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Unlock the Borrowing Power of Your Portfolio

Finance today's needs without sacrificing tomorrow's goals.

A sudden need for significant funds arises—where should you turn? One strategy may be leveraging your portfolio's assets to access liquidity. What do you need to know about using your holdings as collateral? We sat down with Jon Coppola, director of Private Banking at Wilmington Trust, for the skinny on potential rewards and risks of this complex yet engaging space.

Jon Coppola
Director of Private Banking
Wilmington Trust

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Jon, some wealthy clients may be thinking, why shouldn't I just keep a large portion of my portfolio stashed in cash, so it will be right there if I need it?

A. Well, it depends. There's no right or wrong answer. This is just one of many decisions that needs be part of a discussion between clients and their advisors, based on their goals and objectives. One potential downside of keeping a great deal of uninvested cash on the sidelines—or "dry powder" as some refer to it—may be a missed opportunity to let invested monies work for you. Whether you're talking about capital appreciation, dividends, or yields, there's something to be said for letting assets continue to try and grow in order to help achieve your long-term goals. Staying invested may potentially be more productive, especially when you consider the bare-bones interest rates on holding cash. A key factor in the decision of how individuals decide to prepare to access liquidity is the degree of risk they feel comfortable taking and how to manage it efficiently.

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Let's say someone is more inclined to be fully invested. Couldn't they just redeem some holdings if a significant cash need arises?

A. Certainly, but there may be ramifications to doing so. Redeeming investments can trigger taxable events if the sale results in a gain. Also, by cashing in some investments, they stop working for you, reducing the value of your overall portfolio. So, like everything, there's a cost-benefit analysis.

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What is securities-based lending? What advantages can it offer?

A securities-based loan means you have fairly simple, quick access to your money at attractive interest rates.

A. A securities-based loan is an interest-only loan where the borrowed amount is collateralized or backed by a portion of the stocks, bonds, or eligible securities in one's portfolio. You can create ready cash for any spending need—such as tax payments, lifestyle purchases, charitable giving, home renovations, or even business opportunities. The application process is streamlined, and the loan can be set up fairly quickly, often within just a few days. Also, it's pretty cost-effective with no set-up, non-use, or cancellation fees. There is competitive pricing, compared to some other financing strategies that reward a client for the overall relationship.

How much can someone borrow against their securities? How does it work?

A. How much leverage a portfolio can support is based on the advance rates we assign to each security held in the pledged account. The borrowing power will depend on a variety of factors, such as: asset class, type, and liquidity of the investment; whether there's a concentration, say, of equities; how vulnerable a particular asset class is to market volatility; the size and value of a portfolio, etc. However, regardless of the size of the portfolio we always work with our clients to be sure that the amount being leveraged is suitable and being done in a strategic and thoughtful way. We develop a plan with clients based on their goals, time horizon, risk tolerance, and what we believe is use of leverage.

Are there any risks associated with securities-based lending?

Leverage is a component of return and can magnify both losses and gains.

A. There are risks associated with any type of borrowing and clients need to be aware of them. Leverage is a component of return and can magnify both losses and gains. When it comes to securities-based lending, the securities you borrow against have a value. In the event of major market fluctuations, the value of your pledged assets could decline considerably, leading to a possible margin call, which may require additional collateral or principal repayment. That in and of itself could involve an additional need for cash to supply new collateral to "cover" the borrowed amount, presenting a problem or even a need to redeem assets at inopportune times and unfavorable values. Of course, a sudden redemption could entail unanticipated tax consequences. And another risk is that a loan's low interest rate could increase, making the loan more expensive than originally anticipated.

How do you manage those risks for your clients?

A. We start by understanding a client's overall balance sheet, goals, and objectives, and advise the client to use leverage strategically and in a suitable way. Furthermore, there are a number of ways to protect against some of the risks I just discussed. One way is to diversify and selectively borrow against less volatile investments. Those holdings are generally less vulnerable to sharp market shocks that could lower the value of your portfolio. Regular monitoring of investments, especially during volatile times, can be very important to help sidestep drawdown exposure (a peak-to-trough drop in asset values).

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What is the most important takeaway for those considering a securities-based loan?

A. Credit solutions are broader than just securities-based lending. Our advisory, consultative process manages balance sheets to see that a short-term funding strategy complements—not competes with—one's overall long-term wealth management goals. When a client comes to us with a liquidity challenge—or even better, before one takes place—we have a conversation to determine the right solution that's tailored to an individual's particular circumstances.

It's important to align the level of debt, the reason for the debt, and the length of time until the debt is repaid. If, for example, a debt is going to be in place long term, we may consider alternate credit solutions. In the case of a client, once the liquidity has been deployed, the individual works with his or her team to determine if permanent financing makes sense, given the timeframe expected to have the balance outstanding. This could take the form of our advisory credit solutions, residential mortgages, etc. Ultimately, it comes down to maintaining a culture of advice that places emphasis on the strategic use of leverage to underscore a thoughtful approach to managing wealth.

