

## **Testimony of James W. Giddens**

Trustee for the Securities Investor Protection Act Liquidation of MF Global Inc.  
U.S. Senate Committee on Banking, Housing & Urban Affairs  
April 24, 2012

Chairman Johnson, Ranking Member Shelby, and Members of the Committee: Thank you for inviting me to testify today. My name is James Giddens. I am the court-appointed Trustee for the Securities Investor Protection Act (SIPA) liquidation of the failed broker-dealer, MF Global Inc. I am also the Trustee for the liquidation of the failed broker-dealer, Lehman Brothers Inc., and have extensive experience in broker-dealer liquidations. As a SIPA Trustee, I have all the powers and duties of a trustee liquidating a futures commission merchant under Chapter 7 of the Bankruptcy Code.

### **Considerations**

I would like to provide to this Committee some considerations on topics that may merit further study and input from regulators, industry experts, and members of the public. My comments are based on my experiences as Trustee generally, as well as my discussions with former MF Global customers, a group that includes thousands of America's farmers and ranchers, many of whom are undoubtedly your constituents. I understand the frustrations of the many former MF Global customers. My goal is to return as much money to customers as possible, as quickly as possible. All of us hope to avert a repeat of the MF Global catastrophe, or, at a minimum, alleviate its consequences, and with this goal in mind, I offer the following topics for consideration:

- Strict liability for the senior officers and directors of a commodities broker.
- Establishment of a commodities customer protection fund.
- Suitability requirements for commodities customers.
- Segregation requirements in excess of 100% of customer funds; notice requirements for the withdrawal of "excess" segregated funds.
- Complete segregation of 30.7 "secured" funds and elimination of alternative calculation.
- Improved international cooperation.

### Strict Liability for Senior Officers and Directors

The failure of MF Global Inc. was in part due to a failure to maintain integrated systems for tracking liquidity and the movement of funds, a lack of supervision of key treasury functions, fragmentation of responsibility, and inattention to the details of maintaining the segregation of customer funds at senior levels of the company. Because regulations require futures commission merchants (FCMs) to segregate customer funds at all times, it may be appropriate to impose civil fines in the event of a regulatory shortfall on the officers and directors who are responsible for signing the firm's financial statements.

Consideration should be given to requiring the chief executive officer, the chief financial officer, the chief compliance officer, and the general counsel of an FCM to certify not only their company's financial statements but also their compliance with customer segregation requirements on a frequent and continuing basis. Consideration should also be given to making

the officers responsible for establishing and overseeing a company's internal controls and procedures and certifying that they have done so. Where there is a shortfall in customer funds, Congress should consider making the officers and directors of the company accountable and personally and civilly liable for their certifications without any requirement of proving intent and without permitting them to defend on the basis that they delegated these essential duties and responsibilities to others.

#### Commodities Customer Protection Fund

The liquidation of MF Global Inc. would have played out differently had there been even a modest protection fund for commodities customers. The statistics we have gathered in the claims process demonstrate that the accounts of more than two-thirds of the customers who filed claims represent only 3% of the total amount that MF Global was required to segregate for commodities customers, or no more than \$200 million in total. Of the commodities customer claims received by my office, 78% seek a return of less than \$100,000. Thus, a fund limited to protecting these smaller accounts -- representing many farmers and ranchers -- could be of relatively modest size but would suffice to make these customers whole very quickly even in a case with a shortfall the size of MF Global's. With such a fund in existence, three-quarters of MF Global's commodities customers would not have been subject to any loss and could have been made whole within days of the bankruptcy filing.

A protective fund of this nature could be modestly funded and maintained at a minimal cost until such time as necessary to advance funds to customers, thereby allowing them to resume trading with little or no delay. The fund could be replenished by industry assessments when needed to satisfy claims in FCM failures.

#### Suitability Requirements for Commodities Customers

MF Global's commodities customers included farmers, ranchers, and members of the general public. Commodities trading is clearly an important part of the economy that, among other things, assists our vital agricultural base in hedging risk and funding itself. However, my staff and I have heard from many claimants across the spectrum of day traders and others who appear to have invested their retirement accounts and life savings in products in the U.S. and abroad that they may not have fully understood. We have heard from some former MF Global customers who have said they did not understand the account statements they received from MF Global even when it was in business.

Under current regulations, commodities customers are not subject to suitability requirements, such as those that the Securities and Exchange Commission has approved and are applicable to securities customers. Suitability requirements could help ensure that there is reasonable basis to believe that a transaction or investment strategy is suitable for a commodities customer, based on information about that customer obtained through reasonable diligence by the FCM.

#### Segregation Requirements In Excess of 100% of Customer Funds; Notice Requirements for Withdrawal of Residual Balances

Consideration should be given to requiring an FCM to segregate an amount in excess of 100% of customer funds. Requiring FCMs to post proprietary funds beyond the margin provided by customers could help ensure that there is a sufficient cushion at all times for commodities

customers. Consideration should also be given to implementing specific review and sign-off requirements by the CFO or other senior officers whenever an FCM seeks to withdraw even what are believed to be residual or excess segregated funds from a segregated (or secured) account when the withdrawal exceeds a certain dollar amount or percentage of either the account or the calculated excess.

#### Complete Segregation of 30.7 Funds

Under current rules, FCMs are not required to calculate “secured” amounts for customer funds held for trading on foreign exchanges per Commodities Futures Trading Commission Rule 30.7 (“30.7 funds”) the same way that they must calculate “segregated” amounts for customer funds held for trading on U.S. exchanges per section 4d of the Commodity Exchange Act (“4d funds”). Specifically, the rules allow a FCM to calculate the “secured” amount according to one of two methods:

A. Net Liquidating Equity Method: the net liquidating value of the net equity of all customer accounts plus the market value of any securities held in customer accounts; or

B. Alternative Method: a risk-based measurement based on margin required, plus or minus the unrealized gain or loss on futures positions, plus long option value, minus short option value.

In the case of MF Global, reliance on the Alternative Method in the time period leading up to the liquidation resulted in substantially fewer funds being segregated than under the Net Liquidating Equity Method. This allowed the FCM to believe that it was in regulatory compliance, with hundreds of millions of dollars to spare, even when the amount in segregation was actually in or perilously close to being in deficit. If FCMs were required to compute the secured amount under the Net Liquidating Equity Method, it could help ensure that all customer funds are properly segregated at all times and eliminate a difference in treatment among customers of which most customers are unaware.

#### International Cooperation

The collapse of MF Global, like the collapse of Lehman Brothers, has revealed significant gaps between protections afforded customers in U.S. and foreign countries, such as the United Kingdom, arising largely from differences in insolvency laws and the absence of clear legal precedent. Though there may not be a one-size-fits-all solution for these issues, customers would benefit from greater harmonization of rules governing the segregation of customer funds and treatment of omnibus accounts. A jurisdiction outside the United States should only be approved as a location for the deposit of U.S. customer segregated funds if there are adequate assurances that other governments and firms themselves are requiring and effecting segregation consistent with the representations made by a U.S. broker to its customers.

When a company like MF Global or Lehman Brothers fails, it is important that property segregated in one country for customers in another country is returned to the trustee or administrator in the country where the customer resides. In my experience, however, these tend to be the last issues to be resolved, which often require protracted litigation. In the case of MF Global, I have been engaged in active discussions since November with the administrators for

the estate of MF Global UK Ltd. concerning the return of approximately \$700 million of segregated customer property. I have filed a client claim in that proceeding seeking the return of all such segregated property, and have engaged in an exchange of information with the British administrators regarding this claim. That process has shown that there is a dispute as to whether the customer property that is the subject of my claim was or should have been segregated under English law. I believe that is in the best interests of MF Global Inc.'s former commodities customers that this dispute be resolved by the court, and the British administrators, at my request, have agreed to seek direction from the English court on these issues. Though I will press to have this litigated as expeditiously as possible, adjudication and resolution will likely take significant time and expenditure of resources, all the while holding up the possibility of substantial distributions to 30.7 customers in the United States.

### **Update on Trustee's Investigation**

As Trustee, my statutory mandate as the customers' advocate is to preserve and recover MF Global Inc. customer assets so that they can be returned to the rightful owners and to maximize the estate for all stakeholders.

As part of my statutorily-mandated duty, I am investigating the extent of and reasons for any shortfall in customer funds. This includes a deliberate, thorough, and independent investigation of the complex cash movements made by MF Global Inc. prior to its liquidation. My investigative team consists of counsel experienced in broker-dealer liquidations and expert consultants and forensic accountants from both Deloitte & Touche and Ernst & Young. All efforts are conducted under the supervision of the Bankruptcy Court and are coordinated with the United States Department of Justice, the CFTC, the SEC, and SIPC.

On February 6, 2011, I issued a preliminary report on the status of my investigation, which preliminarily determined that MF Global Inc. had a shortfall in commodities customer segregated funds beginning on Wednesday, October 26, 2011, and that the shortfall continued to grow in size until the bankruptcy filing on Monday, October 31, 2011. As detailed in the preliminary report, my office has traced substantially all of the cash transactions made in and out of MF Global Inc. in the last week before bankruptcy, totaling more than \$105 billion. At the request of the Committee, I have attached as an appendix a timeline of key events leading up to MF Global's bankruptcy filing based on my investigation.

My investigation has included thorough review of the actions of JPMorgan Chase, N.A., regarding JPMorgan's activities in connection with MF Global. JPMorgan has cooperated with my investigation, which has included witness interviews and review of extensive documentation by my staff, including attorneys and forensic accountants from Ernst & Young. My office and JPMorgan are presently engaged in substantive discussions regarding the resolution of claims.

I also believe, based on my investigation of conduct, allocation of responsibilities and reporting with respect to the segregated customer accounts, that there may be claims against certain responsible individuals at MF Global Inc. and MF Global Holdings Ltd. for, among other things, breach of fiduciary duties owed to both MF Global Inc. and its customers, and violations of the

segregation requirements of the Commodity Exchange Act. I may pursue these legal actions separately or in conjunction with commodities customers.

As I move forward with my investigation, I will continue to provide updates to the Court and public on my findings and conclusions.

### **Status of Customer Distributions**

My office has distributed nearly \$4 billion to former MF Global Inc. retail commodities customers with US futures positions via three bulk transfers:

- Within days of the bankruptcy, I received court approval for the transfer of 10,000 commodities customer accounts with three million open positions, along with approximately \$1.5 billion in collateral associated with those positions at the time of the bankruptcy. These open positions had a notional value of \$100 billion. A serious disruption in markets was avoided by the transfer.
- A transfer of 60% of the cash attributable to approximately 15,000 customer commodity accounts with cash only in the accounts, totaling approximately \$500 million, was completed in November.
- In December and January, a third transfer occurred that moved approximately \$2 billion to restore 72% of US segregated customer property to all former MF Global Inc. retail commodities customers with US futures positions.

My office has received 26,778 total commodities claims and has received over 4,500 additional general creditor claims that were likely misfiled, which will be treated as commodities claims. I expect that the total number of unique claims from former commodities customers (accounting for duplicates and amendments) will be approximately 23,000.

My office has determined and issued letters of determination for nearly 22,000 commodities claims, which is over 90% of the expected total claims.

In addition to the completed distributions, I have filed a motion with the Bankruptcy Court seeking authority for a distribution of up to approximately \$600 million of customer property held as segregated by MF Global Inc. for its former commodities futures customers who traded on US exchanges (4d funds); up to approximately \$50 million of customer property associated with commodity transactions in foreign markets (30.7 funds); and up to approximately \$35 million of customer property to a domestic delivery class, which we have identified as consisting of physical customer property that has been or will be reduced to cash in any manner.

I have also received Court approval to sell and transfer approximately 318 active retail securities accounts, which is substantially all of the securities accounts at MF Global Inc. Nearly all securities customers have received 60% or more of their account value and already 194 of former MF Global Inc. securities customers have received the entirety of their account balances because of a SIPC guarantee.

## **Conclusion**

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

If your constituents have any questions, I encourage them to visit [MFGlobalTrustee.com](http://MFGlobalTrustee.com), email my staff at [MFGITrustee@hugheshubbard.com](mailto:MFGITrustee@hugheshubbard.com), or call our call center at 1-888-236-0808.

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

Thank you Chairman Johnson, Ranking Member Shelby, and other Members of the Committee for the opportunity to testify before you and to submit this testimony for the full record of the hearing.