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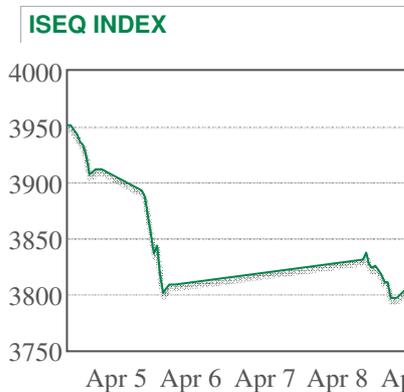
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Betting on better regulation

00:58, 31 March 2013 by Philip Connolly



Betting on Obama: after making its name during the US presidential election, financial spreadbetting firm Intrade fell foul of the US Commodity Trade Futures Commission.



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Intrade: The online prediction market ceased trading earlier this month due to circumstances that may include "financial irregularities", as payments of \$1.2 million in 2010 and \$1.39 million in 2011 to former director John Delaney emerged in the companies accounts.

Worldspreads: Last year, the Dublin-based firm, which operated mainly in Britain, collapsed when its board discovered a £13 million funds shortfall, owing clients £29.7 million with just £16.6 million to pay them.

MF Global: The company went bankrupt in October 2011 after making a series of short bets on peripheral eurozone sovereign bonds and using \$1.6 billion in customer funds to try to plug holes in the balance sheet.

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News

Armed forces to line out for 7 funeral

Few of the customers visiting online prediction exchange Intrade late on a Sunday night three weeks ago would have expected to see the message that greeted them when they logged on. The Dublin-based firm had immediately ceased trading, according to the directors, due to "financial irregularities" and "circumstances recently discovered".

The financial irregularities in the company's accounts were mystery payments of \$1.2 million in 2010 and \$1.39 million made in 2011 to former director John Delaney.

During preparation of the firm's financial statements, the current directors discovered the funds had been transferred to the bank accounts of the Irish businessman, who passed away in May 2011 at the age of 42 on Mount Everest after coming within 50 yards of the summit.

The "circumstances recently discovered" were less clear, as there was "insufficient documentation and information" available to "ascertain the nature of the payments"

Intrade, which became well known beyond its mostly American client base during last year's US presidential election, occupied an odd space in the spreadbetting market. Instead of just taking positions on the movement of markets, Intrade customers could bet on any kind of event, from elections to wars to the weather. This made it awkward to regulate.

Unlike financial spreadbetting firms based in Dublin, for instance, it was not supervised by the Central Bank of Ireland. Late in November 2012, however, the firm fell foul of the US Commodity Trade Futures Commission, which sued the company for running an unregulated futures market, leading to a sharp fall in business.

However, missing funds are more than a technical violation.

"There has always been a bit of dubious nature on how spreadbetting firms make money," said Brenda Kelly, market strategist with IG Group in London. "That is one of the things we always try to clarify: we make our money on the spread. When you place your money with a spreadbetting company, what you need to be sure of is that your funds are segregated from the company's, so if it goes under the funds are held at a bank account in your name."

For those involved in spreadbetting markets, controversy surrounding some of the companies involved is nothing new. Last year, Dublin-based WorldSpreads, which



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EU finance ministers will meet in Dublin this week to respond to a faltering economy, writes...

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Business Interview

The Sunday Interview: Jim Whelton



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operated mainly in Britain, collapsed in a tangle of legal action and official investigations.

The firm blew up in dramatic fashion when its board discovered it owed clients £29.7 million, but had just £16.6 million to pay them. Money deposited by clients with spreadbetting firms is supposed to be segregated, and the Financial Services Authority had been making moves to tighten its regulations.

"Companies need to make money off the spread, not off people winning or losing," said Kelly. "It is a zero sum game, it is about risk management. If you are going to be successful with spreadbetting you need to be able to take some downside risk to be able to pull the reward out of it. While the spreads might not be as tight at one firm compared to another, there might be a reason for that."

On Wall Street, commodities broker MF Global rapidly went bankrupt in October 2011 after making a series of short bets on peripheral eurozone sovereign bonds and then dipping into customer funds, to the tune of \$1.6 billion, to try to plug the holes in the balance sheet.

"If companies are misusing funds to try to prop up their books then you have a problem," Kelly said. "It should be the same for everybody, but at times it is not, which is why you have to do your homework on the broker."

Spreadbetting companies do well during periods of volatility because there is usually an uptick in activity as people trade in and out of markets very quickly.

Calm markets suit longer-term traders. Given the volatile nature of the sort of trading in which spreadbetting firms specialise, one of main areas for concern is capitalisation.

"If people are using spreadbetting or any derivative product, they should use the biggest and best capitalised firms to do it," said Paul Sommerville, who runs Sommerville Advisory Markets (SAM). "Companies like IG don't bet against their clients. It is important to distinguish the reputable firms in the market. Lots of small firms have gone bust with management taking too much risk. They must have much better capital buffers than some firms are able to have."

Competing with IG in the Irish market, Shelbourne Markets, formerly known as MarketSpreads, recently rebranded and is the biggest indigenous player in the spreadbetting market. But it also had an accounting scare. In late 2011, the board of MarketSpreads discovered apparent financial irregularities under former directors

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from the period prior to the firm's buyout from the Irish arm of British group WorldSpreads in 2009.

As a result of the discovery, the Central Bank ordered MarketSpreads to suspend its operations for three weeks last March, citing "capital adequacy and audit issues".

The problems dated back to 2009, before the current owners and management took over the business from WorldSpreads, and by April last year the central bank had lifted restrictions on the company, after the firm "addressed the matters of concern relating to its regulatory capital and financial accounts".

Over the past few years, supervisors have stepped into the area as updated European legislation brought spread betting into the regulatory fold. Now the business is treated like contracts for difference (CFD), instruments that allow investors to speculate on the future direction of prices without owning the underlying security.

Under current legislation, a firm such as Shelbourne Markets is governed by the same set of rules as a stockbroking firm such as Davy's.

However, it wasn't always like that, and the standards are now much more stringent for the likes of Intrade or Worldspreads.

"Until 2007, spreadbetting wasn't a regulated activity," said Kevin O'Doherty of regulatory consultancy Compliance Ireland. "Financial spreadbetting firms were closely aligned with sports betting firms and ended up having to separate.

"The firms are now under one of the highest forms of licences that the Central Bank gives out and they are very strict about it. There are complex requirements about the amount of capital you must hold and there are extensive internal audit and risk management requirements. It is the same code under which stockbrokers are regulated. This is kicking some of the smaller cowboys out of the market."

Putting money into something like spreadbetting can be a dangerous game for some investors. The European Securities and Markets Authority (ESMA) recently warned retail investors about the risks of investing in CFDs. This came amid concerns that during the current period of low investment returns, inexperienced retail investors across the EU are being tempted to invest in complex financial products, which they may not fully understand and which can end up costing them money they cannot afford to lose.

"The Central Bank has a slight difficulty with these firms as they are not part of mainstream financial services," said O'Doherty. "There was a report issued by the ESMA which said that these CFDs weren't really suited to retail customers, because you have to very tightly manage your position. They are more volatile than an investment in something like oil shares, but they are entirely legal and the rules are the same across the European Union; someone at a European level has decided these things are suitable for sale to the general public."

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