

# Reducing the interest rate on your Protected Loan



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The cost of the capital protection component associated with Protected Loans has increased in recent times due to the sharp rise in volatility associated with equity markets. The increase in volatility has pushed up Protected Loan interest rates which incorporate both funding and capital protection costs.

Now available under Commonwealth Bank's Options and Lending Facility, the Reduced Interest Rate is an optional feature which you can apply to your Protected Loan. This feature allows you to reduce the interest rate on your Protected Loan by agreeing to forego any capital growth above a "Capped Price". This effectively places a cap on the capital growth you are entitled to.

*The following case study is a hypothetical example only and uses rates and figures selected by Commonwealth Bank to illustrate how the Reduced Interest Rate feature under the Protected Loan works. It is not intended to explain any other features of the Protected Loan. The example should not be taken as personal advice or an indication of actual or future prices that may apply. It is not a recommendation to you to acquire either a Protected Loan or the shares referred to and should not be regarded as an accurate statement of affairs concerning any listed company.*

## Introducing Anthony

Anthony is the trustee of his Self Managed Superannuation Fund and has \$40,000 in cash available to invest. He is aware of the benefits of borrowing to invest and would like to use the cash available to gain an equity exposure of \$100,000.

## The Strategy

Anthony and his financial adviser seek to invest into the SPDR S&P/ASX 200 Fund (ASX code STW), a fund which tracks the performance of the ASX200 Index. Over a three year term Anthony and his adviser would be satisfied with a return potential of around 13.30% p.a., which equates to a 40% increase over the period.

After discussing his objectives and also carefully considering the risk profile and time horizon of the SMSF, Anthony's financial adviser recommends a three year \$100,000 Protected Loan offered under Commonwealth Bank's Options and Lending Facility. The SMSF will need to contribute \$30,000 toward the purchase, with the remaining \$70,000 borrowed.

The remaining \$10,000 cash Anthony has in his SMSF will be used to service the loan, as will any dividends/distributions paid by the SPDR S&P/ASX 200 Fund.

To lower the cost of the interest rate, Anthony applies for a Reduced Interest Rate facility with the Capped Price set at 140% of the initial security price. This means that the SMSF will be entitled to all growth up to this level over the three year loan period. In exchange for foregoing growth above this cap, Anthony's interest rate is discounted by 2.46% from 12.11% p.a. to 9.65% p.a.

The terms of Anthony's Protected Loan are as follows:

Portfolio Value	\$100,000
Loan Amount	\$70,000
Total equity contribution	(\$30,000)
Protection / gearing level	70%
Capped Rate	140%
Interest Rate with cap	9.65% p.a.
Tax Rate	15%
Term	3 years
Interest Rate Type	Variable (paid monthly in arrears)
Estimated ATO Deductible Rate	8.40% p.a.

Note: The Capped Price per share is determined by multiplying the Capped Rate by the Protected Price of each security. Figures do not take into account any brokerage or establishment fee.

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## The Result

Let's assume three years has passed and Anthony's portfolio at maturity has performed as follows:

ASX Code	# Units	Initial share price	Protected Price	Capped Price	Share Price at Maturity	Unrealised Gain/Loss (without cap)	Unrealised Gain/Loss (with cap)	Protected Loan value at maturity (with cap)
STW	2,366	\$42.25	\$29.58	\$59.15	\$60.25	\$42,588	\$39,985	\$139,985

As you can see in the table above, Anthony's Protected Loan matured with a market value of \$139,985 which represents the maximum return of 40% over the three years. While this is less than the returns generated from having no cap in place, by capping the potential capital growth on his investment Anthony was able to reduce his interest rate by 2.46% and hence the amount of monthly interest repayments on his loan. Over the course of 3 years, this amounts to a saving of around \$5,166 over the term (i.e. 2.46% p.a. interest saving x \$70,000 loan amount x 3 years).

## Getting the right advice

As with any financial strategy, using a Protected Loan to borrow and invest is not without its risks. One of the key risks of using a Protected Loan is that your return could be negative, after taking into account the performance of your shares and borrowing costs over the term. That's why it's important to read the Product Disclosure Statement to ensure you are fully informed.

**Speak to your Financial Adviser or call us on 1300 786 039 for more information about how reducing the interest rate on your Protected Loan can help you achieve your goals.**

### Important information

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