Refco case: too soon to decide, too hurry to liquidate

Almost two weeks ago, a going concern; right now, a company under bankruptcy protection. It does not make sense, if looked at from the outside, when this whole process is being triggered from a presumably undisclosed debt owed to the company by its CEO.

As a financial intermediary, Refco operated in two formally regulated businesses (futures trading and stock brokerage) and in an unregulated one (over the counter derivatives trading). Its market value since its IPO last August was close to US$ 3,5 billion, and the controversial debt value was US$ 430 mm.

Now, let us assume that the US$ 430 mm debt was in fact uncollectible: that sole effect would have left a value for Refco close to US$ 3 billion, if no financial liquidity restrictions had existed. How then do you get into a bankruptcy protection along with a company value far smaller than that ?

It is the case that that debt has already been paid, but the implosion of the Company has continued. A market rumor, seconded by regulators, prosecutors and market participants, is doing this wealth destruction and redistribution job. The access to the financial market for Refco, vital for any firm but especially for a financial one, has certainly not been working properly: if that had been the case, bankruptcy would not have been the daily word attached to it and the Company could have continued its operations properly while simultaneously solving the controversial debt issue.

The reasonable course of action for any Refco shareholder should have first been to protect the value of the Company, and then to take all the necessary measures to sanction any procedure, act or lack of act that was not consistent with the creation of value for its shareholders under the institutionality of the laws and the market. But here we are just looking at a totally different picture: the already accorded sale of assets even before anything wrong is proven. This common sense value-maximizing course of action should have also been applicable to regulators and prosecutors, in defense of a proper functioning of the market, under which firms should not be put into a situation where the only exit is Court protection. It does not seem efficient, and it finally only helps those parties that profit from transactions over liquidated companies or business units at values that do not keep consistency with real ones – those that originate once the uncertainty of the legal and regulatory process is eliminated -.

Under these abnormal conditions, the Court should reject any attempt to liquidate the Company or its independent units, and if not so, define sales only under parameterized conditions, which, if realized, would allow investors to recapture that wealth that was put temporarily and unfairly out of their property. Investors (i.e., Refco shareholders) should not be made responsible for malfunctioning or temporarily closed financial markets that exclusively hurt them, and whose conditions were exacerbated and possibly created by regulatory and prosecutorial activities.

Looking for perfection, these overpublisized interventions from authorities usually get imperfect results, in the sense that wealth is finally destroyed and the remaining of it is usually redistributed to third parties who essentially have in their advantage that they can operate under more flexible capital markets. The signaling to the market is quite obviously different than the pursuit of more perfect markets, but that you have to be there if you want bigger "authorities generated" prizes. In fairness, some price should be exacted from these same authorities that usually have the virtue of making a manageable situation unmanageable. Their priority should be to make the whole system work and only then take corrective measures, which could incidentally be wider than an "uncollectible debt".

Refco was a small company; next time, as in the past, it could be the tears of much bigger ones. Citicorp, JP Morgan and the rest, you have already been notified.

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