvin (phonetic) ("Durvin") – is already present on site at MFGI when CME arrives.
	CME begins making contingency plans for transferring MFG customer accounts to other FCMs.
	2 p.m.: Individuals from MFGH and CME communicate via email to set up a conference call to discuss a number of items including: (1) MFGI's liquidity; (2) repo counterparties update; (3) any issues with transfers of customers to other FCMs; (4) margin calls resulting from downgrades; (5) amount of segregated assets not currently pledged to a DCO; (6) contingency plans.
	2:50 pm: Taylor communicates with Ananda Radhakrishnan ("Radhakrishnan"), Director, Division of Clearing and Risk, at the CFTC regarding an FCM that has the capacity to take on some portion of MF Global's business. CME President Phupinder Gill ("Gill") also communicates with Radhakrishnan via email throughout the day.

	3:53 pm: Procaljo emails a letter to Christine Serwinski ("Serwinski"), the CFO of MFGI, Ferber and Bolan stating "Effective immediately, any equity withdrawals from MF Global Inc. must be approved in writing by CME Group's Audit Department."
	4 p.m.: CME arranges an industry call regarding the MF Global situation.
	5:30 p.m.: Ramirez and Guch leave MFGI for the night, having completed work on documents and information supplied by MFGI as of that time.
	Evening: Procajlo, Taylor, Doar, Gill and others participate in a call with Ferber and Steenkamp, who are in New York. Ferber and Steenkamp provide assurances that MFGI has appropriate liquidity and also that MFGI is taking steps to reduce its securities inventory (not on the FCM side). Additionally, CME encourages MFG to pursue a strategic solution for the company. Ferber provides comfort that MFG is aggressively pursuing a transaction.
October 28, 2011	**7:30 a.m.:** Ramirez and Guch arrive at MFGI and continue trying to tie out the 10/26 seg. statement. They still have not received all of the documents they requested from MFGI and that they need to complete their tie out. They are also working on tying out the Daily Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to Commission Regulation 30.7 ("secured statement"). CME and CFTC are in communication throughout the day about MFGI's 30.7 secured computations and MFGI topping up the 30.7 secured assets.
	The CFTC – Hendrickson, Marlow, and Durvin – is again present on site at MFGI in Chicago and appears to also be working on tying out MFGI's seg. statement.
	Morning: Duffy receives a call from Radhakrishnan and Gensler. Radhakrishnan and Gensler tell Duffy that the CFTC has concerns about MFG and ask him about CME's thoughts with respect to MFG. Duffy tells them that he does not have the information they seek, and suggests they speak with CME Clearing House personnel. Radhakrishnan speaks with Gill later that day.
	Procajlo and senior management at CME have another call with MFGH, including Steenkamp and Ferber, who assure CME that they have drawn down all or substantially all of their line of credit – which has a limit of approximately $1.2 billion – but are not yet using the money. They confirm that MFGH believes finding a buyer is the best option at this

	point.
	3:54 p.m.: MFGI submits its 10/27 seg. statement showing excess segregated funds of $200,178,912.
	4 p.m.: CME arranges an industry call regarding the MF Global situation.
	6 p.m.: Ramirez and Guch leave MFGI, expecting to come back Monday and finish tying out the 10/26 seg. statement. At this time, Ramirez and Guch do not yet have all of the documents necessary to tie out the 10/26 seg. statement. Based on their review of the documents they have received, they have no reason to believe that the segregated account is out of compliance as of 10/26 close of business.
	8:25 p.m.: Taylor emails Radhakrishnan at the CFTC to relay information she received from Ferber. MFGI has a "very motivated buyer" and needs to obtain approvals from the SEC, FINRA, and CFTC.
October 29, 2011	Procajlo is in communication with Hendrickson of the CFTC via phone about a potential sale of MFGI's FCM business.
	2:30 p.m.: Taylor speaks with Radhakrishnan regarding a potential asset sale of MFGI's assets. The CFTC is concerned with a transfer because of the CFTC's rules on bulk transfers, though note that they will waive the rule if an asset sale works out.
	3:40 p.m.: Taylor forwards to Radhakrishnan a Bloomberg News report stating that MFGH's Board of Directors will be meeting later that day regarding options to sell the company.
	4:30 p.m.: Taylor speaks with Radhakrishnan, who states that the SEC told him the FSA in the UK may be starting to panic. Radhakrishnan says he is going to call the FSA to share insights into his thinking and learn FSA's thinking. Taylor and Radhakrishnan also discuss additional details regarding a potential sale.
	7:50 p.m.: Radhakrishnan forwards to Taylor an email chain between Ferber and Radhakrishnan regarding a meeting of MFGH's Board.
	11 p.m.: Interactive Brokers ("IB") is the leading candidate, looking to buy either the entire business, or possibly just the FCM.
October 30, 2011	**8:30 a.m.:** Taylor speaks with Paul Brody ("Brody") at IB regarding details of the potential transaction.
	8:45 a.m.: CME is making contingency plans in case the proposed sale falls

	through.
	12:30 p.m.: Taylor receives email correspondence from Radhakrishnan indicating that the CFTC is concerned about having a contingency plan for MFGI if the IB deal falls though.
	1 p.m.: Conference call between CME and IB regarding operations issues in the event the sale is completed.
	Approx. 1 p.m. - 2 p.m..: Taylor participates in a conference call with the CFTC, SEC, and MF Global.
	Approx. 2 p.m.: Taylor, Procajlo and others arrive at CME offices to work on matters that need to be addressed to facilitate the MFGI transaction.
	Approx. 2 p.m.: Hendrickson, who is present at MFGI in Chicago, calls Procajlo and tells him that she has seen a draft of the 10/28 seg. statement and it shows a deficiency in the segregated funds.
	After 2 p.m.: Ramirez and Guch are sent to MFGI's Chicago office. Malcolm is sent to MFGI's New York office.
	4 p.m.: CME arranges an industry call regarding the MFG situation.
	4:18 p.m.: Bolan responds to an email from Procajlo, in which Procajlo had indicated that Malcolm is on his way to MFGI's office in New York, by stating that MFGI has been working with Hendrickson at the CFTC and that he will update Procajlo later.
	Late afternoon or evening: Taylor briefs the CME Emergency Financial Committee concerning MFGI's status. The CME Emergency Financial Committee is composed of Donohue, Duffy, Taylor, Gill, and CME Clearing House Risk Committee Co-Chairs James Oliff and Howard Siegel.
	6 p.m.: MFGI forwards to CME a draft press release announcing deal with IB.
	Approx. 6 p.m. and into the evening: Procajlo and Taylor engage in a series of phone calls with Ferber, Bolan and/or O'Brien. Initially, Ferber and Bolan explain that there is an apparent deficiency, which they believe is an accounting error. At some point, MFG representatives state that they believe they found the error and it is on the liability side. Procajlo calls Ramirez and Guch, who are at MFGI's offices in Chicago, to confirm that the accounting error has been identified. Ramirez and Guch inform Procajlo that MFGI has not found the error.

	Procajlo asks Bolan to explain what the error is in an in-person meeting with Malcolm (CME) and Jerry Nudge (CFTC), who are in MFGI's New York office. 30 minutes or so later, Malcolm calls Procajlo and tells him that Bolan says the accounting error is based on a $450M mis-posting. The error Bolan described to Malcolm is not on the liability side. Procajlo again calls Ramirez and Guch to confirm that the accounting error has been identified. Ramirez and Guch again inform Procajlo that they are with MFGI individuals working on the reconciliation, and they are not aware of anyone having found the error. Taylor and others at CME have calls with O'Brien regarding the potential error.
	Approx. 6 p.m. - 7 p.m.: O'Brien, MFGI's treasurer, calls a meeting with the CFTC, CME, and MFGI employees present at MFGI's Chicago office and confirms that MFGI has a potentially huge deficiency in the segregated account due to what MFGI states is an unidentified accounting mistake, such as a mis-booking.
	Later that evening, while at MFGI, CFTC's Marlow gives Guch and Ramirez a disc containing documents the CFTC received from MFGI supporting the 10/26 seg. statement. At this time, however, Ramirez and Guch are assisting with trying to locate the accounting error and therefore do not look at the documents to tie out the rest of the 10/26 seg. statement at this time.
	8:30 p.m.: Radhakrishnan talks to Gill.
	8:40 p.m.: Procajlo sends an email to Bagan and Debbie Kokal ("Kokal") stating that MFGI's "explanation of the $900 million shortfall proved to be unsubstantiated."
	8 p.m. - 9 p.m.: Procajlo arrives at MFGI. He speaks to CFTC's Hendrickson and gets a status update.
	Christine Serwinski arrives at MFGI.
	9 p.m. - 10 p.m.: Procajlo speaks with Serwinski and O'Brien, who repeat the explanation that the deficiency must be an accounting error and make statements to the effect that it is too big to be anything else.
	10 p.m.: Procajlo meets with Serwinski and O'Brien again and asks if

	MFGI has tried to locate funds MFGI can transfer into segregation first thing in the morning as a contingency in the event that they cannot locate the accounting error.
	10:50 p.m.: CME requests via email that "MF not add any further exposure to your house account." CME does not request MFGI to "liquidate the positions that you have in place, but that you not add to them at this point."
	11:30 p.m.: The CFTC leaves MFGI's Chicago offices.
	11:40 p.m.: Procajlo emails Bagan and Kokal, stating that he is now at MFGI's offices and the shortfall, of approximately $950 million in segregation, is still a "huge issue." No one has found the error, but the belief is still that there is an error. Serwinski is looking into coming up with additional funds to transfer into segregation as a contingency in the event that they cannot locate the accounting error. Procajlo also states that he understands IB is now aware of the potential shortfall.
October 31, 2011	**12 a.m.:** Ferber emails Taylor, stating only: "we may have it."
	Approx. 12:30 a.m.: At this time: (1) The IB deal is ready to go – apparently including regulatory signoffs; (2) there is still a $900M apparent segregation shortfall and MFGI says it is an accounting error; (3) the transfer cannot happen until it is clear there is no segregation shortfall; (4) MFGI is starting to identify sources of funds available to top up segregation – and the latest report from MFGI is that they may have sufficient funds; (5) IB and MFGI have spoken to CME and both seem aligned on the importance of the transfer occurring promptly, and state they are open to the suggestion of having MFGI top up segregation and IB making corresponding adjustments to the deal economics.
	Approx. 1 a.m. – 2 a.m.: CME learns the deficiency is real: Serwinski and O'Brien call Procajlo into Serwinski's office and tell him there is an actual shortfall; about $700M was moved to the broker-dealer side of the business to meet liquidity issues in a series of transactions on Thursday, Friday, and possibly Wednesday. Additionally, Procajlo is told there was a loan of $175M of segregated funds to MF UK.
	CME stops its efforts to look for the accounting error. CME understands that MFGI is attempting to find available funds and get Fedwire to open early so they can start transferring money into the segregated account.
	2 a.m.: Taylor emails the FSA and CFTC to let them know that IB has gone

	home to get some sleep, but may still be interested in the transaction.
	2 a.m.: Procajlo communicates via email with Thelma Diaz from the CFTC Washington D.C. office, who is on a regulatory call at the time, and discusses whether Fedwire can open early so MFGI can start transferring funds into segregation.
	3 a.m.: Ramirez and Guch leave MFGI for the night. Procajlo stays until 8 p.m. the following day.
	During the night, Procaljo also participated in a phone call with senior MFG employees wherein one employee indicated that Corzine knew about loans that had been made from the customer segregated accounts. CME Group has provided information about this call and related conversations, and the names of the individuals who participated, to the Department of Justice and the CFTC who are investigating these matters.
	4 a.m.: Taylor and Gill participate in a call with MF Global and the regulators.
	4:37 a.m.: Procajlo emails others at CME with a list of potential assets MFGI has identified that it could move into segregation.
	The deal with IB to buy MFGI collapses.
	6:45 a.m.: Taylor emails CME senior management to inform them that the deal has collapsed, the shortfall is real, and there will likely be a bankruptcy.
	7:30 a.m.: Procajlo, Ramirez and Guch are on site at MFGI while MFGI attempts to make transfers of funds back into segregation. The CFTC is also present.
	8:30 a.m.: Taylor and Radhakrishnan communicate via email regarding MFGI bulk transfers.
	9 a.m.: MFGH files for bankruptcy.
	10 a.m.: Taylor and Radhakrishnan communicate via email regarding the amount of shortfall.
	10:30 a.m.: CME's Emergency Financial Committee orders that all trading of MFGI and its customers be for liquidation only. Taylor's assistant emails a letter from Taylor to Dennis Klejna ("Klejna"), Assistant General Counsel of MFGI, stating the Committee's order. The letter further states that CME will no longer permit floor trading to be guaranteed by MF Global, and that

	CME will process account transfers at the Friday settlement price but that customers will need to re-margin transferred positions.
	Moody's further downgrades MFGI.
	S&P and Fitch downgrade MFGH to default following MFGH's filing for bankruptcy protection.
	11 a.m.: A SIPA proceeding is filed for the liquidation of MFGI and a SIPC Trustee is appointed.
	12:15 p.m.: CME's Emergency Financial Committee orders that MFGI liquidate its house proprietary positions. Taylor's assistant subsequently emails a letter to this effect to Klejna and Serwinski. The Committee also authorizes CME to liquidate securities held as house and customer collateral under the control of the Clearing House to cash.
	Throughout the day, Ramirez and CME staff – Guch, Jared Jarvis ("Jarvis"), Procajlo, and Mudassir Arby ("Arby") – attempt to tie out the 10/28 seg. statement.
	7 p.m.: CME's Emergency Financial Committee approves a rule change releasing members qualified by MFGI, such that those members could become qualified and guaranteed by another clearing member in order to resume trading.
	7:46 p.m.: CME receives the amended MFGI seg. statement for 10/27 showing a segregation deficiency of $213,062,967.
	7:55 p.m.: CME's Emergency Financial Committee (i) authorizes the Clearing House to conduct an auction of MFGI's house positions in order to transfer the positions to another clearing member, and (ii) authorizes the Clearing House to accept certain deliveries from MFGI customers through Friday November 4 in order to minimize disruption to the markets.
	8 p.m.: CME notifies MFGI that it is suspended as a clearing member on all CME Group exchanges. Taylor's assistant subsequently emails a letter from Taylor to Klejna and Serwinski confirming the suspension.
	8:06 p.m.: CME receives MFGI's seg. statement for 10/28 showing a segregation deficiency of $891,465,650.

Statement for the Record
Tariq Zahir, Managing Member, Tyche Capital Advisors LLC, Laurel Hollow, NY
December 7, 2011

Congressman King,

I would like to provide a brief statement on how the MF Global situation has impacted us. I am a Commodity Trading Advisor (CTA) in your district. We have expanded our client base by over 250% in the last year and have hired new employees and started a training program for new potential candidates. Since the MF Global bankruptcy happened we have had over 40% of our client assets frozen and have not been able to trade their accounts. We haven't been able to generate revenues from any our MF clients in October and November and now it has continued through December. A few weeks ago we had to cut our full time employees down to part time and completely halted out training program for several new employees that we were going to bring on.

Our continued alarming concern is the horrific pace of clarity regarding the existing MF Global clients in the segregated accounts. This has now spilled into all of our other clients who are not with MF Global asking the simple question could this happen to us also?

If this situation continues we will have to make a decision if we have to shut down our business which has taken over four years to develop. I would really hate to see thousands of hours lost, but more importantly let down the people in my district who are counting on us not just for a job but a career in our business.

Tariq Zahir

U.S. House of Representatives
Subcommittee on Oversight and Investigations
Committee on Financial Services
Hearing entitled "The Collapse of MF Global"
December 15, 2011
Questions for the Hearing Record
Mr. Bradley Abelow

Representative Bill Posey

Question

- Are you still employed by MFGI and/or MFHI? What is your total annual compensation? What was it for 2009 and 2010? [Please include salary, bonuses, stock options, etc.]

Response

I am employed by MF Global Holdings Ltd. ("MF Global"), which is currently overseen by a Chapter 11 Trustee, the Honorable Louis J. Freeh. On November 9, 2011, I voluntarily agreed with the Compensation Committee of the Board of Directors of MF Global to reduce my annual base salary to $60,000, as stated in the MF Global's SEC Form 8-K dated November 10, 2011. I was not employed by MF Global in 2009. According to MF Global's records, my total annual compensation in 2010 included $454,545 in salary and an option to purchase 1,750,000 shares of common stock of MF Global at $7.31 per share. According to MF Global's records, my total annual compensation for 2011 included $1,315,000 in salary, $1,250,000 in bonus, and 201,342 restricted shares of common stock of MF Global.

Question

- Describe the work you have performed for MFGI/MFHI since October 31, 2011. What are your current duties/responsibilities?

Response

After MF Global filed for bankruptcy on October 31, 2011, the Board of Directors asked me to remain in my position to close the firm's operations and maximize the value of MF Global's estate. Following the appointment of the Chapter 11 Trustee, I have been assisting the Trustee and his professionals in fulfilling their duties and responsibilities. I have shared my knowledge of MF Global, assisted in the winding down of businesses and closing of offices, and facilitated the recovery and liquidation of MF Global's assets in the United States and abroad.

Question

- When was the last audited annual report for MF Global filed with the SEC?

Response

The last audited annual report for MF Global was filed with the SEC on or about May 20, 2011.

United States House of Representatives
Subcommittee on Oversight and Investigations
Committee on Financial Services

RESPONSES OF JON S. CORZINE TO
QUESTIONS FOR THE RECORD

Questions by Chairman Randy Neugebauer

1. Yes or No: Did any holding company or subsidiary of MF Global use segregated client funds to meet any margin calls or to make payments to creditors?

I don't know. I still do not have access to the relevant MF Global financial records.

2. Yes or No: Did you instruct employees of MF Global to meet all margin calls made by MF Global's counterparties?

To the best of my recollection, I never gave such an instruction.

3. Yes or No: Was the oral certification made by MF Global to JP Morgan Chase that funds provided to JP Morgan Chase did not include customer segregated funds legally-binding and substantively equivalent to a written response?

I do not know whether the conversations between MF Global and JP Morgan Chase constitute an "oral certification." Nor do I know whether an "oral certification" would be legally-binding or would be substantively equivalent to a written response.

4. Please describe the basis for your assertion on October 25, 2011 that MF Global could manage the liquidity risk of its long European sovereign debt repo-to-maturity positions. How did you think MF Global would handle margin calls on these positions if the firm's credit rating fell, if the European countries' ratings fell, or if the price for European bonds fell?

As of October 25, 2011, I believed that MF Global had cash, free collateral, securities, and unused bank credit lines that would allow it to manage the European sovereign debt repo-to-maturity positions.

5. Did MF Global have sufficient balance sheet capacity to manage the exposure of its proprietary positions?

I am not sure that I understand the term "balance sheet capacity." As stated in my answer to the previous question, I believed that MF Global had adequate capital and liquidity to manage its RTM portfolio.

6. Yes or No: Was issuer default the only risk posed by MF Global's European sovereign debt repo-to-maturity trades?

No. Additional risks are identified in my written statement to this subcommittee.

7. Yes or No: Would adverse changes in the market prices and/or credit ratings of European sovereign debt require MF Global to post significant amounts of additional collateral against their repo-to-maturity agreements collateralized by European sovereign debt?

As stated in my written statement to this subcommittee, if a clearing house determined that the value of the underlying security had decreased, it could demand that MF Global increase its margin.

8. Please provide a narrative description explaining the rationale for and the conditions which prompted MF Global to produce a presentation entitled, "Stress Scenario Analysis – Downgrade Potential Impact on MF Global" outlining a "break the glass" plan. Please indicate whether the independent auditor of MF Global requested such an analysis and/or if this analysis was shared with the independent auditor.

My best recollection is that the analysis was requested by the board of directors of MF Global. I do not recall if the analysis was shared with the independent auditor.

Questions by Representative Posey

- Please provide the names of individuals who maintained records as to repos, loans and other transfers of assets between MFGI and other subsidiaries of MFGH, and between MFGH (including all subsidiaries) and third parties.

I believe that the individuals who maintained the referenced records would have been in the Treasury department, which was headed by Vinay Mahajan.

- What was the maximum amount of cash and other assets that could be wired or otherwise transferred out of MFGI and MFGH without requiring the approval of you, Mr. Abelow, or Mr. Steenkamp? What was the threshold amount requiring the approval of at least two individuals?

I do not know the answers to these questions.

- Companies are required by law to have documented internal controls to prevent and detect errors and irregularities in the financial accounting systems. Please provide the name and title of the individual at MF Global who was responsible for this.

MF Global had various internal controls relating to financial accounting systems. At the time of the bankruptcy, the Chief Financial Officer of MF Global was Henri Steenkamp, the Global Treasurer was Vinay Mahajan, the Chief Risk Officer was Michael Stockman, and the Global Head of Internal Audit was Marcus Adams. A team of individuals led by Brian Palmieri audited compliance with Sarbanes-Oxley regulations.

House Financial Services Committee Oversight and Investigations Subcommittee Hearing
"The Collapse of MF Global"
December 15, 2011
Questions for the Record from Rep. Bill Posey (R-FL)

Mr. Terrence Duffy, Executive Chairman, CME Group Inc.

- *The New York Times* has reported that CME auditors left New York on Friday, October 28, 2011, and returned to Chicago without ever completing their audit. Is that correct? If so, when did they return to MF Global offices in New York?

  As has been reported in the press and set forth in the timeline CME Group submitted to the Committee in conjunction with the December 15, 2011 hearing (the "Timeline"), on the afternoon of Thursday, October 27, 2011, CME Group sent two members of the Audit Department to MF Global's offices in Chicago (not New York). The CME employees sought to tie out the daily segregation statement for October 26, 2011, which MF Global submitted to CME and CFTC on October 27, 2011 and which showed excess segregated funds of $116,164,132. CME employees performed tie out work on the October 26, 2011 segregation statement on October 27 and October 28, 2011, but were unable to complete that work by the end of the day on Friday, October 28 because MF Global had not provided all of the documents necessary to complete the tie out. CME employees returned to MF Global's offices in Chicago during the afternoon of Sunday, October 30, 2011, in response to a notification that there was a deficiency shown on a draft of the October 28, 2011 segregation statement that MF Global had prepared over the weekend. MF Global told CME that they believed this deficiency was due to an accounting error, and CME employees spent time on the afternoon and evening of October 30 helping MF Global identify whether an accounting error existed. The Timeline sets forth the chronology of work that CME audit staff performed from October 27, 2011 through October 31, 2011, and identifies which CME Group employees were present at MF Global's Chicago and New York offices.

  Neither the tie out work relating to the October 26, 2011 segregation statement nor the work on Sunday, October 30, 2011 relating to the apparent accounting error was an "audit." An audit involves many weeks of fieldwork, tests and procedures and months of follow-up work that were not and could not have been performed over a period of a couple of days. Instead, the tie out consisted of checking the numbers on MF Global's October 26, 2011 segregation statement against MF Global's general ledger and third-party account statements.

- As the designated Self Regulatory Organization (SRO) charged with the task of auditing Futures Commission Merchants to verify that customer funds are properly segregated, did the CME properly fulfill its mandate and meet its legal and fiduciary obligations to the CFTC and MF Global customers? Why do you recommend maintaining a SRO-based regulatory system, if the SRO is not responsible and accountable for regulatory failures?

Yes, CME properly fulfilled its mandate and performed its duties as MF Global's DSRO. As MF Global's DSRO, CME was responsible for, among other things, conducting periodic audits of MFG's FCM arm. CME conducted audits of MFG pursuant to standards and procedures established by the Joint Audit Committee, which is a representative committee of U.S. futures exchanges and regulatory organizations that participate in a joint audit and financial surveillance program that has been approved and is overseen by the CFTC. CME conducted audits of MF Global every 9-15 months in accordance with JAC procedures, the last of which was as of the close of business on January 31, 2011. This audit began subsequent to the audit date and was completed with a report dated August 4, 2011.

CME fully complied with all of its professional obligations and responsibilities with respect to the January 31, 2011 audit. During this audit, CME reviewed the manner in which segregated funds were invested and held by MF Global. CME requested certain modifications regarding the manner in which segregated funds were invested, which MF Global immediately implemented. All other audit points were relatively minor and were immediately implemented. As of January 31, 2011, MF Global held funds and securities in segregated accounts in amounts more than $400 million in excess of its segregation obligations. There was no indication based on the CME's audit work that MF Global was misusing segregated funds at that time or that segregated funds were missing.

The DSRO structure is not the cause of the MF Global customer losses. MF Global removed customer funds in violation of CFTC rules and regulations. It appears MF Global did so over the course of only a few days. CME takes the protection of customer funds very seriously and views the MF Global failure as an opportunity to improve upon the segregation rules and JAC audit procedures. CME is working with the CFTC and other regulators to make those improvements and to strengthen customer safeguards. However, the apparent failure of MF Global to follow the existing rules over a period of only a few days prior to its failure – whether intentional or not – does not justify eliminating the SRO-based regulatory system.

- Did the CFTC and/or DOJ instruct CME to stay out of the MF Global investigation?

In November of 2011, the CFTC told CME that CME should not conduct its own regulatory investigation of MF Global. CME has heeded the CFTC's directive and has not conducted its own regulatory investigation. CME has been fully cooperating with the CFTC and DOJ in their investigations.

Responses from James B. Kobak, Jr. , Counsel for the Trustee for the Securities Investor Protection Act Liquidation of MF Global Inc. to questions from Congressman Bill Posey:

With respect to the first two questions, the Trustee for the liquidation of MF Global Inc., the U.S. broker-dealer unit of MF Global, has never been in possession of the bonds that were formerly owned by MF Global Holdings Ltd. and does not have first-hand knowledge of any transactions that may have involved those bonds. We believe this issue might be better addressed by the office of the Chapter 11 bankruptcy Trustee for MF Global Holdings Ltd., Judge Louis Freeh.

With respect to question 3, the Trustee for MF Global Inc. has undertaken to follow all significant flows of funds to or from all the customer segregated property accounts in the last month of MF Global's existence. The Trustee's investigation has also undertaken to determine when a deficit in customer segregated funds arose. Those details are set forth in the attached report to the Court and customers and creditors, as filed with the Court on February 6, 2012, particularly in the materials located in Appendix A, pages 1 and 4. The MF Global Inc. Trustee continues to investigate complex factual and legal questions to determine whether particular movements of funds were improper and may be actionable by the Trustee and how best to pursue any possible recoveries of property that may exist for distribution to former customers. The Trustee is prepared to use all legal avenues available to him in a productive and efficient manner to pursue recoveries where the facts and law support such efforts.

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Attorneys for James W. Giddens,
Trustee for the SIPA Liquidation of MF Global Inc.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re MF GLOBAL INC., Debtor.	Case No. 11-2790 (MG) SIPA

TRUSTEE'S PRELIMINARY REPORT ON STATUS OF HIS INVESTIGATION AND INTERIM STATUS REPORT ON CLAIMS PROCESS AND ACCOUNT TRANSFERS

1. James W. Giddens (the "Trustee") as trustee for the liquidation of MF Global Inc. ("MFGI"), respectfully submits this preliminary report on the progress of his investigation and interim status report on the claims process and account transfers, in accordance with his duties under sections 78fff-1(c) and (d) of the Securities Investor Protection Act ("SIPA"), 15 U.S.C. §§ 78aaa *et seq.*, and in accordance with the suggestion of the Court that the Trustee prepare reports on a more frequent basis than a six-month formal reporting period (Hr'g Tr., Nov. 22, 2011, ECF No. 423).

2. As the Court is aware, on October 31, 2011, the Honorable Paul A. Engelmayer, United States District Court Judge for the Southern District of New York, entered an Order (the "MFGI Liquidation Order") commencing liquidation of MFGI pursuant to the provisions of SIPA in the case captioned *Securities Investor Protection Corp. v. MF Global Inc.*, Case No. 11-CIV-7750 (PAE).

3. The MFGI Liquidation Order, *inter alia*: (i) appointed James W. Giddens as Trustee for the liquidation of the business of MFGI pursuant to SIPA section 78eee(b)(3); (ii) appointed Hughes Hubbard & Reed LLP counsel to the Trustee pursuant to SIPA section 78eee(b)(3); and (iii) removed the case to this Court as required for SIPA cases by SIPA section 78eee(b)(4).

INVESTIGATION

4. The Trustee's investigation has preliminarily determined that MFGI had a shortfall in commodities customer segregated funds beginning on Wednesday, October 26, 2011,

and that the shortfall continued to grow in size until the bankruptcy filing on Monday, October 31, 2011.[1]

5. The Trustee's investigators have now traced a majority of the cash transactions, totaling more than $105 billion, made in and out of MFGI in the last week before bankruptcy and are completing the process of tracing the remaining transactions. MF Global also executed securities transactions totaling more than $100 billion during its final week of operations. These included liquidation of customer securities, proprietary positions and other items. The securities included complex instruments, such as off-balance sheet repurchase transactions involving sovereign debt securities and derivative structures.

6. For three months the Trustee's investigative team has worked to understand what happened during the final days of MF Global when cash and related securities movements were not always accurately and promptly recorded due to the chaotic situation and the complexity of the transactions. With these preliminary investigative conclusions in hand, the Trustee's investigative team will analyze where the property wired out of bank accounts established to hold segregated and secured property ultimately ended up. The Trustee will then determine whether there is a sound and legal basis for recoveries against third parties that will help make customers whole. These will be very complex legal and factual determinations, which the Trustee will make consistent with his duty as the advocate for the former customers of MFGI.

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1 This preliminary report on the progress of the Trustee's investigation is supplemented by slides that are annexed as Appendix A.

7. The investigation to date has found that transactions regularly moved between accounts and that funds believed to be in excess of segregation requirements in the commodities segregated accounts were used to fund other daily activities of MF Global. In the past, such transfers were in amounts of less than $50 million, but as liquidity demands increased and could not be met from internal sources, much larger amounts were used, apparently with the assumption that funds would be restored by the end of the day. By Wednesday, October 26th, as the result of increasing demands for funds or collateral throughout MF Global, funds did not return as anticipated. As these withdrawals occurred, a lack of intraday accounting visibility existed, caused in part by the volume of transactions being executed, and the 4(d) U.S. segregated commodity customer account appears to have reached a deficit condition on Wednesday, October 26th that continued through to MF Global's bankruptcy.

8. The Trustee has identified most of the parties that were the immediate recipients of transfers from MFGI during the final days and weeks of operation. These transfers were largely effected through the clearing banks acting on behalf of MFGI. The ultimate recipients of these transfers included banks, exchanges and clearing houses, MFGI affiliates, counterparties, and customers of the futures commission merchant and the broker-dealer.

9. The number of transactions executed by MF Global during the last week prior to the initiation of insolvency proceedings escalated to unprecedented volumes. The rush to meet funding needs for collateral, margin and customer liquidations led to billions of dollars in securities sales, draws on credit facilities, and a web of inter-company loans across affiliates, some foreign. The company's computer systems and employees had difficulty keeping up with the unprecedented volume of transactions. A number of transactions were recorded erroneously or not at all. So called "fail" transactions—where either the buyer or seller fails to deliver the

cash or the security, respectively—were five times the normal volume during the firm's final week.

10. The investigation has revealed that a confluence of factors contributed to the deterioration of MF Global's liquidity position. The exposure to European sovereign debt, coupled with the announcement of disappointing quarterly results, triggered credit downgrades by Moody's, Fitch and S&P. This escalation in credit risk mandated substantial margin calls and increased demands from counterparties and exchanges for collateral. As an example, the additional margin paid to support only the sovereign debt positions exceeded $200 million during the final week of operations. This was a significant drain on available cash and securities. The sovereign debt investments undertaken on a repo to maturity basis allowed some immediate gains to be booked, but these were purely paper profits generating negligible cash while the underlying transactions resulted in calls for substantial additional margin.

11. The heightened risk and apparent loss of confidence drove customers to close their accounts and withdraw funds, resulting in even greater demands on a relatively limited amount of available cash. The Trustee's investigation has revealed that, while personnel may not have been immediately aware of it, MFGI experienced a shortfall in 4(d) customer funds beginning during the day on Wednesday, October 26th. MF Global Holdings Ltd., the MF Global parent company, struggled to continue to operate and even to sell the business, but MFGI appears to have remained in a shortfall of commodity customer segregated funds virtually continuously until its parent filed for Chapter XI protection on Monday, October 31st and the SIPA proceeding was commenced against MFGI later that afternoon.

12. The Trustee's investigators, including the legal and forensic accounting teams, have conducted over 50 witness interviews, preserved secure access to thousands of boxes

of hard copy documents, imaged over 800 computer drives, and are maintaining over 100 terabytes of data.

13. To understand where the funds went during October 2011, the analysis conducted by the Trustee's professionals has included 840 cash transactions in excess of $10 million that total $327 billion, and an ongoing analysis of related securities transactions involving a value of over $100 billion. These large cash transactions alone span 47 bank accounts across eight financial institutions. An additional 20,000 cash transfers that total $9 billion involve transfers of less than $10 million.

14. The Trustee's investigation is continuing to correlate cash transfers to relevant movements of securities used as collateral or loaned to counterparties. To that end, the Trustee is now working with various third parties to further define these securities transactions and obtain more complete information about the extent and basis for transfers to select parties. The Trustee continues to investigate the complex factual and legal questions to determine how best to pursue possible recoveries and the extent to which applicable law would support claims against particular recipients of funds, affiliates, and possibly to other parties, including employees of MF Global.

15. The Trustee's investigation will continue, in coordination with the regulatory and law enforcement investigations that are being conducted by the Department of Justice, the Commodity Futures Trading Commission, and the Securities Exchange Commission on an ongoing basis. The Trustee will seek to release additional information related to his investigation in the future, but cannot prematurely release information that might compromise the integrity of those investigations or the Trustee's own efforts to recover funds for customers and the estate.

CLAIMS PROCESS AND ACCOUNT TRANSFERS

16. The Trustee's staff is continuing its analysis of customer claims after the claims filing period for commodities customers closed on January 31, 2012.

17. Once a claim is reviewed by the Trustee's staff on as expedited a basis as possible, a determination letter will be issued to the claimant. These determination letters are being issued on a rolling basis. The determination letter will acknowledge the claim and provide a determination as to whether the claim has been allowed, denied, reclassified, or is subject to further reconciliation or information requests.

18. The Trustee is eager to make additional distributions to former MFGI customers as soon as possible. However, the Trustee is required by law to hold an appropriate reserve of funds until disputed claims are resolved either through negotiation or by the Court. At this time, the Trustee anticipates significant disputed claims against the MFGI estate by MF Global Holdings Ltd., MF Global UK Limited, and other entities. The Trustee will move to attempt to resolve these claims as quickly as possible, but it is uncertain how long resolution will take. Therefore, it is not known at this time when the Trustee will be legally able to make additional distributions.

19. The Trustee has already distributed nearly $4 billion to former MFGI retail commodities customers with U.S. futures positions via three bulk transfers:

- Within days of the bankruptcy, the Trustee received Court approval for the transfer of 10,000 commodities customer accounts with three million open positions, along with approximately $1.5 billion in collateral associated with those positions at the time of the bankruptcy. These open positions had a notional value of $100 billion. It is estimated that 40% of all commodity futures exchange activity in U.S. markets came from MFGI trades and a serious disruption in markets was avoided by the transfer.

- A transfer of 60% of the cash attributable to approximately 15,000 customer commodity accounts with cash only in the accounts, totaling approximately $500 million, was completed in November.

- In December and January a third transfer occurred that moved approximately $2 billion to restore 72% of U.S. segregated customer property to all former MFGI retail commodities customers with U.S. futures positions.

20. In addition, the Trustee has received Court approval to sell and transfer approximately 318 active retail securities accounts, which is substantially all of the securities accounts at MFGI. Nearly all securities customers have received 60% or more of their account value and already 194 of former MFGI securities customers have received the entirety of their account balances because of a Securities Investor Protection Corporation guarantee.

Dated: New York, New York
February 6, 2012

Respectfully submitted,

HUGHES HUBBARD & REED LLP

By: /s/ James B. Kobak, Jr.
A member of the firm

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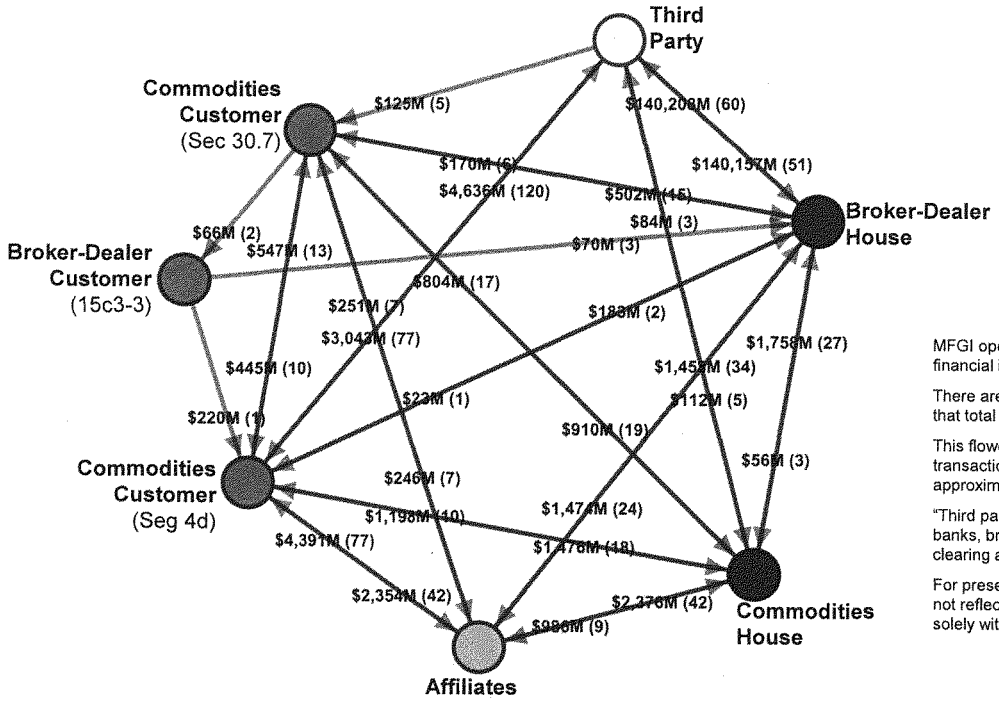
Attorneys for James W. Giddens,
Trustee for the SIPA Liquidation of
MF Global Inc.

Appendix A

Consolidated Overview of Cash Movement
MF Global Inc. 10/1 – 10/31



MFGI operated 47 bank accounts held at 8 financial institutions.

There are 840 transactions > $10 million that total approximately $327 billion.

This flowchart excludes roughly 20,000 transactions < $10 million that total approximately $9 billion.

"Third party" includes customers, lending banks, brokerage firms, exchanges, and clearing agents.

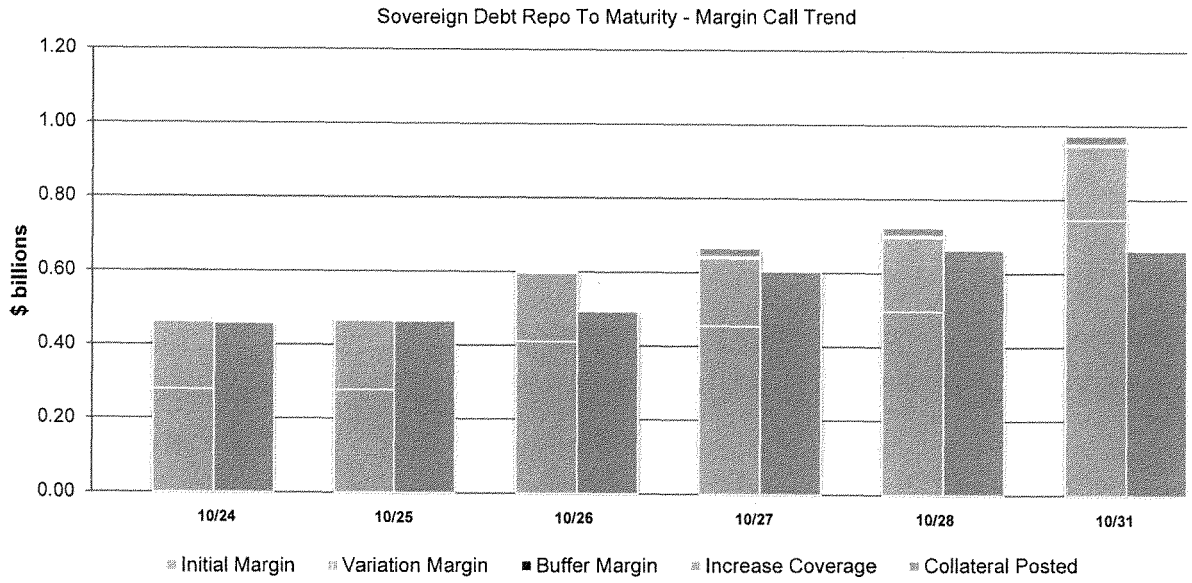
For presentation purposes, this chart does not reflect certain transactions that occurred solely within a related grouping of accounts.

This reflects cash movement only. Investigation is ongoing to trace correlated securities, collateral and other assets.

Pertinent Liquidity Events 10/24 – 10/31

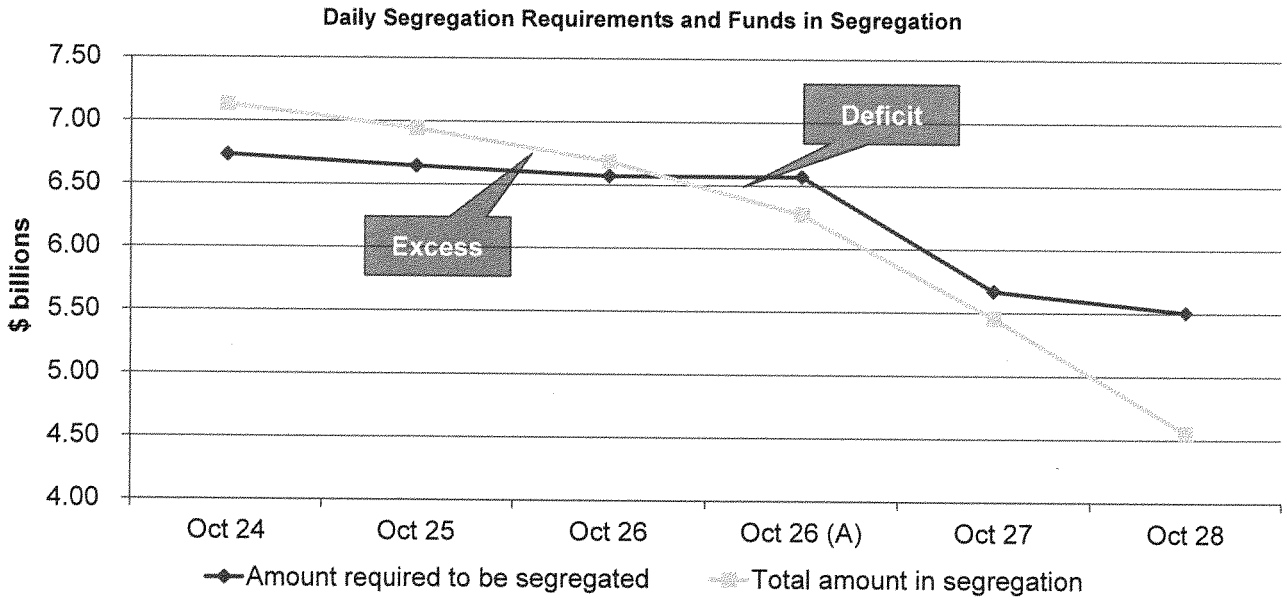
- Credit rating downgrade
- Increased margin calls
- Funds in segregation: excess turns into deficit
- Customer liquidations / withdrawals
- Bonds borrowed program unwind creates liquidity gap of approx $450 - 500 million
- Increased draws on both credit facilities:
  - Unsecured Revolving Credit Facility nearly fully drawn on 10/28 at $1.17 billion of the $1.2 billion
  - Secured facility balance of at least $130 million of the $300 million.

Increased margin calls



Date	Initial Margin	Variation Margin	Buffer Margin	Increase Coverage	Total Margin	Collateral Posted	Margin Call
10/24	278,049,205	182,979,874	5,000,000		466,029,079	457,962,898	8,066,181
10/25	277,302,875	188,277,470	5,000,000		470,580,345	464,694,118	5,886,227
10/26	410,963,534	185,592,415	5,000,000		601,555,949	492,732,015	108,823,934
10/27	454,624,390	182,811,558	5,000,000	23,280,469	665,716,417	604,003,047	61,713,370
10/28	495,975,763	199,344,353	5,000,000	23,219,740	723,539,856	663,925,523	59,614,333
10/31	745,975,763	199,344,353	5,000,000	23,219,740	973,539,856	663,925,523	309,614,333

Customer funds in segregation: excess turns into deficit



(A) A shortfall in segregated customer funds occurred during 10/26. The calculation originally prepared by MFGI contained an error. Cash deposits in segregated funds bank accounts were erroneously overstated.