

CFDs adopt a transparent mode

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Contracts for difference and margin foreign exchange contracts, the financial products used by thousands of Australians daily to speculate in investment markets from shares to currencies to precious metals and commodities, have entered a new phase of their development.

The changes, by the start of 2012, will encourage all promoters to be more forthcoming about themselves and what they offer.

With more than 40,000 investors estimated to have tried CFDs and margin forex contracts in the past year and more expected to be attracted in the future, albeit at a slower rate of growth than in previous years, corporate regulator the Australian Securities and Investments Commission has devised new disclosure rules that are expected to be embraced by all serious promoters.

Encouraging promoters to accept these voluntary rules is a desire to turn around a poor public image of CFDs as high-risk products, not just because they are leveraged investments mainly used for speculation, but because they are also seen as being risky at a promoter level.

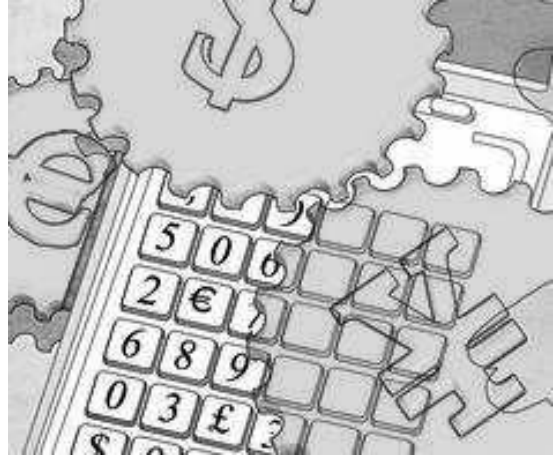
Reinforcing this impression has been the high-profile collapse last year of middle-ranking Melbourne broker Sonray Capital Markets which was one of the early promoters of CFDs less than a decade ago.

While CFDs have been blamed for Sonray's multi-million dollar demise, other problems that have been identified in recent court proceeding against two Sonray directors have been allegations of fraud, theft and dishonesty that had nothing to do with CFDs as financial products.

The main issue for investors illustrated by Sonray is being careful about which provider you choose to partner your CFD forays, says Tamas Szabo, chief executive of CFD provider IG Markets. To this end the new ASIC disclosure rules should help as they require promoters to provide more public information about the way they run their businesses and manage the risks they face when offering margin derivative products.

The sort of information that promoters will be encouraged to publicly reveal includes how they treat client money and, in particular, whether they pool this and can draw on it to support the financial obligations of other clients, such as meeting margin calls, if this should become necessary.

Although there is nothing stopping promoters from pooling client money, they don't have to do this as many consider it is a riskier way of running a derivatives business. The new disclosure



The push for greater disclosure from the industry is aimed at restoring CFDs' poor public image. **Illustration Karl Hilzinger**

A better bet

- More than 40,000 Australians are estimated to have invested in CFDs and margin forex contracts in the past year.
- CFDs have a poor public image as high-risk products, reinforced by the collapse last year of Melbourne broker Sonray Capital Markets.
- Providers are therefore expected to embrace the new voluntary disclosure code.

rules require a promoter's policy to at least be stated allowing investors to choose which approach they prefer.

Promoters will also be encouraged to reveal how they reduce risk when offering CFD and margin forex derivatives to the public as well as the financial resources and backing they can draw upon to meet their obligations.

At a more personal client level, promoters will be encouraged to clearly explain to new clients the products they offer and the risks associated with them, including how margin calls work and the risk that clients could lose substantially more than their initial investments. They will also be encouraged to not take on new clients until they are satisfied the clients understand what they are getting into. Also at the personal level is restricting new accounts opened with credit cards to a \$1000 limit.

While these various ASIC initiatives that are expected to be in place by the start of 2012 are not compulsory, promoters who don't implement them are required to explain why have chosen not to and what alternatives they follow.

Louis Cooper, head of CMC Markets in Australia, says the new rules are a welcome measure to lift the CFD and margin forex disclosure standards. He says that while CFDs like other sectors have slowed down because of the state of the financial world, they remain a steady business, unlike the stock broking sector which has been struggling. The CFD trading community, he says, has been very durable during the current financial crisis. He attributes this to constant sector innovation and the fact that CFDs are very efficient to trade as well as being very cost effective.

CMC Markets has just launched a new trading platform that includes the scope for investors to choose flexible leverage and built-in stop-losses. Creating this new system has been part of a focus by CMC on retaining and looking after existing clients and looking to the next level of potential clients, the more than 600,000 investors who trade online.

Although things have lately been quiet as far as new business is concerned, Cooper says there is scope for further growth. Financial markets researcher Investments Trends noted in its most recent CFD survey that with about 7 per cent of the online share trader population, adoption of CFDs in Australia was half the level of acceptance in the UK.

While the industry has been affected lately by developments such as regulators tightening up on disclosure, this does suggest potential for future growth.

Despite the fact that the top six promoters control nearly 80 per cent of the market with IG controlling one third and CMC controlling 20 per cent, new promoters are continuing to come. One of the more recent arrivals is Capital CFDs, part of the UK London Capital Group which ranks alongside CMC and City Index in the UK.

Australian managing director Andrew Merry says Capital lodged its application for an Australian licence last October on the same day Sonray went bust, so it was an interesting welcome to the market.

Merry says Capital's first year has definitely been affected by the adverse attention attracted by Sonray and the fact the Australian economy is not as buoyant as many think, although Australia is ranked as the second most important market for CFDs in the world.

But it will be a market where the next year or so will see a lot of competition within the existing market. Although it has been suggested there are around 41,000 CFD and margin forex traders, Merry estimates the active number of traders is about 20,000.

It's this pool that the dozen or more promoters will be chasing with competitive products. A lot of the CFD business in the year ahead will be promoters looking to attract clients from others using innovative products.

Capital, for instance, offers a CFD with an automatic stop loss. IG's Szabo says Australia over the next year or so won't be an easy market for CFD promoters although it should be good for investors. One reason is that CFDs and margin forex are not as broadly used as in the UK.

The other is that investors have become more cautious because of the attention that Sonray and the new disclosure rules have attracted.

That said, established promoters such as IG have managed to grow their businesses because CFD traders do tend to switch promoters until they find the one they like.

Szabo says the CFD market is not unlike online broking where the different participants spend a lot of their time trying to win clients from each other. While there is definitely scope for market growth in the future, this won't happen until the negative views about CFDs are left behind.

Another market development has been traders deciding whether to focus on margin foreign exchange. Alex Douglas, managing director of IBFX Australia, says it can take a while for CFD and margin forex traders to become established. Many start small and will trade until their money runs out. They put trading down to experience. It's not until traders commit larger amounts, perhaps \$20,000, that they take trading seriously, reckons Douglas.

The Australian Financial Review

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