

# \$34m investor funds in limbo

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It was the business model adopted by Tricom, Opes Prime, Sonray, Chartwell and other sensational collapses or near collapses. *Photo: Stephen Yang*

MORE than six weeks after the spectacular worldwide collapse of MF Global, the \$313 million pot of Australian client money remains frozen in hope of a full recovery as the liquidators, lawyers and regulators try to unravel some poor regulatory decisions made worse by the complex derivative trading, counter-party risk and the pooling of client money.

Australia's situation is in embarrassingly sharp contrast to several other countries, including Canada, that have been able to speedily repay client money.

Part of the problem is caused by shortcomings in the regulatory and legislative framework, as well as a decision taken to grant MF Global an exemption so that it could use its British business as the market participant in Australia rather than its Australian business.

This decision has left \$34 million of Australian client money in limbo as a legal minefield is set to erupt between the British administrators, expected to argue that the funds technically belong to MF Global UK, while the Australian administrator Deloitte believes they belong to Australian clients.

Until the turf war is sorted out, the ASX has refused to hand over the money.

Put simply, clients are owed \$313 million, there is \$232 million in the bank, leaving more than \$80 million outstanding, which is owed by various counter-parties including \$10 million in MF Singapore, \$13 million in contracts for difference (CFDs), \$5 million in margin foreign exchange and \$5 million in online FX.

Given the complex situation, coupled with the exemption that ASIC gave to MF Global in Australia, administrator Deloitte and law firm Blake Waldron will have to go to court next year to sort out the mess and work out and get a ruling on how exactly to calculate and return funds.

MF Global collapsed on October 31 after it was forced to reveal that it had made a \$US6.3 billion bet on European sovereign debt.

Some of the \$US1.2 billion in client money is believed to have been lent to its European affiliate to stave off insolvency.

And herein lies the problem.

Derivatives such as CFDs mostly trade in the murky and largely unregulated over-the-counter market that allows organisations such as MF Global to take client money and pool it into one big account.

It is a business model that results in the client becoming an unsecured creditor if the company collapses.

In some cases, these businesses use pooled client funds to meet their daily business obligations in connection with margining, guarantee securing, transferring, adjusting or settling dealings in derivatives.

It was the business model adopted by Tricom, Opes Prime, Sonray, Chartwell and other sensational collapses or near collapses over the years.

According to latest Australian Financial Markets Association data, the over-the-counter market turned over \$78.1 trillion in the year to June compared with \$49.7 trillion for the total exchange-traded markets, which includes the ASX and the Sydney Futures Exchange.

It is in this over-the-counter market that most contracts for difference are traded, which is one of the key product offerings of MF Global.

What happened at MF Global could happen again and again until regulators and the government address the issue.

I have been highlighting the risks associated with the pooling of client funds since early 2008 when Tricom almost collapsed, followed by that of Opes Prime. Two years later on July 13, 2010, when ASIC came out guns blazing with a regulatory guide relating to OTC derivatives, I pointed out that in the guide ASIC had failed to deal with the riskiest aspect of these products: that a client's money is pooled into one account, that the money can be used for purposes unrelated to that client and if the company goes under the client becomes an unsecured creditor.

The collapse of MF Global has finally prompted the government to at least acknowledge the issue with the release of a consultation paper on client money.

It has set a deadline of January 27 for submissions, which is a period when most people will be away on holiday.

The risks of operating in the OTC market are made worse because Australia doesn't have a compensation fund when things go bad. Canada has the Canadian Investor Protection Fund, which has come to the rescue.

The futures exchange CME Group in the US has guaranteed \$550 million to the bankruptcy trustee of MF Global to increase the payout percentage from 60 to 75 per cent. In Britain clients will be paid compensation of up to £50,000 (\$A77,800) per customer and administrators have asked customers to make formal claims immediately and will make an interim payment within 14 days of approval, with the aim of completing the process by the next March.

In Australia it is understood that no client funds will be returned before April 2012, at the earliest. Customers are yet to be provided their client balance or indication of how much is likely to be returned. Indeed, a court will have to decide this.

It is a situation that is becoming explosive as some clients get perilously close to collapse the longer it takes to access their funds.

The lawyers and administrators are doing everything they can to speed up the process but the longer it takes, the more money they charge and the less clients get back. Let's hope this finally gets the government off its backside to make some well-needed changes, including the introduction of a compensation fund.

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