

Contracts for Difference

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Synopsis

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Learn about Contracts for Difference with iMinds Money's insightful fast-knowledge series. Contracts for difference, or simply CFDs, are a type of derivative whereby two parties agree to exchange the difference between the current value of an underlying asset and its value upon expiry. The underlying assets can be very diverse, from equity to commodities, but share prices, exchange traded funds or market indices are most commonly used. The most notable distinction of a CFD is that no assets are physically traded – instead, the contract merely stipulates that the difference in price between opening and closing dates be exchanged between each party.

The main advantage therefore is that brokerage fees incurred in the purchase of an asset are abolished. CFDs are also partially collateralised, requiring only a small margin be paid at the opening of a contract, and so are highly leveraged products. CFDs are most commonly traded over-the-counter and are not standardised in the same way that similar contracts often are. This means the contracts can be very flexible and there is a wide range of options that can be personalised depending on each party's preferences. Contrary to other OTC derivatives like futures contracts, CFDs do not have fixed expiry dates or standard contract sizes. The margins required are also variable, ranging in size from 30% to less than 1%. Values are largely dependent on the expected volatility of the asset's value.

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