The Collapse of MF Global: Summary & Analysis

By:

Cause of Action

Introduction

Less than two years after Jon Corzine became CEO of MF Global Holdings, Ltd., the international commodities broker filed a voluntary petition for bankruptcy under Chapter 11 on October 31, 2011 – fittingly enough on Halloween, the most frightening day of the year, as MF Global's brokerage customers would soon discover.

The company's failure has since been blamed on a risky trading strategy that Corzine introduced to increase revenues in the face of MF Global's declining core business. Corzine effectively engineered a more than $6 billion bet on the sovereign debt of Ireland, Italy, Spain, Portugal and Belgium through the use of a financial transaction commonly referred to as a "Repo to Maturity" (RTM). Although Corzine was prescient in betting that European sovereign debt would not default, margin calls by MF Global's counterparties ultimately overwhelmed the company and triggered a classic liquidity crisis. By the time the tailspin had reached its natural conclusion, $1.6 billion of customer funds were missing due to sloppy bookkeeping and mismanagement.

As a financial services holding company, MF Global Holdings has a number of subsidiaries throughout the world. MF Global, Inc. (MFGI) was the company's U.S.-based futures commission merchant (FCM) and registered broker-dealer, subject to regulation by both the CFTC and SEC. MFGI was also a designated primary dealer in U.S. Treasury securities. MF Global's UK-based subsidiary (MFGUK) was instrumental in the vast majority of the trades the firm embarked.

A traditional bankruptcy trustee has been appointed to oversee the liquidation of MF Global Holdings, the parent company, while the Securities Investor Protection Corporation has appointed its own trustee to liquidate MFGI, the FCM/broker-dealer. It is the job of the "SIPA Trustee" – so called because of the Securities Investor Protection Act, which created SIPC – to maximize the return of customer funds to their proper owners. As a futures commission merchant, MF Global was required to keep certain customer funds in segregated accounts. In spite of the segregation requirements, the SIPA Trustee has returned $4.9 billion to customers and anticipates a $1.6 billion shortfall.[1]

Each of the trustees has produced an extensive reports detailing MF Global's collapse, as has the House Financial Services Oversight Subcommittee. What follows is a brief summary of their findings, along with appendices listing questions about the investigation and the answers so far.

[1] Dow Jones Newswires (December 5, 2012), *MF Global Trustee Cites Progress in Resolving Disputes*, http://www.nasdaq.com/article/mf-global-trustee-cites-progress-in-resolving-disputes-20121205-00978#.UMX9ZoPAdkt.

History of MF Global

The Origins of an International Commodities Broker

MF Global started out as a unit of Man Financial, a financial conglomerate that began as a London sugar brokerage 229 years ago. MF Global spun off from Man Financial in 2007 and went public in what turned out to be a rather disappointing initial public offering (IPO) - management had hoped to raise $5 billion, but they netted only $2.9 billion in no small part because of the dark clouds forming over Bear Stearns, Lehman Brothers and other financial institutions. [2] A year later the company's shares dropped 28% after a rogue trader lost the company more than $140 million in unauthorized trades on wheat futures in February of 2008. In response, CFTC fined the firm $10 million after identifying weaknesses in MF Global's internal controls and risk management procedures. [3]

MF Global soon found itself unable to repay a revolving credit facility it had drawn on, driving the company into the arms of J.C. Flowers, a private equity titan and former colleague of Jon Corzine's at Goldman Sachs. Flowers helped MF Global refinance its debt in return for two seats on MF Global's board. [4] In October of 2008, the board appointed Bernard Dan as CEO, whose first order of business was to persuade the NY Federal Reserve to designate MF Global a primary dealer. [5] The NY Fed, however, had recently changed their rules for primary dealer designation and required that at least a year transpire after the rogue trading fiasco. MF Global also saw its credit rating downgraded multiple times by Moody's and S&P between 2008 and 2009. Unable to return the firm to profitability, Dan resigned in November of 2009. [6]

As a brokerage firm, MF Global's primary source of revenues came from interest it charged customers for trading on margin. But because interest rates had been so low as a result of the Federal Reserve's loose monetary policies following the 2008 financial crisis, earnings were suffering and the company was seeking new opportunities to generate the revenue it needed. One option they pursued was securing designation as a primary dealer in U.S. Treasury securities, but the change in Fed Policies meant they would have to wait at least a year after the regulatory action by the CFTC.[7]

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[2] Jacob Bunge, *MF Global: History From IPO to Bankruptcy*, WALL ST. J. (Oct. 31, 2011), http://blogs.wsj.com/deals/2011/10/31/mf-global-history-from-ipo-to-bankruptcy/.
[3] *Id.*
[4] HOUSE FINANCIAL SERVICES COMMITTEE, SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS, 112th Cong., Staff Report (November 15, 2012), *available at* http://financialservices.house.gov/uploadedfiles/256882456288524.pdf [hereinafter House Subcommittee Report].
[5] *Id.*
[6] Sarah Lynch, *A persistent MF Global won NY Fed dealer status*, Reuters (December 14, 2011), http://us.mobile.reuters.com/article/internal_ReutersNewsRoom_ExclusivesAndWins_MOLT/idUSTRE7BD2B920111215.
[7] *Supra* note 2.

After Dan's resignation in March of 2010, J.C. Flowers approached Jon Corzine about the position. Having just lost reelection as New Jersey's governor, Corzine was itching to return to work in financial services and accepted the offer.[8]

Corzine's Strategic Makeover

Corzine set about transforming the firm from a sleepy securities and commodities broker into a small investment bank along the lines of Goldman Sachs. He immediately set upon a two-fold strategy to bring MF Global back to profitability: first, to obtain the designation from the Federal Reserve Bank of New York as a primary dealer for trading U.S. Treasury securities; second, to generate additional revenue using MF Global's available capital in aggressive, highly leveraged trades in European debt securities.

After Corzine took the helm, MF Global embarked on a risky trading strategy in European debt securities that involved transactions known as "repos to maturity" (RTM). Acting on Corzine's belief that the market had overestimated the risk of sovereign default, MFGI purchased short-term European sovereign debt with a maturity date prior to June 30, 2013, the date that the European Financial Stability Facility – a bailout fund for European sovereigns – is due to expire.[9] The purchases were typically made through MF Global's UK subsidiary (MFGUK) acting as an intermediary.[10]

MFGUK would then undertake a reverse[11] "repo to maturity" (RTM) with the American subsidiary, MFGI, in which it purchased the European debt securities from MFGI, while MFGI simultaneously agreed to repurchase the securities at a specified price on their maturity date.[12] At the same time, MFGUK would itself repo the European sovereign debt to yet a third party[13], i.e. sell them while simultaneously agreeing to buy them back at a set price immediately before maturity.[14] The terms of the RTM allowed MFGUK, the counterparty to the trade, to demand

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[8] *Id.*

[9] Miles Weiss et al., *Corzine Pushed Europe Bet to $11.5bn*, Bloomberg (Nov. 29, 2011), http://www.bloomberg.com/news/2011-11-29/corzine-pushed-fatal-europe-bet-to-11-5-billion-as-mf-global-board-balked.html.

[10] First Rep. of Louis J. Freeh, Chapter 11 Trustee of MF Global Holdings Ltd., et al., for the Period Oct. 31, 2011 through June 4, 2012, at 33, *In re MF Global Holdings Ltd.*, Case No. 11-15059 (MG) (June 4, 2012) [hereinafter Freeh Report].

[11] The term "reverse repo" describes the repo transaction from the perspective of the counterparty, i.e., the party "buying" the securities (that is to say, lending the cash against the securities as collateral). See *id*., at Annex 1.

[12] Actually, MFGI agreed to repurchase the securities two days before of their maturity date, but close enough to the actual maturity date that the impact on the accounting treatment is immaterial. *Id*.

[13] That third party was typically LCH.Clearnet. *Hearing on the MF Global Bankr. Before the House Comm. on Agric.*, 112th Cong. 68 (December 8, 2011) (Statement of Jon S. Corzine., Former Chief Executive Officer, MF Global, Inc.) [hereinafter *Corzine Statement of Dec. 8, 2011*].

[14] Freeh Report, *supra* note 10, at 33.

additional margin[15] from MFGI in the form of either cash or securities should either MF Global or the collateral lose value.[16]

Unfortunately, Corzine's strategy simply overlooked the risk that the European sovereign debt used in these RTM transactions would lose value to such extent that margin calls might drain the company of cash – precisely the scenario that ultimately brought MF Global down. The irony is that Corzine's bet has so far proven correct: those counterparties who seized the collateral have since either watched the securities increase in value or have been paid in full by the issuer upon maturity. The story of MF Global is thus a classic illustration of the bromide made famous by John Maynard Keynes, himself a commodity trader: the market can stay irrational longer than a trader can stay solvent. These transactions were structured in such a way that the risk of ownership shifted from the subsidiary, MFGUK, to the American counterpart, MFGI, as per the demands of MFGUK's counterparty, LCH.Clearnet.[17]

For accounting purposes, repo transactions are traditionally treated as a form of secured lending, in which the company "selling" the securities is actually borrowing cash subject to a liability in the amount of the repurchase price.[18] The accounting treatment for RTM transactions is slightly different, however. Because the counterparty "purchasing" the securities holds them to maturity, the counterparty has a choice between selling the securities back to the transferor for the agreed upon repurchase price, or it can redeem the securities for payment from the issuer directly.[19] In short, the rationale for treating a "repo to maturity" as a sale is that effective control over the securities has moved from transferor to counterparty.[20]

Hence the Financial Accounting Standards Board (FASB) treats the counterparty as having sold the securities, so the transaction is recorded as a sale subject to a repurchase agreement - not a secured loan, as in the case of traditional repos.[21] The repurchase agreement itself is recorded as a derivative, and any change in value is reflected in the borrower's income

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[15] The additional payment required in response to a decline in the value of the collateral is known as *variation margin*, sometimes also called *maintenance margin*, as opposed to the margin amount the counterparty may require be posted at the outset of the transaction, also known as *initial margin*. See Investopedia, *Dictionary*, http://www.investopedia.com/dictionary/#axzz2GwW2PiTU.
[16] Dec. 8, 2011 Hearing *supra* note 13, at 68.
[17] *Id.*
[18] Hearing on the MF Global Bankr. Before the House Comm. on Financial Services, Subcommittee on Oversight and Investigations, 112th Cong. 68 (March 28, 2012) (Statement of Susan Cosper, Technical Director, Financial Accounting Standards Board) [hereinafter Cosper Statement of March 28, 2012].
[19] Cosper Statement of March 28, 2012, p. 8.
[20] Cosper Statement of March 28, 2012, p. 8-9; see also Floyd Norris, *Accounting Backfired at MF Global*, NY TIMES (June 7, 2012), http://www.nytimes.com/2012/06/08/business/mf-global-case-exposes-weakness-in-accounting-rules.html?pagewanted=all&_r=0. Norris points out that this form of accounting treatment began in response to an earlier abuse, when firms *avoided* classifying the transfer of U.S. Treasury securities used in RTM's as sales because their fair market value was declining in the face of rising interest rates.
[21] See FINANCIAL ACCOUNTING STANDARDS BOARD, *Accounting Standards Update, Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements* (April 2011), http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175822403435&blobheader=application%2Fpdf.

statement.[22] This allows the borrower – the party that "sells" the securities – to remove them from its balance sheet.[23] FASB has since announced their intention to revisit "repo to maturity" accounting treatment in light of recent events.[24]

Corzine's strategy was supervised by the MF Global's board of directors and by the chief risk officer, Michael Roseman. By September of 2010, after MF Global's sovereign debt portfolio increased to as much as $2 billion, Roseman and Corzine were butting heads. [25] Corzine dismissed Roseman's risk scenarios extremely implausible, and went so far as suggesting that he would leave if the board did not take his side.[26] He met with the the board several times for permission to increase the company's exposure to European sovereign debt, demands that were only rejected once. [27] Roseman was eventually replaced with Goldman alum Michael Stockman in January of 2011. Stockman would not sound the alarm about excessive risk until three months before the bankruptcy.[28]

The Regulatory Context

MF Global's U.S.-based subsidiary, MFGI, was both a broker-dealer and commodities exchange and ultimately subject to regulation both by the SEC and CFTC. It was also subject to regulation the various self-regulatory organizations (SRO's) to which it belonged, including the exchanges through which it executed trades.[29]

As a broker-dealer in securities, MFGI was required to belong to FINRA.[30] MFGI's designated examining authority was the CBOE (Chicago Board Options Exchange).[31] CBOE is both an SRO under the Exchange Act and also a designated contract market under the Commodity Exchange Act; in short, it had responsibility for monitoring MFGI's compliance with regulations governing it both as a broker-dealer and as a futures commission merchant.[32]

MFGI was subject to the broker-dealer Customer Protection Rule, which required that it maintain a special "Reserve Account" separate and apart from its other bank accounts for the

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[22] Susan Cosper Prepared Statement, 12/8/2011, p.
[23] Dec. 8, 2011 Hearing *supra* note 16, at 68.; see also Floyd Norris, *Accounting Backfired at MF Global*, NY Times, (June 7, 2012).
[24] Michael Cohn, *FASB Plans to Revise Repo Agreement Standards,* Accounting Today, March 21, 2012.
[25] House Subcommittee on Oversight Report, supra note 4.
[26] Aaron Lucchetti and Julie, *Corzine Rebuffed Internal Warnings on Risks*, Wall St. J, *(*December 6, 2011), http://online.wsj.com/article/SB10001424052970204083204577080723935363452.html.
[27] *Id.*
[28] Ben Protess and Azam Ahmed, *Lax Oversight Blamed in Demise of MF Global*, New York Times, (February 2, 2012),http://dealbook.nytimes.com/2012/02/02/lax-oversight-is-blamed-in-demise-of-mf-global/.
[29] Rep. of the Trustee's Investigation and Recommendations, *In re MF Global Inc.*., No. 11-2790 (MG) SIPA, at 27 (Bankr. S.D. N.Y. June 4, 2012) [hereinafter MFGI Trustee Report].
[30] *Id, at 28.*
[31] When a financial institution is a member of multiple SRO's, one of them will be named the "designated examining authority" for monitoring the firm's compliance securities laws. *Id, at 28.*
[32] *Id.*, at 27.

benefit of their customers.[33] The amount of capital required to be held in the account is set by an SEC reserve formula.[34] It was also subject to the broker-dealer Net Capital Rule, which required that it maintain an appropriate level of excess net capital to ensure that it has sufficient assets to liquidate in an orderly fashion should its reserve account fall below the minimum.[35]

MFGI was subject 17 CFR 240.15c3-3, the broker-dealer "Customer Protection Rule," and was therefore required to maintain a special "Reserve Account" separate and apart from its other bank accounts for the benefit of their customers. It was also subject to 17 CFR 240.15c3-1, the broker-dealer "Net Capital Rule," and therefore required to maintain an appropriate level of excess net capital to ensure that it has sufficient assets to liquidate in an orderly fashion should its reserve account fall below the minimum.

As a registered futures commission merchant (FCM), MFGI was also subject to CFTC oversight and regulation.[36] CME Group was the designated SRO for MFGI's commodities trading activities, responsible for conducting audits, reviewing monthly and annual reports, and monitoring compliance with CFTC regulations.[37]

MFGI was subject to the FCM Net Capital Rule, [38] but as a broker-dealer it had to comply with FINRA's stricter 120% net capital rule.[39] It was also subject to the "segregation requirement" of Section 4d(2)(a) of the Commodity Exchange Act, which requires that customer property be separately accounted for and not commingled with the FCM's own funds (often referred to as a "Section 4d" account).[40] MFGI was also required to maintain an altogether separate account sufficient to satisfy its obligations to foreign futures/foreign options customers (often referred to as a "Rule 30.7" account).[41] The SIPA trustee report notes that "some personnel at MFGI interpreted the regulations as permitting customer funds to be used intraday."[42]

FCM's are permitted to withdraw funds from the segregated accounts, but only account "to the extent of its own interest" therein: in other words, MFGI could only withdraw any excess above and beyond the amount required by law to be in the Section 4d or Rule 30.7 accounts.[43]

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[33] 17 CFR 240.15c3-3(e).
[34] 17 CFR 240.15c3-3(e).
[35] See generally 17 CFR 240.15c3-1.
[36] MFGI Trustee Report, *supra* note 29, at 32.
[37] *Id.*
[38] 17 CFR 1.17.
[39] MFGI Trustee Report, *supra* note 29, at 33.
[40] See 7 U.S.C. § 6d(a)(2); more specifically, the rule is codified at 17 CFR 1.20(a) ("All customer funds shall be separately accounted for an segregated as belonging to commodity or option customers.") and again at 17 CFR 1.20(c) ("Each futures commission merchant shall treat and deal with the customer funds of a commodity customer or of an option customer as belonging to such commodity or option customer.").
[41] 17 CFR 30.7(a); see also 17 CFR 30.7(d) (requiring that such Rule 30.7 account be segregated from the Section 4d account).
[42] MFGI Trustee Report, *supra* note 29, at 36.
[43] See 17 CFR 1.23.

As for how the funds can be used, the regulations governing the two accounts were slightly different. Funds held in a Section 4d customer segregated account are subject to Regulation 1.25, which restricts the investments available to safe U.S. government securities, agency securities, sovereign debt, and reverse repos, inter alia. Until last summer, the restrictions on the use of funds in a Rule 30.7 account were more forgiving; Rule 30.7 accounts have since been subjected to Regulation 1.25 as well.[44]

The regulations place a number of daily reporting burdens on FCM's. At the close of each day, MF Global was required to compute a daily "Segregation Statement" for the Section 4d account[45] and 17 CFR 30.7(f) required that they compute a daily "Secured Statement" for the Rule 30.7 account, both of which were then filed with regulators. Each report had to include the same basic information: (1) the total amount of customer funds currently on deposit in the Section 4d and Rule 30.7 accounts; (2) the total amount of such funds required to be so segregated; and (3) the amount of MF Global's residual interest in such accounts.

FCM's are permitted to use two different methods to compute amount required in the Secured Statement, i.e. the Rule 30.7 account: the Net Liquidating Method ("NetLiq Method") (the net liquidating value of customer accounts plus any customer securities held) or the Alternative Method ("Alt Method") (the sum of the account's risk maintenance margin requirement, open trade equity, securities and net options value).[46] The SIPA Trustee noted in his report that the Alt Method results in a significantly lower regulatory capital requirement.[47] MF Global's Secured Statements on file with their regulators show that the company indeed used the Alt Method for reporting purposes.[48]

The House Financial Services Oversight Subcommittee report blamed MF Global's use of the Alt Method for having aggravated the risk that the secured amounts on deposit would fall below the company's liabilities to its Rule 30.7 customers.[49] By the time MF Global declared bankruptcy, the deposits in MF Global's Rule 30.7 accounts exceeded its liabilities to Rule 30.7 customers by a mere $4 million dollars.[50] The Oversight Subcommittee report called on CFTC

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[44] MFGI Trustee Report, *supra* note 29, at 39.
[45] See 17 CFR 1.32.
[46] MFGI Trustee Report, *supra* note 29, at 37.
[47] *Id.*, at 38. The difference between the two methods can be illustrated by the following simple example: a customer deposits $100,000 into her MF Global Rule 30.7 account, but does not execute any trades with the money and has no open positions. The NetLiq Method would require MF Global to set aside $100,000, but the Alt Method would not. MFGI Trustee Report, *supra* note 29, at 28, n.23. The difference in the amount of the reserves called for by the two calculations (NetLiq – Alt) is typically referred to as "Regulatory Excess." *Id*.
[48] MFGI Trustee Report, *supra* note 29, at 38.. The Trustee notes that MF Global switched from the NetLiq Method to the Alt Method after they purchased assets from Refco in 2005, itself a failed former commodities brokerage that preferred the latter method. The decision to adopt Refco's business practices is peculiar in light of Refco's own sullied past.
[49] House Subcommittee on Oversight Report, supra note 4, at 90-91.
[50] House Subcommittee Oversight Report, p. 91 n. 488; note this is *after* MF Global regulators pushed the company to deposit more funds into their Rule 30.7 accounts. Id. at 90-91.

to prohibit use of the Alt Method,[51] and CFTC has issued a Notice of Proposed Rulemaking that proposes to eliminate the Alt Method as an option for regulatory reporting.[52]

In July of 2011, MFGI's CFO produced a memo that suggested the firm could provide overnight "loans" from the FCM's segregated and secured accounts to be used as working capital for broker-dealer operations in New York, a dramatic change from customary practice.[53] The memo found that the regulatory excess in the Rule 30.7 accounts ranged from just over $340 million to $800 million using the Alt Method, but under the NetLiq Method, the amounts ranged from *negative* $98 million to over $600 million.[54] The CFO concluded that the FCM had about $433 million in regulatory excess available to fund broker-dealer operations.[55] A review of CFTC regulations and several FINRA interpretations and consultation with outside counsel found nothing prohibiting them from "borrowing"$250 million overnight from the FCM segregated and secured customer accounts.[56] The SIPA Trustee's report noted that in its final days, MF Global went far beyond "borrowing" that amount, however.[57]

MF Global's Financial Regulatory Group prepared the daily Segregation Statement and the Secured Statement that were submitted to regulators.[58] The Financial Regulatory Group also compiled a "Daily Estimated Net Capital – US Benchmark Summary" and it along with the Segregation and Secured statements to senior management, including Jon Corzine.[59] Although MF Global used the Alt Method in its regulatory filings, the company used both the Alt and NetLiq methods for internal reporting.[60] The SIPA Trustee Report notes that liquidity reporting was done manually, despite the fact that a number of individuals in the company had been requesting that the IT department automate the process.[61]

The Final Curtain: August 2011 to Bankruptcy

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[51] House Subcommittee Oversight Report, p. 92.
[52] Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 77 Fed. Reg. 66,866-67,971 (Nov. 14, 2012) (to be codified at 17 CFR Parts 1, 3, 22, 30, and 140. Note that CFTC recently approved a proposal by NFA to require its members to dispense with the Alt Method. See Reed Smith LLP, The Swap Report: CFTC Approves New NFA Rules to Protect Customer Funds Held by FCMs: Corzine Rule Approved; Alternative Method Dead for Foreign Futures Seg Account, (July 15, 2012), http://www.theswapreport.com/2012/07/articles/mf-global-1/cftc-approves-new-nfa-rules-to-protect-customer-funds-held-by-fcms-corzine-rule-approved-alternative-method-dead-for-foreign-futures-seg-account.
[53] MFGI Trustee Report, *supra* note 29, at 75.
[54] *Id.*, at 76.
[55] *Id, at 76.*
[56] *Id.*, at 77.
[57] *Id., at 77.*
[58] *Id.*, at 40.
[59] *Id.*, at 33.
[60] *Id.*, at 79.
[61] *Id.*, at 80.

In August of 2011, FINRA reconsidered the capital treatment of European debt securities used in RTM transactions under the SEC's net capital rule, Rule 15c3-1.[62] After consulting with the SEC and CBOE, FINRA demanded that MF Global take a capital charge against its position in European debt securities as if those securities were on its balance sheet, notwithstanding their off-balance sheet accounting treatment, under which they were classified as "sold."[63] FINRA based its decision on the fact that unlike RTM's collateralized with U.S. Treasury debt, SEC guidance does not exclude RTM's collateralized with foreign sovereign debt from net capital rule calculations, and in their judgment, the two-day shortfall in the trades meant that MFGI retained the risk of default.[64]

Corzine argued against the change and met with officials from the SEC and CFTC on August 15, 2011, to no avail.[65] The firm complied[66] and disclosed the increased net capital charge by filing an amendment to its Form 10-Q on September 1, 2011.[67] FINRA's capital charge did not make news until October 17, 2011, when the Wall Street Journal ran a story about concerns by regulators that financial firms were too exposed to sovereign debt.[68] News of the capital charge came at a particularly bad time - the company had already been set to announce a $191.6 million loss[69] on October 27 in its quarterly earnings report.[70]

As the demand for liquidity increased throughout October, the company became more and more reliant on the excess cash in the FCM customer accounts to fund operations.[71] But the curtain really began to drop on October 24, when Moody's downgraded MF Global to one level above junk status and the firm suddenly found itself unable to finance its short term obligations.[72] By Wednesday, October 26, the company's share price lost 50 percent and was

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[62] The net capital rule "requires firms to maintain sufficient liquid assets to satisfy customer and creditor claims. It accomplishes this by requiring brokerage firms to maintain net capital in excess of certain minimum amounts. . . . The net capital rule is intended to provide an extra buffer of protection, beyond rules requiring segregation of customer funds, so that if a firm cannot continue business and needs to liquidate, resources will be available for them to do so." Statement of Richard G. Ketchum, Chairman & CEO of FINRA, Senate Banking, Housing & Urban Affairs Committee, April 24, 2012.
[63] MF Global first came to FINRA's attention when it posted a loss of $38 million in March of 2011, which prompted FINRA to learn more about the company's RTM trades in European sovereign debt. House Subcommittee on Oversight Report, supra note 4, at 50.
[64] Ketchum Statement, Senate Banking, Housing & Urban Affairs Committee, April 24, 2012.
[65] Dec. 8, 2011 Hearing *s*upra note 13, at 70.
[66] House Subcommittee on Oversight Report, supra note 4, at 55. The Report indicates that MF Global Holdings increased MFGI's excess net capital by between $183 million and $287 million.
[67] Dec. 8, 2011 Hearing *s*upra note 13, at 70.
[68] Aaron Luchetti, *MF Global Told to Boost Capital*, Wall St. J., (Oct. 17, 2011), http://online.wsj.com/article/SB10001424052970203658804576635361082548304.html.
[69] Corzine testified that the $191.6 million loss had nothing to do with MFGI's investment in European sovereign debt, but blamed it on the loss of a tax asset, costs associated with the closing of their Japanese securities trading subsidiary, and a charge taken for paying off some debt, among other things.
[70] House Subcommittee on Oversight Report, supra note 4, at 56.
[71] MFGI Trustee Report, *supra* note 29, at 81.
[72] Moody's Investors Service, *Rating Action: Moody's Downgrades MF Global to Baa3; reviews for further downgrade*, http://www.moodys.com/research/Moodys-downgrades-MF-Global-to-Baa3-reviews-for-further-downgrade--PR_229068.

trading in the single digits. MG Global's final days were particularly hectic: the SIPA Trustee's Report details a flurry of wire transfers, as the company found itself in a shell game and would inevitably lose track of the money it shuffled around to finance a tsunami of margin calls.[73]

October 24 to 25, 2011

In response to Moody's downgrade, Corzine decided to move up the quarterly earnings call to Tuesday, October 25. On the call, he reassured investors and sought to minimize the FINRA capital charge as part of a "regulatory reinterpretation" of the rules applicable to the company's European sovereign debt holdings but took responsibility for the RTM strategy.[74] One of the comments Corzine made during that call underscores that he had yet to fully appreciate the risk to which he had exposed MF Global: "The spread between interest earned and the financing cost of the underlying repurchase agreement has often been attractive even as the structure of the transaction themselves *essentially eliminates* market and *financing risk*."[75]

By the end of Tuesday, October 25, MF Gobal's stock price fell another 44 percent and closed at $1.86. The company's largest customers began closing their accounts and withdrawing funds, and HSBC pulled its credit line and demanded the company wind up its affairs with the bank by the end of the year.[76]

October 26, 2011

On Wednesday, S&P placed MF Global on "Credit Watch Negative," noting that the company's "continued volatility in the capital markets and low interest rates could further harm MF Global's ability to generate capital."[77] MFGI had reported to regulators excess funds of $1 billion in its segregated and secured accounts, using the Alt Method, despite the fact that its internal records showed only $21.5 million available.[78] Nonetheless Edith O'Brien, the company's assistant treasurer, authorized $615 million in transfers from the MFGI's FCM customer accounts.[79] Because these transfers exceeded the excess capital available, the difference came from customer funds.[80]

October 27 to 28, 2011

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[73] See Appendix 1, a spreadsheet of the wire transfers executed over between October 24 and October 28.
[74] House Subcommittee on Oversight Report, supra note 4, at 58 ("On a personal note, our positions and the judgment about risk mitigation steps are my personal responsibility and a prime focus of my attention.").
[75]Felix Salmon, *What Happened at MF Global*, Reuters, (November 1, 2011) (emphasis added) http://blogs.reuters.com/felix-salmon/2011/11/01/what-happened-at-mf-global/.
[76] House Subcommittee on Oversight Report, supra note 4, at 59.
[77] *Id.*, at 60.
[78] *Id*.
[79] *Id*.
[80] The CFTC has confirmed there was a deficiency in the segregated accounts as of October 26, 2011. *Id*, at 60, n. 354.

On Thursday, Moody's and Fitch downgraded MF Global's credit to junk status.[81] The downgrades further exacerbated the margin calls and customer withdrawals. MF Global was forced to draw down $805 million from its revolving credit facility, leaving that source of funds fully tapped.[82] Counterparties to MF Global's RTM trades began demanding increased haircuts.[83] JP Morgan put all MF Global's accounts on "debit alert" on Thursday evening, meaning it would only execute transfers from MF Global accounts only after determining that the account had funds sufficient to support the transfer, and terminated its uncommitted intraday credit lines.[84]

The next day, MFGUK overdrew several of its accounts at JP Morgan by $175 million. Corzine contacted O'Brien and instructed her to resolve the overdrafts by wiring $200 million from a MF Global customer segregated account to a "house" account; O'Brien then transferred $175 million from the "house" account to JP Morgan in London.[85] O'Brien executed this transfer *before* she had received the daily segregation statement.[86] JP Morgan's Chief Risk Officer demanded Corzine's assurance that the transfer did not represent customer funds.[87] The bank went so far as to request Corzine sign a letter specifying that the transfers complied with CFTC customer protection rules; *no one from MF Global ever signed it*.[88]

Meanwhile, MF Global's Treasury Department had first spotted a $300 million deficit in the customer segregated customer accounts.[89] After reviewing the company's books, the Treasury Department erroneously concluded that the shortfall was caused by $540 million in wire transfers that had not been properly accounted for.[90] They alerted MF Global's Financial Regulatory Group, which then made a $540 million adjustment to the Segregation Statement *without anything to back it up*.[91] This adjustment falsely inflated the company's excess reserves in statements that were filed with regulators, not to mention in the capital account summaries distributed internally to senior management.[92]

That evening, the NY Fed suspended MFGI's ability to conducts transactions as a primary dealer.[93]

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[81] *Id, at* 61.
[82] *Id., at* 61-62.
[83] *Id., at* p. 62.
[84] *Id., at* p. 63.
[85] *Id., at* p. 64.
[86] *Id., at* p. 64.
[87] *Id., at* p. 65.
[88] *Id., at* p. 65.
[89] MFGI Trustee Report, *supra* note 29, at 111-112.
[90] *Id.*, at 112.
[91] MFGI Trustee Report, *supra* note 29, at 112. The SIPA Trustee's Report makes clear that the managers involved have yet to provide a good explanation for the errant adjustment: "The witnesses' descriptions regarding this matter are confusing and contradictory."
[92] MFGI Trustee Report, *supra* note 29, at 112-113.
[93] House Oversight Subcommittee, p. 66.

October 29, 2011 to Bankruptcy

By Saturday, Treasury personnel discovered a deficit in the segregated and secured accounts of almost $1 billion, which they initially dismissed as an error.[94] MF Global had retained investment bank Evercore Partners to explore the possibility of a sale of the company.[95] The bank identified Interactive Brokers Group, Inc., a competing commodities broker, as a potential buyer, and MF Global's senior management began seeking approval for the transaction from regulators.[96]

MF Global's Financial Regulatory Team spent most of the following day trying to reconcile the enormous deficit in the customer segregated and secured accounts, to no avail.[97] Finally, the team was forced to conclude the obvious: the deficit could not be reconciled because the Segregation Statement was accurate - the $1 billion deficit was not a reporting error.[98] They also concluded that the $540 million adjustment to reconcile the earlier imbalance was errant as well.[99] The team confirmed their findings to the CFTC in the early morning hours of October 31, 2012, and the potential deal with Interactive Brokers fell apart.[100] After a brief scramble for any and all potential sources of cash, MF Global Holdings, Inc. filed for bankruptcy that morning.[101] The Securities Investor Protection Corporation commenced liquidation proceedings against MFGI that afternoon.[102]

The SIPA Trustee has since concluded that the Segregation Statement for October 26 had failed to deduct $415 million in outgoing wire transfers, creating a deficiency in the customer segregated funds of more than $298 million, which only grew from that point forward.[103] The SIPA Trustee has explained the shortfall as a result of the failure of MF Global employees to keep up with an unprecedented number of transactions in the week leading up to the bankruptcy petition.[104]

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[94] MFGI Trustee Report, *supra* note 29, at 116.
[95] *Id.*, at 116.
[96] *Id.*, at 117.
[97] *Id.*, at 118.
[98] *Id.*, at 119. In fact, they confirmed a deficit in the customer accounts of $952,047,822.
[99] *Id.*, at 119.
[100] *Id.*, at 119.
[101] *Id.*, at 119-120.
[102] *Id.*, at 121.
[103] *Id.*, at 122.
[104] MFGI Trustee Report, *supra* note 29, at 123.

Q&A / Topics for Investigation

1. Why did the Fed designate MF Global a primary dealer despite the fact that one of its traders lost the firm billions of dollars and its business was deteriorating?

Findings: With the appointment of Bernard Dan as CEO, MFGI contacted the New York Fed in December of 2008 to express an interest in being designated a primary dealer. The CEO and other MFGI officials had a meeting with the New York Fed's Markets Group in January of 2009.[105] There were a few problems with its application, however. MGI was incorporated in Bermuda and it was not clear whether Bermuda met the requirements of the Primary Dealers Act of 1988. Additionally, Bermuda's reputation as a tax haven caused some concern. MFGI responded by reincorporating in Delaware in January 2010.[106]

The NY Fed was also concerned about the CFTC's investigation into the trading scandal that cost the firm $141 million in losses on wheat futures and destroyed 40% of MFGI's value. When officials at the NY Fed learned that the investigation was ongoing, they suspended MFGI's application. The CFTC later found MFGI at fault and fined the company $10 million. Shortly thereafter the NY Fed revised its policies and announced that it would deny primary dealer designation to any firm that had been involved in relevant litigation or regulatory action in the year prior to its application, which precluded MF Global's designation until February of 2010.[107]

After MF Global announced the hiring of Jon Corzine as its new CEO, Corzine met with NY Fed officials on June 1, 2010. The meeting spurred the NY Fed into action: just two days later, on June 3, 2010, the NY Fed discussed MF Global's candidacy with the CFTC. Formal review sessions followed in August and September, along with a visit to MF Global's headquarters in early November. The application was approved in January 2011 and MF Global was designated a primary dealer on February 2, 2011.[108]

Note that MF Global was designated a primary dealer in the face of a deteriorating business. Jon Corzine himself testified that the company had lost money each of the three years before he signed on as CEO.[109] During fiscal years 2009 and 2010, MF Global's annual net commission revenue fell by 32 percent and its futures and options trading volume fell by 20 percent.[110] MF Global's stock value had dropped from $30 per share to less than $10 at the end of 2009. Just three months before MF Global became a primary dealer, it announced a $38.7

[105] *Hearing on the Collapse of MF Global Before the Subcomm. on Oversight and Investigations of the House Comm. on Fin. Services*, 112th Cong. 93 (2011) [hereinafter Dec. 15, 2011 Hearing] (statement of Thomas C. Baxter, Jr., Gen. Counsel, NYFRB).
[106] House Subcommittee on Oversight Report, supra note 4, at 12-13.
[107] Dec. 15, 2011 Hearing, *supra note 105* (statement of Thomas C. Baxter, Jr., Gen. Counsel, NYFRB).
[108] *Supra* note 2.
[109] Dec. 8, 2011 Hearing, *supra* note 13, at 63. The net losses for fiscal years 2008, 2009, and 2010 were $69.54 million, $48.61 million, and $136.97, respectively.
[110] *Id.*

million loss for the fiscal quarter ending on September 30, 2010. In the same month, S&P downgraded MF Global to BBB-. The day after its announcement as a primary dealer, MF Global announced a $4.7 million loss for the quarter ending on December 30, 2010.[111]

Mark Williams, a former Federal Reserve risk examiner, described the situation thusly: "From a risk perspective, its capital position was 30 times weaker than that of most primary dealers. It was also new to investment banking, a higher risk area than its core brokerage business. Under Mr. Corzine it placed ever bigger bets, and more of its own capital, at risk. With less capital, trading losses could quickly erode its financial stability. Within months it had placed a single bet of $6.3bn – six times its capital – on risky European sovereign debt. Its leverage, assets to capital, leapt to a ratio of 40 to 1."[112]

The President of the New York Fed at the time was Goldman Sachs alum William C. Dudley. Dudley worked at Goldman from 1986 to 2007 as its chief economist. Corzine testified he had no contact with Dudley regarding the MF Global's primary dealer application, although they did correspond during the week before MF Global declared bankruptcy.[113] It is clear that the NY Fed had rejected MF Global's previous applications for primary dealer status, yet fast tracked the application after meeting with Corzine. MF Global's primary dealer designation was suspended on Friday, October 28, 2011, and then terminated on October 31, 2011.[114]

The House Subcommittee concluded that although MFGI met the basic requirements for primary dealer designation, the NY Fed should have tabled the application in light of CFTC warnings about the company's risk management capabilities and the absence of a proven business plan. The report notes that a key focus of Corzine's turnaround strategy was to take advantage of the primary dealer designation as a "good housekeeping" seal of approval, in spite of the Fed's ongoing efforts to temper such perceptions about the designation and their explicit warnings to MF Global management not to plan their business around obtaining it.[115]

2. Why did FINRA waive its Series 7 licensing requirement in the case of Jon Corzine? Why did NFA waive its Series 3 (National Commodity Futures Exam) licensing requirement?

Findings: The securities licensing systems administered by FINRA and the NFA appear to be vulnerable to cronyism, and have led some to complain the use of waivers has created a more

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[111] *Id.*
[112] Mark Williams. *MF Global gives the Fed a lesson in how to pick friends*, Financial Times, (November 6, 2011), http://www.ft.com/cms/s/0/012c4c2a-0871-11e1-9fe8-00144feabdc0.html#axzz2FKyvaQUP.
[113] Dec. 8, 2011 Hearing, *supra* note 13.
[114] Federal Reserve Bank of New York. Statement Regarding Termination of MF Global Inc. as a Primary Dealer, Oct. 31, 2011,. (http://www.newyorkfed.org/newsevents/statements/2011/1031_2011a.html (last accessed on Dec. 17, 2012).
[115] House Subcommittee on Oversight Report, supra note 4, at 92-95.

lax set of licensing requirements for well-connected industry professionals. Corzine passed the Series 24 Principal in 1982 and the Series 7 Representative exam in 1975.[116] According to FINRA, securities professionals may reactivate their representative or principal exam up to two years after the end of their last employment.[117] FINRA granted Corzine a waiver for the Series 7 exam, but and FINRA Chairman Richard Ketchum insists that Corzine received "absolutely no favoritism."[118] Corzine was required to take a Series 32 limited futures exam, but was not required to take the full Series 3 National Commodity Futures Exam. In 2011, FINRA issued 1,556 exam waivers.[119]

3. Did the relationship between CFTC Commissioner Gary Gensler and Jon Corzine lead to any special treatment for the latter?

Findings: Gensler and Corzine were partners at Goldman Sachs back in the 1990's and worked together in the bank's fixed income division.[120] Concerns about a potential conflict of interest led Gensler to recuse himself from the MF Global investigation within a week of the bankruptcy filing, despite the fact that ethics lawyers at CFTC found recusal unnecessary.[121]

However, when Gensler's CFTC began exploring an amendment to 17 CFR Part 1.25 that would have prevented FCM's from engaging in "repos to maturity" with related borker-dealers, the brokerage industry opposed the rule change and Corzine personally lobbied each of the CFTC commissioners against it.[122] Corzine admitted this himself in testimony before the House Agriculture Committee when he recited his contacts with Gensler regarding the proposal: MF Global submitted a letter to the CFTC along with Newedge, a competing brokerage firm; along with other industry leaders, Corzine participated in a conference call held by Gensler and four other CFTC officials; and that same afternoon, he and MF Global's General Counsel spoke to CFTC Commissioner Bart Chilton along with another CFTC official.[123] Gensler shelved the idea in July of 2008, refusing to hold a vote on the matter when he realized he did not have the support he needed to change the rule.

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[116] FINRA, Broker Check, http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/ search for Jon Corzine (last accessed on December 17, 2012).
[117] FINRA, Qualifications FAQ – Registration, http://www.finra.org/Industry/Compliance/Registration/QualificationsExams/Qualifications/p011102 (last visited on Dec. 17, 2012).
[118] Suzanne Barlyn, *FINRA head "not apologetic" about Corzine exam waiver*, Reuters, (November 14, 2011), http://www.reuters.com/article/2011/11/14/corzine-waiver-idUSN1E7AD1M520111114.
[119] *Id.*
[120] Silla Brush, *Corzine Wasn't Too Close With CFTC Chief, Review Finds*, Bloomberg, (July 31, 2012), http://www.bloomberg.com/news/2012-07-31/corzine-wasn-t-too-close-with-cftc-chief-review-finds.html.
[121] *Id*.
[122] Bryan Burrough, William D. Cohan, and Bethany McLean, *Jon Corzine's Riskiest Business*, Vanity Fair, at p. 6, (February 2012), http://www.vanityfair.com/business/2012/02/jon-corzine-201202.
[123] Dec. 8, 2011 Hearing, supra note 13, at 71.

Corzine admitted to a number of other contacts with Gensler while at MF Global: Gensler was a guest lecturer at Corzine's class on government regulation at Princeton University; they met at CFTC headquarters on May 5, 2010 and again in December of 2010; they happened to be at an investment conference held by Sandler O'Neil at the same time, although they did not discuss anything in private; and they attended the wedding of mutual friends on September 14, 2011.[124] Nonetheless, the official explanation for Gensler's decision to table the Rule 1.25 changes is that he was unable to get any support for the proposal.

4. How did $1.6bn of customer funds that by law should have been held in segregated accounts end up in the hands of MF Global creditors?

Findings: The official explanation so far is sloppy bookkeeping. Early on into the investigation, CFTC Commissioner Scott O'Malia told the media that "Their books are a disaster."[125] MF Global employees tracked loans and repayments by manually entering them into a spreadsheet and through journal entries in the back office Treasury system.[126] The very group responsible for ensuring the firm balanced its books and for preparing compliance reports for regulators had no involvement in approving transfers.[127]

For example, the infamous $200 million that ended up in the hands of JP Morgan, was wired from its customer segregated accounts to JP Morgan's UK subsidiary as per Corzine's instructions to MF Global Treasury officer Edith O'Brien.[128] MF Global had been trying to sell $5 billion in bonds with JP Morgan's help, but had overdrawn several of its accounts at JP Morgan the day before by approximately $175 million. O'Brien approved a $200 mil wire transfer from one of MF Global's customer segregated accounts to one of its "house" accounts, and then a $175 mil wire transfer from that account to one of its house accounts at JP Morgan in London.[129]

Because JP Morgan was the depository bank for some of MF Global's customer funds, these wire transfers set off alarm bells at JP Morgan's compliance department – so much so that JP Morgan's Chief Risk Officer, Barry Zubrow, called Corzine himself for reassurance that they were not being given customer funds. The very next day, JP Morgan sent a letter to MF Global,

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[124] *Id., at* 70-71.
[125] Scott Patterson and Aaron Lucchetti, *Inside the Hunt for MF Global Cash*, Wall St. J., {November 11, 2011}, http://online.wsj.com/article/SB10001424052970203537304577030440112366870.html.
[126] MFGI Trustee Report, *supra* note 29, at 62.
[127] Id.
[128] Roe, John L., Memorandum: Evidence of Intent to Commit an Actual Fraud in the Collapse of MF Global, Commodity Customer Coalition, 2, April 2, 2012, http://media.futuresmag.com/futuresmag/article/2012/04/02/CCC%20Memo%20on%20Criminal%20Intent%20-%20Redacted%20(3).pdf.
[129] House Subcommittee on Oversight Report, supra note 4, at 63-54. A "house" account is an account designated for a company's own funds.

to be signed by O'Brien, affirming that the $200 mil transfer out of MF Global's customer segregated account was not customer money and was done according to law.[130] That letter was never returned.[131] Corzine testified that he asked numerous times whether the money represented customer funds or not, and while he took full responsibility for the firm's European sovereign debt trades, he was not nearly as eager on the compliance side of things.[132]

What accounts for MF Global's poor recordkeeping, bookkeeping, and risk management failures? The official answer is that the company's internal controls failed to keep pace with the aggressive business strategy that Corzine introduced to the firm.[133] That being the case, then why didn't either MF Global's auditor, PricwaterhouseCoopers (PwC) or designated examining authority (CBOE) observe these basic compliance deficiencies and bring them to the attention of regulators? Attention has since begun to focus on the integrity of PwC's performance as auditor.[134]

5. Did MF Global engage in a form of "check kiting" when it began payment customer redemption requests in the form of a check, where they had previously done so by wire transfer?

Findings: About the same time MF Global wired $175 million to JP Morgan, it began redeeming customer withdrawal requests by check, rather than wire transfer as it had done in the past. Checks issued via U.S. mail to redeem customer withdrawal requests would clear after a week or more, whereas the check is immediately debited to the customer's account using MF Global's accounting software. This would have allowed MF Global to report a lower number of customer funds when calculating the segregation amount, even though MF Global's cash balance would have been unchanged because its customers had yet to cash their checks. In short, MF Global was allegedly engaging in a form of check kiting: taking advantage of the time lapse between issuing a check and its payment to meet regulatory capital requirements.[135]

Redeeming customer withdrawals by issuing a check was highly unusual and marked a sharp deviation from MF Global's usual conduct in the normal course of business.[136] Customer

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[130] *Id.*, at Exhibit 1.

[131] Note that FCM's such as MF Global are legally permitted, and often do, commingle their funds with those of their customers. Such "excess funds" belong to the firm, and may be transferred out of the account at will – assuming there is no shortfall in customer funds. Id., at 2.

[132] Dec. 8, 2011 Hearing, *s*upra note 13, at 65 ("I did not, however, generally involve myself in the mechanics of the clearing and settlement of trades or in the movement of cash and collateral, nor was I an expert on the complicated rules and regulations governing the various different operating businesses that comprised MF Global.").

[133] Sital Patel and Chalie Gasparino, *MF Global was sloppy, but not criminal*, Fox Business, (Feb. 24, 2012), http://www.foxbusiness.com/2012/02/24/sloppy-book-keeping-led-to-mf-globals-demise.

[134] Nate Raymond, *MF Global Customers Sue PricewaterhouseCoopers in amended lawsuit*, Reuters, (November 5, 2012), http://www.reuters.com/article/2012/11/05/us-mfglobal-lawsuit-pwc-idUSBRE8A41H020121105.

[135] Id., at 2.

[136] Id., at 3.

requests to be paid by wire transfer were ignored and converted to check.[137] Virtually all of these checks bounced.[138] The SIPA Trustee noted that he investigated this matter and has since distributed funds pari passu to customers whose accounts were closed with checks that ultimately bounced, but nonetheless concluded that he " has not seen evidence that there was any connection between the sending of checks and segregation considerations, or that there was a deliberate effort to use checks rather than wires to delay actual outlay of funds."[139] On the other hand, "[t]he Trustee is continuing to look into these allegations."[140]

6. Did MF Global comply with its disclosure obligations under the securities laws?

The prevailing opinion is that MF Global fulfilled its legal obligation to disclose the investments in European sovereign debt securities. The RTM strategy was disclosed in press releases, earnings calls, as well as publicly disclosed financial statements. Corzine testified that both the May 20, 2011 Form 10-K and the July 28, 2011 Form 10-Q disclosed the company's investments in the sovereign debt of Italy, Spain, Belgium, Portugal, and Ireland and explained that those investments had been "de-recognized.[141] And the company filed an amendment to Form 10-Q dated September 1, 2011, to report the adverse action taken by FINRA[142]

However, civil lawsuits filed on behalf of MF Global investors point out that those same filings touted MF Global's "effective risk management framework," and claim that "[s]enior management takes an active role in the risk management process…."[143] Moreover, prospectuses filed by MF Global in August of 2011 did not disclose its ongoing debate with FINRA about the net capital treatment of its sovereign debt RTM portfolio.[144]

Finally, as noted above, Corzine continued to downplay the risks of MF Global's exposure to sovereign debt right until the very end, during an earnings conference call held the week before the bankruptcy filing: "The spread between interest earned and the financing cost of

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137 Id.
138 Id.
139 MFGI Trustee Report, *supra* note 29, at 123.
140 *Id*, at 125.
141 Dec. 8, 2011 Hearing, *s*upra note 13, at 69.
142 The "Additional Information" section of the Form 10-Q/A states the following: "The Company was recently informed by the Financial Industry Regulatory Authority, or FINRA, that its regulated U.S. operating subsidiary, MF Global Inc., is required to modify its capital treatment of certain repurchase transactions to maturity collateralized with European sovereign debt and thus increase its required net capital pursuant to SEC Rule 15c3-1. MF Global Inc. has increased its net capital and currently has net capital sufficient to exceed both the required minimum level and FINRA's early-warning notification level. The Company does not believe that the increase in net capital will have a material adverse impact on its business, liquidity or strategic plans." See http://www.wikinvest.com/stock/MF_Global_Ltd._(MF)/Filing/10-Q/2011/F97903904.
143 Plaintiff's Complaint, *Context Partners Fund, LP v. Jon Corzine, et al.*, SDNY 11-Civ-8888, p. 34-35, *available at* http://www.entwistle-law.com/our_work/00022_data/Complaint.
144 Petter Henning, *MF Global and the Problems With Murky Accounting*, New York Times, (November 14, 2011), http://dealbook.nytimes.com/2011/11/14/mf-global-and-the-problems-with-murky-accounting/.

the underlying repurchase agreement has often been attractive even as the structure of the transaction themselves essentially eliminates market and financing risk."[145]

7. Why hasn't the SIPA Trustee returned all the money it has recovered so far to MF Global's customers?

There remains a dispute about whether $640 million of MFGI customer money deposited with MFGUK will be returned to customers of the U.S. based subsidiary or used to pay MFGUK creditors. A trial to decide the issue is to be held in the UK beginning on April 19, 2013.[146]

Bankruptcy trustees James Giddens and Louis J. Freeh made a deal in December of 2012 to settle claims with MF Global's London arm. The SIPC announced that securities customers would likely see full restoration of accepted claims and commodities customers would receive further compensation as well. If approved by US bankruptcy court, customers would receive about $500 to $600 million in compensation.[147]

Conclusion

There are two very different narratives to explain MF Global's demise, and the jury is unfortunately still out on which version is correct. On the one hand, critics of Jon Corzine prefer to emphasize that within two years of taking the helm at MF Global, he browbeat MF Global's board into accepting a highly risky bet on European sovereign debt using exotic, off-balance sheet RTM trades while ignoring the risk that the margin calls on those trades would tailspin the firm into a liquidity crisis from which it could not recover. Jon Corzine and his defenders would be correct to point out that he was correct in assuming the market had overestimated the risk of European sovereign default, and that the singular event which triggered MF Global's business decline was FINRA's capital charge, followed by a quarterly loss arising from business decisions that were made long before Corzine joined MF Global.

Regardless of which version the reader prefers, no one can dispute the fact that MF Global was negligent, if not *grossly negligent*, in mishandling its bookkeeping and accounting systems so badly that it simply lost track of customer funds. The failure of MF Global's managers to ensure that adequate accounting and risk management systems were in place makes civil liability for any number of securities law violations a near certainty. Any future regulated

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[145] Salmon, supra note 75.
[146] House Subcommittee on Oversight Report, supra note 4, at 3.
[147] Associated Press (December 29, 2012), *MF Global customers might get money back*, http://bostonglobe.com/business/2012/12/29/global-trustee-some-clients-may-made-whole/79Ye8N9TCOPX918o3xjymO/story.html.

broker-dealer or futures commission merchant is likely to find the cost of taking a D&O insurance policy on Corzine (or any other senior manager at MF Global) prohibitively expensive.

As for the likelihood of criminal charges against Jon Corzine, it is worth remembering that business failure is not in itself a crime. Nonetheless, those who deplore the crony capitalism of our nation's financial services industry are likely to note that Evan Dooley, the "rogue trader" who lost $141.5 million of MF Global's money betting on wheat futures, recently pled guilty to violating commodities trading laws and now faces a maximum 10 years in prison and a potential $1 million fine. Meanwhile, the entire management team at MF Global may have lost their customers nearly $1.6 billion betting on European sovereign debt. Perhaps the only real explanation for this disparity lies within Clarence Oddbody's parting wisdom to George Bailey in *It's a Wonderful Life*: "Remember, no man is a failure who has friends."

Appendix 1: Cash Transfers

Date:	Amount (in millions):	From Acct:	To Acct:	To Acct:
24-Oct	$15	JPM Foreign Secured Trust Acct	JPM B-D Wire Accnt	
25-Oct	$32	JPM Foreign Secured Trust Acct	JPM Customer Trust Acct	
	$16.60	JPM Foreign Secured Acct	JPM B-D Wire Acct	
	$19		JPM B-D Wire Acct	
26-Oct	$125	JPM Foreign Secured Trust Acct	Treasury House Acct	BNYM Clearing Acct
	$75	JPM Foreieng Secured Trust Acct	Treasury House Acct	JPM Clearing Acct
	$200	JPM Customer Trust Acct	Treasury House Acct	BNYM DTC Acct
	$50	JPM Customer Trust Acct	Treasury House Acct	JPM Clearing Acct
	$165	JPM Customer Segregated Acct	JPM Clearing Acct	
	$325	BNYM Clearing Acct	ad hoc "Customer CFTC 1.25" Acct	
	$74	JPM Foreign Secured Acct.	JPM B-D Wire Acct	
27-Oct	$325	ad hoc "CFTC 1.25" Acct	BNYM XGX Acct	
	$200	JPM Customer Segregated Acct	Treasury House Acct	BNYM XGX Acct
	$540	BNYM XGX Acct	Treasury House Acct	
	$123.20	JPM Foreign Secured Acct	JPM B-D Wire Acct	
28-Oct	$200	JPM Customer Segregated Acct	Treasury House Acct	
	$175	Treasury House Acct	MFGUK Acct	JPM London*
	$69.50	*FCM*	*O's in NY*	
	$163.80	JPM Foreign Secured Acct	JPM B-D Wire Acct	

* The infamous $175 million transfer per Corzine's instructions to O'Brien.

Appendix 2: Mechanics of a "Repo to Maturity"

Suppose MF Global has $2,000,000 in cash (customer margin deposits, earnings from operations, etc.) that it needs to invest. It purchases $1,000,000 of Italian bonds with a coupon rate of 5% per annum, to mature in 5 yrs, currently trading at $1,100,000 (so a discount of about 12% from book value, which is $1,250,000). So a very, very crude MF Global balance sheet will change *from this*:

Assets		**Liabilities**	
Cash	$2,000,000		$0
Sec's	$0		
		Equity	
			$2,000,000

to this:

Assets		**Liabilities**	
Cash	$900,000		$0
Sec's	$1,100,000		
		Equity	
			$2,000,000

MF Global then uses the bonds in a repo to maturity with Counterparty Bank, according to the following terms: Counterparty Bank will pay MF Global $1,050,000 (the discount of $50,000 being a "haircut" designed to offer the counterparty more security) and hold the bonds to maturity. At maturity (or two days before, technically), Counterparty Bank will remit the $250,000 less a $50,000 interest payment back to MF Global. Note that MF Global will book the $200,000 as profit *up front* and account for it as a "Gain on Sale of Securities," not at maturity when it receives the cash, but at the commencement of the trade. So our very, very crude MF Global balance sheet will finally look like this:

Assets		**Liabilities**	
Cash	$1,950,000	Interest	$50,000
Sec's	$0		
"Gain"	$250,000		
		Equity	
			$2,150,000

Appendix 3 – Frequently Used Acronyms

CBOE: Chicago Board Options Exchange.

CFTC: Commodity Futures Trading Commission

CME Group: A corporation formed by the merger of CME – the Chicago Merchants Exchange – and somebody else.

FCM: Futures Commission Merchant

FINRA: Financial Industry Regulatory Authority

MFGI: MF Global, Inc., the U.S. based subsidiary of MF Global Holdings, Ltd.

MFGUK: MF Global's subsidiary in the United Kingdom.

NFA: National Futures Association

SRO: Self-regulatory organization, an organization entrusted with policing its members and ensuring their compliance with SEC and CFTC regulations.

SEC: Securities & Exchange Commission

RTM: "Repo to Maturity"