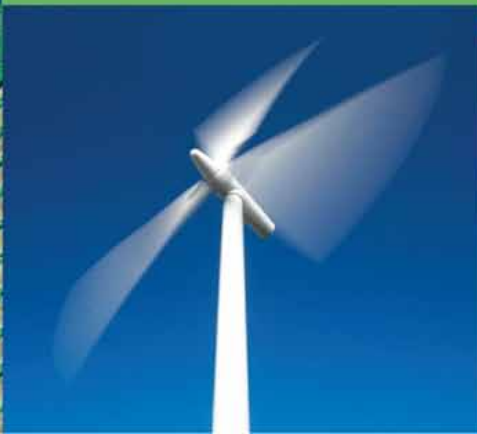


MF Global and Risk Management: A Lender's Perspective

National Grain and Feed Association
Annual Convention 2012

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CoBank Is Interested Because.....



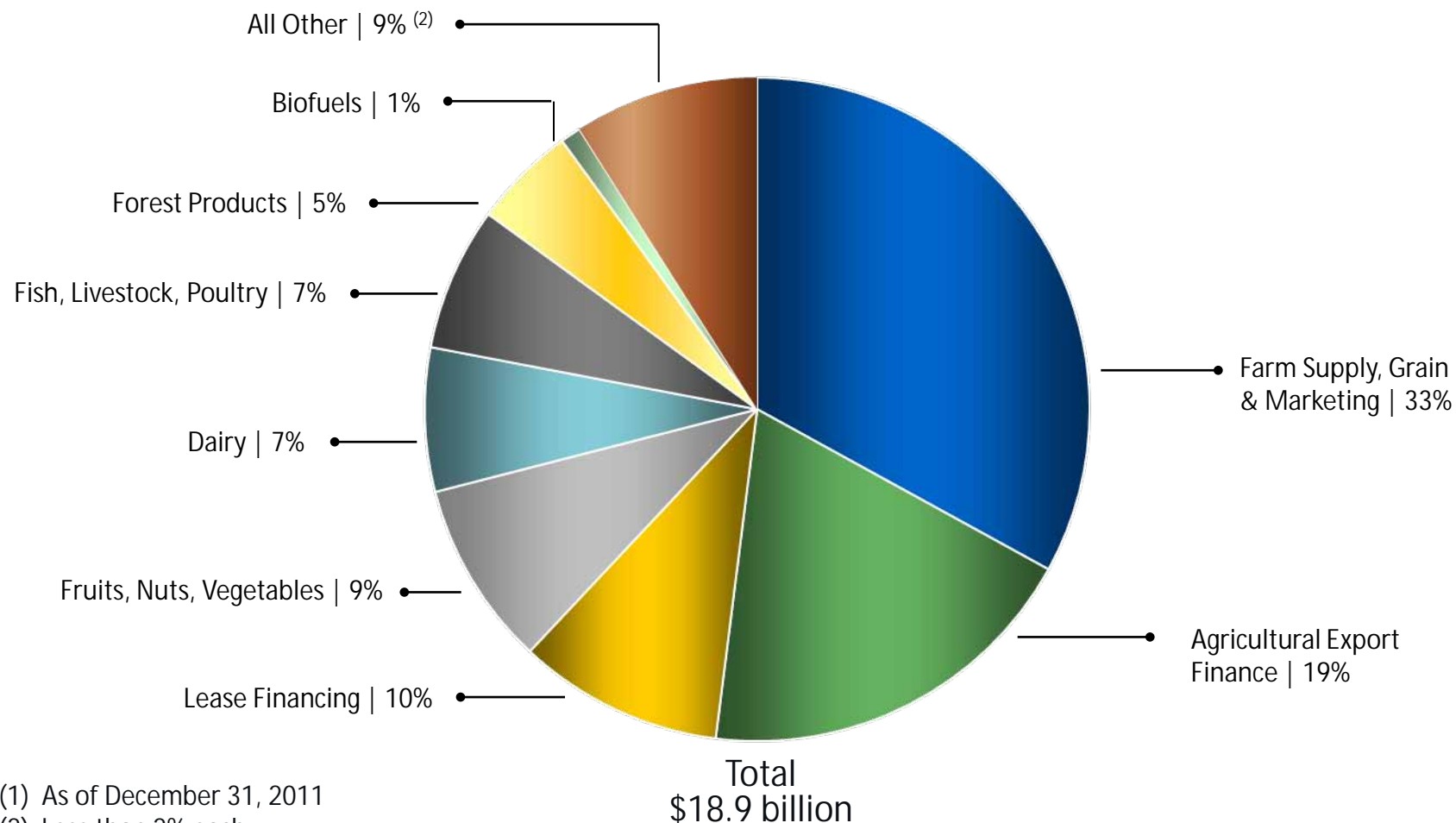
- ∅ CoBank is one of the largest grain and farm supply lenders in the country at retail, and is the wholesale lender to farm credit associations that lend directly to farmers and ranchers in 23 states
- ∅ CoBank lends directly against hedged grain assets as part of a borrowing base formula
- ∅ CoBank had more than 100 customers that were impacted by the MF Global filing, but have hundreds more with hedging relationships with other commodity broker / dealers



CoBank Retail Agribusiness Loans



Agribusiness Lending Portfolio ⁽¹⁾



(1) As of December 31, 2011

(2) Less than 2% each



- ∅ MF Global, the parent of the country's eighth largest futures broker, filed for bankruptcy protection on October 31, 2011
- ∅ As of August 2011, MF Global held more than \$7.0B in customer funds
- ∅ Post-filing, it was revealed that customer funds were missing
- ∅ Roughly \$1.6B of those funds remain unaccounted for at present, creating losses for merchandisers, farmers and ranchers, as well as other hedgers, funds and traders



- ∅ MF Global's roots can be traced to a sugar trading business founded in England in 1783
- ∅ It's former parent, E D & F Man moved from cash trading to commodity futures in the 1970s
- ∅ It remained part of the E D & F Man family of companies, (ultimately Man Financial) until 2007





- ∅ Man Financial became a global broker of exchange traded derivatives such as futures and options, as well as OTC products, and was a primary dealer in U.S. Treasuries
- ∅ In October 2005, Man Financial acquired the brokerage assets of failing Refco, then the largest broker on the CME. Refco's failure was the result of an accounting scandal involving the CEO





- ∅ Man Financial split its investment and brokerage businesses in an IPO in 2007 and the brokerage segment was renamed MF Global
- ∅ In 2008, MF Global loses \$141.5MM in unauthorized wheat trades executed by a rogue trader
- ∅ Recapitalized with an investment by JC Flowers, which gained 2 board seats as a result. J. Christopher Flowers was a Goldman colleague of Jon Corzine

Some History (cont.)



- ∅ Jon Corzine is named Chairman and CEO in March 2010 and in 2011 announces a plan to evolve MF Global into an investment bank over a 5 year horizon
- ∅ Regulators order MF Global to boost net capital in August 2011, in response to concerns over European debt positions
- ∅ Moody's downgrades MF Global debt rating on 10/24/11





- ∅ On 10/25/11, MF Global reports a significantly wider loss than anticipated for the quarter ended 9/30/11, generating a 48% decline in the value of the company's stock
- ∅ MF Global parent files for bankruptcy on 10/31/11, after failing to arrange a last minute sale of the futures business
- ∅ Disclosure of missing customer funds





- ∅ Counterparty credit risk is a term to describe the risk that the other party to an agreement will not live up to its obligation, or will otherwise default
- ∅ The collapse of Lehman Brothers brought the issue of counterparty risk into the spotlight with its filing in 2008, but it resurfaced in the commodity arena with the filing at MF Global



Why Lenders Are Watching



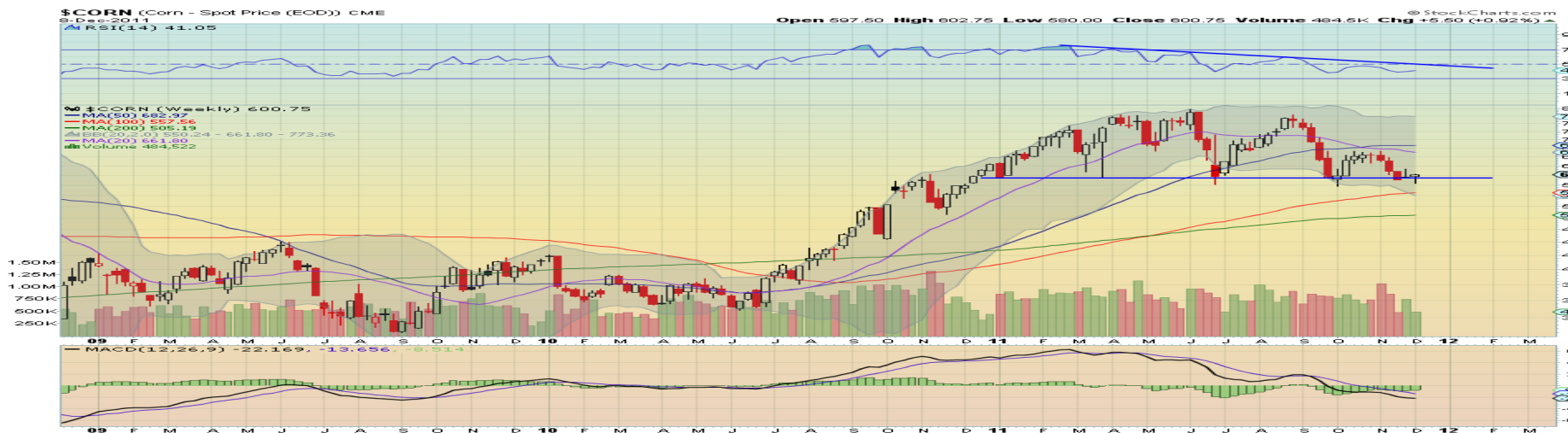
- ∅ Financial losses of borrowers obviously an important consideration
- ∅ Risk management practices are a key risk mitigant and strong contributing factor to borrower success
- ∅ Brokerage accounts and hedge positions on inventories are an important piece of the bank's collateral position



Why Lenders Are Watching (cont.)



- ∅ Borrowers shying away from risk management products creates MORE risk for borrowers and lenders
- ∅ Timing - Markets were relatively flat in October 2011. Results could have been catastrophic during a price run-up
- ∅ Increased market volatility equals greater price risk



How Have Lenders Responded?



- ∅ Anecdotal evidence suggests possible tightening of parameters at community banks
- ∅ Lenders are more interested in risk management generally, and in borrower assessment of counterparty risk in all phases of operations
- ∅ Greater due diligence and more questions





∅ At CoBank

- § No changes to credit policies
- § Some changes to procedures in settlement process to protect customers
- § Making the margin call matters





∅ More Due Diligence on Counterparties - Know your Counterparty!

§ General

- How long have they been in business
- History
- Management
- Business philosophy
- How are segregated funds invested

§ Financial

- Earnings, leverage and capital
- Ongoing financial analysis difficult based on the nature of the business

§ Regulatory

- History of violations by firm and individual available on NFA website at www.nfa.futures.org





- ∅ Diversification of risk - Using multiple sources for hedging accounts limits the impact of a single counterparty default
- ∅ Account awareness - Avoid leaving significant excess balances in uninsured brokerage accounts. Know and understand daily trading and settlements
- ∅ Current event awareness - Rating agency downgrades, credit default swap spreads, and even the rumor mill





∅ Other

- § Funds and financial investors employing use of “Amber” provisions in brokerage agreements, which require action if predetermined thresholds are reached
- § Hedged positions such as credit default swaps (substitutes one kind of counterparty risk for another)





- ∅ Counterparty risk increasingly important to most in a post crisis world, and is critical for grain merchandisers
- ∅ Increased awareness and proactive responses are the best starting point for action at the customer level



