

Updating the structure of the Provision Fund

As an investor with RateSetter, you will be familiar with our Provision Fund. RateSetter pioneered the Provision Fund concept in peer-to-peer lending back in 2010 as a way to offer greater predictability for investors, allowing them to focus on setting the rate they require for their money. It has ensured that no individual investor has ever lost a penny – a track record that we are proud of and will always strive to maintain.

The Provision Fund is, and will remain, hugely important to our model. Therefore we have identified improvements which we think are in the best interests of investors. Here is an explanation of the changes and their impact.

Can you give me a summary of what is happening?

The Provision Fund is changing from being a trust to a legal company called RateSetter Trustee Services Limited. This change will not affect the day-to-day operation of the Provision Fund, nor reduce the level of protection it offers to RateSetter investors. Borrowers will continue to pay into the Provision Fund and it will continue to repay investors if a borrower misses a payment.

Why are you doing this?

The Provision Fund is currently a discretionary trust. It is unusual to use a trust in this way – they are commonly used for estate planning, rather than for business purposes. Like any trust, the trustees must act in the interests of the beneficiaries, which in this case are RateSetter's investors.

But there are downsides too, which have become more apparent as RateSetter has grown.

The first is transparency: discretionary trusts are not obliged to be audited, nor to publish accounts. The second is certainty: discretionary trusts are not obliged to pay out – the trustees are obliged to act in the interests of all investors, but there is no contractual obligation.

Therefore investors have had to trust RateSetter's integrity in terms of accurately reporting the size of the Provision Fund and in terms of ensuring that it pays out to investors in line with expectations. We would argue that this trust was well placed, but we think we can improve on this for the future.

As a legal company, the Provision Fund will publish independently audited annual accounts, significantly improving transparency. The company will also be obliged to reimburse investors providing there is sufficient money in the Provision Fund, removing the element of discretion in order to give greater certainty.

We would reiterate that the Provision Fund does not offer a guarantee to investors – we always strive to make this clear when we discuss our Provision Fund because we want all our investors to be clear on risk and reward.

The other reason why we are doing this is that it removes a potential conflict of interest. RateSetter has always made continual decisions on how to split the fees charged to borrowers between the Provision Fund and RateSetter. In theory, this could create a conflict of interest about what proportion of the fees should go to each party. We do not believe this conflict has arisen because we have built fairness and rational behaviour into our company, but this new structure addresses any potential conflict head on. It aligns the risk and reward of credit performance and means RateSetter will lose if the Provision Fund suffers losses – in other words, RateSetter has 'skin in the game'. We believe this is very positive. It creates a clear link between our long-term performance as a business and our long-term performance managing risk on behalf of our investors. We now have

a clearer incentive to be prudent and long-term – this ethos already exists but the incentive is now clearer and we can use that long-term incentive to make long-term decisions.

Who are the Directors of RateSetter Trustee Services Ltd?

The Directors of the company are the current trustees of the Provision Fund Trust: Rhydian Lewis and Pete Behrens. We have decided that we would like to go further and bring in another Director who will have a role to oversee the Provision Fund and ensure it is appropriately governed. We will confirm the third Director as soon as they are appointed and we will aim to do this in the first half of 2016.

How will this change come into effect?

Being a company, RateSetter Trustee Services is registered with Companies House. It has actually been registered since 2012 - it was performing a number of duties but these have been moved to RateSetter as part of the sensible changes involved in our FCA authorisation process.

As funds can't simply be transferred from the trust to the company, we are transitioning from the trust to the company over a period of time. During this time, the Provision Fund will be defined as the trust and company combined. RateSetter will continue to charge borrowers a risk-adjusted fee, which will continue to be added to the Provision Fund (more on this below). From 1st January 2016 all these fees will be paid into the Provision Fund company as opposed to the trust. From the same date, no further contributions will be paid into the trust, which will be run down over time.

All Provision Fund figures presented on the RateSetter website, in marketing and other communications will reflect the combined position of the trust and company until the trust is fully wound down. The Provision Fund company, RateSetter Trustee Services, will publish its next annual accounts by 31st December 2016.

Will there be any changes to how the Provision Fund is funded?

The Provision Fund's main source of funds is the risk-adjusted fee charged to borrowers. This has two components: an upfront credit charge, and a recurring credit fee which is added to the interest rate of the loan. We are gradually increasing the proportion of borrower contributions made via the recurring credit fee. This builds the Provision Fund more gradually than the upfront charge, but provides the advantage of a sustainable income stream for the Provision Fund into the future.

The Provision Fund also receives recoveries of outstanding debt. For example, in November 2015, this added around £80,000 to the Fund.

Does the Provision Fund hold any other assets?

In addition to cash contributions into the Provision Fund, we require that some categories of borrowers, for example businesses or property developers, also provide security against their loans. If one of these borrowers were to default, the Provision Fund would pay back the lender in the usual way, but the Provision Fund would also be able to use the security to recover the outstanding debt.

The total amount of security the Provision Fund holds on behalf of investors currently stands at well over £100m. In order to improve transparency for investors, we will report on this figure alongside the Provision Fund on the RateSetter website.

Does this change what RateSetter offers to investors?

No, this does not change what we offer. We hope it is a more robust structure that gives RateSetter 'skin in the game' with strong clarity, governance and transparency. Otherwise it is business as usual: the purpose of the Provision Fund has always been and always will be to attempt to give our investors an attractive combination of predictability and that cherished thing in life – value for your money.