IFRS 9 - Explanatory Note – April 2018

Adjusting how the Net Asset Value is calculated

Reflecting a new accounting standard

All financial institutions reporting under International Financial Reporting Standards (IFRS), including the Funding Circle SME Income Fund, will be required to adhere to a new accounting standard, IFRS 9: *Financial Instruments,* in 2018.

What does IFRS 9 cover?

IFRS 9 is concerned with accounting for financial instruments, including assets like small business loans. One of the key changes under IFRS9 concerns how impairment (the recognition of credit losses) is measured.

Implementing IFRS 9 will require institutions to:

- Provide an impairment charge based on expected credit losses, at the point each loan is originated
- Adjust these expectations to reflect future macroeconomic conditions, for example future trends in monetary policy

The expected credit loss is calculated using a number of variables including historic SME loan data and the expected probability of default of each loan.

How does IFRS 9 affect the Funding Circle SME Income Fund?

Previously, credit losses were reported as and when there was objective evidence of financial distress, for example once a loan had been late for a certain number of days. By recognising an expected credit loss for every single loan held in the portfolio – even those that are currently performing - there will be an increase in the impairment provision and, consequently, a reduction in the Net Asset Value upon introduction of the new rules.

Underlying performance is unaffected

This change is purely an accounting adjustment, and has no bearing on the loans held within the Funding Circle SME Income Fund. There will be no change to the underlying risk or future cash flows of the portfolio.