MF Global 'Debacle' Continues To Rattle Confidence In The Marketing Chain

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Even if you were lucky enough to avoid losing money in the MF Global "debacle," you will still likely be impacted by the fallout. That's because the case, with $1.2 billion in customer funds still missing after the firm declared bankruptcy, is shaking up the way producers, lenders and the futures industry have traditionally looked at managing volatility and price risk.

"If the regional banks and the Farm Credit System lose confidence in the marketing system and view those hedge accounts as having risk from unauthorized use, then the whole marketing chain is in trouble," emphasizes Kansas State Agricultural Economist Art Barnaby.

"Elevators need margin money to manage the price risk for stored grain. If the collateral and interest rates increase to cover the perceived risk in margin accounts, then elevators (grain buyers) will need to widen their margins. Bottom line, higher marketing risk means lower cash bids than otherwise would be the case. Farmers who have never used futures will be affected in the cash market if this problem is not fixed," Barnaby adds.

For now, most of the focus is still on recovering the missing funds and figuring out who knew what and when. It's a process expected to take several more months, if not years.

During a number of December congressional hearings, former MF Global CEO Jon Corzine said he did not know anything about the movement of customer funds that were supposedly segregated.

"I never intended to break any rules," he said in response to questions from House Agriculture Committee Chairman Frank Lucas, R-Okla. "I am not in a position, given the number of transactions, to know anything specifically about the movement of any specific funds. I can only say I know I had no intention to ever authorize the transfer of segregate moneys."

Corzine departed MF Global on Nov. 3 after the firm declared bankruptcy on Oct. 31. He told the Committee he did not become aware of un-reconciled customer accounts until the evening of Oct. 30.

But in a separate hearing, CME Group Executive Chairman Terrence Duffy delivered a much different story. Testifying before the Senate Agriculture Committee a week after Corzine's original testimony, Duffy said Corzine knew the firm used customer funds for MF Global to make a loan before its collapse.

He told committee member that, according to a senior MF Global employee, Corzine was aware of loans being made from segregated customer accounts to MF Global affiliates, specifically a $175 million loan made to a European affiliate of MF Global. Duffy said he would provide the name of that MF Global employee to the Committee, but declined to do so publicly. Duffy said he received this news last Saturday, after the House Committee on Agriculture held its investigative hearing.

"It strikes me as a bombshell," said Senator Charles Grassley, R-Iowa. "Because just minutes before, Mr. Corzine continued to express his lack of understanding of how MF Global lost up to $1.2 billion in customer funds."

Duffy also testified, as he did during the House Agriculture Committee hearing, that MF Global informed the CFTC and CME on Monday, Oct. 31, that customer money had been transferred out of segregation to firm accounts.

"Transfers of customer funds for the benefit of MF Global constitute very serious obligations of our rules," he added. "Somebody went in, violated the rule of CME and transferred customer money into the broker-dealer account. I was told there was $950 million moved from segregated customer accounts to the broker-dealer."

New rules needed?

In the wake of the MF Global losses, several lawmakers have called for increased federal regulations and for the CME Group to rethink their traditional models.

Sen. Tom Harkin, D-Iowa, noted that, between 2000 and 2005, the rule regulating the use of customer accounts expanded, allowing firms to use funds to invest in securities other than treasury and municipal obligations.

"Welcome to the world of deregulation," Harkin said, suggesting that the period of relaxed rules may have led to the current problem. The Commodity Futures Trading Commisssion (CFTC) recently voted to approve a rule that limits more of these exemptions.

However, American Farm Bureau Federation (AFBF) President Bob Stallman says it's too soon to jump to conclusions, such as the need for new regulations.

"Any of us that have been involved in the commodity markets have always expected our margin funds to be segregated," he said. "The first thing we have to determine with MF Global is what happened? Were there laws violated?"

If any people broke the law, those individuals need to be prosecuted, Stallman said. If it is also determined that a lack of sufficient oversight existed, then the next step is to look at provisions that maintain the sanctity of customer funds.

"If the entire futures markets are going to operate for agriculture, we need to have confidence in the way they operate," he said. "I don't want to start talking about knee-jerk reactions until we fully understand what happened with MF Global."

MF Global's lost accounts translated into a massive loss of confidence in the futures market and the ability for producers to hedge their losses. Lack of confidence in the timing to sell commodities means lower prices for farmers and higher prices for consumers, testified Advanced Trading Inc. president Jeffrey Hainline.

But even if additional restrictions on financial instruments or accounting or other operational measures are proposed, Hainline encouraged members of the Senate Agriculture Committee to not forget a few things:

• "That Clearing Members also have their capital pledged to their segregated customer funds against the single greatest threat they themselves face, which is that their customers defraud or go bankrupt on them. This has occurred with relative frequency, and because the capital of the Clearing Member itself was required to be paid into its customers' seg funds, the other customers were made whole with little if any delay.

• "That new financial techniques will arise thereafter, accounting-rules ambiguity will always foster different opinions, and financial executives will always take innovative steps to maximize returns.

• "So establishing rules that would have precluded the last problem will not necessarily preclude the next, and may in haste tend toward overkill to assuage those angry at being damaged," he added.

Still searching

As the investigation continues, people across the countryside are still looking for their missing funds and rethinking whether or not they will use the futures market in the future.

C. J. Blew, director of the Mid Kansas Cooperative Association, told members of the Senate Agriculture Committee that MKC is still missing 64% of the association's margin funds and excess cash since the collapse of MF Global.

Immediately following MF Global's bankruptcy, MKC and its respective grain marketing arm, Team Marketing Alliance, struggled with lack of access to futures positions and had no access to the funds in their accounts. Their accounts were eventually transferred to a new futures commission merchant (FCM).

"We have spent countless hours trying to understand how and why various adjustments to account balances took place," Blew said. "While we now have access to positions in our hedge accounts, only 36 percent of the initial margin funds needed for the transferred positions have been transferred to the new accounts." He added that the MF Global bankruptcy impacted the cooperative's borrowing base, since missing funds cannot be used as collateral.

Roger Hupfer, a grain elevator operator in Michigan, testified that his customers place confidence and trust in their operation when delivering their commodities to the grain elevator and he's not sure how that confidence can be restored.

"They expect us to provide and maintain competitive, perpetual marketing programs to assist them with their risk management," he said. "How will we be able to effectively manage the increased volatility and price risk, and place our hedges with confidence if the very integrity of exchange-based futures trading is in jeopardy?" Δ

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