Department for Business, Energy & Industrial Strategy

To: Secretary of State

From: Sam Beckett, Acting Permanent Secretary and Accounting Officer

Date: 19 May 2020

Dear Secretary of State

THE FUTURE FUND

I am writing following your verbal confirmation on Sunday 17 May that you are directing me to implement the Future Fund. This letter subsequently records my reasons for seeking a direction for this scheme, which is planned to launch for applications on 20 May with guidance materials having been published by the British Business Bank (BBB) on 18 May.

As I have previously reflected, the impact of this national emergency on the UK economy will be significant. The OBR in their "reference scenario" published on 14 April has already indicated that they expect a contraction, which includes real GDP falling by 35 per cent in the second quarter before bouncing back.

The potential scale of the impact is also reflected in the Bank of England's own analysis. I note that the Monetary Policy Committee's May 2020 report says:

> "While there are wide bands of uncertainty around any estimates of activity at the present time, UK GDP is expected to be close to 30% lower in 2020 Q2 than it was at the end of 2019 (Chart 1.2). UK GDP is expected to have fallen by around 3% in 2020 Q1 and then to fall by a further 25% in Q2."

Whilst predicting how dramatic the reduction in the UK economy will be, these reports also note that the action the Government is taking will undoubtedly be central to limiting the impact by preserving jobs and businesses. Therefore, when it comes to considering this new scheme I fully understand and expect that this fund also presents an opportunity to further add to the benefits already being delivered through other schemes.

The aim of the Future Fund is to provide an incentive for equity funds and angel investors to continue to support the development trajectory of innovative, high-growth businesses. According to Beauhurst only 95 deals were announced in March 2020, which totalled £595m, compared to 174 deals in March 2019 totalling £1.46bn. Investors are retrenching to focus on their existing portfolios, with some adopting a wait and see approach. There are also the practicalities of closing deals in the current circumstances.

Action is therefore important to protect the scale-up and innovation ecosystem as a key plank of the recovery. These firms are unable to benefit from the existing coronavirus loan schemes, both because of State aid rules and because they are not yet generating the necessary cashflows with which to repay any borrowing.

The Future Fund is designed to encourage investors to continue to back companies that would have received investment in the absence of the pandemic and are now struggling to raise their next funding round. These may be worthwhile investments, as fund managers do not have perfect foresight of which companies in their portfolio will be most successful. However, in a rules-based scheme there will be no additional control over the quality of investee companies beyond the willingness of the private sector to provide match funding.

We asked BBB to conduct a value for money (VfM) assessment. Having initially produced an assessment that suggested a positive economic benefit to cost ratio (BCR), this was then stress-tested with market practitioners on their board who considered the assumptions too optimistic. The revised assumptions generated a negative BCR.

Given the uncertainty, we commissioned the economic consultancy Oxera for a further independent view. Oxera were familiar with the scheme, having conducted a previous assessment of the Future Fund’s compliance with the market economy investors principle. Oxera analysed the potential outcomes from the Future Fund portfolio based on their own data and understanding of the market. These assumptions provided a different set of potential outcomes, with a positive BCR in each case.

Both Oxera and BBB noted the unprecedented nature of current economic conditions and hence the uncertainty surrounding these assessments. For this reason, it is not possible to advise that one of the outcomes is more or less likely than the other, or to choose between them. The range of plausible outcomes illustrates the sensitivity of the results to the underpinning assumptions and the uncertainty of the current economic context. As a result, it is not possible to determine that the scheme will be value for money.

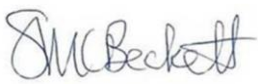
As part of their work, BBB and Oxera assessed the potential returns to government as an investor in the Future Fund portfolio. Again, their assessments generated a range of potential outcomes. We consider that a commercial investor, looking at this range of estimates, could reasonably conclude that they had a good chance of making a commercial return based on the evidence presented in the Oxera report and on that basis would be prepared to invest on the terms proposed for the Future Fund. We therefore consider the scheme to be State aid compliant.

BEIS officials also consulted the Industrial Development Advisory Board (IDAB) on 14 May. The Board recognised the need for financial support where there is poor liquidity and supports the principle of the Future Fund. However, the Board was unable to recommend the proposal for the Future Fund as presented, noting concerns about value for money. The rules-based nature of the scheme does not allow us to mitigate some of the concerns that the Board expressed.

We will of course closely monitor the new scheme to see what kind of funds and businesses come forward to use it. This will allow us to recommend appropriate further action that could help to improve value for money and impact, such as a more selective approach to investment. Subject to HM Treasury agreeing to provide the necessary funding, we should aim to follow good investment practice by participating selectively in future funding rounds, so as to capture more of the upside from our successful investments.

Whilst my view is the Accounting Officer standards around feasibility, regularity and propriety have been met, based on the limited information and the range of analysis that has been conducted, I am unable to conclude that the scheme as currently designed represents value for money at this time. Consequently, as required by *Managing Public Money,* I sought a direction from you. Given more time, it is possible that alternative options for delivering the policy intent could have been developed that may have offered better value for money to the taxpayer. However, I recognise that both you and the Chancellor were able to take into account wider considerations when making this decision, including the further adverse impact on businesses that a delay to implementing this scheme might have.

In line with the usual process for ministerial directions, I am copying this letter to the Comptroller and Auditor General (who will inform the Public Accounts Committee in due course) and the Treasury Officer of Accounts. There will be significant public interest in the matter, which should be balanced against the potential impact that making this request public might have on the confidence and take-up of the scheme, and consequently on our efforts to support the economy. Accordingly, I propose to review the case for publication of this letter and your reply in the coming weeks, once the scheme is fully established.



Sam Beckett