



COMMODITY CUSTOMER COALITION

## The Collapse of MF Global

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Background, Impacts &  
Outlook

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MF Global



# Safe Harbor Statement

**This presentation may include predictions, estimates or other information that might be considered forward-looking. While these forward-looking statements represent our current judgment on what the future holds, they are subject to risks and uncertainties that could cause actual results to differ materially. You are cautioned not to place undue reliance on these forward-looking statements, which reflect our opinions only as of the date of this presentation. Please keep in mind that we are not obligating ourselves to revise or publicly release the results of any revision to these forward looking statements in light of new information or future events. Throughout today's discussion, we will attempt to present some important factors relating to MF Global and its liquidation proceeding that may affect our predictions.**



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# Introduction: The Commodity Customer Coalition



# An Unbiased Advocate for Commodity Customers

The **Customer Commodity Coalition (CCC)** is a nonprofit advocacy group which promotes the interests of customers of commodity brokerage firms. The group formed in the wake of MF Global's bankruptcy, seeking the quick return of missing customer funds along with regulatory and legislative reform for the commodities industry.

## **Accomplishments:**

- Quickly raised donations, constructed a legal team, offered pro-bono legal services to former MF Global customers and began filing motions before the court on their behalf
- Actively advising members of Congress and staff on the MF Global crisis
- Advised the SIPA Trustee for the MFGI Liquidation on the claims process and the treatment of specifically identifiable property
- Pushing other industry associations and groups to action
- Working with major media organizations to improve reporting on the MF Global bankruptcy and the plight of customers
- Providing a central clearing house of information for customers, lawmakers, media and the general public on the MF Global crisis



# A Brief History of MF Global



# Born in Bankruptcy, Mired in Scandal

## The Refco Connection

- In August 2005, commodity broker Refco goes public
- 60 days later, Refco files the 4th largest bankruptcy and follows the quickest path from IPO to bankruptcy in US history
- The world's largest hedge fund, Man Financial UK buys Refco's FCM business and adds it to their US-based commodity brokerage business

## MF Global Limps Out of the Gate, Stumbles & Falls

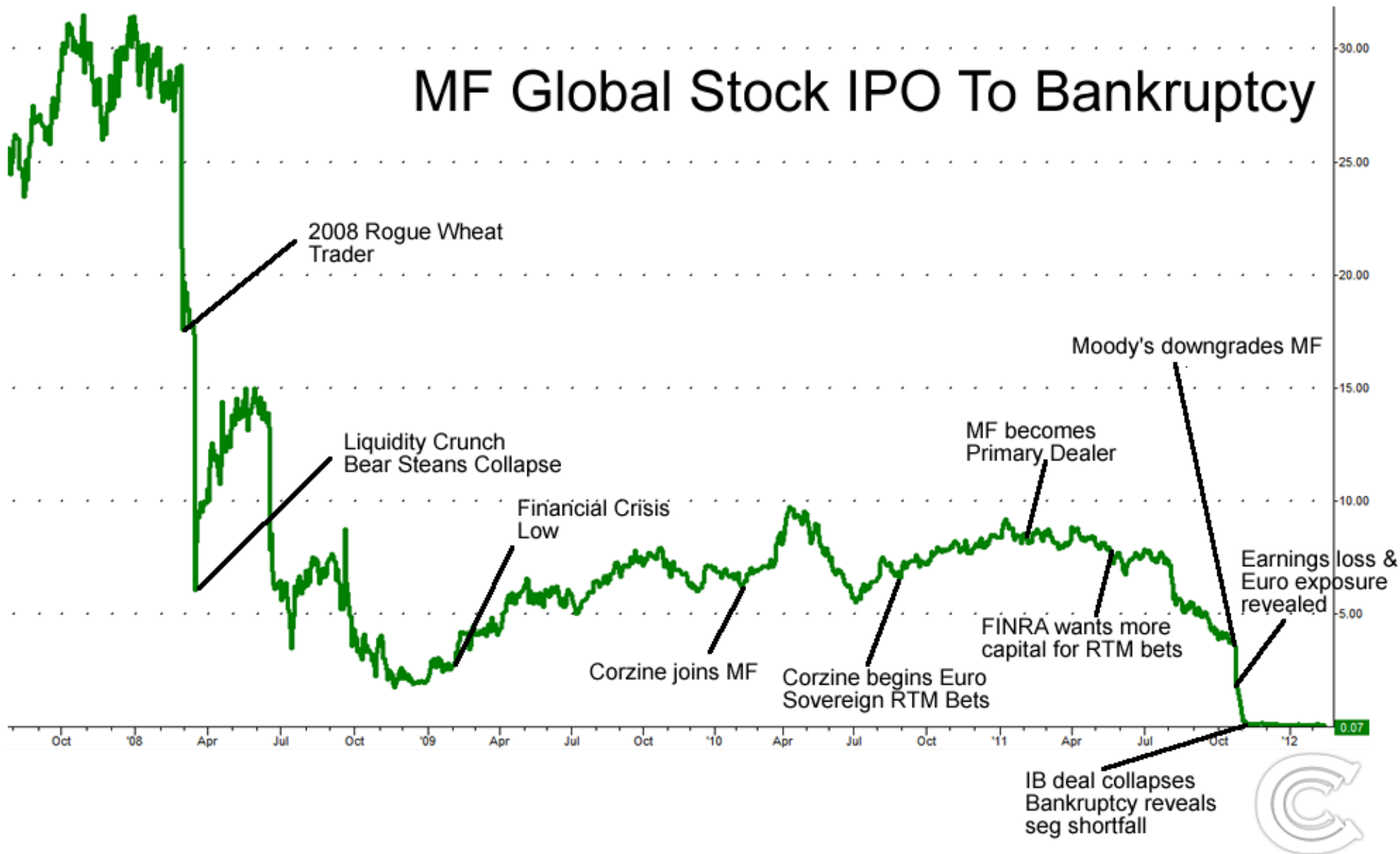
- In June 2007, Man Financial spins off its brokerage unit as MF in IPO on NYSE. Stock trades as high as \$32 a share
- IPO saddles MF with large bridge loan from parent Man Financial, makes profitability for MF difficult
- Rogue trader in Feb 2008 delivers first blow to market confidence in MF's risk management, on heels of SocGen's \$4.9 bil rogue trading incident the month prior
- Liquidity concerns tied to Bear Stearns collapse drop MF shares to \$6.05, 82% drop from 52 week high
- ZIRP wipes out MF's profitability, sending shares to trade at \$1.72 during financial crisis
- In March 2010, Corzine is brought to MF by largest stakeholder (Flowers & Co.) to reposition firm as investment bank, primary dealer to restore profitability



# The Bankruptcy of MF Global & Its Causes

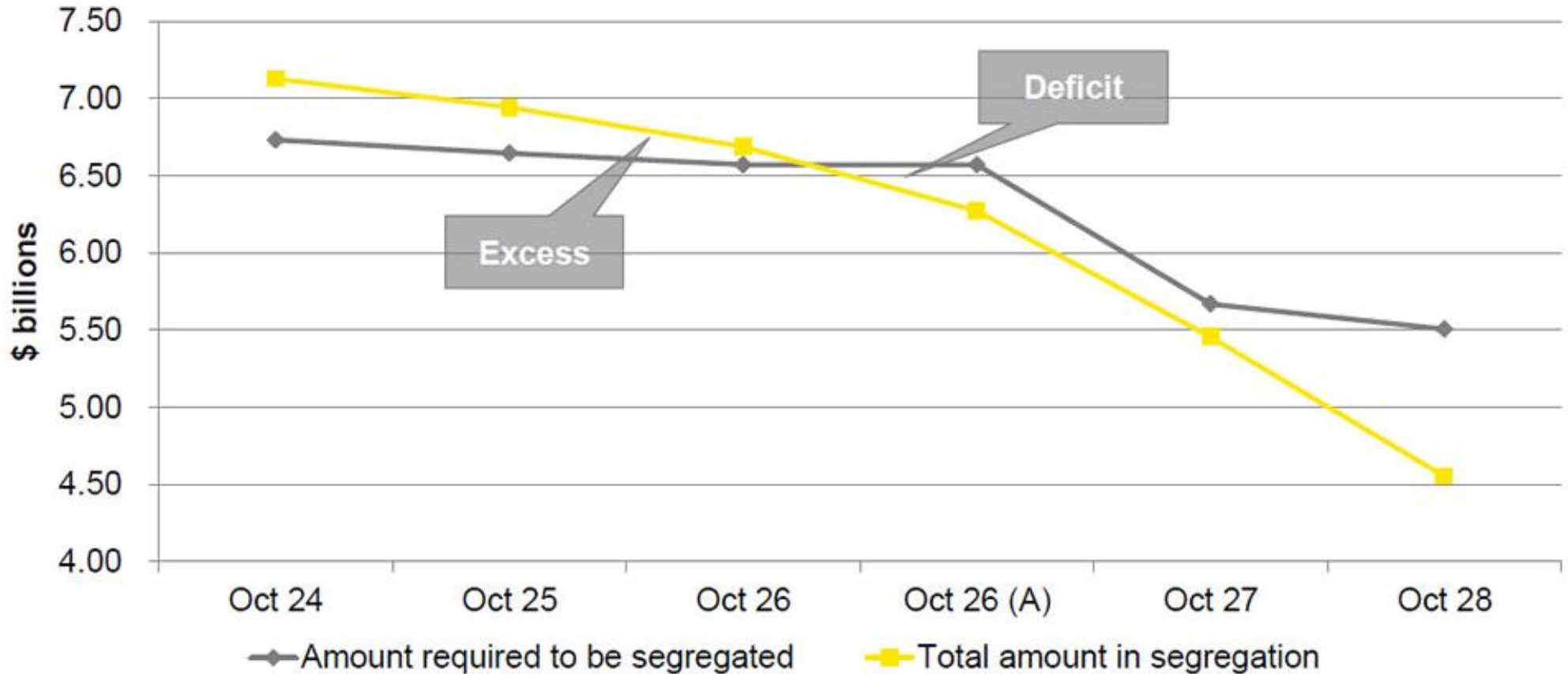


# Tale of the Tape



# Robbing Peter: Segregation Violated Day After Earnings

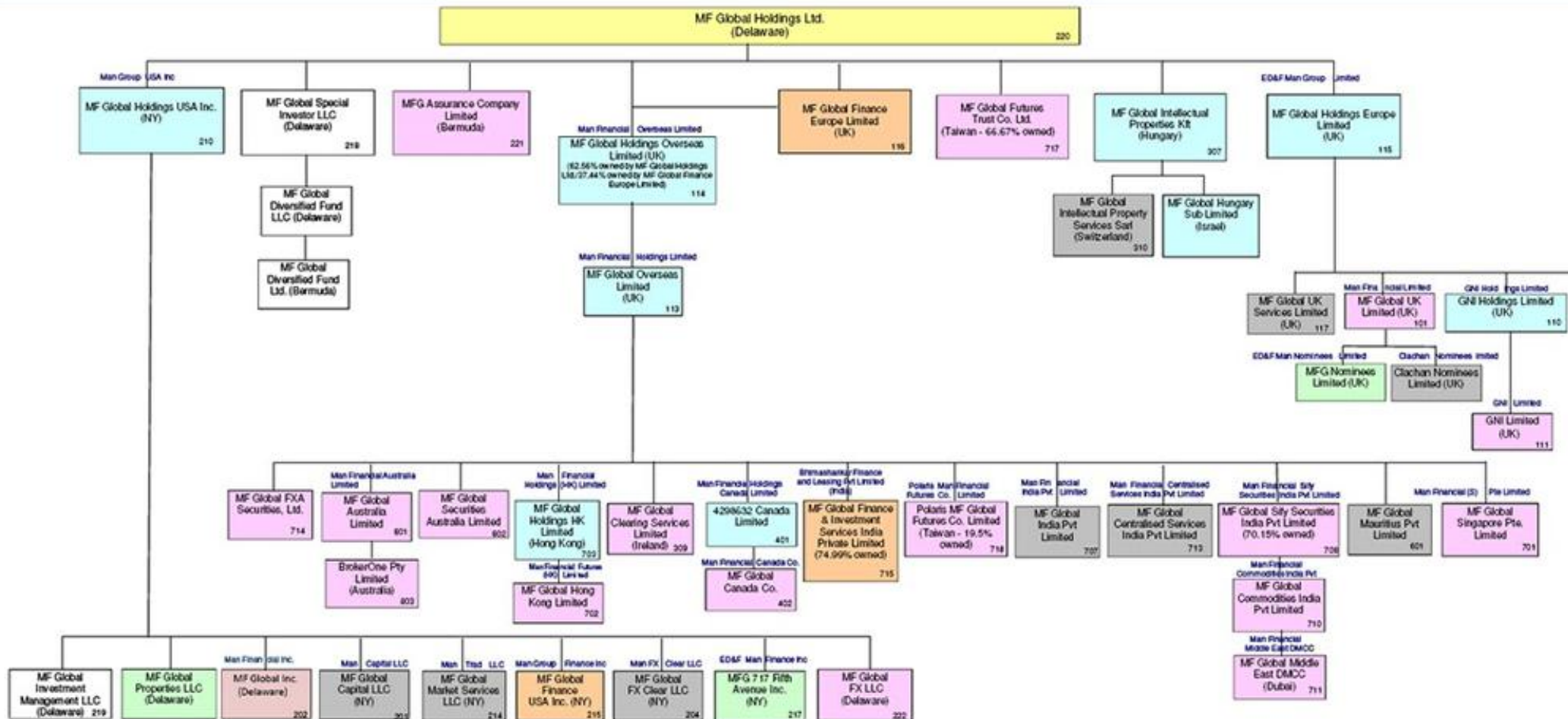
Daily Segregation Requirements and Funds in Segregation



(A) A shortfall in segregated customer funds occurred during 10/26. The calculation originally prepared by MFGI contained an error. Cash deposits in segregated funds bank accounts were erroneously overstated.



# Complex Legal Structure of MF Global



Collapse triggers 2 US bankruptcy filings and 8 foreign proceedings:

- MFGH enters Chapter 11 proceeding
- MFGI enters SIPA liquidation proceeding
- Foreign entities adjudicated locally



# Enter SIPA

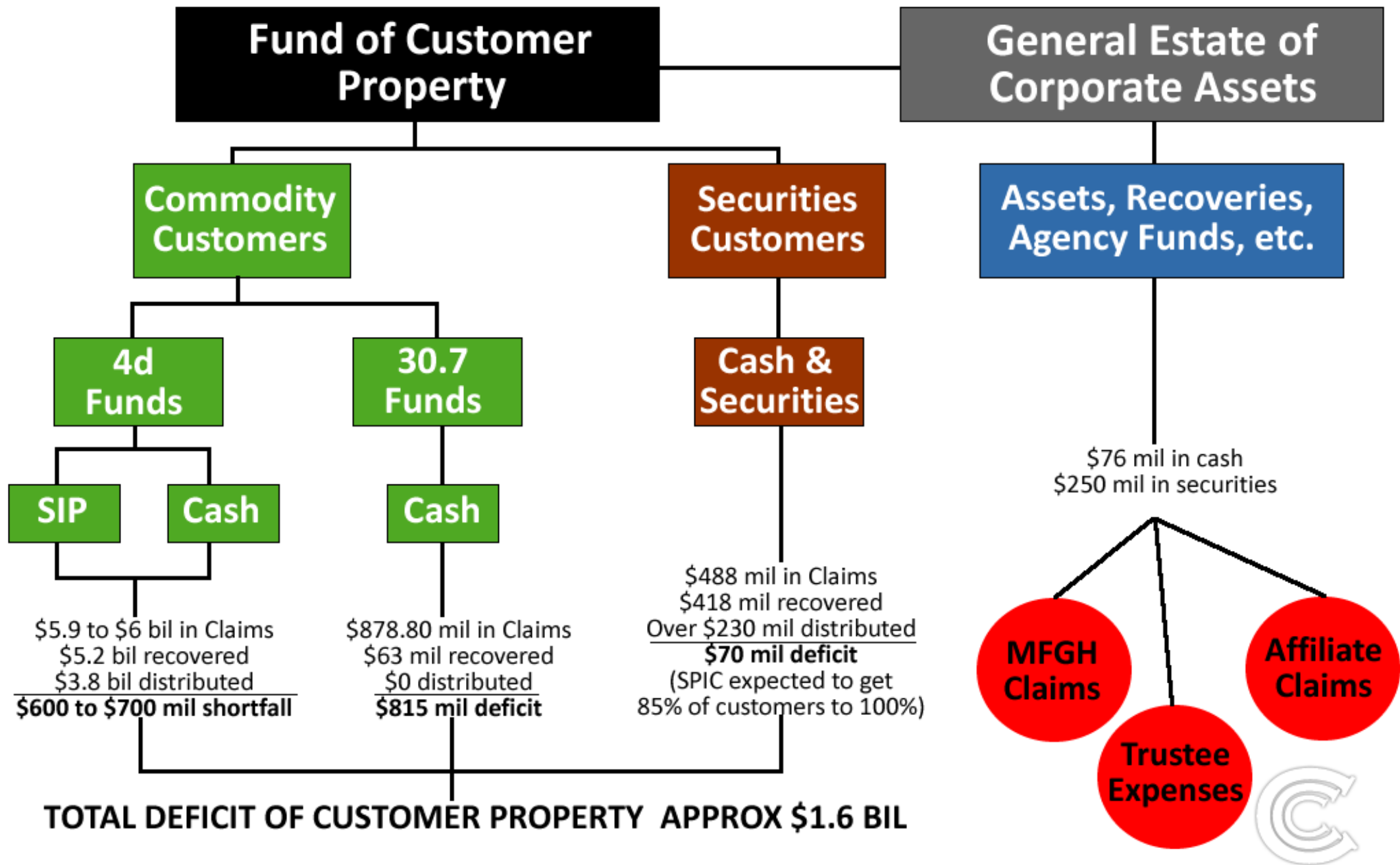
On October 31, the CFTC and SEC decide that a SIPC led liquidation of MF Global is in the best interest of commodity customers.

- SIPC provides relief to securities customers, subordinates commodities customers
- MFGI has 200 to 300 securities accounts totaling less than \$500 million in assets; over 38,000 commodity customer accounts totaling over \$7 billion in assets
- Trustee initially signals distributions will begin in June 2012, shortfall in customer funds to fall in line with general creditors of the estate

**CCC and other customer groups immediately file various motions to affect Trustee's treatment of estate and customer accounts.**



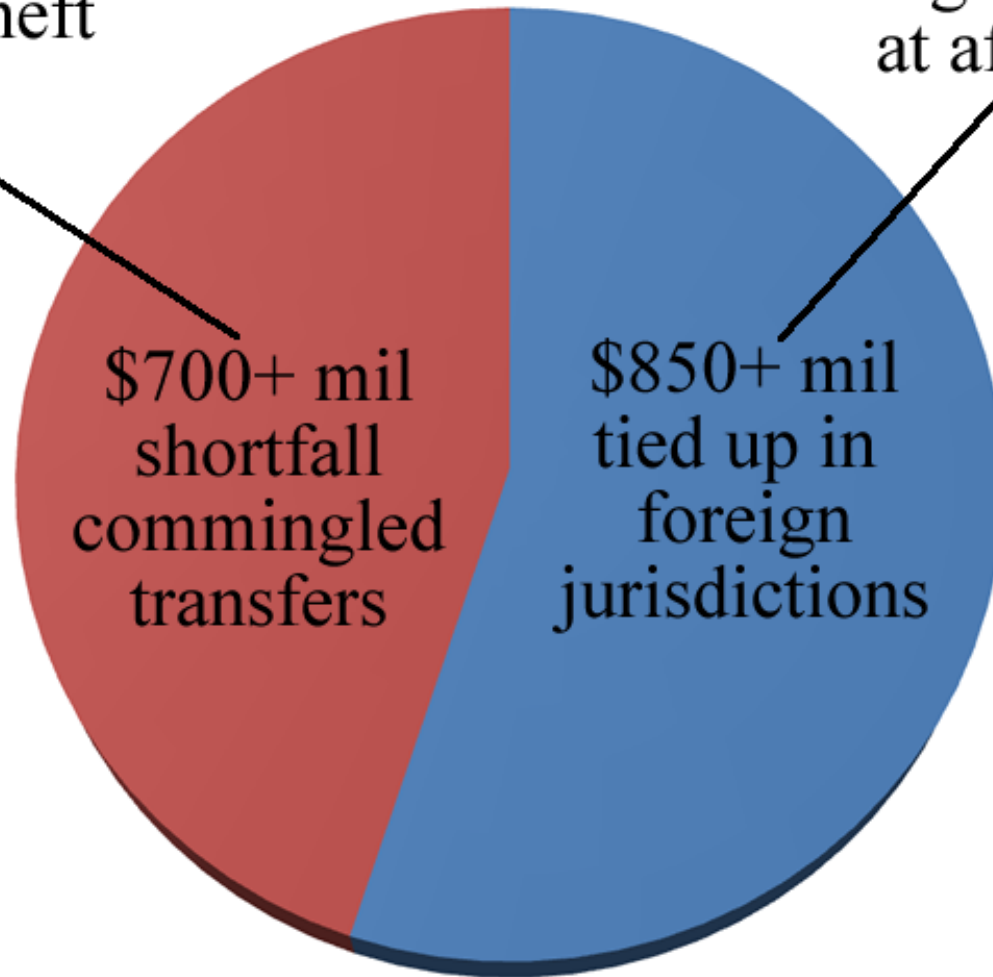
# Anatomy of MFGI in Bankruptcy



# A Clearer Picture of the Unclear Shortfall

Some of the 'shortfall' results from a theft

Most of the 'shortfall' legitimately tied up at affiliates



Approx \$1.6 billion total deficit



# Bulk Transfers of 4d Assets & Positions

In advance of the claims process, the SIPA Trustee distributed funds to MF Global's 4d accounts holding cash, cash equivalents and positions on US exchanges via three bulk transfers. Customer accounts were transferred to new brokerage firms, along with positions and a portion of collateral.

Transfer	Accounts Affected	Number of Accounts Transferred	Property Amount	
			Percentage Transferred	Amount Transferred (in billions)
First Bulk Transfer	Accounts containing open U.S. Commodity contracts and a percentage of the associated margining collateral as of October 31, 2011	10,202	N/A	\$1.519
Second Bulk Transfer	Accounts containing only cash or cash equivalents as of October 31, 2011	15,148	60%	\$ .477
Third Bulk Transfer	Uniformly equalizing <i>pro rata</i> interim distribution to former U.S. commodity futures customers of MF Global Inc.	27,905	72%	\$1.832
<b>TOTALS</b>				<b>\$ 3.828</b>

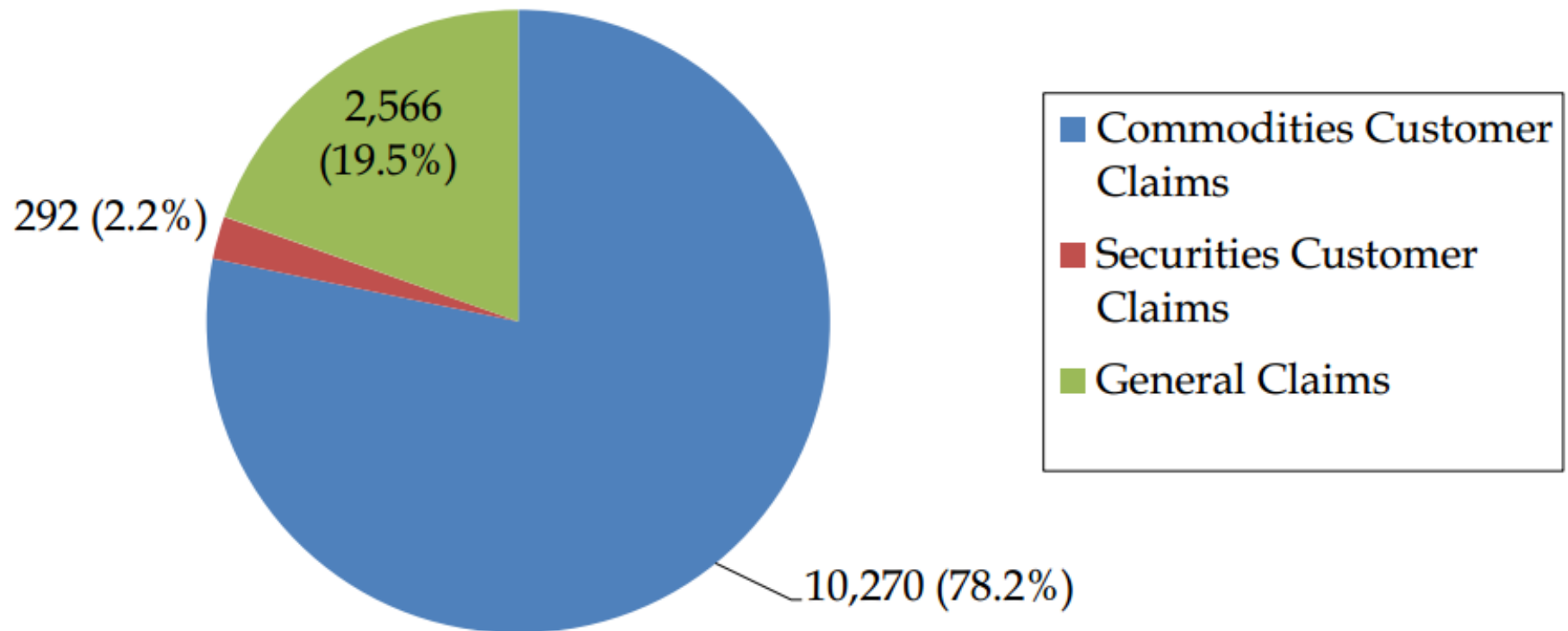


# Claims Process

Trustee establishes separate claims process for commodity customers, securities customers and general creditors.

## Claims Filed

(total of 13,128 as of January 11, 2012)



# Treatment of Customers Holding Physical Assets

Approximately \$150 million in customer assets at MFGI was held in physical assets or 'specifically identifiable property", such as gold bars, warehouse receipts for commodities, etc.

These customers were able to negotiate the dispensation of their property through the Trustee on an individual basis.

**Through the work of attorneys of the CCC, many were able to reach deals financing a deposit of 28% of the value of their physicals in exchange for 100% of the property.**



# Impacts of the Bankruptcy



# The Collateral Damage of Frozen Collateral

## **Segregated Funds Violated**

The stabilizing principle of the markets is called into question: how can customers trust a system that does not protect their money?

## **Market Participants Exposed to Market Risk Without Mechanism to Manage that Risk**

Inability to enter new positions, modify existing positions or in some cases know about the liquidation of positions exposed customers to unnecessary market risk

## **Bulk Transfers Briefly Create New Protected Classes**

Customers with positions on US exchanges transferred in such a way that liquidations were inevitable; customers in cash got a substantial portion of their assets faster

## **Market Participants Have No Advocate Before the Court**

Prior to the entry of the CCC, customers had no unified voice representing their interests before the court



# The Collateral Damage of Frozen Collateral

## Near term volume stifled

CME Group Volume						
Month	Total volume (million contracts)			Avg. Daily Volume (million contracts)		
	2010	2011	% Change	2010	2011	% Change
October	240	261	+8.8	11.4	12.4	+8.8
November	297	276	-7.1	14.2	13.2	-7.0
December	232	201	-13.4	10.5	9.6	-8.6
	2011	2012		2011	2012	
January	246	232	-5.7	12.3	11.6	-5.7

Source: CME Group data



# Outlook for Recovery: Constructive Trusts, Safe Harbors & Seg Funds



# Avenues of Recovery

## **MFGI Customers have several avenues of recovery in bankruptcy:**

- Additional distribution of assets held in Fund of Customer Property
- Liquidation of assets currently held by MFGI estate
- Recoveries from traceable funds transferred to affiliates & MFGH
- Recoveries from counterparties
- Class actions & insurance

## **The Problem Presented by Safe Harbor**

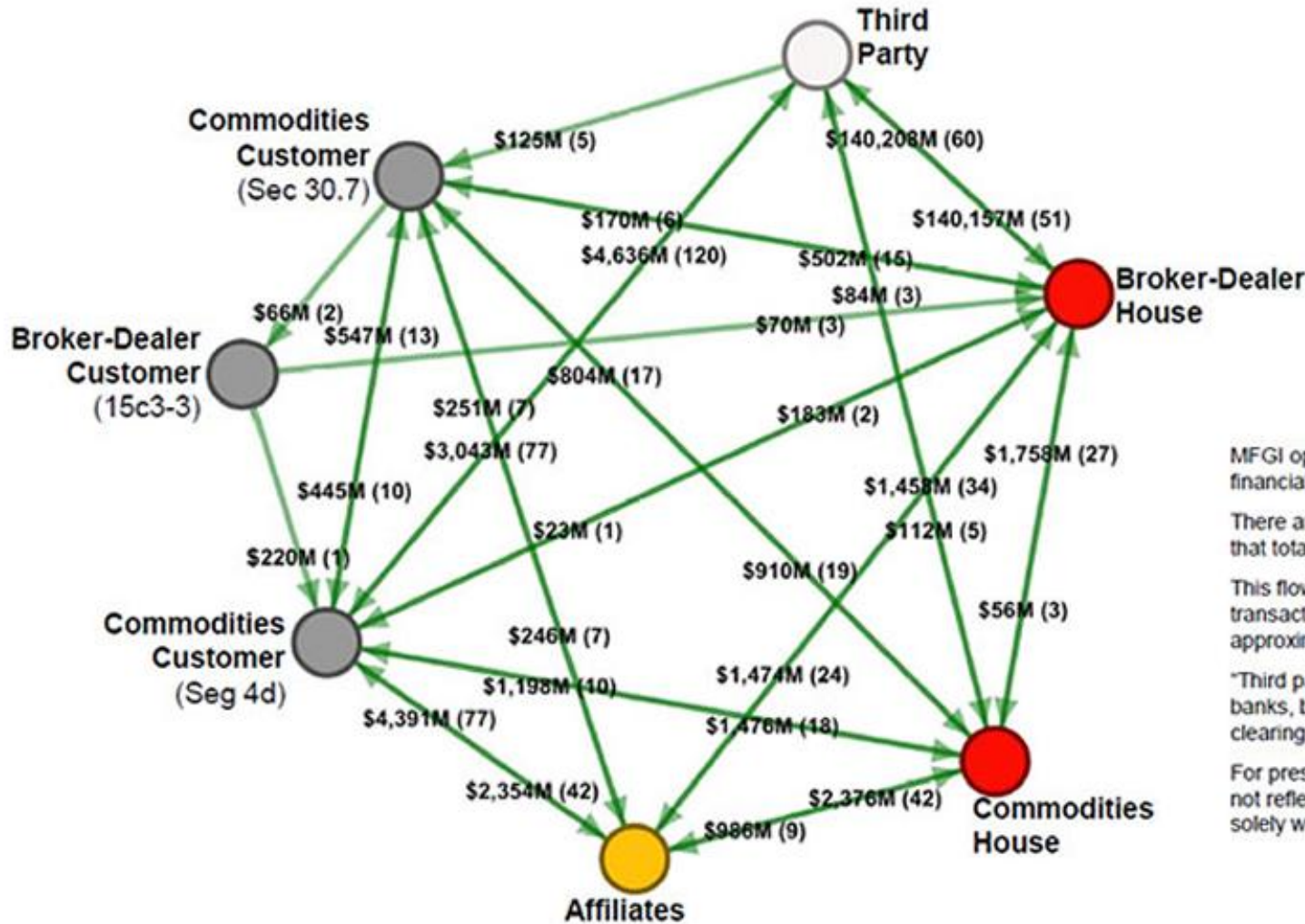
The Trustee may bring lawsuits against counterparties--but they will invoke the Safe Harbor provision of the bankruptcy code if he cannot prove actual fraud. This means demonstrating intent on MF Global's behalf.

Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 added this 'safe harbor' provision to bankruptcy code: money cannot be recovered from securities counterparties unless actual fraud is proven. Bankruptcy judge will have to decide if provisions in the CEA trump Safe Harbor.



# SIPA Trustee's Tracing of MF Global's Cash

## Consolidated Overview of Cash Movement MF Global Inc. 10/1 – 10/31



MFGI operated 47 bank accounts held at 8 financial institutions.

There are 840 transactions > \$10 million that total approximately \$327 billion.

This flowchart excludes roughly 20,000 transactions < \$10 million that total approximately \$9 billion.

"Third party" includes customers, lending banks, brokerage firms, exchanges, and clearing agents.

For presentation purposes, this chart does not reflect certain transactions that occurred solely within a related grouping of accounts.

This reflects cash movement only. Investigation is ongoing to trace correlated securities, collateral and other assets.



# Ongoing Investigations, Industry Reaction & Political Outlook



# Current Investigations

## **Criminal Probe**

Justice Department conducting criminal probe into the shortfall of customer funds. Little information is available at this time.

## **Regulatory Probes**

The SEC and CFTC are conducting investigations into MF Global's violation of securities and commodities laws and regulations.

## **Investigation of Trustees**

Both the SIPA Trustee and the US Trustee are conducting forensic investigations into transfers of cash to and from MFGH and its subsidiaries and counterparties.

## **Congressional Investigations**

- Oversight and Investigations Subcommittee of the House Financial Services Committee
- Senate AG Committee
- House AG Committee



# Industry Reactions

## **CFTC**

- Modified Rule 1.25 provisions for allowable investments for segregated customer funds
- Conducting ongoing regulatory probe with SEC
- Examining measures to mitigate future FCM bankruptcies

## **DSROs**

- CME established protection fund for 'farmers and ranchers'
- CME working with other exchanges to develop additional measures

## **NFA**

- Examining changes in current rules in their purview
  - Daily reporting of seg balances for clearing FCMs
  - Codifying executive level approval of certain transfers to avoid the 'Corzine' defense
- Establishing committee to look at changes to the bankruptcy code as it relates to commodity customers



# Industry Reaction: Proposals of the CCC

## **Separation of FCM/BD**

This prevents SIPA from confusing the process for commodity customers. Separate BD entity allows Chapter 7 for FCM, SIPA for securities firm--separate interests of customers more clearly protected.

## **Codifying Customer Protections in Law**

Making explicit in the CEA and bankruptcy code what is implicit now: that commodity customers have a super-priority over the assets of estate in bankruptcy. Codify that protections for segregated funds travel with those funds when transferred, making counterparties custodians of segregation.

## **Amending Safe Harbor**

Allow fraudulent conveyance to prevent application of Safe Harbor or otherwise prevent Safe Harbor from permitting securities transactions from siphoning off customer segregated funds.

## **Self-Insurance through a Trust Fund**

Available examples of insurance are costly and inadequate; CCC favors an industry-wide liquidity fund to facilitate transfers of accounts from failed FCMs to new brokers.



# Industry Reaction: Proposals of the CCC (continued)

## **Daily Reporting of Seg Balances for ALL FCMs**

Currently daily reporting only applies to non-clearing FCMS; this would be a simple way to add a little more oversight.

## **Creating Statutory Right for Customer Representation on Creditors Committee**

Maintaining a presence before court is expensive; adding a provision in law for customer representatives to be added to the creditors committee in bankruptcy offers a cost-effective way for the interests of customers to be represented before the court.

## **Create Rule Which Elevate Certain Transfer Approvals to C Suite**

Without creating a burden, require that certain types of transfers or amounts of transfers require executive level approval.

## **Review Accounting Practices**

Refco's leveraged capital structure overstated company value (bankruptcy shrinks from 4<sup>th</sup> largest to 13<sup>th</sup>); no doubt MF's is overstated as well. MF crisis should prompt a review of modern accounting practices for financial services firms, especially with respect to quarterly reporting.



# Limiting Your Exposure to FCM Default



# Strategies to Mitigate Impact of FCM Bankruptcy

## **Use Active Cash Management Strategies**

- Trade with less money on deposit with FCM
- Use a 'cash sweep' strategy to keep funds in 4d and move excess 4d to custodian

## **Diversify Your Operational Risk**

- Split up collateral amongst multiple FCMs or at least establish an account with an alternate FCM in the event your primary FCM fails
- Self-insure with capital reserve to provide collateral for trading if asset freeze occurs in the future

## **Seek FCMs with Less Risky Business Models**

- Avoid BD/FCMs
- Avoid FCMs with over-leveraged capital structure
- Look for FCMs who do not engage in proprietary trading



# Conclusion

