Appendix F

More Detail on ABLF, Risk Details, and Official Statement of Disclosure and Understanding

More Detail on ABLF

As for the ABLF, or the asset-based loan facility, this kind of loan facility was at the heart of *The Value of Debt* and is of central importance here as well. One of the great things about an ABLF is that money borrowed is generally not taxable, and is generally not amortizable; that is, you don’t have to make a fixed monthly payment (or any payment at all until you are ready to do so). Importantly, an ABLF can be defined in both a narrow sense, as I usually use it here, as well as in a broad sense, as follows:
• **Broad definition of ABLF:** Any loan facility based on pledged assets, which can include an ABLF based on your taxable stock portfolio, a margin loan based on your taxable portfolio, and even a home equity loan or line of credit.

• **Narrow definition of ABLF:** A loan facility provided to you by your brokerage firm or another firm that is based on pledging assets in your taxable portfolio, not in tax-deferred (qualified) accounts such as an IRA or 401(k).

Throughout this book, most references to ABLF are to the narrow definition. And with regard to this kind of ABLF, it’s important to know that it can only be put into place on the parts of your investment portfolio that are considered taxable assets or after-tax money. For example, you won’t be able to get an ABLF by pledging the investments you have in your IRA or 401(k).

Note that most of the financial pundits and retirement gurus who are out there will tell you from the very start that you should put every bit of your extra money into tax-deferred vehicles—that is, into vehicles that are not eligible for an ABLF. Why is this? Sadly, blinded by antidebt ideology, they just don’t know any better, and unfortunately, if you follow (or have followed) that advice it will be difficult to implement these ideas.

**Statement of Disclosure and Understanding**

This book does not provide individually tailored investment advice. It has been prepared without regard to the circumstances and objectives of those who receive it. This book contains general information only, does not take account of the specific circumstances of any reader, and should not be relied upon as authoritative or taken in substitution for the exercise of judgment by any recipient.

Each reader should consider the appropriateness of any investment decision as it regards to his or her own circumstances, investment objectives, investment experience, risk tolerance, liquidity needs, time horizon, the full range of information available, and appropriate professional advice.

The author recommends that readers independently evaluate particular investments and strategies, and encourages them to seek a financial
advisor's advice. Under no circumstances should this publication be construed as a solicitation to buy or sell any security or to participate in any trading or investment strategy, nor should this book, or any part of it, form the basis of, or be relied on in connection with, any contract or commitment whatsoever.

The value of, and income from, investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies, and geopolitical or other factors.

Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized. The information and opinions in the book constitute judgment as of the date of publication, have been compiled and arrived at from sources believed to be reliable and in good faith (but no representation or warranty, express or implied, is made as to their accuracy, completeness, or correctness), and are subject to change without notice.

Investing with leverage contains multiple risks, including, but not limited to, interest rate risk, greater volatility risk, liquidity risk, call provision risk, rollover risk, and the risk of a total loss of capital.

The information provided is based on tax laws currently in effect and is subject to change. There is a possibility that current tax legislation will be amended or repealed in the future. In that case, the outcome of these planning ideas may not be as advantageous. None of the information herein is to be considered tax advice. All ideas are intended to represent tax facts at the time of publication and are subject to change without notice. All ideas must be reviewed by your tax, legal, and financial advisors based on your individual situation.

Tax information contained in this presentation is general and not exhaustive by nature. It is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding U.S. federal tax laws. Pursuant to the rules of professional conduct set forth in Circular 230, as promulgated by the United States Department of the Treasury, nothing contained in this book was intended or written to be used by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer by the Internal Revenue Service, and it cannot be used by any taxpayer for such purpose. Federal and state tax laws are complex
and constantly changing. Investors should always consult their tax advisor for information concerning their individual situation.

No one, without the express prior written permission of the author, may refer to any of the debt, investment, or tax strategies found in this book.

The author does not accept any liability whatsoever for any loss or damage arising from any use of this book and its contents. All data and information and opinions expressed herein are subject to change without notice.

With Respect to ABLFs

Asset-based loan facilities (ABLFs) are securities-based loans, which can be risky and are not suitable for all investors. Before opening an account, you should understand the following risks:

• The firm can call the loan at any time and for any reason.
• Sufficient collateral must be maintained to support your loan(s) and to take future advances.
• You may have to deposit additional cash and/or eligible securities on short notice.
• Some or all of your securities may be sold without prior notice in order to maintain account equity at required maintenance levels. You will not be entitled to choose the securities that will be sold. These actions may interrupt your long-term investment strategy and may result in adverse tax consequences or in additional fees being assessed.
• Firms typically reserve the right not to fund any advance request due to insufficient collateral or for any other reason.
• Firms can increase your collateral maintenance requirements at any time without notice.
• There may be minimum line sizes and minimum initial draws.
• Disbursements are subject to your available credit and are at the sole discretion of the firm.
• Annual fees typically apply for Standby Letters of Credit, if issued. Standby Letters of Credit carry issuance fees based on the issued amount of the Letter of Credit and are due in advance.
• For brokerage firms, ABLFs are typically offered by the bank affiliated with the issuing brokerage firm.
• Credit lines are often subject to credit approval.
• You should consult your legal and tax advisors regarding the legal and tax implications of borrowing using securities as collateral for a loan.
• For a full discussion of the risks associated with borrowing using securities as collateral, you should review the Loan Disclosure Statement that will be included in your application package.

ABLFs can be either what are called purpose or non-purpose loans. A non-purpose loan is a line of credit or loan that is based on the eligible securities held in a brokerage account. It can be used for any suitable purpose except to purchase, trade, or carry securities or repay debt that was used to purchase, trade, or carry securities, and should not be deposited into a brokerage account. A purpose loan, or margin loan offered by a brokerage firm, is a revolving line of credit based on securities held in a brokerage account. These loans are primarily used to purchase securities but can be used for any other purpose. The text is not intended to imply that having an ABLF is guaranteed liquidity. It is important to note that many ABLFs are not committed facilities. Therefore, a lender has no obligation to make an advance and can reject any advance request from a borrower in its sole discretion.

ABLFs could in fact actually increase your risk of distress. If you have an ABLF and the market drops (including the securities securing your loan), you could be forced into a margin call with no additional securities/collateral to deposit and in a situation where you don’t have liquid funds to pay down the loan. Accordingly, you could be forced to sell the securities collateral at that time, which if the market is depressed, would be at a bad price and potentially trigger tax consequences.

ABLFs generally are structured as demand facilities, which means that the institution offering the loan can demand repayment at any time. Also, the lender usually maintains the right to liquidate the securities-held collateral at any time. You must work with your advisors to understand and mitigate these risks.

All examples within the book assume that the loan is in good standing, credit is available, securities are eligible, and that the lender is willing to continue advancing money.
Securities-Based Loans: Borrowing against securities may not be suitable for everyone. You should be aware that securities-based loans (ABLFs) involve a high degree of risk and that market conditions can magnify any potential for loss. Most importantly, you need to understand the following: An ABLF is not a committed facility, the lender has no obligation to make an advance, and therefore an ABLF does not offer a guaranteed liquidity solution.

Although your lender may not have a cost in establishing an ABLF, you must visit with your tax, legal, and financial advisors before implementing any of these ideas. Accordingly, there may be professional advisory fees in pursuing the ideas expressed in this material.

Additional Important Notes

Taxes: Tax laws are complex and subject to change. This material was not intended or written to be used for the purpose of avoiding tax penalties that may be imposed on the taxpayer. Individuals are encouraged to consult their tax and legal advisors (a) before establishing a retirement plan or account, and (b) regarding any potential tax, ERISA, and related consequences of any investments made under such plan or account.

Point of Views: The views expressed herein are those of the author. All opinions are subject to change without notice. Neither the information provided nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. Past performance is no guarantee of future results.

Strategies: This material does not provide individually tailored investment advice. It has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The strategies and/or investments discussed in this material may not be suitable for all investors. The author recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial advisor and their tax and legal advisors. The appropriateness of a particular investment or strategy will depend on an investor’s individual circumstances and objectives.

Asset Allocation: Asset allocation and diversification do not guarantee a profit or protect against a loss.

Bonds: Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond’s maturity, the more sensitive
it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate. International bonds are subject to these and may be subject to other risks such as risk of default, greater volatility, and currency risk.

Municipal bonds: Interest in municipal bonds is generally exempt from federal income tax. However, some bonds may be subject to the alternative minimum tax (AMT). Typically, state tax exemption applies if securities are issued within one’s state of residence, and local tax exemption typically applies if securities are issued within one’s city of residence. Bonds are affected by a number of risks, including fluctuations in interest rates, credit risk, and prepayment risk. In general, as prevailing interest rates rise, fixed-income securities prices will fall. Bonds face credit risk if a decline in an issuer’s credit rating, or creditworthiness, causes a bond’s price to decline. Finally, bonds can be subject to prepayment risk. When interest rates fall, an issuer may choose to borrow money at a lower interest rate, while paying off its previously issued bonds. As a consequence, underlying bonds will lose the interest payments from the investment and will be forced to reinvest in a market where prevailing interest rates are lower than when the initial investment was made.

Note: High-yield bonds are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issuers.

Equities: Equity securities may fluctuate in response to news on companies, industries, market conditions, and general economic environment. Companies paying dividends can reduce or cut payouts at any time.

Case Studies: The case studies presented are for educational and illustrative purposes only and do not indicate future performance. Past
performance is no guarantee of future results. Investment results may vary. The investment strategies and products and services presented are not appropriate for every investor. Individual clients should review with their financial advisors the terms and conditions and risks involved with specific products or services. Neither the information provided nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. All of the illustrations throughout the book are hypothetical and not intended to demonstrate the performance of any specific security, product, or investment strategy.

Home Loan—Mortgage: Proceeds from mortgage loan transactions including initial draws and advances from HELOCs are not permitted to be used to purchase, trade, or carry marginable securities, repay margin debt, or to make payments on any amounts owed under a note or HELOC loan agreement.

LIBOR and Interest-Only Loans: An interest-only LIBOR loan is not for everyone. These loans enable borrowers to make monthly payments of only the accrued monthly interest on the loan during the introductory interest-only period. Once that period ends, borrowers must make monthly payments of principal and interest for the remaining loan term, and payments will be substantially higher than the interest-only payments. During the interest-only period, the total interest that the borrower will be obligated to pay will vary based on the amount of principal paid down, if any. If a borrower makes just an interest-only payment, and no payment of principal, the total interest payable by the borrower during the interest-only period will be greater than the total interest that a borrower would be obligated to pay on a traditional loan of the same interest rate having principal-and-interest payments. In making comparisons between an interest-only loan and a traditional loan, borrowers should carefully review the terms and conditions of the various loan products available and weigh the relative merits of each type of loan product appropriately. Your interest rate can increase and monthly payments can increase every one or six months, depending on the index you choose. On a six-month LIBOR, if you prepay principal during the first 10 years, your required monthly payment may include some principal until your next six-month adjustment.

Life Insurance: Since life insurance is medically underwritten, you should not cancel your current policy until your new policy is in force.
A change to your current policy may incur charges, fees, and costs. A new policy will require a medical examination. Surrender charges may be imposed and the period of time for which the surrender charges apply may increase with a new policy. You should consult with your own tax advisors regarding your potential tax liability on surrenders.

*Investments and insurance products* are not FDIC insured, are not bank deposits, are not insured by any Federal government agency, are not bank guaranteed and may lose value.\(^2\)

**Notes**

2. Author’s Note: The information in this appendix is to be considered in a holistic way as a part of the book and not to be considered on a stand-alone basis. This includes, but is not limited to, the discussion of risks of each of these ideas as well as all of the disclaimers throughout the book. The material is presented with a goal of encouraging thoughtful conversation and rigorous debate on the risks and potential benefits of the concepts between you and your advisors based on your unique situation, risk tolerance, and goals.