

Annex: Midlands Engine Investment Fund – Ex-ante assessment
Supporting text from the Full Application

- **Article 37 (2)(b) – State Aid Implications of the envisaged Financial Instrument**
The following text, from section 10.7 of the application, refers

The funding passes through, or is managed by, MEIL, BBFSL and the selected fund managers. We do not believe there is any State aid at the level of these entities. There is, however, potentially State aid present at the level of the beneficiary SMEs. All investments and loans made under the Call Off Contract into SMEs will be state aid compliant on the following basis:

Lot 1 – Equity

It is the responsibility of the Fund Manager to ensure that each equity and quasi – equity investment and instrument applied under Lot 1 - Equity is fully compliant with the requirements of Article 21 (and related provisions) of the GBER

Lot 2 – Debt

It is the responsibility of the Fund Manager to ensure that each debt loan made under Lot 2 - Debt is State aid compliant – either by (1) operating under the MEOP by lending pari passu with the private lender, or by applying as a minimum the Reference Rate Communication for senior debt or the Brandenburg Methodology for subordinated debt; or (2) under Article 21 (and related provisions) of the GBER. If the Fund Manager does not have robust evidence to lend under MEOP or the Reference Rate Communication or Brandenburg Methodology then it must apply the GBER.

Lot 3 – Small Business Loans

It is the responsibility of the Fund Manager to ensure that each microfinance loan under Lot 3 – Small Business Loans is State aid compliant – either by (1) operating under MEOP by lending pari passu with the private lender, or by applying as a minimum the Reference Rate Communication for senior debt or the Brandenburg Methodology for subordinated debt; or (2) under Article 21 (and related provisions) the GBER; or under the De Minimis Regulation. If the Fund Manager does not have robust evidence to lend under MEOP or the Reference Rate Communication or Brandenburg Methodology then it must apply either the GBER or the De Minimis Regulation.

Lot 4 - Proof of Concept, early stage Fund (including equity, debt & mezzanine)

It is the responsibility of the Fund Manager to ensure that each equity and quasi – equity investment and instrument applied under Lot 1 - Equity is fully compliant with the requirements of Article 21 (and related provisions) of the GBER.

- **Article 37 (2) (c) Identification of additional public and private resources to be potentially raised by the envisaged FI and assessment of indicative timing of national co-financing and of additionally contributions (mainly private);**
The following information provided in the annexes to the application refers:

Funding Source	Amounts	Type
BEIS capital grant	£32.6m	Investment
European Investment Bank senior loan	£122.5m	Loan
British Business	£32.5m	Loan

Financial Services Limited junior loan		
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- **Article 37 (2) (c) Estimation of the leverage for the envisaged FI**
The following estimate is provided in the annexes accompanying the application:

Private investment matching public support to enterprises - £250.6m

- **Article 37 (2) (e) Definition of the level of detail for the proposed investment strategy (maintaining a certain degree of flexibility); and Selection of the financial product to be offered and the target final recipients.**

The following text, from pp.28-30 of the full application refers

The format is an open procurement with four lots/frameworks. Each lot/framework will focus on one of the four product funds (equity, debt, small business loans and Proof of Concept and early stage). Fund managers will be appointed to the frameworks based on their capabilities and pricing. Call offs will be made under each framework to select fund managers to manage a product fund over some or the entire Midlands Engine area. It is expected that multiple managers will be called off under each framework to ensure overall geographic coverage.

Initial allocations to fund managers will be made, holding back some of the capital to allow for market developments and to enable more resource to be provided for funds/segments which perform well. That is there may be future call offs during the life of each of the frameworks

Funding will also be retained to allow for follow on investment (where appropriate)

BBFSL will ensure that contracts / agreements with underlying fund managers will indicate a target investment size for each LEP area equivalent to ESIF allocations and associated match funding, subject to demand and quality of investment opportunities.

[.....]

Investment Policies applicable to each Lot are as follows:

Lot 1 – Equity

Equity finance will be invested in MEIF SMEs in amounts up to £2,000,000. The Manager shall ensure that investments will be allocated by the Manager as follows:

at least 20% of investments by value will be in amounts of under £250,000;
at least 70% of investments by value will be in amounts of under £750,000

Equity finance to any MEIF SME may exceed the £2,000,000 limit only in exceptional circumstances and with the consent of the Investor.

Lot 2 –Debt

Debt finance will consist of loans for a business purpose to MEIF SMEs in a principal amount of between £100,000 and £1,500,000.

Loans to any MEIF SME may exceed £1,500,000 or be in an amount less than £100,000 in exceptional circumstances and only with the consent of the Investor.

The Manager will ensure that investments will be allocated by the Manager as follows:

at least 25% of investments by value will be in loans of principal amounts of under £200,000;

at least 70% of investments by value will be in loans of principal amounts of under £500,000

Loans will have duration of no less than [twelve months] and shall not have a maturity date outside of the Realisation Period.

Lot 3- Small Business Loans

This will consist of loans for a business purpose to MEIF SMEs in a principal amount of between £25,000 and £150,000.

The Manager will ensure that investments will be allocated by the Manager as follows:

at least 25% of investments by value will be in loans of principal amounts of under £50,000;

at least 70% of investments by value will be in loans of principal amounts of under £75,000.

Loans shall be for a duration of no less than [12 months] and shall not have a maturity date outside of the Realisation Period.

Lot 4 Proof of Concept and Early Stage Fund

This will consist of £20m for investments to any MEIF SME below £750k.

The Manager shall ensure that investments will be allocated by the Manager

So that at least 50% by value of investments is under £250k.

Finance to any MEIF SME may exceed the £750,000 limit only in exceptional circumstances and with the consent of the Investor.

For Debt and Small Business Loans: none of the following will be permitted:

Entry into regulated credit agreements (as defined in Article 60B of the RAO);

Entry into regulated consumer hire agreement (as defined in Article 60N of the RAO); or

Provision of credit broking for the purposes of Article 36A of the RAO

- **Article 37 (2) (e) Definition of the governance structure of the financial instrument**

The following text, from pp.28-30 of the full application refers

Governance and Structure

MEIF will be a [Fund of Fund]. The legal entity through which all funds will flow and which will make investments in the underlying product funds is MEIL, a company limited by guarantee wholly owned by BEIS. Whilst BEIS is the applicant for the ESIF investment, the investment recipient will be MEIL. All other funding sources, including the loans from EIB and BBFL, will be advanced to MEIL which will pool all funds and apply those funds in investing in the underlying product funds and paying costs and management fees.

BBFSL is wholly indirectly owned by BEIS and was established to provide administrative, management and advisory services to BEIS in the SME access to finance space, including managing programmes that sit on the BEIS balance sheet.

MEIL is wholly owned by BEIS, the company together with its assets and liabilities will sit on the BEIS balance sheet and therefore it will be administered for BEIS by BBFSL under the existing Service Agreement with BEIS (as further described in our answer to question 1.19). The Service Agreement will be supplemented with an addendum in accordance with which (i) BBFSL will manage the MEIF programme, (ii) MEIL will appoint BBFSL as its agent and investment advisor, and (iii) MEIL will appoint BBFSL to act as its “delivery partner” for the purposes of the investment funding agreement. The Service Agreement includes an established system of governance and delegation agreed with BEIS and will provide an additional layer of governance and oversight to the project.

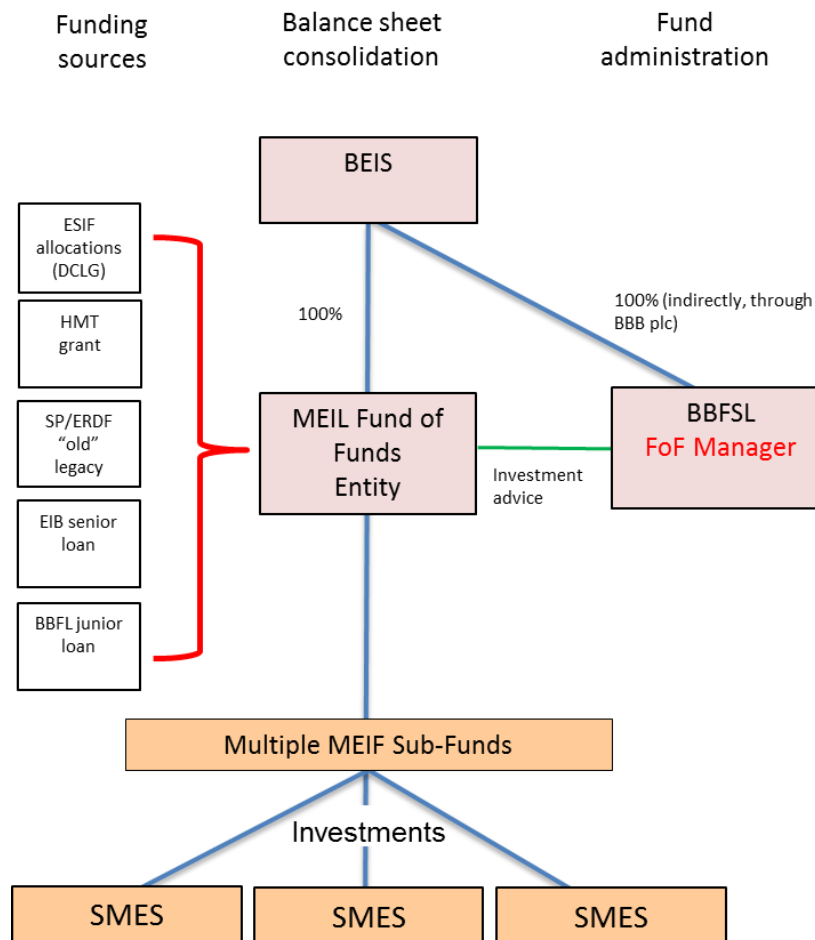
In terms of the role played by each legal entity, it is important from a financial regulation perspective that MEIL acts as principal investor. In practice this means that MEIL will sign all funding agreements, sign all Limited Partnership Agreements (LPA) with product fund managers, and exercise the rights of investor during the life of the fund (e.g. give consents to key man changes, agree to fund life extensions) as principal investor.

However, MEIL will delegate to BBFSL day to day investment and monitoring activities. MEIL will receive investment advice and recommendations from BBFSL before making investment decisions. BBFSL has the staff, resources and knowhow to provide investment advice to MEIL.

MEIL will also receive strategic advice from the SOB as further described below, and this provides an element of oversight and governance from the LEP stakeholders.

MEIF Fund Structure

MEIF fund structure



[.....]

In respect of governance structure, there are several layers.

As noted above MEIL will be a company and therefore have a board of directors which, in essence, will be a non-executive board that delegates day to day investment activities to BBFSL. Since MEIL will be wholly and directly owned by BEIS and all sources of funding will flow through MEIL (and not, for the avoidance of doubt, through any member of the BBB group) all assets and liabilities will consolidate on the BEIS balance sheet. Because of this consolidation to BEIS, it is a matter of BEIS policy that the board of MEIL has an appropriate accounting officer. For this reason, MEIL's board will be comprised of senior BBB staff, with the BBB group CEO take on accounting officer responsibility in addition to his existing accounting officer responsibilities). MEIL will therefore be within the scope of HMG's

“Managing Public Money” in addition to normal Companies Act governance procedures.

As part of the agreement with the LEPs, BBB has structured further layers of governance that allow key stakeholders (BEIS, DCLG, EIB, and the LEPs) to participate in the strategic governance of MEIF.

MEIL will constitute a SOB that will advise on overall fund of funds strategy, final structure e.g. number of funds and what they target, together with reallocations between funds and regions. Membership of the SOB will comprise representatives from seven LEPs, BBB, BEIS, DCLG, HMT and EIB. The SOB is already operating in shadow form and the LEP members agreed its Terms of Reference on 24 June 2016. At “go live” those Terms of Reference will be formally adopted by MEIL. Whilst separation of powers was fundamental to the SOB concept, meaning that BBFSL will retain control for investment advice to MEIL, the Terms of Reference include a suitable escalation to Ministers in the event of disagreement between the SOB and BBFSL.

The next layer of governance is the two RABs (incorporating appropriate local expertise alongside, DCLG, EIB and BBFSL). The RABs will be established to review the performance of funds and fund managers at a local level and recommend appropriate action to BBFSL.

More detailed overview of the SOB and the RABs:

Strategic Oversight Board -

- The SOB will consist of seven senior LEP level representatives, members representing the regional groupings along with HMT, BEIS, DCLG, EIB, MEIL and BBFSL.
- The SOB has Terms of Reference which reflect the desire of LEPs to have a genuine say over the strategic direction of the fund as well as input into key decisions. The SOB will:
 - Advise MEIL on the overall Fund of Funds strategy;
 - Advise MEIL on final structures (e.g. how many funds and what they target) and weightings for the tendering of fund managers;
 - Advise MEIL on overall investment levels and targets;
 - Advise on reallocations between funds where this impacts more than one region;
 - Provide a point of escalation for the two RABs if agreement cannot be reached between BBFSL and the respective RAB(s);
 - Consider what further actions might strengthen the Midlands Engine area building on MEIF; and

- Provide ad hoc advice to MEIF and BBFSL upon request on matters relating to the MEIF project

Although BBFSL/MEIL will remain responsible for any investment decisions including those on reallocation, BBFSL/MEIL will give any advice from the SOB full due consideration and that if, for any reason, BBFSL/MEIL went against this advice (and the majority of LEP members of the SOB disagreed with BBFSL/MEIL's position) the BBFSL will be required to write to BEIS and DCLG Ministers to explain why BBFSL/MEIL was still taking this course of action.

Regional Advisory Boards

Two RABs will be established, one for the West Midlands and one for the East and South East Midlands, to review the performance of funds and fund managers at a local level and recommend appropriate action to BBB.

- Building on best practice with current Northern JEREMIE Investment Advisory Boards (IABs), appointment to the RABs to include LEP nominees with appropriate access to finance expertise along with other private sector reps, DCLG, EIB and BBFSL in its capacity as investment adviser to the FoF.
- BBFSL would consult with those RABs affected before switching, increasing or reducing the allocation to funds and on action being taken to, for example, improve geographical coverage.
- As with the SOB, BBFSL will not act against the advice of the RABs (where the majority of LEP Members support the proposal) without first giving a detailed explanation to both the RAB and if necessary the SOB. If the SOB disagrees then this will also trigger the Ministerial letter.

MEIF will be overseen and delivered by a dedicated team within BBB who will provide their services through BBFSL. See annex Steady State Organogram.

- **Article 37 (2) (f) Specification of how the envisaged FI will contribute to deliver the desired strategic objectives.**

The following text, from section 3.8 of the full application refers

MEIF will directly support the England Operational Programme by delivering an FI that will support the following Priority Axis objectives:

1.Promoting research, technological development and innovation (Priority Axis 1): Through the provision of early stage equity focussing on the financing needs of early stage technology companies and by building strong links with Universities, Incubators / Accelerators and Catapult Centres across the Midlands Engine area MEIF will be able to back innovative businesses from early to later stage through equity funds of size and scale

3. Enhancing the competitiveness of SMEs (Priority Axis 3): Through the provision of small business loans, debt and equity, MEIF will be able to support new and established SMEs across the Midlands Engine to start, grow, innovate and invest in their business. MEIF will also seek to strengthen

connections with wider business support activity including Growth Hubs to ensure that SMEs are able to access the full range of business services.

4. Supporting the shift towards a low carbon economy in all sectors (Priority Axis 4): MEIF will provide both debt and equity funding to support SMEs who are developing new products and services in clean technologies. Building on the BBB's current experience of investing in clean tech funds we will ensure that MEIF is able to finance clean tech innovation in the Midlands Engine area.

MEIF directly targets these market issues to reduce the divergence in the provision of finance affecting the Midlands, and the resulting negative impact on business performance. MEIF will do this by specifically increasing the supply of :

Small Business Loans - This supports Priority Axis 3 by helping to increase entrepreneurship in areas with low levels of enterprise activity and amongst underrepresented groups who may not have access to existing finance sources.

Debt finance- This contributes to growth capability of SMEs by providing finance for growth.

Early and later stage Equity Capital- This contributes to Priority Axis 1 by providing finance to support increased business investment in research and innovation and support wider improvements in the innovation environment by increasing existing networks of businesses, research institutions and funders through creating a positive funding environment. The provision of Growth capital through MEIF will support Investment 3d by supporting the capacity of small and medium sized enterprises to grow in regional, national and international markets and to engage in innovation processes.

The British Business Bank has a co-ordination role and is responsible for overseeing deployment of the most significant proportion of the Government's SME investment activity, including in the Midlands.

By bringing together activity that covers both the West and the East and South East Midlands BBB is able to maximise scale efficiencies through procurement and monitoring systems, as well ensuring more effective fund manager selection through BBB's experience of other funding programmes such as the Enterprise Capital Funds and the VC Catalyst funds in the Equity space and Investment Programme, Start-up Loans, Equity Finance Guarantee in the lending space.

The ERDF Operational Programme (OP) 2014/20 for England has a clear aspiration to invest an increased amount of resources into FI in comparison to the previous programming period. MEIF will make a strong and tangible contribution to that goal. The underlying UK Partnership Agreement also recognises the ability of FI to increase the efficiency and effectiveness of ERDF resources, leverage additional public/private investment and recycle investments for long-term economic benefits beyond the life of the ERDF programming period. The MEIF instrument and supporting Fund Manager contracts therefore demonstrate a strong alignment with the overarching aspirations of the OP and its supporting priority axis and cross cutting themes.