WHITE PAPER:
Background, Impacts & Solutions to MF Global's Bankruptcy

By John L. Roe & James L. Koutoulas, Esq.
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Purpose

This white paper is intended to offer a plain language understanding of the backgroundand impacts of the MF Global bankruptcy for non-financial professionals. It was originally published November 10, 2011 and revised to reflect new information December 1, 2011 and May 6, 2012.

Summary

MF Global was a commodities and securities brokerage firm which filed for Chapter 11 bankruptcy protection on October 31, 2011 after federal regulators discovered hundreds of millions of dollars of client money missing from the brokerage. The fallout from this event has led to a series of global bankruptcy proceedings, triggering two in the US alone. To date, MF Global's customers, who include farmers, ranchers and investors, are still missing an estimated $1.6 billion of their property. Investigations into the collapse of MF Global are being conducted by the Department of Justice, the Securities and Exchange Commission, the Commodity Futures Trading Commission, two bankruptcy trustees and four congressional committees. No criminal charges have been filed thus far.

The failure of MF Global has wide ranging consequences for the American economy. The freezing of customer segregated funds is having a chilling effect on global financial markets. It also has a less obvious but significant impact on the day-to-day operations of farmers, mining operators, ranchers, and other commodity consumers and producers, as well as the portfolios of pension funds and retirees alike. If commodity customers can no longer trust that funds they tender to brokers will be segregated and in fact may be tied up for months and years in a bankruptcy, commodity producers and consumers will seek other means to hedge their exposure to commodity prices. This will include seeking alternative trading jurisdictions (perhaps in Asia and Europe) and an increased use of over-the-counter derivatives, increasing counterparty credit risk. The end result will be that commodity hedgers will find it more expensive to hedge their price risk. This will eventually yield inflation in end-user prices for consumer goods and services.

Beyond the obvious peril this poses to the fragile US economic recovery, the long-term implications of MF Global's bankruptcy are dire. The relationship of MF Global management to regulators and the political establishment has cast a pall over the investigations. **Substantial public pressure must be brought to bear to ensure that customer assets are returned quickly and in total, as well as to ensure that culpable players are brought to justice. Additionally, a robust policy response will be required from legislators and regulators to mitigate the impact of future commodity broker bankruptcies.**

About the Authors

This white paper was co-authored by the founders of the Commodity Customer Coalition ("CCC"), John L. Roe and James Koutoulas, Esq. They formed the CCC in the days immediately following the October 31st bankruptcy filing of MF Global after it became clear that every entity which purported to protect and advocate for commodity customers failed to do so. The group represents more than 8,000 commodity customer accounts of MF Global and maintains a strong presence in the bankruptcy court and media on behalf of its membership. For more information on the CCC, please visit our website (http://goo.gl/dmswn).

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A Brief History of MF Global

MF Global was a commodities and securities brokerage firm dealing primarily in commodity contracts. It was responsible for holding clients' collateral in order to margin their trading positions. The firm was also a primary dealer for the Federal Reserve Bank of New York, serving as a trading counterparty in the implementation of monetary policy. It maintained proprietary trading operations in securities, futures and foreign exchange markets, along with other financial services.

MF Global traces its roots to James Man's sugar trading business in England in the late 18th century. This business evolved into commodities brokerage through subsequent firms ED&F Man, Man Financial and Man Group. These firms were British-based commodity brokerage and asset management companies with global operations. Man Group evolved into a hedge fund, which had a robust US brokerage arm. In 2005, Man Group purchased commodity broker Refco, Inc. in bankruptcy, vastly expanding its brokerage operations. In 2007, Man Group spun off its brokerage operations in an initial public offering on the New York Stock Exchange with the newly formed firm MF Global. Its consolidated share price history can be viewed via pink sheets listings: http://goo.gl/MPZCu.

MF Global was structured in a holding company-subsidiary configuration. The parent firm, MF Global Holdings, Inc. (MGFH), managed a global network of subsidiary firms, including its US-based broker-dealer/Futures Commission Merchant (FCM) entity, MF Global, Inc. (MFGI), along with similar firms in the UK, Canada, Hong Kong, Singapore, India and other foreign jurisdictions. A host of finance, asset and operations entities facilitated MF Global's worldwide operations.

After fetching an IPO price of over $30 per share, MF Global's share price collapsed in 2008 as the result of a 'rogue trader' loss of $141 million and liquidity fears stemming from the financial crisis. Share prices plummeted to a low of $1.72 in early 2009. Given the zero interest rate environment and its debt burdened capital structure, MF Global's stock value remained stagnant until the company began reorganizing under the leadership of Jon Corzine in early 2010.

Mr. Corzine is well known as one of the executives behind the successful public offering of investment bank Goldman Sachs, as well as his political career as a Senator and Governor of New Jersey. During 2010, MF Global's share prices recovered, reaching a high of over $10 shortly after Mr. Corzine took the helm. Much of this can be attributed to Mr. Corzine's plans to reposition the firm from primarily a broker-dealer/FCM to an investment bank and Primary Dealer of Treasury securities. Prior to Mr. Corzine's tenure, MF Global was exclusively a broker of financial instruments, meaning it took no proprietary positions in the markets it accessed for its clients. Mr. Corzine instituted proprietary trading operations for MF Global in a variety of financial markets when he came on as CEO

During the last week of October 2011, MF Global suffered severe liquidity stress as its second quarter earnings revealed a net loss and a highly leveraged proprietary position in European sovereign debt. Specifically, MF Global revealed revealed $6.3 billion in exposure to debt of peripheral EU nations in the form of repo-to-maturity transactions. Mr. Corzine noted in a quarterly earnings call that week that he took "personal responsibility" for these positions. As a result of these revelations, two ratings agencies cut MF Global's bond rating to junk and its stock fell to new all time lows. An increase in redemptions of customer assets, margin calls for proprietary trades and an inability to adequately finance its operations led MFGH to file for Chapter 11 bankruptcy protections on October 31, 2011. It was revealed that its MFGI subsidiary had a shortfall in customer assets of a disputed amount. This led Securities Investor Protection Corporation (SIPC) to file for a liquidation proceeding under the Securities Investor Protection Act of 1972 (SIPA) for the MFGI entity. The amount of this shortfall has been pegged at $1.6 billion by the SIPA Trustee.

At this time, the MFGH parent firm remains in a Chapter 11 bankruptcy under US Trustee Louis Freeh. MFGI, the US based broker-dealer/FCM subsidiary of MFGH, remains in a SIPA liquidation proceeding under SIPA Trustee James Giddens. The MFGI entity had approximately 38,000 commodity customer accounts holding around $6 billion in assets and 200 securities customer accounts holding around $400 million in assets.

MFGI customers fall into four basic classes in bankruptcy: regulation 4d or segregated funds customers (commodity customers trading on US exchanges margined by cash and treasury securities), regulation 30.7 or secured funds customers (commodity customers trading on foreign exchanges margined by foreign currency), customers holding specifically identifiable property (physical property such as warehouse receipts, metals certificates, marketable securities, etc) and securities customers (holding cash and securities). To date, recoveries for these pools of customers are as follows: 4d customers, 72% of assets; 30.7 customers, 0% of assets; specifically identifiable property customers, 72% of assets; securities customers, 100% of assets. The SIPA Trustee is in the process of making an additional distribution of 8% to 4d and physicals customers, along with the first distribution of 10% to 30.7 customers.

Investigations into regulatory violations and criminal wrongdoing are ongoing under the Department of Justice (DOJ), Commodity Futures Trading Commission (CFTC) and Securities Exchange Commission (SEC). Congressional hearings into the MF Global collapse have been held by the following committees: the House Committee on Agriculture, the Senate Committee on Agriculture, Nutrition and Forestry, the Oversight and Investigations Subcommittee of the House Financial Services Committee and the Senate Committee on Banking, Housing and Urban Affairs.

Who Are MF Global Clients?

Customers of MF Global represent a cross-section of people across America and the world, from farmers and ranchers who hedge their crops and herds, to oil producers and miners who use futures to lock-in prices and make delivery of physical commodities, to retirees and pension funds who invest in futures to diversify their portfolios. They can be divided into two basic groups: hedgers and speculators. An example of a hedger would be a farmer who has crops in the field who sells futures in commodity markets so he can lock in prices for his future yields today. Otherwise, he would be exposed to the risk of volatile price swings in commodities. An example of a corporate hedger would be a company like Coca-Cola who generates revenue in foreign markets. It does not want to lose money when it repatriates revenue earned in foreign currency. It has to be able to forecast future expenses and profits accurately in the currency of its domicile and hedge that currency price risk in futures markets accordingly. These commodity producers (farmers) and consumers (companies like Coca-Cola) are commonly referred to as *hedgers* as they use futures markets to offset their price risk in producing or the need to consume a given commodity.

Speculators, like retirees, pension funds and individual traders, add volume and liquidity to these markets. These traders access commodity markets in a variety of ways, either directly or through a broker or commodity trading advisor. Many seek commodities as a means of diversifying their portfolio, while others trade as a means of earning a living. Speculation allows for better, more efficient pricing of commodities and creates stability for prices.

Hedgers can then make reasonable projections of future costs, profit and loss, which in turn allows for stability in producer and consumer prices of finished goods. Speculators accept price risk in the hopes of profiting from their speculation. This action stabilizes the business cycle itself. This happens in every commodity market, from grains like corn and wheat, to energy like oil and natural gas, to softs like cotton and sugar, to metals like gold and silver, to currencies like the US dollar and Euro, to financial instruments like treasury bonds and stock indices. Simply put, trading in commodity futures markets is an essential component of the American economic engine.

How Trading with MF Global Worked
Customers of MF Global opened brokerage accounts, similar to opening a stock trading or bank account. They would deposit assets, most often cash and treasury bills, in accounts in their name which were to be held segregated from MF Global assets. These assets were deposited for the purposes of posting margin for trades on various commodity exchanges. In addition to cash, some customers deposited stock certificates or physical certificates, such as gold depository receipts, also for the purpose of posting margin for trading.

Movement of Customer Collateral
As MF Global was in the business of facilitating futures trading, part of its daily operations included satisfying the margin requirements of its clients' positions on the exchanges where its clients held positions. If a customer opened a position on an exchange, MF Global was required to post the margin required to hold that position on the exchange. For the most part, the amount of margin required was determined using a standardized algorithm called the Standard Portfolio Analysis of Risk (SPAN). CFTC regulations require certain margin requirements; the exchanges maintain additional margin requirements and FCMs like MF Global also maintain additional margin requirements. Customer collateral which was not margining a futures position could be invested by the FCM, subject to the provisions of the Commodity Exchange Act (CEA) and regulations of the CFTC.

Segregated Funds: Cornerstone of the Commodities Industry
The primary difference between the treatment of funds held on the commodities side of the ledger versus the securities (stocks and bonds) side is that firms have an obligation to keep customer funds *completely* segregated from the firm's own assets. This is to ensure that clients are completely protected from losses sustained by the firms' trading and operations. Industry groups and regulators argue that the commodities trading industry is able to function with lighter regulations than securities trading because customer accounts are segregated from firm assets. Many, including the Chicago Mercantile Exchange (CME), have heralded the fact that because of segregated account protections, no client has ever lost a penny from a segregated account as the result of a broker bankruptcy. Customer assets are to be segregated at all times from company assets. There is no permissible exception to this rule.

From MF Global's perspective, there are one or more omnibus accounts in which all customer assets are pooled. So while there are many thousands of individual customer accounts within these omnibus accounts, there may only be one or two customer segregated accounts at the FCM level. Customer assets and trading positions within these omnibus accounts are accounted for using a back office software platform called GMI (from Sungard). On a daily basis, this accounting platform would compute the amount of assets required for the firm to have in segregation. It would do so by totaling customer assets, netting trading positions marked to the market and totaling customer liabilities. Each customer would have an account generated showing his positions and assets. Customers who did not have enough on deposit to fully margin their positions would be placed on margin call, requiring them to deposit additional funds or have their positions liquidated.

The firm adds its own capital to this account in a practice commonly referred to as 'topping up' the customer segregated account. The firm's capital within the customer segregated account is called 'excess segregation', meaning an amount over and above the amount of customer assets the firm is required to keep in the customer segregated account. This practice is intended to offer protection against customer losses within the segregated account. In other words, if a single customer within the segregated account took losses beyond the value of his assets, the clearing firm has its own assets deposited in this account to prevent that deficit from affecting other customers' assets. MF Global would regularly engage in 'topping up' this account with its own capital, which it could remove at any time to satisfy proprietary obligations.

Securities customer accounts are also required to be segregated from firm capital, but the nature of securities dealings makes this segregation less distinct. Consider for example that most stock held by securities clients is held in "street name", which is to say in the name of the brokerage house not the individual customer who owns the shares. Brokerage failures can result in the liquidation of those securities and a shortfall of customer assets. To fill this gap, securities clients are afforded some insurance in the event of a broker bankruptcy. Commodities clients are afforded no such insurance since their funds cannot be comingled with a broker's assets and cannot be used to pay creditors in a bankruptcy. Commodity customer segregated funds are accounted for daily to the Commodity Futures Trading Commission (CFTC) through the broker's designated self-regulatory organization (DSRO), which in MF Global's case was the CME. In the event of the bankruptcy of a commodities broker, customer accounts, assets and positions have historically been almost seamlessly transferred to a new broker (see Refco, Inc. bankruptcy: http://goo.gl/lyLsy).

For this reason, many commodity customers 'over-margin' their accounts. This means they deposit much more collateral than is required for trading because the segregated funds protection makes a commodity account a 'safe' place to park assets. If you placed $1 million dollars in a securities account and that broker went bankrupt, you are only entitled to $250,000 in insurance and may take losses on the remainder of the account if there is a shortfall. Whereas, until the MF Global debacle, if your $1 million dollars were in a commodity account with a bankrupt broker, it would simply be transferred to another broker. It is strictly segregated and cannot be used to pay obligations of the broker in bankruptcy. If a broker breaks the law, steals customer funds and is unable to return money to customer, those customers have a first priority right over the assets of the broker.

Segregated Assets versus Secured Assets

The phrase 'segregated funds' relates to Section 4d(a)2 of the Commodity Exchange Act (CEA) and regulates only the handling of US futures customers trading US futures and options. Assets held in this regard are known as segregated assets or 4d assets. But this is not the only type of customer property held by FCMs to margin trading positions. Assets held by US customers trading non-US futures and options are commonly known as secured funds or 30.7 funds, named for CFTC rule 30.7(a) which governs them.

For example, if you opened a futures trading account with MF Global and traded gold futures at the US based Chicago Mercantile Exchange (CME), your assets would be held as segregated funds. If you then decided to trade futures on copper at the UK based London Metals Exchange (LME), the cash margin required to hold that position at the LME would be partitioned off from your account and handled as secured funds according to CFTC rule 30.7(a). Your account would show three balances: your 4d balance, your 30.7 balance and a consolidated or total balance of your assets. Even if you closed your position on the LME, the margin and proceeds from this trade would still be held as secured funds unless you or your broker requested that MF Global sweep the funds back into 4d segregation.

Secured funds are treated in a somewhat similar fashion to segregated funds, in that they must be held separate from the firm's assets. However, until recently there was no limitation as to what type of assets in which 30.7 funds could be invested. Moreover, once the funds are moved offshore, they are subject to the regulations of local jurisdictions which may be more liberal in their approach to the use of these funds.

The Investment of Segregated and Secured Assets

Segregated and secured funds are permitted to be invested by the FCM for the benefit of the FCM, pursuant to various regulations which are intended maintain the liquidity of the customer segregated account. The simplest way of conceptualizing this is to imagine all customer assets are cash are deposited into a bank account which earns a 2% interest rate. The FCM is permitted to keep the proceeds of the 2% interest rate on those customer assets.

Prior to the year 2000, segregated customer funds were permitted to be invested only in Treasury securities. The Commodity Futures Modernization Act of 2000 vastly expanded the universe of investments available for customer assets. Prior to MF Global's collapse, these investments included municipal securities, repurchase agreements (repos, repo-to-maturity transactions), commercial paper, foreign sovereign debt and in-house transactions (repos with affiliates). Regulation 1.25 deals with the types of investments, ratings standards, concentration limits and liquidity standards for these investments. Prior to MF Global's collapse, 30.7 funds were not subject to Regulation 1.25.

Circumstances Surrounding the Bankruptcy

Former New Jersey Senator and Governor Jon Corzine took over as CEO of MF Global in March 2010 with the intent of turning it into an investment bank that makes bets with its own capital. FINRA (the Financial Industry Regulatory Authority, the self-regulatory organization for broker dealers) gave Mr. Corzine a waiver which allowed him to be the head of MF Global without a license, despite a 12-year absence in the industry. Since commodity brokers make most of their money on interest earned by holding customers' collateral for trading, the low interest rate environment since the financial crisis of 2008 has been tough on many brokers.

This has led some firms like MF Global to seek higher yields using more aggressive strategies. Mr. Corzine took on too much risk in seeking greater yields and on October 25, 2011 MF Global reported a larger than expected quarterly loss. Most of the loss derived from a 40:1 leveraged exposure to European sovereign debt. Fears over this leveraged exposure crushed MF Global's stock, caused its bonds to trade at distressed levels and led it to max out company lines of credit. The MFGH parent firm sought Chapter 11 bankruptcy protection on October 31, 2011 after an acquisition of MFGI's commodities accounts by rival firm Interactive Brokers fell through. The acquisition collapsed because of a reported discrepancy of $633 million dollars in customer segregated funds (out of a total of $5.45B, or 11.6%).

Compromise of the Segregated Accounts System & Bankruptcy

In the early morning hours of October 31st 2011, MF Global reported to the CFTC that there may be a shortfall in customer funds. Early reports in the press indicated that the shortfall was $900 million or more, but by the close of business on the 31st, the CME reported to the CFTC that they were confident that the shortfall was $633 million.

Early in the US trading session on October 31, the CME and other exchanges halted all trading for MF Global and its customers. For over an hour, clients were exposed to unlimited market risk unable to trade out of their positions even if they wanted to liquidate. The CME then instated a 'liquidation only' order, in which MF Global customers were permitted to exit their positions only. Other exchanges allowed liquidations at times and at other times they would not allow it, wreaking havoc across the value of MF Global accounts. MF Global's small trading desks became overwhelmed as customers controlling over 38,000 commodities accounts called to exit their highly leveraged positions. As this was playing out, the CFTC and SEC decided that a Securities Investor Protection Corporation (SIPC) liquidation of MF Global was the best course to protect customers.

SIPC petitioned the bankruptcy court to begin a liquidation proceeding of MF Global's broker-dealer under the Securities Investment Protection Act (SIPA) of 1970. SIPA was designed to protect owners of securities in a similar way that FDIC protects bank depositors, by offering them insurance for their deposits with brokers in the event of a bankruptcy. However, the vast majority of customer assets affected by this bankruptcy are not securities, rather they are cash and commodity futures contracts held in commodity regulated accounts. There are only about 400 securities accounts at MF Global with only $100 million or so in assets, while there are over 38,000 commodities accounts with over $5.4 billion in assets. Not only do SIPC's attorneys have limited

experience with commodity futures contracts, SIPA offers no such insurance for losses in commodity customer segregated funds.

Why is there a Shortfall in Customer Funds?

Through testimony in congressional hearings, it has been revealed that the shortfall in customer assets has two basic causes: (1) MF Global transferred more funds from its customer segregated account than it maintained in excess segregation to satisfy obligations of the firm and (2) funds which resided in foreign jurisdictions for the benefit of MF Global's customers are tied up in foreign bankruptcy proceedings. The SIPA Trustee has reported that the total shortfall in customer assets is $1.6 billion. Of that total, around $800 million is tied up in foreign proceedings and around $800 million has been transferred to US counterparties of MF Global for various reasons (primarily settling trades and debts). The SIPA Trustee has also reported that all funds have been traced and their whereabouts are known.

The most public of these transfers out of segregation relates to a transfer Mr. Corzine personally ordered of $200 million from excess segregation to an overdrawn account at JPMorgan in the UK. On Friday October 28, 2011, Mr. Corzine was informed by the MFGH Treasurer that an MF Global house account was overdrawn by $175 million at JPMorgan in the UK. This was causing JPMorgan to hold up operations vital to MF Global. The overdraft needed to be cleared immediately. Deviating from the normal course of business, Mr. Corzine personally ordered Treasury Operations staff at the MFGI subsidiary to transfer $200 million in funds from the customer segregated account to MF Global's UK affiliate, MFG UK. That affiliate then transferred $175 million to JPMorgan to cover this overdraft.

In addition to the JPMorgan transfer out of segregation, the SIPA Trustee has indicated that there are perhaps 7 or 8 additional counterparties who may have received transfers of customer segregated assets in the final days of MF Global. The SIPA Trustee is presently in negotiations to recover funds transferred out of the customer segregated account to counterparties of MF Global. If these negotiations are unsuccessful, it will be necessary for the Trustee to enter into protracted litigation to recover these assets.

The vast majority of funds tied up in foreign jurisdictions are at MF Global's UK affiliate. Some of those funds legitimately resided in those foreign jurisdictions to margin positions on foreign exchanges. Some of those funds were transferred from MFGI to those foreign jurisdictions in the final days, like the transfer of $200 million from MFGI to MFG UK.

Criminal Wrongdoing or Incompetence?

MF Global executives maintain that they did not intend to misappropriate customer funds in the firm's final days. The CCC contends that this assertion does not withstand even cursory scrutiny in light of facts which are now in the public domain. The actions of these executives in the final days of MF Global indicate that they knew or should have known that they were using customer assets to pay the firm's debts. In our opinion, the actions of these executives demonstrate they did intend to misuse customer funds to preserve liquidity at the firm and these actions constitute intent to commit an actual fraud.

Our assertion centers on the combination of two different sets of transfers. Documents obtained by the CCC show that in the final week of October 2011, MF Global converted customer wire transfer requests to payments by check. At the same time, MF Global sent wire transfers to counterparties from that same customer segregated account to satisfy proprietary obligations. Specifically, we are referring to the wire transfer of $200 million dollars from MF Global's customer segregated account to a proprietary MF Global account held by JPMorgan in the UK. At the same time MF Global was wiring this money to its creditors out of customer segregated funds, it was sending money by check to customers seeking withdrawal of their funds, despite the

fact that customers asked for wire transfers and MF Global's standard practice was to send customers their funds by wire.

These activities—paying creditors quickly while returning customer funds as slowly as possible—provide strong evidence that MF Global knew or should have known that it was sending customer funds (not excess segregated funds) to its creditors in its final days. Though MF Global maintained excess proprietary funds in the customer segregated account, they would not have made such a drastic change in standard business practices unless they knew that there could be issues with their own transfers out of segregation. Moreover, we now know that a CME spot audit of MF Global revealed that the firm maintained only $117 million in excess segregation as of October 27th. It is highly unlikely that a firm under great liquidity stress would be able to increase the amount of capital contributed to its customer segregated account, especially within 24 hours, so that it could make a transfer of $200 million out of that account for its own benefit. This knowledge, along with several 'badges of fraud' in MF Global's actions, provide enough evidence of actual fraud.

Checks issued to customers from the customer segregated bank account could take a week or more to clear that bank account. By changing customer redemptions from a wire transfer (which clears instantaneously) to a check sent via US mail, MF Global artificially reduced the amount of assets they were required to keep in segregation on paper, while not reducing the amount of assets in the customer segregated bank account. Checks that are issued to customers from their MF Global accounts are immediately debited in the customer's account at MF Global through Sungard's GMI software, MF Global's derivatives accounting software. This would have given MF Global a lower number to report in their Friday segregation calculation, tabulated by netting customer debits, debts and liabilities against customer positions, cash, collateral and assets. Comparing this number against their balance from Harris bank, which would not have shown debits from checks which had not yet cleared, would have distorted the segregation report in MF Global's favor. In other words, MF Global was engaged in a form of check-kiting in order to keep its business going while avoiding scrutiny from its regulators.

For more information regarding the CCC's theory of how criminal intent is established in the case of MF Global, please refer to our memorandum entitled "Evidence of Intent to Commit an Actual Fraud in the Collapse of MF Global": http://goo.gl/FwY5Y.

The Case for an Independent Counsel
Given the continuing political influence of Jon Corzine, it is incumbent that Attorney General Holder ensures that politics do not prevent justice from being done. The best way to do that is by authorizing an Independent Counsel to take over the investigation of MF Global. The CCC believes that the current investigation has stalled. The key witnesses we have spoken to have yet to even begin the proffer process by which an immunity deal could be reached.

MF Global is a case with $1.6 billion in stolen customer property, three government agencies are investigating, four congressional committees investigating, two domestic Trustees are investigating, at least 4 foreign Trustees are investigating, with clear circumstantial evidence of fraud in the public domain and yet no one has been arrested 7 months later. We have a US Trustee who cannot even produce a schedule of assets to tell us what the company is worth after 7 months of running up millions of dollars in legal fees to do so. We believe that an Independent Counsel would fast track not only the criminal investigation, but the fruition of the entire MF Global saga. We commend Representative Grimm for making the request and call on all of Congress to sign on to his letter: http://goo.gl/xF8WT. We implore Attorney General Holder will act in the best interest of MF Global's customers.

Distributions of Customer Funds in Bankruptcy

The SIPA Trustee has two funds of property in which he is marshalling assets of MFGI for the SIPA liquidation. These funds will be used to pay for the administration of the bankruptcy, to return property to customers and to pay creditors according to their priority in the Bankruptcy Code.

The first pool of assets is a fund of customer property. This fund contains all of the assets of MF Global's customers. These assets are then subdivided into classes of customers according to the laws and regulations under which their assets were maintained: segregated funds (4d customers), secured funds (30.7 customers), customers holding physical property (specifically identifiable property) and securities customers. The SIPA Trustee is working to recover assets to the fund of customer property. This fund currently has about $1.4 billion in it, with a pending distribution to 4d and physicals customers of around $700 million.

The second fund of property in the bankruptcy is the assets of MFGI's estate. This pool of assets contains all assets owned by MFGI, including exchange seats, guarantee funds posted to exchanges, operational assets, etc. The SIPA Trustee will liquidate assets to marshal as much cash as he can for MFGI's customers and creditors. The most recent reports indicate that the SIPA Trustee has marshaled around $300 million into the fund of property of MFGI's estate. Recoveries paid from this fund will be made to all MFGI customers, regardless of whether their assets were held in 4d or 30.7 segregation. The longer the liquidation proceeding drags on the higher administrative fees climb for adjudicating the bankruptcy.

The SIPA Trustee has two procedures by which he is able to return assets to customers: a bulk transfer process and a claims process. The bulk transfer process involves transferring customer assets to new accounts in the customer's name at a new brokerage firm. The claims process involves a customer submitting a claim for his assets, the Trustee deciding if it is legitimate and returning a portion of those assets to the customer. The Trustee used the bulk transfer process on three occasions to return assets, totaling about $4 billion. It is unlikely that there will be additional bulk transfers.

The Trustee is now working through the claims process. This will be the process by which any remaining funds are returned to MF Global customers. The window for filing customer claims against MFGI has closed and the window for claims of general creditors is June 2, 2012. The SIPA Trustee has issued claims determinations for over 25,000 customer claims and has won approval from Bankruptcy Court Judge Martin Glenn for the first claims process transfer. This transfer will be done on a rolling basis by check sent to the address of record for each account.

The asset returns via the bulk transfer process were done in a capricious manner, which demonstrates SIPC's ignorance of commodity futures accounts. The net effect of this has been to accidentally create new protected or favored classes within the bankruptcy of an FCM. The first bulk transfer on November 7, 2011 involved moving only accounts with open positions on US exchanges and only 60% of the collateral needed to trade them. For example, let's say you had $100,000 in cash in your commodities account and had one open position of the December CME Wheat contract (which requires $3,375 in margin). The Trustee moved the position and only $2,025 in cash--about 2% of your account. Moving only 60% of the margin on open positions placed 10,000 accounts with 3 million positions on margin call instantly.

Customers were forced to either wire additional funds by the close of business the following day or they could have the position liquidated. Brokers receiving these transfers did not have adequate staff to process these margin calls. Even if they did, it is highly unlikely banks would have been able to process these wires in a timely manner, as wires intended to post on the same day must be submitted prior to 1 PM EST. Hedgers like farmers, who are typically illiquid with assets tied up in real estate or equipment, were among those who had

difficulty meeting margin calls so quickly. If their positions were liquidated too early, it could result in large losses. If you had positions of foreign exchanges, nothing was transferred.

Very little of this was communicated to MF Global customers who, in some cases, have yet to be contacted by anyone as to the whereabouts of their property. Even if a customer wanted to post additional margin to back the trades, the brokers where the accounts were sent were overwhelmed by the administrative task of clearing 10,000 margin calls in one business day. The Trustee has made no effort to utilize the tools at MF Global's disposal to communicate with clients. Most MF Global accounts are established via an introducing broker (IB), a third party who acts as a broker on MF Global's behalf. The Trustee could have used this network of IBs to communicate with customers, reducing confusion and aiding in the administration of these transfers.

On November 17, a second bulk transfer was completed for 60% of the assets of accounts which had 'unencumbered cash', meaning no open positions on futures contracts. Only cash could be transferred, not physical deposits or t-bills. So if you were a customer with $100,000 in cash and no positions in your MF Global account, you received $60,000 or 60% of your assets. If you had unencumbered cash in secured funds (30.7 funds), none of your assets were transferred.

Over the last weeks of December and January 2011, a third bulk transfer was completed to 'true-up' all US based segregated accounts (4d) to the same level at 72% of their assets. Accounts with assets in secured funds (30.7 funds) received no assets in this transfer.

It is important to note that the SIPA Trustee originally proposed an unnecessarily slow claims process. We were informed that distributions would likely begin after the claims window closed, sometime in June 2012. The CCC filed an objection to this claims process, arguing that it benefited no one. Though our objection was eventually overruled, the bankruptcy judge ordered the Trustee to meet with us and include some of our suggestions in the claims process. The Trustee did so and his revised claims process was ordered, along with these bulk transfers.

Means of Additional Recoveries

There are several avenues of additional recoveries available to customers of MFGI. The SIPA Trustee will have about $700 million remaining in the MFGI fund of customer property for 4d customers after his next distribution. The SIPA Trustee has not distributed this property as claims have been made against this property by MFGH and MFG UK. If someone places a claim on the fund of customer property at MFGI, the SIPA Trustee must reserve assets against it until the dispute is resolved. Most of the claims against this fund should fail and this $700 million should be released to customers, though the time frame for this is uncertain. It is highly unlikely that another distribution will be made to customers this calendar year. If all assets in the fund of customer property were to be distributed, it would bring recoveries for 4d and physicals customers to around 90%.

The SIPA Trustee intends to pursue recoveries through negotiation and litigation from MF Global's parent company (MFGH), its affiliates and counterparties who received transfers from MF Global's customer segregated account before the bankruptcy. If assets can be traced to MFGH, MFG UK or other affiliates, the SIPA Trustee will take appropriate measures to recover these funds. Additionally, MF Global's directors and officers insurance may be a source of recovery through litigation.

Recoveries for 30.7 customers hinge on foreign bankruptcy proceedings. Almost all of the secured funds not in control of the SIPA Trustee are held by MF Global's UK affiliate. These funds are in control of a British Trustee, KPMG, known as a Special Administrator. The SIPA Trustee has retained UK counsel to pursue those funds.

Finally, MF Global customers may receive some restitution through a consolidated class action lawsuit which is now taking shape.

Claims Trading of MF Global Claims

A portion of the distressed securities market consists of firms purchasing claims of a bankrupt firm's creditors at a discount. Such a trade would involve a creditor selling his claim to an investor or broker for less than he is owed. In the case of MF Global, distressed debt firms are offering to purchase the remainder of customer claims according to their class in bankruptcy. If a customer wants to access his capital now, he can use the distress debt market to access much of his capital now minus a haircut, though in doing so he trades away his right to additional recoveries. The current market for MF Global customers breaks down as follows:

MFGI Claim Type	Market Indications
4d QEP or Institutional Claims Greater than $100K	92% to 93% of face value
4d non-QEP Claims or Claims Less than $100K	90% of face value
30.7 QEP or Institutional Claims Greater than $100K	70% to 71% of face value
30.7 non-QEP Claims or Claims Less than $100K	60% of face value
General Creditor Claims of MFGI	No Market

The amounts listed above are paid on the face value of the customer's claim. For example if you were a QEP customer who had a $1,000,000 4d account at MF Global, you have been paid 72% or $720,000 in the SIPA Trustee's bulk transfers. If you sold your claim for 92%, that would mean you would receive a total of $920,000 or 92% of the face value of your claim. So the distressed debt firm would pay you the difference between $920,000 and $720,000, or $200,000. They would then be in line to receive all additional recoveries from the SIPA Trustee, class actions suits or any recover paid to your claim--the buyer of the claim now owns the claim.

The CCC helped consolidate this market in February 2012. Through collective bargaining, we raised bids from the 87% range for 4d customers to the 92% to 93% range for 4d claims and 65% to 71% for 30.7 claims for customers who are Qualified Eligible Participants (with $1 million in liquid net worth) or institutions. Small or non-QEP claims were more difficult instruments for which to find buyers. Even though institutional claims were paying 92 cents on the dollar or higher, non-QEP claims were transacting in the 85 to 87 cents range. Claims buyers were leery of transacting with smaller customers because of the cost and potential for litigation. There was sufficient interest on the part of CCC membership in small claims trading, so the CCC began seeking buyers for a bundle of small claims at better prices. We were able to raise that market to 90% for 4D claims and 60% for 30.7 claims.

While the CCC has helped facilitate these trades for the benefit of its membership, we do not recommend trading them, nor do we dissuade trading distressed claims. We simply wanted to offer our membership the ability to access more of their capital quickly to mitigate opportunity cost of assets frozen in bankruptcy. The claims market may go up or down in the future, though we believe that higher recoveries are probable.

Why Commodities Customers Should be Made Whole

A central tenant of the success, stability and efficiency of commodity markets in the United States is that the segregation of customer funds is absolute. If that tenant was violated by MF Global, at the minimum it constitutes a serious breach of fiduciary duty; at worst it was a federal crime. The resulting shortfall in customer funds is thus either the result of fraudulent conveyance, possibly both active and constructive, or it is the result of a co-mingling of corporate and customer assets. In either case, customers are entitled to a super-priority lien over the assets of the estate of MF Global to make up the shortfall in segregated funds ahead of all creditors, secured and unsecured. This can be achieved through a claw back of the funds from the MF Global

estate to the fund of customer property or by piercing the corporate veil and liquidating the assets of the estate for the same purpose.

The Trustee does not agree with this argument. He has made it known that he believes customers of MF Global have to share in the loss of segregated funds on a pro-rata basis with creditors. By subordinating customers with collateral in segregated funds to creditors of MF Global's estate, the Trustee is essentially making the creditors the beneficiary of a criminal act. It spreads the creditors' losses to customers, benefiting only the creditors. Paying JP Morgan with an Iowa farmer's money is not only morally and legally wrong, it risks the future of the American economic model. Who would want to hold a commodities account in the United States ever again? Considering that MF Global's clients have no representation on the creditors committee, but the big banks do (like JP Morgan and Bank of America), that is exactly what will happen without intervention.

This process has already frozen customer assets for over two weeks, despite the majority of these assets being accounted for and their owners easily affirmed. This is unacceptable. In fact, as the delay of a release of funds persists, the damage to our fragile economic recovery increases exponentially. Customers with frozen assets will face bankruptcy and financial ruin. This could lead to fewer commodity producers, resulting in scarcity and diminished competitiveness. Confidence in our capital markets will continue to erode, with fewer players willing to risk their capital to a flawed system. Commodity markets will see liquidity diminish and price volatility expand. This will lead to inefficient hedging for commodity producers and consumers, which will in turn lead to higher consumer prices for everything from food to fuel to clothing.

Questions Surrounding Bankruptcy: Why Chapter 11 over Chapter 7 for MFGH? Why SIPC over Chapter 7 for MFGI?

One of the questions raised by the CCC is why MF Global Holdings, Inc, MFGI's parent company, is in a Chapter 11 bankruptcy proceeding and not a Chapter 7 liquidation proceeding. Chapter 11 bankruptcy protections are designed to allow firms to deal with their creditors and reemerge from bankruptcy as functioning businesses. No subsidiary, affiliate or parent in the MF Global mess will survive bankruptcy to conduct business again. Moreover, MFGH appears to be administratively insolvent. The proceeding which was designed to deal with this type of bankruptcy is a Chapter 7 proceeding.

The costs involved in administering a Chapter 11 proceeding far exceed that of a Chapter 7 proceeding. Attorneys' fees will run into the tens of millions and perhaps hundreds of millions for a firm which is not reorganizing and does not need their expertise. These administrators are in a habit of charging many times the market rate for their services to bankrupt firms. Moreover, a creditors committee is formed in Chapter 11 which allows the creditors to pay for their legal expenses relating to the bankruptcy out of the assets of the estate. It is more than a little irksome that 2 of the largest banks in the country (JPMorgan and Bank of America) get to pay for their legal expenses from the assets of MF Global while farmers and ranchers have to scrape funds together to pay for their own.

The CCC is presently in the process of preparing a motion for the involuntary conversion of MFGH from a Chapter 11 proceeding to a Chapter 7 proceeding. For more information on this, please review our letter to the Senate Banking Committee: http://goo.gl/xh417.

Another question which has emerged is why a SIPC proceeding was initiated for MFGI, since the vast majority of its customers' assets (97%) were held in commodity accounts which are not covered by SIPC insurance. Bankruptcies of commodity brokers are intended to go through Chapter 7 proceedings. The sole discretion as to whether or not to initiate a SIPA proceeding for a SIPC member firm rests with SIPC itself, subject to the

approval of the bankruptcy judge. The question remains why the CFTC decided that a SIPC-led proceeding was the best means to protect customers and did not object to a SIPA liquidation.

SIPC proceedings incurr high administrative costs. The administrators are first in line to receive payments from the estate of the bankruptcy and are the only class in bankruptcy which has priority over customers. Since securities customers have insurance, they are less concerned with the glacial pace and high cost of a SIPA liquidation as they have insurance to mitigate the losses which could stem from administrative fees. Commodity customers have no such insurance. If the shortfall in customer assets persists, then the erosion of assets in the estate of MFGI is of particular concern to commodity customers. High administrative fees would then be paid from assets which could be used to pay recoveries to customers. A Chapter 7 proceeding negates many of these fees and would streamline the bankruptcy.

How the Asset Freeze Could Have Been Avoided

It is possible that the asset freeze of commodity customer assets could have been prevented early on in this process. Had MF Global been able to successfully transfer commodity accounts to Interactive Brokers, there would not have been a disruption in trading operations. This would have reduced the virtually incalculable loss customers have borne from unnecessary exposure to market risk, inability to place new trades, etc.

Unresolved Tax Issues

In addition to the above problems, commodity customers are also faced with unknown tax implications. The CCC lobbied the IRS and SIPA Trustee, and with the help of Congress, won assurances from the Trustee that customer 1099's would be delivered. Additionally, the CCC requested tax guidance and safe harbor from the IRS (see our letter here: http://goo.gl/P49Xe) and received this response: http://goo.gl/G6rZ5. The IRS did provide penalty relief for farmers filing late, along with an articulation of some relevant rules, but failed to provide the safe harbor the CCC was requesting.

Though these were important steps in simplifying tax issues for many MF Global customers, other tax issues remain unresolved. For example, 30.7 customers still do not know at what price their positions were liquidated. Some customers holding stock in their accounts are still unable to obtain the liquidation price of the shares or how many were liquidated. Congress should consider mandating automatic safe harbor provisions in future FCM bankruptcies.

Potential Solutions

While the details of MF Global's collapse are still forthcoming, we know that customer money was not where it was supposed to be. Customer money was not lost through some investment scheme; it did not 'vaporize', as was characterized by anonymous sources reporting to a major newspaper. Instead, it was comingled with the firm's capital and used to satisfy MF Global's proprietary obligations. While there are many terms one could apply to describe the wrongful acquisition of the property of another, the correct one is larceny.

The question before Congress is one which asks if the system of rules and regulations governing the commodities industry failed MF Global's customers. We have heard, from many corners of the industry, the notion that one cannot stop fraud. Quite simply, no law would have stopped Jesse James from robbing banks. We agree that laws, rules and regulations cannot deter another MF Global from happening.

However, we can write laws and make meaningful reforms which can mitigate the impact of future broker failures for those who have to endure them. In short, we can make sure that after Mr. James robs a bank, that bank does not shut down and withhold its depositors' money for years. One of the worst results for MF

Global's customers is not that their money is tied up in a bankruptcy; it is that customers were locked out of trading and exposed to unlimited market risk without the tools to manage it. Policy reforms should focus on shoring up customer protections while allowing customers to continue to access the markets.

We hope that this policy response is effective, yet we need to ensure that it treads lightly. Unnecessary restrictions or costly new regulatory burdens may produce the unintended consequence of more broker bankruptcies. As a result of MF Global, customers are unlikely to maintain much money with their brokers beyond the minimum required to margin their trading positions. A brokerage firm navigating a volatile market of highly correlated assets with fewer customer funds on deposit operates in a new era of institutional risk. An extended environment of zero interest rates is taking its toll. Regulators and policy makers must be measured in their response to ensure their remedies do not cause the failure of additional brokers.

Therefore, the Commodity Customer Coalition supports the following initiatives to provide better protections for customer property.

Separation of Broker-Dealer/FCM Entities or Excess Margin Sweeps to SIPC Accounts
Futures customers are best protected through a Chapter 7 liquidation proceeding, as opposed to the SIPA Liquidation proceeding now underway for MF Global. There are two methods to remedy this in the future:

- Bar firms from housing their Broker-Dealer and FCM operations in the same entity; so when a firm fails, its Broker-Dealer entity goes through SIPC and its FCM goes through Chapter 7.
- If barring Broker-Dealer/FCMs is too sweeping or costly, create rules which automatically sweep excess futures margin into a SIPC insured account, so at least customers of Broker-Dealer/FCMs can have their assets which do not margin positions insured by SPIC.

Self Insurance through an Industry Managed Liquidity Fund
We do not believe that commodity customers would benefit from a SIPC-like insurance mechanism for futures accounts. Such schemes tend to raise costs for market participants and pervert incentives for financial institutions. As Mr. Terry Duffy, Executive Chairman of CME Group, noted in his testimony before this Committee's hearing, there is over $158 billion in segregation in the United States. It is impossible to insure all of that money.

But the reality is that you do not have to insure all of that money to protect it; we only require protections against shortfalls in customer funds. We believe that futures customers could benefit from a liquidity fund, managed by the industry, which could plug future shortfalls in segregation to facilitate the continuation of trading for customers. This fund would make assets available to ensure the quick transfer of customer accounts and positions to new brokers and would act as the single entity which represents customers for recoveries before the bankruptcy court. It could be cost effectively implemented and, if history is any guide, will be used sparingly.

Bankruptcy Reform & Codifying Customer Protections
Though I am not a lawyer, I am aware that the law does not typically allow those who receive stolen property to keep it. Yet this is precisely how the 2005 Safe Harbor amendment to the Bankruptcy Code will be used in this case by counterparties who received transfers out of customer segregation in the waning days of MF Global. We believe that the Safe Harbor provision should be amended to prevent its automatic application in cases of

constructive fraud or in instances where segregated property of futures customers may have been used to satisfy a firm's obligation.

For Chapter 11 proceedings involving FCMs or their holding companies, we believe there should be a statutory right for customers to have a seat on the creditors committee. It is more than a little galling that the two largest banks in the US get to pay for much of their legal expenses related to the MF Global bankruptcy out of the holding company assets, while customers have to scrape together to pay for their own legal representation.

Many customer protections are implicit or can be inferred in the law which should be made explicit. Customers of failed FCMs should have a super priority right over not only the assets of the FCM entity, but over any affiliate or parent firm's assets as well. The consequence of misusing customer property should be dire for the entire corporate structure of financial firms. We also believe that it should be codified that the segregation protection follows customer funds wherever they are transferred. We believe that entities who accept customer funds in essence become custodians of segregation. These entities should be subject to similar rules and regulations whenever applicable. If these firms facilitate the misappropriation of customer property, they should have to set aside their own assets to repay customers.

Orderly Liquidation Rules

Uncertainty is the greatest fear of financial markets. The liquidations and transfers of customer positions and accounts which occurred after MF Global's failure created huge uncertainties for market participants. We are extremely lucky that MF Global's collapse occurred during a period of relative calm in financial markets. If these transfers had occurred according to a pre-determined set of rules, at a minimum market participants could have made long-term decisions based on the potential outcomes derived from those rules.

Review of Accounting Practices

Futures broker Refco, Inc. filed for bankruptcy with the fourth largest filing by assets in US history. However, that was later revised to ranking around 13th or 14th historically, as the bankruptcy proceeding revalued assets. MF Global Holdings, Inc. filed for bankruptcy protection with the eighth largest filing by assets in US history, listing $41 billion in assets and $1.2 billion in positive equity. No doubt, this will be drastically reduced as its bankruptcy proceeding progresses. A serious review of accounting practices of financial services companies should be undertaken when companies purporting to be worth tens of billions are revealed to be worth far less than reported. Attention should be paid to the treatment of off-balance sheet liabilities, particularly with respect to derivatives. Many financial services companies have off-balance sheet derivative exposure in the trillions of dollars. A failure to address these practices will only lead to a greater financial crisis in the future.

Support for the Reforms of the NFA

At an open forum prior to the annual meeting of the National Futures Association, NFA President, Mr. Dan Roth, outlined the NFA's internal reforms, as well as their efforts to advise changes in law and regulation outside their purview. We fully support these efforts, along with those Mr. Roth detailed last week to the Subcommittee on Oversight and Investigations for the House Committee on Financial Services. This includes requiring daily reporting of segregated balances to the NFA, elevating approvals for certain transfers from customer segregation to the C-suite and various revisions to the Bankruptcy Code to name a few.

We believe that the model of self-regulation still works. MF Global represents a spectacular test of this model and an opportunity to modernize rules and regulations. It presents a great challenge for policy makers, regulators and institutions that I believe we can overcome.