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Settling MF Global Claims: Who Gets What and Why?

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On January 31, the bankruptcy court overseeing the MF Global liquidation approved a plan that will bring this case much closer to resolution. Following its collapse in October 2011, over 27,000 commodity customer claims totaling $10 billion and more than 1,000 securities customer claims totaling $1.4 billion were filed against MF Global Inc. These claims consisted of cash and other assets held in margin accounts, physical commodities held for delivery against futures positions, and investments held in brokerage accounts, all of which became unavailable when the company closed its doors.

Further complicating matters was the fact that there was not just one, but several different MF Global bankruptcies. The one of most interest to farmdoc Daily readers is MF Global Inc. (MFGI), which included the US commodity and securities brokerage operations. The responsibility of the MFGI bankruptcy trustee has been to recover as much as possible for the commodity and securities customers, because these assets belonged to the customers, not MF Global. For this reason the bankruptcy laws give special treatment to these customer-owned assets, and a number of legal experts claim that no one else – including general creditors – should receive anything until these customer claims are satisfied.

However, there also was a bankruptcy filing by MF Global Holdings (Holdings). The responsibility of the Holdings bankruptcy trustee has been to recover as much as possible for the general creditors, who range from office supply vendors to holders of MF Global corporate debt. Many of these general creditors viewed the assets held in commodity and securities accounts as belonging to the parent company, not the individual account holders, and saw no reason why MGGI account holders should be allowed to go to the front of the line.

A third bankruptcy filing was made by MF Global UK Ltd. (MFGUK), which included MF Global's London-based operations. In MF Global's final days, money was shuttled back and forth between the US and London in a failed attempt to prevent the company's collapse. Some of these funds were stranded in London when MF Global folded, at which point they became subject to the bankruptcy laws of England, not the US.

For the past 15 months these three groups have been engaged in a tug-of-war over who is entitled to what, including a number of lawsuits and counter-suits. One unfortunate result of these legal battles was that each side needed to hold back a reserve of funds, rather than distribute those funds to claimants. In December the two US trustees finally settled their differences, largely in favor of the customers, and together reached an agreement with the MFGUK administrators in January. A distribution plan was filed with the court on February 4, and the following details are drawn from court documents filed by the MFGI trustee.

Claims for the commodities and securities customers were divided into several classes, with each customer within a particular class expected to receive a percentage of its “determined,” or trustee-approved, claim:

- Owners of physical commodities held for delivery against futures positions were put into a special class of bankruptcy claims and have already been paid 100% of their claims.
- Securities customers are expected to receive 100% of their claims. In fact, most individual securities investors were already covered by the Security Investors Protection Corporation (SIPC), a fund that covers losses in the event that a brokerage firm fails and customer cash and/or securities are missing.
- Owners of 4d property – named after the section of the Commodity Exchange Act covering segregated customer funds, and consisting of customers holding futures and options traded on US exchanges – are expected to receive 93% of their claims.
- Owners of 30.7 property – named after the section of the CFTC regulations that requires futures and options traded on foreign exchanges to be kept separate, and consisting of customers holding futures and options traded on foreign exchanges – are expected to receive 54% now, and perhaps as much as 82% eventually as additional property is recovered

For MF Global’s former US futures and options customers, 93 cents on the dollar is much better than the 72 cents that they received at the outset. But it is still less than the full 100 cents that they felt they deserved. For decades, futures/options traders have been assured that they would be fully protected in the event of a brokerage firm default, but these assurances proved to be false. And while a loss of 7 cents on the dollar may not sound like much, it means that customers as a group lost more than $52 million on the approximately $750 million in 4d property.

In contrast, stock/bond customers will recover everything they lost, with the losses covered by SIPC. This has prompted interest in creating a SIPC-like fund for futures/options customers. SIPC was created by Congress in 1970 in response to a rash of financial problems in the securities industry. It currently has a $1 billion reserve fund, which has accumulated over the years from assessments on brokerage firms. The standard assessment is ¼ of 1% per year of each brokerage firm’s net operating revenues from the securities business, but the actual rate may vary depending on the level of reserves held by SIPC at the time.

Since it was founded, SIPC has paid out more than $1.8 billion to over 767,000 investors. In the event of a brokerage firm failure, the firm’s assets are distributed to customers on a pro-rata basis. Then any shortfall is made up by SIPC, up to a maximum of $500,000 per customer, including up to $250,000 of cash. However, it is important to note that SIPC does not pay anything in cases of fraud. Therefore, while such a SIPC-like fund for futures/options customers would have been useful in the MF Global situation, customers of Peregrine Financial/PFG Best would have been left empty-handed.

Futures and options volume at US exchanges fell by 13.2% in 2012, and many observers believe that in part this decline is due to a loss of customer confidence in the integrity of these markets. While an industry-wide reserve fund is just one of several ideas under consideration, futures and options customers may remain cautious until some type of program is in place that fully protects their funds against these and other types of non-market losses.