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Sonray Collapse Gives CFDs An Unfair Rap

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Reputable providers fear a "guilty by association" tag following Sonray Capital's collapse despite publically emphasising their internal operations had nothing in common with Sonray.

The collapse of Sonray Capital Markets has put the spotlight on the fastest growing trading instrument in Australia, contracts for difference (CFDs).

Since 2002, when CFDs were first launched in Australia, tens of thousands of Aussie speculators have been successfully trading them - taking long and short positions over domestic and international equities, indices, foreign exchange and commodities. CFDs are also an effective weapon in preserving wealth when acting as a hedge.

It's a point that seems to have been largely ignored when CFDs were put under the media microscope following the collapse of stockbroking firm Sonray in June, 2010. Since the collapse, it's been widely reported that Sonray client funds had been pooled, rather than held in trust, and used for general working capital purposes. It also appears that Sonray's accounting and financial management systems had been in disarray for a considerable time prior to it entering voluntary administration.

Against this backdrop, the CFD industry was a target of considerable public and media scrutiny and providers came forward to defend their company's management procedures and practices, fearing a widespread backlash. Reputable providers also feared a "guilty by association" tag, despite publically emphasising their internal operations had nothing in common with Sonray.

In response to the Sonray upheaval, global CFD providers, IG Markets and First Prudential Markets, have again this week emphasised that client funds are segregated from their businesses.

IG Markets spokesman Cameron Peacock says: "All client funds and running profits are held in trust accounts and are completely separated from our business. Furthermore, IG Markets has its own funding lines available for working capital purposes and therefore does not need or rely on client funds."

Peacock, a market analyst, says he would welcome any regulatory move that enforces segregating client funds because pooling can create financial irregularities when one client's money is used to cover the losses of another.

As a financial instrument, Peacock says CFDs are publically compared to "punting on a horse or betting at a casino". He says this is narrow-minded as "CFDs can be very effective hedging instruments".

"Think how effectively CFDs could have been used to protect an investor's portfolio during the GFC," he says. "An investor with an equity portfolio of $100,000 could have effectively used CFDs to protect its value during a severe market downturn. For example, an investor could have sold short the ASX 200 index using a CFD at a level that would have created a near perfect hedge for his or her portfolio. The fall in value of an underlying equities portfolio would have been offset by the profit made on a short ASX200 position. This side of CFD trading never seems to get any attention."

CFDs are leveraged instruments traded under an agreement to exchange the price difference in an underlying asset between opening the CFD and closing the position. CFDs mirror movements in the underlying asset class and, as a leveraged instrument, profits and losses can be quickly magnified for a small up-front outlay.

Peacock says IG Markets adopts a rigorous approach to opening accounts and it rejects between 10 per cent and 15 per cent of applications due to unsuitability. He says before opening an account, applicants are questioned about their employment, annual income and savings levels. "They are also questioned about their level of experience and knowledge around trading shares and derivatives as well as their understanding of leveraged and margined products," he says.

Peacock says claims that CFD providers win when clients lose is "most definitely not the case at IG Markets". Peacock says: "Think about it. Is it a sustainable model for a business to want its clients to lose all their money? No, as they won't trade again."

First Prudential Markets general manager Matthew Press says while Sonray was a CFD provider, the actual trading instrument had nothing to with the company's high profile collapse. Press says Sonray's failure related to questionable operational and compliance procedures. "It's the company's operations that should trouble Sonray clients, not the CFD product," he says.

Press also takes issue with media reports saying that CFDs are banned in the US. Rather, he says, CFD trading has never been introduced into America.

Press is the first to acknowledge that CFD trading isn't for everyone, and he says FP Markets clearly explains to clients the risks involved in trading leveraged instruments, which are also clearly displayed on the company's website.

Press says traders using FP's Direct Market Access platform, webIRESS, know their orders are hedged before they go to the ASX. There is no intervention from FP Markets and traders can see orders in the queue. They know whether their order is going to be filled. "The principal of the DMA model is to provide transparent pricing, while providing an array of trading opportunities," he says. "By hedging all our transactions, our interests and those of our clients are aligned, enabling us to focus on risk management and customer service."

Recent findings of a survey undertaken by CFD researcher Investment Trends showed a 22 per cent increase in the number of CFD traders in Australia, from 32,000 to 39,000 in the past 12 months. It also found that customer satisfaction with CFD providers had risen, trading on indices had increased and more trades had been closed out on the same day. According to Investment Trends, responses were received from 9644 investors.

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