

## CFD market trades on undaunted

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When individual contracts for difference trader Andrew Hunter heard CFD provider MF Global had collapsed, his main response was to think that in future he would have to keep his trading positions tighter. He was not scared away from trading. The present volatile market is enough to keep him on the sidelines.

Instead Hunter, a retired computer consultant who mainly uses CityIndex but also has an account with IG Markets, says he will take care to keep his position trim day-to-day and not let balances build up as he sometimes has when trading.

He will also look at CFD providers' business models. In other words, the MF collapse has added another dimension to the risk management already practised daily by serious traders. That risk management typically includes self-imposed limits on the amount at risk at any one time, as a proportion of total trading capital, and the number of positions to be open at any time, among other matters.

Now traders also have to consider the risk of the CFD trading platform itself collapsing, and whether its business model permits clients' money to be pooled with that of the platform operator. It's a moot point for Hunter. As noted, he finds the present market too volatile, so he is "sitting on the sidelines".

"Maybe it will steady by December," he says.

But his reaction is typical of individual traders not involved in the collapse, and of the operators of other platforms which offer trading through the highly leveraged market instruments.

CFDs permit traders to take big positions with a small cash margin, either in going long or selling short. The leverage is built into the contract, so that traders automatically take a loan along with the CFD. The whole position is automatically unwound and the loan paid back when the contract is sold.

When MF failed and more than 20,000 Australian CFD accounts were frozen, market commentators regarded the collapse as justifying previous warnings that CFDs were inherently too risky to use.

Instead of heeding those renewed warnings, CFD traders not affected by the collapse and still active in a market that quickly destroys the undisciplined, barely paused in their trading to check the business model of their provider. Other platform providers said there was no change in trading as a result of the collapse.

A spokesman for IG Markets, Chris Weston, said the provider got calls from traders wanting to know about its business model. Did IG keep clients' money separate from IG company funds? The answer was yes, but the calls prompted IG to put a statement on its website.

"We hedge client exposures in the underlying market (on a net basis, or directly through our



CMC Markets head Louis Cooper.

direct market access offering),” the statement said, “but we only use our own funds to finance such hedging activity. Other Australian CFD providers routinely use their clients’ money to hedge their risk from clients. While this practice is permitted under Australian Securities and Investments Commission rules (provided it is properly disclosed to clients), we believe it inappropriately exposes clients to counter-party risk from hedging counter-parties and other clients.”

As all in the industry contacted by the *Weekend Financial Review* were quick to point out, the collapse of MF Global had nothing to do with mass CFD trading as such.

MF traders made enormous, leveraged bets on the euro and then refused to close the position and take the loss until it was too late. In other words, the company did what veteran CFD traders know you must never do, put all your capital into one trade and then hang onto a losing position, hoping it will turn.

There was no suggestion that the Australian arm of MF was trading on its own account, but the company placed itself in voluntary administration when its US parent went out of business.

Administrators from Deloitte have since publicly declared that the Australian company was in surplus when it went into administration, but a little more than half of the \$313 million owed to traders had yet to be recovered, with overseas parties withholding vital information. As a result the administrators have declared that they cannot guarantee that traders with frozen MF accounts will get all their money back.

A survey by consultancy Investment Trends released in May this year estimates MF’s share of the Australian market at 5 per cent.

But the *Weekend Financial Review* understands that this applies only to accounts in MF’s name. The company also ran a “white label” service for both Westpac and CommSec online services, among others. Those two financial groups offered a CFD service, but the platform used was that of MF. Industry insiders estimate that MF’s actual share was probably a touch over 10 per cent.

Now that it is gone, however, the other CFD providers see plenty of opportunities in grabbing both MF’s direct share of the market and its white label business.

The head of major CFD provider CMC Markets in Australia and New Zealand, Louis Cooper, said the only result of the MF collapse detected on the CMC platform was an increase in new accounts.

The increase was probably traders unable to use MF accounts looking for a new outlet. In addition, there would be opportunities in picking up business in the services MF provided for others, he said.

One other important point to note, he said, was that CMC did not trade on its own account.

IG also noticed an increase in account openings, with Weston hoping that his platform might pick up a large part of the MF business.

Like IG, MF has a direct market access platform. That is, any trades made on the platform are automatically echoed on the main market. The direct access system is in contrast to the market-maker approach, where the platform is close to being a shadow exchange. The sell and buy orders are retained on the platform, but the providers will hedge their exposure by taking positions on the main exchange.

Another senior executive in the CFD market, the chief operating officer of City Index Australia,

Nathan Briggs, also brushes aside any suggestion the MF collapse will damage the CFD market.

“We don’t think there will be any backlash specifically against CFD providers. If you look closely, MF Global is a major player in the futures market and CFDs is only a small part of their overall business. And it is the investment arm of MF that caused them the trouble, not the CFD business.”

Although it is still too early to decide exactly what will happen in the Australian market as a result of the collapse, he says, investors may become selective when it comes to choosing their brokers or dealers.

But they should be selective in any case, and most traders have multiple accounts with various CFD providers, he says.

There may be some consolidation within the industry and ASIC will work harder to achieve “ongoing and consistent regulation” of CFD providers.

“We support all of ASIC’s endeavours to protect investors,” he said.

He also noted City Index was “mandated to keep segregated accounts for all client moneys”.

The Australian Financial Review

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