

# Coronavirus Large Business Interruption Loan Scheme (CLBILS)

## Background:

- We welcome CLBILS to support UK plc through the COVID-19 impacts.
- However, there are a series of issues with CLBILS design that limit its ability to support corporates operating in the real economy. As design issues, the resultant challenges in CLBILS deployment are broadly consistent across lenders.
- In the spirit of openness and collaboration, we want to ensure that these challenges are known to the British Business Bank (BBB) and we have also made a series of recommendations that could alleviate or mitigate these challenges and enhance CLBILS deployment.
- A number of media outlets have been reporting over the last few days that HMT is considering raising the maximum facility able to be awarded under CLBILS by a significant amount. This would clearly be a positive step, however, access to the scheme will remain limited (particular for larger/ more complex corporates) if the points set out below are not resolved, so we believe these changes must go hand in hand. Furthermore, increasing the maximum facility amount without addressing some of these underlying challenges, risks simply adding to the list of facilities currently 'on hold' for CLBILS.

## Key Challenges:

### 1. CLBILS loan pari passu ranking across Group structure:

- As a general point, bank practice for structuring facilities with appropriate security will vary across sectors/ lending type/ borrower strength and imposition of any single rule for the taking of security will exclude a number of borrowers that would otherwise access CLBILS
- Specifically, banks have been guided to use what appears to be a misinterpretation of clause 16.10 of the Guarantee Agreement which states that the CLBILS debt will share in collateral taken by any lender from the Borrower or a member of its Group. However, 16.10 specifically limits this to ranking, *“on at least a pari passu basis with the most senior obligation (including any secured and/or super-senior obligation) of the Borrower”, and only in regard of ‘all Collateral that has been taken by any lender from the Borrower or a member of its Group at such time to support any one or more borrowing facilities of the Borrower’*
- The principle of sharing security at borrower level is understood. However, the interpretation that the CLBILS loan has to share in all security across the Group presents a material challenge in Group structures with multiple lenders each funding different entities (and activities) which, in effect, means that it is almost impossible to obtain such pari passu ranking and prevents CLBILS from being deployed in these scenarios.
- Common sectors where CLBILS finds issues due to the current interpretation include Real Estate, Hotels, Leisure and Healthcare where an overall Group structure may include:
  - Distinct pools of assets and security, each supported by different / multiple lenders.

- It would be highly impractical and jeopardise existing borrowings to obtain pari passu ranking from third party lenders in these scenarios so, in effect, CLBILS cannot be used here.
- Importantly, given leverage and the COVID-19 impacts, in many of these scenarios, lenders will not have the conventional appetite to support or the appetite will be limited to below a holistic COVID-19 liquidity requirement. Therefore, the ability to offer the CLBILS solution is an important one.
- In addition, a requirement (part of the BBB's CLBILS FAQs issued on 07 May 2020) highlighted a need to share pari passu on assets held outside of the UK in scenarios where the borrower is part of a multi-national group. This will make it very difficult or impossible to provide CLBILS in these scenarios as overseas lenders to the overseas parts of a multi-national group will have no motivation to share security with a UK lender.

**Recommendation:**

- **Either remove 16.10 in its entirety, relying on bank 'skin in the game' given 20% risk retention and Standard of Care obligations to ensure facilities are structured with appropriate security, or**
- **Confirm industry understanding of clause 16.10 as meaning the pari passu requirement relates to other obligations of the Borrower only i.e. this will not include a pari passu ranking with other obligations of a wider Group unless the Borrower already has access to this security.**

**2. Asset-Based Lending (ABL): lack of carve out:**

- Asset-Based Lending (ABL) includes financing of Receivables, Inventory, Plant & Machinery and Property, and documented under a single legal contract which will typically rank the ABL funding as senior to other forms of debt.
- However, whilst clause 16.10 of the Guarantee Agreement has carve-outs for Invoice Finance and Asset Finance, no carve-out exists for ABL. In other words, the Receivable components of the ABL structure can be ring-fenced due to the Invoice Finance carve-out but the non-Receivable components cannot.
- Given it is standard practice for ABL to rank senior to other forms of debt, then the effect is to negate origination of CLBILS to a corporate that has third party ABL funding, given the ABL funder will not dilute their security.

**Recommendation:**

- **Extend the existing Invoice Finance and Asset Finance carve-out to also include Asset-Based Lending (ABL) facilities.**

### 3. Undertaking in Difficulty (UiD):

The Undertaking in Difficulty (UiD) assessment requirement is causing material confusion and risk for lenders, esp. for the following reasons:

<p><b>Entity for UiD assessment:</b></p>	<ul style="list-style-type: none"> <li>○ Lenders believe that the UiD assessment should be conducted on either a borrower / legal entity basis or on only a relevant part of the Group. Similarly, the Guarantee Agreement refers to “Applicant” within the context of this assessment.</li> <li>○ However, current BBB guidance states it should be conducted on either a Group basis or, assuming there is read-across from CBILS to CLBILS (12 May FAQs), on a legalistic concept of Undertaking which relates to entities with the ability to “exercise decisive influence”.</li> <li>○ This legalistic concept is open to much interpretation / misinterpretation and will generally cause confusion across lenders and inconsistent outcomes for customers.</li> <li>○ It should also be noted that this confusion between borrower entity and group is now extending to other scenarios. For example, the BBB’s CLBILS FAQs (07 May) now state the dividend restrictions apply to the whole Group whereas the Guarantee Agreement is clear that these restrictions apply to the borrower. The confusion between requirements at borrower or Group level is increasing operational risk for lenders.</li> </ul>
<p><b>Subordinated Shareholder Loan Notes (SLN) and preference shares:</b></p>	<ul style="list-style-type: none"> <li>○ A lender treats SLN and preference shares as equity from a credit risk perspective, given that they are deeply subordinated to bank debt and do not lead to an increase in lender credit risk. This differs from accounting treatment where SLN and preference shares are treated as debt.</li> <li>○ Current BBB guidance appears contradictory on their treatment for UiD purposes: <b><i>“Shareholder loans may be included if these have been converted into equity. Loan notes (and other equity like instruments) may also be included. The inclusion of these should follow their accounting treatment.”</i></b></li> <li>○ Note that treatment of SLN and preference shares as debt does not reflect the true financial risk profile of the borrower and will result in certain viable businesses failing the UiD test.</li> </ul>

<p><b>Recommendation:</b></p>
<ul style="list-style-type: none"> <li>• <b>Relevant lenders, acting as Prudent Lender within the context of the Standard of Care (section 3 of Guarantee Agreement) and through UK Finance, to determine sensible parameters for assessment of UiD i.e. whether this would be borrower entity only or, for example, borrower entity and any parent that provides a guarantee in support of the borrower.</b></li> </ul>

- Confirmation required that SLN and preference shares can be treated as equity for purposes of the UiD assessment.
- Confirmation required that interest on subordinated SLNs and preference shares should be removed from the Net Interest charge for the Interest Cover tests, and the SLNs and preference shares being excluded from Book Debt in the Gearing tests
- Confirmation required that for the Accumulated Losses test, all historic non cash-paid subordinated loan note and preference share interest should be retrospectively removed from the cumulative historic P&L account / Balance Sheet accumulated losses

#### **4. Multi-Bank structures:**

- Having both accredited and non-accredited lenders in a corporate's funding structure makes it very challenging to provide CLBILS in this scenario because:
  - Accredited lenders will have limited appetite to cover a portion of additional lending (even under CLBILS) that they view should be provided by non-accredited lenders;
  - Similarly, non-accredited lenders will not provide funding pari-passu to a CLBILS facility, as it will dilute their security without the benefit of the HMG guarantee.
- The result is an inter-creditor impasse that could prevent a solution for the liquidity needs of a corporate being made available in a timely, cost effective manner that shares the additional risk equitably amongst lenders.

#### **Recommendation:**

- Establish a mechanism between all lenders (accredited and non-accredited) to share the CLBILS guarantee on a pro-rata basis to existing lending.
- Banks are willing to investigate how this could best work practically and propose a solution, subject to BBB's views and approval.