

Securities Regulation Daily Wrap Up, TOP STORY—S.D.N.Y.: Corzine charged over MF Global collapse; firm will pay \$1 billion in restitution settlement, (Jun. 27, 2013)

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By Amanda Maine, J.D.

The CFTC charged MF Global, its former CEO Jon Corzine, and its former assistant treasurer Edith O'Brien with the misuse of customer funds that eventually led to the collapse of MF Global. The CFTC's complaint alleged that due to MF Global's investments in risky instruments such as European sovereign debt, MF Global's capital and liquidity became increasingly strained and that to support its own operations, MF Global unlawfully used nearly \$1 billion of customer segregated funds (*CFTC v. MF Global Inc.*, June 27, 2013)

Risky investments. Corzine, a former U.S. senator and governor of New Jersey, joined MF Global as CEO in March 2010 and planned to change the firm from a commodity brokerage firm into a global investment bank that generated substantial revenue from proprietary trading activities. One of his strategies was the investment in European sovereign bonds through repurchase-to-maturity transactions (RTMs) where an MF Global affiliate borrowed money to pay for the bond, simultaneously pledged the bond as collateral on that loan, and was obligated to pay back the loan when the bond eventually matured. However, if a European nation defaulted prior to the maturity of the bond, MF Global could be left with a virtually worthless bond but still be required to pay back the entire amount of the loan.

Liquidity stresses. Corzine directed MF Global's CFO to explore all potential sources of funds and assets that could be used to meet the company's liquidity needs for its proprietary trading. The firm adopted the CFO's recommendation, which was a conservative approach that required that available FCM cash be maintained at a positive balance. Both Corzine and O'Brien were aware of this policy, but engaged in several activities that went against it, according to the CFTC's complaint. Faced with increasing liquidity demands, MF Global on several occasions violated its own policy with regard to using funds from customer accounts, the CFTC alleged. The complaint described several instances in which either Corzine or O'Brien, or both, had been made aware of these practices and did not take steps to ensure that the firm's daily draws of cash from the customer accounts did not result in the unlawful use of customer funds.

Use of customer funds. CFTC rules require that futures trading merchants (FCMs) account separately for and segregate customer funds at all times. In addition, an FCM must at all times have enough funds in customer segregated accounts to satisfy its financial obligations to its customers. Following a negative earnings report and a credit rating agency downgrade, MF Global continued to experience liquidity stresses as customers demanded return of funds, counterparties increased margin calls on MF Global's RTMs, and counterparties unwound transactions with MF Global, requiring it to use cash for settlement.

According to the CFTC's complaint, O'Brien and her staff directed, approved, and/or caused transfers totaling more than the excess funds from MF Global's segregated accounts to its proprietary accounts to help meet its liquidity needs. The CFTC also alleged that Corzine was made aware of the firm's liquidity issues and knew that the firm lacked the cash to satisfy its obligations. The complaint describes emails, meetings, and telephone calls that indicated Corzine's knowledge of the situation.

Failure to report deficiencies and use of customer funds for overdrafts. Although required to report to the CFTC the deficiencies in customer segregated accounts, MF Global did not do so, even when it was under-segregated by approximately \$900 million, according to the CFTC's complaint. In addition, facing overdrafts in MF Global's account with JPMorgan Chase Bank, Corzine instructed O'Brien to transfer funds to pay for the overdrafts without inquiring where the money would come from, even though he knew about MF Global's extremely limited sources of cash, the CFTC alleged. Corzine allegedly did not take any further steps to investigate whether customer funds had been used to satisfy the overdrafts. The CFTC also indicated that

O'Brien knew that the transfers were unlawful, describing a recorded telephone conversation in which O'Brien said, "I don't care where you get it, quite frankly" in regards to the deficiencies.

Charges and relief sought. The CFTC charged MF Global, Corzine, and O'Brien with the failure to segregate and the misuse of customer funds. MF Global was charged with failure to report under-segregation and the submission of false reports to the CFTC. In addition, the CFTC charged MF Global and Corzine with violations of its rules requiring the diligent supervision and handling of accounts.

The MF Global trustee agreed to settle the charges against the company. Under the agreement, which must be court-approved before it is final, MF Global will pay nearly \$1 billion in restitution to its customers, as well as a \$100 million monetary penalty. The CFTC is also seeking full restitution and penalties against Corzine, O'Brien, and MF Global Holdings, Ltd., MF Global's parent company. In addition, the CFTC is seeking trading and registration bans and injunctions against Corzine and O'Brien.

Attorneys: Steven Ringer for the U.S. Commodity Futures Trading Commission.

Companies: MF Global, Inc. MF Global Holdings Ltd.

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