

## UK Announces New Funds to Support Startups in the COVID-19 Era

***The UK government is pledging at least £250 million in convertible loan notes to UK-registered businesses.***

On 20 April 2020, the UK government issued a press release announcing a new Future Fund scheme for the financing of startup companies facing financing difficulties due to the coronavirus outbreak.

### Future Fund

The new Future Fund scheme will launch in May 2020 and remain open until the end of September 2020. The UK government will initially make up to £250 million available under the scheme, which will be run by the British Business Bank. Subject to private investors at least matching the funding provided under the scheme, the British Business Bank will subscribe for convertible loan notes issued by startup companies for three-year terms between £125,000 to £5 million.

### Eligibility

To be eligible for the scheme, the startup company must meet all of the following:

- Be an unlisted UK-registered company (if the company is a member of a group, only the ultimate parent company, if a UK registered company, is eligible to receive the loan)
- Have a substantive economic presence in the UK
- Attract the equivalent funding from third-party private investors and institutions, such that the funding from the UK government is no more than 50% of the aggregate bridge funding
- Have previously raised at least £250,000 in equity investment from third-party investors in the last five years

### Key Terms

The UK government has published the expected headline terms of the convertible loan note. The following 14 key terms are likely to be of interest to companies seeking to utilise this scheme:

- **Simultaneous funding:** This term is still unclear as to whether the funding from matched investors needs to be provided simultaneously with or after the UK government's funding, or whether matched investors can invest now with the confidence that the UK government will invest from May 2020 (although the authors would caution against this until the final particulars of the scheme are issued).
- **Form of funding:** Whether the terms of the matched funding need to be identical to that provided by the UK government, or whether variances will be permitted is unclear. For example, convertible loan notes are generally not eligible for SEIS or EIS relief but, with some limited amendments, can become Advanced Subscription Agreements which are eligible for such relief.
- **Qualifying matched investors:** This term is also unclear whether financing from founders / executive management will qualify for the purposes of matched funding. The current guidance refers to "private third party investors in previous funding rounds", which could be interpreted either way.
- **Discount rate:** The principal amount of the loan will convert on the next qualifying funding round (being a round at which proceeds raised equal at least the aggregate bridge funding provided) at a minimum discount rate of 20% (the Discount Rate), with a repayment right in respect of the accrued interest. If the matched investors agree a deeper discount with the company, the UK government would have the benefit of a larger discount.
- **Non-qualifying round conversion:** On a non-qualifying round, at the election of the holders of a majority of the principal amount held by the matched investors (and not the UK government), the bridge funding shall convert into equity at the Discount Rate.
- **Exit events:** On a sale or IPO of the company, the loan shall either convert into equity at the Discount Rate or be repaid with a redemption premium (being a premium equal to 100% of the principal of the bridge funding (the Redemption Premium)), whichever shall provide the higher amount for the lenders.
- **Maturity:** On maturity of the loan, at the option of the holders of a majority of the principal amount held by the matched investors (and not the UK government), the loan shall either: (i) be repaid with the Redemption Premium; or (ii) convert into equity at the Discount Rate, provided that the UK government's loan shall convert into equity unless it requests repayment of its loan. The automatic conversion is expected to provide the UK government the opportunity to benefit in any upside in the highest performing companies which exceeds a 2x return on the loan. A maximum term of three years is contemplated.
- **Interest-bearing loan:** The UK government's loan shall accrue interest of 8% per annum unless the matched investors agree to a higher interest rate, in which case the interest on the UK government's loan shall be increased accordingly and the accrued interest is payable on maturity.
- **Limited governance rights:** The UK government shall have limited corporate governance rights during the term of the loan. The authors expect that post-conversion of the loan, the nature and extent of rights the UK government would have would depend on its shareholding stake post-conversion and the class of shares it would hold.
- **No valuation cap:** Although the UK government does not expect to dictate a valuation cap, it would expect a cap to apply to its loan if the matched investors and the company were to agree a cap.

- **Most-favoured nation:** The UK government expects to benefit from any favourable terms contained in convertible loan note instruments issued subsequently to any investor — companies should be mindful of this provision when seeking additional bridge financing during the term of the loan.
- **Warranties:** The UK government requires warranties from the company and these relate to the company's eligibility under the scheme, compliance with laws, borrowing facilities, litigation, insolvency, title, and capacity will be required to be provided — these go beyond current market practice for convertible loan note instruments. Whether disclosures will be permitted remains unclear.
- **Other debt:** No senior ranking indebtedness to the loan shall be permitted other than bona fide senior indebtedness from a person that is not an existing shareholder or matched investor. In practice, a company is unlikely to seek secured debt financing from its shareholder base (the norm is to achieve this through convertible loan note instruments) and so this is unlikely to be a real restriction on companies.
- **Transferability:** The UK government shall be permitted to freely transfer the loan and, upon conversion, shares to an institutional investor that is acquiring a portfolio of the UK government's interest in at least 10 companies owned in respect of the scheme. This may result in an undesirable institutional investor acquiring an interest in the company, and founders and existing shareholders should be alive to this possibility.

Full and final details of the scheme and eligibility requirements are expected to be published in due course.

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