WEALTH MANAGEMENT ALTERNATIVE LENDING

Voices How securities-based loans help advisors bond with clients

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When clients think about taking out a loan, they likely picture borrowing money from a traditional bank or credit union. Those loans have their place, but lesser-known securities-based loans collateralized by a client's investment portfolio can be a flexible and cost-effective way to access liquidity strategically.

Eden Lopez is Managing Director – Financial Advisor, RBC Wealth Management – US.

Matthew Franks is the head of High Net Worth Credit at RBC Wealth Management — US.

There's a misconception that these lines of credit are only used to purchase extravagant items like vacation homes and sports cars. While securities-based loans, or SBLs, are certainly more common among high net worth investors, they can be used to address a broad spectrum of financing needs, from short-term emergency cash flow to financing a business or even a college education.

Strategic borrowing can both add value to a client's life and enable advisors to build deeper relationships with their clients. While there will always be a need for traditional bank loans secured by one's residence or business assets, here are five factors to consider when speaking with clients about SBLs and the value they can offer as part of a broader wealth planning strategy.

Relationship focus

Borrowing with the assistance of a financial advisor allows for more personalization than the largely transactional process often experienced when seeking a loan from a bank. As an advisor, and very possibly a fiduciary, to your clients, you understand their full financial picture and can advocate for them to obtain a loan backed by their investment holdings. You have a seat at the table throughout the process, helping to ensure your client's best interests are always top of mind. Your clients will appreciate your partnership and involvement, which further deepens their trust and your relationship. Knowing an advisor is there to guide them through the process fosters a more positive experience compared to a traditional lender, where the borrowing experience can often be impersonal and overly focused on FICO scores and cash flow analysis.

Cost structure

Even in an inflationary environment, an SBL will usually offer a lower interest rate than a traditional business loan or mortgage. The relatively lower rate is the result of lower risk to the lender because the securities can be easily liquidated, if necessary. Other factors, such as the loan size and the size of the client's asset holdings, can also impact the interest rate. Advisors

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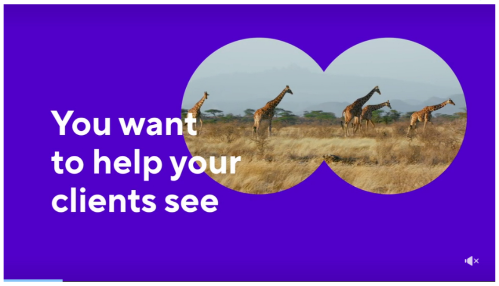
can further demonstrate their value to clients by helping them leverage their advisory relationship to obtain the lowest-possible rate on a loan.



Depending on where the accounts are held, there may be no fees involved in setting up, maintaining or canceling an SBL, and typically there are no penalties if the client never uses the credit line. This is not the case for some home or business loans, which may require appraisals or other upfront costs, or even annual fees. Lastly, leveraging a client's investment portfolio to secure financing may also avoid potential tax liabilities and transaction costs that can accompany selling portfolio assets.

Flexibility and speed

Because there is no formal underwriting with SBLs, clients are typically able to access funds faster than with traditional loans — often within just a few days. Payment terms are flexible and offer both variable and fixed rate options, and often interest-only payment structures as well. Advisors can play a vital role in helping clients determine the best payment option for their overall financial goals, and can advise them on how to use the loan to increase their overall financial flexibility. An advisor could, for example, help a client use their SBL as a bridge to pay their child's upcoming college tuition, rather than selling their 529 portfolio and losing the value of that investment.

Peace of mind

With securities-based loans, clients have access to a line of credit that only incurs interest if it is used. An SBL can help provide clients with peace of mind, knowing that if ever they need access to cash in an emergency, the line of credit has been proactively set up by their advisor to use when the unexpected strikes. Consider the risk a client could face if their home was destroyed by a natural disaster. An SBL could provide much-needed emergency financing for living expenses while the client rebuilds, and the credit line can be paid off once they receive their insurance check.

Risks

While SBLs offer many advantages relative to bank lending, this type of loan may not be suitable for all clients, and it is important to clearly communicate the potential risks involved. Because of the volatility of investment assets, there is risk of forced liquidation if the market falls. While all clients have different tolerances for risk, they must understand that with an SBL their portfolio is subject to margin calls and can be sold without notice if it is pledged as collateral for a loan (although, generally speaking, lenders typically give notice as a matter of practice). In most cases, an SBL works best when used for short periods of time in situations that demand a significant amount of cash quickly, such as a bridge loan.

A securities-based line of credit can be a practical and integral part of a client's wealth plan that allows them to focus on their goals, while feeling confident and prepared for unexpected scenarios. However, when it comes to guiding your clients, it's important to remember each client has unique needs and preferences when it comes to borrowing. Many may be unfamiliar with the role that financial advisors can play in helping them navigate the lending environment and finding a solution that works best as part of their overall wealth planning strategy. If your clients aren't already familiar with non-traditional approaches to lending, it might be time to discuss their borrowing options.

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Matthew Franks Head Of High Net Worth Credit, RBC Wealth Management - US

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