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How DMA CFD Business Make Money

There are two kinds of CFD models, Market Maker and Direct Market Access. Each type has its own advantages and disadvantages and each CFD provider makes money in a very different way. It is important to understand how CFD providers generate profits whenever you trade. In this short article we will look at Direct Market Access or DMA CFD providers only.

Direct Market Access CFDs are the most transparent type of CFD available, the main reason for this is basically because DMA CFD providers hedge every trade they receive from their clients in the underlying market. When buying and selling DMA CFDs you'll actually see the CFD providers hedge order in the order book of the stock listed on the underlying exchange on which the CFD is quoted.

In order to hedge in a cost efficient way and enable the DMA CFD provider to provide CFDs on overseas exchanges the DMA CFD provider will utilize the execution services of a international investment bank which has exchange memberships globally. Creating a relationship with one execution provider also allows the DMA CFD provider to attain economies of scale resulting in lower execution and financing costs for the provider and eventually the end client.

The global investment banking institutions providing the DMA execution into the underlying exchange on behalf of the CFD provider also provide the financing on the positions, this execution and financing service combined works much like a CFD but on a much larger scale. The CFD provider's hedge transactions with the investment bank are often called SWAP transactions and the service offered by the bank is known as prime broking.

A DMA CFD provider model is simple, aggregate as many client orders and positions as possible in order to achieve reduced execution and financing rates on the SWAP contracts offered by their prime broker.

CFD providers generate profits very similar to any business where the business owner buys from the wholesaler and then offers the merchandise in stores to retail customers.

The formula is simple, if your CFD provider is charged 0.01% commission on their SWAP trade and pay a financing rate of 0.50% over or beneath the RBA rate any they charge you 0.10% commission on the trade and 3.00% over or below the RBA rate they will make money. In addition to making money on commission and financing DMA CFD providers also receive the benefit of netting all customer positions against each other. Put simply netting means that if a long position offsets a short position the CFD provider has no position, however, as the client who is long is having to pay interest and the customer who is short is being paid interest less a small haircut, the CFD Provider profits through the difference between both interest rates.

It is essential to note that prime brokers won't deal with retail clients themselves and will normally only deal with large hedge funds and CFD providers, as such CFDs are an ideal way of achieving access to global markets in much the same way as the international investment banks themselves and hedge funds do.