

**STATEMENT OF MR. GERALD F. CORCORAN  
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**SPEAKING ON BEHALF OF R.J. O'BRIEN AND ON BEHALF OF  
THE COMMODITY MARKETS COUNCIL, WASHINGTON, D.C.**

**BEFORE THE HOUSE COMMITTEE ON AGRICULTURE**

**REGARDING THE EXAMINATION OF THE MF GLOBAL BANKRUPTCY**

**THURSDAY, DECEMBER 8, 2011**

**I. Introduction**

Chairman Lucas, Members of the Committee, good morning. My name is Gerry Corcoran, and I am the Chairman and Chief Executive Officer of R.J. O'Brien & Associates ("RJO"). Today I am honored to speak on behalf of both RJO and the Commodity Markets Council ("CMC"). I would like to thank you for hosting this critical hearing and for including RJO and the CMC.

The CMC is a trade association bringing together commodity exchanges with their industry counterparts. The activities of CMC members represent the complete spectrum of commercial users of all futures markets. CMC member firms trade regularly on CME Group, ICE Futures U.S., the Kansas City Board of Trade and Minneapolis Grain Exchange. CMC provides the access, forum and action for exchanges and exchange users to take a leadership role in addressing global market and risk management issues in various sectors, including agriculture, energy, finance, transportation and infrastructure.

At R.J. O'Brien, we are especially proud of our agricultural roots, our commitment to the agricultural community and our leadership in the futures industry. Personally, I am passionate about this business and the important role we play in helping individuals, farmers, agribusiness, corporations and institutions manage their risk.

Founded in 1914, RJO is a privately owned futures commission merchant ("FCM"). With our origins in the cash butter and egg business, today we are the oldest and largest independent futures brokerage and clearing firm in the United States. We are the only remaining founding member of the Chicago Mercantile Exchange, and our Chairman Emeritus, Robert J. O'Brien, served on its Board during the years when agricultural futures products blossomed and the financial futures markets were born. Throughout our history, RJO has stood side by side with our clients, exchanges and regulators during every significant market event this industry has seen.

**II. Impact of the MF Global Bankruptcy on RJO, its Customers and the Futures Industry in General**

The primary purpose of statutory segregation requirements for FCMs under the Commodity Exchange Act ("CEA") is to ensure FCM obligations are not met with customer funds; and, in

the case of an FCM insolvency, segregation requirements are also designed to protect customer monies. When a futures broker such as MF Global defaults, the entire industry is affected – the customers of the defaulting broker, the clearing organizations in which the defaulting broker participates, as well as other brokers that are members of the clearing organization. Typically, customer trades and the associated collateral held at a defaulting FCM must be moved to a new FCM. Moving customer trades and collateral requires significant coordination by affected participants throughout the industry, and transparency with respect to the location and booking of customer accounts and collateral is a crucial ingredient for a successful response to the default of an FCM.

MF Global was required by federal law [CEA and Commodity Futures Trading Commission (“CFTC”) regulations] to maintain adequate segregated funds to cover its liability to all of its customers who had a positive net liquidating value in their segregated account balances. As has been reported, the total pool of MF Global segregated funds is insufficient to cover that customer liability, and though the precise amount of the deficiency is at present unknown, all indications point to the amount exceeding \$600 million. Part 190 of the CFTC regulations sets forth the process for handling the pro-rata distribution of funds to customers in the event its FCM is the subject of a U.S. bankruptcy liquidation proceeding and has a shortfall in segregated funds held to keep its customers whole. This is the process that is currently underway and overseen by the Trustee.

This process is completely different from and bears no relationship to clearinghouse default rules.

Clearinghouse default rules and procedures are in place to protect the financial integrity of the clearing members on the opposite sides of trades in the event a defaulting clearing member fails to pay the variation call necessary to satisfy and make whole the opposite parties to the defaulting firm's trades. These rules ensure that, in the case of MF Global, had the firm not been able to meet its margin call to the clearinghouse and had there been a shortfall of margin collateral on deposit at the clearinghouse to satisfy all clearing members on the opposite sides of MF Global's customer positions, then in accordance with each clearinghouse's rules, other financial resources would be deployed to cover the shortfall.

MF Global did not default to any clearinghouse.

Clearinghouses met their obligations to all other clearing member firms and their customers and have undertaken welcomed efforts toward speeding customer access to their trading accounts, transferring their positions and providing the Trustee with support to encourage him to quickly release customer funds. Transfers of customer funds, effectuated by MF Global for the benefit of the firm and resulting in a segregated fund deficiency, constitute very serious violations of CFTC and Self-Regulatory Organization (“SRO”) rules and regulations.

Since the MF Global bankruptcy filing and default, RJO has worked hand in hand with the CME Group and the other domestic exchanges to provide a home for a substantial number of MF Global accounts and brokers. In a matter of a few days, we assumed a bulk transfer of 20,000 accounts without incident, and our shareholders provided an infusion of approximately \$50 million of capital to ensure that we would be sufficiently capitalized for this unexpected event.

At the same time, we worked very hard to ensure that our long-standing clients continued to receive the outstanding service to which they are accustomed. Our management and staff worked literally around the clock for 25 days straight in a massive effort that involved coordination of systems, processes and people, and sometimes working with incomplete data and rapidly changing circumstances. We fully recognized that the clients of MF Global had just experienced a traumatic event, and we did everything we could to provide vehicles for addressing their questions and providing reassurances as soon as we had answers. This effort included tripling the size of our client services staff, creating a dedicated hotline to answer questions from incoming clients and brokers, and establishing a website with continuous updates on the changing circumstances.

Unfortunately, these efforts, along with those of the Trustee, the CFTC and Designated Self-Regulatory Organizations (“DSROs”), have not mitigated the substantial loss of trust and confidence by market participants as a result of the MF Global bankruptcy. I believe that FCMs, exchanges and regulators alike would acknowledge that trust in the futures industry has been severely impaired. In the past five weeks, at our firm alone, we’ve received more requests from clients for our financial data than we have in the last three years combined. We have addressed more than 1,000 inquiries seeking assurances that this won’t happen at our firm. We continue to witness cash withdrawals to remove excess balances because there is a lack of confidence in the system as a whole.

So while the investigation continues into the causes of the MF Global bankruptcy and the whereabouts of segregated assets, one thing is clear. MF Global did not respect the sanctity of the segregated funds system. This violation forces us to engage in a discussion of policy recommendations which would not otherwise have been necessary. Looking ahead, I am certain, very certain of this: we CANNOT let this event destroy the long-term trust and confidence upon which market participants rely. This is an industry that is vitally important not only to the interests of the agricultural community, but to the world. In order to restore trust, we strongly encourage the MF Global Bankruptcy Trustee to conclude its investigation and facilitate the prompt return of all available customer segregated funds as soon as possible. We also believe the industry must move quickly to restore trust and confidence but in a measured and thoughtful fashion. It is incumbent on all interested parties – whether you are a legislator, a regulatory organization, an exchange, an FCM or even a customer – to work together to strengthen the financial safeguards of the futures industry.

### **III. The Cause of MF Global’s Failure is Uncertain**

RJO and CMC believe the businesses of all CMC members depend upon the reliable implementation of customer asset protection requirements by FCMs, clearing agencies and depositories. We likewise opine it is crucial for regulators, the MF Global Trustee and law enforcement authorities to conduct a full investigation. At this point, facts indicate there may be a shortfall of customer funds that could exceed \$600 million. Again, reestablishing trust and confidence in the futures markets is of paramount importance. Fact-finding investigations should focus on this issue and seek to determine whether the asset protection shortfall was the result of abuse by MF Global or others. CMC and RJO urge Congress, the MF Global Trustee, and the

applicable regulatory authorities to examine closely the circumstances surrounding the movement of customer collateral at MF Global to determine whether any abuse took place. If segregation violations occurred, measures should be carefully considered to enhance oversight, enforcement, or sanctions to further deter such violative behavior in the future.

Although we offer several ideas for thoughtful consideration and discussion, we urge Congress and the regulators to be cautious in any steps you may take to address the MF Global bankruptcy. We recommend you carefully measure the cost and market implications that may be associated with any changes.

#### **IV. Strengthening the Customer Asset Protection Regime in the Futures Industry**

At this early stage of the process and after a dialogue with CMC members and RJO customers, we are certain there are no possible “fixes” for the asset protection regime that would ensure safety of customer assets with 100% certainty. The ideas we raise today all offer some advantages and some disadvantages, and we highlight them for consideration by policymakers and regulators; however, we do not wish to endorse any specific proposal until all stakeholders have the appropriate factual information available.

##### **A. Separation of Proprietary Trading by FCMs**

On this point, I am speaking strictly on behalf of RJO, which operates on an “agency” only model and does not engage in proprietary trading. This model has served our customers well for almost 100 years. Customer protection should continue to be the bedrock upon which the industry has been built. We at RJO suggest those FCMs who want to conduct proprietary trading utilize other FCMs or create a separately capitalized special purpose FCM for this activity. Doing so will require the same oversight afforded to customer accounts, including proper margining at all times.

##### **B. Improvements to the FCM Net Capital Regime**

The remainder of my testimony reflects the views of both RO and CMC. In the absence of a finding of abuse of the customer asset protection regime, the industry should evaluate the adequacy of the current FCM capital regime in terms of whether the risk capital required adequately reflects the risk of an FCM default. We offer the following ideas for consideration towards more accurately reflecting that risk.

##### **1. “Double-Counting” of Funds by Dually Registered FCM / Broker-Dealers to Satisfy Capital Requirements**

FCMs are required to maintain liquid assets in excess of their liabilities to provide resources for the FCM to meet its financial obligations as a broker in the futures market. These capital requirements also are intended to ensure an FCM maintains sufficient liquid assets to wind-down its operations by transferring customer accounts in the event the FCM defaults.

Currently, FCMs that are dually registered as a broker-dealer are permitted to rely on the same funds to satisfy the broker-dealer’s net capital requirement and the FCM’s capital requirement. The rules of the CFTC generally permit an FCM that is dually registered as a broker-dealer to satisfy its capital requirement through compliance with the capital requirements imposed on the firm by the Securities and Exchange Commission (“SEC”) in light of the firm’s registration as a

securities broker-dealer. The CFTC's rules therefore tend to treat the capital requirements of FCMs and broker-dealers as equivalent, yet such equivalent treatment may not be appropriate.

The amount of risk capital that may be reasonable for a particular FCM, in light of the credit and market risks faced by the FCM in its house and customer accounts, may be lower or much higher than the comparable risk capital requirements applicable to the firm as a broker-dealer. The deemed equivalence of broker-dealer capital requirements, which generally do not turn on risk associated with customer futures positions as do FCM capital requirements, may require reevaluation.

## **2. Maintaining Capital in Segregation**

The inquiry into the role of capital of an FCM in protecting futures customers should also evaluate whether a certain proportion of funds designated as capital (*e.g.*, 50%) should be required to be placed in a segregated account dedicated to capital protection. Maintaining capital in segregation could generally contribute to the liquidity position of FCMs.

## **3. Low Concentration Risk Charges May Incentivize FCMs to Leverage Exposures to Single Credit Risks**

Where the concentration risk capital charge associated with exposures to a single issuer is too low, FCMs may have inappropriate incentives to leverage their exposure to such issuers. As the bankruptcy of MF Global made clear, excessive concentration of a firm's exposure to specific credit risks – in the case of MF Global, European sovereign debt – significantly increases risk to a firm's capital base. When evaluating whether the current mix of risk capital considerations (including legal risk, credit risk, liquidity risk, custody and investment risk, concentration risk, default risk, operational risk, market risk and business risk) adequately delivers a risk capital requirement and protects the firm and its customers against losses, regulatory agencies should take care to consider whether the concentration risk ratio should be limited to 50% of excess adjusted net capital for all credit risk exposures, excluding U.S. Treasury securities.

## **C. Enhanced Monitoring and Reporting With Respect To FCM Segregation Practices**

It may be worth discussing whether SROs and regulators should conduct more frequent audits of FCM segregation practices. Such exercises might increase transparency to customers of potential asset protection issues an FCM may be experiencing, promote enhanced risk management practices, and potentially provide the regulators with an early-warning mechanism. Accordingly, policymakers might consider imposing discrete reporting obligations that would mandate regulatory reporting by FCMs in the event of a decline below specified thresholds (*e.g.*, 25%) of customer-segregated to customer non-segregated assets.

## **D. Customer Trading Practices Also Impact Customer Asset Protection**

While this point does not directly relate to the MF Global situation, it is worth considering in the context of the financial stability of FCMs. Significant losses by a customer of an FCM can also result in catastrophic losses to the FCM itself. Improved customer collateral management could potentially be achieved by ensuring the adequate maintenance of customer collateral levels. An idea we offer for deliberation is to require accounts which exceed certain margin thresholds on

an intra-day basis to fund their account through direct wire transfer, thereby ensuring intra-day margin calls are met.

#### **E. A Potential Requirement for Individual Segregation of Customer Accounts**

The industry's objective must be to establish safe, liquid markets and to protect the assets of customers who rely on futures brokers to access the market. We believe the industry has spent considerable time discussing full physical segregation of customer accounts. While such a concept is worthy of study, it is too complicated to help in the near term, and resources would be better spent on solutions that are achievable and deployable in relatively short order to increase the safety and stability of the market today.

#### **V. Conclusion**

In summary, I would state that the failure of MF Global has had a great impact on futures markets, and the need to restore market confidence is urgent. However, the cause of the collapse is unascertained at this moment, and there is currently an investigation underway to determine the same. The facts need to be unearthed before concrete policy measures, if any, are taken. Meanwhile, in the spirit of discussing constructive and thoughtful ideas with lawmakers and regulators, CMC and RJO offer for your consideration, the following ways to strengthen the customer asset protection regime in the futures industry:

- Improving the FCM net capital regime,
- Enhancing monitoring and reporting with respect to FCM segregation practices,
- Considering the impact of customer trading practices on customer asset protection, and
- Potentially requiring individual segregation of customer accounts

CMC and RJO thank the House Agriculture Committee for the opportunity to testify on this important matter. We look forward to working with Congress and the regulatory authorities as we learn more.

Mr. Chairman, we compliment you and the Committee's efforts, and we look forward to answering any questions you may have on this vital topic that impacts our industry.

Please do not hesitate to contact Christine Cochran of CMC at (202) 842-0400 or via email at [Christine.cochran@commoditymks.org](mailto:Christine.cochran@commoditymks.org), or Gerry Corcoran of RJO at [gfcorcoran@rjobrien.com](mailto:gfcorcoran@rjobrien.com).

Thank you again for the opportunity to testify.