

UK Announces £500 Million Convertible Loan Scheme for UK Start-ups Hit By Coronavirus (COVID-19)

21 April 2020

On April 20, 2020, the UK Chancellor, Rishi Sunak **announced** a new £500 million scheme (delivered by the UK Government in partnership with the British Business Bank) to provide convertible loans (alongside private third party matched investors) as bridge funding to innovative companies facing financial difficulties due to the coronavirus (COVID-19) pandemic. The Chancellor indicated that such companies would be high growth companies that drive innovation including in the tech and life science sectors. The scheme, called the 'Future Fund', will launch in May 2020 and will initially be open until the end of September 2020.

The UK Government has published **guidance** on the Future Fund (including indicative **headline terms** for the convertible loans) but notes that final details of the scheme will be published shortly. Specifically, the UK Government has noted that it will initially make up to £250 million available for the Future Fund and will keep this amount under review.

Key headline terms of the convertible loans

- **Eligibility** – To be eligible for the Future Fund convertible loans,
 - the ultimate parent company of the business must be an unlisted UK registered company;
 - the business must have raised at least £250,000 in total from private third party investors in the last five years; and
 - the business must have a substantive economic presence in the UK.

It appears that that the above criteria may not be exhaustive as the headline terms contemplate that full eligibility criteria will be published shortly. Notably, the above does not provide any details on which high growth companies would be eligible for such loans.

- **Loan size** –
 - The minimum amount of a Future Fund convertible loan is £125,000.
 - The maximum amount of a Future Fund convertible loan is the lower of: (i) £5 million; and (ii) 50% of the total bridge funding being provided to the company by the UK Government and private investors (matched investors).
- **Interest rate** – The higher of: (i) 8% per annum (non-compounding); and (ii) any higher rate agreed between the company and matched investors.
- **Maturity** – A Future Fund convertible loan will mature after a maximum of 36 months.
- **Use of proceeds** - Future Fund convertible loan amounts may only be used for working capital purposes. Such amounts cannot be used to repay any debt, make any dividend or bonus payments or pay any advisory or placement fees or bonuses to external advisers.
- **Conversion** – Future Fund convertible loans will convert into the most senior class of shares in the company in certain circumstances:
 - *Qualifying funding round* – If the company raises equity funding equal to at least the total bridge funding provided to it by the UK Government through the Future Fund and matched investors (a qualifying funding round):

- the principal amount of the convertible loan will automatically convert into equity at a discount (Discount Rate) of the higher of: (i) 20% to the qualifying funding round's issue price; and (ii) any higher discount agreed between the company and the matched investors; and
 - the accrued interest of the convertible loan will automatically convert at the qualifying funding round's issue price (i.e. with no Discount Rate) unless the company elects to repay such interest.
- *Non-qualifying funding round* – If the company raises funding in an equity funding round that does not qualify as a qualifying funding round (a non-qualifying funding round) the convertible loan (principal amount and accrued interest) will not convert automatically into equity. Instead, it will be up to the holders of a majority of the principal amount of the bridge funding provided by the matched investors to elect for the conversion of such loan (both the principal amount and the accrued interest) into equity on the same conversion terms for a qualifying funding round.
- *Sale or IPO* – On a sale or IPO of the company:
- the convertible loan will convert as follows:
 - the principal amount will convert into equity at the Discount Rate to the issue price for the most recent non-qualifying funding round following the bridge funding or where the most recent non-qualifying funding round takes place prior to the bridge funding, at the issue price for such funding round without a Discount Rate; and
 - the accrued interest will convert at the issue price for the most recent non-qualifying funding round with no Discount Rate; or
 - be repaid with a redemption premium of 100% of the principal amount (Redemption Premium),
- whichever will provide a higher amount for the UK Government and the matched investors.
- *Maturity of the convertible loan* – On maturity, at the option of the holders of a majority of the principal amount of the bridge funding provided by the matched investors, the convertible loan may be:
- repaid by the company with a Redemption Premium; or
 - converted into equity as follows:
 - the principal amount will convert into equity at the Discount Rate to the issue price for the most recent funding round following the bridge funding or where the most recent funding round takes place prior to the bridge funding, at the issue price for such funding round without a Discount Rate; and
 - the accrued interest will convert at the issue price for the most recent funding round with no Discount Rate.

If a further funding round is completed within six months of any of the above conversion events, the UK Government and the matched investors will be entitled to convert their shares into the senior class of shares of the company in issue following such funding round.

- **Most favoured nation** – If the company issues further convertible loans with more favourable terms, those terms will apply to the Future Fund convertible loans.

- **Transfer rights** - The UK Government will be entitled to transfer the Future Fund convertible loans (as well as shares following such conversion) without restriction:
 - to any institutional investor acquiring a portfolio of the UK Government's interest in at least 10 companies owned in respect of the Future Fund; and
 - within the Government and to entities wholly owned by central UK Government departments.

It should be noted that the terms of the Future Fund convertible loans are not finalised yet, and that the UK Government will be publishing full and final details of the scheme shortly.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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