Thinking of trading contracts for difference (CFDs)?

This guide from the Australian Securities and Investments Commission (ASIC) can help you assess the risks of CFDs.

ASIC

Australian Securities & Investments Commission

How this booklet can help you

- This booklet has information about the operation and risks of trading contracts for difference (CFDs). In producing this booklet, ASIC does not endorse or promote this product or consider that it is suitable for many investors.
- The complex structure of CFDs and the risks associated with them mean that they are unlikely to meet the investment needs and objectives of most retail investors.
- Read this booklet, especially the section 'Are CFDs right for you?' together with the Product Disclosure Statement (PDS) before deciding whether or not to trade CFDs.
- ASIC has also developed 7 new disclosure benchmarks for 'over-the-counter' (OTC) CFDs to help you assess the risks.
- CFDs are a complex and risky product. Make sure you understand the risks before making a decision about trading CFDs.
- The information in this booklet is general in nature. For a detailed strategy that takes into account your individual needs and circumstances, consider seeking professional advice from a licensed financial adviser.

Remember

Anything you put your money into should meet your investment goals and suit your circumstances.

No one can guarantee the performance of any financial product.

You can lose all of or more than the money you put in if something goes wrong.

You are taking a big risk if you put all your money into one type of investment (for example, trading CFDs). Spreading your money between different types of investments ('diversification') reduces the risk of losing everything.

Contents

Your questions answered

CFDs are a high-risk financial product. It is important that you understand the key features of CFDs before you decide whether or not to risk your money.

All the information in this booklet is important if you are considering this product. However, if you have a specific question, the following table may help you find the relevant information.

Know what the product is

What is a CFD?

A CFD is a leveraged 'derivative' financial product. CFDs are derivatives because their value is derived from the value of another asset (for example, a share, commodity or market index).

When you trade CFDs, you take a position on the change in value of the underlying asset over time. You are essentially betting on whether the value of an underlying asset is going to rise or fall in the future compared to what it was when the contract was taken out (or executed).

All CFD companies ('providers') let you trade both 'long' and 'short'. 'Going long' means *buying a CFD* in the expectation that the underlying asset will *increase in value*. 'Going short' means *selling a CFD* with the expectation that the underlying asset will *decrease in value*. In both cases, when you close the contract, you hope to gain the difference between the closing value and the opening value.

For example, you might buy a CFD ('go long') over Company X's shares. If the price of Company X's shares rises and you close out your CFD, the seller of the CFD (the counterparty) will pay you the difference between the current price of the shares and the price when you took out the contract.

However, if the price of Company X's shares falls, then you would have to pay the difference in price to the seller of the contract. This could be many times the amount of money you originally put in, because of leveraging.

CFDs do not have an expiry date like options or futures contracts. A CFD can only be closed by making a second, 'reverse' trade.

What is 'leverage'?

CFDs allow you to bet on rises and falls in shares, currency and other assets while only putting up a small amount of your own money. You are leveraging off the money you do have, in the hope of making more.

With CFDs, you only have to put in a fraction of the market value of the underlying asset when making a trade, sometimes as little as 1%. The remaining 99% of the value of the asset is covered by the CFD provider. Even though you only put up 1% of the value, you are entitled to the same gains or losses as if you had paid 100%. The actual percentage of the market value that you will be asked to put in will vary for different CFD providers, and for different underlying assets.

This can make CFDs seem very attractive. Even if you don't have the money to buy the underlying asset itself, you can share in potential gains and losses on the value of that asset.

But because you are trading with leverage, the gains and losses are magnified—and the risks are much greater. You can end up losing much more than you put in.

How is trading CFDs different to investing in shares?

Unlike investing in shares, when you trade CFDs, you are not buying or trading the underlying asset. What you are buying is a contract between yourself and the CFD provider.

Because all you own is a contract with the CFD provider, you are also taking a bet that the CFD provider is in a sound financial position and will be able to meet their obligations to you. For more on this risk, known as 'counterparty risk', see page 14.

Also, while the value of the CFD is derived from the value of the underlying asset, it may not track it exactly. These small differences can significantly affect any gains or losses you make.

What is the ‘underlying asset’?

When you buy or sell a CFD, you are making an agreement to trade the difference in the value of an underlying asset (sometimes called the ‘underlying security’ or the ‘reference asset’) between now and a future date. But you are not actually trading the underlying asset itself.

CFD providers allow you to buy or sell CFDs on a range of underlying assets. Shares are the most common underlying asset. But most CFD providers also allow you to trade CFDs on other underlying assets, such as commodities and foreign exchange (FX).

They may also allow you to trade certain market indices, such as the ASX 100, which aggregates the price movements of all the top 100 stocks listed on the Australian Securities Exchange (ASX).

If you are thinking of trading CFDs, you need to know and understand both how CFDs work and also about the underlying assets on which the CFDs are traded. For example, if you want to trade CFDs where the underlying asset is FX, then you must have knowledge and experience of the FX market and the conditions that affect that market.

All CFD providers are legally obliged to give you a disclosure document called a Product Disclosure Statement (PDS) before you open an account. This document should clearly set out what the underlying assets of any CFDs are. Read this information carefully. If you don’t understand how CFDs work and how the underlying asset, such as FX, works, then you are unlikely to be able to trade CFDs on that asset successfully.

For more about PDSs and information given by CFD providers, see ‘Do your own research’ on page 34 and ASIC’s disclosure benchmarks for OTC CFD providers on pages 42–50.

What's at stake for you?

CFDs are not a simple product. Trading CFDs is complex for several reasons:

- CFDs might seem similar to mainstream investments such as shares, but they are very different.
- CFDs are not standardised and every CFD provider has their own terms and conditions.
- It is very hard to assess the counterparty risks involved in trading with any CFD provider (see page 14).
- Leverage means small market movements can have a big impact on the success of your trades.
- CFDs are dependent on conditions in the market for the underlying asset, even though you are not actually trading the underlying asset.

As well as understanding how CFDs work, you also need a good understanding of the risks of trading CFDs. For more about these risks, see page 12.

Example of a CFD trade

Peter has been trading shares and derivative investments such as options for 10 years and has recently started to trade CFDs. He shopped around and looked at several CFD providers before opening an account.

Peter has been doing some research on Beta Pty Ltd (Beta) and thinks that its share price is undervalued. He decides to take a long position on CFDs over Beta shares.

The current price of a CFD over Beta shares offered by the CFD provider is $5. Peter logs into his CFD trading account and places an order to buy 4,000 Beta CFDs. His order is accepted by the CFD provider at $5 per CFD. The total contract value is $5 x 4,000 = $20,000.

The CFD provider requires a 5% margin to open a trade, which is deducted from Peter's CFD trading account. The margin is equal to $20,000 x 5% = $1,000. The provider also charges Peter a commission of 0.15% of the contract value, which is $30 on this trade.

What happens next depends on what happens to the price of Beta shares (see table opposite).

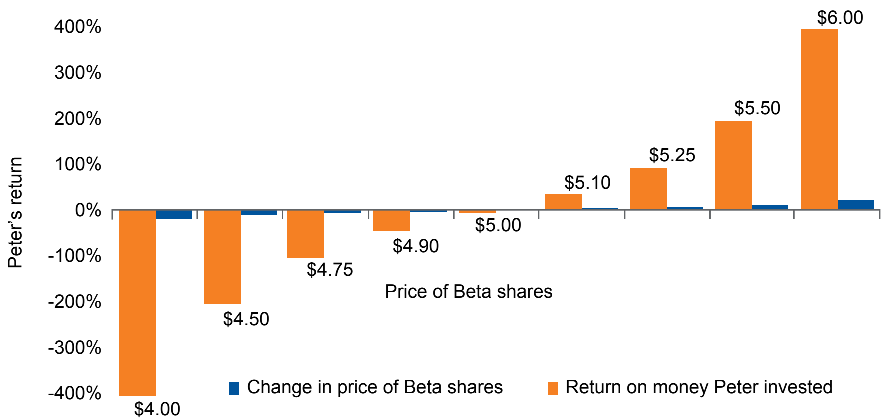
Any gains Peter makes on this trade are also dependent on the CFD provider being willing to accept his trades and meeting all their obligations to him. This includes crediting any gains to his CFD trading account after the closing of a position and transferring them to his bank account on request.

How the price of Beta shares affects Peter's return*

If the price of Beta shares	to	Peter would gain/lose	Resulting in a return on his initial margin of
Rises by 20%	$6.00	$3,934.00	393%
Rises by 10%	$5.50	$1,937.00	194%
Rises by 5%	$5.25	$938.50	94%
Rises by 2%	$5.10	$339.40	34%
Stays the same	$5.00	-$60.00	-6%
Falls by 2%	$4.90	-$459.40	-46%
Falls by 5%	$4.75	-$1058.50	-106%
Falls by 10%	$4.50	-$2,057.00	-206%
Falls by 20%	$4.00	-$4,054.00	-405%

*This example assumes that Peter closes his trade at the indicated price. Gains/losses and rate of return take into account commission charged at 0.15% on the face value of the opening and closing trades, but do not take into account any other fees, charges or interest. In practice, these other factors will affect your returns from trading CFDs.

Return on Peter's CFD trade



Consider the risks

How much can you afford to lose?

The risks and complexity of CFDs mean that they are unlikely to meet the investment needs and objectives of many retail investors.

If you trade CFDs, you are putting potentially very high amounts of your own money at stake. Here are some of the risks in trading CFDs:

- **Investment risk:** This is the risk that investment markets move against you.
- **Counterparty risk:** This is the risk that the CFD provider or another counterparty to a trade fails to fulfil their obligations to you. Trading CFDs exposes you not only to the risk of the CFD provider failing to act as promised, but you could also lose money if other companies the provider deals with, or other clients, fail to meet their obligations.
- **Client money risk:** This is the risk of losing some or all of your money held by the CFD provider.
- **Liquidity, gapping and execution risks:** Market conditions and the mechanics of trading might mean you cannot make trades when you would like to, or that your trades are not filled at the price you expect.

While you can take steps to reduce some of these risks, you cannot protect yourself from all of them. If you are considering trading CFDs, make sure you understand these risks. See also ‘Are CFDs right for you?’ on page 20 and ASIC’s disclosure benchmarks for OTC CFD providers on pages 42–50.

Investment risk

When you buy a CFD over a share, index or commodity (known as 'going long'), you hope that the value of that underlying asset will rise, so you can sell the CFD for a profit. If you a sell a CFD over a share, index or commodity (known as 'going short'), you hope that the value will fall.

However, the reality of investment markets means that even the most educated predictions can prove wrong, especially in the short term. Unexpected new information, changes in market conditions, changes in government policy and many other unpredictable events can result in quick changes in market value.

Because CFDs are very highly leveraged, even a small change in the market can have a big impact on your trading returns.

If changes in market value have a negative effect on your trade, the CFD provider may demand that you put more money in at short notice (called a 'margin call') to cover the adverse change and keep your trade open. If you cannot meet this margin call, you may have to sell at a loss, or the CFD provider may close out your trades at a loss without consulting you. For more about margin calls, see page 31.

Providers of OTC CFDs that meet ASIC's disclosure benchmark on margin calls should clearly explain their policy on margin calls to you. For more information, see page 50.

Counterparty risk

A ‘counterparty’ is the person or company on the other side of a financial transaction. When you buy or sell a CFD, the only asset you are trading is a contract issued by the CFD provider, so the CFD provider becomes your counterparty. In addition to the CFD provider, trading CFDs also exposes you to the provider’s other counterparties, including other clients and other companies the CFD provider deals with.

Counterparty risk (sometimes called ‘credit risk’) is the risk that a counterparty fails to fulfil their obligations.

ASX exchange-traded CFDs carry a much lower level of counterparty risk compared to over-the-counter (OTC) CFDs. This is because the exchange’s clearing house, ASX Clear (Futures) Pty Limited, acts as the counterparty to each trade, so both the buyer and the seller contract with the clearing house and not directly with each other.

All ASX exchange-traded CFD trades are centrally cleared and processed by ASX Clear (Futures) Pty Limited, which can also draw on money in the Fidelity Fund. The Fidelity Fund is designed to assist investors where an investor has given money or other property to an ASX participant for a transaction and the participant has misappropriated or fraudulently misused the money or other property.

For more about the differences between ASX exchange-traded CFDs and other types of CFDs, see pages 22–25. For details about ASIC’s counterparty risk disclosure benchmarks for OTC CFD providers, see pages 46–47.

Following are some examples of the different counterparty risks that can be involved in trading OTC CFDs.

The CFD provider

The success of CFD trading doesn't just depend on picking the right CFDs to trade. When you trade CFDs, you are relying on the CFD provider to accept and process your trades, make payments owed to you while your trades are open (for example, notional 'dividend' payments), credit any proceeds of profitable trades to you, and pay you money out of your CFD trading account when you ask for it.

If the CFD provider gets into financial difficulties, they may fail to meet some or all of these obligations to you. This means that even if you have been trading profitably, you may never receive those profits.

Check the financial statements of an OTC CFD provider, if they are available, to get some idea of whether they have sufficient financial resources and cash available to run their business. Check also the OTC CFD provider's disclosure against Benchmark 4 (Counterparty risk – Financial resources). For details, see page 47.

Other clients

If the CFD provider's business is concentrated with a few clients and one or more of those clients suffer trading losses which the client can't cover, this may cause significant financial problems for the CFD provider, which may then affect whether or not they can meet their obligations to you.

Because most OTC CFD providers pool the money of different clients together into one or more client accounts, your access to money held by the CFD provider could be affected if other clients fail to pay the CFD provider the money they owe. For more information, see 'Client money risk' on page 17.

The CFD provider

Other companies the CFD provider deals with

OTC CFD providers generally have arrangements with other companies that can have a significant impact on you. If one or more of these companies gets into financial difficulty, this may affect the ability of the CFD provider to meet their obligations to you.

For example, the CFD provider may ‘hedge’ your trades with one or more other companies. This means that if you place a CFD trade over a particular share, commodity or index, the CFD provider may take out corresponding arrangements with another company to get exposure to that share, commodity or index for internal risk management purposes. If the other company doesn’t deliver what they promised under the hedging arrangement, the provider may close your trades without warning or be unable to pay you any profits or other money.

Look for information in the CFD provider’s Product Disclosure Statement (PDS) or ask them about their hedging arrangements. If they hedge with multiple companies of strong financial standing, this can reduce the risk of something going wrong.

Some CFD providers ‘white label’ another company’s CFDs. This means the CFD provider relies very heavily on the other company to be able to offer CFDs, process trades and administer client CFD trading accounts. The CFD provider is also totally reliant on this company for hedging. In this situation, the CFD provider may have only very little capital or resources themselves. This exposes you to the double risk of either the CFD provider or the company they rely on getting into financial difficulties.

For details about ASIC’s disclosure benchmarks covering counterparty risk for OTC CFD providers, see pages 46–47.

Client money risk

The law sets down some requirements for how CFD providers deal with your money, including how they handle it and what they can do with it. They must separate your money from their own money. They are not obliged, however, to separate your money from the money of other clients and most providers 'pool' all their clients' money into one or more pooled client accounts.

While the client money provisions in the law protect you from some misuses of your money by the CFD provider, they don't protect you in all circumstances.

When you place a CFD trade, the law permits the CFD provider to withdraw an initial margin and any further margin required from the pooled client account while the trade is open. Not all CFD providers do this. If the CFD provider does withdraw margins from the client account, the money ceases to be 'client money' and is no longer protected by the law.

The customer agreements used by some OTC CFD providers allow them to make withdrawals from client money for a wide range of other purposes. You should check the details carefully as these clauses mean that your money is much less protected. Read the terms of the client agreement and PDS carefully to find out where you stand (see page 34). For the client money disclosure benchmark for OTC CFD providers, see page 48.

The actions of other clients can also affect the protection of your money. Because most CFD providers pool all their clients' money together in one or more accounts, if one client fails to pay money they owe (for example, on a losing trade), the pooled client account which is holding your money could be in deficit. If the CFD provider does not cover this deficit, there may not be enough money in the account to pay you what you are owed. If the CFD provider goes out of business while the pooled client account is in deficit, there is no guarantee that you will recover all or any of your money that is in the account.

Liquidity risk, gapping and other trading risks

Liquidity risk is a reality of trading on any market.

If there aren't enough trades being made in the market for an underlying asset (called a lack of 'liquidity'), you may be unable to trade CFDs over that asset. The CFD provider may either decline to fill your trades, or only agree to process the trade at an inferior price, even if you already have an open CFD position over that underlying asset. This means you could be left with an open CFD position that you are unable to close.

CFD and other market prices can move very quickly and sometimes they can even skip one or more price points. For example, the price of a CFD could fall from $2.54 to $2.50 without trading at any of the prices in between. If you had placed a trade to sell this CFD at $2.52, your order may only be executed at $2.50 (or less) or alternatively not executed at all (depending on the order type). This is known as 'gapping'.

Gapping is a fundamental risk of trading CFDs. You may be told or hear that a stop-loss strategy or a particular order type can mitigate the risk of gapping. You should be wary of such advice. See our warning on stop-loss strategies on page 32.

In addition, when you place a buy or sell order with a CFD provider through their trading platform or over the telephone, there may be a time lag between when you place your order and when that order is executed (this is called 'execution risk'). If the market for the underlying asset moves in the time between when you place the order and the execution of the order, this could also result in your trade being executed at a worse price than when the order was made, especially if markets are very volatile.

What's at stake for you?

The risks of trading CFDs are significant, and some of them can be very difficult to assess. Even if you manage investment risk and the risks associated with leverage, it is very difficult to manage the other risks of CFDs—such as counterparty risk, client money risk, liquidity risk, gapping and execution risk—and these could result in losses you did not expect.

You need to consider whether the uncertain returns from trading CFDs justify the time and effort you need to put in to assess and try to manage these risks. Remember, if things go wrong, your losses could outweigh any gains you have made. **Depending on the terms and conditions of your agreement with the CFD provider, the potential losses are unlimited.**

Are CFDs right for you?

Perception versus reality

Unfortunately, many novice traders are attracted to CFDs by slick advertising and free seminars (see 'Tips and traps' on page 51). Yet people who have traded CFDs point out that CFDs are not 'get rich quick' products.

People who have traded CFDs say that novice or beginner investors should not start by trading CFDs. These products do not suit people who are risk averse or conservative in their investment style.

You should only consider trading CFDs if:

- you have extensive trading experience
- you are used to trading in volatile market conditions, and
- **you can afford to lose all of, or more than, the money you put in.**

The following table compares the expectations people might have before they trade CFDs with the reality of trading CFDs.

Expectation	Reality
CFDs are easy to trade and don't require a lot of effort.	CFD trades need to be regularly monitored.
CFDs generate high returns.	People who trade CFDs often suffer trading losses. Large returns on individual trades are often counterbalanced by losses on others.
Trading CFDs is similar to online share trading.	While CFD trading platforms are similar to those for online share trading, the nature and risks of trading CFDs are quite different.
Education seminars will provide the necessary skills for trading.	People who attend education seminars before trading CFDs still have to learn a significant amount about the products while trading.

‘I didn’t realise how stressful it would be if trades were not doing what [I] expected. What do you do, how do you cope with that? Because [nobody] really talks about that. They said, “You’ve got to manage your risk”, but what does that mean?’ – CFD trader

What’s at stake for you?

If you are thinking about trading CFDs, here are some questions you should ask yourself:

- How much experience do you have trading shares? Do you understand the differences between investing in shares and trading CFDs?
- What are your investment goals? Does trading CFDs fit in with those goals?
- How much risk are you willing to take when investing?
- How much of your investment portfolio are you looking to put into trading CFDs?
- If your trading goes badly, do you have extra money or assets to cover any losses?
- How much experience do you have with other speculative or volatile investments? Is it enough?
- How much experience do you have in borrowing to invest?
- How much time can you devote to trading CFDs and monitoring your trades? Will it be enough?
- Have you read and do you understand the PDS for the CFDs?
- Do you have a plan to monitor and manage the risks of trading?
- How well could you cope psychologically with wide swings in returns on trades?

Not all CFDs are the same

CFD provider business models

If you decide to open an account with a CFD provider, you should know what the provider's business model is (that is, how they structure and price their CFDs). In Australia, there are three types of business models: 'market maker', 'direct market access' and 'exchange-traded'.

Market maker and direct market access models are both provided over-the-counter (OTC) and are the most commonly available CFDs in Australia and overseas. Several CFD providers offer both market maker and direct market access CFDs, so you need to pay careful attention to what type of CFDs you are buying or selling for any trade. Exchange-traded CFDs are provided by the Australian Securities Exchange (ASX) and this model is unique to Australia.

In all cases, the CFD provider determines the underlying assets on which CFDs may be traded. They also define the terms and conditions of the client agreement, including the margin requirements for client accounts (see page 30).

The following table summarises the features of each model.

Market maker model (OTC)	In a market maker business model, the CFD provider comes up with their own price for the underlying asset on which the CFDs are traded.
Direct market access model (OTC)	In a direct market access model, the CFD provider places your order into the market for the underlying asset. The price you pay will be determined by the underlying market.
Exchange-traded model (ASX)	In the exchange-traded model, you are trading CFDs that are listed on the ASX. ASX exchange-traded CFDs can only be traded through brokers authorised to trade these CFDs.

What are market maker and direct market access CFDs?

With these OTC CFDs, you enter directly into an agreement with the CFD provider to trade CFDs. The term ‘OTC’ refers to the fact that each provider has their own CFD terms and conditions, and that the CFDs are traded directly between clients and the CFD provider, rather than on an exchange such as the ASX. CFD providers may issue OTC CFDs either via the market maker or the direct market access models.

Market makers quote their own prices for all CFDs they offer. The price offered may or may not diverge significantly from the market price of the underlying asset. People who trade CFDs are expected to be *price takers* (rather than price makers as for the other business models). Market makers may or may not hedge client positions with other counterparties or in the underlying market (see ‘Questions to ask the CFD provider’ on page 26 for more about ‘hedging’). This means that the CFD provider may directly benefit if you lose on your trade.

Market makers tend to offer more CFDs than other providers as they can write CFDs against ‘synthetic’ assets (for example, an index) or against real assets, even if there is little or no liquidity in the market for the underlying asset, or a market does not exist.

The CFD prices of *direct market access* providers correspond directly to the prices of those assets in the underlying market. These CFD providers automatically place each client order into market for the underlying asset, so people who trade CFDs are *price makers*. The CFD providers do not carry any market risk from the trade. As a result, these providers will only offer CFDs over an asset if there is sufficient trading volume in the underlying market.

What are ASX exchange-traded CFDs?

ASX exchange-traded CFDs are listed on the ASX. They are traded through brokers authorised by the ASX to deal in these CFDs. The CFD terms and conditions are standardised by the ASX, which reduces some of the risks. The market for these CFDs is separate to the market for the underlying assets.

In the exchange-traded model, CFD prices are determined by trading activity in the CFD market, and people who trade CFDs may be price makers. CFD prices closely follow the market price of the underlying asset, although there may be divergence if there is limited liquidity in the CFD market.

ASX 24 (formerly the Sydney Futures Exchange), which is part of the ASX Group, is responsible for registering, clearing and processing all trades in ASX exchange-traded CFDs. ASX 24 acts as a counterparty to these transactions, which means that both the buyer and the seller contract with ASX 24 and not directly with each other. This significantly reduces counterparty risks you are exposed to. For more about counterparty risk, see page 14.

ASX exchange-traded CFDs are regulated by ASX and ASX 24 operating rules and ASIC market integrity rules.

What's at stake for you?

In the market maker business model, the CFD provider determines their own price for the CFDs they offer, which may be the same as the market price for the underlying asset, or may involve an extra margin on that price (known as a 'spread'). This means you must accept whatever price the CFD provider makes for the underlying asset (or other products) on which you are trading. The CFD provider can also reserve the right to re-quote prices after you have submitted an order.

In the direct market access business model, the CFD provider's prices match those in the underlying market. But if there is not much trading in the underlying market, you may not be able to open or close CFD trades when you want to. These providers also tend to offer fewer CFDs than market makers.

In the exchange-traded model, you can't directly trade ASX exchange-traded CFDs yourself. This means you must open an account with a broker authorised to trade these CFDs. However, the counterparty risk is less. Check the ASX website at **www.asx.com.au** for a full description of how ASX exchange-traded CFDs work and a list of authorised brokers.

Questions to ask the CFD provider

It can be difficult to figure out which business model a particular CFD provider uses. Ask the CFD provider these questions, or look for answers in the PDS, to work out which model they use and what it means for you. For OTC CFD providers, check whether they meet ASIC's 7 disclosure benchmarks (see pages 42–50).

Q: What is the financial position of the CFD provider?

To adequately run their day-to-day business, a CFD provider must have enough capital and cash flow. Don't take glossy advertising and a slick website as a sign that the provider is financially secure. Wherever possible, check the facts by reading the provider's financial statements if they are available.

Q: What is the CFD provider's policy on the use of client money?

The law sets down some requirements for how CFD providers deal with your money. Not all CFD providers handle and use client money in the same way. Some providers give your money more protection than others, so make sure you find out what a CFD provider's policies are, and check how they compare to other providers. For more information on client money risk, see page 17.

Q: How does the CFD provider determine the prices of CFDs they offer?

CFD providers should let you know how they arrive at their CFD prices. Some OTC CFD providers' prices mirror the price of the underlying asset (direct market access providers). Other OTC CFD providers (market makers) may add an extra amount ('spread') to the underlying market price. The spread may be fixed or may vary.

The pricing of CFD providers who use the direct market access model is more transparent, but they may offer a more limited range of CFDs. CFD providers who determine their own prices generally offer more CFDs, but you need to consider the impact of wider spreads and the possibility of re-quoted prices on your trading profits.

Prices for ASX exchange-traded CFDs are determined by trading on the ASX CFD market, which is transparent.

Q: Can the CFD provider change or re-quote the price after you have already placed your order?

Some CFD providers reserve the right to re-quote prices to you after you have placed your order. While these CFD providers tend to offer a wider range of CFDs than other providers, re-quoting of prices by providers can affect the profitability of your trades.

Q: When processing CFD trades, does the CFD provider enter into a corresponding position in the market for the underlying asset?

CFD providers using the direct market access business model promise to ‘hedge’ all client trades in the underlying market.

This means that when you place a CFD trade, you should be able to see the corresponding trade being placed in the underlying market. This makes the CFD pricing and trading process more transparent for people trading CFDs, although it limits the number and types of CFDs that can be traded. Even though the order is placed in the underlying market, it doesn’t mean that you own or are entitled to the underlying asset, and you are still subject to counterparty risks.

Market maker CFD providers may also hedge the CFDs they offer, but these arrangements are generally less transparent than for direct market access providers. Market makers may not hedge all the CFD trades you place, and so may directly benefit if you lose on your trade.

For all OTC CFD providers, make sure you read the PDS or ask the provider about their hedging policy, including what will happen to your trades or your account if the hedging fails. If a provider only hedges with one company, this can significantly increase the risks for you. Check whether the provider meets ASIC’s 7 disclosure benchmarks (see pages 42-50).

Q: If there is little or no trading going on in the underlying market for an asset, can you still trade CFDs over that asset?

Being able to make trades even if there is little or no trading going on may be useful if you have an open CFD position that you want to close. However, in these circumstances, CFD providers are very likely to apply wider spreads or re-quote on CFD trades, which can affect your trading bottom line. Also, most CFD providers reserve the right to refuse to accept trades, so you can’t rely on being able to trade in these circumstances.

Q: Does the CFD trader let you trade CFDs even if the underlying market is closed?

While it might seem good to be able to trade whenever you want, there are additional risks involved if the CFD provider lets you trade when the market is closed. When the underlying market is closed, you can’t check how CFD prices compare to market prices, which could result in price distortions.

Trading essentials

How you trade CFDs depends on the CFD provider. The terms and conditions of client agreements vary widely and can be structured in many different ways.

It's especially important to understand how the CFD provider handles trades, including what trading platform they use and what you'll be paying to trade.

For more about CFD trading jargon and what it really means, see page 38.

CFD trading platforms

A CFD trading platform is the system a CFD provider uses to allow you to make CFD trades.

Usually, when you open an account with a CFD provider, you are given online access to their trading platform. You log on to the platform and place your buy and sell orders. The platform also provides you with a suite of research tools and certain kinds of information, such as data on the way underlying assets are performing in the market.

CFD providers each have their own particular platform. Some may be physically easier to use than others. Some CFD providers may offer telephone or mobile phone services through which you can place buy and sell orders.

You must do your own independent research on the quality of the trading platforms that are currently available. If possible, you should trial a CFD provider's platform before opening an account (see page 51).

Fees and charges (including interest)

You must pay the CFD provider fees and charges to trade CFDs.

In all cases, CFD providers will charge you for each order that you place on their trading platform. This charge may vary from provider to provider.

In most cases, CFD providers will also charge you for additional information or research data, such as data on ASX or foreign market shares. Some CFD providers may tell you that you have access to certain information free of additional cost, as long as you make a certain number of trades per month. But remember, you are still paying for those trades.

As well as fees and charges for trading, the CFD provider will charge you interest on any long CFD positions held open overnight. Often interest is charged on the full face value of your trade. The interest rate you are charged will vary depending on the CFD provider.

The PDS and the terms and conditions of the client agreement should clearly set out all fees and any other charges. It should also clearly set out how interest will be charged on any leveraged trade. While it may not indicate a specific amount, it should give you a method for calculating the interest and explain how and when interest is charged.

Make sure you understand what you are paying for and how you will be charged. Keep records of what you pay. If you have any complaints or disputes about fees and charges that you can't resolve with the CFD provider, contact the provider's external dispute resolution scheme (see page 54).

Margin requirements

To open a CFD trade, you need to pay a margin, which will be a percentage of the total value of the trade. For example, if you buy a CFD over XYZ shares, you may need to pay a margin equal to 5% of the current XYZ share price. The initial margin amount will be withdrawn from your account by the CFD provider when you place the trade.

Different CFD providers will have different margin requirements for CFDs over the same underlying asset. Margin requirements will tend to be higher for CFDs over shares than for other assets.

Even if you shop around for the lowest margin rates, you need to remember that regardless of how little margin you pay, you are always responsible for the full face value of the trades you make. Paying less margin upfront means that small price fluctuations can have a bigger impact on your trades.

For example, if you have a trade open and the market moves against you, the CFD provider may demand that you pay an additional margin to keep the trade open. If you have cash in your trading account, this additional amount will be automatically debited. However, if you don't have enough money in your CFD trading account, the provider may make a margin call demanding extra funds.

Margin calls and liquidation

A CFD provider will make a margin call when you have a CFD trade or trades open which have lost money, and there is not enough cash in your CFD trading account to cover this loss.

The CFD provider may contact you, either by telephone or by email, to alert you to your margin call requirements and to ask you to put extra money in. However, they are not obliged to do so. Many providers expect you to monitor your account regularly and so may not notify you of a margin call.

If you get a margin call, you will usually have to pay in extra money that same day, or face automatic closing (called 'liquidation') of one or all of your trades.

CFD providers will also usually set a 'liquidation' level on your CFD trading account. This is the level at which any open CFD trades will be closed if you do not have enough money in your account to cover adverse movements on your trades. CFD providers may express this level as a percentage, say 10–20%, of your margin requirement.

For example, you might be required to keep $1,000 in margin. If the balance in your account goes down to $100 (at 10% liquidation level), the CFD provider may liquidate your open trades, as well as charging you a fee (penalty) for the liquidation.

The PDS and the terms and conditions of the client agreement should clearly set out margin call procedures and your rights and obligations. It should also set out the circumstances in which the CFD provider will liquidate your trades.

For details about ASIC's disclosure benchmark on margin calls for OTC CFD providers, see page 50.

Stop losses

A stop loss is a trading strategy that may mitigate some of the risks involved in trading CFDs. Most CFD trading platforms will allow you to set a stop-loss price at which you will be automatically closed out of an open trade. This means that if the underlying asset on which you are trading reaches a certain price, your trade will be closed out.

Relying on a stop-loss strategy can be risky. Even if you have set a stop-loss price, the CFD provider may not always execute your stop-loss at the price you have set.

This will only be the case if you have a 'guaranteed stop loss'. When you set a guaranteed stop-loss price, the stop-loss will always be executed when the underlying asset reaches your set price. This is a premium service for which CFD providers charge a premium price.

You need to read the PDS and the terms and conditions of the client agreement to understand the stop-loss options for a particular CFD and what you might risk if stop-loss orders aren't guaranteed.

'Dividend' payments

If you buy shares in a company, you normally receive dividends on those shares. If you trade CFDs over an underlying asset, you are not buying that asset itself. However, CFDs are designed in such a way so that you still receive some of the benefits of ownership.

When you buy a CFD over an underlying asset, your CFD trading account will be credited with a certain amount of money that mirrors what the owner of that asset (for example, a shareholder) would receive as a dividend payment.

On the other hand, when you sell a CFD over an underlying asset, your CFD trading account will be debited with a similar amount, which is paid to the counterparty.

Make sure you read the PDS and the terms and conditions of the client agreement so you understand how and when dividend payments are made to you and when you must pay them.

What's at stake for you?

The way a CFD provider operates—and the terms and conditions of a particular client agreement—can have unexpected consequences:

- For example, people who trade CFDs have reported problems with some trading platforms that are currently available, including delays in the execution of buy and sell orders. This means market conditions might change and you could lose out.
- Even if you're thinking of accessing a trading platform via mobile phone, remember that mobile phone connections to the internet are notoriously slow and prone to connectivity issues. Don't be fooled into thinking that trading on your mobile phone will make trading easier.
- Check what the CFD provider will do in the event of a margin call. Margin calls can be very stressful events and often you are only given a short amount of time to transfer extra money to cover the margin call. If you can't quickly transfer extra funds, the CFD provider may automatically close ('liquidate') your open CFD trades to prevent losses escalating, although you will still be liable for any losses incurred.
- CFD providers often reserve discretion to liquidate your trades without warning if your CFD trading account is in deficit. If the CFD provider keeps your trades open, even when they have run into losses that cannot be met by your margin, you will lose more money than if the trades had been liquidated.

Before you sign any agreement, ask the CFD provider to clarify their policy and procedures on these important points.

For details about ASIC's disclosure benchmark on margin calls for OTC CFD providers, see page 50.

Do your own research

Trading CFDs is time consuming and requires significant research, diligence and patience.

Regardless of how you trade CFDs, it's important to understand the features and risks of the product before you trade. A good place to start is the Product Disclosure Statement (PDS). But make sure that the PDS is up-to-date:

- For ASX exchange-traded CFDs, check with the broker that the ASX has authorised them to deal in these CFDs, or contact the ASX directly.
- For OTC CFDs, check with the CFD provider that the PDS is current and ask if they have issued any supplementary disclosure information. Also check if the provider meets ASIC's 7 disclosure benchmarks (see pages 42-50) and if they do not meet a benchmark, the explanation of why not.

You should also read closely the terms and conditions of any client agreement to trade CFDs and any other relevant information on the CFD provider's website.

Some CFD providers issue many documents, including the mandatory PDS and a Financial Services Guide (FSG). Certain providers will take some or all of these documents as forming part of the terms and conditions of their agreement with you. This might mean that the rights and obligations set out in some or all the disclosure documents will determine your rights and obligations when dealing with the CFD provider.

What information is available through the CFD provider's website?

All CFD providers put information about CFDs on their websites. The PDS and any other disclosure information on the CFDs should also be available on the website, although this information can be difficult to locate. If you cannot easily find the information you need, contact the CFD provider.

Information about ASX exchange-traded CFDs can be found on the websites of brokers that the ASX has authorised to trade these CFDs, and on the ASX website at www.asx.com.au.

What information is provided at seminars?

CFD providers often hold free seminars to promote their products. You might see advertisements for these seminars on a provider's website or on television or in the financial press. CFD providers promote these seminars as 'information' or 'education' seminars.

The information provided at these seminars does not always give you a complete picture about how difficult and time consuming trading CFDs can be. This information is also unlikely to fully reflect the risks involved in trading CFDs, including margin calls, counterparty risks (especially for OTC CFDs) and technical issues with trading platforms.

As part of your research strategy, carefully assess the information you receive from CFD providers and ask them for more information and clarification if necessary. Avoid being drawn in by any promotional deals offered to attract clients, such as mobile phones or other benefits given for signing up on the spot (see 'Tips and traps' on page 51 for more about promotions).

Above all, never rely solely on the information provided at a seminar to make a decision about trading CFDs. The presenters at a seminar do not know anything about your financial situation or goals. They are not in a position to recommend CFDs to you. It is up to you to check the PDS and do your own research before deciding to trade CFDs.

What about recommendations from family or friends?

If you are thinking about trading CFDs, don't rely on word-of-mouth from family or friends. Just because a family member or a friend has successfully traded CFDs does not mean that you will have the same experience.

CFDs are not an investment like shares. You do not buy and sell a CFD in the same way that you would a share. While it might be tempting to trust your family, friends or colleagues, it is always preferable to do your own research about trading CFDs.

Why is the PDS important?

The PDS from the CFD provider contains important information that you must read and understand before deciding to trade CFDs, either over-the-counter or through an exchange.

The PDS tells you how the particular CFDs work. It should tell you everything you need to know about the CFD provider and the trading platform they use. It should also tell you about the risks of trading CFDs and the terms and conditions of the client agreement.

The PDS should explain the key features and risks of trading CFDs and, for OTC CFDs, give you information about certain indicators or disclosure 'benchmarks', which can help you assess the risks of OTC CFDs (see pages 42-50).

Some people find the PDS hard to read and understand. It is very important that you carefully read all the sections of the PDS that explain:

- the CFD provider’s business model and trading platform
- for OTC CFD providers, whether they meet ASIC’s 7 disclosure benchmarks, and if they do not, an explanation of why not
- the underlying assets you can trade
- fees and charges (including interest)
- how the CFD provider handles counterparty risk
- trading strategies such as gapping and stop losses
- the CFD provider’s policy on margin calls and liquidation
- dividend payments
- how the CFD provider handles client money, and
- complaint and dispute procedures.

You should check that you can find all of this information prominently displayed in the PDS.

A ‘PDS in-use’ notice must be lodged with ASIC before a PDS can be used by the CFD provider. However, this does not mean that ASIC has checked or endorsed the product or the CFD provider in any way.

How to read a PDS and other disclosure documents

Highlighted below are the most important issues to check in a PDS or other disclosure document, with an explanation of what to look for and some things you should consider.

PDSs and other disclosure documents for CFDs vary widely depending on the CFD provider. This is only an indication of the important information to look for.

Provider

What to look for	Things to consider
The PDS should state clearly who the provider is—that is, the company providing (or 'issuing') the CFDs. A company will sometimes offer CFDs created by another company (known as 'white-labelling').	• Which company is actually providing the CFDs? • Is there enough information about the history, performance and financial strength of the provider?

Key product features

What to look for	Things to consider
The PDS should explain how CFDs work, what CFD products the provider offers, and how they operate. It should also summarise key product features such as minimum account balance, minimum trade size, trading hours and so on. The provider may also discuss what they see as the key benefits of trading their products.	• Does the provider offer CFDs as a market maker or by direct market access, or do they offer ASX exchange-traded CFDs? • What discretions does the CFD provider have (for example, in accepting trades or quoting prices)? • Do the potential benefits of trading CFDs outweigh the risks for you?

Disclosure benchmarks

What to look for	Things to consider
OTC CFD providers should address the benchmarks on an 'if not, why not' basis to help you understand the risks.	• Does the provider meet each benchmark? • If not, do they explain why and say how they deal with this risk in another way? • Are you satisfied with how the provider deals with this risk?

Risks

What to look for	Things to consider
The PDS should clearly explain the risks involved in trading CFDs. It should also explain any specific risks that apply to the particular type of CFDs the provider offers. These risks include the risk of losing all of (or more than) the money you put in, the risk of margin calls, liquidity risk and counterparty risk.	• Do you understand all the risks that are discussed? • Are there any strategies that can be put into place to manage those risks? • If a worst-case scenario happened, could you cope with losing much more money than you invested?

Fees and charges

What to look for	Things to consider
All CFD providers charge you to trade CFDs on their trading platform. Fees and charges may include: • commissions on trades • interest and financing charges • rollover charges • interest charges applied to debit balances in your account • exchange fees • guaranteed stop-loss premiums • data and software fees • account keeping fees • administrative charges.	• Do you know which fees are compulsory and which can be avoided? • Do you have to pay data and software costs even if no trades are made? • Are there any account inactivity fees? • Are there any fees for transferring money in or out of your CFD trading account?

Types of accounts

What to look for	Things to consider
You must open an account with a CFD provider if you want to trade CFDs. The PDS should explain the different types of accounts offered and the process for opening an account.	• Does the CFD offer an account type that suits you?

Trading CFDs

What to look for	Things to consider
CFD providers allow you to execute trades on their trading platforms, usually by placing orders over the phone or online using the provider's trading platform software. The PDS should explain how you can make trades.	• Do you understand any discretions the CFD provider has? • Do you know how to track trades and open CFD positions? • Are there are any circumstances where the provider will close their CFD market?

Types of orders

What to look for	Things to consider
The PDS should outline the different types of orders the CFD provider offers. These may include 'market orders', 'limit orders', 'contingent orders', and stop-loss orders. The PDS should also explain whether the CFD provider offers both long and short orders and in what circumstances.	• Do you understand the different types of orders? • What are the costs for different orders? • Is it possible to change or cancel orders after they have been placed? What are the costs? • If the CFD provider offers stop-loss orders, are they guaranteed? • Do you understand how to close out your position on a CFD?

Client money

What to look for	Things to consider
How the CFD provider can and cannot deal with your money is regulated by law. The PDS should make it clear how the CFD provider complies with these requirements.	• Does the CFD provider clearly explain what they will and won't do with your money? • What are the implications of their policies for you? • Will you be affected if other clients suffer losses they cannot pay?

Margin requirements

What to look for	Things to consider
CFD providers may require different levels of margin depending on the CFD or account type.	• What are the margin requirements for the CFDs to be traded? • Can the margin requirements change after a trade is opened?

Margin calls

What to look for	Things to consider
The PDS should explain what the CFD provider's processes are for making a margin call, including whether they will contact you directly about the margin call, how long you will have to meet the margin call, and any other discretion they have to close out your trades if a margin call occurs.	• Do the CFD provider's policies on margin calls suit you? • Will you have extra money available if you need to cover a margin call? • What might you risk if you can't find the money (for example, would you be putting other assets, such as your house, at risk)?

Client complaints

What to look for	Things to consider
The PDS should explain how the CFD provider handles client complaints and disputes (see page 54).	• Are the CFD provider's processes for dealing with client complaints fair and clearly explained?

Tax implications

What to look for	Things to consider
The PDS should explain the tax implications of trading CFDs.	• Have you sought professional advice about the specific tax implications for you of trading CFDs?

ASIC’s 7 disclosure benchmarks for OTC CFDs

ASIC has developed 7 benchmarks to help you assess the risks of trading over-the-counter (OTC) CFDs.

Each provider of OTC CFDs should state in their PDS whether or not they meet each benchmark. If a provider does not meet a benchmark, they should explain why not, allowing you to decide whether you’re comfortable with the explanation. OTC CFD providers should disclose the additional risks to you and describe any alternative strategies they have in place to deal with these risks.

You should find this information in the first few pages of a PDS. An OTC CFD provider should also update you about any significant changes to this information over time (through ongoing disclosure). Ask your provider whether they will provide regular updates about their disclosure against benchmarks, and where you can find this information.

Here’s how you can use ASIC’s benchmarks to assess the risks in OTC CFDs:

Look for information about each benchmark in the PDS.

Check if the provider meets the benchmark.

If a benchmark is not met, does the provider explain why and say how they deal with this risk in another way?

Are you satisfied with how the provider deals with the risk?

If not, are you willing to risk your money trading these CFDs?

ASIC’s 7 disclosure benchmarks for over-the-counter CFDs

These benchmarks are designed to help you:

- understand the risks of OTC CFDs, and
- decide whether to trade OTC CFDs.

Remember

Remember: Even if an OTC CFD provider meets all the benchmarks, you could still lose some or all of your money if things go wrong. The benchmarks are simply designed to help you understand the risks and make a decision about whether to trade OTC CFDs.

Take your time and think things over before you trade OTC CFDs. Get professional financial advice if you’re unsure what to do.

1 Client qualification

To meet this benchmark, an OTC CFD provider should have a written policy explaining the minimum criteria you need to meet before you can open a CFD account. They should outline how and why you will be stopped from opening an account if you don't meet the criteria. Providers should also keep written records of client assessments.

Qualification assessments may include online tests, face-to-face meetings or telephone interviews. You should also be offered a 'practice account' so you can try trading OTC CFDs without using real money.

A provider's PDS should clearly explain their qualification policy and that, because of the risks, CFD trading is not suitable for all investors.

What's at stake for you?

Qualification assessments can help you decide whether OTC CFD trading is right for you, and whether you understand the features and risks.

Even if you meet the criteria, CFDs remain complex and risky products that are unlikely to meet the investment needs and objectives of most retail investors. The qualification assessment, meeting or interview is not personal financial advice, and you should not solely rely on it when making your decision.

If you are assessed and do not meet the qualification criteria, you should not trade CFDs.

2 Opening collateral

To meet this benchmark, an OTC CFD provider must only accept cash or cash equivalents, or credit card payments under $1000, from individuals opening CFD accounts.

A provider's PDS should explain the forms of money they accept as opening collateral. If non-cash assets (such as property or shares), or credit card payments above $1000, are accepted, the PDS should say why and explain the additional risks to you.

What's at stake for you?

If you open a CFD account using money other than cash, your risks may be higher. For example, using borrowed money (including credit card debt) to trade CFDs which are already 'leveraged' products, may increase your risks and potential debts.

If you don't have enough cash or money in your bank account to start trading CFDs, and you use your credit card instead, you may be less able to cover future CFD losses.

3 Counterparty risk − Hedging

To meet this benchmark, an OTC CFD provider should have a written policy explaining how they manage (or ‘hedge’) their market risk. The policy should explain how they select the companies they deal with (‘hedging counterparties’), and make their identities available to you.

A provider’s current hedging policy should be displayed on their website.

Providers should also give a clear explanation of the counterparty risk associated with OTC CFDs.

What’s at stake for you?

If a CFD provider does not hedge its risks, and bears too much risk itself, your risks are increased.

It’s important to understand the financial standing of both the CFD provider and their hedging counterparties because this may affect the safety of your investment.

If a provider owes you money but defaults on their obligations and goes into liquidation, you will become an unsecured creditor in the winding up of the provider. This means you may not get some or all of your investment back.

For more information about counterparty risk, see page 14.

4 Counterparty risk − Financial resources

To meet this benchmark, an OTC CFD provider should have a clear policy on maintaining adequate financial resources. It should tell you how they monitor compliance with their financial licence conditions and how they 'stress-test' their ability to withstand significant adverse market movements.

A provider's PDS should explain this policy, and the latest audited annual financial statements should be available to you either online or as an attachment to the PDS.

What's at stake for you?

If a provider has insufficient financial resources, they risk not being able to meet their obligations to you and other investors, and may need to use client money to meet their obligations. This increases risks for investors.

For more information about counterparty risk, see page 14.

5 Client money

An OTC CFD provider should maintain and apply a clear policy on the use of client money, including whether they use money deposited by one investor to meet the margin or settlement requirements of another.

If a provider's policy allows them to use money deposited by one client to cover money they are owed from another (including margin or settlement requirements), this practice and its additional risks should be clearly and prominently explained.

What's at stake for you?

Your risks are increased if all client money is pooled, and if money owing to you can be used to cover another customer's margin or settlement requirements. If a provider goes out of business while the pooled account is in deficit, you may not receive all of your money back.

For more information about client money risk, see page 17.

6 Suspended or halted underlying assets

To meet this benchmark, an OTC CFD provider should not allow you to open new CFD positions when ordinary trading in the underlying assets, such as shares, has been suspended or halted.

A provider should clearly explain their approach in the PDS. The additional risks of opening new CFD positions when underlying assets are suspended or halted should also be explained.

What's at stake for you?

If you are able to open new CFD positions when underlying assets are suspended or halted, your risks are increased. These risks include the possibility that you will make trades without having all the information you need, or that you may trade CFDs at a price that doesn't reflect the value of the underlying asset.

7 Margin calls

To meet this benchmark, an OTC CFD provider should maintain and apply a clear, written policy about its margining practices, and how they will monitor your account to ensure you receive early notice of when you are likely to enter into a margin call. They should explain the rights they have in relation to your account, and the factors they will take into account before making a margin call or closing out your position.

A provider should notify you through a pre-agreed method (for example, phone message, email or SMS) before closing out your CFD positions.

A provider's PDS should clearly state that trading CFDs involves the risk of losing substantially more than your initial investment.

What's at stake for you?

You should read and understand the provider's policy on margin calls. There is a reasonably high chance that CFD trading will result in a margin call, because small movements in the price of underlying assets may lead to large changes in the value of your CFD position. When this happens, the provider is likely to make a margin call, or close out your position, to limit their exposure and your potential losses. You need to understand the impact on your investment position and your obligations if the provider makes a margin call.

For more about margin calls, see page 31.

Tips and traps

CFD providers are increasingly promoting their products to Australian investors on websites, in the financial press, on television and in free information or education seminars.

If you are interested in trading CFDs, you need to evaluate any promotional material very carefully, especially advertisements and information provided at free seminars.

Here are some tips and common traps.

Trial the CFD provider's trading platform before signing up

There are many CFD providers operating in Australia and they each have a unique CFD trading platform.

CFD trading platforms are not perfect systems. People who trade CFDs often experience technical problems that negatively affect their trading (for example, delays in executing orders during which time the market has moved).

Some CFD providers allow you to open a trial account for a limited time. These trials should be cost-free and obligation-free. This can be a good way of gaining an understanding of the general logic and process of trading CFDs on an online trading platform.

If you trial a platform, remember that you are not trading in real-life conditions. You are likely to take greater risks because you know you are playing a game and are not risking any real money.

However, if you take the game seriously, observe and study the way the trading platform works or doesn't work and take note of your own behaviour.

If you don't enjoy the trial experience, it is probably safe to assume that you will not enjoy the real thing. If you consistently fail to make any gains in the trial runs, think carefully about whether you are likely to do better with the real thing.

Make sure you have the time and money to trade CFDs

Trading CFDs is not a passive activity.

People who trade CFDs say that trading takes a lot of time and concentration and that they underestimated the amount of time that was required to trade, monitor trades and maintain their accounts.

Given that you are potentially putting very high amounts of your own money at stake when trading CFDs, you can't afford to be casual about trading.

Unlike betting, the potential for losses in trading CFDs is far greater than your initial stake. When you place a bet on a horse, you can only ever lose the amount of money you put on the bet. With CFDs, you can lose much more than you put in because you have to pay for any losses which exceed the margin you put up.

While most people can meet margin calls of $100, ask yourself if you could meet a margin call of $1,000 or $10,000, or even $100,000 on bad trades.

Do your homework

CFDs are a complex and high-risk product.

Even highly skilled and knowledgeable traders with extensive experience (not just with CFDs but also with the underlying assets of CFDs) usually only trade CFDs as one part of their investment portfolio, often to hedge their bets across a range of investment options. As well as understanding CFD trading strategies, they also have the time and resources to keep close watch over the market.

Unless you feel confident that you have the time and patience to build your knowledge and skills over a long time before taking any risks, CFDs may not be the best product for you.

Don’t fall for pressure selling or promotional gimmicks

You should never sign up to trade CFDs unless you have read and understood the PDS and other disclosure documents, and preferably only after you have seriously trialled a CFD trading platform.

Often CFD providers will promote their products with seductive language at free seminars and on their websites. Some CFD providers may focus only on the benefits of trading CFDs, and may even claim that trading CFDs is easier and more rewarding than trading shares.

You should never feel obliged to sign up to trade CFDs, no matter how much time and effort the CFD provider has put into explaining their product and trading platform to you. You have no obligation to sign anything at any time.

As part of their marketing, CFD providers will often offer gifts or limited deals to attract new clients. In the past, some CFD providers have offered mobile phones or gadgets. Similarly, they might offer you a discount on some fees and charges for a limited period if you sign up with them immediately.

CFDs are a complex product with high risks. They are a serious business with potentially very high stakes. When confronted with the opportunity to gain a free gadget or discounted fees and charges for a limited time, think carefully about the real benefits of such upfront offers. They may cost you more than you ever imagined.

Misleading advertising? Hard sell?

Have you come across an advertisement for a financial product that you think is misleading?

Or have you been pressured by a sales person to make a decision when you didn't have enough information, or weren't sure that the product was right for you?

Go to www.moneysmart.gov.au for some strategies to help you resist pressure selling. Make sure you don't end up investing in a financial product that doesn't suit your needs.

How to complain

Under the law, you have the right to complain if you are not happy about any aspect of a financial product or service including a bank, building society or credit union account, insurance policy, superannuation, investments or any financial advice you receive.

Go to www.moneysmart.gov.au to find out more. You can lodge a formal complaint online or phone ASIC on 1300 200 630.

All CFD providers must also be a member of an ASIC-approved external dispute resolution scheme. These schemes are:

- Financial Ombudsman Service (FOS)
  www.fos.org.au or phone 1800 367 287
- Credit and Investments Ombudsman (CIO)
  www.cio.org.au or phone 1800 138 422.

Check the PDS or the CFD provider's website to see which scheme they are a member of.

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