

Clients & Friends Memo

MF Global UK Enters Special Administration Regime

3 November 2011

MF Global UK Limited In Special Administration

The Financial Services Authority (“FSA”) has confirmed that MF Global UK Limited (“MF Global UK”) has entered the Special Administration Regime created under the Investment Bank Special Administration Regulations 2011 (“Regulations”).¹ MF Global UK is the first investment bank to enter the Special Administration Regime. The decision to apply for special administration was initiated by the board of MF Global UK.

Richard Fleming, Richard Heis and Mike Pink of KPMG have been appointed as joint special administrators. The special administrators have also been appointed as joint administrators (i.e., ordinary administrators under the Insolvency Act 1986) of MF Global UK Services Ltd., which provides employee and pension services in relation to the UK operations of MF Global.

What Does the Special Administration Regime Do?

Following the collapse of Lehman Brothers, the unanticipated complexities of resolving a failed investment bank in the UK became apparent, and the Regulations are a direct response to those issues.

The Regulations came into effect in February 2011 and set three objectives for a special administrator:

- Objective 1 - to ensure the return of client assets as soon as is reasonably practicable;
- Objective 2 - to ensure timely engagement with market infrastructure bodies and the authorities; and

¹ The Regulations were in turn created under the Banking Act 2009 (“Banking Act”) as insolvency provisions intended to apply specifically to failing investment banks. The Regulations can be found here: http://www.legislation.gov.uk/ukxi/2011/245/pdfs/ukxi_20110245_en.pdf

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- Objective 3 - either to rescue the firm as a going concern or wind it up in the best interests of the creditors.

In an “ordinary” corporate administration proceeding conducted under the Insolvency Act 1986 (“**Insolvency Act**”), only the third objective would apply.

The special administrator is required to commence work on each objective immediately after appointment and has the ability to prioritise the order of work on each of the objectives as it considers fit in order to achieve the best result overall for clients and creditors. However, the FSA (in consultation with Treasury and the Bank of England (“**BoE**”)) may direct the special administrator to prioritise any of the objectives if such a direction is necessary having regard to the public interest in (i) the stability of the financial systems in the UK; or (ii) the maintenance of public confidence in the stability of the financial markets in the UK. The test of necessity has a high threshold in similar contexts under the Banking Act, and it is questionable whether MF Global UK’s failure alone would constitute a threat to UK financial systems, or public confidence in the markets.

The Return of Client Assets

Of most interest to affected clients and some counterparties will be the return of client assets. There are two key Regulations concerning this process:

1. Regulation 11 gives the special administrator the power to set a **bar date** for the submission of claims over the client assets held by the investment bank, and provides for the treatment of claims after the bar date and after a distribution of assets has taken place. Where a late claim is received in respect of client assets already returned, there can be no “disruption” in respect of those assets returned and the person to whom the assets are returned acquires good title to them as against the late claiming claimant. Note that this Regulation 11 applies to “client assets” but not to “client money”, the treatment of which is subject to separate FSA rules.

In setting the bar date, the special administrator must allow a reasonable time after notice of the special administration has been published for persons to be able to submit their claims. Notice of the bar date is required to be given by the special administrator to all clients of whose claim the special administrator is aware and to all persons whom the special administrator believes have a right to assert a security interest over the client assets. There are also requirements for advertising (where thought fit) and gazetting the bar date. No client assets are to be returned after the bar date has been set without the approval of the court.

2. Regulation 12 prescribes how the administrator is to deal with a **shortfall in client assets** held by the investment bank in a client omnibus account. In the event of a shortfall, the special administrator shall ensure that it is borne pro-rata by all clients for

whom the investment bank holds securities of that particular description in the same account in proportion to their beneficial interest in those securities.

“Timely Engagement”

In respect of the second objective (ensuring timely engagement with market infrastructure bodies and the authorities), Regulation 13 sets out details surrounding the requirements of the special administrator to work with market infrastructure bodies to facilitate the operation of default rules and arrangements and to facilitate the settlement of trades. Regulation 13 also sets out requirements for the special administrator to work with the relevant authorities (FSA, BoE and Treasury) to facilitate actions such authorities propose to take to minimise the disruption of businesses and the markets as a consequence of a special administration order having been made.

The Role of Creditors and Clients

The special administrator is required to pursue the special administration objectives in accordance with a statement of proposals approved by a meeting of creditors and clients. The Regulations make it clear that, aside from the differing objectives of special administration as described above, the special administration procedure is substantively the same as that set out for an “ordinary” administration under Schedule B1 of the Insolvency Act (subject to specific modifications, and the inclusion of certain liquidation provisions of the Insolvency Act).

Complementary Insolvency Rules

In addition to the Regulations, specific insolvency rules (the Investment Bank Special Administration (England and Wales) Rules 2011 (the “**Rules**”)²) have been created for the Special Administration Regime under section 411 of the Insolvency Act. The Rules set out the procedural requirements that the special administrator has to follow in order to comply with the Regulations, including:

- clients must be present at the meeting of creditors;
- clients must be represented on the creditors committee; and
- costs of returning client assets will be paid out of client assets.

The Rules also detail the bar date process.

² The Rules can be found here: http://www.legislation.gov.uk/uksi/2011/1301/pdfs/uksi_20111301_en.pdf

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