

MF Global and the New UK Special Administration Regime

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The MF Global UK Limited (MFG UK) case is the first opportunity for market participants to observe the impact of the UK's new Special Administration Regime (the SAR) for failed investment banks.

Background

The SAR is Britain's response to perceived defects — highlighted by the collapse of Lehman Brothers — in the UK insolvency regime, including the delay in the return of assets to clients. Under the SAR, the appointed insolvency administrator has three objectives:

1. to ensure the return of client assets as soon as is reasonably practicable;
2. to ensure timely engagement with market infrastructure bodies, The Bank of England, Her Majesty's Treasury and the UK Financial Services Authority; and
3. to rescue the investment bank as a going concern or to wind it up in the best interests of the creditors.

Under the new regime, the administrator also can set a bar date for claims to client assets (other than client money) held by the investment bank to expedite the process.

MF Global UK Limited

In the case of MFG UK, a bar date of February 29, 2012, was set, and a client asset distribution plan is due to be presented to the High Court in the coming weeks. An interim dividend of 26 percent has been declared, and approximately 250 clients have received some compensation under the UK Financial Services Compensation Scheme.

However, a number of creditors and clients have complained about the apparent lack of progress in comparison to the size and total amount of distributions made in the U.S. by the Securities Investor Protection Act trustee of MF Global Inc. While SAR is designed to minimize disruption and expedite the return of assets, general and case-specific factors inevitably will cause delay.

General Factors

Timing. Investment banks are complex and broad-ranging in their operations and systems. As seen with MF Global, an investment bank can collapse swiftly. Administrators in the MFG UK case had little time to understand the scope of the bank's business before they were appointed.

Investor Protections. In the U.S., the Securities Investor Protection Corporation typically arranges the transfer of a failed brokerage firm's accounts to a different securities brokerage firm to facilitate the return of client assets as quickly as possible. The UK has no industry-funded pool designed to compensate investors before the extent of any shortfalls have been established.

Court Implementation. The SAR contemplates the involvement of the High Court at various stages of the special administration; its role includes approving the client asset distribution plan. Creating and implementing a distribution plan through the court with the prospect of active client participation is not something that realistically can be achieved in a short time.

Liability. Administrators also will be conscious of the fact that they may be held personally liable if they fail to fulfill their responsibilities with due care.

Case-Specific Factors

The Lehman Brothers Client Money Litigation. On the same day the MFG UK administrators set their bar date, the UK Supreme Court issued its judgment on the client money issues that arose during the administration of Lehman Brothers International (Europe).¹ The decision held that any client whose money should have been segregated has a client money claim — even if their money was not in fact segregated — and that a factual inquiry needs to be undertaken to try to trace nonsegregated client monies into other accounts. This process may well be tortuous, time-consuming and costly in practice, and likely will require further applications to the court for directions.

Eurozone Sovereign Bonds. The UK and U.S. MF Global estates are in dispute over the eurozone sovereign bond positions, which played a central role in the final days of the bank. The administrators have stated that this dispute is the largest single variable affecting returns to creditors in the UK. This claim for \$639 million has recently been scheduled for trial in London in April 2013.

Looking Ahead

Regulators and legislators should strive for structural improvements to the processes applicable to failed banks. However, the appointed administrators and other professionals involved on the ground have to work within the context of the situation. How the MFG UK case is handled — and whether the administrators can meet the objectives of the SAR successfully — will determine whether the new regime can address the demands of future crises triggered by failed financial institutions in the eurozone or beyond.

¹ See “UK’s Supreme Court Issues Judgment on Lehman Brothers Client Money Litigation,” Skadden, Arps, Slate, Meagher & Flom LLP, March 13, 2012, available at <http://www.skadden.com/Index.cfm?contentID=51&itemID=2697>.