National Grain and Feed Association
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TESTIMONY OF THE NATIONAL GRAIN AND FEED ASSOCIATION TO THE COMMITTEE ON AGRICULTURE U.S. HOUSE OF REPRESENTATIVES

JULY 25, 2012

Good morning, Chairman Lucas, Ranking Member Peterson, and members of the committee. I am John Heck, Senior Vice President of The Scoular Company in Omaha, Nebraska. The Scoular Company, founded in 1892, manages commodity supply-chain risk for customers in food, feed and renewable fuel markets. From more than 70 locations across North America, nearly 700 Scoular employees tailor risk-management solutions for their customers by buying, selling, storing, and transporting grain and ingredients.

This morning, I am testifying on behalf of the National Grain and Feed Association (NGFA), the national trade association representing grain elevators, feed manufacturers, processors and other commercial businesses that utilize exchange-traded futures contracts to hedge their risk and to assist producer in their marketing and risk management strategies. We appreciate the opportunity to testify before the committee today.

I serve on the NGFA's Executive Committee and Board of Directors, and I also serve as chairman of the Association's Finance and Administration Committee. More recently, I was asked to co-chair the NGFA's MF Global Task Force, formed to develop responses and recommendations to the failure of MF Global. Our priorities are to advocate regulatory and policy changes that will help ensure that another similar situation does not recur and to enhance protections for commodity futures customers.

Many NGFA-member firms have been deeply affected by the MF Global Holdings bankruptcy and the subsequent liquidation of futures commission merchant (FCM) MF Global Inc. Following the bankruptcy, customers' accounts were frozen, then transferred to other FCMs in chaotic fashion and with a dearth of information to help customers manage their financial exposure. Today, another distribution of funds from the MF Global trustee has begun with the goal of bringing all commodity customer distributions to about 80% of account value, but many firms still have received only 72% of their funds with no assurance they ever will be made whole.

It is worth emphasizing again that these customer funds were required to be segregated and held safe by MF Global. Our industry had believed for years that segregated customer funds were completely safe, but we now see that was not the case. The unprecedented loss of customer funds in the MF Global debacle has led to a loss of confidence in futures markets and in the ability of the current system to protect customer funds.

As our Task Force considered regulatory and policy changes in the aftermath of MF Global, we asked ourselves: "Was MF Global a one-time situation, or is the level of customer risk still significant? Did the MF Global failure and its consequences rise to the level that merited significant change?"

Unfortunately, we know today that serious risk still is present. The discovery of apparent long-term fraud and misappropriation of customer funds at Peregrine Financial Group (PFG) highlights again the need for more effective regulatory oversight and meaningful change that will provide additional safety for customer funds both before a failure occurs and in the event of future FCM liquidations.

We are still awaiting details of the situation surrounding the PFG situation. On its face, the PFG failure appears to have some key differences from MF Global – namely, that customer funds were intentionally misappropriated for a variety of illegitimate purposes over a very long period of time. However, the cumulative effect of MF Global and PFG failures within a relatively short time – and especially the failure of PFG at a time when regulators presumably were on heightened alert for problems – has been a huge loss of confidence in regulators and in the adequacy of current rules to protect customer funds. We look forward to a full explanation by regulators of exactly what happened at PFG. In the meantime, we believe there are steps that should be taken to begin restoring confidence and to bolster protections for segregated customer funds.

In early April, the NGFA submitted to the Commodity Futures Trading Commission (CFTC) preliminary recommendations for enhanced reporting, transparency and accountability. Generally, these recommendations were developed with the intent of assisting customers by providing them with more information to evaluate FCMs with whom they do business. In addition, several of our recommendations were aimed at requiring greater scrutiny by the CFTC and self-regulatory organizations of FCM practices and financial reporting, and requiring FCMs to develop and adhere to policies and procedures that rigorously will ensure proper safeguarding of customer funds. Those recommendations are attached, and I would be happy to discuss them in greater detail.

Late last month, the NGFA submitted a second set of recommendations to leadership of both the Senate and House Agriculture Committees. These recommendations involve significant changes in customer account structure, reforms to the U.S. bankruptcy code to enhance customer rights and protections, and the potential extension of insurance coverage to commodity futures customers. The NGFA's letter transmitting our latest recommendations is attached, and I would like to highlight several of our recommendations today:

Reforms to the U.S. Bankruptcy Code

- The Commodity Exchange Act, CFTC regulations and the bankruptcy code should be harmonized to provide greater clarity and avoid interpretive inconsistencies in the event of future FCM liquidations.

- The CFTC's authority to appoint a trustee to represent exclusively the interests of commodity customers should be strengthened. In a situation like MF Global, where over 95% of assets and accounts affected were those of commodities customers, we believe the CFTC should play a larger role and that a trustee with commodities expertise should be involved.

- The bankruptcy code should state clearly that customers always are first in line for distribution of funds, ahead of creditors, and that all proprietary assets of affiliates should go to reimburse segregated customer accounts first.

- The bankruptcy code clearly should state authority for establishment of commodity customer committees to represent their interests in an FCM liquidation.

- Regardless of the intent behind transfer of customer funds, "safe harbor" provisions of the bankruptcy code should not limit powers of a trustee to recover customer funds.

We understand that significant reforms to the U.S. bankruptcy code are a major undertaking. For that reason, the NGFA would welcome working together with other organizations that have similar goals in order that legislation can be moved expeditiously by Congress.

Fully Segregated Customer Accounts

Current legal authority provides for *pro rata* distribution by the trustee of customer property that was held by a failed FCM. That means that all customers must share equally in losses in the event of a shortfall of funds. The NGFA recommends establishment of a new type of account structure for use by FCM customers on a voluntary basis that provides for full segregation of customer assets, not commingled with FCM funds or other customer funds. It will be important in establishing a new fully-segregated structure that customer funds not fall under the "customer funds" definition in the bankruptcy code, thereby exposing them to *pro rata* distributions and loss-sharing. Creation and maintenance of fully-segregated accounts necessarily will result in some additional costs that likely will be borne by customers. For that reason, we prefer that use of such accounts would be on a voluntary basis, at the agreement of an FCM and its customers.

We believe that a pilot program would be a useful way to test the mechanics of this new account structure and to begin to judge its true costs. The NGFA will look to work with commodity customers, FCMs, lenders and regulators to identify potential participants. We believe a pilot program leading to fully-segregated accounts can be implemented relatively quickly without the need for legislation.

Insurance for Commodity Futures Customer Accounts

Because a fully-segregated account structure may not prove to be a practical alternative for all customers, the NGFA also has recommended that insurance coverage be extended to commodity customers, in much the same way that insurance protection currently exists for securities customers under the Securities Investor Protection Corporation (SIPC). Details involving the appropriate level of coverage and funding will need to be determined, but we believe the added protection for customers will be perceived as significant and meaningful in today's environment.

Dodd-Frank Implementation

Finally, I would like to share with the committee the NGFA's views on the ongoing implementation by CFTC of the Dodd-Frank law. We believed from the beginning that agriculture, and the use of agricultural risk management tools, had nothing to do with the financial crisis that served as the catalyst for passage of Dodd-Frank. Responding to the barrage of proposals from the CFTC to implement Dodd-Frank has required much time and effort by agriculture and agribusiness firms.

While some uncertainties still exist in how the law will be implemented by the CFTC, the NGFA generally has appreciated the Commission's openness and responsiveness to agriculture and agribusiness concerns. However, I would like to close my testimony with some comments about one proposal that has generated serious and widespread concern among NGFA-member firms and the agricultural producers with whom they work so closely.

Briefly, the proposal would require that any member of a designated contract market (DCM) – like the Chicago Board of Trade, Kansas City Board of Trade or Minneapolis Grain Exchange – record all oral communications that could lead to a cash transaction. In addition, records would need to be kept for CFTC inspection for up to five years, identifiable by counterparty and transaction. There are several problems with the proposal as currently written:

- The proposal would require, for example, a country elevator operated by a company that is a member of a commodity futures exchange to record telephone conversations with farmers about a forward cash contract – contracts that specifically are exempted in the Commodity Exchange Act from CFTC's jurisdiction. Taken even farther, a country elevator manager's conversation behind the stands at the high school football game on Friday night with a farmer in the community about buying cash grain the next day would be required to be recorded. Clearly, this would constitute a huge expansion of CFTC's authority in the cash marketplace.

- Country elevators are not equipped with the technology to record conversations and maintain a record of them. The proposal would require a huge new investment in communications technology for many small businesses.

- The proposal would create a bifurcated cash marketplace in which some grain purchasers would be required to record communications and maintain records, while others not operated by a member of a DCM would not be covered by the rule. Will a farmer call the elevator where all conversations must be recorded and records kept for CFTC inspection, or the elevator down the road where no such requirement exists? Serious competitive issues are involved.

The NGFA respectfully suggests that the enforcement goals of the Commission can be effectively accomplished and better served without this huge new intrusion into the cash grain marketplace.

Thank you for the opportunity to share the views of the National Grain and Feed Association. I would be happy to respond to any questions.

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June 29, 2012

The Honorable Frank Lucas
Chairman
Committee on Agriculture
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Collin Peterson
Ranking Member
Committee on Agriculture
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Lucas and Ranking Member Peterson:

As you are well aware, companies and individuals that were customers of MF Global Inc.'s futures business continue to deal with the aftermath of parent company MF Global Holdings' bankruptcy and the subsequent liquidation of the futures commission merchant (FCM). Most customers so far have received distributions from the trustee of about 72% of their funds – funds that were supposed to have been segregated and protected – with no assurance of being made whole.

Shortly following MF Global's demise, the National Grain and Feed Association (NGFA) established a task force to formulate recommendations for change to help ensure that another MF Global-type situation does not occur. On April 2, we submitted to Congress and to the Commodity Futures Trading Commission (CFTC) a number of preliminary recommendations for enhanced reporting, transparency and accountability (attached). We are pleased that the CFTC and the regulated exchanges have begun to implement some changes quite similar to the NGFA's preliminary recommendations.

This letter transmits a second set of NGFA policy recommendations. Many of these changes will require action by Congress and/or the CFTC, and we urge expeditious consideration to protect customers' funds and to reinforce the principle that "Customers Come First."

The NGFA's recommendations are as follows:

Reforms to U.S. Bankruptcy Code – The NGFA believes strongly that reforms to the U.S. bankruptcy code are critically important to preserving customers' rights and protecting customers' assets in the event of future FCM insolvencies. To that end, the NGFA recommends the following statutory changes:

- Generally, the bankruptcy code provides a limited description of the liquidation process of a commodity futures broker. The Commodity Exchange Act and bankruptcy regulations drafted by the CFTC provide much greater and more detailed guidance for the liquidation of a commodity broker or FCM. The NGFA recommends that Part 190 regulations of the CFTC should be incorporated into Subchapter IV of Chapter 7 of the bankruptcy code to harmonize the statutes and avoid interpretative inconsistencies.

- Under SIPA, the SIPC is authorized to select a trustee and to oversee the trustee's compensation, while the CFTC has a limited role. Further, the SIPA trustee is obligated to protect the interests of both securities and commodities customers. In order to strengthen commodity customer protection, the NGFA recommends that CFTC should have a specifically identifiable role in the liquidation of an FCM. The CFTC should have the authority to appoint its own trustee to represent exclusively the interests of commodities customers. (This recommendation is not intended as a criticism of the SIPA trustee appointed to oversee liquidation of MF Global Inc. However, in a case where over 95% of the assets and accounts affected were those of commodities customers, we believe the CFTC should play a much larger role.)

- Currently, an FCM is required to keep customer funds segregated from the firm's proprietary funds, but customer property is commingled. As a result, under the current statutory scheme, all customers share *pro rata* in the event of a shortfall. The NGFA recommends that the bankruptcy code should state clearly that customers always are first in line for distribution of funds, ahead of creditors, and that all proprietary assets including those of affiliates must go to customers first. Knowing that their claims could be subordinated in the event of a shortfall would provide incentives to the FCM and any controlling parent firm to ensure adequate internal controls to prevent segregation violations. Further, this provision would provide clarity to regulators and to the courts in terms of prioritization of claims, an area in which precedent has not been established.

- In the MF Global situation, creditor committees were established under the MF Global Holdings Chapter 7 proceeding, but there was no statutory provision under the SIPA liquidation of the MF Global Inc. FCM for establishment of customer committees. The NGFA recommends that the bankruptcy code expressly should authorize the establishment of customer committees to represent customer interests.

- Under current bankruptcy law, powers of a trustee to recover customer funds are limited under so-called "safe harbor" provisions unless actual intent to defraud customers/creditors can be shown. The NGFA strongly recommends that any transaction involving the misappropriation of an FCM's customer property should not be protected under safe harbor provisions, regardless of the intent behind a fund transfer.

We are aware that other organizations also are working toward specific recommendations for changes in the bankruptcy code that will enhance customer protections. The NGFA would welcome the opportunity to work cooperatively with such groups to develop consensus reforms that can be moved by Congress expeditiously.

<u>Fully Segregated Customer Accounts</u> – Currently, the Commodity Exchange Act and U.S. bankruptcy code provide for pro rata distribution of all customer property that was held by a failed futures commission merchant (FCM). In the case of MF Global, the result has been that former customers of the firm so far have received only 72% of their supposedly safe segregated funds back through distributions from the trustee, with no assurance that they ever will receive all of their funds. We believe strongly that a new type of account structure needs to be established for use by FCM customers on a voluntary basis that will shield customer assets from pooled losses in the event of an FCM bankruptcy.

It will be of paramount importance in establishing this new structure that fully-segregated customer funds not fall under the "customer funds" definition of the bankruptcy code, thereby exposing them to pro rata distributions (as discussed above in recommendations for changes in the bankruptcy code.)

Creation of a fully-segregated account structure necessarily will result in some additional costs that likely will be borne by customers utilizing this voluntary option. If that is the case, it is likely that some customers will opt for the added protections despite extra costs, and some customers will be unwilling or unable to bear those extra costs. For that reason, we propose that the full-segregation option be utilized on a voluntary basis at the agreement of an FCM and its individual customers. The NGFA will look to work with like-minded organizations to design a full-segregation option that responds to customer needs.

Pilot Program for Full-Segregation Option – We suggest that a pilot program involving commodity futures customers, FCMs, banks and regulators could be a useful means of testing the mechanics and beginning to judge the true costs of a full-segregation structure – and in the process, moving as quickly as possible toward a more generally available full-segregation option for customers. The NGFA recommends a pilot program at the earliest possible date, and commits here to working with its member firms, the CFTC and other parties to identify potential participants.

SIPC-Like Insurance for Commodity Futures Customer Accounts – Because the full-segregation option discussed above may not prove to be a practical alternative for all market participants, the NGFA recommends that insurance coverage in the event of an FCM bankruptcy be extended to commodity futures accounts similar to that currently provided for securities customers.

Much in the way that the Securities Investor Protection Corporation (SIPC) has provided insurance protection for securities accounts, the NGFA recommends creation of a similar structure for commodities. We believe that a significant fund could be established through very modest dedicated assessments on commodity futures transactions. Details concerning the appropriate size of such a fund and the appropriate level of assessment will need to be determined, but we believe the customer protections provided will be significant and meaningful to market participants.

The NGFA does not recommend herein whether housing a commodity futures insurance fund within the existing structure of the SIPC is the correct solution, or whether a new and separate entity resembling the SIPC but dedicated to providing insurance protection for commodity futures accounts should be established. However, we believe strongly that insurance protection for commodity futures accounts should be established, action that likely will require authorizing legislation. We look forward to working with Congress to achieve that goal.

We look forward to working with Congress, the CFTC and other stakeholders to achieve the afore-mentioned changes with the goal of protecting customer funds, both prior to and following a bankruptcy or an FCM insolvency. Please do not hesitate to contact the NGFA with any questions.

Sincerely,

Matt Bruns

Matt Bruns, Chair
Risk Management Committee

John M. Heck

John Heck, Chair
Finance & Administration Committee

National Grain and Feed Association

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April 2, 2012

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Dear Chairman Gensler:

The demise of MF Global has shaken the confidence of many futures market participants with regard to the safety of segregated customer funds. Many NGFA-member companies continue to struggle to recover their funds and property.

The NGFA respectfully submits the following preliminary recommendations as first steps to begin re-establishing confidence among futures market participants and to help safeguard customer funds. However, it is extremely important that these types of changes – designed to enhance reporting, transparency and accountability, with recommendations we believe should be relatively easily implemented – are not the end of efforts to ensure that another MF Global-type situation never recurs.

The NGFA's MF Global Task Force continues its work to examine various models for segregating and safeguarding customer funds; to explore the viability and costs of extending insurance coverage to commodities accounts; and to analyze potential changes to the U.S. bankruptcy code to provide customers with needed protection, especially to protect customer segregated funds from being swept into liquidation proceedings and to ensure that "safe harbor" rules under the bankruptcy code aren't used to preclude retrieving customer funds. We expect to issue additional recommendations in these areas soon. In all these efforts, our bedrock principle will be:

"Customers Come First"

The preliminary recommendations of the NGFA are as follows:

- The CFTC should require daily reporting of segregated fund positions by FCMs to both their Self-Regulatory Organization (SRO) and to the CFTC.

- The CFTC should require daily reporting of segregated fund investments by FCMs, detailed by maturity and quality, to both their SRO and to the CFTC.

- The CFTC should conduct a formal review of FCM investment options for customer funds, with a view to whether the Commission should further limit allowable investments only to very safe instruments.

- The CFTC should require reporting by FCMs to their SRO and to the CFTC of significant changes in investment policies or holdings.

- FCMs should be required to provide greater transparency to customers of where customer funds are invested, potentially achieved through means such as posting on the CFTC web site, FCM web sites and/or publication in a customer "prospectus."

- The CFTC and SROs should enhance monitoring of FCM reporting. Both regulators should conduct more detailed and more frequent audits, and unannounced spot checks of FCMs.

- To assign accountability and to aid in establishing that fraudulent activity has occurred in the event customer funds are misappropriated, CFTC should require the signature of two authorized principals of an FCM (e.g., CEO, CFO or other senior officers) to move funds out of segregated customer fund accounts to non-customer accounts.

- FCMs should be required to provide immediate notice to their SRO and to the CFTC if the firm moves more than some percentage, to be determined by the CFTC, of excess segregated funds to non-customer accounts.

- FCMs should be required by their SRO to periodically certify policies and procedures to ensure the safeguarding of customer segregated accounts and compliance with applicable laws and regulations regarding such accounts. As part of all examinations by SROs, principals of FCMs must certify that policies and procedures are adequate, effective and being observed by the FCM. At least annually, SROs should be required by CFTC to review policies and procedures to determine adequacy and compliance.

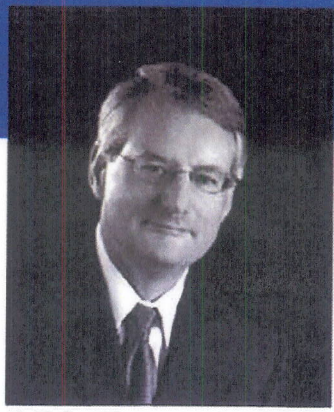
- A rigorous review by the CFTC of capital requirements for FCMs and broker-dealers needs to be conducted, with a view to scrutinizing the current practice of allowing double-counting of required capital when a firm operates as both an FCM and a broker-dealer.

We appreciate the opportunity to share these recommendations with you, and we look forward to working with you to ensure that customer funds truly are segregated and safe from future misappropriation.

Sincerely,

Matt Bruns
Chair
Risk Management Committee

John Heck
Chair
Finance and Administration Committee



John M. Heck
Senior Vice President
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The Scoular Company®

John M. Heck is The Scoular Company's Senior Vice President, Business Development.

He began his Scoular career in 1981 when he joined the company as a grain merchandiser. Mr. Heck held positions of increasing responsibility with Scoular; he was named Operations Manager of the Nebraska Region in 1984 and Vice President responsible for the management and operation of the Eastern Region in 1985. Seven years later he was promoted to Senior Vice President.

A native of Council Bluffs, Iowa, Mr. Heck received his B.S. degree in Economics from The University of Iowa in 1977. Prior to working for The Scoular Company, Mr. Heck worked as an engineering technician for Shoemaker Consulting Engineers and as a construction estimator for the Union Pacific Railroad.

Mr. Heck currently serves on the Board of Directors and the Executive Committee of the National Grain and Feed Association and is Chariman of the Finance and Administration Committee. He is a past Chairman of the Agriculture Council and a member of the Public Policy Committee for the Omaha Chamber of Commerce. He serves on the Board of Habitat for Humanity of Omaha, and is a past trustee of the Nebraska 4-H Foundation. Mr. Heck is past President of the Omaha Grain Trade Association.

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2009.

Name: John Heck

Organization you represent (if any): National Grain and Feed Association

1. **Please list any federal grants or contracts (including subgrants and subcontracts) <u>you</u> have received since October 1, 2009, as well as the source and the amount of each grant or contract. House Rules do <u>NOT</u> require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:**

Source:__________ **Amount:**__________

Source:__________ **Amount:**__________

2. **If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) <u>the organization</u> has received since October 1, 2009, as well as the source and the amount of each grant or contract:**

Source:__________ **Amount:**__________

Source:__________ **Amount:**__________

Please check here if this form is NOT applicable to you: __________

Signature: J. M. Heck Senior Vice President

* Rule XI, clause 2(g)(5) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

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