Casualties From Swiss Shock Spread From New York to New Zealand

By David Evans and Kevin Buckland - Jan 16, 2015

Losses mounted from the Swiss currency shock as the largest U.S. retail foreign-exchange brokerage said client debts threatened its compliance with capital rules and a New Zealand-based dealer went out of business.

FXCM Inc. (FXCM), which handled a record $1.4 trillion of trades by individuals last quarter, said clients owe $225 million on their accounts after the Swiss National Bank’s decision to abandon the franc’s cap against the euro roiled markets worldwide. Global Brokers NZ Ltd. said losses from the franc’s surge are forcing it to shut down. IG Group Holdings Plc (IGG) estimated an impact of as much as 30 million British pounds ($45.5 million) and Swissquote Group Holdings SA set aside 25 million francs ($28.4 million).

“I would be astonished if we did not see more casualties,” Nick Parsons, the London-based head of research for the U.K. and Europe at National Australia Bank Ltd., said by phone from Sydney. “This was a 180-degree about turn by the SNB. People feel hurt and betrayed.”

The franc surged as much as 41 percent versus the euro on Thursday, the biggest gain on record, and climbed more than 15 percent against all of the more than 150 currencies tracked by Bloomberg. Dealers in London at banks including Deutsche Bank AG, UBS Group AG and Goldman Sachs Group Inc. battled to process orders yesterday when the SNB surprised markets with its announcement in Zurich.

Unprecedented Volatility

Market turmoil from the move extended into a second day as Asian shares dropped with U.S. index futures, while Japanese and Australian government bond yields plunged to records as investors sought haven assets.

“Clients experienced significant losses” after the franc’s surge, FXCM said in a statement dated Jan. 15. That “generated negative equity balances owed to FXCM of approximately $225 million.”

The brokerage dropped 15 percent in New York trading yesterday to an almost two-year low of $12.63, leaving the company valued at about $596 million. The shares were cut to sell from neutral by Citigroup Inc., which lowered its price target to $5 from $17.
Spokeswoman Jaclyn Klein didn’t immediately respond to calls to her mobile and office phones.

The U.S. Commodity Futures Trading Commission allows investors to put down as little as 2 percent of the value of their foreign-exchange bets. Brokers may get stuck with the balance of losses suffered by clients who used leverage, borrowed on credit cards, or did both to bet against the franc.

**Leveraged Trades**

Drew Niv, FXCM’s chief executive officer, said that individual currency traders are enticed by the chance to control large positions with little money down, in remarks that were published in Bloomberg Markets magazine’s December issue.

“Currencies don’t move that much,” he said. “So if you had no leverage, nobody would trade.”

The company warned investors in a regulatory filing last March that its risk controls were imperfect. FXCM had 230,579 retail customers on Dec. 31. They traded $439 billion of currency in December, with an average of 595,126 trades a day.

“There are methods for managing risk are discretionary by nature and are based on internally developed controls and observed historical market behavior,” the company said in the regulatory filing. “These methods may not adequately prevent losses, particularly as they relate to extreme market movements.”

**Swiss Surprise**

Most of FXCM’s retail clients lost money in 2014, according to the company’s disclosures mandated by the CFTC. The percentage of losing accounts climbed from 67 percent in the first and second quarters to 68 percent in the third quarter and 70 percent in the fourth quarter.

The SNB ended its three-year policy of capping the franc at 1.20 per euro a week before the European Central Bank meets to discuss government bond purchases to boost the euro-area economy. Such a policy, known as quantitative easing, could spur pressure on the franc to appreciate against the euro. The SNB spent billions defending the currency cap after introducing it in September 2011.

“Many clients were following the confirmed longstanding strategy from the SNB and were anticipating a weakening of the Swiss franc against the euro,” Swissquote said in its statement. The drop “left the clients with a negative balance and has prompted the bank to activate a provision of 25 million francs.”

Deutsche Bank was among dealers to suffer disruptions to electronic trading, with its Autobahn platform temporarily ceasing to provide quotes, according to a dealer from outside the bank. Auckland-based Global Brokers NZ said the market for francs was disrupted for hours.
HSBC Customers

“The majority of clients in a franc position were on the losing side and sustained losses amounting to far greater than their account equity,” Global Brokers NZ director David Johnson said in a statement dated Jan. 15 and posted on the website of affiliated company Excel Markets. All of the firm’s client funds are in segregated accounts and “100 percent of positive client equity or balance is safe and withdrawable immediately,” Johnson said.

HSBC Holdings Plc is investigating reports that customers in Hong Kong bought the Swiss franc below market rates when an online banking system failed to keep up with the currency’s gains after the removal of the cap.

Apple Daily and the Hong Kong Economic Journal cited unidentified bank customers as saying that they took advantage of the mistake yesterday evening. HSBC spokeswoman Maggie Cheung said in an e-mail that the lender was looking into the reports.

Fund Pain

IG Group shares fell 4.4 percent yesterday. The U.K. spread-betting firm said the financial impact from the surge in the Swiss franc was partially dependent on its ability to recover client debts.

The market turmoil turned the $1.9 billion John Hancock Absolute Return Currency Fund (JCUAX) into the biggest loser among U.S. peers. It tumbled 8.7 percent yesterday, the steepest drop on record and the most among more than 2,000 U.S.-domiciled funds tracked by Bloomberg with at least $1 billion under management. The fund had its second-biggest short position in the franc at the end of November, according to the latest fact sheet on John Hancock’s website.

“When they pulled the rug under the market, the Swiss franc rallied against everything,” said Chris Weston, chief market strategist at IG Markets Ltd. in Melbourne. Many funds “would have been in a lot of pain last night,” Weston said.

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