

Topic 1: The ASX CFD Market	3
What are CFDs?	3
The popularity of ASX CFDs has arisen from two main features:.....	3
ASX CFDs offer additional features not available from OTC CFD providers:	4
How can you access ASX CFDs?	4
Trading ASX CFDs	5
Price discovery and the role of DPMS	5
Topic 2: Margins.....	7
Role of initial margins and example	7
Role of variation margins	7
Settlement price and variation margin example.....	8
Margin effect on a position held for 4 days.....	8
Topic 3: Cashflows	9
Dividends.....	10
ASX Index CFDs.....	10
Franking Credit Cashflow (FCC)	11
Topic 4: Risks.....	12
Implications of leverage	12
Additional margin calls and unlimited loss.....	12
Foreign exchange risk.....	13
Liquidity risk.....	13
Summary.....	14

Information provided is for educational purposes and does not constitute financial product advice. You should obtain independent advice from an Australian financial services licensee before making any financial decisions. Although ASX Limited ABN 98 008 624 691 and its related bodies corporate ("ASX") has made every effort to ensure the accuracy of the information as at the date of publication, ASX does not give any warranty or representation as to the accuracy, reliability or completeness of the information. To the extent permitted by law, ASX and its employees, officers and contractors shall not be liable for any loss or damage arising in any way (including by way of negligence) from or in connection with any information provided or omitted or from any one acting or refraining to act in reliance on this information.

© Copyright 2010 ASX Limited ABN 98 008 624 691. All rights reserved 2010.

All Ordinaries®, All Ords®, AllOrds®, ASX®, ASX100®, CHESS®, ITS® are registered trademarks of ASX Operations Pty Limited ABN 42 004 523 782 ("ASXO").

ASX20™, ASX50™, ASX200™, ASX300™ are trade marks of ASXO.

S&P™ is a trademark of Standard and Poor's, a division of The McGraw-Hill Companies Inc.

Topic 1: The ASX CFD Market

What are CFDs?

A CFD (Contract for Difference) is an agreement between a buyer and a seller to exchange the difference in value of a particular instrument between when the contract is opened and when it is closed. The difference is determined by reference to an 'underlying' - a share, index or commodity.

CFDs allow a trader to participate in the performance of the underlying instrument without actually owning it. Trading in CFDs can allow a trader to benefit from a change in the price of the underlying without having to pay the full price of the underlying instrument.

CFDs are leveraged instruments this means they offer the potential to make a higher return from a smaller initial outlay than investing directly. However, leverage usually involves more risks than a direct investment in the underlying.

It is important to understand that this effect may work against as well as for traders - the use of leverage can lead to large losses as well as large gains.

The popularity of ASX CFDs has arisen from two main features:

Leverage: Enables you to obtain full exposure to a share or commodity for a fraction of the price of buying the underlying. ASX CFDs require only a small margin to secure a trade.

The ability to go 'short': ASX CFDs allow traders to sell shares or commodities they don't already own. This enables traders to make money even when the market is going down.

Unlike CFDs offered by OTC (over-the-counter providers), ASX listed CFDs are the only CFDs that are listed and traded on ASX.



ASX CFDs offer additional features not available from OTC CFD providers:

Central counterparty clearing: The Clearing House provides central counterparty clearing for the ASX Listed CFD market. Through the novation process, the Clearing House becomes the principal to all trades and effectively 'guarantees' performance to other Clearing Participants.

A regulated market: ASX is required under the Corporations Act to ensure that its markets are fair, orderly and transparent. ASX ensures a sound operational and front-line regulatory environment for its exchange-traded markets and clearing and settlement facilities. For the ASX Listed CFD trader, this means being able to participate in the market with confidence.

Market Transparency: When trading ASX Listed CFDs, your order is entered into the ASX Listed CFD central market order book via an ASX Participant. This order book is available for the market to see. All orders are executed on a strict price/time priority. This means that the first order with the best bid or offer price is always executed first.

Product	OTC CFDs	ASX CFDs
Central counterparty clearing	✗	✓
Regulated market	✗	✓
Receive franking credits	✗	✓
Market transparency	✗	✓

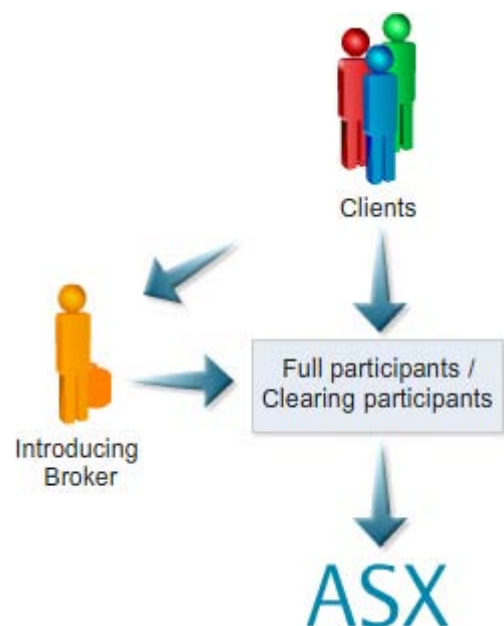
How can you access ASX CFDs?

ASX CFDs are traded on the ASX Trade24 trading platform and operate under the ASX Operating Rules.

Access to products listed on ASX Trade24 is facilitated by Full Participants. Full Participants provide services to end-customers and Introducing Brokers who themselves have end-customers. Full Participants can provide customers with either direct market access (electronic) to ASX Trade24 or through a dedicated ASX Trade24 Workstation.

As with investing in shares a trader needs to first decide whether they wish to receive trading advice or not.

All advisers offering ASX CFDs to end-customers are encouraged to become accredited by their firms. This involves the adviser undertaking training and passing an examination created by ASX.



For a full list of parties (Full Participants, Introducing Brokers) that are accredited and provide access to ASX CFDs and an insight into the services they offer - visit the [ASX website](#).

Trading ASX CFDs

Traders of ASX CFDs can either:

- Buy - undertake a long transaction; or
- Sell - undertake a short transaction.

When you first buy (or sell) an ASX CFD it is called an opening transaction. If you then sell (or buy) an ASX CFD to cancel an existing bought (or sold) open position, it is called a closing transaction. The market automatically recognises if a trade is an opening or closing trade.

Trading on ASX Trade24 is anonymous, this means the identity of the buyer or seller is unknown to the market.

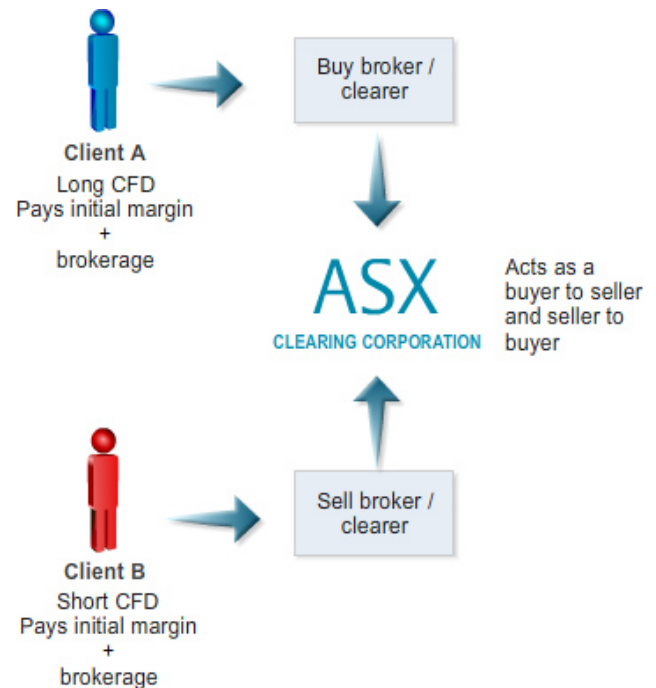
After the trade occurs the nexus between the two original contracting parties is broken through the process of novation. Novating contracts is where ASX Clear (Futures) Pty Limited becomes the buyer to the seller, and the seller to the buyer. ASX Clear (Futures) Pty Limited effectively becomes the counterparty for both buyer and seller.

Price discovery and the role of DPMs

ASX CFDs are a derivative of the underlying. Their price is determined with reference to another instrument.

There are four factors that work to align the ASX CFD price with the price of the underlying.

- **The Daily Settlement Price** of ASX CFDs is the same price as the underlying instrument or index. This ensures both markets close at parity.
- **Contract Design and cashflows** - The ASX CFD contract design automatically calculates cashflows (Contract Interest, Dividend Cashflows, etc) on all positions held. This has the economic effect of



making the ASX CFD position identical to holding a leveraged spot position in the underlying.

- **Arbitrage.** During trading hours, if the price of the ASX CFD and the underlying instrument diverge, a potential profit arises by taking advantage of the price discrepancy. Designated Price Makers and other traders in the market can be expected to use the principles of arbitrage to ensure prices remain at or close to parity.
- **Designated Price Makers (DPMs)** are appointed by ASX to participate in the ASX CFD market. Their role is to provide liquidity. They do this by competing against each other to provide tight spreads. This contrasts with the OTC MM model where the issuer is the only provider of liquidity.

XYZ \$24.50 BUY	XYZ \$24.55 SELL
-----------------------	------------------------



If the ASX CFD is offered at any price below (\$24.50), a trader will profit from buying the ASX CFD at the lower price and selling the shares at \$24.50

Topic 2: Margins

Role of initial margins and example

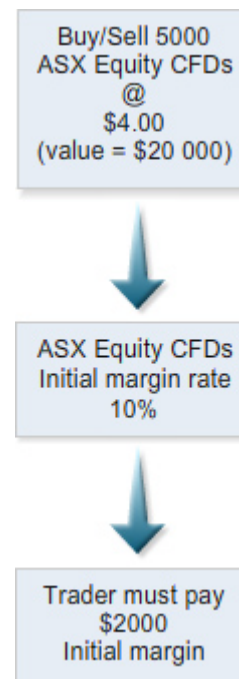
Traders in ASX CFDs are required to put up an **initial margin** for each contract they trade. This applies to both buyers and sellers.

Initial margins protect the Clearing House from risk resulting from a negative movement in the value of a position as a result of a change in market prices.

The initial margin is typically set at a level designed to cover reasonably foreseeable losses on a position between the close of business on one day and the next.

The amount of initial margin for each contract varies according to the price volatility of the underlying, but is usually about 5% to 10% of the value of the goods described by the contract.

Unless called on to support a position, initial margins are returned when the contract is closed out.

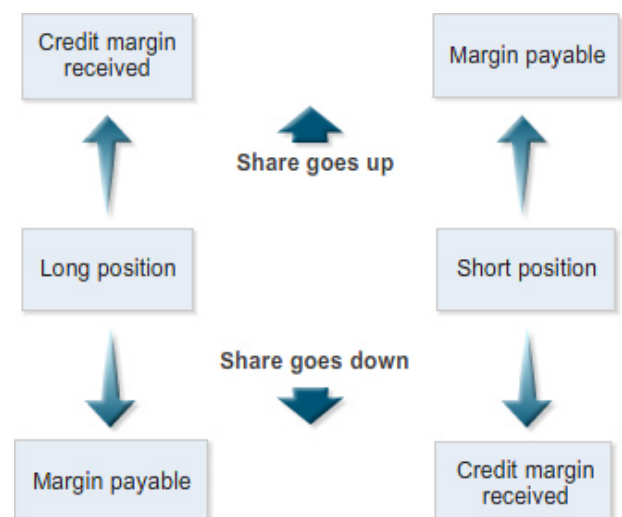


Role of variation margins

In addition to the initial margins required to open contracts, any adverse price movements in the market must be covered by further payments, known as variation margins.

If you have a long position and the price falls below either the position's entry price (if the position was opened that day), or previous day's closing price if held overnight, then you are required to pay a variation margin large enough to cover the adverse marked-to-market movement in the value of the position.

On the other hand, if you have a short position and the price falls, you would receive a variation margin equal to the positive marked-to-market movement in the value of the position.



Failure to meet (pay) a variation margin call can lead to the position being compulsorily closed out. The position holder is obligated to pay for any shortfall in funds if variation and initial margins are insufficient to cover the shortfall.

Initial and variation margins aim to provide the Clearing House with sufficient collateral to support the positions it has novated between buyers and sellers.

Settlement price and variation margin example

The **variation margin** is based on the end of day marked-to-market revaluation of an ASX CFD position.

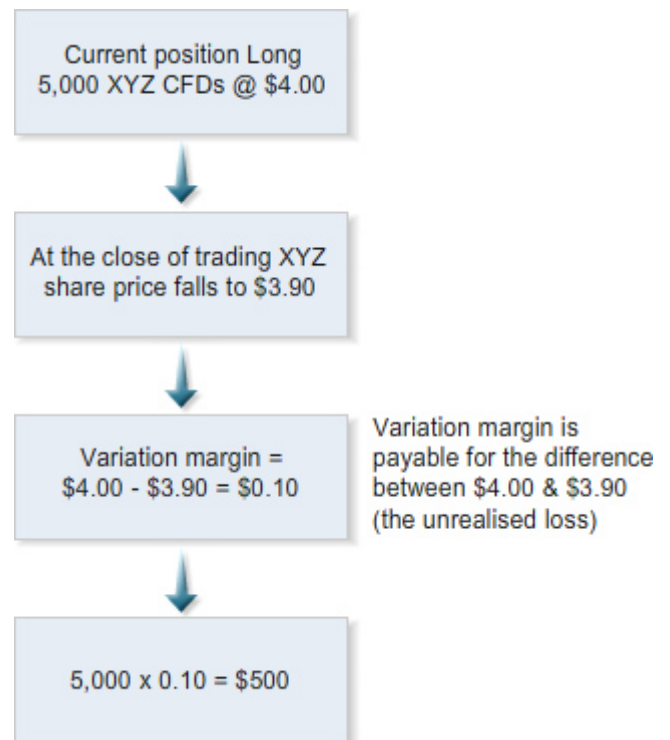
At the close of trading, all open positions are revalued against the relevant **Daily Settlement Price (DSP)**.

The DSP forms the basis for calculating variation margins.

The DSP for ASX CFDs is the closing price of the underlying product. For example, the DSP for Telstra ASX CFD is the closing price of the Telstra underlying share.

This ensures the ASX CFD and the underlying instrument or index are at parity at the close of each trading day.

On the right is a diagram showing how variation margins are calculated.



Margin effect on a position held for 4 days

Variation formula		
Long = today's DSP - yesterday's DSP		
Short = yesterday's DSP - today's DSP		
Long position = 10,000 XYZ CFDs at \$4.00		
Short position = 10,000 XYZ CFDs at \$4.00		
Initial margin paid by Long & Short (10%) or \$4,000		
DSP	Day	DSP
DSP	Day 1	\$4.10
DSP	Day 2	\$4.20
DSP	Day 3	\$4.00
DSP	Day 4	\$3.90

	Long position	Short position		Day 4
Open	-\$4,000	-\$4,000	DSP	\$3.90
Day 1	+\$1,000	-\$1,000	Long	10,000 x (3.90 - 4.00) (-0.10) = \$1,000 paid
Day 2	+\$1,000	-\$1,000		
Day 3	-\$2,000	+\$2,000		
Day 4	-\$1,000	+\$1,000	Short	10,000 x (4.00 - 3.90) (0.10) = \$1,000 received
Close	+\$4,000	+\$4,000		
P&L	= -\$1,000	= +\$1,000		

The table on the right shows the variation margin applicable for each position at the end of each day based on changes to the Daily Settlement Price (DSP).

Topic 3: Cashflows

Contract Interest: the daily cost of funding an ASX CFD overnight position. Contract Interest is paid daily by holders of long positions and received daily by holders of short positions.

The Contract Interest Rate is fixed to a benchmark overnight cash rate and is varied whenever the relevant benchmark rate is varied.

Note: If the ASX CFD is denominated in a foreign currency, the Contract Interest Rate will be based on the applicable benchmark overnight cash rate of that currency. For example, contracts denominated in US Dollars have the Contract Interest Rate fixed to the Federal Funds Rate as published daily by the Federal Reserve Bank of New York. If the contract is denominated in Australian Dollars, the Contract Interest Rate is fixed to the Target Overnight Cash Rate as published daily by the Reserve Bank of Australia.

It is important to note that as Contract Interest is paid daily, Contract Interest payable for positions held on Friday night will also include Saturday and Sunday (3 days).

Open Interest Charge (OIC): the daily cost charged by the Exchange for holding an open position in the ASX CFD.

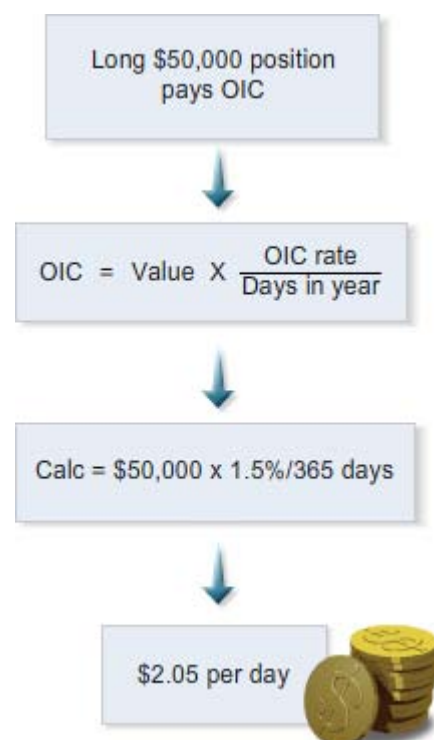
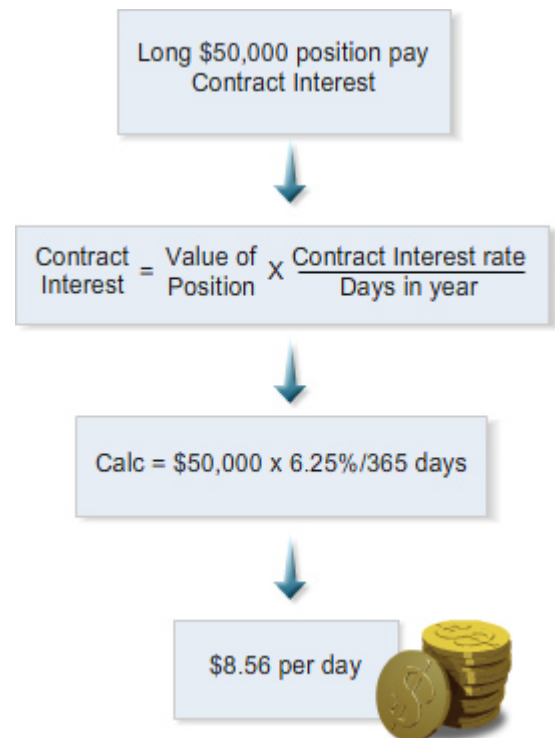
In the over-the-counter CFD market this cost is generally referred to as the financing margin.

The OIC rate is set by the Exchange and is paid daily by both long and short positions.

The OIC can be changed by the Exchange in response to market circumstances. The rate can move up and down but is expected to be adjusted only infrequently.

Traders will be able to view current OIC rates and any upcoming changes to the OIC on the [ASX website](#).

Holders of both long and short positions pay the OIC the next trading day.



The formula for calculating the OIC follows the same principles as Contract Interest calculations.

When determining the total interest rate or carry cost of holding a long position, simply add the Contract Interest Rate and the OIC Rate.

For example, if the Contract Interest Rate is 6.0% p.a. and the OIC Rate is 1.5% p.a., then the total interest rate for holding a long position overnight is 7.5% p.a.

Note: $CI + OIC = Bundle$

Dividends

ASX CFDs replicate the dividends paid by the underlying share(s). It is important that dividend cashflow occurs in CFDs as the value of the underlying share is reduced when the shares go ex-dividend. The timing for payment/receipt of the Dividend cashflow is different to that of the underlying shares. In weeks after the ex-date. ASX Equity CFDs dividend amount is payable/received on the ex-date. Dividend cashflow applies to:

- **Long ASX Equity CFD positions receive dividends and short positions pay dividends.**

Positions are calculated at the close of trading on the last day cum dividend. Dividends are paid the following day (the first day ex dividend).

ASX Index CFDs

When a share in an index goes ex-dividend, the ASX Index CFD recognises the dividend and generates a Dividend cashflow. This cashflow mirrors what would have been paid or received had someone held the physical share as part of the overall index. As with ASX Equity CFDs longs receive whilst shorts pay.

Long/Short \$50,000

	Long	Short
CI	\$8.56 paid by investors	\$8.56 received by investors
OIC	\$2.05 paid by investors	\$2.05 paid by investors
Bundle	\$10.61 paid by investors	\$6.51 received by investors



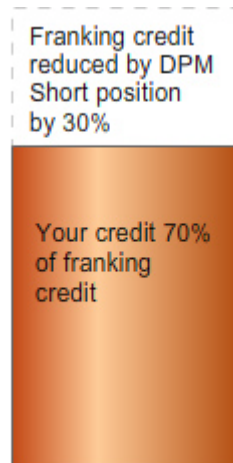
Franking Credit Cashflow (FCC)

Franking Credit Cashflow applies only to ASX Equity CFDs. With equities, franked dividends have a value which, for ASX Equity CFDs is described as Franking Credit Cashflow (FCC). FCC represents the monetary equivalent of the declared franking credit.

Holders of short positions pay FCC. Holders of long positions receive FCC. FCC paid by holders of short positions and FCC received by holders of long positions differs depending on the percentage of net short open (NSOP) held by DPMs at the close of trading on the last cum date.

The NSOP is determined by the Exchange calculating net open positions of DPMs and expressing it as a percentage of the total short open position. If the net DPM position is long, you receive the full FCC. If the DPM net position is short, then the FCC is discounted by the NSOP percentage.

This calculation is discussed further in Course 2. The daily NSOP of the DPMs for each ASX Equity CFD is available on the [ASX website](#).



Topic 4: Risks

Implications of leverage

Leverage (or gearing) is the use of given resources in such a way that the potential positive or negative outcome is magnified.

ASX Equity CFDs are leveraged in that they offer the potential to make a higher return from a smaller initial outlay than for a non-leveraged transaction such as direct share investing.

The example illustrates the effect of leverage on a long ASX Equity CFD position. The table compares the possible purchase of 10,000 long ASX Equity CFDs and 10,000 shares. The higher percentage return from the ASX Equity CFD demonstrates how leverage can work.

The initial outlay of capital is small relative to the total position value. Consequently, a relatively small market movement has a proportionately larger impact on the amount of funds supporting the position.

It is important to remember that leverage can work both for and against you by magnifying gains and losses.

Additional margin calls and unlimited loss

It is important to note that the liability for a holder of either a long or short ASX CFD position is not limited to the margin paid.

If the market moves against a position or margin levels are increased, then the holder of that position may be called upon to pay additional funds on short notice to maintain the position (see the section on Variation Margins).

If a holder of a position fails to comply with a request from their broker for additional funds within the time prescribed, the broker may close out the position. In addition, the holder will still be liable for any further losses that may have resulted from the position being closed out.

Opening contract value	Share	ASX CFD
Quantity purchased	10,000	10,000
Price	\$20.00	\$20.00
Position value	\$200,000	\$200,000
Capital outlay (Assume initial margin for CFD = 5%)	\$200,000	\$10,000
Market/closing contract value	Share	ASX CFD
Quantity held	10,000	10,000
Market/closing price	\$22.00	\$22.00
Position value	\$220,000	\$220,000
Gross profit/loss	\$20,000	\$20,000
Gross return on initial capital outlay	10.00%	200.00%

Note: The potential for loss is not limited to the amount of money paid as initial and variation margins. Adverse market moves can result in losses being a multiple of the initial margin originally provided to support the position.

For a holder of a short position, a continuing adverse market price movement (e.g. market price rise), can result in theoretically unlimited losses being accumulated.

Foreign exchange risk

Not all ASX CFDs are denominated in Australian Dollars.

It is important to keep in mind that when trading overseas indices/commodities all profits/losses are denominated in the currency of the particular product.

The following list indicates the currency denomination of each ASX CFD.

- ASX Dow Jones Industrial Average CFD - USD
- ASX Gold CFD - USD

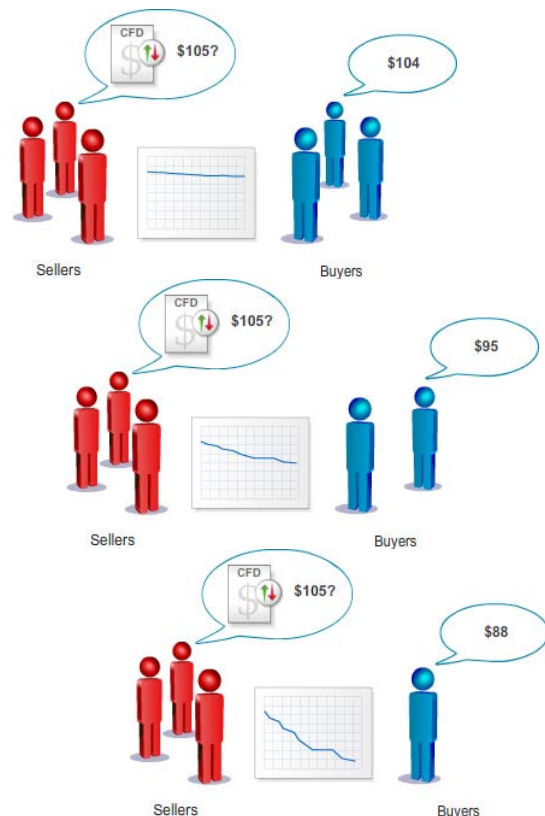
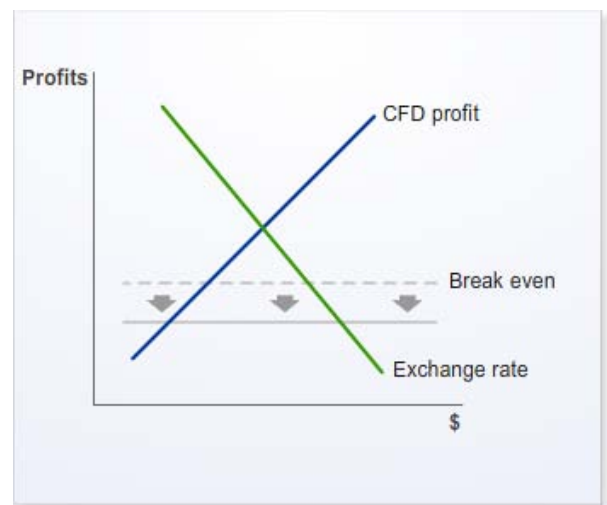
Liquidity risk

Market conditions (for example, lack of liquidity) may increase the risk of loss by making it difficult to effect transactions or close out existing positions.

Normal pricing relationships may not exist in certain circumstances, for example, in periods of high buying or selling pressure, high market volatility or lack of liquidity in the market for a particular ASX CFD.

Gapping, whereby a market price falls or rises without the opportunity to trade, can result in significant losses even when a stop loss has been put on. This is because it may not be possible to get out at the nominated price if the market has gapped.

CFD Traders may reduce liquidity risk by combining CFD positions with Exchange Traded Options. The result is similar to a guaranteed stop loss. This strategy is discussed further in Course 2 - ASX Equity and Index CFDs.



Summary

- A CFD (Contract for Difference) is an agreement between a buyer and a seller to exchange the difference in value of a particular instrument between when the contract is opened and when it is closed. The difference is determined by reference to an 'underlying' - such as a share - and the period over which the CFD is held.
- CFDs are leveraged instruments. This means that you are fully exposed to price movements of the underlying instrument without having to pay the full price of that instrument.
- Leverage, however, usually involves more risk than a direct investment in the underlying. It is therefore important to understand both the upside benefits as well as the downside risks.
- ASX Listed CFDs are not suitable for all traders and investors. In light of the risks associated, you should only trade them if you are confident that you understand ASX Listed CFDs and their risks. Before trading ASX Listed CFDs you should carefully assess your experience, investment objectives, financial resources and all other relevant considerations.