REPORT OF INVESTIGATION

BERKELEY RESEARCH GROUP, LLC

ANALYSIS OF THE NATIONAL FUTURES ASSOCIATION'S AUDITS OF PEREGRINE FINANCIAL GROUP, INC.

RETENTION OF BRG AND SCOPE OF THE INVESTIGATION

On August 2, 2012, the Special Committee for the Protection of Customer Funds ("Special Committee"), a committee comprised solely of Public Directors of the National Futures Association ("NFA")[1] retained professionals at Berkeley Research Group, LLC ("BRG Investigative Team")[2] to conduct an independent review of the NFA audit practices and procedures, and the execution of those procedures in the specific instance of Peregrine Financial Group, Inc. ("PFG"), to assure that adequate procedures are in place and that they are being followed properly.

The BRG Investigative Team was specifically tasked with:

- Conducting a review of the NFA audit regulatory framework over the period during which NFA conducted audits of PFG;
- Evaluating the execution of NFA audits of PFG; and
- Determining whether the applicable policies and procedures that govern the conduct of NFA audits could be improved.

It was not the BRG Investigative Team's mandate to determine how former PFG Chief Executive Officer ("CEO") Russell Wasendorf, Sr. ("Wasendorf") conducted the fraud that caused the failure of PFG, and we have not conducted an exhaustive analysis of how he perpetrated the fraud. The BRG Investigative Team did review relevant documents during the investigation and spoke to numerous individuals, including Wasendorf himself, regarding Wasendorf's fraud for the purpose of understanding whether NFA auditors executed their audits appropriately and how those audit procedures could be improved. However, the BRG Investigative Team's conclusions are limited to the extent of its current understanding of the facts.

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[1] On March 28, 2012, following the collapse of MF Global, Daniel Roth, the President and Chief Executive Officer of NFA, testified before Congress that NFA had appointed a Special Committee for the Protection of Customer Funds comprised of the public directors on NFA's board. Testimony of Daniel J. Roth, President and Chief Executive Officer, National Futures Association, before the Oversight and Investigations Subcommittee of the Committee on Financial Services of the U.S. House of Representatives, March 28, 2012 at 1-2.

[2] The BRG Investigative Team consisted of Charles Lundelius, H. David Kotz, Jim Conversano, Jennifer Hull, Emre Carr, Karina Bjelland, Matt Torpey, Emre Aydin, Kristin Smyth and James Christenson.

EXECUTIVE SUMMARY

The BRG Investigative Team conducted a review of NFA's audits of PFG from the period of 1995 through 2012. During the course of its investigation, the BRG Investigative Team reviewed over 190,000 NFA documents containing over 3 million pages, including over 166,000 emails and related attachments sent and received by current and former NFA employees. The BRG Investigative Team also conducted interviews of 32 individuals with knowledge of the facts or circumstances surrounding NFA's audits of PFG, including 25 current or former NFA employees, 5 former PFG officials (including former PFG CEO Wasendorf), the Receiver appointed by the United States District Court for the Northern District of Illinois, and the founder of Confirmation.com, the electronic confirmation service that NFA auditors used in 2012 which resulted in the discovery of the fraud.

The investigation found that NFA conducted a total of 27 audits of PFG during the period between 1995 and 2012. These included 17 unannounced annual audits conducted every 9 to 15 months, 7 audits of PFG's branch offices, an additional audit during 2010 and two additional audits in 2011. In 7 of the 17 annual audits, NFA auditors sent a bank confirmation to U.S. Bank. The audits did not find any material issues with the confirmations until 2012, when they began using an electronic confirmation process and the fraud was uncovered.

The investigation further found that these audits were, for the most part, routine audits designed to review PFG's operations and systems in accordance with procedures established by the NFA and the Joint Audit Committee ("JAC"), and were not specifically directed to a particular tip or complaint alleging that Wasendorf was conducting a fraud. In fact, the BRG Investigative Team specifically investigated whether NFA auditors received any specific tip or complaint indicating that Wasendorf was conducting a fraud and found none. We also found that Wasendorf was able to conceal his fraud meticulously by providing numerous convincingly forged documents to his staff for use in PFG's operations and directly and indirectly to NFA auditors.

The investigation found that, overall, NFA audits were conducted in a competent and proper fashion and the auditors dutifully implemented the appropriate modules that were required in the annual audits which were based upon the JAC audit program. However, we did find that some NFA auditors did not always exhibit sufficient professional skepticism in assessing and evaluating fraud risks. We also found that some of the members of the NFA audit teams were relatively inexperienced and unfamiliar with the futures industry, and in a few instances, additional support from senior members of the auditing team was warranted. We found that, while training at NFA was readily available and effective, particularly for the inexperienced auditors, there was not always consistency in training sessions after important events in the industry, such as the Bernard Madoff Ponzi scheme, or the MF Global collapse, where there were opportunities for significant lessons to be learned for NFA auditors.

We also found that the NFA audits of PFG did not focus adequately on internal controls of PFG. For instance, some NFA auditors were not aware that Wasendorf was the only individual within PFG who had access to the original U.S. Bank statements (which provided him the ability to falsify the statements provided to PFG's staff and NFA), or that senior PFG officials, such as the Chief Financial Officer ("CFO") after 2006, had questionable qualifications. We further found that the NFA auditors had little interaction with PFG's outside auditor, did not review the outside auditor's workpapers, and some NFA auditors were not aware until the 2012 annual audit that PFG's outside auditor was, in the later years, a one-person auditing firm in suburban Chicago.

We also found that NFA auditors did not fully examine the fact that PFG was losing significant money in many years, Wasendorf's frequent and significant capital contributions, or the source of his capital contributions.

We found that NFA auditors did not express significant concerns about PFG's reverse repurchase agreements ("repos") and sweep accounts, notwithstanding their examination of such arrangements in several audits and the fact that PFG decided to forgo this arrangement altogether in 2009. In our review of PFG's repos and sweep accounts, we found that PFG historically reported the repo amounts as cash deposits in many years on the improper line of one of the largest items of PFG's financial filings. We also found that PFG's repos were subject to various NFA audit test procedures during NFA's periodic audits. However, NFA auditors did not treat the repos balance as high-risk despite: (1) the magnitude of the balance; (2) the lack of separation of duties and weak internal controls over cash and investments; and (3) repeatedly noting that the value of PFG's repos was omitted from the ending balance on the bank statement yet included in the confirmation amount.

The BRG Investigative Team found that the JAC audit program for repos noted that a Futures Commission Merchant ("FCM") should receive daily confirmations for sweep funds. However, some NFA auditors apparently were unaware that daily confirmations should have been produced and made available for review during audits. In 1999, the NFA auditors made notes about the fact that PFG could not record interest daily. The NFA auditors noted that PFG recorded a daily estimated accrual and reconciled interest income at the end of every month by using the bank statement. Further, during each of the 2003, 2008 and 2009 audits, the NFA auditors accepted one daily confirmation as sufficient audit evidence of PFG's repos. The BRG Investigative Team found no evidence that NFA auditors obtained additional daily confirmations during the 2003, 2008 and 2009 audits or that they obtained any daily confirmations for repos during other audits.

We also found that, in audits subsequent to PFG's discontinuance of repos and sweep accounts in 2009, NFA auditors did not question this decision or why approximately $200 million was being left in a customer segregated funds account and not being invested overnight.

The investigation further found that NFA's audits of PFG over the years were made more difficult in some instances because of the aggressive approach and demeanor of PFG's Director of Compliance, Susan O'Meara ("O'Meara"). However, we did not find that these concerns of possible intimidation on the part of O'Meara were elevated from the staff auditor level to senior officials at NFA.

We did not find evidence that Wasendorf's reputation or influence with the NFA or industry had any impact on NFA audits of PFG. Prior to the fraud being uncovered, Wasendorf served on the NFA's Futures Commission Merchant Advisory Committee, but the investigation found that many auditors were not aware of this fact and no one felt Wasendorf's role on an NFA advisory committee or his reputation in the industry as a whole had any effect on NFA's audits.

We also found that, while the U.S. Commodity Futures Trading Commission ("CFTC") conducted a few limited reviews of PFG over the years, there was little evidence of coordination between the CFTC and NFA with respect to their examination of PFG. In two instances, NFA auditors were not aware of the results of CFTC reviews conducted immediately prior to or simultaneous with NFA audits.

In addition, prior to the 2010, 2011 and 2012 audits, PFG was subject to several disciplinary complaints and/or warnings brought over the years by the NFA Business Conduct Committee ("BCC"), which is a group made up of industry members and public representatives who meet approximately once a month to consider potential disciplinary actions against member firms. Complaints and/or warning letters were issued against PFG on three occasions: once, in December 1996, alleging that PFG used false and deceptive promotional material, failed to maintain adequate segregated funds and failed to report to the NFA that the firm was undersegregated; again in June 2004, alleging that PFG failed to comply with an Order issued by the NFA Membership Committee in violation of NFA Compliance Rule 2-5; and in December 2008, for PFG's failure to respond properly and completely to an NFA Information Request.[3]

We also found that the BCC issued a formal complaint against PFG, and several of its senior officials, including O'Meara and Russell Wasendorf, Jr. ("Wasendorf, Jr."), in February 2012 for their failure to supervise in connection with a Ponzi scheme operated by Trevor Cook (although unrelated to PFG), in which he sold investments in a foreign currency trading program but diverted a substantial portion of the money provided to him for other purposes, including making payments to previous investors and paying personal expenses. PFG eventually resolved the BCC action by agreeing to certain undertakings and to pay a $700,000 fine. The BRG Investigative Team found that the BCC complaints and warnings against PFG prior to 2012 did not cause NFA to extend their audit procedures in connection with their audits of PFG.

Further, we found that, prior to 2012, consistent with Statement on Accounting Standard ("SAS") No. 67, the bank confirmation process used by NFA involved filling out a bank confirmation form, having a principal sign it, and then putting it in an envelope, and sending it to the bank through the mail without having any direct verbal or physical (in-person) communication with the bank. In the years when NFA auditors sent confirmations to U.S. Bank, NFA auditors reviewed the confirmations they received in the mail to attempt to verify that they showed the same balance in the bank statement.

We found that on Friday, May 13, 2011, O'Meara emailed NFA's bank confirmation to Hope Timmerman at U.S. Bank in connection with the 2011 NFA audit of PFG. That same day, Hope Timmerman sent O'Meara and the NFA field supervisor for the 2011 audit a bank confirmation that reflected a balance of $7,181,336.36 (the "$7 million Confirmation") for the PFG customer segregated account. The field supervisor stated that she did not recall looking at the U.S. Bank confirmation or comparing it to a bank statement. On Monday, May 16, 2011, the next business day, the NFA field supervisor sent an NFA staff

[3] The BCC actions are initiated by NFA staff and are often established as a result of an NFA audit against a member firm or person.

auditor working on the PFG audit the confirmations for several bank balances and banks, including the U.S. Bank confirmation. The staff auditor stated that she uploaded and scanned the bank confirmations into NFA's audit software, noticed that the $7 million confirmation balance did not match the U.S. Bank statement which showed a balance of $218,650,550.96 and informed the field supervisor that the figures did not match. The field supervisor, on the other hand, did not recall the staff auditor having any reaction to the $7 million confirmation or any discussion at all among the auditing team about this issue. The other NFA audit team members also did not recall seeing the $7 million confirmation or being aware that a confirmation was received by NFA auditors showing an amount that was substantially different than the amount shown in the U.S. Bank statements supplied by Wasendorf.

According to Wasendorf, when he found out that NFA auditors had received the correct confirmation indicating a balance of $7 million, his reaction was, "I am in shock –I'm caught." He claimed that on May 16, 2011, he walked into U.S. Bank and convinced Hope Timmerman that the first confirmation obviously was a mistake because it did not have a correct U.S. Bank address.[4] It is undisputed that he then prepared a forged confirmation statement. Later, that same day, the NFA field supervisor received a facsimile purportedly from Hope Timmerman of U.S. Bank, with a note stating, "attached please find a corrected copy of the Bank Balance Confirmation for the Peregrine Financial Group account #621010845. Customer Segregated Account." The bank confirmation attached to the facsimile cover sheet showed a balance of $218,650,550.96. The staff auditor uploaded this "corrected" confirmation into the NFA module software and noted that the bank confirmation now matched the U.S. Bank statement created by Wasendorf. The staff auditor stated she could not recall any further conversations about the two confirmations or learning how it was resolved. We found no evidence that NFA auditors questioned the new version of the confirmation purportedly from Hope Timmerman. Instead, the NFA auditors accepted the new version, despite the vast difference between the numbers provided in the two versions of the confirmation, and did not extend their audit procedures.

In addition, an NFA manager acknowledged that, if staff determined during the confirmation process that the confirmation from the bank did not match the bank statements, there should have been further discussion, not just with him but also with his supervisor, an associate director or director, to resolve the matter.

This Report of Investigation provides a factual summary of the NFA audits of PFG from 1995 to 2012. In addition to this Report of Investigation, the BRG Investigative Team is providing a Recommendations Report that will include 21 specific recommendations to improve NFA's audit program. These recommendations are based upon the findings in this report and will be tailored to address the areas where we think that NFA audit practices and procedures can be improved.

[4] Counsel for U.S. Bank stated that "we do not believe that any such conversation [with Hope Timmerman] took place" but did not explain what actually occurred. *See also*, Letter from Peter W. Carter, Dorsey & Whitney LLP, counsel for U.S. Bank dated January 8, 2013.