

Borrowing to Invest

Borrowing to invest, also known as leveraging, can help grow your money, but it can also lead to larger losses. Leveraging is not suitable for all investors, and your financial adviser should take a number of things into account (such as your financial circumstances, your age, your investment goals and risk tolerance) before recommending leveraging.

How does leverage work?

Taking a loan from a bank – Use caution - if you choose to use the equity in your home to secure this loan and the investment doesn't work out, you may have to sell your home to pay back the loan.

Borrowing money through a brokerage firm – This is also known as buying on margin. Have a back-up plan if the investment doesn't work out because you will have to put more of your own money into your margin account to cover any losses.

What are some of the risks?

The risks of borrowing to invest are high. It is important that you are ready to cover any losses with other savings. Be sure you understand these key points before borrowing money to invest:

- **You could lose money:** Whether the returns on your leveraged investments are positive or negative – you still have to pay back the loan, plus interest.
- **It costs more to invest:** Although returns on leveraged investments may be positive, you don't get to keep it all. You still have to pay the interest costs on the loan, and these could exceed your returns. Be sure to fully understand all associated borrowing costs before making any final decision.
- **You could damage your credit:** If you are relying on the returns from leveraged investments to cover the cost of borrowing, you could default on the loan if the value of the investment decreases.

Is leveraging suitable for me?

Leveraging outside of an RRSP may not be appropriate for investors who:

- have indicated they have limited investment knowledge
- have low risk tolerance
- are retired or nearing retirement
- will need to access the money in less than 5 years
- would have debt payments higher than 35% of their gross income

Questions to ask

Yourself:

1. Do I fully understand how borrowing to invest works?
2. Am I comfortable with the risk in the investment I want to make?
3. How much interest will I pay each month? How does that compare with what I hope to make from my investment?
4. If interest rates rise, will my costs increase? How will this affect what I make on the investment?
5. Can I afford to lose some, or even all of the investment I made with the borrowed money? Will I be able to pay back what I borrowed from my savings?

Questions to ask

Your adviser:

1. What are the risks associated with this investment?
2. How are you paid for selling this investment?
3. How will this investment help me reach my long-term goals?
4. Are you and your firm registered with the New Brunswick Securities Commission?

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The New Brunswick Securities Commission is the Crown corporation established by the Province of New Brunswick in 2004 to regulate the securities industry and ensure the efficiency and integrity of capital markets in New Brunswick.

Our mandate is to protect investors from unfair, improper or fraudulent practices, and to foster fair and efficient capital markets and confidence in capital markets.

We develop and enforce securities regulation, and offer impartial educational information and resources to New Brunswick residents about the investing process.

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Remember, before you borrow to invest, be sure to fully understand the real cost of borrowing, the risks involved, and have a back-up plan to cover losses in case your investments don't work out. If you are not comfortable taking on this risk, you can talk to a financial adviser about other ways you can invest to help meet your goals - borrowing is not the only way.