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## THE ELEPHANTS IN THE ROOM

With all the hoopla surrounding the recent demise of MF Global on the heels of their overexposure to euro zone debt; the focus should be to find out who, when and where moved monies from customer segregated funds accounts of the FCM (Futures Commission Merchant) to the MF Global Broker-Dealer resulting in the 8<sup>th</sup> largest bankruptcy in history. This event has wreaked havoc on what has been reported to be 38,000 customers in an unheard of theft of “good faith deposits” in commodity accounts. However, before getting to the criminal indictments, enforcement of Dodd-Frank and increased regulations that will surely be imposed, one should first look at the two elephants in the room that have been largely unnoticed or ignored.

Number one, why are commodity account holders having their issue dealt with by SIPC rather than the CME and CFTC? SIPC should have domain over MF Global’s broker dealer, the one with the risky security trades, but SIPC from what I can see, has no experience in the commodity space. It is axiomatic that those individuals and traders that make “good faith deposits” in a commodity accounts have always known that the money is backed by the “financial integrity of the clearinghouse.” If there is money missing from customer segregated funds account, especially following only a one week old review by the clearing house (CME Group), then the exchange should have activated their emergency fund and with assistance from the CFTC, facilitated account transfers, either to the firm that had agreed already to take over the MF Global FCM or to a host of other clearing houses. The CME profits in 2010 were just shy of a billion dollars and to risk a year’s earnings to prove that the system works is a drop in the bucket compared to the public relations nightmare they have created by standing aside. As a CME Group shareholder I would gladly let my shares fall, knowing from their responsible action that the system works! Instead, accounts were frozen and those with futures positions saw them transferred to previously unnamed firms with only enough cash in the transfer to assure that they would get a margin call as soon as the transfer took place, while the rest of their funds remained with the trustee. I’m sure some of those accounts that were “sold out” by the margin department of their new broker for lack of funds, experienced losses that might be excessive especially if they were hedging a physical commodity. This is living testimony as to the lack of understanding by SIPC with an “assist” from the trustee, in handling the customer futures piece of the MF Global matter. Ultimately CME Group guaranteed \$550 million of potential losses but this can only be described as “too little too late.” What were they thinking and what do they expect investors will think in the future about having their segregated funds regulated by the CME Group? Once they throw investors under the bus after failing to fulfill their supervisory, fiduciary and financial responsibilities, my guess is that the futures industry is not going to be what it used to be, a shame given the global success of electronic trading.

Number two, there are many rules in place that are imposed on the host of banks that hold funds in segregated fund accounts for the various futures commission merchants. Is it really possible that a custodian bank holding customer segregated funds for an FCM would permit the release of funds directly to that or any broker dealer to satisfy a margin call that the broker dealer had with them or any other bank? When a financial institution is a custodian of customer segregated funds for a futures firm while also financing the security positions of that firm’s broker dealer, the potential conflicts of interest are obvious. Are there no rules prohibiting custodian banks from moving funds from an FCM to a Broker-Dealer? If not, then why refer to the assets as “segregated funds?” Banks getting a call on

customer assets to meet margin requirements of the banks customers gives new meaning to the phrase “too big to fail.” It has been almost two months since the MF Global bankruptcy and it is hard to believe that with all of the talented forensic accountants auditing the books that funds are still missing. Remember, the MF Global books were fine a week before the event so even if there weren’t proper journal entries, it shouldn’t be that hard to identify where the funds went. Apparently there must be a lot going on behind the scenes that’s not being aired. We’re now hearing that precious metal assets designated to specifically name entities held in custody for MF Global are being “haircut” by the trustee. There is no way that creditors should receive compensation from these assets. What if a bank were to fail? Do creditors have a lien on the assets held by individuals in the banks lock boxes? The same applies to the \$700 million of segregated funds for U.S. customers held in the U.K. These are customer assets that were stolen and regulators on both sides of the pond should make sure those futures customers are made whole. If not, then what are the regulators really regulating?

Simply said, if I was trustee of my grandmothers’ trust and I took \$50,000 out of the trust account at her bank and then used that money to pay off a maturing loan I had at that bank to keep me from going bankrupt, wouldn’t someone at the bank prevent me from doing that? If they didn’t then granny could hire a lawyer and there wouldn’t be a court in the land that wouldn’t repatriate the funds to the trust, while possibly having me fitted for an orange jumpsuit. If our premiere banks, trustee law firms (at \$980/hr) and government regulators view the situation differently, count me in the 99%, make that 99 ½%.

C.W. Hornsby  
Hornsby & Company, Inc.  
505 995 0003  
Santa Fe, N.M. 87506