



COMMODITY CUSTOMER COALITION

INFO@COMMODITYCUSTOMERCOALITION.ORG | WWW.COMMODITYCUSTOMERCOALITION.ORG

125 SOUTH WACKER DRIVE, STE 300 | CHICAGO, IL 60606

FAX: 312-212-4073 | OFFICE: 312-344-3076

April 3, 2012

Statement of John L. Roe
Co-Founder, Commodity Customer Coalition

I would like to thank Chairwoman Stabenow and Ranking Member Roberts, along with their staffs and the staff of the Committee on Agriculture, Nutrition and Forestry for the opportunity to participate in today's panel.

I am the co-founder of the Commodity Customer Coalition, a non-profit advocacy group formed by MF Global customers in the wake of the broker's collapse. After it became clear customers would not have a unified voice before the court, a group of futures professionals based in Chicago organized customers, formed a legal team, raised money and engaged co-counsel to begin advocating for MF Global's customers before the bankruptcy court and in the public arena. That group became the Commodity Customer Coalition. We are proud of the work we have done to influence the bankruptcy process for the benefit of MF Global's customers.

To date, the Commodity Customer Coalition has succeeded in speeding up distributions of customer property, consulted in streamlining the claims process, spearheaded negotiations for customers with physical assets and assisted customers in completing their claims. We have filed briefs arguing for the primacy of customer property, worked with industry leaders on reform and negotiated claims deals for customers. These distressed debt negotiations raised the claims market to recoveries of over 92% in segregated funds and 66% in secured funds. We have worked with members of Congress in their investigation of MF Global, lobbied for tax guidance and relief for customers and pushed for a swift and thorough prosecution of any criminal wrongdoing which may have occurred at MF Global. We are currently advocating for an involuntary conversion from a Chapter 11 proceeding to a Chapter 7 proceeding for MF Global Holdings, Inc. We are also composing our detailed recommendations for industry reform, which we will tender that report to this Committee prior to its June 4 deadline.

I am also a principal of BTR Trading Group, a Chicago based introducing broker which was a division of MF Global, until separating from the firm in July 2010. I am also the president of Roe Capital Management, a commodity trading advisory firm.

I have been in this business for almost 10 years. In that time, I have been through two commodity broker IPO's and two commodity broker bankruptcies. Respectively, these were the fourth and eighth largest bankruptcy filings in US history. I arrived at Refco, Inc. in 2005 on the day of its IPO. In 60 days, it would have the dubious distinction as the firm which clocked fastest IPO-to-bankruptcy in US history. Refco's futures business would become MF Global, Inc., purchased out of bankruptcy by UK hedge fund Man Financial and later spun off in an IPO in July of 2007.

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 you 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. There are examples to support this. Refco collapsed because its CEO hid the firm's bad debt; had he disclosed it, Refco would likely have had a successful IPO. It simply would have set a lower IPO price, delivering Refco's CEO a payday of \$50 million instead of a jackpot of \$100 million. I agree that laws, rules and regulations cannot deter greed of this scale.

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 they 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 SIPC.

Self Insurance through an Industry Managed 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 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. With that, I look forward to participating in our discussion today.