

Bryan Durkin Speech to NGFA
Monday, December 12, 2011
Marriott Magnificent Mile, Chicago
9:10 a.m.

Thank you for that kind introduction.

First of all, I'd like to thank you for your gracious invitation to speak here today. This is a tremendous group, made up of people who are vital not only to our exchange, but to ensuring that the world is fed. That is a high calling, and I'm proud to be addressing you.

I know there are always a lot of concerns on the minds of grain producers in the winter months as it relates to hedging and futures markets, but certainly this year presents a different level of difficulty given the failure of MF Global. I'm here to share with you the CME Group perspective on things, and provide some updates, and hope that I address all of your concerns.

As hedgers, you experienced an unprecedented shock to the market several weeks ago with the bankruptcy of MF Global, and the discovery of a shortfall in customer-segregated funds.

In the wake of that event, we've held a few calls with members of NGFA, and I know some of you are wondering about the long-term safety of futures; and more immediately, about whether or not you'll see money you invested with MF Global returned in full.

Those two things – the integrity of our markets, and the protection of our customers – have been our primary concerns throughout this process.

For a very long time – about 150 years – farmers and agribusiness never worried about the safety of their money when hedging on futures exchanges. The fact is the system continued to work at the clearing house, where \$2.5 billion of your money was held.

But given what did not work at the firm level of MF Global, many of you are now awaiting the return of funds. And if you're affected by this situation, we understand that the farmers and lenders you do business with are affected too. For you to do your job, they must have confidence in the futures markets' ability to manage price risk. This has been an industry-wide blow to the heart of commodities markets – its producers, processors and distributors. And that blow was dealt by the violations committed by MF Global.

As MF Global's primary exchange operator, and one of its regulators, CME Group has faced a lot of questions following MF Global's failure about how a shortfall in customer funds occurred, about the security of our clearing operation, and our ability to return customer funds to their owners and restore confidence.

I'd like to take the next few minutes to review a timeline of events and our response to those events, that I hope will help answer some of these questions.

TIMELINE

During the week of October 24, MF Global was downgraded by several credit ratings firms after announcing poor earnings. During this time, CME Group was in daily contact with MF and received assurances that the firm had sufficient liquidity.

On Thursday, Oct. 27, two CME auditors went to MF Global's Chicago offices to review their daily segregation report for Wednesday. The report showed full compliance. Our auditors asked for the necessary material to check the numbers on the report, and began to tie out those numbers with third parties.

On Friday, Oct. 28, the Thursday segregation report was delivered to CME stating that MF Global was in full compliance and had \$200M in excess seg. When our auditors left MF Global on Friday night, they had no indication that any segregated funds were missing.

On Sunday, Oct. 30, Our auditors returned because they learned from the CFTC that a draft segregation report for Friday – which we would normally receive on Monday – showed an approximate \$950 million shortfall. MF Global said this discrepancy was caused by an accounting error.

Our auditors worked with the CFTC and MF Global for the rest of the day and night Sunday to find the so-called accounting error. No such error was ever found.

Instead, at about 2 am Monday morning, October 31st, MF Global informed both the CFTC and CME, at approximately the same time, that the shortfall was real and that customer segregated funds had been transferred out of segregation to the firm's broker dealer accounts.

MF Global filed for bankruptcy, and as a result, their assets – and in this case the customer funds held at the firm – were frozen by the Trustee as soon as bankruptcy was filed.

Of course, this is not our industry's first bankruptcy. What makes this case different is the shortfall in funds, which is a clear and significant violation of CME rules and government regulation.

RESPONSE

Since the beginning of this episode, our number one priority has been to assist customers in securing MF's return of every penny that rightfully belongs to the customers.

To that end, we've acted aggressively – and with as much speed as the situation allows – to share information with customers and give them full access to their accounts.

I say “with as much speed as the situation allows” because MF filed for bankruptcy and, as a matter of law, the SIPC Trustee has been in control of the process and all decisions regarding distribution of funds.

In the week following the bankruptcy filing, after bankruptcy court approval, we successfully transferred 15,000 accounts and \$1.45 billion dollars.

Within two weeks of the filing, we offered a \$250 million dollar guarantee to the trustee so that he could accelerate the distribution of funds to customers without a loss to the bankruptcy estate. A week later, we increased this guarantee to \$550 million.

We offered these guarantees not because a rule says we have to, but because we are in uncharted territory, and we felt an inherent responsibility to our customers to help them receive distributions as quickly as possible.

In addition to our guarantees to the trustee, CME Trust is providing virtually all of its capital – \$50 million dollars – to cover CME Group customer losses due to MF Global’s misuse of customer funds.

The process of returning warehouse receipts to customers has also begun.

As a result of these actions, MF Global customers – not just CME Group customers – have already started to see substantial cash returned. And by later this week, customers should have access to two-thirds of their balances.

This is progress, but it really only means we're two-thirds of the way there. We believe that all customers affected should have their full balances and property returned by MF before we consider the process complete.

Again, the decision on the portion of customer collateral transferred to new accounts is ultimately up to the Trustee. However, we continue to advocate the release of additional funds as soon as possible.

As you know, there is also a claims process in place, which I know many have found to be a bit cumbersome. Last week, we released a Question-and-Answer document to address the many questions former MF customers have about that process. This can be found on the MF Global page of the CME Group website.

MF SHORTFALL

In the MF Global case, some might conclude that the prescribed system of account segregation failed. It's important to note, however, that this was a failure of a firm that broke the rules. Not the failure of any clearing house. At CME Group, we met our obligations to all other clearing member firms and their customers.

MF Global's transfer of segregated funds out of the appropriate accounts constitute serious violations of our rules and of the Commodity Exchange Act. And we are currently cooperating with federal agencies investigating MF Global.

We recognize, however, that investigations and any future punishment is of little comfort to those customers – like some of you here today – who are still suffering, and awaiting the return of funds they thought were safe. What happened to customers as a result of MF Global's actions is tragic, and it's an unfortunate first for our industry.

That's why we will continue to use all of our available resources to minimize the impact of this event on our customers and the industry. Our guarantee has already accelerated the return of capital to customers, and we continue to work with the Trustee on additional distributions.

Moving forward, we intend to work with regulators and industry leaders on ways to strengthen protection of customer funds at the firm level, and prevent a repeat of this episode.

A FINAL WORD

In the derivatives business, we often use the term “underlying asset.” As in, the real product on whose value traders buy and sell futures and options on futures, whether or

not they're planning to actually take delivery of the asset. Without these assets, of course, we would not have commodities markets, and all the futures products that go with them.

Rather than just trading contracts on these assets, those of you in this audience are investing significant capital to manufacture, store, process, and deliver them. You do all of this with no promise of things like good weather, favorable regulation, or consistent market conditions in other parts of the world.

We understand the significant risk you face. It's why we exist. So when – in an effort to manage all this risk – you lose funds – even temporarily – that's troubling. You deserve answers as to what happened, and it's our responsibility to restore your confidence.

Going forward, we will continue to work with industry groups like the NGFA to evaluate the lessons of this experience, and ensure that, in the future, there are greater protections for customer funds at the firm level.

Thank you very much for your time. I'm happy to take any questions you might have.