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## Topic 1: Basic features

A contract for difference (CFD) is an agreement for a payment to be made by one party to another, based on the difference between the price of the CFD at the time the CFD position is opened and the price at the time the CFD position is closed.

The price of the CFD reflects the price of the underlying asset, which may be a:

- share, or
- share price index

A CFD does not convey a right, or obligation, to buy or sell the underlying asset.



### Opening and closing CFD positions

You can open your position by buying a CFD (going long), or by selling a CFD (going short).

A long position reflects a bullish view of the underlying asset, a short position reflects a bearish view.

CFD position	Opening trade	Closing trade
Long	Buy	Sell
Short	Sell	Buy

Once opened, your position remains in place until you close it out. CFDs do not expire.

'Closing out' means trading the opposite side to your existing position. If you have an open long position, you need to sell to close. If you have an open short position, you need to buy to close.

### Novation

You are not exposed to the credit risk of the person you originally traded with.

When you open a CFD position, a contract is created between you and the person you trade with, or more accurately between your broker (in this case, your clearing participant) and the other party's broker (clearing participant).

This contract is registered by ASX Clear (Futures), the clearing house for CFDs, and is then replaced by two separate contracts:



- one between your broker and ASX Clear (Futures), and
- one between the other broker and ASX Clear (Futures).

This process is called novation.

Via novation, the clearing house becomes the counterparty to your broker, and guarantees performance of the contract.

### CFD pricing

Although there is no guarantee the two prices will be the same, you can expect the CFD price to be at or very close to the price of the underlying.

The main factors that keep the price of the CFD in line with the price of the underlying asset are:

- daily settlement
- competition between designated price makers (DPMs)
- arbitrage opportunities

#### Daily settlement

At the end of each trading day, all positions in ASX Listed CFDs are 'marked to market' using the daily settlement price (DSP). This means positions are re-valued daily against the market price and any profit or loss is adjusted to the position.

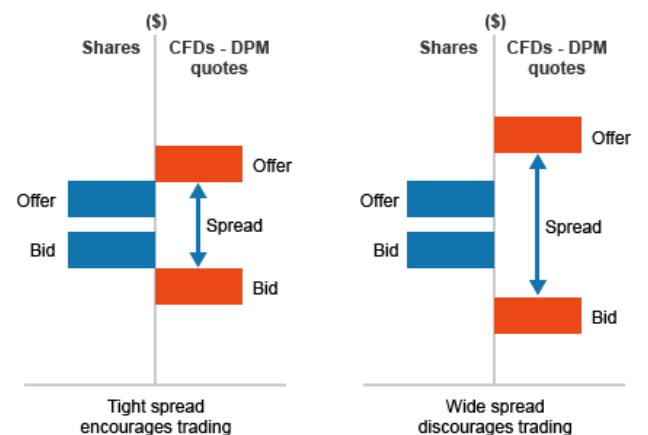
The DSP is the same as the closing price for the underlying instrument or index. Daily settlement ensures that both markets close at parity.

### Competition between DPMs

ASX has appointed market makers to provide prices in the ASX Listed CFD market. These market makers are called designated price makers (DPMs).

ASX offers DPMs incentives that are based on each DPM's trading volume.

It is in the interests of each DPM to quote the tightest possible bid/offer spreads around the price of the underlying asset to encourage CFD users to trade with them.



## Arbitrage opportunities

If the price of the CFD moves out of line with the price of the underlying shares, this presents an Arbitrage opportunity. Arbitrage is a technique used by professional traders to take advantage of mispricing of related instruments.

For example, if the CFD price is above the price of the underlying shares, a trader can simultaneously buy shares at the lower price and sell CFDs at the higher price.

Selling pressure will push down the CFD price until it is again in line with the price of the underlying shares.

Once parity is restored, the trader can sell the shares and close out the CFD position at a profit.



Trades that can take advantage of an arbitrage opportunity		
	While mispricing exists	Once parity is restored
CFDs	Sell	Buy
Shares	Buy	Sell

## Adjustments

Sometimes it is necessary for ASX to adjust CFD positions. These adjustments are required usually because there has been a corporate action that affects the value of the underlying shares. If no adjustment was made, your CFD position could be unfairly advantaged or disadvantaged.

Such corporate actions include:

- Share splits
- Bonus issues
- Rights issues
- Returns of capital

In adjusting open CFD positions, ASX's intention is to maintain the same economic exposure after the corporate action that you had before the corporate action.

An adjustment normally involves a reduction or increase in the number of CFDs held. To learn more about adjustments to CFDs, refer to the document [ASX Corporate Action Information Paper](#).

## Topic 2: Margins

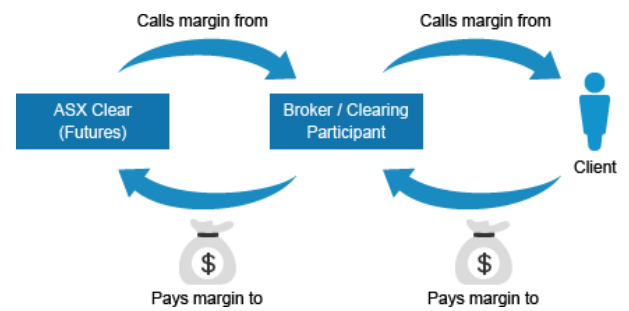
### Introduction

Margins protect the financial security of the CFD market by ensuring that traders can meet their obligations.

ASX Clear (Futures) calculates the margin obligation for all CFD positions.

Your broker is responsible for settling your margin obligation with the clearing house.

Your responsibility is to your broker, who will require you to have sufficient cash deposited with them to cover your obligation.



### Initial margin

On opening a CFD position (whether long or short) you pay a deposit known as initial margin.

The purpose of the initial margin is to cover ASX Clear (Futures) against a possible deterioration in your position the next trading day.

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

The initial margin is returned when you close your CFD position.

### How much is the initial margin?

For equity CFDs, the initial margin is expressed as a percentage. Typically it is around 5% to 10% of the value of the underlying asset. You can find current initial margin rates for CFDs at [www.asx.com.au/cfds](http://www.asx.com.au/cfds).

The main influence on the margin is the volatility of the underlying asset. The more volatile the asset, the higher the initial margin percentage.

Your broker is entitled to call a margin from you that is higher than the margin ASX Clear (Futures) calls from your broker. To find out whether your broker's margins vary from those of the clearing house, you will need to refer to your broker.

Share	Share price	Initial margin of CFD	Volatility of share
A	\$10.00	8%	Moderate
B	\$10.00	5%	Low
C	\$10.00	10%	High

As the price of the underlying asset changes, the initial margin in dollar terms will vary, and you will be debited or credited the difference on a daily basis.

For index CFDs, the initial margin is a fixed dollar amount per CFD.

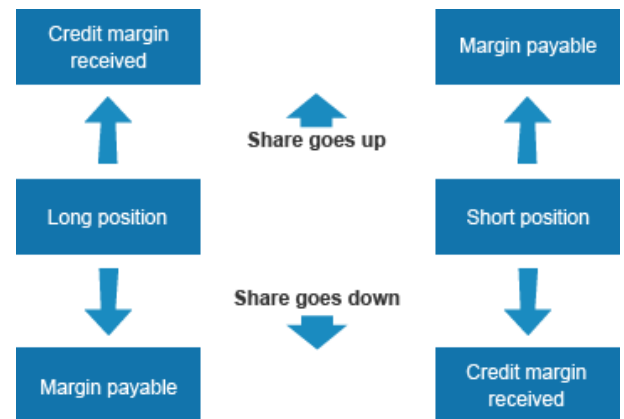
### Variation margins

At the end of each trading day, your CFD position is given a new value, or 'marked to market', by the clearing house\*. That new value uses the daily settlement price (DSP) of the CFD which is the same as the closing price of the underlying asset.

If your position has moved unfavourably since the previous valuation, you will be required to pay a variation margin to cover the adverse movement.

If your position has moved favourably you will be credited for the improvement in your position.

\* In exceptional circumstances, such as in extremely volatile markets, margins may be recalculated intra-day.



### Debits and credits

While your position remains open, the margining process will result in margins being debited from or credited to your account each day to reflect the value of your position.

#### Example

Let's look at an example of how margins are applied to CFD positions over four trading days.

The example assumes that on Day 1:

- you enter a CFD position for 10,000 XYZ CFDs @ \$10.00
- the initial margin per CFD is \$0.80

Day	DSP	Long position		Short position	
		\$	DR/CR	\$	DR/CR
Open position	\$10.00	\$8,000 (initial margin)	DR	\$8,000 (initial margin)	DR
1	\$10.20	\$2,000	CR	\$2,000	DR
2	\$10.40	\$2,000	CR	\$2,000	DR
3	\$10.10	\$3,000	DR	\$3,000	CR
4	\$10.15	\$500	CR	\$500	DR
Close position	\$10.15	\$8,000 (initial margin)	CR	\$8,000 (initial margin)	CR

### How do I pay my margins?

CFD margins must be paid in cash.

Your broker will ask you to provide enough cash to enable them to cover the margin called by ASX Clear (Futures).

Typically you would set up a cash account with your broker which they are authorised to access. Your broker can withdraw funds from this account when margins are required, and credit the account when you are owed margins.

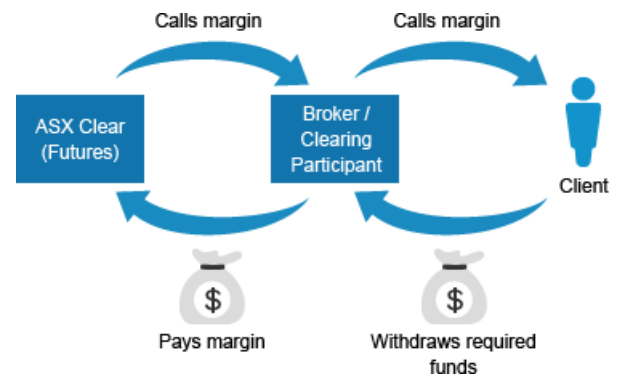
### How long do I have to pay a margin?

Settlement requirements for trading ASX Listed CFDs are strict.

You must pay margin calls by the time stated in your Client Agreement, usually within 24 hours of being advised of the margin call by your broker.

If you do not pay in time, your broker can close out your position without further reference to you. If the initial and variation margins you have already paid are not enough to cover the cost of closing out your position, you will have to pay the shortfall.

CFD traders typically lodge more cash than is required when opening a position to avoid having to provide additional cash on a daily basis.





## Topic 3: Cashflows

### Daily cashflow

The costs and benefits of holding the underlying asset are not built into the price of a CFD.

For example, shareholders incur the cost of funding the shareholding, whether from cash or using borrowed money. On the benefit side, shareholders may receive dividends and franking credits.

The CFD price does not reflect these costs of benefits. Instead, they are paid in a daily cashflow to or from the holder of a CFD position.

Let's take a look at the cashflows of ASX Listed CFDs.

### Contract interest - long CFD position

When you buy shares, you pay the full value of the shares at the time of purchase.

In contrast, when you enter a long equity CFD position, you get full exposure to the underlying shares for an initial margin that is a fraction of the value of those shares.

Effectively you are borrowing the value of the shares.

The interest cost of borrowing that money is not built into the cost of the CFD.

Instead, for each day that your position is open, you must pay contract interest (CI) to cover the borrowing cost of the value of the shares.

### Contract interest - short CFD position

When you enter a short position, the reverse applies. You receive contract interest cashflow for each day you hold a short position.

The contract interest that is paid by holders of long CFD positions is passed via ASX Clear (Futures) to holders of short CFD positions.



### How is contract interest calculated?

For ASX equity CFDs, the CI rate is the overnight cash rate as published by the Reserve Bank of Australia (RBA).

To calculate the daily contract interest payable/receivable, the following formula is used:

$$CI = \text{value of position} \times \text{contract interest rate} / \text{no. of days in year}$$

Interest cashflow is based on the number of calendar days since interest was last paid/received. So three days' interest applies to a position held over the weekend.

### Open interest charge

The open interest charge (OIC) is an amount charged by ASX for holding an open position in an ASX Listed CFD.

The OIC rate is set by ASX and is paid daily by both long and short positions. You can find the current rate at [www.asx.com.au/cfds](http://www.asx.com.au/cfds)

To calculate the daily OIC payable, the following formula is used:

$$OIC = \text{value of position} \times \text{OIC rate} / \text{no. of days in year}$$

Like the contract interest rate, the OIC is based on the number of calendar days since the charge was last paid.

### Total interest rate

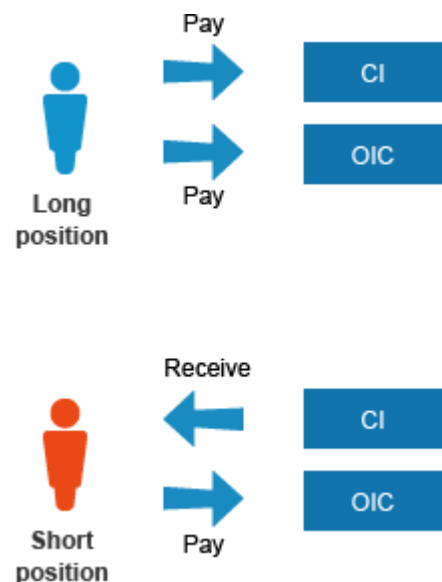
You can work out your combined interest rate by 'bundling' the contract interest and open interest charge.

Long positions pay CI and pay OIC, so:  
**Total interest rate payable = CI + OIC**

Short positions receive CI and pay OIC, so:  
**Total interest rate receivable = CI - OIC**

CI = value of position x contract interest rate/no. of days in year

Number of CFDs	DSP	Position value	Contract interest rate	Contract interest
10,000	\$5.00	\$50,000	3.5%	\$4.79
8,000	\$8.00	\$64,000	3.5%	\$6.14
2,000	\$26.00	\$52,000	3.5%	\$4.99



### Example

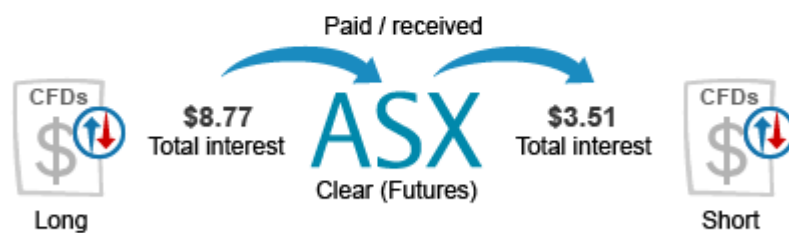
Assuming:

- CI rate = 3.50%
- OIC rate = 1.5%

Total interest rate payable for long CFD positions  
= 5.0%

Total interest rate receivable for short CFD  
positions = 2.0%

Total interest example	
Position value	\$64,000
CI rate	3.5%
OIC rate	1.5%
C.I	\$6.14
O.I.C	\$2.63



## Topic 4: Cashflows (continued)

### Dividend cashflow

The shares underlying an equity CFD may pay dividends.

Unlike shareholders, CFD holders do not receive dividends from the underlying company.

Instead, holders of long CFD positions are paid a dividend cashflow.

A share price will typically fall on its ex-dividend date. The corresponding CFD will also fall in value on that date. The dividend cash flow will have offset the variation margin you will to pay as a result of that fall in the CFD price.

Holders of short CFD positions pay the dividend cashflow.

The dividend cashflow that is paid by short positions is passed via ASX Clear (Futures) to holders of long positions.

The cashflow is debited from short positions, and credited to long positions, on the ex-dividend date.

This differs from the timing of dividend payments to shareholders, where the payment date is usually several weeks after the shares go ex-dividend.

### Franking credit cashflow (FCC)

The dividend paid by the shares underlying your ASX Listed CFD may be franked. If this is the case, shareholders will receive a franking credit attached to their dividend.

For holders of CFD positions, the monetary equivalent of the franking credit is the franking credit cashflow (FCC).

Just like the dividend cashflow, holders of short positions pay the FCC, holders of long positions receive the FCC.



## Franking credit cashflow (FCC) adjustment

Holders of short CFD positions must always pay the full FCC.

However, holders of long positions do not always receive the full FCC.

If the designated price makers (DPMs) have a net short position on the last cum-dividend date, then the FCC paid to long position holders will be reduced.

If the DPMs have a net long position, then the full FCC will be paid to long position holders.

For an explanation of how the reduction in FCC is calculated, please refer to [www.asx.com.au/cfds](http://www.asx.com.au/cfds).

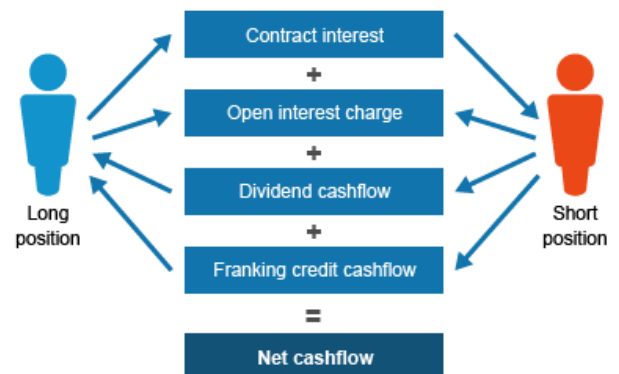
DPM open positions	CFD long positions	CFD short positions
	FCC received	FCC paid
Long > short	Full	Full
Short > long	Reduced	Full

## Net cashflow

Your net cashflow on any given day is simply the sum of the four cashflows for that day:

- contract interest
- open interest charge
- dividend cashflow
- franking credit cashflow

The dividend cashflow and franking credit cashflow are paid/received only when a share goes ex-dividend - typically twice a year. On all other dates, your net cashflow will comprise just contract interest and the open interest charge.



## Cashflows for Index CFDs and CFDs

The cashflows discussed so far apply to ASX equity CFDs.

Cashflows for ASX index CFDs include:

- contract interest
- open interest charge, and
- dividend cashflow.

There is no franking credit cashflow for index CFDs.

Index CFDs are covered in Module 5.

## Topic 5: How CFDs are traded

ASX Listed CFDs are traded on ASX Trade24, which is used to trade key futures and options contracts. ASX Listed CFDs are cleared through ASX Clear (Futures).

Shares and other securities are traded on the ASX Trade platform and cleared through ASX Clear.

The ASX Listed CFD market operates under ASX 24 Operating Rules.

Product	Trading platform	Clearing house
Shares	ASX Trade	ASX Clear
ASX Listed CFDs	ASX Trade24	ASX Clear (Futures)

### CFD brokers

ASX Listed CFDs cannot be traded through all brokers. A current list of brokers is available on the [ASX website](#).

You will need to open a CFD trading account and sign a CFD client agreement. A CFD agreement and account is required even if you already trade shares through the broker.

### DJIA CFDs

ASX equity CFDs are transacted in Australian dollars.

However CFDs over the Dow Jones Industrial Average (DJIA) are transacted in US dollars.

If you intend to trade DJIA, you will need to talk to your broker about how they administer the conversion of Australian dollars into and out of US dollars.

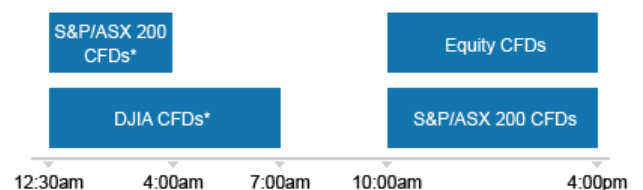
The implications of the foreign currency exposure of DJIA CFDs are discussed in detail in Module 5.

### Trading hours

Trading hours vary for the different types of CFD.

Equity CFDs trade between 10.00am and 4.00pm Sydney time.

CFDs over the S&P/ASX 200 Index have a day trading session from 9.50am until 4.00pm, and an overnight session.



\*Trading hours for Australian daylight saving/US daylight saving shown

CFDs over the DJIA are traded overnight.

The times of the night sessions vary depending on whether Daylight Saving is in operation in Australia and the US.

For current trading hours, refer to [CFD trading hours](#).

### Order types

The order types that can be entered into ASX Trade24 for ASX Listed CFDs are the same as those you can place for shares.

Note that stop loss orders are not available on the ASX trading platform.



## Summary

- A CFD is an agreement for a payment to be made by one party to another, based on the difference between the price of the CFD at the time the CFD position is opened and the price at the time the CFD position is closed.
- You can open your position by buying or by selling. Once opened, your position remains in place until you close it out. CFDs do not expire.
- Although there is no guarantee the two prices will be the same, you can expect the CFD price to be at or very close to the price of the underlying asset.
- On opening a CFD position you lodge an initial margin, typically around 5% to 10% of the value of the underlying asset.
- At the end of each trading day, your CFD position is marked to market, and you will either pay or receive a variation margin.
- CFD position holders pay or receive an amount every day to reflect cashflows such as holding costs and dividends.
- For equity CFDs, cashflows include:
  - Contract Interest
  - Open Interest Charge
  - Dividend Cashflow, and
  - Franking Credit Cashflow.
- ASX Listed CFDs are traded on the ASX Trade24 trading platform, and cleared by ASX Clear (Futures).
- You will need to open a CFD trading account and sign a CFD client agreement with a CFD broker, even if you already trade shares through the broker.