



Stockbrokers and Investment
Advisers Association

Serving the interests of investors

Margin Lending Refresher

PRESENTED BY

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Agenda

Margin Lending

Overview of margin lending (features, risks and benefits)
Examples of margin lending

Lombard Loans

Overview of Lombard loans (features, risks and benefits)
The current economic environment and possible impacts on Lombard loans
The LGT Crestone Lombard facility
Recent cases involving Lombard loans and potential red flags



Overview of margin lending

What?

A Margin Loan (ML) allows you to borrow money to invest in shares and managed funds, using your own money or your existing portfolio as security.

Why?

A margin loan helps you to increase the size and diversity of your investment portfolio.

How?

The amount that can be borrowed at any point in time is determined by:

- your pre-approved Credit Limit;
- the current value of your secured portfolio;
- the Loan to Value Ratio (LVR) assigned to each Acceptable Security



Key things to note

- Acceptable Securities List register
- Fixed rate loans
- Loan facility
- Repayments – either direct debit or recapitalized to the loan
- No regular repayments are required
- Buffer of 10%
- Call alerts via SMS, email or both
- Restoring the borrowing limit



Features of margin loans

Margin loan statements are issued quarterly

24-hour online access to the facility

There are no establishment, account keeping or transaction fees



Benefits

Dedicated relationship manager to assist with your margin loan and 24-hour online access to your account

Flexible repayments as the facility is typically open ended with no set principal repayment schedule

Wholesale clients with provision of a current Accountant's Certificate, means you don't need to provide your financial details to support your application

Part or full repayments can be made anytime



Benefits

A wide selection of approved securities including shares and managed funds with LVR's of between 35% to 75%

Tax benefits against the loan

Approved clients can also access international listed securities including Apple, Facebook and Google with LVR's of 75%



Tax Benefits

Tom had \$300,000 invested in shares, which he purchased using a margin loan of \$240,000. His interest expense on the margin loan, at 8 per cent per annum, would be \$19,200 (representing 12 months of interest). If Tom prepaid the interest for the next 12 months, he may be able to claim a **tax deduction** in the year of payment.

Investments Value	Margin Loan	Interest @ 8%	Income (Franked dividends and credits)
\$300,000	\$240,000	\$19,200	\$12,000 + \$4,000 = \$16,000



Risks (!)

Borrowing to invest can increase returns but can also increase potential losses.

If you can't fund your obligations under the loan, the securities can be sold to satisfy obligations.

Value of your securities may not appreciate or if they do, the value may not be sufficient to cover the costs of investing.

Consider tax implications and seek professional tax advice



Let's take a closer look

Your Margin Loan currently has a \$0 balance, and your **credit limit** is \$200,000. Your secured investment portfolio has a market value of \$100,000 and comprises of the following investments:

Investments	Market Value	LVR	Borrowing Limit
Share A	\$50,000	70%	\$35,000 (\$50,000 x 70%)
Share B	\$50,000	60%	\$30,000 (\$50,000 x 60%)
Total	\$100,000	65%	\$65,000



Example



As your **Borrowing Limit** (\$65,000) is less than your **Credit Limit** (\$200,000), and your **Loan Balance** is \$0, your Funds Available will be calculated as follows:



Funds available = **Credit Limit** or **Borrowing Limit** (whichever is lower) - **Loan Balance**



= \$65,000 - \$0 = \$65,000



This means you can borrow up to \$65,000 to invest, however you may be able to borrow more than \$65,000 if you choose to invest in shares or managed funds in the Acceptable Secs List.



The Multiplier Effect

- As shown in the earlier example, your investment portfolio is valued at \$100,000 and you have **Funds Available** of \$65,000. Let's say you wish to buy shares in XYZ Ltd which has a LVR of 75%.
- The amount you could borrow would be calculated as follows:
- **Funds Available** / (1-LVR) = \$65,000 / 1 - 0.75
- \$65,000 / 0.25
- = \$260,000



The Multiplier Effect

- Your current **Funds Available** of \$65,000 would allow you to borrow \$260,000 to invest in XYZ Ltd shares. However, as your **Credit Limit** is \$200,000 and **Loan Balance** is \$0, you would only be permitted to borrow a maximum of \$200,000 to invest in XYZ Ltd.



Using Cash as Initial Contribution



You currently have \$30,000 cash which you would like to invest in DAG Ltd which has a LVR of 70%. The amount you could borrow and invest in DAG Ltd is as follows:



Total amount you can invest = Initial contribution / (1-LVR)
 $\$30,000 / 0.3 = \$100,000$



Total amount you can borrow = Total amount you can invest (\$100K) - Cash contribution (\$30K)
= \$70,000



The value of your investment will be \$100,000 and your loan balance of \$70,000



Buffers

Based on a percentage of the market value of each investment held as security

Typically set at 10% of the market value of each security

Can be changed at any time by the provider



How a buffer works with Margin Calls

As investment markets are by nature volatile, a Buffer is added to the LVR of each Acceptable Security to ensure small fluctuations in the market value of your investments do not result in a Margin Call.

It is especially useful if you have borrowed up to the maximum amount permitted.

The Buffer gives you time to take the appropriate actions to return your loan to a suitable security position and reduce your chance of a Margin Call.



Example



You have decided to invest \$100,000 in ABC Ltd shares (which has a 70% LVR) by contributing \$30,000 cash and borrowing the maximum of \$70,000 (70%).



The value of the investment subsequently falls in value to \$92,000, placing your loan inside the 10% Buffer. At this point no action is required, however it is recommended you monitor your loan and take action to avoid a Margin Call.



Example cont.



The value of your ABC Ltd shares falls further to \$85,000 resulting in your Loan Balance exceeding the 10% Buffer.



A Margin Call of \$10,500 ($\$70,000$ Loan Balance - $\$59,500$ Borrowing Limit) is triggered requiring you to make a loan repayment of \$10,500 to reduce your loan to the \$59,500 Borrowing Limit.



Alternatively, you may increase your Borrowing Limit by lodging additional Acceptable Securities or by selling a sufficient amount of securities.



Margin Call Repayment Options

1. Make a loan repayment to reduce your outstanding **Loan Balance**; or
2. Transfer/lodge additional **Acceptable Securities** (held externally) into the **Margin Loan** to increase your Borrowing Limit; or
3. Sell securities held on your **Margin Loan** to repay a portion of the loan; or
4. Any combination of the above.

If you don't clear your Margin Call in full within the required timeframe, your provider may sell some or all the investments held as security to reduce the outstanding Loan Balance to your Borrowing Limit.



Lombard loan History



- The term “Lombard” is derived from the northern Italian region of Lombardy, where money was being lent against collateral securities as early as the 12th century.
- The Franciscan monks were allowed to engage in Lombard lending, allowing them to circumvent the restrictions imposed by the Vatican on charging interest.



Why a Lombard loan?

- **Access to liquidity:** the borrower can obtain additional capital without having to sell existing assets
- **Comparatively low interest:** since the borrower deposits collateral, a Lombard loan is often characterized by relatively lower interest rate in comparison to other types of credit.
- **Earnings potential is retained:** if securities are used as the collateral for the Lombard loan, the potential returns on the pledged securities are retained by the borrower.



Typical uses of Lombard loans

- Purchasing property
- Refinancing property
- Securities trading
- Business expansion



Risks

- **Incalculable risk:** the pledged securities are exposed to price fluctuations on the stock exchange.
- **Insufficient coverage:** if the pledged assets decrease in value, the loan may no longer be sufficiently covered and additional collateral may have to be provided or the loan may have to be paid back.
- **Disposal of securities:** if the borrower does not meet their obligations on time, the lender can liquidate the assets deposited as collateral.
- **Interest rates**



The Current Economic Environment

- Central banks appear to be still in play as inflation will take time to get within acceptable bands
- The future of interest rates will dictate where investors place their funds
- What is in store for the next 12 months?
 - Will interest rates stay higher for longer?
 - Or will hard landing scenarios eventuate, as currently priced into yield curves?



Landscape Full Of Opportunities

- Liquidity will stay at a premium
- High net wealth clients will look to lean toward ‘alternative’ assets and move away from the typical 60% stock/40% bond to a possible 40% stock/30% bond/30% alternative portfolio
- Private market investments that complement income and growth:
 - private equity for capital appreciation;
 - private debt for income generation; and
 - private real estate for inflation protection.



The LGT Crestone Lombard Facility

A custom-made product providing access to global opportunities, consolidated reporting via the LGT Crestone platforms including tax reporting and daily credit positions, backed by the largest privately owned wealth manager in the world

Minimum limit facility of AUD 500,000 and no minimums amount to draw

AUD, CAD, CHF, EUR, GBP, HKD, JPY, NZD and USD

Variable loans with interest calculated daily and added to loan balance monthly in arrears

Cost of funds + agreed margin (no platform or low balance fees)

Approval timeframes are typically 2 days for amounts to AUD 50 Mio and longer timeframes for larger amounts or special requests

Daily credit position statements and quarterly and annual statements including tax reporting

Acceptable securities are the marketable assets on the LGT Crestone platform

Collateral can be held in any currency set up on the LGT Crestone platform



LTV (Loan to Value)

- Loan to Value (LTV) ratios broken down as:
 - Cash 0-95%
 - Fixed Income 0-90%
 - Managed Funds 0-90%
 - Equities 0-70%
 - Structured Products 0-90%
 - Alternatives 0-55%
 - Haircuts will be applied to concentrated portfolios and/or loan to currency mismatch



Margin Calls



WHEN COLLATERAL
VALUES FALLS BELOW
UTILIZATION AMOUNT



WHEN FACILITY LIMIT
FALLS BELOW
UTILIZATION AMOUNT



IF TOPS UPS ARE
REQUIRED, THEY ARE
COMMUNICATED BY THE
CLIENT'S ADVISER



LETTERS ISSUED IN THE
EVENT OF A MARGIN
CALL



TOP UP OPTIONS
INCLUDE SELLING
SECURITIES, REDUCING
LOAN BALANCES OR VIA
ADDITIONAL
COLLATERAL



Close outs

- At the discretion of LGT Crestone with an accompanying letter



Areas of Concern

- Are risks clearly explained?
- When selling securities, are timelines clearly defined?

