

CFD collapse: thousands hit with margin calls

PUBLISHED: 01 Nov 2011 PRINT EDITION: 01 Nov 2011

John McDuling and John Kehoe

Thousands of retail investors have been hit with surprise margin calls as one of the world's largest broking houses faces bankruptcy.

Clients of CommSec, Westpac Banking Corp's online broking arm and ANZ Banking Group's E*Trade are among those affected.

Margin calls have been issued to some holders of controversial "contracts for difference", about which the corporate regulator has repeatedly warned.

CommSec, the country's largest retail broker, told clients yesterday it would not allow them to open new contracts for difference and advised them to close out existing positions.

It raised collateral requirements on CFDs to a minimum of 25 per cent, up from 10 per cent. Some investors have until 2pm today to meet the demand for more collateral.

The increased margin requirements were triggered by [credit rating downgrades of New York-based MF Global](#), reflecting its \$US6 billion (\$5.7 billion) exposure to European sovereign debt. MF Global's CFD products are used by clients of CommSec, Westpac and E*Trade, either directly or through referrals.

The credit ratings downgrades caused MF Global's trading partners to demand more collateral from the US broker, leading it to call for more funds from its CFD customers, including those in Australia.

CFDs are derivative instruments that follow the movements in the price of an underlying asset and enable investors to gain leveraged exposure to an asset, usually shares.

The CFD market has quadrupled to about 39,000 active users in Australia in the past six years, according to researcher Investment Trends.

Investors using CFDs can make large bets across a range of markets using small amounts of capital, with the potential to gain or lose multiples of their initial capital, depending on which way markets move.

Collateral damage

What is a CFD?

Contracts for difference (CFDs) are highly leveraged, derivative products marketed to and traded by retail investors. CFDs are a leveraged bet on changes in the price of shares, commodities, indices or exchange rates.

Risks identified by ASIC

- The potential for great losses due to high leverage ratios
- Unanticipated or poorly managed margin calls
- Significant counter party risks
- Time delays between the placement and execution of trader orders
- Limitations of the explanation of key risks
- An unsuitable investment for some retail investors

Key facts

- Most CFD trades are only held open for less than one week, commonly one or two days
- Issuers may let traders borrow up to 95% of the value of their contract
- CFD positions are marked to market on a regular basis



SOURCE: ASIC

The Australian Securities and Investments Commission said it was in discussions with the Australian Securities Exchange and MF Global Australia about developments.

ASIC said it had been in contact with international regulators and will monitor the situation.

CommSec client and private investor Chris Harris, who uses CFDs, was furious about the short notice given for

extra margin requirements.

“There would be hundreds of millions of dollars of shares tied up in CFDs for their clients. They’ve changed the margin requirements without notice and they’ve increased the margins on the blue chips by 250 per cent,” Mr Harris said.

The change applies to over-the-counter CFDs, which are the most common forms of the derivatives. Those traded on the ASX are not affected. CommSec’s general manager of distribution, Brian Phelps, moved to reassure investors yesterday.

“CommSec acts in the interests of our clients in every transaction that we undertake. We will continue to do so with regard to our OTC CFD business and the safety of our clients’ funds,” Mr Phelps said.

“E*Trade provides a link from the E*Trade website to the MF Global Australia website for E*Trade clients that want to trade in MF Global Australia CFDs,” the spokesman said.

“These E*Trade clients then need to open a separate MF Global Australia account if they want to trade MF Global Australia CFDs.”

In August, ASIC chairman Greg Medcraft warned investors of the risks CFDs posed. “CFDs are extremely risky financial products. Most investors don’t understand that complexity and they don’t get independent financial advice,” he said.

“That means we need CFD issuers to do a much better job of spelling out to investors the risks, as well as the rewards of these complex products.

“ASIC’s No. 1 priority is ensuring investors and financial consumers are confident and informed. We want issuers to work harder to ensure people investing in CFDs better understand what they are getting into – before they start trading.”

MF Global disclosed in its quarterly earnings last week that it had \$US6 billion of exposure to European sovereign debt. The company has more than 100 Australian employees and is one of the largest participants in the domestic futures market.

with Bianca Hartge-Hazelman and Peter Wells

The Australian Financial Review

Related News

People [Greg Medcraft](#)

Topics [Financial Markets/Derivative Markets](#), [Financial Services Industry/Banking & Finance](#), [Economy](#)



Create an alert

Click on the links below to create an alert and receive the latest news as it happens

People [Greg Medcraft](#)

Topics [Financial Markets/Derivative Markets](#), [Financial Services Industry/Banking & Finance](#), [Economy](#)

See also

- [CFD accounts frozen, broker in admin](#)
- [MF Global files for bankruptcy protection](#)
- [MF Global's crisis loosens Corzine's grip](#)
- [MF Global developments being monitored: ASX](#)
- [Smart Investor | What are CFDs?](#)