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New flexibility for PE-backed businesses to access financial support schemes

New rules making the UK Government's financial support schemes more accessible to PE-backed businesses.

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Background

The Coronavirus Business Interruption Loan Scheme ("**CBILs**") and the Coronavirus Large Business Interruption Loan Scheme ("**CLBILs**") were introduced by the UK Government as part of its financial support measures designed to help businesses weather the economic impact of the COVID-19 pandemic. Both schemes have the UK Government guaranteeing commercial loans from accredited private lenders to eligible businesses.

The CBILs scheme is available to eligible companies with a turnover of less than £45,000,000 and fewer than 250 employees. Eligible companies can borrow up to £5,000,000, in the form of term debt, invoice finance, asset finance and revolving credit facilities. Loans provided by accredited lenders under the scheme benefit from a UK Government-backed guarantee of 80% of the loan value.

The CLBILs scheme is available to eligible companies that exceed the turnover and employee criteria for CBILs. The scheme will guarantee 80% of loans of up to £200million in term loans and up to £50million in invoice finance and revolving credit facilities. For both CBILs and CLBILs schemes, borrowers have to meet the specific eligibility criteria.

So far, most private equity-backed businesses have been unable to take advantage of either scheme, because their funding structures have fallen foul of EU state-aid rules. The schemes' rules have now changed so that PE-backed businesses now may be able to access UK Government's financial support.

EU State Aid Rules

Under EU state-aid rules, companies that are "undertakings in difficulty" are not eligible for the CBILs and CLBILS schemes. Please see details in box below. This includes businesses whose accumulated losses are greater than half their share capital (as well as businesses that have fallen below required solvency ratios for the previous two years). This includes a debt to equity ratio and EBITDA tests. Typically, the levels of debt carried by PE-backed businesses (whether external or shareholder debt) and the related interest payments can result in a breach of the accumulated losses threshold, even if the business is operating well. This has prevented PE-backed businesses from accessing the schemes. Equally, the solvency ratios may cause issues in practice - although the business would have to fall beneath both the EBITDA level as well as the debt to equity ratio.

These rules has prevented operationally viable private equity-backed companies from accessing the schemes because they have been inadvertently triggered by a company's leveraged funding structure – due to high level of debt on balance sheets – irrespective of whether the company is operating on other metrics.

The "undertaking in difficulty" test was relaxed for businesses with fewer than 50 employees and less than £9,000,000 annual turnover. Such businesses are no longer deemed to be "undertakings in difficulty", if their accumulated losses exceed half of their share capital. But they will still be "undertakings in difficulty", if they are subject to collective insolvency procedure under their national law or in receipt of rescue aid (which has not been repaid) or restructuring aid (and are still subject to a restructuring plan).

New Rules

The British Business Bank has now taken a further step towards making CBILs and CLBILs available for larger private-equity-backed businesses. The date on which the banks will assess whether a company is an "undertaking in difficulty" is now the **date you apply for the loan – not 31 December 2019**. This will give private equity-backed companies the

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chance to restructure their balance sheets to avoid a technical breach of the "undertakings in difficulty" test, although there may be other consequences of doing so.

Restructuring to Access the Schemes

Any balance sheet restructuring will most likely involve the conversion of shareholder loan notes into equity shares before making an application for a CBIL or CLBIL.

The restructuring must be tax-neutral for both PE investors and the company. From the company's perspective, it should be possible to use the debt for equity swap exemption, but care will need to be taken to make sure that the new shares are not fixed rate preference shares as these will not fall within the exemption. For UK investors, the provisions for tax-free conversion of securities are likely to assist and the availability of similar rollover provisions for investors in other jurisdictions will need to be investigated.

Withholding tax will also need to be considered if there is accrued but unpaid interest and the loan notes are not listed. It may be pragmatic to leave accrued interest outstanding until an exit. Care will also be needed to make sure that the restructuring does not result in any accidental de-grouping for tax purposes or adversely impact any remuneration planning for managers.

If the group is still benefitting from tax deductions on shareholder debt (regardless of recent changes), this benefit will be lost on any loan notes which are converted into preference shares.

It may also be advisable in these financial circumstances for the PE investor to keep some shareholder debt so that it is a creditor in any insolvency situations.

Companies will obviously need to consider whether applying with a later date means that they are ineligible because their financial circumstances have worsened, which may have particular impact on the solvency ratios referred to above.

Timing

The Chancellor of the Exchequer announced on Thursday 24 September 2020 as part of his Winter Economy Plan that both the CBILS and CLBILS are extended to 30 November 2020.

The Chancellor of the Exchequer also announced that CBILS lenders will be able to extend the repayment date of loans from six years to 10 years if it will help businesses to repay the loans.

Undertakings in difficulty

This definition will capture businesses that:

- Have accumulated losses greater than half of their subscribed share capital (for limited liability companies)
  or
- Have entered into collective insolvency proceedings or fulfilled the criteria to be put into collective insolvency proceedings
  or
- Have previously received rescue aid and were still under a restructuring plan
  or
- Have previously received restructuring aid and were still undera restructuring plan
  or
- Have fallen below both the required book debt to equity and EBITDA interest coverage ratios for the previous two years

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