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