Lombard loans

What is a Lombard loan?

A Lombard loan is loan granted against a deposit and pledge of realizable collateral (capital market investments such as stocks, bonds, fund shares, etc.). Since securities are exposed to price fluctuations, the loanable value of the deposited assets against which the Lombard loan is granted will not equal 100% of the value of such assets because the bank will set aside a security margin. The maximum drawdown amount is therefore limited to the market value of the collateral less the security margin. In principle, your securities deposit used to secure the Lombard loan should be widely diversified. This means that the invested assets should be spread over a variety of different securities, countries, sectors, currencies and investment categories in order to reduce the risk of insufficient collateral, which usually materializes more quickly if the portfolio is insufficiently diversified or a large portion of the loanable value is drawn down from the outset.

What are the risks to which a Lombard loan is exposed?

Leverage effect

Using a credit facility will change the risk/return profile of the portfolio. Using borrowed capital may allow you to obtain a higher return on your own capital if the investment moves in the expected direction. Such higher potential returns on investment are associated with increased investment risk, since the costs of borrowing (costs of interest and repayment) are fixed. And while these expenses are fixed, the anticipated returns on the investment are uncertain.

This leverage effect generally results not only in greater potential gains but also higher risks of loss which, in extreme cases, may result not only in a total loss of the investor's capital but also lead to repayment obligations related to borrowing.

Unforeseeable market variations

If a Lombard loan is used for investment purposes, the risk of loss of the investor's capital increases since there is no certainty about the returns that will actually be generated from an investment. Based on the current market situation, the interest expense may exceed the returns. In that case, a negative leverage effect is produced.

Minimum collateral requirements

If the value of your collateral falls below a certain threshold, the Bank may require you to post additional collateral (margin call) or to repay all or part of the loan. If the additional margin deposit or repayment is not made on time, the Bank may exercise its right to liquidate all or part of the investment securities pledged to the credit facility.

Liquidity problems

In case of insufficient funds to honour the interest payments due or to repay the loan, the pledged investments may be liquidated at an unfavourable time.

Change of risk/return profile

Taking out a Lombard loan increases portfolio risk (especially in case of strong market fluctuations).

Exchange rate and interest rate fluctuations

Fluctuations due to the exchange rates of foreign currencies and interest rates may have a significant impact on the expected performance and value of the investment. If the currency of the loan does not correspond to the currency of the pledged collateral and investments, exchange rate fluctuations can have adverse effects that may increase the amount of potential losses associated with an investment strategy.

Taxation

In principle, individuals subject to unlimited tax liability in Switzerland may deduct their debts and interest payments from their taxable assets and income. The tax authorities consider credit-backed financing of securities transactions as one of the criteria used to determine whether the taxpayer is deemed to be acting as a professional securities broker. Such a classification means that capital gains that would otherwise be tax-exempt are taxable as income. For persons residing abroad, the tax consequences depend on the tax system applicable in the country of residence.

DISCLAIMER

This information sheet contains extracts from the brochure “Risks Involved in Trading Financial Instruments” published by the Swiss Bankers Association (SBA), the complete version of which can be consulted at the website www.swissbanking.org or on the Bank’s website (www.corner.ch).

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