ALLEN & OVERY

Covid–19 update

UK business loan package – are you eligible to participate?

(Updated: 4 May 2020)

The UK government has announced a number of measures designed to respond to the economic shock arising from Covid-19 coronavirus (**Covid-19**) – these include providing businesses of all sizes with access to a £330 billion package of government-backed loans and guarantees. In this bulletin we consider the key elements and eligibility requirements of the Covid Corporate Financing Facility (**CCFF**), the Coronavirus Business Interruption Loan Scheme (**CBILS**), the Coronavirus Large Business Interruption Loan Scheme (**CLBILS**) and the Bounce Back Loan (**BBL**).

Executive summary

Both the CCFF and the CBILS were made available to businesses from 23 March 2020 in order to provide eligible businesses with some much-needed financial breathing space in the current turbulent market and economic downturn that is almost o follow. On 3 April 2020, the UK government announced clarifications to the CBILS and took further action to strengthen support for businesses by announcing details on the CLBILS. The CLBILS launched on Monday 20 April 2020 to facilitate access to finance for medium-sized and larger businesses affected by Covid-19.

On 27 April 2020, the UK government announced that it was launching a fast-track ‘Bounce Back’ guaranteed lending scheme aimed at small businesses that are suffering due to the financial impact of the Covid-19 lockdown. The scheme launched on 4 May 2020.

Prospective borrowers should consider which of the schemes may be available to them and the viability of access to the relevant scheme in light of their existing obligations and longer term cash flows.

The Covid Corporate Financing Facility (**CCFF**)

Introduction

On 17 March 2020, HM Treasury and the Bank of England announced the CCFF to help [counter] the negative impacts of Covid-19 on their cash flows, which are likely to driven by significant disruptions to supply chains and weaker economic activity.

The CCFF is intended to provide funding to businesses across a range of sectors by purchasing commercial paper of up to one-year maturity, which has been issued by those corporates making "a material contribution to the UK economy" or by financing subsidiaries of such corporates. It is intended to support those businesses in paying salaries, rents and suppliers, even while experiencing severe disruption to cash flows. Determinations of eligibility are made by the BoE's risk management staff.

Broadly, the CCFF offers financing on terms comparable to those prevailing in markets in the period before the Covid-19 economic shock, and is open to corporates that can demonstrate that they were in sound financial health prior to the shock. The facility looks through temporary impacts on firms' balance sheets and cash flows by basing eligibility on firms' credit ratings as at 1 March 2020. The scheme will operate for at least 12 months and for as long as steps are needed to relieve cash flow pressures on eligible businesses. The BoE will provide six months' notice before withdrawing the facility.

The BoE set out further details of the operation of the CCFF in a Market Notice which was published on 18 March and a set of questions and answers which were published on 20 March (the **FAQs**). The following sections summarise the key elements and requirements as regards eligibility.

As articulated in the press announcement linked above, the CCFF is intended to preserve the capacity of the banking system to lend to other companies, including small and medium-sized enterprises (**SMEs**), which rely on banks. On 11 March 2020, the BoE boosted this capacity by:

- launching a new Term Funding Scheme with additional incentives for lending to SMEs, which will be operational from May; and
- reducing the UK countercyclical capital buffer rate to 0% of banks' exposures to UK borrowers with immediate effect.

Eligibility – corporates that make a "material contribution" to UK economic activity

The Covid Corporate Financing Facility Limited (the **Fund**) – which is to be operated by the BoE on behalf of HM Treasury - will purchase commercial paper issued by companies (including their finance subsidiaries) that – in the opinion of the BoE's risk management staff - make "a material contribution to economic activity" in the UK. The Market Notice states that UK incorporated companies (including those with foreign-incorporated parents and with a genuine business in the UK), will normally be regarded as meeting this requirement. Companies with significant employment in the UK or with their headquarters in the UK will normally be regarded as meeting this requirement. The BoE will also consider whether the company generates significant revenues in the UK, serves a large number of customers in the UK or has a number of operating sites in the UK. The detail provided thus far does not suggest that the BoE will seek to monitor how funds are deployed within corporate groups, raising the question of whether funds may in fact flow to affiliates, employees or suppliers outside of the UK.

The CCFF is open to companies that can demonstrate they were in sound financial health prior to the shock – ie companies that had a short or long-term rating of investment grade, as at 1 March 2020, or equivalent. If companies do not have an existing credit rating from the major credit ratings agencies, the

BoE has suggested that they speak to their bank in the first instance. If that bank's advice is that the company was viewed internally as equivalent to investment grade as at 1 March 2020, then the company should contact the BoE to discuss potential eligibility and whether the BoE can make an assessment that deems the business to be equivalent to having a public investment grade rating. Another potential route to evidencing credit status is for the company or its bank to get in touch with one of the major credit rating agencies to seek an assessment of credit quality in a form that can be shared with the BoE and HM Treasury, noting that the purpose of the enquiry relates to access to the CCFF.

If an issuer is downgraded after 1 March 2020 below the minimum credit ratings set out above, the issuer will remain eligible for primary and secondary market purchase in the CCFF, subject to HM Treasury approval. Commercial paper issued by non-financial companies should also qualify provided the BoE is satisfied that the issuer makes a material contribution to corporate financing in the UK. However, paper issued by leveraged investment vehicles or from companies within groups that are predominantly banks, investment banks or building societies will not be eligible.

How will the CCFF operate in practice?

The Fund will purchase, at a minimum spread over reference rates and during a defined period each business day, newly issued commercial paper in the primary market via dealers and after issuance from eligible counterparties (who are authorised under FSMA 2000 (**eligible institutions**)) in the secondary market. These purchases will be financed by BoE reserves.

The Fund will purchase securities at a spread above a reference rate, based on the current sterling overnight index swap (**OIS**) curve. Spreads will be set such that pricing is close to the market spreads prevailing before the economic shock from Covid-19:

Primary market purchase – commercial paper will be discounted using a rate based on the maturity-matched OIS rate, as determined by the BoE on the day of purchase. Money market yield conventions will be applied.

Secondary market purchase – commercial paper will be purchased at the lower of amortised cost from the issue price and the price as given by the method used for primary market purchases as set out above.

The BoE will send a written electronic confirmation of each transaction on the day of purchase and the purchase will normally settle on a T+2 basis. At 3pm each Thursday, the BoE will publish details of:

- the total amount of commercial paper purchased that week up until the previous day, in terms of the amount paid to the sellers; and
- the sum of commercial paper purchased, less redemptions, to date.

The Fund may limit the quantum of paper it will purchase from an issuer (or a corporate group of issuers) in the primary market: details of any such limit imposed will be available (to the issuer only) on request. Limits applied to a corporate group of issuers on an aggregate basis will be fungible as between the issues in that group.

What securities will be eligible for purchase?

The Market Notice and FAQs confirm that the Fund will purchase sterling-denominated commercial paper which has the following characteristics - non-standard features such as subordination are unlikely to be acceptable:

- A maturity of one week to 12 months if issued to the BoE at issue via a dealer (an eligible institution acting as principal). Drawings can be rolled while the CCFF is open, subject to eligibility.
- Where available, a minimum short-term credit rating of A-3/P-3/F-3 from at least one of Standard & Poor's, Moody's and Fitch as at 1 March 2020.
- Where a short-term credit rating is not available the BoE will consider whether a long-term credit rating can be used to assess eligibility and pricing, or whether the BoE can assess that the issuer is of equivalent financial strength.
- Issued directly into Euroclear and/or Clearstream.

Securities issued by a finance subsidiary should be guaranteed by their parent company in a form acceptable to the Bank.

The Coronavirus Business Interruption Loan Scheme (**CBILS**)

In addition to the CCFF, HM Treasury brought forward the commencement date for the CBILS which had been announced as part of the Budget on 11 March 2020 and was intended to become available "over the coming weeks".

The CBILS became available in the week commencing 23 March and is provided by the British Business Bank through approximately 40 participating providers (ie commercial banks and other lenders). The scheme provides the lender with a government-backed guarantee against the outstanding facility balance and the government will also cover the first 12 months of fees and interest payments (extended from six months, as originally announced), so businesses will benefit from lower initial repayments. The business borrower will remain liable for repayments of the capital. The maximum value of a facility provided under the scheme will be £5 million pounds (increased from the originally expected limit of £1.2m).

The amount of the facility must not be more than:

- double the annual wage bill of the applicant for 2019 or if the applicant commenced trading after 1 January 2019, the estimated annual wage bill for the first two years of operation; or
- 25% of total turnover of the applicant in 2019; or
- the applicant's liquidity needs for the next 18 months (in the case of SMEs) or 12 months (in the case of large enterprises) which may be self-certified by the applicant.

The scheme is available to small businesses who:

- are UK based, with a turnover of up to £45m including those with more than 250 employees;
- operate a business which is not a bank, insurers or reinsurers, a public-sector body, a further-education establishment which is grant-funded or state-funded primary and secondary schools (further detail on eligibility of different business types is set out in this list which is maintained by the British Business Bank);

- are able to confirm that they have not received de minimis State aid beyond €200,000 equivalent over the current and previous two fiscal years;
- have passed the business viability test – CBILS can be used when the business has a viable business proposition assessed according to a Lender's normal commercial lending criteria. However, where there are some concerns over the short-to-medium term business performance due to the uncertainty and impact of Covid-19, provided the Lender reasonably believes that (a) the finance will help the business trade-out of any short-to-medium term cashflow difficulty, and (b) if the facility is granted, the business should not go out of business in the short-to-medium term, then the proposition may be considered eligible under the CBIL Scheme.;
- have not fallen foul of the "business in difficulty" test as at 31 December 2019 – discussed further below; and
- self-certify that they have been adversely impacted by Covid-19.

Unless a business is less than three years, if it has accumulated losses greater than half of its subscribed share capital as at 31 December 2019, it will not be eligible for CBILS. This is because the State aid framework CBILS operates under requires that a business is not an "undertaking in difficulty" as at 31 December 2019 to be eligible (as defined in Article 2 (18) of the Commission Regulation (EU) No 651/2014).

The CBILS is intended to support a wide range of business finance products including term facilities, overdrafts, invoice finance facilities and asset finance facilities. Facility terms can range between three months and six years, with a three year limit for overdrafts and invoice finance.

On 3 April, the UK government announced that to maximise the support available, CBILS would be extended so that all viable small businesses affected by Covid-19, and not just those unable to secure regular commercial financing, will now be eligible should they need finance to keep operating during this difficult time. The UK government has also stopped lenders from requesting personal guarantees for loans under £250,000 and has made operational changes to speed up lending approvals. For facilities above £250,000, personal guarantees may still be required, at a lender's discretion, but:

- they must exclude the Principal Private Residence (**PPR**); and
- recoveries under such personal guarantees are capped at a maximum of 20% of the outstanding balance of the CBILS facility after the proceeds of business assets have been applied.

The British Business Bank has published these questions and answers which provide more details for businesses, including in relation to what lenders will require from prospective borrowers as regards supporting documents.

On 28 April 2020, the FCA published a statement in relation to CBILS and the BBL (discussed further below) confirming that it would not expect firms to comply with the affordability assessment in CONC 5.2A.4-34 where the firm complies with the relevant requirements of CBILS. CONC 5.2A contains rules and guidance on carrying out a reasonable assessment of a customer's creditworthiness before taking the process forward. Firms must continue to carry out creditworthiness assessments in line with the whole of CONC 5.2A on all other regulated lending.

The Coronavirus Large Business Interruption Loan Scheme (**CLBILS**)

On 3 April, the UK government announced an additional new scheme to ensure that more businesses are able to benefit from government-backed support during this period. The new CLBILS will provide a government guarantee to participating banks for 80% of the value of an individual loan of up to £25m for borrowers with a group turnover of up to £250m or £50m for borrowers with a group turnover greater than £250m. In each case the amount borrowed should not be greater than (i) double the borrower's annual wage bill for the most recent year available, or (ii) 25% of the borrower's total turnover for the most recent year available, or (iii) with appropriate justification and based on self-certification of the borrower, higher amounts as is necessary to cover their liquidity needs for the next 12 months. The maximum repayment term is three years. Facilities backed by a guarantee under CLBILS will be offered at commercial rates of interest.

Businesses will still be 100% responsible for paying the facility back, along with interest and fees charged by the lender. Accredited Lenders making use of the scheme will pay a fee in order to benefit from the partial government guarantee on each CLBILS facility. The amount of the fee for each facility is based on the balance of the facility multiplied by a margin of 50bps for the first year of the facility and 100bps thereafter.

Lenders will still be expected to conduct their usual credit risk checks but the scheme is designed to allow lenders to specifically support businesses that were viable before the Covid-19 outbreak but now face significant cash flow difficulties that would otherwise make their business unviable in the short term.
No personal guarantees will be permitted for facilities under £250,000. For facilities of £250,000 and over, claims on personal guarantees applied to the scheme facility cannot exceed 20% of losses on the scheme facility after all other recoveries have been applied.

The eligibility criteria for the CLBILS do not require lenders to take into account the other forms of government support that businesses may be benefiting from – for example, the Coronavirus Job Retention Scheme, business rate reliefs or grants unrelated to the CBIL Scheme. The only exception to this is that large investment grade companies may not utilise both CLBILS and the CCFF.

The CLBILS will allow eligible businesses to access finance products including short term loans, revolving credit facilities (including overdrafts), invoice finance and asset finance facilities.

The facility must benefit at all times during its life, on an at least *pari passu* basis with other senior obligations (including secured and/or super-senior obligations, if any) of the borrower, from collateral constituting a substantial percentage of the then current market value of all collateral made available by or on behalf of the borrower to support all borrowing facilities of that borrower with the lender, with an exception in relation to secured facilities for individual assets of a minimal value.

Who is eligible to access the CLBILS?

The CLBILS is designed to support mid cap and larger businesses from all sectors that do not meet a lender's normal lending requirements for a fully commercial loan or other facility, but who are considered viable in the longer-term. To be eligible, the business must:

- be UK-based in its business activity;
- have an annual turnover of more than £45m;
- not have received a facility under the BoE's CCFF;
- generate more than 50% of turnover from trading activity;
- have passed the borrower viability test – ie have a borrowing proposal which the lender (in accordance with its normal commercial lending criteria): (i) would consider viable (were it not for the Covid-19 pandemic) and (ii) believes:
  - will enable the business to trade out of any short-term to medium-term difficulty; and
  - that the borrower should not go out of business in the short to medium term if the facility is granted.
- have been adversely impacted by Covid-19; and
- not be a "business in difficulty" as at 31 December 2019. Similar to the CBILS, the State aid framework that the CLBILS operates under requires that a business is not an "undertaking in difficulty" as at 31 December 2019 to be eligible (as defined by Article 2 (18) of the Commission Regulation (EU) No 651/2014). 'Undertaking in difficulty' means an undertaking in respect of which at least one of the five circumstances listed in that Article 2(18) occurs with a couple particularly worth drawing out – namely:
  - limb (a) which states that unless a business is less than three years old, it must not have accumulated losses greater than half of its subscribed share capital as at 31 December 2019 otherwise it will be classified as 'in difficulty'; and
  - limb (e) which states that for the two years prior to 31 December 2019, where the book debt to equity ratio of a business has been greater than 7.5 and the EBITDA interest coverage ratio has been below 1.0, the business will be classed as 'in difficulty'. It is worth noting that this limb is not relevant for the CBILS.

Lender and Borrower are still free to enter into loan agreements outside of the CLBILS – for example, where there is no economic benefit to the borrower of taking out a CLBILS loan over normal commercial lending.

The scheme is not available for banks, building societies, insurers, reinsurers (but not insurance brokers), public-sector bodies, further education establishments, if they are grant-funded and state-funded primary and secondary schools.

The Bounce Back Loan (**BBL**)

On 27 April 2020, the UK government announced the BBL to help SMEs affected by Covid-19 to borrow between £2,000 and 25% of a business' turnover or £50,000, whichever is lower. The government will guarantee 100% of the loan and it will make a Business Interruption Payment to cover the first 12 months of interest payments. Loan terms will be up to six years with no repayments due during the first 12 months, thereafter capital will be repaid on a straight line basis. Early repayment is permitted without early repayment fees.

Similar to CBILS and CLBILS, the scheme is being delivered through a network of accredited lenders and the government has set the interest rate for this facility at 2.5% per annum. Businesses will be required to fill in a short online application form on their lender's website, which self-certifies whether they are eligible for a BBL facility. Eligible companies will be subject to standard customer fraud, Anti-Money Laundering and Know Your Customer checks. Lenders are not permitted to take personal guarantees or take recovery action over a borrower's personal assets (such as their main home or personal vehicle).

Accredited lenders are only permitted to provide term loans under the BBL because the scheme is targeted at supporting those businesses who need access to finance quickly and, therefore, requires lenders to offer a standard product.

Who will be eligible to access the BBL?

The Scheme is open to most businesses, regardless of turnover, who meet the eligibility criteria and who were established on or before 1 March 2020. Borrowers are required to declare, amongst other things, that:

- The business is engaged in trading or commercial activity in the UK at the date of the application, was carrying on business on 1 March 2020 and has been adversely affected by Covid-19.
- The business (and any wider group of which it is part) has not already received a BBL facility.
- The business (and any wider group of which it is part) has not yet obtained a loan through either the CBILS, CLBILS or the CCFF, unless that loan will be refinanced in full by the BBL facility.
- That the business is a UK limited company or partnership, or tax resident in the UK
- The business is not a bank, building society, insurance company, public sector organisation, state-funded primary or secondary school, or an individual other than a sole trader or a partner acting on behalf of a partnership.
- Whether or not the business was, on 31 December 2019, a "business in difficulty" and does not breach State aid restrictions under the Temporary Framework; and if it was a "business in difficulty" then it must confirm it does not breach *de minimis* State aid restrictions and will not be used to support export-related activities.
- At the time of submitting their loan application, the business is neither in bankruptcy, debt restructuring proceedings, liquidation or similar.
- More than 50% of the income of the business (together with that of any member of any group of which it is a part) is derived from its trading activity. This confirmation is not required if the borrower is a charity or a further education college.
- They will use the loan only to provide economic benefit to the business, and not for personal purposes. They have understood the costs associated with repayment of the loan and that they are able and intend to complete timely repayments in future.

The application form also requires confirmations to be given in relation to losses that may be incurred, impact on credit rating, financial risk to personal assets (other than primary residence and primary personal vehicle), reduced consumer protection provisions, data protection consents and that lenders will not assess affordability. Borrowers are advised that they should seek independent legal advice if they are in any doubt about the consequences of the loan agreement not being regulated by the Financial Services and Markets Act 2000 or the Consumer Credit Act 1974 or any other aspect of taking out a loan.

For some businesses, who self-declare as being a "business in difficulty" on 31 December 2019, there may be restrictions on the amount of finance they are allowed to borrow and what they can do with the loan.

The BBL will initially open until 4 November 2020, with the government retaining the right to extend this.

Next steps

Each of the schemes discussed above are intended to help businesses weather the turbulent economic times expected in the short to medium term and should provide some welcome relief. However, those businesses considering availing themselves of funding via the schemes would be prudent to consider their exiting financial covenants and also their longer term expected cash flow position, as each scheme will provide funding requiring repayment in due course.

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