

**HEARING TO EXAMINE THE MF GLOBAL  
BANKRUPTCY**

---

---

**HEARING**  
BEFORE THE  
**COMMITTEE ON AGRICULTURE**  
**HOUSE OF REPRESENTATIVES**  
ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

DECEMBER 8, 2011

**Serial No. 112-28**



Printed for the use of the Committee on Agriculture  
*agriculture.house.gov*

U.S. GOVERNMENT PRINTING OFFICE

73-118 PDF

WASHINGTON : 2012

---

For sale by the Superintendent of Documents, U.S. Government Printing Office  
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800  
Fax: (202) 512-2104 Mail: Stop IDCC, Washington, DC 20402-0001

## COMMITTEE ON AGRICULTURE

FRANK D. LUCAS, Oklahoma, *Chairman*

BOB GOODLATTE, Virginia, <i>Vice Chairman</i>	COLLIN C. PETERSON, Minnesota, <i>Ranking Minority Member</i>
TIMOTHY V. JOHNSON, Illinois	TIM HOLDEN, Pennsylvania
STEVE KING, Iowa	MIKE McINTYRE, North Carolina
RANDY NEUGEBAUER, Texas	LEONARD L. BOSWELL, Iowa
K. MICHAEL CONAWAY, Texas	JOE BACA, California
JEFF FORTENBERRY, Nebraska	DENNIS A. CARDOZA, California
JEAN SCHMIDT, Ohio	DAVID SCOTT, Georgia
GLENN THOMPSON, Pennsylvania	HENRY CUELLAR, Texas
THOMAS J. ROONEY, Florida	JIM COSTA, California
MARLIN A. STUTZMAN, Indiana	TIMOTHY J. WALZ, Minnesota
BOB GIBBS, Ohio	KURT SCHRADER, Oregon
AUSTIN SCOTT, Georgia	LARRY KISSELL, North Carolina
SCOTT R. TIPTON, Colorado	WILLIAM L. OWENS, New York
STEVE SOUTHERLAND II, Florida	CHELLIE PINGREE, Maine
ERIC A. "RICK" CRAWFORD, Arkansas	JOE COURTNEY, Connecticut
MARTHA ROBY, Alabama	PETER WELCH, Vermont
TIM HUELSKAMP, Kansas	MARCIA L. FUDGE, Ohio
SCOTT DESJARLAIS, Tennessee	GREGORIO KILILI CAMACHO SABLAN, Northern Mariana Islands
RENEE L. ELLMERS, North Carolina	TERRI A. SEWELL, Alabama
CHRISTOPHER P. GIBSON, New York	JAMES P. McGOVERN, Massachusetts
RANDY HULTGREN, Illinois	
VICKY HARTZLER, Missouri	
ROBERT T. SCHILLING, Illinois	
REID J. RIBBLE, Wisconsin	
KRISTI L. NOEM, South Dakota	

---

### PROFESSIONAL STAFF

NICOLE SCOTT, *Staff Director*  
KEVIN J. KRAMP, *Chief Counsel*  
TAMARA HINTON, *Communications Director*  
ROBERT L. LAREW, *Minority Staff Director*

## CONTENTS

---

	Page
Baca, Hon. Joe, a Representative in Congress from California, prepared statement .....	6
Lucas, Hon. Frank D., a Representative in Congress from Oklahoma, opening statement .....	1
Prepared statement .....	2
McIntyre, Hon. Mike, a Representative in Congress from North Carolina, prepared statement .....	6
Peterson, Hon. Collin C., a Representative in Congress from Minnesota, opening statement .....	3
Prepared statement .....	5
Pingree, Hon. Chellie, a Representative in Congress from Maine, prepared statement .....	7

### WITNESSES

Sommers, Hon. Jill E., Commissioner, Commodity Futures Trading Commission, Washington, D.C. ....	7
Prepared statement .....	10
Supplementary material .....	155
Submitted questions .....	159
Kobak, Jr., James B., Lead Counsel to James Giddens, Trustee, Securities Investor Protection Act Liquidation of MF Global Inc., New York, NY .....	14
Prepared statement .....	15
Corzine, Hon. Jon S., former Chief Executive Officer, MF Global Inc., New York, NY .....	63
Prepared testimony .....	65
Submitted questions .....	160
Fletcher, John, General Manager, Central Missouri AGRIService LLC, Marshall, MO; on behalf of National Grain and Feed Association .....	113
Prepared testimony .....	114
Duffy, Hon. Terrence A., Executive Chairman, CME Group Inc., Chicago, IL .....	116
Prepared testimony .....	117
Submitted question .....	161
Brodsky, J.D., William J., Chairman and Chief Executive Officer, CBOE Holdings, Inc. and Chicago Board Options Exchange, Inc., Chicago, IL .....	121
Prepared testimony .....	124
Roth, Daniel J., President and Chief Executive Officer, National Futures Association, Chicago, IL .....	128
Prepared testimony .....	130
Luparello, Stephen, Vice Chairman, Financial Industry Regulatory Authority, Washington, D.C. ....	132
Prepared testimony .....	134
Corcoran, Gerald F., Chairman of the Board and Chief Executive Officer, R.J. O'Brien & Associates, Chicago, IL; on behalf of Commodity Markets Council .....	137
Prepared testimony .....	140

### SUBMITTED MATERIAL

National Pork Producers Council, submitted statement .....	156
--	-----



# HEARING TO EXAMINE THE MF GLOBAL BANKRUPTCY

THURSDAY, DECEMBER 8, 2011

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON AGRICULTURE,  
*Washington, DC.*

The Committee met, pursuant to call, at 9:31 a.m., in Room 1300 of the Longworth House Office Building, Hon. Frank D. Lucas [Chairman of the Committee] presiding.

Members present: Representatives Lucas, Goodlatte, Johnson, King, Neugebauer, Conaway, Fortenberry, Schmidt, Thompson, Rooney, Stutzman, Gibbs, Austin Scott of Georgia, Tipton, Crawford, Roby, Huelskamp, DesJarlais, Ellmers, Gibson, Hultgren, Hartzler, Schilling, Ribble, Peterson, Holden, McIntyre, Boswell, Baca, Cardoza, David Scott of Georgia, Cuellar, Costa, Walz, Kissell, Owens, Pingree, Courtney, Welch, Fudge, Sablan, Sewell, and McGovern.

Staff present: John Goldberg, Tamara Hinton, Kevin Kramp, Josh Maxwell, Josh Mathis, Ryan McKee, Mary Nowak, Matt Perin, John Porter, Debbie Smith, Patricia Straughn, Pelham Straughn, Lauren Sturgeon, Wyatt Swinford, Heather Vaughan, Suzanne Watson, Liz Friedlander, Robert L. Larew, C. Clark Ogilvie; Anne Simmons, John Konya, Merrick Munday, Margaret Wetherald, and Caleb Crosswhite.

## OPENING STATEMENT OF HON. FRANK D. LUCAS, A REPRESENTATIVE IN CONGRESS FROM OKLAHOMA

The CHAIRMAN. This hearing of the Committee on Agriculture to examine the MF Global bankruptcy will come to order.

Thank you for joining us today for this important hearing. And I would like to thank the Ranking Member and his staff for their help in pulling this hearing together. I would also like to thank our witnesses for being here.

Each Member of this Committee understands the importance of the futures market for farmers and ranchers across the country. For decades, futures markets have been a trusted tool for businesses seeking to manage risk. The bedrock of their trust in these markets is based on the fundamental protections provided by mandatory segregation of customer funds. This has supported explosive growth and innovation in futures products in recent years providing farmers, ranchers, and businesses throughout the economy with risk-management tools. These tools allow businesses to reduce the volatility in the price of goods and services for consumers.

Unfortunately, the very cornerstone of the futures market—customer funds segregation—has been severely and suddenly called into question. On October 31, 2011, MF Global filed for bankruptcy after revealing that a substantial amount of customer funds were missing. There are now reports that as much as \$1.2 billion may have disappeared. Dozens of my constituents have been left not only without their property but also without answers about why and how this happened. I know my colleagues have all heard similar stories from constituents who now lack confidence in the system that served them well for many years.

Today, this Committee will examine the bankruptcy of MF Global. From the start, I would like to make it clear that our intention is not to sensationalize the events that have unfolded, and we are not here to simply or haphazardly point fingers and place blame. We take seriously that we have asked both the Trustee and the relevant regulatory organizations to appear before us. And we realize that this inevitably diverts their time and resources from the most critical objective at this time—to recover and return to customers the property that belongs to them.

However, it is critical that this Committee shed light on the circumstances surrounding the bankruptcy, to insert additional facts and information into the public domain, and to dispel much of the confusion and misinformation that exists. A deeper more comprehensive understanding of the facts will put all of us in a better position to address this situation and to begin to restore confidence in the futures markets. This is the objective of the hearing today.

To that end, last week this Committee took extraordinary action to compel witness testimony that is essential to understanding the whole picture and building a comprehensive record. I assure you, both the Ranking Member and I did not take this action lightly.

Last, it is important to stress that this hearing is not simply a check-the-box exercise. This Committee will continue to monitor the investigation into MF Global's actions and will work to ensure that customers receive fair treatment throughout this entire process.

Thank you and I look forward to hearing from our witnesses.  
[The prepared statement of Mr. Lucas follows:]

PREPARED STATEMENT OF HON. FRANK D. LUCAS, A REPRESENTATIVE IN CONGRESS  
FROM OKLAHOMA

Thank you for joining us for this important hearing. I'd first like to thank the Ranking Member and his staff for their help in pulling this hearing together. I'd also like to thank our witnesses for being here.

Each Member of this Committee understands the importance of the futures markets for farmers and ranchers across the country.

For decades, futures markets have been a trusted tool for businesses seeking to manage risk. The bedrock of their trust in these markets is based on the fundamental protections provided by mandatory segregation of customer funds.

This has supported explosive growth and innovation in futures products in recent years, providing farmers, ranchers and businesses throughout the economy with risk management tools. These tools allow businesses to reduce the volatility in the price of goods and services for consumers.

Unfortunately, the very cornerstone of the futures markets, customer funds segregation, has been severely and suddenly called into question.

On October 31, 2011, MF Global Holdings filed for bankruptcy, after revealing that a substantial amount of customer funds were missing. There are now reports that as much as \$1.2 billion may have disappeared.

Dozens of my constituents have been left not only without their property, but also without answers about why and how this happened. I know my colleagues have all heard similar stories from constituents who now lack confidence in the system that has served them well for years.

Today, this Committee will examine the bankruptcy of MF Global. From the start, I'd like to make it clear that our intent is not to sensationalize the events that have unfolded. And we are not here today to simply or haphazardly point fingers and place blame.

We take seriously that we have asked both the Trustee and the relevant regulatory organizations to appear before us. And we realize that this inevitably diverts their time and resources from the most critical objective at this time: to recover and return to customers the property that belongs to them.

However, it is critical that this Committee shed light on the circumstances surrounding the bankruptcy, to insert additional facts and information into the public domain and to dispel much of the confusion and misinformation that exists.

A deeper and more comprehensive understanding of the facts will put us all in a better position to address this situation and begin to restore confidence in the futures markets. This is the objective of the hearing today.

To that end, last week this Committee took extraordinary action to compel witness testimony that is essential to understanding the whole picture and building a comprehensive record.

I assure you, both the Ranking Member and I do not take this action lightly.

Last, it is important to stress that this hearing is not simply a check-the-box exercise. This Committee will continue to monitor the investigation into MF Global's actions and will work to ensure that customers receive fair treatment throughout this process.

Thank you. I look forward to hearing from our witnesses today.

The CHAIRMAN. And I now turn to the Ranking Member for his comments.

**OPENING STATEMENT OF HON. COLLIN C. PETERSON, A  
REPRESENTATIVE IN CONGRESS FROM MINNESOTA**

Mr. PETERSON. Good morning. And thank you, Mr. Chairman.

As the Chairman said, today's hearing is to review the bankruptcy of MF Global, potentially the eighth largest bankruptcy in history. Given that futures customers—particularly those in agriculture—were affected by MF Global's collapse, it is necessary that we hear directly from all those involved and find out who knew what and when they knew it.

I want to thank the Chairman for working with us to have this hearing. The Committee has held plenty of hearings about problems that may or may not occur regarding the implementation of Dodd-Frank. Given the serious problem that currently exists for thousands of futures customers of MF Global, I think it is appropriate that we refocus our attention.

After the bankruptcies of Bear Stearns and Lehman Brothers, the subsequent financial collapse in 2008 and the passage of the historic financial reform legislation, I think it is pretty amazing that we are in this situation. It appears to me that nobody has learned a thing from what has gone on here, that Wall Street is operating as if 2008 never happened.

From all accounts, MF Global was leveraged at 37.5 to 1 at one point, far higher than either Bear Stearns or Lehman Brothers when they folded. Ironically, it is very possible that there is nothing in Dodd-Frank that would have prevented MF Global's financial collapse. And that is why I think we should tread very cautiously before rolling back Dodd-Frank's protections.

Given what happened here, we should probably be talking about strengthening Dodd-Frank, not weakening it. Three big financial

firm bankruptcies over a 3 year period is not a track record that should be extended. During the 2008 financial crisis, futures markets continued to function smoothly. When Refco and Lehman failed, their regulated commodity customer accounts were transferred to other futures commission merchants with no disruption. Wall Street, apparently not content to sully its own reputation, now has stained our well-run futures markets by apparently violating the supreme law, which is protection of customer funds.

The futures industry helps farmers, manufacturers, energy companies, and a host of other industries mitigate risks so that they can go about growing, producing, generating, and making the things that make this country run. We need to get to the bottom of what happened with MF Global as quickly as possible in order to restore the confidence that has been greatly shaken, as the Chairman indicated. We cannot let one company succeed in undermining an industry that has operated safely for customers for decades.

Unfortunately, some of my friends on the other side of the Capitol seem hell-bent and ready to assign blame for MF Global to the CFTC for what they perceive as failing to do their jobs. Do we blame the police officer the day after our house gets broken into? Of course we don't. The futures world operates with a self-regulatory system of oversight because the CFTC cannot afford and doesn't have the resources to put a watchdog into every futures commission merchant. If these Members had their way, the Commission would get even less funds than they do now. This blind rush to judgment fails to take into account how the self-regulatory system works, and in my view, undermines it.

On a personal note, I find the press accounts expressing surprise that the Agriculture Committee could approve something as serious as a Congressional subpoena—unanimously I would say on a bipartisan basis—quite amusing. The Committee's oversight of the futures and derivatives market is a responsibility that I do not take lightly, and I think the Members do not take lightly either. On these issues the Committee, more often than not, will work across party lines because when it comes to matters affecting the financial health and stability of our country, partisan games have no place. I know that that is not something that the press is used to seeing from Congress, but it is how we do things on the Agriculture Committee.

Here at the Agriculture Committee, we are focused on the facts. It is the facts that will tell us what happened, who knew about it, and consequently, who was responsible. Only by uncovering the facts can we prepare ourselves with policy responses that are necessary to address what happened. And that is what this hearing is all about.

Again, I want to thank the chair for working with us to hold today's hearing, and I am hopeful that today's witnesses will shed light on some of what exactly was happening at MF Global, and I also want to thank all the witnesses for being with us today and look forward to the testimony and the questions.

[The prepared statement of Mr. Peterson follows:]

PREPARED STATEMENT OF HON. COLLIN C. PETERSON, A REPRESENTATIVE IN  
CONGRESS FROM MINNESOTA

Good morning and thank you, Chairman Lucas.

As the Chairman said, today's hearing is to review the bankruptcy of MF Global, potentially the eighth largest bankruptcy in history. Given that futures customers, particularly those in agriculture, were affected by MF Global's collapse it is necessary that we hear directly from all those involved and find out who knew what, and when they knew it.

I want to thank Chairman Lucas for granting my request to have this hearing. The Committee has held plenty of hearings about problems that may or may not occur regarding the implementation of Dodd-Frank. Given the serious problem that currently exists for the thousands of futures customers of MF Global, I think it is appropriate that we refocus our attention.

After the bankruptcies of Bear Stearns and Lehman Brothers, the subsequent financial collapse in 2008, and the passage of historic financial reform legislation, it is pretty amazing that we're in this situation. It appears to me that no one has learned a thing; that Wall Street is operating as if 2008 never happened. From all accounts, MF Global was leveraged as much as 40 to 1, far higher than either Bear Stearns or Lehman Brothers when they folded. Ironically, it is very possible that there is nothing in Dodd-Frank that would have prevented MF Global's financial collapse. That's why I think we should tread very cautiously before rolling back Dodd-Frank's protections. Given what happened here we should probably be talking about strengthening Dodd-Frank, not weakening it. Three big financial firm bankruptcies over a 3 year period is not a track record that should be extended.

During the 2008 financial crisis, futures markets continued to function smoothly. When Refco and Lehman failed, their regulated commodity customer accounts were transferred to other futures commission merchants with no disruption. Wall Street, apparently not content to sully its own reputation, has now stained our well-run futures markets by apparently violating the supreme law—protection of customer funds.

The futures industry helps farmers, manufacturers, energy companies, and a host of other industries mitigate risk so they can go about growing, producing, generating, and making the things that make this country run. We need to get to the bottom of what happened with MF Global as quickly as possible in order to restore a confidence that has been greatly shaken. We cannot let one company succeed in undermining an industry that has operated safely for customers for decades.

Unfortunately, some of my friends on the other side of the Capitol seem hell-bent and ready to assign blame for MF Global to the CFTC for what they perceive as failing to do their jobs. Do we blame the police officer the day after our house gets broken into? Of course not. The futures world operates with a self-regulatory system of oversight because the CFTC cannot afford to put a watchdog into every futures commission merchant. And, if these Members had their way, the Commission would get even less funds than they do now. This blind rush to judgment fails to take into account how the self-regulatory system works, and in my view, undermines it.

On a personal note, I find the press accounts expressing surprise that the Agriculture Committee could approve something as serious as a Congressional subpoena, unanimously on a bipartisan basis, quite amusing. The Committee's oversight of the futures and derivatives markets is a responsibility that I do not take lightly. On these issues, the Committee—more often than not—will work across party lines because when it comes to matters affecting the financial health and stability of our country, partisan games have no place. I know that's not something the press is used to seeing from Congress, but it's how we do things on the Agriculture Committee.

Here at the House Agriculture Committee, we are focused on the facts. It is the facts that will tell us what happened, who knew about it, and consequently, who was responsible. Only by uncovering the facts, can we prepare ourselves for policy responses that are necessary to address what has happened. That is what this hearing is all about.

Again, I thank the Chairman for holding today's hearing and am hopeful that today's witnesses will shed some light on what exactly was happening at MF Global.

The CHAIRMAN. The chair thanks the Ranking Member for his comments.

The chair would request that other Members submit their opening statements for the record so that the witnesses may begin their testimony and to ensure that there is ample time for questions.

[The prepared statements of Mr. Baca, Mr. McIntyre, and Ms. Pingree follow:]

PREPARED STATEMENT OF HON. JOE BACA, A REPRESENTATIVE IN CONGRESS FROM CALIFORNIA

Chairman Lucas and Ranking Member Peterson:

Thank you for convening this hearing to examine the situation surrounding MF Global's filing for chapter 11 bankruptcy.

I know these are unique circumstances—with the Agriculture Committee subpoenaing a former Member of Congress as a witness for the first time in over 100 years.

But with anywhere from \$600 million to \$1.2 billion in customer funds completely missing—we all understand the seriousness of this matter.

I want to recognize our witnesses for being here this morning—and helping us better understand the circumstances that led to this financial disaster.

What role did exposure to European sovereign debt play in the collapse of MF Global?

Will customers who lost funds—through both security and futures transactions—all be able to recoup lost dollars?

What steps must we take to prevent other brokerage houses from making the same mistakes as MF Global?

These are just some of the key questions we must answer today.

The American people must have the OVERSIGHT and ACCOUNTABILITY to ensure that consumers are protected.

And our regulatory agencies—including the SEC and the CFTC—must be better funded by Congress in order to have the resources necessary to effectively carry out their duties.

Again, I want to thank the Chairman and Ranking Member for their leadership on this critical issue.

I look forward to this opportunity to learn about what happened at MF Global—so we can ensure these missteps are not made again.

Thank you.

---

PREPARED STATEMENT OF HON. MIKE MCINTYRE, A REPRESENTATIVE IN CONGRESS FROM NORTH CAROLINA

This Committee has a duty to protect one of our nation's most prized assets—its farmers—from the ill effects of financial institutions and regulatory oversight in New York and Washington. Many of America's farmers and grain merchandisers have been deeply affected by the MF Global bankruptcy. That is why we are here today to investigate the events which led to the suffering incurred by the clients of MF Global, so that we may hopefully prevent occurrences of this nature from happening in the future.

The agricultural community is the originator of the derivatives contract. Farmers, more than most, rely on the sequencing of events as a part of their business. The derived value from their labor is paid out in the future, and unsurprisingly, their industry was at the forefront in utilizing futures contracts as a way to mitigate the risks of their practices. Farmers hedge responsibly, with purpose, and do so using sound information based on years of practice and evidence from the market. They, as a group, are the gold-plated example of how financial tools should be used responsibly and provide the greatest example for why financial tools are so necessary in the modern economy.

Producers and agribusinesses that rely on exchange-trading to manage their risks have been startled by the recent events surrounding MF Global. Laws are on the books that, if functioning properly, should prevent customers' accounts from being ensnared in the fallout from risks taken by companies like MF Global on their own principal. Now, in unprecedented circumstance, many accounts of farmers and grain merchandisers have been frozen, and the prospect for the recovery of their property is uncertain.

MF Global must be held accountable for the suffering that it has brought on innocent American farmers and agribusinesses. These risky bets were not placed on the farm; they were placed on Wall Street, and the financial harm that has resulted from this potentially illegal activity must be examined. Specifically, we must determine how the segregated funds were implicated in the trading activities of the firm and if laws were broken in the process. Whether it is gross mismanagement or in-

tentional criminal behavior, the sequence of events must be reviewed carefully so that client funds may be returned to their rightful owners.

The hard lessons of the financial crisis are still fresh in the minds of many Americans, and it is now more important than ever that financial regulators take prudent measures to oversee the American financial system and protect the innocent from the harm of the few. Today, MF Global provides more concern about this fact. I will continue to work with my colleagues in the House of Representatives to find sensible solutions to the problems associated with the actions of overzealous investors that threaten the financial security of honest Americans.

PREPARED STATEMENT OF HON. CHELLIE PINGREE, A REPRESENTATIVE IN CONGRESS  
FROM MAINE

Thank you Mr. Chairman and Ranking Member Peterson for calling this hearing to discuss what went wrong at MF Global and what we can do to avoid these types of failures in the derivatives markets in the future.

It may seem strange for the Agriculture Committee to delve into this issue, but, in fact, we have oversight over the CFTC and the derivatives markets for a very good reason. The very derivatives were futures and options contracts that provided farmers with a tool to protect themselves if the price of their crops fell before they were able to harvest or sell. These futures contracts acted as a form of insurance, allowing farmers, grain elevator operators and others in the agriculture industry to hedge against unpredictable risks. Soon enough these contracts were used in other industries to hedge other risks, and eventually someone saw them as an opportunity to gamble on those risks.

Nevertheless, the origins of the derivatives market were literally in American soil, in the common sense ideas of American farmers to protect their livelihoods. It is fitting therefore that we examine the dangers in our commodities markets and the risks demonstrated by the failure of MF Global with the common sense approach that the Agriculture Committee is known for.

Ms. Sommers, on Tuesday the CFTC adopted the so-called “MF Global Rule” which bans the use of customer funds for in-house repo-to-maturity transactions and re-defines the permitted investments that FCMs can purchase with customer funds in repo-to-maturity transactions with third parties. The original list of acceptable investments for customer segregated funds is spelled out in the Commodity Exchange Act, and hews to conservative choices such as Treasuries, municipal bonds, and other products fully backed by the United States or a U.S. locality.

Beginning in 2000, however, the CFTC used its discretionary authority under the statute to expand the list of allowable investments, first allowing the purchase of certificates of deposit, commercial paper, and interests in government sponsored entities. In 2005, it permitted investments in foreign sovereign debt and in-house transactions.

Now that the CFTC has rolled back those de-regulatory measures, how can we as lawmakers ensure that a similar de-regulatory slide does not happen again?

The CHAIRMAN. I would like to welcome our first panel of witnesses to the table—the Hon. Jill Sommers, Commissioner, Commodity Futures Trading Commission, Washington, D.C.; Mr. James Kobak, Lead Counsel to the Trustee for the Liquidation of MF Global Incorporated, New York, New York.

Commission Sommers, please begin when you are ready.

**STATEMENT OF HON. JILL E. SOMMERS, COMMISSIONER,  
COMMODITY FUTURES TRADING COMMISSION,  
WASHINGTON, DC.**

Ms. SOMMERS. Good morning, Chairman Lucas, Vice Chairman Goodlatte, Ranking Member Peterson, and other Members of the Committee. Thank you for inviting me here today to discuss the MF Global Bankruptcy. I understand the severe hardship this bankruptcy has caused for customers of MF Global. These customers correctly understood the risks associated with trading futures and options but never anticipated that their segregated accounts were at risk of suffering losses not associated with that

trading. Many customers have reached out to me and my staff directly, and we are doing everything we can to get as much of their money back to them as quickly as possible. I have made that my number one priority.

The Commission has dozens of staff members, including auditors, attorneys, and investigators in New York, Chicago, and Washington, D.C., working on these issues. I am unable to discuss matters that might compromise the ongoing enforcement investigation or parallel investigations by other government agencies, so I will focus my comments on the bankruptcy cases pending in New York and on the legal requirements surrounding the segregation of customer funds held at futures commission merchants.

As I understand the Securities Investors Protection Act of 1970, or SIPA, the SEC has the authority to refer an entity registered as a broker-dealer—whether or not such entity is also registered as an FCM—to the Securities Investors Protection Corporation, or SIPC, if there is reason to believe that the entity is in or is approaching financial difficulty. SIPC may initiate a liquidation proceeding to protect customers of an insolvent broker-dealer when statutory criteria are met. In this instance, the liquidation was initiated on October 31 with the support of the CFTC and consent of MF Global. When a broker-dealer is also a registered FCM, as MF Global was, there is one dually registered entity and the entire entity gets placed into liquidation.

Because there is one entity, it is not possible to initiate a SIPA liquidation of the broker-dealer and a separate bankruptcy proceeding for the FCM. It is important to note, however, that when a dually registered BD/FCM is placed into a SIPA liquidation proceeding, the relevant provisions and protections of the Bankruptcy Code, the Commodity Exchange Act, and the Commission's regulations apply to customer commodity accounts just as they would if the entity were solely an FCM and not in a SIPA bankruptcy proceeding.

The Commission is no stranger to FCM bankruptcies. Lehman Brothers and Refco are the two most recent. While the Lehman Brothers bankruptcy was monumental in scale and the Refco bankruptcy involved serious fraud at the parent company, commodity customers did not lose their money at either firm. In both instances, commodity customer accounts were wholly intact; that is, they contained all open positions and all associated segregated collateral. That being the case, customer accounts were promptly transferred to healthy FCMs, with the commodity customers having no further involvement in the bankruptcy proceeding. Unfortunately, that is not what happened at MF Global because the customer accounts were not intact.

In FCM bankruptcies, commodity customers have 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, the Commission regulations allow 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.

For the past few weeks, the Trustee, with the encouragement and assistance of the CFTC, has transferred nearly all positions of customers trading on U.S. commodity futures markets and has transferred approximately \$2 billion of customer property. Tomorrow, we hope the court will approve a “top-up” of all commodity customers to at least  $\frac{2}{3}$  of their account values. These transfers demonstrate that commodity customers are indeed receiving the highest priority in claims to customer property. We understand that more must be done.

An FCM is authorized to invest funds that are in customer segregated accounts. This authorization is found in Section 4d of the CEA and Commission Regulation 1.25. The Commission finalized changes to Regulation 1.25 on Monday of this week. Those changes just reinforce the long-held view of the Commission that customer segregated funds must be invested in a manner that minimizes their exposure to credit, liquidity, and market risks both to preserve their availability to customers and DCOs. Regulation 1.25 is a general prudential standard which requires that all permitted investments be, “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 customer segregated account must remain intact 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 a segregated account, invest it, and then return the money to the segregated account at some later time. Regulation 1.25 has never allowed a firm to transfer customer money out of segregated accounts to be used for other purposes.

When a customer opens a trading account at an FCM, Commission Regulations require that the customer be provided with a risk disclosure statement that generally centers on market risk, market volatility, and leverage. We also require FCMs to notify the Commission immediately of an occurrence of under-segregation or instances of significant margin calls.

While our current focus is returning as much money as possible to the customers, we are expending an enormous amount of effort to locate the missing customer funds and pursue the enforcement investigation. All of the information we learn during these aspects of our work will be relevant to the Commission as it considers “lessons learned” and any policy responses or regulatory changes.

Obviously, the Commission has a great deal of work ahead of it to get customer funds back where they need to be, to determine what went wrong with the segregated funds at MF Global, and to determine whether to prosecute any violations of the Act, and to determine what needs to be done to prevent a similar circumstance in the future. Commission staff is coordinating on these issues with other regulators both internationally and domestically. We are also closely working with the SIPA Trustee to provide whatever support he needs to resolve issues with commodity customer accounts.

I greatly appreciate the continued support of this Committee as we move forward with this important work. Thank you and I am happy to answer any questions.

[The prepared statement of Ms. Sommers follows:]

PREPARED STATEMENT OF HON. JILL E. SOMMERS, COMMISSIONER, COMMODITY  
FUTURES TRADING COMMISSION, WASHINGTON, DC.

Good morning Chairman Lucas, Vice Chairman Goodlatte, Ranking Member Peterson, and Members of the Committee. Thank you for inviting me today to discuss the MF Global Bankruptcy. I understand the severe hardship this bankruptcy has caused for customers of MF Global. These customers correctly understood the risks associated with trading futures and options, but never anticipated that their segregated accounts were at risk of suffering losses not associated with trading. Many customers have reached out to me and my staff directly, and we are doing everything we can to get as much of their money back to them as quickly as possible. I have made that my number one priority.

On November 9th, the Commission voted to make me the Senior Commissioner with respect to MF Global Matters. This authorizes me to exercise the executive and administrative functions of the Commission solely with respect to:

- The pending enforcement investigation;
- The pending bankruptcy case in the Southern District of NY involving MF Global, Inc. (which is the broker-dealer/futures commission merchant);
- The pending bankruptcy case in the Southern District of NY involving MF Global Holdings, Ltd. (which is the parent company); and
- Other actions to locate or recover customer funds or determine the reasons for shortfalls in the customer accounts.

The Commission has dozens of staff members (including auditors, attorneys, and investigators) in New York, Chicago, and Washington, D.C. working on these issues. I am unable to discuss matters that might compromise the ongoing enforcement investigation, or parallel investigations by any other government agency, so I will focus my comments on the bankruptcy cases pending in New York and on the legal requirements surrounding the segregation of customer funds held at futures commission merchants (FCMs).

**Pending Bankruptcy Cases**

As I understand the Securities Investors Protection Act of 1970 (SIPA), the SEC has the authority to refer an entity registered as a broker-dealer (whether or not such entity is also registered as an FCM) to the Securities Investors Protection Corporation (SIPC) if there is reason to believe that the entity is in or is approaching financial difficulty. SIPC may initiate a liquidation proceeding to protect customers of an insolvent broker-dealer when certain statutory criteria are met. In this instance, the liquidation was initiated on October 31st, with the support of the CFTC and consent of MF Global. When a broker-dealer is also a registered FCM, as MF Global was, there is one dually-registered entity and the entire entity gets placed into liquidation. Because there is one entity, it is not possible to initiate a SIPA liquidation of the broker-dealer, and a separate bankruptcy proceeding for the FCM. It is important to note, however, that when a dually-registered BD/FCM is placed into a SIPA liquidation proceeding, the relevant provisions and protections of the Bankruptcy Code, the Commodity Exchange Act ("CEA"), and the Commission's regulations apply to customer commodity accounts just as they would if the entity were solely an FCM and in a non-SIPA bankruptcy proceeding.

An obvious point to make is that if a firm is involved in a bankruptcy proceeding, something must have gone very wrong. Bankruptcy proceedings can be very complicated and at times, messy. This can be magnified when the bankruptcy is among the largest in history and there are serious questions about the location of customer funds. The Commission is no stranger to FCM bankruptcies. Lehman Brothers and Refco are the two most recent FCM bankruptcies. While the Lehman Brothers bankruptcy was monumental in scale, and the Refco bankruptcy involved serious fraud at the parent company, commodity customers did not lose their money at either firm. In both instances, commodity customer accounts were wholly intact, that is, they contained all open positions and all associated segregated collateral. That being the case, customer accounts were promptly transferred to healthy FCMs, with the commodity customers having no further involvement in the bankruptcy proceeding.

Unfortunately that is not what happened at MF Global because customer accounts were not intact.

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 allow 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 the BD/FCM had, 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 November 29th, the Trustee moved to transfer an additional \$2.1 billion back to customers, to be used to "top up" all commodity customers to at least  $\frac{2}{3}$  of their account values as reflected on the books and records of MF Global, Inc. The Bankruptcy Court will hear the motion on December 9th. If the Court grants the motion we expect the transfer may be complete in 2 to 4 weeks, given the Trustee's estimate of the timeframe within which he can complete the administrative functions necessary to effectuate the transfer. These transfers demonstrate that commodity customers are indeed receiving the highest priority in claims to customer property. We understand that more must be done.

#### **FCM Investment of Customer Funds**

An FCM is authorized to invest funds that are in customer segregated accounts. This authorization is found in Section 4d of the CEA and in Commission Regulation 1.25 (a brief history of changes to Regulation 1.25 is found in the attached *Appendix*). It may be helpful to draw an analogy to a savings account at a bank. Let's say someone opens a savings account with \$1,000 and the bank agrees to pay 0.25% interest annually. That \$1,000 is not just sitting at the bank waiting for the depositor to come and get it. The bank invests that money, or loans it to others, *etc.*, with the goal of earning a rate of return greater than the 0.25% interest the bank is obligated to pay the depositor. Very simply stated, if the bank earns a rate of return greater than 0.25%, that is net revenue for the bank. If the bank earns a rate of return less than 0.25%, there is a net loss.

Broadly speaking, the investment of customer funds by an FCM is similar, but there are critical safeguards and restrictions placed on FCMs. Section 4d of the CEA and Commission Regulation 1.25 list the only permissible investments an FCM can make with customer funds. 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 both to preserve their availability to customers and DCOs and to enable investments to be quickly converted to cash at a predictable value. As such, Regulation 1.25 establishes a general prudential standard by requiring that all permitted investments be "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 a segregated account, invest it, and then return the money to the segregated account at some later time.

#### **Customer Accounts at FCMs**

When a customer opens a trading account at an FCM, Commission Regulations require the customer to be provided with a risk disclosure statement that generally centers on market risk, market volatility, and leverage. Pursuant to Commission Regulation 1.55(b)(6), the required risk disclosure statement must also include the following: "You should consult your broker concerning the nature of the protections available to safeguard funds or property deposited for your account." There are no required disclosures concerning how customer funds can be invested by an FCM.

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 ac-

knowledging that the depositories cannot exercise any rights of offset to such accounts for obligations of the FCM.

Commission Regulation 1.12 requires FCMs to notify the Commission immediately of an occurrence of under-segregation. FCMs also must notify the Commission of instances of significant margin calls (such as a margin call to a customer, which if not made, would put fellow customers at risk if an adequate buffer or “excess segregation” was not in segregated accounts).

A customer is required to post margin to support futures positions. Generally, a customer deposits more than the minimum initial margin required for the positions established. 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 having positions liquidated if margin calls are not met on a timely basis. In addition to customers depositing additional margin, in practice, FCMs typically maintain significant amounts of their own 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 given the legal obligation at all times to have sufficient funds in segregated accounts to cover all liabilities to customers, FCMs generally find it wise to have a buffer.

A customer may withdraw excess margin funds or use such funds as the customer deems appropriate. This would include 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.

#### **Oversight of FCMs**

FCMs are subject to CFTC-approved minimum financial and reporting requirements that are enforced in the first instance by a designated self-regulatory organization (“DSRO”), for example, the Chicago Mercantile Exchange or the National Futures Association. DSROs also conduct periodic compliance examinations on a risk-based cycle every 9 to 15 months. The requirements of DSRO examinations are contained in Financial and Segregation Interpretations 4–1 and 4–2, which are specified as application guidance to Core Principle 11 (Financial Integrity) for Designated Contract Markets. The Commission has proposed codifying the essential components of these interpretations into an amended Commission Regulation 1.52.

An examination of segregation compliance is mandatory in each examination (certain other components need not be included in every examination). This examination includes a review of the depository acknowledgement letters and the account titles of segregated accounts (unless unchanged from the prior examination); verifying account balances, and ensuring that investment of customer funds is done in accordance with Commission Regulation 1.25.

Commission Regulation 1.10 requires FCMs to file monthly unaudited financial reports with the Commission and the DSRO. These reports include the FCM’s segregation and net capital schedules, and any “further material information as may be necessary to make the required statements and schedules not misleading.” Each financial report must be filed with an oath or attestation, and for a corporation, the oath must be by the CEO or CFO.

Commission Regulation 1.16 requires FCMs to file annual certified financial reports with the Commission and the DSRO. The audits require, among other things, that if a new auditor is hired, that new auditor is required to notify the Commission of certain disagreements with statements made in reports prepared by prior auditors. Auditors also 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.

#### **Conclusion**

While our current focus is returning as much money as possible to customers, we are expending an enormous amount of effort to locate the missing customer funds and pursuing the enforcement investigation. All of the information we learn during these aspects of our work will be relevant to the Commission as it considers “lessons

learned” and any policy responses or regulatory changes. It is just too early to tell, however, what responses and/or changes the Commission will find appropriate.

Obviously, the Commission has a great deal of work ahead of it to get customer funds back where they need to be, to determine what went wrong with segregated funds at MF Global, to determine whether to prosecute any violations of the Act, and to determine what needs to be done to prevent a similar circumstance in the future. Commission staff is coordinating on these issues with sister regulators both domestically and overseas, and is working closely with the SIPA Trustee to provide whatever support he needs to resolve issues with commodity customer accounts. I greatly appreciate the continued support of this Committee as we move forward with this important work.

Thank you. I am happy to answer any questions you may have.

#### APPENDIX

Under Section 4d of the CEA, customer segregated funds may be invested in:

- obligations of the United States and obligations fully guaranteed as to principal and interest by the United States (U.S. Government securities); and
- general obligations of any state or of any political subdivision thereof (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:

- general obligations issued by any enterprise sponsored by the United States (government sponsored enterprise or GSE debt securities);
- bank certificates of deposit (CDs);
- commercial paper;
- corporate notes;
- general obligations of a sovereign nation (to the extent the FCM holds customer funds denominated in that sovereign nation’s currency); and
- interests in money market mutual funds (MMMFs).

In connection with that expansion, the Commission included several provisions intended to control exposure to credit, liquidity, and market risks associated with the additional investments, *e.g.*, requirements that the investments satisfy specified rating standards and concentration limits, and be readily marketable and subject to prompt liquidation.

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 May 2005, the Commission adopted amendments to Commission Regulation 1.25 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 (in-house transactions);
- rating standards and registration requirements for MMMFs;
- an auditability standard for investment records; and
- certain other technical changes.

In 2007, the Commission’s Division of Clearing and Intermediary Oversight (Division) launched a review of the nature and extent of FCM investment of customer funds in order to further its understanding of investment strategies and practices and to assess whether any changes to the Commission’s regulations would be appropriate. As part of this review, all registered Derivatives Clearing Organizations (DCOs) and FCMs carrying customer accounts provided responses to a series of questions. As the Division was finalizing its review of materials submitted by DCOs and FCMs, and conducting follow-up interviews with them, the market events of September 2008 occurred and changed the financial landscape such that much of the data previously gathered no longer reflected current market conditions.

In May 2009, the Commission issued an advance notice of proposed rulemaking to solicit comment prior to proposing amendments to the list of permitted investments. The Commission sought comments, information, research, and data regarding regulatory requirements that might better safeguard customer segregated funds. It also sought comments, information, research, and data regarding the impact of applying the requirements of Regulation 1.25 to 30.7 funds (30.7 refers to funds of foreign futures and options customers). The Commission received twelve comment letters—eleven supported maintaining the list of permitted investments and/or ensuring that MMMFs remained permitted investments; five focused solely on the topic of MMMFs, providing detailed discussions of their usefulness to FCMs; and several addressed issues regarding ratings, liquidity, concentration, and portfolio weighted average time to maturity.

In October 2010, the Commission proposed changes to the list of permissible investments, and on December 5, 2011 adopted final rules in that regard. The final rules, among other things:

- retain U.S. agency obligations, including implicitly backed GSE debt securities, but allow investment in debt issued by Fannie Mae and Freddie Mac only as long as they operate under the conservatorship or receivership of FHFA;
- remove corporate debt obligations not guaranteed by the United States;
- eliminate foreign sovereign debt;
- eliminate in-house and affiliate transactions; and
- impose asset-based concentration limits on various investments.

The CHAIRMAN. Thank you, Commissioner.

Mr. Kobak, you may begin when you are ready.

**STATEMENT OF JAMES B. KOBAK, JR., LEAD COUNSEL TO  
JAMES GIDDENS, TRUSTEE, SECURITIES INVESTOR  
PROTECTION ACT LIQUIDATION OF MF GLOBAL INC., NEW  
YORK, NY**

Mr. KOBAK. Thank you, Chairman Lucas, Ranking Member Peterson, 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 Kobak, Jr. I am a partner at the law firm of Hughes, Hubbard, and Reed and lead counsel to James Giddens, the court-appointed Trustee for MF Global Inc., under the Securities Investor Protection Act, or SIPA

By statute, the Trustee is the customers' advocate. The Trustee's staff, which includes legal experts, consultants and forensic accountants, is 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. We have been working closely and continuously with the Securities Investor Protection Corporation, with Commissioner Sommers and the Commodity Futures Trading Commission, with the Securities and Exchange Commission, with the Chicago Mercantile Exchange, and with other industry members and industry groups.

The Trustee and everyone working with him understands the frustration of many former MF Global Inc., customers. When a broker-dealer with 36,000 commodity customers fails under the unprecedented circumstances here, the liquidation is necessarily complex. The Office of the Trustee has been working tirelessly with speed and diligence to marshal customer assets and find ways to return them to customers to the full extent of our ability under the applicable provisions of SIPA, the Bankruptcy Code, and CFTC regulations.

We were appointed on the afternoon of October 31. Through expedited court proceedings beginning in less than 2 days that have already been approved by the court and with the assistance and consent of the CFTC, we distributed \$2 billion of property. We have a hearing in bankruptcy court tomorrow where we are asking the court to approve a transfer of an additional slightly over \$2 billion that should bring all customers with domestic commodities positions up to an amount slightly in excess of  $\frac{2}{3}$  of the value of their accounts. The customer claims process is also up and running with claim forms on the Trustee's website and also sent by mail. Claims are being filed and reviewed as we speak.

As part of his statutorily mandated duty, the Trustee is also investigating the extent of and reasons for the shortfall and what MF Global management should have segregated or otherwise set aside at depositories for the benefit of commodity customers. The investigation is ongoing and the Trustee is not yet in a position to make any definitive conclusions. However, he has determined that even if he could recover everything that is presently available at U.S. depositories, there will be a significant shortfall.

At present, the Trustee believes the shortfall, based on everything he is looking at across the entire business, may be as much as \$1.2 billion or more. The Trustee felt obligated to share these preliminary numbers and explain the uncertainty around them, first to the court supervising the liquidation, and then to the public through his website. It is the Trustee's hope that the shortfall number will come down, but no matter the final amount of the shortfall, under any of the estimates that have been made, it is significant and substantially affects the Trustee's ability to make a 100 percent distribution to former MF Global customers.

Further complicating matters, assets located in foreign depositories for customers that traded in foreign futures are or should be under the control of foreign bankruptcy trustees or administrators. The Trustee is pursuing these assets vigorously but recovery may be uncertain and may take more time.

The Office of the Trustee has made every effort to communicate directly and frequently with customers through his website, mailings, and frequent meetings with various groups. In closing, you can be assured that the Trustee and his staff are fully committed to returning customers' property as quickly as possible and in a fair and equitable manner that complies with the law.

[The prepared statement of Mr. Kobak follows:]

PREPARED STATEMENT OF JAMES B. KOBAK, JR., LEAD COUNSEL TO JAMES GIDDENS, TRUSTEE, SECURITIES INVESTOR PROTECTION ACT LIQUIDATION OF MF GLOBAL INC., NEW YORK, NY

Chairman Lucas, Ranking Member Peterson, 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 Kobak. 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 31st, 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 former MF Global Inc. retail customers, whether farmers, day traders, or institutional investors, have been made within weeks of the bankruptcy filing. Through already approved expedited court filings and additional court filings that will be heard by the Bankruptcy Court tomorrow, we have laid the ground work for up to \$4.1 billion in customer distributions. The customer claims process, which we asked the Bankruptcy Court to authorize us to establish on an expedited basis, is also up and running, with claims forms on the Trustee's website and also sent by mail.

The goal of the Trustee 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 U.S. 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. The Trustee's 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 e-mails and holding meetings with customer groups and counsel. In the month of November, the Trustee's call center handled more than 8,500 calls, and more than 60,000 individuals accessed the Trustee's detailed website on more than 222,000 occasions.

If your constituents have any questions, we encourage them to visit the Trustee's website at [MFGlobalTrustee.com](http://MFGlobalTrustee.com), e-mail the Trustee's staff at [MFGITrustee@hugheshubbard.com](mailto: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 may have heard from directly. When a broker-dealer fails under the unprecedented circumstances surrounding MF Global's demise, the liquidation is necessarily complex. The Office of the Trustee 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 former MF Global Inc. retail commodities customers has been accomplished thus far through two Bankruptcy Court-approved bulk transfers. The Trustee has filed a motion for an additional bulk transfer for commodities accounts that will be before the Bankruptcy Court for approval at a hearing tomorrow morning.

Approximately \$2 billion has already been distributed to former MF Global Inc. retail commodities customers through the first two bulk transfers. The first transfer was approved by the Court just 2 days after the appointment of the Trustee and implementation began immediately.

The approval of the third bulk transfer will allow the distribution of an additional \$2.1 billion, which will restore approximately  $\frac{2}{3}$  or more of U.S. segregated customer property *pro rata* to all former MF Global Inc. retail commodities customers with U.S. positions.

Once approved by the Court, the Trustee expects that the process to implement the third bulk transfer can start immediately on a rolling basis working with the CME and other derivative clearing organizations and industry participants, who estimate the transfers will take them 2 to 4 weeks to complete in most cases.

The Trustee appreciates the exhaustive efforts of the CME and other derivative clearing organizations, which have made the bulk transfers possible. The Trustee also appreciates 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 Trustee filed an expedited motion with the Bankruptcy Court seeking authorization to sell and transfer substantially all retail securities accounts to Perrin, Holden & Davenport Capital Corp. If successfully implemented, this transfer of approximately 300 accounts will allow former MF Global Inc. retail securities customers to receive all or a majority of the net equity in their accounts. This motion will also be heard by the Bankruptcy Court tomorrow.

The Trustee appreciates the ongoing support and partnership of SIPC. The staff of SIPC have been an invaluable resource for the Trustee's office as both groups 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 Trustee's 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 commodity account estate. They will receive an equal, prorated distribution from two subsets in that estate: one for U.S. positions traded through U.S. 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 U.S. customers. At this time, the Trustee does not have control of most of these assets and it is not known when, or if, the assets will become available to the Trustee. 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.

General creditors cannot receive distributions from the customer estates and can only recover claims from the general creditors' estate.

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 general creditors' estate 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, and the Trustee's office is committed to processing them promptly and to supporting a customer-friendly claims process. More than 75,000 claims forms were mailed to customers last week, and PDF claims forms have been available on the Trustee's website since November 23, 2011. The Trustee has also provided detailed instructions and deadlines on the website and has been meeting with customer groups and counsel about the process.

#### **Investigation and "Shortfall"**

As part of his statutorily-mandated duty, the Trustee is investigating the extent of and reasons for the shortfall in customer funds. The Trustee's 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 the Trustee is not yet in a position to make any definitive conclusions. However, he has determined that even if he could recover everything that is at U.S. depositories, there will be a significant shortfall in what MF Global management should have segregated at U.S. depositories for the benefit of customers. At present, the Trustee believes this shortfall may be as much as \$1.2 billion or more. These are preliminary numbers that may well change, and the Trustee will update these numbers as appropriate. The Trustee felt obligated to share these preliminary numbers and their uncertainty with the public to dampen assumptions that some smaller amount of the shortfall was known with certainty and could not be larger. It is the Trustee's hope that, for the benefit of customers, the number will come down. No matter the exact size 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 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 of course 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 U.S. Attorneys. It is expected that the Trustee will make an interim report on the investigation to the Court at an appropriate time, and that on completion of the investigation, the final report will be made public.

#### **Conclusion**

Thank you Chairman Lucas, Ranking Member Peterson and other 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 the Trustee and his staff 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 p.m. 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 of up to an additional \$2.1 billion to restore approximately  $\frac{2}{3}$  or more of U.S. segregated customer property *pro rata* to all former MF Global Inc. commodities customers with U.S. positions. The motion is scheduled for hearing on December 9.
- **November 30, 2011**—Trustee files motion seeking authorization to sell and transfer substantially all retail securities accounts to Perrin, Holden & Davenport Capital Corp. The motion is scheduled for hearing on December 9.

The CHAIRMAN. Thank you, Mr. Kobak.

I now recognize myself for 5 minutes.

Commission Sommers, it has become clear that there were warning signs at MF Global in the weeks if not months leading up to the bankruptcy—increased exposure in foreign sovereign debt, increased leverage, insufficient capital. Was the CFTC aware of these warning signs?

Ms. SOMMERS. Mr. Chairman, the investments in foreign sovereign debt would be on the broker-dealer side of that business. The types of reports that we receive from the FCM we were receiving daily segregation reports from MF Global, and those did not raise red flags for us until right before the bankruptcy.

The CHAIRMAN. So it is fair to say, then, that the first time you were made aware of these issues was right before the bankruptcy. Who has primary responsibility for monitoring those segregation account records, the CFTC or the DSRO or the NFA? Who verifies their accuracy in addition to monitoring?

Ms. SOMMERS. A typical FCM would be required to compute and keep daily segregation records that the DSRO or the CFTC would be able to come in and look at. In the case of MF Global, those daily seg reports were not actually just kept at MF Global, but they were sent to the CFTC and the DSRO.

The CHAIRMAN. Nonetheless, the bottom line is still that the daily reports were prepared, they were examined at CFTC, but the mechanism by which to verify the accuracy, how is that done?

Ms. SOMMERS. You would have to go back to bank records to make sure. The daily seg reports would compute how much of customer segregated money was required to be there and how much was actually there.

The CHAIRMAN. So on a day-to-day basis, we were taking their word for what they told us they had in the accounts in which accounts?

Ms. SOMMERS. That is right. Our system relies on self-reporting, and an FCM is required to report to the CFTC if they are ever undersegregated.

The CHAIRMAN. And once again, remind me what CFTC did to protect those customer accounts leading up to that bankruptcy filing?

Ms. SOMMERS. We were reviewing the daily segregation reports.

The CHAIRMAN. Okay.

Mr. Kobak, you indicated that potentially there was at least if not more than \$1.2 billion in these funds that are not accounted for at the present time?

Mr. KOBAK. That is our best estimate to date, yes, Chairman Lucas.

The CHAIRMAN. That is a substantial sum of money by anybody's definition. Tell me this—if the Trustee is unable to recover the

missing funds, what priority will MF Global's commodity customers be given in the bankruptcy proceedings?

Mr. KOBAK. I actually refer to it not as a priority but really with respect to the funds that are there in the segregated accounts, it is really an exclusive right of commodities customers. So general creditors, securities customers, other kinds of claimants have no right at all to those funds. If there is an insufficiency, if there are other sources available that we can legally pursue, we would do that. As Commissioner Sommers indicated, there are provisions that allow us to do that. There are also provisions that allow general estate assets to be put into the segregated funds and to be available for commodities customers.

The CHAIRMAN. Mr. Kobak, the CME has estimated that its \$550 million guarantee would facilitate the distribution of assets to ensure that every customer receives at least 75 percent of its account value. Is that correct?

Mr. KOBAK. The \$550 million guarantee really just goes to truing up accounts so that if somebody in some of the transfers got more than their proportionate share at the end of the day, it would be evened. We don't think it is enough to let us get to quite 75 percent. I think the distribution that we are hoping the Bankruptcy Court will authorize tomorrow will get us up to the area of 69 to 70 percent, somewhere in that vicinity for customers.

The CHAIRMAN. So if I am a customer out in the countryside caught in this situation, how would I assume that you would proceed with this extra money? Will I have to wait substantially longer to get potentially up to that 75 percent?

Mr. KOBAK. We have been working with the CME closely. If the court approves the transfer, we have systems in place to start the mechanism rolling immediately. Some accounts may be more complicated than others. The CME thinks that the process should take between 2 to 4 weeks depending on the accounts involved.

The CHAIRMAN. We have read reports that MF Global's records were a mess and that this has complicated the investigation. And I ask this of the panel—is that an accurate description of MF Global's books and records, a mess?

Mr. KOBAK. Yes. I am no accountant, but I think it is fair to state—and I think this often happens in situations like this where a company gets in trouble, where there is a run on the bank, and there is a tremendous volume of transactions over the last week or 10 days of its business, many unusual transactions, it is very hard to sort through all that. There are a lot of—especially with electronic systems nowadays, there are a lot of things that get entered in the record that may or may not represent actual transactions. So in that sense, the records are a mess.

The CHAIRMAN. And if this goes back previous to the final painful days of this business, shouldn't the previous audits have forced MF Global to straighten up or clean up their records?

Mr. KOBAK. Well, I think most of the mess we see is really from the last week or 2. And again, I am not an accountant. We have Deloitte and others working for us and they could probably answer these questions better than I can. I think frankly the customer account records for individual customers were actually in fairly good shape up until toward the end, as I understand it.

The CHAIRMAN. Commissioner Sommers, any comment on that?

Ms. SOMMERS. Yes. I think that there is no real way to over-emphasize the complexity here. I mean there are over 38,000 customer position accounts. As I understand it, some of the primary bank statements are 300 to 500 pages long. There are thousands of transactions that have to be traced from beginning to end because we need to know where every penny of the money went.

The CHAIRMAN. Thanks, Commissioner.

My time has expired. I now turn to the Ranking Member for 5 minutes.

Mr. PETERSON. Thank you, Mr. Chairman.

I am an accountant and I can understand how it could get in this situation that last couple weeks given what went on. And from what I can tell, Mr. Corzine, his testimony says he was stunned to find out that the customer money was missing, so apparently he didn't know about until Sunday either.

I guess my first question is you have those accountants now and they are now sorting through all of this. How long is it going to take before they are going to be able to find out what happened to this money? Do you have any idea, either one of you?

Mr. KOBAK. We are basically working 24/7. I really can't answer that question. I think no one will know the exact amount of money that is owed to customers until we are through the claims process, and that basically began about a week ago and there is a 60 day period. So I would hope that at least by the end of that period we would have a good understanding of what this shortfall is and a better understanding of all the reasons for it.

Mr. PETERSON. But during the process, you are also trying to figure out who it was that knew about this, authorized it, and whatever. That is part of your——

Mr. KOBAK. Yes. Our primary emphasis, though, is how much money——

Mr. PETERSON. Yes.

Mr. KOBAK.—is missing? Where did it go? Do we have a legal way to get it back?

Mr. PETERSON. Right.

Mr. KOBAK. And there are law enforcement investigations with the U.S. Attorney and we really don't want to get in the way of those. So we see that as very much a secondary mission right now to finding out where the money went.

Mr. PETERSON. Right. On November 29, the *New York Times*, there was an article by Ben Protess and Azam Ahmed about how some investigators suspect that there was a transfer of some \$200 million from MF Global to JP Morgan Chase in Britain and it may have been the first major misuse of customer money it was reported. It was also said that the authorities are looking into whether JP Morgan initially questioned the source of this cash and sought proof from MF Global that it was complying with regulations. Generally, when third parties receive funds from futures commission merchants, what is the third party's obligation to confirm or inquire with the FCM whether or not these funds are customer funds? And if the third party knows or suspects that the funds they receive are from customer funds being inappropriately

transferred, what obligation does that party have to report this knowledge or suspicion to the regulator?

Ms. SOMMERS. I will take the first part of that question first and to say simply that if there is any customer money that has been transferred out of the section 4d accounts, that is part of what we are working together to find and that money will be clawed-back to be distributed back to customers.

The second part of the question on the obligations of an FCM or of a third party, generally speaking, transactions like that to take customer money out of a section 4d segregated account and transfer it to pay some other debt do not happen. That is a violation of the Act. So there wouldn't be an obligation for the third party. I mean I would not think that it would generally come to somebody's mind to question it.

Mr. PETERSON. As I understand what I have read, this stuff that these segregated accounts have a different name. And so if you are involved in this business, you are going to understand if it has that name, it is a customer's account. I think that is part of the issue here is that there was apparently some question about the way this thing was named. So if that in fact is the case, I mean is there responsibility on the part of JP Morgan Chase to question that or did they question that if you are looking into that?

Ms. SOMMERS. I am not aware of those specific circumstances that you are describing, but I would think that in a normal course of business there would not be a case for a third party to ask for some sort of verification.

Mr. PETERSON. Hopefully you will look into that because I also had heard that they were fairly trying to get preference to get this money back somehow or another. I don't know. Anyway, there was this story out there so hopefully somebody is looking into that.

The other question I have is if you determine—this is for both of you—in the course of doing this that the customer funds were inappropriately commingled or used, can personnel at MF Global, if they authorized these actions, be held personally responsible or liable? And can the Commission or the Trustee require MF Global personnel responsible for missing funds to use personal assets to compensate victims who lost their money?

Mr. KOBAK. It sounds like that is a question for me in the first instance, and those are certainly issues that we are looking into apart from what their liability might be from a criminal side or a regulatory side. As I said, our mission right now is to see if there are causes of action and that is something that—first, we have to know if people did do things improperly, and then if they did, are there legal theories to pursue that. But that certainly is the kind of thing we would be looking into and are looking into.

Mr. PETERSON. Ms. Sommers?

Ms. SOMMERS. From the CFTC's perspective, they are subject to civil prosecution under our rules, and there would also be potential for criminal violations of the Act as well, so criminal prosecution by other authorities.

Mr. PETERSON. So your civil authority, would that just be fines?

Ms. SOMMERS. Right.

Mr. PETERSON. And is there a limitation on how much the fines could be or can you charge enough fines to cover this? And if you

did, could you use that to make—you probably couldn't use that to make good these accounts anyway.

Ms. SOMMERS. It is my understanding that there are a number of different avenues with regard to the authority we have for fines. It is \$140,000 per violation of the Act, or three times the amount of the monetary gain, as well as additional fines that we could charge for restitution to customers and various other fines. So there are a number of different ways we could go in assessing the fine that would be appropriate.

Mr. PETERSON. But that money wouldn't be available to make good the customer account. That is going to go to the CFTC, right?

Ms. SOMMERS. It is my understanding that would go to general Treasury fund. Restitution would go back to the customers but the fines would——

Mr. PETERSON. Yes.

Ms. SOMMERS.—be returned to the general Treasury fund.

Mr. PETERSON. Right.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired.

I now recognize the gentleman from Virginia for 5 minutes.

Mr. GOODLATTE. Thank you, Mr. Chairman. Commissioner Sommers, Mr. Kobak, welcome.

My first question to you, Commissioner Sommers, is related to how this works. As I understand it, customers of MF Global would place funds—in fact in many instances very large amounts of funds—into an account that is like a trust account or an escrow account that would be held there, and then at appropriate times the customer would give instructions to MF Global to engage in a particular trade, and when they did that, they would take the funds from that account to engage in the trade. So what has happened is that MF Global has taken those funds without the customers' authorization and placed them in various types of investments, some of which like foreign sovereign debt might be viewed to be quite risky. Is that what is at the heart of this?

Ms. SOMMERS. Mr. Goodlatte, I wouldn't want to discuss any of the details that may compromise the enforcement investigation, but to say that generally speaking, yes, a customer would place money in a section 4d account with an FCM and that FCM is not allowed to use customer funds, for instance, to make proprietary investments for their own account.

Mr. GOODLATTE. Okay. And on Monday, the Commission, after considerable investigation and deliberation and starting prior to this MF Global problem arising, made changes to Rule 1.25 which gives instructions to companies like MF Global about what they can do with the funds in those accounts. Is that not correct?

Ms. SOMMERS. That is correct. But I think it is also—just to be clear, when an FCM is using funds to invest in permissible investments under rule 1.25, simultaneously the exact amount of money has to be put back into the customer account. They can't take the money out there, use it, invest it, and then at some other time put it back.

Mr. GOODLATTE. Correct. So they have to maintain the funds in that account much like if you put money into a bank account, the bank, using that as collateral, will make investments in various

things but they can't deduct it from the account and put it back in later on.

Ms. SOMMERS. That is exactly right.

Mr. GOODLATTE. It operates similarly.

Do you believe that the changes that were enacted by the CFTC on Monday would have made clear—I don't know if you can say it would have prevented actions that may have been illegal—but would it have made it clear that the actions taken by MF Global were not legal had they been operating under the new rule?

Ms. SOMMERS. Nothing under rule 1.25 has ever allowed an FCM to use customer funds for investments for their own account. So changes that we made on Monday or previous to Monday would have ever allowed that.

Mr. GOODLATTE. What was the purpose of making the changes on Monday? What did those accomplish?

Ms. SOMMERS. Actually, there is a long history there that goes back to after 2008 when the reserve fund broke the bank, and since then, the CFTC has been looking into what type of investments should be allowed for customer funds. And one of the beginning issues is whether or not an FCM should be allowed to put 100 percent of customer money into one money market fund like the reserve fund. So we were looking at concentration levels and asset-based concentration levels, issuer-based levels on those money market accounts.

Mr. GOODLATTE. And you also restricted their ability to invest in foreign sovereign debt, did you not?

Ms. SOMMERS. We did on Monday. Yes, we did.

Mr. GOODLATTE. Okay. Do you think that those changes would have prevented what happened in MF Global from occurring in terms of where they made investments? Maybe not in terms of how they conducted the account, which is a whole separate part of this investigation, but in terms of where they made the investments?

Ms. SOMMERS. At this point, I believe it would be premature for us to assume that what has happened, that they used permitted investments that may have been permitted before Monday and that that is where the money was lost. We don't know that that is what happened.

Mr. GOODLATTE. So the money could have been lost that way, the money could have been embezzled, the money could be somewhere that the Trustee hasn't yet located. That part of the investigation is not yet clear?

Ms. SOMMERS. That is correct.

Mr. GOODLATTE. And one hopes for the best but from looking at this one expects the worst.

Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. The gentleman yields back.

The chair now recognizes the gentleman from Pennsylvania for 5 minutes.

Mr. HOLDEN. Thank you, Mr. Chairman.

Ms. Sommers, if I understand your answer to Chairman Lucas' question, the CFTC was receiving daily reports from the FCM that indicated no problem at MF Global?

Ms. SOMMERS. Daily segregation reports.

Mr. HOLDEN. Okay. When was the last CFTC audit of MF Global and what did that audit show?

Ms. SOMMERS. The CFTC is not the frontline regulator for FCMs, so we do not perform audits on FCMs. We do spot checks and other different procedures to review books and records. But the audits are performed by the DSROs.

Mr. HOLDEN. Are you aware of the results of the last audits by the DSROs and what it showed?

Ms. SOMMERS. CFTC staff would review those.

Mr. HOLDEN. So you don't have personal knowledge of that?

Ms. SOMMERS. I do not.

Mr. HOLDEN. Okay. How closely does the CFTC monitor capital levels at FCMs?

Ms. SOMMERS. I am sorry, how often?

Mr. HOLDEN. Not how often, how closely?

Ms. SOMMERS. That would be——

Mr. HOLDEN. Give it a lot of attention.

Ms. SOMMERS. For an entity that is FCM solely, those types of capital levels would be part of our oversight for an FCM—or I am sorry for an entity that would be a broker-dealer FCM, then those capital levels would be reviewed by either the securities side or the futures side, depending on the higher of the two is what the regulations require.

Mr. HOLDEN. Did the CFTC coordinate with other regulators leading up to MF Global bankruptcy? Did you consult with FINRA and the SEC?

Ms. SOMMERS. I am not sure exactly of the circumstances of who was consulting with the SEC or FINRA in the days leading up to the bankruptcy. I was not involved at that point.

Mr. HOLDEN. Well, would it be common practice to consult with the SEC?

Ms. SOMMERS. I think that there are periodic meetings that regulators have to review issues in the markets, but I am not sure how often those happen.

Mr. HOLDEN. Thank you.

Mr. Kobak, how many accounts were affected? I believe you said 36,000; Ms. Sommers said 38,000, so somewhere——

Mr. KOBAK. Our best number is approximately 36,000.

Mr. HOLDEN. How many of those accounts are commodity accounts?

Mr. KOBAK. I am talking about commodities accounts. A small number, about 300 or 400 act as securities accounts on the broker-dealer side of the business.

Mr. HOLDEN. Okay. How many accounts have been transferred to a different futures commission merchant?

Mr. KOBAK. When we will have completed—assuming the court approves the transfer tomorrow—we expect that substantially all accounts should move. There are a number of very small accounts—I am talking about accounts with less than \$1,000, many times just \$100 or \$200 that may not have been active accounts for a long time—it may be possible to find other FCMs to take those, so we may try to expedite the resolution of those claims in the claims process. But other than that, virtually all accounts should

get to another FCM with something like  $\frac{2}{3}$  of the value of their domestic positions.

Mr. HOLDEN. And the transfer has to be reviewed by the Trustee, correct?

Mr. KOBAK. Well, we have to move the Bankruptcy Court actually, and that is what we are doing tomorrow. And there are people that oppose the transfer for various reasons. We are hopeful that it will be approved.

Mr. HOLDEN. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman yields back.

The chair now recognized the gentleman from Illinois for 5 minutes.

Mr. JOHNSON. Thank you, Mr. Chairman, Members of the Committee.

Ms. SOMMERS, you are in the unfortunate position of having to take some slingshots from Members of the Committee that I think are legitimately directed to CFTC but not to you personally. But I guess you have broad shoulders and you are going to have to accept that.

I am wondering in the first instance why Mr. Gensler isn't here today?

Ms. SOMMERS. Congressman, Mr. Gensler has recused himself from matters regarding MF Global.

Mr. JOHNSON. It is interesting to me that Mr. Gensler, who has been willing to come in here hearing after hearing to explain the inordinate delays that CFTC has had in regulations and rules on perhaps the most important—at least as to the agricultural community nationwide—the most important hearing we have had in years has chosen to send you in here for him. We are glad to have you here, but I find that, in light of his past filibustering, entirely unacceptable. When did he first determine that he was going to recuse himself?

Ms. SOMMERS. It is my understanding that he made that decision on November 4.

Mr. JOHNSON. Is that because he is part of this Goldman Sachs fraternity that includes ministers of foreign governments in which the money is invested, Mr. Corzine himself, Mr. Gensler himself, and this whole nebulous group of individuals? Is that why he has decided to recuse himself because he is part of that group or why did he do that?

Ms. SOMMERS. I do not know the reason.

Mr. JOHNSON. So you are simply here—and we appreciate your being here—but I find that entirely unacceptable. And Mr. Gensler is here somewhere in the room or listening to this which I assume he is, I must tell you that from the standpoint of Congressman Johnson, in light of your past testimony and the role of CFTC, I find your failure to testify here totally unacceptable.

Mr. PETERSON. Will the gentleman yield?

Mr. JOHNSON. Sure.

Mr. PETERSON. Yes, I just wanted to inform the gentleman that I think the thing that precipitated this is that Senator Grassley asked Chairman Gensler to recuse himself.

Mr. JOHNSON. Well, I am not certain——

Mr. PETERSON. It was Senator Grassley that precipitated this, just so people understand.

The CHAIRMAN. And if both gentlemen yield, I would note I believe the Chairman is out of the country today. Is that correct?

Ms. SOMMERS. Yes, he is.

The CHAIRMAN. He is in Europe.

Mr. JOHNSON. When and from whom did CFTC first hear of these concerns that were actually expressed as long ago as June that MF Global was undercapitalized?

Ms. SOMMERS. It is my understanding that CFTC staff, in reviewing a focus report that was submitted to us by MF Global in August, showed the under-capitalization for July.

Mr. JOHNSON. Does CFTC have the power or authority to force a firm into bankruptcy?

Ms. SOMMERS. No, we do not.

Mr. JOHNSON. What is your authority in that regard and how far can you push the envelope so to speak in terms of your role in the process?

Ms. SOMMERS. For a BD/FCM, that would be SIPC. For a firm or an entity that was an FCM only, the FCM would have to initiate the bankruptcy proceedings.

Mr. JOHNSON. How often do you examine the FCMs?

Ms. SOMMERS. The CFTC is not the frontline auditor for FCMs. It is the self-regulatory organizations that are the frontline auditors for FCMs.

Mr. JOHNSON. Was there a point—and if so when was it—when you audited MF Global? And what were the results if any of that audit?

Ms. SOMMERS. The DSRO would be the one to audit. And in MF Global's case, the DSRO is the Chicago Mercantile Exchange.

Mr. JOHNSON. And again can you explain to us—just so I will understand when Mr. Corzine is here later because he is the other part of the trilogy—what the basis is by which Mr. Gensler chose to recuse himself? I just want to know the background. I don't understand. I think Mr. Peterson and Chairman Lucas' questions are good ones. The points are good ones. I am just not entirely sure I understand what the basis was for the recusal.

Ms. SOMMERS. Congressman, I am not familiar with the basis of his—he has a recusal letter, but that is the limit of my understanding.

Mr. JOHNSON. I guess the last question which is in some ways a rhetorical question, and I think probably everybody in here, the Chairman, Ranking Member, and the Members of this Committee—and I am not sure you are in a position nor your co-witness at the table answer—I think on behalf of farmers and the agricultural sector, investors all over the country, we need to know how soon we can give answers to our constituents, our people who are trying to buy seed and otherwise when they are going to get their money back. What would you expect?

Ms. SOMMERS. I understand that completely and want to emphasize that that is our number one priority. And we are working closely with the Trustee to make sure that happens as soon as possible.

Mr. JOHNSON. Well, I guess my last question is—I know and appreciate your desire to get that done. I guess my question is if a co-op, as they have, a number of co-ops in my district would ask me and I were to give them an estimate, what would I tell them? Because they have to buy seed and land and equipment and various other things right now for the next crop year.

Mr. KOBAK. Yes, I understand that. People should be getting another—assuming the court approves our motion—another \$2 billion shortly. It should get them up to around 69, 70 percent. Until we recover more funds, if we recover more funds, we can't really do further bulk transfers. At this point, we have started the claims process. It has a 60 day period. We have started it on an expedited basis. We are already reviewing and determining claims, and through that process, people should get the remainder of the money that is available. I can't really give you a better estimate than that of exactly how long it will take.

As has been noted, some of the accounts are fairly simple to determine. Some are very complicated.

Mr. JOHNSON. My time has run out. I would just simply say that we are all here and inside the Beltway operation, and there are millions of people around the country whose lives are depending on what we do.

Mr. KOBAK. We are well aware of that.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from Iowa for 5 minutes.

Mr. BOSWELL. Well, thank you, Mr. Chairman. And thank you and Ranking Member for having this hearing, and I thank our witnesses for being here today.

The last line of questioning kind of triggered me to ask this question to both of you. Do you think the CFTC is properly funded to do the job that we have charged you to do?

Ms. SOMMERS. Congressman, I think that what I have said all along with regard to the new authorities that we have been given under Dodd-Frank is that it is premature for us to know how much more funding we are going to need. I think there is no doubt that we cannot implement and enforce Dodd-Frank without additional funding, but until we are down the road far enough to know who a swap dealer is and what a swap is, it is hard for us to know exactly what type of funding we need.

Mr. BOSWELL. Well, I appreciate that.

An earlier comment was made that someone breaks the law or breaks the rule, whichever way you want to put it, you don't go after the law enforcement. I had an experience with that violation of my own home not too many weeks ago. I don't blame the law enforcement. They have done a good job. I think you are trying to do a good job. But, I am concerned whether you have the resources to do the job that we expect you to do? We have had that discussion going on here for a while.

In Dodd-Frank, we seem to expand your responsibilities quite a bit, and I have said from the onset that my first priority is the producers out there that have this unbelievable capital investment these days, which I will probably say more about when we get to the third panel, and how do we give them the tools they need? And

then how are they protected? And that is where you folks come in as well. So that is a concern. We have a lot of people waiting to ask questions so I am going to yield back and probably concentrate on the later panel.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman yields back his time.

The chair now recognizes the gentleman from Texas, Mr. Neugebauer, for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Ms. Sommers, I want to go back to the rule 1.25 change that you all had on Monday. And basically, I think a point was made by the gentleman from Virginia was that it prohibited now those funds being invested in foreign sovereign debt, is that correct?

Ms. SOMMERS. It eliminated foreign sovereign debt as a permissible investment under rule 1.25, but we did invite petitioners to petition us for section 4c exemptive relief if they choose to do that.

Mr. NEUGEBAUER. So do we believe then that since this entity in their proprietary trading accounts was investing their own money in foreign sovereign debt with repurchase agreements and others, do we believe that monies for customers were being invested in foreign sovereign debt as well?

Ms. SOMMERS. I think, Congressman, I would not be able to do discuss the specifics of where we believe the money is at this time for fear of compromising the investigation.

Mr. NEUGEBAUER. Yes, I am not asking you where it is, but do you have knowledge that the entity was investing customers' money into foreign sovereign debt?

Ms. SOMMERS. There is no evidence for us to assume that at this point, but it is premature because the investigation is not finished.

Mr. NEUGEBAUER. So when you are doing the daily reconciliation—and as I understand it all the way through Friday the reconciliation showed that the customers' accounts were whole—who would determine from an oversight perspective what kinds of investments that they are investing customers' account money into? Who would oversee that?

Ms. SOMMERS. My understanding would be that the FCM oversees how the section 4d account would be invested. But the CFTC currently does not receive reports to let us know what individual FCMs are investing customer money in, what permissible investments under rule 1.25.

Mr. NEUGEBAUER. And I think you also mentioned that you really didn't have any knowledge that this entity was having financial problems up until the day of the bankruptcy. Is that correct?

Ms. SOMMERS. The daily segregation reports did not indicate that for us.

Mr. NEUGEBAUER. But, one of the things that we were promised in Dodd-Frank that there was going to be tremendous amount of interagency coordination, and so obviously this entity has other regulators—SEC, FINRA. They were concerned about the condition of this company earlier in the year. Were they not relaying that to you?

Ms. SOMMERS. It is my understanding that we were made aware of the increased capital charges on MF Global through their focus report.

Mr. NEUGEBAUER. Mr. Kobak, I want to go to you. I want to stay on this rule 1.25 question because I think this is something that will be very interesting to see how this plays out. Do you have knowledge that the funds of customers on behalf of those customers were being invested in foreign sovereign debt?

Mr. KOBAK. At this point, I would say we have suspicions but we really don't have knowledge. And again we are coordinating with regulators and with law enforcement on the investigation. So I think I am a little limited in what I could say. I certainly don't want to do anything that would delay or interfere with any ongoing criminal-type investigations.

Mr. NEUGEBAUER. And obviously the foreign sovereign debt market has been very volatile here lately, so if I had \$10,000 in MF Global and they decided to invest my \$10,000 while it was just sitting idly in my account, they had decided to invest that on my behalf in foreign sovereign debt and that became a losing position for me. Then that would diminish my asset value and it would be the responsibility of MF Global to then make up the difference of that since they had invested my cash in something that was——

Mr. KOBAK. Well, they shouldn't have done what you are hypothesizing.

Mr. NEUGEBAUER. But as I understand it, for liquidity purposes they can put those monies in other areas and one of them is foreign sovereign debt.

Mr. KOBAK. Yes.

Mr. NEUGEBAUER. So if they do that, even though they are not doing it on their account, they are doing it basically on my account, if there is a loss suffered because they decided to invest that in something that turned out not to make me whole, whose responsibility is that?

Mr. KOBAK. Well, it is really management's responsibility. Whether there is liability or not, I don't know. Then that is something obviously we would be looking into.

Mr. NEUGEBAUER. So obviously there are three ways my account can be diminished. One is I make an investment and I lose my money or somebody illegally transfers money out of my account for other purposes or they, for liquidity purposes, the cash management tool they used didn't make me whole. Is that correct?

Mr. KOBAK. Potentially. It is probably not just your money but the money in the pool for customers.

Mr. NEUGEBAUER. Yes.

Mr. KOBAK. If that happened?

Mr. NEUGEBAUER. Yes. So if the pool shrunk, then we are all——

Mr. KOBAK. Yes.

Ms. SOMMERS. If I could just clarify for the record that investments in foreign sovereign debt by an FCM are only allowable up to the amount that that customer posts a foreign currency with the FCM as collateral. So it is to prevent the FCM from having to take on currency risk.

Mr. NEUGEBAUER. Okay. That is an important point. Thank you, Ms. Sommers, for that information.

Thank you.

The CHAIRMAN. The gentleman's time has expired.

The Chairman would note to the Committee that we have a series of votes that has begun. I would ask if the gentleman from California, Mr. Cardoza, would like to be recognized for 5 minutes——

Mr. CARDOZA. Thank you, Mr. Chairman.

The CHAIRMAN.—and then at that point we will stand at ease until after the vote series.

The gentleman is recognized.

Mr. CARDOZA. Thank you, Mr. Chairman.

Ms. Sommers, did the CFTC coordinate with other regulators leading up to the MF Global bankruptcy? For example, did the CFTC consult with FINRA and the SEC when they forced MF Global to change its capital treatment of its foreign sovereign debt positions?

Ms. SOMMERS. That would not be part of our oversight. No.

Mr. CARDOZA. Okay. Well, I am looking ahead a little bit, and in the written testimony that we have received from Mr. Corzine, on page 11 it indicates that he had a series of meetings in June or calls with the SEC, CFTC, and FINRA, and perhaps other regulators, and it goes on to talk about August 15 when he met with the SEC to question FINRA's requirements that they increase their capital requirement. And then it talks further about on September 1 that MF Global was still not happy with the fact that they were going to have to increase their net capital, and yet they filed the required documents with FINRA. During that time, the Federal Government, the different agencies involved in this, you weren't coordinating at all?

Ms. SOMMERS. The increased capital on the broker-dealer side would be something that we would receive notice of from the BD/FCM. So we were made aware of that issue by MF Global in a report that they are required to file with us monthly.

Mr. CARDOZA. Earlier in your testimony, you indicated that you really didn't know about this until a few days before, all of a sudden everything unraveled. Yet there were reports that indicated there were some problems going on here.

Ms. SOMMERS. They were required to post more capital on the BD side, and they did. So although they reported being undercapitalized for July, because of the increase in their capital required by FINRA, they did post that capital. So, for instance, we may then look at the house proprietary trades of MF Global on our side to look at the risk exposure that they have to look at what kind of collateral they are holding.

Mr. CARDOZA. Did you look at any of those things?

Ms. SOMMERS. Yes, sir.

Mr. CARDOZA. Okay. And did you find any shortfalls when you took those views of their accounts?

Ms. SOMMERS. No, sir.

Mr. CARDOZA. Our financial system has traceability protocols. When money is transferred from account A to account B, we can trace that, correct?

Ms. SOMMERS. I am not familiar with—I assume that that is true I guess I should say.

Mr. CARDOZA. Okay. My point is at this time does anyone in your agency—can you tell us why we can't find the money that is supposed to be in MF Global's segregated accounts?

Ms. SOMMERS. As I stated earlier, I think that we can't over-emphasize the complexity of the books and records of MF Global. The amount of accounts and transactions are enormous.

Mr. CARDOZA. I understand, but frankly, either we have to be able as regulators to do that or we have to throw up red flags and say that these things are too complex and we are going to have to do a better job. Because ultimately, we are put in place to protect the public interest, and if we lose confidence in these markets, it is going to affect our entire economy, not just the people who lose the money in a one-time trade. Others won't want to go in and invest.

Ms. SOMMERS. I don't want to suggest that we are not making progress. Certainly, we are making enormous amounts of progress every day, and there is no doubt that we at the end of the day will know where all of these transactions were from beginning to end. That is our job.

Mr. CARDOZA. How many companies would you say are engaging in transactions that are too complex for us to understand on a daily basis?

Ms. SOMMERS. I also do not think that they are engaged in transactions that are too complex for us to understand. It is just tracing the amount of different accounts and the transactions from one place to the other.

Mr. CARDOZA. Will your agency be coming forward with protocols that will change and make easier our ability to trace and understand on a more timely basis?

Ms. SOMMERS. I think that there is no doubt after this is over and at the end of the day when we know exactly what happened that there are going to be "lessons learned." There will be policy changes that we will want to come to this Committee with for your consideration.

Mr. CARDOZA. I would suggest that is a good idea. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired.

The chair would note to the Members that we are in the first of a series of four votes. When we return, Mr. Conaway will be next, followed by Mr. Scott.

The Committee stands in recess until the conclusion of these votes. Please promptly return.

[Recess.]

The CHAIRMAN. This hearing of the Committee on Agriculture to examine the MF Global bankruptcy will come back to order.

The chair will now recognize the gentleman from Texas for 5 minutes, Mr. Conaway.

Mr. CONAWAY. Thank you, Mr. Chairman. I appreciate it. And, Ms. Sommers and Mr. Kobak, thank you for being here.

In the risk of not asking questions I am going to ask over and over and over, Ms. Sommers, when you get these daily reports if you see the daily reports with respect to the segregated accounts, you never expect to get one that shows a breach of the segregation. Is that the norm?

Ms. SOMMERS. We do not normally get daily segregation reports from an FCM.

Mr. CONAWAY. But if you got daily ones, you would normally see them to be clear that the segregated funds are there and the——

Ms. SOMMERS. Absolutely.

Mr. CONAWAY. And you are relying on the integrity of management and the employees of the FCM in this instance—whichever one that they are doing—to prepare those reports properly and for those reports to properly reflect the status on that day?

Ms. SOMMERS. Right. They are required to report to us if they are under segregation, and that has happened.

Mr. CONAWAY. So that is a positive that they have to do when you get the statement. And then at the company itself, they are relying on first the integrity of the management and the employees there. And I assume your requirements under Sarbanes-Oxley and others that they have control systems and management systems in place that drive information to management that is accurate and timely with respect to a variety of instances but in particular with respect to this segregated account?

Ms. SOMMERS. Absolutely.

Mr. CONAWAY. And if that didn't happen, if the reports don't reflect the underlying activity, then a variety of things could have happened which we can subject to conjecture. But suffice it to say that the segregated account had a leak of about \$1.2 billion as we currently understand that number.

Mr. KOBAK, if the ratios are right, the total segregated funds should have been in the \$6 billion range?

Mr. KOBAK. Somewhere between about \$5.5 and \$6 billion.

Mr. CONAWAY. Okay. So the \$1.2 is a meaningful number against the total under any circumstances?

Mr. KOBAK. Yes, very.

Mr. CONAWAY. Even here in Congress——

Mr. KOBAK. Even \$600 or \$700 million would be meaningful in this situation, yes.

Mr. CONAWAY. Okay. So at this point the variety of investigations will look to how that happened.

From a management control standpoint, Ms. Sommers, is a breach of the segregated fund a meaningful breach in your overall regulatory scheme with respect to FCMs?

Ms. SOMMERS. It is extremely serious and it is not something that we typically see.

Mr. CONAWAY. Okay. I roll through a stop sign; that is one thing. I do something much more severe, then that is—I am trying to get the severity of where a breach in the segregated account would fall under the attention that your investigators and the folks that regulate—would they immediately talk to you about it or somebody?

Ms. SOMMERS. It is one of the most serious breaches of CEA regs.

Mr. CONAWAY. Okay. And then if that is the case, at a company—now we are going to hear some testimony later on where the witness will say, “I was so far up the food chain that I really didn't get involved in the details.” But from a company standpoint—and we have some FCMs coming later; we will ask this question of them as well—where would that breach fall in terms of importance that upper management should be made aware of it?

Ms. SOMMERS. I am not familiar enough to be able to answer that. I assume on the FCM side, it would be the upper management of the FCM. But as far as a parent company, I would not know.

Mr. CONAWAY. Okay. Mr. Kobak, you are representing MF Global Inc. Is that the overall parent or is that——

Mr. KOBAK. No, that is the broker-dealer FCM. There was a holding company and a number of affiliates——

Mr. CONAWAY. Right. What is the name of the holding company?

Mr. KOBAK. MF Global, Limited, I believe.

Mr. CONAWAY. Okay. Is it in bankruptcy?

Mr. KOBAK. It is in Chapter 11, yes.

Mr. CONAWAY. Okay. Well, I am going to try to ask Ms. Sommers to get her on the hook. If whoever is in charge of the segregated funds accounting, the top person there, the person in charge of the FCM—and this is the broker-dealer—they would have been made aware of it.

Ms. SOMMERS. I wasn't sure if the CFO had to sign a daily seg report but we could charge them with a failure to supervise if the management at an FCM did not know.

Mr. CONAWAY. Okay. And then, of course, there had been a breach and they had failed to notify you of that, that is in and of itself a separate violation?

Ms. SOMMERS. That is right.

Mr. CONAWAY. And again, this is just for the record, in the scale of bad things FCMs could be accused of doing, breaching this secured accounting concept is at the top?

Ms. SOMMERS. Absolutely.

Mr. CONAWAY. Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. The gentleman's time has expired. The chair now recognizes the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. DAVID SCOTT of Georgia. Thank you very much, Mr. Chairman.

Ms. Sommers, let me just get right to what I think is a very serious point in this. First of all, I find it very unacceptable that Commission Chairman Gensler is not here, that he has recused himself, that he has gone out of the country at the very time that we are faced with the eighth largest bankruptcy in the history of the United States on a firm that comes under his oversight. Where \$1.2 billion of our constituents' money is missing, and where Mr. Gensler has a very close personal relationship with Mr. Corzine where they both worked at Goldman Sachs. Now, I am just raising this because it raises a great deal of suspicion.

But here is the real point: the core of this entire investigation and resolution of this investigation rests with the application of Rule 1.25. And in that rule, it clearly states you can't commingle any of the customers money with the business accounts. Here we have a company and a firm, MF Global, who goes out, over-leverages tremendously with European sovereign debt. You all put a rule in that you passed just Monday, but that isn't the first time you put it out. You put this rule out in June or July of this year. Then, Mr. Corzine calls Mr. Gensler, opposes this, and you delay that implementation of this rule to prohibit the use of customers' funds for sovereign debt on Monday, just 3 days ago, after the fact.

This is a glaring, glaring example of why the American people are rapidly losing faith in our ability here in Washington to get our hands around this. So I think that at some point Mr. Gensler is going to have to answer some questions about what happened here about this, and I think that it just raises some questions there. So I think that this is something we have to really answer. Could you please tell me why you delayed putting this rule into place after Mr. Corzine contacted the CFTC?

Ms. SOMMERS. Congressman, I think just to clarify, the investments in foreign sovereign debt or the repo to maturity investments that have been widely reported is my understanding are on the BD side of the broker-dealer FCM. Rule 1.25 is a regulation that governs what are permissible investments for an FCM to be able to use customer funds to invest in. Rule 1.25 has never allowed an FCM to take money out of a customer segregated account, invest it, and not simultaneously put back the exact amount into the customer's—

Mr. DAVID SCOTT of Georgia. Ms. Sommers, my time is pretty short, but just my question is why the delay after you were contacted by Mr. Corzine on an agreement to prohibit at that point—but prior to that point, prior to Monday, it was okay to use customers' funds for an account. But here is a company that went down in 10 months. They moved from \$1.5 billion in sovereign debt to \$6.3 billion in sovereign debt, which is the cause of their problems. So you see the connection here and you have a rule now to prohibit that. Here he is in this and that decision was made to delay it until now.

Ms. SOMMERS. The Rule 1.25 would not govern what type of investments a broker-dealer would be able to make with their—whether it is their house funds, Rule 1.25 only governs customer segregated money on the FCM side. The rule that we passed on Monday would not prohibit a BD from making investments out of their house account in foreign sovereign debt.

Mr. DAVID SCOTT of Georgia. All right. But now, under this rule, it is illegal; it is wrong; you cannot take a customer's money now and apply it to foreign debt under the rule you just passed Monday.

Ms. SOMMERS. The rule we passed on Monday eliminates foreign sovereign debt as a permissible investment but allows FCMs to petition us for exemptions.

Mr. DAVID SCOTT of Georgia. All right. Let me just ask you this on the DSROs, the designated self-regulatory organizations, do you feel that that is sufficient in the wake of the spectacular collapse of MF Global, can this model continue to be justified? Should not the CFTC be conducting some of these audits themselves? And do you have the capacity to do so?

Ms. SOMMERS. We do reviews of the DSROs to make sure that the DSROs are performing those audits in an adequate manner. So we have authority over the DSROs, and if we ever find any deficiencies there, the DSROs are required to correct those deficiencies.

Mr. DAVID SCOTT of Georgia. Mr. Kobak, I just want to ask you a really quick question. You are now nor have you ever been an employee of MF Global?

Mr. KOBAK. No.

Mr. DAVID SCOTT of Georgia. And you are employed by Hughes, Hubbard, and Reed, the court-appointed bankruptcy Trustee, is that correct?

Mr. KOBAK. The Trustee is James Giddens, who is a partner of our firm and our firm was appointed to be his counsel.

Mr. DAVID SCOTT of Georgia. It is my understanding though that your firm, this firm, also has in its employ nearly 200 former MF Global staffers as part of its forensic accounting team.

Mr. KOBAK. Well, we have about 175, some in Chicago, some in New York. They are really not part of the forensic work. They are really more the people that understood the accounts, were the back office people who processed trades. We have hired them temporarily for about 3 months in order to help with the transfer——

Mr. DAVID SCOTT of Georgia. Do you feel that this complicates matters any to have the employees formerly of the firm who were on the audit forensic team of the——

The CHAIRMAN. The gentleman's time is about to expire. The witness may answer the question.

Mr. KOBAK. Yes, they are really not on the audit forensic. They are just really helping us do account transfers, look at the accounts. We need people. We did the Lehman case. A lot of the employees had been hired by Barclays that bought a lot of the business. We didn't have people like that available to help us understand the accounts. And I am not talking about the big accounting transfers; I am talking about the individual commodity claims. So that is really why we hired them.

Mr. DAVID SCOTT of Georgia. Thank you, sir.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from Nebraska for 5 minutes.

Mr. FORTENBERRY. Thank you, Mr. Chairman, particularly for coordinating this important hearing. Welcome to our witnesses.

A number of years ago in the wake of the near financial collapse due to Wall Street's reckless behavior, I had met with a group of Nebraskans who are members of the Chamber of Commerce; they were bankers there. And I looked at them and I asked, I said how many of you use synthetic collateralized debt obligations? And they just stared at me. They didn't know what I was talking about. And I thanked them because our financial institutions back home didn't take advantage of liberalized credit, didn't do things out of the lanes, stayed responsible, lived up to their fiduciary responsibility. And so consequently, we have not suffered some of the problems that the rest of the country has because of this reckless behavior.

The reason I say this—and I want to quote directly from a *Thomson Reuters* article that has just come out—and it is a new term I have never heard of called “rehypothecation.” And I am going to quote directly from the article. “MF Global's bankruptcy revelations concerning missing client money suggests that funds were not inadvertently misplaced or gobbled up in MF Global's dying hours but were instead appropriated as a part of a mass Wall Street manipulation of brokerage rules that allowed for the wholesale acquisition and sale of client funds through rehypothecation.” Would you explain this, please?

Mr. KOBAK. I really can't explain it. I don't think that is what our investigation has shown at this point necessarily. Now, we are at an early stage and it may be that we will find that there is money that went to account A and then that got rehypothecated somewhere else.

Mr. FORTENBERRY. Let me read the next sentence. "A loophole appears to have allowed MF Global and many others to use its own client funds to finance an enormous 6.2 billion eurozone repo bet."

Mr. KOBAK. I think there was a repo on the securities side. I don't think at this point we know all the details of that or what the outcome was.

Mr. FORTENBERRY. But again the issue is the segregation of client accounts and now we are learning there may be a loophole manipulated to get around this requirement. Am I reading this correctly?

Mr. KOBAK. Yes, I think it is on the broker-dealer side, not necessarily the commodities side. It is something that we are looking into. It is a very complex transaction.

Mr. FORTENBERRY. But it still applies because it is effectively commingling clients' funds, which is disallowed by these rules that we are talking about.

Mr. KOBAK. Well, except I think it is on the broker-dealer side, not the commodities side. And one of the things we are looking at is in doing some of these transactions, were commodities, funds that should have been segregated, used? Were securities funds that should have been segregated used improperly? That is one of the things we are looking at.

Mr. FORTENBERRY. How long do you think before we will have that answer?

Mr. KOBAK. I just can't give you a definitive answer. As I said, we have this 60 day claim period. We will know then what the amount of the claims are, and I am hoping that in that time frame we will have a pretty good idea of what happened.

Mr. FORTENBERRY. I am going to speed up some questions because the time is limited. Who owns MF Global?

Mr. KOBAK. Are you referring to the broker-dealer entity that we are involved in or the holding company entity?

Mr. FORTENBERRY. MF Global. You define it.

Mr. KOBAK. Well, okay. The holding company, which was our parent company, is now in Chapter 11 and an independent Trustee was recently appointed by the bankruptcy court. Our entity——

Mr. FORTENBERRY. So how is it structured and who owns it?

Mr. KOBAK. Well, it is now under the jurisdiction of the bankruptcy court.

Mr. FORTENBERRY. Well, no, I understand that, but prior to this?

Mr. KOBAK. Prior to that, it was owned—I am not exactly sure but it was owned as any holding company would be. It had a management. It owned a number of companies, including our entity and a number of other affiliates.

Mr. FORTENBERRY. Okay. It goes to the issue of fiduciary responsibility and to a question that the Ranking Member asked earlier. In regards to your investigations, if you find that funds were inappropriately commingled, will you be able to go after the personal assets of people who violated the public trust here?

Mr. KOBAK. We would have to look carefully at what the law says. If there is a theory, we would go after people.

Mr. FORTENBERRY. Can particular personnel be held liable, accountable, their personal funds?

Mr. KOBAK. I think it depends on the facts and circumstances. That certainly is something that we would be prepared to do if the law provides for it.

The CHAIRMAN. The gentleman's time has expired.

The chair now turns to the gentleman from North Carolina, Mr. Kissell, for his 5 minutes.

Mr. KISSELL. Thank you, Mr. Chairman, and I welcome our witnesses here today, obviously a very important, very timely hearing. A lot of important issues have been raised and I am trying not to go through the same questions.

So Ms. Sommers, I want to try to look at some of the red flags, the warnings, maybe things that were missed and kind of understanding maybe why they were missed, what could have been done. Did I understand you correctly that prior to just very recently there were no red flags that would have been sent in your direction, CFTC's direction?

Ms. SOMMERS. Yes, Congressman. The types of reports that we receive, the daily segregation reports from MF Global would show how much segregated funds should be there and how much were there. But we don't, on a daily basis, look behind those reports to look at bank statements. So if the FCM is reporting that that segregated money is there, then there would be no red flags for us.

Mr. KISSELL. Now, I am just curious. If they had shown that there had been a breach of the segregated funds, what would have been your reaction? What would have happened next?

Ms. SOMMERS. If they had reported to us that there had been a breach—

Mr. KISSELL. Yes, ma'am.

Ms. SOMMERS.—of segregation? Then, they are required to come into compliance immediately.

Mr. KISSELL. Okay. Does that happen much with corporations or is that a very rare thing?

Ms. SOMMERS. It has happened in the past. I cannot tell you how many times.

Mr. KISSELL. And do they come into compliance fairly quickly?

Ms. SOMMERS. Yes.

Mr. KISSELL. Okay. I had read that the risk assessment manager for MF Global had issued warnings that they were going into dangerous territory some time ago, maybe even a year ago, and this person was fired. Is that your understanding?

Ms. SOMMERS. I do not have knowledge of that.

Mr. KISSELL. If that was the case and this person was seeing the warning signs, is there any way that those warning signs would come in your direction?

Ms. SOMMERS. I suppose if that risk officer would contact us to give us some sort of tip, that could come our way.

Mr. KISSELL. But internally, if somebody sees something going wrong, unless they do make that effort, there is no institutional way in which that information would be sent up the chain to you guys?

Ms. SOMMERS. Not that I know of.

Mr. KISSELL. Okay. Okay. Thank you so much for being here.

I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman yields back.

The chair now recognizes the gentleman from Florida, Mr. Rooney, for 5 minutes.

Mr. ROONEY. Thank you, Mr. Chairman, caught me off guard there for a second.

I just have some basic fact-finding-type questions for Ms. Sommers. From what I have read, the CFTC—first of all, the CFTC, months prior to the collapse of MF Global, had been trying to change the rule for whether or not the type of trading that ended up leading to the collapse of MF Global, they were trying to reign in that type of behavior, is that correct?

Ms. SOMMERS. If you are referring to Regulation 1.25, that is not—to clarify, 1.25 only goes to permissible investments of customer funds.

Mr. ROONEY. I am just trying to get some basic information here. The kind of trading that apparently MF Global was involved in, this repurchase agreements that had become somewhat commonplace, your agency was trying to reign that in. You weren't? You weren't trying to reign in something that was overly risky to investors?

Ms. SOMMERS. As I understand it, Congressman, the repo to maturity or foreign sovereign debt investments that MF Global was engaging in is on the BD side of that entity. The Regulation 1.25 under our rules would not prohibit a broker-dealer from using house funds to invest in foreign sovereign debt or repo to maturity instruments.

Mr. ROONEY. Okay. So it is of the opinion of your agency that that kind of activity is not risky and should not be regulated?

Ms. SOMMERS. It is not regulated by us.

Mr. ROONEY. Is it your opinion that it should be?

Ms. SOMMERS. No. That is on the broker-dealer side regulated by the Securities and Exchange Commission.

Mr. ROONEY. Okay. I am just trying to, as I said, get some background.

And the gentleman that Mr. Johnson was referring to before, Mr. Gensler, who is recused from testifying today is your superior, your boss so to speak?

Ms. SOMMERS. He is not my boss, but he is the Chairman of the Commission.

Mr. ROONEY. And Mr. Gensler used to work for Mr. Corzine at Goldman Sachs?

Ms. SOMMERS. That is my understanding.

Mr. ROONEY. So what I am trying to get my hands around is that when the CFTC was trying to curb certain investment types like these repurchasing agreements or risky behavior—I am getting this from the *New York Times* article which you probably are familiar with—months before this happened that there was pushback from the industry not just from MF Global but from various trading people that work in this business and that there was pushback and that Mr. Corzine was one of the ones that pushed back against

your agency. And then you guys backed off because of that effort. Is that correct?

Ms. SOMMERS. I didn't personally have any conversations with Mr. Corzine.

Mr. ROONEY. What I am just trying to get my arms around here is: it seems like we have an agency that saw a risky behavior and was trying to impose a rule. People like Mr. Corzine said, hey, back off, and the fact that your boss or the guy that is in charge of your agency used to work for Mr. Corzine, you all did back off. And now, in retrospect—you can correct me if I am wrong. But now, in retrospect, your agency is trying to go back in and enforce that rule, which is too late for the people that have lost their shirt under MF Global, but, now in hindsight you are trying to do it again. So I am just trying to get my arms around the players that were involved and the timeline.

Ms. SOMMERS. Right. So Regulation 1.25 does not apply to the investments that MF Global may have made on the broker-dealer side out of their house account investing in foreign sovereign debt. So going back and finalizing that rule does not apply to those investments.

Mr. ROONEY. So the article that I am referring to, this *New York Times* article, their factual basis is incorrect?

Ms. SOMMERS. I am not familiar with the article.

Mr. ROONEY. Okay. I yield back, Mr. Chairman.

Mr. PETERSON. Mr. Chairman, with the Committee's indulgence, I am going to get out on a limb here and hopefully not cause too much trouble.

As I understand it, MF Global was not—was an FCM for years, and what they did was they charge commissions to do these trades and they had this segregated money and they made money on that. But as I understand it, this business has become increasingly competitive, and it is to the point where they cannot make money, any of these firms, on their commissions that they charge to do these trades. The way they are making money is on investing the customer money. And so one of the reasons they wanted to liberalize, as I understand it—this is my interpretation—liberalize that is that then they could make more money. But when they invest this money, if they put it into a sovereign debt, they have to put treasury bonds into that fund to cover it. So the customer is not at risk.

What happened with this FCM is they were losing money so Mr. Corzine came in and made them a broker-dealer. Well, the broker-dealers are not regulated by the CFTC; they are regulated by the SEC. And so this is where the confusion is coming in. So they got into the broker-dealer business. They started investing in sovereign debt, and doing these repos, adding their risk. They leveraged themselves up somewhere between 30 and 37.5 times and this thing moved against them. They had to come up with margins; they couldn't come up with the margins; the firm collapsed.

So there are two different things, and what Commissioner Sommers is trying to tell you is that the CFTC doesn't regulate the broker-dealer side of this. I am sure some of my folks back home that did business with MF Global forever, are—I don't know if they weren't paying attention—but all of a sudden now that firm be-

came a broker-dealer, got into a much riskier business, and jeopardized their customer accounts. That is what happened basically.

So, you need to split this between what the CFTC can do and what they can't.

The CHAIRMAN. And to distill it even further was money from the futures side of the business that is regulated by CFTC used to offset the stakes made in the securities side of the——

Mr. PETERSON. Right.

The CHAIRMAN.—company regulated by a different entity, and that transfer then is the legal question and the question of responsibility that ultimately has to be addressed.

Mr. PETERSON. And if the bottom line here as I understand it that I have been considering requiring that this money be put in a third party account so somebody else would hold the money instead of the firm. But I have been told if I did that, we would bankrupt all of these FCMs because they can't make money just doing business on commissions.

So it is kind of like the issue with the banks on their interbank fees. If you do this, these people are going to have to raise their commissions and the people that do business with them are going to have to pay more money in order to keep them in business. So it is complicated.

The CHAIRMAN. And the Ranking Member touches on several subjects for several more hearings.

With that, let us return to regular order.

And the next person the chair would like to recognize for 5 minutes is the gentleman from Connecticut.

Mr. COURTNEY. Why thank you, Mr. Chairman. And I appreciate the colloquy actually which just took place and would just like to reiterate also the comments the chair and the Ranking Member made earlier regarding the Chairman, Chairman Gensler, which is that his decision to recuse himself was in response actually from a Member of the Senate who demanded that he recuse himself because of allegations that somehow there was some relationship with MF Global. You can get whiplash around this place sometimes trying to keep up with the competing finger-pointing that is going on right now. But I think he followed what was a demand from this Branch of the Government to step back from this whole question.

Going to the rulemaking process on Monday, which again you did a nice job, Commissioner, in terms of explaining the distinction between what the rule applied to what the hearing is about today. Nonetheless, I mean if you look at the notice that the *Federal Register* posted after you voted and it was a unanimous vote, am I correct? You know, it stated what the sort of legal source of that rule was, which was a statutory source like almost all administrative regulations, which was Section 939(a) of the Dodd-Frank Act. And I realized your staff had been working on this issue for a number of years, as you testified earlier.

But nonetheless, the legal trigger for the process that took place on Monday, according to your own notice that was issued by the Commission, was 939(a) of the Dodd-Frank Act. Am I correct?

Ms. SOMMERS. That was part of it. That section, as I understand it, required us to remove all references to credit rating agencies. So that was part of what we did in the amendments to 1.25.

Mr. COURTNEY. Thank you. And I ask that question because frankly, for the last 11 months, I mean this Committee—and Chairman Gensler has been here on a number of those hearings and so have you—has been bitterly complaining that you are moving too fast. And now today we get another case of whiplash from people who are saying you move too slow. And what I would just simply say is that—what I think we ought to do is let you do your job and also, by the way, give you the resources that you need so that you can do your job.

And you testified earlier again that it may be inappropriate for the Commission to get more money before you know what the scope of your duties are pursuant to Dodd-Frank. But nonetheless, I mean what we just went through in terms of the budget this year wasn't about increasing your budget. The House reported out an appropriations to cut your budget by about \$30 million. And we are talking about a total budget that is about \$200 million. So I mean that is a huge decrease. And again here we are today with Members of Congress complaining that you are not doing enough when at the same time it is the same chamber which was out to really just knock the legs out from you in terms of having the resources to do your job.

And again this is a Committee that reported out a bill H.R. 1573 which pushed back Title VII of Dodd-Frank for 2 years in terms of implementing any of the rules on derivatives despite the fact that for some of us you are not moving fast enough. You are using all deliberate speed in terms of trying to digest tens of thousands of comments that are flooding into your agency.

So, there are times when I just look at your agency, which in my opinion is so important to the smooth functioning of markets and our economy and the punching that you are subjected to from all sides, whether it is to participate or recuse or to defund it or not fund it.

And then we have a situation like this today when again it is hopefully an educable moment about the value of what the CFTC brings to our country and to our economy. And I again just hope all of us will let you guys just proceed and do your job and in my opinion follow the mission in a reasonable, balanced way in terms of what the Dodd-Frank Act asks for.

And with that I yield back.

The CHAIRMAN. The gentleman yields back his time.

The chair now recognizes the gentleman from Indiana, Mr. Stutzman, for 5 minutes.

Mr. STUTZMAN. Thank you, Mr. Chairman.

And first of all, Mr. Chairman, I would like to identify myself with Mr. Scott and his comments earlier. You know, I guess I just believe that for us to get the facts to everything that has happened here, every player should be willing to step forward and share with this Committee what they know and when they knew it. You know, I believe the buck always stops at the top, and in this situation I believe that Mr. Gensler should be here as well and I believe that for us to get to the bottom of this we could get the answers that we are looking for more quickly. And I believe that a trip internationally today must have been more important and I think that the timeliness of that trip is no coincidence.

But I would like to ask Mr. Kobak. You have been working with about 200 employees I believe from MF Global through this liquidation. Is that correct?

Mr. KOBAK. About 175.

Mr. STUTZMAN. About 175? How has that been working? I mean obviously they are in a tough situation with them losing the company that they worked for. Have you heard from them? Did they see things happening? I mean the timeline that I see—and I would like you to comment on that—and then also this might be a question for the Federal Reserve Bank folks—but it looks like according to this company, a company that had \$41 billion in assets when Mr. Corzine became the CEO in 2010, as early as June of 2011 the FINRA started to grow concerned. But in February of this year, MF Global was designated as a primary dealer in February of 2011. And so there seems to be a very short timeline here that I have a real problem with that weren't there red flags being thrown up somewhere along the way with as many eyes that were looking at this particular company? And also if you could comment about the employees that are now working with you.

Mr. KOBAK. Okay. So that is a couple of questions.

Mr. STUTZMAN. Sorry.

Mr. KOBAK. So I will take the second part first. I think it is fair to say that our investigation in the short term has been focusing more on what happened on the end. Is there missing money? If there is, where do we think it went? And if we can find out where it went, what if anything can we do about recovering it? So those other questions, although we are looking into them, are kind of questions for a later day.

On the first part of your question about the 175, most of those people were systems people and things like that so I don't think they are the ones who would know the answers to these questions.

Mr. STUTZMAN. Have any of them mentioned, though, that they had concerns earlier on?

Mr. KOBAK. We have been talking to them. We have also been talking to others. One of the first things in this case was get an order from the bankruptcy court confirming our power to do a very thorough and independent investigation. Some of the holding company that I alluded to, which obviously would be one of the groups of people we would be looking at to possibly recover money wanted to participate in that investigation and we filed papers and argued to the judge that we didn't think that was at all proper. We are supposed to have independent authority and that having some of the very people we might need to investigate looking over our shoulder wasn't appropriate. And the judge immediately, while he was on vacation I think, wrote an opinion confirming our independence.

So we are talking to people, both the people we employ but more importantly other people. Now, some of those people have lawyers and might not allow us to talk to them. We also are trying to coordinate our investigation with the U.S. Attorney's offices, so in some cases we may need to hold off talking to a witness until they have done their job.

Mr. STUTZMAN. Okay. Real quick, I have a question for Commissioner Sommers. In reviewing daily segregation reports, were there

any signs that anything was awry? If so when? And also, could MF Global, without commingling, use the buying power with segregated funds in purchasing sovereign debt?

Ms. SOMMERS. So the last part of that question if you could repeat, could they——

Mr. STUTZMAN. Without commingling funds, could you use the segregated, sacred, funds to use to buy sovereign debt?

Ms. SOMMERS. So typically an FCM in purchasing foreign sovereign debt would be purchasing the amount of foreign sovereign debt that a customer would have posted to them as collateral. So you could do that without commingling.

Mr. STUTZMAN. Okay. All right. And then also real quick, anything awry on the daily segregation reports? Did you see anything?

Ms. SOMMERS. As I stated before, although we review those daily segregation reports, an FCM is required to report to us if they are undercapitalized. We don't look behind them to bank records to verify that what they have reported to us on a daily basis is absolutely accurate.

Mr. STUTZMAN. Thank you, Mr. Chairman. I will yield back.

The CHAIRMAN. The gentleman's time has expired.

The next person up will be Congressman Owens of New York, and I would serve note to Congressman Austin Scott, you are after that.

The gentleman from New York is recognized for 5 minutes.

Mr. OWENS. I thank you, Mr. Chairman.

Your testimony here today has indicated that prior to the weekend of the collapse of MFG that there was no indication in the reports, nor was there any self-reporting that they were out of compliance.

Ms. SOMMERS. That is correct.

Mr. OWENS. That being the case, what audit techniques or risk management techniques or procedures should be in place in order to require that type of reporting? I think we can safely assume based upon the facts that we know to date that this is likely a fraud perpetrated by MFG at some level. And it seems to me that we can't rely on the individuals in this particular instance to self-report. Is there some technique that you are aware of—either a computer program or other audit technique that would require the self-reporting?

Ms. SOMMERS. They are already required to self-report if they are under seg.

Mr. OWENS. So we assume that they did not.

Ms. SOMMERS. Right.

Mr. OWENS. Then is there some independent analytic tool that you could access remotely, if you will, to determine whether or not they have made any inappropriate use of their customer funds?

Ms. SOMMERS. I think in the end when we know exactly what happened and how it happened, it will be appropriate for us to go back and look at every single measure that could be used to prevent this from ever happening in the future.

Mr. OWENS. And if you do discover that there are tools available, would you be inclined to impose those requirements on these organizations?

Ms. SOMMERS. Absolutely. And I think in some cases if there are changes that need to be made, we would come to this Committee to ask for you to give us the authority.

Mr. OWENS. So it is your belief, then, that this is a serious enough issue that this type of regulation would be appropriate?

Ms. SOMMERS. When we are able to look at what went wrong, I think that absolutely that may be one of the things that we can look to to change in the future.

Mr. OWENS. Thank you very much.

I have no further questions. I yield back.

The CHAIRMAN. The gentleman's time has expired. The chair now recognizes the gentleman from Georgia for 5 minutes.

Mr. AUSTIN SCOTT of Georgia. Thank you, Mr. Chairman.

And I share the concerns of the other Committee Members about the money that my constituents lost. And you know, I think what we have to get to here is how do we work together to stop this from ever happening again.

I guess, Ms. Sommers, one of the things I would like to get back to is the reporting. As I understand it, it is self-reporting of the segregated accounts. And I guess when I look at the Moody's ratings and everything else, this firm was rated investment grade less than 10 days before the bankruptcy. I think that is an indication of how complex these issues are and how hard it is to just unwind everything that is on the books of some of these firms like this.

But getting back to the reporting, if we audited those on an unannounced basis, spot-checking if you will, do you believe that that would have been enough of a deterrent to stop this?

Ms. SOMMERS. Congressman, that already happens. DSROs certainly do spot-checks on unannounced basis right now.

Mr. AUSTIN SCOTT of Georgia. Okay.

Ms. SOMMERS. That is, in the end, what they are responsible for.

Mr. AUSTIN SCOTT of Georgia. So obviously, then, that is not enough to stop it from happening if we are doing it right now and it hasn't stopped it. I will be interested as you go through your investigation to know what mechanisms we need to put in place to ensure that the reports that we are getting—that your agency is getting are actually reflective of what is going on in the firm.

Mr. Kobak, as you go into the courtroom tomorrow, what are some of the issues that you think may arise that would prevent the customers, the consumers from being made whole throughout this bankruptcy process?

Mr. KOBAK. Well, what we are doing tomorrow is asking the court to give us authority to distribute another little over \$2 billion, which we think would bring everybody up to around 69 or 70 percent. We have had some opposition to that motion and there are some people that represent the creditors committee in the holding company case—that would be the creditors of the parent company, not even us—have opposed it on the ground that it might be taking money away from those creditors' banks and bond-holders——

Mr. AUSTIN SCOTT of Georgia. Yes.

Mr. KOBAK.—in favor of commodities customers and we have opposed that pretty vigorously, as you might imagine. We think it kind of turns the whole statute and our whole proceeding on its head to say that customers don't come before those people. So we

are getting oppositions like that. There are some foreign administrators who are holding funds that are customer funds abroad that we are not including in this motion, although I think eventually we will probably come to some understanding with them, and their customers can also receive funds. It is just not right now. Their big concern was maybe we weren't holding back money and we are holding back some money for that. So I don't think that will be a problem.

Mr. AUSTIN SCOTT of Georgia. If I could interrupt you real quick because I am down to a little better than a minute, but as far as putting the customers first with regard to who gets paid first, do you believe that the statute is clear on that or do you think that is something that this Committee should address?

Mr. KOBAK. I am happy to have the Committee address it. I believe it is crystal clear. I don't think, as I said, it is just a priority—

Mr. AUSTIN SCOTT of Georgia. Yes, sir.

Mr. KOBAK.—the way that is used in bankruptcy. It really says customers have exclusive rights to these funds.

Mr. AUSTIN SCOTT of Georgia. Thank you, sir. And thank you, ma'am, for your testimony.

Mr. Chairman, I yield back the remainder of my time.

The CHAIRMAN. The gentleman yields back his time.

The chair now turns to the gentleman from Texas for 5 minutes.

Mr. CUELLAR. Thank you, Mr. Chairman.

Commissioner Sommers, let us talk about lessons learned. What is it that we have not learned from the past issues that are so novel in this case, so novel that we have to change policy? Could you outline the lessons that you have learned from this particular case in order to protect customers?

Ms. SOMMERS. Certainly. We are not used to having a bankruptcy in the futures side that customers lose money, that customer segregated accounts are not whole. And as I talked about in my testimony, the past two bankruptcies, the most recent two bankruptcies, even though there were problems with those companies, customer segregated accounts were whole. So those customers and their positions and the collateral supporting those positions were transferred to healthy FCMs with no issues for customers.

Mr. CUELLAR. That is lesson number one. Give me lesson number two.

Ms. SOMMERS. So we need to look forward as to how we—if there are loopholes or if there are any parts of our regulation that don't provide for the ultimate protection for customer funds, those need to be changed.

Mr. CUELLAR. So that is lesson number one. Give me lesson number two. And this is not a one-term bankruptcy. I am looking forward so we can do some preventive medicine before we get in that situation. Give me another lesson.

Ms. SOMMERS. Well, it may be a little bit premature for me to already say that I know what the lessons learned are when we are not sure what happened.

Mr. CUELLAR. Right, but you said earlier I think it was for Mr. Cardoza you had said that there were some lessons learned that would change policies. So I assume you do know of some lessons

learned because I mean this is not the first time. And I know Enron and the other situations were different. I understand but I mean every time we get into this situation, our regulators, the first thing they say, oh, lessons learned. So how many more situations do we need to have before we get it right? So you said lessons learned. Is that the only one you can give me, a post-situation, after the bankruptcy for better protection? Can you name any other ones?

Ms. SOMMERS. Not at this point. And I certainly didn't mean to suggest before that we know everything and we know what lessons we have learned. I think this is going to be something that will be comprehensive for us but we don't have all the facts.

Mr. CUELLAR. All right. Could you submit that to the Chairman, the Ranking Member, the Committee any lessons learned——

Ms. SOMMERS. Absolutely.

Mr. CUELLAR.—because apparently the only thing we have learned so far has to do with better protection of the bankruptcy situation. Is that correct?

Ms. SOMMERS. Better protection——

Mr. CUELLAR. That is the only one you can name right now.

Ms. SOMMERS. For customer funds.

Mr. CUELLAR. Right, for customer funds.

This question is to Mr. Kobak. Is this basically a straight bankruptcy? Do the bankruptcy laws apply on secured creditors? And I assume that is where those creditors are coming in. Give us the priority on secured creditors and where customers fall in and what priorities do they have?

Mr. KOBAK. SIPC is a special statute that incorporates elements of the bankruptcy to the extent they are consistent with SIPA. SIPA puts a priority on customers, on the securities side, also says the Trustee has the same duties as a Trustee would have if it was a straight commodities.

Mr. CUELLAR. And again I wish you all the luck tomorrow for the protection of those customers.

Mr. KOBAK. Thank you.

Mr. CUELLAR. So again just so we get the picture, where do the customers fall in this particular situation?

Mr. KOBAK. Customers have rights. I will talk about commodities customers against the segregated funds. They are the sole people that have rights against those funds. The bondholders, the banks, and so forth may have rights against general estate assets in some cases but nothing to do with the fund. If there are general estate assets, it may be possible to allocate some or all of those to make up for shortfalls in the commodities case.

Mr. CUELLAR. Mr. Kobak, again, let us assume that you are successful tomorrow. That will get the customers up to 59, 69 percent?

Mr. KOBAK. Sixty-nine to seventy percent is our best estimate.

Mr. CUELLAR. Sixty-nine. And I know this is just the beginning of the Trustee's work and the attorneys, but do you foresee other assets that could be out there that could make the customers whole?

Mr. KOBAK. I think there will be other distributions. Whether customers—we sincerely hope—it is our goal; it is our aspiration anytime we do cases like this to try to get customers to 100 per-

cent. I think it would be premature to say either yes, that will be the case or no, it won't be the case. We just don't know.

Mr. CUELLAR. We wish you luck. I know bankruptcies are always difficult and all that.

And Commissioner, again, I would appreciate if you can get those lessons learned. Thank you.

Thank you, Madam Chair. I yield back the balance of my time.

Mrs. SCHMIDT [presiding.] Thank you. Mr. Tipton?

Mr. TIPTON. Thank you, Madam Chair and Ranking Member.

Commissioner Sommers, can you explain—I would just like to make sure that I am clear—with the Regulation 1.25 that you just approved, this is going to be able to prevent MF Global-type companies that are under the CFTC's regulation from being able to take those segregated funds and treasury funds and being able to put them into foreign investments. Is that correct?

Ms. SOMMERS. Sir, the way that Regulation 1.25 treats or has treated up until Monday the investments in foreign sovereign debt if a customer were to post a foreign currency——

Mr. TIPTON. I am talking after Monday.

Ms. SOMMERS. So after Monday the regulation eliminated foreign sovereign debt as a permissible investment but invited petitions for exemptions to that.

Mr. TIPTON. And the problem that we are really having the challenge with right now was some investment in foreign sovereign debt as it relates to MF Global.

Ms. SOMMERS. What has been reported is that there were investments in foreign sovereign debt and the repo to maturity instruments that were on the broker-dealer side——

Mr. TIPTON. Right.

Ms. SOMMERS.—of MF Global, so Regulation 1.25 would not speak to those investments.

Mr. TIPTON. Even after——

Ms. SOMMERS. Even after.

Mr. TIPTON.—the approval end of it? You know, I think some of the comments—and I think it is worthy of some note—where there is real concern when we are talking about lessons learned, we do have the report that was mentioned earlier out of the *New York Times*. I will just quote it. It said, “Mr. Corzine and other members of the firm met with the Commission in July to discuss the proposed rule changes. Following that meeting, the rule changes were not implemented.” Is there a problem to where we are seeing the Commission's judgment being influenced not by good policy decisions but by outside influences?

Ms. SOMMERS. Sir, my recollection is that there were a number of different issues with the proposed rule last summer. They had to do with both in-house repos, as well as the foreign sovereign debt, as well as the concentration levels for money market funds, and there were a number of different issues that we were working through. I don't think it was ever the Commission's intention to never take up the rule.

Mr. TIPTON. Right, yes, because in your opening statement you had—I think I quoted you correctly here—that it was “the long-held view of the Commission to be able to get this Rule 1.25

through.” But the concern seems to be after Mr. Corzine’s meeting, it stopped.

Ms. SOMMERS. The rule was already in place so the long-held view of the Commission was that standards that are——

Mr. TIPTON. But you just attested the rule on Monday.

Ms. SOMMERS. We made amendments to Regulation 1.25 that has been in effect for many, many years.

Mr. TIPTON. I would like to follow up a little bit because I am disturbed as some of my colleagues are that Chairman Gensler has recused himself. He is recusing himself from the enforcement matters related to MF Global and any matter directly related. Does this preclude him from being able to answer questions regarding events that led up to the bankruptcy and the normal operations of the CFTC?

Ms. SOMMERS. Sir, I don’t think I am in a position to tell Mr. Gensler what he should and should not answer questions with regard to. His recusal is his personal decision.

Mr. TIPTON. In your opinion, since it is obviously an important issue, is this recusal impacting CFTC’s ability to be able to address this issue?

Ms. SOMMERS. I believe that we have dozens of capable professional staff that have been working on this issue since day 1 and are doing an excellent job.

Mr. TIPTON. I am out of time. Thank you, Madam Chairman.

Thank you, Commissioner.

Mrs. SCHMIDT. Thank you.

Mr. Costa, you are next.

Mr. COSTA. Thank you, Madam Chair and both to our chair and Ranking Member for holding this important hearing.

Most of my questions regarding the proceedings of the bankruptcy, Mr. Kobak, have been asked by other Members, but Ms. Sommers, I would like to focus my line of questioning to you.

MF Global, eighth largest bankruptcy in American history, do you have any idea under those of your regulatory authority if there are other potential bankruptcies out there like this?

Ms. SOMMERS. Sir, I am not exactly sure if you are asking whether or not a potential bankruptcy of a very large FCM would be larger than the eighth largest?

Mr. COSTA. I am asking, do you have a watch list? Do you have any idea under the fragile nature of this economic recovery that we are dealing with on, I might add, a global basis, are there others out there that potentially might fall in this category and would you know if in fact there were?

Ms. SOMMERS. What we have the ability to see is the FCM or the futures side of the business. So what we are looking at on a daily basis are the investments of an FCM both in their customer accounts and if there are house or proprietary investments of those firms.

Mr. COSTA. Okay. That is the process. Do you have a watch list?

Ms. SOMMERS. I am sure that there are firms that may be close to the margins of what collateral they have——

Mr. COSTA. Let me ask it in this way. Is there any concern among you and your fellow colleagues, the regulators, that there may be others out there that are in harm’s way or, on the other

hand, that we have farmers and ranchers and dairymen around the country in danger? That is my focus, my concern, the agricultural futures trading industry that is so essential toward financing both short-term and long-term, both domestically and internationally, and I don't want to see these future markets destroyed or the confidence in them tremendously eroded.

Ms. SOMMERS. I understand.

Mr. COSTA. And so again my question, can you actually perform the duties as a regulator, as a watchdog?

Ms. SOMMERS. Absolutely. And certain economic——

Mr. COSTA. But you don't know if there is a list?

Ms. SOMMERS. I don't think that there is a particular list and it is certainly not a list that is shared with me on a daily basis, but we have financial——

Mr. COSTA. Would you think that is something that you ought to be looking at?

Ms. SOMMERS. I don't mean to suggest we don't look at firms. We have a financial surveillance team and that is their job, to make sure that firms have the appropriate collateral posted with regard to risk exposure of that firm.

Mr. COSTA. Do you have the tools, and do you have the staffing to do that job?

Ms. SOMMERS. We do.

Mr. COSTA. Do you have 77 full-time equivalents on oversight on all the futures commission merchants I understand and introducing brokers and commodity cooperators, as well as trading advisors, which are under the self-regulatory organizations? Is that correct?

Ms. SOMMERS. I am not exactly sure the exact amount of employees we have——

Mr. COSTA. Well, let me ask this. Are your frontline auditors enough to do the job?

Ms. SOMMERS. We are not the frontline auditor for FCMs——

Mr. COSTA. I know——

Ms. SOMMERS. The DSROs do that.

Mr. COSTA.—but do you believe they are?

Ms. SOMMERS. Do I believe that we are the frontline auditors?

Mr. COSTA. No, no, no, no, no. I am trying to get a handle on whether or not you are able to do your job and also the FCMs as well. And do you have a sense of this? Could you tell the Committee?

Ms. SOMMERS. We are absolutely able to do our jobs. There is no question about that. We have very capable staff that do financial surveillance of these firms that look and review the statements that they are required to send to us. We look at yearly audits that they are required to send to us. We review all of these and——

Mr. COSTA. Before my time expires, we have heard the complaints that the claim process sent to the commodity customers is very complicated. Is there some way we can make it less complicated?

Ms. SOMMERS. Not unless you limit the amount of transactions that an FCM is able to do. I don't know how else——

Mr. COSTA. Should a customer use in any one of our districts an account equity in October 31 when a bankruptcy was filed to establish a claim or should the customer use an account equity at the

close of business 4 days later when the bulk account transfer took place? Mr. Kobak, do you want to respond?

Mr. KOBAK. I think under the CFTC rules you look to when positions were liquidated if they were liquidated. So that means it wouldn't necessarily be the 31st. If you just had cash in your account, it would be the 31st. Otherwise, it might be a later date. I know customers have problems with this concept. It is difficult to apply. But what we are going to try to do is get them statements to show where they were on the 31st and then the subsequent activity. It may not be 100 percent reliable at this point, but it is the best we have, and that should allow people to help them because I realize people have had questions about how to fill out——

Mr. COSTA. No. And the questions continue to arise. My time has expired but, Mr. Chairman and the Ranking Member, as we try to determine the fault lines on this effort and what is the proper mix, it seems to me that the potential to have another MF Global out there is real. Notwithstanding the answers to the questions I raised, I am not confident that you have a good handle on whether or not you are able to provide that insight to us as to who ought to be on a watch list so that we are not surprised like this. I think that is an area we need to work on.

The CHAIRMAN. The gentleman's time has expired.

And observations are important. The chair would note the next gentleman will be from Kansas followed by, Mr. Baca, from California. The gentleman, Mr. Huelskamp, is recognized for 5 minutes.

Mr. HUELSKAMP. Thank you, Mr. Chairman. First question would be for Mr. Kobak. There have been news reports that indicated in the last week of October that customers or clients that requested the return of their funds in accounts were mailed paper checks, the dollars were to subtract out of their account. Then, when they went to cash in the checks at the bank, are those treated any differently? What are we doing to track this down? Because that to me demonstrates clear intent at least a week before the bankruptcy to withhold funds.

Mr. KOBAK. We found out about that situation. The accounts reflected that the money went out even though the accounts bounced, so in this third transfer, assuming the court approves it, we are going to include them. There are approximately \$57 million worth of bounced checks that we know about. I think that is the universe, and they should all get the 69 to 70 percent of that. It was unfortunate that we couldn't include them in the earlier transfers.

Mr. HUELSKAMP. Okay. And I daresay before going further, producers always thought the risk they faced was in the market rather than the firm that was handling their dollars and this has caught a number of my constituents.

I have a question for Ms. Sommers if I might. I am looking at the first question. What is a statement of nonparticipation *versus* recusal? Is that the same thing, Ms. Sommers?

Ms. SOMMERS. Congressman, I don't know the answer to that.

Mr. HUELSKAMP. Well, the letter that Mr. Gensler sent out does not mention recusal at all. It mentions nonparticipation. Can you further describe his being a fellow Commissioner at CFTC what exactly that is *versus* recusal?

Ms. SOMMERS. I wouldn't know the differences between the two. I will say that the CFTC doesn't have a specific policy dealing with recusal. We follow the Office of Government Ethics regulations on that.

Mr. HUELSKAMP. I appreciate that. I appreciate the comments of Mr. Stutzman suggesting how that would be a great question if we could hear from Mr. Gensler at a later time. But again it has been noted in here that Mr. Gensler was forced by a Senator but that makes no notice of that in a statement of nonparticipation. But again I will note that he participated in numerous calls and interactions, activities with MF Global after the bankruptcy. Has he indicated to you or other members of the staff of CFTC why suddenly he decided after he had already participated after the fact in multiple negotiations?

Ms. SOMMERS. He has not discussed the particulars of his recusal with me, sir, but that is his personal decision.

Mr. HUELSKAMP. Thank you. And I wish you would share with the other Commissioners that obviously, if you were unaware, that looks rather suspect and reflects poorly on him as a Chairman of the Commission to invent something such as a statement of nonparticipation, which no one seems to know what it is other than he has already participated.

And another question I have, on July 20, which was the 1 year anniversary and then-deadline for the Dodd-Frank requirements, there were four conference calls and I believe you participated in one with MF Global. And could you describe what occurred in those conference calls?

Ms. SOMMERS. I don't believe I participated in a conference call with MF Global in July.

Mr. HUELSKAMP. You are correct. I am sorry. That was in December. I know there were four conference calls. I apologize. I had the wrong date on that.

Ms. SOMMERS. In December of 2010 I had a meeting in my office with MF Global.

Mr. HUELSKAMP. Yes. Was Jon Corzine in on that meeting?

Ms. SOMMERS. He was.

Mr. HUELSKAMP. And were there notes kept of this particular meeting?

Ms. SOMMERS. Perhaps. I don't recall whether I took notes. It was approximately a 15 minute meeting.

Mr. HUELSKAMP. Yes. I might ask if you would provide those to the Committee.

[The information referred to is located on p. 155.]

Is it normal that a meeting such as this there may not be notes taken and no one outside the room will know what occurred inside this——

Ms. SOMMERS. My staff was in the meeting with me. Mr. Corzine had staff with him as well, but if no real substantive issues were discussed, it is not uncommon to have a meeting where there are no notes taken.

Mr. HUELSKAMP. Well, it indicated to discuss segregation and bankruptcy with MF Global on 12/21 of 2010, I would think that would be a particularly important subject as we continue here.

But one other item as far as Mr. Gensler's meetings with Mr. Corzine, which one did occur on July 20. Do we have notes of what they discussed? And I think this is very strange. I was unaware until today that Mr. Gensler actually used to work for Mr. Corzine at Goldman Sachs and that seems very suspect, certainly, to my constituents. So if I might have an answer to that question.

Ms. SOMMERS. I can pass that on. I don't know if there are——

Mr. HUELSKAMP. We do not know if there are any notes of this closed-door meeting?

Ms. SOMMERS. To Mr. Gensler's meeting I do not know if there are notes.

[The information referred to is located on p. 155.]

Mr. HUELSKAMP. Okay. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired. The chair now recognizes the gentleman from California, Mr. Baca, for 5 minutes.

Mr. BACA. Thank you very much, Mr. Chairman.

Commissioner Sommers and Mr. Kobak, thank you very much for coming and testifying before us on the enforcement investigation into the MF Global. I guess from this we have learned a lot of valuable lessons. It is too bad that the valuable lessons are at the expense of the consumers. Apparently, we need a lot more oversight and accountability, and that is why we need the Dodd-Frank Act as well. And we can't assume that everybody is going to do the right thing to follow the correct guidelines, policies, or procedures, and that is what has led to some of the problems.

But let me ask you, Ms. Sommers, from your testimony it is my understanding that MF Global is different than the previous FCM bankruptcy such as Lehman Brothers and Refco because the commodity customers at MFG lost their money. In layman's terms, can you explain to the Committee why these losses occurred for commodity customers at MFG but not at Lehman Brothers or at Refco?

Ms. SOMMERS. Sir, in both of the previous, most recent, bankruptcies, Lehman Brothers and Refco, the customer accounts were whole or fully intact meaning that all the positions and supporting collateral for those positions were in the section 4d segregated accounts. So when the FCM went into bankruptcy proceedings, the customers were transferred to healthy FCMs and the customers were whole. In MF Global, that didn't happen.

Mr. BACA. Why not?

Ms. SOMMERS. Because the customer segregated accounts were not whole. All the money was not there.

Mr. BACA. Should they have been?

Ms. SOMMERS. Absolutely.

Mr. BACA. Then why not?

Ms. SOMMERS. The money was not there and that is part of what our investigation—both on the enforcement side and in the accounting or bankruptcy to look through the books and records, we are looking at exactly what did happen to the money.

Mr. BACA. So there is probability that the money was never there or was there?

Ms. SOMMERS. I think the money was there in the beginning. The customers deposited that money with the FCM. So the money belonging to the customers was there.

Mr. BACA. But now it is poof, gone? Okay.

Let us talk for a moment about staffing needs at CFTC. Simply put, does CFTC have enough manpower to effectively regulate—I say regulate all of the futures exchanges and trades that need to be monitored in the United States?

Ms. SOMMERS. Sir, we do have a system where we rely on self-regulatory organizations——

Mr. BACA. Do you have enough manpower? I am asking a specific question.

Ms. SOMMERS. We do.

Mr. BACA. Okay. So that means you don't need any additional manpower to monitor what goes on in the exchange or trades in the United States?

Ms. SOMMERS. I think that there is no doubt as we implement Dodd-Frank and are given the new authority that we were given under that law overseeing swap dealers, major swap participants and all the over-the-counter trades that we will be overseeing, that there is no doubt that we will need to increase the staff and the resources that we have at the CFTC.

Mr. BACA. Okay. Mr. Kobak, can you explain to the Committee some of the difficulties you are facing in collecting MFG customer funds that are now located in foreign depositories?

Mr. KOBAK. Yes, there is a separate pool of property under different CFTC regulations for that property. Virtually all of the property that was held or should have been held for those accounts at MFGI is held in foreign locations. Those are affiliates of the business that are in bankruptcy or other kinds of insolvency proceedings themselves. So they are now held by foreign administrators. We have been contacting those administrators and seeking to get both an accounting of what they have and also to talk to them about getting the funds back. But experience tells me that it may be a longer process to do that than it is domestically.

Mr. BACA. Are there any steps that we in Congress can take or the CFTC can take to help facilitate the return of the customers' funds? And I say the customers' funds because that is what we are dealing with. And the American people are tired of their funds being spent somewhere else in foreign depositories. Are there any steps that we should be doing or the CFTC can take?

Mr. KOBAK. Well, the Trustee is taking all the steps that he can take. Unfortunately, that might mean having to go to litigation with people. Whether there are steps that could be taken between regulators and different jurisdictions, that might be helpful. I know from experience that one problem in these cases sometimes is insolvency rules in other parts of the world don't always work the same way they do in the United States. And I don't know what the impact of that might be on the administrators' decisions.

Mr. BACA. If not, then maybe we need to develop some guidelines to make sure that this happens if they are not or make sure that they are clear and they are followed as well.

Mr. KOBAK. Yes, it would be very helpful to have international protocols, have countries follow much more similar rules than they do today.

Mr. BACA. Okay. Thank you. I know my time has expired.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from Pennsylvania, Mr. Thompson, and Mr. Hultgren of Illinois should be standing ready.

Mr. THOMPSON. Thank you, Mr. Chairman. Commissioner Sommers, Mr. Kobak, thank you for your testimony and thank you for your due diligence in this ongoing investigation. I think the findings from the investigations being completed are obviously extremely important to us. This particular situation to me in just simple terms poses three potential losses—the real loss of the customer monies, and I wish you the best of luck in being able to make these individuals whole and their resources, their monies; second, is loss of opportunity for proper investments where this money would be out and earning for those individuals; and finally, a loss of confidence. I think a loss of confidence for those in the system that we have for trading futures and options in this country.

Commissioner, a situation like this is exactly why many farmers are not using hedging to manage or mitigate risk and control their costs. In terms of agricultural producers, what can the CFTC do to help rebuild and grow confidence in this system?

Ms. SOMMERS. Congressman, I think that you have certainly hit on a very important issue because we want to make sure that confidence is maintained in the markets that we oversee, that the integrity and the proper functioning of those markets is communicated to the public and to those who are using the markets. Shortly after I took over as senior commissioner for MF Global, working with the DSROs, I directed a spot review of segregated funds so that we can give the public confidence that all other clearing FCMs are in compliance with Commission regulations and are treating customer segregated funds properly.

Mr. THOMPSON. MF Global was required to file daily segregation reports, monthly audited financial reports and annual certified financial reports. Was there a failure on the part of CFTC to act on and utilize these reports?

Ms. SOMMERS. Absolutely not. If we would have seen any sort of red flags with regard to these daily segregation reports, we would have acted upon that. The FCM is obligated to notify us of being undersegregated and that did not happen.

Mr. THOMPSON. And I know the investigation is ongoing but it appears if there was a requirement for daily reporting, the information at MF Global was reporting on a daily basis obviously was failing to disclose the realities that now it appears that we have with this loss of funds.

Ms. SOMMERS. The red flags were raised for us in the week preceding the bankruptcy of MF Global. So, we had staff in MF Global starting on the 26th of October.

Mr. THOMPSON. My last question actually is for both of you. Given that commodity accounts are settled daily, why has it taken 5+ weeks to determine if custodial customer account excess cash is missing? And are there any preliminary recommendations that have been identified to correct that from continuing in the future?

Ms. SOMMERS. I will certainly let Mr. Kobak answer as well, but I think we can't overemphasize again the complexity of these books and records, the thousands of accounts, the tens of thousands of transactions and following each of these transactions, the bank reports, looking through what I understand from primary accounts

reviewing 300–500 pages of summaries from bank accounts. It is very complex.

Mr. THOMPSON. Mr. Kobak, any comment?

Mr. KOBAK. Sorry, yes. I would support it is very complex. You also have to understand that in the early days of one of these proceedings, one may not have perfect access to books and records. Sometimes depositories turn off screens or don't allow you access. Sometimes system vendors threaten to shut off their systems. In our case, we did have some issues with the holding company about getting access to documents that both of us had an interest in. So in addition to the sheer complexity, they are just the practicalities that it may be a few days before one can actually get into all the systems and records one needs to review.

Mr. THOMPSON. Okay, thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired.

The chair will next call upon the gentleman from Illinois and note to Mr. Sablan he will be after that, followed by Mr. Gibbs.

Mr. HULTGREN, you are recognized for 5 minutes.

Mr. HULTGREN. Thanks, Mr. Chairman. I will be briefer than that. I just have a couple questions for Mr. Kobak.

First, I wonder to what extent the U.S. Department of Treasury is involved.

Mr. KOBAK. I am not aware. I know there are some U.S. Attorneys that are looking at things, as well as the CFTC and the SEC and FINRA.

Mr. HULTGREN. So as far as you know, you don't know anything as far as they are tracking funds either domestically or internationally?

Mr. KOBAK. Not as far as I know.

Mr. HULTGREN. Okay. I wondered if all domestic exchanges or clearinghouses that held MF Global customer money released that money to the Trustee?

Mr. KOBAK. They have or they will be doing so. And in the first transfers, we actually used—because we hadn't gotten all the money from U.S. depositories and a lot of it was at the exchanges. So we actually were—especially the CME. We are largely using their money to affect the transfers. So they have been very good about that.

Mr. HULTGREN. Okay. And you said they have or they will be so when would you expect that to be completed?

Mr. KOBAK. Well, if the court approves our motion for the next transfer, which is on for a hearing tomorrow morning, I think it might take 2 to 4 weeks to implement. It will be a little faster for some customers than for others.

Mr. HULTGREN. Okay. Last question and then I will yield back my time. Does the Trustee seek or conduct assessments of the health of the receiving firms prior to transferring MF Global accounts?

Mr. KOBAK. Well, the way the CFTC regulations work, we have to get a consent to the CFTC, and one of their criteria is that the receiving broker not only agree to take the account but be in appropriate financial condition so it wouldn't put them under their capital requirements.

Mr. HULTGREN. So there is an assessment of their health——

Mr. KOBAK. Yes.

Mr. HULTGREN.—to make sure that they could handle it?

Mr. KOBAK. Yes.

Mr. HULTGREN. Okay. Well, I know there is a number of other witnesses that we want to hear from today, so I will yield back the balance of my time, Mr. Chairman.

The CHAIRMAN. The gentleman yields back.

The chair recognizes the gentleman, Mr. Sablan, for 5 minutes.

Mr. SABLAN. I don't have any questions at this time.

The CHAIRMAN. Thank you.

The chair recognizes the gentleman from Ohio, Mr. Gibbs.

Mr. GIBBS. Thank you, Mr. Chairman, and thank you to our panelists today.

The question I am concerned about is the integrity of the futures market. I think it is an essential tool for our agricultural producers and hopefully Mr. Kobak will be able to make our farmers out there whole as quickly as possible; because I understand as a farmer when you are making margin calls and putting cash up front, it can be detrimental to the operation.

Along the questions on that, I assume that moving segregated funds to their house account, *per se*, is illegal. Is that correct, Commissioner?

Ms. SOMMERS. That is right.

Mr. GIBBS. Okay. What are the penalties for doing that? We talk about how complex all this is and I understand the complexity of that, so enforcement or penalties I would think would have to be how we really monitor this or control this. So what are the penalties under current law?

Ms. SOMMERS. The way the statute reads it would be \$140,000 per violation or three times the monetary gain, as well as potential restitution and other types of fines we may find appropriate.

Mr. GIBBS. Okay. Also, when funds are moved to a third party, okay, does that third party have any obligations to the entity it is moving the funds from to make sure they are not segregated funds and do they have any obligations?

Ms. SOMMERS. There are obligations that are from our CEA regulations put on the banks that hold section 4d accounts. They have to provide acknowledgement letters that they understand that this is customer segregated money, and so there are obligations from our regs. There may well be other obligations from banking regulations on other banks with regard to those kind of transfers.

Mr. GIBBS. Okay. I just want to follow up a little bit on the Ranking Member's comments. I think he did a really good job explaining what really happened here. There was a lot of money that moved from margin accounts on the commodities side over to the securities side to do their deal they were doing. When there are funds like that moved from the commodities side of the operations of an FCM, is there any reporting that they have to do when it goes over to say the securities side of their operation?

Ms. SOMMERS. If money is moved out of a section 4d segregated account into a permissible investment, the exact amount of collateral has to be put back into the customer segregated account. It would be a violation of the Act——

Mr. GIBBS. Okay.

Ms. SOMMERS.—to just take that money out and use it for your own use.

Mr. GIBBS. Okay. Thank you very much and I yield back my time.

The CHAIRMAN. The gentleman yields back.

The chair turns to the gentleman from Minnesota, and would note that then the gentlelady from Ohio will follow that. Mr. Walz is recognized for 5 minutes.

Mr. WALZ. Well, thank you, Mr. Chairman, and thank you for your timeliness on getting on this. I know you mentioned and I agree \$1.2 billion is a lot by any standard. But I have to tell you it is the 30,000 of my constituents that I am really concerned about. So I know this was probably asked. I don't want to take up any more of the time as we move on. Thank you both for being here.

As we look at Regulations 1.20 to 1.30, you need to look at those in entirety I understand because I am sure the two of you are familiar with the infamous 1.29 as everybody says. Are we interpreting that wrong? I know you have had to answer this over and over and over again. It appears that in 1.29 that those segregated accounts were fair game. Have you told us, Ms. Sommers, that that is incorrect and you have to see that rule in its entirety, not in the small piece of 1.29?

Ms. SOMMERS. Regulation 1.25 deals with the investment of customer funds in permissible investments and gives a list of what investments are permissible for an FCM to use. But an FCM is not allowed to take customer funds out of a segregated account to use for their own use. That has never been permitted.

Mr. WALZ. So when the next panel arrives, that is the question we should be asking. Did those funds get removed for use?

Ms. SOMMERS. For use on the house side or the securities side, however—

Mr. WALZ. Great. My final question is—and maybe, Mr. Kobak, you can help me from a bankruptcy side on this. Are the claims by the segregated account holders, are those superior to all other claims?

Mr. KOBAK. They have claims against that account that no other creditors have claims against.

Mr. WALZ. So if JP Morgan asked, these folks are first in line?

Mr. KOBAK. In line for those firms. First in line, they are really the only line unless there happened to be an excess, but, we are not dealing with an excess; we are dealing with a deficit.

Mr. WALZ. Okay. Thank you very much.

I yield back. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman yields back.

The chair will next recognize the gentlelady from Ohio and she will be followed by the gentleman from New York, Mr. Gibson.

The gentlelady from Ohio, Mrs. Schmidt, is recognized for 5 minutes.

Mrs. SCHMIDT. Thank you, Mr. Chairman.

And Ms. Sommers, I would like to go back to something you said a few minutes ago about a December 10 meeting with Mr. Corzine. And while you may or may not have taken notes, normally when

somebody requests a meeting there is a purpose for the meeting that has been documented. What was the purpose for that meeting?

Ms. SOMMERS. As I recall, the issue that we spoke about on that day was the issue of individual segregated accounts for swaps *versus* individual segregation for futures accounts. We were discussing at the time whether or not we should put swaps in individually segregated accounts and whether or not that structure or that framework would be appropriate for futures as well.

Mrs. SCHMIDT. And what was Mr. Corzine's position and what was yours?

Ms. SOMMERS. His position, as is the same position for a lot of FCMs, is that it would be a very costly structure to impose on the futures market.

Mrs. SCHMIDT. And did you have a position on that Ms. Sommers?

Ms. SOMMERS. We are still looking at that issue. It is one of the issues that we have not finalized with regard to swaps, but the proposal that we have been discussing is only for swaps. It is not for futures.

Mrs. SCHMIDT. Thank you. To go to another part of the question, if MF Global was not a broker-dealer and held no securities accounts, would SIPC have been involved? Would MF Global go through regular bankruptcy proceedings? And what would be different from our present situation? And who would be in charge? I know that is a couple of questions wrapped into one, Ms. Sommers, and then, Mr. Kobak, if you want to follow.

Ms. SOMMERS. I am sorry. I thought you were asking him a question about the SIPA bankruptcy. Could you repeat?

Mrs. SCHMIDT. Sure. If MF Global was not a broker-dealer and held no securities accounts, would SIPC have been involved? Would MF Global go through regular bankruptcy? What would be different from our present situation? And who would be in charge? If you can't answer that——

Ms. SOMMERS. If MF Global were an FCM only, the proceeding would not have been a SIPC or SIPA bankruptcy liquidation. However, the Commission CEA regulations, part 190 of our rules do apply even in a SIPA bankruptcy. So the customers would not be treated any differently in an FCM-only bankruptcy to my understanding.

Mr. KOBAK. Yes, and the SIPA statute says that not only does the Trustee have duties towards security customers but he has all the same duties and rights and so forth as the Trustee and bankruptcy if it were just the straight commodities liquidation.

Mrs. SCHMIDT. Okay. And maybe somebody has already answered this, but at the Senate Agriculture Committee hearing last week, Chairman Gensler said individuals who commingled customer segregated funds with their own funds could face civil penalties. Can you confirm that there are civil sanctions for this behavior? Are they just monetary? Is their punitive damage or jail time for taking a customer fund and using it for a non-authorized purpose?

Ms. SOMMERS. A misuse of customer funds is a violation under our Act and we have civil authority to impose civil penalties for violations of our Act.

Mrs. SCHMIDT. Are they monetary only or——

Ms. SOMMERS. Monetary penalties. The criminal authorities have the right, of course, to look into this and pursue criminal——

Mrs. SCHMIDT. And would it be appropriate for you to seek those criminal authorities to get involved or would you just hope that they would be looking at this and get involved on their own?

Ms. SOMMERS. In many cases we do referrals to criminal authorities.

Mrs. SCHMIDT. And do you anticipate that action happening here?

Ms. SOMMERS. It is my understanding that there are a number of different authorities that are looking into this matter.

Mrs. SCHMIDT. And if you have an opportunity to weigh in, would you be weighing in favor of criminal penalties from the civil side or would you just take a—or can't you answer that?

Ms. SOMMERS. Well, I think we will pursue to every extent of the law that we have under our authority—we will pursue that as vigorously as we can. I can't speak to what will happen on the criminal side.

Mrs. SCHMIDT. Thank you. I yield back my time.

The CHAIRMAN. The time has expired.

The chair now recognizes Mr. Gibson for 5 minutes. Thank you.

Mr. GIBSON. I thank the chair and I thank the panelists for being here.

My question: with regard to the daily segregation reports, is it a requirement to report on the weekend?

Ms. SOMMERS. The daily segregation reports are required to be kept by FCMs. MF Global provided the CFTC with daily segregation reports because we required them. It is not required of all FCMs.

Mr. GIBSON. And the last report that you are aware of was on Friday, the 28th?

Ms. SOMMERS. Right. Although I guess I should clarify. Our staff went into MF Global on October 26, that Wednesday, and hasn't left yet. So we didn't leave on Friday night and come back on Monday. We were there Saturday and Sunday.

Mr. GIBSON. So where I am heading with this is we have a report on Friday, the 28th. We have a written statement today from the former CEO who says he was stunned the funds were not there. Any early indication that had there been a report over the weekend we may have captured some important information?

Ms. SOMMERS. The way I understand this would work, the end-of-the-day reports from Friday would normally be filed on Monday, but if there were examiners in a firm on Saturday and Sunday, they could be getting end-of-day Friday reports earlier than what they normally would get them.

Mr. GIBSON. So in other words, there is the process where it allows for if there is movement over a weekend, you can capture that?

Ms. SOMMERS. If there are examiners in an FCM, they could ask to be looking at those books and records over the weekend.

Mr. GIBSON. Okay. And from the vantage point now of my farmers, from customers, and certainly we have had testimony here this morning, talked about when you moved the funds even if it is in something permissible there is collateral that goes into the account, do you think it is reasonable that a farmer would expect some kind of disclosure if an FCM is moving their money?

Ms. SOMMERS. Absolutely. And I think a customer of an FCM should be able to ask that FCM what they invest customer money in so the customer would know.

Mr. GIBSON. Any thought—it is certainly early in the process, but have you had any discussions about that, about how things might need to change to provide that?

Ms. SOMMERS. We have had a lot of discussion internally about those types of requirements, and I think as we get towards the end, knowing from the investigation exactly what happened, we will be able to put a comprehensive list of lessons learned together.

Mr. GIBSON. Well, I thank you for that. And I will be watching for that very keenly.

I yield back.

The CHAIRMAN. The gentleman yields back.

The chair now recognizes the gentelady from Alabama who will be followed by the gentelady from North Carolina, Mrs. Roby is recognized for 5 minutes.

Mrs. ROBY. I am having a hard time putting my eyes on you. Thank you both for being here today.

And just real briefly, Commissioner, you said that very emphatically when you were asked by Mr. Costa about whether or not you have the ability to do your job, you said very emphatically, yes, I have the ability to do my job. So I just want to ask a real easy question. Is what we are here today about with all of the really particular nuances surrounding it, is this about whether or not our current laws are appropriate or they are strong enough protections in place as it is right now, or is this just really about one or more individuals' poor decision-making ability?

Ms. SOMMERS. Well, I think certainly after we learn what happened, we can look back and see whether or not our current statutory authority was appropriate. But at this point, there are adequate laws that protect customer segregated funds and that do not permit an FCM to take customer funds and misuse them.

Mrs. ROBY. And as it relates to the self-reporting aspect, why would one self-report their own wrongdoing?

Ms. SOMMERS. Well, if they are even undersegregated for a little while and they know that it may be an issue for bank transfers, an FMC is required to report to us if they are undersegregated for that small amount of time. And that does happen. FCMs do report that.

Mrs. ROBY. Okay. Thanks so much.

I yield back, Mr. Chairman.

The CHAIRMAN. The gentelady yields back.

The chair now recognizes the gentelady from North Carolina for 5 minutes.

Mrs. ELLMERS. Thank you so much to our panel.

And Ms. Sommers, my questions are pretty much for you. I would like to first make a comment and associate myself with the

comments that have been made today about Chairman Gensler not being here. I think that he should be here. I know it has been discussed that there was someone from the Senate who compelled him to not be here, but this is the House of Representatives and he has been here on a number of occasions on behalf of the CFTC, and I think he should have been here as well.

And I applaud you for coming and taking part, Ms. Sommers.

I just want to clarify something that you had said and maybe I misunderstood. In some of the questions you had said if we are able to move forward on our investigation, is there something standing in the way of the CFTC?

Ms. SOMMERS. No, and I am sorry if I said that. I misspoke. It is not if; it is when.

Mrs. ELLMERS. Okay. So it is a necessary progression.

Also, getting back to the red flags and not seeing red flags go up and whatnot, I am just going over some of the dates. On September 1, MF Global announced in a public filing that it would comply with the FINRA determination to increase its capital. Was this considered a red flag by the CFTC?

Ms. SOMMERS. That was something that we were made aware of by a previous filing in August by MF Global to us, but because they were required to post more capital and they did, it was not necessarily a red flag to us. At that point, we would then look at that firm for the FCM side of the business, the futures side of the business and make sure that we were reviewing the risk associated with their futures positions and making sure that they had enough collateral to support their business on the futures side. And at that time they did.

Mrs. ELLMERS. Thank you. I yield back.

The CHAIRMAN. The gentlelady yields back. All Members have had an opportunity to question.

The chair wishes to thank this panel for their insights and their participation today. And you are dismissed.

I would like to welcome our second panel witness to the table, the Hon. Jon Corzine, former CEO, MF Global, Incorporated, New York, New York.

Mr. Corzine, would you please stand for administering of the oath, which will be administered to the rest of the witnesses in this hearing. Please raise your right hand. Please state your name for the record.

Mr. CORZINE. My name is Jon Stevens Corzine.

The CHAIRMAN. Do you solemnly swear that the testimony you are about to give before this Committee in the matters under consideration on this day, December 8, 2011, is the truth, the whole truth, and nothing but the truth so help you God?

Mr. CORZINE. I do.

The CHAIRMAN. I thank you. Please be seated, Mr. Corzine. Do you know you have the right to counsel?

Mr. CORZINE. Yes, I do, sir.

The CHAIRMAN. Is your counsel in the room?

Mr. CORZINE. My counsel is.

The CHAIRMAN. Would you please state his name for the record?

Mr. CORZINE. Andrew Levander.

The CHAIRMAN. Thank you, Senator. Of course, I am pleased to begin your testimony when you are ready.

**TESTIMONY OF HON. JON S. CORZINE, FORMER CHIEF  
EXECUTIVE OFFICER, MF GLOBAL INC., NEW YORK, NY**

Mr. CORZINE. Thank you, Chairman.

Chairman Lucas, Ranking Member Peterson, and distinguished Members of the Committee, like all of you I am devastated by the enormous impact on many people's lives resulting from the events surrounding the MF Global bankruptcy. Of course, my distress and sadness pale in comparison to the losses and hardships that customers—farmers and ranchers and others—employees and investors have suffered. Their plight weighs on my mind every day. As the chief executive officer of MF Global at the time of its bankruptcy, I truly apologize to all those affected.

Before I address what happened, I must make it clear that since my departure from MF Global on November 3 this year, I have not had access to many of the relevant documents which are essential to my being able to testify accurately about the chaotic days preceding the declaration of bankruptcy. The Members should also understand the Committee 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 Committee. While I intend to be responsive to the best of my ability today, without adequate time and material 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. I make it very clear many of your questions may well be ones I myself have.

When I joined the company in late March 2010, MF Global was primary a voice-based broker that provided execution and clearing services for products traded in derivative markets on exchanges around the world. The firm had reported losses in five consecutive quarters before I arrived and it had lost money in each of the previous 3 years.

On my arrival at MF Global, management and the board, advised by an outside consultant, devised the new business plan. The plan was communicated to the public and provided in substance that MF Global would evolve into a broker-dealer and ultimately into an investment bank. The implementation of the plan was expected to take 3 to 5 years. 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. In addition, on a number of occasions I purchased shares of the company with my own funds. I never sold any stock.

In the summer of 2010, I met several times with Global senior traders to discuss ways to improve the company's revenues and profitability. One of the ideas discussed was for MF Global to purchase short-term European sovereign debt using repos to maturity, known as RTMs. Before I came to MF Global, the firm had engaged in billions of dollars of RTMs with regard to U.S. Treasury securi-

ties, U.S. agencies, bonds, and corporate debt. It had also previously held billions of dollars of foreign sovereign debt positions.

In the summer of 2010, we decided to draw on these experiences and to engage in RTMs involving short-term foreign sovereign debt. In these transactions, MF Global purchased foreign sovereign debt from a seller and sold the same to a counterparty with an agreement to purchase the securities from the counterparty at the maturity of the debt.

When MF Global entered into the transactions, I believed that its investments in short-term European debt securities were prudent investments. MF Global invested in RTMs with respect to the debt of Belgium, Italy, Spain, Ireland, and Portugal. The first three of these were rated AA or better when MF Global invested in them. Even today, all three remain A rated or better. Ireland and Portugal were lower rated but they were largely backed by the European Financial Stability Facility and the IMF.

I accept responsibility for the RTM trades. I strongly advocated that trading strategy. Nevertheless, it is important to recognize that MF Global's investment in these positions was the subject of internal discussions with senior managers, traders, and with MF Global's Board of Directors. The trades were described, analyzed, and debated at multiple board meetings. I believe that the board members, all of whom joined the board before I joined MF Global were independent and sophisticated. They asked hard questions and raised concerns.

The directors approved sovereign risk limits for these RTM trades. At the time of the bankruptcy, MF Global was within these risk limits. The RTM positions were also publicly disclosed both in the periodic financial statements, which were reviewed by the company's counsel and accountants, and other public statements including press releases and earnings calls.

As of today, none of the foreign debt securities that MF Global used to engage in RTM trades has defaulted or been restructures. All of those securities that reached maturity while they were a part of the RTM position paid in full.

In my written statement, I have attempted to describe the relevant contacts with regulators during my time at MF Global. As explained in that statement, I did not exert undue or improper influence on regulators. My communications were typically in the presence of various members of the regulatory staff, as well as my own colleagues.

The late summer and fall of 2011 were extraordinarily difficult times in financial markets for almost all market participants. On October 17, 2011, *The Wall Street Journal* published an article that described a FINRA ruling regarding the capital treatment of RTM positions which MF Global had disclosed on September 1, 2011. Other news stories followed. On Monday, October 24, rating agencies began to cut MF Global's ratings. MF Global announced its quarterly earnings on October 25. The announcement revealed that MF Global had lost \$191.6 million in the quarter that ended September 30.

In light of the attention that has been given to RTMs and the reports that attributed MF Global's loss to RTMs involving European debt securities, it is important to note that the loss was not,

and I will repeat, not related to those positions. As I have explained in my written statement, the lion's share of the quarterly loss was a write-off of approximately \$119.4 million that related to tax losses accumulated largely in the years before I arrived.

Shortly following the earnings announcement and the ratings downgrade, some clients and counterparties withdrew their business from the firm. Others required increased margins. Firms' stock traded at sharply higher volumes and lower prices. Despite our best efforts to sell assets and generate liquidity, the marketplace lost confidence in the firm.

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 on MF Global's customers and others. I simply do not know where the money is or why the accounts have not been reconciled to date.

As the Chief Executive Officer of the MF Global holding company, 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.

In short, I do not know which accounts are unreconciled or whether unreconciled accounts were even subject to the segregation rules. Moreover, there were an extraordinary number of transactions during this period, the last few days of MF Global. 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 our clients, employees, and shareholders. Once again, let me go back to where I started. I mean this with sincerity. I apologize both personally and on behalf of the company to our customers, our employees, and our investors. I truly know they are bearing the brunt of the impact of the firm's bankruptcy.

This concludes my prepared remarks and I am willing to answer your questions.

[The prepared testimony of Mr. Corzine follows:]

PREPARED TESTIMONY OF HON. JON S. CORZINE, FORMER CHIEF EXECUTIVE OFFICER,  
MF GLOBAL INC., NEW YORK, NY

Chairman Lucas, Ranking Member Peterson and Distinguished Members of the Committee:

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 sad-

ness. 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 Committee 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 Committee.

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 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 3 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.<sup>1</sup>

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),<sup>2</sup> and it had lost money in each of the previous 3 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.<sup>3</sup> (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 3 to 5 years. This new strategic plan was communicated to the public.<sup>4</sup>

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.<sup>5</sup> 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.<sup>6</sup>

### **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.<sup>7</sup>

#### *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 liabil-

ity (the money owed to the Counterparty) must be “derecognized,” *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.<sup>8</sup>

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.<sup>9</sup>

#### *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.<sup>10</sup> The company also reported that it had used RTM agreements to purchase some securities, although not specifically foreign government debt.<sup>11</sup>

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.<sup>12</sup> 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."<sup>13</sup> 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."<sup>14</sup>

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."<sup>15</sup> 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.<sup>16</sup> In a conference call that MF Global held on July 28 to announce its results, the RTMs collateralized with European sovereign debt were discussed.<sup>17</sup>

#### *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 . . . .<sup>18</sup>

#### *B. My Communications Regarding Proposed CFTC Rules Changes*

Sometime in late 2010 or early 2011, the CFTC proposed certain changes in 17 CFR § 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.<sup>19</sup> 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.

During my tenure at MF Global, to the best of my recollection I never spoke about business with Chairwoman Schapiro of the SEC, another of our regulators, or any other SEC Commissioner. (I may have greeted Chairwoman Schapiro at a conference.) 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 2 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 writeoff 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 UK'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 Committee's questions.

#### Endnotes

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](http://www.fitchratings.com); [www.moodys.com](http://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.

The CHAIRMAN. Thank you, Governor. And I now recognize myself for 5 minutes.

And you have served in the role of Congressional oversight before. You know we have an obligation to get to the facts, to address the uncertainties in the market and address whatever laws may need to be focused upon.

Thousands of your former customers across the country are experiencing severe financial hardship because of the events that occurred under your watch. Many of those customers are the very farmers and ranchers I represent in Oklahoma and that this Committee represents in the House of Representatives. The fact that their property is missing is alarming and, yes, disheartening. The fact that they have lost confidence in the futures market may have a long permanent impact on the hedging practices of the agricultural community.

Mr. Corzine, many of my constituents I am sure, the 3,000 or so people that used to work for you are watching today also and they are looking for answers, too. I expect you may have some of those answers and so I would like to ask you to answer these questions to the best of your ability.

Mr. Corzine, is there a shortfall in the customer funds that MF Global was legally required to keep segregated?

Mr. CORZINE. Mr. Chairman, I know only what I read and it certainly was true on the late evening of the 30th of October that there were unreconciled accounts.

The CHAIRMAN. To the best of your knowledge based on your time at the company before you left, why is there a shortfall?

Mr. CORZINE. Well, there are, Mr. Chairman, many transactions that occurred in those last chaotic days and I am not aware of all those, nor do I have the information to be able to look at those transactions. And as a consequence, it would be very hard for me to speculate why or where that shortfall took place.

The CHAIRMAN. Let me ask in a very precise fashion. In your role at MF Global, did you authorize a transfer of customer funds from these segregated accounts?

Mr. CORZINE. I never intended to break any rules, whether it dealt with the segregation rules or any of the other rules that are applicable.

The CHAIRMAN. Are you aware of any transfers authorized or unauthorized of funds out of customer accounts?

Mr. CORZINE. I am not in a position, given the number of transactions, to know anything specifically about the movement of any specific funds, and I will repeat I certainly would never intend to direct or have segregated funds moved.

The CHAIRMAN. At what point were you made aware that customer funds were missing?

Mr. CORZINE. As I said in my statement, Mr. Chairman, the first that I heard of the many millions, hundreds of millions missing was on Sunday night.

The CHAIRMAN. I would like to discuss how a company that has been around for 230 years fails to the surprise of its customers and investors, and based upon press reports and your testimony, under your direction. MF Global's sovereign debt position increased steadily. In fact, it has been reported that MF Global's exposure went from \$1.5 billion at the end of 2010 to \$6.3 billion at the time of the bankruptcy. So let me ask this, Governor. Who is Michael Roseman?

Mr. CORZINE. Michael Roseman was the Chief Risk Officer of the firm preceding my joining the firm and was up until the end of 2010.

The CHAIRMAN. Explain to me what a chief risk officer does.

Mr. CORZINE. A chief risk officer represents the Board of Directors in administering the delegation of authorities that the board assigns to the activities of the firm and looks at market risk, credit risk, operational risk. He consults with the board and consults with management.

The CHAIRMAN. Is it true that Mr. Roseman on multiple occasions both directly to you and to the board expressed concerns that MF Global was overexposed in European sovereign debt and that the firm did not have enough capital to withstand potential losses those positions might impose upon the firm?

Mr. CORZINE. Mr. Roseman certainly had a different view about the sovereign default risk associated with euro sovereigns and particularly in the context that we did other business in those countries, and he expressed that to me directly; he expressed that to the board.

The CHAIRMAN. Did any members of the MF Global Board express concerns to you with the level of risk accumulating in the firm's portfolio?

Mr. CORZINE. There were multiple discussions, as I have said in my testimony, most of which I think once I have access to records will be documented in the minutes of the board meetings about this subject. And there were people who dissented in the debates and then sometimes supported actions that we were taking after those debates. Sometimes there were people who did dissent. I don't know the exact elements but generally we arrived at a consensus.

The CHAIRMAN. Is it true, Mr. Corzine, that you threatened to leave the firm as CEO if the board did not trust your judgment?

Mr. CORZINE. Mr. Chairman, I did not threaten the board that I would leave. I had one specific conversation with the lead director, which could have been interpreted that way in the sense that I said if the board, using the powers that it held, had lost confidence in me, I would be willing to step down.

The CHAIRMAN. Mr. Corzine, I understand that Mr. Roseman was no longer chief risk officer after March of this year. Were you involved in that decision?

Mr. CORZINE. My view was that we needed someone in the chief risk officer position that was more fully attuned to the broker-dealer side of our business than what Mr. Roseman's background was about. And there were other issues about how people worked with

each other, not with me in particular but within the firm, that led the board and my agreement to that that we should change chief risk officers.

The CHAIRMAN. We have all been watching the eurozone crisis unfold, and there has been significant uncertainty about its resolution, yet you pushed forward with aggressive bets despite warnings from employees and even the board it seems. What do you know, Mr. Corzine, that we didn't? Why were you so confident about those bets to the degree that you were willing to bet the survival of the firm, and yes, its employees which you were responsible for?

Mr. CORZINE. Mr. Chairman—I looked at many conditions, first of all, the ratings but they were certainly not the only consideration, I looked at what counterparties would charge for initial margin, you would look at how individual securities were looked at by regulatory authorities around the globe, what they were able to be used as collateral for, you would look at prices in markets to determine whether people thought the default or restructuring risk was being priced into it. So there were many, many different considerations along with the ongoing dialogue which after the fact clearly can be second-guessed, that the European community was going to take a much more—would take much more forceful steps to avoid bankruptcy or insolvency rather in sovereigns cases and hold to full payment of the securities.

The CHAIRMAN. In the days leading up to bankruptcy, how often did you talk with Gary Gensler? Daily or——

Mr. CORZINE. There were no private conversations in my recollection were held between Mr. Gensler and myself. I—to the best of my recollection and this is one of the reasons I need records to be able to verify—Mr. Gensler was on the general discussion with regulators on the very early hours of October 31. And if I am not mistaken, a posting that was given to regulators on Saturday, which I guess would have been the 29th were there were a series of regulators.

The CHAIRMAN. At any point did Mr. Gensler encourage a bankruptcy filing?

Mr. CORZINE. In my recollection, there was no encouragement in any of those forms and I don't recall anyone suggesting that he was encouraging bankruptcy filings.

The CHAIRMAN. Mr. Corzine, as a registered futures commission merchant, MF Global was subject to periodic audits both by regulators and accounting firms. What generally were the results of those audits over the past year?

Mr. CORZINE. Mr. Chairman, from my recollection——

The CHAIRMAN. As chief executive officer, you would have reviewed those, correct?

Mr. CORZINE. Some of them I would, particularly if there were exceptions to challenges. As I included in my statement, we certainly had discussions with FINRA in the August time frame that I was very much aware of, further discussions with the SEC. There were inquiries from the SEC about the treatment of repos at different points in the year but no reporting of significant challenges to how the firm was operating that I can recall except with respect to the FINRA issue.

The CHAIRMAN. But when directions and suggestions were made, as is the nature of many auditing reports, did you make those changes?

Mr. CORZINE. To my recollection of the details—and there are many, many elements of internal outside consultants', regulators' observation, we had people who made sure that we were responding. We went through audit committee reviews of those kinds of actions that were taken in response to questions. And so I had reason to believe that we did.

The CHAIRMAN. So Mr. Corzine, how would you respond to charges that MFG's books were a mess? And you were a supporter of Sarbanes-Oxley, too——

Mr. CORZINE. Yes.

The CHAIRMAN.—just like myself.

Mr. CORZINE. Mr. Chairman, my understanding is that our books and records were reflecting the chaos that occurred in the last 2 or 3 days as the firm was under severe pressure and had lost the confidence of the marketplace. I think that is distinct from the books and records. I think I have reason to believe based on at least the reporting that occurred in our audit committees over a period of time that our books and records weren't in a mess. But that is a question I think others will have to opine about after they look at those in retrospect. It is clear that in the last hours, the last days, there were many, many, many, many more transactions than typically occur.

The CHAIRMAN. One last question. Why did MF Global report to FINRA in late September of 2010 that it didn't have any position in foreign sovereign debt when it began entering into transactions that carried European debt exposure in mid-September 2010?

Mr. CORZINE. Mr. Chairman, I believe—again, without checking records and without the ability to be certain on this—always open to confirming with records, I think you must be referring to—or looking to the month-end reports that we filed with FINRA on our capital position. And in September of 2010 it is quite possible—and again, I don't have records to confirm this with, but it is quite possible that beginning positions that we took in euro sovereigns were on the books of one of our other subsidiaries not in the FINRA regulated subsidiary.

The CHAIRMAN. My time has expired. The chair appreciates the indulgence of the Ranking Member and the Members and turns to the Ranking Member. If he would like to begin his questions, we will soon have to break for a series of votes. The gentleman is recognized.

Mr. PETERSON. Well, Mr. Chairman, thank you.

I wanted to follow up on a couple things: the one thing that struck me, Mr. Corzine, about—or Governor or Senator, I don't know what to call you exactly—but——

Mr. CORZINE. A lot of people have bad names.

Mr. PETERSON. Mr. Corzine, I don't know. Anyway, in your testimony about the leverage, apparently when you took over the leverage was 37.5 to 1 or something.

Mr. CORZINE. Something in that neighborhood.

Mr. PETERSON. And then you got it down to 30 and that somehow or another that is a good thing. You know, this mentality on Wall

Street, about this leverage, I don't get it. You know, and I guess maybe you have to do that in order to make money given the circumstances, I don't know, but it just seems pretty risky, you know.

Mr. CORZINE. Congressman, if I might, 30 to 1 was a lot higher than I would have wanted to have on a sustained basis over a period of time. I think if you review my written testimony, you will see that we were actively involved in seeking a strategic partnership with the FCM. In the last days, we actually moved to trying to sell the FCM. If that had been accomplished and we had made progress on that, we were all very hopeful that we would. That would have lowered our leverage down into the mid-teens to high-teens, which was certainly the strategic objective that we wanted to get to. The challenge—and I listened to some of the earlier conversations—the challenge of running MF Global as it was organized is it was both an FCM and a broker-dealer. And those two elements posed different kinds of constraints, but one of those is it built up your leverage higher than would otherwise be the case in an organization that was just one or the other.

Mr. PETERSON. Well, according to your testimony, these positions or securities you never lost any money on. None of them ever defaulted.

Mr. CORZINE. Not to this point.

Mr. PETERSON. So basically what put you in trouble was when the margin call or when the FINRA required you to put up considerable more money——

Mr. CORZINE. The FINRA capital adjustments that we took are really different than the capital—I mean the liquidity issues. Those were things that we had, the capital and different parts of our overall organization that we could put into the regulated subsidiary that FINRA looked at. And with not much difficulty we were able to more than meet and run excess capital positions. You are suggesting that the RTM positions were a drag or a significant user of liquidity is true on the clearing exchanges in Europe where sovereign RTMs were cleared. On the other hand, the cause of MF Global's stress in its last few days was a combination certainly of sovereign positions, which were a concern to the marketplace. Make no mistake about that. It was also, though, the ratings downgrades and what I have tried to say in my oral statement, a—I think an inability for those of us in management at MF Global to convey what the losses were all about and often got conflated with euro sovereign positions which there actually were no losses in.

Mr. PETERSON. Well, I guess we have to go vote, Mr. Chairman. I do have a few more questions——

The CHAIRMAN. The Committee will stand in recess and you will be back in questions when we return.

[Recess.]

The CHAIRMAN. This hearing of the Committee on Agriculture to examine the MF Global bankruptcy will come to order.

I now recognize the Ranking Member to continue his questions.

Mr. PETERSON. Thank you, Mr. Chairman.

Mr. Corzine, your testimony indicates that on Sunday, October the 30th, that you were informed that MF Global could not account for client funds. Who told you this information and when on that day did they tell you?

Mr. CORZINE. Congressman, to the best of my memory I was informed someplace 10:30, 11:00 on Sunday evening. And I will admit that I was in a group of people and I don't know exactly whether it was the CFO or the general counsel or who exactly——

Mr. PETERSON. Somebody from your firm?

Mr. CORZINE. It was pretty stunning, however.

Mr. PETERSON. Somebody from the firm, though?

Mr. CORZINE. From the firm.

Mr. PETERSON. Yes. So apparently I had talked to Chairman Gensler the next morning. He said he had been woken up at 2:30 and informed of this. Do you have any idea why it took from 11:30 or 10:30 until 2:30 before he was informed? Because I guess he was informed as soon as they knew. Do you have any recollection of what happened there?

Mr. CORZINE. To be careful with my remarks, Congressman, there was a presumption—although the CFO to my recollection was saying people were still working to try to reconcile the books. They were going through records and they hadn't established unequivocally that the money was missing but there was a serious concern that they were not going to be able to do that. As you probably have read, the—MF Global—I should say the firm was working to be sold at the time and we were in the process of doing due diligence with that prospective buyer and that individual buyer obviously wanted this reconciliation established as well.

Mr. PETERSON. So I take it that there wasn't any kind of explanation given to you at the time about why this happened?

Mr. CORZINE. Nothing satisfactory.

Mr. PETERSON. Pardon?

Mr. CORZINE. Not a satisfactory explanation, although theories and mostly unreconciled accounts that they were attempting to go through, not unlike what I think now is being reconstructed. But again I have to—I really should not speculate. But that was the efforts that were being put in place at that time.

Mr. PETERSON. And so at any point during your tenure I assume from what you have said that you were not aware of any segregated commodity customer funds being transferred to the broker-dealer arm or otherwise?

Mr. CORZINE. I am not—again I have not reviewed records and to be absolutely precise of whether there was some small entry at some point, but I don't remember. As I sit here and as I said to the Chairman, I feel comfortable there was no intention certainly on my part to violate any of these segregation rules.

Mr. PETERSON. So in your testimony you say you have little expertise in operational aspects of the business such as movement of cash and collateral and rules and regulations governing the various operating business. So who at MF Global had that expertise? Who did you rely on for that?

Mr. CORZINE. Sir, every firm would put in place control elements, policies, procedures, hire people to give assurance to ourselves in the first instance, to our auditors and regulators in the filings that we would make to make sure those were true and accurate. And at least in the experience of the 19 months—roughly 19 months that I was at the firm, certainly after I got my feet on the ground

I had confidence that people were doing that. We went through, as I suggested to the Chairman, audit committee reviews of the various procedures and——

Mr. PETERSON. There was not one person that——

Mr. CORZINE. Well, it—ultimately, the CEO is responsible for all aspects of——

Mr. PETERSON. Well, I understand that——

Mr. CORZINE. And then the CFO is responsible for the financial aspects of the firm. And there are people in our organizational chart that were responsible for the operations aspects of the firm. And there are people who are responsible for the auditing aspects of the firm, including, by the way, a separate group to assure management or to give confidence to management that you could comfortably sign the Sarbanes-Oxley affirmations on quarterly financial statements.

Mr. PETERSON. Well, I am sure there are different people but who had the authority to move customer funds from segregated accounts? Is there somebody there——

Mr. CORZINE. I believe that it is a team of people in our——

Mr. PETERSON. So there are a number of people——

Mr. CORZINE. Cash financing, cash management that have that authority. I don't think it rests with any one single individual, although there is a CFO of our—was a CFO of our North American operations, a CFO of European operations, Haitian operations. That individual, again, in a normal course of an organizational structure that would have people who handled cash management, handled controls, and would report to them. Ultimately, there is somebody that hits a button. I wouldn't—probably don't to this day probably would not have known who that person was that would send money under the system. I—one of the reasons that I have been careful to say that without looking at records it is very hard to try to reconstruct from the position that I held how that all would have worked. It is a complex process.

Mr. PETERSON. Just a couple things here. Did your firm invest customer segregated funds in sovereign foreign debt?

Mr. CORZINE. To my recollection—and again all records would verify this—the answer to that is no. The sovereign positions were held at the broker-dealer and they were not a part of the FCM process.

Mr. PETERSON. And I don't know a lot about this business but I am told a good part of the profitability of the FCM is in the earnings or arbitrage on the customer accounts as opposed to the commissions that are earned.

Mr. CORZINE. I won't bore you with rehashing what is in the oral statement, but we try to make it precise. You buy a security that yields five percent——

Mr. PETERSON. Right.

Mr. CORZINE.—and we finance a security to maturity with a payment of two percent of interest to who is financing you, and the difference is the profitability that you would make on——

Mr. PETERSON. Right.

Mr. CORZINE.—that RTM.

Mr. PETERSON. Yes, but what I was asking is is that a bigger part of your profitability than the actual commission business itself?

Mr. CORZINE. No, the commission business is still a larger percentage of revenue.

Mr. PETERSON. Revenue but I mean are you making money on that or where are you making money?

Mr. CORZINE. The—as I—again I tried to frame some of that history of MF Global. The FCM business is under enormous pressure—

Mr. PETERSON. Now that is what I was getting at.

Mr. CORZINE.—given the legitimate competition for commission, high-frequency trading puts enormous pressure on it, and so commissions had declined and frankly we had not stayed up-to-date with technology so that we were still voice-brokering much more than technological delivery or—of brokerage services. And probably more important than any element in the current environment is that the extended period of low interest rates in the United States and around the globe had compromised what kind of spread an FCM like MF Global would be able to earn on those balances. On an upward-sloping yield, higher rates would have been positive for the earnings. They weren't that—from our FCM business was—made it much, much more difficult to be successful. Had other long-term aspects that I spoke about in my oral—I mean in my written statement that were attractive because of the reach and the scope of the business and its reach and scope to clients, but it was a business in stress.

Mr. PETERSON. Thank you, Mr. Chairman, for your indulgence.

The CHAIRMAN. The gentleman's time has expired. The chair now recognizes the gentleman from Virginia for 5 minutes, Mr. Goodlatte?

Mr. GOODLATTE. Thank you, Mr. Chairman. And of course then I would like to follow up with some of the questions regarding what happened to the best of your knowledge. Can you tell us what role you personally played in monitoring the segregation of customer funds?

Mr. CORZINE. Congressman, my role would be primarily to bring assurance to myself on an ongoing operating basis that we had the people, the policies, the procedures in place to maintain that segregation, which, as I had said to previous questions, at least until those last few chaotic days, how comfortable we had adhered to.

Mr. GOODLATTE. How often were you shown data demonstrating that customer funds were intact?

Mr. CORZINE. I was aware that we had to make those calculations daily. I didn't look at those on a daily basis.

Mr. GOODLATTE. How often would you say you did look at them?

Mr. CORZINE. I wouldn't say I looked at them other than the fact that I was assured that they were calculated every day and submitted to the appropriate bodies.

Mr. GOODLATTE. And when did you first discover that the segregated accounts were missing funds?

Mr. CORZINE. As I had answered in previous questions, the lack of reconciliation was brought to my attention with regard to many millions on Sunday.

Mr. GOODLATTE. Which Sunday?

Mr. CORZINE. The 30th. October 30.

Mr. GOODLATTE. Got you. And are you aware of any instances prior to the events immediately preceding the bankruptcy in which there were shortfalls in consumer funds?

Mr. CORZINE. I am not aware of any shortfall that had been presented to me.

Mr. GOODLATTE. Prior to learning that on the Sunday, October 30.

Mr. CORZINE. Prior to—my recollection of events.

Mr. GOODLATTE. And is it possible that any such shortfalls could have gone undetected by you or other senior management?

Mr. CORZINE. I am not being flip. Apparently, there were——

Mr. GOODLATTE. What I am trying to get at is is this something that has been going on for a long time or did it——

Mr. CORZINE. Yes.

Mr. GOODLATTE.—suddenly happen——

Mr. CORZINE. My impression, Congressman, is——

Mr. GOODLATTE. Someone made a decision to raid these accounts in order to recover for——

Mr. CORZINE. My impression of it, Congressman, is is that in the chaos of the last few hours and days either a miscalculation or money that was expected to come in *versus* transactions that occurred as I think I said in my statement.

Mr. GOODLATTE. It would be a rather large miscalculation, wouldn't it, missing \$1.2 billion?

Mr. CORZINE. I agree.

Mr. GOODLATTE. Have customer funds at MF Global ever been used to fund investments in its house or proprietary accounts?

Mr. CORZINE. To my knowledge, customer funds, segregated funds for futures accounts have been invested in what I would call Rule 1.25 eligible securities or were held in depositories for the client.

Mr. GOODLATTE. And did your firm ever invest the customers' segregated funds in foreign sovereign debt without first the approval of the customer to make such an investment?

Mr. CORZINE. Congressman, any recollection I have, that did not occur.

Mr. GOODLATTE. And when you have these separate segregated funds, I mean the money is not in a vault. You put it someplace. What was the——

Mr. CORZINE. Generally, it is invested in securities that are allowable under the 1.25 rule or it is in depositories.

Mr. GOODLATTE. But there is some question about whether securities under the 1.25 rule could also have included foreign sovereign debt.

Mr. CORZINE. Again, I am—I don't want to claim that I am the world's greatest expert here, but I think that that is only available if you have foreign deposits, foreign denominated currency.

Mr. GOODLATTE. And from what you have learned since you became aware of this in late October, is it your impression that money was taken from those funds to invest in foreign sovereign debt or was it used for other purposes?

Mr. CORZINE. Congressman, I really—I don't want to speculate and I don't have the information that would allow me to do that. As you know, I left on November 3 and I have had no access to books and records. And all I can do is read the same reports that are in the public forum. And I must say that those are confusing to me.

Mr. GOODLATTE. Me, too.  
Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from Pennsylvania for 5 minutes.

Mr. HOLDEN. Thank you, Mr. Chairman.

Senator, I have two questions and one of them you addressed several times already but I want to make sure I understand clearly your answer. Commission Regulation 1.10 requires an FCM to file monthly fiscal reports. Each report must file with an oath or attestation and since an FCM is a corporation, it must be signed by the CEO or the CFO. From your previous answers, I assume the CFO was signing the monthly reports, correct?

Mr. CORZINE. I presume so myself, Congressman, since I am not aware of signing those reports.

Mr. HOLDEN. So in your best recollection he would have been the one signing the October 2011 report?

Mr. CORZINE. To be honest, I have no recollection whatsoever, but I know to the best of my knowledge anyway I don't think I signed those reports.

Mr. HOLDEN. And in your written testimony, you stated that you wanted to voluntarily testify before this Committee in January to give you more time to have access to the records so you could respond to this Committee's inquiry. Since it has been over a month since you stepped down and you have not had access to those records, what made or makes you think you would have access between now and the 1st of the year?

Mr. CORZINE. Well, that is a good—first of all, it is a good question, Congressman. My expectation is that we will, as we get farther down this path, have access. We have requests into the Trustee of the holding company for access to my e-mails, papers, files, things that would potentially shed light and give me the ability to be more precise in my answers.

Mr. HOLDEN. So actions you would take to your counsel to try and gain records is what would make you think you would be more helpful——

Mr. CORZINE. Right.

Mr. HOLDEN.—in the next several weeks?

Mr. CORZINE. Right.

Mr. HOLDEN. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman yields back.

The chair now recognizes the gentleman from Illinois for 5 minutes.

Mr. JOHNSON. Thank you, Mr. Chairman, Members of the Committee.

Senator, Governor, Mr. Corzine, in my comments, sir, both comments and questions and there is some kind of a hybrid so you will have to consider them accordingly, I represent—and I think the

people in this room represent—a large number of ranchers, farmers, small business people whose lives and livelihood have been jeopardized by their investment, which has apparently gone south. My question is do you have an estimate—and I know you can't tell us exactly—as to how much money collectively at this point has been lost by those investors?

Mr. CORZINE. Congressman, that is a question I would like to know the answer to as much as you and I am hopeful that there will be effective recovery and reconciliation of these accounts.

Mr. JOHNSON. I would ask this further. I haven't done a net worth analysis of individuals who have testified before this Committee, but at least according to any accounts, you are a person of substantial wealth and I congratulate you on your acquisitions. My question for you on behalf of these people who are largely small farmers, small businesses, co-ops all over the country, assuming that they are not made whole, are you and other executives of your company willing to stand the loss with your personal fortunes and allow them to be compensated and made whole?

Mr. CORZINE. Congressman——

Mr. JOHNSON. Either yes or no, it is fairly simple.

Mr. CORZINE. Congressman, I don't think that this will go unresolved.

Mr. JOHNSON. Assuming it does go unresolved through the system, and it appears that there is a lot that is falling through the cracks, are you willing to commit that you will commit yours and the other executives' personal fortunes——

Mr. CORZINE. As I am sitting here——

Mr. JOHNSON.—to making these people whole?

Mr. CORZINE.—today I would not do that.

Mr. JOHNSON. My second question is Mr. Gensler has decided, and I think appropriately so, to recuse himself on this issue largely I think because of your relationship and I guess I would say the whole Goldman Sachs fraternity which would encompass a number of individuals, including foreign ministers of several of the countries in Europe to which you invested. I guess my question is if he did that within the last several days and given the fact that you probably occupy in some ways a position kind of semi-analogous to an attorney before a judge where recusal would be appropriate, why didn't this happen a year ago? Given your relationship and the CFTC's oversight relationship with your company, why wasn't recusal something that was pursued a lot earlier in the process?

Mr. CORZINE. Congressman, I think you can expect that I would not really speculate about the internal considerations that Mr. Gensler or the people at the CFTC took. I hope that we demonstrated that in the normal course——

Mr. JOHNSON. I am down to a minute and 45 seconds, so I appreciate your response.

I am quoting from you several days ago when you indicated, “as the chief executive officer of MF Global, I ultimately had overall responsibility for the firm.” Then you go into in the course of a statement or subsequent statements to indicate everybody else in the process other than you who was responsible for this. My concern is that based on a failure to segregate funds and/or a failure to oversee the operation of the company and/or a technical deficiency

in terms of the overall responsibility of governing the firm, something fell short. And at the end of the day, the Members of this Committee and I have people that live in the real world as you do, a lot of people who have suffered dramatically and will suffer since they won't be able to buy seed, they won't be able to buy equipment, they won't be able to invest for the future year, this coming year in what they do. They have suffered dramatically.

And while I certainly commend you in your life history, you have been the leader of a state and represented a state with millions of people, you have been a CEO of major corporations, people have given you a lot of responsibility, fiduciary capacity, and I am concerned, frankly, that those capacities have fallen short and that a lot of individuals all over the country and the people they represent are going to wind up holding the bag because of what is either negligence and/or commingling and/or abnegation of your responsibility as a fiduciary in that capacity.

So I guess I am down to 14 seconds. I appreciate your being here. I also appreciate your not using the veil of the 5th Amendment to refuse to answer questions. I must say there are a lot of unanswered questions that are going to be answered hopefully—and I think you would agree—over the course of the next several months so that my constituents, these individual constituents are made whole and life can go on out in the real world outside the beltway of this process, outside the beltway of Wall Street where people live in an everyday world who have to make a living. And at this point they are hurting real badly.

The CHAIRMAN. The gentleman's time has expired.

Mr. CORZINE. If I may, Mr. Chairman, just respond to say that I share the sentiments that the Congressman expresses with respect to the people who are caught in the crossfire of this.

Mr. JOHNSON. Thank you. And we will be anxious to see the next few months.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from Iowa, Mr. Boswell, for 5 minutes.

Mr. BOSWELL. Well, thank you, Mr. Chairman. And in the interest of time I don't see much point in repeating so many of the things that have been said.

I am just curious as we think about the capital investment that people that I represent have to do to put a crop in and so on—and you know all about that—but what would you say to them? What would you suggest we say to them as they contemplate on how they deal with futures, the market, hedging funds, to use the system? What do we tell them? What lesson have we learned?

Mr. CORZINE. Congressman, first of all, I would convey the kinds of sentiments that I spoke to the previous Congressman about at a personal level. I believe that and have the expectation that given some of the options that I have put into my written testimony and oral testimony and the hard work that regulators and the Trustee know that the missing funds will be found. That, first and foremost, is the obligation. I would expect and legitimately so—and these kinds of hearings help bring out some of the elements of—where exposures exist that should be corrected when they are understood in the light of the facts. And then hopefully that can ad-

dress some of those holes in a way that gives people greater confidence in the markets, going forward. There is no question that futures markets, security markets are essential for the operations of our economy and the global economy at large.

Mr. BOSWELL. Well, with that I am going to yield back, Mr. Chairman, but I would just say to Governor Corzine, I would that as we continue to discuss this, because of your background, that we might call on you to make a suggestion or two beyond what you have already done. Thank you for your time.

I yield back.

The CHAIRMAN. The gentleman yields back the balance of time.

The chair now recognizes the gentleman from Iowa, Mr. King, for 5 minutes.

Mr. KING. Thank you, Mr. Chairman. I appreciate this hearing and, Governor Corzine, I appreciate your testimony as well. I listened to some of the comments here and I didn't think I would probably say it but I did hear from Mr. Johnson from Illinois about personal risk being part of this. And I know this has got to weigh heavily on your conscience. It might be a great loss to others and may not be a significant personal loss to you, but I just ask you do you anticipate a significant personal loss when this has all shaken out in proportion to those who are investors who entrusted you with their money?

Mr. CORZINE. Congressman, first of all, the hope, my own expectation even at these late hours are that the money will be recovered, but no matter the anguish that individuals feel because they are uncertain is very serious. And for that I both apologize and I will certainly do those things that I can to help assess—make that process——

Mr. KING. I am convinced of that, but do you anticipate a proportional personal loss?

Mr. CORZINE. I think I will repeat what I said to Congressman Johnson.

Mr. KING. Then let me just go another way here and looking at some of the reports and I think the agriculture piece of this thing will continue to be thoroughly examined. So I look at the investment in the bonds of Spain, Italy, Portugal, Belgium, and Ireland, that investment that was made and that seemed to have triggered this. And as I look at that list, that is the list of the countries that we have had the greatest concern about except Greece. Was there a rationale for not trading also in speculating in the bonds of Greece as well as the other sovereign nations that I have talked about?

Mr. CORZINE. If one did a detailed credit analysis of the underlying sovereigns, which not only people at MF Global but other financial analysts would have contributed, Greece seemed as a country that could potentially—with a significant probability go through a restructuring process.

Mr. KING. Substantially less solvent than the other countries?

Mr. CORZINE. A substantially higher debt to GDP, much more unreliable statistics on which one could——

Mr. KING. Well, I know that clock is ticking and I talk faster than most of the folks in this capital, but is the investment in the

countries, was it made with the anticipation that Greece would be bailed out?

Mr. CORZINE. The investments in those five countries were made because there was a judgment, as I said it was a judgment challenged by people and——

Mr. KING. And was part of that judgment that Greece was likely to be bailed out by the rest of the——

Mr. CORZINE. No, no. The answer is no to that.

Mr. KING. Okay. Thank you. Then I would just go back to some of the other history that sticks in my mind here. The news reports about the investments by the State of New Jersey into Lehman Brothers shortly before the economic situation we all know so well in the fall of 2008, do you have an estimate or a number on how much money was lost over that investment into Lehman Brothers shortly before the fall if I can refer to that?

Mr. CORZINE. I don't recollect the amount of loss. And as I think——

Mr. KING. Would it be in the area of \$100 million?

Mr. CORZINE. It may very well have been but I would suggest that we had an investment department that was separate from the Governor's department.

Mr. KING. Okay. And then when Governor Christie alleged that there were hundreds of millions of dollars that were transferred in the last hours before he was sworn in as Governor of New Jersey and that you had spoken to him and promised him that he had a \$500 million surplus going in. It turned out to be less than that. I think you said in a news report \$2.2 billion. I think you add the \$500 million to that so that comes to around \$2.7 billion of——

Mr. CORZINE. I think we had——

Mr. KING.—shortfall. I wanted to give you an opportunity publicly to respond to that. I don't know that I have seen a response in the media.

Mr. CORZINE. First of all, I think my former treasurer did respond to those numbers and there is a difference about the timing on when one was making those judgments. And I would have to go back and prepare myself to speak to that.

Mr. KING. Would you state, though, that the current Governor's allegations are substantially correct or incorrect?

Mr. CORZINE. I don't accept the analysis exactly as he has framed it. There was a growing shortfall, as you know, in the winter of 2009 and 2010. The economy was falling dramatically and revenues were falling and estimates with regard to what revenues would be collected were off in most states.

Mr. KING. And perhaps a compulsion to take risk. Thank you very much.

Mr. Chairman, I yield back.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from California, Mr. Cardoza, for 5 minutes.

Mr. CARDOZA. Thank you, Mr. Chairman.

Mr. Corzine, Governor Corzine, my grandmother, an Azorean immigrant to this country in the 1920s, who did not benefit from our fantastic education that both you and I benefitted from used to give me some great advice. She used to admonish me daily when she

was still alive to always do the right thing when nobody was looking. Can you, sir, tell us today that while you have been the head of this organization, MF Global, that you always did the right thing when no one was looking, followed my grandmother's advice?

Mr. CORZINE. In every effort in intent in my actions were to do the right thing.

Mr. CARDOZA. When the wheels started coming off your company, did you set up a war room to try and deal with the financial crisis and figure out what was going on? Or did you bring your folks around you in the corporate room? How did you handle yourself at that point?

Mr. CORZINE. There were constant meetings, including with the board——

Mr. CARDOZA. Right.

Mr. CORZINE.—in the last few days.

Mr. CARDOZA. That is what I suspected. That is why I asked the question. And my next question is was there a point in time where you got the first inkling that there was a substantial amount of money that had disappeared, been stolen, we don't know what happened to it. That is one of the things that happened. At that very second that you got the first inkling that there was substantial loss in your corporation and that you were going to be held liable or your company was going to have to take this tremendous hit, what was the first thing that you thought of and did? Did you call the police? Did you run to the bathroom and throw up? I mean to me you lose a billion or \$2 billion, that is——

Mr. CORZINE. Congressman, in those late hours—and I think I said this earlier to the other question—really was disbelief, stunned disbelief that this could be the case when many hundreds of millions was reported to be missing. And go back——

Mr. CARDOZA. I understand that——

Mr. CORZINE.—and check your work is the first response——

Mr. CARDOZA. I understand but I mean did you call and tell your CFO, expletive, expletive, expletive——

Mr. CORZINE. I was with the CFO.

Mr. CARDOZA. You were? Where is the money? I mean what was the first thing that you did? Do you remember?

Mr. CORZINE. The first thing that followed from this conversation was let us get the people to recheck the figures, make sure that we have done everything we can to appropriately confirm what you are suggesting. It wasn't—it was—it wasn't as if all expectations had been closed. There was still a hunt.

Mr. CARDOZA. I would have probably gone to the restroom and thrown up myself, but that is—thank you for the answer.

A few years ago when I first came to Congress, I introduced an ethics bill that said if you break the public trust as a Member of Congress, as a member of the public society as a police officer, anyplace that you have the public's trust and you commit a crime in that public trust—and this came in response to my dealings with Ken Lay from Enron in California as State Legislator—I said you should do double the penalty. We passed that bill in the House. It didn't get through the Senate. But just looking back on your career in government and in business—because I think this applies to business as well—when you are in a position of public trust, do you

agree with me that we have a higher standard to the public? And if we don't rebuild that public trust in our governmental and business institutions that we are going to have a very difficult time in this country to succeed in the future?

Mr. CORZINE. I do agree with you, Congressman. And as an elected public official, the oath of office that I have taken deeply impacts how I try to address the efforts I fulfilled when I served in those offices. And I believe that to tell the truth as you know it is the responsibility of all of us and certainly one of those issues that I believe the public is concerned that they don't get a fair shake on today.

Mr. CARDOZA. Thank you for your answer and thank you for being here.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from Texas, Mr. Neugebauer, for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Mr. Corzine, I want to go back to some of your earlier testimony because I think the question was asked of you: did you authorize the transfer of funds from the segregated accounts to other places? And the answer that you gave was no, I did not. You said, "I never intended to violate any rules."

Mr. CORZINE. I would repeat that in the context that there were people who handle the transfer of funds and I am not one of those. There are people——

Mr. NEUGEBAUER. That wasn't the question. The question was did you ever in the heat of the moment in those last days when you were trying to sell this company, trying to keep this company afloat to make the transfer, to hopefully kind of pull the rabbit out of the hat, did you ever authorize any of your people——

Mr. CORZINE. I never intended to authorize anyone.

Mr. NEUGEBAUER. So you never intended to but you may have?

Mr. CORZINE. If it did, it was a misunderstanding because there is no intention under any context that I can think of that I was authorizing tapping into segregated funds.

Mr. NEUGEBAUER. So the answer that you gave to this question so I don't want to mischaracterize this is you gave orders and you don't know whether you gave an order——

Mr. CORZINE. No, that is not what—since I don't have access to records or phone records or anything that I could rely upon, I can only say I know I had no intention to ever authorize the transfer of segregated monies.

Mr. NEUGEBAUER. So the answer is is you don't know whether you did or not?

Mr. CORZINE. I certainly couldn't confirm based on what I have in—available to me today, but I know what my intentions are, yes.

Mr. NEUGEBAUER. So earlier in the year you were granted primary dealer status by the Federal Reserve Bank of New York, is that correct?

Mr. CORZINE. Yes, sir.

Mr. NEUGEBAUER. And you were very proud of the fact that you all were able to achieve that and there are some reports—and again as you said there are a lot of reports out there—but on a conference call you were exhorting the fact that you would really be

able to take the company to a new level with this status. What was the strategy that being a primary dealer would give you?

Mr. CORZINE. Congressman, I don't recall framing it the way you would suggest—

Mr. NEUGEBAUER. Well—

Mr. CORZINE.—and matter of fact, it would be in my view inappropriate and probably would have been criticized by the Fed if I had. Now, I often was asked a question on calls what does it mean to have primary dealer status?

Mr. NEUGEBAUER. Yes.

Mr. CORZINE. It does mean that you have access at financing arrangements with some clients that you might not otherwise have. You have the ability to transact business with people around the globe that you would not otherwise be able to transact business with. It does give you the chance when the Federal Reserve is executing its open market operations to do that directly without having an intermediary to do that, which is certainly constructive. And I would—I am not walking away from the fact that it is better to have than not to have in the context of how clients and others would see you.

Mr. NEUGEBAUER. Yes, but there are only I think 20 companies—

Mr. CORZINE. I think there are 21 today, but 20, yes.

Mr. NEUGEBAUER. And so what would be the criteria? I mean that is a fairly—

Mr. CORZINE. I am sorry?

Mr. NEUGEBAUER. That is a fairly prestigious designation. What is the criteria that your company had that would have caused the Fed to give you that status?

Mr. CORZINE. Well, first of all, the Fed tests you for a very long time to see whether you are transacting business and treasury securities, agency securities with estimates. Are you financing customers? Are you doing repurchase agreements, reverse repurchase agreements for clients so they could facilitate access at the market? I am under the impression that they have an under—don't recall the exact number but they have capital requirements. They review your systems and operations with onsite reviews and other things and observe your participation in markets.

Mr. NEUGEBAUER. Do you think it is a little strange that a company that had been consistently losing money, which would indicate to me would be a company that is deteriorating would get such a status to that?

Mr. CORZINE. My own perspective on this is is that we were at the time and it had gone on for a better part of 18 months then demonstrating that we were participating with clients at levels that were significantly higher than some of the other people recognized. We had adequate capital and while—as I indicated in my written testimony—our historical earnings hadn't been so good, they had gotten slightly better.

Mr. NEUGEBAUER. But two of your rating agencies, the SEC and FINRA, had questioned whether you had adequate capital or not.

Mr. CORZINE. Those questions came well after the designation, which I believe was early in 2010; the FINRA challenge was in August of 2010 if I am not mistaken. And that was with regard to

their interpretation of how the capital haircut charges were applied to euro sovereigns.

The CHAIRMAN. The gentleman's time has expired.

The chair now turns to the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. DAVID SCOTT of Georgia. Mr. Corzine, welcome to the Committee. I must say at the outset it is really at the height of disbelief that you as a former Senator, former Governor, you are the former head of probably the premier, most prestigious investment banking operation in the whole world, and to sit there and to say that under your watch as chief executive for \$1.2 billion of customers' money, you know nothing about it. Now, the key to finding out where my constituents' money went—I represent Georgia, a lot of farmers. They are sitting here watching trying to figure am I going to get my money back? The key to this is you. You are the CEO.

Now, Mr. Corzine, who at MF Global was ultimately responsible for determining which products the company invested in on its behalf? Now, I would think that is you as the CEO. Am I right about that?

Mr. CORZINE. Ultimately, the Board of Directors at the recommendation of management, which I was the lead manager of, makes those decisions. It delegated authority and then the company operates within those authorities.

Mr. DAVID SCOTT of Georgia. Tell me this, what did you do at this company? Was it run by the board? Who made these decisions? Who made the decision to go in——

Mr. CORZINE. Ultimate decisions are always at a board in a public company on the recommendation—and I take full responsibility for the recommendations that went before that board, not tried to say otherwise. And so those investment decisions are ones that—particularly as it relates to the European sovereign RTM positions—rest in my judgment.

Mr. DAVID SCOTT of Georgia. Rests in your area. Now, explain to me when you came in you made that decision, and when you came in you had been in the company a relatively short time. And when you came in, your holdings in foreign sovereign debt was about \$1.5 billion. In 11 months—that was as of October of last year, and now October of this year, that holding has ballooned up to \$6.3 billion in foreign sovereign debt at a time when each of these foreign companies that you get into debt from are teetering on disaster. Was that your decision?

Mr. CORZINE. I take responsibility for that decision.

Mr. DAVID SCOTT of Georgia. Now, let me ask——

Mr. CORZINE. In my oral statement, Congressman, though, I would—I tried to give—I mean not—in my written statement some perspective on why I thought it was at the time that we took those decisions somewhat different than how one might assess it in the current environment.

Mr. DAVID SCOTT of Georgia. Now, Mr. Corzine, did you commingle customer funds with your proprietary funds?

Mr. CORZINE. The——

Mr. DAVID SCOTT of Georgia. Yes or no.

Mr. CORZINE. I am going to answer this question the same way—there was never any directed intent to commingle those funds.

Mr. DAVID SCOTT of Georgia. So in other words you could have? Throughout this hearing I can count the times you used the words “never intent,” “not to my knowledge,” “not to my recollection,” “never intended to,” and I understand the position that you are in. But Mr. Corzine, we have to find that money. We have to get that \$1.2 billion and get it back out to our customers and to my clients and my farmers in Georgia. And as I said before, we have to get better answers than this from you because you are the CEO.

Well, let me ask you this, Mr. Corzine. Did you use client funds to pay for or to pay off MF Global’s debts and bolster the \$6.3 billion purchase of sovereign European debt that led to your bankruptcy?

Mr. CORZINE. I am going to repeat what I said before. I have no recollection whatsoever of client monies being used—client monies out of the FCM being used to purchase euro sovereigns. Again, the euro sovereign positions were held in the broker-dealer.

Mr. DAVID SCOTT of Georgia. Did you ever use your customer funds to buy foreign sovereign debt?

Mr. CORZINE. Client dollars that were in the FCM to my knowledge were not financed out of the FCM.

Mr. DAVID SCOTT of Georgia. Then why did you lobby the CFTC against proposed changes to the CFTC regulations that would have prevented futures commission merchants from investing customer funds in obligations of foreign governments? If you never did that, had no intention to do that, why did you lobby when they wanted to put tighter controls on that?

Mr. CORZINE. The meeting that you are referencing I presume is the July 20 meeting with Mr. Gensler, which actually is a conference call was about the percentages that—concentration percentages which actually I was more in support of the CFTC’s recommendations, thought they should be modified a bit, but I was more in support of, and as it related to the internal repurchase agreements that CFTC just ruled on this last Monday.

Mr. DAVID SCOTT of Georgia. And if you weren’t the one responsible or had a role in playing about the misappropriation and the loss of this \$1.2 billion, somebody is. Who would that be?

The CHAIRMAN. The gentleman’s time has expired. The witness may answer.

Mr. CORZINE. As I have said repeatedly, we had people, policies, and procedures, and as I have said in my testimony, I don’t know whether this is inadvertent. I don’t know whether in the flows of transactions that were occurring—and there were more flows of transactions than typically occur at MF Global in the last chaotic days. So whether someone held onto some of the funds that were rightfully to have been delivered to MF Global, I—without being able to look in detail into those records, those are our options. And I don’t have the ability other than to speculate where they would be.

The CHAIRMAN. The gentleman’s time has expired.

Mr. DAVID SCOTT of Georgia. Thank you, sir.

The CHAIRMAN. The chair now recognizes the gentleman from Texas, Mr. Conaway, for 5 minutes.

Mr. CONAWAY. Governor, thank you for being here.

You have testified that you weren't an expert in all aspects of any business and no one really is but help us understand your appreciation for the duty that FCMs have to maintain segregated accounts. Now, was that something that you were aware of——

Mr. CORZINE. Yes, sir.

Mr. CONAWAY. Was there somebody in your organization that when the report was prepared the next morning after yesterday's close of business and that was out of whack, their job was to come hunt you down and show that to you?

Mr. CORZINE. The——

Mr. CONAWAY. I mean did the issue of segregated funds rise to that level in your mind.

Mr. CORZINE. If the—if there were an outage——

Mr. CONAWAY. Right.

Mr. CORZINE.—it would be brought up in exception——

Mr. CONAWAY. Right. And——

Mr. CORZINE.—not on the——

Mr. CONAWAY.—would that have been something that you would have been made aware of or is that somebody else in your organization?

Mr. CORZINE. If there had been an unreconciled——

Mr. CONAWAY. Right.

Mr. CORZINE.—circumstance, I believe it would have been——

Mr. CONAWAY. Brought to your attention?

Mr. CORZINE.—raised to my attention.

Mr. CONAWAY. All right. I am just trying to get a sense of how important MF Global's team felt segregated accounts were. We obviously think they are very important. That is the one area of this aspect that we are supposed to be paying attention to.

In terms of tone from the top, many organizations take on the attitude of their leadership with respect to compliance, with respect to regulations and those kinds of things. *The Wall Street Journal* reported that you actually placed orders yourself on sovereign debt which is a whole different conversation, but in the placing of those orders, did you go through all the normal routine that anybody who has authority to place orders on behalf of MF Global would have gone through or did you——

Mr. CORZINE. Congressman, I in fact didn't place orders although I worked with traders who would——

Mr. CONAWAY. Right.

Mr. CORZINE.—place orders.

Mr. CONAWAY. And——

Mr. CORZINE. And I went through normal routines and we had special compliance oversight of my activities.

Mr. CONAWAY. Okay. Well, that is helpful.

One of the other aspects of leading a broker-dealer at a company in the financial services business that you are in obviously is a liquidity risk.

Mr. CORZINE. Absolutely.

Mr. CONAWAY. You are not telling us that just showed up in October——

Mr. CORZINE. No.

Mr. CONAWAY.—on your radar screen. You also had some sense that the second quarter results were not going to be as favorable as you wanted to see them.

Mr. CORZINE. We were very well aware——

Mr. CONAWAY. Well——

Mr. CORZINE.—that either at the end of that second quarter or a third quarter, fiscal quarter, that the deferred tax asset——

Mr. CONAWAY. Right.

Mr. CORZINE.—was going to have to be reduced.

Mr. CONAWAY. Okay. So you are aware that during the July–August–September time frame that you were going to get \$120 million hit just from the deferred tax asset. And we don't have to worry about what that is. But the bankruptcy filing said it was really a contraction of your proprietary trading helped drive much of the loss in that second quarter. But given that you knew about the deferred tax and potentially—I don't want to get off on that rabbit trail.

You knew that MF Global faced a liquidity risk. When did you begin to put in place the steps necessary to protect MF Global from a liquidity risk? And then into October when the wreck started happening and the fur started flying, margin calls started happening and your customers started wanting their money back, your lieutenants are coming to you saying this is what we got to do. Did you ask them where did we get the money to meet those calls? Where do we get those from? In other words, we are short \$1.2 billion. Where were your lieutenants telling you here is how we solve the problem with respect to this run on the bank? What were they telling you? Where were you getting the money?

Mr. CORZINE. We had done stress tests about securities we would be able to sell in the broker-dealer for purposes of generating free-up of margin, repurchase agreements that we would be able to close. That would accomplish that. But more than anything else we had undrawn credit lines that were held in reserve for crunch time——

Mr. CONAWAY. Why didn't that system work?

Mr. CORZINE. The real answer is I don't know all of the details of what—I really don't, Congressman. There are many things that were presumed to have been able to generate liquidity. For instance, did all the banks actually——

Mr. CONAWAY. Right.

Mr. CORZINE.—live up to their delivery of the cash that was supposed to be available——

Mr. CONAWAY. Line of credit.

Mr. CORZINE.—by the line.

Mr. CONAWAY. Yes. Let me finish off. Back on the culture issue, when things got crazy on Wednesday, Thursday, and Friday, you had people in place who knew the difference between segregated funds and proprietary funds. They knew ahead of time what was right and what was wrong and character is tested in those crucibles. Is there anything that you think you could have ever done that would have said to them that that is okay, that in these extreme circumstances, the disaster we are in, it is going to be okay to breach those—the folks that actually do it, they can't hide be-

hind not knowing the difference. So the team you put in place——

Mr. CORZINE. I don't think anyone would interpret anything—I don't think. You know, not on the other side of the phone, but there was never any intent——

Mr. CONAWAY. Well, that is——

Mr. CORZINE.—in either my language or actions——

Mr. CONAWAY. I understand the reasons why you keep using the word “intent.” And I am not trying to pin you down. We are not the prosecution in this instance. But the team failed. We have had testimony that the Lehman Brothers had a catastrophic failure and their FCM business moved the next day without a penny. I have to believe that the chaos surrounding the bankruptcy of Lehman was not dissimilar to the one that happened at MF Global. Why was the team at MF Global unable to do the right thing in the heat of the moment?

The CHAIRMAN. The gentleman's time has expired. The witness may respond to the question.

Mr. CORZINE. First of all, there is a proportionality difference. The FCM is significantly larger——

Mr. CONAWAY. Okay. I see.

Mr. CORZINE.—and global. Our FCM was a much bigger part of our business than theirs. That doesn't answer your question because I don't know the answer to that and I would be speculating if I did.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from Connecticut for 5 minutes.

Mr. COURTNEY. Thank you, Mr. Chairman.

Mr. Corzine, in your testimony you mentioned and you mentioned earlier the phone conference with CFTC regarding the 1.25 rule, the Dodd-Frank rulemaking. And in your testimony you said that the principle topic of discussion was whether 1.25 should be changed to prevent FCMs from engaging in repurchased transactions with related brokers and dealers. Earlier today, we spent a lot of time with Commissioner Sommers about the rule that was adopted on Monday regarding foreign sovereign debt, and she was repeatedly pointing out to us that that rule wouldn't have changed anything because it only applied to customer accounts. The problem was more in the broker-dealer accounts based on what they knew at this point.

So I guess the question I would like to ask in looking again at MF Global's letter to the Commission regarding the rulemaking when it was a comment that they submitted was the rule that was adopted on Monday regarding in-house repurchase agreements—I mean what impact could that have had in terms of the events that you described in your testimony regarding repurchase?

Mr. CORZINE. First of all, the rule that was adopted on Monday—and I am not quite as well versed as I would be if I were still in the business—did not deal with foreign sovereigns other than that they were precluded without application for exception.

Mr. COURTNEY. Right.

Mr. CORZINE. But they were never available for any purposes as far as I know as well as I can recollect the rules except for deposits

that were taken from customers in foreign currency denominated deposits.

Mr. COURTNEY. Okay.

Mr. CORZINE. This was not the issue that not only MF Global but the FIA, the CMA, many—most of the FCMs if not all the FCMs were petitioning because of the cost and inefficiency that would occur if that—those internal repos were not allowed to be able to take place.

Mr. COURTNEY. Well, Chairman Gensler certainly in his comments on Monday felt that they had taken a great step forward in terms of trying to reduce the risk that is surrounding these repurchase agreements. I mean are you just saying it is irrelevant? It is a dead letter?

Mr. CORZINE. Clearly, the issues of having an FCM and a broker-dealer in the same entity certainly in a time of stress as MF Global was experiencing in the last days, I think does call—or raises the issue that I think Chairman Gensler was trying to speak to in an ongoing operating basis. I probably stand with the arguments I made, but at a time of stress, his arguments may be much stronger.

Mr. COURTNEY. Well, I am glad to hear you say that because, having been here in 2008 and when the world was collapsing and frankly the process of enacting Dodd-Frank was like crawling over broken glass, in terms of just doing something so complex. I think it was our duty to try and address the fact that there clearly were systemic problems that exposed the taxpayer and the middle-class to the damage that could happen when these systems malfunctioned.

And again the efforts by the Commission have just gotten trashed in this room frankly for the last year in terms of trying to implement Dodd-Frank. You know, I just think it is time for us to recognize that everybody can't have it the way they would always want it. There have to be some rules in place to limit the high risk that, again, exposes farmers and small businesses and people who are just trying to lead their lives and have some confidence in these markets.

And you know what happened in this incident is that there are going to be lots of—I am sure investigations that are going to look for, along with the bankruptcy court and maybe other authorities, but we as lawmakers. I mean our job here is to try and figure out the right way to balance rules that will prevent these things from recurring again. And frankly I am just, in retrospect I just wish the Commission had moved faster in terms of implementing these rules because I just think it would have created a structure which reduces risk which, at the end of the day, is what we have to do if we are going to have any stability in this economy.

I yield back.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from Nebraska for 5 minutes.

Mr. FORTENBERRY. Thank you, Mr. Chairman.

Thank you, Governor, for your willingness to come today and answer questions.

Governor, I was recently at an Eagle Scout ceremony and one of the young people there stood up and he said this: he said America depends upon the quality of her citizens. And I was struck with the beauty, the simplicity, and the profundity of that statement. The problem here is we can't pass enough laws fast enough, create enough regulatory entities quick enough if there is a collapse of the types of values that lead to responsibility and commitment to the common good. We simply can't do it. Therefore, it is incumbent upon those of us in government, business, the media, education, the other institutions that shape our culture and give us good order, fairness, justice, opportunity, it is incumbent upon all of us to act in the public's trust. And in this regard I am going to ask you a few questions. Who owned MF Global? I asked the question of the regulator prior to this. They couldn't give me an answer. I would like to know.

Mr. CORZINE. MF Global is a public company. Shareholders broadly held the stock. There is actually a report I can give you exactly who those people are or institutions that were the owners.

Mr. FORTENBERRY. Who were those institutions if you could identify them?

Mr. CORZINE. Well, there is a whole range of large institutions.

Mr. FORTENBERRY. But I would like to understand the interconnections here of the financial industrial complex.

Mr. CORZINE. Well, fidelities, mutual fund complex, there are a number of other institutional holders like that. There are hedge fund holders. There are individual holders. I am a holder. There are private equity holder J.C. Flowers, which I mentioned inside my remarks.

Mr. FORTENBERRY. Who hires you?

Mr. CORZINE. The board of MF Global.

Mr. FORTENBERRY. Who?

Mr. CORZINE. The board of MF Global is the hiring—responsible hiring authority. If you are asking who introduced me to——

Mr. FORTENBERRY. It would helpful to know the story.

Mr. CORZINE. Some of this is in the written statement but I had as a private investor a holding in the private equity firm J.C. Flowers. The CEO of MF Global in March of 2010 abruptly resigned. They were about to instigate a search for a CEO at the board level and I presume it was suggested from the board member from J.C. Flowers that sat on that board that they ought to talk to me.

Mr. FORTENBERRY. We talked a little bit about this in your testimony but just basically describe your job.

Mr. CORZINE. As the CEO of MF Global? First of all, set strategy. I think I spoke to—about—in my written testimony that needed to be defined not just with myself but with our board, needed to represent the firm externally with clients, counterparties, regulators, and given the business strategy that we were about, I needed to make sure that we had personnel——

Mr. FORTENBERRY. And in that regard who did you hire?

Mr. CORZINE. A whole host of folks. There was significant change——

Mr. FORTENBERRY. Main principles?

Mr. CORZINE. Well, we hired a new chief operating officer, new internal audit, new chief risk officer, new heads of Europe, new head of Asia, lots of——

Mr. FORTENBERRY. Sorry, my time is running a little short. You have said that it was never your intention to commingle segregated funds. How could you, in a scenario in which you could unintentionally do that?

Mr. CORZINE. Well, that would be speculative on my part. Someone could misinterpret we have to fix this, which I said the evening of October 30. We have to find the money.

Mr. FORTENBERRY. Mr. Chairman, my time is——

The CHAIRMAN. Would the gentleman yield for one question on his line of——

Mr. FORTENBERRY. From the Governor or from you?

The CHAIRMAN. Just yield to me——

Mr. FORTENBERRY. Yes, I—if I could conclude——

The CHAIRMAN. Mr. Corzine—and then we will conclude of course with you—what percentage of the equity or ownership in MF Global did you own for curiosity's sake? Not a very large amount I would assume?

Mr. CORZINE. No. No.

The CHAIRMAN. Less than ten percent, less than five percent, less than one percent?

Mr. CORZINE. It was I think closer to the latter than any of the other numbers you mentioned.

The CHAIRMAN. So a single digit or in that range somewhere? Is that the typical nature for senior management of these kind of firms, these very small equity stakeholders in the inner——

Mr. CORZINE. It is not only the amount that I had bought but it was also how my compensation was structured, which I also went through.

The CHAIRMAN. Stock options?

Mr. CORZINE. Stock options.

The CHAIRMAN. So typically in a company like this or one that you would be a part of, over time your interest in the company would grow through the use of stock options, a reward for——

Mr. CORZINE. Right.

The CHAIRMAN.—good management.

Mr. CORZINE. Correct, Mr. Chairman.

The CHAIRMAN. So just from the perspective of asking questions about the nature of your business, then, a person in a role like that in a company just to the layman's perspective it would appear that the more aggressive the enterprise, the better those kind of rewards would be. Now, certainly most of the investors are very sophisticated people, correct? They understand the nature of the kind of enterprise that you have been a part of——

Mr. CORZINE. Most of these investors are strategic investors.

The CHAIRMAN. In Oklahoma we would call that a high-powered gun. I yield back to the gentleman from Nebraska.

Mr. FORTENBERRY. Mr. Chairman, I will just conclude by saying this: I think what we have here is another example of inordinate risk-taking, leveraging other people's money. We have the possibility of an improper commingling of funds, but the third point is

I think we have another assault on the nation's trust of a financial institution. I will yield back.

The CHAIRMAN. The gentleman yields back.

The chair now recognizes the gentlelady from Alabama for 5 minutes.

Ms. SEWELL. Thank you, Mr. Chairman.

I want to begin with a brief statement or a comment before I start my questioning.

You know, this hearing is important today not only because we are trying to get to the bottom of how thousands of farmers and growers and producers currently have lost their capital and are struggling to figure out how they are going to make ends meet, but we are also here because this has vastly affected hundreds of Americans who have lost their jobs directly and indirectly because of the loss. And in these trying and challenging economic times, it is even more important I believe that we who have the public trust really do become good stewards or try to be good stewards of the money and that trust. And so my hope today is that we not only get to the bottom of what happened to MF Global but how this affects more broadly the financial industry generally, and in particular, how it affects our farmers and growers.

Having said that, I spent my formative professional career as a securities lawyer in New York City, and I can tell you that what differentiated me as a lawyer and the investment bankers that I represent is our appetite for risk. And so I guess I ask you, Senator Corzine, as the CEO and Chairman of MF Global, the direction and the appetite for risk in steering this company, could you speak a little bit about how MF Global was positioned prior to you getting there and what your hopes were when you assumed the responsibility of CEO, and how you would rate the risk appetite of the company and perhaps yourself?

Mr. CORZINE. Thank you, Congressman—Congresswoman, it is—it primarily was a broker firm, commissions and earnings on the balances as the basic source of revenue, although there were some principle risk-taking. They had already begun to apply for that primary dealership, so they were taking broker-dealer risks and the government securities business did the same and European sovereigns in our European operations before I came. And one of the commonly used metrics with respect to risk is what we call value at risk and that was roughly \$5 million before I came with an authorization or a delegation of authority at \$15 million. And we were pretty much at that level while I was at the firm. There certainly were periods where it was higher and there were periods when it was lower both on reporting and internal basis.

Ms. SEWELL. But the use of the repo to maturity transactions used to mask—for lack of a better word—any shortfalls? I mean like what was the direction that was given by yourself as management with respect to those kinds of transactions?

Mr. CORZINE. The repo to maturity positions look like things that we had done on repo to maturity with U.S. treasuries, with U.S. agencies, with corporate—actually at larger amounts than what we were talking about with the euro sovereigns.

Ms. SEWELL. But we also knew that the euro sovereigns were becoming quickly insolvent. I mean the world events were sur-

rounding a lot of the eurozone countries. It was obviously quite known to most of us, very different——

Mr. CORZINE. There is clearly a difference although they were still highly rated by agencies and, as I said in some of the earlier remarks, my other metrics that one would judge based on margins that were required by clearing organizations or individuals, it was our judgment that they were—particularly the ones that we were involved in were less risky than would otherwise be the case. The point being——

Ms. SEWELL. My time is actually kind of running out and really my last question is what do you think would be a fair outcome given the state of affairs currently? If you could wave a magic wand and figure out how we solve this crisis that we are currently facing with MF Global? What do you think would be a fair settlement?

Mr. CORZINE. I am absolutely hopeful that a full understanding of what happened in those last few days will review the source of where these monies are. I continue to believe that those resources are in the hands of either counterparties or there has been some mistaken forwarding of those to some place that I wouldn't know. That is what I tried to write in my remarks.

Ms. SEWELL. Well, hope does spring eternal.

And I yield back the rest of my time.

The CHAIRMAN. The gentlelady's time is expired.

The chair will now recognize Mrs. Schmidt for 5 minutes and Mr. Scott should stand ready.

Mrs. SCHMIDT. Thank you.

Mr. Corzine, I know that you said that you weren't quite sure about when the money was wire transferred, but Mr. Corzine, MF Global's 10-K for the year ending March 31, 2011, shows a net position in the price risk and default risk at \$6.3 billion of the debt in Belgium, Italy, Spain, Portugal, and Ireland, but Bloomberg reported that you pushed this foreign sovereign debt to \$11.5 billion and your hedges were insufficient to dampen your risk. Based on this, some observers have pointed out that MF Global would have had cash problems on several trading days throughout 2011. Surely you were aware of the problem so I ask you, were you, and about the wire calls?

Mr. CORZINE. Congresswoman, first of all, the \$11.5 is a gross of both short and longs, reverse RTMs to maturity as well as RTMs to maturity. And therefore, if I am reading their reporting, and I don't know where they got their facts, but it is a combination of the longs and shorts. I don't think that therefore the conclusion is exactly how you would see it because the short——

Mrs. SCHMIDT. At some point you had to know that there wasn't enough money.

Mr. CORZINE. The only time that we could conclude there wasn't enough money was when the unreconciled accounts——

Mrs. SCHMIDT. Well——

Mr. CORZINE.—were notified.

Mrs. SCHMIDT. Okay. Were repo to maturity transactions used to hide or mask the risks associated with your positions in Europe's sovereign debt? It has been reported that the use of these transactions increased over your time as CEO, so did you personally di-

rect the firm to use these transactions as a means to hide the risks?

Mr. CORZINE. Congresswoman, the disclosure that you have cited was in our reports to the public and our public disclosure documents along with its implications for gains and losses. And those disclosure documents were reviewed by our outside auditors, they were reviewed by counsel, they were reviewed by our audit committee, and discussions of those elements were a part of public discussions with analysts and others.

Mrs. SCHMIDT. Well, it has been reported by *The Wall Street Journal* that, despite warnings from board members and from your own employees, you pushed forward with aggressive and highly leveraged positions on foreign debt, foreign sovereign debt. Mr. Corzine, we have all been watching the eurozone crisis unfold and there has been significant uncertainty about its resolution so why were you so confident about these bets, and to what degree were you willing to bet the very survival of the firm, its employees, and most importantly, the shareholders?

Mr. CORZINE. The investments that we had in the euro sovereigns were bought and financed to their maturity. And those positions were very difficult to be able to be unwound and once they were in position, they had significantly less liquidity than a security held that was not financed to its maturity, on the other hand, significantly less risky because financing was in place. Having financing in place diminished the overall risk of holding a particular security.

Mrs. SCHMIDT. Well, that all sounds good but how did you take a company that was in existence for almost 230 years to bankruptcy within a year and a half of takeover? How do you explain to all the customers, investors the reason for the collapse of MF Global? I mean your answers sound so nice but you riskily invested people's money without their knowledge in a market that I wouldn't invest in.

Mr. CORZINE. Congresswoman, sitting here today with knowledge that the market has drawn the conclusion that it has drawn and the facts are what they are, it would have been better to have taken different judgments at the time they were taken. But, we and I did those things that we thought were in the best interest of shareholders and all of the stakeholders given the inability of the old business plans that the firm was executing on to generate the kinds of revenues that would protect customers as well.

The CHAIRMAN. The gentlelady's time has expired.

The chair now recognizes the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. AUSTIN SCOTT of Georgia. Thank you, Mr. Chairman.

Mr. Corzine, I want to thank you for coming before the Committee. I don't think many people would have joined us for as long as you have and been willing to answer the questions. Thank you for being here.

You have repeatedly said that client funds were not used to purchase foreign sovereigns. Were those client funds ever pledged as collateral on the purchase of foreign sovereigns at MF Global, though?

Mr. CORZINE. To my knowledge—and again this is one of those things that you have to get into the records to be absolutely precise on—I am not aware of that.

Mr. AUSTIN SCOTT of Georgia. Okay. And it is apparently from all the reports that there was commingling of funds. Just approximately when do you believe the commingling first occurred?

Mr. CORZINE. Given all of the transactions that were occurring in those closing days, Congressman, I don't want to speculate. I just—I know that several of senior management were informed at roughly the same time on Sunday night of many hundreds of millions of dollars being unreconciled in the accounts.

Mr. AUSTIN SCOTT of Georgia. Do you believe that that commingling started to occur in the last 10 days before the bankruptcy?

Mr. CORZINE. I am under the impression—and again I don't have records——

Mr. AUSTIN SCOTT of Georgia. Yes, sir.

Mr. CORZINE.—to confirm and so it is farther than I should go but I am—we have to—MF Global had to submit reports——

Mr. AUSTIN SCOTT of Georgia. Yes, sir.

Mr. CORZINE.—each day and it is, as I had suggested to one of the previous questioners, if we had been out of balance, it is my presumption that it would have been reported upward.

Mr. AUSTIN SCOTT of Georgia. Yes, sir. But those reports, they are not audited by anybody as I understand it. They are self-reported.

Mr. CORZINE. They are self-reported. I think if I am not mistaken a number of the regulators were on premise from the 26th on. That doesn't mean that they audited——

Mr. AUSTIN SCOTT of Georgia. Yes, sir.

Mr. CORZINE.—all aspects but were very close——

Mr. AUSTIN SCOTT of Georgia. Yes, sir, but at that stage, at the point that the regulators came in, it was pretty much too late at that stage, wasn't it?

Mr. CORZINE. Congressman, it certainly was not my operating premise that it was too late at those stages. We were generating liquidity——

Mr. AUSTIN SCOTT of Georgia. Right.

Mr. CORZINE. We were drawing our liquidity facilities and to the best of my recollection, meeting our obligations.

Mr. AUSTIN SCOTT of Georgia. If I am not mistaken, you were still rated as investment grade less than 10 days prior to the filing by Moody's and Fitch both. I may not be correct about that.

Mr. CORZINE. That is true, sir.

Mr. AUSTIN SCOTT of Georgia. You can correct me if—sir?

Mr. CORZINE. That is true.

Mr. AUSTIN SCOTT of Georgia. Well——

Mr. CORZINE. I think the first rating change occurred on Monday, October 24.

Mr. AUSTIN SCOTT of Georgia. Yes, sir, and then——

Mr. CORZINE. Moody's.

Mr. AUSTIN SCOTT of Georgia. And then they happened very fast thereafter.

Mr. CORZINE. There was another set of rating changes——

Mr. AUSTIN SCOTT of Georgia. Two days.

Mr. CORZINE.—Thursday if I am not mistaken.

Mr. AUSTIN SCOTT of Georgia. Okay.

Mr. CORZINE. The 27th.

Mr. AUSTIN SCOTT of Georgia. Well, you have been a Governor, a Senator, had a very successful life, accomplished a lot of things. I sense the pain that you recognize. This is one of the things that your life will be judged by.

What can we make good out of this? What can you tell us? Sitting where you are, what rules and regulations would you put in place if you were sitting up here to prevent an MF Global from ever happening again?

Mr. CORZINE. Congressman, I have given it some thought, not great thought. It is clear that in moments of stress, organizations do not always operate in the same way that they would in a normal operating environment. And I certainly would look for triggers that would enhance the oversight of organizations in those conditions.

Mr. AUSTIN SCOTT of Georgia. Thank you for joining us.

Mr. Chairman, I yield back.

The CHAIRMAN. The gentleman yields back his time.

The chair now recognizes the gentleman from Colorado, Mr. Tipton, for 5 minutes.

Mr. TIPTON. Thank you, Mr. Chairman. And thank you, Mr. Corzine, for joining us.

I would like to follow up on a comment that Congressman Scott just made. The 10 days prior to the debacle, Moody's and Fitch had MF Global rated as investment grade. Was that a good decision 10 days prior?

Mr. CORZINE. The rating agencies——

Mr. TIPTON. From your knowledge of the company, was that a good assessment by Moody's and Fitch that you were investment grade?

Mr. CORZINE. Certainly, the facts afterwards don't make that look effective as an assessment, but at the time that they had last reviewed and were intending to review around our quarterly earnings announcement, at least several of them had put new assessment directions into the works.

Mr. TIPTON. There was an assessment so it was probably a poor one.

I wanted to follow up on a comment that you made earlier in questioning saying on October 30—and it was in regards to the commingling of assets—you had thrown out the statement that “we have to find the money.” Was that your statement? Was that the corporate mentality?

Mr. CORZINE. It was all of us.

Mr. TIPTON. It was all of you?

Mr. CORZINE. Everyone felt an obligation to get the books reconciled.

Mr. TIPTON. Wherever it was, had to be able to find that.

I just want to get a sense truly I guess of the corporate mentality. When you went on to head up Global, did you read through the mission statement and believe in it? I can give you a couple of quotes from it: “MF Global is well capitalized and diversified intermediary and a strong conservative managed balance sheet. Because of our financial strength and comprehensive risk management, cli-

ents can have confidence that they are trading with strong counterparty.” Was that your sense? Did you believe in that?

Mr. CORZINE. I believe that those statements were right at the time and that we needed to enhance it with a growth strategy that would provide for the success of the firm as opposed to what had been in recent years——

Mr. TIPTON. As a business guy, and I am a small businessman—was a small businessman until I took this job, you had to look at it—not trying to mix metaphors here—you had to look at your business globally knowing that the impact of one section of the business could impact another section of the business as well. When you made that determination given the comments that we were just talking about in terms of the Fitch Moody’s rating of Global 10 days prior as being investment grade, looking out over the horizon into the eurozone for those investments, given the foreknowledge that in this country with \$15 trillion in debt, we had had our credit rating downgraded, did that tie back into the corporate mantra and the beliefs that you were just saying was the original intent? Or was it a risky investment that was going to ruin the entire operation——

Mr. CORZINE. As I have tried to state probably more articulately than I will do here that with the analysis and the perspectives on how those particular sovereigns were looked at, we thought they were prudent investments.

Mr. TIPTON. Was that your personal investment? Would you have been willing to personally risk your funds?

Mr. CORZINE. I absolutely was willing to invest and was investing in MF Global up until August.

Mr. TIPTON. And I am not trying to put you on the spot and I know this is going to be maybe a little offensive from this standpoint but where you were stock-motivated, did that help drive some of that decision based off of the performance of the stock to try and get this kind of return?

Mr. CORZINE. The performance is not based—is one element but also protecting the value of the stock is another responsibility. And as a shareholder, I would expect decisions to reflect those concerns as well. It is not only performance.

Mr. TIPTON. Okay. And I certainly agree with Congressman Scott. I can sense from you some agony personally over this, but believe me, talking to many of our folks in rural America, \$10,000, \$20,000, \$30,000, that is not a nice evening out. That is all they have. And when we look at it globally, I think we all have to be very distressed in terms of some of that collateral damage, particularly now when we can’t find \$1.2 billion of struggling people’s dollars to be able to meet their needs.

So I am out of time, Mr. Chairman. I yield back. Thank you, sir.

The CHAIRMAN. The gentleman’s time has expired.

The chair now recognizes the gentleman from Arkansas, Mr. Crawford, for 5 minutes.

Mr. CRAWFORD. Thank you, Mr. Chairman.

Mr. Corzine, are you licensed to trade securities?

Mr. CORZINE. Yes.

Mr. CRAWFORD. What licenses do you hold?

Mr. CORZINE. I would have to go back. I have all of the——

Mr. CRAWFORD. Series 3, Series 7, Series 6, and some others or—I figured that was the case.

Do you trade on your own account?

Mr. CORZINE. Not regularly.

Mr. CRAWFORD. Have you ever traded on your own account using customer funds?

Mr. CORZINE. On my own account using customer funds? No.

Mr. CRAWFORD. Okay. Is——

Mr. CORZINE. To my knowledge, I haven't.

Mr. CRAWFORD. Okay.

Mr. CORZINE. I don't trade for my personal account.

Mr. CRAWFORD. Has any employee to your knowledge of MF Global ever used client funds to trade on proprietary——

Mr. CORZINE. I am going to repeat what I had said——

Mr. CRAWFORD. Right. Okay.

Mr. CORZINE.—to the other folks.

Mr. CRAWFORD. Got that. If you did have knowledge of an employee trading on customer account, what would the penalty be for that employee?

Mr. CORZINE. I certainly—as far as I could ever imagine they would probably be terminated.

Mr. CRAWFORD. Okay. Have you ever dismissed an employee at MF Global for any kind of malfeasance that would be of that nature?

Mr. CORZINE. I think there is a fairly notorious trading situation that occurred in 2008 before I joined the firm, and there were other disciplinary actions that have been taken through the years.

Mr. CRAWFORD. But under your direction——

Mr. CORZINE. There were some, yes.

Mr. CRAWFORD. Okay. Can you describe some of that malfeasance that required there to be disciplinary action or possibly termination?

Mr. CORZINE. I really would like to have specifics about that so that I don't get into talking about an individual and I don't have my facts straight.

Mr. CRAWFORD. Okay. Okay. I just read an article that *Reuters* put out about a farmer who had \$200,000 in an account with MF Global that hasn't been returned to him yet. It has been almost a month since MF Global filed for bankruptcy. There is no telling when he will get his money back. He has missed a deadline for buying his seed to pre-purchase discount for next spring's corn and soybean crops; the financial future of his operation is certainly in peril. Most of the farmers in my district—and I think this is true with farmers throughout the country are really one crop failure away from bankruptcy. The action that we have seen here with MF Global puts them that much closer to bankruptcy themselves. As the former head of a now bankrupt company that this man trusted—in fact, trusted to the degree that he would rather have his money in one of those segregated accounts than he would in a bank, what would you say to that farmer who now is facing bankruptcy of his own or to any farmer who may be in a similar situation?

Mr. CORZINE. Congressman, as I said multiple times, I think about this every day. I could not be more regretful of the stress

that we are bringing to people's lives and I could not be more anxious to see resolution of where those unreconciled accounts——

Mr. CRAWFORD. Let me ask you this. I mean you have an impressive background with respect to financial services, banking industry, and so on. And I am going to ask you to speculate. I am going to ask you to think what you would do in this situation. In all seriousness, I would like to know what we tell farmers that are facing this. If you were in the situation where you had potentially \$200,000 or more, as Congressman Tipton said—\$20,000 or \$30,000, \$40,000, what would you do if you were that farmer? As I understand it, you also have a little history in farming?

Mr. CORZINE. My father was one of those folks that went to the grain elevator and hedged out future crops.

Mr. CRAWFORD. And I am really not trying to—I know you have expressed remorse here and I appreciate that, but I am in all seriousness trying to figure out how do you advise these farmers who are in this situation?

Mr. CORZINE. Congressman, I am not sure I have specific advice. I only can say that this process of seeking to find these funds is one that absolutely needs every resource possible to make sure that it is accomplished. I think I have to leave it there.

Mr. CRAWFORD. Sure. Last question. Do you have a compliance officer at MF Global?

Mr. CORZINE. Absolutely.

Mr. CRAWFORD. Sure. And at what point did he bring this to your attention? How often did he review the activity?

Mr. CORZINE. There are a broad set of compliance issues and internal audits and as I suggested Sarbanes-Oxley internal audits that confirm that kinds of operations are operating the way they are supposed to. And so those are ongoing; they are daily.

Mr. CRAWFORD. Okay. Thank you, sir. I appreciate it. I yield back.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentleman from Kansas for 5 minutes.

Mr. HUELSKAMP. Thank you, Mr. Chairman.

And Senator, I will follow up on the question of the gentleman from Arkansas. You did mention your concern about that. If you were so concerned about making certain that your investors were whole, how come you quit 4 days after bankruptcy was declared?

Mr. CORZINE. In a response to a board request is why I resigned.

Mr. HUELSKAMP. Okay. And during those 4 intervening days, what did you do to attempt to make the investors whole?

Mr. CORZINE. I resigned on November 3. That is correct. It is 2 days and I spent Tuesday at least in the early morning hours trying to find out some of the same questions that people are asking here with no particular positive results on that.

Mr. HUELSKAMP. So nobody seemed to know where the funds were and no one would tell you?

Mr. CORZINE. There were——

Mr. HUELSKAMP. Did you ask the question where those funds were and what was the answer?

Mr. CORZINE. People were still looking. Lots of transactions were in train that——

Mr. HUELSKAMP. I appreciate that. I am short of time and I appreciate it. I think it would be the same answer as we received before. I want to establish a little bit of timeline. I am trying to understand. On the 1 year anniversary of Dodd-Frank on July 20, you conducted numerous meetings with members of the CFTC——

Mr. CORZINE. I had two conference calls with the CFTC on those days.

Mr. HUELSKAMP. I have you down—according to the records at the CFTC you had a meeting with a former employee at 1:00 p.m. on the phone with Mr. Gensler, at 2:15 you had a meeting with Ms. Sommers on the phone, and at 3:30 with a third Commissioner, Mr. Chilton. Can you describe the topics of those calls?

Mr. CORZINE. To my recollection I was on the phone call—conference call with Chairman Gensler at one and Commissioner Chilton at the time that you brought forward. And again, as we have suggested in both written and my response to questions, primary subject of that conversation were repos between the broker-dealer and the FCM.

Mr. HUELSKAMP. Three separate meetings according to the CFTC with three separate Commissioners that you participated in. Did you have any separate calls or conversations with Mr. Gensler when you took the job at MF Global to the present time other than what you have——

Mr. CORZINE. That has been my recollection. You have my calls, my meetings outlined.

Mr. HUELSKAMP. Okay. You never once called his cell phone?

Mr. CORZINE. No.

Mr. HUELSKAMP. Okay. Did you ever call another member of the Administration during this time about any of these issues?

Mr. CORZINE. I am sorry, Congressman. I couldn't hear you.

Mr. HUELSKAMP. Did you ever call a member of the Administration? I mean you are very close to the current Administration. As a very generous campaign bundler, did you ever visit with anybody in the Administration about your business at MF Global?

Mr. CORZINE. To my knowledge, I have never spoken about the business of MF Global to anyone in the Administration.

Mr. HUELSKAMP. Did you visit with anybody at the Federal Reserve?

Mr. CORZINE. I have visited with people at the Federal Reserve as I reported with respect to the primary dealer as I testified to, a primary dealer relationship always with staff and staff and never with either the President or Chairman or any of the Board of Governors.

Mr. HUELSKAMP. On December 21 of the last year you had a meeting with the CFTC Commissioner again about segregation and bankruptcy. Do you recall the topic of those particular discussions which seem very appropriate given our conversation——

Mr. CORZINE. If I am not mistaken, Commissioner Sommers spoke about that meeting this morning and it had to do with issues on the treatment of swaps consistent with how futures were traded, and how Dodd-Frank would deal with those issues in coming CFTC discussions.

Mr. HUELSKAMP. So no——

Mr. CORZINE. Frankly, I don't remember even the specifics, a relatively short meeting.

Mr. HUELSKAMP. Well, we are lucky that at least the CFTC had a record there was a meeting. As we learned earlier, though, apparently they don't keep notes. Does your private secretary keep notes of these meetings that might be helpful to understand at the Committee?

Mr. CORZINE. To my knowledge, they did not.

Mr. HUELSKAMP. Thank you, Mr. Chairman.

And Senator, I appreciate your time and I appreciate the questions but again I would like to ask the question directly for myself. What do I tell my producers that—should I suggest that you were contrite, you felt sorrow, but you are not going to try to make them whole and that just good luck, we hope you find your \$200,000? Is that a pretty good summary?

Mr. CORZINE. Congressman, I hope you believe that I am as intent in answering the question of where this money is as anyone in the room.

The CHAIRMAN. The gentleman's time has expired.

Mr. HUELSKAMP. Thank you, Mr. Chairman.

The CHAIRMAN. The chair now looks to the gentleman from Wisconsin, Mr. Ribble, for 5 minutes.

Mr. RIBBLE. I will move over here. It has been a long afternoon.

How many Federal regulatory agencies have some type of oversight responsibilities for the type of business you are in?

Mr. CORZINE. I haven't counted them up but it is multiple—CFTC, SEC. There are all kinds of agencies that deal with labor and other activities; the Federal Reserve has oversight not regulatory responsibility. As we have become a primary dealer, there are more and then there are whole host of self-regulatory organizations the number of which you will speak with in the next panel.

Mr. RIBBLE. How often did you have an opportunity to visit with the regulators? How often were they there? You were there about 18 months. Was this a regular occurrence? Did the Federal Government have a lot of responsibility in oversight?

Mr. CORZINE. A number of them would visit the firm more broadly than just with me. Sometimes people more senior would come and visit in offices. We tried to outline some of those. There was one meeting which I cited where all of the regulators or at least most of the regulators in the U.S. visited us in June of 2010 where I addressed them for 10 minutes. And the rest of my colleagues, at least on the operations and controls side and finance side spoke more lengthily. I would point out that these aren't the only regulators. Then you have international regulators in multiple venues across the globe that also have responsibility in oversight that participate.

Mr. RIBBLE. Well, then, do you think adding more regulations and more regulators—let me change that. Do you think we can regulate greed, incompetence, and fraud out of existence?

Mr. CORZINE. Could you repeat that question?

Mr. RIBBLE. Can we regulate——

Mr. CORZINE. The incompetence——

Mr. RIBBLE. Can we regulate greed, incompetence, and fraud out of existence? Because at the end of the day, sir, we have to make

a decision of how, going forward, we can help protect consumers and investors from having another MF Global happen. And my fear is that we will do what government always does—make up more rules and send more regulators and a year from now we will have another example. And I am wondering what the real solution is. I am trying to figure out was there greed, incompetence, and fraud at MF Global that no matter what we do on this side of the dais, it still would happen.

Mr. CORZINE. Whether it is for those reasons or poor judgment or bad judgment or—mistakes will continue to happen in the course of human events and that is inevitable. As it relates to regulation, that is one that historically has been more supportive rather than against. There is an enormous need from my view and probably doesn't amount for much at the moment, but my view to have it consolidated so that it is more—it is less complex to manage.

Mr. RIBBLE. It is difficult to manage a company your size.

Mr. CORZINE. With the multiple regulators that exist and then we live in a global world that increases the complexity. The segregation rules in London are different than the segregation rules in U.S. futures markets. The futures markets are different than securities markets and so the answer is yes. A more integrated approach, at least from one man's point of view, would make this world easier.

Mr. RIBBLE. I am trying to get a sense from what my takeaway needs to be today and so I thank you. It has been a long afternoon so I thank you for your time.

And I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired.

The chair now recognizes the gentlelady from North Carolina for her 5 minutes.

Mrs. ELLMERS. Thank you, Mr. Chairman.

Governor Corzine, I have a couple questions for you for clarification. The question was posed to you why did you resign on November 3 and you indicated that it was at the request of a board member or was this a——

Mr. CORZINE. The leading—the lead director.

Mrs. ELLMERS. The lead director. And that person's name?

Mr. CORZINE. Ed Goldberg.

Mrs. ELLMERS. Ed Goldberg. Thank you.

Now, I know we have talked about where we feel and where the responsibility lies and you have identified that it could be procedural, the money is gone. Who do you hold responsible and accountable for this money being gone?

Mr. CORZINE. As the CEO of an organization, I hold responsibility that the implementation of policies, procedures and the people we had in place to execute on these issues lies—the buck stops here on that score. The details of how that gets executed are an organizational issue that is broad-faced. We had people certainly were prepared and were—at least from all reports to me as best I can recollect—executing appropriately on those rules. Again, at the chaotic final days and hours, I think you have a different set of conditions in place.

Mrs. ELLMERS. I would like to go back, too, to the relationship that you have with Chairman Gensler. I know that he apparently

worked for you while you were at Goldman Sachs and he also worked at Goldman Sachs, is that correct?

Mr. CORZINE. That is correct.

Mrs. ELLMERS. And I believe that means that there have been a couple of years that you have had a relationship—a couple of years of a relationship since that time.

Mr. CORZINE. We had—Chairman Gensler and I had other interactions. He was on Senator Sarbanes' staff when I was a Senator. I was aware of and in contact with him on an occasional basis but not on a frequent basis in any stretch of the imagination.

Mrs. ELLMERS. Would you describe your relationship as friendly? Would you pick up the phone and call him and just say, hey, how are you doing?

Mr. CORZINE. We were not the kind of folks that were checking in on each other week to week, month to month, maybe not even year to year. I think one of the newspapers reported he neither attended my recent wedding or I attended a tragic loss in his family.

Mrs. ELLMERS. Thank you.

And my last comment I would like to associate myself with one of the comments that were made very recently when you said, "in retrospect, decisions that are made in crisis are usually not very good decisions." And that that may have had a part in this. And I would just like to state that I do believe that as well and that is one of the reasons that I believe Dodd-Frank is detrimental to the financial industry in this country.

Thank you very much, Mr. Chairman. I yield back.

The CHAIRMAN. The gentlelady yields back her time.

The chair now recognizes the last Member for questions for 5 minutes, the gentleman from North Carolina, Mr. McIntyre.

Mr. MCINTYRE. Thank you, Mr. Chairman. And thank you for your patience today with the questions.

According to Janet Tavakoli, in substance, your repo to maturity transactions were total return swaps which were off balance sheet and a type of credit derivative. MF Global retained the price and default risk. The head of the FCC is now probing the accounting treatment and the disclosure. The Financial Accounting Standards Board recently decided that repo to maturity is the only kind of repo transaction to get off balance sheet treatment. And Janet Tavakoli says that this is a form-over-substance ruse to dodge using the term "total return swap" since these transactions are well known as a means of using leverage. Would you say that her characterization is accurate and why or why not?

Mr. CORZINE. Congressman, there is a lot in that statement.

Mr. MCINTYRE. Right. That is why I wanted to give you a chance to respond.

Mr. CORZINE. My view is that a better analogy would be match-book transactions where repurchase agreements against reverse repurchase agreements were put on the books of a broker-dealer or an institution as opposed to total return swap. You mentioned that you retain the price movement. You only retain the price exposure to the extent that it implicates margin—variation margin in the exchange.

The total return swap—and again I am—don't want to be expert and I am certainly not expert with regard to the accounting issues

on this—would reflect the price appreciation or depreciation in these RTM positions, both the ones that were held with respect to government—U.S. Government securities, agencies incorporates or whether it was in these euro sovereigns had no price risk other than as it implicated margins. And you did, however—as the analyst or the consultant said—retain the default risk, the default and actually restructuring risk.

But I think—I don't think it is a clear analogy and at some conditions some people would say total return swaps are a way to take price risk off the balance sheet. This is not a way to do that. This is a way to take matchbook risk, substantially less off balance sheet but it is not an analogy that I would identify with.

Mr. MCINTYRE. All right. Thank you.

And thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired. The chair would now like to recognize the Ranking Member for a unanimous consent request.

Mr. PETERSON. Mr. Chairman, I have some quick questions that were submitted to me by Ms. Kaptur, who spent a good part of the hearing today—she is interested and has some questions for Mr. Corzine. So without objection, I would like those questions be submitted and have him respond in writing.

The CHAIRMAN. Seeing no objections, the questions will be accepted and submitted.

Seeing no other questions or requests, Mr. Corzine, thank you for your appearance today. You are now dismissed.

Mr. CORZINE. Thank you, sir. I thank the Committee.

The CHAIRMAN. And while the next panel is preparing to come to the table, I would like to note that our witnesses on the third panel will be Mr. John Fletcher, General Manager of Central Missouri AGRIService LLC, on behalf of the National Grain and Feed Association, Marshall, Missouri; Terrence Duffy, Executive Chairman of the CME Group, Incorporated, Chicago, Illinois; Mr. William J. Brodsky, Chairman and CEO, the Chicago Board Options Exchange, Chicago, Illinois; Mr. Dan Roth, President and CEO, National Futures Association, Chicago, Illinois; Mr. Stephen Luparello, Vice Chairman, the Financial Industry Regulatory Authority, Washington, D.C.; Mr. Gerry Corcoran, Chairman and CEO of R.J. O'Brien & Associates, on behalf of the Commodity Markets Council, Chicago, Illinois.

Now, gentleman that you are in place, in the spirit of the importance and the relevance of this Committee, I would ask you to rise and raise your right hand. Please state your name for the record.

Mr. FLETCHER. John Fletcher.

Mr. DUFFY. Terrence Duffy.

Mr. ROTH. Dan Roth.

Mr. CORCORAN. Gerry Corcoran.

Mr. LUPARELLO. Stephen Luparello.

Mr. BRODSKY. William Brodsky.

The CHAIRMAN. Do you solemnly swear that the testimony you are about to give before this Committee in the matters under consideration on this day, December 8, 2011, is the truth, the whole truth, and nothing but the truth so help you God?

Mr. FLETCHER. I do.

Mr. DUFFY. I do.  
Mr. ROTH. I do.  
Mr. CORCORAN. I do.  
Mr. LUPARELLO. I do.  
Mr. BRODSKY. I do.  
The CHAIRMAN. I do.  
Mr. Fletcher, begin whenever you are ready.

**TESTIMONY OF JOHN FLETCHER, GENERAL MANAGER,  
CENTRAL MISSOURI AGRISERVICE LLC, Marshall, MO; ON  
BEHALF OF NATIONAL GRAIN AND FEED ASSOCIATION**

Mr. FLETCHER. Good evening, Mr. Chairman, Ranking Member Peterson and Members of the Committee that are still here. My name is John Fletcher. I am General Manager of Central Missouri AGRIService LLC in Marshall, Missouri. Our firm purchases 15 million bushels of corn and soybeans annually from about 150 producers in our trade territory. We work closely with producers on marketing and risk management strategies and we thank you for the opportunity today to give National Grain and Feed Association's perspective on the MF Global bankruptcy and its ripple effects across agribusiness and production agriculture.

After listening to the questions of previous panelists, we realize that most of you have a good grasp of where things are today, so I will keep my remarks quite short.

MF Global Holdings bankruptcy has been a shock to our industry and to my firm. We have believed for decades that risk to segregated customer funds was virtually zero and now we have learned the hard way that this is not the case. Our number one goal at this point is the return of funds and property to the customers as quickly as possible. It is important to realize that everyone—it is important for everyone to realize that assets held by a brokerage firm in segregated accounts like warehouse receipts, treasury bills, shipping certificates for cash are not really debts of the brokerage firm. They are assets owned by the depositor and held in trust by the firm. And by law these funds should be segregated and not used for other purposes.

It is difficult to—this is no different than if a failed bank held a deed of trust on a piece of property. The failure of the bank doesn't make the property evidenced by the deed of trust an asset of the failed bank. Title documents like warehouse receipts are property of the specific customers and should be returned without requiring surcharges for customers to buy back their own property. At the end of this, customers must be made whole and any outcome—any other outcome will result in a damaging loss of confidence in our risk management system.

Looking ahead, it is very important to re-establish confidence in futures markets and the safety of customers' funds and property being held by these brokers. We need to know just what happened at MF Global and whether changes need to be made so that producers, agribusinesses, and the lenders who support the entire risk management process are confident that funds used will be available back to the customer.

Serious questions need to be answered by regulators and self-regulatory organizations that they oversee. Changes may be needed to

restore confidence in the use of exchange-traded risk management tools. MF Global's failure has left customers unsure of whether segregated funds will ever be safe. It may be that some other entity other than the FCMs should be responsible for holding and safeguarding segregated funds. Should some form of insurance coverage be provided to—on commodities as well as securities? Are additional changes needed in the ways segregated customer funds are allowed to be invested? Should exchanges bear some responsibility for customer funds lost in the case of bankruptcy or malfeasance by a clearing member?

Just to be clear, we are not proposing legislation or new regulatory authority at this point, but these issues need to be examined carefully and quickly. Ultimately, our goals are twofold—to ensure that assets of MF Global customers are returned quickly and to make sure this situation does not happen again. We must be confident that the system works and it properly safeguards customer funds and that customers have full confidence in the exchange-traded tools.

Again, National Grain and Feed appreciates the opportunity to share its views today. We—this concludes my remarks and I am glad to take questions.

[The prepared testimony of Mr. Fletcher follows:]

PREPARED TESTIMONY OF JOHN FLETCHER, GENERAL MANAGER, CENTRAL MISSOURI AGRISERVICE LLC, MARSHALL, MO; ON BEHALF OF NATIONAL GRAIN AND FEED ASSOCIATION

Good morning, Chairman Lucas, Ranking Member Peterson, and Members of the Committee. My name is John Fletcher. I am General Manager of Central Missouri AGRISERVICE LLC in Marshall, Missouri. Our firm purchases about 15 million bushels of corn and soybeans annually from 100–150 producers in our trade territory, with whom we work closely on marketing and risk management strategies. We also provide a range of feed, fertilizer, seed and crop protection products and services to our farmer-customers. Thank you for the opportunity today to provide the NGFA's perspective on the MF Global bankruptcy and its ripple effects across agribusiness and production agriculture.

My firm is a member of the National Grain and Feed Association (NGFA), the national nonprofit trade association representing agribusinesses that include grain elevators, feed manufacturers, oilseed processors, flour mills, biofuels producers and related businesses. We estimate that the 1,050 NGFA-member firms nationwide operate more than 7,000 facilities and purchase, store, process and export well in excess of 70% of U.S. annual grains and oilseeds production. Many of our member firms are country elevators that work very closely with their farmer-customers to merchandise their crops and manage their risk.

The MF Global Holdings bankruptcy has been a shock to our industry and to our firm. We have believed for decades that risk to segregated customer funds held by members of the clearinghouse was virtually zero. Now, we know that was not the case.

Immediately following the October 31 bankruptcy filing, MF Global customers struggled with lack of access to futures positions, no access to funds in their accounts, having accounts transferred to new futures commission merchants (FCMs), and understanding how and why various adjustments to account balances took place. In those early days, there was a dearth of information to help customers manage their financial exposure and resume normal risk management activities.

Today, former MF Global customers continue to deal with the aftermath of the situation. Customers now have access to hedge accounts, but only about sixty percent of initial margin funds needed for the transferred positions have been transferred to the new accounts. We welcomed the SIPA Trustee's proposal last week for an additional distribution of funds and property that would bring the value of customer distributions to about  $\frac{2}{3}$  of original account values for all customers. However, many firms still will have significant amounts of margin funds and excess cash tied up with the Trustee—or missing. Even at a relatively small firm like Central

Missouri AGRIService, we are trying to manage a \$600,000 deficit in the value of our account. We are fortunate to have close relationships with our lenders, who have responded with strong support of their ag sector customers.

We were pleased to see that the Trustee recently announced a claims process for former commodities customers of MF Global. However, that process looks to be complicated and cumbersome. Even the seemingly simple task of informing the Trustee of the amount a commodities customer is claiming is not straightforward. Should a customer use his account equity on October 31 when the bankruptcy was filed to establish a claim? Or should that customer use the account equity at the close of business 4 days later when the bulk account transfer took place? The difference can be hundreds of thousands of dollars. We need clarification from the Trustee and the exchanges on proper reporting of such claims.

Ultimately, the number one goal of the NGFA is to advocate the return of funds and property to customers as quickly as possible. By law, these customer funds were to be segregated and not used for other purposes. Title documents like warehouse receipts are property of specific customers and should be returned without requiring a surcharge for customers to buy back their own property. At the end of this process, customers must be made whole—any other outcome will result in a damaging loss of confidence in our risk management system. We urge this Committee, regulators and exchanges, and the Trustee to make return of customer funds and property the highest priority.

Make no mistake—the U.S. risk management system for agribusiness and producers has been one of the industry's strengths and competitive advantages over the last century. The ability to hedge risk on an exchange has allowed thousands of businesses like mine to offer producers a wide range of cash forward contracts that help optimize income from markets. Many individual producers also hedge their risk through use of futures and options on a regulated exchange. To this point, we have done so with confidence. We knew we could lose money on a trade, but we also thought we knew that our funds were safe with a member of the clearinghouse.

Looking ahead, it will be very important to re-establish confidence in futures markets and the safety of segregated customer funds and property. As part of that process, we need to know just what happened at MF Global and whether changes need to be made so that producers and agribusiness—as well as their lenders who support the entire risk management process—are confident that their funds are being protected and always will be available.

We suggest that serious questions need to be answered by regulators and the self-regulatory organizations they oversee. What customer protections currently are in place to safeguard segregated customer funds? Were audit procedures properly implemented in a timely way? How often were accounts audited, and who was responsible for enforcing compliance? Questions like these need to be examined to determine exactly what happened and how customer funds apparently were misappropriated.

Very importantly, changes may be needed to begin restoring confidence in future use of exchange-traded risk management tools. Weaknesses in customer protections brought to light by MF Global's failure have left customers unsure of whether segregated funds will continue to be fully available. It may be that some entity other than FCMs should be responsible for holding and safeguarding segregated customer funds. Rather than a clearing firm, should the clearinghouse or the exchange itself or some independent third party perform that role? Should SIPC insurance be expanded to provide coverage for commodities as well as securities? Or is there some private-sector solution that would better provide insurance against any future losses? Are changes needed in the ways segregated customer funds are allowed to be invested? Should exchanges bear some responsibility for customer funds lost in the case of bankruptcy and/or malfeasance by a clearing member?

We make no judgments or recommendations on these questions today—and to be clear, we are not proposing that legislation or additional regulatory authority are needed—but the issues need to be examined carefully and quickly.

Ultimately, our goals are twofold: to pursue all possible actions that will ensure that assets of MF Global customers will be returned quickly, and to make sure this situation never happens again. The U.S. agricultural sector relies heavily on regulated exchanges for risk management. The ability of both commercial and producer hedgers to use futures markets to manage price risk depends on lenders agreeing to meet margin calls, which demands full confidence by all lenders in the safety of those funds. We must be confident the system works, that it properly safeguards customer funds, and that customers can have full confidence in continuing to utilize exchange-traded tools.

Again, the NGFA appreciates the opportunity to share its views today. That concludes my prepared remarks, Mr. Chairman. I would be happy to respond to any questions.

The CHAIRMAN. Thank you.  
Mr. Duffy?

**TESTIMONY OF HON. TERENCE A. DUFFY, EXECUTIVE  
CHAIRMAN, CME GROUP INC., CHICAGO, IL**

Mr. DUFFY. Chairman Lucas, Members of the Committee, I am Terry Duffy, Executive Chairman of the CME Group.

Mr. Corzine's firm, MF Global, has put market users in a tragic position. Let me start by saying 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 onsite at MF Global along with the CFTC in the days immediately preceding this bankruptcy. My written testimony expands on this introductory statement and includes substantial background material.

About the middle of the week of October 24, MF Global had announced poor earnings and was downgraded by several credit 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 27, two of our auditors went to MF Global's Chicago office to review MF Global's daily segregation report for the close of business on Wednesday, October 26. 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 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. MF Global's segregation report for Thursday, October 27, 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 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 28, which showed more than a \$900 million shortfall in required segregation. The CFTC and the CME staff and auditors returned to the firm on Sunday, October 30, and were informed by MF Global employees that this discrepancy was caused by "an accounting error." Our auditors working with the CFTC devoted the rest of the day and night on Sunday to find this so-called "accounting error." No such error was ever found. Instead, at about 2:00 a.m. Monday morning, October 31, MF Global informed both the CFTC and CME at approximately the same time that the shortfall was real and that customer segregated funds had been transferred out of segregation to the firm's broker-dealer accounts.

However, on Monday, October 31, the day the SIPC Trustee took over, MF Global revised its segregation report for Thursday, October 27, indicating that the alleged \$200 million in excess segregated funds should have been reported as a deficiency of \$200

million. This shortfall in segregation on Thursday, October 27, 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 very serious violations of our rules and that of the 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 amounts of customer segregated funds on behalf of MF Global's customers. I also want to be clear about the purpose of the CME's Guaranty Fund. The Guaranty Fund does not belong to CME. It is the property of the member firms and exist to prevent the systemic risk that might arise when a clearing firm defaults to the clearinghouse. The Guaranty Fund ensures that the clearinghouse can satisfy its obligations to its counterparties. It may not be used to cover losses suffered by customers of a failed clearing member firm.

Given that, all CME Group's efforts have been directed towards speeding customer access to their trading accounts, transferring their positions, and providing the Trustee with the \$550 million guarantee from CME Group to encourage him to quickly release customer funds that were securely held at CME Clearing.

I also want to make mention there is not another clearinghouse or exchange in the United States or abroad that put up any such guarantee that CME did. The federally mandated Customer Segregation Program has been in place since 1936. In that time, prior to the MF Global failure, no customer has ever lost their segregated funds because of the failure of a clearing member of the CME.

Moving forward, we intend to work with Congress, regulators, and industry leaders to strengthen customer safeguards at the firm level.

I thank you very much and I look forward to answering your questions.

[The prepared testimony of Mr. Duffy follows:]

PREPARED TESTIMONY OF HON. TERENCE A. DUFFY, EXECUTIVE CHAIRMAN, CME GROUP INC., CHICAGO, IL

Chairman Lucas, Ranking Member Peterson, Members of the Committee, 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 con-

tracts, as well as for over-the-counter (“OTC”) derivatives transactions through CME Clearing and CME ClearPort®.

### **Introduction**

As the Committee 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.<sup>1</sup>

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 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 Committee 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 through 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. Addi-

<sup>1</sup>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.

tionally, 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")<sup>2</sup> 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,

<sup>2</sup>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.

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 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 a.m. Monday morning, MFG informed the CFTC and CME that customer money had been transferred out of segregation to firm accounts. 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  $\frac{2}{3}$  of the value of frozen customer segregated accounts, up to an additional \$2.1 billion, in roughly 2 to 4 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+ 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.

The CHAIRMAN. Thank you, Mr. Duffy.  
Mr. Brodsky, whenever you are ready.

#### **TESTIMONY OF WILLIAM J. BRODSKY, J.D., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CBOE HOLDINGS, INC. AND CHICAGO BOARD OPTIONS EXCHANGE, INC., CHICAGO, IL**

Mr. BRODSKY. Mr. Chairman, Mr. Peterson, and Chairman Lucas and Members of the Committee, I am William Brodsky. I am Chairman and CEO of the Chicago Board Options Exchange, and I would hope that my written statement will be entered into the record.

CBOE Holdings owns and/or operates four exchanges—three securities exchanges and one futures exchange. Our regulatory division provides comprehensive regulatory services to each of these exchanges to a broad array of market surveillance mechanisms by conducting examinations of member firms and by conducting examinations of exchange members.

As the Securities Exchange Commission has designated us as the designated examining authority for MF Global, CBOE continues to work closely with the SEC with FINRA and other regulators to critically evaluate the events leading up to and following the bankruptcy of MF Global. We take our self-regulatory responsibility

very seriously and we have the deepest sympathy for the customers of MF Global whose funds are currently frozen or may be missing as a result of the bankruptcy.

As background, let me make note that MF Global was both a securities broker-dealer under the jurisdiction of the SEC and the futures commission merchant under the CFTC as you have heard earlier today. On the securities side, MF Global is also a FINRA member and therefore subject to FINRA's rules and oversight. On the futures side, as you know, CME Group serves as the designated self-regulatory organization of FINRA.

Although some of MF Global's activities were on the securities side, the largest share by far took place on the futures side both by number of accounts and by value of customer assets of MF Global and many times more than that of the securities side.

There are not only different regulators but different rules for trading securities and futures. CBOE's oversight role as DEA pertains to the securities trading at MF Global, and I will briefly discuss the Federal regulatory scheme that exists. And I think for the purpose of time I will leave that out because it is in my written statement.

The customers of a failed brokerage firm on the securities side get back all their stocks and bonds, all the securities in the account registered—that are in their name or in the process of being registered. Once this step is taken, the firm's remaining customer assets are then divided on a *pro rata* basis with funds shared in proportion to the size of their claims. If sufficient funds are not available in the firm's customer accounts to satisfy the claims, then the reserve funds of SIPC are used to supplement the distribution up to the ceiling of \$500,000 per customer, which includes cash of up to \$250,000 a customer. Additional funds may be available to satisfy the remainder of customer claims.

On November 30, 2011, the SIPC Trustee appointed for the estate of MF Global filed a Motion to Transfer the majority of the remaining 330 securities accounts to another broker-dealer. Under the terms of the proposed purchase agreement with that broker-dealer and approved by the Bankruptcy Court, approximately 85 percent of the customers assigned to MF Global's customer account will be fully reimbursed for the amount in equity claims. The remaining customers with net equity claims of about \$1.5 million will receive recoveries ranging between 60 and over 90 percent, depending on the size of their claim. Additionally, these customers not receiving full refund may be able to recover the full amount of their remaining claim depending on the outcome of the litigation.

This process applies to securities accounts. Commodity futures contracts are among the investments that are ineligible for SIPC protections unless they are in a portfolio margin account defined as customer property under the Acts.

Now, turning to the events leading up to MF Global's bankruptcy as understood at this point in the ongoing investigation, on or about May 31 we became aware of the exposure of MF Global to the European sovereign debt when reviewing the company's audited financial statements. In the footnotes of the financial statements, there was a discussion of the accounting treatment of the repo agreements and reverse repo agreements when the maturity

date of the underlying collateral is the same as the maturity date of the agreements. A couple of weeks later, on June 14, the SEC conducted a Rule 17h risk assessment program with MF Global. As is ordinary practice, CBOE and FINRA participated in this conference call and throughout July and August 2011 there were a number of conversations, including two or more with these parties including MF Global, SEC, FINRA, and CBOE regarding MF sovereign debt exposure and discussions about how that risk of exposure should be accounted for by the firm in calculating its required net capital.

Although there may have been some room for debate about whether these agreements were properly left of the balance sheet, CBOE, FINRA, and the SEC agreed that it was appropriate to apply net capital charges to these positions considering the significant market and credit risk. MF Global subsequently held further conversations with the SEC staff arguing that it should not have to take a capital charge for the sovereign debt, but by the second half of August, FINRA, CBOE, and the SEC ultimately affirmed that a net capital charge was appropriate.

Because the securities regulators determined that it was necessary and appropriate for MF Global to apply this net capital charge retroactively, MF Global determined that it was a net capital deficiency as of the end of July 2011. However, the firm was able to continue to operate at this point because it had taken a number of preemptive steps to increase its capital in anticipation of the regulators affirmation that the net capital charge would have prevailed.

While the securities regulators continued to discuss the sovereign debt exposure with MF Global, CBOE separately initiated its own investigation of MF Global on August 22, 2011. And as is common practice, CBOE's examination focused on the most recent complete month, which was July 2011. Beginning in August of 2011, CBOE's staff requested and received a variety of financial data from MF Global and these various computations were received daily at least through the end of October 2011.

In addition, our staff reviewed a variety of financial statements from the firm throughout this time determining the financial health of the firm. It is important to note that up until the end of the period, the financial information that we received from MF Global on a daily basis never showed a deficit of any kind. On September 18, CBOE formally requested documents pertaining to the financial investigation of the European debt portfolio.

Although MF Global routinely showed significant excess capital, the firm was placed under a higher level of surveillance by CBOE beginning back in December of 2010 and for every month thereafter primarily as a result of repeated monthly and quarterly losses. CBOE shared these closer-than-normal surveillance reports with SIPC and the SEC and the Options Clearing Corporation and the National Securities Clearing Corporation. CBOE's staff has been onsite at the firm every day for the past couple of months. We have spent significant time piecing together all the money wires and transfers that occurred during the week of October 24 to October 31, including the funding of daily settlement needs and the funding of customer withdrawals, bank reconciliations, and the

manner in which margin calls on European sovereign debt was met.

We shared all of this information with the SEC, the CFTC, and SIPC. CBOE, along with other regulators, continues to piece together the wires that were creating the shortfall in the segregated futures accounts in order to obtain a comprehensive understanding of the events that led to MF's bankruptcy. We and other regulators continue to consult with each other and share information as we learn it. CBOE continues to work with the SEC's Chicago office and in turn communicates daily with the SEC's headquarters.

In conclusion, CBOE and other regulators are still gathering and examining information needed to make a full assessment of the matter and to define and address the lessons learned from the MF Global bankruptcy. In addition to a comprehensive investigation, we believe that the issues surrounding the MF Global also provide the impetus for regulators to consider whether their rules and policies that should be adopted or amended to add to a greater level of protection of customer assets in broker-dealers and FCMs during bankruptcy scenarios. Any such rules or policies should necessarily also focus on ensuring that customer assets can be transferred as quickly as possible in those types of events.

We intend to take this opportunity to determine whether there any other improvements that should be made in terms of cooperation and communications among regulators when faced with a financially troubled firm subject to the oversight of multiple entities. We hope that the foregoing narrative is helpful to the Committee's understanding of the events leading up to and surrounding the bankruptcy. We are committed to assisting the Committee and its staff in its continued inquiry.

[The prepared testimony of Mr. Brodsky follows:]

PREPARED TESTIMONY OF WILLIAM J. BRODSKY, J.D., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CBOE HOLDINGS, INC. AND CHICAGO BOARD OPTIONS EXCHANGE, INC., CHICAGO, IL

Mr. Chairman and Members of the Committee, I am William J. Brodsky, Chairman and Chief Executive Officer of the CBOE Holdings, Inc. and its principal subsidiary, the Chicago Board Options Exchange, Incorporated (CBOE). For the past 37 years, I have served in leadership roles at major U.S. stock, futures and options exchanges, including 14 years in my current role as CBOE Chairman and CEO and 11 years as CEO of the Chicago Mercantile Exchange. I also recently completed a 2 year term as Chairman of the World Federation of Exchanges whose membership includes over fifty of the largest stock, options and futures exchanges in the world.

In addition to operating CBOE, which is the leading securities options exchange in the United States, CBOE Holdings also operates C2, which is a fully electronic options exchange, runs the CBOE Stock Exchange as a facility of CBOE, and owns and operates CBOE Futures Exchange. CBOE's Regulatory Division provides comprehensive regulatory services to each of these exchanges by conducting a broad array of market surveillances on those markets, by conducting various examinations of members of those exchanges, and by conducting investigations of the members of those exchanges based on the results of its surveillances, its examinations, or based upon complaints. In addition, all of the nine U.S. options exchanges, including CBOE and C2, are participants of a national market system plan, *i.e.*, the Options Regulatory Surveillance Authority (ORSA). ORSA was formed so that the U.S. options exchanges could jointly fulfill their statutory obligation to surveil for instances of insider trading involving listed options. The participants of ORSA have selected CBOE to be the exclusive regulatory services provider to look for insider trading in listed options on behalf of all of them.

Now, turning to the specific matter that is the subject of these hearings, we would first like to state that we have the deepest sympathy and concern for those cus-

tomers of MF Global, Inc. (MFGI)<sup>1</sup> whose funds are currently frozen or may be lost or missing as a result of the recent MF Global bankruptcy. We take our self-regulatory responsibilities very seriously and, as one of the regulators responsible for overseeing MFGI, we have devoted many resources over the last few months to working with the Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and other regulators to carefully evaluate the events leading up to and following the filing for bankruptcy by MF Global. We will attempt to describe in greater detail below the steps the CBOE has undertaken to date. In addition, we would like to assure the Committee that we will continue to make available all staff resources necessary to assist in an expeditious and thorough investigation of all matters related to the events at MF Global with the hopes that a resolution can be found to return as many customer funds as quickly as possible.

Although some of MFGI's activities that are the subject matter of this inquiry took place in the securities markets, by far the larger share of its activities took place in the futures markets. To clarify CBOE's role in overseeing MFGI, we believe it is instructive to first discuss briefly the Federal regulatory scheme for the oversight of securities firms as established by law. There are two primary financial responsibility rules that are designed to protect customers' assets held in a securities account: the Securities and Exchange Commission's uniform net capital rule (Rule 15c3-1) and the SEC's customer protection rule (Rule 15c3-3). The net capital rule focuses on liquidity and is designed to protect securities customers, counterparties, and creditors by requiring that broker-dealers have sufficient liquid resources on hand at all times to satisfy claims promptly. Rule 15c3-3, or the customer protection rule, is designed to ensure that customer property (securities and funds) in the custody of broker-dealers is adequately safeguarded and generally segregated from the firm's own funds and securities. By law, both of these rules apply to the activities of registered broker-dealers, but not to unregistered affiliates. Assuming a securities firm complies in all respects with the operation of these two rules, securities customers should be able to recover all of the value of their funds and paid for securities in their account at that broker-dealer.

Securities customers are afforded further protection through the Securities Investor Protection Corporation (SIPC), which was created in 1970 as a nonprofit, non-government, membership corporation, funded by member broker-dealers. The primary role of SIPC is to return funds and securities to investors if the broker-dealer holding those assets becomes insolvent. Customers of a failed brokerage firm get back all securities (such as stocks and bonds) that already are registered in their name or are in the process of being registered. Once this step is taken, the firm's remaining customer assets are then divided on a pro rata basis with funds shared in proportion to the size of claims. If sufficient funds are not available in the firm's customer accounts to satisfy claims within these limits, the reserve funds of SIPC are used to supplement the distribution, up to a ceiling of \$500,000 per customer, including a maximum of \$250,000 for cash claims. Additional funds may be available to satisfy the remainder of customer claims after the cost of liquidating the brokerage firm is taken into account.

SIPC generally covers notes, stocks, bonds, mutual funds and other investment company shares, and other registered securities. Among the investments that are ineligible for SIPC protections are commodity futures contracts (unless in portfolio margining accounts and defined as customer property under the Securities Investor Protection Act). As the Committee knows, a SIPC Trustee has been appointed for the estate of MF Global. On November 30, the SIPC Trustee filed a motion to transfer the majority of the remaining approximately 330 non-affiliate securities accounts to another broker-dealer. Under the terms of the proposed purchase agreement with the acquiring broker-dealer, if approved by the bankruptcy court, approximately 85% of customers with MFGI custody securities accounts will be fully reimbursed for the amount of their net equity claims. The remaining customers with net equity claims above \$1.25 million would receive recoveries ranging from 60% to over 90% of those claims, depending upon the size of their claim. Additionally, these customers not receiving a full refund may yet be able to recover up to the full amount of their remaining claim depending on the outcome of the SIPC liquidation.

Supporting the Federal securities regulatory scheme, of course, is the oversight of the securities firms by securities exchanges and FINRA to check that firms are, in fact, complying with the financial responsibility rules. Section 19(g)(1) of the Se-

---

<sup>1</sup> MF Global, Inc. is a wholly-owned subsidiary of MF Global Holdings USA, Inc. The ultimate parent is MF Global Holdings Ltd. MF Global, Inc. is a broker-dealer registered with the Securities and Exchange Commission. MF Global, Inc. is also registered with the Commodities Futures Trading Commission as a futures commission merchant. When referencing the MF Global structure generally in this testimony, we will use the term "MF Global."

curities Exchange Act of 1934 (Act) requires every self-regulatory organization (SRO) registered as either a national securities exchange (*e.g.*, CBOE) or a national securities association (*e.g.*, FINRA) to examine its members and persons associated with its members to ensure compliance with the Act, the rules and regulations thereunder, and the SRO's own rules, unless the SRO is relieved of this responsibility pursuant to Section 17(d) or Section 19(g)(2) of the Act. With respect to a common member (*i.e.*, one that is a member of more than one SRO), Section 17(d)(1) authorizes the Commission to relieve an SRO of the responsibilities to receive regulatory reports, to examine for and enforce compliance with applicable statutes, rules, and regulations, or to perform other specified regulatory functions.

To implement Section 17(d)(1), the Commission adopted Rule 17d-1 under the Act. Rule 17d-1 authorizes the Commission to designate a single SRO as the designated examining authority (DEA) to examine common members for compliance with the financial responsibility requirements imposed by the Act, or by Commission or SRO rules. When an SRO has been designated as a common member's DEA, all other SROs to which the common member belongs are relieved of the responsibility to examine the firm for compliance with the applicable financial responsibility rules. On its face, Rule 17d-1 deals only with an SRO's obligations to enforce member compliance with financial responsibility requirements.<sup>2</sup>

The Commission designated CBOE to act as the DEA for MF Global, Inc. and CBOE has acted in this capacity with respect to MFGI (and its predecessors) since March 2003. CBOE is currently the designated examining authority for 160 registered broker-dealers. As a designated examining authority, the CBOE is responsible for enforcing the financial, margin, and books and records requirements of the SEC, the Federal Reserve Board and CBOE. This is accomplished through routine financial monitoring (on, at minimum, a monthly basis), routine main office examinations, and special investigations. During the time CBOE has served as the DEA for MFGI (and its predecessors), CBOE has conducted nine routine examinations of MFGI and three financial investigations to investigate specific matters. CBOE has taken disciplinary action against MFGI five times as a result of these examinations and investigations.

Of course, MFGI is both a broker-dealer under the jurisdiction of the SEC and a futures commission merchant under the jurisdiction of the Commodities Futures Trading Commission. Consequently, MFGI has been subject to examination by both securities and futures regulators, but the number of accounts and the value of the customer assets are many times greater on the futures side than they are on the securities side. On the futures side, the Chicago Mercantile Exchange (CME) serves as the Designated Self Regulatory Organization (DSRO). In addition, FINRA has been involved in overseeing MFGI on the securities side as MFGI is a member of FINRA and is subject to FINRA's rules and oversight.

For the benefit of the Committee, I would like to discuss our understanding of how the issue of MF Global's exposure to European sovereign debt in the form of repurchase agreements came to be known and the various steps that were taken by CBOE and other regulators to oversee the risk of that exposure. CBOE became aware of the exposure of MF Global to European sovereign debt on or about May 31, 2011 from reviewing the company's annual audited financial statements. In the footnotes to the financial statements there was a discussion of the accounting treatment for repurchase agreements and reverse repurchase agreements when the maturity date of the underlying collateral is the same as the maturity date as the agreements. The firm believed that generally accepted accounting principles allowed these agreements to be treated as sales and not to be recognized as assets and liabilities on MFGI's balance sheet. Because the repurchase agreements did not appear on the financial statements, those agreements did not appear on the FOCUS Report<sup>3</sup> submitted to regulators.

A couple of weeks later, on June 14, 2011, the SEC conducted its Rule 17h risk assessment program meeting with MFGI.<sup>4</sup> Pursuant to ordinary practice, CBOE and

<sup>2</sup>Rule 17d-1 does not relieve an SRO from its obligation to examine a common member for compliance with the SRO's own rules and provisions of the Federal securities laws governing matters other than financial responsibility, including sales practices and trading activities and practices. As such, CBOE also has responsibility to oversee MFGI's trading activity on the CBOE. CBOE is also a party to a Rule 17d-2 agreement with FINRA by which FINRA has assumed responsibility under the Act for overseeing the sales practice activities of common members, including MFGI.

<sup>3</sup>FOCUS Report is an acronym for Financial and Operational Combined Uniform Single Report. The uniform regulatory report (Form X-17A-5) filed periodically by all broker-dealers pursuant to SEC Rule 17a-5. The reports detail capital, earnings and other pertinent information.

<sup>4</sup>Rules adopted under Section 17(h) of the Securities and Exchange Act of 1934 require broker-dealers that are part of a holding company structure with at least \$20 million in capital

FINRA participated in this conference call meeting. At this meeting, MF Global discussed organizational and management changes within the Firm, its strategic direction, financial information, risk management, current litigations, and some information about the European sovereign debt. Throughout July and August 2011, there were a number of conversations held involving two or more of these parties (MFGI, SEC, FINRA, and CBOE) regarding the sovereign debt exposure and discussions about how the risk of this exposure should be accounted for by the firm in calculating the required net capital, which the firm was required to keep to protect against market risk. It is our understanding that the SEC staff indicated that MFGI would need to take a net capital charge for these repurchase agreements due to the market risk exposure that they created for the MF Global entity. Although there may have been some room for debate about whether these agreements were properly left off of the balance sheet, CBOE nonetheless agreed with FINRA and the SEC that it was appropriate to apply a net capital charge to these positions given the significant market and credit risk posed by them.

The firm held further conversations with SEC staff in August suggesting that it should not have to take a net capital charge for the sovereign debt exposure. Ultimately, by the second half of August, however, FINRA, CBOE and the SEC all affirmed the determination that a net capital charge was appropriate. Because the securities regulators determined that it was necessary and appropriate for MFGI to apply this net capital charge retroactively, MFGI determined that it was in net capital deficiency at the end of July 2011. MFGI, however, was able to continue to operate at this point because the company had taken a number of steps to increase its net capital in anticipation that affirmation of a net capital charge would prevail. Among the steps that MFGI took to remain in net capital compliance included: a capital infusion from its parent company (MF Global Holdings USA, Inc.), the transfer of some sovereign bond positions to MF Global Finance USA, Inc as a reverse repo-to-maturity transaction, and the liquidation of foreign affiliates' open futures positions, which had the effect of reducing the firm's required net capital. It should also be noted that on August 31, 2011, CBOE joined CME in a meeting with MF Global for an overview of the transactions and the charge. CME agreed with the decision that had been made by the securities regulators requesting the adjustment to the firm's net capital.

During the time that the securities regulators were discussing the sovereign debt exposure issue with MFGI, CBOE separately initiated its own examination of MFGI on August 22, 2011. CBOE determined that it would review the European sovereign bond portfolio dating back to the beginning of 2011 to check whether the retroactive application of the increased capital charge would have had the effect of causing MFGI not to be in compliance with its financial responsibility rules retroactively. CBOE staff was on-site in MFGI's offices starting on September 7th and as is common practice, CBOE's examination focused on the most recent month in which all of the books have been closed, in this case July 2011. CBOE sent a formal request for documents pertaining to the financial investigation of the European Sovereign Debt portfolio on September 19, 2011. MF Global provided the requested documents on September 23, 2011.

Another primary focus of CBOE's examination (as is the case with all annual financial and operational examinations of this type) was to determine whether MFGI was appropriately segregating its customer funds in securities accounts in compliance with SEC Rule 15c3-3. CBOE spent considerable time looking closely at these issues. Any potential rule violations that the CBOE and SEC may identify to date could become the subject of disciplinary action against individuals at MFGI through the ongoing investigation.

Beginning on August 26, 2011, CBOE staff requested and received a variety of daily financial information from MFGI. These various computations were received daily through the end of October 2011. In addition, CBOE staff reviewed a variety of financial documents from the firm throughout this time to determine the financial health of the firm. It should also be noted that the financial information we received from the firm on a daily basis never showed a deficit of any kind. In fact, until the bankruptcy filing, MFGI never reported excess net capital of less than \$100 million for any month-end since April 2008 (with the exception of its July 2011 revised net capital calculation mentioned above) and always maintained open funding from its

---

to file with the Commission disaggregated, non-public information on the broker-dealer, the holding company, and other entities within the holding company. The purpose of the Broker-Dealer Risk Assessment program is for staff in the SEC's Division of Trading and Markets to assess the risks to registered broker-dealers that may arise from affiliated entities, including holding companies and keep apprised of significant events that could adversely affect broker-dealers, customers and the financial markets.

parent if needed. Although MFGI routinely showed significant excess net capital, through CBOE's monthly closer-than-normal (CTN) surveillance reports (which CBOE generates from the monthly FOCUS reports), MFGI has been on a level of higher surveillance by CBOE for every month since December 2010 for various reasons. These monthly CTN write-ups are shared with SIPC, the SEC, the Options Clearing Corporation, the National Securities Clearing Corporation, and other securities self-regulatory organizations. During the final days of October, however, news about MF Global's exposure to sovereign debt surfaced, its stock price declined, and its credit rating was downgraded. Nevertheless, we received a preliminary net capital computation for Friday, October 28th on Saturday, October 29th which indicated the firm was still in net capital compliance. Just two days later, on Monday, October 31, staff at MF Global sent an e-mail stating a "significant shortfall in segregated futures accounts." That same day MF Global Holdings, Ltd. and MF Global Finance filed for bankruptcy.

Almost every day for the last couple of months, CBOE staff has been on site at the firm continuing to review all elements of the firm's Rule 15c3-3 computation. We have also spent significant time piecing together all the money wires and transfers that occurred during the week of October 24th to 31st, 2011, including the funding of daily settlement needs, the funding of customer withdrawals, bank reconciliations, and the manner in which margin calls on the European Sovereign debt was met. We also have shared this information with the SEC, the CFTC, and SIPC. We, along with the other regulators, have been piecing together the wires that created the shortfall of the Segregated Futures accounts and have been consulting with each other on the events as we learn them. We are continuing to work with the SEC Chicago office, which in turn communicates daily with staff in SEC headquarters.

In conclusion, CBOE is still gathering information and we will need to learn more before we are able to make a full assessment of this matter and to be able to define and address any "lessons learned." We believe that the issues surrounding the MF Global bankruptcy provides an impetus for CBOE, FINRA, and the statutory regulators to discuss amongst ourselves whether there are rules or policies that should be adopted or amended to add a greater level of protection to customer assets in broker-dealer or FCM bankruptcy scenarios. Any new or amended rules or policies should necessarily also focus on ensuring that customer assets can be transferred as quickly as possible in these types of events. We also intend to take this opportunity to determine whether there can be any improvements in the nature of the cooperation among regulators when faced with a financially troubled firm subject to oversight by multiple entities.

We hope that the foregoing narrative was helpful to the Committee's understanding of the events leading up to and surrounding the bankruptcy of MFGI. We stand ready to continue to assist the Committee and its staff with its continued inquiry.

Mr. CONAWAY [presiding.] Thank you, Mr. Brodsky.  
Mr. Roth for 5 minutes.

**TESTIMONY OF DANIEL J. ROTH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL FUTURES ASSOCIATION, CHICAGO, IL**

Mr. ROTH. Thank you, Mr. Chairman.

My name is Dan Roth and I am the President of National Futures Association and I appreciate the opportunity to be here today to talk about the types of regulatory changes which might be necessary in light of MF Global. And clearly, Mr. Chairman, some regulatory changes are going to be necessary.

Congress recognized a long time ago that efficient futures markets are vital to our economy, that efficient futures markets depend on liquidity, and that that depends on public confidence. The whole point of the regulatory structure for the U.S. futures industry is to ensure that that public confidence is intact.

For a long time, the futures industry enjoyed a great reputation for financial integrity, a reputation that survived the crisis of 2008. But now, as a result of MF Global, that reputation and public confidence has taken a great hit and it is up to all of us that are in-

volved in the regulatory process to take a top-to-bottom look at what we do and how we do it and try to figure out a better way to do it and try to make sure that we re-earn that public confidence.

I think that that inquiry about how we can do things better falls into two separate categories. I think we have to look at the steps that we can take to try to prevent insolvencies from occurring in the future; and second, how we deal with those insolvencies when they do occur. I have outlined in my written testimony what NFA's role in the current regulatory structure and how we monitor our firms for seg compliance. What I would like to do today is just basically talk about a couple of the seven or eight ideas that I included in my written testimony.

With respect to preventing insolvencies, I think the two points to start out with are obvious and I am sorry to take time to restate the obvious. But first, if a person is intent upon violating the law, if a person is intent upon committing a felony, there is no regulatory practice that will in every instance prevent that person from doing just that. And second, I think one of the best tools that we have to prevent this type of conduct is to deter that type of conduct through vigorous enforcement of the existing law. Just under the Commodity Exchange Act, it is a violation—it is a felony violation to misappropriate customer segregated funds punishable by up to 10 years in prison. And I know we have an ongoing investigation but I am hopeful and confident that if that investigation uncovers criminal activity, that that activity will be prosecuted vigorously.

But vigorous prosecution of the existing rules isn't going to be enough to get us where we want to go. That is not going to be enough to restore public confidence in the financial integrity of these markets. I have again outlined a couple of different things that I think need to be discussed and considered in my written testimony.

I think we have to look at how we monitor our firms for compliance with segregated fund requirements. We are the DSRO for about 26 non-clearing FCMs. Those firms file daily segregation reports with us. We get more detailed reports on a monthly basis outlining not only what their seg funds numbers are but where those funds are invested and what type of instruments. We spot-check for compliance with seg funds requirements by verifying to outside depositories of the balances that are reported to us. We do that in the course of our regular audits of FCMs, and we do that when we are doing the audit for a number of date that we spot-check throughout the year.

I think we could do more on that. I think we could do more systematic and more regular surprise spot-checks of that type of stuff. And we would be happy to talk with the Commission and with Congress to see how that could be improved. We also discuss in the written testimony ideas such as requiring FCMs to maintain a certain amount of excess segregation possibly the idea of a third-party depository. And there are a number of different items. And I think my basic point is that I am not advocating any of the items that are listed in the testimony, but they are all items which require very serious, very thoughtful consideration so that we can try to restore public confidence to these markets.

With respect to handling insolvencies when they do occur, in 1985, the CFTC asked NFA to do a study of customer account protection issues in the light of a failure of a firm called Volume Investors. And in 1986 we submitted that report to the CFTC. That data that was in that report I think made clear that no customer funds had ever been lost to—due to insolvency by a clearing FCM. With respect to non-clearing FCMs, the report presented that that I think—from which people concluded that the losses had been so infrequent and so small that a formalized response mechanism like an insurance program might not be appropriate.

Well, that was then and this is now and things may have changed and I think all of the issues that were discussed in that 1986 report have to be revisited and have to be revisited in some detail.

With that, Mr. Chairman, we look forward to working with the industry, with the Commission, and with Congress to try to restore that public confidence that is so vital to our markets. Thank you.

[The prepared testimony of Mr. Roth follows:]

PREPARED TESTIMONY OF DANIEL J. ROTH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL FUTURES ASSOCIATION, CHICAGO, IL

My name is Daniel Roth and I am the President and Chief Executive Officer of National Futures Association. NFA is the industry-wide, self-regulatory organization for the futures industry. Our 4,000 Member firms include futures commission merchants, commodity pool operators, commodity trading advisors and introducing brokers. The recent demise of MF Global has dealt a severe blow to the public's confidence in the financial integrity of our futures markets. This is much more than an academic argument. Thousands of customers have suffered and continue to suffer from a breakdown in the regulatory protections they have come to expect. Their frustration with the situation is completely understandable. Reestablishing the public's confidence is essential to our futures markets, which, in turn, are an essential part of our nation's economy.

All of us involved in the regulatory process have to work to restore that confidence and that effort must begin with identifying and implementing regulatory changes to try to prevent such insolvencies from occurring and to better respond to them when they do occur. Even while the MF Global investigation is ongoing, we should be able to identify certain frailties of the current structure that will need to be addressed. No ideas should be off the table in this process. At the same time, though, we should not hastily discard regulatory approaches that have been historically sound and I would note that the basic concept of self-regulation has served our markets and our nation very well for a very long time. Until this investigation is complete, we will not know the full facts of exactly what went wrong at MF Global. What I do know, though, is that no system of regulation can in every instance prevent people intent on breaking the law from doing so, and that is why the Commodity Exchange Act provides that stealing customer funds is a felony punishable by up to 10 years in prison. With that in mind, I would like to outline today some of the possible regulatory changes that need to be considered.

First, though, let me describe NFA's current role in the regulatory structure, in particular with regard to FCMs. Our 4,000 Member firms include approximately 70 FCMs that hold customer funds. The largest of these are members of one or more exchanges and therefore members of multiple Self-Regulatory Organizations (SROs). Pursuant to CFTC rules, the SROs have formed a Joint Audit Committee. For FCMs that have multiple SROs, the Joint Audit Committee assigns one SRO to be the primary regulator, what is referred to as the Designated Self-Regulatory Organization or DSRO. With very limited exceptions, NFA acts as the DSRO for 26 FCMs that hold customer funds and that are not clearing members of any exchange. On a daily basis each of these firms must report to NFA the amount of funds required to be held in segregation; the amount actually held; customer debit information; open trade equity for both customer and proprietary futures trading; long and short option value for customer accounts; and debits and deficits for non-customers such as employees or affiliates of the firm. Firms for which NFA is the DSRO must also file a Segregated Investment Detail Report (SIDR report). This report lists the types

of investments in which customer segregated funds are held. These reports must be filed either monthly or whenever there is a material change in the information. Our systems for the daily segregation reports and the SIDR reports generate alerts whenever there is a change in information regarding segregated funds that could signal a problem with the firm.

Each FCM is also subject to two annual examinations, one by an outside CPA that produces an annual certified report and the other by its DSRO. Let me assure you that those annual examinations focus extensively on testing for segregation compliance and confirming to outside sources the segregated fund balances reported by the FCM. We also act as the exclusive SRO for all commodity pool operators, commodity trading advisors and most introducing brokers.

Although we were not the DSRO for MF Global, we participated with other members of the Joint Audit Committee to receive regular updates on MF Global's condition in the week prior to its bankruptcy. When the shortfall in customer segregated funds became known, we focused on the five FCMs for which we are the DSRO that had customer funds on deposit with MF Global. Our goal was to ensure that those FCMs could satisfy their obligations to their customers and that they were in compliance with all segregation and capital requirements. We worked closely with the CFTC in that effort and continue to monitor those firms, all of which appear to be in compliance.

We have also identified 150 commodity pools operated by NFA Member firms that had funds on deposit with MF Global. We have worked with those Member firms to ensure that their pool participants are receiving adequate disclosures regarding the impact of MF Global's failure on the pools and to ensure that redemption requests from participants are being handled fairly. We also have 261 introducing broker Members who either had a portion of their own capital on deposit with MF Global or who satisfied their capital requirements by operating pursuant to a guarantee agreement with MF Global. Introducing brokers do not hold customer funds. We have, though, monitored those IBs to ensure that they either have new guarantee agreements or have sufficient net capital to satisfy their regulatory requirements.

With respect to the regulatory changes that have to be considered, there are two broad issues to be addressed. First, what changes can be made to rules or regulatory practices that would be better designed to prevent customer losses due to an FCM's insolvency. Second, since we cannot completely eliminate the possibility of FCM insolvencies, how can we improve the way we handle those insolvencies to limit the impact on customers and the markets. The following list of topics is certainly not exhaustive but should be among the topics under discussion.

#### **Prevention of FCM Insolvencies**

**Gross Margining**—Should the CFTC require all clearinghouses to collect margin on a gross rather than net basis?

**Commingling of Customer Segregated Funds**—FCMs are prohibited from commingling customer funds with the firm's assets but may commingle funds from different customers in the same segregated account. Though not an issue in MF Global, this can expose customers to loss due to the default of another customer. Various alternatives to this approach have been discussed.

**Monitoring for Segregation Compliance**—Should SROs change the manner in which they monitor Member firms for compliance with segregation requirements? Should SROs perform unannounced spot-checks to confirm balances to outside sources more frequently? Should FCMs be required to have an independent CPA conduct unannounced segregation compliance exams annually? Should SROs periodically test to see if there have been intraday transfers of customer segregated funds that could arouse suspicion? Should information be made publicly available about how each FCM invests its customer funds?

**Mandatory Excess Segregation**—Most FCMs deposit some of their own funds as excess customer segregated accounts to act as a buffer in case some customers go into a debit position. Should FCMs be required to maintain a certain minimum in excess segregated funds?

**Internal Controls**—Should there be either specified requirements or best practice guidance on the types of internal controls that should be in place for the authorization to transfer segregated customer funds above a certain threshold level?

**Third Party Depositories**—Some have suggested that customer funds not needed to margin positions at the clearinghouse should be held not by the FCM but by a third party depository.

**Notice to Regulators**—Should an FCM be required to give notice to either its DSRO or the CFTC when the firm makes any transfer of customer segregated funds, including intraday transfers, above a certain threshold?

### Responding to FCM Insolvencies

Implementation of some of the changes described above could obviate the necessity of a formalized response mechanism, such as some form of customer account insurance. On the other hand, the changes described above may not be sufficient to restore public confidence, and we need to examine the pros and cons of establishing a formalized mechanism to address customer losses due to an FCM insolvency. Any such study will have to address each of the following broad issues:

**Goal of the Insolvency Response Mechanism**—Would the mechanism be designed to compensate customers for their losses, along the lines of a SIPC type program, or to facilitate the immediate transfer of open positions to a financially stable FCM?

**Administration of the Mechanism**—If there should be a formalized insolvency response mechanism in place, should it be government sponsored, administered by an industry organization or accomplished through private insurance?

**Funding the Mechanism**—If the response mechanism is some form of industry administered fund, the question of how to fund it depends on who would be covered. Would it be desirable to limit the beneficiaries to the public customers, *i.e.*, non-members of the exchange of the insolvent FCM?

**Limitations on Compensation**—Regardless of whether the mechanism is administered by an industry group or by the government, what restrictions or limitations on customer compensation would be appropriate? Should such a mechanism follow the SIPC model and compensate 100% of customer losses up to a certain limit? Would that form of protection address the needs of the institutional participants that form the bulk of the industry's customer base? Should the mechanism make a pro rata distribution to customers? Should there be a limit as to the amount of coverage related to any one FCM insolvency?

We should also consider how the bankruptcy laws should apply to a firm that is both an FCM and a broker-dealer but is primarily engaged as an FCM. That is the fact pattern here and we should consider whether a SIPC administered bankruptcy proceeding is the most appropriate means of dealing with such an insolvency.

The basic point here, Mr. Chairman, is that there is work to be done. The failure of MF Global will require significant regulatory changes to bolster public confidence in our markets. The list of possible options is long. The issues are complex and their importance is profound. The process of weighing those choices must be deliberate and careful but we must not lose time in starting that review. NFA hopes to play a constructive role in that process and we look forward to working with the industry, the CFTC and with Congress to ensure that what emerges is a better regulatory model.

Mr. CONAWAY. Thank you, Mr. Roth.  
Mr. Luparello?

### TESTIMONY OF STEPHEN LUPARELLO, VICE CHAIRMAN, FINANCIAL INDUSTRY REGULATORY AUTHORITY, WASHINGTON, DC.

Mr. LUPARELLO. Chairman Lucas, Ranking Member Peterson, and Members of the Committee, thank you for the opportunity to testify today.

My name is Steve Luparello and I am the Vice Chairman of the Financial Industry Regulatory Authority, or FINRA. When a firm like MF Global fails, there is great value in reviewing the events leading up to that failure and examining where rules and processes might be improved. I commend the Committee 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 these accounts as quickly as possible.

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 and the SEC. For broker-dealers that are mem-

bers 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 registered 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 focus is 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 of that year, 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 discussion 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 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 reporting the repos of sale may have been consistent with GAAP, this should not be treated as such for purposes of capital rule given the market and credit risk these 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 that interpretation through the summer appealing directly to the SEC before eventually conceding in late August.

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

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 on the firm. At the end of that week, FINRA was on-site at the firm with the SEC and CBOE 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 of customer securities and worked closely with potential acquirers in hopes of avoiding SIPC liquidation. As it 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 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 proposed two rules that we believe would assist us in our work in monitoring 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 fees to the firm, regulators, and SIPC after the commencement of a liquidation. The rule would also require firms to maintain current records in a central location. The other proposal would require FINRA-regulated firms to file additional financial and operational schedules or reports as we deem necessary to supplement the FOCUS filing report.

FINRA shares your commitment to reviewing MF Global's collapse. We will review our rules and our procedures but would also 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 and I would be happy to answer any questions.

[The prepared testimony of Mr. Luparello follows:]

PREPARED TESTIMONY OF STEPHEN LUPARELLO, VICE CHAIRMAN, FINANCIAL  
INDUSTRY REGULATORY AUTHORITY, WASHINGTON, DC.

Chairman Lucas, Ranking Member Peterson and Members of the Committee:

I am Steve Luparello, Vice Chairman 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 Committee 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 matu-

urity 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 e-mail 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.

Mr. CONAWAY. Thank you, Mr. Luparello.  
Mr. Corcoran?

#### **TESTIMONY OF GERALD F. CORCORAN, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, R.J. O'BRIEN & ASSOCIATES, CHICAGO, IL; ON BEHALF OF COMMODITY MARKETS COUNCIL**

Mr. CORCORAN. Chairman, Members of the Committee, good evening. My name is Gerry Corcoran and I am the Chairman and Chief Executive Officer of R.J. O'Brien & Associates, a duly registered FCM.

Today, I am honored to speak on behalf of both RJO and the Commodity Markets Council. I would like to thank you for hosting this critical hearing and for including RJO and CMC.

The CMC is a trade association bringing together commodity exchanges with their industry counterparts. The activities of CMC

members represents the complete spectrum of commercial users for all futures markets.

At R.J. O'Brien, we are especially proud of our agricultural roots, our commitment to the agricultural community, and our leadership in the futures industry. We are passionate about the business and the important role we play in helping individuals, farmers, agribusinesses, corporations, and institutions manage their risk. Founded in 1914, RJO is a privately owned futures commission merchant. With our origins in the cash butter and egg business, today we are the oldest and largest independent futures brokerage and clearing firm in the United States. We are the only remaining founding member of the Chicago Mercantile Exchange, and our Chairman emeritus, Robert J. O'Brien, served on the board during the years when agricultural future markets blossomed and the financial futures markets were born.

Throughout our history, RJO has stood side by side with our clients, exchanges, and regulators during every significant market event this industry has seen.

Since the MF Global bankruptcy filing and default, RJO has worked hand in hand with the CME Group and the other domestic exchanges to provide a home for a substantial number of MF Global accounts and brokers. In a matter of days, we assumed a bulk transfer of over 20,000 accounts without incident, and our shareholders provided an infusion of approximately \$50 million of capital to ensure that we would be sufficiently capitalized for this unexpected event.

At the same time, we worked very hard to ensure that our long-standing clients continued to receive the outstanding service to which they are accustomed to. Our management and staff worked literally around the clock for 25 straight days in a massive effort that involved coordination of systems, processes, and people and sometimes working with incomplete data and rapidly changing circumstances. We fully recognized that the clients of MF Global had just experienced a traumatic event, and we did everything we could to provide vehicles for addressing their questions and providing reassurances as soon as we had answers.

And so while the investigation continues into the causes of the MF Global bankruptcy and the whereabouts of segregated assets, I am certain, very certain we cannot let this event destroy the long-term trust and confidence upon which the market participants rely. This is an industry that is vitally important not only to the interests of the agribusiness community but to the world. Obviously, the industry must move quickly to restore trust and confidence but in a measured and thoughtful fashion. It is incumbent on all interested parties—whether you are a legislator, a regulatory organization, an exchange, an FCM, or even a customer—to work together to strengthen the financial safeguards of the futures industry.

To that end, I am going to briefly offer some suggestions which are further detailed in my written testimony that is available to you.

So how can an FCM fail? The catastrophic failures of FCMs in my experience are surrounding two events: either a proprietary trading loss—large proprietary trading loss or catastrophic loss by a customer, in both cases, erode the entire capital of the futures

firm and puts them undercapitalized and in many cases out of business. This is the only case in the history of the futures industry where customer segregated funds were violated.

The R.J. O'Brien model of business is principally an agency-only model. We do not participate in any material proprietary trading and so we believe that that is a very, very safe way to operate a business where its customers cannot be violated by proprietary trading losses of a firm.

The second event that could cause an FCM default is a very catastrophic customer loss. That is a case where a customer lost an excessive amount of money on the balance sheet of an FCM and failed to meet their margin requirement to answer that call or to fulfill that loss. We believe that it should be seriously considered whether FCMs should maintain an agency-only model. And we also believe and recommend that regulation should be prescribed that customers that have very large margin calls in excess of a threshold would have to meet those margin calls within 24 hours. This would ensure that an FCM would not be waiting more than 24 hours to find out if a customer's default was going to exist.

Another suggestion that we have is that in some cases and in the cases of MF Global, MF Global was a combined FCM broker-dealer. We might suggest and we might consider that being a combined broker-dealer and an FCM is a model that should no longer exist. One of the reasons I say this is because operating as a combined broker-dealer FCM, there are certain capital advantages that a combined entity may receive compared to the capital requirements of a separately owned broker-dealer and a separately owned FCM. In some parlance this might be called double-dipping on the capital base or even one might call it a leverage on the capital base of a combined company.

Another suggestion—and it has been spoken to—the NFA has this in place already—is the daily reporting of segregation reports to all the DSROs. I mean it has been duly noted here that it is the obligation of the FCM to report a failure of segregation, but I think in the age of technology and the abundance of caution, it would be no problem for FCMs to submit daily segregation reports electronically to their DSRO.

And finally, I would say this: in the case of R.J. O'Brien, since we are principally an agency model, the vast majority of our capital is invested in the segregated—with and along with the segregated assets of our customers. Today, we have over \$175 million of excess segregated assets, all of which is the capital of our firm. We believe there should be a threshold that all FCMs contribute a portion of their capital into the customer segregated asset domain. In doing so, it would be protecting the customers further, you would be protecting the assets of the FCM that protects the underlying customers because these assets would also be subject to being invested under Rule 1.25 as amended.

This concludes my thoughts for this evening. I thank you and I compliment you and the Committee for putting this together. RJO and CMC will work alongside with regulators, legislators, customers, and exchanges alike to find the best ways to strengthen the financial safeguards of the futures industry.

[The prepared testimony of Mr. Corcoran follows:]

PREPARED TESTIMONY OF GERALD F. CORCORAN, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, R.J. O'BRIEN & ASSOCIATES, CHICAGO, IL; ON BEHALF OF COMMODITY MARKETS COUNCIL

## I. Introduction

Chairman Lucas, Members of the Committee, good morning. My name is Gerry Corcoran, and I am the Chairman and Chief Executive Officer of R.J. O'Brien & Associates ("RJO"). Today I am honored to speak on behalf of both RJO and the Commodity Markets Council ("CMC"). I would like to thank you for hosting this critical hearing and for including RJO and the CMC.

The CMC is a trade association bringing together commodity exchanges with their industry counterparts. The activities of CMC members represent the complete spectrum of commercial users of all futures markets. CMC member firms trade regularly on CME Group, ICE Futures U.S., the Kansas City Board of Trade and Minneapolis Grain Exchange. CMC provides the access, forum and action for exchanges and exchange users to take a leadership role in addressing global market and risk management issues in various sectors, including agriculture, energy, finance, transportation and infrastructure.

At R.J. O'Brien, we are especially proud of our agricultural roots, our commitment to the agricultural community and our leadership in the futures industry. Personally, I am passionate about this business and the important role we play in helping individuals, farmers, agribusiness, corporations and institutions manage their risk.

Founded in 1914, RJO is a privately owned futures commission merchant ("FCM"). With our origins in the cash butter and egg business, today we are the oldest and largest independent futures brokerage and clearing firm in the United States. We are the only remaining founding member of the Chicago Mercantile Exchange, and our Chairman Emeritus, Robert J. O'Brien, served on its Board during the years when agricultural futures products blossomed and the financial futures markets were born. Throughout our history, RJO has stood side by side with our clients, exchanges and regulators during every significant market event this industry has seen.

## II. Impact of the MF Global Bankruptcy on RJO, its Customers and the Futures Industry in General

The primary purpose of statutory segregation requirements for FCMs under the Commodity Exchange Act ("CEA") is to ensure FCM obligations are not met with customer funds; and, in the case of an FCM insolvency, segregation requirements are also designed to protect customer monies. When a futures broker such as MF Global defaults, the entire industry is affected—the customers of the defaulting broker, the clearing organizations in which the defaulting broker participates, as well as other brokers that are members of the clearing organization. Typically, customer trades and the associated collateral held at a defaulting FCM must be moved to a new FCM. Moving customer trades and collateral requires significant coordination by affected participants throughout the industry, and transparency with respect to the location and booking of customer accounts and collateral is a crucial ingredient for a successful response to the default of an FCM.

MF Global was required by Federal law [CEA and Commodity Futures Trading Commission ("CFTC") regulations] to maintain adequate segregated funds to cover its liability to all of its customers who had a positive net liquidating value in their segregated account balances. As has been reported, the total pool of MF Global segregated funds is insufficient to cover that customer liability, and though the precise amount of the deficiency is at present unknown, all indications point to the amount exceeding \$600 million. Part 190 of the CFTC regulations sets forth the process for handling the *pro rata* distribution of funds to customers in the event its FCM is the subject of a U.S. bankruptcy liquidation proceeding and has a shortfall in segregated funds held to keep its customers whole. This is the process that is currently underway and overseen by the Trustee.

This process is completely different from and bears no relationship to clearinghouse default rules.

Clearinghouse default rules and procedures are in place to protect the financial integrity of the clearing members on the opposite sides of trades in the event a defaulting clearing member fails to pay the variation call necessary to satisfy and make whole the opposite parties to the defaulting firm's trades. These rules ensure that, in the case of MF Global, had the firm not been able to meet its margin call to the clearinghouse and had there been a shortfall of margin collateral on deposit at the clearinghouse to satisfy all clearing members on the opposite sides of MF Global's customer positions, then in accordance with each clearinghouse's rules, other financial resources would be deployed to cover the shortfall.

MF Global did not default to any clearinghouse.

Clearinghouses met their obligations to all other clearing member firms and their customers and have undertaken welcomed efforts toward speeding customer access to their trading accounts, transferring their positions and providing the Trustee with support to encourage him to quickly release customer funds. Transfers of customer funds, effectuated by MF Global for the benefit of the firm and resulting in a segregated fund deficiency, constitute very serious violations of CFTC and Self-Regulatory Organization (“SRO”) rules and regulations.

Since the MF Global bankruptcy filing and default, RJO has worked hand in hand with the CME Group and the other domestic exchanges to provide a home for a substantial number of MF Global accounts and brokers. In a matter of a few days, we assumed a bulk transfer of 20,000 accounts without incident, and our shareholders provided an infusion of approximately \$50 million of capital to ensure that we would be sufficiently capitalized for this unexpected event. At the same time, we worked very hard to ensure that our long-standing clients continued to receive the outstanding service to which they are accustomed. Our management and staff worked literally around the clock for 25 days straight in a massive effort that involved coordination of systems, processes and people, and sometimes working with incomplete data and rapidly changing circumstances. We fully recognized that the clients of MF Global had just experienced a traumatic event, and we did everything we could to provide vehicles for addressing their questions and providing reassurances as soon as we had answers. This effort included tripling the size of our client services staff, creating a dedicated hotline to answer questions from incoming clients and brokers, and establishing a website with continuous updates on the changing circumstances.

Unfortunately, these efforts, along with those of the Trustee, the CFTC and Designated Self-Regulatory Organizations (“DSROs”), have not mitigated the substantial loss of trust and confidence by market participants as a result of the MF Global bankruptcy. I believe that FCMs, exchanges and regulators alike would acknowledge that trust in the futures industry has been severely impaired. In the past 5 weeks, at our firm alone, we’ve received more requests from clients for our financial data than we have in the last 3 years combined. We have addressed more than 1,000 inquiries seeking assurances that this won’t happen at our firm. We continue to witness cash withdrawals to remove excess balances because there is a lack of confidence in the system as a whole.

So while the investigation continues into the causes of the MF Global bankruptcy and the whereabouts of segregated assets, one thing is clear. MF Global did not respect the sanctity of the segregated funds system. This violation forces us to engage in a discussion of policy recommendations which would not otherwise have been necessary. Looking ahead, I am certain, very certain of this: we CANNOT let this event destroy the long-term trust and confidence upon which market participants rely. This is an industry that is vitally important not only to the interests of the agricultural community, but to the world. In order to restore trust, we strongly encourage the MF Global Bankruptcy Trustee to conclude its investigation and facilitate the prompt return of all available customer segregated funds as soon as possible. We also believe the industry must move quickly to restore trust and confidence but in a measured and thoughtful fashion. It is incumbent on all interested parties—whether you are a legislator, a regulatory organization, an exchange, an FCM or even a customer—to work together to strengthen the financial safeguards of the futures industry.

### **III. The Cause of MF Global’s Failure is Uncertain**

RJO and CMC believe the businesses of all CMC members depend upon the reliable implementation of customer asset protection requirements by FCMs, clearing agencies and depositories. We likewise opine it is crucial for regulators, the MF Global Trustee and law enforcement authorities to conduct a full investigation. At this point, facts indicate there may be a shortfall of customer funds that could exceed \$600 million. Again, reestablishing trust and confidence in the futures markets is of paramount importance. Fact-finding investigations should focus on this issue and seek to determine whether the asset protection shortfall was the result of abuse by MF Global or others. CMC and RJO urge Congress, the MF Global Trustee, and the applicable regulatory authorities to examine closely the circumstances surrounding the movement of customer collateral at MF Global to determine whether any abuse took place. If segregation violations occurred, measures should be carefully considered to enhance oversight, enforcement, or sanctions to further deter such violative behavior in the future.

Although we offer several ideas for thoughtful consideration and discussion, we urge Congress and the regulators to be cautious in any steps you may take to ad-

dress the MF Global bankruptcy. We recommend you carefully measure the cost and market implications that may be associated with any changes.

#### **IV. Strengthening the Customer Asset Protection Regime in the Futures Industry**

At this early stage of the process and after a dialogue with CMC members and RJO customers, we are certain there are no possible “fixes” for the asset protection regime that would ensure safety of customer assets with 100% certainty. The ideas we raise today all offer some advantages and some disadvantages, and we highlight them for consideration by policymakers and regulators; however, we do not wish to endorse any specific proposal until all stakeholders have the appropriate factual information available.

##### *A. Separation of Proprietary Trading by FCMs*

On this point, I am speaking strictly on behalf of RJO, which operates on an “agency” only model and does not engage in proprietary trading. This model has served our customers well for almost 100 years. Customer protection should continue to be the bedrock upon which the industry has been built. We at RJO suggest those FCMs who want to conduct proprietary trading utilize other FCMs or create a separately capitalized special purpose FCM for this activity. Doing so will require the same oversight afforded to customer accounts, including proper margining at all times.

##### *B. Improvements to the FCM Net Capital Regime*

The remainder of my testimony reflects the views of both RJO and CMC. In the absence of a finding of abuse of the customer asset protection regime, the industry should evaluate the adequacy of the current FCM capital regime in terms of whether the risk capital required adequately reflects the risk of an FCM default. We offer the following ideas for consideration towards more accurately reflecting that risk.

##### 1. “Double-Counting” of Funds by Dually Registered FCM/Broker-Dealers to Satisfy Capital Requirements

FCMs are required to maintain liquid assets in excess of their liabilities to provide resources for the FCM to meet its financial obligations as a broker in the futures market. These capital requirements also are intended to ensure an FCM maintains sufficient liquid assets to wind-down its operations by transferring customer accounts in the event the FCM defaults.

Currently, FCMs that are dually registered as a broker-dealer are permitted to rely on the same funds to satisfy the broker-dealer’s net capital requirement and the FCM’s capital requirement. The rules of the CFTC generally permit an FCM that is dually registered as a broker-dealer to satisfy its capital requirement through compliance with the capital requirements imposed on the firm by the Securities and Exchange Commission (“SEC”) in light of the firm’s registration as a securities broker-dealer. The CFTC’s rules therefore tend to treat the capital requirements of FCMs and broker-dealers as equivalent, yet such equivalent treatment may not be appropriate.

The amount of risk capital that may be reasonable for a particular FCM, in light of the credit and market risks faced by the FCM in its house and customer accounts, may be lower or much higher than the comparable risk capital requirements applicable to the firm as a broker-dealer. The deemed equivalence of broker-dealer capital requirements, which generally do not turn on risk associated with customer futures positions as do FCM capital requirements, may require reevaluation.

##### 2. Maintaining Capital in Segregation

The inquiry into the role of capital of an FCM in protecting futures customers should also evaluate whether a certain proportion of funds designated as capital (*e.g.*, 50%) should be required to be placed in a segregated account dedicated to capital protection. Maintaining capital in segregation could generally contribute to the liquidity position of FCMs.

##### 3. Low Concentration Risk Charges May Incentivize FCMs to Leverage Exposures to Single Credit Risks

Where the concentration risk capital charge associated with exposures to a single issuer is too low, FCMs may have inappropriate incentives to leverage their exposure to such issuers. As the bankruptcy of MF Global made clear, excessive concentration of a firm’s exposure to specific credit risks—in the case of MF Global, European sovereign debt—significantly increases risk to a firm’s capital base. When evaluating whether the current mix of risk capital considerations (including legal risk, credit risk, liquidity risk, custody and investment risk, concentration risk, de-

fault risk, operational risk, market risk and business risk) adequately delivers a risk capital requirement and protects the firm and its customers against losses, regulatory agencies should take care to consider whether the concentration risk ratio should be limited to 50% of excess adjusted net capital for all credit risk exposures, excluding U.S. Treasury securities.

*C. Enhanced Monitoring and Reporting With Respect To FCM Segregation Practices*

It may be worth discussing whether SROs and regulators should conduct more frequent audits of FCM segregation practices. Such exercises might increase transparency to customers of potential asset protection issues an FCM may be experiencing, promote enhanced risk management practices, and potentially provide the regulators with an early-warning mechanism. Accordingly, policymakers might consider imposing discrete reporting obligations that would mandate regulatory reporting by FCMs in the event of a decline below specified thresholds (*e.g.*, 25%) of customer-segregated to customer non-segregated assets.

*D. Customer Trading Practices Also Impact Customer Asset Protection*

While this point does not directly relate to the MF Global situation, it is worth considering in the context of the financial stability of FCMs. Significant losses by a customer of an FCM can also result in catastrophic losses to the FCM itself. Improved customer collateral management could potentially be achieved by ensuring the adequate maintenance of customer collateral levels. An idea we offer for deliberation is to require accounts which exceed certain margin thresholds on an intraday basis to fund their account through direct wire transfer, thereby ensuring intraday margin calls are met.

*E. A Potential Requirement for Individual Segregation of Customer Accounts*

The industry's objective must be to establish safe, liquid markets and to protect the assets of customers who rely on futures brokers to access the market. We believe the industry has spent considerable time discussing full physical segregation of customer accounts. While such a concept is worthy of study, it is too complicated to help in the near term, and resources would be better spent on solutions that are achievable and deployable in relatively short order to increase the safety and stability of the market today.

**V. Conclusion**

In summary, I would state that the failure of MF Global has had a great impact on futures markets, and the need to restore market confidence is urgent. However, the cause of the collapse is unascertained at this moment, and there is currently an investigation underway to determine the same. The facts need to be unearthed before concrete policy measures, if any, are taken. Meanwhile, in the spirit of discussing constructive and thoughtful ideas with lawmakers and regulators, CMC and RJO offer for your consideration, the following ways to strengthen the customer asset protection regime in the futures industry:

- Improving the FCM net capital regime,
- Enhancing monitoring and reporting with respect to FCM segregation practices,
- Considering the impact of customer trading practices on customer asset protection, and
- Potentially requiring individual segregation of customer accounts.

CMC and RJO thank the House Agriculture Committee for the opportunity to testify on this important matter. We look forward to working with Congress and the regulatory authorities as we learn more.

Mr. Chairman, we compliment you and the Committee's efforts, and we look forward to answering any questions you may have on this vital topic that impacts our industry.

Please do not hesitate to contact Christine Cochran of CMC at [Redacted] or via e-mail at [Redacted], or Gerry Corcoran of RJO at [Redacted].

Thank you again for the opportunity to testify.

Mr. CONAWAY. Well, thank you, gentlemen. I appreciate that. Under leave of the Chairman, I will go first.

First off, my compliments to all six of you for sitting here from 9:30 until this afternoon and during this. It shows your commitment to this business, so thank you very much for doing that.

Mr. Duffy, just as an aside, I don't know that I have ever had a more straightforward statement as to things that you think hap-

pened that didn't happen. So thank you for that straightforwardness.

Both Mr. Duffy and Mr. Luparello, you had auditors and/or representatives watching the fight. You heard the Chairman say it was chaotic, those last 2 or 3 days. Did you get anecdotal evidence back from your folks who observed that in terms of just—if you listen to Mr. Corzine, he has a scene that is almost unimaginable. That is obviously auditors looking for those kinds of panics. Did your people see that, Mr. Duffy? Did your folks see that?

Mr. DUFFY. I did not receive any reports back from any of the auditors that were in there the last final days that there was chaos or panic until when they were notified that the accounting—supposedly accounting error was now transferred into—from the segregated pool to the broker-dealer. When MF Global told us that, I think that is more when the panic set in.

Mr. CONAWAY. So your statement that that happened came from MF Global's folks——

Mr. DUFFY. MF Global told CME and CFTC at the same time at 2:00 in the morning that they transferred customer segregated funds into MF Global's broker-dealer account.

Mr. CONAWAY. All right. Thank you, sir.

Mr. Luparello, did your team sense anything out of the—I mean it is obviously chaotic but anything——

Mr. LUPARELLO. That is exactly right. I would say not necessarily panic but it was a chaotic scene that week and over that weekend. And the reports I was getting back from my team onsite as the firm was trying to deal with customers that seemed to be uncertain about what was next as well as potential counterparties and acquirers. There was an awful lot going on. I think the panic——

Mr. CONAWAY. Yes.

Mr. LUPARELLO.—did not set in until there was a realization that there was a shortfall in the customer segregation funds.

Mr. CONAWAY. And that is on Saturday/Sunday when——

Mr. LUPARELLO. Correct.

Mr. CONAWAY.—customers don't—they are not answering the phone for customers at that point in time.

Given what your team observed and both of you have been in the business a long time, does that create an excuse of some sort to transfer segregated funds out of the segregated accounts into the proprietary accounts? Is that any kind of excuse whatsoever for that to happen?

Mr. LUPARELLO. No.

Mr. CONAWAY. Either one of you think that could happen by accident, the folks who actually triggered those trades, triggered that movement didn't know in fact that they were doing something they weren't supposed to?

Mr. LUPARELLO. You know, I think given the chaos of the situation and without knowing the facts as they have progressed from that point on, as we have been in more of a support role with the SIPC Trustee, there are certainly possibilities that funds could have not been received that should have been received, or could have been wired out that shouldn't have been wired out. But from an intent standpoint, I would say the answer to that is clearly no.

Mr. CONAWAY. All right. Mr. Duffy, do you get a sense that that is business as usual in those circumstances?

Mr. DUFFY. I don't believe business as usual is to transfer customer segregated funds out of their accounts into broker-dealer accounts, sir.

Mr. CONAWAY. Okay. Mr. Corcoran, thank you for coming today. Given that the market I think self-heals far better than regulatory fixes that come in after the fact, would an FCM-only agency—wouldn't you be able to pitch that as being safer and more competitive? And wouldn't that give you in fact a competitive advantage that would work for your customers to make their own choices as to how they wanted to take risks *versus* going with an MF Global which had a mixed arrangement that you could play off and say hey, you are not going to have that risk? Would the market fix itself in this instance?

Mr. CORCORAN. It is very possible that the market itself will fix itself in a sense and that customers will look very closely at FCMs, how they conduct their business. And hopefully from the outcome of these hearings and other factors related to this event, there will be further transparency to FCMs' investment of customer assets and customers should have more transparency and be able to make a wiser selection of which FCM is safer for them.

Mr. CONAWAY. Sure. Mr. Roth, Mr. Fletcher, in the time left what we hear is this: that the market is spooked, that the market is not working, but the truth of the matter is we have had a month of activity. Do you sense the folks trying to put in perspective the MF Global reg *versus* the broader history of how safe these transactions have been in the past and are beginning to move back toward their normal functioning?

Mr. FLETCHER. It will move back towards the normal function, but it won't be the same. My company, for example, had accounts with MF Global and with Newedge. When we are done settling down from this, we will probably have our business divided amongst five or six companies rather than just one or two just to minimize that risk.

Mr. CONAWAY. Okay. Mr. Roth, what about your folks real quick?

Mr. ROTH. Yes, I would agree with Mr. Fletcher that trading activity may return to normal but there are going to be residual effects of an erosion in confidence that are going to affect the markets. I think we need to look for solutions that can be market-driven, they can be regulatory solutions, but we need to find solutions to try to restore that public confidence.

Mr. CONAWAY. Thank you, gentlemen. I yield back.

The Ranking Member for 5 minutes.

Mr. PETERSON. Thank you. I am going to yield briefly to Mr. Boswell.

Mr. BOSWELL. Well, thank you very much. Because of a conflict I am going to have to go, but I have talked with some of you previously and I concur with some of the things that have already been said. I am concerned very much about the futures hedging, the whole planning process that our ranchers and farmers and others must depend on. This is a big setback, a big loss, but I guess until the bankruptcy part is settled, it is going to be kind of hard to determine what can be recovered as we go into that. But I think

we are going to have a lot of contact with you as the days lay ahead to get this sorted out. And I appreciate the sincerity. But it must be done. We have no disagreement on that.

So with that, Mr. Ranking Member, I will yield back and also give you my 4 minutes or whatever I had left.

Mr. PETERSON. Thank you, Mr. Boswell.

And yes, I have been thinking about some of these changes and was actually thinking about putting a bill in this afternoon, but I held back because I think we need to find out a little bit more about this. I think we need to seriously examine whether we should put these segregated accounts with a third party. And I know that is going to apparently cause some people to go ballistic, but we need to look at that.

I think this double capital issue needs to be looked at. You know, that doesn't seem to make any sense to have people use the same capital. So hopefully, the Committee can spend some time looking at this and working with people and try to get the understanding of what the best solution would be. What I do not want to do personally is any kind of a thing where we are going to set up any kind of an insurance fund or anything like that. I am against that. I think that is a bad idea.

But the other thing I am concerned about, and it relates to Dodd-Frank. You know, we exempted the end-users from some of these requirements and there are bills in to try to fix what some people are afraid of is happening there, but as near as I can tell it is not us that is causing the problem. It is the prudential regulators which we don't have any control over in terms of whether there is going to be margin and capital requirements on the end-users.

But my concern is that you could potentially—if we exempt end-users completely from the swap dealer and major swap participant regulations, then you are going to also exempt them from segregating those funds. And if you had a situation where one of those organizations went bankrupt, you would have the people involved in that in the same situation that these folks are in here today. And I am not sure we want to create a situation like that. So, Mr. Fletcher, you are an end-user I guess. You know, do you have concerns about that, now all of a sudden you are going to be doing business with somebody that is not regulated, the money is not segregated?

Mr. FLETCHER. Well——

Mr. PETERSON. If they do something and go down and——

Mr. FLETCHER. My firm is a grain elevator and most—nearly all of the business that we do is actually futures contracts to hedge purchases that we——

Mr. PETERSON. So you don't do swaps?

Mr. FLETCHER. No.

Mr. PETERSON. Well. I guess it wouldn't affect you directly, but you understand what I am getting at?

Mr. FLETCHER. Sure.

Mr. PETERSON. So I think we need to take a look at that as well because people say this is never going to happen. Part of how we got into a lot of these different issues is because back in the CFMA in 2000, the argument was, well, these are all a bunch of rich people and they are all gambling with each other's money and it is no-

body's business what they are up to. And you know, they almost took the country down and now they have put a bunch of people in jeopardy here. So obviously they can't control themselves so we need to make sure that we don't leave any loopholes here. So with that, Mr. Chairman, I will yield back.

The CHAIRMAN [presiding.] The gentleman yields back his time. The chair recognizes the gentleman from Georgia who has been very patient. Proceed, Mr. Scott.

Mr. AUSTIN SCOTT of Georgia. Thank you, Mr. Chairman.

Gentlemen, thank you for being here today and I am somebody who has a Series 7 and less than 12 months ago was in that highly regulated industry and still maintain my license to this day. And so I guess when I see what has happened here, it is pretty clear to me that rules were broken, laws were broken. And again, I want to make sure we do whatever has to be done to protect the consumer, but we also don't want to do so much that it creates a burden on the ethical people that are out there conducting business.

So with that said, if I could just ask a couple of quick questions. Mr. Duffy, do you think that what happened at MF Global, was it standard operating procedure or did they get to the end of their rope and say, we are going to make one big bet here and if the bet goes right we will be okay and if it goes wrong, we won't?

Mr. DUFFY. I can't even comment on this, sir. I have no idea what was going through their heads in the final moments. I have only gotten the reports back from my legal folks of what happened and that is what I factually reported out to the Congress.

Mr. AUSTIN SCOTT of Georgia. Do you believe that if we had more audits of the reports, the segregated fund reports, would doing more audits of those reports, whether we did every firm on a monthly basis, would that have prevented this?

Mr. DUFFY. Well, it is important to note that we do audit each and every firm every year. So we have 50 auditors on staff at CME Group that we use to audit them. On the segregation reports, which I think is what you are referring to, I did say in my oral testimony where I demonstrated where people falsified reports so—

Mr. AUSTIN SCOTT of Georgia. Yes.

Mr. DUFFY.—even though we tied out these reports, but if they give you the real report afterwards, it is a bit of a problem. So that is—I don't know if you could ever stop—I think to what Mr. Roth said—if there is corruption and people are convinced that is the way they are going to do it, that is what they are going to do. So we have done everything that we feel that we can to prevent this type of activity, but again, it happened.

Mr. AUSTIN SCOTT of Georgia. But if they know that they are more likely to be audited in the future, that would be a deterrent.

Mr. DUFFY. I think the penalties need to be stiffer. I truly believe that. I think the penalties are too loose and they need to be implied—applied and they just need to be stricter penalties.

Mr. AUSTIN SCOTT of Georgia. Okay. All right. And I will leave it at that. Thank you for coming today. I know it has been a long day. And Mr. Chairman, I yield back the remainder of my time.

The CHAIRMAN. The gentleman yields back. The chair now recognizes the gentleman from Texas for 5 minutes, Mr. Neugebauer, sir.

Mr. NEUGEBAUER. Well, thank you, Mr. Chairman.

Mr. Duffy, I had to step out of the room but I wanted to make sure that you got an opportunity if you haven't already to explain the efforts that CME Group has taken to increase the speed for many of those customers to get their money back because that is something you didn't have to do but your firm has stepped up. Did you have a chance to—

Mr. DUFFY. I didn't walk them through all the steps, Congressman. I am happy to do it. The original—when this first happened we were trying to desperately get the accounts transferred to Mr. Corcoran's firm. Obviously, it took a significant amount of—but the most important thing was to get the monies that the Trustee had into the participants' hands. And our board made a decision not based off of large hedge funds or institutional dealers. Our board really made a decision off of the farmers and ranchers who needed those monies back into their accounts. So we put up originally a \$200 million guarantee to encourage the Trustee to give as much money back as possible. That was slowing the process so we upped it to \$550 million to encourage the Trustee to pay up to 75¢ of every dollar and if he fell short, CME would eat the \$550 million loss.

Mr. NEUGEBAUER. Yes, and I commend you for that because it has been I think pointed out in this testimony today that a lot of small farmers and ranchers got quite a bit of their operating capital tied up in—it puts a hardship on them.

Mr. Brodsky, you mentioned that along the way over the last I guess year or so you have had concerns about MF Global. And I know that FINRA has had some similar concerns and so did you all have discussions together about that?

Mr. BRODSKY. Yes, there were a variety of meetings and conversations, particularly between FINRA, CBOE, and the SEC on the broker-dealer side. And in fact when MF Global was pushing not to allow—or to cause the—us to not charge their capital for the concentration they had in the sovereign debt securities, the three of us got together and said we are not agreeing with you; you must do it. And that was something that we came to, and again, they pushed and we pushed back. And ultimately, the SEC has the final word and it was their decision that obviously we concurred in that they had to take a—recognize that even though it might not have been the way they would have wanted it to happen.

Mr. NEUGEBAUER. And so was the CFTC, did you all ever bring them into that conversation?

Mr. BRODSKY. I am not aware that they were at that point. This is the—I would call the issue of the bifurcated regulation that you have. And on the SEC side, you tend to see the securities regulators working together though I do know that in the recent past the SEC and the CFTC have worked together. But I think when the earlier conversations were taking place, I think it was just among the securities regulators.

Mr. NEUGEBAUER. Yes, because under Dodd-Frank, we have set up FSOC and one of the charges to FSOC was there was going to

be more cooperation and collaboration. This way when regulators are talking, everybody that could be impacted—so from the testimony that was issued today, I am beginning to think that evidently Secretary Geithner in his role as facilitator has some work to do in that area because we didn't seem to have the same levels of conversation going on at the CFTC as it seems that was going on at the Chicago—with the three entities——

Mr. BRODSKY. One of the suggestions we made in our testimony is that once we get through all the heavy work that we have to do to understand what happened that we as regulators should all sit together and determine whether there should be a more formalized kind of coordination in matters like this. So I think there was some—I am sure there was room for improvement.

And in addition, under Dodd-Frank there are certain mandates in the bill that require that the SEC and CFTC identify areas where they should harmonize regulations. There is no deadline to that but I certainly support that as a very positive objective of Dodd-Frank.

Mr. NEUGEBAUER. And that harmonization is an important part of that as well so that we don't put a bigger strain on the industry.

But I will say this—and I think Mr. Duffy pointed this out—since 1936 I think this is the first time that accounts have been commingled and there has been a loss. So I think one of the things we want to do here is we want to go on a fact-finding mission, make sure we understand all of the things that were going on so that—there will be some people that want to jump out there and create some more regulation. I am not sure that anything that was passed under Dodd-Frank would have prevented what happened here from happening. As alleged here, maybe some people broke the rules. And so when people break the rules, it doesn't matter how many rules you have.

So I think it is good and we look forward—I think some of you will be at our hearing next week. We want to make sure we have a thorough understanding of all of the pieces here before we jump to any conclusions.

And Mr. Chairman, I want to commend you for holding this hearing today. I think it was a very productive hearing, but what it did point out is there are still a lot of things we don't know and we need to know.

The CHAIRMAN. The gentleman is exactly right and I expect with good efforts we will know more of those things shortly, won't we?

With that, the gentleman yields his time back and I yield myself 5 minutes.

Mr. Brodsky, you testified that the CBOE had taken disciplinary action against MF Global five times as a result of examinations and investigations. What kind of activity did you find that was worthy of a discipline? And what kind of disciplinary actions did you take since we are discussing consistencies of management?

Mr. BRODSKY. In the course of our regulation of MF Global going back to 2003, there were a variety of actions, several of which resulted in financial penalties and censures. And there were I would say more technical things that happened but there were several times, as I said—I would say one, two—at least five and several of them resulted in fines and censures.

The CHAIRMAN. Okay. Mr. Fletcher, you commented as I was coming in the room I think to Mr. Conaway's question something about how you would address dealing with these issues in the future, and your response was I believe spread your business out?

Mr. FLETCHER. Yes. And I have thought about that afterwards. I would spread mine out but in the case of my customers, that is not an acceptable answer to them. I have probably 30 to 35 customers of mine who have individual brokerage accounts with—and as it happened, every one of them was with MF Global that I am aware of. They are—they have an IB that has a significant presence in our area and that is really not an option for them, because, they may be trading two to five to ten contracts, you know. My company is going hundreds of them; I can spread my stuff out. They can hardly do that.

The CHAIRMAN. So going from there, what would you say would be the single-most important action regulators could take to try and restore confidence in the futures markets?

Mr. FLETCHER. I am here testifying for National Grain and Feed Association and we, as an association, haven't come to a conclusion on what the best action would be. If you asked me that personally, the first thing that comes to my mind is having third party fiduciary holding the segregated funds that had an arrangement with CME to pay margins as necessary rather than a brokerage firm doing it.

The CHAIRMAN. Fair enough.

Mr. Duffy, when CME conducted the audit of MF Global the week of October 24, did the CME check the balances of the accounts with the depositories holding those funds or rely solely on the statements from MF Global's daily segregation reports?

Mr. DUFFY. What is important to note is that we did not do a full audit on the week prior to the bankruptcy. What we did was send in auditors to check the segregation reports to make sure that they tied out against third parties and ledgers and the third parties being the banks. When we did the initial report Wednesday—it takes a couple days to go through it when we are tying these out—we had most of it tied out between 85 and 95 percent of the tie-outs were done against the banks and the monies were there from Wednesday. So again if these transfers occurred from after Wednesday, we would not have known it. We were still tying out Wednesday on Thursday and Friday.

The CHAIRMAN. When was the first time you were contacted regarding any doubts about whether customer segregated funds were intact at MF Global by anyone?

Mr. DUFFY. The only time I was contacted was I will say Chairman Gensler called me on Friday prior to the Sunday or Monday bankruptcy and he asked me if I had any concerns about MF Global's capital. I said I have no knowledge; you will have to call our clearinghouse because I have no knowledge of that. So then I learned of a problem with their capital on Sunday evening early that it was an accounting error of roughly \$900 million, and then I was not informed until Monday morning of the 31st that it was no longer an accounting error and it had been transferred to the broker-dealer.

The CHAIRMAN. So Chairman Gensler contacted you on Friday before.

Mr. DUFFY. He contacted me along with their head of clearing and asked me if we had any concerns with MF Global's capital and I said I would have no reason to be. You would have to contact their folks in clearing and risk.

The CHAIRMAN. Did he offer anymore comments that——

Mr. DUFFY. That was the end of my conversation.

The CHAIRMAN. Fascinating. Mr. Luparello, based on press reports, it appears that FINRA raised red flags back in June regarding the risk-building within MF Global. Can you describe those risks and how you came to identify them?

Mr. LUPARELLO. Yes. The analysis we did of their audited financials filed in June had a footnote disclosure about the large repo to maturity on the European sovereign debt. That started the analysis that we shared with CBOE and eventually the SEC that the firm was not taking the proper haircuts on those positions. That conversation, as we have discussed, culminated in August with the firm taking those additional haircuts and disclosing them both in their periodic filings as a listed company and also in their FOCUS filings.

The CHAIRMAN. Thank you. My time has expired.

For the final period of questioning I turn to the gentleman from Virginia, Mr. Goodlatte.

Mr. GOODLATTE. Thank you, Mr. Chairman. This has been a long day and I appreciate you and the Ranking Member holding this hearing. And we certainly had a comprehensive exposition of the issues. I don't know if we have gotten all the answers that we need but certainly this has been worthwhile to assure folks that we and the industry are paying attention to the concerns that have been raised by the debacle at MF Global.

Mr. Roth, in your testimony you mention that FCMs are required to report on a daily basis the amount of funds required to be held in segregation and the amount actually held. Was MF Global fulfilling this requirement?

Mr. ROTH. Congressman, I think my testimony says that for the FCMs for which NFA is the DSRO, we require those firms to file the daily seg statements with us. We were not the DSRO for MF Global so not—MF Global was not making any filings with NFA.

Mr. GOODLATTE. Do they have a similar obligation to any other entity?

Mr. ROTH. Well, the CME was the DSRO and I am sure the CME has its own means of monitoring compliance with segregation requirements, but they would not have been filing their reports with NFA.

Mr. GOODLATTE. So you say the CME——

Mr. ROTH. CME was the DSRO.

Mr. GOODLATTE. Okay.

Mr. ROTH. And I am saying I am sure the CME monitors in its own way compliance with segregation requirements, but MF Global would not have been filing reports with NFA because we were not their DSRO.

Mr. GOODLATTE. Got you. So I should direct that question to Mr. Duffy?

Mr. DUFFY. We were—I am sorry.

Mr. ROTH. Go ahead.

Mr. DUFFY. We were receiving regular updates from MF Global on their segregation report, and as I said in my testimony, they showed excess funds of \$200 million all the way through Friday afternoon and then until the report came back to us on Monday when they gave us the real report and said it was a \$200 million deficit with the same date from the prior Thursday's report. So I know it is a little confusing, sir, but they were giving us updates. We were—I was just telling the Chairman before you walked in we were doing tie-outs of those segregation reports to the bank ledgers and other means to make sure that the money was matching up.

Mr. GOODLATTE. So is what you are telling me that they were providing you with false information up until they corrected all that with their——

Mr. DUFFY. I can only tell you what I have been shown by our attorneys, sir. We had two reports, one dated I believe October 27—and you can—they can correct me if I am wrong on the date—that we received I believe on Friday that showed a \$200 million excess of segregated funds. Once they decided to tell us not to look for the accounting error of \$900 million anymore, that it has been transferred into their broker-dealer account, they submitted another segs daily with the same October 27 date that showed a \$200 million deficit and not a \$200 million gain——

Mr. GOODLATTE. So——

Mr. DUFFY.—excess funds.

Mr. GOODLATTE. But it doesn't stand to reason that that all occurred over that weekend.

Mr. DUFFY. It doesn't stand to reason. All I can tell you is that we received one report on Friday that said they had \$200 million in excess funds and the same report we got on the following Monday dated from that Friday now showed a \$200 million deficit in segregated funds.

Mr. GOODLATTE. So that is when you first became aware that the amount required to be held in segregation was not the amount actually held?

Mr. DUFFY. I became aware of the amount that was a deficit on Sunday evening that there was a \$900 million shortfall. They called it an accounting error. They informed us at 2:00 in the morning that it was not an accounting error; they transferred the money to their broker-dealer. So that is when I found out that there was a problem.

Mr. GOODLATTE. Some news reports state that MF Global had been commingling funds for several days if not weeks. If this proves to be true, could MF Global have ensured in their daily report that there were enough funds in the segregated accounts?

Mr. DUFFY. Could they have—I am sorry, sir?

Mr. GOODLATTE. Could they have ensured that that was the case without giving you false information?

Mr. DUFFY. Again, we were tied out 85 to 90 percent of the third party tie-outs from the Wednesday daily report on Thursday and Friday and it did show that they were in excess segregation of \$200 million.

Mr. GOODLATTE. Great. Thank you.

Mr. DUFFY. Thank you.

Mr. GOODLATTE. Mr. Roth, I will go back to you. You state in your written testimony that self-regulation has served our markets and our nation well for a very long time. Would you elaborate on why market participants should remain confident in the current system?

Mr. ROTH. Well, I would point out a number of different things. One thing is that the self-regulators are subject to pervasive oversight by the CFTC. The CFTC comes in and does rule enforcement reviews of NFA all the time. They have reviewed every one of our regulatory programs. And as part of that review, the CFTC conducts audits of firms we have just audited to make sure that our audits were comprehensive and complete. And to my knowledge, they had never had any sort of material finding or any sort of problem with the audits that we have done. So I don't think the problem is who is doing the audits. I think the audits that have been done by the SROs have been comprehensive and complete, but there is no system that is foolproof. And as I mentioned earlier in my testimony, if someone is intent upon committing a violation of the Act, it—there is no regulatory system that can prevent them from doing that.

Mr. GOODLATTE. Okay. And then I will go back with your permission, Mr. Chairman, one last question for Mr. Duffy on that very point.

CME finished an audit of MF Global on August 4 and then another audit a week before MF Global filed for bankruptcy. Did these audits ever turn up anything of concern?

Mr. DUFFY. Congressman Goodlatte, the audit you are referring to that was complete on August 4 started in January. These audits take several months to do. There were some minor discrepancies but nothing out of the ordinary that they immediately fixed when we reported the audit to them of which we sent the letter to Mr. Corzine and he was sent the letter of our—copy of our audit. Then, we did not do a full audit the week prior to bankruptcy. As I said, we sent auditors in to do tie-outs of segregation reports. Full audits take 4 to 5 months.

Mr. GOODLATTE. So going back to the audit that was completed on August 4, does that lead you to conclude that these problems occurred over a short period of time toward the end of October or do you think the audit was insufficient that was completed—

Mr. DUFFY. Again, I am not an auditor. I can only go by what the reports say. It was started in January, it was completed in August, there were some minor discrepancies, they were fixed immediately by the firm. That is the last I had heard of it.

Mr. GOODLATTE. Okay. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. The gentleman's time has expired.

All time for questions has expired. Does the Ranking Member have any closing remarks?

Seeing none from the Ranking Member, I would simply note that this is not the last hearing nor certainly the last time this issue or the laws related to it will be addressed. We have discovered fascinating information that unfortunately still leaves many, many questions unanswered.

With that, the chair would like to dismiss the panel. And under the rules of the Committee, the record of today's hearing will remain open for 10 calendar days to receive additional material and supplemental written responses from witnesses and to any question posed by a Member.

This hearing of the Committee on Agriculture is adjourned.  
[Whereupon, at 5:57 p.m., the Committee was adjourned.]  
[Material submitted for inclusion in the record follows:]

SUPPLEMENTARY MATERIAL SUBMITTED BY HON. JILL SOMMERS, COMMISSIONER,  
COMMODITY FUTURES TRADING COMMISSION

During the December 8, 2012 hearing entitled, *Hearing To Examine the MF Global Bankruptcy*, requests for information were made to Hon. Jill Sommers. The following are the information submissions for the record.

**Insert 1**

Mr. HUELSKAMP. Thank you. And I wish you would share with the other Commissioners that obviously, if you were unaware, that looks rather suspect and reflects poorly on him as a Chairman of the Commission to invent something such as a statement of nonparticipation, which no one seems to know what it is other than he has already participated.

And another question I have, on July 20, which was the 1 year anniversary and then-deadline for the Dodd-Frank requirements, there were four conference calls and I believe you participated in one with MF Global. And could you describe what occurred in those conference calls?

Ms. SOMMERS. I don't believe I participated in a conference call with MF Global in July.

Mr. HUELSKAMP. You are correct. I am sorry. That was in December. I know there were four conference calls. I apologize. I had the wrong date on that.

Ms. SOMMERS. In December of 2010 I had a meeting in my office with MF Global.

Mr. HUELSKAMP. Yes. Was Jon Corzine in on that meeting?

Ms. SOMMERS. He was.

Mr. HUELSKAMP. And were there notes kept of this particular meeting?

Ms. SOMMERS. Perhaps. I don't recall whether I took notes. It was approximately a 15 minute meeting.

Mr. HUELSKAMP. Yes. I might ask if you would provide those to the Committee.

Attached is a record of the meeting with MF Global on December 21, 2010, which lists possible agenda items for the meeting and reflects that Jon Corzine and Laurie Ferber, General Counsel of MF Global, attended. The only note taken at the meeting was an addition to the agenda to reflect that the subject of disruptive trading practices was discussed.

ATTACHMENT

**Meeting with MFGlobal, December 21<sup>st</sup> at 10:30am**

**Agenda**

Dodd-Frank rule proposals, for example, those addressing conflicts of interest and governance of DCOs, DCMs and SEFs as they relate to fair and open access; the amendments to Rule 1.25 (Investment of Customer Segregated Funds) and the Protection of Cleared Swaps Customers Before and After Bankruptcy (individual customer segregation).

**Attendees**

Jon Corzine, MF Global's Chief Executive Officer  
Laurie Ferber, General Counsel

*disruptive trading practices*

**Insert 2**

Mr. HUELSKAMP. Well, it indicated to discuss segregation and bankruptcy with MF Global on 12/21 of 2010, I would think that would be a particularly important subject as we continue here.

But one other item as far as Mr. Gensler's meetings with Mr. Corzine, which one did occur on July 20. Do we have notes of what they discussed? And I think this is very strange. I was unaware until today that Mr. Gensler actually used to work for Mr. Corzine at Goldman Sachs and that seems very suspect, certainly, to my constituents. So if I might have an answer to that question.

Ms. SOMMERS. I can pass that on. I don't know if there are——

Mr. HUELSKAMP. We do not know if there are any notes of this closed-door meeting?

Ms. SOMMERS. To Mr. Gensler's meeting I do not know if there are notes.

I have referred Representative Huelskamp's request for notes to Chairman Gensler's office.

---

SUBMITTED STATEMENT BY NATIONAL PORK PRODUCERS COUNCIL

### Introduction

The National Pork Producers Council (NPPC) is an association of 43 state pork producer organizations and serves as the voice in Washington, D.C., for the nation's pork producers. The U.S. pork industry represents a significant value-added activity in the agriculture economy and the overall U.S. economy. Nationwide, more than 67,000 pork producers marketed more than 110 million hogs in 2010, and those animals provided total gross receipts of \$15 billion. Overall, an estimated \$21 billion of personal income and \$34.5 billion of gross national product are supported by the U.S. hog industry. Economists Dan Otto and John Lawrence at Iowa State University estimate that the U.S. pork industry is directly responsible for the creation of 34,720 full-time equivalent pork producing jobs and generates 127,492 jobs in the rest of agriculture. It is responsible for 110,665 jobs in the manufacturing sector, mostly in the packing industry, and 65,224 jobs in professional services such as veterinarians, real estate agents and bankers. All told, the U.S. pork industry is responsible for more than 550,000 mostly rural jobs in the U.S.

Exports of pork continue to grow. New technologies have been adopted and productivity has been increased to maintain the U.S. pork industry's international competitiveness. As a result, pork exports have hit new records for 18 of the past 20 years. In 2011, so far, the U.S. pork industry has exported nearly \$5 billion of pork, which added \$57 to the price producers received for each hog marketed. Net exports this year represent about 20 percent of pork production. The U.S. pork industry today provides 21 billion pounds of safe, wholesome and nutritious meat protein to consumers worldwide.

### Profile of Today's Pork Industry

Pork production has changed dramatically in this country since the early 1980s. Technology advances and new business models changed operation sizes, production systems, geographic distribution and marketing practices.

U.S. pork farms have evolved from single-site, farrow-to-finish (*i.e.*, birth-to-market) production systems that were generally family-owned and small by today's standards to multi-site, specialized farms that generally are still family-owned. (There are still many single-site operations.) The changes were driven by the biology of the pig, the business challenges of the modern marketplace and the regulatory environment. Separate sites helped in controlling troublesome and costly diseases and enhanced the effect of specialization. Larger operations can spread overhead costs, such as environmental protection investments and expertise, over more farms and buy in large lots to garner lower input costs. The change in sizes has been the natural result of economies of scale.

Marketing methods have changed as well. As recently as the early 1980s, a significant number of hogs were traded through terminal auction markets. Many producers, though, began to bypass terminal markets and even country buying stations to deliver hogs directly to packing plants to minimize transportation and other transaction costs. Today, hardly any hogs are sold through terminal markets and auctions, and the vast majority of hogs are delivered directly to plants.

Pricing systems have changed dramatically, too, from live-weight auction prices to today's carcass-weight, negotiated or contracted prices, with lean premiums and discounts paid according to the predicted value of individual carcasses.

Today, the prices of a small percentage of all hogs purchased are negotiated on the day of the agreement. All of the other hogs are sold/priced through marketing contracts or are packer produced in which prices were not negotiated one lot or load at a time but determined by the price of other hogs sold on a given day, the price of feed ingredients that week or the price of lean hog futures on the Chicago Mercantile Exchange (CME). These risk-management mechanisms are entered into freely and often aggressively by producers and packers alike to ensure a market for and a supply of hogs, respectively, and to reduce the risks faced by one or both parties.

All of this means the days of rising at dawn to simply feed and care for ones pigs are over. In addition to that daily task, today's pork producers—many of whom have at least a bachelor's degree in animal science, business, economics or similar discipline—must be very proficient at managing the prices they pay for their inputs, *i.e.*, corn and soybean meal, and at calculating the prices they'd like to receive for their hogs when they sell them.

There are a number of ways that pork producers manage their risk, but the most common is use of the futures market—at least for a percentage of the pigs they sell each year.

### **How Futures Market Works**

The futures market, which has been used for nearly 150 years, provides an efficient and effective way to manage, or transfer, price risk. It also provides price information that is used as a benchmark in determining the value of a particular commodity or financial instrument at a specific time.

The market's benefits, risk transfer and price discovery, reach every sector of the world economy, where changing market conditions create economic risk in the diverse fields of agricultural products, foreign exchange, imports, exports, financing and investments.

In the agricultural industry, futures contracts are bought and sold to protect producers from the volatility in the commodities market. Hundreds of different strategies are used, but all establish a price level now for items such as feed grains to be delivered later, providing what amounts to insurance against adverse price changes. This is called hedging.

A relatively small amount of money, known as initial margin, is required to buy or sell a futures contract. So, for example, on a particular day, a margin deposit of just \$1,000 might allow for the purchase or sale of a futures contract covering \$25,000 worth of soybean meal. (These transactions, however, must be backed by the financial resources of the purchaser; the buyer must be able to execute the contract.)

The margin deposit simply locks in the price—based on that particular day's market for, say, soybean meal—that will be paid at a future date. Using the example above, suppose on Dec. 20, 2011, soybean meal is selling for delivery in March at \$100 a ton. A pork producer buys a futures contract for 250 tons—\$25,000—with a \$1,000 margin deposit.

If at delivery time the price in the market has risen to \$110 a ton, the producer will need to pay the soybean meal supplier \$27,500 (250 tons times \$110 per ton), or \$2,500 more than the price at the time the futures contract was bought. But that higher cost is offset by the profit the producer makes selling the \$100-a-ton futures contract; the contract is worth \$10 a ton more, or \$2,500.

The margin required to buy or sell a futures contract is solely a deposit of good faith that can be drawn on by a brokerage firm to cover losses that a customer may incur. If the funds in a margin account are reduced by losses to below a certain level—known as the maintenance margin requirement—a broker will require an additional deposit of funds to bring the account back to the level of the initial margin. (Additional funds also may be required if an exchange or brokerage firm raises its margin requirements.) Requests for additional funds are known as margin calls.

Had the price of soybean meal in the example above dropped by \$10 a ton, selling for \$22,500, the producer would have a margin call of \$2,500 (250 tons times \$10 per ton).

Because accounts must maintain the initial margin deposit, margin calls may occur numerous times throughout a futures contract's time span, even, theoretically, every day.

Minimum margin requirements for a particular futures contract at a particular time are set by the commodities exchange, such as the CME, on which the contract is traded. Exchanges continuously monitor market conditions and risks and, as necessary, raise or reduce their margin requirements. Individual brokerage firms may require higher margin amounts from their customers than the exchange-set minimums.

### **Pork Producers Use Futures To Manage Risk**

U.S. pork producers use futures contracts to manage risk—that is, the price volatility of commodities—and to bring a semblance of stability to their business. Indeed, in today's financially uncertain times, most agricultural lenders, who provide pork operations with working capital—and even lines of credit to purchase futures contracts—require producers to employ risk management tools such as futures contracts.

It is important to point out that pork producers (and other farmers and ranchers) use the futures market to ensure the viability of their business and, thus, to produce pork; they are not speculators who “play” the market simply for the profits they can make—using futures contracts as financial—and who never take delivery of product for which they purchase or sell a futures contract.

Without futures contracts or other risk-management tools, producers would lose flexibility and revenue, and consumer prices would increase, testified one witness

at the Dec. 13 hearing of the Senate Agriculture, Nutrition, and Forestry Committee.

Livestock producers must hedge against increases in the prices they pay for feed grains *and* against decreases in the prices they receive for their animals. And most of them use hedging to plan for the next year or more. Some producers, for example, already have purchased futures contracts for feed grains on which they will take delivery in early 2013.

Here's how one pork producer hedges his risk:

The producer pays a broker \$1,400 for each futures contract, locking in the price of corn and soybean meal—contracts are for 5,000 bushels of corn and for 100 tons of soybean meal—and setting the sales price of his hogs—a contract covers 40,000 pounds of carcasses, which is about 200 pigs. (The prices are locked in on the date the contracts are bought.)

This producer hedges his risk on about 1/3 of the 350,000–400,000 hogs he markets each year, or about 150,000 pigs. (The other hogs are priced through contracts with a meat packer; the feed grain prices are set through contracts with feed mills, which, in turn, manage their risk, using the futures market.) That means hundreds of futures contracts, with between \$1.3 million and \$1.5 million—the initial margin—to cover them deposited with a broker. The producer also has with a lender a line of credit that can be tapped should he need to deposit additional funds to meet margin calls. Every day, the producer must be aware of—and sometimes act on—the market fluctuations in prices.

If corn and soybean meal prices in the market go up and hog prices go down, the producer will have excess funds in his account. If the feed grain prices go down and hog prices go up, the producer will have a shortfall in funds, and the broker will issue a margin call for additional funds to be deposited.

Producers of all sizes achieve risk management through the futures market without directly using a broker. Some producers, for example, sell pigs to be delivered at a future date to a packer or buy feed grain to be delivered in a month or two from a supplier. The risk associated with those transactions are borne by the packer and the feed grain supplier, which manage *their* risk in the futures market.

It must be noted that having commodities exchanges in the United States is vitally important not only to livestock and poultry producers and other farmers but to consumers. If producers had to use an exchange in, say, Brazil, the price of commodities would be set by that exchange—certainly still determined by supply and demand—but the total cost would be higher because of transportation fees. This would raise producers' costs of getting a hog to market, and some part of that, no doubt, would be passed along to consumers in the form of higher retail pork prices. (NOT SURE ABOUT THIS.)

#### **Implications for Pork Producers of MF Global's Bankruptcy**

Many agricultural producers, including U.S. pork producers who produce at least 20 percent of U.S. hogs, had funds with MF Global. Most, if not all, of them, however, did not deposit their funds directly with the clearing broker. They opened futures trading accounts with an "introducing" broker, which put the funds into MF Global, which had the financial wherewithal to make large transactions in the commodities exchanges.

Most producers were unaware of their connection to MF Global, so they were stunned to learn in early November, when the clearing broker filed for bankruptcy, that their futures accounts were frozen and funds were "missing."

The seriousness of the MF Global debacle cannot be understated. Had such a loss of customer funds happened during a worse economic climate—2008–2009, for example, when pork producers were losing \$24 per hog and 50 percent of their equity and more than several went out of business—there likely would have been widespread bankruptcies in the agricultural industry and severe food supply issues.

It has been reported that financial market participants were not so shocked by the size of MF Global's loss but by the fact that retail investors lost money in "customer accounts," which were supposed to be segregated, or at least there were supposed to be restrictions on how funds in the accounts could be used by the clearing broker. (It was far from comforting for producers to hear former MF Global CEO Jon Corzine testify Dec. 8 before the House Agriculture Committee, "I simply do not know where the money is.")

It remains unclear exactly how customer funds were lost, but for pork producers, the "how" is almost irrelevant. The loss *and* use of funds they expected to be used for their transactions—and the apparent lack of adequate oversight of MF Global's activities by governmental and non-governmental entities—has shaken producers' confidence in the futures market and in regulators' ability to police traders.

And that loss of confidence will cost producers and consumers.

**NPPC Asks**

U.S. pork producers need assurance that the markets will work and that the funds in their futures accounts are safe. And while NPPC is pleased that the Commodity Futures Trading Commission (CFTC) has approved a rule to enhance protections for where customer funds can be invested, it does not support more regulations for regulations' sake.

The entire futures trading system must be assessed, from exchanges to brokers to clearinghouses, and oversight of the system must be exercised by the public- and private-sector entities that have responsibility. Put simply: There must be trust in the exchanges between the buyers and sellers; commodities trading customers must have faith in the system.

Possible "fixes" to prevent another MF Global situation include:

- Impose stiffer criminal and/or civil penalties for misuse of customer accounts.
- Require brokers to obtain permission before using customers' funds for purposes other than customer transactions.
- Extend to commodities exchange customers insurance similar to that provided to securities investors through the Securities Investors Protection Corporation.
- Require other financial tests and additional audits of brokers and dealers by governmental and non-governmental entities.

**Questions**

The collapse of MF Global and the missing customer funds raise a number of questions to which NPPC hopes Congress will get answers. Among pork producers' questions:

- Are there mechanisms that can be put in place to prevent another MF Global?
- Will customers be given priority in the bankruptcy proceedings to recover funds?
- Will producers whose funds were with MF Global be made whole?
- How will the transfer of funds from MF Global to new accounts with other clearing brokers be treated by the Internal Revenue Service? Will such transfers be treated as taxable events?
- Will actions be taken to simplify and expedite claims to recoup funds, which producers must file with MF Global's bankruptcy trustee?

**Conclusion**

U.S. pork producers depend on, and in many cases are required by their lenders—through the covenants of operating capital loans—to have, risk management tools, including futures contracts. So, producers must have confidence in the futures market; the credibility of entire system, therefore, must be restored.

NPPC is ready to work with lawmakers and, if necessary, regulators to re-establish integrity *and* faith in the system.

---

SUBMITTED QUESTIONS

**Response from Hon. Jill Sommers, Commissioner, Commodity Futures Trading Commission**

*Question submitted by Hon. Chellie Pingree, a Representative in Congress from Maine*

*Question.* Ms. Sommers, on Tuesday the CFTC adopted the so-called "MF Global Rule" which bans the use of customer funds for in-house repo-to-maturity transactions and re-defines the permitted investments that FCMs can purchase with customer funds in repo-to-maturity transactions with third parties. The original list of acceptable investments for customer segregated funds is spelled out in the Commodity Exchange Act, and hews to conservative choices such as Treasuries, municipal bonds, and other products fully backed by the United States or a U.S. locality.

Beginning in 2000, however, the CFTC used its discretionary authority under the statute to expand the list of allowable investments, first allowing the purchase of certificates of deposit, commercial paper, and interests in government sponsored entities. In 2005, it permitted investments in foreign sovereign debt and in-house transactions.

Now that the CFTC has rolled back those de-regulatory measures, how can we as lawmakers ensure that a similar de-regulatory slide does not happen again?

*Answer.* First, I would like to address some misconceptions regarding the relationship between Commission Regulation 1.25 and the investments MF Global made in

foreign sovereign debt through the off-balance sheet “repo-to-maturity” transactions that have been widely reported. MF Global was a dually-registered Broker Dealer/Futures Commission Merchant (BD/FCM). The BD arm of MF Global was regulated by the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA). The FCM arm of MF Global was regulated by the CFTC. The “repo-to-maturity” investments in foreign sovereign debt made by MF Global were conducted through the BD arm of the company under the oversight of the SEC and FINRA.

Commission Regulation 1.25 lists the investments that a CFTC-regulated FCM is permitted to make with customer segregated funds. Prior to the recent changes made to Regulation 1.25, FCMs were allowed to invest customer funds in highly-rated foreign sovereign debt, but only to hedge foreign currency risk posed by fluctuations in a particular foreign currency posted by the customer to the FCM. Such investments were strictly limited to the amount of a foreign nation’s currency that the customer posted. Investment in foreign sovereign debt for purposes of speculation was never allowed by Regulation 1.25, and Regulation 1.25 does not, and never has, governed investments made by the BD arm of a dually-registered BD/FCM.

“Repo-to-maturity” investments have never been allowed under Regulation 1.25. Section 4d of the Commodity Exchange Act and Regulation 1.25 require that the value of customer segregated accounts remain intact at all times. When an FCM invests customer funds, that actual investment, or collateral equal in value to the investment, must remain in the customer segregated account. 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 a segregated account, invest it, or use it for its own purposes, and then return the money to the segregated account at some later time. If an FCM does so, it has violated the law. If an FCM were to invest customer segregated funds in foreign sovereign debt in order to speculate and hopefully make a profit, the FCM would violate the law under either the current or former versions of Regulation 1.25.

It is critical that customer funds be invested in a manner that minimizes their exposure to credit, liquidity and market risks, both to preserve their availability to customers and clearinghouses and to enable investments to be quickly converted to cash at a predictable value. Accordingly, Regulation 1.25 establishes a general prudential standard by requiring that all investments be “consistent with the objectives of preserving principal and maintaining liquidity.” In order to ensure that all investments of customer funds continue to meet this prudential standard, I believe the CFTC should receive information from FCMs and clearinghouses on a regular basis detailing how customer funds are invested. The Commission should also regularly review the list of permitted investments under Regulation 1.25 and revise the list as necessary to reflect current market conditions.

**Response from Hon. Jon S. Corzine, former Chief Executive Officer, MF Global Inc.**

*Questions submitted by Hon. Chellie Pingree, a Representative in Congress from Maine*

*Question 1.* You have described the profit MF Global obtained from RTM transactions as the difference between the interest earned on the security and the interest charged to MF Global for the purchase of that security. As you described it, the interest on the security would be greater than the interest charged for that purchase, producing income for you.

Since these transactions involved the use of customer funds, how much of that interest income was provided to the customers?

*Answer.* It is my understanding that no FCM customer funds were invested in the RTM transactions. It is further my understanding that the RTM transactions were entered into for the benefit of MF Global, and that all interest income earned from the transactions was for the benefit of MF Global.

*Question 2.* Do you know if customers were even aware of these transactions?

*Answer.* MF Global made numerous disclosures regarding the RTM transactions, including in its audited financial report that was issued at the close of the 2011 Fiscal Year, and in certain quarterly financial filings both before and after that year-end filing. MF Global also discussed the RTM transactions during various investors calls. MF Global also issued regulatory filings in connection with FINRA’s decision that MF Global needed to maintain additional net capital.

**Response from Hon. Terrence A. Duffy, Executive Chairman, CME Group Inc.**

*Question submitted by Hon. Chellie Pingree, a Representative in Congress from Maine*

*Question.* Part of the oversight of FCMs like MF Global involves disclosures to one of the self-regulatory organization for the derivatives industry. In the case of MF Global, it appears the front-line SRP was the Chicago Mercantile Exchange (CME). But the CME is also a publicly-traded entity that generates revenue through trades made through its exchange. MF Global accounted for a significant volume of those trades.

Is there a conflict of interest for a public company that is tasked with regulating an entity that is a critical part of its own business plan?

*Answer.*

**Industry Regulation**

Futures markets are commonly referred to as being “self-regulated,” but “self-regulation” in that context is a misnomer because the regulatory structure of the modern U.S. futures industry is in fact a comprehensive network of regulatory organizations that work together to ensure the effective regulation of all industry participants. The Commodity Exchange Act (“CEA”) establishes the Federal statutory framework that regulates the trading and clearing of futures and futures options in the United States, and following the recent passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, its scope has been expanded to include the over-the-counter swaps market as well. The CEA is administered by the U.S. Commodity Futures Trading Commission (“CFTC” or “Commission”), which establishes regulations governing the conduct and responsibilities of market participants, exchanges and clearing houses. The CFTC conducts its own surveillance of the markets and market participants and actively enforces compliance with the CEA and Commission regulations. In addition to the CFTC’s Federal oversight of the markets, exchanges separately establish and enforce rules governing the activity of all market participants in their markets. Further, the National Futures Association (“NFA”), the registered futures association for the industry, establishes rules and has regulatory authority with respect to every firm and individual who conducts futures trading business with public customers. The CFTC, in turn, oversees the effectiveness of the exchanges, clearing houses and the NFA in fulfilling their respective regulatory responsibilities.

It should be clear from the foregoing that the futures industry is a very highly-regulated industry with several layers of oversight. The industry’s current regulatory structure is not that of a single entity governed by its members regulating its members, but rather a structure in which exchanges, most of which are public companies, regulate the activity of all participants in their markets—members as well as non-members—complemented with corollary oversight by the NFA and CFTC.

**CME Group Regulation**

As the world’s leading and most diverse derivatives marketplace, CME Group is deeply cognizant of its important role in the context of the global market infrastructure. We serve the risk management needs of a wide variety of customers across a broad array of asset classes, and economic decisions around the globe are informed by the price discovery provided through our transparent and competitive markets. CME Group fully appreciates the responsibilities that come with the leadership position we occupy, and we are unequivocally and demonstrably committed to preserving the integrity of our markets and protecting the financial safety and soundness of our clearing house. We understand better than anyone that our company’s reputation and our customers’ confidence are on the line with every transaction executed on our markets and with the completion of every clearing cycle.

As discussed further below, there is no *per se* conflict of interest that arises simply because CME Group is a public company that is also tasked with keeping its markets fair and open by regulating the users of our markets. To the contrary, there is substantial evidence that such private regulation has served the markets and market participants very well. Although we recognize that exchange sponsored regulation creates a theoretical possibility of conflicts, such possibilities exist in every organization, and the operative issues are whether organizational structures are effectively designed to mitigate the potential for conflicts and whether appropriate controls are in place to properly remediate any potential conflict that does in fact arise. At CME Group, we have very compelling incentives to ensure that our regulatory programs operate effectively and we have established a robust set of safe-

guards designed to ensure these functions operate free from conflicts of interest or inappropriate influence.

#### ***Incentives for Rigorous Regulation***

In our view, no entity operating independent from CME Group could possibly have stronger intrinsic motivations to ensure the operation of a fair and financially sound marketplace.

- Our ability to attract and retain business fundamentally depends on our customers' confidence in the integrity of our markets, and exceeding our customers' expectations in that regard is one of the cornerstones of our business model. Ensuring that our markets are defined by effective and appropriately balanced regulation is a competitive advantage that draws institutional, commercial and individual customers to CME Group.
- As a public company, it is only by performing our regulatory functions well that we avoid the severe reputational repercussions and associated impacts to shareholder value that would arise if lax regulation or improper conflicts were to compromise our commitment to fair, transparent and financially sound markets.
- CME Group's own capital is first at risk if a failed clearing firm's capital and collateral posted to CME is insufficient to cover a default at the clearing house, giving us the strongest possible economic incentive to ensure robust oversight of our clearing firms' compliance with our rules and CFTC regulations.
- In addition to strong economic and reputational self-interest, CME Group is subject to robust regulatory oversight, as further detailed in the next section, creating powerful regulatory incentives for CME Group to effectively regulate its markets.

No other entity that might conceivably conduct the regulation that CME Group performs of its markets and of the financial practices of its clearing members would have such compelling interests to perform as well. Given this context, there can be little question that the interests of CME Group, its customers and its shareholders are fully aligned in promoting a rigorously effective regulatory environment.

#### ***Government Oversight***

As introduced at the outset of this letter, it is important to recognize as well that regulation at CME Group does not operate in a vacuum, but is subject to active government oversight, primarily by the CFTC.

- CME Group's exchanges are registered as designated contract markets (DCMs) with the CFTC, and our clearing house is likewise registered as a derivatives clearing organization (DCO).
- In order to achieve registered status, we are required to fulfill substantial regulatory obligations codified in the Commodity Exchange Act's 23 core principles for DCMs and 18 core principles for DCOs. These include core principles requiring that we establish structures and enforce rules to minimize conflicts of interest in our decision making processes and that we have appropriate procedures for resolving potential conflicts.
- The CFTC's Division of Market Oversight actively oversees DCM compliance with core principles and its Division of Clearing and Risk oversees DCO compliance. Exchanges and clearing houses are continually subject to both formal and informal reviews of how effectively we fulfill our regulatory mandates. In the event CME Group's exchanges or clearing house were to fail to comply with the core principles, the company could face significant sanctions, reputational exposure and even compromise the registration status which allows us to operate our markets.

#### ***Proven Track Record as Industry Leader***

CME Group has a proven track record of taking industry leading measures to ensure that our regulatory responsibilities are executed without conflicts or undue influence.

- CME Group was the first futures exchange to create a Market Regulation Oversight Committee (MROC) to augment the independence of our regulatory functions. The MROC is a board-level committee composed solely of independent (*i.e.*, public) members of CME Group's Board of Directors, and we created this committee well before the CFTC determined to require that all DCMs establish

such committees. Pursuant to its publicly available charter,<sup>1</sup> the MROC provides independent oversight of the policies and programs of CME Group's Market Regulation and Audit Departments in order to help ensure the effective administration of our SRO responsibilities and that those responsibilities are executed independent of any improper interference or conflict of interest.

- CME Group was also the first futures exchange to include independent, public individuals on our disciplinary committees. Again, the CFTC subsequently adopted this model for all DCMs, establishing minimum requirements for public representation on disciplinary panels, requirements which CME Group independently chooses to exceed.
- We also have a substantial ethics and compliance program and related certification processes for all employees, as well as an additional Confidentiality Policy for the Market Regulation and Audit Departments<sup>2</sup> which sets forth a rigid framework that precludes the use or disclosure of information obtained in the context of fulfilling our regulatory obligations other than for regulatory or risk management purposes.

#### ***Investment in Integrity of our Markets***

CME Group invests substantial resources in our efforts to protect the integrity of our markets and the financial stability of our clearing house. These include:

- 150-person Market Regulation Department.
- 61-person Audit Department.
- Functions such as Clearing Risk Management, Regulatory Information Technology, the Globex Control Center and the Legal Department, among others, additionally support various facets of our regulatory functions.
- Our investment of tens of millions of dollars each year in our regulatory efforts reflect the importance we place on this commitment to our market participants, and also substantially reduces the financial and operational burdens on Federal regulatory agencies. The exchanges' regulatory programs operate at no cost to the taxpayer and, in fact, the exchanges pay the CFTC for the CFTC's program of oversight of exchange regulatory programs.
- Significant investments in our regulatory technology, including staff dedicated solely to the support and continuous development of our regulatory technology infrastructure, ensure that our regulatory and market protection capabilities anticipate and evolve with the changing dynamics of the marketplace. CME Group owns or has applied for numerous patents related to its regulatory technology and other tools designed to help protect against disruptions in our markets. We have developed an exceptionally granular audit trail of market activity and powerful and flexible data query and analytical tools that allow our regulatory staff to examine real-time and historical order, transaction and position data, maintain profiles of markets and market participants, and to detect trading patterns potentially indicative of market abuses.
  - Following the "Flash Crash" on May 6, 2010, for example, CME Group was able, later that same night, to provide the CFTC with a detailed account, sequenced to the millisecond, of every order, trade, cancellation and modification that took place in its relevant markets on that day. Moreover, it was our ingenuity and investment in developing and implementing market controls that effectively halted the market break that day by automatically pausing the market long enough to source liquidity and that helped to ensure, unlike other venues, that no trades had to be canceled.
- With respect to our open outcry markets, we independently elect to invest in high-end, comprehensive camera surveillance of our trading floors to detect and deter abuses—not because any rule mandates that we do so, but because of our commitment to effectively fulfill our mission to protect the integrity of our markets.
- Our clearing house's financial safeguards system is continually evaluated and updated to reflect the most advanced risk management and financial surveillance techniques and capabilities.

<sup>1</sup> <http://files.shareholder.com/downloads/CME/1670414224x0x119341/d801a2be-bc2f-40fa-94b1-1dadd0d59171/market-regulation-committee.pdf>.

<sup>2</sup> <http://www.cmegroup.com/market-regulation/overview/files/confidentialitypolicy.pdf>.

**Enforcement**

CME Group's effectiveness and assertiveness in regulating its markets are also reflected in the results of our surveillance and enforcement programs.

- In 2011, CME Group's exchanges opened approximately 700 regulatory inquiries, in addition to conducting proactive regular surveillance, and took 138 formal disciplinary actions against market participants.
- Two of those recent actions, resulting in \$850,000 in fines and remedial actions, were taken against one of our most active proprietary trading firms for failing to properly supervise and test its deployment of automated trading systems. In another recently resolved matter, eighteen brokers and locals in a particular market on the trading floor were fined more than \$600,000 and subject to trading suspensions for engaging in non-competitive trades that disadvantaged other market participants.

Direct regulation by the exchange offers our regulators unique proximity to the markets, market participants and the broader resources of the exchange in ways that foster the development of expertise that not only helps to make our regulatory staff more effective, but also assists Federal regulators in our common objective of preserving the integrity of the markets.

- Most of our interaction with Federal agencies occurs with the CFTC, and its Division of Enforcement publishes a report of its activity for each fiscal year. Its most recent full report, for FY 2010, noted that it took 57 enforcement actions.<sup>3</sup> In 30% of those actions, CME Group either referred the matter to the CFTC or provided assistance to the CFTC.
- Excluding enforcement actions outside of CME Group's regulatory purview, such as forex fraud, the percentage of CFTC actions in which CME Group referred the matter to the CFTC and/or provided assistance to the CFTC was 68%.
- An example of how exchange sponsored regulation and Federal regulation work together is evident in another 2011 matter whereby CME Group regulators initially took summary and emergency actions to bar a party engaged in violative practices from our markets and referred the matter to the CFTC and Department of Justice. The CFTC subsequently filed a civil action against the individual, and in December 2011, he was sentenced to 44 months in prison and ordered to pay restitution of approximately \$369,000 after having pled guilty to wire fraud.

Exchange sponsored regulation also often allows for more expedient identification of potential issues given our knowledge of and proximity to the markets, as well as the ability to react more quickly and flexibly to potential market and regulatory issues; in certain matters, that speed can make all the difference between having the ability to freeze or recoup misappropriated money and losing it forever to wrongdoers.

- For example, in a series of three separate recent cases resolved in 2011, the CME Group exchanges were able to quickly identify suspicious activity in our markets involving off-shore parties seeking to misappropriate money from other unwitting market participants. We promptly referred those matters to the CFTC which subsequently filed suit against the parties in Federal court. Our ability to quickly detect this activity and assist the CFTC in its subsequent investigatory efforts resulted in fines and restitution of more than \$3.5 million and, by quickly freezing funds, prevented \$7.2 million more from being stolen.

**MF Global Bankruptcy**

The MF Global bankruptcy was not a failure of exchange sponsored regulation. CME Group's clearing house fully met its obligations to all other clearing member firms and their customers, and our Audit team performed its responsibilities in regard to MF Global consistent with the highest professional standards.

- As CME Group has noted in its testimony before several Congressional committees, 100% of the customer segregated collateral posted to CME and held at the clearing level, amounting to \$2.5 billion, was fully accounted for. The well-publicized shortfall in customer collateral came from the customer segregated funds held at the FCM level, not funds held at the clearing level.

<sup>3</sup>The CFTC recently released statistics for FY 2011, which noted the filing of 99 enforcement actions and the opening of more than 450 investigations, but the full report is not yet available.

- MF Global's improper transfer of customer segregated funds held at the FCM level was a very serious violation of the Commodity Exchange Act and exchange rules, and the resulting shortfall in customer segregated funds was an unfortunate first in our industry's long history. However, no regulator, whether an exchange sponsored regulator or otherwise, can guarantee that individuals will not break rules—regulators can seek to establish appropriate rules, monitor compliance with the rules and ensure that market participants are appropriately accountable for breaches of the rules.
- CME Group is fully cooperating with Federal authorities in the MF Global matter to assist them in their investigatory efforts and is working with the industry to review how current safeguards for customer segregated funds held at the firm level can be strengthened.

To put it plainly, there was no conflict of interest with respect to CME Group's regulation of MF Global, and any suggestion that conflicted regulation contributed to the MF Global fiasco is misplaced. Indeed, in 2008 and 2009, CME Group fined MF Global \$400,000 and \$495,000, respectively, for supervision failures and other violations of trading practices rules, clearly indicating that CME Group's regulators actively monitored and enforced compliance with the rules by MF Global, just as we do with every other market participant.

Notwithstanding the fact that MF Global's misconduct was the cause of the shortfall in customer segregated funds, CME Group's efforts in the wake of these events speak to the level of our commitment to ensuring our customers' confidence in our markets.

- We made an unprecedented guarantee of \$550 million to the SIPC Trustee in order to accelerate the distribution of funds to customers.
- CME Trust pledged virtually all of its capital—\$50 million—to cover CME Group customer losses due to MF Global's misuse of customer funds.
- CME Group has also recently announced that it will establish a \$100 million fund designed to provide additional future protections of customer segregated funds for U.S. family farmers and ranchers who hedge their business in our markets.

No other exchange or clearing house has taken such actions.

### **Conclusion**

CME Group's record belies any suggestion that conflicts of interest arising from exchange sponsored regulation have precluded us from assertively regulating our markets. The current regulatory model has served the futures industry, its customers and the public very well, and MF Global's misconduct should not undermine that record.

The utility of SROs has been consistently recognized by Congress. For example, the Commodity Futures Modernization Act of 2000 embraced the SRO regulatory structure by further defining the SROs' complementary role *vis-à-vis* the CFTC and law enforcement agencies. In 2008, in "The Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure", Treasury recommended that the SRO model be preserved for the futures and securities industries "[g]iven its significance and effectiveness." Similarly, in 2009, Treasury's "Financial Regulatory Reform—A New Foundation: Rebuilding Financial Supervision and Regulation" further endorsed the SRO structure. Most recently, the Dodd-Frank Wall Street Reform and Consumer Protection Act recognized the substantial public good that effective exchange sponsored regulation delivers and extended the core principles based SRO regulatory regime to the previously unregulated swaps market.

In conclusion, CME Group's regulatory efforts have had a significant impact on enhancing market integrity. We have a robust and proven model for managing against potential conflicts of interest, and the public's and market participants' interest in well and efficiently regulated CME Group markets continues to be best served by our strong and innovative self-regulatory programs buttressed by effective CFTC oversight.