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CFTC Commissioner Blasts MF Global Repayment Plan

By **Ian Thoms**

Law360, New York (November 16, 2011, 2:09 PM ET) -- A U.S. Commodity Futures Trading Commission member said Wednesday that customers of collapsed brokerage MF Global Inc. should get their money back sooner than proposed by the bankruptcy trustee liquidating the failed firm.

Scott D. O'Malia, a Republican CFTC commissioner, said the lengthy delay in returning customer funds, plus MF Global's egregious misplacement of some \$600 million in client cash, eroded confidence in the futures market. So it is necessary for his agency to act now to make customers whole, according to O'Malia.

"The inability of MF Global customers as a whole to access their funds has affected trading in futures markets, and has shaken public confidence in our customer protection regime," he said. "The livelihood of market participants has been dangling by a thread for over two weeks."

On Tuesday, bankruptcy trustee James W. Giddens asked a New York bankruptcy court for permission to transfer \$520 million to commodity customers whose accounts held only cash as of Oct. 31, when MF Global's parent company filed for bankruptcy protection. The transfer would cover about 60 percent of the \$869 million MF Global owes its roughly 21,000 cash-only customers.

The collateral transfer was made possible by a \$250 million guarantee by the Chicago Mercantile Exchange Group Inc., Giddens — a partner at Hughes Hubbard & Reed LLP — said in a motion.

While O'Malia applauded the move, he said the CFTC should collaborate with Giddens to ensure that cash-only customers receive all of their money as soon as possible and that other customers get as much of their money back as possible, given the breadth of the shortfall.

"I fully support both the transfer and the expedited claims process. My only concern is that neither happened quickly enough," O'Malia said.

MF Global customers have also criticized Giddens for neglecting to act more equitably towards all customers.

Commodity customer Jason Skole said he held a hefty chunk of excess cash with MF Global, but because he had a few open positions, he would not be included in the early round of returns. A little more than \$7,500 of his funds was transferred post-collapse, while the remainder of his net liquid account — more than \$185,000 — remains untouchable, according to Skole.

"Everybody should be getting the same amount and that's definitely not happening, not even close," Skole said.

Others ripped the bankruptcy trustee for declining to use MF Global's \$1.2 billion in excess equity and the \$250 million lifeline from the CME Group to return customer funds. Since the available funds far eclipse the estimated \$600 million shortfall, Giddens does not need to wait for a full accounting before conducting wholesale transfers, the coalition contends.

"That simply isn't good enough," the coalition said in a statement. "It's time to truly expedite this process and make customers whole."

The group also chafed at Giddens' refusal to base customer claims on MF Global's books. He is insisting on having customers mail him statements, but, as the coalition points out, those statements are based on the firm's books anyway.

John L. Roe, a principal at BTR Trading Group Inc. in Chicago, said he believed the bankruptcy trustee — who was appointed by the Securities Investor Protection Corp. through the Securities Investor Protection Act — was tackling the MF Global meltdown as if it dealt with securities instead of futures markets.

The leveraged customer funds now frozen in the bankruptcy process plays a crucial role in the futures market, according to Roe. He said that their absence was doing significant damage to the wider economy.

"They look at this and say Lehman [Brothers Holdings Inc.] was five, six, seven times bigger," Roe said. "But we're talking about leveraged capital here and we're talking about people who are hedging their price risks ... and at the end of the day the cost of doing business is going to go up. The producer is going to have to pay more and the consumer is going to have to pay more."

The CFTC commissioner also said that those who looked at MF Global and compared it favorably to the collapse of Lehman missed some important points. For one, Lehman did misplace customer funds that were supposed to have been segregated, he said

The CFTC needs to immediately check with all intermediaries to ensure they are in compliance with segregation requirements, according to O'Malia. He added that intermediaries should employ third parties to verify their accounting.

"Many have said that the failure of MF Global was not systemic and that we are lucky," O'Malia said. "I don't view it in the same light. I am certain that the thousands of individuals who have lost money or can't get access to their rightful property don't share that sentiment, either."

The FBI is investigating MF Global for allegedly commingling client and company cash, as are the CFTC and the U.S. Securities and Exchange Commission. The brokerage, which holds more than \$6 billion in European sovereign debt, suffered a liquidity crisis last week after it issued a disappointing earnings report and rating agencies downgraded its debt to just above junk status.

The CFTC has caught flak for failing to adopt a proposed rule that would have prevented brokerages from using customer funds for internal repurchase, or repo, transactions — currently legal but controversial arrangements some suspect led to the lost money in MF Global's case.

Earlier this year, MF Global CEO Jon Corzine and other industry leaders persuaded the CFTC to extend the comment period of Rule 1.25 instead of implementing it immediately, according

to a regulator.

On Wednesday, CFTC Chairman Gary Gensler said the commission would vote on rule at its Dec. 5 meeting.

Besides Giddens, the Hughes Hubbard team working on the case under the SIPA includes James B. Kobak Jr. and Christopher K. Kiplok.

MF Global is represented by Kenneth S. Ziman, J. Gregory Milmo, J. Eric Ivester and George Panagakis of Skadden Arps Slate Meagher & Flom LLP.

The Chapter 11 case is In re: MF Global Holdings Ltd. et al., case number 1:11-bk-15059, in the U.S. Bankruptcy Court for the Southern District of New York.

The liquidation case is In re: MF Global Inc., case number 1:11-ap-02790, in the same court.

--Additional reporting by Hilary Russ. Editing by Eydie Cubarrubia.

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