IIROC OCRCVM
Investment Industry Regulatory Organization of Canada
Organisme canadien de réglementation du commerce des valeurs mobilières

Investor **Bulletin** de l'investisseur

The Investment Industry Regulatory Organization of Canada (IIROC) produced this bulletin to help investors learn what's involved when using borrowed money for investment purposes.

Borrowing to invest is sometimes used to potentially enhance returns. It may be appropriate for some and not others. As with any investment tool, you must recognize and understand the potential risks and benefits to determine if and when borrowing to invest is appropriate – given your overall financial situation, risk appetite and ability to withstand loss.

Here are some tips to help you make an informed decision:

Consider your overall financial situation

It's important to look at your whole financial picture if you are considering the use of borrowed funds to purchase securities. For instance, borrowing to invest may not be appropriate for an investor whose primary concern is preserving capital. That might include someone who is retired or nearing retirement, or who may need access to their money in the near future.

You may also want to think about other factors such as:

- How secure is my income?
- What is my cash flow like?
- What other debts do I already have and can I afford to pay for them?

Asking yourself these questions could help you decide if borrowing to invest may be appropriate for you:

- ***How does the investment fit into my overall plan?*** You probably have specific reasons for investing. Be certain the investments you make with borrowed funds will get you closer to those objectives.
- ***Do I have money set aside or adequate cash flow to make my loan payments?*** Keep in mind that you have to repay the amount you borrow and make interest payments even if you are losing money on your investment.
- ***Can I afford to lose what I have put up to back the loan (the collateral)?*** There is no guarantee the value of your investment will go up. In certain circumstances, the collateral you borrowed against – be it your home, investments or other assets – could end up belonging to your creditors if you're unable to repay the loan or make interest payments.

Ensure you understand all the terms of the arrangement

Borrowing-to-invest strategies might include borrowing to top up your RRSP, borrowing against the equity in your home, and borrowing "on margin" in your brokerage account – an arrangement in which the firm lends the investor cash to buy stocks with the account serving as collateral for the loan.

Whatever the form of the loan, make sure you understand how it works, including the interest rate, how interest is calculated, and any other risks and conditions associated with the arrangement.

There are several types of borrowing-to-invest strategies and some forms are riskier than others; some could lead to losses beyond the amount you invested. Be sure you understand the risks associated with any borrowing-to-invest strategy.

Have a plan for covering your borrowing costs – even if your investment is losing value

Although it's tempting to believe an investment will pay back the loan and even cover interest payments, in reality, there is no sure thing.

For instance, when you buy a stock on margin you borrow part of the purchase price from the brokerage firm. In this arrangement, your investment serves as equity to secure the loan. The understanding is that, should the stock price fall below certain pre-set levels, you may be asked to repay all or part of the loan. You could make this repayment by depositing additional cash into your account, putting up other investments you own, or by selling some of the securities in your account to cover borrowing costs.

If you can't meet these requirements, the brokerage firm may sell all or part of your stock holdings – which eliminates or reduces your chance to regain losses should the stock price rise again. Since you still have to pay back the loan and make interest payments, you could end up losing more money than you invested.

Similarly, a line of credit or loan that's secured by the equity in your house puts your collateral, that is, your home, at risk if you can't make loan payments.

Be aware of the potential tax implications

The tax rules that apply to an investment loan could depend on the purpose of that loan. For example, financial institutions commonly offer loans designed to help investors to "top up" their RRSP contributions. You should be aware that interest payments on RRSP loans are not generally deductible for tax purposes.

Recognize all the risks, especially those explained to you by your financial advisor

IIROC requires the firms and representatives we regulate to meet strict supervisory and suitability obligations when they recommend, or become aware that their clients are using borrowing-to-invest strategies. Requirements include ensuring clients are fully aware of the risks, including three key considerations:

- using money borrowed from others to purchase investments involves greater risk than a purchase using your own money;
- you have a continuing obligation to repay principal and interest even if the value of the investment goes down;
- use of a borrowing strategy could result in far greater losses than an investment strategy that does not involve the use of borrowed money.

HAS YOUR ADVISOR:

- ☐ explained fully the risks of borrowing to invest?
- ☐ asked about your full financial situation, including any investment or other loans outside of your account with the firm?

Take a holistic approach, including informing your advisor about any loans you have

As an investor, you also have obligations. If you are using, or intend to invest with borrowed funds, it's crucial to let your financial advisor know about it. Whether a bank loan, a line of credit or another type of third-party investment loan, borrowing can affect your overall financial circumstances and your ability to achieve your financial goals. ■

HAVE YOU:

- ☐ discussed with your financial advisor your short- and long-term goals for your money?
- ☐ informed your financial advisor about any debts, including money you've borrowed for investment or any other purposes?

WHO WE ARE

IIROC is the national self-regulatory organization which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. There are more than 28,000 individuals and approximately 200 firms under IIROC regulation across the country.

Be an informed investor!

For helpful tips, useful tools and more important information, visit the IIROC Investor Resource Centre at ***www.iiroc.ca***