Clubfinance

Additional Risk Warnings for Debt-based Crowdfunding: Peer-to-Peer Lending (P2P Lending) & Unlisted Debt Securities ('Crowd Bonds')v1

Debt-based Crowdfunding ('Debt Crowdfunding') can be divided into Peer-to-Peer Lending ('P2P Loans') and Unlisted Debt Securities ('Crowd Bonds'). Both are typically offered via Crowdfunding Platforms.

Clubfinance Ltd offers an execution-only service; Clubfinance does not give advice or recommendations. If you have any doubts as to the suitability of a particular product or Debt Crowdfunding in general, or you require advice of any kind, you should seek a personal recommendation from a professional adviser.

Do not invest in a Debt Crowdfunding product unless you have carefully thought about whether you can afford it and whether it is right for you.

Please also refer to the risk warnings and other information contained within the product documentation relating to the Debt Crowdfunding product that you have chosen, together with Clubfinance's Terms of Business.

General

- The risks on these investments are much higher than those for deposits, and generally higher than those applying to more traditional investments, making them unsuitable for inexperienced investors.
- The investor typically has limited information available to make a decision about a particular product, and the credit and investment risks could be mispriced meaning that the potential return may represent insufficient reward for the risks being taken by the investor.
- The Crowdfunding Platform or other product provider may have conflicts of interest, e.g. its remuneration will usually be linked to transactions undertaken.
- Due diligence on underlying loans/securities may be limited. There is a risk money may be obtained for fraudulent purposes and therefore subject to loss.
- There is a risk that the platform or other product provider fails or its administration is poor. Following failure, a borrower may default as it may be uneconomic for investors holding small stakes to chase missing payments.
- P2P loans & Crowd Bonds generally have fixed terms and it may not be possible to withdraw any cash before the end of the term. They should therefore be viewed as medium to long-term products.
- Through peer-to-peer lending you are acting as a lender making a loan to an underlying borrower and the P2P Lending provider is facilitating this. An unlisted debt security is a debt instrument issued by a company (e.g. a bond). It is important to note therefore that Debt Crowdfunding products are **not** similar to cash deposits.
- The money you put in is at risk and you could lose part or all of it. This is in addition to the risk of late or defaulted interest payments. Due to the risks involved, these products may only be suitable as part of a diversified investment portfolio.
- Unlisted Debt Securities, P2P Loans, and P2P Lending providers are **not** covered under the Financial Services Compensation Scheme. This is the case even if the loans are held in a wrapper such as a SIPP or ISA.
- Unlisted Debt Securities are a form of 'Non-Readily Realisable Security' ('NRRS'). Please refer to the Clubfinance Non-Readily Realisable Securities Risk Warnings for further risks applicable to these investments.
- Payments of renewal commission (if any) to Clubfinance and the corresponding commission rebates to you are usually conditional upon you continuing to hold the product, and may cease if Clubfinance is no longer your agent.
- Although some P2P lending providers have protection funds in place these funds tend to be small in comparison to the total of loans outstanding. They would therefore not be able to cover all the losses if a large proportion of loans defaulted.
- Past default levels and losses experienced by a P2P lending provider or relevant to a particular Unlisted Debt Security are not a reliable indicator of future risks of default or losses. P2P Lending and/or Unlisted Debt Securities in general could also be influenced by external factors such as general economic conditions and this could reduce the benefits of diversification across loans or securities, and exhaust any protection funds a P2P Lending provider may have in place.
- The repayment of both the capital and interest is dependent on the ability of the underlying borrower or company to pay interest and repay the loan or bond. Non-payment could arise from default, fraud, or firm failure. The P2P Lending or Crowd Bond provider is not liable to make up any shortfalls. The financial solvency of the P2P Lending provider itself could affect the level of any protection funds they

may have in place and the ongoing collection of any capital or interest outstanding on loans on your behalf.

Innovative Finance ISAs

- Even when held within an Innovative Finance ISA, P2P Loans and Crowd Bonds are **not** covered by the Financial Services Compensation Scheme.
- Unlike a Stock & Shares ISA or Cash ISA, there is no automatic right to be able to transfer an Innovative Finance ISA to a different ISA Manager, although the terms & conditions of the particular Innovative Finance ISA account may permit this. It may therefore not be possible to transfer your Innovative Finance ISA to a different ISA Manager.

Taxation

- The tax treatment of Debt Crowdfunding investments can be complex. Please refer to the product documentation for a summary of the tax consequences for investors generally. However, please be warned that:
    - taxation levels, bases and reliefs can change;
    - the summary will be based on assumed rates of taxation;
    - the reliefs stated will be the ones which currently apply;
    - there is an additional tax to pay – not all tax may be deducted at source; and
    - taxation levels, bases and reliefs depend upon your individual circumstances.
- Changes in tax or other legislation may adversely affect the value of your investment.
- If you are unsure about your tax situation, you should seek professional advice. Clubfinance cannot give you this advice.

Realising your investment

- You may have difficulty selling your P2P Loan or Unlisted Debt Security at a reasonable price before the end of the term and, in some circumstances, it may be difficult or impossible to realise it at any price even at the end of the term.

NON-READILY REALISABLE SECURITIES RISK WARNINGS

WHAT ARE THE CHARACTERISTICS OF NON-READILY REALISABLE SECURITIES?

- They are generally the equity or debt securities of small and medium enterprises.
- They are illiquid securities which means it can be difficult or even impossible to claim back money invested or have it converted back into cash, i.e. there is no, or only a limited, secondary market to sell your investment.
- They are difficult to value and hard to price.
- Investors in them generally have no recourse to the Financial Services Compensation Scheme ('FSCS').
- They are high risk and can be complex.
- They provide **no** guarantee investors will receive a return.
- The Financial Conduct Authority ('FCA') defines them as securities that are **not** 'readily realisable securities', 'packaged products' or 'non-mainstream pooled investments'.

RISKS

It is not possible to cover every risk in this document, but here are some important risk areas to consider.

Start-up business failures & the risk of capital loss

Most start-up businesses fail, so investors in them need to understand that it is likely they will lose 100% of any money invested, and they have little or no protection if the business or project fails. Therefore, do not invest any money you are not prepared to lose. The risk of capital loss, even if the business does not fail, is exacerbated if the price paid for a security is based on an over-valuation of the business, or if the security is a long-term debt security that will not return capital for periods such as 20-25 years. Investors should not invest in a start-up business unless they know how to value it, and/or have carried out their own due diligence on the investment professional who will make the investment on their behalf (e.g. an authorised and regulated investment manager).

No dividends and equity dilution

Dividends are usually rare or non-existent. Even if the company remains a going concern, investors in unlisted shares in a start-up or young company face the risk of never receiving a return on their investment if those controlling the company decide not to issue dividends. In addition, if the business is sold or becomes listed, investors may find their share in these profits (if any) is reduced if the value of shares is diluted by subsequent issues of new shares (which may include the grant of options to employees or directors for example). Investors need to understand that they will have almost no control over these decisions. In addition, new or existing shares may have more favourable rights (e.g. to dividends and/or sale proceeds) compared to those you invest in.

No secondary market - illiquidity

After purchasing unlisted equity or debt in a company, even if it remains a going-concern, investors will usually find there is no, or only a limited, secondary market for their investments. Investors need to understand that they will probably have to wait until an event occurs, such as the sale of the company, a management buy-out or a flotation, before getting a return on an equity investment (if any). Also, in the event of their death, ownership of these investments will probably need to be transferred the investor's beneficiaries, which may incur costs (e.g. administration and/or valuation charges).

Returns

Achieving a positive return when investing in unlisted securities is difficult and statistically unlikely. It can also take considerable time for a start-up business to generate a return, so investors must be prepared to wait until well into the future for a potential return.

Due diligence

It is difficult for an investor to assess the value of an investment and the likelihood of investment returns without access to reliable due diligence information. Investors need to be properly informed to ensure they can understand and assess what is involved. The due diligence could be carried out by: the investor; a third party (such as an authorised and regulated investment manager); or both.

So that they can make decisions on an informed basis, investors need to be satisfied that they have enough reliable information to enable them to understand:

- the nature of the investment or service offered;
- the nature of the parties involved;
- the risks applying including the risk of fraud; and
- the charges that will be payable.

Investor behaviour

Detrimental biases that can be relevant to non-readily realisable securities include (but are not limited to) the following.

- Overconfidence - where investors decide to invest in a single recipient of funds they may be overconfident, i.e. they may overestimate their ability to assess risk. This could lead to a lack of diversification and financial loss.
- Anchoring - this occurs when investors base their evaluation and purchase decision exclusively on one fact (e.g. a projected headline rate of return), not taking other factors (such as risks, fees, or tax) into account.
- Herding - investors may use sub-optimal rules of thumb to make investment decisions, e.g. interpreting the level of investor interest in a proposition to infer something about the quality of the overall investment.

Other risks, including investment-specific risks

- It is not possible to cover all risks in this or any document – unforeseen risks can result in losses.
- Where an investment potentially qualifies for a particular tax treatment or relief (e.g. Enterprise Investment Scheme ('EIS'), Seed Enterprise Investment Scheme ('SEIS'), or Business Property Relief ('BPR')), the tax treatment depends on the investor's individual circumstances and may be subject to change in future.
- The risks that apply depend on the particular investment – investors should make sure they read and understand all the information and documentation specific to that investment.
- Investors should make sure they refer to Clubfinance's additional risk warnings for EIS and SEIS investments, Business Property Inheritance Tax Products, and also any others provided in relation to a particular investment.