Financial Restructuring Alert

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UK Government Backed Financing 2.0: Key Updates and Issues to Consider for UK Businesses

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On April 3, 2020, the Chancellor announced the introduction of the Coronavirus Large Business Interruption Loan Scheme (**CLBILS**) to be made available to UK businesses with an annual turnover of between £45 million and £500 million and will see the UK government guarantee 80 percent of new loans up to £25 million.

According to the Chancellor, CLBILS is intended to give banks "the confidence to lend to more businesses which are impacted by COVID-19 but which they would not lend to without CLBILS." Further details of the CLBILS will be announced by the UK government later in April although it appears that CLBILS is intended to operate in a similar manner to the current Coronavirus Business Interruption Loan Scheme (**CBILS**) aimed at UK SMEs. Other than differences in turnover thresholds and the size of loans available, it remains unclear what other key differences will ultimately exist between the CLBILS and CBILS. However, it does appear that CLBILS will (i) **not** include coverage for the first 12 months of interest and fees as is currently available under the CBILS, and (ii) only apply where borrowers have been unable to secure regular commercial financing in the first instance.

The CLBILS therefore seeks to fill the gap between:

- The COVID-19 Corporate Financing Facility (**CCFF**) that went live on March 23, 2020, and is aimed at investment grade companies that make a material contribution to the UK economy – according to the UK government, £1.9 billion of financing has been provided under the CCFF (and a further £1.6 billion financing committed to be provided to date).
- The CBILS that went live on March 23, 2020, and is aimed at UK based small to mid-sized enterprises (**SMEs**) with an annual turnover of less than £45 million – accordingly to the UK government, £90m of loans have been made available under the CBILS to approximately 1,000 UK businesses.

Prior to the introduction of the CLBILS, many UK businesses (particularly those backed by private equity) would have fallen into the clear gap between CCFF and CBILS in that (i) they will not be of the investment grade financial strength pre-COVID-19 required to consider the CCFF, and (ii) they will have a turnover in excess of £45 million per annum and therefore not be eligible for the CBILS.

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One key change announced by the Chancellor that is expected to improve access to the CBILS (but seemingly not the CLBILS which could potentially be a barrier to its use depending on the final details of the scheme) is the removal of the previous requirement that the relevant UK business was unable to secure regular commercial financing. As such, among other changes, insufficiency of security will no longer be a condition for accessing the CBILS. The revised CBILS is expected to be operational with eligible lenders from April 6, 2020.

As the Chancellor acknowledges, the next challenge will be for lenders under the CLBILS to "move quickly to support the economy, jobs and businesses" as anecdotal evidence suggests that the eligible lenders were already inundated with requests under the smaller CBILS (UK government figures suggested some 130,000 enquiries to access the CBILS have been received to date) and, according to media reports, some smaller lenders have temporarily suspended advertising that they are eligible lenders under the CBILS. The UK government has stated that it is making operational changes intended to accelerate lending approvals.

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High level key terms of CLBILS currently known

What companies can benefit?	*UK businesses* • In short, businesses that are "UK based in [their] business activity" with an annual turnover of between £45 million and £500 million. (Announced). *Sectors* • Any sectors, except (i) banks and building societies, (ii) insurers and reinsurers (but not insurance brokers), and (iii) public-sector organisations (including UK government funded primary and secondary schools). (Announced). *Inability to secure regular commercial financing* • Borrowers are unable to secure regular commercial financing. (Announced) It remains to be seen how this will impact the ability of borrowers to access the CLBILS (as the equivalent requirement was, prior to the recently announced amendments to the CBILS, one of the issues for borrowers accessing the CBILS). Hopefully, the reference to "regular commercial financing" is intended to pick-up financing at commercially acceptable interest rates / terms (and not just access to commercial finance generally). *Borrowing proposal and impact of COVID-19* • Borrowers are required to have a borrowing proposal that the lender (i) would consider viable if

it were not for the current COVID-19 issues, and (ii) believes will enable the borrower to trade out of any short-term to medium-term difficulty.

What financing is potentially available?

Amount

- Maximum value of facilities is £25 million. (Announced)

Government partial guarantee

- UK government will provide the lender with a guarantee of 80 percent of the outstanding balance (plus, we assume, any lender fees). (Announced)

No 12 month interest and fees holiday

- Unlike the CBILS, it does not appear that this will be covered by CLBILS.

Term/type of facilities

- Similar to CBILS, a wide range of finance products including short term loans, overdrafts, invoice finance and asset finance. (Announced)

Interest rate, security/guarantees and underlying principles of lending

- The UK government has specifically referenced that facilities made available under CLBILS will be offered at "commercial rates of interest". (Announced) No details of how this will be achieved have been published to date.
- According to the UK government's website, "Lenders will still be expected to conduct their usual credit risk checks, but [CLBILS] allows them to specifically support business that were viable before the COVID-19 outbreak but are facing significant cash flow difficulties, that would otherwise make their business unviable in the short term." (Announced)
- No specific reference to security.

Timing

- Further details are expected later in April – exact timing currently unclear.

Process

- We expect CLBILS will be available through the British Business Bank's 40+ accredited lenders (these include all the leading banks) in the same manner as the CBILS.

High level recap of the key terms of the CCFF and CBILS, including key updates

CCFF

What companies can benefit?

UK businesses

- UK incorporated companies (including those with foreign-incorporated parents) and with a "genuine business in the UK" will normally be regarded as making a "material contribution to economic activity in the UK."
- The Bank of England will take into account the following factors when determining if a company has "genuine business in the UK": (i) significant employment in the UK, (ii) headquartered in the UK, (iii) significant revenues in the UK, (iv) serves a large number of customers in the UK, and (iv) a number of operating sites in the UK.
- Leveraged investment vehicles and companies within groups that are predominantly banks, investment banks, building societies or are regulated by the Bank of England or Financial Conduct Authority are excluded.

Sound financial health pre-COVID-19

- Existing credit rating: The CCFF is aimed at investment grade companies, so accepted ways of proving this is if a company has a: (i) minimum short-term credit rating of A-3/P-3/F-3 /R-3 or above, or (ii) a long-term rating of BBB-/Baa3/BBB- or above, from at least one of Standard & Poor's, Moody's, Fitch or DBRS Morningstar as at March 1, 2020 (i.e. assessing the pre-COVID 19 position) (Note: If a company has a split rating and one is below the above minimums, the company will not be eligible).
- No existing credit rating: Two (2) main options: (1) companies request confirmation of whether their bank internally would consider the company to be equivalent to investment grade (and this information is then passed on to the Bank of England for consideration), or (2) companies seek a credit rating from one of the major credit rating agencies in a form that can be shared with the Bank of England i.e. including private indicative ratings or credit assessments (typically, this takes 4-6 weeks but the Bank of England is in

discussions with the major credit rating agencies to significantly reduce this time when companies are seeking one for the purposes of utilising the CCFF).

What financing is potentially available?

Type of instrument

- GBP denominated commercial paper (CP) (being a type of short-term unsecured promissory note) issued by the relevant company to the Bank of England via a dealer (or purchased by the Bank of England in the secondary market).
- Issued directly into Euroclear and/or Clearstream, so a paying agent will be required.

Amount

- £1 million minimum (subject to limits per issue that will only be advised by the Bank of England direct to the company upon request).

Maturity date

- One week to 12 months.

Security/guarantee and ranking

- If CP is issued by a finance subsidiary, a guarantee will be required from the primary entity in the group.
- CP to rank at least pari passu with unsecured and unsubordinated indebtedness of the group – however, the "Eligibility Form" contemplates that the CP will benefit from any guarantee or similar arrangements that have been provided by the group for the benefit of the issuer's other creditors. This will potentially impact the utility of the CCFF for already leveraged borrowers or issuers (subject to a detailed review of relevant existing financing arrangements).

Terms

- Bank of England may not approve commercial paper with certain non-standard features – two (2) specific examples given are: (i) subordination, and (ii) extendibility.
- The "Eligibility Form" also requires confirmation that (i) there are no financial covenant breaches or defaults under existing facility agreements (and none likely to occur as a result of issuing the CP),

and (ii) the CP will not result in any breach of borrowing limits.

- The terms of the CP requires various representations and warranties to the Bank of England (in some instances with qualifications due to the COVID-19 shock).

Pricing

- Comparable pricing to those prevailing in the markets pre-COVID-19.
- Primary market purchases: Bank of England will acquire CP at a spread above a reference rate based on the current GBP overnight index swap (OIS) rate – credit ratings will impact the amount of the relevant spread.
- Secondary market purchasers: Bank of England will acquire CP at the lower of (i) amortised cost from the issue price, and (ii) the equivalent price using the primary market purchase methodology. The Bank of England will apply an additional small fee (currently set at 5bps and subject to review) for use of the secondary facility, payable separately).

Timing

- CCFF went live on or about March 23, 2020, and will close to new issuers on December 31, 2020 (and secondary purchases on March 23, 2021).
- In terms of accessing the CCFF, it will be easier for those companies that already have existing CP programs in place as (i) it is more likely that they contemplate the issuance of CP as part of their existing capital structure, (ii) they will have an existing credit rating, and (iii) they are more familiar with the documentation/process.
- Whilst the CCFF is available to companies who have not previously issued CP, additional work will be required by them including (i) in many instances, obtaining a credit rating, (ii) more detailed analysis of their existing financing arrangements (and potentially existing lender consents), and (iii) potential preparation of an information memorandum (although this requirement is currently unclear).

Process

- CCFF is being run by the Bank of England.
- Relevant documentation has been published by the Band of England and the Bank of England has indicated that it (i) will accept CP issuing

International Capital Market Association standard documentation, and (ii) may accept simplified versions of such documentation.

- Companies wanting to use the CCFF should speak with relevant banks (who would act as dealers) in the first instance.

CBILS

What companies can benefit?

UK businesses

- In short, businesses that are "UK based in [their] business activity" with an annual turnover of £45 million or less.

Sectors

- Most sectors are covered (save for certain exclusions, in whole or in part, in the agricultural, financial services, insurance, education and care sectors).

Borrowing proposal and impact of COVID-19

- Borrowers are required to have a borrowing proposal that the eligible lender would consider viable if it were not for the current COVID-19 issues.
- Borrowers must self-certify that they have been adversely impacted by COVID-19.

What financing is potentially available?

Amount

- Maximum value of facilities is £5 million.

Government partial guarantee

- Government will provide the lender with a guarantee of 80 percent of the outstanding balance (plus any lender fees).

Term/type of facilities

- Term and asset finance facilities with terms of up to six (6) years.
- Overdraft and invoice facilities with terms of up to three (3) years.

Security

- Insufficiency of security is no longer a condition. (Update)

Pricing

	• As negotiated with the relevant lender. • However, the Chancellor and Bank of England have requested banks to "support small and medium-sized enterprises in any way they can. This included ensuring interest rates offered to struggling businesses are reasonable and to pass on the benefit of the [UK government] guarantee to those borrowing under the [CBILS]" – this is in response to anecdotal evidence/media reports suggesting that some banks in certain instances may have been seeking to charge relatively high rates of interest on loans backed by CBILS. (Update) *Underlying principle* • The Chancellor has announced that, to maximise the support available, CBILS should be available to SMEs affected by COVID-19 and not just those unable to secure regular commercial financing i.e. CBILS is now less of a "last resort" option after seeking to access commercial financing has been exhausted. (Update)
Timing	• CBILS went live on March 23, 2020, and will initially run for six (6) months.
Process	• CBILS is available through the British Business Bank's 40+ accredited lenders – these include all the leading banks and many alternative finance lenders are being accredited under the scheme. • Approach to sub-participation of accredited lenders' positions is unclear – we suspect this will become more of an issue with the CLBILS given the larger size of the facilities potentially being made available under that scheme.

Issues with certain leverage-backed businesses accessing the CCFF and CBILS

Very few privately owned leverage-backed businesses will be able to access the CCFF because (i) they are not investment grade (especially having regard to their debt position), and (ii) it is not available to leveraged investment vehicles. It would also be very difficult for CP issued as part of the CCFF to fit within the capital structure of many borrowers or issuers where the existing lender group benefits from security (as the expectation, at least based on the "Eligibility Form" to access CCFF, is that the CP will also benefit from such security which it would not likely be able to do without lender consent and the CCFF will not apply to CP with non-standard features such as subordination – it is unclear how this will play out in practice).

In relation to the CBILS, many companies (including many of those backed by private equity) will exceed the £45 million turnover threshold even ignoring some of the anecdotal teething issues around how this £45 million threshold is calculated where the proposed borrower is part of a privately owned group or the relevant company has operations in both the UK and abroad as many do.

Therefore, the announcement of the CLBILS appears to be positive news for many larger non-public borrowers or issuers (particularly those backed by private equity) subject to understanding the requirement for such borrowers or issuers not being able to secure "regular commercial financing" as a pre-condition for accessing CLBILS. We would expect borrowers, issuers and sponsors to commence discussions with eligible lenders (especially those with an existing debt position) regarding (i) the financing assistance that can be made available under CLBILS, and (ii) how it will fit into existing capital structures.

Of course, in addition to the above issues, proposed borrowers or issuers will need to consider the:

- Extent to which any new indebtedness is "Permitted Financial Indebtedness" (or the equivalent) for the purposes of their existing financing arrangements (or, if not, where such new debt would rank in the capital structure and any required intercreditor or subordination arrangements); and
- Speed with which any such new financing for working capital purposes can be put in place – the UK government is aware of this issues and seems engaged to try to speed up access to CCFF, CBILS and CLBILS.

We also understand that, in certain restricted circumstances where a business's current working capital facilities are inadequate, businesses may be able to refinance into the CBILS (and hopefully the same potential flexibility will be available to CLBILS).

Availability of other UK government schemes and support measures

It is hoped that CLBILS will assist many companies (including leverage-backed companies) in a way that the CCFF and CBILS have not been able to assist to date. In addition, most UK based companies still have the ability to benefit from the following schemes or measures to help them seek to manage their working capital position in the short-term:

- Coronavirus Job Retention Scheme (the **CJRS**):
  - The CJRS is available to all UK employers with a pay as you earn (PAYE) scheme as of February 28, 2020, i.e., available to all UK employers irrespective of size or sector – in order to seek to minimise redundancies (to the extent possible), Her Majesty's Revenue and Customs (HMRC) will reimburse employers for 80 percent of the wages of "furloughed workers" (being workers who are being asked to stop working for the time being but remain employees during this time) up to £2,500 per month.
  - UK employers will still need to comply with applicable law and employment contracts in relation to making employees "furloughed workers".
  - The CJRS is open for an initial period of at least three (3) months starting from March 1, 2020.
- Deferred Value-added tax (VAT) and Income Tax payments:

- VAT payments are permitted to be deferred for three (3) months – this deferral applies from March 20, 2020, to June 30, 2020.
- All UK businesses are eligible.

- Time to Pay service: All businesses that pay tax to HMRC and have outstanding tax liabilities may be eligible to receive support with their tax affairs from HMRC - this is aimed at companies in financial distress and is considered on a case-by-case basis.
- Statutory Sick Pay scheme:
  - Statutory Sick Pay scheme is available to UK based businesses that are small or-medium sized with fewer than 250 employees as of February 28, 2020.
  - Government will cover up to two (2) weeks per relevant employee who is absent from work due to COVID-19.
- Business rate holidays:
  - For retail, hospitality and leisure businesses in England and for certain UK nursery businesses, they will be entitled to a business rate holiday for the 2020/2021 tax year.
  - This will be benefit properties that are wholly or mainly used (i) as shops, restaurants, cafes, drinking establishments, cinemas and live music venues, (ii) for assembly and leisure, (iii) as hotels, guest and boarding premises and self-catering accommodation, and (iv) certain nursery businesses.
- Commercial insurance: Although likely to only be relevant to a very small number of businesses as most insurance policies will not cover COVID-19, businesses should consider whether they have in place any insurance arrangements that may apply to any loss or damage that they suffer as a result of COVID-19 issues (either as a result of its declaration as a pandemic or as a result of the UK government ordered lockdown).
- Eviction protection for commercial tenants: Although not a rent holiday, there is protection for commercial tenants from being evicted if they miss rental payments up to June 30, 2020, due to COVID-19 issues.

Many of these measures will be helpful to assist UK businesses manage working capital. Other self-help measure we expect borrowers and issuers to be considering include:

- Drawing down under any available revolving credit facilities (or the equivalent) immediately and thereby seeking to avoid any ability of lenders to seek to not fund drawdown requests whether due to “material adverse effect” outs or otherwise.
- Seeking extended credit terms from suppliers, landlords or other debtors.
- Where possible (mainly when contracting with governmental authorities), seeking shorter payment terms from customers and clients.
- To the extent possible with HMRC’s prior approval, seek to agree deferred payment of taxes (beyond the deferrals announced by the UK government).
- Where relevant to the business, active discussions with trade credit insurers.

- To the extent possible in the circumstances having regard to general logistics (depending on the nature of the asset) and valuation, exploring the disposal of non-core assets.

Approach of lender groups to businesses impacted by COVID-19

Despite the above measures which may partially assist some UK businesses managing their working capital, we anticipate that many companies will struggle to maintain compliance with the covenants in their financing arrangements (especially those with acquisition debt prior to the "cov-lite" trend of recent years). In this regard, the Prudential Regulatory Authority (**PRA**) recently issued a "Dear CEO" letter in respect of, among other things, the prudential treatment of loans to borrowers affected by COVID-19. The tone of the letter is to encourage PRA-regulated firms not to exercise excessive caution with respect to borrowers experiencing difficulties arising from the COVID-19 restrictions, including where covenant breaches and waivers have taken place, or where repayment breaks are granted. The PRA expects lenders:

"…to consider the need to treat [covenant breaches that arise from COVID-19 related matters that are of a general nature or are firm-specific but unrelated to the solvency or liquidity of the borrower] differently compared to uncertainties that arise because of borrower-specific issues and in doing so consider waiving the resultant covenant breach. [The PRA] would expect firms to do so in good faith and not to impose new charges or restrictions on customers following a covenant breach that are unrelated to the facts and circumstances that led to that breach."

This message was subsequently repeated in a joint statement by the PRA and Financial Conduct Authority (**FCA**) and a similar sentiment is separately clear from a number of recent FCA announcements. The clear messaging is that banks and other financial institutions are expected to play an active part in helping UK businesses navigate the challenges of the severe economic disruption caused by the COVID-19 measures and that they will be under ongoing scrutiny to assess whether they are providing the assistance required. Additionally, it should be noted that the Bank of England has taken material measures to make additional resources available to UK banks to encourage lending to businesses that need financial assistance as a result of the direct or indirect impact of COVID-19 on the business (including new regulatory guidance confirming that banks are permitted to use capital and liquidity buffers to address temporary shocks and a reduction in the UK countercyclical buffer to zero percent).

We are continuing to closely monitor developments for our clients. If you have any questions around access to UK government support finance packages or the other schemes announced to date or in the future, Akin Gump is tracking and is available to assist.

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