U.K. CORONAVIRUS FUTURE FUND: CONVERTING POTENTIAL

On 18 May the U.K. Government released full details of the Coronavirus Future Fund, a co-investment scheme between the private and public sectors aimed at securing equity investment for start-up companies unable to access existing state-backed loan schemes. An initial tranche of £250 million is available between now and September 2020, with potential disbursement of further funds to be kept under review.

SCHEME OVERVIEW

The Future Fund will provide convertible loans to UK-based companies ranging from £125,000 to £5 million, subject to at least equal matched funding from private investors. The maximum amount of the Government loan is £5 million. There is no cap on the amount that the matched investor(s) may loan to the company. The Government will invest on the same terms as private investors and expects to make a commercial return on its investment.

WHO IS ELIGIBLE ?

The scheme is in principle open to UK private limited companies in all sectors and regions, that were incorporated on or before 31 December 2019. The company must either have at least 50% of its employees in the UK, or derive at least 50% of its revenues from UK sales.

The company must have raised at least £250,000 in equity from third-party investors in previous funding rounds in the last five years (from 1 April 2015 to 19 April 2020, inclusive), and not have any of its shares or other securities listed on a regulated market, a multilateral trading facility, a recognised investment exchange and/or any other similar market, stock exchange or listing venue.

A director of the company will also be asked to provide a signed confirmation giving details of the company's issued share capital and certifying that it has the appropriate authorisations, waivers and approvals in place, to fulfil its obligations in respect of the convertible loan agreements, including the ability to issue equity on conversion.

SOURCING INVESTMENT

The application process is led and initiated by the private sector investor(s) rather than the applicant company. Investors are required to be investment professionals, high net worth companies or high net worth or sophisticated

Key issues

- The Future Fund will provide convertible loans to UK-based companies ranging from £125,000 to £5 million
- £250 million is available between now and September 2020
- Funds are targeted at private companies who have completed initial fundraisings but not yet migrated to public market issuance
- Private sector co-investment is required, with Government contributing on a match funded basis

investors; retail investors are excluded from participation in the scheme. There is no limit on the number of companies that an investor may support with participation in the scheme. Investors can be based abroad. Matched investors will not be able to benefit from tax relief schemes such as the Enterprise Investment Scheme and the Seed Enterprise Investment Scheme relief, as such relief does not apply to convertible loans.

The Future Fund does not provide any introductory services between investors and investees, and prohibits the payment of any financial advisory fees in connection with participation in the scheme. This will therefore mean that companies are likely to need to reach out to existing investors, or otherwise be compelled to wait for an approach from prospective investors, which is likely in practice to limit the universe of companies that are able to access the scheme with the risk that a number of lower profile potential borrowers slip under the radar of time-pressed investors.

Somewhat curiously the scheme restricts the total number of investors to 149 in order to fall within the exemption under the Prospectus Regulation from the obligation to produce a prospectus in connection with an offer of securities to the public, although the scheme architects must have concluded that there is no offer of securities to the public for the purposes of section 755 Companies Act 2006 as otherwise the requirement for the application company to be a private limited company would be of concern. In practice it seems unlikely that the company and its investors will be testing the upper limits of this threshold, but it may be prudent to ensure that these apparently conflicting assumptions can be safely reconciled.

Applications for participation in the scheme are expected to take a minimum of 21 days between application and disbursement. Applications will be processed on a "first-come, first-served" basis to eligible applicants.

LOAN TERMS

The Government has published standard loan terms which must be accepted as they stand and are not permitted to be negotiated. Only the pricing terms such as interest rate and conversion discount may be negotiated between the company and investors, subject to a minimum interest rate of 8% per annum and a minimum conversion discount of 20%.

Both the government and the private sector investors are required to lend on the standard terms. This is likely to limit the appetite of private sector investors to lend in excess of the amounts match funded by government.

If the company is a part of a corporate group, the borrowing entity must be the ultimate parent company of the group. Each loan will have a three year maturity and will not be capable of early repayment other than by mutual agreement of all parties. Upon an exit or new funding round the loan will convert into the most senior class of shares of the company. Although the loan will carry an interest rate of 8% per annum, this will not be paid over the life of the loan but will be rolled up until maturity.

At maturity the loan will either convert into equity or (at the option of the majority lenders) be redeemable in cash. The loan is also automatically repayable in cash in the event that the redemption value of the loan exceeds the cash value of any consideration for the underlying shares in the event of an exit.

Restrictions

In order to ensure that funds are employed to secure the future growth of the company, rather than being used to fund short-term returns to investors, participants in the scheme will be subject a number of restrictions on the use of the loan proceeds. The company must not:

- repay any borrowings from a shareholder or a shareholder related party (other than the repayment of any borrowings pursuant to any bank or venture debt facilities);
- pay any dividends or other distributions;
- for a period of twelve months from the date of the relevant convertible loan agreement, make any bonus or other discretionary payment to any employee, consultant or director of the company other than those that had been committed prior to the start of the scheme; or
- pay any advisory or placement fees or bonuses to any corporate finance entity or investment bank or similar service provider from monies advanced by the Future Fund.

The loan also requires that the company does not enter into any prior ranking indebtedness other than senior indebtedness raised from unconnected third parties on arms' length terms. The loan also contains most favoured lender protection in the event that the company issues further loan notes or grants forward subscriptions on more favourable terms. More generally, the company and investors should not enter into side arrangements which would adversely affect the economic interests of the Future Fund under the loan.

In order to address reputational concerns for the Future Fund and U.K. Government, the loan also contains an unfettered right for the Future Fund to require repayment of the loan and/or put any shares back to the company at any time in the event that the Future Fund (in its sole discretion) determines that it would be prejudicial to the reputation of the Future Fund or HM Government to continue to holds its interest in the loan or the fund. The scheme rules do not offer any guidance as to how this right may be exercised, and so this may be a meaningful consideration for companies looking to ensure certainty of funds for the full loan term.

The loan also includes a right for the Future Fund to request, upon a conversion of the loan, a meeting to discuss in good faith a suite of shareholder governance rights that may be afforded to the Future Fund.

Other Commitments

The Government is also encouraging investors to sign up to the Investing in Women Code, which aims at supporting female entrepreneurship in the U.K. The Future Fund will also collect diversity statistics from all applicants for participation in the scheme and will publish anonymised data once a meaningful volume of applications has been processed.

FUTURE DEVELOPMENTS

The Government will keep the scheme under review and may commit further funds to the scheme in the event of high demand.

At this stage the Government has not published firm commitments as to how it intends to monetise any investments upon maturity of the loans, although the loan terms provide the Future Fund with the right to transfer any shares arising upon conversion to an institutional investor that is acquiring the whole or part of the Future Fund's interest in a portfolio of similar investments (comprising not fewer than 10 companies). While the loan remains a debt obligation, the Future Fund is to be able to transfer the loan as if it were subject to the same restrictions as holders of the most senior class of shares under the current articles of association or shareholders' agreement of the company, and may transfer the loan to other government entities on an unrestricted basis.

Equally relevant will be what approach the Government will take to asserting its rights as a creditor in the event that the investment is not successful and the company defaults on its obligations under the loan. It is likely that private sector investors will want some assurances from Government as to its likely course of future action, and in particular that it will act in a manner that strikes an appropriate balance between the interests of the borrower and the commercial interests of its fellow creditors.

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