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EXAMINING THE FUTURES MARKETS: RESPONDING TO THE FAILURES OF MF GLOBAL AND PEREGRINE FINANCIAL GROUP

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY UNITED STATES SENATE

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EXAMINING THE FUTURES MARKETS: RESPONDING TO THE FAILURES OF MF GLOBAL AND PEREGRINE FINANCIAL GROUP

Wednesday, August 1, 2012

UNITED STATES SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY,
Washington, DC

The Committee met, pursuant to notice, at 9:07 a.m., in room 328A, Russell Senate Office Building, Hon. Debbie Stabenow, Chairwoman of the Committee, presiding.

Present: Senators Stabenow, Harkin, Baucus, Klobuchar, Gillibrand, Roberts, Lugar, Johanns, Boozman, Grassley, Thune, and Hoeven.

STATEMENT OF HON. DEBBIE STABENOW, U.S. SENATOR FROM THE STATE OF MICHIGAN, CHAIRWOMAN, COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

Chairwoman STABENOW. Well, good morning. The Committee on Agriculture, Nutrition and Forestry will be called to order. We appreciate very much our witnesses this morning on a very, very important topic and appreciate members' attendance this morning.

About 8 months ago, farmers and ranchers all across America woke up to some shocking news: MF Global, one of the Nation's largest futures commission merchants, had filed for bankruptcy, and at minimum, hundreds of millions of dollars of customer money had gone missing.

A loss of customer money of this magnitude had never happened before. It was something that should not have been able to happen. It has been an article of faith since the early days of the futures markets that customer money is to be kept separate and safe. But on October 31, 2011, that faith was broken.

Questions were raised about how these segregated funds were being used or if the system worked. Questions were raised about how repeated audits and reviews had missed problems that contributed to the failure. We were assured that MF Global was an outlier.

Then, on July 10, 2012, it happened again. The circumstances were certainly different and in some ways more dramatic. For the second time in 8 months, customers were left holding the bag when their segregated money was misused. Our farmers and ranchers and other businesses need these markets to work. They need to have faith that they can use these markets to manage their risk.

We have certainly seen this year that their risks are many, but one of those risks should not be that their futures broker firm will go out of business and their money will disappear.

We have heard from farmers and businesses who, after MF Global collapsed, opened accounts at Peregrine. For these folks, lightning really does strike twice, and they rightfully want to know why. I want to know why. The members of this Committee want to know why. And millions of farmers, ranchers, and business owners across the country who need these markets to function properly are demanding to know why.

I have three goals for this hearing, the same goals that we had last December when we brought the MF Global executives before the Committee. First of all, our charge is to make sure customers get their money back. It is critical for the integrity of these markets that customers are first in line to get their money. We also want to make sure that individuals who engage in wrongdoing are held accountable. And we want to determine what change need to be made to prevent something like this from happening again.

What that change will look like is a question that we need to resolve. I have asked for recommendations after MF Global. The Ranking Member and I have asked for input, and the Committee today will hear from some of those who have given us their input.

We also asked where the investigations were after MF Global, and all these months later, they are still ongoing. I am eager to hear an update on where things stand with the investigations now. We need to know answers and hold people accountable. If customers do not have faith in the markets, the markets fail. It is as simple as that.

I hope today's hearing can start to rebuild that faith for the millions of people that need these markets to work.

I would now turn to my friend and Ranking Member, Senator Roberts.

STATEMENT OF HON. PAT ROBERTS, U.S. SENATOR FROM THE STATE OF KANSAS

Senator ROBERTS. Well, thank you, Madam Chairwoman, for that excellent statement, and thank you for scheduling this hearing on an important issue regarding our oversight responsibilities for the CFTC.

While today's hearing is certainly of concern to our constituents, we must also work with you and the rest of our colleagues to consider how we can help farmers and ranchers who are suffering from the most serious drought in memory, but we cannot ignore our responsibilities to oversee an equally important part of the American economy. That is the commodity futures and derivatives industry.

So today we have a two-part hearing. First, we will hear from the CFTC and the bankruptcy trustees who continue to investigate the details of the MF Global situation and now Peregrine's collapse and bankruptcy. Second, we will hear from industry groups with regard to their recommendations to strengthen and secure the futures and derivatives industry.

MF Global and Peregrine are no ordinary bankruptcies. For the first time in history, last fall the customers of a futures commission

merchant's segregated funds were absconded. Then what was unthinkable actually happened again with the news from Iowa regarding the Peregrine Financial Group.

I would like to hear in as much detail as possible from the trustees of both of these bankruptcies about the efforts to return all of the segregated account funds to the customers of these two firms. I appreciate the MF Global Inc. trustee and the new Peregrine trustee being here today to update us on their efforts. The trustee for MF Global Holdings, Judge Louis Freeh, could not be here today, but I thank him for his submitted testimony.

I am also looking forward to hearing from key stakeholders and the futures industry on our second panel here today. You have put a tremendous amount of thought and effort into your recommendations to make the system stronger. I am eager to hear those recommendations.

This input is critically important to this Committee as we consider the fundamental question of whether the self-regulatory structure that has existed for decades is capable of regulating the industry or whether it has outgrown its time and needs to be replaced by a massive transfer of authority—and money, for that matter—to Washington and the CFTC. It should be noted that while Chairman Gensler does not advocate this approach, why, some do.

I also thank Commissioner Sommers, who is leading the investigation of the MF Global failure, for being here this morning.

Now, today's topics are serious matters. I know there are folks out there that believe the CFTC is moving too slowly. They are asking why are not certain people in Federal court already. I understand those frustrations.

I also know that investigations are ongoing, and we must be sensitive of how much information is actually disclosed. We want to allow law enforcement to do their job so that we do not jeopardize an arrest or a conviction.

Hopefully today we will learn as much as possible about what took place during the final chaotic days at MF Global. I also look forward to hearing the recommendations put forward in today's second panel, again, to see if we could work with the futures industry to prevent anything like this from happening again.

Our futures markets are an absolutely critical part of what allows this Nation to provide its citizens with the least expensive and most reliable food supply in the world. For decades, our regulatory model has assured us that our futures markets have functioned properly, but in light of recent events, it certainly can and should be improved.

Madam Chairwoman, I look forward to hearing the recommendations being brought forward this morning regarding any possible improvements, and thank you again for holding this hearing.

Chairwoman STABENOW. Thank you very much, and certainly we want—any member that would like to submit an opening statement for the record, we would welcome that.

We will turn to our panelists now. We have an excellent group of panelists. We appreciate your joining us today. One of our witnesses today, Judge Louis Freeh, who is serving as the bankruptcy trustee for the parent company, MF Global Holdings, was unable

to attend. Judge Freeh has submitted written testimony and will be responding to members' questions for the official record.

[The prepared statement of Mr. Freeh can be found on page 69 in the appendix.]

Chairwoman STABENOW. I am pleased to introduce our first panelist, Chairman Gary Gensler, certainly no stranger to the Committee, and we welcome you back. Prior to his service on the CFTC, Chairman Gensler served in several positions in the Treasury Department and before that had a very successful career in the private sector. So we appreciate your being here.

Our second panelist is Jill Sommers, who is a member of the Commodity Futures Trading Commission, as well no stranger to the Committee, and has been selected by her colleagues to serve as the senior Commissioner in charge of MF Global-related matters. She previously served as head of Government Affairs for the International Swaps and Derivatives Association and worked in governmental affairs for the Chicago Mercantile Exchange. We welcome you back and look forward to hearing about the progress of your efforts.

Certainly, James Giddens, again, we welcome you back to the Committee. We appreciate your efforts serving as the trustee for the Securities Investor Protection Act Liquidation of MF Global. In that role, Mr. Giddens is charged in part with the task of retrieving lost funds for customers, and we know Mr. Giddens as well is a partner at the law firm of Hughes, Hubbard & Reed, and a nationally recognized leading expert on brokerage firm liquidation. So welcome back to the Committee.

Our final panelist is Ira Bodenstein. Mr. Bodenstein is serving as the Chapter 7 trustee for Peregrine Financial Group. We welcome you to the Committee and to your position. Mr. Bodenstein is also a member of the law firm of Shaw Gussis, based in Chicago, and previously U.S. Attorney General Janet Reno selected Mr. Bodenstein to serve as the United States trustee for the Northern District of Illinois and the State of Wisconsin. So we appreciate you joining us on short notice, and we look forward to working with you.

We will now turn and ask Chairman Gensler for his opening remarks, and I know that you all understand we are asking for 5 minutes of verbal testimony. We certainly welcome any written testimony as well, and then we will open it to questions.

Chairman Gensler?

STATEMENT OF HON. GARY GENSLER, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, DC

Mr. GENSLER. Good morning, Chairwoman Stabenow, Ranking Member Roberts, and members of the Committee. I am pleased to be with you. I am particularly honored to be here with Commissioner Sommers on these important matters.

The Commission and I take very seriously the losses of customer funds that should have been segregated at all times. Customers should have been able to rely on a system of protection that protects them at all times, and it is not just about the customers that lost money. It is about farmers and ranchers and other end users that need to have confidence in these markets. It is these critical

markets—futures markets and ultimately in the swaps market as well—that customers need to be able to hedge their risk, lock in the price of corn or wheat or an interest rate and hedge their risk so as to focus on what they do best—producing food and fiber and other essential products.

Now, the recent events at Peregrine remind me of a saying my grandfather had, and it was handed down in my family and repeated quite often. This immigrant from Russia used to say, "Figures do not lie, but liars sure can figure." And simply put, the evidence points to the owner, Russ Wasendorf, taking the funds of customers right out of the bank and lying about it for years.

The National Futures Association, the self-regulatory organization responsible for front-line oversight of Peregrine, is required to conduct periodic audits of Peregrine's customer funds and, in addition, an independent CPA audited Peregrine's annual financial statements, including all the way to December 31, 2011.

Just like the local police cannot prevent against all bank robberies, market regulators cannot prevent against all financial fraud. But having said that, I believe the system failed to protect Peregrine's customers here and that we all must do better, including the CFTC.

The Commission has been actively working to improve protections of customer funds. We have finalized four separate rules strengthening protections for investment of customer funds, something called gross margining; segregation of customer funds in the new world of swaps; and also working that the self-regulatory organizations have specific requirements for their financial surveillance.

We have also worked very closely with the Futures Industry Association, the NFA, the CME, and others on new rules finalized just last month concerning new controls over customer segregated accounts, and I think that those working relationships served well, but they will be tested further as we think through changes post-Peregrine.

The CFTC also has implemented a significant restructuring of our oversight of SROs and intermediaries, actually hiring new leadership over the last 9 months, both a full partner of an accounting firm and a full partner from a law firm, to help us guide this effort.

Looking forward, though, I do believe it is critical that we further update our rules, giving regulators direct electronic access to all bank and custodial accounts holding customer funds.

In addition, I believe we should incorporate the NFA rules, those that were just finalized, put them in our rule book. I think there is a consensus to do that. But also I think that we should give futures customers access to information about how their assets are held. Where is their money held? I think we have to enhance internal controls of these futures commission merchants regarding how customers' accounts are handled, and I also think we need to carefully consider additional rules laying out how SROs' requirements for conducting their exams and audits, and as the Ranking Member said, I think it has been embedded in our system for decades. There is self-regulation, and then we examine the examiners, but I think we need to look at how we examine the examiners and set those rules in place.

We will conduct a full rule of the CFTC and SRO examination and audit oversight, looking openly for improvements including getting advice from the Public Company Accounting Oversight Board that has been gracious enough to tell us how do they do what they do and how can we learn from what they do, and based on those conducts and oversight.

I think we must do everything within our authorities and resources to strengthen our oversight programs and the protection of customer funds, and as I think back to my grandfather's saying, keep his values and wise admonition in mind.

I thank you.

[The prepared statement of Mr. Gensler can be found on page 75 in the appendix.]

Chairwoman STABENOW. Thank you very much.

Commissioner Sommers.

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

Ms. SOMMERS. Good morning, Chairwoman Stabenow, Ranking Member Roberts, and members of the Committee. Thank you for inviting me here today to testify about MF Global.

Over the past 9 months, the Commodity Futures Trading Commission has conducted a thorough analysis of the books and records of MF Global and continues to work closely with Mr. Giddens in the SIPA bankruptcy proceeding to recover customer funds. We are also engaging in a comprehensive and ongoing enforcement investigation. It is imperative that the Commission, the industry, and the Congress identify and assess the causes for the shortfall in customer funds and take corrective action where possible. At Chairman Gensler's request, Commission staff has developed recommendations for enhancing Commission and designated self-regulatory organization programs related to the protection of customer funds, which includes changes to Commission rules governing futures commission merchants, enhanced Commission oversight of DSROs, and possible statutory changes, among other things. We must do everything in our power to restore confidence in the futures markets so that producers, processors, and other end users of commodities can once again hedge their price risks without fear of their funds being frozen or lost.

On November 9, 2011, 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 bankruptcy proceedings, and other actions to locate or recover customer funds or determine the reasons for the shortfall. While I am unable to discuss the specifics of our ongoing enforcement investigation, I will provide a brief overview.

Our Division of Enforcement is actively engaged in the investigation concerning the shortfall of customer funds. We have a dedicated team working every day on this case. They are interviewing witnesses and reviewing documents as well as other information and are proceeding as expeditiously as we can.

As the Committee will understand, I cannot disclose any specific details of the investigation because they are nonpublic and because I do not want to prejudice any potential enforcement action. In general, however, depending on the specific facts and circumstances, a shortfall in customer segregated funds could amount to a violation of the CEA and Commission regulations including those that govern segregated funds, prevent theft of customer money, require our registrants to properly supervise accounts, prevent making false statements, and prohibit deceptive schemes. Depending on the specific facts and circumstances, the Commission could file an enforcement action against corporate entities and/or individuals who have violated the CEA or regulations. In addition, depending on the specific facts and circumstances, individuals could also be liable if they are control persons of a company that has violated the law. A control person generally refers to management. Depending on the specific facts and circumstances, an enforcement action could be filed against individuals who aid and abet violations by companies. Finally, Commission regulations impose obligations on accountants who audit FCMs and on the banks that hold customer segregated funds.

Generally, the Commission has the authority to, among other things, seek and impose civil monetary penalties, require a defendant to disgorge ill-gotten gains, obtain restitution for customers, and obtain other injunctive relief. In terms of civil monetary penalties, the Commission can seek the greater of three times the defendant's gain or a set amount, which is currently at $140,000 per violation. Civil monetary penalties are, of course, paid to the U.S. Treasury while restitution would be paid to the victims who suffered losses.

The Commission is a civil enforcement agency, so we cannot seek imprisonment as a sanction in an enforcement action. However, a willful violation of the CEA or our regulations is a Federal crime, which can be prosecuted by a U.S. Attorney. We do not have any say in whether or not the criminal authorities prosecute, and I understand that they have a higher burden of proof.

There is no doubt that MF Global's bankruptcy has caused severe hardship for thousands of customers who trusted the system and trusted their FCM. I believe the Commission can make improvements to our regulatory oversight of FCMs and DSROs to help restore confidence in the futures markets, and I will work with the Commission and Congress to implement the rules necessary to enhance our ability to protect market users.

Thank you.

[The prepared statement of Hon. Jill Sommers can be found on page 109 in the appendix.]

Chairwoman STABENOW. Thank you very much.

Trustee Giddens, welcome.

STATEMENT OF JAMES W. GIDDENS, TRUSTEE FOR SECURITIES INVESTOR PROTECTION ACT LIQUIDATION OF MF GLOBAL, INC., HUGHES HUBBARD & REED, NEW YORK, NEW YORK

Mr. GIDDENS. Thank you. Chairwoman Stabenow, Ranking Member Roberts, and Committee members——

Chairwoman STABENOW. I think you need to push a button there.

Mr. GIDDENS. Yes.

Chairwoman STABENOW. All right.

Mr. GIDDENS. Thank you. Chairwoman Stabenow, Ranking Member Roberts, and Committee members, it has been 9 months since the bankruptcy of MF Global where irresponsible actions of company management caused an unprecedented invasion of customer funds. I know this has been a long, frustrating period for former customers waiting for the return of property rightfully belonging to them. However, significant progress has been made for the benefit of customers, including returning 80 percent of customer property to commodities customers who traded on U.S. exchanges, completing an extensive investigation and issuing a public report on its findings, and identifying and pursuing recoveries of additional assets for customers, I, and more importantly the customers, have appreciated this Committee's support for these efforts.

My consistent goal remains to return as much customer property as possible, as quickly as possible, in a fair, lawful manner, and that is what I have done.

It is important to understand that I have no role in the bankruptcy of MF Global Holdings, which was the holding company of the broker-dealer and is now represented by a separate trustee. As a liquidation trustee, I do not have law enforcement or regulatory authority, though I continue to cooperate with and have shared my report and its findings with all the relevant agencies.

Currently my office is completing a fourth distribution to former commodities customers, bringing total distributions to $4.7 billion, 80 percent of their property for the U.S. exchange trades and 5 percent for foreign exchange trades. For securities customers, substantially all non-affiliate accounts were transferred and approximately 80 percent received nearly all of their account balances because of the Securities Investor Protection Corporation advances.

I have also conducted a claims process that involves more than 34,000 claims. Determinations for virtually all commodities claims have been made, and most have been agreed to by the claimants. We are working hard to resolve claims disputes absent litigation.

The approximately $1.6 billion shortfall in segregated property available for the return to customers remains. I am urgently working to eliminate the shortfall by determining the size of customer claim pools and recovering funds through negotiation and litigation, if necessary. I may also request the bankruptcy court approval for the allocation of non-segregated property to customers.

Significant agreements have been reached pending court approvals with the CME Group and with MF Global Canada, which will also support my ability to distribute additional funds to customers.

There are very substantial disputed claims from MF Global affiliates, including the holding company, which require me under law to hold appropriate reserves until those disputes are resolved. And until those disputes are resolved by the bankruptcy court, they stand as a very significant impediment to further distributions to customers.

In the United Kingdom, litigation continues to resolve my claim against the U.K. Joint Special Administrators for $700 million in customer property. Our extensive and thorough investigation into

the failure of MF Global led to my conclusion that there may be valid claims against directors and officers, including Jon Corzine. I am prosecuting these claims with plaintiffs in pending lawsuits against those parties.

Active discussions continue with JPMorgan Chase concerning transfers that I believe may be voidable or otherwise recoverable.

I have made recommendations about how to avert a similar future catastrophe and protect customers, and I support reforms recently approved by regulators.

Thank you very much for the opportunity to testify here today.

[The prepared statement of Mr. Giddens can be found on page 86 in the appendix.]

Chairwoman STABENOW. Thank you very much.

Mr. Bodenstein, welcome.

STATEMENT OF IRA BODENSTEIN, CHAPTER 7 TRUSTEE FOR PEREGRINE FINANCIAL GROUP, INC., SHAW GUSSIS, CHICAGO, ILLINOIS

Mr. BODENSTEIN. Thank you. Good morning, Chairwoman Stabenow, Ranking Member Roberts, and members of the Committee. Thank you for this opportunity to appear before you today. I have submitted my full written testimony. My name is Ira Bodenstein, and I am the appointed interim Chapter 7 trustee of Peregrine Financial Group, Inc. I was appointed as the successor trustee by the Office of the United States Trustee, which is a component of the Department of Justice, on July 11, 2012. My appointment was preceded by the filing of a complaint by the U.S. Commodity Futures Trading Commission which sought injunctive relief against Peregrine and Russell R. Wasendorf, Sr., on July 10, 2012, and the filing of a voluntary Chapter 7 bankruptcy petition by Peregrine within hours after the entry of a temporary restraining order and the appointment of a receiver in the CFTC proceeding.

Since the date of my appointment as the Peregrine trustee, I have been working diligently to comply with my fiduciary duties under the Bankruptcy Code. To that end, I have taken steps to secure Peregrine's assets and to protect customer accounts and information. To prevent the loss of institutional knowledge and to assist in the taking control of the assets and information, I have obtained a bankruptcy court order allowing me to operate the business of Peregrine on a limited basis through September 13, 2012. That authority includes the retention of certain key employees at Peregrine. I have also selected a group of professionals which I feel are necessary to assist me in this liquidation effort.

I have been working cooperatively with the CFTC, the NFA, the FBI, and the U.S. Attorney's Office in coordinating the liquidation of Peregrine and providing access to all information under my control for use in the pending civil and criminal investigations. On the other hand, I have been getting cooperation from the other side in getting information that they already have control of and allowing me to see that information.

I have also been working cooperatively with the receiver who was appointed in the CFTC action. Initially there was some concern over competing orders and who had jurisdiction over what. That has been straightened out in the receivership matter, and an

amended receivership order and an amended statutory restraining order have been entered, making it clear that all assets of Peregrine are under the control of the bankruptcy trusteeship.

In conclusion, with the assistance of the team I have put in place, I intend to confirm the validity of the information on the books and records at Peregrine and disseminate such information to account holders with all deliberate speed. Once customer balances are calculated, I intend to seek court authority to make an initial distribution to the customers as soon as I can.

I thank you for the opportunity to appear before this Committee.

[The prepared statement of Mr. Bodenstein can be found on page 50 in the appendix.]

Chairwoman STABENOW. Well, thank you very much, and we realize you are new to the position you are in, and we appreciate your willingness to come before the Committee as you begin this very, very important process.

For the Committee members, we will do two rounds of 5-minute questions this morning, and let me start with Chairman Gensler. How quickly can the CFTC move to improve the protection of customer accounts? You have talked about various things you are looking at. How quickly can you do that? Do you need more legal authority to protect futures markets, or do you feel you have the authority right now that you need to be able to move?

Mr. GENSLER. I think that we have strong legal authority, though I keep an open mind to work with this Committee and others if there are suggestions for changes, whether it is about the civil money penalties that we can impose on people or maybe possibly with regard to the Bankruptcy Code itself. But in terms of our legal authority, it is quite strong.

In terms of timing, we have moved I think very effectively with the National Futures Association and the industry on those changes. We would like to incorporate those into our rule book as well. But I would be hopeful that with what is in front of Commissioners now in draft form—and it is only in draft form—that we could try to get it out to public comment in the month of September, is my hope. But, again, a lot of feedback will come.

We have a public roundtable as well, I think towards the end of next week. We are going to hear more from the public on these matters.

Chairwoman STABENOW. Okay. Thank you. Well, obviously the public is watching here, and, again, certainly from my perspective, I am asked way too many times now whether or not people should be investing and using the futures markets, and that is not a good thing. So we do need to make the right decisions, but we do need to move.

Let me ask you, Commissioner Sommers, how much time on average has the CFTC needed to bring charges in a case like this? I know you cannot speak of this particular case, but when we look at the kinds of cases that the CFTC has brought, what would be, given the size and complexity, the normal time frame?

Ms. SOMMERS. Well, I think in my time at the CFTC the past 5 years, we have not had a case like this. This is unprecedented for the Commission to have a case of this complexity, of this size, 38,000 commodity customers, and with customer money missing,

which is in a bankruptcy case. This has never happened before, this is unprecedented for us, and I want to assure the Committee that we are moving as expeditiously as we can.

Chairwoman STABENOW. Do you believe you have the resources to be able to do this in the quickest way possible?

Ms. SOMMERS. We have a dedicated team on MF Global with a number of different people from our Division of Enforcement in our New York office as well as assistants from Chicago and here in Washington working on this.

Chairwoman STABENOW. Is that a yes?

Ms. SOMMERS. Yes.

Chairwoman STABENOW. Okay. Thank you. Will any funds collected as a result of successful cases that you would bring go directly to make customers whole?

Ms. SOMMERS. Seeking restitution would allow us to give that money back to customers. Civil monetary penalties would, of course, go back to the U.S. Treasury.

Chairwoman STABENOW. Okay. Thank you very much.

Trustee Giddens, we have heard from Judge Freeh in his written testimony that he believes there is enough money to make customers whole and there should be "significant excess funds"—his words—for creditors. How would you respond to that?

Mr. GIDDENS. Based on our claims analysis, we estimate that U.S. customers have valid claims for approximately $6 billion and the 4d estate has approximately $5.2 billion in assets. Customers who traded on foreign exchanges, the so-called 30.7 funds, have pending claims of approximately $1 billion. The 30.7 estate at present has assets of $90 million. That is a shortfall.

As I indicated, we very much would like to pay every customer 100 percent; however, it will be a time-consuming, difficult, and uphill battle to be successful in marshaling substantial additional assets needed to pay commodities customers 100 percent. We appreciate Mr. Freeh's apparent support and confidence in our ability to collect and allocate additional substantial assets, and certainly that remains our singular focus. But, for example, $700 million of what should have been segregated funds are at issue in litigation in the United Kingdom. We are very hopeful about our success in that litigation, but by no means is that assured. That is a matter that will be decided by English courts under English law.

Chairwoman STABENOW. Well, obviously a top priority for our Committee—and I believe I can speak for everyone—is to make sure that people are made whole, and we appreciate your aggressiveness in doing that and support you in doing whatever is necessary to do that.

Given that my time has expired, I would now turn to our Ranking Member, the distinguished Senator from Kansas, Senator Roberts.

Senator ROBERTS. Well, thank you, Madam Chairwoman.

Mr. Giddens, you report indicates that MF Global Assistant Treasurer Edith O'Brien knew on October 26th that the firm was out of seg or compliance on October 26th, yet on October 28th, she was still wiring out another $175 million to the United Kingdom per Mr. Corzine's instructions. Is this correct?

Mr. GIDDENS. Yes, sir.

Senator ROBERTS. Well, the obvious question: Didn't MF Global have internal controls regarding how and where money could be moved that would prevent this from happening?

Mr. GIDDENS. They purportedly had such internal controls, but they were obviously ineffective or ignored.

Senator ROBERTS. So is Mr. Corzine simply overruling the internal controls? Was this sheer incompetence? Or did someone somewhere within MF Global know exactly what they were doing and, if so, willfully moved the money out of the segregated accounts?

Mr. GIDDENS. I believe our report, which deals with these subjects in the 275 pages, makes clear our conclusion that there was knowledge that segregated customer funds were being improperly moved.

Senator ROBERTS. Did the CFTC changes after the fact to its Rule 1.25 regarding the international rule or 30.7 investments really matter in terms of what MF Global was doing with its customer segregated funds?

Mr. GIDDENS. The subsequent change in terms of how much should be segregated we think would have been—had the rule been changed—would have been very important. I think we indicated it is something like $1 billion that would have been required to be segregated for the 30.7 customers was not segregated. So that certainly would have been material.

Senator ROBERTS. At the end of the day, what is your best estimate of the percentage of customers' money they will finally get back out of this bankruptcy?

Mr. GIDDENS. Again, certainly it is my goal that they recover 100 percent. We are up to 80 percent on the 4d; we are up to only 5 percent on the 30.7. We have had other collections of non-segregated funds as to which we have to go to the bankruptcy court and have the bankruptcy court finally allocate.

It will be our position that a substantial part of those funds should be allocated to customers, and with the amount of funds that we have under control and if we are successful in pending litigations, I think we are comfortable saying that additional distributions should certainly be in the 90-percent range. It is going to be an uphill fight, as I indicated, to get to 100 percent.

Senator ROBERTS. I appreciate your dedication.

Chairman Gensler, welcome back. Today right now can the CFTC tell if an FCM is shuffling its customers' money intraday in and out of a segregated account?

Mr. GENSLER. I think that we would be hard pressed to be able to do that. I think that our rules forbid it, that somebody even intraday has to be fully segregated, but we do not have online access and we are not in those accounts. But it is absolutely against our rules to take money intraday even. It has to be in segregation all day long.

Senator ROBERTS. Well, following that, have you done anything to more quickly resolve a situation where somebody is out of seg or compliance at the end of the day? If we cannot do it intraday, can we do it at the end of the day?

Mr. GENSLER. Yes, and I think even these recent rules that were adopted by the NFA that I am sure Dan Roth will mention more about——

Senator ROBERTS. Right.

Mr. GENSLER. —were a very positive step, as you say, for each day. And then if management wants to tap into what is called the excess funds—sometimes they put their own funds, the company's funds in. They cannot take that out more than a limited amount, 25 percent, without having senior management signing it, notifying the regulators as well. We are recommending that also regulators get direct view only online access to see the bank accounts and custodial accounts, but that will take some further rule changes and technology changes.

Senator ROBERTS. So if the rating agency had not downgraded MF Global, how much longer would this intraday use of customer funds have gone on by MF Global before any regulator would have caught it?

Mr. GENSLER. As to the specifics of this one institution, I might leave it to those who know more about the company now than I do, but I think that the obligation of the self-regulatory organizations and the CFTC is to ensure that all institutions comply with the law, even if there are not ratings downgrades.

Senator ROBERTS. I appreciate that, and I will have further questions in the second round, Madam Chairwoman. Thank you.

Chairwoman STABENOW. Thank you very much.

Senator Harkin?

Senator HARKIN. Thank you, Madam Chair.

Mr. Gensler, according to information I received from the National Futures Association, the NFA has taken five enforcement actions against Peregrine: in 1996, 2004, 2008, 2012, and again on July 9, 2012. In fact, in 2004, according to a story that was in the New York Times, a Peregrine client sent a letter to the National Futures Association and the CFTC asking it to intervene to prevent the firm from misusing its customers' money. A copy of the letter was obtained by the New York Times. Five years later, in 2009, again a tipster wrote to the NFA asking it to review Peregrine's bank account information for accuracy.

In 1996, the action involved two separate incidents in which Peregrine failed to maintain adequate significant funds. Again, in 2011, in the course of an audit, NFA was informed that Peregrine was undersegregated by over $200 million. There were two letters—one on Friday, one on Monday—that sort of changed those figures.

My questions are: Was CFTC aware of the 2011 incident, the one in which there were two letters—one on Friday and one on Monday? If so, what did you do? And if not, should the CFTC have been made aware of it?

Mr. GENSLER. To the best of my knowledge, we were not, but we are going to learn more facts even in looking at our own files at the CFTC. But the audit work papers of the NFA may have that, but we do not necessarily review NFA's audits. There is an outside auditor and then the self-regulatory organization. What we have moved to in the last 2–1/2 years is we quarterly now look at NFA and CME's reviews but just on a sample basis. We sample some, and it happens to be Peregrine was not part of our small sample in these last 2 years.

Senator HARKIN. Is it typical for a firm like Peregrine to have that many enforcement actions taken against it during a similar time period? That is one, two, three, four, five, six going back to 1996. Is that typical?

Mr. GENSLER. I would have to get back to you because there are, especially in large financial institutions—and this was smaller—often disciplinary actions or sales practice issues. But I would say in looking back at the record and even looking at a 2000 action that the CFTC brought—and there was a settlement in 2000 that the CFTC had about accounting records at Peregrine. I think that the system failed to protect the public on this when you look at the various incidents over the years. Now, that was 12 years ago at the CFTC, but——

Senator HARKIN. Well, I guess I just basically—my question is that one red flag ought to be enough, but if you get two red flags, then three red flags, pretty soon somebody ought to start paying attention.

Mr. GENSLER. Right. And that is why we are looking very closely at how we can enhance the standards of the audit itself. That is why we have reached out, and the Public Company Accounting Oversight Board does something similar. It is not identical, but they look at auditors, and we have this responsibility to sort of look at how the auditors at NFA and CME do their job. We want to learn from that and see how we can be better examiners of the examiners embedded in this self-regulatory function.

Senator HARKIN. Well, then that raises the question. Does the CFTC have enough power and authority and personnel to ensure that industry self-regulatory organizations fulfill their responsibilities?

Mr. GENSLER. We will continue to look at the statute, but my initial thought is we probably do have the authorities. I think we do need to upgrade some of our rules and how they have to comply with generally accepted auditing standards, what outside auditors have to do, the direct electronic confirmation, direct electronic access.

On funding, no, I have said before in front of this Committee I think we are underfunded to oversee the futures industry that has grown five-fold since the 1990s, and then we have the swaps industry as well.

Senator HARKIN. It is my understanding that a futures commission merchant does not have to carry a bond or insurance to protect its customers against losses such as from fraud or malfeasance. Again, I question whether or not there should not be. There has been some who have suggested there should be an insurance fund. There is for securities, there is for Federal deposit insurance, but there is not for futures commission merchants. Do you have anything thoughts on that?

Mr. GENSLER. The Commission is currently focused on doing everything we can under current law to protect customers, and I think there is more that we need to do. I certainly have an open mind as to this dialogue, and I think it is really a weighing of costs and benefits. And it is an age-old issue of insurance does take a cost. I think we need to focus in on our rules and ensure customers do better and the self-regulatory function works better.

Senator HARKIN. My time is up. I would just say that you do it for securities, you do it for deposits, but not for futures. I just wonder if we should not be looking at something like that.

Thank you, Madam Chair.

Chairwoman STABENOW. Thank you very much.

Senator Lugar?

Senator LUGAR. Thank you, Madam Chairman.

Let me follow up Senator Harkin's line of questioning. Chairman Gensler, in your last testimony you mentioned the struggle of getting to the rulemaking. You were through 30-some rules and heading toward 50. And you mentioned in September there may be more adequate hearings with other parties, other businesses, and what have you. I am just curious in terms of the dynamics of the CFTC, your own members of the Commission, quite apart from the testimony of those you are regulating. Is there such tension with the private community or within the board that brings about this delay? It will be about 2 years from the time the Dodd-Frank bill was passed, and earlier on I know you gave more optimistic predictions about the rulemaking. What delays the rulemaking? What is the dilemma you have there?

Mr. GENSLER. Thank you for saying that. I think the complexity of the topic and the task that Congress gave us; two is we want to get this right and balanced. This is a true paradigm shift to this swaps market. We are in a sense now in the back half or the back nine, if I can use—I am not a golfer, but we have completed 36 final rules with all the foundational rules. I think the Commission serves the public well. Commissioner Sommers can speak to it. We have largely done this with consensus, but occasionally we break ranks, but we really do want to find consensus where we can amongst the five of us to get this done. I think it is more sustainable for the public if we do. And then, as you rightly say, we have 35,000 comment letters, so we have to deal with every one of those and do cost/benefit analyses and the like.

Senator LUGAR. Well, what sort of comment letters come in? How would you characterize the 35,000? Who are writing all these letters?

Mr. GENSLER. Market participants. I mean, they are weighted towards the financial community. I think we have adequately and appropriately addressed many of the end-user issues around what is the definition of a swap dealer and the like and the end-user exception. But we are going to continue to get comments from end users who do not want to get caught up in this, and we are going to try to work with that.

Senator LUGAR. Is there a sense with the industry involved of the degree of crisis in terms of public understanding of this? We have had these two incidents, but there may be lurking out there somewhere some more. This is not quite parallel to the cybersecurity thing we are debating on the floor right now, but the thought here is that we may have sort of a 9/11 situation at some point where our telephone system, our market system, and everything else is shut down.

Now, that may not be as dire with regard to what we are talking about today, but, nevertheless, the lack of confidence in the markets. But the resistance obviously by private companies, investors,

and others to do their thing in their way, I am just curious about this tension and what our role ought to be legislatively quite apart from this oversight.

Mr. GENSLER. Well, I think we have made tremendous progress, but 4 years since the crisis and 8 million people losing their jobs, I do think we need to get on and try to complete the swaps market reform.

As it relates more directly to the customer protection issues, there has been, I think, tremendous interaction and support from the futures industry and thee self-regulatory organization to enhance the system, because the system did fail to protect the public in these matters in these last 9 months.

Senator LUGAR. Have you made any recommendations for legislative reform, amendments that we ought to be offering here as legislators that would be helpful to you?

Mr. GENSLER. We have not but remain open to it. I do think that, whether it is in the area of civil money penalties and maybe some possible issues in the Bankruptcy Code, we have pretty strong legislative authorities to enhance our rules for this customer protection area and enhance our rules for the auditing of futures commission merchants.

Senator LUGAR. Thank you very much.

Thank you, Madam Chairman.

Chairwoman STABENOW. Thank you very much.

Senator Klobuchar is next.

Senator KLOBUCHAR. Thank you very much, Madam Chair. Thank you to our witnesses and thanks for holding this hearing. I know when it was originally scheduled, it was to focus on MF Global and the steps that have been taken since then. Yet today we find ourselves here trying to understand how something like this happened again, this time with Peregrine Financial Group, where something went undetected for many years.

I actually have one farmer who had invested in MF Global, then the disaster happened, puts his money in Peregrine, and loses out twice. So clearly the system has not protected the people that it should, and there have been people left holding the bag that should not be holding the bag.

I would like to give credit for the important steps that have been taken so far to strengthen consumer protections, but as we all know, rules are only as good to the extent that they are enforced. That is something I certainly used as a prosecutor. You can have all the books with all the laws in them, but if you do not enforce them, sometimes it is worse than not having them at all.

So I wanted to first ask about some of the major revelations in the report released by Trustee Giddens, Chairman Gensler, and that was that there was this incredible mismatch between the increasingly complex liquidity needs of MF Global and the treasury unit that managed the company's cash flows and compliance with account segregation. The report found that in an electronic age MF Global was still managing its liquidity using manual entries on spread sheets and oral reports.

I guess, first, to you, Chairman Gensler, is this finding as concerning to you as it is to me? And going forward, what is being done to ensure that firms not only have adequate capital but also

the systems, procedures, and technology is in place to monitor their risk?

Mr. GENSLER. I am concerned about the internal controls of futures commission merchants and ultimately of swap dealers as well, and we are looking at and have in draft form in front of our Commissioners rules to ensure that these futures commission merchants have policies and procedures for better internal controls. And staff has built those recommendations on the full public record, including Trustee Giddens' report.

Senator KLOBUCHAR. Okay. Then how about the staffing and expertise of the NFA. You stated in your testimony that as part of your oversight you review their training. You went on to say that recent examinations of the NFA included recommendations for enhanced training and supervisory review procedures. How do you think that is going? And what is the experience level of front-line audit staff and what should change?

Mr. GENSLER. I think it still needs to be enhanced. I think that there is a great deal not just out of the Peregrine situation but just in the growth of the futures model and these two circumstances in the last 9 months, and I know that they are committed to doing that. But we are also looking to put in some rules about how they follow generally accepted auditing standards, how the joint audit program works be the SROs, which I think inevitably will raise some of the standards of the self-regulatory organizations.

Senator KLOBUCHAR. One of the things that struck me—I know Senator Harkin asked about this, but according to a Wall Street Journal article, one NFA employee actually called and found out that the bank showed that the account was dramatically underfunded, and then even though they had that information over the phone, then believed a fax that said everything was fine.

My question is: Why wasn't verbal contact taken more seriously? And is that something that should be considered as you go forward in your process?

Mr. GENSLER. I think it is very concerning, and I share the public's view and Senator Harkin's and your view that that should have been looked at and pursued with a phone call to the bank directly or other matters. I think that is what a risk-based auditor would do.

Senator KLOBUCHAR. Okay. Trustee Giddens, I will just end with this. What has been the greatest frustration in your efforts to recover customer funds? I know some of my colleagues asked about the money, but what was your greatest frustration in getting the money from MF Global? And what is the one lesson you think should be taken from your investigation in terms of how we move forward with a better system?

Mr. GIDDENS. Among the recommendations that we made on the basis of our experience for a study was really—which would have been very beneficial and eliminated a lot of the problems there, would be the study of an insurance fund for commodities customers that was comparable to the protection provided to securities customers by SIPC and also by the FDIC for bank depositors. Most of the accounts in MF Global, and as I understand in many other futures commission merchants, are really under $100,000, so they are small farmers, ranchers, and others, so that the amount of protec-

tion to provide $100,000 if there were a deficiency in an account, if something like that had existed, that would have permitted us to have paid, I think—and I am talking off the top of my head—something like 78 percent of all the claimants almost immediately. That would have been sufficient to cover costs. And how feasible that would be, how it would be funded by the industry, is a subject for study. But that limited amount of coverage, as I say, in our case would have permitted us to quickly move and cover substansial deficiencies in the case.

We were able to do that with the securities customers because of the existence of SIPA and the SIPA protections. In terms of the collection of assets, even though monies were at banks and other depositories throughout the world, it is not an automatic process of simply saying I assert that these are segregated funds, because these institutions in many cases all were reluctant to release funds and in some cases said, well, we have counterclaims and setoffs and so it is a cumbersome process even to try to collect funds that I think demonstrably belong to customers because they are held at third parties.

There were some exceptions to that, and some of the institutions showed some concern for the public interest and also for the concerns of customers. But nothing works quite as it is prescribed when you are actually in a bankruptcy.

Chairwoman STABENOW. Thank you very much.

Senator KLOBUCHAR. Thank you very much.

Chairwoman STABENOW. Senator Johanns.

Senator JOHANNS. Thank you, Madam Chair.

Mr. Giddens, if I could start with you, as you were looking through the facts surrounding MF Global, I would like to know if the facts illustrate that Mr. Corzine knew that segregated funds were being moved.

Mr. GIDDENS. I think we deal with that very important $64,000 question in the report with the nuances and the like, and as I say, I think that issue is also being looked at by those who have regulatory and legal enforcement.

My own view is I think the preponderance of the evidence indicates that management, senior management at MF Global, was aware of the liquidity crisis and was aware that customer funds toward the end were being utilized to cover other costs in the firm. As I say, the principal purpose of my report under SIPA is to explain why the firm failed with the point of view of coming up with causes of action that we can pursue to try to bring in additional assets.

Senator JOHANNS. And I appreciate that, but you must also appreciate that we have constituents who are not only interested in getting the money back that they lost, but they are interested in making sure that if something was done wrong, those who did it are brought to account in some form or fashion.

Mr. GIDDENS. We agree with that totally. There have been lawsuits already instituted against, in particular, Mr. Corzine and against other of the senior officers. We are plaintiffs' counsel, and we are working together. All those cases are consolidated before Federal District Judge Marrero in the Southern District of New York. Those are civil actions. The amounts that are sought are in

the hundreds of millions, and those are part of the efforts we are making and the plaintiffs' lawyers are making in concert to hold those people that we think were responsible for some of the losses accountable.

Senator JOHANNS. Now, when you refer to—when you answered my question, you referred to senior management, and I guess it cannot get more senior than being the top guy. So I am taking your answer to mean you are also referencing Mr. Corzine.

Mr. GIDDENS. Yes, sir. Yes, sir.

Senator JOHANNS. Again, going back to your report, do the facts indicate that Mr. Corzine, in fact, authorized the movement of customer segregated funds?

Mr. GIDDENS. I cannot say that the total analysis of that proves that point unequivocally.

Senator JOHANNS. Is part of your responsibility, does it also involve cooperation with the U.S. Attorney's Office?

Mr. GIDDENS. Yes.

Senator JOHANNS. And that investigation is ongoing?

Mr. GIDDENS. Yes, sir, as well as the CFTC regulatory investigation.

Senator JOHANNS. Okay. Commissioner Sommers or Chairman Gensler, either one of you can attempt to address this. Let me express a concern I have, and I would like your reaction to it. I am becoming even more of a skeptic than I was at the time of the passage of Dodd-Frank that, we fill books with rules and regulations and statutes and on and on, but the reality of the world is that you can write and write and write and write and pass laws, but at the end of the day there are two things very difficult to protect yourself from: number one, stupidity, and we see plenty of that in the financial crisis amongst some very powerful people; and, number two, thievery. And I just worry that what we have ended up with here is a very hugely complex system. It is hammering the little guy out there. We struggle to even tell them whether they are going to be caught up in end-user rules or not. And at the end of the day, the big get bigger because they have the capital and the wherewithal to hire the accountants and the lawyers and everything else that is required these days. And I think we are just hurting the system.

Commissioner Sommers, I would like your reaction to that, and you get—I am out of time already, so if you could just answer very briefly.

Ms. SOMMERS. Senator, I would say that I wholeheartedly agree with your assessment. I think that as we write these new rules implementing Dodd-Frank, we need to keep the goals of that legislation in mind and to make sure that it works for market participants.

Senator JOHANNS. Thank you.

Thank you, Madam Chair.

Chairwoman STABENOW. Thank you very much.

Yes, Senator Baucus.

Senator BAUCUS. Thank you, Madam Chairman.

I have two questions, basically, for the CFTC. First, Chairman Gensler and Commissioner Sommers, are you familiar with a private firm called Atlas Ratings?

Mr. GENSLER. No, I do not believe so.

Senator BAUCUS. Well, Atlas Ratings is a company that puts together information with respect to FCMs subsequent to the MF Global collapse, and they take the information that the CFTC requires and others require, they take it all, then they compile it. And they put together a composite score of various FCMs. And this is a copy of it here, and they go through all—the top score is 83, then they go all the way down through all the others, and they rate according to all kinds of data: transparency, net clearing or non-clearing FCMs, net capital ratios, capital trend, customer flow, funds flow, market valuation, lots of factors. And they concluded in May of this year that Peregrine is third or fourth from the bottom, one of the worst scores. It was right here. It is—well, it is fourth from the bottom. They have not counted all the FCMs, but there is a bunch of them.

My question is: If this outfit can get all this data and reach a conclusion that Peregrine is in real rough shape here, why can't the CFTC, why can't your agency know that this company, Peregrine, is doing so poorly and ready to probably collapse based upon the data at least this one company put together? Do either of you know about Atlas? I do not know what other system, what other outfits are that give information with respect to the status, financial status, of the FCMs. But here is one outfit, in May, down the bottom, and nobody—your agency did nothing about it, as far as I can tell.

Mr. GENSLER. There may be others at the agency, but I think we hugely benefit from the public input, and whether it is analysts, as this is, this research, I would like to know who the other three or four at the bottom are, but——

Senator BAUCUS. I will tell you who they are right now. Maybe it will give you a little——

Mr. GENSLER. But I think we need to——

Senator BAUCUS. —protect some account holders. I will tell you if they are. Down at the bottom, the very bottom, is Pioneer Futures. Second from the bottom is Rosenthal Collins Group. Third from the bottom is Crossland. And the fourth from the bottom is Peregrine. And there is a bunch here, I would say 70, 80, 90 different FCMs.

Mr. GENSLER. I think that we need to move the self-regulatory organizations and the CFTC a bit more to risk-based approach and not just what auditors might call ticking and flicking, just, checking the boxes off the page, whether it is the risk of getting a fax on a Friday that is different than the fax on a Monday or the risk that this Atlas group that you have mentioned have looked at. So I think it is part of why Congress ultimately also put a whistleblower piece into our statute that now even whistleblowers can come forward, and if there have been penalties paid, they can get part of that. I think we are helped out by that because we are ultimately reliant on the public, the self-regulatory organizations and the like, as well as our own work.

Senator BAUCUS. Well, anyway, I ask, Madam Chairman, that this be included in the record, this report.

Chairwoman STABENOW. Without objection.

Senator BAUCUS. It is just disturbing data. Here is a report which ranks Peregrine down at the bottom, near the bottom, fourth from the bottom, and that is the first information that seems to be

public, and your agency, which is supposed to be the regulator, did not do much about it. There is something wrong here.

[The report can be found on page 116 in the appendix.]

Senator BAUCUS. Second, and a little disturbing, this question I think has been touched on, basically I met you, Ms. Sommers, and asked the degree to which, subsequent to the MF Global collapse, you are following up and looking to other FCMs and to make sure we do not have another MF Global, you said, "We are doing that, we are doing that, we are doing that." But it seems to me that the Commission's information about Peregrine is just based upon this self-certification, and Peregrine just asked, "How are you doing?" "Oh, we are doing fine," and without an audit, without digging in behind the veil, finding out exactly what is the status of some of these outfits. I am just concerned you are just asking, "Oh, we are doing fine." And, of course, that is insufficient. You have got to get down deeper and find out whether or not that is true, and it just seems to me that your follow-up subsequent to my request, verbal plus written, is pretty superficial, not very direct, I mean not deep. My impression is you just do not dig deep enough to find out what is happening because you are just—you allow self-certification. Is that correct or incorrect? And why not?

Ms. SOMMERS. The follow-up, Senator, that I believe that you are referring to is the spot seg audits that we did after MF Global, and you are correct that those were not full, complete audits of the FCMs. Those were done by not only the CFTC for the top 10 or 12 firms, but they were also done by the CME for the clearing firms and the NFA for the remainder of the FCMs, and those were just spot seg audits.

Senator BAUCUS. Well, my time is up. You are the responsible agency. You have got to find a solution. And if you do not have the power, you have got to ask for the power. You are the cop on the beat. You have got to do your job. I do not think you have been.

Thank you.

Chairwoman STABENOW. Thank you very much.

Senator Grassley.

Senator GRASSLEY. Thank you.

Mr. Gensler, it has been reported that the CFTC conducted examinations of Peregrine in 2006 and 2007. Did the CFTC actually conduct these examinations? And if so, why didn't CFTC examiners figure out that bank statements were not matching up with what was actually in the bank account? And did the examiners independently verify account balances with Peregrine's bank?

Mr. GENSLER. Senator, we have looked back. We had done a number of reviews, some in the late 1990s and the two that you mentioned in the past decade as well. These are not audits. We rely on the front-line regulators, the NFA, and also the outside CPA. So it is correct that we did not verify bank statements.

What we are looking at, sometimes we look at anti-money-laundering things, like in 2010 there was another review. Sometimes we end with an enforcement action, like in 2000. We actually ended up with an enforcement action against Peregrine that was settled back then 12 years ago.

Looking back now at some of those work papers, I do wonder about the red flags of what we might better have caught in 1999

and 2000 and so forth. So I have the same question that you have about our own work, and we are looking to see how we can do better as well.

Senator GRASSLEY. Okay. Another question for you. The National Futures Association is an organization that serves as these frontline regulators, and that would apply to Peregrine. It has been reported in the Wall Street Journal that the CEO of NFA, Mr. Roth, expressed his opinion at a congressional staff briefing that "auditors are not looking for fraud" when conducting their regular audits of firms like Peregrine.

Would you agree with Mr. Roth that our auditors who are auditing these brokerage firms are supposed to be looking for signs of fraud or not?

Mr. GENSLER. Though I am not myself an auditor, I have heard there is something—there is a distinction between a fraud audit and a financial audit, and it may be that that Mr. Roth was referring to. They do not do full-scale fraud audits.

Having said that, the records are supposed to be confirmed, the balance is validated with the banks and custodials, and Mr. Wasendorf has admitted in a statement left when he tried to take his life that he had been falsifying these. I mean, this was somebody that for year was dishonest to a broad group of people, his outside auditors, including the NFA.

Senator GRASSLEY. Okay. I do not know whether a statement that Senator Klobuchar made about a phone call was made would fall into the whistleblower category, but you know my interest in protecting whistleblowers, so I have this question for you, Chairman Gensler. Since the collapse of MF Global and now Peregrine, there is a lingering question on a lot of people's minds that is something like this: Are there any other firms out there that are going to go bust? The Dodd-Frank legislation required the Commodity Futures Trading Commission to establish a whistleblower office, and I understand that this office was officially put in place last January.

So my question: Since the opening of the whistleblowers office at CFTC, have complaints been made about inappropriate activity going on at any futures firms? If so, how many active cases does the whistleblower office have that are looking into claims of impropriety? And do you think that the CFTC has done enough to raise awareness in the futures industry that the whistleblower office exists and what the function of the office is supposed to be to encourage people to come forth?

Mr. GENSLER. I thank you for your support because it is an important office. It has been set up. There is a fund set aside with money. In fact, with this settlement in this LIBOR case with Barclays, the fund will be up to the full maximum Congress made of $100 million.

I think that we could do more to educate the public. We do have a consumer office that is now set up, but it is, I think, just two people because, realistically, we are a small agency. And, yes, we have had whistleblowers come forward. If you wanted a fuller report, I would have to work to get you the details of how many. I cannot remember the inventory of claims, but there are a number of whis-

tleblowers that have come forward in general matters. I do not know if they have been about customer funds, though.

Senator GRASSLEY. In the 11 seconds I have left—because I have to go Madam Chairwoman—I wanted to raise an issue that I was going to raise with Mr. Roth, and it will take 30 seconds to read this, and then he can answer for the record. And it is similar to what Senator Harkin asked of Mr. Gensler.

One of the things that continues to trouble me are reports of the red flags that were raised about Peregrine Financial, and those red flags were ignored. For instance, it has been reported that in March 2011, a confirmation form was faxed directly from US Bank to the National Futures Association showing that there was about $7 million in the bank account designated for segregated customer money. Then shortly thereafter, either that day or the following business day after finding out US Bank had send the confirmation, Mr. Wasendorf, Sr., sent another confirmation showing that there was approximately $220 million in the account for customers.

Question: Is this factual account accurate? Did US Bank send a confirmation showing only $7 million of customer money? And then what did the NFA do in following up on the contrasting confirmation reports? And did anyone from NFA call the US Bank to verify how much was in the account? And if not, why not?

Thank you.

Chairwoman STABENOW. Senator Grassley, that is a question for the record, I understand?

Senator GRASSLEY. Yes.

Chairwoman STABENOW. Yes. Thank you very much.

[The following information can be found on page 264 in the appendix.]

Chairwoman STABENOW. Senator Boozman, No? Senator Hoeven.

Senator HOEVEN. Thank you, Madam Chairman.

Chairman Gensler, In the simplest, most straightforward way, if you would explain to me, how do you ensure that funds from customer segregated accounts are not used by commodity firms? Just lay it out. Given what has happened, given Peregrine failing after MF Global, how do you protect customers?

Mr. GENSLER. I think that we will never protect that there will not be somebody trying to steal or lie or cheat, as my grandfather sort of laid out. But I do think that getting rules in place that the regulators can directly on a daily basis see the account balances, now with technology's help, is a big plus.

I think also filling the hole that Trustee Giddens and the industry and we have all focused on these foreign accountable—I mean, it was a gap in our regulations that, just listening to the numbers, is nearly $1 billion—or maybe I misunderstood the numbers that he said from the public record.

So I think that there are always going to be folks—most people are good people, but some people are going to be bad, and we have to close out the avenues where they can defraud the public. But we bring 100 enforcement actions a year, and, unfortunately, there are going to be some folks that are trying to defraud the public.

Senator HOEVEN. So you feel you have a better track of the segregated accounts. Do you agree with Trustee Giddens that there should be some type of insurance fund like FDI insurance for de-

positors and banks for smaller customers? If so, at what threshold? And how should it be funded?

Mr. GENSLER. I am certainly open to it, but I think it is an issue of costs and benefits, and I think that certainly I stand ready at the Commission to hear more from the public, from farmers and ranchers and others that use these products, as to how to move forward on that, and it certainly would be Congress to take up. But I think we have to focus on everything within the laws, within the rules that we have now, to ensure that they best protect the public and not necessarily sort of just rely or wait for that very important policy debate.

Senator HOEVEN. Commissioner Sommers, your response to the same two questions—protecting customer segregated accounts, and then should there be some type of fund to protect small customers?

Ms. SOMMERS. Senator, I believe that there have been a number of enhancements that have been identified, not only by the NFA but by industry, by the CFTC staff, by the trustee, and we are moving forward to implement all of those enhancements.

With regard to the insurance fund, I think that the issue—as we always say the devil is in the details. Who is going to be paying these premiums? Is this going to be the FCM? Is it going to be the farmer and rancher? I have had a number of conversations with producers with regard to whether they would be willing to pay additional costs for premiums if they knew that their accounts were protected. Some are, and some are skeptical. So it is something that we need to continue to review and study to understand whether it is something the industry would want.

Senator HOEVEN. Trustee Giddens, customers are concerned about how much they are going to get paid back of their segregated funds, their account, and when; also, as Senator Johanns said, that the senior executives who did wrong are held to account. Give me your timeline on both. So with customers, how much are they going to get back, in what time frame, your best guesstimate, simple terms? And why haven't charges been fully brought in MF Global given that that occurred longer ago than the Peregrine case?

Mr. GIDDENS. To take the second question first, the timing on when any criminal or enforcement actions will come is really up to the U.S. Attorney and to the CFTC enforcement actions. As I say, we have, as indicated, already commenced working with the plaintiffs' counsel to bring litigation action against senior management of MF Global in order to collect additional funds for customers if we are successful in those litigations. So we are moving ahead on that.

The second question is we are and I am determined to return money to customers as quickly as I can. I cannot now return money until disputes over large claims are resolved by the bankruptcy court. We are moving quickly to resolve those disputes. As soon as those disputes are resolved, that frees up additional money for distributions.

How long that process may take, it may take 3 months, it may take 6 months, or it may take longer, depending on the complexities of the claims.

The holding company itself has filed claims against us of $2.2 billion in which it asserts—some of them they assert are securities

claims, some of them they assert are commodities claims. And those kind of issues have to be resolved, and I have to keep reserves so that I do not discriminate if it turns out those claims are allowed we have sufficient money to do that. So that is the biggest problem at present.

As we collect additional funds from segregated funds or whatever, we move as quickly as we can with the court. We will be distributing additional funds we have collected from the CME, and we will make those distributions as quickly as we can.

So I see this as going on as a sort of serial process. The litigation with the U.K. administrator is over $700 million. That case is being pushed before the courts. They have put in their initial position on that. The U.K.'s administrator's position is that these funds are not segregated under U.K. law, and they are going to be unsecured general assets for his administration. My position is these were 30.7 funds that the firm, the U.K.—part of the firm agreed and said should be segregated. Our position on—our responding position on that case will be filed in September. There will be discovery depositions, and the case should go to trial early in 2013. But that is an issue involving $700 million, which, literally I cannot control the timetable. The U.K. courts do.

But, again, all I am trying to point out is we are doing everything we can as quickly as possible to get funds back to customers.

Chairwoman STABENOW. Thank you very much.

Mr. GIDDENS. Thank you.

Chairwoman STABENOW. Senator Thune.

Senator THUNE. Thank you, Madam Chair.

Let me just say, to try to kind of personalize this to the people that I represent, I think the biggest question that we are faced with is: What needs to be done to ensure that farmers, ranchers, and investors and others who utilize commodities and futures can be protected from losing their money through misuse of customer funds, as has occurred with MF Global and now with Peregrine Financial Group, even though there are laws and regulations that have been in place to prevent these types of losses from occurring? I think anytime that we talk about making changes to any regulatory structure, we as lawmakers need to ensure that we emerge from these bankruptcies with what we have learned and able to provide adequate legislative and regulatory modifications to ensure that those types of scenarios do not occur again. And we also need to make certain that what we do does not create overly cumbersome compliance requirements and overtake normal oversight operations.

So, that said, the Peregrine Financial Group bankruptcy and the misuse of customer funds that occurred there, given the fact that MF Global occurred just 9 months earlier, is really troubling. And the CFTC has made some changes since that time, including implementing some reforms, Rule 1.25, which is known as the "MF Global Rule," but it is not clear that these rules have enabled the CFTC to more effectively oversee their self-regulatory system of the futures industry.

That point aside, and I would ask this question I guess to Chairman Gensler and to Commissioner Sommers, would you agree that the self-regulatory structure of the futures industry along with

some proposed reforms that various self-regulatory agencies have been discussing is capable of regulating the modern futures industry?

Mr. GENSLER. I think that the system can work. I think it does need some enhancements, and I do think given that we are also going to ask the NFA to register swap dealers—we actually had our first swap dealer register with them last Friday. But as they start to take on those examination functions, they will have to step up their resources, which they plan to do, but they will be challenged. And firms will fail in the future. Firms should be allowed to fail in our system, I believe in our system, and not have taxpayers back it either. But when they fail, the customer money has to be fully protected, and that is what we—as you say, lessons learned from here in this system. But I think it can work with enhancements.

Senator THUNE. Commissioner Sommers.

Ms. SOMMERS. Senator, I agree. I think the self-regulatory system has worked for the history of the futures industry, and with the enhancements that have been identified, unfortunately, Peregrine happened before we were able at the Commission to implement any further enhancements to our own rules. But we plan to do that, and I am hopeful that we will get to that as soon as we can.

Senator THUNE. Let me ask, since the passage of Dodd-Frank, do you think the CFTC is spending so much time writing new rules and regulations that it has not had time to adequately enforce the existing ones like the segregation of customer accounts?

Mr. GENSLER. I think that we are stretched, but we are very much focused on the futures market, and we have restructured our group that oversees intermediaries. We were working on, you referred to, Rule 1.25 well before some of the swaps rules, and even this LIBOR case is an example. I think hopefully I can speak for both of us, so proud of the Division of Enforcement to bring this case that they started working on in April of 2008 on something that is 70 percent of the futures industry is related to LIBOR. So we are very much focused on the futures market and farmers and ranchers, but we are stretched thin because the futures market has grown so much and now we have these new obligations in the swaps market as well.

Senator THUNE. Commissioner Sommers, what do you think? Spending too much time on Dodd-Frank to keep up with the stuff you have to do already?

Ms. SOMMERS. Well, I do believe that we identified many of the enhancements that we could have made to the futures industry 6 months ago, so the changes that are before us now are changes that we could have implemented months ago.

Senator THUNE. Thank you. Let me ask you, Trustee, Giddens, in your testimony you provided recommendations for legislative, regulatory, and other reforms that might help avert similar liquidations in the future, and I guess the question is: What would you say is the single most important and effective legislative change that should take place based upon your experience with MF Global?

Mr. GIDDENS. I think the one that would have had the most material effect would have been the consideration of the creation of a modest investor protection fund. As I say, the number of customers we discovered, unlike securities customers, the average account here was less than $100,000. So it is a modest amount of money, up to $100,000 would have—and the shortfalls might have been $20,000 per account or something, would have permitted sort of seamless restitution to these customers early on. Now, whether the cost of that is practical and so on, but I think that recommendation or something like that would be the most important.

Senator THUNE. Okay. Thank you. I see my time has expired, Madam Chairman. Thanks.

Chairwoman STABENOW. Thank you very much.

Chairman Gensler, you mentioned a saying that your grandfather used, and I am reminded of another Russian saying used by President Reagan: "Trust, but verify." How often are filings by FCMs received but not verified?

Mr. GENSLER. Well, in fact, they make a filing every month, and under the new rules, they will make filings every day. But the verifications to outside third parties have historically been done by paper and only done annually by the outside auditors or the NFA every 9 to 15 months. We want to change our rules to say daily that you can see those account balances directly from the bank. And if you see it directly from the bank electronically, I think that is a form of verification that will significantly enhance this audit function.

Chairwoman STABENOW. Thank you.

We have heard from many on the buy side who would like to see the option of being able to fully segregate their assets for both futures and swaps. Would you or the Commission support customers' having the option of complete segregation? What are the costs and benefits to that approach from your perspective?

Mr. GENSLER. We adopted earlier this year for swaps something that walked in that direction, something called "legal segregation but operation commingling." Some pension funds have asked to move a step further. We had roundtables on it. I think there is something very interesting to pursue, but as I understand it, it might need some changes to the bankruptcy law as well to fully facilitate what some of these accounts would like to do. But we can encourage the dialogue because I think it is very helpful dialogue.

Chairwoman STABENOW. Well, speaking of the Bankruptcy Code, Trustee Bodenstein, the Code and other relevant laws have different views on the priority of commodity customers over creditors. Would you agree that customers should have a special status in these proceedings ahead of general creditors?

Mr. BODENSTEIN. Madam Senator, I believe that one of the provisions of——

Chairwoman STABENOW. If you might speak a little bit more in the mic, I am not sure you have the——

Mr. BODENSTEIN. I am sorry. I believe that under the special provisions for commodity broker liquidations in the Bankruptcy Code, there is a separate customer property pool that would have priority over the pool of general creditors.

Chairwoman STABENOW. And would you support clarifying that, making it very clear that customers go ahead of general creditors?

Mr. BODENSTEIN. Excuse me?

Chairwoman STABENOW. Right now bankruptcy law conflicts with other laws as to who comes first——

Mr. BODENSTEIN. Well, my understanding——

Chairwoman STABENOW. —and so as we look at——

Mr. BODENSTEIN. I am sorry. My understanding of the Bankruptcy Code—and we will see how these special provisions for commodity broker liquidations play out in this case. My understanding at present is that, in fact, the customers do have a priority over the claims of the general creditors.

Chairwoman STABENOW. That is correct. There are other laws like the bankruptcy provisions in the Commodity Exchange Act that have a different view, so that is I guess what I was asking. You support having the status in proceedings for general creditors. So we will leave it at that. Let me ask you——

Mr. BODENSTEIN. Well, I guess the answer is—I am not an advocate for any one particular group as the trustee, but I will study the different provisions and ensure that I apply them with the consent of the court on all the actions as appropriately as possible.

Chairwoman STABENOW. Sure. Let me ask you, when will Peregrine customers start to get their money back? Do you estimate a timeline?

Mr. BODENSTEIN. I do not have an estimate at this point in time. We are working diligently right now to verify customer balances and customer segregated funds so that that sort of calculation and determination can be made in the near future.

Chairwoman STABENOW. And along that line, Trustee Giddens, how many MF Global accounts were transferred to Peregrine Financial?

Mr. GIDDENS. Of 27,000 accounts, approximately 590 accounts and something like $197 million of associated cash collateral was transferred. It was not transferred to PFGBest directly, but it was transferred within CME and other exchanges.

Chairwoman STABENOW. Okay.

Mr. BODENSTEIN. I have a slightly different take on that.

Chairwoman STABENOW. Yes, Mr. Bodenstein?

Mr. BODENSTEIN. I believe that approximately 627 accounts were transferred and approximately $197 million. But of that amount, only $3.7 million stayed at Peregrine Financial, and the account value now of those accounts is slightly in excess of the $3.7 million. So, by and large, within days or months after the accounts were transferred from MF Global to Peregrine, those customers removed the funds, transferred their accounts out of Peregrine.

Chairwoman STABENOW. Okay. Just to be clear then for the record, Mr. Bodenstein, could you give the number again of accounts that you believe—600? What was the number?

Mr. BODENSTEIN. Based on the preliminary information I requested from the employees at MF Global—at Peregrine, they tell me that approximately 627 accounts were transferred.

Chairwoman STABENOW. Trustee Giddens, you were giving some different numbers here. Could you repeat those?

Mr. GIDDENS. The number we had from our records is not significantly different. We said 590 accounts. And I do not know what the accounts did when they were transferred, but I am pleased to hear that large numbers of them transferred to another firm. But we agree on the figure. I had 590 and approximately $197 million of assets that were transferred, and as I say, I think we are glad to hear that a significant number of those moved on, and as I understand it, only claims in excess of $3 million remain at Peregrine.

Chairwoman STABENOW. Okay. Thank you very much.

Senator Roberts.

Senator ROBERTS. Well, Madam Chairman, I do not want to beat up on a horse that is already out of the barn and in another pasture. But there is a lot of angst, a lot of frustration, and a lot of anger in farm country about this. And when I asked Mr. Giddens this question, did someone somewhere within MF Global know exactly what they were doing and, if so, willfully move the money out of these segregated accounts, the answer was yes. A later question by one of the other Senators indicated that that also obviously involved a person at the top, i.e., Mr. Corzine.

Senator Johanns followed up and indicated, does that mean that he is guilty of that willful movement of the money, you were hesitant to say that. I understand that. But certainly I do not want to parse words, but it seems to me that he was at least complicit and culpable, which leads me to the question of Ms. Sommers. I know that you cannot answer the question that farmers and ranchers are asking me—and probably asking you as well—why isn't he in court? But my question to you is: Is the Department of Justice working with you on this investigation to your satisfaction to bring forward criminal charges against those who should be held accountable?

Ms. SOMMERS. Senator, we have been working with other authorities since the beginning, and just to point out again that a willful violation of the Commodity Exchange Act is a Federal crime. So if there is evidence to indicate that, that would be something that a U.S. Attorney would be able to pursue.

From our side of this investigation, I think we would never want to risk a successful outcome until we are able to review all of the facts and circumstances of this case to be able to bring a possible case against an entity or a person who may have violated the Commodity Exchange Act.

Senator ROBERTS. But are you satisfied with the cooperation to date with the Department of Justice?

Ms. SOMMERS. Yes, sir.

Senator ROBERTS. Well, there is one instance.

Mr. Bodenstein, can you explain the difference between SIPC bankruptcy in the case of MF Global and your Peregrine Chapter 7 bankruptcy?

Mr. BODENSTEIN. Senator, I am not an expert on SIPC bankruptcy. I would certainly defer to Mr. Giddens with respect to that.

With respect to the Bankruptcy Code as it exists, my duties are set forth in Section 704 as a general trustee, and now we have this overlay of the commodity broker liquidation provisions beginning in Section 761 through 767. And I have not had previous experience working with those particular provisions, and very few people have

had that honor or that daunting task of deciphering the meaning of those provisions of the Bankruptcy Code, but I look forward to that challenge, and I will faithfully—I expect to learn quite a bit and form opinions about how those provisions work in tandem with the other provisions of the Bankruptcy Code and what recommendations I might have as we go through this liquidation of Peregrine on how those can be improved. On future dates, I am sure I will be happy to share my thoughts on that with you.

Senator ROBERTS. A final question for everybody. What do you think of CME's new proposal regarding where segregated funds should be held? We can start with the Chairman.

Mr. GENSLER. We have had very fruitful discussions with the CME, with Terry Duffy, who I think might be on your next panel. I do think that it, as I understand it, might raise some issues back to the Bankruptcy Code again if the funds are not specifically at the futures commission merchant, just how it goes into these various provisions that Trustee Bodenstein referred to.

Senator ROBERTS. Ms. Sommers?

Ms. SOMMERS. Senator, I think I would applaud all of the market participants' efforts through the last 9 months and the different options that are on the table, and we need to continue to review all of these because I think that they could offer some good alternatives to what we currently have.

Senator ROBERTS. Trustee Giddens?

Mr. GIDDENS. I think it is a promising proposal.

Senator ROBERTS. Thank you for your brevity.

Mr. Bodenstein?

Mr. BODENSTEIN. I am not familiar with that proposal, Senator.

Senator ROBERTS. Well, get familiar. I appreciate that very much. My time is up.

Chairwoman STABENOW. Well, thank you very much. And let me just say as we dismiss you that there really are three goals that we have, as I said in the beginning: Making sure people get their money back in the unfortunate 500 or 600 accounts which have been hit twice, certainly I do not blame them for being very angry and very concerned about the system, as well as everybody else. We also want to make sure that people are held accountable for wrongdoing. And we want to make sure that the system improves, because the first time we heard it was an outlier, and it happened again, and I can assure you, if this is happening again, people are going to be extremely upset if we are not able to make changes. And we certainly support you doing that.

So you represent all three of those goals sitting before us, and we look forward to working with you, and we want to be able to answer the question yes when somebody asks us whether or not they can trust the futures markets and participate and not put their money under their mattress.

So thank you very much, and we look forward to working with you.

[Recess.]

Chairwoman STABENOW. Well, good morning, and we welcome you to a very, very important second panel. We appreciate your participation and input today, and let me introduce each of our witnesses. And as you are aware, we would ask for 5 minutes of open-

ing comments, and anything further for the record we certainly would welcome.

I am pleased to introduce our first panelist: Walt Lukken. Mr. Lukken is currently the president and CEO of the Futures Industry Association. Mr. Lukken formerly served as a Commissioner and Acting Chairman of the CFTC but, more importantly, Mr. Lukken is also an alumnus of the Committee, having served as counsel under then-Chairman Richard Lugar. And we welcome you back to the Committee.

Our next panelist is Terry Duffy, certainly no stranger to the Committee. Mr. Duffy is the executive chairman and president of CME Group. Prior to his work with CME Group, Mr. Duffy was president of TDA Trading. He was appointed by

President Bush and confirmed by the U.S. Senate in 2003 as a member of the Federal Retirement Thrift Investment Board. Welcome back.

Mr. Roth, Dan Roth, is the president and CEO of the National Futures Association. It is good to see you. Since joining NFA in 1983, Mr. Roth has served that organization as its chief operating officer, executive vice president, and assistant general counsel. Welcome.

Our next panelist is Diana Klemme. Ms. Klemme is here on behalf of the National Grain and Feed Association and is vice president and director of the Grain Division at the Grain Service Corporation. Ms. Klemme leads a staff that develops merchandising and risk management programs and is a well-known author of a number of articles on agricultural risk management, and we look forward to hearing your perspective this morning.

Our final panelist is John Roe. Welcome. Mr. Roe is the co-founder of the Commodity Customer Coalition, serves as its vide president, also president of Roe Capital Management. In addition to these roles, Mr. Roe is a principal and co-founder of BTR Trading Group, and prior to that ran the division of MF Global, which they left in June of 2010. We welcome you as well this morning.

Let us start first with Mr. Lukken.

STATEMENT OF HON. WALT LUKKEN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FUTURES INDUSTRY ASSOCIATION, WASHINGTON, DC

Mr. LUKKEN. Good morning. Chairwoman Stabenow, Ranking Member Roberts, FIA is the leading U.S. trade organization for the futures industry. While we are not a regulatory authority like the NFA or the CFTC, FIA's mission since its inception has been to protect the public interest through adherence to high standards of professional conduct and financial integrity. With that in mind, I would like to address the recent failures of MF Global and Peregrine Financial Group.

Three weeks ago, we learned that more than $200 million in customer funds was missing from Peregrine and that the fraud appears to date back 20 years. This is appalling and absolutely devastating news, especially for our customers, many of them farmers and ranchers. Members of the futures industry remain outraged, and we strongly encourage the PFG trustee as well as the MF

Global trustee to quickly return as much money as possible to customers.

The futures industry took considerable pride that the regulated futures markets had come through the financial crisis with relatively few problems. Tragically, we can no longer make that claim. These events are a stark reminder that we must never lose sight of the most fundamental and basic purpose of our regulatory system: protecting customer funds.

FIA is pleased that the regulators have adopted and implemented many of our MF Global recommendations. Post-MF Global, FIA formed a special expert committee to evaluate necessary changes to the customer protection framework.

In February, we released our initial report, which called on FCMs to ensure that they meet the highest industry standards for protecting customer funds. For example, we recommended that FCMs: one, report daily customer segregated balances and twice-monthly how customer funds are invested under permitted CFTC rules; two, annually certify that there are no material weaknesses in their internal controls and policies; three, that they maintain appropriate separations of duties among individuals responsible for customer funds protections; and, four, that we develop a certified training program for chief financial officers and other relevant employees.

In addition to our support of the NFA and CME's recent changes to improve customer protections, the FIA also generally supports the MF Global trustee's recommendations, which are consistent with many of these industry proposals and include studying the feasibility of a targeted insurance fund. Even with all that has been done, more is needed, and FIA is actively working on such improvements.

First, FIA strongly supports immediately authorizing regulators with the ability to independently review and confirm customer segregated balances electronically across every FCM at any time.

Second, FIA supports the creation of an automated confirmation system for customer segregated funds that will provide regulators with timely information that customer funds are secure. FIA participated in last week's CFTC Technology Advisory Committee meeting that discussed such technology solutions, and there are several viable technology systems worthy of near-term consideration.

Third, FIA supports the creation of an FCM Information Portal that will centrally house firm-specific financial information regarding FCMs so customers can more readily access material information when evaluating FCMs.

Fourth, FIA recommends that FCMs publicly certify as soon as practicable that they are in compliance with FIA's initial recommendations and that these controls are independently reviewed and audited.

I was also encouraged by Chairman Gensler's remarks that the Commission is adopting many of these sensible industry recommendations that I have discussed today. The basic blocking and tackling of regulation depends on ensuring that firms have proper risk controls and systems in place with independent auditing and

verification by regulators. At a time of great regulatory change, we cannot lose sight of these oversight fundamentals.

In conclusion, the embezzlement at Peregrine Financial appears to have been missed by a generation of regulators at both the Federal and self-regulatory levels. This, along with MF Global, is unacceptable by any measure. There is no easy solution, no magic bullet that will bring back the lost trust from these incidents. Instead, it is going to take time and hard work across the industry to implement these improvements to earn back the public's trust. Customers deserve better, and FIA is wholly committed to winning back their confidence by ensuring they have the highest degrees of protections going forward.

Thank you, Madam Chairman.

[The prepared statement of Mr. Lukken can be found on page 96 in the appendix.]

Chairwoman STABENOW. Thank you very much.

Mr. Duffy.

STATEMENT OF TERRENCE A. DUFFY, EXECUTIVE CHAIRMAN AND PRESIDENT, CME GROUP, INC., CHICAGO, ILLINOIS

Mr. DUFFY. Chairwoman Stabenow, Ranking Member Roberts, we at CME Group are appalled by PFG's theft of customer segregated funds. This fraud, following MF Global, has shaken the very core of our industry. Any breach of trust relating to customer funds is absolutely unacceptable—whether at PFG, MFG, or any other firm.

Since the failure of MF Global, CME Group and others in our industry have been committed to strengthening the protections that guard customer property. The industry has recently implemented new regulatory measures, one of which was the new electronic confirm tool that uncovered Mr. Wasendorf's misreporting, forgery, and theft. But more needs to be done.

CME and the National Futures Association have adopted four measures to deter, detect, and prevent misuse of customer funds. Three have been implemented, and the fourth will be made effective in coordination with the NFA next month. We have been conducting surprise reviews of customer segregated accounts since last December. We have implemented mandatory daily reporting of segregation statements by all FCMs. And we now require bimonthly reporting to ensure that segregated funds are properly invested and held at the approved depositories.

Also, in mid-July CME began using Confirmation.com, an electronic method of receiving statements directly from third-party depositories to verify investment reports. We also began using Confirmation.com as a tool in our regulatory audits and plan to require banks to confirm segregated funds using this tool.

In direct response to the MF Global disaster, we will be implementing the Corzine Rule on September 1st. The rule requires that the FCM's CEO or CFO sign off on any withdrawal of consumer segregated funds that exceeds 25 percent of the excess segregated funds. They must also inform the CME at the same time.

As I said, more can be done. At the same time, CME believes that the regulators and industry must be careful in weighing the

costs and benefits of all proposals that may enhance protections for the segregated funds of our clients.

Some have suggested the creation of an industry-funded insurance program covering fraud and failure losses, possibly supplemented by private-arranged insurance. Such a fund would certainly boost confidence, but needs to be balanced against known negatives. The negatives are the obvious: it being cost-prohibitive and ineffective due to the amount held in U.S. segregation over $150 billion.

We need to develop rules, procedures, and systems that give regulators direct, real-time access to customer segregated account balances, and we are working with regulators to do so. In the meantime, today while conducting regular surprise audits, we have the ability to call upon our clearing members to access online account balances for our on-site review. And while it will be controversial and perhaps have disruptive consequences, we should explore whether customer property not required as collateral at clearinghouses should, nonetheless, be held by clearinghouses or other custodians and whether safeguards should be put in place to limit the ability of FCMs to transfer such property except to the authorized recipients.

In addition, CME Group proposes that Congress amend the Bankruptcy Code to permit clearinghouses that hold sufficient collateral to support customer positions of a failed clearing member transfer those positions of all non-defaulting customers with the supporting collateral to another stable clearing member.

While we expect that the misconduct of MF Global and PFG will renew calls to eliminate the role of exchanges and clearinghouses in auditing and enforcement of their members, we do not believe that a legitimate case can be made to transfer these responsibilities to a Government agency.

CME Group is committed to working with the Congress, the CFTC, NFA, FIA, and market participants to re-evaluate the current system to find solutions to further protect customer funds at the FCM level. We are also committed to restoring confidence in the markets that so many rely on for their risk management needs.

I thank you for the opportunity to testify before you today, and I look forward to any questions you may have.

[The prepared statement of Mr. Duffy can be found on page 64 in the appendix.]

Chairwoman STABENOW. Thank you very much.

Mr. Roth.

STATEMENT OF DANIEL J. ROTH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL FUTURES ASSOCIATION, CHICAGO, ILLINOIS

Mr. ROTH. Thank you, Madam Chair. As you noted in your opening comments, this is the second time in just 8 months that we are here discussing a misuse of customer seg funds, a theft of customer seg funds by an FCM.

This time involving Peregrine, there is a shortfall of approximately $200 million. This fraud was perpetrated through a sea of forged bank documents. Peregrine was required to report on a daily basis to NFA the amount of customer funds it was holding and

where those funds were being held. Those reports were false, and they were supported by forged daily bank activity statements, forged monthly statements, forged acknowledgement letters, forged deposit slips, forged certified checks, and forged bank confirmation notices.

We began our most recent exam of Peregrine in mid-June, and as part of that process, we very early on in the examination informed the firm that we were switching our bank confirmation process, that in the past we had used a traditional bank confirmation process. In which Peregrine would sign a document authorizing its banks, all of its banks, to release certain information to NFA. We would then take those documents, mail them to the bank; the bank would mail the response directly to NFA; and we would compare what the bank was telling us with what the firm was telling us.

We told Peregrine that we were switching from that to this e-confirmation process that we began using in January. It is a Web-based e-confirmation process. We told the firm that the firm would have to authorize its participation in that e-confirmation process. Mr. Wasendorf, Sr., executed that authorization on Sunday, July 8th, and the following day he attempted suicide, leaving a note describing the bank forgeries. As soon as we were notified of that event, there was an immediate phone call, a teleconference between the CFTC, NFA, and Peregrine personnel.

As of the previous Friday, Peregrine had reported to us that they were holding approximately $380 million in customer funds with over half of that, about $200 million, being held at US Bank, the office in Cedar Falls. During the teleconference on that Monday morning, we immediately instructed the firm personnel to go to the bank and get the bank manager on the phone, and when we had him on the phone, he told us that the actual balance in the account as of the previous Friday was approximately $5 million.

We then told him that we had written confirmations from the bank from our two previous audits and would he please confirm balances for those dates, the audit dates for those two previous years, 2011 and 2010. For each of those two dates, he again told us that the confirmations that we had were false and that they had been similarly inflated.

What we draw from all of this are the same painful lessons that we learned in MF Global. The facts that are undeniable are that, number one, customers have to know that their funds are safe.

Number two, it is up to the regulators, both at a governmental level and a self-regulatory level, to provide the highest level of assurance of that that we can.

Number three, we followed standard audit procedures in our examinations of Peregrine, including the bank confirmation process, and those standard audit procedures just were not good enough. He beat us. He fooled us. He fooled us for too long. We have to do better. We have to find a better way of monitoring members for compliance with all the requirements, but especially customer segregated funds.

We began that process immediately after MF Global. We formed both a special committee of our public directors at NFA and a committee of self-regulatory organizations with the CME, and we

began developing sets of rules—Mr. Duffy described some of them, Mr. Gensler described some of them—that have already gone to our board of directors. But we also began working on rules to make better use of technology to monitor seg compliance. And at our August board meeting, our board will consider a rule that will require all FCMs to provide the regulators with direct, view-only, online access to all customer seg bank accounts so that we can go in and check a balance at the bank anytime we want, for any bank we want, for any FCM we want, without contacting either the firm or the bank.

Beyond that, we hope to build a system, we will build a system that takes the e-confirmation process that uncovered this fraud and essentially turn it into a daily event. We need to get reports on a daily basis from all the depositories holding customer segregated funds—banks, FCMs, money market funds. Whatever the permissible investments are, wherever those depositories are, they have to file daily reports with regulators which the regulators can then on an automated basis compare with the reports we receive from the firms to generate alerts regarding any suspicious discrepancies.

We look forward to working with Congress, with the Commission, with the industry, and with all the stakeholders to ensure that we tighten these systems. We know we cannot eliminate fraud, but we will continue to strive to do that.

Senator, if I could ask your indulgence for one second, on the first panel Senator Grassley raised a question about a comment, a quote, a story in the Wall Street Journal that said that I had said that it was not NFA's role to detect fraud. Senator, I have been at NFA for 29 years, and I will guarantee you that I have not only never said that, I have never thought that. Detection of fraud, combating fraud in the futures industry, has been central to our mission for the last 30 years, and it remains so today.

Secondly, with respect to the red flags that Senator Harkin and others have asked, if it would be helpful, I could just submit a written statement outlining our responses to each of the instances that were noted in the press or here today.

Chairwoman STABENOW. That would be helpful. We would appreciate that.

Mr. ROTH. Thank you. And I apologize for going over my time.

[The prepared statement of Mr. Roth can be found on page 105 in the appendix.]

Chairwoman STABENOW. That would be helpful. Any information or responses that you would like to share would be helpful.

[The following information can be found on page 264 in the appendix.]

Chairwoman STABENOW. Ms. Klemme, welcome.

STATEMENT OF DIANA KLEMME, VICE PRESIDENT AND DIRECTOR, GRAIN DIVISION, GRAIN SERVICE CORPORATION, ATLANTA, GEORGIA, ON BEHALF OF THE NATIONAL GRAND AND FEED ASSOCIATION

Ms. KLEMME. Good morning, Chairwoman Stabenow, Ranking Member Roberts, other members of the Committee. As you mentioned, I am Diana Klemme. We are an introducing Broker based in Atlanta, Georgia. We provide brokerage and advisory services to

country grain elevators, farmers, and end users of commodities, and I am testifying on behalf of the National Grain and Feed Association.

Many NGFA member firms have been deeply touched by the failure of MF Global, including the firm that I work for. We cleared MF Global. I have seen it firsthand. These were the toughest 9 months of my career. It is as if a bank failed and the customers discovered that the contents of their safety deposit boxes had been raided and taken in the bankruptcy.

The unprecedented loss of customer funds in the MF Global debacle has led obviously to a loss of customer confidence in the futures markets and in the system itself. I hear this all the time from our own customers. And so as NGFA has considered what changes might be workable in the aftermath of MF Global, we asked whether these failures justify systemic change. Then with the discovery of long-term fraud and misappropriation in the PFG debacle, it does drive home the need not just for regulatory oversight and change, but rapid change to fully protect customer funds. In the meantime, the customers are still waiting.

Two such failures in 9 months, especially the failure of PFG when regulators presumably were on heightened alert, is just incomprehensible and unconscionable to customers. I get these questions all the time.

Let me illustrate why by taking one customer from my own client base. This is a typical grain elevator. I will not even tell you the State. It does not matter.

Country elevators buy grain from farmers and provide a vital service to agriculture. They buy when farmers want to sell. They sell grain to end users when a buyer needs a commodity. Elevators also provide the service of buying from farmers who may want to sell a future crop, which then gives the farmer confidence to go out and buy land or rent land or buy inputs.

But this elevator then has to hold and maintain short futures hedges for a year or more and be financially able to meet any margin calls that might occur. And with the drought this year, we know what that is involving.

This one particular customer that I am speaking of currently was holding 4.2 million bushels worth of short futures across corn, beans, and wheat on July 20th. The combined margin requirements for those positions on that day were $9.4 million that this fairly small business had to send to Chicago. They have met every margin call immediately, which is a huge act of faith given they just went through MF Global and they are still waiting for 20 percent of their funds. And, importantly, all hedgers—my customers and others—rely on lenders to provide much of the financing for these margin calls. So this is not just about farmers, ranchers, elevators, et cetera. It is about the ag lenders at the backbone of this.

This is just one example. It is not even a large company, just a typical elevator. Multiply it by the aggregate size of U.S. agriculture, and you can envision the scope of the financial demands and exposure that these businesses are participating in right now on faith.

The CFTC's own Commitment of Traders Report from last Friday showed that the hedger/producer/merchant category is holding com-

bined long and short futures in just corn, beans, and wheat of 9.7 billion bushels that is having to be margined every day with lenders providing these funds. Hedgers have to know these funds are safe. Lenders have to know these funds are safe. And brokers want to know those funds are safe.

You might ask why lenders are continuing to fund this system. Well, partly because we have all assured customers, NGFA members, and lenders that, after MF Global, change is coming. I have been assuring people of that. But they keep asking when. Filing reports is not the answer. It is not enough. Audits are an important part of the process, but they are backward-looking, and they do not restore confidence. An audit is a piece of paper. It is going to take real change with protection of funds in one way or another, much like protecting safety deposit box contents. And to get this done, not after endless regulatory debate, finger pointing and meetings, we have to get it done quickly, especially in the face of the markets that we face right now.

Our full recommendations are outlined in my written testimony, which includes a pilot program to test a full segregation system with customer funds held separately and includes a number of changes to the way bankruptcy laws and the Bankruptcy Code handles failures. We recognize that a full segregation structure would include additional costs, may not be workable or preferable for all customers, but neither is losing their money. For that reason, NGFA also recommends insurance protection for customers. Such a fund does not need to be large enough, certainly in the beginning, to fund the entire futures industry. If that ever occurs, we have bigger issues to worry about. But we do need something that is large enough to protect customers caught in the occasional failure while perhaps longer-term systems are being evaluated and implemented.

I thank you for the opportunity to share the views and policies of the National Grain and Feed Association.

[The prepared statement of Ms. Klemme can be found on page 91 in the appendix.]

Chairwoman STABENOW. Thank you very much.

Mr. Roe.

STATEMENT OF JOHN L. ROE, CO–FOUNDER, COMMODITY CUSTOMER COALITION, CHICAGO, ILLINOIS

Mr. ROE. Good morning, Chairwoman Stabenow, Ranking Member Roberts. Thank you for the invitation to appear before you today to discuss the Commodity Customer Coalition's recommendations for the policy response to the MF Global and PFGBest insolvencies.

It seems it has become a very risky proposition to tender your property to a commodity broker. An industry which just a year ago prided itself that no customer had ever lost a penny as the result of a clearing member default now hopes that losses due to broker insolvencies will be limited to hundreds of millions of dollars, instead of billions of dollars.

The system of commodity regulation is clearly broken. In fact, part of that system is so broken that the regulator in charge of auditing PFGBest's financials could not tell that the fines they levied

against PFGBest were being paid to them with money that belonged to customers—$700,000 this year alone.

Before this Committee, Chairman Gensler of the CFTC testified that just as it is unreasonable to expect police to stop all bank robbers, it is unreasonable to expect commodity regulators to stop all fraud. Yet bank customers do not live in fear that their deposits will be robbed by the bank. Moreover, in the event that a bank theft is so large that it causes the bank to become insolvent, those customers have insurance to protect those deposits. If Chairman Gensler's robbers were to rob a securities broker, they, too, have customer account insurance. Commodity customers are only protected by the regulators.

There is no mechanism in place outside of the bankruptcy process to deal with shortfalls in customer property. Once customer accounts are attached to an FCM bankruptcy, the losses to customers have only just begun. In addition to whatever assets with which the broker has absconded, customers face losses stemming from their inability to manage frozen trading positions and collateral. Customers then endure an arduous bankruptcy process with fees far in excess of the market price for comparable legal services. These bankruptcies will drag on for years, and the administrative fees, which may be paid from customer property, will run into the hundreds of millions of dollars.

Participants in American financial markets deserve better. They deserve the strongest, most efficient legal protections available. They deserve a safety net when the regulators fail. We have to stop expecting the regulators to do their jobs and start offering customers protections when they do not. If Mr. Gensler's robbers cannot be stopped, then at a minimum they must be insured against.

Among the policy recommendations that we tendered to this Committee, the most important is an account insurance mechanism. We propose that Congress authorize an industry-funded liquidity facility, which focuses on providing liquidity to plug shortfalls in customer property and ensure customer accounts are quickly transferred to new brokers with their positions intact. This fund would then step into the shoes of customers who would have been in the bankruptcy. It would pursue recoveries for the fund's distributions and reserve property against claims made against customer property.

This liquidity facility would not be Government funded or managed. Assets for the fund could be raised transactionally as well as through member firm assessments.

There is a working model of this type of fund known as the Canadian Investment Protection Fund in Canada. At MF Global's Canadian subsidiary, some 7,800 customer accounts were transferred with 100 percent of their property to a new broker within 2 weeks. In fact, the only reason that it took 2 weeks is accidentally the SIPA trustee moved Canadian property that belongs to Canadian customers inadvertently and it had to be moved back to be transferred. They were able to make customers whole with the facilitation of a guarantee from that protection fund covering a 20-percent shortfall in assets. As a result, Canada's customers can now say, as we used to, that no customers ever lost a penny as a result of a clearing member default.

Like all types of insurance, any such insurance would have to have coverage limits. But if the FDIC can ensure $4.3 trillion in bank deposits, surely we can ensure $190 billion in customer segregations cost effectively.

Congress must also consider enacting new criminal penalties for the misuse of commodity customer property. While the PFGBest case will likely result in criminal convictions, the probability for a criminal conviction in the MF Global case is less certain. The lesson of MF Global should not be that there are no criminal consequences for swiping customer funds.

Congress must consider measures to counteract the risks to customers resulting from the combination of broker-dealers and FCMs in a single corporate entity. Over 80 percent of customer segregated property in the United States resides in just 10 of these firms. Broker-dealers and FCMs and single entities have exposed over $35 billion in commodity customer property to insolvency since the financial crisis. We urge Congress to consider forcing broker-dealer FCMs to split their operations into separate legal entities. At a minimum, the unencumbered collateral of commodity customers with accounts at those firms should have SIPC insurance coverage.

Lastly, Congress must consider making reforms to the Bankruptcy Code, and I know that that is outside the purview of this Committee, but it is an important part of an appropriate and complete policy response. A complete overview of our recommendations for bankruptcy reform can be found in the recommendations that we tendered to the Committee.

Some in the industry will argue that substantive changes have already been made to commodity regulations. They will argue that these changes are sufficient to diminish the likelihood of future shortfalls. They will say that we just need to enforce what is on the books. However, this logic assumes that thieves lack ingenuity. It assumes that the same technological advances adopted by the regulators will not also aid the thieves themselves. History demonstrates that regulators are the last to adopt new technologies. No more poignant evidence of this is that, in 2012, regulators were still relying on paper statements requested from a P.O. box in Cedar Rapids, Iowa. If we are to protect ourselves from Chairman Gensler's thieves, we are going to have to do a little bit better than that.

We urge Congress to act to protect commodity customers when and where the industry does not.

[The prepared statement of Mr. Roe can be found on page 101 in the appendix.]

Chairwoman STABENOW. Thank you very much.

Mr. Lukken, first of all, we have all heard from Peregrine customers, and I have heard from one person who is facing the possibility of losing his life savings and literally said he would rather put his money under a pillow at the moment rather than invest in the futures markets. I am sure that is shared by many people.

Should futures commission merchants be allowed to hold customer money, or do we need to serious look at an alternative custodial arrangement? And would you support the CME's recent call for funds to be held outside of firms but to have any interest earned returned to the firm?

Mr. LUKKEN. Well, we are certainly looking at all ideas to help restore customer confidence in this area. As you note, in the futures model, customers give money to their FCM, their brokerage; but along with that, there is also a guarantee. The FCM is guaranteeing those customers, and so the FCM has skin in the game as well to make sure that the customers' funds are properly invested and that there is due diligence there as well.

So if we take the FCM and move the customer money up to the clearinghouse and do not allow the FCMs to do their own risk management, because of this guarantee they simply become insurance companies, passing that money through.

I think if you look at the totality of the system, where we are strengthening FCMs and the segregation, the internal controls that we have recommended, the things that have been recommended and implemented by the CFTC, the NFA, and the CME, those are all strengthening things that are going to help the system.

I do think we have to look at more things. We have to look at this idea of a targeted insurance fund, as we mentioned——

Chairwoman STABENOW. Could you speak more about that? Because Mr. Roe talked about having an insurance-type mechanism. How do you feel about that?

Mr. LUKKEN. Well, this is something I think we are actively considering. Mr. Giddens in his report said, that a $100,000 insurance fund may have covered 78 percent of MF Global's customers. So that is, I think, something that we have to look at. But as has been noted, there are serious costs that may go with these insurance programs that we have to consider: coverage, actuarial soundness, and also potentially a lot of these insurance programs have a Government guarantee behind them, such as SIPC. So at a time when people are nervous about too big to fail, putting in Government guarantees is something we have to seriously consider.

So certainly we are going to be looking in the coming weeks at insurance options. We think it may be something we can look at, but we will come back to this Committee with our findings.

Chairwoman STABENOW. Thank you very much.

Mr. Duffy, on the same note, when you were before us in December, you testified that the costs of an insurance fund would be cost-prohibitive, but then you, in fact, have put I place something on a limited basis for farmers and ranchers and co-ops. So do you believe that this kind of fund is feasible on a larger scale? Wouldn't this sort of an expanded fund help restore the faith in the systems?

Mr. DUFFY. As I said to you, Madam Chairwoman, when I testified right after MF Global to your Committee, if our family farmer/rancher fund was in place during MF Global, all of the people who put food on the tables of the people in America would have been made whole. That $100 million fund would have paid $33 million out to those farmers. That is exactly what they would have been out, and we backed out the accounts of pure bona fide hedgers—not speculators, not people doing other things, just people that are processing and growing food.

As far as an insurance fund goes, I think it is really important to note in order to get to a billion dollars of insurance, you need to charge 5 cents a side a trade for 3 years to get to $1 billion. We are charging clients 7 to 10 cents to trade a day, so now we are

going to double their cost to add to this fund. When you look at something like the Securities—everybody wants to refer to SIPC, how it is a great bailout. Well, ask the folks that were invested with Mr. Madoff when he took $50 billion and SIPC gave him $2.5 billion in return. They were basically getting nothing in return.

Also, in SIPC, the clients do not pay for that insurance. The dealers pay for that insurance. Why? Because there is a payment for order flow in the securities world, a completely different structural model. We do not have a payment for order flow model in the futures industry. We have a central limit, open, transparent book for all to see. And I think that is a completely big, huge difference when you talk about who is going to fund these types of insurance programs.

I am not opposed to insurance. I am all for if people want to pay for it, they should have the ability to do it, and we will be happy to try to facilitate some forms of them to do so. But I think you need to understand there are huge differences when people are trying to draw the line between SIPC and what happens in our industry today. Completely different models, who pays for it and why they pay for it.

Chairwoman STABENOW. Okay. Thank you very much. And I think, Senator Roberts, with the two of us here, I am going to take an extra question on the time and let you do the same.

Mr. Roth, I want to ask you, with MF Global and Peregrine, there were certainly red flags. And with Peregrine there was a long history of violations and enforcement actions. Were they receiving additional scrutiny compared to other firms because of the violations?

Mr. ROTH. Senator, Peregrine's customer base was overwhelmingly retail speculator type customers, and they did receive a good deal of regulatory scrutiny, and there were a number of enforcement actions. But, frankly, firms that do retail speculator type business tend to encounter more regulatory problems, particularly in the area of sales practices, promotional material, the way they trade customer accounts in some cases. So Peregrine was subject, I think in both the CFTC and NFA, to more regular examinations and repeated enforcement actions. None of those examinations and none of those enforcement actions, however, involved allegations of fraud regarding customer segregated funds. There was not an indication of that.

Chairwoman STABENOW. Well, but reportedly Mr. Wasendorf, Sr., was the sole person in the company officially receiving the bank statements, and other individuals in the company, including the chief compliance officer, took his word for the fact that the documents were real, at least according to reports. So when we look at this, would this consolidation of functions have violated any standard of internal controls that would have been identified in audits or other reviews, or should they have?

Mr. ROTH. Our examinations certainly would have covered internal controls, as would the examinations by the outside CPA. We tried to make sure that there was a segregation of duties and that the people preparing the segregation computations on a daily basis had the expertise to do that function.

So, obviously, there was a failure of internal controls in this case, and I am not suggesting otherwise, and I think we do need to develop more stringent standards for internal controls. But there was—during our examinations we covered that, and we looked to make sure that there was—that the people preparing the segregation computations that were reported to us had the ability to do so.

Chairwoman STABENOW. You talked about the e-confirmation process that you are now using. Do you think that is enough? One of the concerns, of course, is that, on the one hand, we can say you can never totally stop fraud if someone wants to have an elaborate scheme. On the other hand, that is not much confidence to people who want to use the futures markets. And so going forward, again, the trust, but verify position in terms of from a customer's standpoint. What is the verification, what is the independent verification beyond having e-confirmation?

Mr. ROTH. And, clearly, the e-confirmation process was very helpful in this case, but it is equally clearly not enough. And that is why we are taking a two-step process on this. At our August board meeting, we will require all FCMs to give their regulators view-only online access to customers' segregated bank accounts so that the regulators can go in and check a balance anytime we want, any day we want, for any bank we want, without the involvement of the firm or the bank. But even that is not enough. As I mentioned in my testimony, we need to develop—we need to change the e-confirmation process essentially and make it a daily event so that we get daily reports from all the depositories of customer segregated funds, not just banks but FCMs and money market funds. Wherever those funds are invested, we need to get daily reports from all those seg depositories and then be able to compare those daily reports on an automated basis with the reports we are receiving from the firm. So we want to take the e-confirmation process and basically make it a daily event.

Chairwoman STABENOW. Thank you.

Senator Roberts.

Senator ROBERTS. Well, thank you, Madam Chair. This has been an excellent panel. I wish the other members had stayed.

Mr. Roth, it looks like our standard audit practices obviously need to be updated in order to catch somebody like Mr. Wasendorf at Peregrine. And you indicate that you have, like Moses sort of coming down with a tablet, recommendations that you will give to the Committee. Are you sharing those with the rest of the panel here?

Mr. ROTH. Well, actually, our testimony I think was shared with the other panel, so I hope so.

Senator ROBERTS. Right.

Mr. ROTH. If not, we can certainly provide it. The recommendations that we are talking about were developed in large part through an SRO committee in which the CME is an active participant. And we have also conferred very closely with FIA in developing all of the proposals, including——

Senator ROBERTS. Well, I am just asking a stovepipe question with the exception of Mr. Roe, who is a sheriff of a new posse.

Mr. ROTH. Right.

Senator ROBERTS. And riding point, pretty hard. But at any rate, know, do you all ever get together and talk this over? Because it seems to me that you all have some very good suggestions, either with some kind of insurance electronic transparency, et cetera, et cetera. Maybe that is the wrong question to ask you, but at any rate, Mr. Lukken, once your recommendations or any of the recommendations are in place, could an MF Global or a Peregrine-type event still occur?

Mr. LUKKEN. I think anybody who is bent on fraud or misappropriation of funds can, try to confound the most sophisticated compliance systems. However, I think what we have recommended is going to make that significantly more difficult after the MF Global situation, including separation of duties, as I mentioned. This idea of going to risk-based audits I think is an important one, this modernizing of how we audit away from a check-the-box system to more of an automated daily confirmation directly from the banks, that is independently verified. Those are really important steps, and the good news is it will also free up auditors to ask the more difficult questions, to see the red flags, to go forward with their audits in a more risk-based fashion than check the box.

So these are important improvements, and I will mention—you talk about discussion between the groups. We independently huddled with our experts, and we all came to roughly the same improvements, including the idea of studying an insurance fund, which some on the panel have looked at as well. So even though we have independently studied this, there is significant alignment among the recommendations that we have put forward.

Senator ROBERTS. Well, that is good news. Does the FIA support bankruptcy reform?

Mr. LUKKEN. Certainly we are supportive of some of the recommendations. Obviously it is complex. I think this idea of making the Bankruptcy Code easier for people to port away positions so that customers at distressed FCMs can move their positions to other FCMs, is an important concept. Giving customers more of a voice either through the CFTC or through committees on their own is an important concept that may need to be addressed. And also, I think, when we talk about a broker-dealer FCM going down like MF Global. You know, there are differences between the SEC and the CFTC rules in this area that for years have not been addressed. I think it is important for those two organizations to sit down and make sure there is certainty of rules that when this happens, people know what is going to happen.

Senator ROBERTS. That is a big issue that the Committee is really interested in, both the Chairwoman and myself.

This question I asked Chairman Gensler on the first panel. Once you have electronic access, won't you be able to monitor an FCM's account for any unusual intraday activity?

Mr. LUKKEN. Is that for me?

Senator ROBERTS. Well, anybody on the panel. Mr. Duffy, you have already gone into the insurance question, which I truly appreciate. But I guess that would be for anybody here that wanted to talk about it. Mr. Roth, do you want to take that one?

Mr. ROTH. Sure. I believe the direct, online, view-only access could be helpful under those types of circumstances in that when

a firm was under financial duress, I think we would be making much greater use of that tool, checking perhaps several times during the day to make sure that the seg deposits were as reported by the firm, and if there were fluctuations in those balances intraday, it could raise a red flag and create suspicions. If the funds are going down and then miraculously at the end of the day they pop back up, I think that would be something that would draw the attention of the regulator.

Senator ROBERTS. Ms. Klemme, you are certainly a feisty advocate on behalf of your organization that I am fully acquainted with, and I thank you for your interest and your leadership. You cannot do a rain dance somewhere, can you?

[Laughter.]

Ms. KLEMME. I wish I could.

Senator ROBERTS. All right. What kind insurance would you like to see developed?

Ms. KLEMME. Every form of insurance that has been discussed so far has some costs and some drawbacks. To my own point of view, and I think on behalf of NGFA, the first thing is urgency. So we might start with something that is not the long-run solution but the first step. Perhaps it is self-funding, such as Chairman Duffy said. Even if it is not a fund of a billion dollars but 20 percent of that, 1 cent a side, my customers would pay for it right now. Maybe that is not the long-term solution. We want to look at all the possibilities, including something that might be SIPC-like, could be industry funded, could be totally optional for each individual customer with perhaps CME, perhaps it is through NFA, creating the aggregate pool of coverage that customers can take or not take. A lot of people might decide not——

Senator ROBERTS. And your lenders would support that? I know you are quoting your lenders a lot. Your lenders have told you something like that?

Ms. KLEMME. They are concerned about the safety of the money, and if there is a very small cost attached to it, I think we would find that a lot of lenders would step up to that.

Mr. ROTH. Senator, could I just make one point? With respect to a fee generated through NFA to cover the cost of the insurance, I would just point out as a technical matter that would require an amendment to the statute because under the existing law, there are very strict limits on what we can use our fees and assessments for. They can only be used to defray reasonable administrative expenses. So if we wanted to use the NFA fee to be a mechanism to fund an insurance program, just so you are aware, that would require a change to the statute.

Senator ROBERTS. I thank you for that clarification.

Mr. Roe, you are riding point on this new outfit. You are the cofounder of this group, the Commodity Customer Coalition, following the MF Global situation. Do you think the self-regulatory model, all these folks sitting to your right, are still viable given these recent events?

Mr. ROE. I think so in the sense that I do not think it matters whether the regulator is paid privately or paid by the Government. I think that what both these failures show is that there will be future failures. The system is human, and, therefore, it is going to

be able to be breached by other humans. So to our mind, it is not to look for ways to make it more difficult in the sense of finding new technologies to stop fraud, but it is really to backstop this with insurance. It is the only thing that really effectively addresses what market participants are seeing, which is, regardless of who is in charge, they cannot be assured that their funds are actually going to be there when the music stops.

Senator ROBERTS. Would you be in favor of the proposal by Ms. Klemme? We will call it the "Klemme Plan."

[Laughter.]

Mr. ROE. I would have to know a little bit more about it, but——

Senator ROBERTS. Step by step. It is called "Step by Step." Not at a full gallop.

Mr. ROE. On the surface, absolutely. I think that Mr. Duffy is right that we cannot try to raise $1 billion in 3 years off an industry that is already hurting.

Senator ROBERTS. I hope not.

Mr. ROE. But the NFA just doubled its fee this year, and the world did not stop turning. So I think we can raise about $30 million per cent that we assess. We can look at maybe getting some assessments from member firms, grow it slowly, and if Congress will give the fund the authority to borrow funds at the discount window, then based on the cash flow of the fund, you can actually insure quite a bit more. And if the fund then goes into bankruptcy and pursues recoveries, it can get all its money back just like the Canadian Investor Protection Fund did. I think we can do it cost-effectively and quickly.

Senator ROBERTS. I appreciate your answer. I am way over time. I am 4 minutes over time, which is not a record for me, by any means.

[Laughter.]

Senator ROBERTS. But I just want to make a point, Madam Chairwoman; I think with all of the questions that were by members, which have been good questions—and the previous panel has been a good panel. But these folks here I think are the ones that are going to actually come up with the suggestions that turn into policy changes that will make a difference. And from that standpoint, I thank you all of you, and I urge you, do not stovepipe this. You know, let us work together. Be nice, Mr. Roe. You are going to be fine.

Thank you.

Chairwoman STABENOW. Well, thank you, Senator Roberts, and I am in complete agreement. I appreciate the recommendations we have already received, certainly after MF Global, as we put the call out. We appreciate that. But clearly there is more to do. This is number two now, and we cannot afford number three. Customers cannot afford number three.

So I think it is important. This has been very substantive. I appreciate all of you. As the Ranking Member indicated, this is a very important panel, and you have perspectives that are very important for us. And so as we move forward both with the regulators, both from the voluntary and the Government regulators, as well as the customers who are the most important in this whole process,

we look forward to working with you and having integrity in a system that needs to work for people in order for them to do business.

So thanks very much for your time.

[Whereupon, at 11:44 a.m., the Committee was adjourned.]

A P P E N D I X

AUGUST 1, 2012

WRITTEN STATEMENT OF IRA BODENSTEIN

TRUSTEE FOR THE CHAPTER 7 BANKRUPTCY ESTATE OF PEREGRINE FINANCIAL GROUP, INC., IN CONJUNCTION WITH TESTIMONY BEFORE THE SENATE COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

AUGUST 1, 2012

I. INTRODUCTION

Good morning Chairwoman Stabenow, Ranking Member Roberts, and members of the Committee. Thank you for inviting me to appear before you today. I am the newly appointed Chapter 7 Trustee of Peregrine Financial Group, Inc. ("Peregrine"), a future commissions merchant ("FCM") who filed bankruptcy on July 10, 2012. I am here to present the Committee with a brief introduction of my background and employment experience, my role as the Chapter 7 Trustee for the Peregrine estate and events of note in the bankruptcy case in the three weeks since the date of its filing.

I am currently a member of the law firm of Shaw Gussis Fishman Glantz Wolfson & Towbin, LLC, a 25 lawyer boutique law firm specializing in corporate insolvency and commercial litigation. I am also currently a member of the private panel of trustees in Chicago under the supervision of the United States Trustee Program, a component of the Department of Justice. Prior to joining Shaw Gussis, I served as the United States Trustee for Region 11, which is comprised of the Northern District of Illinois and the State of Wisconsin from May 1998 through January 2006. I also served as United States Trustee of Region 9, which is comprised of the States of Michigan and Ohio from September 2001 through August 2002. In connection with my work as United States Trustee I was involved in the supervision of several large cases including United Airlines, Kmart, Conseco and LTV Steel.

Prior to being appointed United States Trustee, I was a practicing attorney involved in various facets of bankruptcy law and commercial litigation. I am licensed to practice law in the States of Illinois (1980) and Florida (1982). I am a 1980 graduate of the University of Miami School of Law, in Coral Gables, Florida with a JD degree and a 1977 graduate of Franklin and Marshall College in Lancaster, Pennsylvania with a BA degree in Government.

Since joining Shaw Gussis in 2006, I have been appointed a Receiver in Efoora, Inc. (SEC Action) and Steven W. Salutric (SEC Action), and served as counsel for the Receiver in Lake Shore Asset Management Limited (CFTC Action). In connection with my work in Lake Shore, I have also served as a non-voting member of both the Creditors Committee and Liquidation Trust Committee in the chapter 11 bankruptcy of Sentinel Management Group, Inc., a registered investment advisor and future commissions merchant.

II. THE TRUSTEE'S ROLE IN THE PEREGRINE CASE

A. The Role of Chapter 7 Bankruptcy Trustees in General (11 U.S.C. § 704)

The primary role of any Chapter 7 trustee in bankruptcy is to maximize the net value of the estate created by the commencement of the bankruptcy case. When I refer to the net value, I mean that a cost benefit analysis must be employed to ensure that the cost of collecting and liquidating Peregrine's assets must not exceed their value with respect to any particular asset.

Another important duty is to provide information concerning the estate and its administration to parties in interest. That would include all creditors, customers and governmental units. It is my goal to make the process of the estate's administration as transparent as possible. As described below, I have already taken steps to that end.

One of my immediate concerns is the preservation and organization of financial and other information relating to Peregrine's assets, liabilities and financial affairs. This is important for several reasons, including my need to understand Peregrine's financial affairs in order to

properly administer the Peregrine estate, as well as fulfilling the needs of customers, creditors and governmental units for such information.

As Trustee, I am also charged with investigating the financial affairs of Peregrine. I am mindful of the pending investigations now being conducted by both law enforcement and regulatory agencies. I do no intend to duplicate that effort. It is my intention to fully cooperate with those authorities, including making available financial and other records of Peregrine under appropriate agreements and safeguards. To the extent I need to investigate Peregrine's financial affairs to administer the estate, object to claims or prosecute causes of action, I have retained competent and qualified professionals to assist me in those efforts.

In any case, whenever a trustee comes into possession of property that belongs to a third party, the trustee's goal is to return such property to its rightful owner and to pay allowed claims as expeditiously as possible. As discussed more fully below, those goals take on special significance with respect to customer property in a commodity broker liquidation.

However, it is important to note that as the Trustee for the Peregrine estate, my duties run to the estate and all of its constituents. In other words, it is not my role to advocate for or against any particular creditor constituency. My role is to maximize the estate for the benefit of all parties. If there is a dispute among competing claimants to particular assets or proceeds, the bankruptcy court will resolve those disputes in accordance with applicable law and rules of procedure after providing the parties with adequate notice and a full and fair opportunity to be heard.

In this case, I have been granted limited authority to operate Peregrine's business in order to wind it down in an orderly fashion and maximize the value of Peregrine's remaining assets. Consequently, I will also be filing with the bankruptcy court and appropriate governmental units

periodic reports and operational summaries. Most, if not all of this information will also be contemporaneously available on the website which I have established for this case.

At the conclusion of the case, after all assets of the estate have been collected and liquidated, and all disbursements have been approved, I will file a final report and account of the administration of the estate with the United States Trustee and the bankruptcy court. All of the reports and summaries of my administration of the Peregrine estate will be public documents, available to all interested parties.

B. Special Bankruptcy Code Provisions Applicable To Commodity Broker Liquidations (11 U.S.C. §§ 761-67)

When the Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.*, was enacted in 1979, the Commodity Futures Trading Commission ("CFTC"), which administers the Commodity Enforcement Act, 7 U.S.C. §§ 1 *et seq.* ("CEA"), advocated for a set of rules for the systematic and uniform treatment of commodity customer accounts in commodity futures merchants ("CFM") bankruptcies. Subchapter IV of Chapter 7 of the Bankruptcy Code is largely the result of the CFTC's efforts. The special commodities provisions of the Bankruptcy Code have been amended in material ways five times since 1979, most recently in 2005. Each time the Bankruptcy Code's special commodities provisions have been amended, the rules have been clarified and strengthened to broaden their application to a variety of transactions.

The Bankruptcy Code's special commodities provisions relate to three primary types of commodity contracts: (1) "commodity futures contracts," (2) "commodity option contracts," and (3) "leverage contracts." Other provisions of the Bankruptcy Code relate to "forward contracts." The commodities covered by most forward contracts, unlike those covered by commodity futures contracts, are generally delivered to the buyer. Buyers under commodity futures contracts normally cancel or "hedge" their contracts with offsetting trades.

Section 24 of the CEA authorizes the CFTC to adopt rules that: (1) specify what may be included in or excluded from the Bankruptcy Code's definition of "customer property"; (2) specify what property shall be considered "specifically identifiable" to a particular customer; (3) prescribe the method by which the business of a bankrupt commodity broker is to be conducted or liquidated; (4) specify the types of commodity firms to which the contracts and property of an insolvent commodity firm may be transferred; and (5) prescribe how the "net equity" of a customer is to be determined.

Pursuant to its statutory authority, the CFTC has enacted detailed regulations (17 C.F.R. Part 190) relating to, among other things, definitions of relevant terms; operation of the bankruptcy estate; making and taking delivery of commodity contracts; transfers of property, accounts, and contracts; calculation of allowed net equity; and allocation of property and allowance of claims.

The CFTC's other bankruptcy-related powers are contained in the Bankruptcy Code's commodity broker liquidation subchapter. For example, the CFTC may intervene in any commodity broker bankruptcy case and can, in effect, immunize transfers of customer accounts from avoidance by bankruptcy trustees by approving the transfers, either by rule or order, either before or after the transfer occurs.

In commodity broker bankruptcy proceedings, the trustee's tasks may include, in addition to the customary duties of all Chapter 7 trustees, the following:

1. provide notice to the CFTC;

2. attempt to estimate any short-fall in customer segregated funds;

3. attempt to effectuate a "bulk transfer" of customer positions and property to a solvent commodity broker,

4. determine which open commodity contracts and property are "specifically identifiable" to customers;

5. notify customers who have "specifically identifiable" property or commodity contracts, and request instructions from such customers;

6. liquidating or offsetting of property which is not "specifically identifiable" or which is "specifically identifiable" but for which no instructions are received;

7. make margin calls and meet timely delivery requirements;

8. compute estimated and then fully "funded balances" (net equity claims) for each customer; and

9. distribute customer property.

CFTC regulations set forth an approximate schedule during which trustees should perform their duties during the early stages of commodity broker bankruptcy proceedings.

C. Treatment of Customer Property (11 U.S.C. § 766)

The Bankruptcy Code gives commodity customers an important priority in the distribution of a bankrupt commodity broker's assets, subordinate only to: (a) certain domestic support obligations, if applicable; (b) certain administrative claims of the debtor's estate; and (c) certain expenses attributable to administering customer property and claims.

The Bankruptcy Code, in effect, divides the debtor's assets into two distinct estates: (1) the "customer property" estate and (2) the general estate. Customer property may not be used to pay the claims of the broker's general creditors until the commodity customers' claims have been fully satisfied. After the trustee's customer specific expenses have been satisfied, the assets remaining in the customer-property estate are distributed to customers on a pro rata basis, according to the net equity in accounts. If there are insufficient assets in the customer-property estate to satisfy customer claims, the customers become general creditors as to the unpaid portion

of their claims and share equally with the other general unsecured creditors in the distribution of any assets in the general estate.

The Bankruptcy Code's underlying policy is the equality of distribution among all customers within the same creditor class. Therefore, all customer property, whether or not separately maintained, is subject to pro rata distribution. "Specifically identifiable" property may be transferred or returned, but only upon the payment by the customer to the estate of cash equaling the difference between the value of the property and the customer's pro rata share of the estate.

Under prior law, the trustee of a bankrupt commodity customer might have been able to recover the margin payments that had been made by a debtor to an FCM within one year of bankruptcy. Similarly, the trustee of a bankrupt FCM might have been able to recover the margin payments that had been made by the FCM to another FCM or to the clearinghouse of a commodity exchange. The Bankruptcy Code, however, prohibits recovery of these payments unless the trustee can show that the bankrupt customer or FCM made the payments with "actual intent" to hinder, delay, or defraud creditors. Even if the trustee can meet its burden, recovery is prohibited from a payee that took the payment in "good faith."

The Bankruptcy Code also facilitates efforts of exchanges and regulators to transfer customer property from failing FCMs to solvent FCMs. If the failing firm declares bankruptcy, the Bankruptcy Code prohibits the firm's trustee from recovering the transferred funds if the transfers were approved by the CFTC.

The 2005 Amendments to the Bankruptcy Code introduced additional protections to participants of certain financial contracts by providing that their exercise of rights under

applicable provisions of the Bankruptcy Code does not affect the priority of any unsecured claim such participant might have after the exercise of those rights.

Customer property which is "specifically identifiable" receives special treatment under the Bankruptcy Code. While other customer property is within the sole control of the trustee to transfer or liquidate, Bankruptcy Code § 766 grants customers who own "specifically identifiable" property certain rights regarding the property.

Bankruptcy Code § 766(c) provides that the trustee shall return promptly to a customer any specifically identifiable security, property, or commodity contract to which such customer is entitled, or shall transfer such security, property, or commodity contract to a solvent commodity broker, to the extent that the value of such security, property, or commodity contract does not exceed the customer's pro rata share of the estate if such security, property, or commodity contract were not returned or transferred under this subsection. Bankruptcy Code § 766(d) provides that if the value of a specifically identifiable security, property, or commodity contract exceeds the customer's pro rata share of the estate, the customer may deposit cash with the trustee equal to the difference between the value of such security, property, or commodity contract and such amount; and the trustee shall return the property to the customer or transfer it to a solvent broker. Bankruptcy Code § 766(a) requires the trustee to answer all margin calls with respect to a customer's specifically identifiable commodity contract until such time as the trustee returns or transfers such commodity contract, but the trustee may not make a margin payment that has the effect of a distribution to such customer of more than the customer's pro rata share of the estate.

The Bankruptcy Code itself does not define the term "specifically identifiable" property. The CFTC has enacted regulations containing such definitions. Securities which margin,

guarantee, or secure an open commodity contract and which are held for the account of a customer, registered in the customer's name, not transferable by delivery, and not a short-term obligation are specifically identifiable property, as are documents of title which are identified as held for the account of a particular customer. As to open commodity contracts, only hedge positions' identified on the books of the debtor as held for the account of a particular customer in a designated hedge account are specifically identifiable property. Certain other property is also deemed to be "specifically identifiable." CFTC regulation 17 C.F.R. Part 190.02(b) requires the trustee to request customer instructions concerning the transfer or liquidation of specifieally identifiable property or contracts within two days following entry of the order for relief. If instructions are not timely received, the trustee will liquidate the property or contract. Customers requesting the transfer or return of specifically identifiable property must deposit with the trustee cash equaling the difference between the value of the property and the customer's pro rata share of the estate, together with "adequate security" to protect against overpayment by the trustee.

Bankruptcy Code § 766(e) provides, inter alia, that the trustee shall liquidate any commodity contract that is not specifically identifiable to a particular customer. Therefore, if the trustee concludes that it will not be possible to transfer commodity contracts and property to a solvent broker, the trustee must begin liquidating nonspecifically identifiable contracts and property "promptly and in an orderly manner." The prompt liquidation of such contracts and property protects the estate against exposure to the risk of adverse market fluctuations in the value of those contracts and property.

III. EVENTS OF SIGNIFICANCE IN PEREGRINE CASE TO DATE

Upon my appointment as trustee and consistent with my fiduciary duties, I took steps to secure Peregrine's assets and to protect customer accounts and information. I immediately went to Peregrine's Chicago office to confer with Peregrine's management in connection with my

need to operate the business on a limited basis for a limited period of time. I also spoke to certain employees about remaining employed for a limited period of time as their services are imperative to an orderly liquidation of Peregrine's estate. Those employees are currently assisting in my endeavors.

A. Trustee's Professionals

To assist me in connection with my duties as trustee, and subject to the approval of the bankruptcy court, I have selected various professionals which I am seeking to retain. The professionals include: (i) Shaw Gussis Fishman Glantz Wolfson & Towbin, LLC ("Shaw Gussis") to represent me as general bankruptcy counsel, (ii) Rust Consulting, Inc. ("Rust Omni") to serve as a claims and noticing agent, (iii) PricewaterhouseCoopers ("PWC") to serve as financial advisor, and (iv) Foley & Lardner, LLP to serve as special counsel to assist me in liquidating Peregrine's estate on technical issues related to the Commodities Enforcement Act and customer property issues. I have also selected and will retain Canadian counsel to assist in addressing issues related to Peregrine Financial Group Canada, Inc., a wholly owned subsidiary of Peregrine. The Investment Industry Regulatory Organization of Canada ("IIROC") has commenced regulatory hearings on the status of Peregrine's case and with the assistance of Canadian counsel, I am working with IIROC to ensure that the matter is handled properly.

B. Significant Actions by the Trustee

Prior to Peregrine filing a petition for relief in bankruptcy, the United States Commodity Futures Trading Commission filed a lawsuit in the United States District Court for the Northern District of Illinois ("District Court") alleging that Peregrine and its founder, Russell Wasendorf Sr. ("Wasendorf"), committed fraud, customer-funds violations and made false statements (the "District Court Case"). In connection with the District Court Case, on July 10, 2012, an Order

was entered appointing Michael Eidelman (the "Receiver") as a temporary receiver over the assets of Peregrine and Wasendorf (the "Receiver Order").

On that same day, Peregrine filed a petition for relief in bankruptcy. Peregrine's bankruptcy petition reflects that its assets total approximately $500,000,001 to $1 billion and that its liabilities total approximately $100,000,001 to $500 million.

Immediately following my appointment as Trustee, on July 12, 2012, I filed an emergency motion in the Bankruptcy Court for authority to operate Peregrine's business on a limited basis to facilitate the liquidation of Peregrine's assets, which included a request for authority to retain certain employees and pay their accrued but unpaid pre-petition wages. On July 13, 2012, the bankruptcy court granted the motion allowing me to operate the business through September 13, 2012, without prejudice to my ability to seek further extensions. To that end, I have been working on obtaining applicable customer account information and locating Peregrine's assets with the assistance of Peregrine's employees.

I am also working diligently to address employee issues, including those related to an investigation that has been initiated by the Department of Labor into Peregrine's employee 401(k) plan.

To assist in the management of customer and creditor inquires, Rust Omni is setting up a data room whereby the trustee's professionals will be able to view Peregrine's accounts and all related financial transactions. Rust Omni has also assisted in creating an informational website, which can be accessed at www.pfgchapter7.com and a call center in which customers can access automated information by dialing (877) 465-1849. Rust Omni will continue to assist in this case by managing creditor information and serving notices to Peregrine's creditors.

I have also met with the Receiver and his counsel on several occasions and maintain a continuing dialogue with him and his staff in order to ensure the orderly liquidation of Peregrine's assets. Both the Receiver Order and a CFTC statutory restraining order have also been amended to provide that the Receiver is only the receiver over the assets of Wasendorf, and not Peregrine.

With the assistance of my counsel, I have also spent a significant amount of time at Peregrine's offices in Chicago, Illinois as well as Cedar Falls, Iowa. While at Peregrine's offices, I have been gathering information and facilitating the wind down of Peregrine's business.

Recently, pursuant to a court order entered on July 25, 2012, I have been given authority from the bankruptcy court to prepare schedules and statement of financial affairs ("Schedules") on behalf of Peregrine. Schedules list all of a debtor's assets and liabilities, as well as information regarding certain of a debtor's activities prior to filing for relief in bankruptcy. It is a debtor's duty to file Schedules with the bankruptcy court, but under the unique circumstances of this case, I have sought and obtained authority to file the Schedules as they will be imperative in this case. The deadline for me to do so is September 6, 2012.

Pursuant to the provisions of 11 U.S.C. § 341(a), a meeting of creditors has been scheduled to take plaee in Chicago on September 10, 2012. The meeting will be held in the Dirksen Federal Building, 219 S. Dearborn Street, beginning at 10:00 a.m. At that meeting, I will question a representative of the debtor concerning the information contained in the filed Schedules.

Among other items of note, the Trustee consulted with the CTFC regarding the appropriate and necessary notice to be sent to holders of specifically identifiable property and

prepared and presented a motion to authorize limited notice to those customers, rather than notice by publication to all of Peregrine's customers per CFTC regulations, and approve the form of that notice. The relief was granted, and notice was immediately sent to the customers. The Trustee is currently in the process of coordinating the return of specifically identifiable property consistent with the provisions of 17 C.F.R. Part 190.

After consultation with the CFTC and the National Futures Association, the Trustee has also filed a motion with the bankruptcy court seeking approval of procedures for fixing pricing and claim amounts in connection with the termination and liquidation of Peregrine's foreign currency ("forex") customer agreements and transactions. Section 766(f) of the Bankruptcy Code provides that "as soon as practicable after the commencement of the case," the trustee of a commodity broker liquidation "shall reduce to money, consistent with good market practice, all securities and other property, other than commodity contracts, held as property of the estate . . . ." 11 U.S.C. § 766(f). This motion is pending.

IV. CONCLUSION

Since the filing of the Peregrine bankruptcy and my appointment as trustee my priorities have been to investigate and secure the assets of Peregrine and its customers and to ensure that all current information be preserved. To that end I have retained the professionals necessary to assist me in securing the assets and taking control of, preserving and consolidating the databases and paper records of Peregrine.

This information is being preserved in order to ensure transparency in the liquidation of Peregrine. I have been and will continue to coordinate and work cooperatively with the CFTC, the NFA, the FBI and the US Attorneys Office in coordinating the liquidation of Peregrine and providing access to all information needed in their respective civil and criminal investigations. I

have also been contacted by counsel for the Commodity Customer Coalition and expect to have a continuing dialogue with that group as the bankruptcy case progresses.

I can assure you that the determination of accurate customer information for all Peregrine account holders is also one of my upmost priorities. With the assistance of the team I have put in place, I intend to confirm the validity of the information on the books and records at Peregrine so that such information can be disseminated to the account holders with all deliberate speed, ultimately allowing me to determine the appropriate distribution(s) to be made to customers and allowing for such distributions to be made as soon as practicable.

Thank you for the opportunity to appear before this Committee.

WRITTEN TESTIMONY
OF
TERRENCE A. DUFFY
EXECUTIVE CHAIRMAN & PRESIDENT
CME GROUP INC.
BEFORE THE
SENATE COMMITTEE ON AGRICULTURE, NUTRITION & FORESTRY HEARING ON
"Examining the Futures Markets: Responding to the Failures of
MF Global and Peregrine Financial Group"
August 1, 2012

Chairwoman Stabenow, Ranking Member Roberts, Members of the Committee, thank you for the opportunity to testify regarding the industry's efforts to deter, detect and prevent the misuse of customer funds. We, at CME Group, are appalled by the theft by Mr. Wasendorf of Peregrine Financial Group ("PFG") of customer segregated funds. This fraud, following MF Global Inc. ("MFG"), has shaken the very core of our industry.

Any breach of trust relating to customer funds is absolutely unacceptable, period – whether at PFG or MFG, or any firm. Since the failure of MFG, CME Group and others in our industry have been committed to strengthening the protections that guard customer property. The industry has recently implemented new regulatory measures, one of which was the new electronic confirm tool that uncovered Mr. Wasendorf's misreporting, forgery and theft. But more needs to be done.

Industry Proposals to Protect Customers in the Wake of MFG's Failure

On March 12th, a special committee composed of representatives from the futures industry's regulatory organizations, including CME (the "SRO Committee"), offered four recommendations to strengthen current safeguards for customer segregated funds held at the firm level. The first three have been implemented, and the fourth will be made effective in coordination with the National Futures Association (" NFA") in September:

- Requiring all Futures Commission Merchants (FCM) to file daily segregation reports.
- Requiring all FCMs to file bi-monthly Segregation Investment Detail Reports (**"SIDR"**), reflecting how customer segregated funds are invested and where those funds are held.[1]
- Performing more frequent periodic spot checks to monitor FCM compliance with segregation requirements since last December.
- In direct response to the MFG collapse, the "Corzine Rule" will be implemented on September 1st. The "Corzine Rule" requires the CEO or CFO of the FCM to pre-approve in writing any

[1]Daily segregation reporting and bimonthly SIDRs were also recommended by the Futures Industry Association in its proposed initial recommendations made on February 29th. **http://www.futuresindustry.org/downloads/Initial_Recommendations_for_Customer_Funds_Protection.pdf**

disbursement of customer segregated funds not made for the benefit of customers and that exceeds 25% of the firm's excess segregated funds. The CME (or other SROs) must be immediately notified of the pre-approval.

In addition, to enhance intra-regulator coordination, we have established routine communications with FINRA for all of our common firms – the firm coordinators/relationship managers will reach out to each other to have these communications.

The SRO Committee has also implemented, or is in the process of implementing, the following initiatives:

- Using Confirmation.com – an electronic method of receiving account statements or balances from a third party bank or depository to check information provided by FCMs to regulators. NFA's use of Confirmation.com uncovered the initial statement and reporting irregularities at PFG.

  The SRO Committee plans to use the Confirmation.com tool as follows:

  - In regulatory audits now and going forward;
  - To verify bi-monthly SIDRs (investment reports). CME started using the tool for this purposed in mid-July; and
  - To periodically review the accuracy of daily segregation statements.

- Also, the SRO Committee agreed to develop rules to require all FCMs to provide them with direct online access to their bank or depository accounts to confirm segregated funds balances.

The Futures Industry Association's internal controls recommendations will be presented to the FCM Advisory Committee in August. These include:

- Requiring FCMs to assure the appropriate separation of duties among individuals working at FCMs who are responsible for compliance with the rules protecting customer funds;

- Requiring FCMs to document their policies and procedures in several critical areas, including the valuation of securities held in segregated accounts, the selection of banks, custodians and other depositories for customer funds, and the maintenance and withdrawal of "residual interest," which consists of the excess funds deposited by firms in the customer segregated accounts.

NFA's Website Access to FCM capital ratios and investment reports (SIDRs) will be presented to the NFA's Board of Directors in August.

CME Group Initiatives

Notwithstanding the fact that MFG'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:

- Guarantee for SIPC Trustee. We made an unprecedented guarantee of $550 million to the SIPC Trustee in order to accelerate the distribution of funds to customers.

- CME Trust Pledge. CME Trust pledged virtually all of its capital - $50 million – to cover CME Group customer losses due to MFG's misuse of customer funds.

- CME Group Family Farmer and Rancher Protection Fund. On April 2, 2012, CME Group launched the CME Group Family Farmer and Rancher Protection Fund to protect family farmers, family ranchers and their cooperatives against losses of up to $25,000 per participant in the event of shortfalls in segregated funds. Farming and ranching cooperatives also will be eligible for up to $100,000 per cooperative.

  The Protection Fund is available to PFG customers that qualify under Program terms.

- Agreement with MFG Trustee. On June 14, 2012, the agreement between the SIPC Trustee for MFG and CME Group was filed in the Bankruptcy Court. It provides for the distribution of approximately $130 million of MFG proprietary assets, on which CME and its members held perfected security interests, to MFG customers. The agreement is currently under review by the Bankruptcy Court.

- Bankruptcy Code. The shortfall in customer segregated funds occurred only in regard to funds under MFG's control. The customers' funds held in segregation at the clearing level at CME and other U.S. clearinghouses were intact. However, the clearinghouses were not able to avoid market disruptions by immediately transferring those customer positions and any related collateral because of limitations under the Bankruptcy Code. We propose that Congress amend the Bankruptcy Code to permit clearinghouses that hold sufficient collateral to support customer positions of a failed clearing member promptly to transfer all customer positions with supporting collateral, except defaulting customer positions, to another stable clearing member.

More Can Be Done

However, CME Group believes that more can be done, especially in light of the recent fraud at PFG and its impact on public confidence. CME believes that the regulators and industry need to carefully weigh the costs and benefits of even the most far-reaching proposals that might enhance protection for the segregated funds of our customers.

Some have suggested creating an industry-funded insurance program covering fraud and failure losses, possibly supplemented by privately arranged insurance. Such a program would certainly boost confidence but needs to be balanced against known negatives. It is likely to be cost prohibitive and ineffective given the size and scope of the accounts in our business, and may encourage the "moral hazard risk" that comes into play when customers feel they don't need to worry about their choice or stability of their FCMs.

We need to develop procedures and systems that give regulators direct, real time access to customer segregated account balances, and, as stated above, the SRO Committee is working to do so. Today, as part of regular or surprise audits, and while we are onsite in their offices, we are instructing clearing members to access their online bank or depository segregated account balances so our auditors can review them real-time. As stated earlier, CME is working to codify this real-time access in our rules.

And, while it will be controversial and perhaps have disruptive consequences, we should explore whether customer property not required as collateral at clearing houses should, nonetheless be held by clearing houses or other custodians (while returning interest earned on that money back to the FCMs) and whether safeguards should be put in place to limit the ability of FCMs to transfer such property except to authorized recipients. We believe a look at these proposals in conjunction with our other efforts is necessary to restore public confidence in the derivatives markets while preserving the operating model for the vast majority of firms who respect and comply with the rules.

Finally, while we expect that the misconduct of MFG and PFG will renew calls to eliminate the role of exchanges and clearing houses in auditing and enforcement of their members, we do not believe that a legitimate case can be made to transfer these responsibilities to a government agency. Our regulatory systems are resilient, adaptive to address the challenges and efficient. The next section of my testimony focuses on why it is more important than ever to not only retain, but strengthen the self-regulatory structure.

Current Regulatory Structure Should Not Be Abandoned

Some critics suggest that the current regulatory framework is somehow to blame for MFG's and PFG's misconduct. As further detailed in the discussion below, "self-regulation" in the context of futures markets regulation 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 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 CFTC, which establishes regulations governing the conduct and responsibilities of market participants, exchanges and clearing houses.

With respect to MF Global, CME was the designated self-regulatory organization ("DSRO"). As MFG's DSRO, CME was responsible for conducting periodic audits of MFG's FCM-arm and worked with the other regulatory bodies of which the firm is a member. Some critics have suggested that the failure of MFG demonstrates that the current system of front line auditing and regulation by clearing houses and exchanges is deficient because of conflicts of interest. However, there is no conflict of interest between the CME Group's duties as a DRSO and its duties to its shareholders – both require that it diligently keep its markets fair and open by vigorously regulating all market participants.

Federal law mandates an organizational structure that eliminates conflicts of interest. In addition, we have very compelling incentives to ensure that our regulatory programs operate effectively. We have established a robust set of safeguards designed to ensure these functions operate free from conflicts of interest or inappropriate influence. 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 oversight of the markets, exchanges separately establish and enforce rules governing the activity of all market participants in their markets. Further, the 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.

In summary, 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 further oversight by the NFA and CFTC.

Conclusion

CME Group is committed to working with Congress, CFTC, NFA, FIA and market participants to re-evaluate the current system to find solutions to further protect customer funds at the FCM level, and to restoring confidence in derivatives markets that so many rely on for their risk management needs. Finding solutions continues to be or highest priority. We are prepared to lead.

Thank you for the opportunity to testify before the Committee today.

STATEMENT OF LOUIS J. FREEH
BEFORE THE UNITED STATES SENATE
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

AUGUST 1, 2012

Chairwoman Stabenow, Ranking Member Roberts, and Distinguished Members of the Committee:

My name is Louis J. Freeh and I am the Chapter 11 Trustee of MF Global Holdings Ltd., the ultimate parent of the entire worldwide enterprise commonly known as MF Global, and five of its subsidiaries, which I will refer to as the chapter 11 estates. Thank you for inviting me to submit a written statement to the Committee in connection with the hearing on August 1, 2012. I regret that a long standing, prior commitment prevents me from appearing in person at the hearing, and I truly appreciate our conversation, Chairwoman Stabenow, and your understanding in that regard. I welcome the opportunity to share with the Committee some of my observations as the trustee of the chapter 11 estates and to respond to any follow up questions for the record, as you have requested.

Prior to its collapse, the entities that comprised the MF Global enterprise, which I will refer to as the "MF Global Group", employed 2,870 people and, through their regulated and unregulated broker-dealers and futures commission merchants, were some of the world's leading brokers in markets for commodities and listed derivatives. The MF Global Group maintained operations in, among other countries, the United Kingdom, Australia, Singapore, India, Canada, Hong Kong, Japan and Taiwan, and these entities provided access to more than seventy exchanges globally. The MF Global Group was a leader by volume on many of the world's largest derivative exchanges and, additionally,

was an active broker-dealer in markets for commodities, fixed income securities, equities, and foreign exchange.

The MF Global Group's priority was to serve the needs of its diversified global client base, which included a wide range of professional traders, corporations, sovereign entities, institutional asset managers and hedge funds, and financial institutions. The MF Global Group also offered a range of services for brokers and individual traders -- including farmers and ranchers.

Revenues were derived from three main sources: (i) commissions generated from execution and clearing services; (ii) principal transactions revenue, generated both from client facilitation and proprietary activities; and (iii) net interest income from cash balances in client accounts maintained to meet margin requirements, as well as interest related to the MF Global Group's collateralized financing arrangements and principal transactions activities. For fiscal year 2011, the MF Global Group generated total revenues of approximately $2.2 billion, revenues net of interest and transaction-based expenses of approximately $1.1 billion, and incurred a net loss of $81.2 million.

In October 2011, everything changed. On October 31, 2011, MF Global Holdings Ltd. and MF Global Finance USA Inc. filed for bankruptcy under chapter 11 of the Bankruptcy Code; the Securities Investor Protection Corporation put MF Global Inc., the U.S. broker-dealer and futures commission merchant subsidiary of MF Global Holdings Ltd., into a SIPA liquidation proceeding and appointed Mr. James Giddens as the SIPA Trustee; regulated entities in the U.K. were put into administration; and other entities around the world began their own wind down proceedings.

As a result, entities that once operated as part of a global enterprise began to act as individual, independent entities, functioning separately with independent trustees or administrators at the helm. These trustees and administrators not only owe separate and distinct fiduciary duties to their respective entities and those entities' customers and creditors, but they are operating under competing bodies of law. Broadly speaking, for example, as the Chapter 11 Trustee I have a fiduciary duty to protect the interests of the creditors of the chapter 11 estates, which includes the financial institutions that provided MF Global with its $1.2 billion revolving credit facility, and the bondholders of MF Global's publicly traded debt. My fiduciary duties do not extend to the former customers of the U.S. and U.K. broker dealers and futures commission merchants.

The SIPA Trustee's fiduciary duties, however, run to a broader constituency, which includes not only the customers of MF Global Inc., but the general creditors of MF Global Inc. – including the chapter 11 estates. Similarly, the administrators of the former U.K. broker-dealer subsidiary have fiduciary duties akin to that of the SIPA Trustee, as the U.K. administrators owe duties to both the former customers of the U.K. broker-dealer and the general creditors of that entity as well.

All of these factors work to the detriment of the customers and creditors of the various estates, and add to the administrative costs borne by the respective estates. There inevitably is unavoidable, significant delay associated with implementation by the various trustees and foreign administrators of the statutory processes governing the liquidation of their respective estates. This is not to say that the trustees and administrators are not working cooperatively. For example, my professionals and the SIPA Trustee's professionals often speak daily, have engaged in information sharing

calls, and are currently discussing coordinated efforts to assist one another in the administration of their respective estates. Indeed, we had a very productive meeting with the SIPA Trustee's advisers just last Thursday. We find this cooperation to be invaluable, if not essential. I believe that the interests of all stakeholders are best served through coordinated efforts to return funds to customers and creditors in the manner prescribed by law, whether that law is Chapter 11 of the Bankruptcy Code, the Securities Investor Protection Act, the CFTC rules or foreign law.

I would like to take a moment to address the subject of employees. The chapter 11 estates now employ 12 non-executive individuals and three remaining senior executives. This skeletal staff continues to serve an important function in the cost-efficient administration of the chapter 11 estates. As I said in my written testimony and statements made in response to questions from the Senate Banking, Housing and Urban Affairs Committee on April 24, 2012, no formal bonus program has been implemented nor will bonuses be paid to the executives or employees. This continues to be my position.

As stated in my June 4th report filed in the bankruptcy court, a copy of which is submitted with my written statement, the chapter 11 estates and non-debtor affiliates under my control filed 112 claims against various MF Global affiliates with a face value of between $3.1 billion and $3.3 billion. Of those claims, 68 were filed against MF Global Inc., with a face value of $2.3 billion. Whether creditors of the chapter 11 estates will receive a significant distribution on their claims depends largely on whether the chapter 11 estates recover on their claims against MF Global Inc. And, ultimately, the

chapter 11 estates recovery on their claims against MF Global Inc. depends on MF Global Inc.'s ability to recover from counterparties and foreign affiliates.

Another potential source of recovery for the chapter 11 creditors is causes of action. At this time, I cannot go into further detail as to any potential causes of action or recoveries on those causes of action as I have not completed my investigation, which is statutorily mandated by Bankruptcy Code section 1106(a)(3). Upon completion of my investigation, I will issue a report with my findings. I can affirmatively say that I am investigating all potential parties and all causes of action that might be brought on behalf of the chapter 11 estates, as I am obligated to do.

To be clear, the various trustees and foreign administrators can and likely will assert different legal arguments to support their claims to property located throughout the world. The U.S. Bankruptcy Court and perhaps other courts will make those legal determinations. Notwithstanding court supervision of the wind-down of the chapter 11 estates and the liquidation of the SIPA estate, it is clear even at this early stage that the competing, and perhaps at times conflicting, obligations and duties of the various trustees and foreign administrators have had, and will continue to have, the effect of extending the length of time necessary for all of the estates to conduct their investigations, to determine the location and value of assets, to recover those assets, and ultimately to make distributions to customers and/or creditors.

There has been a great deal of publicity regarding the alleged shortfall in customer property, including media reports as recently as last week that referenced the disappearance of $1.6 billion in customer funds, or a shortfall of $1.6 billion in customer funds. It is my belief, however, based upon currently available public data in the United

States and reports issued by affiliates and administrators around the world, that -- whether from the return of funds from foreign administrations or settlements obtained by the SIPA Trustee from bank clearing houses, exchanges and trading counterparties -- all of the customers of MF Global Inc. eventually will be made whole by the SIPA Trustee. Further, this current data demonstrates that MF Global Inc. should have significant excess funds available after its former customers have been made whole for distribution to its general creditor claims class, which includes the chapter 11 estates' sizable claims against MF Global Inc.

The administration of these chapter 11 estates, together with the parallel work of the SIPA Trustee and that of the foreign administrators, makes this one of the most complex matters of its kind. The shared goal, however, is very simple: to recover every single dollar available, in the manner prescribed by law, for the benefit of every eligible customer and creditor, and not for those who brought about this historic collapse in the process.

TESTIMONY OF GARY GENSLER

CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

BEFORE THE

U.S. SENATE COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

WASHINGTON, DC

August 1, 2012

Good morning Chairwoman Stabenow, Ranking Member Roberts and members of the Committee. I thank you for inviting me to today's hearing on the recent events related to Peregrine Financial Group. I'm pleased to testify along with my fellow Commissioner Jill Sommers.

Peregrine Financial Group, Inc.

Background

On July 10, the Commodity Futures Trading Commission (CFTC) filed a complaint in federal court against Peregrine and its sole owner, Russell Wasendorf, Sr., alleging that they misappropriated customer funds from an account held at US Bank.

Criminal authorities arrested Mr. Wasendorf for lying to the CFTC, and they advised the court that they intended to file more criminal charges in the future.

The CFTC's complaint, along with the criminal charges, tells a story of deliberate dishonesty and deception. In a written statement found when he attempted suicide, as quoted in the criminal charges, Mr. Wasendorf said he committed fraud, manufactured phony bank documents, and forged bank signatures. In short, the charges against him are that he took customers' funds right out of the bank, and lied about it for years.

The System of FCM Oversight

Peregrine is a CFTC-registered Futures Commission Merchant (FCM). The National Futures Association, a futures industry self-regulatory organization, is responsible for the firm's front-line oversight. The way our oversight system has been set up for decades, SROs are the primary regulators of FCMs, introducing brokers, commodity pool operators, and commodity trading advisors. In 2000, Congress affirmed the Commission's reliance on SROs by amending Section 3 of the Commodity Exchange Act to state: "It is the purpose of this Act to serve the public interests . . . through a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals under the oversight of the Commission." Further, based on this system and the realities of limited CFTC resources, in the wake of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the NFA also will take on additional examination and registration duties with regard to swap dealers.

As part of its oversight responsibility, the NFA is required to conduct periodic audits of non-clearing member FCMs' customer funds in segregated and secured accounts. The CFTC oversees the NFA, examining them for the performance of their duties. We do such

examinations on a periodic basis, usually looking at one of these significant areas: the NFA's FCM examination program, sales practices, disciplinary programs, monthly financial statement reviews, and the NFA's training and staffing levels. Prior to 2008, the CFTC only infrequently reviewed the NFA's FCM examination program. More recently, the CFTC has moved to a quarterly review of the NFA's FCM examination program in which the agency selects a small sample of the NFA's FCM work papers to review. Recent CFTC examinations of the NFA included recommendations for clearer documentation of audit procedures, enhanced training and supervisory review procedures, and establishing requirements for the filing of amended financial statements. In addition, the CFTC also does limited-scope reviews of FCMs in a "for cause" situation that are sometimes referred to as "audits," but they are not full-scale audits as accountants commonly use that term.

Under CFTC rules, FCMs must have their annual financial statements audited by an independent CPA using Generally Accepted Auditing Standards. As part of this certified annual report, the independent accountant also must conduct appropriate reviews and tests to identify any material inadequacies in systems and controls that could violate the Commission's segregation or secured amount requirements. Any such inadequacies are also to be reported to the SRO and the Commission.

The Oversight of Peregrine

The NFA last completed an audit of Peregrine in May 2011, and was in the process of conducting another periodic audit over the last several weeks. Peregrine's financials for the year

ending December 31, 2011, were reviewed and certified by its independent CPA expressing a clean opinion on both the financial statements and internal controls report.

In 2000, the CFTC brought an enforcement action against Peregrine, finding in an Order that the firm had violated net capital rules. At the time, Peregrine was much smaller than it was in 2012, with roughly $800,000 in net capital requirements and $23 million in customer segregation requirements. The firm was ordered to pay a civil penalty and to take steps to improve its financial controls, including retaining a second independent public accounting firm to perform reviews of certain financial accounts and to report its findings to the CFTC. The firm retained PricewaterhouseCoopers.

The CFTC's Order in 2000, resolving the enforcement investigation, was the culmination of a process that began with limited-scope reviews conducted by the CFTC examinations staff in the 1990s. During these reviews, the staff noted a number of problems at Peregrine regarding, among other things, net capital, infusions of capital to avoid net capital violations, internal financial controls, and records of segregated and secured customer assets and liabilities. Other issues related to accounting for receivables and payables; transactions and agreements with affiliates; differences between journal entries on the company's books and the statements of one of its banks, Harris Bank; accuracy of books and records; the abilities of the firm's auditor; and providing customers with timely trade confirmations and monthly statements. In addition, CFTC staff questioned whether Peregrine had tried to mislead them concerning some of these accounting issues. The staff also noted issues regarding the sufficiency of NFA audits.

Subsequently, in 2007 and 2008, the CFTC examinations staff reviewed Peregrine's classification and reporting of customer-owned securities and the investment of customer funds for compliance with CFTC Regulations. The limited reviews identified improperly titled segregation bank accounts, which were corrected during the examination. In addition, the staff in 2010 performed a limited, two-day review of Peregrine's anti-money laundering compliance.

Although we do not yet know the full facts of what happened in this matter, it is clear that the system failed to protect the customers of Peregrine. The NFA and CFTC staff over the years did not detect Mr. Wasendorf's alleged stealing of customer funds, which came to light only a few weeks ago. Though the local police cannot prevent every bank robbery and market regulators cannot prevent every financial fraud, we all must do better. We must do everything within our authorities and resources to strengthen oversight programs and the protection of customer funds.

Customer Protection

CFTC Customer Protection Reforms to Date

The Commission has been actively working to improve protections for customer funds. This includes:

- The completed amendments to rule 1.25 regarding the investment of funds bring customers back to protections they had prior to exemptions the Commission granted

between 2000 and 2005. Importantly, this prevents use of customer funds for in-house lending through repurchase agreements;

- Clearinghouses will have to collect margin on a gross basis and FCMs will no longer be able to offset one customer's collateral against another and then send only the net to the clearinghouse;
- The so-called "LSOC rule" (legal segregation with operational comingling) for swaps ensures customer money is protected individually all the way to the clearinghouse; and
- The Commission included customer protection enhancements in the final rule for DCMs. These provisions codify into rules staff guidance on minimum requirements for SROs regarding their financial surveillance of FCMs.

In addition, last month, we approved an NFA proposal that stemmed from a coordinated effort by the CFTC, the SROs, and market participants, including from the CFTC's two-day roundtable earlier this year on customer protection.

The three key areas of reform included in the NFA rules are:

- First, FCMs must hold sufficient funds in Part 30 secured accounts (funds held for U.S. foreign futures and options customers trading on foreign contract markets) to meet their total obligations to customers trading on foreign markets computed under the net liquidating equity method. FCMs will no longer be allowed to use the alternative method, which had allowed them to hold a lower amount of funds representing the margin on their foreign futures;

- Second, FCMs must maintain written policies and procedures governing the maintenance of excess funds in customer segregated and Part 30 secured accounts. Withdrawals of 25 percent or more of excess funds in these accounts (that are not for the benefit of customers) must be pre-approved in writing by senior management and reported to the NFA; and
- Third, FCMs must make additional reports available to the NFA, including daily computations of segregated and Part 30 secured amounts, as well as twice monthly detailed information regarding the cash deposits and investments of customer funds.

CFTC Restructuring and Enforcement

The CFTC also has implemented a significant restructuring, based on a new strategic plan, regarding our oversight of SROs and intermediaries.

The CFTC last year established a new division dedicated solely to the oversight of the SROs and intermediaries. We created a branch within the division to specifically oversee examinations. We were able to attract talented individuals from the private sector with many years of relevant experience to lead this new division and branch. We have begun the process of strengthening our examination program, including adding risk and control elements. Separately, we also recently created a Consumer Outreach Office to help consumers get information about avoiding fraud.

In addition, the CFTC's enforcement arm aggressively pursues bad actors in the markets. In the last two years, the Division of Enforcement has been filing cases and opening investigations at the highest rate in the CFTC's history. Roughly half of the cases involve fraud against customers.

Since October 2009, the CFTC has brought 22 cases against registered FCMs, 13 of which involved supervision failures and one of which involved a failure to maintain customer secured funds properly. In the same period, the CFTC brought two cases in federal court against FCMs, one for violating segregation rules and the other for failing to be properly capitalized and to maintain books and records.

The Commission in April charged JPMorgan Chase Bank, N.A. for unlawful handling of Lehman Brothers, Inc.'s customer segregated funds and imposed a $20 million civil monetary penalty. In another case against a public accounting firm and a CPA partner of the firm, the Commission imposed sanctions for failing to conduct proper audits of a registered FCM. In one of our supervision failure cases, a registered FCM was sanctioned for failing to follow its own compliance procedures regarding "know your customer" requirements.

Customer Protection Reforms Ahead

While the Commission's enhanced customer protection rules, staff reorganization and enforcement efforts to date have been significant, I believe we must do more. I believe we need to further enhance the agency's rules for customer protection. As outlined below, staff

recommendations, based on substantial commissioner and market participant feedback, are now drafted and in front of commissioners.

First, we must incorporate the NFA rules approved last month into the Commission's regulations so that the CFTC can directly enforce these important reforms.

Second, I believe it is critical that we bring the regulators' view of customer accounts into the 21st century. We must give the SROs and the CFTC direct electronic access to FCMs' bank and custodial accounts for customer funds, without asking the FCMs' permission. Further, acknowledgement letters (letters acknowledging that accounts contain segregated customer funds) and confirmation letters must come directly to regulators from banks and custodians.

Third, I believe we need more transparency to customers about their funds. Futures customers, if they wish, should have access to information about how their assets are held and with whom, similar to that which is available to mutual fund and securities customers.

Fourth, I believe we need to consider enhanced controls at FCMs regarding how customer accounts are handled.

In addition, I believe we need to carefully consider additional rules laying out the SROs' requirements for conducting examinations and audits.

Regarding the Commission's oversight of SROs and intermediaries, though we're making progress through our reorganization and new rules, the recent events at Peregrine highlight the necessity of looking at the decades-old system of SROs and the Commission's role in overseeing SROs.

I have directed the CFTC's staff to do a full review of how the agency conducts oversight of the SROs, as well as limited scope reviews of FCMs, to determine what improvements can and should be made. As part of this review, we have reached out to the Public Company Accounting Oversight Board (PCAOB), which oversees the audits of public companies. The Dodd-Frank Act gave the PCAOB oversight authority over the audits of brokers and dealers who are registered with the Securities Exchange Commission. The PCAOB has agreed to give us the benefit of its insights and expertise.

Last week, the CFTC held a Technology Advisory Committee meeting to examine how technology can be incorporated as a tool for customer fund verification. Building on the customer protection public roundtable earlier this year, I also have asked CFTC staff to hold another public roundtable discussion on customer protection issues, including examination techniques and procedures, which will take place during the second week of August.

Resources

Confidence in the futures and swaps markets is dependent upon a well-funded regulator. The CFTC is a good investment of taxpayer dollars. This hardworking staff of 710 is just 10

percent more than what we had at our peak in the 1990s though the futures market has grown fivefold. The CFTC also will soon be responsible for the swaps market – eight times bigger than the futures market.

The Commission's limited resources have historically not allowed for direct oversight of FCMs. There are 46 staff members, including 35 audit staff, on the CFTC's examinations team who oversee four SROs, which in turn have responsibilities for more than 4,341 registered persons. On top of the current lack of staff for examinations, our responsibilities are expanding to include reviews of many new market participants. For instance, there are currently 115 FCMs, and staff estimates a similar number of swap dealers will ultimately register. More frequent and in-depth risk-based, control-oriented examinations are necessary to assure the public that firms have adequate capital, as well as systems and procedures in place to protect customer money. Greater coverage by regulators – like having more cops on a beat – will improve the integrity and heighten the deterrent effect of the review process.

The President's FY2013 budget, following a similar request in 2012, asked for $308 million, investing in our technology and human resources, to better protect the public.

Market participants depend on the credibility and transparency of well-regulated U.S. futures and swaps markets. Without sufficient funding for the CFTC, the nation cannot be assured that the agency can adequately oversee these markets.

Thank you and I look forward to your questions.

Testimony of James W. Giddens
Trustee for the Securities Investor Protection Act Liquidation of MF Global Inc.
U.S. Senate Committee on Agriculture, Nutrition and Forestry
August 1, 2012

Chairwoman Stabenow, Ranking Member Roberts, and Members of the Committee: Thank you for inviting me to testify today. My name is James Giddens. I am the court-appointed Trustee for the Securities Investor Protection Act (SIPA) liquidation of the failed broker-dealer, MF Global Inc. I would like to provide the Committee with an update on efforts to return assets to former customers of MF Global Inc., as well as an update on my investigation into the events that led to the failure of MF Global and considerations stemming from the lessons learned in the liquidation.

My office continues to work tirelessly and expeditiously for the benefit of the former customers of MF Global Inc., and my consistent goal has been the return of as much customer property as possible, as quickly as possible, in a manner that is fair to all customers and that is consistent with the law.

Customer Distributions

When I last testified before this Committee in December, I reported to you that my office had distributed over $4 billion to former MF Global Inc. retail commodities customers with US futures positions via three bulk transfers.

I am now making an additional interim distribution to former commodities customers with finalized claims, as approved by the Bankruptcy Court:

- 4d property: I am distributing approximately $600 million of customer property held as segregated by MF Global Inc. for its former commodity futures customers who traded on US exchanges (4d property). This distribution is in addition to the more than $4 billion in 4d property already distributed and allows customers to receive approximately 80% of their 4d property.

- 30.7 property: I am distributing approximately $50 million of customer property held as secured by MF Global Inc. for its former commodity futures customers who traded on non-domestic exchanges (30.7 property), primarily in the United Kingdom. This is the first distribution of 30.7 property, and this distribution allows customers to receive approximately 5% of their 30.7 property.

- Domestic delivery class: A distribution will also begin shortly for customer property related to a domestic delivery class, which I have identified as consisting of physical customer property that has been or will be reduced to cash in any manner and which the Court approved as a separate class of commodities customer property.

With the completion of the first interim distribution, I will have returned approximately $4.7 billion to the former commodities customers of MF Global Inc.

I have also received Court approval to sell and transfer approximately 318 active retail securities accounts, which is substantially all of the non-affiliate securities accounts at MF Global Inc. All retail securities customers have received 60% or more of their account value, and already approximately 80% of former MF Global Inc. securities customers have received nearly the entirety of their account balances because of Securities Investor Protection Corporation (SIPC) advances.

Claims Process

My office has received over 27,000 commodities customer claims asserted in amounts of approximately $10 billion, over 1,000 securities customer claims asserted in amounts of approximately $1.4 billion, and over 6,000 general creditor claims asserted in amounts of approximately $23 billion.

My office has now determined virtually all commodities customer claims and securities customer claims. Determination letters are being issued to claimants on a rolling basis. The deadline for filing general creditor claims more recently passed, and my office is in the process of reviewing and analyzing these claims.

Most retail customer claimants have agreed to the determinations made by my office, and fewer than 2% have so far filed objections, many of which seek clarifications as opposed to challenging the merits of my determination. In that regard, my staff is working with claimants at all stages of the process in an attempt to reconcile and resolve claims matters, and my instruction to the team is only to pursue claims-related litigation when absolutely necessary to preserve the estate for all customers. All such claimants are entitled to due process and ultimately a trial before the Bankruptcy Court if the disputes cannot be resolved without judicial intervention. Until these disputes are resolved, I am limited in the amount of additional funds that I can distribute to customers, because I must appropriately reserve funds for all possible outcomes.

The primary objections to my claims determinations requiring large reserves were filed by administrators or trustees for affiliated MF Global entities, including MF Global UK Ltd. and particularly MF Global Holdings Ltd. and its affiliated debtors, which have filed securities customer claims of over $607 million and commodities customer claims of over $147 million, in addition to general creditor claims of over $1.6 billion.

I have also marshaled over $1 billion in assets that were not specifically segregated for customers by MF Global Inc. I believe that, at a future date after the claims determinations are finalized, a significant portion of these assets may need to be allocated to commodities and securities customers under principles and in amounts that will be established by an allocation motion subject to Court approval.

Agreements and Litigation

Since the initiation of the liquidation proceeding, I have worked to recover and distribute as much customer property as possible as quickly as possible, and in furtherance of that goal, I have sought to resolve outstanding conflicts with parties through negotiation wherever possible.

I have now reached agreements with two significant parties: the CME Group and MF Global Canada. Both of these agreements will support my ability to distribute additional customer funds:

- CME Group: I have filed a motion seeking Bankruptcy Court approval for an agreement reached between my office and CME Group that includes the return of over $130 million in property held by CME Group to the MF Global Inc. estate for the benefit of former commodities customers, as well as additional unallocated funds.

- MF Global Canada: The Bankruptcy Court approved in July an agreement between my office and MF Global Canada Co. that provides for the return of approximately $61 million to the MF Global Inc. estate. In addition, the resolution completely withdraws the MF Global Canada omnibus claim of approximately $53 million against MF Global Inc. Subject to parallel approval by the Canadian Court, the agreement will reconcile and net the parties' respective claims and avoid the uncertainty, delay, and expense of complex, cross-border litigation with a foreign affiliate.

In the U.K., litigation is progressing to resolve a dispute between my office and the U.K. Joint Special Administrators as to whether the customer property that is the subject of my approximately $700 million client claim with the Joint Special Administrators was or should have been segregated under English law. A target date of April 2013 has been set by the English Court for the start of the trial. I believe it is crucial that this intellectual dispute over how property was or should have been handled be urgently resolved so that the affected customers can receive back the property that is owed to them, and I will continue to explore a consensual resolution, if possible.

Investigation and Potential Claims

In June, I filed a report on my independent investigation into the failure of MF Global with the Bankruptcy Court.

My investigation concluded that as attempts were made to transform MF Global into a full-service global investment bank, management failed to add to its Treasury Department and technology infrastructure, which was needed to meet the demands on global money management and liquidity. Management's actions, along with the lack of sufficient monitoring and systems, resulted in customer property being used during the liquidity crisis to fund the extraordinary liquidity drains elsewhere in the business, including margin calls on European sovereign debt positions.

In light of these conclusions, I have determined there may be valid claims against certain individuals and entities:

- Directors & Officers: I believe that there are colorable claims, including claims for breach of fiduciary duty and negligence, against former MF Global CEO Jon Corzine, former MF Global CFO Henri Steenkamp, and former MF Global Assistant Treasurer Edith O'Brien, among others. In this connection, I am participating in the prosecution of these claims by cooperating with plaintiffs in the pending lawsuits against these parties. Any funds received through prosecution of the claims will be returned to customers by my office, based on determinations already made through the claims process as described above.

- JPMorgan Chase: I am engaged in active discussions with JPMorgan Chase (JPM) with respect to transfers that I believe may be voidable or otherwise recoverable. JPM has cooperated with my investigation. To date, JPM has returned approximately $89.2 million in customer property and $518.4 million in non-segregated unallocated MF Global Inc. assets, subject to certain reservations of JPM's security interest in such funds. This sum includes $168.1 million in funds representing the proceeds of excess collateral that JPM held at the commencement of MF Global Inc.'s liquidation.

Shortfall

There remains an approximately $1.6 billion shortfall in segregated property available to return to former customers. I am urgently working to eliminate the shortfall by determining the size of customer claims pools with the passing of the June 2, 2012, deadline for filing claims and by continued efforts at the recovery of funds through negotiation and litigation. In addition, I may request Court approval for the allocation of non-segregated property to the pools of customer property.

Recommendations

My investigation report included recommendations for legislative, regulatory or other reforms that might help avert similar liquidations in the future, or at least alleviate their consequences. These topics may merit further study and input from regulators, industry experts, and members of the public:

- Eliminating the segregated versus secured distinction in CFTC Regulation 30.7, ensuring consistency of customer protection when trading overseas, and monitoring compliance abroad closely.
- Creating a protection fund for futures and commodities customers – to provide parity with securities customers and bank depositors – under a certain threshold, and implementing suitability standards for customers of Futures Commission Merchants (FCMs).
- Providing for civil liability for officers and directors in the event of a commodities segregation shortfall.
- Considering simplifying some CFTC rules for bulk transfers and claims in an FCM liquidation proceeding.

- Enacting legislation explicitly authorizing a trustee's standing on behalf of customers.

I also support the new rules recently approved by the CFTC that will further protect futures customers, including rules that:

- Abolish the alternative calculation method and require FCMs to use the net liquidating equity method representing the total account balance owed to customers when determining the secured funds the FCM must hold to meet customer obligations.
- Require FCMs to maintain written policies and procedures governing the maintenance of excess customer segregated and secured funds.
- Require written pre-approval by senior management for any withdrawal of more than 25% of excess segregated or secured funds that is not for the benefit of customers, and filing of notice with the National Futures Association (NFA) of any such withdrawal.
- Require additional filings with the NFA, including daily segregation and secured amount computations.

Conclusion

My office has made every effort to communicate directly and frequently with customers. Our website includes updates, court filings, and claims information, including a section addressing the common questions being asked by customers in calls or other communications to my staff. My staff and I are answering customer calls and emails and holding meetings with customer groups and counsel. I have established special hotlines for customers to call with questions about their claims determinations, the treatment of their physical property, or tax issues.

If your constituents have any questions, I encourage them to visit MFGlobalTrustee.com, email my staff at MFGITrustee@hugheshubbard.com, or call our call center at 1-888-236-0808.

I fully understand the frustration of many former MF Global Inc. customers, some of whom you have heard from directly. When a broker-dealer fails under the unprecedented circumstances surrounding MF Global's demise, the liquidation is necessarily complex. My office has been working tirelessly with speed and diligence to identify ways to return assets to customers to the full extent of our ability under the applicable provisions of SIPA, the Bankruptcy Code, and CFTC regulations.

Thank you Chairwoman Stabenow, Ranking Member Roberts, and other Members of the Committee for the opportunity to testify before you and to submit this testimony for the full record of the hearing.

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TESTIMONY OF THE

NATIONAL GRAIN AND FEED ASSOCIATION

TO THE

COMMITTEE ON AGRICULTURE

UNITED STATES SENATE

AUGUST 1, 2012

Good morning, Chairman Stabenow, Ranking Member Roberts, and members of the committee. I am Diana Klemme, Vice President and Director of the Grain Division at Grain Service Corporation, an Introducing Broker based in Atlanta, Georgia. GSC provides brokerage services to businesses and individuals hedging agricultural price risk, as well as advisory and educational services to clients and other firms. Our clients include country grain elevators, farmers and end-users of commodities.

This morning, I am testifying on behalf of the National Grain and Feed Association (NGFA), the national trade association representing grain elevators, feed and feed ingredient manufacturers, processors and other commercial businesses that utilize exchange-traded futures contracts to hedge market risk and assist producers in their marketing and risk-management strategies. We appreciate the opportunity to testify before the committee today, and commend you for conducting this important hearing.

I serve on the NGFA's Risk Management Committee, as well as its MF Global Task Force, formed to develop recommendations in the aftermath of the failure of MF Global. Our priorities are to advocate regulatory and policy changes that will help ensure that another similar situation does not recur, and to enhance protections for commodity futures customers.

Many NGFA-member firms have been affected deeply by the MF Global Holdings bankruptcy and the subsequent liquidation of futures commission merchant (FCM) MF Global Inc. Following the bankruptcy, customers' accounts were frozen, and then transferred to other FCMs in a chaotic fashion and with a dearth of information to help customers manage their financial exposure. Today, another distribution of funds from the MF Global trustee is underway with the goal of bringing all commodity customer distributions to about 80 percent of account value.

However, many firms still have received only 72 percent of their funds with no assurance they ever will be made whole.

It is worth reemphasizing that these customer funds were required to be segregated and held safe by MF Global. Our industry had believed for years that segregated customer funds were completely safe. But we now see that was not the case. The unprecedented loss of customer funds in the MF Global debacle has led to a loss of confidence in futures markets and in the ability of the current system to protect customer funds.

As the NGFA's task force considered regulatory and policy changes in the aftermath of MF Global, we asked ourselves: "Was MF Global a one-time situation, or is the level of customer risk still significant? Did the MF Global failure and its consequences rise to the level that merited significant change?"

Unfortunately, we know today that serious risk still is present. The discovery of apparently long-term fraud and misappropriation of customer funds at Peregrine Financial Group (PFG) highlights again the need for more effective regulatory oversight and meaningful change that will ensure safety for customer funds, both before a failure occurs and in the event of future FCM liquidations.

We still are awaiting details of the situation surrounding the PFG situation. On its face, the PFG failure appears to have some key differences from MF Global – namely, that customer funds were intentionally misappropriated for a variety of illegitimate purposes over a very long period of time. However, the cumulative effect of MF Global and PFG failures occurring within a relatively short time – and especially the failure of PFG at a time when regulators presumably were on heightened alert for problems – has been a huge loss of confidence in regulators and in the adequacy of current rules to protect customer funds. This failure of two firms in nine months – with massive financial loss to customers – is incomprehensible and demands immediate change. We look forward to a full explanation by regulators of exactly what happened at PFG. In the meantime, we believe there are steps that should be taken to begin restoring confidence and to bolster protections for segregated customer funds. The loss of customer confidence in the system is the most critical and urgent issue that must be addressed.

To better illustrate why the loss of confidence in the present system of managing customer funds is urgent and unsustainable, I would like to use as an example GSC's core client base: the typical country elevator. Country elevators, large and small, buy grain from farmers and sell futures against that ownership. These hedges eliminate price risk until the grain is received, aggregated and sold to exporters, feedlots or other domestic buyers – typically in larger volumes. Hedging provides a vital service to agriculture – buying when farmers want to sell and selling when the end buyer needs the commodity.

Elevators also buy commodities that farmers want to price for future crops. Forward contracts can allow the farmer to buy land and inputs with greater confidence, knowing their production is priced, at least in part. The elevator may have to hold and maintain these short futures hedges a year or more and be financially able to meet any margin calls if prices rise. Consider an actual typical country elevator that currently holds the following futures positions:

Corn	short 620 futures contracts	= 3,100,000 bushels
Soybeans	short 100 futures contracts	= 500,000 bushels
Wheat	short 120 futures contracts	= 600,000 bushels
	Short Total	**= 4.2 million bushels of open short futures**

As of Friday, July 20:	
Open Trade Equity (7/20/12)	= ($7.5 million) Mark to market 'loss' [1]
Initial Margins	= $1.9 million held on deposit at FCM
Total Funds sent to the FCM	**= $9.4 million** (equivalent to $2.24 per bushel)

[1] Based on the original futures sale price(s) marked to the close on 7/20/2012.

This elevator now has had to send a total of $9.4 million in Initial and Variation margin calls into a system where no one any longer can assure them those funds are 100 percent safe. This customer has met every margin call immediately – a huge act of faith when this business still is hoping for the final recovery of funds missing in the collapse of MF Global. Further, agricultural hedgers and others rely on their lenders to provide much of the financing for these margin calls.

Corn and soybean prices already have hit record highs this summer. Now, this country elevator must ***continue*** to hold short futures hedges until the grain is received and sold, and hedges can be lifted. The firm has sent $9.4 million and the manager must be prepared to ask the lender for, and send more money, as long as market prices continue to increase. Conversely, if futures prices decline, this elevator may show substantial 'mark-to-market' gains on futures day-to-day. The hedger needs to know those funds actually will be available to withdraw upon demand.

This is but one small example. Multiply it by the aggregate size of U.S. agriculture and one can envision the scope of the financial demands and exposure on owners and managers of thousands of businesses that use futures to reduce risk.

NGFA's Recommendations

In early April, the NGFA submitted to the Commodity Futures Trading Commission (CFTC) preliminary recommendations for enhanced reporting, transparency and accountability. Generally, these recommendations were developed with the intent of assisting customers by providing them with more information to evaluate FCMs with which they do business. In addition, several of our recommendations focused upon requiring greater scrutiny by the CFTC and self-regulatory organizations of FCM practices and financial reporting, as well as requiring FCMs to develop and adhere to policies and procedures that rigorously will ensure proper safeguarding of customer funds. Those recommendations are attached, and I would be happy to discuss them in greater detail.

Late last month, the NGFA submitted a second set of recommendations to the leadership of both the Senate and House Agriculture Committees. These recommendations involve significant changes in customer account structure, reforms to the U.S. bankruptcy code to enhance customer rights and protections, and the potential extension of insurance coverage to commodity futures customers. The NGFA's letter transmitting our latest recommendations is attached, and I would like to highlight several of those today:

Reforms to the U.S. Bankruptcy Code

The NGFA believes that a number of revisions in the U.S. bankruptcy code would provide greater protection for commodity futures customers. Briefly, we would like to see various provisions of the Commodity Exchange Act, CFTC regulations and the bankruptcy code harmonized to provide greater clarity and avoid interpretive inconsistencies. The NGFA also would like to see the code revised to strengthen CFTC authority to appoint a trustee and to state clearly that customers always should be first in line for distribution of funds in a liquidation. Commodity customer committees should be authorized to represent commodity customers' interests, and "safe harbor" bankruptcy provisions should be revised so as not to limit a trustee's ability to recover customer funds.

The NGFA's recommendations are described in more detail in the attached letter, and we would welcome the opportunity to work with the committee, regulators and stakeholders to move bankruptcy code reforms forward as expeditiously as possible.

Fully Segregated Customer Accounts

Current legal authority provides for *pro rata* distribution by the trustee of customer property that was held by a failed FCM. That means that all customers must share equally in losses in the event of a shortfall of funds. The NGFA recommends establishment of a new type of account structure for use by FCM customers on a voluntary basis that provides for full segregation of customer assets, not commingled with FCM funds or other customer funds. It will be important in establishing a new fully-segregated structure that customer funds not fall under the "customer funds" definition in the bankruptcy code, thereby exposing them to *pro rata* distributions and loss-sharing. Creation and maintenance of fully-segregated accounts necessarily will result in some additional costs that likely will be borne by customers. For that reason, we prefer that the use of such accounts be voluntary, based upon the agreement between an FCM and its customers.

We believe that a pilot program would be a useful way to test the mechanics of this new account structure and to begin to judge its true costs. The NGFA is eager to work with commodity customers, FCMs, lenders and regulators to identify potential participants. We believe a pilot program leading to fully segregated accounts can be implemented relatively quickly, without the need for legislation.

Insurance for Commodity Futures Customer Accounts

Because a fully segregated account structure may not prove to be a practical alternative for all customers, the NGFA also has recommended that insurance coverage be extended to commodity customers, in much the same way that insurance protection currently exists for securities customers under the Securities Investor Protection Corporation (SIPC). Details involving the appropriate level of coverage and funding will need to be determined. But the NGFA believes the added protection for customers will be perceived as significant and meaningful in today's environment.

Thank you for the opportunity to share the views and policy recommendations of the National Grain and Feed Association. I would be pleased to respond to any questions.

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
U.S. SENATE

EXAMINING THE FUTURES MARKETS: RESPONDING TO THE FAILURES OF MF GLOBAL AND PEREGRINE FINANCIAL GROUP

STATEMENT OF WALTER L. LUKKEN
PRESIDENT AND CHIEF EXECUTIVE OFFICER
FUTURES INDUSTRY ASSOCIATION

AUGUST 1, 2012

Chairwoman Stabenow, Ranking Member Roberts and Members of the Committee, FIA is the leading trade organization for the futures, options and over-the-counter cleared derivatives markets. Our membership includes the world's largest derivatives clearing firms as well as leading derivatives exchanges and clearinghouses from more than 20 countries. Our core constituency consists of futures commission merchants (FCMs), those regulated businesses that transact, guarantee and clear the futures trades of customers and end-users. The FIA's mission since its inception in 1955 has been "to protect the public interest through adherence to high standards of professional conduct and financial integrity..." With that mission in mind, I would like to address the industry's response to the failure of MF Global last October as well as the recent discovery of fraud at Peregrine Financial Group (PFG).

Peregrine Financial Group

Three weeks ago, we were made aware that more than $200 million in customer funds was missing from Peregrine Financial and that the falsification of financial records appears to go back 20 years. On the heels of the MF Global collapse, this is appalling and absolutely devastating news for everyone in our industry, and most of all the customers who are victims of this egregious fraud. PFG was not a big firm, but its demise resonates throughout the industry. Members of the futures industry remain outraged as more becomes known of this extensive fraud carried out on futures customers.

In the futures industry, we took considerable pride in the knowledge that the regulated futures markets had come through the financial crisis of 2008 with relatively few problems. During those difficult weeks, the futures markets continued to operate without significant incident to manage the volatile risk stemming from the financial crisis and to discover transparent prices when confidence was lost in the pricing of the over-the-counter markets. The regulated futures markets, and the regulatory regime that underpins them, became the foundation of mandated swap clearing of Title VII of the Dodd-Frank Act.

We can no longer say that the futures markets came through these times unblemished. The failures of MF Global and Peregrine Financial are a stark and unwelcome reminder that, no matter how well designed a regulatory structure may be, diligent and sustained efforts by regulators and the firms they regulate are essential to prevent losses to customers from mismanagement or fraud.

Peregrine Financial's fraud has had a terribly damaging effect on public confidence in the customer funds protections provided under the Commodity Exchange Act and the Commission's rules. This confidence was earned over decades by the many individuals who comprise the regulated futures industry through their hard work and upright behavior. Unfortunately, one person's conduct has instantaneously shattered this trust and now we all must shoulder the burden of regaining the trust, however long it may take.

At FIA, we understand that it is going to take time to regain public trust and we are committed to doing whatever it takes to restore confidence in the safeguards for customer funds. Doing nothing is not an option.

We also recognize that this is a collective problem, calling for collective solutions. Firms, exchanges, end-users and regulators must work together to identify the additional tools that are needed to protect customer funds and restore confidence and then implement them promptly and efficiently.

Post-MF Global Reforms

The industry and regulators have already taken a number of important steps in the wake of the MF Global collapse to strengthen the customer protection regime in the futures markets. In February, FIA released its Initial Recommendations for Customer Funds Protection, which were prepared primarily by FIA's Financial Management Committee. This committee, which is comprised of senior FCM finance and treasury staff, as well as representatives of depositories, has been meeting regularly since the MF Global bankruptcy to consider enhancements to firm policies and procedures that will further assure customer funds protection. The members of this committee have an exceptional depth of knowledge. They have taken part in several Commission roundtables and can be a tremendous resource for both the Commission and the SROs as they consider additional amendments to their rules.

The FIA recommendations were discussed in detail in our letter to Chairwoman Stabenow in June, a copy of which is included with this testimony for the benefit of the Committee. In brief, FIA called on each FCM to adopt and document – to the extent not already in place – internal control policies and procedures relating to the protection of customer funds. In particular, FIA recommended that FCMs maintain appropriate separation of duties among individuals responsible for compliance with customer funds protections and develop a training program for chief financial officers and other relevant employees to help ensure that the individuals responsible for the protection of customer funds are appropriately qualified. FIA is pleased to see that the CFTC and industry self-

regulatory organizations (SROs) have adopted or are actively considering adopting all of these suggestions.

We also recommended and supported rules recently adopted by the Chicago Mercantile Exchange and National Futures Association that subject all FCMs to enhanced recordkeeping and reporting obligations, including: (i) transmitting daily customer segregation balances to their respective designated self-regulatory organization (DSRO); and (ii) requiring the chief financial officer or other appropriate senior officer to authorize in writing and promptly notify the FCM's DSRO whenever an FCM seeks to withdraw more than 25 percent of its excess funds from the customer segregated account in any day. The Commission has now approved these changes.

Another of our recommendations calls on the Commission to require that each FCM certify annually that there are no material inadequacies in its internal controls regarding maintenance and calculation of adjusted net capital and compliance with the rules regarding the protection of customer funds. FIA encourages the Commission to adopt this recommendation as part of its package of audit improvements.

Clearly, these recommendations for strengthening internal controls are relevant to both MF Global and Peregrine Financial. We have witnessed over the years a number of instances where lax auditing controls or a lack of separation of duties related to the movement and protection of customer money have led to wrongful activity and fraud. The adoption of these basic audit and internal control recommendations will go a long way to detect and deter inappropriate behavior going forward.

FIA also has taken efforts to educate customers on the scope of the protections for their funds so they can make well-informed decisions when choosing where to do business. In February, we issued Frequently Asked Questions on Customer Funds Protections, which is being used by FCMs to provide their customers with increased disclosure on the scope of how the laws and regulations protect customers in the futures markets. This document continues to be updated as we gather comments from regulators on other areas that should be covered. In addition, we will be expanding this document to ensure that customers have material information when evaluating an FCM.

FIA's Transparency Initiative

Even with all that has been done, the recent events involving Peregrine Financial make it evident that more is needed. In this respect, I would like to discuss the "Transparency Initiative" that I announced two weeks back.

First, FIA strongly supports providing regulators with the independent ability to electronically review and confirm customer segregated balances across every FCM at any time.

Second, FIA supports the creation of an automated confirmation process for segregated funds that will provide regulators with timely information that customer funds are secure.

Technology solutions can help prevent this type of event from occurring again and several board members of the FIA participated in last week's CFTC Technology Advisory Committee meeting that discussed technology solutions aimed at better protecting customer funds.

Third, FIA supports the creation of an "FCM Information Portal" that will centrally house firm-specific financial and related information regarding FCMs so customers can more readily access material information when evaluating an FCM. FIA's board is actively considering ways to construct and populate such a system.

Fourth, FIA recommends that FCMs publicly certify as soon as practicable that they are in compliance with the Initial Recommendations for Customer Funds Protection that FIA issued in February, specifically that they have adopted and implemented the internal control policies and procedures related to the protection of customer funds. These controls should be subject to independent review and oversight by the SROs and independent auditors.

Most individual firms have already begun to make efforts to implement these important changes and disclose more information in response to this crisis of confidence, but this effort must be industry-wide and FIA is committed to leading that effort.

In this regard, FIA member firms have been pleased to take part in several forums focused on means to better protect customer funds, including this Committee's staff roundtable in April, several Commission staff roundtables, and the Commission's Technology Advisory Committee last week. We look forward to the Commission staff roundtable on customer protection issues that Chairman Gensler has announced will take place in the second week in August. These forums have generated a number of worthwhile ideas from industry and customer representatives, including my fellow-panelists today, for further protecting customer funds and bringing confidence back to the marketplace. These recommendations deserve careful consideration.

I was encouraged by Chairman Gensler's remarks before this Committee two weeks back that the Commission will be supporting and adopting many of these sensible industry recommendations that I have discussed. The "blocking and tackling" fundamentals of regulation depend on ensuring that firms have proper internal risk controls in place and that these are independently reviewed and verified. Those basics of smart regulation have not changed over time, and we look forward to working with the Commission to prioritize initiatives aimed at protecting customers.

These preventative measures must also be accompanied by strong enforcement when fraud and other illegal conduct are uncovered. The prosecution of these individuals punishes those guilty parties and serves as a powerful deterrent for others tempted to defraud customers. We encourage law enforcement in these instances to vigorously pursue and prosecute these blatant violations of the law.

Conclusion

While an individual bent on fraud can confound even the most sophisticated compliance framework, measures to mitigate the risk of fraud must continue to be vigorously pursued at all levels. The embezzlement at Peregrine Financial appears to have been missed by a generation of regulators at both the federal and self-regulatory levels. But it is going to take a collective effort by these same regulators, as well as the industry whose reputation has been severely damaged by these incidents, to find the necessary solutions to bring customer confidence back to the markets.

There is no easy solution—no magic bullet—that will bring back the trust lost in these past weeks. Instead, it's going to take a lot of hard work across the whole industry to implement a host of improvements to how FCMs conduct their business and how their conduct is examined and audited by the regulators. Better internal controls, more transparency on the movement of funds, independent and more frequent third-party verification of customer balances—those are the starting points for this process, but we are actively seeking out and considering any and all solutions that might contribute to the healing process. I hope today's hearing is the beginning of a constructive, fruitful dialogue with Congress on how to make this industry safer than ever before, and restore your faith in our model for price discovery and risk management. Our customers deserve better and FIA is wholly committed to earning back their confidence and ensuring that customer funds have the highest degree of protections going forward.

Thank you for allowing me to testify.

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STATEMENT OF JOHN L. ROE
BEFORE THE UNITED STATES SENATE
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
AUGUST 1, 2012

Good morning Chairwoman Stabenow, ranking member Roberts and members of the Committee. Thank you for the invitation to appear before you today to discuss the Commodity Customer Coalition's recommendations for the policy response to the MF Global bankruptcy, as well as the recent insolvency of PFGBest. It has become a very risky proposition to tender one's property to a commodity broker. An industry which just a year ago prided itself that no customer had ever lost a penny as the result of a clearing member default now hopes customer losses due to broker insolvencies will be limited to hundreds of millions of dollars, instead of billions of dollars.

Whatever the motives for recent breaches in the segregation protections, simple schemes subverted hundreds of regulators and auditors tasked with monitoring customer property at commodity brokers. The system of commodity regulation is broken. In fact, the system which regulates non-clearing FCMs is so broken that the regulator in charge of auditing PFGBest's financials could not tell that the fines levied against PFGBest were being paid to regulators with customer money--$700,000 this year alone.[1]

Before this Committee, CFTC Chairman Gensler testified that, just as it is unreasonable to expect police to stop all bank robbers, it is unreasonable to expect commodity regulators to stop all fraud. Yet, bank customers do not live in fear that their deposits will be robbed by the bank. Moreover, in the event that a bank theft is so large that it causes the bank to become insolvent, bank customers have insurance to protect their deposits. Should Chairman Gensler's robbers hold up a broker-dealer, their customers are also afforded insurance to protect their cash and securities. Commodity customers are only protected by the regulators and the Commodity Exchange Act, the relevant portions of which were passed when the industry was about 2% of its present size. [2]

There is no mechanism in place outside of the bankruptcy process to deal with shortfalls in customer property. Once customer accounts are attached to an FCM bankruptcy, the potential for losses to customer property has only begun. In addition to whatever assets with which the broker has absconded, customers face losses stemming from their inability to manage frozen trading positions and collateral. In the first bulk transfer of customer property ordered by the SIPA Trustee for MF Global customers, 10,000 margin calls were issued which had to be cleared on the same business day. As a result, millions of positions were liquidated. Customers holding positions on foreign boards of trade had their positions held for much longer periods and were unable to manage their risk associated with these positions.

Customers then face a bankruptcy process with fees in excess of $200 an hour for paralegals, $450 an hour for inexperienced attorneys and law firm partners billing nearly $1,000 an hour. The firms submitting these bills have the audacity to claim their rates have been discounted in the public interest. The market price for these services is anywhere from 30% to 70% less than the rates in the applications for fees we see in recent court filings. The bankruptcies of MF

[1] NFA fined PFGBest in February 2012: http://goo.gl/NrpQL. If PFGBest had a deficit in segregation at that time, then this money belonged to PFGBest customers.

[2] Bankruptcy provisions of the Commodity Exchange Act were amended in 1978, a year in which the Futures Industry Association reports 58 million contracts trading in the US. in 2011, over 3 tracts traded in the US.

Global and PFGBest will drag on for years, the administrative fees will run into the hundreds of millions of dollars and if there is not enough estate property to cover these fees, customer losses will be compounded.

Participants in American financial markets deserve better. They deserve the strongest, most efficient legal protections available. They deserve a safety net when regulators fail. We have to stop expecting the regulators to do their jobs and start offering customers protections when they do not. If Mr. Gensler's robbers cannot be stopped then at a minimum they must be insured against.

AN FCM LIQUIDITY FACILITY

Among the policy recommendations that the Commodity Customer Coalition has proposed to mitigate future FCM insolvencies[3], the most important is an account insurance mechanism. We propose an industry-funded liquidity facility, which focuses on providing liquidity to plug shortfalls in customer property and ensure accounts are quickly transferred to new brokers with positions intact. The fast transfer of customer accounts is critical to clearing the customers from the machinations of bankruptcy proceedings. This fund would then step into the shoes of customers who would have been in the bankruptcy. It would pursue recoveries for the fund's liquidity disbursement to facilitate the transfer of customer accounts and reserve property against claims made against customer property by counterparties.

This liquidity facility would not be government funded or managed and it would be designed to shield taxpayers from the burden of FCM insolvency. Assets for the fund could be raised transactionally, as well as through member firm assessments. Last year, a one penny per contract fee--half of the transaction fee assessed per contract by the NFA--would have raised over $30 million for such a fund. Such cash flow would grow to substantial resources in little time and provide collateral for loans to cover insolvencies in the immediate term.

There is a working model of this type of fund in Canadian markets. Both PFGBest and MF Global had Canadian subsidiaries. The insolvency of these Canadian affiliates is expected to result in no losses for Canadian customers. MF Global's Canadian subsidiary held about $385 million in customer property, an amount roughly equivalent to the customer property held by PFGBest[4]. Some 7,800 customer accounts of MF Global Canada were transferred with 100% of their property to a new broker within two weeks of the insolvency. This transfer was facilitated by the Canadian Investor Protection Fund which provided MF Global Canada's Bankruptcy Trustee with a 20% guarantee of the assets of MF Global Canada's customer property. This guarantee plugged a 20% shortfall in assets and facilitated the immediate transfer of customer property. The only reason it took two weeks to process this transfer was due to the SIPA Trustee's mistaken transfer of assets residing in Canadian customer accounts in the US. These assets had to be transferred back to Canadian control, which delayed the broker transfer.

The Canadian Investor Protection Fund has reserved its own capital in the event ongoing litigation between the US and Canadian entities of MF Global is resolved to the detriment of the Canadian estate. Whether or not it is, Canada's commodity customers can still make the claim that no customer has ever lost a penny as the result of a clearing member default.

Like all types of insurance, there must be some coverage limits for a US-based FCM liquidity facility. The Canadian Investor Protection Fund covers up to $1 million per customer of a shortfall in their property. If such limits were applied to a US insurance mechanism managing MF Global's insolvency, only accounts with more than $5 million in assets would

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[3] For a complete description of all CCC recommendations, please see our proposal entitled: *Recommendotions on the Policy Response to the MF Global Bonkruptcy*. http://goo.gl/L4AJQ.

[4] From the CIPF 2011 Annual Report: http://goo.gl/tlPGc

be at risk of sustaining a loss.[5] Additional limits could include classes of customer property--segregated funds (regulation 4d), secured funds (regulation 30.7 funds) or specifically identifiable property--or an opt-in mechanism could be employed to exclude participants who do not wish to be covered.

If the FDIC can insure $4.3 trillion in bank deposits with a reserve ratio which has fluctuated between 1.22% and 0.27%, surely the commodities industry can insure the $190 billion or so in segregation with a similar reserve ratio of exposure to insured accounts.

SPECIFIC CRIMINAL PENALTIES FOR MISUSE OF CUSTOMER FUNDS

While the PFGBest case will most certainly result in criminal convictions for perpetrators of its fraud, the probability of a criminal conviction in the MF Global case is less certain. The lesson of MF Global should not be that there are no criminal consequences for swiping customer funds for the proprietary benefit of a broker. Should prosecutors not seek charges in connection with MF Global's insolvency, Congress must enact specific criminal penalties to punish the misuse of customer property at FCMs. While no law can deter the raw greed of a PFGBest-like scheme, strict criminal penalties can deter firms which might be willing to use customer funds for proprietary purposes in the absence of them. It is doubtful that executives or their subordinates will be willing to risk incarceration for misusing customer property.

MEASURES TO DIFFUSE THE RISK OF DUALLY REGISTERED BROKER-DEALERS

One of the most obvious differences between the PFGBest and MF Global bankruptcies is that PFGBest's liquidation is being conducted under the Chapter 7 provisions of the Bankruptcy Code as opposed to the SIPA statute. MF Global's broker-dealer and FCM operations were combined in a single corporate entity and, as a SIPC member, SIPC petitioned the Court for a SIPA liquidation of MF Global. PFGBest did have a SIPC-member broker-dealer affiliate, but its operation was held in a separate legal entity from PFGBest's FCM operation.

The combination of broker-dealer and FCMs into a single corporate entity carries with it several risks. One is that, at the outset of an insolvency of such a firm, the application of SIPA will cause tremendous confusion as to customer priorities. At a minimum, this results in more pleadings and a slower track for the bankruptcy proceeding. Additionally, securities customers are less sensitive than commodity customers to the administrative costs of a SIPA liquidation as they are afforded account insurance. In this sense, it was possible for the 200 or so securities accounts (which contained only around $400 million) to prime the 38,000 commodity customer accounts holding over $6 billion in assets in MF Global's SIPA Liquidation. SIPA's claims process is much slower and affords far less discretion to the Trustee than the Chapter 7 and CEA provisions which typically govern commodity broker bankruptcies.

Another risk of joint broker-dealer FCMs is illustrated by the recent fine levied against JPMorgan for its unlawful handling of Lehman's customer segregated funds. JPMorgan extended credit to Lehman for its own proprietary trading based on the value of customer segregated balances held by Lehman at JPMorgan. After Lehman's failure, JPMorgan attempted to withhold those funds. The CFTC fined JPMorgan $20 million for the unlawful handling of these funds. As was the case with MF Global, Lehman's illiquid broker-dealer operation sought the use of commodity customer collateral for proprietary purposes.

There is a tremendous concentration risk associated with joint broker-dealer FCMs, as 80% of customer segregated property in the US resides in just 10 firms. 9 of these 10 firms were recipients of over $11 trillion in assistance from the

[5] The account class of regulation 4d customers of MF Global, Inc, whose collateral was margining positions on US exchanges, has received 80% of that property from the SIPA Trustee. If insurance covered up to $1 million of a shortfall, then losses would only be incurred by accounts with more than $5 million in assets. Regulation 30.7 customers, who have received less than 10% of the portion of their account held as 'secured funds', would be exposed to losses at a lower threshold.

Federal Reserve Bank during the 2008-2009 financial crisis. In fact, over $35 billion in commodity customer property has been exposed to insolvency at broker-dealer FCMs since the financial crisis.[6] Most of these firms are systemically important investment banks, which means that their comingled FCM operations should give regulators pause.

The Commodity Customer Coalition urges Congress to consider forcing broker-dealers and FCMs to split their operations into separate legal entities. This will ensure that insolvent FCM entities enter Chapter 7 liquidations while insolvent broker-dealers undergo SIPA liquidations. Forcing this separation will also reduce the potential for illiquid broker-dealer operations to borrow from commodity customer property. It will also limit the concentration risk associated with broker-dealer FCMs by ensuring that insolvencies are contained within specific entities. If forcing the legal separation of broker-dealer FCM entities is beyond the pale, then at a minimum the unencumbered collateral of commodity customers with accounts at broker-dealer FCMs should be covered by SIPC.

BANKRUPTCY REFORM

Specific reforms to the Bankruptcy Code may be outside the purview of this Committee, but such reforms are an important component of a complete policy response to recent FCM insolvencies. Those reforms should include the prevention of the automatic application of the Safe Harbor provision of the Bankruptcy Code. Simply put, the law should not allow the recipients of stolen property the means by which to keep it. Market pricing or fee limits should be introduced for the administration of bankruptcy cases. Additionally, there should be a statutory provision for customers to sit on the Creditors Committee of a bankrupt FCM's parent company in a Chapter 11 proceeding. This will help defray the legal costs associated with bankruptcies which follow the same tack as MF Global. Finally, affiliate and parent firms of insolvent FCMs should be forced by law to subordinate their claims in bankruptcy to commodity customer claims. This will increase the speed at which future Trustees of bankrupt brokers can make distributions to customers.

CONCLUSION

Some in the industry will argue that substantive changes have already been made to commodity regulations. They will argue that these changes are sufficient to diminish the likelihood of future frauds and will serve to assuage the probability of future insolvencies involving shortfalls in customer property. They will point to the NFA's recent requirement for electronic bank statements and the abolition of the alternative method for the calculation of secured funds as evidence of this. They will say that we do not need costly new regulatory regimes, we simply need to enforce what is on the books.

However, this logic assumes that thieves lack ingenuity. It assumes that the same technological advances used by the regulators will not also aid the thieves themselves. History demonstrates that regulators are the last to adopt new technologies. No more poignant evidence of this is that, in 2012, regulators were still relying on paper statements requested from a Post Office box in Cedar Rapids, Iowa.

If we are to protect ourselves from Chairman Gensler's robbers, the industry is going to have to do a little better than that. We urge Congress to act to protect commodity customers when and where the industry does not.

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[6] MF Global and Lehman, along with firms that would have gone bankrupt without intervention (Bear Stearns and Merrill Lynch), held over $35 billion in segregated customer property.

TESTIMONY OF DANIEL J. ROTH
PRESIDENT AND CHIEF EXECUTIVE OFFICER
NATIONAL FUTURES ASSOCIATION

BEFORE THE UNITED STATES SENATE
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

August 1, 2012

Thank you, Madam Chairwoman. My name is Daniel Roth and I am the president of National Futures Association. For years the futures industry has built an impeccable reputation for safeguarding customer funds deposited at FCMs in connection with futures trading. Now, for the second time in just nine months, we are dealing with a shortfall in customer segregated funds at an FCM. Once again, customers have suffered real harm, the type of harm that all regulators attempt to prevent.

The full facts are not yet known, but it appears that Peregrine's customer losses are the result of an elaborate fraud achieved through a set of forgeries and falsities rooted in both the firm's external and internal financial records. Forged external records included bank statements, bank confirmations, print-outs of daily online summary reports of bank balances, cashier's checks, bank acknowledgement letters, bank deposit tickets and bank receipts all purportedly from US Bank. The firm's internal financial records, including daily and month-end account reconciliations, general ledgers and trial balances were also false to the extent they were based on forged US Bank records. Moreover, Peregrine submitted to NFA false daily segregation reports, monthly financial statements and segregated investment detail reports, and annual certified financial statements. Even the firm's customer statements were false to the extent the firm led customers to believe that sufficient assets were on deposit to cover customers' liabilities.

I would like to review for this committee the recent chronology of events surrounding the Peregrine fraud, the fundamental changes that need to be made in the way we protect customer funds and monitor firms for compliance with the rules, how we are going to make those changes and the steps we have already taken.

NFA began an examination of Peregrine in mid-June. During the audit, we informed Peregrine staff that NFA was changing its method for obtaining bank confirmations to a web-based e-confirmation process. We had completed the necessary data entry for this process by the first week in July, and told Peregrine staff that the firm must authorize its participation in the e-confirmation process. On Sunday,

July 8, Mr. Wasendorf, the Chairman of Peregrine, provided the required authorization that was sent to him a week earlier. The next day he attempted suicide.

As of the close of business on July 6th, the previous Friday, Peregrine had reported to us that the firm was holding approximately $380 million in customer segregated funds, with just over half of that amount on deposit at US Bank. On July 9th, Peregrine notified the CFTC and NFA of Wasendorf's attempted suicide and we immediately joined in a teleconference with Peregrine staff. We directed firm personnel to go to the bank and have the bank manager join the conference call to confirm the balances as of the previous Friday. The bank manager informed us that the actual balance in the account was approximately $5 million.

We then asked about the balances on the dates for which NFA had received written bank confirmations in our two most recent audits—in 2010 and 2011. Those bank confirmation requests had been mailed by NFA to the P.O. Box on the purported bank acknowledgment letter we had received for the customer segregated account. (In our experience, it is not at all uncommon for banks holding customer segregated funds to use P.O. Boxes to receive confirmation requests since it is a means for them to control the vast amount of paperwork they receive.) In this case, the bank manager informed us that the balances reflected on the two most recent confirmations received by NFA in 2010 and 2011 were similarly inflated.

NFA immediately issued an emergency Member Responsibility Action, freezing the firm's accounts and restricting it to trading for liquidation only. That night the firm's clearing FCM issued margin calls that were not met and began liquidating open positions. The next day the CFTC filed its injunctive action and the firm filed its bankruptcy petition. By then approximately 98% of customer futures positions had been liquidated.

This is certainly not the first time that NFA has taken emergency action in a fraud case involving forgery. We issue 8 to 10 Member Responsibility Actions per year, most after detecting some form of fraud, many of them Ponzi schemes. In most cases we uncover the fraud relatively quickly and close the firm before the losses mount too high. In a few cases, though, we have uncovered major frauds involving well over $100 million. Several of our cases, both large and small, have involved forged bank documents that were identified by our staff. What sets this case apart is that it involves a registered FCM, an elaborate, pervasive and convincing level of forgeries, and worst of all the loss of segregated customer funds.

This most recent case is an extremely painful reminder of the lessons we learned, and have acted on, after MF Global. The following points are clear:

- For our markets to thrive, customers must know that their funds are safe.
- It is the job of the regulators, both government regulators and SROs, to provide the public with the highest level of assurance possible.

- NFA followed audit steps developed by the Joint Audit Committee that were consistent with CFTC Financial and Segregation Interpretation No. 4-1 in all of our examinations of Peregrine. But to assure ourselves of that, a committee of our public directors has directed the commission of an internal review of our audit practices and procedures, and the execution of those procedures in the specific instance of Peregrine.

- Notwithstanding that, and notwithstanding it was NFA's actions that uncovered this fraud in our most recent exam, the simple fact is that Wasendorf's forgeries fooled us, and fooled us for longer than any of us would like.

- Our audit steps alone are not good enough anymore. We are implementing better ways to monitor members for compliance, especially with regard to customer segregated funds, and are looking for even more ways to improve monitoring of firms for compliance with the rules.

Shortly after the demise of MF Global, we formed an SRO Committee with the CME and representatives of other exchanges, including ICE, the Kansas City Board of Trade and the Minneapolis Grain Exchange. As discussed below, the SRO Committee developed a number of rule proposals that have already been approved by our Board. Early on in its deliberations, the committee recognized that we need to make better use of technology to monitor firms for compliance with segregation requirements.

The committee has developed a proposed rule that will be presented at NFA's August Board meeting that would require FCMs to provide online, view-only access to bank balances for customer segregated and secured amount accounts to the firm's designated SRO. We understand the CME will adopt the same rule. Under this rule, SROs will be able to check any customer segregated bank account balance for any FCM any time, without asking the firm or the bank, and compare those balances to the firm's daily segregation report. NFA intends to expand this approach, once it is implemented, to receive daily reports from all depositories for customer segregated accounts, including clearing FCMs. We will develop a program to compare these balances with those reported by the firms in their daily segregation reports. While there may be reconciling items due to pending additions and withdrawals, the system will generate an immediate alert for any material discrepancies.

We have also agreed with the CME to perform an immediate confirmation of all customer segregated bank accounts for all of our FCM Members using the e-confirmation process I referred to earlier. The completion of this work within the next week or so should help ensure that another Peregrine is not lurking in the industry.

All of this is in addition to the rule changes already approved by NFA's Board in May and just recently approved by the CFTC. Those changes include rules requiring that:

- All FCMs must report certain information concerning the FCM's financial condition that will then be made available to the public on NFA's web site. This information includes the firm's capital requirements; its excess capital; the amount of customer segregated funds held by the firm; the amount of excess segregated funds maintained by the firm; whether the firm engages in proprietary trading, once that term is defined in the context of the Volker rule; and whether any custodial bank holding customer funds is an affiliate of the FCM.

- All FCMs must report to NFA detailed information on how customer segregated funds are invested, and that information will also be made available to the public through NFA's web site.

- If any FCM reduces its level of excess segregated funds by 25% in any one day by making disbursements that are not for the benefit of customers, a financial principal of the firm must approve the disbursement, must immediately notify the firm's DSRO, and must certify that the firm remains in compliance with all segregation requirements.

All of these rule changes promote greater transparency for both customers and regulators and should help prevent a recurrence of the type of problems we saw at MF Global. These rule changes, however, are only the beginning. The MF Global and Peregrine customer losses are a painful reminder that we must continuously improve our surveillance, audit and fraud detection techniques to keep pace with changing technology and an ever-more-complicated financial marketplace.

Madam Chairwoman, for so long as there have been financial markets, there has been fraudsters who attempt to steal other people's money, and no regulator can provide assurance that fraud can be completely eliminated. But this is the second time in nine months that customers have suffered losses due to misconduct or fraud on the part of an FCM, and when customers suffer those devastating losses, it is also devastating for the industry. We know that we can never completely eliminate fraud, but we must continue to adopt rules and surveillance techniques to try to eliminate the possibility that this could happen again. The steps we took at our May Board meeting and the proposed steps outlined above are a start in that process. We look forward to working with Congress, the Commission and the industry to achieve that goal and no ideas should be off the table in this process.

STATEMENT OF COMMISSIONER JILL E. SOMMERS
COMMODITY FUTURES TRADING COMMISSION
BEFORE THE
UNITED STATES SENATE
COMMITTEE ON AGRICULTURE, NUTRITION and FORESTRY
WASHINGTON, DC

August 1, 2012

Good morning Chairwoman Stabenow, Ranking Member Roberts, and members of the Committee. Thank you for inviting me today to discuss "the Continuing Review of MF Global: Accountability in the Futures Markets." Over the past nine months the Commodity Futures Trading Commission has conducted a thorough analysis of the books and records of MF Global and continues to work closely with the Trustee in the SIPA bankruptcy proceeding to recover customer funds. We are also engaging in a comprehensive and ongoing enforcement investigation. It is imperative that the Commission, the industry, and the Congress identify and assess the causes for the collapse and shortfall in customer funds and take corrective action where possible. At Chairman Gensler' s request, Commission staff has developed recommendations for enhancing Commission and designated self-regulatory organization (DSRO) programs related to the protection of customer funds, which includes changes to Commission rules governing futures commission merchants (FCMs), enhanced Commission oversight of DSROs, and possible statutory changes, among other things. We must do everything in our power to restore confidence in the futures markets so that producers, processors and other end-users of commodities can once again hedge their price risks without fear of their funds being frozen or lost.

On November 9, 2011, 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 bankruptcy proceedings, and other actions to locate or recover customer funds or determine the reasons for shortfalls in the customer accounts. Today I would like to provide you with information regarding the SIPA proceedings, our ongoing coordination with the SIPA Trustee, current protections for customer funds, and regulatory oversight of FCMs. While I am unable to discuss the specifics of our ongoing enforcement investigation, I will provide a brief overview.

Dual Registration/SIPA Proceedings

MF Global, Inc. (MFGI), a subsidiary of MF Global Holdings Ltd., was a dually-registered BD-FCM, and therefore was subject to the jurisdiction of both the CFTC and the Securities and Exchange Commission (SEC). The Chicago Mercantile Exchange (CME) was the DSRO for MFGI's futures market activities, and had primary responsibility for overseeing the FCM's compliance with the capital, segregation and financial reporting obligations required by the CFTC. The Chicago Board Options

Exchange and the Financial Industry Regulatory Authority were the SROs for MFGI's securities market activities, and had primary responsibility for overseeing the BD's compliance with securities regulations.

Under the Securities Investors Protection Act of 1970 (SIPA), the SEC has the authority to refer an entity registered as a broker-dealer (BD) to the Securities Investors Protection Corporation (SIPC) if there is reason to believe that the BD is in or is approaching financial difficulty. SIPC may initiate a liquidation proceeding to protect customers of an insolvent BD when certain statutory criteria are met. When a BD is also a registered FCM, as MFGI 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 for the BD and a separate bankruptcy proceeding for the FCM. Indeed, SIPA prevents a BD with even one securities customer from filing for bankruptcy without SIPA's permission, and a SIPA liquidation proceeding acts to stay any other bankruptcy proceeding for the BD.

It is important to note, however, that when a dually-registered BD-FCM is placed into a SIPA liquidation proceeding, SIPA provides that the relevant provisions and protections of the Bankruptcy Code, the Commodity Exchange Act (CEA or Act) and the Commission's regulations apply to the claims of commodity customers just as they would if the entity were solely an FCM and in a non-SIPA bankruptcy proceeding.

Coordination with the SIPA Trustee

The Commission has worked closely with the SIPA Trustee, James Giddens, since the outset of the proceedings, to help protect MFGI's former commodity customers. We have shared information and analysis, including analysis of the movement of commodity customer funds in order to identify potentially improper withdrawals and transfers, and to track down assets for the benefit of the commodity customers. The Commission's staff has given the SIPA Trustee advice on the requirements of commodity broker liquidation laws, under Title 11 and CFTC regulations, to ensure that customers are protected. We have supported his efforts to return the maximum amount of customer property as quickly as possible, consistent with his obligations. As part of those efforts, we have filed a series of briefs in the bankruptcy court explaining how these laws must be applied to effect Congress' and the CFTC's design that customers be repaid in priority to other creditors. Throughout this process, the Commission has maintained, and will continue to maintain, an independent view of the best interests of commodity customers and the requirements of the law. The public interest has been served by this cooperation. The Commission and its staff continue to stand ready to work with the SIPA Trustee to achieve the goal of recovering additional funds for the benefit of MFGI commodity customers, both domestically and abroad.

Current Protections for Customer Funds

Section 4d of the CEA and Commission regulations require an FCM holding customer funds to treat such funds as belonging to the customer at all times and to segregate from its own funds any money, securities or property deposited by its customers to margin, guarantee, or secure futures or options positions entered into on Commission designated contract markets (Section 4d funds). FCMs are prohibited from using a customer's funds to margin or guarantee the trades or contracts of another customer, or of the FCM. The FCM may, however, commingle the funds of one futures customer with funds belonging to other futures customers in a single account or accounts. The FCM is required to maintain sufficient funds in segregated accounts to cover the net liquidating equity (i.e., total account balances due) of each of its customers at any given point in time.

The Act and regulations also require an FCM to hold in separate accounts (designated as "Part 30 secured accounts") customer funds deposited for trading futures and options listed on foreign boards of trade. The FCM may commingle the foreign futures funds deposited by one customer with the funds deposited by other foreign futures customers. An FCM may not, however, commingle Section 4d funds with Part 30 secured account funds.

Customers are required to post margin to support their futures and option 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 to have sufficient funds in segregated accounts at all times to cover all liabilities to customers, FCMs generally find it prudent 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 segregated or secured account, the funds would not have the protections afforded customer funds under the Bankruptcy Code and Part 190 of the Commission's regulations.

FCMs are also free to withdraw excess funds in Section 4d accounts deposited by and belonging to the FCM. At no time, however, may an FCM withdraw customer

funds from a Section 4d account to use those funds for its own purposes, regardless of any intention to replace them at a later date or time.

Oversight of FCMs

FCMs are subject to CFTC-approved minimum financial and reporting requirements that are enforced in the first instance by a DSRO, for example, the CME, or the National Futures Association. DSROs also conduct periodic compliance examinations on a risk-based cycle every 9 to 15 months.

Determining compliance with segregation requirements is a mandatory part of each examination. Examinations also include a review of the depository acknowledgement letters, the account titles of segregated accounts, verifying account balances, and ensuring that investment of customer funds is done in accordance with Commission regulations.

FCMs are required to file monthly unaudited financial reports with the Commission and the DSRO. These reports include the FCM's segregation, secured 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 Chief Executive Officer or the Chief Financial Officer. FCMs must also file annual certified financial reports with the Commission and the DSRO. The audits require, among other things, that if an auditor resigns or is replaced, the FCM is required to notify the Commission of certain disagreements with statements made in reports prepared by the prior auditor. The FCM is also required to request that the prior auditor provide a letter stating whether the auditor agrees with the statements made by the FCM in its notice to the Commission. 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.

Ongoing Investigation

The Commission's Division of Enforcement is also actively engaged in the investigation concerning the shortfall of customer funds. Staff is interviewing witnesses and reviewing documents, as well as other information. They are proceeding as expeditiously as they can. As the Committee will understand, I cannot disclose any specific details of the investigation because they are nonpublic, and because I do not want to prejudice any potential enforcement action. In general, however, depending on the specific facts and circumstances, a shortfall in customer segregated funds could amount to a violation of the CEA and Commission regulations including those that: (1) govern segregated funds; (2) prevent theft of customer money; (3) require our

registrants to properly supervise accounts; (4) prevent making false statements; and (5) prohibit deceptive schemes. Depending on the specific facts and circumstances, the Commission could file an enforcement action against corporate entities and/or individuals who have violated the CEA or regulations. In addition, depending on the specific facts and circumstances, individuals could also be liable if they are "control persons" of a company that violated the law. A "control person" generally refers to management. Depending on the specific facts and circumstances, an enforcement action could be filed against individuals who "aid and abet" violations by companies. Finally, Commission regulations impose obligations on accountants who audit FCMs and on the banks that hold customer segregated funds for FCMs. My mention of these particular provisions does not in any way limit the Division's investigation or the relief we can seek, nor does it indicate that the Division has reached any conclusions.

Generally, the Commission has the authority to, among other things, seek and impose civil monetary penalties, require a defendant to disgorge ill-gotten gains, obtain restitution for customers and obtain other injunctive relief. In terms of civil monetary penalties, the Commission can seek the greater of three times the defendant's gain, or a set amount, which is currently $140,000 per violation. Civil monetary penalties are paid to the U.S. Treasury, while restitution is paid to victims who suffered losses.

The Commission is a civil enforcement agency, so we cannot seek imprisonment as a sanction in an enforcement action. However, a willful violation of the CEA, or our regulations, is a federal crime, which can be prosecuted by a United States Attorney. We do not have any say in whether or not the criminal authorities prosecute, and I understand that they have a higher burden of proof than we have.

Conclusion

I understand the severe hardship that MF Global's bankruptcy has caused for thousands of customers who have not yet been made whole. These customers may have 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. The shortfall in customer funds was a shock to the markets from which we have not yet recovered.

I believe the Commission can make improvements to our regulatory oversight of FCMs and DSROs to help restore confidence in the futures markets, and I will work with the Commission and Congress to implement the rules necessary to enhance our ability to protect market users and to foster open, competitive, and financially sound markGets.

DOCUMENTS SUBMITTED FOR THE RECORD

AUGUST 1, 2012

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May 2012 Report

FCM	Atlas FCM Composite Rating	Atlas Rating 12 month Delta	Transparency	Clearing or Non-Clearing FCM	Net Capital Ratio	Net Capital Ratio Trend	Customer Funds Flow	Adjusted Net Capital Trend	Market Valuation	Business Diversification	Global Exchange Penalties	CFTC/NFA Disciplinary Actions	Arbitration Awards Against	Seg Funds Bank Health	Atlas Proprietary Risk Rating
MORGAN KEEGAN & COMPANY INC	83	9.00	4	NC	9.8	3	†	1.0	14.3	60	1	1	8.3	36.7	33
BOCI COMMODITIES & FUTURES USA LLC	82	-	3	C*	49.2	1	†	1.0	†	40	1	1	8.3	36.7	20
WELLS FARGO SECURITIES LLC	82	(1.50)	4	LC	6.3	7	†	1.0	2.4	50	1	1	8.3	36.7	64
MITSUBISHI UFJ SECURITIES USA INC	82	12.60	4	NC	5.4	1	†	1.0	11.9	60	1	1	8.3	36.7	53
CIBC WORLD MARKETS CORP	81	(2.70)	4	LC	2.8	1	†	1.0	23.8	60	1	1	8.3	36.7	51
STATE STREET GLOBAL MARKETS LLC	80	7.90	5	LC	14.2	24	1	7.2	9.5	40	28	1	8.3	36.7	47
CITADEL SECURITIES LLC	80	(5.90)	3	LC	1.9	4	†	67.0	†	40	1	1	8.3	36.7	18
STEPHENS INC	80	8.80	0	NC	†	†	†	†	†	40	1	1	8.3	36.7	32
DAIWA CAPITAL MARKETS AMERICA INC	80	6.50	5	LC	3.6	1	1	22.6	47.6	60	1	1	8.3	36.7	36
RBC CAPITAL MARKETS LLC	80	1.50	5	C	24.7	18	1	8.2	21.4	40	18.4	1	8.3	36.7	46
NATIXIS SECURITIES AMERICAS LLC	79	6.50	4	NC	4.5	2	†	4.1	85.7	40	1	1	8.3	36.7	27
GUGGENHEIM SECURITIES LLC	78	(2.40)	3	NC	17.7	11	†	57.7	†	40	1	1	8.3	36.7	24
INSTINET LLC	77	(1.70)	3	NC	7.1	8	†	44.3	†	80	1	1	8.3	36.7	23
LEK SECURITIES CORPORATION	76	7.30	4	NC	38.7	1	46.4	1.0	†	80	1	1	8.3	36.7	21
AMERIPRISE FINANCIAL SERVICES INC	74	(10.40)	4	NC	8.0	12	†	92.8	38.1	40	1	1	8.3	36.7	18
STRAITS FINANCIAL LLC	74	(9.00)	5	C	51.9	66	1	58.7	16.7	20	1	1	8.3	36.7	21
WELLS FARGO ADVISORS LLC	74	(10.60)	4	LC	1.0	5	†	89.7	2.4	50	1	1	8.3	36.7	64
TD AMERITRADE INC	73	(7.60)	5	NC	10.6	28	17.3	53.6	31.0	80	1	1	25.0	24.6	24
LIQUID FUTURES LLC	73	-	3	NC	95.7	1	†	1.0	†	80	1	1	8.3	36.7	18
DEUTSCHE BANK SECURITIES INC	73	3.10	5	C	27.3	1	26.4	1.0	71.4	40	16	1	8.3	36.7	68
ICAP CORPORATES LLC	73	(1.10)	4	NC	13.3	13	†	27.8	64.3	80	1	1	8.3	36.7	26
GH FINANCIALS LLC	73	(1.10)	4	C	37.0	35	1	49.5	†	80	1	1	8.3	36.7	24
CX CAPITAL MARKETS LLC	72	2.00	4	NC	56.3	36	1	25.7	†	80	1	1	8.3	50.4	22.4
WELLS FARGO ADVISORS FINANCIAL NETWORK LLC	72	(13.20)	4	LC	15.0	31	†	75.2	2.4	50	1	1	8.3	36.7	64
OPPENHEIMER & CO INC	71	(1.80)	5	NC	45.7	30	4.63	23.7	92.9	40	1	1	8.3	36.7	31.5
RAYMOND JAMES & ASSOCIATES INC	71	(9.60)	4	NC	33.5	34	†	69.0	7.1	60	1	1	8.3	36.7	38

† No data available

Atlas Ratings — Return OF Capital > Return on Capital

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May 2012 Report

FCM	Atlas FCM Composite Rating	Atlas Rating 12 month Delta	Transparency	Clearing or Non-Clearing FCM	Net Capital Ratio	Net Capital Ratio Trend	Customer Funds Flow	Adjusted Net Capital Trend	Market Valuation	Business Diversification	Global Exchange Penalties	CFTC/NFA Disciplinary Actions	Arbitration Awards Against	Segregated Funds Bank Health	Atlas Proprietary Risk Rating
SANTANDER INVESTMENT SECURITIES INC	71	(4.50)	4	C	20.3	40	2.82	96.9	†	40	1	1	8.3	36.7	42
LPL FINANCIAL LLC	71	(6.50)	3	NC	22.9	27	†	77.3	†	60	1	1	8.3	36.7	26.2
ITG DERIVATIVES LLC	71	14.40	4	NC	53.6	1	†	1.0	83.3	80	1	1	8.3	36.7	24.1
BNY MELLON CLEARING LLC	71	(1.30)	5	C	11.5	9	86.3	51.5	52.4	40	1	1	8.3	36.7	24.9
TRADESTATION FOREX INC	71	20.50	1	NC	†	†	†	†	31.0	80	1	1	8.3	43.4	41
BGC FINANCIAL LP	70	2.30	3	NC	12.4	15	†	86.6	†	80	1	1	8.3	36.7	25.6
UBS SECURITIES LLC	70	(4.20)	5	C	30.8	6	40.9	1.0	73.8		13.6	6.9	16.7	36.7	71
MACQUARIE FUTURES USA LLC	70	1.80	5	C	65.9	10	55.5	10.3	26.2	40	35.2	1	8.3	36.7	38.9
MCVEAN TRADING & INVESTMENTS LLC	70	10.40	4	NC	55.4	72	10.1	13.4	†	80	1	1	8.3	36.7	21.5
MAREX USA LIMITED	70	17.60	3	C	58.9	1	†	1.0	†	60	73.6	1	8.3	36.7	31.3
INTERACTIVE BROKERS LLC	70	(4.80)	5	C	40.5	39	6.45	1.0	28.6	80	1	10.3	33.3	43.8	49.7
RAND FINANCIAL SERVICES INC	69	8.20	4	C	50.1	57	1	6.2	†	80	40	1	8.3	36.7	27.4
TRADESTATION SECURITIES INC	69	(1.00)	4	NC	28.2	43	8.26	64.9	†	80	1	1	8.3	43.4	35.8
TRADITION SECURITIES AND FUTURES INC	68	6.80	3	NC	86.1	45	†	5.1	†	80	1	1	8.3	36.7	22.1
MERRILL LYNCH PIERCE FENNER & SMITH	68	(4.90)	5	C	25.6	1	68.2	12.3	78.6	40	11.2	1	8.3	36.7	68.3
MITSUI BUSSAN COMMODITIES USA INC	68	8.50	3	NC	59.8	38	†	20.6	†	80	1	1	8.3	36.7	42.1
CANTOR FITZGERALD & CO	68	(1.60)	4	LC	15.9	25	1	68.0	†	40	56.8	13.8	8.3	36.7	55.9
JP MORGAN CLEARING CORP	68	(9.40)	5	C	54.5	46	48.2	1.0	33.3	40	4	3.4	8.3	36.7	78.2
JP MORGAN SECURITIES LLC	67	(7.80)	5	C	41.4	58	22.8	33.0	33.3	40	4	3.4	8.3	36.7	78.2
JEFFERIES & COMPANY INC	67	(0.90)	4	C	21.2	20	†	40.2	76.2	40	20.8	1	8.3	36.7	62.7
GOLDMAN SACHS EXECUTION & CLEARING LP	67	(2.80)	5	C	26.4	32	1	1.0	61.9	40	1.6	27.6	50.0	36.7	82
BNP PARIBAS SECURITIES CORP	67	(6.20)	5	C	18.5	37	24.6	21.6	88.1	40	30.4	1	8.3	36.7	56.3
BNP PARIBAS PRIME BROKERAGE INC	67	0.80	5	C	44.9	29	1	31.9	88.1	40	30.4	1	8.3	36.7	56.3
NEUBERGER BERMAN LLC	66	(10.60)	3	C	23.8	49	†	97.9	†	60	1	1	8.3	36.7	23.8
XPRESSTRADE LLC	66	28.60	3	NC	96.6	16	†	2.0	†	80	1	34.5	8.3	36.7	27.4
GOLDMAN SACHS & CO	66	(2.90)	5	C	43.1	1	28.2	1.0	61.9	40	1.6	27.6	50.0	36.7	82.5

† No data available

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FCM	Atlas FCM Composite Rating	Atlas Rating 12 month Delta	Transparency	Clearing or Non-Clearing FCM	Net Capital Ratio	Net Capital Ratio Trend	Customer Funds Flow	Adjusted Net Capital Trend	Market Valuation	Business Diversification	Global Exchange Penalties	CFTC/NFA Disciplinary Actions	Arbitration Awards Against	Seg Funds Bank Health	Atlas Proprietary Risk Rating
NOMURA SECURITIES INTERNATIONAL INC	66	(9.70)	5	LC	8.9	14	82.7	42.2	59.5	60	1	1	8.3	36.7	59.6
IRONBEAM INC	66	1.30	4	NC	60.6	53	31.9	43.3	†	80	1	1	8.3	36.7	24.3
ADM INVESTOR SERVICES INC	66	1.30	5	C	81.7	73	11.9	37.1	4.8	20	37.6	31	8.3	36.7	32.1
HSBC SECURITIES USA INC	66	(3.30)	5	C	31.7	17	71.8	28.8	40.5	40	32.8	1	8.3	36.7	65.7
AMP GLOBAL CLEARING LLC	66	(4.30)	4	NC	87.0	91	1	1.0	†	80	1	1	8.3	43.4	29
RBS SECURITIES INC	66	(1.40)	5	C	29.1	1	66.3	17.5	90.5	40	25.6	1	8.3	36.7	63.2
DORMAN TRADING LLC	65	0.70	4	C	47.5	60	1	9.2	†	80	85.6	1	8.3	36.7	18.9
BARCLAYS CAPITAL INC	65	(4.70)	5	C	46.6	47	15.5	35.0	66.7	40	23.2	1	8.3	36.7	65.9
OPTIONSXPRESS INC	64	0.90	5	NC	29.9	22	53.6	72.1	54.8	80	1	1	8.3	43.4	30.4
FRIEDBERG MERCANTILE GROUP INC	63	(12.10)	4	NC	61.5	61	30.0	63.9	†	60	1	1	8.3	43.4	36.9
PHILLIP FUTURES INC	63	(14.50)	4	C	57.1	76	44.6	76.3	†	40	1	1	8.3	36.7	27.6
ADVANTAGE FUTURES LLC	63	0.80	4	C	74.7	48	1	24.7	†	80	59.2	1	8.3	36.7	36.2
ALPARI (US) LLC	63	(10.6)	4	NC	94.9	84	1.0	34.0	†	80	1.0	1.0	8.3	38.4	31.6
MIZUHO SECURITIES USA INC	63	(7.7)	5	C	63.3	70	60.9	70.1	19	40	1.0	1.0	8.3	36.7	41.4
WHITE COMMERCIAL CORPORATION	62	0.5	3	NC	66.8	62	†	60.8	†	80	1.0	1.0	8.3	36.7	21.0
OANDA CORPORATION	62	(7.8)	3	NC	51.0	52	†	65.9	†	80	1.0	1.0	8.3	36.7	43.2
CITIGROUP GLOBAL MARKETS INC	62	(12.0)	5	C	35.2	33	51.8	54.6	69	40	6.4	1.0	8.3	36.7	79.1
EASY FOREX US LTD	62	5.8	3	NC	83.5	67	†	45.3	†	80	1.0	1.0	8.3	36.7	21.0
FRONTIER FUTURES INC	62	2.4	4	NC	73.8	23	73.6	11.3	†	80	64.0	1.0	8.3	19.6	28.9
UBS FINANCIAL SERVICES INC	61	(10.9)	5	C	34.3	42	33.7	59.8	73.8	40	13.6	6.9	16.7	36.7	71.2
INTEGRATED BROKERAGE SERVICES LLC	61	3.4	4	NC	92.2	87	1.0	61.8	†	80	1.0	1.0	8.3	36.7	23.5
TIMBER HILL LLC	61	(11.4)	5	C	22.1	26	70.0	81.4	28.6	80	1.0	20.7	8.3	43.8	51.0
ABN AMRO CLEARING CHICAGO LLC	61	2.3	4	C	71.2	71	19.2	38.1	†	40	54.4	1.0	8.3	36.7	53.9
MORGAN STANLEY SMITH BARNEY LLC	61	(15.0)	5	C	16.8	19	59.1	52.5	81	40	42.4	1.0	8.3	36.7	76.6
SANFORD C BERNSTEIN & CO LLC	60	(16.1)	3	NC	37.8	55	†	83.5	†	80	1.0	1.0	8.3	36.7	54.2
LINN GROUP THE	60	0.8	4	NC	80.8	86	1.0	36.1	†	80	1.0	44.8	8.3	32.1	31.5

† No data available

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May 2012 Report

FCM	Atlas FCM Composite Rating	Atlas Rating 12 month Delta	Transparency	Clearing or Non-Clearing FCM	Net Capital Ratio	Net Capital Ratio Trend	Customer Funds Flow	Adjusted Net Capital Trend	Market Valuation	Business Diversification	Global Exchange Penalties	CFTC/NFA Disciplinary Actions	Arbitration Awards Against	Seg Funds Bank Health	Atlas Proprietary Risk Rating
GLOBAL FUTURES & FOREX LTD	60	(4.1)	4	NC	58.0	54	80.9	55.6	†	80	1.0	1.0	8.3	36.7	27.2
MORGAN STANLEY & CO LLC	59	(8.2)	2	C	44.0	†	†	†	81	40	42.4	1.0	8.3	36.7	76.6
TRADELINK LLC	58	(12.8)	3	C	19.4	41	†	94.8	†	80	61.6	1.0	8.3	36.7	32.5
EAGLE MARKET MAKERS INC	58	2.7	4	LC	42.2	21	89.9	19.6	†	80	92.8	1.0	8.3	36.7	27.6
OPEN E CRY LLC	57	5.3	4	NC	64.2	65	1.0	71.1	†	80	1.0	65.5	8.3	43.4	27.1
CAPITAL MARKET SERVICES LLC	56	11.2	3	NC	62.4	51	†	39.1	†	80	1.0	86.2	8.3	36.7	27.3
COMMONWEALTH FOREIGN EXCHANGE INC	56	(12.4)	3	NC	79.1	82	†	87.6	†	80	1.0	1.0	8.3	36.7	18.2
RJ OBRIEN ASSOCIATES LLC	56	9.2	4	C	89.6	78	1.0	18.5	†	80	66.4	1.0	41.7	36.7	26.1
CUNNINGHAM COMMODITIES LLC	56	0.6	4	LC	70.3	81	1.0	30.9	†	80	90.4	1.0	8.3	50.4	26.3
CREDIT SUISSE SECURITIES (USA) LLC	56	(17.8)	5	C	48.4	59	39.1	79.3	95.2	40	8.8	1.0	8.3	36.7	68.7
MB TRADING FUTURES INC	56	(0.8)	3	NC	97.5	99	†	50.5	†	80	1.0	1.0	8.3	36.7	24.3
ADVANCED MARKETS LLC	56	8.2	3	NC	99.2	88	†	3.1	†	80	1.0	51.7	8.3	†	22.8
ENSKILDA FUTURES LTD	56	9.3	5	C	67.7	1	79.1	1.0	50	60	71.2	48.3	8.3	36.7	63.9
MERRILL LYNCH PROFESSIONAL CLEARING CORP	55	(15.7)	5	C	36.1	56	57.3	95.8	78.6	40	11.2	1.0	8.3	36.7	69.2
FOREX CLUB LLC	55	12.0	3	NC	100	100	†	29.9	†	80	1.0	24.1	8.3	36.7	21.9
MAREX NORTH AMERICA LLC	55	2.9	4	C	76.4	77	21.0	47.4	†	60	73.6	1.0	8.3	36.7	50.4
JEFFERIES BACHE LLC	54	(2.0)	5	C	84.3	64	62.7	41.2	76.2	40	20.8	1.0	8.3	36.7	66.6
FCSTONE LLC	53	(5.6)	5	C	85.2	83	42.7	15.4	42.9	40	83.2	37.9	8.3	36.7	36.5
FX SOLUTIONS LLC	53	(2.5)	3	NC	87.8	92	†	80.4	†	80	1.0	1.0	8.3	36.7	32.1
TENCO INC	53	(0.9)	4	C**	39.6	50	84.5	56.7	†	80	49.6	41.4	8.3	36.7	24.9
NEWEDGE USA LLC	53	2.4	5	C	79.9	1	75.4	14.4	97.6	80	44.8	17.2	8.3	36.7	66.9
GAIN CAPITAL GROUP LLC	52	3.4	4	NC	68.5	69	†	74.2	57.1	80	1.0	55.2	8.3	36.7	26.8
INSTITUTIONAL LIQUIDITY LLC	52	6.6	3	NC	98.4	90	†	16.5	†	80	1.0	62.1	8.3	36.7	37.1
YORK BUSINESS ASSOCIATES LLC	52	(22.7)	4	NC	77.3	89	13.7	93.8	†	80	1.0	58.6	8.3	36.7	23.8
VISION FINANCIAL MARKETS LLC	50	3.6	4	C	65.0	74	1.0	46.4	†	80	88.0	68.9	8.3	36.7	26.9
MID CO COMMODITIES INC	49	(9.1)	4	NC	88.7	96	91.8	88.6	†	80	1.0	1.0	8.3	36.7	22.2

† No data available

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May 2012 Report

FCM	Atlas FCM Composite Rating	Atlas Rating 12 month Delta	Transparency	Clearing or Non-Clearing FCM	Net Capital Ratio	Net Capital Ratio Trend	Customer Funds Flow	Adjusted Net Capital Trend	Market Valuation	Business Diversification	Global Exchange Penalties	CFTC/NFA Disciplinary Actions	Arbitration Awards Against	Segregated Funds Bank Health	Atlas Proprietary Risk Rating
MBF CLEARING CORP	48	(10.9)	4	NC	72.1	94	95.4	100	†	80	1.0	1.0	8.3	36.7	29.9
STERLING COMMODITIES CORP	48	(12.6)	4	NC	75.6	95	97.2	98.9	†	80	1.0	1.0	8.3	36.7	26.1
COUNTRY HEDGING INC	47	(1.7)	4	NC	93.1	79	88.1	73.2	†	80	47.2	1.0	8.3	36.7	23.7
PENSON FINANCIAL SERVICES INC	45	(6.2)	5	C	52.8	63	77.2	90.7	100	80	52.0	1.0	8.3	36.7	46.2
IKON GLOBAL MARKETS INC	44	(11.8)	4	NC	32.6	44	93.6	85.5	†	80	1.0	79.3	75.0	36.7	28.4
FXDIRECTDEALER LLC	44	(10.9)	3	NC	94.0	98	†	84.5	†	80	1.0	72.4	8.3	36.7	29.6
VELOCITY FUTURES LLC	41	(19.6)	4	NC	82.6	68	50.0	48.4	†	80	1.0	89.7	100	36.7	29.6
FOREX CAPITAL MARKETS LLC	41	(9.5)	3	NC	69.4	75	†	82.4	†	80	1.0	93.1	66.6	36.7	27.2
PEREGRINE FINANCIAL GROUP INC	41	(28.4)	4	NC	90.5	80	64.5	62.9	†	80	1.0	75.9	58.3	43.4	36.6
CROSSLAND LLC	40	(17.7)	4	LC	78.2	93	37.3	78.3	†	80	78.4	1.0	91.6	36.7	29.9
ROSENTHAL COLLINS GROUP LLC	36	3.1	4	C	91.4	97	35.5	26.8	†	80	76.0	82.8	83.3	36.7	34.2
PIONEER FUTURES INC	34	(7.5)	3	NC	72.9	85	†	91.7	†	80	97.6	95.6	8.3	36.7	26.3

† No data available

Explanation of Metrics and Classifications

Atlas FCM Composite Rating:
The Atlas FCM Composite Rating is our proprietary composite score of all the criteria measured by Atlas Ratings. Each category is measured, weighed and combined to create the final score awarded to each FCM. This final rating is our measure of the FCM's health in relation to its peers.

Atlas FCM Rating 12-month Delta:
The 12-month change in the Atlas FCM Composite Rating shows the long-term improvement or deterioration in the individual FCM. An ideal FCM maintains a high rating with little annual change, therefore maintaining healthy and sound business practices.

Clearing or Non-Clearing FCM:
Not all FCMs are clearing FCMs. Some clear through other FCMs with established clearing relationships. "C" denotes a clearing FCM and "NC" denotes a non-clearing FCM. "LC" denotes an FCM with limited clearing capabilities, this means they only clear through one or two domestic exchanges. "*" denotes an FCM that has clearing capabilities but is not currently clearing trades. If a FCM is not a clearing FCM, the clearing relationship can be found on our website: www.AtlasRatings.com.

Net Capital Ratio:
The net capital ratio measures the FCM's excess net capital to its net capital requirement. The higher this ratio, the better capitalized the FCM and the larger the financial buffer.

Customer Funds Flow:
The flow of customer funds is monitored to see whether individuals and more importantly institutions are maintaining, beginning or closing out financial relationships with the underlying FCM. A large outflow of customer funds is a red flag and warrants caution as there may be some developments that large institutional clients deem worrisome. Some FCMs that clear through a secondary FCM do not report monthly customer fund levels.

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Transparency:
Atlas Ratings includes this metric to measure the amount of available information about each FCM. The higher the transparency, the more weight can be assigned to our Atlas Composite Rating assigned to the underlying FCM.

Market Valuation:
Atlas Ratings monitors the equity market's composite view of the FCM, if it is publicly traded or if its parent company is publicly traded. The company's stock price performance is not measured against the broad stock market, rather its brokerage and financial peers. As with our other measurements, market valuation is also relative. Atlas monitors the company's valuation relative to the brokerage and banking valuations as whole.

Business Diversification:
An FCM with few sources of operational income can be concerning, particularly in an environment of near-zero interest rates where interest earned on deposits is near-zero. A FCM with a diverse business structure is preferable. In the case of a business disruption, a diverse revenue stream will provide a buffer and allow it to meet operational expenses.

CFTC/NFA Disciplinary Actions:
The CFTC and NFA monitor and audit each and every FCM. Any monetary penalties or disciplinary actions are a red flag and warrant closer examination of the FCM. These disciplinary actions range from a cease and desist order to monetary penalties which range from a couple thousand to several million dollars.

Global Exchange Penalties:
Futures exchanges monitor their clearing member's record keeping, conduct and clearing procedures. When violations arise, the exchange may penalize the clearing FCM. Monitoring the penalties assigned by the exchange provides a view into the business habits of the underlying FCM. The number of penalties and the size of any fines must be viewed in the context of how much business the FCM clears through the exchange and the level of customer assets held under the FCM. We normalize this metric to the volume of trades an FCM clears.

Arbitration and Reparations:
When issues arise between the FCM and a customer, we take notice. Sometimes these cases are as simple as a customer that lost funds through poor trading. Other times, the FCM has not kept up its fiduciary duty or internal errors led to a loss of client funds. Issues are dealt with by the NFA and by a panel of arbitrators. Issues include but are not limited to: churning, misrepresentations, high pressure sales, failure to disclose risks, failure to supervise, unsuitability, omissions of fact, failure to hedge, mismanagement, excessive commissions and finally, fraud.

Segregated Funds Bank Health:
Customer funds are segregated from the FCM and are held with a banking institution or with an exchange. Due to the structure of the futures markets, funds in excess of necessary margin will be kept segregated with the banking institution. We monitor the health of the banks used by each FCM to determine the capitalization levels and their reserves to cover non-performing loans. In addition to monitoring a number of the bank's financial ratios we also monitor the trend of these ratios to determine the bank's financial improvement or deterioration.

Freeh Sporkin & Sullivan, LLP

July 27, 2012

BY EMAIL

The Honorable Debbie Stabenow
Chairwoman, Committee on Agriculture, Nutrition and Forestry
United States Senate
328-A Russell Senate Office Building
Washington, DC 20510

Dear Senator Stabenow:

Thank you for the invitation to submit a written statement for the record in connection with the Committee's upcoming hearing entitled "Examining the Futures Market: Responding to the Failures of MF Global and Peregrine Financial," which is scheduled to take place on Wednesday, August 1, 2012. Accompanying this letter is my written statement and a copy of the First Report of Louis J. Freeh, Chapter 11 Trustee of MF Global Holdings Ltd., *et al.*, For the Period October 31, 2011 through June 4, 2012, which was filed on June 4, 2012 with the United States Bankruptcy Court in the Southern District of New York.

I regret that a long-standing, prior commitment prevents me from appearing in person at the hearing on August 1st, and I greatly appreciate your consideration and understanding in permitting me to submit a written statement in lieu of a personal appearance. I understand that members of the Committee may have questions for the record, and I will respond to any follow up questions if the Committee so desires.

Sincerely,

Louis J. Freeh

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	:	Chapter 11
MF Global Holdings Ltd., *et al.*,	:	Case No. 11-15059 (MG)
	:	(Jointly Administered)
Debtors.	:	

FIRST REPORT OF LOUIS J. FREEH,

CHAPTER 11 TRUSTEE OF MF GLOBAL HOLDINGS LTD., *et al.*,

FOR THE PERIOD OCTOBER 31, 2011 THROUGH JUNE 4, 2012

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INTRODUCTION[1]

Prior to the commencement of the Chapter 11 Cases, MF Global Holdings Ltd. ("**Holdings Ltd.**") and its worldwide affiliates and subsidiaries (collectively, the "**MF Global Group**"), through its regulated and unregulated broker/dealers ("**B/D**") and futures commission merchants ("**FCM**"), were a leading brokerage firm offering customized solutions in the global cash and derivatives markets. The MF Global Group provided execution and clearing services for products in the exchange-traded and over-the-counter ("**OTC**") derivatives markets, as well as for certain products in the cash market. The MF Global Group operated globally, with a presence in, among other locations, the United States, the United Kingdom, France, Singapore, Australia, Hong Kong, Canada, India and Japan, providing its clients with global market access to more than seventy securities and futures exchanges and facilitated trades in the OTC markets.

As the global economy soured in the Fall of 2011, the MF Global Group was confronted by numerous challenges. On September 1, 2011, Holdings Ltd. announced that the Financial Industry Regulatory Authority ("**FINRA**") informed it that MF Global Inc. ("**MFGI**"), Holdings Ltd.'s regulated U.S. operating subsidiary, was required to modify its capital treatment of certain repurchase to maturity ("**RTM**") transactions that were collateralized with European sovereign debt and increase its net capital pursuant to Securities and Exchange Commission ("**SEC**") Rule 15c3-1, with which MFGI complied.

Thereafter, on October 24, 2011, Moody's Investor Service ("**Moody's**") downgraded Holdings Ltd.'s rating to one notch above "junk" status based on its belief that (i) Holdings Ltd. would announce lower than expected earnings and (ii) the current low interest rate environment

[1] This Court approved the appointment of Louis J. Freeh as chapter 11 trustee (the "**Trustee**") on November 28, 2011. On April 12, 2012, the Court requested that the Trustee submit a report on the status of the Chapter 11 Cases (as defined below) and the Trustee's efforts to wind-down the Debtors' (as defined below) estates (the "**Report**"). The Trustee reserves his right to amend this Report should further information arise pertaining to the facts and circumstances set forth in this Report.

and volatile capital markets conditions made it unlikely that the MF Global Group would be able to meet, in the short term, the profitability targets Moody's had set for the MF Global Group. Moody's also raised concerns about the MF Global Group's RTM positions, increased risk appetite and capitalization, as well as internal risk management or control issues.[2]

On October 25, 2011, Holdings Ltd. announced its results for its second fiscal quarter ended September 30, 2011. Holdings Ltd. disclosed that it posted a $191.6 million GAAP net loss in the second quarter, compared with a loss of $94.3 million for the same period the prior year. The net loss reflected, among other things, a decrease in net revenue primarily due to the contraction of proprietary principal activities. The loss also included valuation allowances against deferred tax assets, which accounted for $119.4 million of the $191.6 million in GAAP net loss. With regard to the RTM position, concerns over euro zone sovereign debt had caused global market fluctuations in prior months and, in particular, the weeks leading up to the bankruptcy filings of the Initial Debtors (as defined below). The MF Global Group's weakened core profitability and increased risk-taking, in the form of its European RTM positions, led Fitch Ratings and Moody's to further downgrade the MF Global Group to "junk" status on October 27, 2011. This sparked an increase in margin calls against MFGI and an exodus of its customers, threatening overall liquidity.

Following the October 24 Moody's downgrade, some of MFGI's principal regulators -- the Commodity Futures Trading Commission ("**CFTC**"), the SEC and the Chicago Mercantile Exchange ("**CME**") -- expressed grave concerns about MFGI's viability and whether it should continue operations in the ordinary course. The MF Global Group explored a number of

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[2] The MF Global Group held a long position totaling $6.3 billion in a short-duration European sovereign debt portfolio financed to maturity, which included debt securities of Belgium, Italy, Spain, Portugal and Ireland. These countries had some of the most troubled economies in the euro zone. The RTM exposure was divided between MFGI and FinCo (as defined below).

strategic alternatives with respect to its business operations, including a sale of the businesses in part or in whole. On October 30, 2011, with the MF Global Group's overall liquidity quickly diminishing to unsustainable levels, a sale to Interactive Brokers collapsed when Holdings Ltd. advised Interactive Brokers, and the regulators, that a potential significant shortfall in customer segregated funds had been identified.

Beginning on October 31, 2011 (the "**October Petition Date**"), several entities of the MF Global Group filed for bankruptcy, dissolution, administration and/or liquidation in the various jurisdictions in which the MF Global Group operated. This Report, among other things, summarizes the progress made to date in the chapter 11 cases (the "**Chapter 11 Cases**") of Holdings Ltd., MF Global Finance USA, Inc. ("**FinCo**") (together with Holdings Ltd., the "**Initial Debtors**"), MF Global Capital LLC ("**Capital**"), MF Global FX Clear LLC ("**FX Clear**"), MF Global Market Services, LLC ("**Market Services**," and collectively with Capital and FX Clear, the "**Unregulated Debtors**"), and MF Global Holdings USA Inc. ("**Holdings USA**", and collectively with the Unregulated Debtors, the "**Subsequent Debtors**," and the Subsequent Debtors collectively with the Initial Debtors, the "**Debtors**") to maximize the value of the Debtors' estates for the benefit of creditors and all parties in interest.

This Report focuses on the Debtors' Chapter 11 Cases and the Trustee's efforts to meet his duties under chapter 11 of title 11 of the United States Code, as amended (the "**Bankruptcy Code**"), and his fiduciary duty to maximize value and returns to the Debtors' creditors. To maximize the creditors' returns, the Trustee must realize value from the various entities of the

MF Global Group that are in administration or liquidation proceedings both domestically and abroad.[3]

Initially, the Report details the Debtors, their Chapter 11 Cases, their businesses, the appointment of the Official Committee of Unsecured Creditors of MF Global Holdings Ltd., *et al.* (the "**Committee**") and the Trustee, and the various professionals retained to assist with the wind-down of the Debtors' estates.

The focus of the Report then turns to the relationships between the Debtors and the MF Global Group, detailing the over $2 billion in financing provided by the Debtors to MFGI and the proprietary transactions entered into by the Debtors with and among MFGI and MF Global U.K. Limited ("**MFGUK**"). In addition, an analysis of the claims against the MF Global Group's worldwide affiliates is provided. The Trustee has attempted to provide the most complete and transparent account of all of the Debtors' claims against all other entities in the MF Global Group.

Finally, the Report closes with a discussion of additional topics of interest that have arisen during the Chapter 11 Cases, including various court proceedings, litigations and testimony before Congress.

INITIAL CHAPTER 11 FILINGS

I. MF GLOBAL HOLDINGS LTD. AND MF GLOBAL FINANCE USA INC.

A. October Petition Date and First Day Motions

On the October Petition Date, the Initial Debtors filed voluntary petitions under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of

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[3] For a summary of the claims filed by the Debtors and their non-debtor affiliates against all members of the MF Global Group that are the subject of liquidation proceedings and administrations throughout the world, *see* Exhibit A.

New York (the "**Court**"). On the October Petition Date, the Initial Debtors filed the following first day motions in order to make their transition to, and operation in, chapter 11 occur with minimum interruption or disruption to their businesses or loss of productivity or value.

1. Joint Administration.

The Initial Debtors requested the joint administration of their Chapter 11 Cases for procedural purposes only to reduce costs and facilitate the administrative process by avoiding the need for duplicative notices, applications, and orders. On November 2, 2011, the Court entered an order authorizing joint administration.[4]

2. Schedules and Statements Extension Motion.

The Initial Debtors sought to extend the deadline to file their schedules of assets and liabilities and statements of financial affairs (collectively, the "**Schedules**"). Given the complexity of the Initial Debtors' businesses, as well as the effort required to prepare for and conduct their Chapter 11 Cases on an emergency basis, the Initial Debtors determined that they would not be in a position to accurately complete their Schedules within the deadline provided by the Federal Rules of Bankruptcy Procedure (the "**Bankruptcy Rules**") and the Local Bankruptcy Rules for the Southern District of New York (the "**Local Rules**"). On November 2, 2011, the Court entered an order extending the deadline for filing the Schedules.[5]

3. List of Creditors and Initial Notices.

To ease the administrative burden of the Chapter 11 Cases on the Initial Debtors' estates, the Initial Debtors requested authorization to (i) prepare a consolidated list of creditors in the form maintained in the ordinary course of business and in electronic format only, (ii) file a

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[4] Docket No. 19.

[5] Docket No. 21. The deadline to file the Schedules subsequently was further extended. The Trustee filed the Schedules for five of the Debtors on May 18, 2012 and the remaining Debtor on May 30, 2012 (Docket Nos. 692–701, 707, 708).

consolidated list of the 50 largest general unsecured creditors, and (iii) mail initial notices. The Initial Debtors also requested authority not to file (i) the consolidated list of creditors described above, but instead to make such lists available only upon request, and (ii) a list of each Initial Debtor's equity security holders. On November 2, 2011, the Court entered an order granting the Initial Debtors' requests, provided that a list of the Initial Debtors' equity holders be maintained by GCG, Inc. ("**GCG**"), the Court-appointed claims and noticing agent, and made available upon request.[6]

4. Cash Management, Business Forms, and Intercompany Transfers.

The Initial Debtors requested (i) a waiver of the requirement in the U.S. Trustee Guidelines that pre-petition bank accounts be closed and new post-petition bank accounts be opened, (ii) authority to continue to use all business forms existing immediately prior to the October Petition Date, without reference to the Initial Debtors' status as debtors in possession, provided that the Initial Debtors would use their reasonable best efforts to refer to their status as debtors in possession on all checks issued after the commencement of the Initial Debtors' Chapter 11 Cases and on other physical business forms after the Initial Debtors' existing stock was exhausted, and (iii) authority to continue intercompany transactions among the Initial Debtors and accord superpriority status to all post-petition intercompany claims. The Court entered four interim orders and a final order on December 14, 2011 authorizing the Initial Debtors to continue using their existing bank accounts, cash management system and business forms, and to continue intercompany transactions among the Initial Debtors, according superpriority status to all post-petition intercompany claims.[7]

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[6] Docket No. 20.

[7] Docket Nos. 25, 119, 205, 254, 276.

5. Cash Collateral.

The Initial Debtors sought authority to use funds held in their accounts (the "**Cash Collateral**") at JPMorgan Chase Bank, N.A. ("**JPM**") to maintain sufficient liquidity so that the Initial Debtors could continue to operate their businesses in the ordinary course of business during their Chapter 11 Cases. The Initial Debtors asserted that immediate and ongoing use of Cash Collateral was required to fund the day-to-day activities of the Initial Debtors, including payments to employees and vendors in the ordinary course of business whose services and goods were integral to the Initial Debtors' operations. Without the use of the Cash Collateral, the Initial Debtors would be unable to pay for services and expenses necessary to preserve and maximize the value of the Initial Debtors' estates.

The Court entered an order on November 2, 2011 authorizing the Initial Debtors to use Cash Collateral on an interim basis, and an order on December 14, 2011 authorizing the Initial Debtors to use Cash Collateral on a final basis, subject to certain terms and restrictions.[8]

B. The Initial Debtors' Professionals

1. Skadden, Arps, Slate, Meagher & Flom LLP.

On January 23, 2012, the Trustee filed an application to retain Skadden, Arps, Slate, Meagher & Flom LLP ("**Skadden**"), *nunc pro tunc* to the October Petition Date, as the Initial Debtors' bankruptcy counsel through November 28, 2011 and thereafter as special counsel to the Trustee through March 31, 2012.[9] Prior to the October Petition Date, Skadden was retained for advice on strategic options in connection with efforts to respond to the Debtors' financial circumstances. Skadden's service included, among other things, assisting the Initial Debtors

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[8] Docket Nos. 26, 275.

[9] Docket No. 386.

with restructuring their financial affairs and capital structure, and, as necessary, advising the Initial Debtors with respect to any reorganization cases filed under chapter 11 of the Bankruptcy Code. Skadden worked closely with the MF Global Group to restructure its business, and when those efforts failed, to file petitions under chapter 11 of the Bankruptcy Code and address the numerous issues that resulted therefrom. After his appointment, the Trustee sought to retain Skadden on a limited basis to capture the knowledge and insights into the cases that Skadden had gained during its tenure as the Initial Debtors' proposed bankruptcy counsel, and to ensure a seamless transition to his professionals. Specifically, Skadden's services were used to assist the Trustee with (i) the surrender of leased premises at 717 Fifth Avenue, (ii) tax refund matters, and (iii) other matters where Skadden had acquired material knowledge during its representation of the Initial Debtors. On February 9, 2012, the Court entered an order authorizing the retention of Skadden through and including March 31, 2012.[10]

2. FTI Consulting, Inc.

On January 23, 2012, the Trustee filed an amended application to retain FTI Consulting, Inc. ("**FTI**") as financial advisors to the Initial Debtors from October 31, 2011 to November 28, 2011, and as financial advisors to the Trustee thereafter.[11] FTI provides consulting and advisory services, including assistance with (i) the preparation of financial-related disclosures required by the Court, the Bankruptcy Code, the Bankruptcy Rules and the Local Rules, (ii) analyses related to the pursuit of debtor in possession financing and the use of Cash Collateral, (iii) the identification and implementation of short-term cash management procedures, (iv) the development and implementation of key employee retention and other critical employee benefit

[10] Docket No. 436.

[11] Docket No. 389.

programs, (v) the identification of core business assets and the disposition of assets or liquidation of unprofitable operations, (vi) the identification of executory contracts and leases and analysis of cost/benefit evaluations with respect to the affirmation or rejection of each, (vii) the valuation of the present level of operations and identification of areas of potential cost savings, (viii) analysis of creditor claims, including assisting with development of databases, as necessary, to track such claims, (ix) monitoring the various other insolvency proceedings and administrations of the Initial Debtors' affiliates, (x) the evaluation and analysis of avoidance actions, (xi) forensic accounting, forensic reviews and investigations, information technology issues, data retention, data preservation, data collection, and data analysis, and (xii) certain other issues related to the Chapter 11 Cases. On February 9, 2012, the Court entered an order authorizing the retention of FTI.[12]

3. Kasowitz, Benson, Torres & Friedman LLP.

On January 23, 2012, the Trustee filed an application to retain Kasowitz, Benson, Torres & Friedman LLP ("**Kasowitz**") as the Initial Debtors' conflicts counsel through November 28, 2011 and thereafter as special investigative counsel to the Trustee through March 31, 2012.[13] Kasowitz's tasks consisted primarily of assisting the Trustee in connection with certain formal and informal investigative matters and the transition of those matters to the Trustee and his counsel, Freeh Sporkin & Sullivan, LLP. Since the October Petition Date, the Initial Debtors have received numerous subpoenas and information requests from various governmental agencies such as the SEC and the CFTC, which require the preservation, collection and review of voluminous data and documents in the possession, custody or control of the Initial Debtors.

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[12] Docket No. 438.

[13] Docket No. 384.

Kasowitz had been selected earlier by the Initial Debtors as conflicts counsel to coordinate their document preservation efforts and respond to various investigative subpoenas and requests. The Trustee subsequently sought to retain Kasowitz as special investigative counsel for a limited time to (i) take advantage of the knowledge and experience that Kasowitz acquired in representing the Initial Debtors in these matters prior to the appointment of the Trustee, (ii) avoid unnecessary duplication of efforts, and (iii) assist the Trustee in expeditiously responding to the numerous investigations and requests for information, and managing the process of identifying, preserving, collecting and analyzing electronic and hard copy documents in the Initial Debtors' possession, custody and control. On February 9, 2012, the Court entered an order authorizing the retention of Kasowitz.[14]

4. GCG.

On October 31, 2011, the Initial Debtors filed an application to retain GCG as the claims and noticing agent for the Initial Debtors' Chapter 11 Cases.[15] In light of the number of anticipated claimants and parties in interest, the Initial Debtors believed that appointing GCG, an independent third party, to act as claims and noticing agent would provide the most effective and efficient means, and relieve the Initial Debtors and the Clerk's Office of the administrative burden, of noticing, administering claims, and assisting in other administrative tasks. On November 2, 2011, the Court entered an order authorizing the retention of GCG.[16]

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[14] Docket No. 439.

[15] Docket No. 5.

[16] Docket No. 22.

C. Description of the Initial Debtors' Businesses

1. Holdings Ltd.

Holdings Ltd. was a public company that traded on the New York Stock Exchange under the ticker symbol "MF," and since the October Petition Date trades under the ticker symbol "MFGLQ". Holdings Ltd. is a corporate holding company that is the direct or indirect parent of all of the other companies in the MF Global Group.

2. FinCo.

FinCo is a New York corporation that provided financing services to affiliated companies and third parties.

STATUTORY CREDITORS' COMMITTEE

I. COMMITTEE MEMBERS

On November 7, 2011, the Office of the United States Trustee (the "**U.S. Trustee**"), under Bankruptcy Code sections 1102(a) and (b), appointed the following unsecured creditors to the Committee: (1) Wilmington Trust Company, (2) JPM, (3) Bank of America, N.A. ("**BoA**"), (4) Elliot Management Corporation, and (5) Caplin Systems Ltd.[17]

II. COMMITTEE PROFESSIONALS

A. Dewey & LeBoeuf LLP

On January 19, 2012, the Court authorized the Committee's retention of Dewey & LeBoeuf LLP ("**Dewey**") as legal counsel, *nunc pro tunc* to November 9, 2011, to advise and assist the Committee with respect to the administration of the Chapter 11 Cases.[18]

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[17] Docket No. 51. Upon information and belief, Elliot Management Corporation has resigned from the Committee.

[18] Docket No. 377. The Trustee has been advised that the Committee will substitute Proskauer Rose LLP ("**Proskauer**") for Dewey as counsel.

B. Capstone

On February 9, 2012, the Court authorized the Committee's retention of Capstone Advisory Group, LLC, together with its wholly-owned subsidiary Capstone Valuation Services, Inc. ("**Capstone**", and together with Proskauer, the "**Committee Professionals**"), as its financial advisor, *nunc pro tunc* to November 9, 2011, to help guide the Committee through the Debtors' reorganization efforts and to assist it in the tasks associated with negotiating and implementing a chapter 11 plan.[19]

C. Rust Consulting, Inc.

On May 5, 2012, the Committee filed an application to retain Rust Consulting, Inc. as administrative agent to establish and maintain the Committee's website and to assist the Committee in providing the Debtors' unsecured creditors with access to information in connection with the Chapter 11 Cases.[20] The application will be heard by the Court on June 14, 2012.

III. COMMITTEE ACTIVITY

On March 7, 2012, the Court entered the *Stipulation and Agreed Order Between the Chapter 11 Trustee and the Statutory Creditors' Committee of MF Global Holdings Ltd., et al. Regarding Creditor Access to Information Pursuant to 11 U.S.C. §§ 105(a), 1102(b)(3) and 1103(c)*,[21] which sets forth the procedures for creditors' access to information and provides that a vendor be retained by the Committee to serve as administrative agent for the Committee website.

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[19] Docket No. 435.

[20] Docket No. 668.

[21] Docket No. 533.

As noted, the Committee selected Rust Consulting, Inc. to serve as administrative agent, subject to Court approval.

CHAPTER 11 TRUSTEE

I. APPOINTMENT OF CHAPTER 11 TRUSTEE

On November 21, 2011, the Initial Debtors and the Committee filed a joint emergency motion requesting that the Court direct the appointment of a chapter 11 trustee to reorganize and/or liquidate the Debtors' assets for the benefit of the Debtors' estates, their creditors, and other stakeholders.[22] The Debtors and the Committee believed that a court-appointed chapter 11 trustee would have the reputation, experience, and confidence to manage and coordinate the investigations of the various court-appointed administrators and regulators in the MF Global Group administrations, and would do so in a manner that is more efficient and cost effective than could be achieved by the debtors in possession. The Initial Debtors and the Committee also believed that the appointment of a chapter 11 trustee would be in the best interests of the Initial Debtors' estates and the stakeholders of those estates, allowing the trustee to aid in the management of, and facilitate, global cooperation with the various court-appointed administrators and regulators of the non-Debtors of the MF Global Group, as well as work with the Committee for the prompt recovery of assets for the benefit of creditors.

On November 22, 2011, the Court entered an order directing the appointment of a chapter 11 trustee.[23]

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[22] Docket No. 131.

[23] Docket No. 156.

On November 25, 2011, the U.S. Trustee appointed the Trustee, which appointment was approved by the Court and accepted by the Trustee on November 28, 2011 and December 2, 2011, respectively.[24]

II. TRUSTEE'S PROFESSIONALS[25]

A. Freeh Group International Solutions, LLC

On January 23, 2012, the Trustee filed an application to retain Freeh Group International Solutions, LLC ("**FGIS**") as his business and operations advisors, *nunc pro tunc* to November 28, 2011,[26] to (i) manage the facilitation and coordination of information and data exchange between the various worldwide administrations, (ii) coordinate workflow administration between the Trustee's professionals, the Committee and its professionals, and the various worldwide administrations, (iii) assist the Trustee with the day-to-day management of the bankruptcy process, including evaluation of strategic and tactical options with respect to the liquidation proceeding respecting MFGI under the Securities Investor Protection Act of 1970, 15 U.S.C. § 78aaa, *et seq.*, as amended ("**SIPA**"), and various insolvency administrations throughout the world, as well as management of the wind-down of the Debtors' operations, and (iv) assist the Trustee in undertaking additional tasks that the Court may direct, to the extent those tasks are consistent with these delineated services. As part of the above tasks, FGIS formulates for the Trustee strategies for the cost-effective utilization of existing company personnel and the integration of the company's staff with the financial advisory team and other professionals retained in the Chapter 11 Cases.

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[24] Docket Nos. 168, 170, 210.

[25] The Trustee's professionals have agreed, at the request of the Trustee, to a 10% reduction of their hourly rates.

[26] Docket No. 390.

On April 5, 2012, the Trustee and the U.S. Trustee entered into a stipulation regarding the retention and employment of FGIS,[27] and on April 10, 2012, the Court entered an order authorizing such retention.[28]

B. Freeh Sporkin & Sullivan, LLP

On January 23, 2012, the Trustee filed an application to retain Freeh Sporkin & Sullivan, LLP ("**FSS**") as his investigative counsel, *nunc pro tunc* to November 28, 2011,[29] to (i) represent the Trustee in his dealings with various regulatory authorities, (ii) represent the Trustee in his dealings with various prosecutors' offices and law enforcement authorities, (iii) represent the Trustee in his dealings with various U.S. House and Senate Committees and Sub-Committees, (iv) coordinate information requests and responses to all regulators, congressional committees, prosecutors' offices, lender groups, and other parties in interest in the bankruptcy process, (v) assist the Trustee in his investigation of the acts and conduct of the Debtors, including conducting witness interviews, and (vi) assist the Trustee in undertaking additional tasks that the Court may direct, to the extent those tasks are consistent with these delineated services. On February 9, 2012, the Court entered an order authorizing the retention of FSS.[30]

C. Morrison & Foerster LLP

On January 23, 2012, the Trustee filed an application to retain Morrison & Foerster LLP ("**MoFo**") as general bankruptcy counsel to the Trustee, *nunc pro tunc* to November 28, 2011.[31] As general bankruptcy counsel, MoFo is responsible for (i) advising the Trustee with respect to

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[27] Docket No. 610.

[28] Docket No. 618.

[29] Docket No. 388.

[30] Docket No. 437.

[31] Docket No. 391.

his powers and duties as Trustee and in the continued management and operation of the businesses and properties of the Debtors, (ii) attending meetings and negotiating with creditors and parties in interest, (iii) advising the Trustee in connection with any sale of assets in the Chapter 11 Cases, (iv) taking all necessary action to protect and preserve the Debtors' estates, including prosecuting actions on behalf of the Trustee and the Debtors, defending any action commenced against the Trustee or the Debtors, and representing the Debtors' interests in negotiations concerning all litigation in which the Debtors are involved, including, but not limited to, objections to claims filed against the Debtors, (v) preparing all motions, applications, answers, orders, reports, and papers necessary to the administration of the Chapter 11 Cases, (vi) appearing before the Court, any appellate courts, and the U.S. Trustee, and protecting the interests of the Debtors before such courts and the U.S. Trustee, (vii) performing other necessary legal services to the Trustee in connection with the Chapter 11 Cases, including (a) analyzing the Debtors' leases and executory contracts and the assumption or assignment thereof, (b) analyzing the validity of liens against the Debtors, and (c) advising on corporate, litigation, and other legal matters, and (viii) taking all steps necessary and appropriate to bring the Chapter 11 Cases to conclusion. On February 9, 2012, the Court entered an order authorizing the retention of MoFo.[32]

D. Pepper Hamilton LLP

On January 23, 2012, the Trustee filed an application to retain Pepper Hamilton LLP (**"Pepper"**) as special counsel to the Trustee, *nunc pro tunc* to November 28, 2011,[33] to provide services related to (i) tax issues, including tax audits and refunds, and tax issues involving

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[32] Docket No. 440.

[33] Docket No. 385.

affiliates, employee benefit issues, and certain insurance matters affecting the Debtors' estates, (ii) WARN Act litigation matters and insurance litigation related to insurance claims, defenses and indemnities, (iii) miscellaneous real estate issues involving leases, furniture, fixture and equipment relating to the Debtors' relocation, and employment issues affecting the operation of the remaining business of the estate, and (iv) any matters as to which MoFo has a conflict involving JPM, BoA or UBS, A.G. and their affiliates. On February 9, 2012, the Court entered an order authorizing the retention of Pepper.[34]

E. Covington & Burling LLP

On March 27, 2012, the Trustee filed an application to retain Covington & Burling LLP ("**Covington**") as special insurance counsel to the Trustee, *nunc pro tunc* to November 28, 2011,[35] to (i) provide legal analysis and advice concerning the Trustee's rights and obligations with respect to the captive insurance subsidiary MFG Assurance Company Limited ("**MFGA**"), and policies issued to the Debtors by MFGA, (ii) review claims asserted under outstanding insurance policies and insurers' responses to such claims, and advise the Trustee with respect to such claims, (iii) represent the Trustee in the Chapter 11 Cases with respect to matters involving the scope or availability of insurance coverage or entitlement to proceeds under the policies, and (iv) confer with, and assist when appropriate, the Trustee's bankruptcy counsel concerning insurance coverage issues within the scope of Covington's special expertise, and pursue potential claims for indemnification or reimbursement under such policies on behalf of the Trustee. On April 12, 2012, the Court entered an order authorizing the retention of Covington.[36]

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[34] Docket No. 441.

[35] Docket No. 597.

[36] Docket No. 627.

SUBSEQUENT CHAPTER 11 FILINGS

I. MF GLOBAL CAPITAL LLC, MF GLOBAL FX CLEAR LLC, MF GLOBAL MARKET SERVICES LLC, AND MF GLOBAL HOLDINGS USA INC.

A. Petition Date and First Day Motions

The commencement of the Chapter 11 Cases of Holdings Ltd. and FinCo severely impacted certain of their U.S. affiliates. Since the October Petition Date, the Debtors have been discontinuing their operations and winding down their former businesses.

To avoid the depletion of assets with no attendant benefit, the Unregulated Debtors filed voluntary petitions under chapter 11 of the Bankruptcy Code on December 19, 2011 (the "**December Petition Date**").

To facilitate the ongoing orderly wind-down of the other Debtors and their non-debtor affiliates, Holdings USA filed a voluntary petition under chapter 11 of the Bankruptcy Code on March 2, 2012 (the "**March Petition Date**").

The Trustee filed the following first day motions on behalf of the Subsequent Debtors to ease their transition to chapter 11 and cause minimum interruption or disruption to their businesses or loss of productivity or value.

1. Joint Administration.

The Trustee requested joint administration of the Chapter 11 Cases of the Subsequent Debtors with the jointly administered Chapter 11 Cases of the Initial Debtors to reduce costs and facilitate the administrative process by avoiding the need for duplicative notices, applications, and orders. On December 21, 2011 and March 6, 2012, the Court entered orders granting joint administration of the Initial Debtors' and the Subsequent Debtors' cases.[37]

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[37] Docket Nos. 298, 528.

2. Application of Certain Orders to the Subsequent Debtors.

On each of the December Petition Date and the March Petition Date, the Trustee requested entry of an order making certain of the orders entered in the Chapter 11 Cases of the Initial Debtors applicable to the Subsequent Debtors to avoid unnecessary duplication and expenses to the Subsequent Debtors and their estates.[38] These orders included and/or involved the appointment of the Trustee as the chapter 11 trustee of each of the estates, the retention of the professionals discussed above for each of the estates, and various other motions filed in the Initial Debtors' cases. On December 23, 2011 and March 7, 2012, the Court entered orders declaring these previous orders to be applicable to the Subsequent Debtors.[39]

3. Cash Management, Business Forms, and Intercompany Transfers.

The Subsequent Debtors requested (i) a waiver of the requirement in the U.S. Trustee Guidelines that pre-petition bank accounts be closed and new post-petition bank accounts be opened, (ii) authority to maintain cash management systems, (iii) authority to continue to use all business forms existing immediately prior to the December and March Petition Dates, without reference to the Subsequent Debtors' status as debtors in possession, provided that the Subsequent Debtors would use their reasonable best efforts to refer to their status as debtors in possession on all checks issued after the commencement of the Subsequent Debtors' Chapter 11 Cases and on other physical business forms after the Subsequent Debtors' existing stock was exhausted, and (iv) authority to continue intercompany transactions among the Subsequent Debtors and accord superpriority status to all post-petition intercompany claims. The Court entered various interim orders and final orders authorizing the Subsequent Debtors to continue

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[38] Docket Nos. 293, 509.

[39] Docket Nos. 303, 534.

using their existing bank accounts, cash management system and business forms, and to continue intercompany transactions among the Subsequent Debtors, according superpriority status to all post-petition intercompany claims.[40]

4. Employee Compensation, Expense Reimbursement, and Withholding and Payroll-Related Taxes.

The Trustee determined that the Subsequent Debtors had incurred certain Pre-petition Employee Obligations (as defined below) that remained unpaid as of the December Petition Date. To minimize the personal hardship on the employees, and to maintain the employees' morale during the Chapter 11 Cases, the Trustee requested:

> (i) authority to pay and honor various pre-petition employee-related obligations of the Subsequent Debtors (collectively, the "**Pre-Petition Employee Obligations**") to or for the benefit of their employees, for compensation and expense reimbursements under all plans, programs and policies maintained by the Subsequent Debtors prior to the December and March Petition Dates (the "**Benefit Programs**");[41]
>
> (ii) confirmation that the Trustee is permitted, but not required, to pay any and all local, state, and federal withholding and payroll-related taxes relating to pre-petition periods, whether withheld from employees' wages or paid directly by the Trustee, to the applicable governmental authorities;
>
> (iii) confirmation that the Trustee is permitted to pay to third parties any and all amounts deducted from employee paychecks for payments on behalf of employees for garnishments, support payments, tax levies, bankruptcy payments, savings programs, and other similar programs;
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> (iv) an order directing all banks to honor pre-petition checks, ACH debits, draw-downs, or other forms of funds transfers and

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[40] Docket Nos. 269, 378, 529, 625.

[41] These Benefits Programs include, without limitation, plans, programs, policies and agreements providing for (i) wages, salaries, contractual compensation, and other accrued or incurred compensation; (ii) workers' compensation obligations; (iii) employee health benefits; and (iv) retirement benefits. The Trustee stated that no individual employee was to receive payment in excess of $11,725 for pre-petition amounts owed.

> disbursements for payment of the Subsequent Debtors' Pre-Petition Employee Obligations;
>
> (v) confirmation that the Trustee is permitted to take the necessary administrative actions to cause the 401(k) plan administrator or other benefits administrators, to the extent necessary, to terminate the 401(k) plan and other unnecessary benefits plans and/or programs; and
>
> (vi) authority to continue the post-petition payroll processing and administration of any Benefit Programs and Pre-Petition Employee Obligations that are administered or paid through a third-party administrator or provider, and pay any pre-petition claims of such administrators in the ordinary course of business.

The Court entered several interim and final orders granting this relief.[42]

B. Appointment of Chapter 11 Trustee

On December 23, 2011, the Trustee was appointed as chapter 11 trustee of the estates of the Unregulated Debtors.[43] This appointment was approved by the Court and accepted by the Trustee on December 27, 2011.[44]

On March 8, 2012, the Trustee was appointed as chapter 11 trustee of the estate of Holdings USA.[45] This appointment was approved by the Court on March 8, 2012 and accepted by the Trustee on March 12, 2012.[46]

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[42] Docket Nos. 297, 551, 576, 626.

[43] Docket No. 304.

[44] Docket No. 306, 307.

[45] Docket No. 546.

[46] Docket Nos. 548, 557.

C. Brief Description of the Businesses

1. Capital.

Capital is a New York limited liability company that provided foreign exchange, prime brokerage, and energy and credit default swaps.

2. FX Clear.

FX Clear is a New York limited liability company that provided foreign exchange execution and clearing services.

3. Market Services.

Market Services is a New York limited liability company that entered into matched principal trading of energy and agricultural products.

4. Holdings USA.

Holdings USA is a New York corporation that provided administrative services to Holdings Ltd. and its U.S. subsidiaries.

DEBTORS' OPERATIONS

I. DESCRIPTION OF GLOBAL OPERATIONS

Prior to the October Petition Date, the MF Global Group, through its regulated and unregulated B/Ds and FCMs, was one of the world's leading brokers in markets for commodities and listed derivatives. The MF Global Group provided access to more than seventy exchanges globally and was a leader by volume on many of the world's largest derivative exchanges. The MF Global Group also was an active broker-dealer in markets for commodities, fixed income securities, equities, and foreign exchange.

The MF Global Group was headquartered in the United States and had operations in, among other countries, the United Kingdom, Australia, Singapore, India, Canada, Hong Kong,

Japan and Taiwan. A copy of the MF Global Group's organizational chart is annexed hereto as Exhibit B. The MF Global Group's priority was to serve the needs of its diversified global client base, which included a wide range of institutional asset managers and hedge funds, professional traders, corporations, sovereign entities, and financial institutions. The MF Global Group also offered a range of services for individual traders and introducing brokers.

The MF Global Group derived revenues from three main sources: (i) commissions generated from execution and clearing services; (ii) principal transactions revenue, generated both from client facilitation and proprietary activities; and (iii) net interest income from cash balances in client accounts maintained to meet margin requirements, as well as interest related to the MF Global Group's collateralized financing arrangements and principal transactions activities. For fiscal year 2011, the MF Global Group generated total revenues of approximately $2.2 billion, revenues net of interest and transaction-based expenses of approximately $1.1 billion, and incurred a net loss of $81.2 million.

II. U.S. DEBTORS

A. Attrition of Employees.

Prior to the October Petition Date, the MF Global Group employed approximately 2,870 employees worldwide, with approximately 1,300 employees in the United States. Approximately 250 of the U.S. employees were employed by the Debtors, while the remaining U.S.-based employees worked for MFGI. In the period immediately following the commencement of the Initial Debtors' Chapter 11 Cases, however, the Debtors began the rapid wind-down of their former operations, quickly reducing employee headcount and other costs and taking additional actions to preserve the assets of their estates for the benefit of stakeholders. Holdings Ltd. has been able to retain its President, Chief Financial Officer and General Counsel,

who have remained to assist the Trustee with the wind-down of the Debtors' estates. By December 2011, the Debtors had 30 other employees remaining as a result of the headcount reductions.

Since December 2011, 17 employees have left the Debtors' employment to pursue other opportunities. The loss of these employees had a considerable negative impact on the Debtors. As time passes, employees continue to leave the Debtors in favor of new opportunities and greater job security rather than assist the Debtors in the wind-down of their affairs.

The remaining employees perform a variety of critical functions necessary for an orderly wind-down, a successful chapter 11 liquidation process, and compliance with the various obligations required under the Bankruptcy Code, the Bankruptcy Rules, the Local Rules and the Internal Revenue Code. The remaining employees are vital to the operations of the Debtors and implementation of the orderly wind-down during the pendency of the Chapter 11 Cases. The remaining employees' positions fall into the following descriptions:

- Finance / General Accounting
- Cash Management
- Tax
- Accounting Systems
- Information Technology
- Legal / Insurance
- Transactional Finance
- Restructuring Communications

The remaining employees have essential knowledge and skills required to assist with the efficient and effective wind-down the Debtors' estates. This includes, but is not limited to, knowledge of investment positions to be unwound to maximize value to the estates; knowledge of historical financial and tax reporting and cash management systems; knowledge of intercompany relationships and receivables and payables balances; knowledge of complex legal structures and U.S. tax filing requirements; familiarity with important insurance issues affecting

the Debtors; and knowledge of information technology infrastructure and systems application needs. The remaining employees' knowledge and unique skill sets will enable the Trustee to complete the many tasks mandated by the Bankruptcy Code or that are otherwise necessary in the wind-down of the Debtors' operations and the liquidation of their assets.

The remaining core group of employees also have assumed numerous finance and accounting functions previously provided by employees of MFGI, including certain cash management, payroll and accounts payable accounting and processing for the Debtors. These employees also have assisted with federal and state tax compliance and bankruptcy administration responsibilities, including the preparation of monthly operating reports and the preparation of the Schedules for filing in the Debtors' cases. Moreover, using the Debtors' analysis of intercompany balances as of October 31, 2011, which was made possible through the work and knowledge of the remaining employees, as detailed below, the Trustee is actively pursuing recoveries against former affiliates and has filed or is in the process of filing numerous and substantial claims against certain of the Debtors' domestic and foreign affiliates that are in insolvency proceedings in their local jurisdictions. These employees have shared a wealth of knowledge, which has allowed the Trustee and his professionals to organize and understand quickly the information necessary to create and execute strategies for the orderly liquidation of these estates. This would not have been possible, or certainly could not have been accomplished as quickly or as cost-effectively, without the institutional knowledge of and assistance from the Debtors' employees on a daily basis.

B. Real Estate and Leases.

Prior to the commencement of the Chapter 11 Cases, the Debtors maintained offices at 717 Fifth Avenue, New York, New York 10022 (the related lease is referred to herein

as the "**717 Lease**"). Due to their changed financial circumstances and increasing employee attrition rate, the Debtors determined that they no longer needed to maintain an office of that size. In November 2011, the Debtors terminated the 717 Lease and moved into temporary office space located at 1350 Avenue of the Americas, New York, New York 10019. As of March 1, 2012, the Debtors entered into a lease to maintain their offices at 142 West 57th Street, New York, New York 10019 (the "**57th Street Lease**"). The 57th Street Lease terminates on June 29, 2013. By terminating the 717 Lease and entering into the 57th Street Lease, the Debtors have reduced their rent obligations by approximately $9 million on an annual basis.

C. Pre-petition Debt Facilities

1. Liquidity Facility.

Prior to the October Petition Date, Holdings Ltd. and FinCo (in this capacity, the "**Borrowers**")[47] entered into that certain five-year revolving credit facility dated as of June 15, 2007 (as amended, supplemented or otherwise modified from time to time, the "**Liquidity Facility**") with JPM, as administrative agent, and the several lenders from time to time that are parties thereto (collectively, the "**Liquidity Facility Lenders**"). On June 29, 2010, the Liquidity Facility was amended (i) to permit Holdings Ltd., in addition to certain of its subsidiaries, to borrow funds under the Liquidity Facility and (ii) to extend the lending commitments of certain of the Liquidity Facility Lenders by two years, from June 15, 2012 to June 15, 2014. Under the Liquidity Facility, the Liquidity Facility Lenders made available to the Borrowers the aggregate principal amount of approximately $1.2 billion, $1.172 billion of which was drawn as of the October Petition Date.

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[47] Holdings Ltd. was named as one of the Borrowers. Holdings Ltd. changed its jurisdiction of incorporation from Bermuda to the State of Delaware and has continued its existence as a corporation organized under the laws of the State of Delaware under the name of MF Global Holdings Ltd.

2. Secured Facility to MFGI.

On June 29, 2011, MFGI entered into a $300 million 364-day secured revolving credit facility (the "**MFGI Secured Facility**") with a syndicate of lenders. The Trustee understands that, although the MFGI Secured Facility is not fully drawn, MFGI borrowed a substantial amount on the facility as of the October Petition Date. The SIPA Trustee has not provided a consistent answer regarding the exact amount outstanding on the MFGI Secured Facility as of the October Petition Date.

JPM is the administrative agent under the MFGI Secured Facility. The MFGI Secured Facility is secured by eligible collateral that was held by MFGI. The Trustee believes that the borrowings under the MFGI Secured Facility were over-collateralized by securities pledged by MFGI. However, the SIPA Trustee has not provided any further details to allow the Trustee to ascertain the level of overcollateralization. Holdings Ltd. and FinCo provided unsecured guarantees of MFGI's obligations under the facility.

3. Unsecured Convertible Notes.

Holdings Ltd. owes approximately $287.5 million in unsecured debt under certain 1.875% Convertible Senior Notes due 2016 (the "**1.875% Convertible Notes**"). The 1.875% Convertible Notes mature on February 1, 2016 and are convertible at the option of the holders prior to August 1, 2015 upon the occurrence of certain events relating to the price of Holdings Ltd.'s common stock or various corporate events.

Holdings Ltd. also has outstanding approximately $78.6 million in aggregate principal amount of 9.00% Convertible Senior Notes due 2038 (the "**9% Convertible Notes**"). The 9% Convertible Notes mature on June 20, 2038 and are convertible at the option of the holders at any

time prior to the maturity date. Upon conversion, Holdings Ltd. must pay or deliver cash, common stock or a combination thereof.

In July 2011, Holdings Ltd. raised $325 million in aggregate principal amount of 3.375% Convertible Senior Notes due 2018 (the "**3.375% Convertible Notes**," and, together with the 1.875% Convertible Notes and the 9% Convertible Notes, the "**Convertible Notes**"). In August 2011, Holdings Ltd. also launched and priced its first senior unsecured debt offering, issuing $325,000,000 in five-year 6.25% senior notes (the "**Senior Notes**"). Holdings Ltd. used a portion of the net proceeds from these offerings to repurchase a portion of its existing 9% Convertible Notes, repaid a portion of its outstanding permanent indebtedness under the Liquidity Facility, and used the remainder for general corporate purposes. Wilmington Trust, N.A. is the indenture trustee for each of the Convertible Notes and the Senior Notes.

D. Equity Interests

As of June 30, 2011, there were 1,500,000 shares of Series A Preferred Stock in Holdings Ltd. issued and outstanding to J.C. Flowers. Also as of June 30, 2011, 403,550 shares of Series B Preferred Stock were outstanding.

E. Use of Cash Collateral

In the period immediately following the commencement of the Initial Debtors' Chapter 11 Cases, the Initial Debtors began the rapid wind-down of their former operations, swiftly reducing employee headcount and other costs and taking additional actions to preserve the assets of their estates for the benefit of stakeholders. The Initial Debtors simultaneously focused on obtaining debtor in possession financing to fund an orderly wind-down of their estates. Despite their best efforts and extensive negotiations with potential lenders, the Debtors were unable to secure debtor in possession financing. The Initial Debtors did secure an interim Cash Collateral

agreement through a stipulated order with JPM, the administrative agent to the lenders under the Liquidity Facility, which, along with the recovery of unencumbered, liquid assets, provided the Initial Debtors with $8 million and allowed them to continue wind-down operations. Immediately after the appointment of the Trustee, the Initial Debtors entered into negotiations with JPM to increase the available Cash Collateral for use by the Initial Debtors to fund the Debtors' operations. Thereafter, the Initial Debtors reached an agreement with JPM for the consensual use of approximately $21.3 million in Cash Collateral through and until September 30, 2012. The Court approved the terms of the stipulation and entered a final order on December 14, 2012 (the "**Final Cash Collateral Order**").[48] At the time of the Final Cash Collateral Order, the Initial Debtors had recovered sufficient funds to offset the Cash Collateral previously used.

As a part of the Court's written opinion issued with the Final Cash Collateral Order, the Court ordered the Trustee to conduct an investigation into whether funds of the customers of MFGI that should have been segregated pursuant to CFTC and SEC rules had been commingled with the Debtors' Cash Collateral in the JPM Cash Collateral account. After the Trustee conducted an investigation, the Trustee issued his report on February 16, 2012 that determined that none of the funds in the JPM account were commingled funds.[49] The SIPA Trustee (as defined below) did not disagree with the conclusion reached by the Trustee's investigation.

MF GLOBAL INC.

On the October Petition Date, the Securities Investor Protection Corporation ("**SIPC**") began the orderly wind-down of MFGI when it filed a complaint in the United States District Court for the Southern District of New York (the "**District Court**") for the liquidation of

[48] Docket Nos. 272, 275.

[49] Docket No. 451.

MFGI.[50] At that time, SIPC moved for an order determining that the customers of MFGI were in need of the protections afforded under SIPA.[51] The District Court granted the order (the "**SIPA Proceeding**")[52] and thereafter transferred the SIPA Proceeding to this Court. The case caption and case name were changed to reflect its status as a liquidation proceeding in this Court. The case is now known as *In re MF Global Inc.*, Case No. 11-2790 (MG) SIPA.[53]

I. SIPA TRUSTEE AND PROFESSIONALS

SIPC appointed James W. Giddens (the "**SIPA Trustee**") as trustee for the liquidation of MFGI. The SIPA Trustee then hired his firm, Hughes Hubbard and Reed, LLP as counsel. The SIPA Trustee also has retained Ernst & Young and Deloitte as consultants and forensic accountants to aid him in investigating the details of the collapse of MFGI, and the impact of the MF Global Group's collapse on MFGI, as well as determining the claims customers and creditors have against MFGI, and, ultimately, recovering and distributing MFGI's assets to customers and creditors pursuant to the priority scheme established by statute. To assist the SIPA Trustee with matters in Europe, he retained Slaughter and May as U.K. counsel. Blake, Cassels & Graydon LLP was retained as Canadian counsel. In addition, the SIPA Trustee retained Haynes and Boone, LLP as conflicts counsel.

II. SIPA TRUSTEE'S DUTIES UNDER SIPA

Pursuant to 15 U.S.C. § 78fff-1, the SIPA Trustee has the same fiduciary duties as a chapter 7 trustee, as long as those duties do not conflict with SIPA. The statute states: "[t]o the extent consistent with the provisions of this chapter or as otherwise ordered by the court, a

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[50] *In re MFGI Inc.*, Case No. 11-02790 (MG) SIPA Docket No. 1.

[51] *Id.*

[52] *Id.*

[53] *In re MFGI Inc.*, Case No. 11-02790 (MG) SIPA Docket No. 2.

trustee shall be subject to the same duties as a trustee in a case under chapter 7 of title 11." Chapter 7 of the Bankruptcy Code requires the SIPA Trustee to, among other things, "furnish such information concerning the estate and estate administration as is requested by a party in interest." 11 U.S.C. § 704(a)(7).

Courts reviewing the interplay between SIPA and the Bankruptcy Code have determined that a SIPA trustee is bound to serve all of the creditors of an estate, not one particular subset over another. Indeed, these courts determined that a chapter 7 trustee's primary duty is not to any individual creditor or even any particular class of creditors, but to the estate as a whole. *Kusch v. Mishkin, et al. (In re Adler, Coleman Clearing Corp.)*, Case No. 95-08203(JLG), Adv. Proc. No. 95-9248(A), 1998 Bankr. LEXIS 1076, *49 (Bankr. S.D.N.Y. Aug. 24, 1998) (the court, in dismissing a breach of fiduciary duty claim against a SIPA trustee, stated that the trustee's duties to the estate prevail over the interests of any single customer). The *Adler, Coleman* court explained, in *dicta*, that to find that a SIPA trustee owes a greater fiduciary duty to customers than to general creditors would be "antithetical to the fundamental principles underlying our bankruptcy laws." *Id.*; *see also Germain v. Connecticut National Bank*, 988 F.2d 1323, 1330 n.7 (2d Cir. 1993) (stating that a chapter 7 trustee "is an officer of the court and owes a fiduciary duty both to the debtor and to the creditors as a group.").

The Debtors are (i) a securities customer of MFGI under SIPA regulations (owed approximately $556 million), (ii) a futures customer of MFGI under the CFTC regulations (owed approximately $90 million), (iii) both a secured and unsecured creditor of MFGI (owed approximately $1.667 billion), and (iv) the 100% equity holder of MFGI. The Debtors are the single largest creditor of MFGI. The Debtors' estates are highly dependent on the SIPA estate not only for information, but for the return of value to their creditors, who infused the SIPA

estate with in excess of $950 million in the month of October 2011 alone and more than $2 billion overall.

III. DESCRIPTION OF MFGI BUSINESS/ROLE IN GLOBAL OPERATIONS

MFGI was a wholly-owned subsidiary of Holdings USA and an indirect subsidiary of Holdings Ltd. MFGI provided brokerage services to customers and affiliates on United States securities and commodity futures exchanges and on overseas exchanges through affiliates or independent correspondent clearing brokers. MFGI also was engaged in principal and proprietary[54] trading in U.S government and corporate securities, futures, and purchase and resale agreements, as well as stock/bond borrow and stock/bond loan activities.[55]

MFGI is registered with the SEC as a securities B/D. As a securities B/D, MFGI was a member of several regulatory organizations, including FINRA, the Chicago Board Options Exchange (the "**CBOE**"), the Depository Trust Clearing Corporation, the National Securities Clearing Corporation, and the Fixed Income Clearing Corporation. The CBOE was the designated examining authority of the MFGI B/D's securities related activities.

MFGI also is registered with the CFTC as a FCM. As a FCM, MFGI was a member of the National Futures Association, an industry self-regulatory agency. Additionally, MFGI was a member of the CME, the Chicago Board of Trade, the New York Mercantile Exchange, the Intercontinental Exchange, the Kansas City Board of Trade, and the Minneapolis Grain Exchange. The CME was the MFGI FCM's designated self-regulatory organization.

Beginning in February 2011, MFGI was one of 20 "primary dealers" to the Federal Reserve Bank of New York (the "**Federal Reserve**"). Designation as a "primary dealer"

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[54] *See* Annex 1 ¶ 1.

[55] *See* Annex 1 ¶ 7 for an explanation of stock/bond borrow and stock/bond loan activities.

enabled MFGI to serve as counterparty to the Federal Reserve in open-market operations, participate directly in U.S Treasury auctions, and provide analysis and market intelligence to the Federal Reserve's trading desks.

A. Repos-To-Maturity

In or around September 2010, the MF Global Group began aggressively acquiring long positions in European sovereign debt securities in MFGI as part of its proprietary trading activities. MFGUK acted as agent for the acquisitions, including the repurchase transactions ("**Repos**") to finance the purchases, and also cleared the trades since it was the only member of the MF Global Group that was a member of the relevant clearinghouses, such as the LCH.Clearnet Ltd. (in London) or LCH.Clearnet SA (in Paris) (collectively, "**LCH Clearnet**") or Eurex (together with LCH Clearnet, the "**Exchanges**"). Therefore, MFGUK served as the "counterparty" to MFGI in these transactions.

To finance the MF Global Group's sovereign debt purchases, MFGUK would enter into back-to-back Repo transactions consisting of two legs -- a Repo leg with third parties to finance the acquisition and a reverse Repo leg, with MFGI to finance MFGI's long position.[56] By entering into the two offsetting back-to-back Repos, MFGUK was "flat" to the market and did not bear any of the associated risk that may have resulted from fluctuations in the market value of the European sovereign debt positions. As a result, the economic risk of ownership was transferred from MFGUK to MFGI.

Under the terms of the Repos with third parties, MFGUK agreed to sell to the third party (and the third party agreed to purchase) European sovereign debt securities while MFGUK simultaneously agreed to repurchase those securities from the third party at an agreed upon

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[56] A repurchase agreement, from the viewpoint of the party obtaining financing, is referred to as a Repo and a reverse Repo is from the perspective of the party providing financing.

repurchase price, on a date falling immediately prior to the maturity date of the securities.[57] MFGUK and the third parties entered into the Repos either on a bilateral basis or cleared the transactions through the Exchanges. In the cases where an Exchange cleared the Repo, the Exchange would become the counterparty to the original parties under the Repo. MFGUK would then look to the Exchange, and not the financing counterparty, to satisfy the financing counterparty's obligations under the Repo trade (*i.e.*, delivery of securities to MFGUK upon maturity of Repo against payment by MFGUK of Repo financing).[58] MFGUK posted the initial margin with the Exchanges to finance the leveraged long positions in European sovereign debt.

Under the terms of MFGUK's reverse Repo with MFGI, MFGI agreed to sell to MFGUK various European sovereign debt securities, while MFGI simultaneously agreed to repurchase the securities from MFGUK at an agreed upon repurchase price, on a date falling immediately prior to the maturity date of those securities. The reverse Repo transactions were governed by the master securities sale and repurchase agreement previously entered into between MFGI and MFGUK, dated July 19, 2004 (substantially in the form of the Global Master Repurchase Agreement published by the International Capital Market Association) ("**GMRA**") and the confirmations that provided the details for each of the individual trades entered into thereunder. Under the terms of the reverse Repos, MFGI would post initial margin with MFGUK to finance the leveraged long positions in European sovereign debt. MFGI's purchase of the sovereign debt positions, with the associated financing from MFGUK, resulted in the benefits and risks of economic ownership shifting from MFGUK to MFGI.

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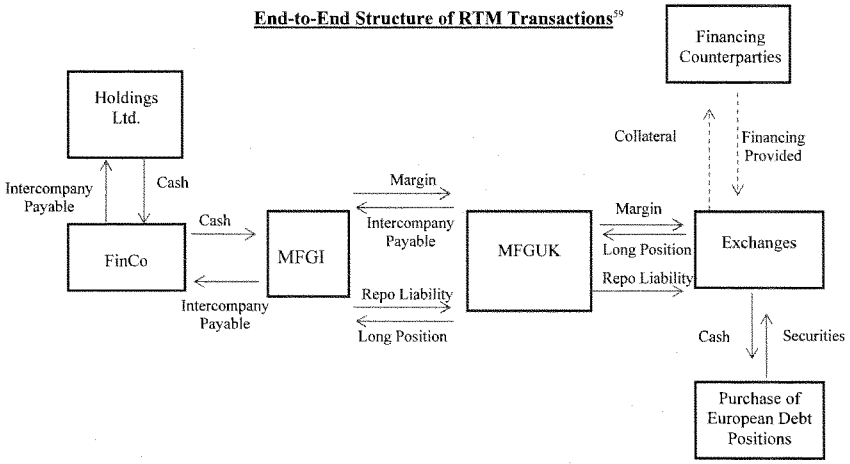
[57] Repo transactions where the maturity date of the financing is within two days of the maturity of the underlying security are commonly referred to as RTMs. *See* Annex 1 ¶ 3 for a more detailed explanation of RTM transactions.

[58] LCH Clearnet acted as a clearing house (or exchange) and was essentially an intermediary that helped mitigate counterparty credit risk. LCH Clearnet played a similar role as that of the Fixed Income Clearing Corporation in the United States.

At the time the MF Global Group began acquiring the European sovereign debt positions, each of the sovereign debt issuances was rated as investment grade (Moody's rated A or better). MFGUK, therefore, was required by the clearinghouses or third parties who were the counterparties to their trades to post only a small initial margin payment -- as low as 3% of the face amount of the securities to be financed through the RTM -- and in turn required only this amount from MFGI. This allowed the MF Global Group to build a highly leveraged portfolio. MFGI met its initial margin obligations to MFGUK and subsequent variation margin calls as required by MFGUK using MFGI's own liquidity as well as intercompany loans provided by FinCo. The below diagram visualizes the end-to-end structure of the Repo to Maturity transactions prior to August 2011.

End-to-End Structure of RTM Transactions[59]



Under the terms of a Repo transaction, the financing counterparty (*e.g.*, MFGUK) generally has the right to require the borrower under the Repo (*e.g.*, MFGI) to post additional

[59] *See* Annex 1 ¶ 8 for an explanation of intercompany payable.

cash or securities as collateral resulting from decreases in the market value of the collateral underlying the Repo transaction. To accomplish this, the financing counterparty would issue a margin call. Accordingly, financing the acquisition of securities through the use of Repos had the potential to create a significant risk to the liquidity of MFGI and the MF Global Group as a whole.[60] A summary of the MF Global Group's net sovereign debt holdings is described in the below diagram.

The MF Global Group's RTM Summary as of 9/30/2011

	Italy [1]	Spain [1]	Belgium	Portugal	Ireland	Net Total
Net size ($ in millions)	$3,213	$1,111	$603	$997	$368	$6,292
% of total portfolio	51%	18%	10%	16%	6%	100%
Weighted Avg. Maturity of Long Positions	Dec 2012	Oct 2012	Dec 2012	Mar 2012	Feb 2012	Oct 2012
Maturity Schedule	6% - Mar 2012	12% - Apr 2012	100% - Dec 2012	3% - Oct 2011	18% - Nov 2011	5% - Nov 2011
	3% - Aug 2012	61% - Oct 2012		36% - Nov 2011	82% - Mar 2012	7% - Mar 2012
	91% - Dec 2012	27% - Dec 2012		61% - Jun 2012		3% - Apr 2012
						7% - Jun 2012
						2% - Aug 2012
						15% - Oct 2012
						61% - Dec 2012

[1] Includes France's short positions of $1.3 billion as proxy hedges, split equally between Italy and Spain.
Source: Second Fiscal Quarter 2012 Results Investor Presentation

As the value of the MF Global Group's European sovereign debt positions deteriorated in the Summer and Fall of 2011, MFGUK -- and consequently MFGI (and later FinCo) -- were required to post additional variation margin. In late October 2011, as the MF Global Group's credit ratings were downgraded, the Exchanges also required additional initial margin. MFGUK, as counterparty to the Exchanges, was responsible for meeting the Exchanges' margin calls, which at certain points were issued on a daily basis. MFGUK would then issue margin calls to

[60] *See* Annex 1 ¶ 3 for an explanation of the potential for liquidity risk posed by these transactions.

MFGI, which the Trustee believes were funded in whole or in part by loans from FinCo. As the Trustee understands it, MFGUK made one or more "house" margin calls to MFGI that were in excess of MFGUK's margin requirements with the Exchanges in order to cover potential intraday liquidity risk on margin calls to MFGI and to satisfy MFGUK's regulators.

Two approaches taken to hedge the European sovereign debt portfolio and to limit the margin posting requirements therewith were: (i) MFGUK shorted $1.3 billion of French sovereign debt through the Exchanges as a proxy-hedge against its exposure to Italian and Spanish sovereign debt; and (ii) MFGUK entered into trades with counterparties, including overnight, short-term and medium-term reverse Repos that were cleared through the Exchanges to reduce margin requirements ("**Margin Reduction Trades**") (with a back-to-back Repo transaction into MFGI).[61]

B. The RRTM

In order to ensure that MFGI was in compliance with its capital requirements as of August 24, 2011, in late August 2011 MFGI entered into "back-to-back" reverse repo-to-maturity ("**RRTM**") transactions with FinCo for a portion of the RTM portfolio[62] pursuant to a master repurchase agreement dated January 6, 2011 between MFGI and FinCo (the "**FinCo MRA**") and the transaction confirmations thereunder. These trades effectively made FinCo the beneficial holder of €2.925 billion of Italian bonds. This strategy allowed the MF Global Group to transfer the economic benefits and risks from MFGI (a regulated entity) to FinCo (an unregulated entity), and thereby reduce MFGI's regulatory capital requirements. The below diagram shows the RRTM transactions between MFGI and FinCo.

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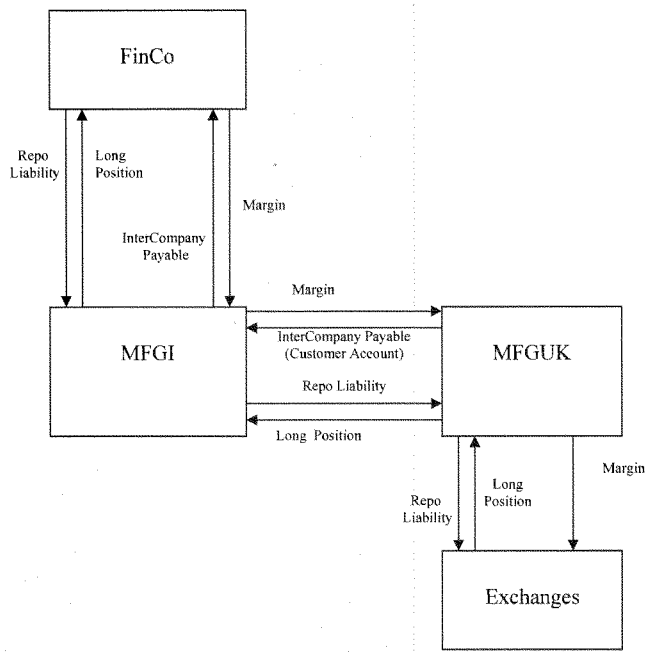
[61] *See* Annex 1 at ¶ 4 for an explanation of Margin Reduction Trades.

[62] *See* Annex 1 at ¶ 3 for an explanation of RRTMs.

MFGI RRTM Transaction



The SIPA Trustee has indicated that the RRTM was booked flat, meaning that the financing was equal to the underlying value of the securities position. The Trustee cannot verify that this information is correct because, despite the Trustee's request for all documents -- including confirmations issued under the master repurchase agreement between FinCo and MFGI, detailing the terms of the RRTM transactions -- the SIPA Trustee has yet to provide any such documents.

C. Pre-Petition Funding

The relationship between the Debtors and MFGI can be reduced to three distinct types of intercompany activities: (i) financing; (ii) trading and (iii) general corporate administration.

1. Financing.

a. Subordinated Debt Financing.

Holdings USA and FinCo provided a total of $600 million in subordinated debt financing (the "**Sub-Debt**") to MFGI prior to the October Petition Date. The Sub-Debt was memorialized in multiple loan agreements. The subordinated notes carried interest at the rate of 30-day LIBOR plus 500 basis points (5%). A summary of the outstanding loan obligations as of the October Petition Date is included in the table below.

Lender	CME/CBOE Loan Number	Effective Date	Maturity Date	Amount
Holdings USA	287-120706-0001	12/31/2007	6/28/2013	$65,000,000
Holdings USA	287-120707-0001	12/31/2007	9/30/2013	$65,000,000
FinCo	287-120701-0001	12/31/2007	expired	$0
FinCo	287-120702-0001	12/31/2007	6/29/2012	$130,000,000
FinCo	287-120703-0001	12/31/2007	3/30/2012	$130,000,000
FinCo	287-120704-0001	12/31/2007	expired	$0
FinCo	287-120705-0001	12/31/2007	9/30/2011	$50,000,000
FinCo	287-081001-0001	8/9/2010	7/31/2013	$0
FinCo	287-081001-002	8/10/2010	7/31/2013	$160,000,000
Total				**$600,000,000**

b. Intercompany Loans.

FinCo generally acted as the financing arm for the U.S. operations of the MF Global Group. FinCo provided substantial amounts of working capital financing to MFGI. In addition to the Sub-Debt, FinCo provided an additional $991 million in intercompany funding to MFGI (the "**Intercompany Loans**"). Substantially all of the Intercompany Loans ($875 million) were funded during October 2011. Again, although the Trustee has requested information relating to

the use of these funds from the SIPA Trustee on multiple occasions, the Trustee only recently received the MFGI bank account statements -- in raw data form -- and the Trustee still is awaiting information regarding the Securities and Futures accounts of MFGI. Therefore, the Trustee has limited access to information that would aid in determining the purposes of MFGI's funding requests. The Trustee believes that a portion of the Intercompany Loans (approximately $233 million to $293 million) was used by MFGI to fund variation margin payments to MFGUK during the ten days prior to the October Petition Date. Below is a schedule detailing the margin calls from MFGUK to MFGI during that timeframe.

Margin Statement

Margin Call Statement MF Global Inc - Collateral Financing Portfolio

As at COB:	28-Oct-11	27-Oct-11	26-Oct-11	25-Oct-11	24-Oct-11	21-Oct-11	20-Oct-11	19-Oct-11	18-Oct-11	17-Oct-11
Initial Margin Requirement	495,975,763	454,624,390	410,963,534	277,302,875	278,049,205	277,679,686	273,604,300		273,939,212	275,899,318
Variation Margin	199,344,353	182,811,558	185,592,415	188,277,470	182,979,874	174,800,604	173,978,422		167,180,609	151,003,397
Buffer margin for fx exposure	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000		5,000,000	5,000,000
Increase coverage	23,219,740	23,280,469								
Total Margin requirement	723,539,856	665,716,417	601,555,949	470,580,345	466,029,079	457,480,289	452,582,722		446,119,821	431,902,715
Collateral received	663,925,523	604,003,047	492,732,015	464,694,118	457,962,898	452,795,960	451,731,735		430,943,455	430,892,493
Additional Collateral Required	59,614,333	61,713,370	108,823,934	5,886,227	8,066,181	4,684,329	850,987		15,176,366	1,010,222
FX Rates	1	1	1	1	1	1	1		1	1
Change attributable to movement in FX Rate	1,675,841	15,397,744	(2,975,361)	(100,430)	823,043	n.a	n.a		n.a	n.a
For Reference:										
I.M. Breakdown	**28-Oct-11**	**27-Oct-11**	**26-Oct-11**	**25-Oct-11**	**24-Oct-11**	**21-Oct-11**	**20-Oct-11**	**19-Oct-11**	**18-Oct-11**	**17-Oct-11**
Eurex	122,303,820	101,486,439	97,908,521	98,729,580	98,761,993	98,676,172	97,341,174		97,377,072	98,066,691
LCH Clearnet SA	324,580,597	318,916,812	285,469,981	159,129,290	159,846,240	159,182,204	156,221,795		156,784,797	157,247,059
LCH SA fwd margin	37,345,178	22,282,810	10,991,748	11,094,572	11,087,738	11,063,861	11,256,792		10,946,410	11,734,066
LCH Clearnet Ltd	11,746,169	11,938,329	16,593,284	8,349,433	8,351,233	8,757,449	8,784,540		8,830,933	8,851,501
Total	495,975,763	454,624,390	410,963,534	277,302,875	278,049,205	277,679,686	273,604,300		273,939,212	275,899,318
V.M. Breakdown										
Eurex	13,764,761	9,717,223	17,035,399	16,677,226	17,107,177	16,480,844	16,371,063		19,123,032	15,418,817
LCH Clearnet SA	92,250,980	69,275,628	69,053,086	69,733,482	68,393,188	66,916,000	67,042,082		61,412,708	50,992,502
LCH Clearnet Ltd	93,551,632	106,431,756	98,390,637	100,548,637	95,296,346	89,594,614	88,843,948		87,174,875	87,285,593
Bilateral	(223,020)	(2,613,049)	1,113,293	1,118,125	2,183,164	1,809,145	1,721,329		(530,005)	(2,693,515)
	199,344,353	182,811,558	185,592,415	188,277,470	182,979,874	174,800,604	173,978,422		167,180,609	151,003,397

c. Margin Financing.

FinCo provided margin financing to certain MFGI customers. The purpose of this financing was to allow customers to acquire additional securities or futures positions. Generally,

the documentation memorializing the financing terms provided that the customers of MFGI granted FinCo a security interest in the customer's securities and/or futures accounts and MFGI, as custodian of the securities and/or futures accounts, acknowledged FinCo's security interest. The SIPA Trustee, however, made distributions to these margin customers irrespective of the FinCo security interest in the account. In certain instances, the SIPA Trustee actually disbursed more money to the margin borrowers than they were entitled to receive. The Trustee understands that this was a result of the SIPA Trustee calculating the net equity of the margin borrower's account without taking into account any outstanding loan obligation to FinCo. As a result, the SIPA Trustee actually distributed the Debtors' property to certain of the margin borrowers. The Trustee has sent letters to ten former customers of MFGI requesting that they repay the margin financing received from FinCo in the approximate aggregate amount of $36.9 million. As of the filing of this Report, FinCo has not received any funds back from these customers.

d. Repo Financing.

(i) HTM Repo.

In or around June 2009, Holdings Ltd. began acquiring a portfolio of securities classified on its balance sheet for account purposes as hold-to-maturity ("**HTM**")[63] and financed the purchases with Repo financing provided by the MFGI B/D. Each Repo was governed by the master repurchase agreement dated as of May 19, 2009 between Holdings Ltd. and MFGI and the confirmations issued detailing the specific transaction details (the "**Holdings Ltd. MRA**").[64]

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[63] *See* Annex 1 ¶ 5 for an explanation of HTMs.

[64] Although requested by the Trustee on multiple occasions, at this time, the Trustee has not received copies of any confirmations issued by the MFGI B/D under the Holdings Ltd. MRA detailing the salient terms of each HTM Repo financing transaction.

Initially, the FCM provided substantially all of the financing MFGI made available for the HTM portfolio. Later, the MFGI B/D diversified the financing of the HTM portfolio to include third party investors. The FCM was able to provide this financing because the HTM securities were eligible investments under CFTC Regulation 1.25 ("**Regulation 1.25**").[65] Pursuant to authority under Section 4(c) of the Commodity Exchange Act, the CFTC established a list of permitted investments under Regulation 1.25 that, prior to the October Petition Date, included general obligations issued by any enterprise sponsored by the United States, bank certificates of deposit, commercial paper, corporate notes, general obligations of a sovereign nation (but only to the extent that the FCM had balances in segregated accounts owed to its customers denominated in that country's currency) and interests in money market mutual funds. In addition, a FCM could buy and sell permitted investments pursuant to resale or repurchase agreements, including Repos entered into with an affiliate and so-called "in-house" transactions, *e.g.*, between the B/D and FCM businesses of the same legal entity. The Trustee understands that over time, the HTM portfolio was increasingly financed by third-party investors (as opposed to using FCM financing) via back-to-back Repo financing transactions entered into with counterparties by the MFGI B/D.

As of October 25, 2011, the HTM portfolio consisted of government agency securities and corporate bonds (mainly issued by financial institutions) with a market value of $8.644 billion (including accrued interest). The Repo financing associated with the HTM portfolio totaled $8.567 billion as of October 25, 2011. As a result, Holdings Ltd. had margin equity of $77 million in the Repo portfolio. The structuring of the HTM Repo is illustrated in the below diagram.

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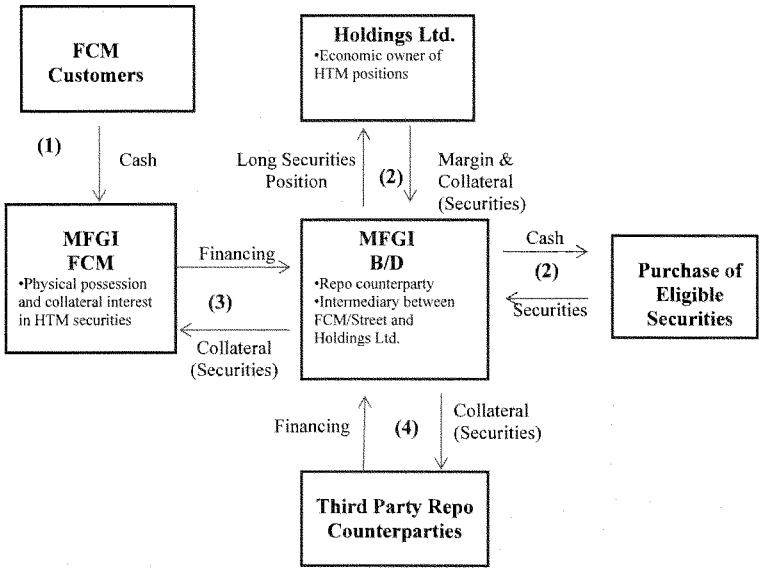
[65] *See* 17 CFR § 1.25.

Hold To Maturity Repo



(1) FCM customers posted cash (*i.e.*, margin) at the FCM to enable them to trade futures.

(2) Holdings Ltd. purchased $8.6 billion (market value as of October 25, 2011) of Regulation 1.25-eligible securities that formed the HTM portfolio from various third party counterparties. The purchase was made by the MFGI B/D side of the MFGI business on behalf of Holdings Ltd. Holdings Ltd. received economic ownership of the positions in exchange for initial margin and the posting of the securities back at MFGI as collateral.

(3) The purchase of eligible securities was financed partially using FCM customer funds. The MFGI B/D entered into intra-company Repos with the FCM, whereby securities were posted as collateral in exchange for financing. The FCM retained physical possession of the securities.

(4) The purchase of eligible securities also was financed partially by third parties. MFGI entered into repo transactions with third party repo counterparties, whereby securities were posted as collateral in exchange for financing.

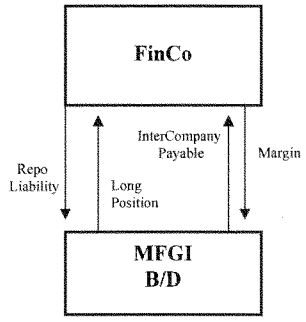
FinCo appears to have provided financing for some HTM positions. According to an October 28 report provided by the SIPA Trustee, there appears to have been $10.3 million (par value) of HTM positions that were not financed by the third-parties (the "**Street**") or with FCM funds and were instead financed through intercompany repos between MFGI and FinCo.

From October 25, 2011 until the October Petition Date, Holdings Ltd. undertook a massive liquidation of HTM positions with the goal of freeing up liquidity, during which time the HTM portfolio was reduced by about $7.2 billion to approximately $1.4 billion by October 31, 2011. The Trustee has requested information from the SIPA Trustee regarding the close-out pricing for both the HTM Portfolio and the back-to-back Repo positions the MFGI B/D entered into with the FCM or third parties. By reconstructing the wind-down of the HTM portfolio, the Trustee can determine the losses resulting from the precipitous liquidation of the HTM portfolio. The Trustee requires this information to determine the HTM portfolio's impact on the funding provided by FinCo to MFGI and the extent of the Debtors' claims against MFGI.

(ii) Box Repo

FinCo entered into Repo financing transactions with the MFGI B/D (the "**Box Repo**") where FinCo agreed to buy from the MFGI B/D various securities (the "**Box Portfolio**"), with a simultaneous agreement of the MFGI B/D to repurchase from FinCo those securities (or securities considered equivalent thereto) at a repurchase price the next day. This type of agreement is commonly referred to as an overnight Repo. The Box Repo transactions were governed by the terms of the FinCo MRA and the confirmations issued for each transaction entered into thereunder. The MFGI B/D held the securities comprising the Box Portfolio in custody for FinCo. The MFGI B/D had the right to substitute collateral of equivalent value in the Box Portfolio and the Box Repo was generally rolled-over on a daily basis; however, the securities that formed the Box Repo portfolio are identifiable. As of the October Petition Date, the MFGI B/D was obligated to repurchase the Box Repo collateral from FinCo for $177,715,443.11.

Box Portfolio Repo



2. Trading.

The Unregulated Debtors conducted certain trading activity, including futures, through MFGI (and also faced certain of its counterparties directly). In addition, a non-debtor wholly-owned subsidiary of Holdings Ltd., MF Global Special Investor LLC ("**Special Investor**"), also acquired a securities portfolio from MFGI and conducted its securities trading activities through MFGI.

3. General Administration.

As a global trading organization, the MF Global Group had integrated systems, including global accounting and tax systems and programs. Many of the MF Global Group's regulated entities also acted as clearing brokers and custodians for their affiliates. As a global organization, certain overhead costs and expenses for shared services that were incurred at the corporate level were allocated across the group in the ordinary course of their business. It was generally believed that system integration, as opposed to operating each of the affiliates in a silo, was a more cost-effective use of the MF Global Group's resources.

IV. CLAIMS FILED AGAINST THE SIPA ESTATE

Total Number of Claims Filed Against this Entity by the Debtors and their Non-Debtor Affiliates[66]: 68.

Total Value of Those Claims: $2,317,765,096.00.

On November 23, 2011, the Court entered an order establishing January 31, 2012 as the bar date for customers' claims against the SIPA estate and established June 2, 2012 as the general bankruptcy claims bar date.[67] The Debtors' estates filed 68 claims against MFGI totaling in excess of $2.3 billion.

Securities and Futures Claims Filed Against MFGI by the Debtors and their Non-Debtor Affiliates: 58.

Total Value of Those Claims: $646,798,448.00

General Unsecured Claims Filed Against MFGI by the Debtors and their Non-Debtor Affiliates: 10.

Total Value of Those Claims: $1,670,966,648.00 ($600 million in Sub-Debt claims)

The below chart reflects a more detailed breakdown of the claims filed by the Debtors and non-debtor affiliates.

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[66] In addition, contingent and unliquidated claims were filed by the Debtors against MFGI.

[67] *In re MFGI Inc.*, Case No. 11-02790 (MG) SIPA Docket No. 423.

Debtors' and Non-Debtor Affiliates' Claims Against MFGI

Claimant	Class of Claim	No. of Claims	Amount	Description
Holdings Ltd.	Securities Customer	1	$77,332,223	HTM
Holdings Ltd.	Securities Customer	1	Unliquidated	Trading
Holdings Ltd.	Futures Customer	3	Unliquidated	Trading
Holdings Ltd.	General Unsecured	1	$38,720,558	General
Holdings USA	General Unsecured	1	$36,585,647	General
Holdings USA	General Unsecured	1	$130,000,000	Sub-Debt
FinCo	Securities Customer	1	$127,151,670	RRTM, Box Repo[68]
FinCo	Futures Customer	10	$36,857,586	Margin Financing
FinCo	General Unsecured	1	$990,943,179	Loans
FinCo	General Unsecured	1	$552,948	General
FinCo	General Unsecured	1	$470,000,000	Sub-Debt
Special Investor	Securities Customer	21	$352,061,762	9/30 statements
Special Investor	Securities Customer	12	Unliquidated	Trading
Special Investor	Futures Customer	1	$140,841	Trading
Capital	Futures Customer	3	$28,236,299	Trading
Capital	General Unsecured	1	$3,733,828	Trading
Market Services	Futures Customer	3	$25,016,824	Trading
FX Clear	Securities Customer	1	Unliquidated	Trading
FX Clear	Futures Customer	1	$1,243	Trading
FX Clear	General Unsecured	1	$398,448	General
FX Clear	General Unsecured	1	$29,300	General
MFGA	General Unsecured	1	$2,740	General
Total		**68**	**$2,317,765,096**	

A. Legal Issues Related to the Debtors' Claims

1. Holdings Ltd. Securities Customer Claim Related to HTM Portfolio.

Holdings Ltd. filed a securities customer claim in an estimated amount of $77,332,223 relating to the HTM Repo transactions. These claims were estimated because, prior to the customer claims bar date, the Trustee was not in possession of an October account statement, but rather was relying on the Debtors' internal risk reports. The Trustee was not in possession of

[68] The total amount financed under the Box Repos was $177,715,443.11.

details confirming the liquidation of HTM securities that took place after September 25, 2011. Therefore, the Trustee determined that, out of an abundance of caution, Holdings Ltd. should file an estimated claim, subject to reconciliation of its books and records with those of the MFGI B/D, the counterparty to the HTM transactions. The SIPA Trustee has not yet provided the details confirming the liquidation of the HTM portfolio after October 25, 2011.

2. FinCo Repo Claim.

On May 18, 2012, the SIPA Trustee denied the FinCo claim related to the Repo transactions, including the RRTM and the Box Portfolio, when he sent the FinCo estate a letter of determination as to that claim. The SIPA Trustee stated that he denied FinCo's claim because, in his determination, the cash and securities upon which FinCo filed its claim are not customer property pursuant to SIPA. In addition, the SIPA Trustee indicated that FinCo's claims were being converted to general creditor claims. Moreover, FinCo's claim for $177,715,443.11 was being reduced to the liquidation value of $63,690,295.38, which appeared on FinCo's account statement as of October 31, 2011.

The Trustee will object to the SIPA Trustee's determination of the FinCo claim for several reasons. First, a number of courts have found that a participant in Repo transactions is a customer for SIPA proceedings. *In the Matter of Bevill, Bressler & Schulman Asset Management Corp.*, 67 B.R. 557 (D. N.J. 1986); *City of Elkins v. Charles Darwin Davidson (In re Swink & Company, Inc.)*, 142 B.R. 874 (Bankr. E.D. Ark. 1992). Second, the FinCo MRA is clear that the parties intended to treat the Box Repo transactions as true purchase and sale transactions, with MFGI holding the securities under the FinCo MRA in custody for FinCo's account. Third, both FinCo and MFGI accounted for these transactions distinctly from other

financings, secured or unsecured. Thus, the Trustee believes that the FinCo claims are customer claims under SIPA, with facts similar to those in *Bevill, Bressler* and similar cases.

Alternatively, if the Court finds that FinCo does not fall within the SIPA definition of a "customer," the Court should hold that MFGI, as custodian for the Box Repo securities, should turn over the Box Repo securities pursuant to Bankruptcy Code section 543. MFGI only has a possessory interest in the Box Repo securities, similar to that of a bailee, and thus the securities are not property of the SIPA estate under Bankruptcy Code section 541.

As previously discussed, many of the documents underlying the Box Repo transactions remain in the possession of the SIPA Trustee and have not been provided to the Trustee. Although the Trustee believes that FinCo's claim is a customer claim based on one of the two alternative theories summarized herein, the Trustee cannot be certain as to the determination of this claim.

3. FinCo RRTM Claim.

The SIPA Trustee has indicated that the RRTM was booked flat (*i.e.*, the Repo financing was equal to the underlying mark-to-market value of the long position at the time the Repo was transacted). Thus, according to the SIPA Trustee, MFGI's books and records reflect that MFGI did not require FinCo to post initial or variation margin with respect to the RRTM transactions. FinCo provided funding to MFGI to enable MFGI to meet initial and variation margin calls from MFGUK with respect to the RTM portfolio. As a result of FinCo entering into the RRTM transaction with MFGI, certain of the financing provided by FinCo to MFGI -- for purposes of meeting margin requirements -- should have been characterized as margin posted by FinCo to MFGI to support the RRTM transactions (as opposed to a financing). In addition, any additional margin required of MFGI by MFGUK related to the RRTM position should have been

characterized as margin posted by FinCo to MFGI rather than as an intercompany loan. Accordingly, it is the Trustee's belief that a portion of the intercompany loans FinCo provided to MFGI should be characterized as margin related to the RRTM position. The finance function of MFGI in Chicago, however, was responsible for booking the intercompany general ledger entries. Therefore, the Trustee believes that FinCo should have either a direct claim against MFGUK for the margin related to the RRTM position or, in the alternative, FinCo should be entitled to priority treatment as a customer of MFGI with a portion of the intercompany loan recharacterized to properly reflect its true nature (*i.e.*, a margin payment).

4. Special Investor Securities Customer Claims.

Special Investor filed securities customer claims in an estimated amount of $352,061,762.16, relating to twenty-one securities accounts. These claims were estimated because, prior to the customer claims bar date, the Trustee only possessed account statements as of September 30, 2011. On April 18, 2012, the SIPA Trustee rejected Special Investor's securities customer claims based upon an alleged subordination agreement, purportedly entered into between Special Investor and MFGI dated as of August 19, 2011. In the subordination agreement, Special Investor purportedly agreed to subordinate its claims to those of MFGI's customers and creditors.

In his denial letter, the SIPA Trustee valued the Special Investor securities claim at $43,768,836 as of October 31, 2011. The Trustee is continuing to investigate the propriety and enforceability of the purported subordination agreement referred to in the SIPA Trustee's denial letter. The Trustee will decide whether to object to the SIPA Trustee's claim determination upon completion of his investigation.

5. Futures Customer Claims.

On December 12, 2011, the SIPA Trustee, the CFTC and SIPC submitted memoranda,[69] pursuant to the Court's direction, setting forth their respective positions as to their expectations for the SIPA Trustee in allocating and distributing the property of the MFGI estate under the various statutory and regulatory provisions applicable to the SIPA Proceeding.[70] Each of the briefing parties argued that under the applicable regulations and statutes, all customer claims must be satisfied in full before property of the estate may be used to pay any general creditors' claims. In addition, the SIPA Trustee, the CFTC and SIPC argued that "insiders," who were also brokerage customers, are subordinated to public customers' claims.

On January 9, 2012, the Trustee filed his *Statement in Response to Briefing Regarding the Legal Principles and Framework for Allocation and Distribution of Customer Property*,[71] wherein the Trustee disputed the purported broad authority granted to CFTC to determine what constitutes "customer property."

All parties acknowledged that there are inconsistencies between the Bankruptcy Code and the Part 190 Regulations. The inconsistencies are highlighted in Bankruptcy Code sections 726 and 766, which addresses the priority scheme for distributions to general unsecured creditors in a Commodity Broker Liquidation, and the Part 190 Regulations. Bankruptcy Code section 766(j)(2) states:

> Except as provided in section 510 of this title if a customer is not paid the full amount of such customer's allowed net equity claim from

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[69] *In re MFGI Inc.*, Case No. 11-02790 (MG) SIPA Docket Nos. 724–726.

[70] The briefs state that the applicable statutes and regulatory provisions include 15 U.S.C.§ 78fff to 78fff-4, Bankruptcy Code sections 105(a) 764, and 766(c), and 17 C.F.R. § 190.01 through 190.10 (the "**Part 190 Regulations**").

[71] *In re MFGI Inc.*, Case No. 11-02790 (MG) SIPA Docket No.824.

> customer property, the unpaid portion of such claim is entitled to distribution under 726 of this title.

11 U.S.C. § 766(j)(2).

The Part 190 Regulations state:

> (a)(1) Customer property includes the following:
>
> > (ii) All cash, securities, or other property which:
> >
> > > (J) Is cash, securities or other property of the debtor's estate, including the debtor's trading or operating accounts and commodities of the debtor held in inventory, but only to the extent that the property enumerated in paragraphs (a)(1)(i)(E) and (a)(1)(ii)(A) through (a)(1)(ii)(H) of this section is insufficient to satisfy in full all claims of public customers.

17 C.F.R. § 190.08(a)(1)(ii)(J).

The potential conflict is actually no conflict at all. The Bankruptcy Code is a set of laws, while the Part 190 Regulations are merely a set of rules. Although rules can help to shape and aid laws, they cannot supersede or overtake them. One bankruptcy court has held just that. According to the Chief Judge for the Northern District of Illinois, when defining "customer property" under 17 C.F.R. § 190.08(a)(1)(ii)(J), the CFTC went beyond its rule making authority. *See In re Griffin Trading Co.*, 245 B.R. 291 (Bankr. N.D. Ill. 2000). The resulting definition of customer property was inconsistent with the plain language of the Bankruptcy Code. *Id.*[72] Moreover, the rule appears to be at odds with the statutory duties that the SIPA Trustee owes to both customers and creditors of MFGI. *See Adler Coleman*, 1998 Bankr. LEXIS, at *48.

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[72] The CFTC appealed the bankruptcy court's decision in *Griffin Trading*. The decision was vacated as part of a settlement agreement before the appeal was decided.

The Trustee continues to believe that the SIPA estate will recover sufficient segregated funds to pay all public futures customers in full. If, however, there is a shortfall of customer assets, the Trustee believes that the SIPA Trustee has misinterpreted the relevant statutory authority governing reallocation of general estate assets to cover such customer segregated assets shortfalls. Accordingly, except to the extent the SIPA Trustee provides a full accounting of the general estate assets sought to be reallocated and such accounting demonstrates that those assets should have been segregated pursuant to applicable regulation, the Trustee will continue to pursue all legal options to recover all assets to which the Debtors' estates are entitled.

MF GLOBAL GROUP ENTITIES IN THE UNITED KINGDOM

I. MF GLOBAL HOLDINGS EUROPE LIMITED ("HOLDINGS EUROPE")

Holdings Europe is a wholly-owned subsidiary of Holdings Ltd. Holdings Europe is an investment holding company that is currently not in administration or liquidation.

II. MF GLOBAL U.K. LIMITED

Total number of claims filed against this entity by the Debtors and their Non-Debtor Affiliates:[73] **10.**

Total Value of Those Claims: $446.4 million to $563.8 million.

MFGUK is a wholly-owned subsidiary of Holdings Europe and an indirect subsidiary of Holdings Ltd. MFGUK carried on business as a broker providing agency services, matched-principal execution and clearing services for exchange-traded and OTC derivative products, and non-derivative foreign exchange products and securities in the cash markets, including interest rates, equities, currencies, energy, metals, agricultural and other commodities. In connection with such business, MFGUK was registered with the United Kingdom's Financial Services Authority ("**FSA**") and authorized to carry on a number of regulated activities including advising

[73] In addition, contingent and unliquidated claims were filed by the Debtors against MFGUK.

and arranging deals in investments, arranging, safeguarding and administering assets, and dealing in investments as agent and principal.

Following the October Petition Date, the directors of MFGUK filed an application for a special administration order pursuant to the Investment Bank Special Administration Regulations 2011 with the High Court of Justice (the "**High Court**"). The High Court granted the application and appointed Richard Fleming, Richard Heis and Michael Pink of KPMG LLP ("**KPMG**") as joint special administrators of MFGUK (the "**Special Administrators**") on October 31, 2011.

A. Reports Filed by the Special Administrators

The Special Administrators have filed a number of reports and updates in respect of the special administration of MFGUK which can be found on a section of KPMG's website relating to the special administration at www.kpmg.co.uk/mfglobaluk. This includes:

(i) the Special Administrators' Proposals for achieving the purpose of the special administration of MFGUK;

(ii) the Special Administrators' presentation provided at the meeting of creditors and clients of MFGUK on January 9, 2012;

(iii) the Special Administrators' Report for a hearing in the High Court of England and Wales on February 3, 2012 (including an interim distribution model and commentary on such model);

(iv) Statement of Affairs of the Directors of MFGUK dated March 7, 2012; and

(v) the Special Administrators' Progress Report for the six month period from October 31, 2011 to April 30, 2012 published on May 30, 2012 (the "**Six Month Report**").

B. Overview of Issues Related to Special Administration of MFGUK

The initial meeting of creditors and clients of MFGUK was held on January 9, 2012. During the meeting, the creditors approved the Special Administrators' Proposals and elected a

creditors' committee. The committee currently consists of (i) BB Energy (Gulf) DMCC, (ii) Unipec Singapore Pte Limited, (iii) MFGI, (iv) Peabody Coal Trade International Limited, and (v) KIT Finance Europe AS.

The claims against MFGUK include proprietary claims against assets held by or on behalf of MFGUK including in the client money pool (as discussed further below) and claims of unsecured creditors.

The Special Administrators established three separate bar dates depending on the class of claim to be filed against MFGUK. The bar date for client assets claims was February 29, 2012. The bar date for client money claims was March 30, 2012. The bar date for general creditor claims was April 30, 2012. Claims can still be made in respect of all these categories of claims after such dates. However, in respect of client monies and general creditor claims, any claim made after the bar date is not entitled to share in the first interim distribution in respect of such claims (as discussed further below). Any client assets claims made after this date cannot disrupt any title acquired by any other person to whom such assets have been transferred.

Client assets: The Special Administrators are not permitted to return client assets within three months of the bar date referred to above and are required to establish a Distribution Plan setting out, among other things, the process and mechanism for the return of client assets and a schedule of dates on which client assets are to be returned. The Six Month Report states that a draft of the Distribution Plan has been shared with MFGUK's creditors' committee and must be approved by the Court. The Special Administrators state that they intend to apply to the Court for the approval of the Distribution Plan in July 2012 with a view to commencing the return of client assets as soon as possible thereafter.

Client monies: In relation to client monies, an interim distribution has been declared at 26% of the amount of claims that have been accepted. The Special Administrators commenced making interim distributions on client money claims in February, 2012. In the Six Month Report, the Special Administrators state that with respect to agreed claims, payments of $92.1 million had been made as of May 29, 2012. This amount is less than 26% of the total amount of agreed claims due to various factors, including timing differences between the agreement of claims and the payment of dividends and "know-your-customer" checks. It was also noted that over 1,100 clients have submitted claims which conflict with MFGUK's classification of their accounts (which represents approximately 25% of all claims received). The Special Administrators also state that as of October 31, 2011, a significant portion of client money was held by third parties including clearing houses and exchanges. They state that as at April 30, 2012, $918 million had been received by the Special Administrators in relation to client money and a further $161.8 million is due from affiliates (with 99% of the remaining client monies to be recovered now being held at affiliated entities).

Client money claims against MFGUK have been affected by the UK Supreme Court judgment in *LBIE v CRC Credit Fund*, which was handed down on February 29, 2012. This was a directions hearing regarding the FSA's client money and client money distribution rules contained in chapter 7 of the FSA's Client Assets Sourcebook ("**CASS**"). Under the CASS rules, all client monies held by the relevant firm are pooled upon certain events, including a special administration, and all clients entitled to such assets share *pro rata* in the client money pool. The U.K. Supreme Court held that (i) a statutory trust attaches to all client money paid into a firm's house account from the moment it is received (whether money is client money will depend upon a number of factors including whether the client is retail or professional and the

relevant terms of business), (ii) the client money pool consists of all client money that is identifiable in any account of the firm, whether or not a segregated account, and (iii) all clients that have an entitlement in respect of client money are entitled to a distribution from the client money pool by reference to their objective contractual entitlement to have client money segregated as at the date of pooling (whether or not actually segregated).

The Special Administrators have stated that as a result of this judgment they will need to conduct a detailed and thorough regulatory and legal analysis of each client's position to establish if they had a claim in respect of client money that should have been segregated and conduct a forensic analysis into MFGUK's own bank accounts and, potentially, other assets to seek to identify client monies that were transferred to such accounts. The Special Administrators noted that the assistance of the court was likely to be needed to deal with these issues.

Thereafter, on May 3, 2012, the Special Administrators filed two applications for directions with the High Court of England and Wales. The first application (i) relates to U.S. treasury bills transferred by MFGI to MFGUK in respect of which MFGI claims were transferred subject to CFTC Rule 30.7, and (ii) seeks directions as to, among other things, (a) the legal basis on which such treasury bills were transferred to MFGUK and (b) whether MFGI has a proprietary interest and/or client asset claim and/or client money claim in relation thereto. A substantive trial on this application is not expected until the second quarter of 2013 at the earliest. The second application seeks directions as to whether a client's client money entitlement in respect of an open position is to be valued by reference to the market value at the date of pooling or by reference to liquidation value. A substantive hearing in relation to this application is not expected until the third quarter of 2012.

The Special Administrators have stated that they continue to pursue the recovery of approximately $400 million from MFGI in relation to segregated client assets and monies and house assets and monies of MFGUK held by MFGI.

General creditor claims: In relation to non-segregated assets, the Special Administrators state in the Six Month Report that they have now received approximately $1.2 billion of non-segregated assets. They state that in excess of 90% of non-affiliated monies outstanding as at April 30, 2012 were held with five entities (reduced to four as at May 30, 2012) and they continue to work with these institutions regarding the return of additional amounts. The Special Administrators state that they are unable to provide a reliable estimate of total unsecured creditors at this time, and material uncertainties remain as to the ultimate quantum of realization of non-client assets and the quantum of claims and contingent claims. The Special Administrators therefore state that they are currently unable to estimate the likely recovery for unsecured creditors.

1. Claims Filed by the Debtors.[74]

The claims filed by the Debtors or their non-debtor affiliates under their control generally pertain to cost allocation for administrative expenses and smaller intercompany receivables. FinCo and Holdings Ltd. filed protective claims for funds loaned to MFGI (which were subsequently transferred to MFGUK) to the extent such loans pertained to margin for the RRTM transactions or may be recoverable by FinCo or Holdings under various legal theories.

The Unregulated Debtors' activities with MFGUK primarily were related to foreign exchange and derivative product trading governed by ISDA Master Agreements.[75] After the

[74] Although the following claims are shown in U.S. Dollars, all claims submitted against entities in administration in the United Kingdom are required to be converted into GBP at the relevant exchange rate on the debtor's petition date. In relation to US$, the relevant exchange rate on the October Petition Date was $1.6141/£.

October Petition Date, these agreements were terminated and the Debtors have worked with MFGUK to calculate their respective obligations under the terminated agreements.

The Debtors filed seven general unsecured claims totaling $28.9 million against MFGUK and one client asset/general unsecured claim with an estimated value between $124.5 million and $242 million, which are detailed in the chart below. In addition, FinCo and Holdings Ltd. each filed a protective claim for $293 million for advances made to MFGI that were subsequently transferred to MFGUK and may be recoverable by FinCo or Holdings Ltd. Non-debtor MF Global Intellectual Properties Kft ("**MFG IP**"), a Hungarian subsidiary wholly-owned by Holdings Ltd., also filed a claim against MFGUK.

Debtors' Claims Against MFGUK

Claimant	Class of Claim	Amount
Holdings Ltd.	General Unsecured	$3,988,608
Holdings Ltd.	General Unsecured	$293,000,000[76]
Holdings USA	General Unsecured	$277,804
FinCo	General Unsecured	$293,000,000[77]
FinCo	Client Asset/General Unsecured	$124,480,000 - $241,920,000
Capital	General Unsecured	$4,979,060
FX Clear	General Unsecured	$17,099,086
MFG IP	General Unsecured	$770,966
Holdings Overseas	General Unsecured	$1,410,172
Holdings Europe	General Unsecured	$354,780
Total		**$446,360,476 - $563,800,476**

On May 3, 2012, the Special Administrators notified FinCo that its claim had been rejected in full. In accordance with the relevant rules relating to the special administration of

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[75] *See* Annex ¶ 6 for an explanation of ISDA.

[76] Each of the claims filed by Holdings Ltd. and FinCo were filed to protect potential claims for the recovery of funds loaned by Holdings Ltd. and FinCo to MFGI and then were subsequently transferred to MFGUK. The Trustee did not include both claims in the total listed in this chart.

[77] *Supra* note 76.

MFGUK, FinCo had 21 days to appeal against such rejection or it would lose its right to object. Accordingly, on May 24, 2012, FinCo lodged an appeal against the rejection of its claim. The initial hearing in respect of such appeal is scheduled to be heard in August 2012.

III. MF GLOBAL UK SERVICES LIMITED ("UK SERVICES")

UK Services is a wholly-owned subsidiary of Holdings Europe and an indirect subsidiary of Holdings Ltd. On October 31, 2011, Richard Fleming, Richard Heis and Michael Pink of KPMG were appointed as joint administrators of UK Services, which provided employee and pension services in relation to the UK operations. On December 19, 2011, Blair Nimmo of KPMG was appointed as an additional administrator of UK Services with the role of primarily and independently acting on behalf of UK Services in relation to the negotiation of a management agreement with the Special Administrators of MFGUK. The Debtors have not filed any claims against this entity.

IV. MF GLOBAL FINANCE EUROPE LIMITED ("FINANCE EUROPE") AND MF GLOBAL MFG OVERSEAS ("MFG OVERSEAS")

Total number of claims filed against Finance Europe by the Debtors and their Non-Debtor Affiliates: 3.

Total Value of Those Claims: $346,717,352.00.

As a result of the Holdings Ltd. and FinCo bankruptcy filings and the subsequent administrations and filings of affiliates in the United Kingdom and Asia, the directors of MFG Overseas and Finance Europe determined that those entities were likely to become insolvent due to a lack of liquidity, uncertainty as to the value of their assets, and their respective liabilities that would become due and payable. Consequently, the boards of directors resolved to appoint Richard Fleming, Richard Heis and Michael Pink of KPMG as administrators (the "**Administrators**") for both entities on November 2, 2011.

Finance Europe is a wholly-owned subsidiary of Holdings Ltd. It was registered in England and Wales and its principal purpose was to provide financing services to the MF Global Group.

Potentially the most significant asset of Finance Europe is a loan of $250 million made to MFGUK. The Administrators have, however, stated in their reports that the terms of the loan provide for subordination of all payments under the loan. According to the Administrators, Finance Europe's claim for the unpaid loan amount ranks behind amounts payable to unsecured creditors of MFGUK.

Total number of claims filed against MFG Overseas by the Debtors and their Non-Debtor Affiliates: 3.

Total Value of Those Claims: $5,815,380.00.

MFG Overseas is a wholly-owned subsidiary of MF Global Holdings Overseas Limited ("**Holdings Overseas**") and an indirect subsidiary of Holdings Ltd. MFG Overseas acted principally as an investment holding company for the MF Global Group's assets in Asia and Canada.

The below chart sets forth claims filed by the Debtors against Finance Europe and MFG Overseas.

Claims Against Finance Europe and MFG Overseas

Claimant	Debtor	Class of Claim	Amount
Holdings Ltd.	Finance Europe	General Unsecured	$34,224,652
Holdings Overseas	Finance Europe	General Unsecured	$299,309,693
Holdings Europe	Finance Europe	General Unsecured	$13,183,008
Total			**$346,717,353**
Holdings Ltd.	MFG Overseas	General Unsecured	$75,000
Holdings Overseas	MFG Overseas	General Unsecured	$5,713,600
MF Global Clearing Services Limited	MFG Overseas	General Unsecured	$26,780
Total			**$5,815,380**

A. **Creditors' Committees of MFG Overseas and Finance Europe**

Holdings Ltd., by virtue of its direct claims and the claims of non-debtor affiliates, as set forth in the chart above, controls all three seats on the creditors' committee for Finance Europe and MFG Overseas. The Trustee, through the creditors' committee, continues to aid the Administrators and provide input on the development of a strategy for the recovery of assets and the flow of funds up to Holdings Ltd. The Administrators continue to provide timely informational updates with respect to the posture of the subsidiary asset sales and the Administrators continue to consult with the Trustee on important decisions.

The Administrators are currently adjudicating intercompany claims and working with the Trustee to ensure a rapid distribution of funds after the liquidation of various assets held by their estates. The Trustee and his advisors are seeking to develop a strategy for interim distributions with the Administrators, which is likely to be through the establishment of a company voluntary arrangement.[78] The Trustee also is working with the Administrators to develop a strategy in relation to the final distribution of assets.

In addition, the Trustee and the Administrators have entered into an agreement with the Committee, allowing the Committee "observer" status on the creditors' committees of Finance Europe and MFG Overseas. This arrangement will facilitate the flow of information to the Committee and their advisors from the Administrators, provided they execute an appropriate non-disclosure agreement.

On February 22, 2012, the Trustee and the Administrators entered into a Cross-Border Insolvency Protocol to facilitate the coordination of the proceedings in relation to each estate, and to enable the Trustee and the Administrators to cooperate efficiently, effectively, and

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[78] A company voluntary arrangement is a binding scheme or arrangement between creditors under supervision of an independent supervisor that must be approved at meetings of creditors and members.

expeditiously in the administration of their respective estates in the best interests of all of the creditors of each estate and other potential stakeholders.

MF GLOBAL GROUP ENTITIES IN THE REST OF THE WORLD

I. AUSTRALIA

Total Number of Claims filed Against Australian Entities by the Debtors and their Non-Debtor Affiliates: 4.

Total Value of Those Claims: $1,389,905.00.

The MF Global Group's Australian operations were performed by three entities, two of which were operationally active as of the October Petition Date. MF Global Australia Limited ("**MFG Australia**"), a wholly-owned subsidiary of MFG Overseas, was a regulated entity that provided derivatives brokering and clearing services. BrokerOne Pty Limited was a wholly-owned subsidiary of MFG Australia that was operationally inactive at the time of administration. MF Global Securities Australia Limited ("**MFG Securities Australia**"), another wholly-owned subsidiary of MFG Overseas, was a regulated entity that provided securities brokerage services.

As of September 30, 2011, MFG Overseas' balance sheet reflected a book value for its equity investment in MFG Australia at £20.3 million, and a book value for its equity investment in MFG Securities Australia at £3.2 million. The Australian entities are currently in administration proceedings and in the process of liquidation. Chris Campbell, Vaughan Strawbridge and David Lombe, of Deloitte, were appointed administrators of the three Australian entities on November 1, 2011. The administrators have taken control of the Australian entities and all of their operations with immediate effect, in accordance with the *Corporations Act 2001* (Cth) (Act).

An official claims bar date has not been established by the administrators. The below chart details the claims filed by the Debtors against the Australian entities.

Claims Filed by the Debtors Against the Australian Entities

Claimant	Debtor	Class of Claim	Amount
Holdings Ltd.	MFG Australia	General Unsecured	$726,226
Holdings Ltd.	MFG Securities Australia	General Unsecured	$139,628
Holdings USA	MFG Australia	General Unsecured	$523,132
Holdings USA	MFG Securities Australia	General Unsecured	$919
Total			**$1,389,905**

II. CANADA

Total Number of Claims Filed Against this Entity by the Debtors and their Non-Debtor Affiliates: 5.

Total Value of Those Claims: $ 1,216,100.

MF Global Canada Co. ("**MFG Canada**") was an indirect, wholly-owned subsidiary of MFG Overseas. MFG Canada was a regulated Canadian broker-dealer that mainly placed orders for commodity futures and options contracts on behalf of its clients. The majority of those orders were executed and cleared by MFGI. MFG Canada also served as the clearing agent for trades of MFGI that were made on the Bourse de Montreal Inc. and ICE Futures Canada. As of September 30, 2011, MFG Overseas' balance sheet reflected the book value for its equity investment in MFG Canada at £1.6 million.

On November 4, 2011, KPMG Inc. (Canada) was appointed as trustee in bankruptcy. To date, MFG Canada clients have received an 80% distribution from the estate. Substantially all of the Canadian client claims protected by the Canadian Investor Protection Fund -- defined as those clients with balances less than C$5 million -- either have been settled in full or paid in substantial part.

The trustees for MFG Canada established May 10, 2012 as the bar date for filing client claims, although all creditors were encouraged to submit claims by this date. At this time, the Trustee cannot estimate the potential distribution the Debtors may receive on account of these filed claims. In addition to the claims held by the Debtors (as set forth in the below chart), MFG IP has a claim against MFG Canada.

Claims Held Against MFG Canada

Claimant	Class of Claim	Amount
Holdings Ltd.	General Unsecured	$676,049
Holdings USA	General Unsecured	$396,916
MFG IP	General Unsecured	$21,676
Capital	General Unsecured	$94,832
FX Clear	General Unsecured	$26,627
Total		**$1,216,100**

III. HONG KONG

Total Number of Claims Filed Against These Entities by the Debtors and their Non-Debtor Affiliates: 4.

Total amount of those claims: **$1,180,965**.

The MF Global Group's Hong Kong operations were performed by two entities: MF Global Holdings HK Limited ("**Holdings HK**"), which is a wholly-owned subsidiary of MFG Overseas, and MF Global Hong Kong Limited ("**MFG HK**"), which was a regulated entity and a member of the Hong Kong Futures Exchange Limited and the Stock Exchange of Hong Kong Limited. MFG HK's principal activity was providing brokerage services to its customers.

On November 2, 2011, Patrick Cowley, Fergal Power and Lui Yee Man were appointed joint and several provisional liquidators of Holdings HK and MFG HK. The initial meeting of creditors took place on March 22, 2012, and was attended by the Trustee's financial advisors. The Debtors were elected as one of the five members of the committee of inspection for

Holdings HK. The Debtors were one of nine creditors that expressed interest in sitting on the MFG HK committee of inspection; however, the committee is limited to seven members. The provisional liquidators have submitted an application with the Hong Kong court seeking, among other things, court approval for the Debtors to be included on the committee. This process takes four to eight weeks and the court has not yet set a hearing date on the application.

The Debtors filed four general unsecured creditor claims totaling $1.18 million against Holdings HK and MFG HK. The Trustee is unable to determine the likelihood of a recovery because the recoveries from these entities are highly dependent upon distributions received from other affiliates on account of intercompany claims. Below is a chart that details the Debtors' claims against Holdings HK and MFG HK.

Claims Against Holdings HK and MFG HK

Claimant	Debtor	Class of Claim	Amount
Holdings Ltd.	MFG HK	General Unsecured	$114,902
Holdings Ltd.	Holdings HK	General Unsecured	$403,525
Holdings USA	MFG HK	General Unsecured	$ 408,716
Holdings USA	Holdings HK	General Unsecured	$253,822
Total			**US$1,180,965**

IV. INDIA

Total Number of Claims Against This Entity by the Debtors and their Non-Debtor Affiliates: 7.

Total Value of Those Claims: **$832,541.00**.

The MF Global Group's Indian operations are comprised of four principal elements discussed below. As of September 30, 2011, MFG Overseas' balance sheet reflected a book value for its Indian operations at £14.8 million.

MF Global Sify Securities India Pvt. Limited ("**MFG Sify**") is a registered broker-dealer that offered institutional equity offerings and retail brokerage and research. MFG Sify is a joint

venture between MFG Overseas and Satyam Infoway Limited (now known as Sify Technologies Limited) in which MFG Overseas owns 70.15% of the equity. MFG Sify had two operating subsidiaries: (i) MF Global Commodities India Pvt Limited, a wholly-owned subsidiary that provides brokerages services in the Indian commodities market, and (ii) MF Global Middle East DMCC, a wholly-owned subsidiary that is a trading and clearing member of the Dubai Gold & Commodities Exchange.

MF Global Centralised Services India Pvt. Limited ("**MFG Centralised Services**") is a wholly-owned subsidiary of MFG Overseas, and is a trading and clearing member of the Dubai Gold & Commodities Exchange.

MF Global India Pvt. Limited is also a wholly-owned subsidiary that acts as a broker for other companies of the MF Global Group and receives commissions for trades performed by customers of MFG Centralised Services on overseas transactions.

MFG Overseas owns 74.99% of MF Global Finance & Investment Services India Pvt. Limited ("**MFG F&I**"), which offers lending services against securities, property and gold. MFG F&I is registered with the Reserve Bank of India as a non-deposit, non-banking financial company.

On March 26, 2012, the Administrators agreed to the terms of a sale of MFG Overseas' share holdings in the Indian operations with Phillip Capital Group. MFG Overseas anticipates realizing an influx of funds from the proceeds of the sale depending on tax issues. The sale is subject to regulatory approval of the purchaser.

The Debtors' books and records show intercompany receivables due from the Indian affiliates as set forth in more detail in the chart below.

Intercompany Receivables Owed to the Debtors

Claimant	Debtor	Class of Claim	Amount
Holdings Ltd.	MFG Sify	General Unsecured	$695,197
Holdings Ltd.	MFG Centralised Services.	General Unsecured	$51,247
Holdings USA	MFG Sify	General Unsecured	$45,110
Holdings Ltd.	MFG Middle East DMCC	General Unsecured	$20,047
Holdings USA	MFG Sify	General Unsecured	$45,110
Holdings USA	MFG Middle East DMCC	General Unsecured	$13,950
FX Clear	MFG Middle East DMCC	General Unsecured	$2,653
Total			**$832,541**

V. IRELAND

MF Global Clearing Services Limited ("**MFG Clearing**"), a wholly-owned subsidiary of MFG Overseas, was created to provide clearing services for The Bank of New York Mellon. As of September 30, 2011, MFG Overseas' balance sheet reflected a book value for its equity investment in MFG Clearing of £17,073. This entity is currently dormant and the Debtors do not anticipate realizing any value upon its dissolution.

VI. JAPAN

Total Number of Claims to be Filed Against this Entity by the Debtors and their Non-Debtor Affiliates: 4.

Total Value of Those Claims: $739,777.

MF Global FXA Securities Limited ("**FXA Securities**"), a wholly-owned subsidiary of MFG Overseas, was a regulated entity engaged primarily in the cash equity brokerage business and OTC margin foreign exchange business. On November 1, 2011, FXA Securities was placed under administration by the Financial Services Authority, the Japanese regulatory agency with oversight responsibility for FXA Securities. As of September 30, 2011, MFG Overseas' balance sheet reflected a book value for its equity investment in FXA Securities at £28.5 million.

FXA Securities entered liquidation following an extended sales process that failed to gain final approval from the Japanese Financial Services Authority. The deadline for filing general unsecured claims against FXA Securities is June 13, 2012. As set forth in the chart below, the Debtors and MFG IP intend to file a total of four general unsecured creditor claims totaling $739,877 against FXA Securities. The Debtors anticipate receiving a full recovery on account of its unsecured claims. The below chart details the Debtors' and MFG IP's claims against FXA Securities.

Claims Against FXA Securities

Claimant	Class of Claim	Amount
Holdings Ltd.	General Unsecured	$227,065
Holdings USA	General Unsecured	$470,219
Capital	General Unsecured	$6,644
MFG IP	General Unsecured	$35,849
Total		**$739,877**

In addition, the Administrators have indicated that they anticipate receiving a distribution on account of MFG Overseas' equity based on a current projected cash surplus after liquidation costs.

VII. MAURITIUS

Total Number of Claims Against this Entity by the Debtors and their Non-Debtor Affiliates: 1.

Total Value of Those Claims: $ 55,400.

MF Global Mauritius Pvt Ltd ("**MFG Mauritius**"), a wholly-owned subsidiary of MFG Overseas, was an unregulated entity engaged in brokering and trading activities. As of September 30, 2011, MFG Overseas' balance sheet reflected a book value for its equity investment in MFG Mauritius at £683,824.

MFG Mauritius has not yet entered liquidation proceedings. Holdings Ltd. has general unsecured creditor claims totaling $55,400 against MFG Mauritius. Holdings Ltd. anticipates receiving a full recovery on account of its unsecured claims. In addition, the Administrators have indicated that they currently anticipate receiving a distribution on account of MFG Overseas' equity based on a current projected cash surplus after liquidation costs. It is anticipated that a distribution on account of equity to MFG Overseas ultimately will benefit Holdings Ltd.

VIII. SINGAPORE

Total Number of Claims Filed Against this Entity by the Debtors and their Non-Debtor Affiliates: 3.

Total Value of Those Claims: $ 26,514,373.

MF Global Singapore Pte. Limited ("**MFG Singapore**"), a wholly-owned subsidiary of MFG Overseas, was a regulated broker-dealer that engaged in exchange traded and OTC derivative transactions. As at September 30, 2011, MFG Overseas' balance sheet reflected a book value for its equity investment in MFG Singapore at £58.6 million.

On November 2, 2011, Chay Fook Yuen, Bob Yap Cheng Ghee and Tay Puay Cheng of KPMG were appointed provisional liquidators of MFG Singapore. A meeting of creditors was held on May 28, 2012. The Trustee was awarded a seat on the committee of inspection. As set forth in the chart below, the Debtors and non-Debtor affiliates filed three general unsecured creditor claims totaling approximately $26.6 million against MFG Singapore. At the creditors' meeting, the liquidators provided a statement of MFG Singapore's affairs, and distributions are highly dependent upon recoveries from claims MFG Singapore has made against other former affiliates. At this time, the Trustee does not know the potential distribution the Debtors may receive on account of these claims.

Claims Against MFG Singapore

Claimant	Class of Claim	Amount
Holdings USA	General Unsecured	$1,219,597
FinCo	General Unsecured	$25,000,000
MFG IP	General Unsecured	$294,776
Total		**$26,514,373**

IX. TAIWAN

The MF Global Group's interest in Taiwan is comprised of direct and indirect equity interests held in two Taiwanese entities: MF Global Futures Trust Co. Ltd. ("**MFG FTE**"), in which Holdings Ltd. has a 67% direct ownership interest, and Polaris MF Global Futures Co. Limited ("**Polaris**"), a publicly traded Taiwanese broker-dealer that is 11% owned by MFG Overseas.[79]

MFG FTE is a regulated entity and one of Taiwan's first fund managers. MFG FTE is not the subject of an insolvency proceeding. As at March 31, 2012, MFG FTE had a net asset position of $8 million. MFG Singapore acted as broker to MFG FTE and, as a result, owes approximately $7.2 million in margin to MFG FTE. MFG Singapore also acted as broker to Polaris and, as a result, the Trustee has been advised that MFG Singapore owes Polaris approximately $24 million in margin. Pursuant to a court order restricting repayment of segregated funds to affiliates, payment of margin to MFG FTE and Polaris was held up by the provisional liquidators of MFG Singapore. By order dated May 25, 2012, the prior Singapore court order was clarified to allow payment, as appropriate, to affiliates of MFG Singapore, including MFG FTE and Polaris, and the Trustee understands that MFG Singapore is in the process of approving an interim distribution to MFG FTE and Polaris. The Trustee is seeking to

[79] Effective April 1, 2012, Polaris merged with Yuanta Futures with MFG Overseas maintaining its approximately 11% ownership share in the surviving entity, Yuanta Polaris Futures Co. Ltd.

sell or liquidate MFG FTE. The timing of any direct or indirect realization by the Debtors remains subject to approval by Taiwanese regulators and may be contingent upon all Taiwanese customers of MFG Singapore and its Taiwan branch receiving the balance of their segregated funds from MFG Singapore.

Polaris had recently traded in the TWD33 per share range, valuing MFG Overseas' stake at approximately $29 million. As of September 30, 2011, MFG Overseas' balance sheet reflected a book value for its equity investment in Polaris at £9.99 million. KPMG Taiwan has been instructed to manage the sales process. As with MFG FTE, any sale and realization remains subject to negotiation with the Taiwanese regulators, assuming all Taiwanese customers are made whole for their segregated funds claims.

MISCELLANEOUS ISSUES

I. RECOVERY OF TRADING CLOSE-OUT VALUATION

The Trustee and his advisors, in conjunction with the Debtors' employees, have worked diligently to recover funds owed to the Unregulated Debtors as a result of the termination of master derivative agreements and the underlying transactions. As a result, the Debtors have been able to recover in excess of $25 million for the Unregulated Debtors from such contract terminations.

II. RECOVERY OF TAX REFUNDS

The Trustee believes that potential federal and state tax refund revenues are likely to come into the FinCo and the Subsequent Debtors' estates that may be in excess of $30 million. Pre-petition, FinCo and the Subsequent Debtors applied to the Internal Revenue Service for a refund of taxes paid in fiscal year 2009 based on losses from 2011 that could be carried back and applied to the 2009 fiscal year.

The Internal Revenue Service is nearing completion of an audit of FinCo and the Subsequent Debtors and continues to review potential refunds for fiscal years 2007-2011. Although the Trustee does not have a finite date as of yet as to when these funds will come into the FinCo and the Subsequent Debtors' estates, he is hopeful the funds will come into these estates in 2012.

III. SALE OF DE MINIMIS ASSETS

On March 22, 2012, the Trustee filed a motion for entry of an order, pursuant to Bankruptcy Code sections 105, 363 and 365, to: (i) establish procedures for the sale or disposal of *de minimis* assets and (ii) authorize the Trustee to (a) pay related fees and (b) assume, assume and assign, or reject related executory contracts or unexpired leases (the "**De Minimis Sales Motion**"). The Court held a hearing to consider the De Minimis Sales Motion on April 12, 2012 and entered an order granting the motion later that day.

Since the entry of the order granting the De Minimis Sales Motion, the Trustee has engaged in one *de minimis* asset sale, as a result of which two computer servers were sold to IT Asset Management Group for $146,640. Oracle America, Inc. ("**Oracle**") filed a limited objection and reservation of rights because these machines had previously been used to run Oracle software. The Trustee and Oracle resolved the issues raised in the limited objection and the Court entered an order authorizing the sale. The Trustee has received the funds from this sale.

At this time, no other *de minimis* asset sales are being contemplated by the Trustee.

IV. INSURANCE

This section of the Report examines the insurance programs maintained by Holdings Ltd. as of the October Petition Date.[80] Although Holdings Ltd. maintained several types of insurance through multiple carriers, this section focuses on the two lines of coverage that have been the subject of most of the insurance litigation since the October Petition Date: (i) the professional liability, or "errors and omissions," policies (the "**E&O Policies**") issued by MFGA and certain third-party excess insurers, and (ii) the directors & officers policies (the "**D&O Policies**") issued by various insurance companies, for the policy period May 31, 2011 to May 31, 2012 (the "**Policy Period**").

A. MFG Assurance

MFGA is a wholly-owned, Class 1, captive insurance subsidiary of Holdings Ltd., domiciled in Bermuda and regulated by the Bermuda Monetary Authority. The Bermuda Monetary Authority requires MFGA to maintain a balance of appropriately skilled, experienced, and qualified individuals who can apply informed and independent judgment to MFGA's governance.[81] Since the commencement of the Chapter 11 Cases, the Bermuda Monetary Authority has increased its regulatory interest in MFGA, with specific regard as to whether MFGA is continuing to honor its policy obligations. MFGA's primary responsibility is to maintain the E&O Policies.

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[80] The statements made in this section of the Report are not intended to be and cannot be relied upon as an interpretation or determination of the meaning, scope or definition of any term, passage or account of any of the insurance programs or policies described herein. No information provided in this section should, can or will serve as a legal opinion or determination of any "claim," as the term claim is used in either the Bankruptcy Code or the insurance policies themselves. No one should consider that these are the actual terms and conditions provided in all or any of the insurance policies. This Report is not intended to be relied upon as an insurance policy or legal advice.

[81] Section 5.0, BMA Insurance Department, Guidance Note #12, Corporate Governance (2005), http://www.bma.bm/uploaded/127-Corporate_Governance_Mar_05.pdf (last visited, May 19, 2012).

B. The E&O Policies

For the Policy Period, Holdings Ltd. entered into thirteen E&O Policies with MFGA -- one primary policy and twelve excess policies -- providing a total of $120 million in aggregate limits of coverage. Holdings Ltd. purchased four additional excess layers of coverage providing an additional $30 million in aggregate limits above the MFGA-issued layers. Therefore, Holdings Ltd. had $150 million in aggregate limits of coverage under the various E&O Policies during the Policy Period.[82] The E&O Policies are "claims made" policies, which provide coverage for claims actually made against the *insured*[83] during the applicable policy period, subject to certain extensions and other terms set forth in the policies.

MFGA fully reinsured the entire $120 million "tower" of E&O coverage through various third-party reinsurance carriers, with the sole exception of the self-insured primary layer providing $7.475 million in coverage, with no aggregate limits, in excess of a $25,000 retention (similar to a deductible). Under the primary E&O Policy, the first $25,000 of loss arising from each *single claim* is borne by the *insured* or *individual insured*, as the case may be, and MFGA covers the next $7.475 million of such loss, without recourse to reinsurance. Loss from any *single claim* in excess of $7.5 million is insured by MFGA up to an aggregate limit of $120 million, subject to third-party reinsurance policies that mirror the coverage of the MFGA policies. Other third-party carriers directly insured Holdings Ltd. against loss from a *single claim* exceeding $120 million, up to $150 million.

For the primary E&O Policy described above, the total premium owed by Holdings Ltd. for the Policy Period was $8,479,959, payable in 12 monthly installments of $706,663.25. For

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[82] Refer to Exhibit C for a depiction of the E&O Policy tower.

[83] Italicized terms used in this section of the Report shall have the meaning ascribed to them in the definitions contained in the E&O Policies, which definitions, in some cases, are provided in this Report.

the excess E&O Policies, the total premium owed by Holdings Ltd. was $3,866,793, payable in 12 monthly installments of $322,232.75. Holdings Ltd. made its last monthly installment payments to MFGA in September 2011. MFGA has fully paid to its third-party reinsurers all premium amounts due for the entire Policy Period.

C. Substantive Provisions of the MFGA E&O Policies.

The E&O Policies cover Holdings Ltd. and its subsidiaries, both domestically and abroad, as well as their directors, officers and employees for their actual or alleged acts, errors or omissions while in the performance of services provided by Holdings Ltd. and its subsidiaries. Specifically, subject to certain exceptions listed therein, the E&O Policies provide:

> The *insurer* shall pay on behalf of the *insured* for all *loss* arising out of a *wrongful act* which gives rise to a *claim* first made against an *insured* by a third party during the *policy period* (or discovery period, if applicable) and reported in writing to the *insurer* pursuant to the terms of this policy.

To properly understand the above language, a breakdown of the defined terms is necessary. The E&O Policies define the *insurer* as MFGA. The *insureds* include the *insured entity* -- Holdings Ltd. and its subsidiaries -- and the *individual insureds*. *Individual insureds* is a broad-ranging group of employees and persons affiliated with Holdings Ltd. and its subsidiaries, including but not limited to:

> (i) Any past, present or future natural person under a contract of employment (be it full time, part-time or temporary, or be it written or implied) with the *insured entity*;
>
> (ii) Any past, present or future natural person working under the direct control and supervision of the *insured entity*;
>
> (iii) Any past, present or future *director* or *officer* when performing acts within the scope of the usual duties of an employee of the *insured entity* or while acting as a member of a committee duly elected or appointed by resolution of the Board of Directors of the *insured entity* to perform specific, as distinguished

from general, directorial acts on behalf of the *insured entity* . . . ; and

(v) Any past, present or future natural person compensated by the *insured* by wages, salaries, commissions or any other form of payments in respect of consultancy services.

The E&O Policies define *Loss* as follows:

(i) *defense costs;* and/or

(ii) damages, *aggravated damages* as permitted by law, judgments (including pre/post judgment interest), restitution orders of a compensatory nature, *claimant's costs, co-defendant's costs,* legal costs and expenses awarded against any *insured;* and/or

(iii) settlements negotiated with the *insurer's* consent (such consent not to be withheld unreasonably); and/or

(iv) awards of punitive, exemplary and multiple damages (where insurable by law). Enforceability of this paragraph shall be governed by such applicable law which most favors coverage for punitive, exemplary and multiple damages; and/or

(v) awards of any referee, arbitrator, the Financial Services Ombudsman or any other ombudsman appointed by the Secretary of State for Trade and Industry or similar *regulator* or by any self-regulatory organization or by any recognized professional body by whose rules the *insured* is bound,

in respect of any *claim* under the policy.

However, *Loss* shall *not* include:

(a) taxes, unless such taxes form part of an award of damages to a third party;

(b) wages, salaries or other remuneration of any *insured*;

(c) the cost of complying with any settlement for or award of non-monetary relief; or

(d) principal, interest or other monies accrued or due (either now or in the future) but not yet paid to the *insured entity* as a result of any loan, lease or extension of credit.

Under the above definition and other terms of the E&O Policies, *Loss* other than *defense costs* and certain other incidental costs generally arises only upon a determination by a tribunal, referee, arbitrator or some other appointed official granting a monetary judgment or award against an *insured*, or upon a final settlement of a claim entered with MFGA's consent.

A *Wrongful Act* is the alleged or actual act, error or omission that leads to a *claim*. In the E&O Policies, *Wrongful Act* means:

> Any actual or alleged act, error or omission by the *insured*, or by any other person for whose act, error or omission the *insured* is legally responsible, arising out of the provision of, or failure to provide the *services*. For the avoidance of doubt, the term "act, error or omission" as used in the foregoing, shall include, but not be limited to any:
>
> > (i) breach of duty, breach of trust (including, but not limited to, breach of constructive trust) breach of fiduciary duty, neglect, error, misstatement, misleading statement, misrepresentation, libel, slander, omission or breach of warranty of authority; or
> >
> > (ii) breach of any statute enacted anywhere in the world (including any statutory provisions and/or any rules or *regulations* made by any regulatory body or authority thereunder, and including any award of any referee, arbitrator, the Financial Services Ombudsman or any other ombudsman appointed by the Secretary of State for Trade and Industry or similar *regulator* or by any self-regulatory organization or by any recognized professional body by whose rules the *insured* is bound); or
> >
> > (iii) other breach of a duty to a third party which is actionable at law in tort, or actionable in delict or quasi-delict in respect of Scotland.

To be clear, a *claim* under the E&O Policies is far different than a "claim" under Bankruptcy Code section 101(5). A claim under Bankruptcy Code section 101(5) is defined as the:

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

11 U.S.C. § 101(5). Under the primary E&O Policy, *claim* means:

> (i) any suit or proceeding, including any civil proceeding, third party proceeding, counter claim or arbitration proceeding, or a regulatory proceeding brought by any person or entity against an insured for monetary damages or other relief, including non-pecuniary relief for a specified wrongful act;
>
> (ii) any written demand from any person or entity seeking monetary damages or other relief, including non-pecuniary relief, from an insured for the results of any specified wrongful act;
>
> (iii) any official investigation, examination, inquiry or other similar proceeding at which an individual insured of the insured entity's attendance is required provided such official investigation, examination, inquiry or other similar proceeding is directly related to an alleged wrongful act of such individual insured or the insured entity in their capacity as such:
>
> > (1) once such individual insured is identified in writing by such investigating authority as a person against whom a civil, criminal, administrative, regulatory or arbitration proceeding for monetary, non-monetary or injunctive relief which is commenced by: (a) service of a complaint or similar pleading; (b) return of an indictment, information or similar document (in the case of a criminal proceeding); or (c) receipt or filing of a notice of charges may be commenced; or
> >
> > (2) in the case of an investigation by a regulatory or a similar government authority, after the service of a subpoena upon such individual insured.[84]

[84] This language appears only in the primary policy. The MFGA excess layers say "in the case of an investigation by the SEC or a similar state government authority, after the service of a subpoena upon such individual insured."

The different definitions of *claim* under the E&O Policies, on the one hand, and under the Bankruptcy Code, on the other hand, as well as the definition of *loss* under the E&O Policies, have led to significant confusion among some customers of MFGI.

D. The D&O Policies.

Holdings Ltd. maintained a D&O insurance program during the Policy Period comprising twenty-one primary and excess D&O Policies with a total aggregate limit of $225 million.[85] These policies provided what is commonly known in the insurance industry as Side A, Side B, and Side C coverage. Side A coverage provides officers and directors of Holdings Ltd. and its subsidiaries with coverage for **Loss**[86] arising from **Claims** made against those directors and officers for **Wrongful Acts** except when and to the extent that Holdings Ltd. has indemnified those directors and officers. Therefore, to the extent Holdings Ltd. or its subsidiaries do not indemnify the officer or director, the D&O Policies cover such **Loss**. Side B coverage (provided under the D&O Policies by part (B)(1) of the coverage grant) reimburses Holdings Ltd. or its subsidiaries for losses that Holdings Ltd. or its subsidiaries paid on behalf of **Insured Persons**. Side C coverage (provided under the D&O Policies by part (B)(2) of the coverage grant) provides entity coverage to Holdings Ltd. or its subsidiaries limited to **Loss** arising from securities claims as defined by the policies.

The Side A coverage does not have a deductible. The Side B coverage and Side C coverage each have a $2.5 million retention by Holdings Ltd. and its subsidiaries. The first ten layers of the D&O Policy tower provide $150 million in aggregate limits as to types of coverage (Sides A, B and C). The next four layers -- which provide coverage for losses arising from a

---

[85] Refer to Exhibit D for a depiction of the D&O Policy tower.

[86] Bold terms used in this section of the Report shall have the meaning ascribed to them in the definitions contained in the D&O Policies, which definitions, in some cases, are provided in this Report.

single claim from $150 million to $200 million -- provide $50 million in Side A coverage to officers and directors. The top two layers -- aggregate coverage from $200 million to $225 million -- provide Side A coverage exclusively for the benefit of **Independent Directors**.

E. Substantive Provisions of the D&O Policies.

As amended by the endorsements, the insuring agreements in the primary D&O Policy, entered into by Holdings Ltd. and U.S. Specialty Insurance Company ("**U.S. Specialty**"), state:

> (A) The Insurer will pay to or on behalf of the **Insured Person Loss** arising from **Claims** first made during the **Policy Period** or Discovery Period (if applicable), against the **Insured Persons** for **Wrongful Acts**, except when and to the extent the **Company** has paid such **Loss** to or on behalf of the **Insured Persons** as indemnification or advancement.
>
> > [a] The insurer will pay, to or on behalf of the **Insured Persons**, **Pre-Claim Inquiry Costs** or **Liberty Protection Costs** arising from **Pre-Claim Inquiries** first received by the **Insured Persons** during the policy period or the Discovery Period (if applicable), except when and to the extent that the **Company** has paid such **Pre-Claim Inquiry Costs** or **Liberty Protection Costs** to or on behalf of the **Insured Persons** as indemnification or advancement.
>
> (B) The Insurer will pay to or on behalf of the **Company Loss** arising from:
>
> (1) **Claims** first made during the **Policy Period** or the Discovery Period (if applicable) against the **Insured Persons** for **Wrongful Acts**, if the **Company** has paid such **Loss** to or on behalf of the **Insured Persons** as indemnification or advancement, and/or
>
> > [a] the Insurer will pay, to or on behalf of the **Company**, **Pre-Claim Inquiry Costs** or **Liberty Protection Costs** arising from **Pre-Claim Inquiries** first received by the **Insured Persons** during the **Policy Period** or the Discovery Period (if applicable), if the **Company** has paid such **Pre-Claim Inquiry Costs** or **Liberty Protection Costs** to or on behalf of the **Insured Persons** as indemnification or advancement.

> (2) **Securities Claims** first made during the **Policy Period** or the **Discovery Period** (if applicable) against the **Company** for **Wrongful Acts**.

Putting the terms used in the primary D&O Policy into industry terminology, Insuring Agreement (A) is the Side A coverage, Insuring Agreement (B)(1) is the Side B coverage, and Insuring Agreement (B)(2) is the Side C coverage.

The excess layers contain a "following form" provision that provides the same coverage as the primary layer. MFGI's customers have withdrawn most of their litigation as it relates to the D&O Policies because the D&O Policies have a priority of payment provision, which states:

> If the Insurer is obligated to pay Loss, including Defense Costs, under more than one INSURING AGREEMENT, whether in connection with a single Claim or multiple Claims, the Insurer will first pay any Loss payable under INSURING AGREEMENT (A) and, if the Insurer concludes that the amount of all Loss, including Defense Costs, is likely to exceed the Insurer's Limit of Liability, the Insurer shall be entitled to withhold some or all of any Loss payable under INSURING AGREEMENT (B)(1) or (B)(2) to ensure that as much of the Limit of Liability as possible is available for the payment of Loss under INSURING AGREEMENT (A). If no Loss is payable under INSURING AGREEMENT (A), or if the Insurer's obligations under INSURING AGREEMENT (A) have been satisfied, then, subject to the Insurer's Limit of Liability as set forth in Item 3 of the Declarations, the Insurer will pay such Loss as it is required to pay under INSURING AGREEMENT (B)(1) or (B)(2) in such manner and, in the event of multiple Claims, apportioned among such Claims as the Named Corporation shall direct in writing.

This priority of payment provision provides priority to the Side A coverage (Insuring Agreement (A) over the Side B (Insuring Agreement (B)(1)) and Side C (Insuring Agreement (B)(2)) coverages. Therefore, under the D&O Policies, officers and directors receive payments prior to Holdings Ltd. or its subsidiaries should they both file claims against the policies.

F. Insurance-Related Litigation.

On February 3, 2012, the Trustee and MFGA served notice that they had entered into a stipulation, which they sought to have approved by the Court,[87] pursuant to which the Trustee and MFGA sought, in the most expeditious and cost-effective way, to allow MFGA to advance *defense costs* and otherwise meet its financial obligations under the E&O Policies. This resulted in four objections, all from customers of MFGI.[88]

By separate motion, on February 8, 2012, U.S. Specialty moved the Court to lift the automatic stay to allow U.S. Specialty to advance defense costs and otherwise meet its financial obligations under its D&O Policy with Holdings Ltd.[89] This resulted in three responses from customers of MFGI.[90]

The Court consolidated these matters and held a hearing on April 2, 2012 to determine whether the automatic stay should be lifted to allow the payment of defense costs of the individual insureds under either the D&O Policies or the E&O Policies or both. On April 10, 2012, the Court issued its opinion, which overruled the various objections and allowed an initial "soft cap" of $30 million of defense costs to be paid by MFGA and U.S. Specialty, to be apportioned as those insurers saw fit.[91]

Among those who objected to the stipulation to allow MFGA to perform under the E&O Policies were Sapere Wealth Management LLC, Granite Asset Management, and Sapere CTA

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[87] Docket No. 409.

[88] Docket Nos. 416, 417, 419, 421.

[89] Docket No. 428.

[90] Docket Nos. 477, 482, 484.

[91] Docket No. 619.

Fund L.P. (collectively, "**Sapere**").[92] Sapere has appealed[93] the Court's decision[94] to lift the automatic stay to allow MFGA and U.S. Specialty to pay defense costs out of their respective policy proceeds. Sapere also sought a stay pending appeal, which this Court denied in a written opinion.[95] After a hearing on May 22, 2012, the District Court likewise denied Sapere's request for a stay pending appeal because, among other reasons, there was not a substantial likelihood that Sapere would succeed on its appeal.[96] Sapere continues to prosecute the appeal and has recently agreed to a briefing schedule with all parties involved.

V. LITIGATION

A. Administration of the Chapter 11 Estate

On December 11, 2011, Sapere filed a motion with the Court requesting that the Debtors' estates be administered pursuant to Bankruptcy Code sections 761–767 ("**Subchapter IV**"), the Commodity Broker's Liquidation subchapter, and the Part 190 Regulations.[97] In addition, Sapere sought authorization to conduct a Bankruptcy Rule 2004 investigation of the Debtors. Sapere's motion alleged, without support, that the Debtors stole customer funds from MFGI and asserted that the Debtors were commodity brokers. Based on the belief that the Debtors were commodity brokers, Sapere argued that MFGI's customers were entitled to receive priority treatment for the alleged $1.6 billion in "missing" customer funds.

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92 Docket Nos. 416, 417, 573, 574.

93 Docket No. 657. *Sapere Wealth Management, LLC., et al., v. Freeh,. et al.* Case No 12 Misc. 143 (KBF).

94 Docket Nos. 619 and 652.

95 *Supra* note 93.

96 *Sapere Wealth Management, LLC., et al., v. Freeh,. et al.* Case No 12 Misc. 143 (KBF) (Docket No. 17).

97 Docket No. 278.

Objections to the motion were filed by the Trustee and the Committee.[98] Those objections asserted, among other things, that while Subchapter IV is applicable to the liquidation of commodity brokers in cases under chapter 7 of the Bankruptcy Code, the Debtors' cases were administered under chapter 11of the Bankruptcy Code and, therefore, Subchapter IV was not applicable to the Debtors' cases. Furthermore, the Trustee argued that Rule 2004 discovery was premature because the Trustee was still conducting his own investigation. The SIPA Trustee filed a statement agreeing that Rule 2004 discovery was not warranted at that time and noted that, although it did not appear that the Debtors had sufficient assets to pay the alleged shortfall of MFGI's customers, it was the SIPA Trustee's responsibility to recover the "missing" assets.[99]

A hearing on the motion was held on January 19, 2012, during which the Court heard oral argument. On February 1, 2012, the Court filed a memorandum opinion and order denying the motion in its entirety, finding that Sapere failed to allege any specific facts supporting its motion and that there was no legal basis to administer the Debtors' cases pursuant to Subchapter IV.[100] In addition, the Court held that Sapere needed to first show that the Debtors' cases should be converted to chapter 7 (relief they had not requested in their motion) and then establish that the Debtors were commodity brokers. The Court found that conversion of the cases was not warranted and that the Debtors were not commodity brokers.

On February 15, 2012, Sapere filed a notice of appeal.[101] On March 30, 2012, Sapere filed a motion seeking direct certification of its appeal to the Second Circuit Court of Appeals.[102]

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[98] Docket Nos. 339, 341.

[99] Docket No. 358.

[100] Docket No. 400.

[101] Docket No. 461.

[102] Docket No. 603.

The Trustee filed an objection to the motion for certification on April 13, 2012 and the Committee filed a joinder to the Trustee's objection.[103] In his objection, the Trustee argued that the Court correctly found that the relief sought in the motion had no basis in law and, accordingly, the motion did not satisfy the standard for certification of an interlocutory order, namely, that the appeal "involves a controlling question of law as to which there is no controlling law in the circuit." On April 25, 2012, the Court filed a memorandum opinion and order denying Sapere's request for certification of its appeal.[104]

On May 11, 2012, the District Court docketed the Sapere appeal.[105] Sapere filed its brief on June 1, 2012.

B. Corporate Personhood

On February 6, 2012, Adam Furgatch ("**Furgatch**"), a customer of MFGI, filed a motion requesting that the Debtors' estates be administered pursuant to Bankruptcy Code sections 523 and 507.[106] The motion, citing to *Citizens United v. Federal Election Commission*, 558 U.S. 50 (2010), contended that corporate parents and subsidiaries are "persons" as such term is defined in the Bankruptcy Code. Therefore, Furgatch argued, MFGI is entitled to receive "domestic support" from its parent, Holdings Ltd., which obligations are granted priority status under the Bankruptcy Code. Objections to the motion were filed by the Trustee and the Committee.[107] Those objections asserted, among other things, that there is no basis in law or fact for the application of Bankruptcy Code section 523(a)(5) to corporate entities such as the Debtors and

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[103] Docket Nos. 632, 639.

[104] Docket No. 655.

[105] *In re MF Global Holdings Ltd., et al.*, Case No 12-cv-03757(JMF).

[106] Docket No. 424.

[107] Docket Nos. 479, 481.

MFGI. The SIPA Trustee also filed a statement agreeing with the points of authority contained in the Trustee's objection.[108] A hearing on the motion was held on March 6, 2012, during which the Court heard oral argument from Furgatch's counsel. Following the hearing, the Court filed a memorandum opinion denying the motion in its entirety.[109]

On March 20, 2012, Furgatch filed a motion for leave to appeal.[110] The Trustee filed an objection to the motion for leave to appeal on April 3, 2012.[111] In his objection, the Trustee argued that the Court correctly found that the relief sought in the motion had no basis in law and, accordingly, the appeal was frivolous and did not satisfy the standard for appeal of an interlocutory motion, namely, that the appeal "involves a controlling question of law as to which there is substantial ground for difference of opinion." As of the date of this Report, the District Court has not granted Furgatch leave to appeal.

C. Miscellaneous Litigation

Various parties, including customers of MFGI, former employees of the MF Global Group and shareholders of Holdings Ltd., have commenced litigation in multiple districts throughout the United States both pre- and post-bankruptcy. Actions filed pre-petition against the Debtors have been stayed pursuant to Bankruptcy Code § 362. Actions filed post-petition, which arose out of the collapse of the MF Global Group, generally do not name the Debtors as parties or are stayed as to the Debtors. A significant number of the customer actions filed post-petition have been consolidated in the Southern District of New York in the case *Joseph*

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[108] Docket No. 485.

[109] Docket No. 526.

[110] Docket No. 579.

[111] Docket No. 607.

Deangelis v. Jon Corzine, et al., C.A. No. 1:11-07866. Attached as Exhibit E is a chart detailing the various litigations.

VI. CONGRESSIONAL HEARINGS AND TESTIMONY

Since the October Petition Date, Congress has invited many people associated with the Debtors -- whether pre-petition or post-petition, tangentially or directly -- to appear and testify before it. The below chart details the hearings held before Congress, and those who appeared as witnesses during those hearings. Attached as Exhibit F is the Trustee's witness statement submitted prior to his testimony.[112]

Date	Committee	Title of Hearing	Witnesses
12/8/2011	House Agriculture Committee	Examination of MF Global Bankruptcy	Jon Corzine
12/13/2011	Senate Agriculture, Nutrition and Forestry Committee	Investigation into the MF Global Bankruptcy Panel I	Robert Hupfer Jeffrey Hainline Dean Tofteland C.J. Blew
12/13/2011	Senate Agriculture, Nutrition and Forestry Committee	Investigation into the MF Global Bankruptcy Panel II	Jon Corzine Henri Steenkamp Bradley Abelow
12/13/2011	Senate Agriculture, Nutrition and Forestry Committee	Investigation into the MF Global Bankruptcy Panel III	Terrence Duffy James Giddens Jill Sommers
12/15/2011	Oversight and Investigations Subcommittee of the House Financial Services Committee	Collapse of MF Global	Jon Corzine Bradley Abelow

[112] All of the witness statements associated with the chart below are available upon request to the Trustee at mfglobalinfo@mofo.com.

2/2/2012	Oversight and Investigations Subcommittee of the House Financial Services Committee	Collapse of MF Global: Part 2 Panel I	Michael Roseman Michael Stockman
2/2/2012	Oversight and Investigations Subcommittee of the House Financial Services Committee	Collapse of MF Global: Part 2 Panel II	Craig Parmelee Richard Cantor James Gellert
3/28/2012	Oversight and Investigations Subcommittee of the House Financial Services Committee	The Collapse of MF Global; Part 3 Panel I	Laurie Ferber Henri Steenkamp Christine Serwinski Edith O'Brien
3/28/2012	Oversight and Investigations Subcommittee of the House Financial Services Committee	The Collapse of MF Global; Part 3 Panel II	Diane M. Genova Daniel J. Roth Susan M. Cosper
4/24/2012	Senate Banking, Housing and Urban Affairs Committee	The Collapse of MF Global: Lessons Learned and Policy Implications	Louis Freeh James Giddens Jill Sommers Robert Cook Richard Ketchum Terrence Duffy

VII. THIRD PARTY INVESTIGATIONS

Since his appointment, the Trustee has negotiated and cooperated with the various governmental agencies investigating the failure of the MF Global Group, including the SEC and CFTC.[113] In addition, the Trustee, on April 24, 2012, testified before Congress as to the lessons learned thus far from the collapse of the MF Global Group.[114]

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[113] Docket No. 538.

[114] *See* Exhibit F for the Trustee's written statement to Congress prior to his testimony.

The Trustee also has commenced his own investigation into the Debtors' operation of their businesses and the facts and circumstances surrounding the Debtors' precipitous downfall as required by Bankruptcy Code section 1106(a)(3), which provides, in pertinent part:

> (a) A trustee shall—
>
> > (3) except to the extent that the court orders otherwise, investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan;

11 U.S.C. § 1106(a)(3). The investigation has included a review of internal documents, interviews with current and former employees, and discussions with third parties with knowledge of the situation.[115]

As soon as practicable, the Trustee will file a statement with the findings of his investigation as he is required to do to meet his statutory and fiduciary duties under the Bankruptcy Code.[116]

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[115] Docket No. 653.

[116] Bankruptcy Code section 1106(a)(4) requires:

> (4) as soon as practicable—
>
> > (A) file a statement of any investigation conducted under paragraph (3) of this subsection, including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate; and
> >
> > (B) transmit a copy or a summary of any such statement to any creditors' committee or equity security holders' committee, to any indenture trustee, and to such other entity as the court designates;

11 U.S.C. § 1106(a)(4).

CONCLUSION

As detailed in this Report, the Trustee has undertaken the wind-down of an extremely complex, global operation. Much of the Trustee's time has been spent interacting with the SIPA Trustee and worldwide administrators in order to understand what occurred in the final weeks leading up to the October Petition Date and figuring out what steps are necessary to maximize the value of the Debtors' estates. With in excess of $3 billion in claims filed against former affiliates, the potential recoveries for the Debtors' creditors will come primarily from recoveries on account of such claims. As a result, the Trustee actively follows the proceedings respecting those entities and even participates on certain of the creditors' committees around the world. Another potential source of value for the Debtors' estates is through litigation. The Trustee's investigation into potential claims and causes of action is in its early stages, and as it progresses, details will be provided to the Court.

Dated: New York, New York
June 4, 2012

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Attorneys for the Chapter 11 Trustee

ANNEX 1

1. **Principal or Proprietary Transaction** is a transaction entered into by a broker/dealer to buy or sell a security for its own account.

2. **A Long Position** in a security, such as a stock or a bond, or equivalently to be long in a security, means the holder of the position owns the security.

3. **RTMs and RRTMs** -- Under the GMRA, MFGI agreed to sell to MFGUK various European sovereign debt securities, while simultaneously entering into an agreement to repurchase those securities from MFGUK (or securities considered equivalent thereto) at an agreed upon repurchase price, on a date falling immediately prior to the maturity date of those securities. This type of sale and repurchase agreement is commonly referred to as a repo-to-maturity -- or RTM -- from the point of view of the seller/repurchaser of the securities/equivalent securities (in this case, MFGI), and a reverse repo-to-maturity -- or RRTM -- from the point of view of the purchaser/reseller of the securities/equivalent securities (in this case, MFGUK). The initial Repo funding is usually less than the value of the securities (or collateral) by an amount or percentage agreed upon by the parties and included in the confirmation detailing the trade. This is known as the initial margin or "haircut." The initial margin protects the buyer against a drop in the value of the collateral, illiquidity of the collateral and counterparty credit risk. In a classic Repo transaction, the initial margin is transferred to the buyer (or supplier of cash). The margin level for Repos varies according to the underlying collateral and is usually determined based on the credit-rating of the security posted as collateral. For example, an investment grade sovereign bond (*e.g.*, UK or Germany) might require a 0-2% haircut, while a non-investment grade bond may require a 15% haircut. The market value of the collateral is maintained through the posting of "variation margin." Variation margin gets its name because the level of additional margin varies with the value of the collateral -- the seller will be required to post additional margin if the

collateral decreases in value and the buyer will return margin if the mark-to-market value of the collateral increases in value. Potential liquidity risks existed because if the value of the collateral underlying the repurchase agreement decreases -- whether because of market conditions or because of issuer-specific concerns -- MFGI was required to post variation margin to maintain the value of the collateral held by the Exchanges. If the value of the collateral became permanently impaired -- for example, if the issuer of the bonds or other securities posted as collateral defaulted on its obligations -- MFGI would still have the obligation to repurchase the collateral at full value upon the expiration of the Repo.

4. **Margin Reduction Trades** are characterized as such because the new positions "offset" the existing trades. Brokers are not required to post margin for both long and short positions. As a result of the offsetting nature of such trades, the brokers' portfolio margin requirements are reduced.

5. **Hold-to-Maturity** -- Under the HTM, Holdings Ltd. agreed to sell to the MFGI B/D the HTM securities, with a simultaneous agreement of Holdings Ltd. to repurchase from the MFGI B/D those same HTM securities at an agreed repurchase price, on an agreed date falling immediately prior to the maturity date of those securities.

6. **ISDA** -- The International Swaps and Derivatives Association (ISDA) is a trade organization of participants in the market for over-the-counter derivatives. ISDA has created a standardized contract (the ISDA Master Agreement) used by counterparties that enter into derivatives transactions.

7. **Stock/Bond Borrow and Stock/Bond Loan** are the different sides to a "securities lending" transaction. Securities lending is used in the securities markets for specific permitted

purposes, which include facilitating (i) settlement of a trade, (ii) delivery of a short sale, (iii) financing a security, or (iv) a loan to another borrower who is engaging in one of the aforementioned permitted purposes.

The principal reason for borrowing a security is to cover a short position. Short-sellers are required to deliver the security they sold short. Thus, unless the short-seller holds a long position in the security, of a "covered" position, the short-seller will have to borrow the security. At the end of the securities loan transaction, the borrower is required to return an *equivalent* security to the lender. Equivalent in this context means completely interchangeable.

8. **Intercompany Payable** refers to a margin payment made from one affiliate of the MF Global Group to another affiliate under a Repo that is to be repaid upon maturity, provided that no default occurred under the Repo prior to such maturity date. Upon a default, the posted margin may be utilized by the non-defaulting party to cover costs associated with unwinding closing out the Repo, thereby reducing the Intercompany Payable.

EXHIBIT A

SUMMARY OF CLAIMS

Jurisdiction / Entity	No. of Claims Filed or To Be Filed	Amount[117]
Australia	**4**	**$1,389,905**
Canada	**5**	**$1,216,100**
Hong Kong	**4**	**$1,180,965**
India	**7**	**$832,541**
Japan	**4**	**$739,777**
Mauritius	**1**	**$55,444**
Singapore	**3**	**$26,514,373**
United Kingdom		
MFGUK	10	$446,360,476 - $563,800,476
Finance Europe	3	$346,717,352
MFG Overseas	3	$5,815,380
United Kingdom Sub-total	**16**	**$798,893,208 - $916,333,208**
United States	**68**	**$2,317,765,096**
Total	**112**	**$3,148,587,409 - $3,266,027,409**

[117] This chart provides a summary by jurisdiction of the claims filed or to be filed by the Debtors and their non-debtor affiliates against their former affiliates. This chart does not include an estimated value for unliquidated claims filed or to be filed against former affiliates or non-debtor third parties.

EXHIBIT B

CORPORATE ENTITY CHART

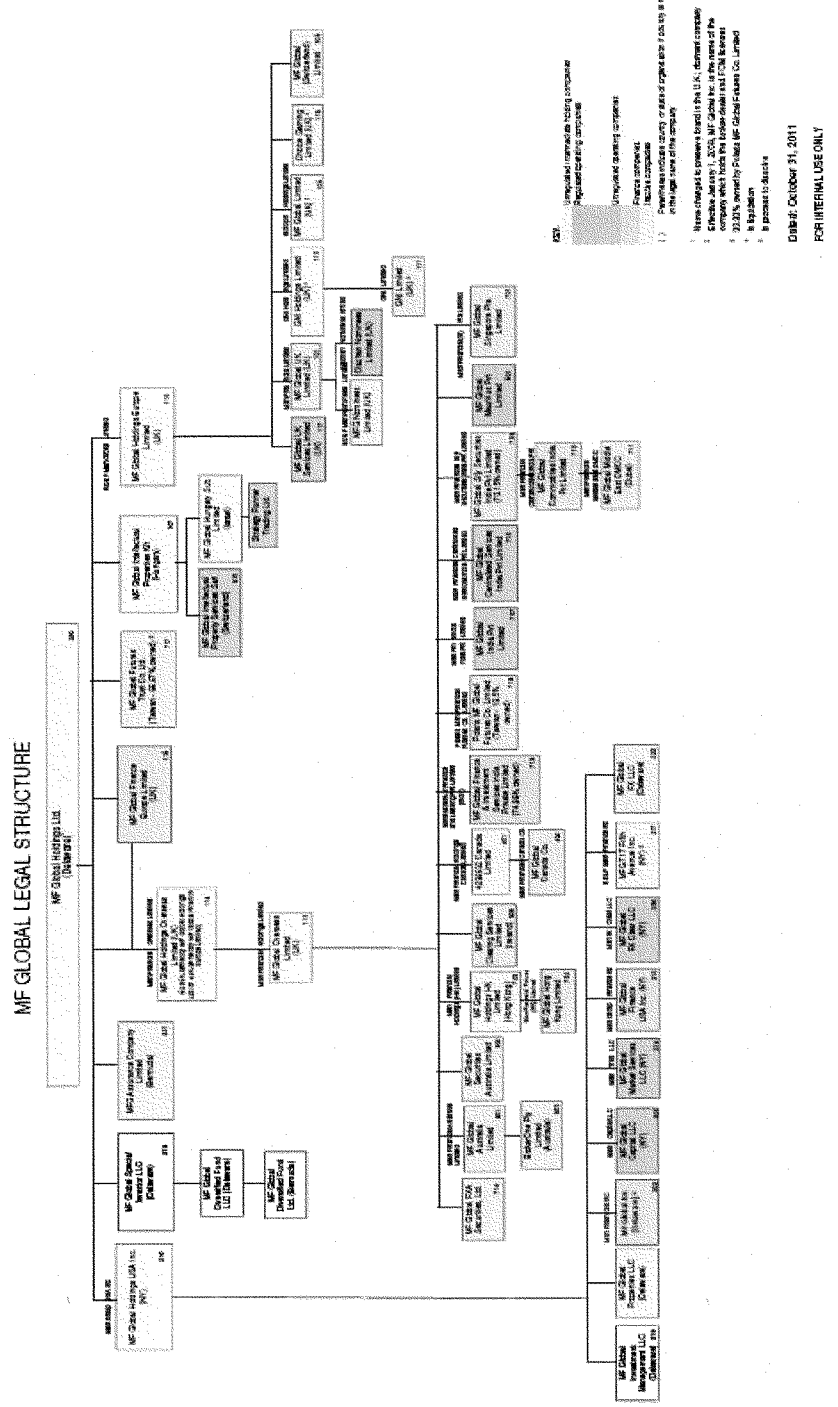
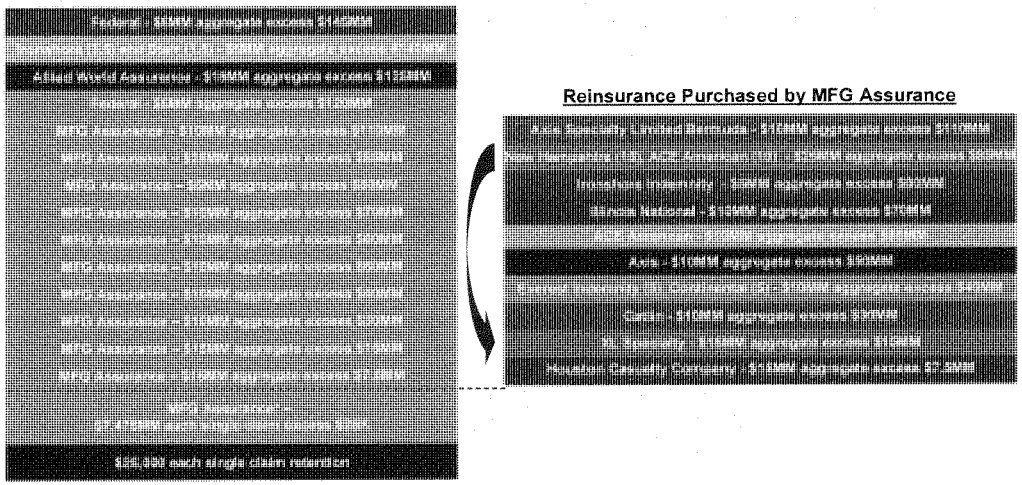

MF GLOBAL LEGAL STRUCTURE
MF Global Holdings Ltd.
(Bermuda)
Date of: October 31, 2011
FOR INTERNAL USE ONLY

EXHIBIT C

E&O POLICY TOWER

MF Global Holdings Ltd.
Professional Liability Insurance Program Structure
May 31, 2011 to May 31, 2012

Total Aggregate Limit = $150MM



Reinsurance Purchased by MFG Assurance

*MFG Assurance Company Limited is MF Global Holdings Ltd.'s wholly-owned captive insurance company domiciled in Bermuda and regulated by the Bermuda Monetary Authority

THIS DOES NOT REFLECT ACTUAL TERMS AND CONDITIONS. THIS IS NOT INTENDED TO BE RELIED UPON AS AN INSURANCE POLICY OR LEGAL ADVICE.

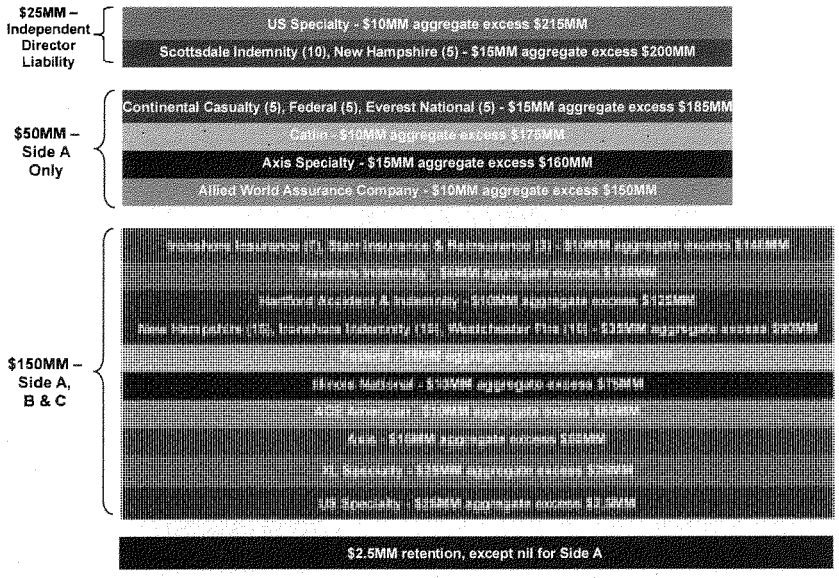
MF Global

EXHIBIT D

D&O POLICY TOWER

MF Global Holdings Ltd.
Directors & Officers Liability Insurance Program Structure
May 31, 2011 to May 31, 2012

Total Aggregate Limit = $225MM



PLEASE NOTE: THIS DOES NOT REFLECT ACTUAL TERMS AND CONDITIONS.
THIS IS *NOT* INTENDED TO BE RELIED UPON AS AN INSURANCE POLICY OR LEGAL ADVICE.

MF Global

EXHIBIT E

MULTI-DISTRICT LITIGATION CHART

Item No.	Case Title[118]	Case No.	Court	Nature of Alleged Claims[119]	Class Action
1.	*DeAngelis v. Corzine*[120]	11-civ-7866	SDNY	C	Y
2.	*Accomazzo v. Corzine*	11-civ-8467	SDNY	C	Y
3.	*Sapere CTA Fund, L.P. v. Corzine*	11-civ-9114	SDNY	C	N
4.	*Henning-Carey Proprietary Trading, LLC v. Corzine*	12-civ-3231	SDNY	C	Y
5.	*Marcin v. Corzine*	12-civ-0499	SDNY	C	Y
6.	*Wacker v. Corzine*	12-civ-0705	SDNY	C	Y
7.	*Andrews v. Corzine*	12-civ-0661	SDNY	C	Y
8.	*Paradigm Global Fund I, Ltd. v. Corzine*	12-civ-0740	SDNY	C	Y
9.	*Paradigm Global Fund I, Ltd. v. MFG Assurance, Ltd.*	12-civ-2471	SDNY	C	Y
10.	*Tee v. Corzine*	12-civ-0195	SDNY	C	Y
11.	*Summit Trust Co. v. Corzine*	12-civ-0087	SDNY	C	Y
12.	*Pierce v. Corzine*	12-civ-3588	SDNY	C	Y

[118] The following chart is provided for informational purposes only. The inclusion of these cases is not, and should not be, construed as an admission of the validity of the claims asserted against the defendants. All Debtors fully reserve all defenses, setoffs and counterclaims in connection with the actions listed herein.

[119] "C" = an MF Global Inc. customer complaint; "S" = a securities claim.

[120] Item numbers 2-23 in the above chart have been consolidated with item number 1, *DeAngelis v. Corzine*, Case No. 11-civ-7866.

Item No.	Case Title[118]	Case No.	Court	Nature of Alleged Claims[119]	Class Action
13.	*Klinker v. J.P. Morgan Chase Co.*	12-civ-3589	SDNY	C	Y
14.	*Varner, Jr. v. Corzine*	12-civ-1722	SDNY	C	Y
15.	*Kennedy v. Corzine*	12-civ-1982	SDNY	C	Y
16.	*Context Partners Fund, L.P. v. Corzine*	11-civ-8888	SDNY	S	Y
17.	*Rodriguez v. Corzine*	11-civ-8815	SDNY	S	Y
18.	*Daly, Jr. as Trustee v. Corzine*	11-civ-8823	SDNY	S	Y
19.	*Espinoza v. Corzine*	11-civ-7960	SDNY	S	Y
20.	*Double D Trading, LLC v. Corzine*	11-civ-8271	SDNY	S	Y
21.	*IBEW Local 990 Pension Fund v. Corzine*	11-civ-8401	SDNY	S	Y
22.	*Teamsters Local Union No. 35 Pension Fund v.Dan*	12-civ-1782	SDNY	S	Y
23.	*Arvelo v. Corzine*	12-civ-3884	SDNY	S	Y
24.	*Untitled*	12-md-2338	SDNY	Overall Case No. for cases transferred by *MDL 2338*	NA
25.	*In re MF Global Holdings Ltd. Investment Litigation*	MDL No. 2338	MDL	Multi District Proceeding now effectively concluded	NA

Item No.	Case Title[118]	Case No.	Court	Nature of Alleged Claims[119]	Class Action
26.	*Butler, Jr. v. Corzine*	653074/2011	New York County Supreme Court	Unknown (no complaint); dormant	N
27.	*McHugh v. MF Global Holdings USA, Inc.*	12-civ-0284	SDNY	Employee claim	N
28.	*Riffice v. MF Global Holdings USA, Inc.*	11-civ-0671	SDNY	Employee claim	N
29.	*Calascibetta, Liquidating Trustee v. MF Global*	Case No. 09-14301, A.P. No. 11-01220	Bankr. D.N.J.	Fraudulent conveyance	N
30.	*Ripes v. MF Global*	13-148 E 01209 11	AAA (Chicago)	Employee claim	N
31.	*Ceko v. MF Global Holdings, Ltd.*[121]	10 CH 25758	Cook County Circuit, Il.	Employee claim	N
32.	*Thielmann, et. al. v. MF Global Holdings, LTD, et al.*	A.P. No. 11-02880 (MG)	Bankr. SDNY	WARN	Y
33.	*Ivan Schertzer v. Jon Corzine et al*	NFA 12-ARB-17	NFA	Customer claim	N

[121] This adversary proceeding was filed but never served on the defendants.

EXHIBIT F

TRUSTEE'S WITNESS STATEMENT

STATEMENT OF LOUIS J. FREEH
BEFORE THE UNITED STATES SENATE
COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS
APRIL 24, 2012

Chairman Johnson, Ranking Member Shelby. and Distinguished Members of the Committee:

My name is Louis J. Freeh and I am appearing before you today in my capacity as the Chapter 11 Trustee of MF Global Holdings Ltd. and five of its subsidiaries.

On October 31, 2011, MF Global Holdings Ltd. and MF Global Finance USA Inc., referred to generally as "Finco", filed for bankruptcy under Chapter 11 of the Bankruptcy Code. Upon the commencement of the bankruptcy cases, the debtors operated as debtors-in-possession. Shortly thereafter, on November 7, 2011, the Office of the United States Trustee formed a creditors' committee representing the unsecured creditor constituency of the Chapter 11 debtor entities. Without any possibility of rehabilitation, the debtors and the creditors committee jointly filed a motion to appoint a Chapter 11 Trustee. That motion was approved by the Court, and I was named as the Chapter 11 Trustee. My appointment was approved by the Bankruptcy Court effective as of November 28, 2011.

On December 19, 2011, three additional MF Global entities that are each indirect subsidiaries of the Chapter 11 parent filed for bankruptcy. I was subsequently appointed the Chapter 11 Trustee of those entities as well. In addition, on March 2, 2012, MF Global Holdings USA Inc., a direct subsidiary of the parent holding company debtor, filed for bankruptcy protection. On March 8, 2012 I was also appointed Chapter 11 Trustee of that estate. As is evident from this brief timeline, we are in the early stages of

this bankruptcy proceeding, and there is still much information to be learned about the facts and circumstances that led to the collapse of MF Global.

My duties as a Chapter 11 Trustee are set forth in Section 1106 of the Bankruptcy Code and include the obligation to investigate the acts, conduct, assets, liabilities and financial condition of the debtor, among other things. Unlike the SIPA Trustee, who is charged primarily with the return to customers of their investment property, the responsibility of the Chapter 11 Trustee is to maximize the value of the estate for the benefit of its creditors.

Upon my appointment on November 28, 2011, I began to assemble a team of legal advisors and financial consultants with extensive experience in bankruptcy matters, as it was widely believed that these proceedings were likely to be among the most complex bankruptcy matters in recent memory. We immediately began to assess the Debtors' state of affairs. Investigations into the collapse of MF Global were already being conducted by the CME, the SEC, the CFTC, and the SIPA Trustee, and at least two federal prosecutors' offices.. Customers of MF Global Inc., the US broker dealer, had already commenced litigation against certain officers and directors of the broker dealer as well as those of the parent holding company debtor.

Even before the commencement of my appointment, the Debtors were faced with a number of expansive requests for documents and information and my team immediately immersed itself in a process that had already been unfolding for several weeks, in an effort to learn what documents were in my possession, how records were maintained, and where files were kept. All of this was critical to our ability to fulfill our obligations as Chapter 11 Trustee.

These difficulties were exacerbated by the fact that what had once been operated as one large MF Global world-wide organization suddenly became fragmented, virtually overnight. Separate proceedings were commenced for individual MF Global entities, most notably the SIPA proceeding here in the US and the UK administration (the UK equivalent of a US bankruptcy proceeding) of the UK broker dealer, which proceed independently from one another. The MF Global entities suddenly found themselves without access to global systems previously utilized by the entire group of companies, because certain entity-wide systems such as accounting and email systems were owned and controlled by individual MF Global companies.

With these difficulties, the Chapter 11 debtors had been able to assemble some materials before my appointment. I needed, however, to ascertain what documents, files, information, and materials were the property of the Chapter 11 parent, versus property of the SIPA estate, the UK broker dealer estate, or perhaps jointly owned by a Chapter 11 debtor and another estate. My advisory team was required to review thousands of pages of e-mails, documents and other files to determine (1) what those materials said, (2) whether the materials were responsive to any request by any governmental agency or the SIPA Trustee, and (3) whether any protectable corporate privilege existed. I then needed to implement a process to produce as quickly as we could documents requested as part of the investigations, but also in a manner that did not unnecessarily result in a broad waiver of any existing privilege. To do otherwise at this very early stage potentially could have been contrary to my obligations as Chapter 11 Trustee. Ultimately, these issues were resolved and the process moved forward expeditiously.

Although none of the entities for which I serve as Chapter 11 Trustee are regulated entities, the concerns of customers are nonetheless important to me and my advisors. With a backdrop of allegations of missing customer funds, the Bankruptcy Judge, the Honorable Martin Glenn, directed that my team perform an analysis of the approximately $25 million held in a cash collateral account owned by Finco to determine whether that cash included misappropriated MF Global Inc. customer property. Thereafter, my advisors poured through account data and transaction documents covering more than $3.5 billion in cash transfers, including transfers from accounts held by MF Global Inc. My advisors interviewed and met with employees of MF Global Inc. and advisors retained by the SIPA Trustee in order to ensure that an appropriate investigation had been conducted in preparing the report. Upon completing the analysis, which was shared with the SIPA Trustee, we concluded with no disagreement from the opinion of the SIPA Trustee that the cash collateral account did not include misappropriated or misdirected customer funds.

There has been a great deal of publicity regarding the shortfall in customer property. Without in any way diminishing the importance of the SIPA Trustee's obligation to locate and recover customer property, the Bankruptcy Code requires me to attempt to recover for the benefit of the creditors of the Chapter 11 estates monies that were obtained by the parent from third party lenders and investors and routed to the US broker dealer or elsewhere. In particular, and by way of example, during the month of October, 2011, in excess of $1 billion in cash was transferred from MF Global Holdings Ltd. and Finco to MF Global Inc. In addition, a substantial portion of the net proceeds from the $650 million of MF Global bonds sold in 2011 to investors by MF Global

Holdings Ltd. had been transferred to MF Global Inc. Just as the SIPA Trustee is analyzing and investigating the whereabouts of funds and property entrusted by customers to the US broker dealer, so too my team must investigate the whereabouts of funds loaned to the US broker dealer for which the Chapter 11 estates remain liable to creditors and investors.

In furtherance of my duty to investigate the affairs of the Chapter 11 debtors for which I serve as Trustee, my advisors and I meet regularly with our creditors committee as well as with representatives of the SIPA Trustee and the representatives of the foreign affiliates. These meetings are important for each of the estates to gather and share information with one another to facilitate a timely investigation of the facts and circumstances leading up to the bankruptcy and to determine where the assets of the various estates may be located.

The representatives of the SIPA Trustee and my advisors often speak daily, have engaged in information sharing calls at least weekly, and are currently discussing coordinated efforts to assist one another in the administration of our respective estates. I have found this cooperation to be invaluable, if not essential, to my ability to satisfy my fiduciary obligations as a Chapter 11 Trustee. I strongly believe that the interests of all of the various estates are best served by cooperating and sharing information to uncover precisely what led to the collapse of MF Global. No one estate has all of the information, but together, the puzzle pieces can be put together.

To be clear, the trustees and foreign administrators can and likely will assert different legal arguments to support their claims to property located throughout the world. The bankruptcy court and perhaps other courts will make those legal

determinations. But the ultimate legal disputes that may arise should not serve as a barrier to sharing the critical facts to tell the world what led to the collapse. Notwithstanding that we are operating under the supervision of the court, however, it is clear even at this early stage that the competing, and perhaps at times conflicting, obligations and duties of the two Trustees and various foreign administrators has and will continue to have the effect of extending the length of time necessary for all of the estates to conduct their investigations; to determine the value and location of assets; and ultimately to make distributions to customers and/or creditors.

At the present time, the Chapter 11 debtors employ approximately 15 non-executive individuals, most of whom had been employed by one of the debtors prior to the commencement of the bankruptcy cases. They, along with the remaining senior executives, continue to provide invaluable support in reconciling the debtors' books and records, closing open trades at the unregulated entities, the preparation of tax returns, and assisting in understanding the many complex pre-petition transactions between and among the various MF Global entities.

In conversations about retaining these individuals and the knowledge they possess, I've discussed at various times the possibility of establishing a retention program. To be clear, no formal program was ever created for senior executives, nor was any motion ever filed with the court for approval in connection with any retention program for senior executives.

As we continue our investigation, we will be filing a report with the Bankruptcy Court on or before June 4, 2012. Mindful of this impending deadline, we have filed with the Bankruptcy Court a motion seeking authority to issue subpoenas for the production of

documents and examination of witnesses on a shortened timetable. That motion will be heard on April 25, 2012. We remain hopeful that parties will be cooperative during this investigation, but a formal process will be utilized as necessary.

It is important to note that the transpareney of the bankruptcy process mandates that the work performed by the Chapter 11 Trustee is closely monitored by the Office of the United States Trustee and supervised by the United States Bankruptcy Court.

I fully intend to fulfill my legal obligations as Chapter 11 Trustee as timely and transparently as I can responsibly do so, recognizing that all of my, and my professionals, actions must be consistent with the duties and obligations set forth in the Bankruptcy Code.

National Grain and Feed Association

1250 Eye St., N.W., Suite 1003, Washington, D.C. 20005-3922, Phone: (202) 289-0873, FAX: (202) 289-5388, Web Site: www.ngfa.org

April 2, 2012

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Dear Chairman Gensler:

The demise of MF Global has shaken the confidence of many futures market participants with regard to the safety of segregated customer funds. Many NGFA-member companies continue to struggle to recover their funds and property.

The NGFA respectfully submits the following preliminary recommendations as first steps to begin re-establishing confidence among futures market participants and to help safeguard customer funds. However, it is extremely important that these types of changes – designed to enhance reporting, transparency and accountability, with recommendations we believe should be relatively easily implemented – are not the end of efforts to ensure that another MF Global-type situation never recurs.

The NGFA's MF Global Task Force continues its work to examine various models for segregating and safeguarding customer funds; to explore the viability and costs of extending insurance coverage to commodities accounts; and to analyze potential changes to the U.S. bankruptcy code to provide customers with needed protection, especially to protect customer segregated funds from being swept into liquidation proceedings and to ensure that "safe harbor" rules under the bankruptcy code aren't used to preclude retrieving customer funds. We expect to issue additional recommendations in these areas soon. In all these efforts, our bedrock principle will be:

"Customers Come First"

The preliminary recommendations of the NGFA are as follows:

- The CFTC should require daily reporting of segregated fund positions by FCMs to both their Self-Regulatory Organization (SRO) and to the CFTC.

- The CFTC should require daily reporting of segregated fund investments by FCMs, detailed by maturity and quality, to both their SRO and to the CFTC.

- The CFTC should conduct a formal review of FCM investment options for customer funds, with a view to whether the Commission should further limit allowable investments only to very safe instruments.

- The CFTC should require reporting by FCMs to their SRO and to the CFTC of significant changes in investment policies or holdings.

- FCMs should be required to provide greater transparency to customers of where customer funds are invested, potentially achieved through means such as posting on the CFTC web site, FCM web sites and/or publication in a customer "prospectus."

- The CFTC and SROs should enhance monitoring of FCM reporting. Both regulators should conduct more detailed and more frequent audits, and unannounced spot checks of FCMs.

- To assign accountability and to aid in establishing that fraudulent activity has occurred in the event customer funds are misappropriated, CFTC should require the signature of two authorized principals of an FCM (e.g., CEO, CFO or other senior officers) to move funds out of segregated customer fund accounts to non-customer accounts.

- FCMs should be required to provide immediate notice to their SRO and to the CFTC if the firm moves more than some percentage, to be determined by the CFTC, of excess segregated funds to non-customer accounts.

- FCMs should be required by their SRO to periodically certify policies and procedures to ensure the safeguarding of customer segregated accounts and compliance with applicable laws and regulations regarding such accounts. As part of all examinations by SROs, principals of FCMs must certify that policies and procedures are adequate, effective and being observed by the FCM. At least annually, SROs should be required by CFTC to review policies and procedures to determine adequacy and compliance.

- A rigorous review by the CFTC of capital requirements for FCMs and broker-dealers needs to be conducted, with a view to scrutinizing the current practice of allowing double-counting of required capital when a firm operates as both an FCM and a broker-dealer.

We appreciate the opportunity to share these recommendations with you, and we look forward to working with you to ensure that customer funds truly are segregated and safe from future misappropriation.

Sincerely,

Matt Bruns

Matt Bruns
Chair
Risk Management Committee

John Heck
Chair
Finance and Administration Committee

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FIA

June 14, 2012

Honorable Debbie Stabenow, Chairwoman
Senate Committee of Agriculture, Nutrition, and Forestry
328A Russell Senate Office Building
Washington DC 20510-6000

Re: Response to Bankruptcy of MF Global Inc.

Dear Chairwoman Stabenow:

The Futures Industry Association ("FIA")[1] is pleased to submit this letter in response to your request for our evaluation of the current regulatory framework for the exchanged-traded derivatives markets established in the Commodity Exchange Act ("Act") and our recommendations on changes that would create stronger, safer markets and provide customers with greater protections. The bankruptcy of MF Global Inc. has been a personal tragedy for its thousands of customers who have suffered financially. It has also imposed a significant reputational cost on the exchange-traded markets generally, seriously damaging the confidence in the markets that is essential to their success. It is critical that the industry, working in coordination with Congress, the Commission and the several self-regulatory organizations ("SROs"), do everything it can to restore this confidence.

As discussed in greater detail below, FIA has identified and recommended to the Commodity Futures Trading Commission ("Commission") and the several SROs, in particular, the National Futures Association ("NFA") and the Chicago Mercantile Exchange ("CME"), which serve as the designated self-regulatory organizations ("DSROs") for all FCMs, a number of amendments to the existing regulatory framework that will strengthen the protections afforded customers and customer funds and help restore confidence in the

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[1] FIA is the leading trade organization for the futures, options and OTC cleared derivatives markets. It is the only association representative of all organizations that have an interest in the listed derivatives markets. Its membership includes the world's largest derivatives clearing firms as well as leading derivatives exchanges from more than 20 countries. As the principal members of the derivatives clearing organizations, our member firms play a critical role in the reduction of systemic risk in the financial markets. They provide the majority of the funds that support these clearinghouses and commit a substantial amount of their own capital to guarantee customer transactions.

FIA's core constituency consists of futures commission merchants ("FCMs"), and the primary focus of the association is the global use of exchanges, trading systems and clearinghouses for derivatives transactions. FIA's regular members, which act as the majority clearing members of the U.S. exchanges, handle more than 90 percent of the customer funds held for trading on U.S. futures exchanges.

markets. These recommendations have been well-received, and we are having productive discussions with the Commission and the SROs regarding their implementation.

At this time, we have not identified any changes to the Act or the Bankruptcy Code that we believe are necessary to enhance protection of customers and customer funds. However, we continue to consider this issue, including evaluating proposals made by other market participants. We will advise you promptly in the event we determine that legislative changes would be appropriate.

We also note the recent publication of the Report of the Trustee's Investigation and Recommendations, which discloses greater details on the MF Global insolvency with recommended changes to prevent this sort of incident from reoccurring. FIA is pleased to report that several of its Initial Recommendations for Customer Funds Protection described below were adopted in the recommendations of the Trustee. We continue to study the remaining recommendations of the Trustee and will keep the Committee apprized whether any of these additional recommendations may deserve further consideration.

FIA's Initial Recommendations for Customer Funds Protection

In January, FIA formed a special committee, the Futures Markets Financial Integrity Task Force, to develop and recommend specific measures that could be implemented in the near term through both industry best practice and regulatory change to address the issues arising from the bankruptcy of MF Global. With the assistance of FIA's Financial Management Committee, whose members include representatives of FIA member firms, derivatives clearing organizations and depository institutions, the Task Force released its Initial Recommendations for the Protection of Customer Funds on February 28, 2012 ("Initial Recommendations"), a copy of which is enclosed for your convenience. The Task Force concluded that, with the possible exception of the rules governing the offer and sale for foreign futures and foreign options, the current regulatory framework is fundamentally sound.[2] The Initial Recommendations, therefore, are intended to enhance, not replace, the existing protections.[3]

The Initial Recommendations generally fell into three categories: (i) enhanced disclosure regarding customer funds protections; (ii) enhanced reporting with regard to customer funds; and (iii) enhanced internal controls.

Enhanced disclosure regarding customer funds protections. The Task Force recognized that one of the more important services an FCM can provide its customers is to assure that these customers appreciate the limitations as well as the benefits of the customer funds protections set out in the Commodity Exchange Act and the Commission's rules. To address

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[2] Our recommendations with respect to the foreign futures and foreign options rules are below.

[3] Several of the Initial Recommendations are similar to the recommendations in the Report of the MF Global Inc. Trustee's Investigation and Recommendations issued on June 4, 2012 ("Trustee's Report").

those elements of the protections that are of immediate concern to customers, the FIA Law and Compliance Executive Committee prepared a memorandum setting out responses to frequently asked questions that FIA member firms have received from their customers. The Task Force determined that this document, which may be accessed on the FIA website, is an appropriate first step in providing customers critical information regarding customer funds protection.[4]

Enhanced reporting with regard to customer funds. Commission rules currently require each FCM (i) to compute as of the end of each business day the amount of funds held, and required to be held, in segregation, and (ii) to maintain detailed records of the investment of customer funds held in accordance with Commission Rule 1.25. NFA has required those FCMs for which it is the DSRO to file a copy of each daily segregation calculation and a monthly report identifying the sectors in which the FCM invests customer funds, the amount of customer funds invested in each sector and the weighted average maturity of the assets held in each sector. However, this information has not been reported to the other DSROs or the Commission on a routine basis.

In order to provide the Commission and all SROs with more up-to-date information on customer segregated funds, the Task Force recommended that the NFA reporting requirements be extended to all FCMs. Specifically, each FCM should be required to file with its DSRO its daily segregation calculation. Further, each FCM should be required to file twice monthly reports, as of each month-end and as of the 15th of each month (or the next business day), identifying: (i) the sectors in which the FCM invests customer funds; (ii) the amount of customer funds invested in each sector; and (iii) the weighted average maturity of the assets held in each sector. FIA understands that the CME and NFA, to the extent necessary, have adopted rules to implement these recommendations and expects that they will be approved by the Commission in the near future.

Enhanced internal controls. The Task Force recognized that no rules can adequately protect customer funds unless the firms responsible for complying with those rules maintain strong internal controls.[5] The Task Force, therefore, recommended that all FCMs document and implement policies and procedures regarding their internal controls. These recommendations reflect the best practices of those firms represented on the Financial Management Committee.

Specifically, the Task Force recommended that:

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[4] A copy of the Frequently Asked Questions available on the FIA website is also enclosed for your convenience. We view this document as a "living document" and will revise the document as other questions are identified or as required by amendments to the Act or the Commission's rules. In this regard, the Commission staff has asked us to prepare a question and answer that would expand on the risks associated with trading on foreign boards of trade. We expect to add this question and answer shortly.

[5] As the Trustee's Report confirms, the lack of strong internal controls played a significant role in MF Global's bankruptcy.

- The Commission propose a rule requiring each FCM to certify annually that there are (and have been since the last report) no material weaknesses in its internal controls regarding the computation of adjusted net capital and compliance with the provisions of the Act and the Commission's rules regarding the protection of customer funds.

- The SROs require FCMs to document their policies and procedures that require an appropriate separation of duties among individuals responsible for compliance with the Act and the Commission's rules relating to the protection of customer funds, subject to appropriate oversight and review.

- NFA consider whether it should develop an examination for chief financial officers of FCMs and other personnel responsible for compliance with the provisions of the Act and the Commission's rules relating to the calculation of the FCM's adjusted net capital and the protection of customer funds.

- The SROs require each FCM to document its policies and procedures for valuing all securities held in the customer segregated account, including permitted investments under Commission Rule 1.25, to assure that such securities are accurately valued and, in particular, are readily marketable and highly liquid.[6]

- The SROs require each FCM to document policies and procedures for selecting the depositories, including affiliates, with which the FCM deposits and maintains customer funds.

- The SROs require each FCM to document its policies and procedures with respect to the FCM's determination of the appropriate targeted residual interest it maintains in the customer segregated account.[7] Such policies and procedures should be designed to reasonably assure that any withdrawals from the customer segregated account to the FCM's own account comprise the FCM's residual interest and will not result in a violation of the Act and the Commission's rules, or the FCM's targeted residual interest.[8] The FCM's chief financial officer or the chief financial officer's delegate must approve in writing any withdrawal from the customer segregated account in

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[6] FIA also recommended that the Commission amend Rule 1.25 to confirm that an FCM investing customer funds in accordance with the rule bears the risk of loss arising from any such investment and must use its own funds to restore the value of the customer segregated account. FIA believes that the responsibility of an FCM for losses incurred in connection with investments under Commission Rule 1.25 is clear and is implicit in the Act and the Commission's rules. Nonetheless, because this question has been raised by certain customers, the Commission's rules should make this obligation explicit in order to remove any ambiguity.

[7] All such FCM funds are held for the exclusive benefit of the FCM's customers while held in a customer segregated account.

[8] The Task Force believes that the Commission or DSRO should have authority to require an FCM to increase the amount of FCM funds held in segregation or to prevent an FCM from withdrawing its residual interest only in carefully circumscribed circumstances and in accordance with carefully articulated objective standards.

violation of the policies and procedures, as well as any material change in the policies and procedures regarding the maintenance of the FCM's residual interest in the customer segregated account.[9]

Foreign Futures and Foreign Options Secured Amount

The Commission's foreign futures and options rules currently provide an FCM with greater flexibility in the manner in which it treats customers that trade on foreign boards of trade and the funds deposited by such customers to margin transactions on foreign boards of trade. For example: (i) foreign futures and foreign options customers are defined to include only those customers located in the US; (ii) only funds received from foreign futures and foreign options customers are required to be taken into account in calculating the foreign futures and foreign options secured amount in accordance with Rule 30.7; (iii) Rule 30.7 provides for an alternative calculation of the foreign futures and foreign options secured amount that does not assure protection of customer funds as fully as the net liquidating equity calculation that is used to determine the amount required to be segregated in connection with trading on US futures markets; and (iv) there is no limit on the amount of foreign futures and foreign options customer funds that may be held in permitted depositories outside of the US (although capital charges may apply).

Providing such flexibility was reasonable in 1987, when the foreign futures and foreign options rules (Part 30) were adopted. US participation in foreign markets was small and generally limited to commercial users. However, the international derivatives markets have changed significantly in the past twenty-five years. Although FIA understands that FCMs have generally adopted policies and procedures designed to provide protections to all customers trading on foreign boards of trade that are comparable to the protections afforded customers trading on US futures markets, the Task Force has recommended that the Commission publish for comment proposed amendments to the Part 30 rules that would:

- revise the definition of a foreign futures and foreign options customer to include all customers, wherever located;
- require all FCMs to calculate the foreign futures and foreign options secured amount using the net liquidating equity calculation;[10]

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[9] The Trustee's Report made a similar recommendation. FIA understands that both NFA and the CME have adopted rules to require the FCMs for which they are the DSRO to document their policies and procedures for determining the appropriate targeted residual amount. Further, the CEO, CFO or, in the case of NFA, a financial principal, would be required to approve in writing any withdrawal of a portion of the FCM's residual amount, not for the benefit of customers, in excess of 25 percent of the residual amount reflected in the FCM's most recent daily segregation calculation. Such written approval would be required before the withdrawal is made, followed by immediate notice to the FCM's DSRO. FIA fully supports these rules.

[10] The Trustee's Report made a similar recommendation.

- hold funds deposited with the FCM for the purpose of trading foreign futures and foreign options in the US, except as reasonably expected to meet margin obligations on foreign boards of trade;[11] and

- provide that, except as the Commission otherwise provides by order, only funds deposited or otherwise required to be held for the purpose of trading foreign futures and foreign options should be held in the foreign futures and foreign options secured amount.

The Task Force further recommended that the Commission withdraw that portion of the Commission's September 30, 2003 order that authorizes firms that are subject to regulation by the FSA and have qualified for an exemption from registration as an FCM in accordance with Commission Rule 30.10 to offer their customers that meet the definition of an eligible contract participant to opt out of the applicable UK segregations requirements.

Conclusion

We would welcome the opportunity to meet with you, Senator Roberts and your respective staffs at your convenience to discuss FIA's recommendations in greater detail.

FIA shares your commitment, and that of the Commission, the several SROs and all other industry participants, to understand fully the reasons underlying the bankruptcy of MF Global Inc., the extent to which any shortcomings in the regulatory framework may have facilitated the conduct that led to its bankruptcy, and the appropriate regulatory response to such shortcomings. We look forward to working with you in this endeavor.

Sincerely,

Walter L. Lukken
President

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[11] The appropriate excess is not amenable to a prescriptive rule, but will depend, for example, on the volatility from time-to-time of the products traded, the type of collateral (cash or securities) deposited with the foreign broker, the time-zone in which the market is located, and the jurisdiction of the markets traded. To the extent that a numerical standard is deemed necessary, the Task Force suggested that it should be no less than 50 percent of the amount that an FCM is required to deposit with a foreign broker to maintain customer foreign futures and foreign options positions. This number is consistent with the provisions of Commission Rule 1.17(c)(5)(xiii)(C), which requires an FCM to take a five percent capital charge to the extent unsecured receivables with a foreign broker is greater than 150 percent of the current amount required to maintain futures and option positions in accounts with the foreign broker.

QUESTIONS AND ANSWERS

AUGUST 1, 2012

Senate Committee on Agriculture, Nutrition & Forestry
Examining the Futures Markets: Responding to the Failures of MF Global and Peregrine Financial Group
Questions For The Record
August 1, 2012
Responses of Chairman Gary Gensler

Ranking Member Pat Roberts

1) It is my understanding that your staff feels they have gone as far as they can under the current bankruptcy regime by increasing collateral protection with the LSOC model the Commission adopted earlier this year. Is this correct?

Response: Section 766(h) of the Bankruptcy Code requires that customer property be distributed on a pro rata basis, which limits the Commission's ability to provide for the individual segregation of customer collateral. The Commission cannot adopt regulations that would segregate collateral on an individual basis. The Commission adopted LSOC earlier this year, which enhanced the available protections for customer collateral for swaps.

The Commission has directed staff to, among other things, consider the viability of adopting LSOC for futures customer funds. To that end, staff held a two-day customer protection roundtable in late February. At that roundtable, market participants discussed the benefits and disadvantages of adopting LSOC for futures. Participants largely acknowledged that the advantage would be enhanced protection for futures customers, while the disadvantage would be the risk and operating costs of adopting LSOC for futures, which could be greater in futures than in swaps. Given the issues identified at the roundtable, some markets participants requested that the Commission focus on implementing LSOC for swaps before further considering LSOC for futures.

The Commission recently issued proposed rules to further enhance customer protections based on staff recommendations. The Commission looks forward to reviewing public comments on that rulemaking.

2) We continue to hear from market participants, including NGFA today, that they want to be able to utilize tri-party custody arrangements for the cleared swaps and futures, much like Europe. Would this require legislative action, including a change to the Bankruptcy Code?

Response: As I understand it, because of the pro rata distribution requirements, a tri-party custody arrangement that would be expected to result in individualized protection for customers would not be permitted.

3) If so, why haven't you asked Congress for this? All I see you doing is approving initiatives the NFA has put in front of you. You have told this Committee you are in charge of the policy response to MF Global, despite being recused from the enforcement matters. If you are in charge, where is the response? If we need to do something why aren't you asking us?

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Response: The Commission recently approved a proposed rulemaking with enhancements to protections for futures customers and their funds. This proposal is about ensuring customers have confidence that the funds they post as margin or collateral are fully segregated and protected.

It is the direct result of significant input from the public and market participants that the CFTC gathered throughout 2012, working with the Futures Industry Association, the NFA and the self-regulatory organizations.

The proposal, which the CFTC looks forward to finalizing in 2013, would strengthen the controls around customer funds at futures commission merchants (FCMs). It also would set new regulatory accounting requirements that would provide stronger protections for customer money held by FCMs and would raise minimum standards for independent public accountants who audit FCMs. And it would provide regulators with daily direct electronic access to FCMs' bank and custodial accounts for customer funds.

In addition, both the Commission and the relevant self-regulatory organizations (SROs; the NFA and the CME) have taken steps to improve the protections given to futures customer funds. These measures include improvements to the internal controls and transparency associated with customer funds held by futures commission merchants (FCMs). Commission staff hosted a public Roundtable on February 29 and March 1, 2012 to obtain input on customer protection issues from a broad cross-section of market participants, FCMs, clearing organizations and regulators.

The Commission has been working closely with industry SROs, such as NFA, to implement improved protections for customer funds held with FCMs. NFA's Board of Directors appointed a Special Committee on the Protection of Customer Funds (Special Committee) to identify and recommend to the NFA Board rule amendments to enhance customer protection. The Special Committee's recommended amendments to NFA rules were approved both by NFA's Board and by the Commission.

Specifically, NFA amended its rules regarding segregated funds to establish additional requirements for FCMs to enhance the safety and control of futures customer funds. The amended rules impose additional financial reporting requirements on FCMs regarding the holding and investment of futures customer funds. For example, NFA rules now require FCMs to have written policies and procedures regarding the maintenance of the FCM's residual interest in its customer segregated and Part 30 secured funds accounts. The FCM's policies and procedures must target an amount that the FCM seeks to maintain as its residual interest in these accounts and be designed to reasonably ensure that the FCM remains in compliance with segregation and secured amount requirements at all times.

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Additionally, any FCM withdrawals in excess of 25 percent of the excess segregated or Part 30 secured funds that are not for the benefit of customers must be pre-approved in writing by the FCM's senior management. Further, under NFA's amended rules, FCMs must file notice with NFA of any withdrawal of 25 percent or more of the excess segregated or Part 30 secured amount funds that are not for the benefit of customers.

Senator Kirsten Gillibrand

1) I know you have used the CFTC's authority to take a number of steps to help improve oversight over the futures markets and customer funds in particular in the wake of MF Global and Peregrine's issues. In addition, to you anticipate making recommendations to Congress about more substantial steps that should be taken to address these issues and restore confidence in the futures market?

Response: **The Commission recently approved a proposed rulemaking with enhancements to protections for futures customers and their funds.**

This proposal is about ensuring customers have confidence that the funds they post as margin or collateral are fully segregated and protected.

It is the direct result of significant input from the public and market participants that the CFTC gathered throughout 2012, working with the Futures Industry Association, the NFA and the self-regulatory organizations.

The proposal, which the CFTC looks forward to finalizing in 2013, would strengthen the controls around customer funds at futures commission merchants (FCMs). It also would set new regulatory accounting requirements that would provide stronger protections for customer money held by FCMs and would raise minimum standards for independent public accountants who audit FCMs. And it would provide regulators with daily direct electronic access to FCMs' bank and custodial accounts for customer funds.

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2) In light of the events and MF Global and Peregrine – in particular, what appears to be nearly two years of outright fraud at Peregrine – do you believe the CFTC has adequate resources for oversight to police the futures markets?

Response: **Confidence in the futures and swaps markets is dependent upon a well-funded regulator and the CFTC is a good investment of taxpayer dollars. Its hardworking staff is just 10 percent more than what we had at our peak in the 1990s though the futures market has grown fivefold. The CFTC also is now responsible for the swaps market – eight times bigger than the futures market.**

The Commission's limited resources have historically not allowed for direct oversight of FCMs. There are 46 staff members, including 35 audit staff, on the CFTC's examinations team who oversee four SROs, which in turn have responsibilities for more than 4,341 registered persons. In addition, agency responsibilities are expanding to include reviews of many new market participants. For instance, there are currently 115 FCMs, and staff estimates a similar number of swap dealers will ultimately register. More frequent and in-depth risk-based, control-oriented examinations are necessary to assure the public that firms have adequate capital, as well as systems and procedures in place to protect customer money. Greater coverage by regulators – like having more cops on a beat – will improve the integrity and heighten the deterrent effect of the review process.

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The President's FY2013 budget, following a similar request in 2012, asked for $308 million, investing in our technology and human resources, to better protect the public.

The Dodd-Frank Act significantly expands the Commission's responsibilities. Market participants depend on the credibility and transparency of well-regulated U.S. futures and swaps markets. Without sufficient funding for the CFTC, the nation cannot be assured that the agency can adequately oversee these markets.

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Questions For The Record
August 1, 2012
Trustee James Giddens

Ranking Member Pat Roberts

1) At the time of the MF Global bankruptcy, did the Commodity Exchange Act's Rule 1.25 contribute to the loss of MF Global customers' segregated funds via investment losses? Would the CFTC's changes to permitted investments under Rule 1.25 have changed the loss of customer funds?

James W. Giddens, Trustee for the SIPA Liquidation of MF Global Inc.

There was a reference to the change in the nature of the permitted investments under Rule 1.25 In the report of the Trustee's Investigation and Recommendations, filed with the U.S Bankruptcy Court for the Southern District of New York on June 4, 2012, but the investigation did not uncover any indication that the nature of the investments of MFGI customers' funds was a cause of the shortfall in customer funds. Accordingly, I do not believe that Rule 1.25 contributed to the loss of MF Global customers' funds via investment losses, nor do I believe that, had the amended rule been in effect prior to October 31, 2011, the shortfall would have been prevented.

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Commissioner Jill Sommers

Ranking Member Pat Roberts

1) Firms will have to register as swap dealers in early October. Currently pending are a proposed exemptive order and proposed guidance on the cross-border application of the CFTC's rules, with comments due by August 13th and 27th, respectively. Even with the exemptive relief, firms are being given little certainty and time with which to make major decision, such as which entity to register and to whom supervisory responsibilities should be assigned. Don't you find this problematic?

Answer: Commission staff recently issued a Frequently Asked Questions document clarifying that, although the swap dealer registration regulations go into effect on October 12, under the final swap dealer definitional rule potential swap dealers will have until two months after the end of the month in which they surpass an $8 billion level of swap dealing to register. This means that the largest swap dealers will not have to register until December 31, and smaller swap dealers may have more time. Even with a December 31 deadline, however, I believe firms will not have sufficient time in which to make decisions regarding which entities to register or how they may have to reorganize their businesses to transfer their swap dealing activity to particular subsidiaries, affiliates, or departments for purposes of registration. I also believe it is problematic for firms to make decisions regarding whether to register as swap dealers before we have finalized critical rules such as capital and margin. The Commission may not complete work on those rules until early 2013, yet we have only extended the registration requirement until December 31, 2012.

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August 1, 2012
Mr. Dan Roth

Senator Kirsten Gillibrand

1) In light of the NFA's role in overseeing Peregrine Financial, in hindsight were there indications that you believe the NFA could have or should have looked at to recognize the fraudulent practices being engaged in?

NFA's Response:

In our August 31st letter to Chairwoman Stabenow, NFA responded to purported "red flags" that were reported in the press or noted during the August 1st hearing entitled *Examining the Futures Markets: Responding to the Failures of MF Global and Peregrine Financial Group* ("PFG") before the U.S. Senate Committee on Agriculture, Nutrition, and Forestry. NFA's responses to the purported "red flags" are outlined below.

- **Bank confirmations sent to a PO Box.**

  NFA's Response: NFA mailed bank confirmation requests for PFG's customer segregated funds account to a PO Box address. There is nothing suspicious about a bank using a PO Box to receive written confirmation requests. Communications sent to the street address of a financial institution employing large numbers of persons can easily get lost within the institution; as a result, it is not uncommon for major financial institutions to use PO Boxes for mail receipt to manage the high volume of mail received on a daily basis to ensure that it gets to the right place.

- **The auditor for PFG was a sole practitioner who operated out of her home.**

  NFA's Response: According to NFA's records, Veraja-Snelling & Company signed the certified financial statements for PFG from 2006 through 2011 that were submitted to NFA. Prior to 2006, NFA's records indicate that this firm had several related predecessor firms with multiple partners and offices in the Chicago Loop and suburbs. The CFTC imposes standards on firms that act as certified public accountants for FCMs, IBs and CPOs, which are set forth in CFTC Regulation 1.16. NFA (as well as the SROs) has always followed those standards when determining whether a CPA is qualified to prepare the annual certified report for an NFA Member. Veraja-Snelling & Company is licensed in the State of Illinois and met the

qualifications of accountants pursuant to CFTC Regulation 1.16. The use of a long-standing auditor who met CFTC standards was not a red flag. As noted below, NFA is working with other SROs and the CFTC to raise the requirements for CPAs that prepare certified financial statements for FCMs.

- **According to a report from the Wall Street Journal, in the spring of 2011, NFA auditors were informed of a significant shortfall of around $200 million of customer funds in a Peregrine account.**

  NFA's Response: Our investigation of this event is continuing, but at this point we have tentatively determined that on Friday May 13, 2011 at 2:08 PM CST, an email purportedly from Hope Timmerman of US Bank to Susan O'Meara, Chief Compliance Officer at Peregrine, was copied to an NFA auditor. Attached to the May 13, 2011 email was a PDF document which contained alleged confirmations of both PFG's US Bank customer segregated and house accounts. The US Bank PFG segregated bank account balance was filled in with a hand-written balance of $7,181,336.36. This confirmation had the PO Box 706 address on it and also identifies the account as "Peregrine Financial Group Inc Customer Segregated Account" (#621011845) and asks for information as of NFA's audit date of March 31, 2011. The email chain suggests that O'Meara had been corresponding with Timmerman and she had previously attached a copy of the confirmation template that NFA had completed with the PFG US Bank customer segregated account's information.

  On Monday May 16, 2011 at 1:56 PM CST (the next business day), NFA received a two-page fax which was delivered via email. The first page purports to be on US Bank letterhead and contains the PO Box 706 address, as well as a "US Bank, Cedar Falls IA" line across the top of the page. The cover page states that the two-page document is from Hope Timmerman, Asst. Relationship Manager, US Bank, Cedar Falls Iowa, and states that Timmerman's fax is 319-277-2106. The memo on the cover page states:

  > **"Re: Corrected Bank Balance Confirmation**
  >
  > **Attached please find the corrected copy of the Bank Balance Confirmation for the Peregrine Financial Group account #621011845. Customer Segregated Account.**
  >
  > **Hope Timmerman"**

  The second page of the fax contains all of the same information as the emailed confirmation – including the same PO Box, same signature authorization from the bank of Timmerman, same audit date, same signature authorization by PFG, and the same information that this was a

segregated account. The handwritten balance included in this confirmation was $218,650,550.96, which agreed to the balance of the purported bank statement provided by the firm to NFA as of March 31, 2011.

During the time that NFA received both confirmations, NFA was in the middle of conducting on-site audit fieldwork of PFG.

- **Press reports stated that NFA was put on notice – in 2004 and again in 2009 – of PFG's fraud. Specifically, a New York Times article stated that in 2004 a PFG client sent a letter to NFA and the CFTC asking them to intervene to prevent the firm from misusing its customers' money. The article further states that five years later (2009), an anonymous tipster wrote to NFA asking it to review PFG's bank account information for accuracy.**

  NFA's Response: NFA read these press reports and asked the reporter to see copies of these purported 2004 and 2009 communications, but he declined. Based on a search of NFA's records to date, NFA has found no record of receiving either the supposed 2004 letter or the supposed 2009 anonymous complaint.

a) If so, what measures could we take to ensure that such indications are appropriately reviewed and investigated to identify these issues earlier? One possible thought might be the use of a well-respected accountant – as I understand Peregrine's financial statements were audited by a small scale firm that appears to have had limited experience overseeing entities on the scale of Peregrine.

NFA's Response:

In NFA's July 30th letter to Senator Harkin and in NFA's August 1st testimony before the U.S. Senate Committee on Agriculture, Nutrition and Forestry, there are four key points that we have tried to make clear:

- **For our markets to thrive, customers must know that their funds are safe.**
- **It is the job of the regulators to provide the public with the highest level of assurance possible regarding the financial integrity of the futures markets.**
- **NFA followed standard and widely accepted auditing practices and procedures in the examinations of Peregrine. Those standard procedures failed in this case and simply were not good enough to penetrate the well of forged documents that were presented to NFA. Wasendorf fooled us and fooled us for longer than we would have liked.**

- **The time tested measures to monitor the safety of customer segregated funds have to be improved.**

We have to find better ways to do our job and have been developing proposals to do that since the demise of MF Global. NFA has adopted the following changes and initiatives to further safeguard customer funds:

MF Global Rule—All FCMs are now required to provide regulators with immediate notification if they draw down their excess segregated funds (funds deposited by the firm into customer segregated accounts to guard against customer defaults) by 25% in any given day. Such withdrawals must be approved by a financial principal of the firm and the principal must certify that the firm remains in compliance with segregation requirements. *Status: Rule has been approved by NFA and the CFTC and became effective September 1.*

FCM Transparency—All FCMs must file certain basic financial information about the firm with NFA and that information will be posted on NFA's web site. The information includes data on the FCM's capital requirement, excess capital, segregated funds requirement, excess segregated funds and how the firm invests customer segregated funds. Similar information regarding "secured amount funds" held for trading on foreign exchanges will also be displayed on NFA's web site. *Status: Rule has been approved by NFA and the CFTC. Information will be displayed on NFA's web site by November 1.*

Electronic Confirmation of Segregated Bank Balances—NFA's switch to an e-confirmation process of segregated fund balances held in banks uncovered the fraud at Peregrine. NFA has since conducted e-confirmations for all segregated bank accounts maintained by FCMs for which NFA is the DSRO as of June 29, 2012 and noted no violations of segregation requirements. NFA continues to utilize e-confirmations in its ongoing audits of the FCMs for which it is the DSRO. *Status: Completed and ongoing.*

Granting Regulators Online, View-Only Access to Customer Segregated Accounts—All FCMs will be required to grant their Designated Self-Regulatory Organization online, view-only access to information on customer segregated bank accounts. SROs will be able to check balances in customer segregated bank accounts at any time without notice to either the FCM or the bank. *Status: Rule has been approved by NFA's Board and is pending approval at the CFTC. We expect the rule to be approved and implemented this year.*

Daily Confirmations from all Segregated Funds Depositories—NFA and the CME have committed to building a system that will provide for all depositories holding customer segregated funds on behalf of an FCM to report balances daily to SROs. The SROs will perform an automated comparison to the reports filed by the FCMs to identify any suspicious discrepancies. ***Status: This program will be fully operational in 2013.***

Raising the Standards for CPAs that Certify FCM Financial Statements—NFA is working with other SROs and the CFTC to raise the eligibility requirements for CPAs that prepare annual certified financial statements for FCMs. ***Status: Enhanced requirements will be addressed through CFTC and/or NFA rulemaking.***

Internal Controls Guidance—NFA, the CME and other SROs are developing more specific and more stringent standards for the internal controls that FCMs must follow to monitor their own compliance with regulatory requirements. ***Status: Proposals will be considered at NFA's November Board meeting.***

Insurance Study—The possibility of providing some form of insurance protections for futures customer accounts, whether based on a SIPC-type model or otherwise, has been discussed. Unfortunately, there has been no formal study of the issue or calculation of the costs since 1985. ***Status: NFA is committed to commission such a study either on its own or with other industry groups.***

Review of NFA Audit Procedures—A special committee consisting of NFA's public directors has commissioned an independent review of NFA's audit procedures in light of the Peregrine fraud. The study is being conducted by Berkeley Research Group, the same firm the SEC retained after the Madoff scandal. ***Status: The study will be completed by the end of 2012.***

The process of refining and improving regulatory protections is ongoing and the initiatives outlined above do not mark the end of our efforts. The MF Global and Peregrine customer losses are a painful reminder that we must continuously improve our surveillance, audit and fraud detection techniques to keep pace with changing technology and an ever-more-complicated financial marketplace. We know that we can never completely eliminate fraud, but we must continue to adopt rules and surveillance techniques to try to eliminate the possibility that this could happen again. We will continue to work with the CFTC, the industry and Congress to ensure that customers have justified confidence in the integrity of U.S. futures markets.

Senator Charles Grassley

One of the things that continues to trouble me are reports that red flags were raised about Peregrine Financial, and those red flags were ignored. For instance, it's been reported that in March of 2012, a confirmation form was faxed directly from U.S. Bank to the National Futures Association showing there was about $7 million in the bank account designated for segregated customer money. Then shortly thereafter, either that day or the following business day, after finding out U.S. Bank had sent the confirmation, Mr. Wasendorf Sr. sent another confirmation showing there was approximately $220 million in the account designated for customer money.

1) Is this factual account accurate? Did U.S. Bank send a confirmation showing only about $7 million customer money in March of 2012?

a) What did the National Futures Association do to follow-up on the contrasting confirmation reports?

b) Did anyone from NFA call U.S. Bank to verify how much was in the account? If not, why not?

NFA's Response:

In letters to both Chairwoman Stabenow and Senator Harkin, NFA provided the following response to the purported red flag regarding a "corrected confirm" received in May 2011:

Our investigation of this event is continuing, but at this point we have tentatively determined that on Friday May 13, 2011 at 2:08 PM CST, an email purportedly from Hope Timmerman of US Bank to Susan O'Meara, Chief Compliance Officer at Peregrine, was copied to an NFA auditor. Attached to the May 13, 2011 email was a PDF document which contained alleged confirmations of both PFG's US Bank customer segregated and house accounts. The US Bank PFG segregated bank account balance was filled in with a hand-written balance of $7,181,336.36. This confirmation had the PO Box 706 address on it and also identifies the account as "Peregrine Financial Group Inc Customer Segregated Account" (#621011845) and asks for information as of NFA's audit date of March 31, 2011. The email chain suggests that O'Meara had been corresponding with Timmerman and she had previously attached a copy of the confirmation template that NFA had completed with the PFG US Bank customer segregated account's information.

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address, as well as a "US Bank, Cedar Falls IA" line across the top of the page. The cover page states that the two-page document is from Hope Timmerman, Asst. Relationship Manager, US Bank, Cedar Falls Iowa, and states that Timmerman's fax is 319-277-2106. The memo on the cover page states:

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The second page of the fax contains all of the same information as the emailed confirmation – including the same PO Box, same signature authorization from the bank of Timmerman, same audit date, same signature authorization by PFG, and the same information that this was a segregated account. The handwritten balance included in this confirmation was $218,650,550.96, which agreed to the balance of the purported bank statement provided by the firm to NFA as of March 31, 2011.

During the time that NFA received both confirmations, NFA was in the middle of conducting on-site audit fieldwork of PFG.

NFA did not call U.S. Bank to look into the two different confirmations. With hindsight, I wish we would have followed up on it and possibly discovered PFG's fraud a year earlier.

Your question makes reference to reports that red flags were raised about Peregrine. In our August 31st letter to Chairwoman Stabenow, NFA responded to purported "red flags" that were reported in the press or noted during the August 1st hearing entitled *Examining the Futures Markets: Responding to the Failures of MF Global and Peregrine Financial Group* ("PFG") before the U.S. Senate Committee on Agriculture, Nutrition, and Forestry. NFA's responses to the purported "red flags" are outlined below.

- Bank confirmations sent to a PO Box.

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institutions to use PO Boxes for mail receipt to manage the high volume of mail received on a daily basis to ensure that it gets to the right place.

- **The auditor for PFG was a sole practitioner who operated out of her home.**

  NFA's Response: According to NFA's records, Veraja-Snelling & Company signed the certified financial statements for PFG from 2006 through 2011 that were submitted to NFA. Prior to 2006, NFA's records indicate that this firm had several related predecessor firms with multiple partners and offices in the Chicago Loop and suburbs. The CFTC imposes standards on firms that act as certified public accountants for FCMs, IBs and CPOs, which are set forth in CFTC Regulation 1.16. NFA (as well as the SROs) has always followed those standards when determining whether a CPA is qualified to prepare the annual certified report for an NFA Member. Veraja-Snelling & Company is licensed in the State of Illinois and met the qualifications of accountants pursuant to CFTC Regulation 1.16. The use of a long-standing auditor who met CFTC standards was not a red flag. As noted below, NFA is working with other SROs and the CFTC to raise the requirements for CPAs that prepare certified financial statements for FCMs.

- **Press reports stated that NFA was put on notice – in 2004 and again in 2009 – of PFG's fraud. Specifically, a New York Times article stated that in 2004 a PFG client sent a letter to NFA and the CFTC asking them to intervene to prevent the firm from misusing its customers' money. The article further states that five years later (2009), an anonymous tipster wrote to NFA asking it to review PFG's bank account information for accuracy.**

  NFA's Response: NFA read these press reports and asked the reporter to see copies of these purported 2004 and 2009 communications, but he declined. Based on a search of NFA's records to date, NFA has found no record of receiving either the supposed 2004 letter or the supposed 2009 anonymous complaint.

I see from your testimony before the House Agriculture Committee last week you take exception with some people implying the Peregrine fraud would have been uncovered sooner had government regulators been serving as the frontline regulators. Your quote was "The suggestion that the fraud at Peregrine would have been uncovered more quickly if it had been government regulators has no rational basis in fact."

It seems you have spent a fair amount of time trying to deflect blame in this whole matter. You have repeatedly cast this fraud by Mr. Wasendorf as elaborate or complex – which it wasn't. He was forging documents, plain and simple. And if auditors would have simply called the bank, it could have discovered there was a problem.

When Chairman Gensler testified before this committee a couple weeks ago, we at least heard from him an admission the system failed Peregrine customers here. But we really haven't heard any admission from NFA that NFA folks mishandled the oversight of Peregrine. I suppose that's because you're afraid such an admission will add fuel to the fire for those who don't think self-regulation works.

I'm not passing judgment on self-regulation, and at this point, I don't think we need to change anything in the law. But our regulators need to enforce the laws that exist, and conduct proper oversight. That goes for the self-regulated organizations such as NFA, as well as the CFTC.

2) Do you think NFA failed in its duty to properly oversee the activities of Peregrine Financial? Or are you satisfied with the fact it took NFA 20 years to uncover this fraud?

I have noticed that the National Futures Association has patted itself on the back, and you even have in your written testimony, that "NFA's actions are what uncovered the fraud at Peregrine."

But NFA didn't uncover this fraud for 20 years. So to say NFA's actions uncovered the fraud doesn't seem too reassuring to myself, or to the people who lost money from the Peregrine Financial collapse.

NFA's Response:

NFA followed standard and widely accepted audit procedures in our examinations of Peregrine. But to assure ourselves of that, a special committee of NFA's public directors commissioned an independent review of NFA's audit practices and procedures, and the execution of those procedures, in light of the Peregrine fraud. Berkeley Research Group, the same firm the SEC retained after the Madoff scandal, is conducting the review. The study will be completed by the end of 2012.

NFA has not tried to deflect blame in this matter. Our written testimony submitted for the August 1st hearing before the U.S. Senate Committee on Agriculture, Nutrition and Forestry states the following: ". . .nothwithstanding it was NFA's actions that uncovered this fraud in our most recent exam, the simple fact is that Wasendorf's forgeries fooled us, and fooled us for longer than any of would like." Dan Roth's oral testimony further states that " . . . those standard audit procedures just were not good enough. He beat us. He fooled us. He fooled us for far too long. We have to do better. "

We are implementing better ways to monitor members for compliance, especially with regard to customer segregated funds, and are looking for even more ways to improve monitoring of firms for compliance with the rules. The process of refining and improving regulatory protections is ongoing and the initiatives outlined below do not mark the end of our efforts. The MF Global and Peregrine

customer losses are a painful reminder that we must continuously improve our surveillance, audit and fraud detection techniques to keep pace with changing technology and an ever-more-complicated financial marketplace. We know that we can never completely eliminate fraud, but we must continue to adopt rules and surveillance techniques to try to eliminate the possibility that this could happen again.

MF Global Rule—All FCMs are now required to provide regulators with immediate notification if they draw down their excess segregated funds (funds deposited by the firm into customer segregated accounts to guard against customer defaults) by 25% in any given day. Such withdrawals must be approved by a financial principal of the firm and the principal must certify that the firm remains in compliance with segregation requirements. *Status: Rule has been approved by NFA and the CFTC and became effective September 1.*

FCM Transparency—All FCMs must file certain basic financial information about the firm with NFA and that information will be posted on NFA's web site. The information includes data on the FCM's capital requirement, excess capital, segregated funds requirement, excess segregated funds and how the firm invests customer segregated funds. Similar information regarding "secured amount funds" held for trading on foreign exchanges will also be displayed on NFA's web site. *Status: Rule has been approved by NFA and the CFTC. Information will be displayed on NFA's web site by November 1.*

Electronic Confirmation of Segregated Bank Balances—As mentioned earlier,NFA's switch to an e-confirmation process of segregated fund balances held in banks uncovered the fraud at Peregrine. NFA has since conducted e-confirmations for all segregated bank accounts maintained by FCMs for which NFA is the DSRO as of June 29, 2012 and noted no violations of segregation requirements. NFA continues to utilize e-confirmations in its ongoing audits of the FCMs for which it is the DSRO. *Status: Completed and ongoing.*

Granting Regulators Online, View-Only Access to Customer Segregated Accounts—All FCMs will be required to grant their Designated Self-Regulatory Organization online, view-only access to information on customer segregated bank accounts. SROs will be able to check balances in customer segregated bank accounts at any time without notice to either the FCM or the bank. *Status: Rule has been approved by NFA's Board and is pending approval at the CFTC. We expect the rule to be approved and implemented this year.*

Daily Confirmations from all Segregated Funds Depositories—NFA and the CME have committed to building a system that will provide for all depositories holding customer segregated funds on behalf of an FCM to report balances daily to SROs. The SROs will perform an automated comparison to the reports filed by the FCMs to identify any suspicious discrepancies. ***Status: This program will be fully operational in 2013.***

Raising the Standards for CPAs that Certify FCM Financial Statements—NFA is working with other SROs and the CFTC to raise the eligibility requirements for CPAs that prepare annual certified financial statements for FCMs. ***Status: Enhanced requirements will be addressed through CFTC and/or NFA rulemaking.***

Internal Controls Guidance—NFA, the CME and other SROs are developing more specific and more stringent standards for the internal controls that FCMs must follow to monitor their own compliance with regulatory requirements. ***Status: Proposals will be considered at NFA's November Board meeting.***

Insurance Study—The possibility of providing some form of insurance protections for futures customer accounts, whether based on a SIPC-type model or otherwise, has been discussed. Unfortunately, there has been no formal study of the issue or calculation of the costs since 1985. ***Status: NFA is committed to commission such a study either on its own or with other industry groups.***

3) NFA claims it was its request for Peregrine to move to this electronic reporting system that caused Mr. Wasendorf's fraud to unravel. However, while the NFA was asking Peregrine to move to this electronic system, NFA was not requiring every futures commission merchant it monitors to switch to this electronic system, correct? Or at least not as of a month or so ago? And in fact, your written testimony suggests there are still FCMs not using the electronic reporting, is that correct?

a) How is it that you aren't requiring all FCMs to use this electronic reporting, given the events of Peregrine Financial?

b) How is it that in 2011 the NFA was still using fax machines to verify the existence of billions of dollars in customer funds?

NFA's Response:

As general matter, prior to 2012, the process of confirming bank balances directly with the bank was based on written paper confirmation requests mailed to the bank with a paper response mailed directly to NFA from the bank. The

acceptance of a fax emailed to NFA was an aberration and as I mentioned earlier, with hindsight, I wish NFA had followed up in this instance.

In early 2012, NFA began using Confirmation.com in all FCM audits, for any banks that are part of Confirmation.com's network. In making this decision, NFA felt the generally accepted paper based confirmation process that we relied upon for years was labor intensive and could cause delays in the audit process.

Immediately upon the uncovering of the Peregrine fraud, NFA agreed with the CME to perform an immediate confirmation of all customer segregated bank accounts as of June 29, 2012 for all of our FCM Members using the e-confirmation process. There were a handful of banks that were not Confirmation.com subscribers and NFA had to rely on paper confirmations for those. NFA completed the e-confirmation process for all segregated bank accounts maintained by FCMs for which NFA is the DSRO and noted no violations of segregations requirements.

In order to make better use of technology, NFA's Board recently approved a rule that would require FCMs to provide online, view-only access to bank balances for customer segregated and secured amount accounts to the firm's DSRO. Under this rule, SROs will be able to check any customer segregated bank account balance for any FCM any time, without asking the firm or the bank, and compare those balances to the firm's daily segregation report. This rule is pending approval at the CFTC. We expect the rule to be implemented this year. We understand the CME will adopt the same rule. NFA and CME believe this is a strong first step in providing DSROs with the information needed to regularly confirm the amounts on deposit in segregated funds accounts. However, NFA and CME intend to expand this approach, once it is implemented, by building a system to receive daily reports from all depositories for customer segregated accounts, including clearing FCMs. The SROs will perform an automated comparison to the reports filed by the FCMs to identify any suspicious discrepancies. This program will be fully operational in 2013.

(ckm/Testimony/PFG Questions Roth 08-01-12 Senate Hearing)

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