Last updated April 2020

Provision Fund Policy

Scope

This policy summary applies to Retail Money Market Ltd ("**RMM**") and all of its subsidiaries referred to as "**RateSetter**". RateSetter operates a contingency fund called the "**Provision Fund**". A summary of our policy for managing and overseeing the Provision Fund is set out below.

Overview

The Provision Fund exists to protect RateSetter investors. It protects all investors equally and so has the effect of mutualising the risk for all investors by diversifying their exposure across the whole loan portfolio. This means that it is the performance of the whole loan portfolio that matters for RateSetter investors.

The Provision Fund consists of money paid by RateSetter borrowers as part of their loan fees. This money is used to automatically reimburse RateSetter investors in the event that their money is not repaid by the borrower.

The protection offered by the Provision Fund is limited to the value of the assets held in the Provision Fund at any point in time (the assets include cash and low-risk liquid investments). In the event that the assets are not sufficient to cover Expected Future Losses, investors are exposed to a loss of interest and, should the addition of the interest not be sufficient, a loss of capital. Investments are not covered by the Financial Services Compensation Scheme.

What is the source of the money in the Provision Fund?

As loans are written, a portion of the fees charged to each borrower is allocated to the Provision Fund. There are two parts to this fee – some is paid upfront at the time a loan is written, and some is paid over the term of the loan as part of the borrower's regular repayments. The amount of fees allocated to the Provision Fund is calculated by RateSetter based on an assessment of the creditworthiness of each borrower. The objective is to have a Provision Fund that is sufficient to cover all Expected Future Losses, although this cannot be guaranteed.

If a borrower misses a repayment, the Provision Fund automatically reimburses the outstanding capital and interest to the investor. This reduces the amount of money in the Provision Fund, although RateSetter will seek to recover as much money as possible from the borrower and any recovery will go into the Provision Fund.

How is the Provision Fund governed?

The Provision Fund is governed by the Board of RateSetter Trustee Services Limited ("**RTS**"), which reports directly to RateSetter's Board. The Board members of RTS are the Chair of the RateSetter Audit Committee, the Chair of the RateSetter Risk Committee and the CEO of RateSetter.

Who does the Provision Fund belong to?

The assets held in the Provision Fund are owned by RTS, which is wholly owned by RateSetter.

These assets are ring-fenced from the other assets of RateSetter. The Provision Fund's assets can be used only to reimburse RateSetter investors and to cover the operational costs of the Provision Fund (for example, third party debt collection agencies that may be used to help recover money from borrowers, and the cost of the annual audit of RTS).

If the Provision Fund accumulates a surplus relative to losses, this surplus ultimately belongs to RateSetter.

Is there any discretion over payments made by the Provision Fund to investors?

There is no discretion in terms of pay out – RTS will pay out to RateSetter investors provided that there are sufficient funds in the Provision Fund to do so (which, to reiterate, is not guaranteed).

How would money in the Provision Fund be treated in the scenario that RateSetter became insolvent?

The money in the Provision Fund cannot be used to settle the obligations of RateSetter in the event of an insolvency of any entity in the RateSetter Group of companies. There is a security structure in place to prevent the flow of funds from RTS to RMM (unless, as stated above, there is ultimately a surplus in the Provision Fund relative to losses). RateSetter commits to ensure the Provision Fund continues to receive the allocated fees paid over the term of the loans.

Adequacy of the Provision Fund

The adequacy of the Provision Fund is expressed by the "**Interest Coverage Ratio**". This is calculated by dividing the size of the Provision Fund by the Expected Future Losses:

- The size of the Provision Fund is its current assets plus the income it will receive in the future from the allocated fees paid over the term of active loans (this figure is discounted to account for early repayments and unrecovered payments).
- Expected Future Losses is the total amount of missed and unrecovered borrower repayments that are expected over the lifetime of active loans in the RateSetter portfolio. Expected Future Losses are calculated on a loan-by-loan basis taking into account historical trends and early performance indicators which enables any changes in the portfolio to be identified on a timely basis. Future economic uncertainty is currently not factored into the Expected Future Loss calculation but this is taken into account by managing the Interest Coverage Ratio to a figure greater than 100%. The assumptions underpinning the Expected Future Loss calculation are reviewed quarterly and updates are communicated to investors via RateSetter Notices.

RateSetter also publishes a **"Capital Coverage Ratio"**. This is calculated by adding the size of the Provision Fund and all the future interest from active loans and then dividing by the Expected Future Losses.

What happens if the Provision Fund is not sufficient to cover Expected Future Losses?

If at any time, RateSetter reasonably believes that the Provision Fund does not have sufficient funds (including expected future inflows) to cover current or expected borrower defaults, RateSetter may implement a "**Stabilisation Period**." In this scenario RateSetter will implement an **"Interest Reduction"**. An Interest Reduction is a reduction (or 'haircut') to interest for all investors on all their investments. This reduction is paid in full to the Provision Fund.

Should the Interest Reduction or Interest Reductions not be sufficient, RateSetter will implement a **"Capital Reduction"**, which like the Interest Reduction, would be a reduction to capital made to all investors on all of their existing investments. This reduction is paid in full to the Provision Fund.