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WEALTH MANAGEMENT

PRACTICAL GUIDE · FINANCING · LUXEMBOURG

# Practical guide to Lombard credit

How to obtain liquidity secured on an investment portfolio without selling it, and the risks, costs and tax effects to consider.

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# What Lombard credit is

Lombard credit is financing secured on financial assets: cash, investment funds, bonds, shares or managed portfolios. It makes funds available without selling the investments and, therefore, without crystallising capital gains or exiting the market.

It is a common tool in private banking, particularly in Luxembourg, where it is documented under Luxembourg law and the security covers the portfolio as a whole. It provides flexibility, but if the credit is high relative to the collateral, a market fall may require additional collateral to be provided or assets to be sold. This guide explains how it works, which assets are accepted, how risk is managed and its legal and tax treatment.

AT A GLANCE

| | |
|---|---|
| **No sale** | The portfolio remains invested and generating returns while liquidity is drawn. |
| **Flexible** | Funds are drawn as needed and interest is paid only on the amount used. |
| **50–95%** | Indicative financing percentage according to the quality and liquidity of each asset. |
| **Risk involved** | If the value of the collateral falls, it may be necessary to provide more or reduce the credit. |

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01 · CONCEPT

# What it is and how it works

### Structure

The lender grants a **credit limit** based on the value of the assets deposited and the **collateral percentage** (or *loan-to-value*) assigned to each. The client retains ownership of the assets, which are pledged in favour of the lender for as long as there is debt.

The most common form is a **credit line** drawn when needed, with interest paid only on the amount drawn; it can also be structured as a loan with a repayment schedule or with bullet repayment at maturity.

### Cost

The interest rate is usually **variable**, referenced to Euribor or another money-market index plus a margin, which depends on the amount, the quality of the collateral and the overall relationship with the lender. There may be arrangement or commitment fees; the total cost should be compared.

Some lenders allow drawings in several currencies, which adds exchange-rate risk if the assets and the debt are in different currencies.

### In Luxembourg

The transaction is documented under **Luxembourg law**, which specifically regulates financial collateral arrangements. The security covers **the portfolio as a whole** rather than each position, which allows it to continue being managed normally and assets to be replaced, provided that coverage is maintained. No notarial involvement is required.

The assets must be deposited with the lender granting the credit. For a Spanish tax resident, a portfolio in Luxembourg is taxed in the same way as if it were in Spain, but entails additional reporting obligations (Form 720 and, where applicable, reporting of foreign transactions to the Bank of Spain).

### In Spain

It is structured as a loan or credit agreement with a **pledge** over securities or fund units, usually in a policy witnessed by a notary, which makes it directly enforceable. A pledge over book-entry securities is created by registration in the corresponding book-entry register.

Enforcement is governed by the Civil Code (Art. 1872, auction sale before a notary) or, where its requirements are met, by the faster financial collateral regime of Royal Decree-Law 5/2005. The Supreme Court, in its judgment 1992/2025 of 22 December, has strengthened the protective nature of the Article 1872 procedure.

02 · COLLATERAL

# Which assets are accepted and how much is financed

The more liquid, diversified and stable an asset is, the higher the financing percentage assigned to it. The following percentages are indicative: each lender has its own policy and adjusts them for concentration, currency and credit rating.

### Indicative percentages

| Asset type | Indicative financing |
|---|---|
| **Money-market funds** | 80–95% |
| **Fixed income, including high yield** | 70–90% |
| **Mixed funds** | 60–80% |
| **Large-cap shares and equity funds** | 50–70% |
| **Other assets** | Case-by-case analysis |

### Assets not accepted

**Pension plans** cannot be pledged, because vested rights are not available until a contingency or liquidity event occurs. Savings life insurance and *unit-linked* policies may be accepted by pledging the policy, with the insurer's involvement.

03 · RISK

# Margin call and risk management

### How a margin call works

The agreement sets a minimum collateral value relative to the debt. If, owing to market falls, the weighted value of the portfolio falls below the credit drawn, the lender may require **additional collateral**, **partial repayment of the credit** or, if the client does not act within the agreed period, **sell assets** to restore coverage.

### Illustrative example

| Concept | Amount |
|---|---|
| **Diversified portfolio (collateral percentage 60%)** | €1,000,000 |
| **Available credit limit** | €600,000 |
| **Amount drawn** | €400,000 |
| **Portfolio value that triggers a margin call (400,000 / 60%)** | €666,667 |
| **Portfolio fall that can be absorbed** | Approx. 33% |

Had the full limit been drawn, any fall in the portfolio would trigger the call. It is therefore essential not to exhaust the limit.

**Good practice**

- Maintain a wide **safety margin**: as a guide, draw no more than half to two thirds of the limit.
- Diversify the collateral and avoid concentrating it in a single security or sector.
- Monitor the correlation between the use of the funds and the pledged portfolio.
- Have a source of liquidity available to meet a possible call without selling at market lows.
- Do not use the credit for speculative investments or to permanently leverage the same portfolio.
- Bear in mind interest-rate risk: as the rate is variable, the cost may rise.

04 · USES

## What it is used for

**Common uses**

- **Bridge financing** to buy a property while another is being sold.
- **Complement to a mortgage**, as additional security or to cover the portion not financed, particularly for non-resident buyers.
- Payment of **taxes** (an inheritance, an income tax or wealth tax assessment) without unwinding long-term investments.
- Seizing a **business or investment opportunity** quickly, or meeting capital calls from a private equity fund.
- Covering a **one-off liquidity need** without selling at a bad time in the market.

**When it is not advisable**

When the need for liquidity is permanent, when there is no clear source of repayment or when the portfolio is highly volatile or concentrated. In such cases, another financing structure or a reduction of the investment is usually preferable.

05 · TAXATION

# Tax treatment

Drawing on the credit is not taxed, but the combined investment and financing structure has effects that should be analysed case by case.

**No capital gain**

Obtaining liquidity through credit **is not a sale**, so no capital gain or withholding arises. Taxation of unrealised gains is deferred until the assets are sold and, where applicable, the regime for tax-free switches between funds is preserved.

Unrealised gains existing at death are not taxed in the deceased's income tax; the heirs acquire the assets at their value for Inheritance Tax purposes.

**Interest and income tax**

As a general rule, interest on a personal loan used to invest in financial assets is **not deductible** from investment income (only securities administration and custody fees are).

If the funds are used to **acquire or improve a let property**, the interest may be deducted from rental income, provided the use of the funds can be traced. In a company, finance costs are deductible within the limits of Article 16 of the Corporate Income Tax Law.

**Wealth tax**

For Wealth Tax and the Solidarity Tax on Large Fortunes, **duly substantiated debts** are deducted from net wealth, except those incurred to acquire exempt assets (for example, the exempt portion of the main home). The tax authorities pay particular attention to the genuine link between debt and assets.

**Reporting**

A credit facility and a portfolio with a foreign institution do not change the taxation, but they do change the reporting obligations of a Spanish tax resident.

FAQ

# Frequently asked questions

| | |
|---|---|
| **Which assets are accepted as collateral?** | Usually cash, investment funds, bonds and listed shares with sufficient liquidity. Each asset is valued at a different percentage. |
| **Can the pledged portfolio be managed?** | Yes, provided the agreed coverage is maintained. In Luxembourg, as the security covers the portfolio as a whole, management is more flexible. |
| **Must the portfolio be transferred to the lender?** | The collateral must be deposited with the lender granting the credit. If the funds are held at another Spanish institution, a fund switch allows them to be transferred without tax. |
| **Can a pension plan be pledged?** | No. Vested rights in pension plans are neither available nor pledgeable until a contingency or liquidity event occurs. |
| **Does it have tax implications?** | Drawing on the credit is not taxed. Interest is deductible only in specific cases, and the debt may reduce the Wealth Tax base if substantiated. |

REFERENCES

# Legislation and case law

Provisions and rulings cited in this guide. The wording in force should be verified in each case in the Spanish Official State Gazette (BOE), the regional gazettes and the electronic office of the Spanish Tax Agency.

**Legislation**

- Civil Code, Articles 1857 to 1873 (pledge agreement) and 1872 (notarial enforcement).
- Royal Decree-Law 5/2005 on urgent reforms to boost productivity (financial collateral arrangements).
- Law 6/2023 on Securities Markets and Investment Services.
- Luxembourg Law of 5 August 2005 on financial collateral arrangements.
- Law 35/2006 on Personal Income Tax (Arts. 23, 26 and 33.3.b), Law 27/2014 on Corporate Income Tax (Art. 16) and Law 19/1991 on Wealth Tax (Art. 25).
- Consolidated Text of the Law on Pension Plans and Funds (unavailability of vested rights).

**Case law and administrative doctrine**

- Supreme Court judgment 1992/2025 of 22 December (notarial enforcement of the pledge, Art. 1872 Civil Code).

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