



Premier Metal Services, LLC.

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To: Robin Wiener, President, Institute of Scrap Recycling Industries

CC: Scott Horne, General Council, Institute of Scrap Recycling Industries
Mark Reiter, Assistant VP Chief Lobbyist, Institute of Scrap Recycling Industries
Jonathan Levy, Director of Member Services, Institute of Scrap Recycling Industries
Chuck Carr, VP Member Services, Institute of Scrap Recycling Industries
John Sacco, Executive Committee President, Institute of Scrap Recycling Industries
Congressman Steve C. LaTourette, 14th District, Ohio

RE: MF Global

The MF Global bankruptcy has exposed a systemic problem with the entire commodity trading system and it is time we look forward on how to fix it. The problem, as I see it, is there is not any mechanism for companies who are hedging or speculators to protect the monies on deposit within each clearing firm. These funds are supposed to be in segregated accounts according to CME regulations but, as illustrated by MF Global, the oversight of this stipulation is lacking at best.

Individuals who use the market on a speculation basis assume an inherent risk to losing all funds on account. They also stand to gain financially if their speculation results in net gains. Companies using the commodity exchanges as a hedging tool to market fluctuations assumed that there was no inherent risk with regards to market conditions. These two types of accounts have functioned without any type of issues and segregated funds were the mechanism used to protect initial and variable margin money on account with the clearing firms. These segregated accounts were the basis for the markets to operate and ensure a mutual trust between the customers using the commodity markets and the CME firms facilitating the trades. This premise was proved to work seamlessly when Refco filed for bankruptcy.

Unfortunately, in my opinion, MF Global has proven that history does not always repeat itself. The current situation with MF Global has illustrated that when the trust between clients and the CME clearing firm is violated and segregated funds are comingled with non segregated

funds the biggest losers are the individuals or companies trading on the commodity exchanges. With the implied trust broken the question is how to fix the problem. As I see it, the following is the most critical flaw within the current system:

1) The concept of segregated funds

- a. According to one application packet to open a commodity trading account with a CME clearing firm there is the following provision
 - i. "Except as prohibited by Applicable Law, all collateral now or hereafter held or carried by the clearing firm (CF) for customer may, from time to time, without notice to customer, be pledged, hypothecated, loaned or invested by CF to or with CF or others, separately or with any other property. CF shall not be required to retain in its possession for delivery a like amount of, or to pay interest or to account to customer for any profits on, such property. All transactions for or on customers behalf may be included in a single account whether or not such transactions are segregated on CF's records into separate accounts, either severally or jointly with others"
 1. This clause basically allows the CF to use the money required to be posted by CME for initial and variable margin at their discretion but does not provide a mechanism for this money to be insured by any government agency like FDIC or SIPA. It also does not allow for receivable insurance companies like COFACE or Euler to recognize these funds as a receivable due to the fact that the segregated account acts like a bank account.
 2. The CME regulations will not allow for the funds to be held in a security account, which is insured by SIPA, but must stay in a segregated fund that isn't really segregated by customer.

In my opinion, the above clause and results from the clause put all initial margin and variable margin money at risk to a bankruptcy. The risk management program for these funds simply doesn't exist. The following options might begin to mitigate some of the risk:

- 1) Allow segregated margin funds to be swept nightly into a securities account that is insurable by SIPA
- 2) Allow T-bills, which are a permissible instrument to post as margin, to be titled in customer name and backed up by a UCC filing
- 3) Allow for margin money to be construed as a revolving receivable by customer so a receivable insurance company would insure the account
- 4) Modify scope of SIPA to insure commodity segregated accounts

- 5) Require that funds in kind must remain on deposit at CF and remove the discretionary policy for investments by CF

All of the above suggestions would require that the CF's either give up the ability to speculate with our required margin requirements or create a vehicle where customers can mitigate their risk from the CF's speculative positions. For true hedging accounts, this is the only logic that makes sense. Remember, hedging accounts are using the commodity exchanges to mitigate market risks and must be able to mitigate risk now demonstrated by the CF's ability to speculate however they choose.

The above mentioned issue is the most critical to address. It doesn't help to list any other flaws in the system due to the fact that if this systemic flaw isn't corrected, the integrity of the system will fail. It is our duty as a trade organization to lobby for change. If we do nothing now, we will be victims again.

Please feel free to call me at 440-519-1104 or email me at meisner@premiermetalservices.com with questions or comments.

Sincerely,



Michael Eisner