

# Closure Review of the Wales Life Sciences Investment Fund

## Summary

Summary	Review the Development Bank of Wales role as Fund Holder and its operational delivery of this role in relation to the Fund Manager and Welsh Government.
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## Governance team

Senior Responsible Officer	Development Bank of Wales - Strategy team
Development team	Development Bank of Wales - Strategy team
Review and approval	Welsh Government - Partnership team

## Redactions

Names of individuals have been removed and replaced with “[REDACTED]” inserted.

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## **Executive summary**

On 28 February 2023, Wales Life Sciences Investment Fund's ("the Fund") 10-year term ended, and the Limited Partnership Agreement was terminated. The Fund was capitalised to £55 million following £5 million private investment from Arix Biosciences PLC ("Arix") and to the £50 million commitment from Welsh Government, £42.4 million of which was Financial Transaction Capital.

Arix Capital Management Ltd (previously Arthurian Life Sciences Ltd) was appointed through a full and open procurement for discretionary Fund Manager services. The Fund Manager fully deployed the Fund by the end of 2017, investing over £50 million in 9 companies, supporting over 300 jobs and generating over £270m deal level co-investment.

### **i. Key events impacting the Fund**

The review focuses on the period from 2019 to Fund closure as events prior are covered by in depth reviews submitted up to and including 2018. An overview of the key events prior to 2019 is provided for completeness in Annex 2.

During this review period several companies failed, most notable was Rutherford Health in 2022. The announcement came at a time when the remaining assets (excluding Rutherford) were declining in value with few opportunities for the Fund Manager to generate returns on them. This changed the outlook for the Fund as the Holding Fund was in talks to utilise the two-year extension period to facilitate maximising value from the Rutherford investment.

Declining value in the portfolio was driven by mixed performance of these businesses. While businesses such as ReNeuron and Intelligent Ultrasound demonstrated positive actions such as raising finance or undertaking trials, this did not translate to an increase in value or a commercially opportune exit point prior to the Fund's closure.

Mixed performance not only impacted the value of the Fund but also its economic development impact as CeQur and Verona Pharma in 2019 and 2020, shifted away from their Wales-based plans. The Holding Fund again reminded the Fund Manager of the Funds economic development requirements but there was not a commercially preferable exit opportunity until Verona Pharma's positive trial outcomes in 2022.

External events impacted the Fund. Many businesses in the portfolio saw revenue shrink during the pandemic and it not rebounding as expected. The 2019 suspension of LF Woodford Equity Income Fund restricted external investment for many businesses in the Life Science sector.

### **ii. Partnership Attainment**

The Fund was concentrated in fewer companies than targeted as 58% of the value of all investments made by the Fund were in three businesses. This impacted what the Fund Manager and therefore the Fund could achieve during closure.

The Fund has, to date, generated a £20m return to Welsh Government. The returns generated were primarily from one investment, Simbec. Simbec is a success story

for the Fund. The investment helped to first safeguard jobs in Wales and then bring back ownership to Wales which was followed by the Fund's largest exit.

All companies had some presence in Wales. However as noted in the 2018 Mid-point review, some did not fully deliver their plans to relocate manufacturing facilities to Wales. The Holding Fund consequently reminded the Fund Manager of the Funds economic development requirements of the Fund.

The value of the remaining assets transferred in specie to the Development Bank was approximately £1.8m at Fund closure in February 2023. The investments are subject to the Development Bank's portfolio management procedures and all relevant documentation relating to the original investments were reviewed prior to the transfers.

### **iii. Holding Fund and Fund Manager Governance**

Management of the contractual requirements, specifically in the early stages of the Fund were not always as envisaged as, the Fund Manager often dealt directly with Welsh Government. This was highlighted by recommendation 5 of the Auditor General report and the 2016 Regeneris report. The 2017 Contracts review process closed these issues, as noted by Welsh Government.

Changes made to the Fund in its early delivery stages and the way they were conducted occurred prior to 2019, had a lasting impact on the Funds outcomes.

### **iv. Maintaining the contract with ARIX**

The 2018 Mid-point report made the recommendation to continue with the current Fund Manager but noted it was likely several firms may fail and therefore it was uncertain whether the Fund would make a positive return. It also resulted in the Holding Fund instructing the Fund Manager to exit the companies no longer operating in Wales at the earliest sensible opportunities.

Failures crystallised and had a material impact on the Fund's performance but termination of the contract in 2018 would have impacted the positive returns from Simbec and Verona Pharma. The findings of the 2018 report therefore remained relevant for the period of 2019 until closure of the Fund.

The Holding Fund continued its in depth reporting to Welsh Government with the support of the other Limited Partner and the Fund Manager as key events impacted the Fund.

### **v. Holding Fund and Welsh Government governance arrangements**

Welsh Government were not party to the LPA. The terms and conditions of the Finance Award letter and discretionary limits set out in the Operational Development Plan (ODP) and Investment and Operating Guidelines (IOGs) were transferred directly to the LPA upon procuring Fund Management services. This ensured that the procured Fund Manager operated within these governance arrangements.

The LPA did not create contractual obligations on the Holding Fund in relation to Welsh Government which were not already detailed elsewhere. The Holding Fund

satisfied the conditions set out in the Finance Award letter by design, through codifying them into the LPA.

The Holding Fund worked with the Welsh Government to enact a number of variations to the Finance Award letters. Variations included changes to the KPI targets for the Fund. In 2014 and 2017 however, variations such as the conversion of the Holding Fund Loan commitment to Financial Transaction Capital (FTC) and a stricter reporting process for the Fund Manager were not fully documented.

#### **vi. Delivery Objectives**

The Fund achieved some of its KPIs, it also raised the profile of life sciences in Wales and increased the availability of finance for the sector. Whilst it did not meet the co-investment target at Fund level the co-investment at deal level was high at over £270m. Below is a table setting out the Fund's KPIs:

<b>KPI</b>	<b>Target</b>	<b>Actual</b>	<b>Performance</b>
Number of companies receiving investment	12	9	75%
Private sector co-investment at Fund level	£60m	£5m	8%
Number of jobs created/safeguarded in Wales	300	311	104%
Number of registered patents	100	59	59%

Its impact was not just at point of investment. The fund supported the wider ecosystem, for example, through cross-pollination as investees conducted trials with established life sciences businesses in Wales.

#### **vii. Closure of the Partnership**

The Limited Partners concluded that winding up the Partnership and transferring the assets in specie represented the best value for money option.

Transfer in specie crystallised the value of the assets and therefore the loss of the Fund. This resulted in a £27.1m RDEL/RAME impact. In 2021/22 a £10.5m Expected Credit Loss provision was posted to the core account.

The final year of the Fund saw the re-emergence of legacy issues in dealing with an external Fund Manager. Subsequent delays in the accounting process impacted to preparations for the closure. As the LPA required the Fund Manager to manage this process and coordinate Limited Partners, the Holding Fund could not act unilaterally in this respect.

The Holding Fund was still able to conduct an in-depth review of fees and the investment documentation before the winding up of the Partnership. Partnership assets were distributed in specie during the process.

#### **viii. Lessons learned**

Recommendation 1 and 2 of the 2017 Contract obligations review, recommendation 8 of the Regeneris report and recommendation 5 of the Auditor General report demonstrates issues with maintaining clear responsibilities and change control governance. Allowing these to be weakened has lasting impacts on the outcomes on such projects.

Future Welsh Government initiatives that involve using a Limited Partnership structure and governance arrangements should more clearly reflect the separation of responsibilities and authorities for the Holding Fund. Clear separation between Welsh Government and management of such a Partnership should also be maintained. This would facilitate greater governance oversight through more stringent change control through a single point of contact for the Fund Manager.

Changes made in the Funds early delivery stages also resulted in a higher exposure to externalities through a concentrated portfolio. The concentrated nature of the portfolio resulted in value changes and market movement having a bigger impact and a Fund Manager with fewer levers to generate value. Suspension of the Woodford funds and its impact on the portfolio is an example of this. Supporting co-investors is key to such projects, changing the Fund to accommodate them and taking on a £3 million loan to do so created a risk which materialised albeit the loan was fully repaid. While more robust change control may not have changed the outcome from this event it may have reduced its impact.

Issues experienced during 2022 were a reemergence of some of the shortcomings in using external Fund Managers. The progress made in the operational delivery of the Fund from 2019 should not be discounted due to the issues experienced prior to its closure. These issues however do present the clear need for more defined roles and responsibilities for such a Fund during its closure if performance is below expectations.

It is recommended that a future project using external Fund Manager have a longer preparatory timeframe built into governance arrangements for closure. This can be based on standard project closure process used in the delivery of past-EU funds. Furthermore, to enact these controls, the Holding Fund should foster strong engagement and collaboration with the other Limited Partners.

A more managed closure can be facilitated by ensuring a strong degree of engagement and collaboration from Limited Partners and the Fund Manager. Strong engagement and collaboration has additional benefits throughout the life of such a project. Section 6.3 details that the Holding Fund acted as a conduit for advice and support. Success of the Fund in this respect should be encouraged in future projects and can be facilitated through the inclusion of relevant requirements within governance documents.

## **1. Introduction**

In 2013, the Wales Life Sciences Investment Fund (“the Fund”) launched. The Fund was capitalised to £55m (£50m Welsh Government investment plus £5m from Arix Biosciences PLC) and was fully invested in 9 companies by the end of 2017. On 28 February 2023, the fund’s 10-year term ended, and the Limited Partnership Agreement was terminated.

## **2. Partnership structure**

Development Bank of Wales, through DBW Investments (9) limited (the “Holding Fund”), acts as the holding fund for the investment into WLSIF on behalf of the Welsh Government. This is formalised through Welsh Government Finance Award Letters, which were updated periodically to reflect the changing nature and accounting treatment of the Fund. The Holding Fund provided key points of governance and communication with the Fund Manager and the Welsh Government.

Following a formal OJEU Tender exercise, Arthurian Life Sciences SPV GP Ltd was appointed as the General Partner with Arthurian Life Sciences Ltd (later to become Arix Capital Management Ltd) acting as Fund Manager. This appointment was for a discretionary Fund Management Contract.

Under the discretionary fund management contract, the General Partner was responsible for operation of the Fund and as Fund Manager they were responsible for all investment decisions and the performance of the Fund. The Holding Fund’s primary responsibilities were to release funds following certified drawdown requests and consolidate the reporting requirements for Welsh Government.

This structure was formalised through a Limited Partnership Agreement (“LPA”) between the Limited Partners – the Holding Fund, the General Partner (which is also a subsidiary of Arix Biosciences plc) and Arthurian Life Sciences Carried Interest Partner LP. Arix Biosciences plc were included in the LPA following their £5 million investment and subsequent equalisation payment in May 2017.

Due to the Fund’s unique funding and governance arrangements, its scale, and the profile of the Fund throughout its 10-year term, the Development Bank has completed an operational review.

## **3. Scope**

The scope of the review will have 2 main aspects:

- How the Fund Holder operated with the General Partner/Fund Manager.
- How the Fund Holder operated with the Welsh Government.

It will not cover matters materially documented in previous reviews conducted prior to 2019 or detail technical accounting issues encountered in the final distribution of assets.

The report is structured to satisfy the terms of reference topics as outlined in Appendix 1.

## 4. Fund delivery

### 4.1. Key events leading to the end position of the Partnership

**Terms of reference:** Detail key events affecting the Partnership and Fund delivery during the period with particular focus on events triggering enhanced stakeholder engagement by the Holding Fund such as the closure of Woodford Funds. It will not include evaluation of the materiality for these events, nor a counterfactual should these events not have materialised.

Key events for the Fund and an evaluation of their impact prior to 2019 are covered by the significant reviews conducted following its launch. These are outlined in Annex 1.

Between the 2016 publication of the *Establishment and oversight of the Wales Life Sciences Investment Fund* report by the Auditor General and the *Review of the Wales Life Science Investment Fund* report by Regeneris and 2019, the Holding Fund submitted several significant reports to Welsh Government detailing key events and recommendations concerning the Fund's Delivery. Therefore Annex 2 includes a summary of key events from Fund launch, giving an overview of the matters covered in the Auditor General and Regeneris reports and further detail on key events impacting the Fund until the submission of the 2018 Mid-point review.

Key events detailed in the following section will only relate to those occurring in 2019 onwards. There were several key events during this period which impacted the exit strategy and last years of the Fund to Termination. These are highlighted below for the Fund and individual assets:

- i. **Exit and distribution to Welsh Government** –Over a two year period the Fund Manager was able to work with Simbec to exit the investment for a 2.7x return, with over £19.7 million returned to the Holding Fund while retaining economic benefits of the investment in Wales. With the rebate mechanism of the new fee structure, this resulted in over £20 million being returned to the Welsh Government once the distribution to the Limited Partners was made.
- ii. **LF Woodford Equity Income Fund suspension** - There were four companies in which the Woodford Funds co-invested – CeQur, Rutherford Health, ReNeuron and Sphere Medical. At the time of suspension in 2019, conflicts of interest concerns were raised but the Fund Manager clarified that “investments including Woodford have been dealt with in full compliance with FCA rules and there were no conflicts of interest.” Due to the concentrated nature of the portfolio and a £3 million loan to undertake further investments alongside Woodford Funds, despite it being repaid, there was an increased exposure to suspension. As Woodford was a major investor in Life Science businesses the suspension restricted the investment pipeline for several businesses in the market but particularly impacted investment pipeline in the Fund's portfolio and notably impacted Sphere Medicals cashflow.
- iii. **Application of IRFS 9** – In 2019, new accounting standards were implemented across the UK for assessing the fair value of assets. This

coincided with a drop in the value of the Fund, following the sale of Simbec, and a change in the accounting period for the partnership. Moving the accounting period for the partnership enabled the Holding Fund to work through the valuations with the Fund Manager and make its own assessment on the assets fair value prior to inclusion into the Development Bank of Wales group accounts.

- iv. **Portfolio administration proceedings** – The Fund Manager under its new structure enabled a more open dialogue with the Holding Fund on the declining performance of the portfolio. By the end of 2019, Apitope and Sphere Medical had announced their intentions to liquidate. Both cited cashflow issues and the inability to raise further finance. Due to the position of both assets at the time, no value was expected to be generated from the liquidations however, the Fund Manager continued to monitor the possibility of a small, deferred value which could be realised following Warg Pharmaceuticals purchasing Apitope’s assets in 2021. Despite growth in Rutherford Health’s centre locations and contract awards in 2021, the Fund Manager communicated that the company only had a cash runway until mid-2022 unless the management team could generate more revenue. By mid-2022, Rutherford Health announced its intention to liquidate.
- v. **Economic Development issues** - CeQur SA notified the Fund Manager in 2019 that its plans to bring manufacturing to Wales were no longer viable and it was therefore removing its operations from Wales. The Holding Fund reminded the Fund Manager of the Funds economic development requirements but there was little commercially preferable exit opportunity. By the end of 2020, Verona Pharma had shifted its focus entirely to the US market and therefore de-listed from AIM. The Fund Manager held the Funds shares in Verona Pharma until the end of a clinical trial run which successfully concluded in 2022.
- vi. **Covid-19 pandemic** – In 2020 the Holding Fund requested that the Fund Manager undertake a half-year review of the Fund and the impact of the pandemic on its portfolio. In this report it was noted that Rutherford Health’s patient volumes were low and would continue to be so until restrictions were removed. Importantly, InterRad and CeQur saw their sales growth stall at a key point in the Fund’s period for generating exits. For privately held assets such as these, a trade exit valuation is driven by sales multiples and this stalling impacted their commercial attractiveness at a key point for the Fund.
- vii. **Listed assets fluctuate** - Intelligent Ultrasound signed a co-development agreement with a world leader in ultrasound manufacturing for AI-based real-time imaging in 2019. By the end of 2022, Intelligent Ultrasound announced it raised £5.2m from shareholders. In early 2019, ReNeuron started its three-year run in generating several FDA-approved positive clinical trial results and signed a licensing deal in April with Fosun Pharma. This licensing deal with Fosun Pharma was renewed in early 2022 but

ReNeuron finished the year with the announcement of negative trial results and its share prices dropped.

- viii. **Handling remaining assets** – The Partnership had a scheduled termination at its 10-year anniversary. The Fund Manager was actively seeking exit opportunities in the lead up to the end of the Partnership however, its reporting function was severely weakened during 2022. This weakened reporting function resulted in management information being submitted significantly behind schedule, impacting discussions on closure options for the Partnership. It was concluded that the best value for money option for handling the remaining assets was to transfer them to the Development Bank. This stopped further Fund Management fees to manage the remaining investments being charged to the Welsh Government particularly as the Fund Manager felt it could add little value by further involvement.
- ix. **Closure of the Partnership** – Throughout 2023, the Holding Fund and Fund Manager has worked to ensure that the remaining assets are distributed correctly. This has included a review of fees which had yet to be drawn covering the period of the contract from 2019. Reviewing these fees was aimed at providing full disclosure of how the fees accumulated in line with the fee structure so that the Holding Fund could authorise the drawdown of the final fees. In parallel to this, the relevant teams in the Development Bank taking over management of the remaining assets reviewed legal documentation relating to the investments. In this asset review, the teams raised several queries which required experts in Swiss provincial law to assess the materiality of certain clauses. By the end of 2023, Development Bank’s brokers had concluded that it could not action the transfer between the Partnership and the relevant legal entity and so an alternative solution was utilised. These both caused significant delay in transfer of the assets.

## 4.2. Partnership attainment

**Terms of reference:** Summarise the outputs from the Partnership in relation specifically to investment of the Holding Fund Loan Commitment. This will not include commentary of the Partnership’s, nor its related parties, efficacy in relation to the Fund’s objectives or key performance indicators.

### 4.2.1. Investment

The Fund Manager fully invested the original Welsh Government commitment by mid-2015 and required a £3m loan from Finance Wales to complete co-investments into new companies CeQur and Apitope late that year.

Following the findings of the 2016 Regeneris report, the Fund level commitment from Arix BioScience was utilised for completing follow-on investments.

The schedule of investments is outlined in the table below.

Ref	Investment - Year	Purpose	Amount	Funding Source
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[1]	Simbec - 2013	Growth opportunity	£750k	Welsh Government
[2]	ReNeuron - 2013	Inward investment	£5m	Welsh Government
[3]	Verona Pharma - 2014	Inward investment	£4.6m	Welsh Government
[4]	Simbec - 2014	Growth opportunity	£8m	Welsh Government
[5]	Intelligent Ultrasound - 2014	Growth opportunity	£600k	Welsh Government
[6]	InterRad - 2014	Inward investment	£2.9m	Welsh Government
[7]	Sphere Medical - 2015	Inward investment	£4m	Welsh Government
[8]	Rutherford Health - 2015	Growth opportunity	£10m	Welsh Government
[9]	ReNeuron - 2015	Follow-on	£5m	Welsh Government
[10]	CeQur SA – 2015	Co-investment	£3.4m	Welsh Government & £3m Finance Wales loan
[11]	Apitope - 2015	Co-investment	£3.6m	Welsh Government & £3m Finance Wales loan
[12]	Sphere Medical	Follow-on	£1m	Arix BioScience
[13]	InterRad - 2017	Follow-on	£756k	Arix BioScience
[14]	Apitope - 2017	Follow-on	£885k	Arix BioScience

As shown in the table above, 57.5% of the value of all investments made by the Fund were in three businesses, ReNeuron, Rutherford Health and Simbec-Orion.

Section 4.1 detailed the key events impacting the outcome of the investments at closure of the Partnership.

#### 4.2.2. Returns

The Fund has generated, to date, a £20m return to Welsh Government. Of the £50m Welsh Government commitment £42.4m was Financial Transaction Capital (FTC) to be repaid together with £7.6m of non-repayable public equity.

The returns generated were primarily from one investment, Simbec. Simbec is a success story for the Fund. The investment helped to first safeguard jobs in Wales and then bring back ownership to Wales which was followed by the Fund's largest exit.

#### **4.2.3. Businesses relocating to Wales**

All companies had some presence in Wales at some point during the investment reflective of the scale of the businesses and existing operational arrangements.

As noted in Section 4.1, CeQur did not fully deliver their plans to relocate manufacturing facilities to Wales. This was due to a change in shareholding and therefore business plan which made the relocation no longer viable. The Holding Fund reminded the Fund Manager of the Funds economic development requirements of the Fund.

#### **4.2.4. Remaining assets**

The value of investments being transferred to the Development Bank as at Fund closure in February 2023 was approximately £1.8m.

The Partnership was terminated in February and the remaining investments transferred are managed by the Development Bank. Privately held investments are managed in the Development Bank's Special Situations team and listed investments by our Portfolio Development team. The investments are subject to the Development Bank's portfolio management procedures and all relevant documentation relating to the investments was reviewed.

Exiting investments by 31 March 2025 is a requirement of the existing Finance Award letter. If this is no longer appropriate after the review of assets, the Welsh Government Partnership Team will be consulted. This will be within the business-as-usual reporting requirements.

#### **4.2.5. Key Performance Indicators**

Information on Key Performance Indicators is given in section 9.1.

## 5. Governance

### 5.1. Holding Funds contractual requirements to the Partnership

**Terms of reference:** Detail initial contractual requirements and governance expectations for the Holding Fund.

Detail any changes to obligations and its delivery against these and how they were implemented in the relevant period.

Evaluate the Development Bank's management of Holding Fund obligations and whether this was in accordance with what was set out.

#### 5.1.1. Limited Partnership Agreement

Following a formal OJEU Tender exercise for appointment of the Fund Manager, The Fund was formalised through a Limited Partnership Agreement (LPA) between the Limited Partners – The Holding Fund (DBW Investments (9) limited), the General Partner (ALS SPV Limited, now a subsidiary of Arix Biosciences plc) and Arthurian Life Sciences Carried Interest Partner LP.

The discretionary nature of the Fund limits the number of contractual obligations on the Holding Fund. Any actions required from DBW Investments (9) limited are generally passive, such as, documentation of annual Fund Manager reports and reviewing where relevant, providing Consent, releasing funds, conveying best practice and support Fund marketing, or are triggered through exceptional circumstances following the Manager's execution of its obligations.

Pursuant to clause 5.2.1, the LPA enables the General Partner to grant full power and authority to the Fund Manager (ACM) on behalf of the Fund and at all times be subject to the supervision of the General Partner. This is consolidated under clause 5.3 of the LPA which stipulates that the Limited Partners take no part in the operation or management of the Partnership or have no right or authority to act, take part or in any way interfere in the Partnership's affairs but, with reasonable notice, has right to access all the books and accounts of the Partnership. Consequently, this is how the Fund can therefore be considered under the discretionary management.

As a discretionary fund and pursuant to clause 5.2 and 5.3, the Holding Fund took no part in the management of the Partnership and had no right to act unilaterally in the Partnership's affairs outside of set thresholds. Consequently, the Development Bank had no role in the investment or exit decisions made by the Fund Manager.

#### 5.1.2. Limited Partnership Agreement Variations

Variations to the LPA could only be approved with investor consent. Investor consent was defined in the LPA as written approval from the Holding Fund and Private Investors following a written request from the General Partner. Welsh Government was not defined as an investor in the LPA due to it being represented in the Partnership through the Holding Fund.

This was expected to give the Holding Fund discretion on which variation requests to approve or escalate to Welsh Government for a decision.

The first round of variations to the LPA were concluded in 2014. These were conducted in partnership with the Fund Manager and Welsh Government. The variations can be summarised as:

- Amendments to the IOGs including removal of a clause excluding investments in listed assets and management buy-out transactions.
- Removal of a clause 12.1 for Termination without cause.
- Restatement of KPIs at revised levels as stated in section 4.2.3.

Setting of initial governance arrangements following contract award to the Fund Manager and their subsequent variation in 2014 are subject of both the Auditor General and Regeneris reports.

The LPA underwent variations again in 2017. These were proposed by the Fund Manager to enable an additional £5m investment into the fund by Arix BioSciences plc. The Holding Fund reviewed the proposals and approved the appropriate variation requests as outlined below.

<b>Request</b>	<b>Status</b>
Amend clause on deadline for Fund's first close to raise further finance.	<b>Approved</b>
Amend investment period to allow investment of new Funds.	<b>Approved</b>
Amend term of Partnership by a further four years.	<b>Denied</b>
Amend key clause for removal of [REDACTED]time requirement and replacement with two full time Fund Managers from Arix.	<b>Approved</b>
Amend clauses to allow re-investment for both prior and after Holding Fund Loan commitment is returned.	<b>Denied</b>
Amend fee structure to reflect new investment but to be adjusted by down valuations and disposals via a rebate to the Holding Fund.	<b>Approved</b>

As the structure and personnel of the Fund Manager was changing, the most material variation request concerned fees.

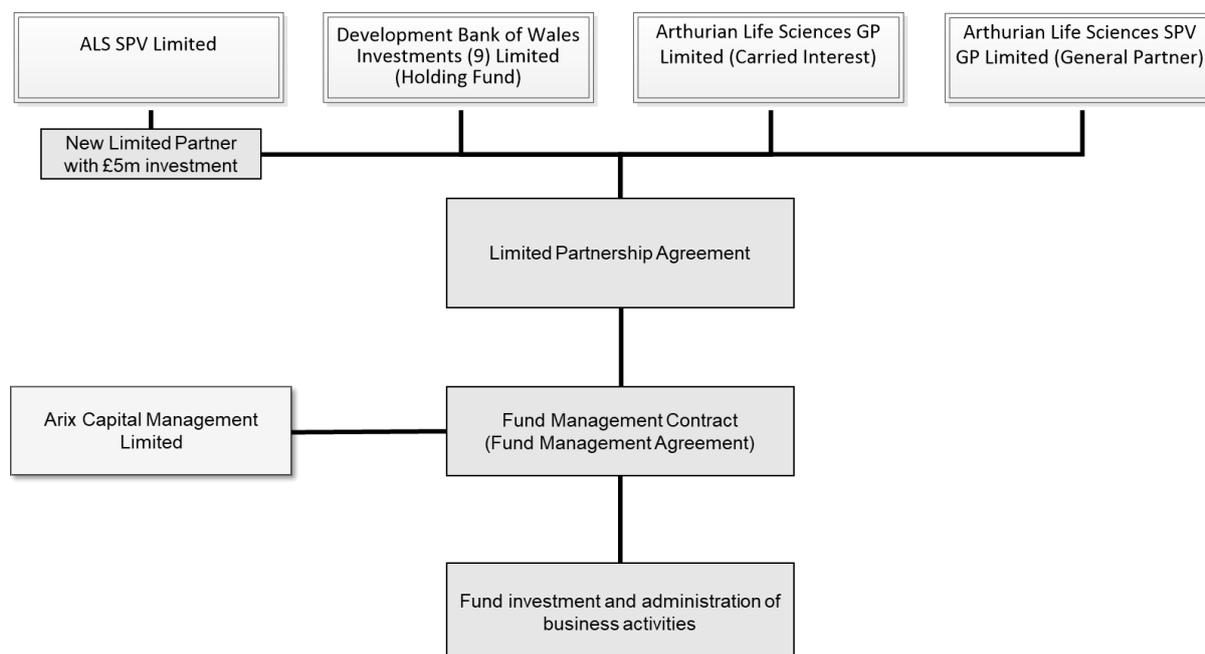
The new fee structure ensured down valuations were reflected in the net fee charged. Net fees were calculated on 2.5% p.a. of the Fund size, then adjusted downwards for exits, down-valuations & losses.

Fees became net through a rebate mechanism in which the Fund Manager had to repay fees based on performance of the portfolio but this repayment would not contribute to the repayment of the Holding Fund Loan Commitment. The Holding Fund denied the request for the new fee structure not to include write downs or write offs of listed assets as this detached fee payment from performance of the entire portfolio although it did create an additional administrative burden on the Fund Manager.

Arix used an intracompany transaction to the Fund Manager to invest the £5m. This was documented in the Deed of Adherence sign by the Fund Manager. However, due to Arix owning the Fund Manager who then invested the £5m, this created unlimited liability for the General Partner and a further change was requested to transfer rights to another entity.

Subsequently a transfer notice was issued and executed with an assignment of interest form and new Deed of adherence for the correct legal entity closed the matter.

Full overview of the variations was detailed in the 2018 mid-point review submitted to the Welsh Government. The Final structure of the partnership is shown below:



The £5m investment also triggered an equalisation payment. The payment ensures new investors can claim their proportion of returns by first paying their proportion of the costs incurred to generate those returns.

In the case of this fund, Arix invested £5m bringing the final fund size to £55m. This entitled them to 5/55ths of returns and they therefore made an equalisation payment equivalent 5/55ths of the costs incurred to operate WLSIF (£479k).

On liquidation of the partnership, the shareholdings and cash are split proportionally to investment in the Fund as a distribution in specie. Therefore 50/55ths of the shares and cash held are transferred to the Development Bank and 5/55ths are transferred to Arix. Following this distribution in specie, each investor does not subsequently have a call on each other's returns generated from these investments.

### 5.1.3. Management of Holding Fund obligations

In 2016 Welsh Government Director of Sectors and Businesses, instructed the Holding Fund to conduct a full review of the Holding Fund's systems and processes

to deliver its contractual obligations. This would close out recommendation 5 from the Auditor General report:

*“The Welsh Government should set out clearly to Finance Wales its expectation with regard to Finance Wales’s role in managing its contract with the Fund Manager.”*

The internal review was submitted in March 2017 as the Holding Fund worked with the Fund Manager to first clarify its role with the Fund Manager. This review made three recommendations:

- Introduce a more stringent communication and documentation processes between the Fund Manager and Fund Holder;
- Proposal for formal notification process concerning specific variation requests from the Fund Manager; and
- Agree Fund promotion with Welsh Language standards compliance with the Fund Manager.

Following implementation agreement to these recommendations from the Fund Manager, the Welsh Government considered recommendation 5 closed by June 2017. Implementation included written clarification that the Fund Manager was not to engage directly with the Welsh Government on variation requests.

Subsequently the Fund Manager ceased engaging directly with Welsh Government facilitating a more active operational dialogue with the Holding Fund in line with the governance arrangements set for the Fund.

## **5.2. Holding Fund and the General Partner and Fund Manager**

<b>Terms of reference:</b> Evaluate the Holding Fund’s working relationship with General Partner and Fund Manager within the context of the Limited Partnership Agreement during the period.
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### **5.2.1. Pre-2019**

Annex 2 details key events impacting the Fund prior to 2019. These events had consequences on the governance of the Fund.

Welsh Government were dealing directly with the Fund Manager and making direct interventions in its early delivery stages. This resulted in Regeneris’ recommendation eight and related findings of recommendation five from the Auditor General.

These direct interventions weakened the governance controls of the Holding Fund and its relationship with the Fund Manager. Intervention to make improvements or variations to the Fund should have been led by the Holding Fund as Limited Partner as was the case concerning issues relating to conflicts of interest and reporting.

Direct interventions from Welsh Government caused a conflation of roles and responsibilities between them and the Holding Fund. While decisions taken may not have been materially different, such conflation weakened governance controls for making variations to the Fund and facilitated an investment strategy of concentrated risk with little ability to provide follow-on as noted in the 2018 Mid-point report.

The conflation of roles and responsibilities during the Funds early delivery stages also resulted in a poor document custodianship within the Partnership. This was

recognised in the 2017 Contract obligations review conducted by the Holding Fund and submitted to Welsh Government (see Annex 1 for further details on the review).

As noted in Annex 2, reviews during this period, structural changes to the Fund Manager and new personnel affirmed the stipulated roles, responsibilities and boundaries of the Partnership as envisaged by the Fund's governance arrangements. This facilitated improved engagement between the Holding Fund and the Fund Manager as they sought to navigate the significant events from 2019 onwards and bringing the Fund to a close.

### **5.2.2. 2019 - Fund termination in 2023**

In 2019, Welsh Government requested clarification on the position of economic development performance of the Fund, specifically the operations of investees located in Wales following the 2018 Mid-point review. Restructure of the Fund Manager facilitated a more open dialogue and more in-depth review of Verona Pharma, CeQur and InterRad.

The Fund Manager shared the relevant investment documentation and highlighted that the appropriate conditions were in place during the investment process. Across these three investments, relocation requirements were partially completed but also pointed to a lack of enforcement mechanisms. In the case of Verona, the Fund Manager had tried to trigger delivery of the full relocation obligations, but there was a lack of enforcement mechanisms to move it beyond partial compliance.

Clarity on these economic development issues was not forthcoming under the previous structure and personnel of the Fund Manager. It also enabled the Holding Fund to recommend that any new and similar Funds by Welsh Government should have restrictive covenants to aid enforcement of relocation obligations.

Key events noted in Annex 2 also required this more effective operational dialogue for management of the Partnership. Events such as a number of companies entering administration proceedings, the implementation of IRFS 9, Woodford Funds closure and the pandemic resulted in the Holding Fund working more closely with the Fund Manager in reviewing the performance of the portfolio and its declining valuations. With the administration of Rutherford Health announced, and its value subsequently considered zero, the value remaining of the Funds investments was less than £10m. The Fund Manager had made it previously clear in 2021 that Rutherford Health had a runway of cash to operate until mid-2022 but this risk materialised. Announcement of liquidation was not communicated to the Fund Manager reflecting the position of their holding in the company and the agency they had in Rutherford Health's decision making.

Following Rutherford's liquidation however, due to the financial position of the company at the announcement, it was clear that the Fund would not receive any return on its investment. This came at a time when the remaining assets were all valued below their acquisition cost without levers for the Fund Manager to generate much value. Further, prior to Rutherford's announcement the Partnership had envisaged utilising the two-year extension clause for Fund Manager to support

maximising returns from a sale of its Rutherford holding. This changed the outlook and prioritisation for the Fund contributing to re-emergence of a legacy issue for the Fund Manager. They became less proactive with the portfolio due to its size, value and opportunity for further funding in comparison with other aspects of their business.

A direct result of this issue was the Fund Manager being nearly a year late to submit the Partnership's accounts. As Holding Fund, the focus was on getting those accounts submitted in order to discuss the next steps for the Fund. Next steps concerning closure of the Fund were preliminarily discussed in mid-2022 but by the final quarter of the calendar year, the Fund Manager did not seem to have the personnel working on the Fund. Its staff turnover during this period led to it not being reactive to Holding Fund requests which resulted in a shortened preparation time for the termination of the Partnership.

Installation of dedicated staff back on the administration of the Fund by the Fund Manager resolved these issues in 2023. Both the Limited Partners and the Fund Manager has since worked cooperatively to transfer the remaining assets and close the Partnership.

From 2019 to the Fund termination, new structure and approach to the Fund facilitated a more clear and consistent operational dialogue between the Fund Manager and Holding Fund. This provided more frequent and detailed updates on the Fund's performance and enabled the Holding Fund to more effectively communicate expectations to Welsh Government.

Whilst the issues experienced during 2022 caused a shortened timeframe for preparatory work, the losses experienced would not have changed.

Retrospectively, the Holding Fund could have driven the process to prepare for closure of the Fund when it became clear that the Fund Manager was not reacting to its requests. Importantly, the LPA required the Fund Manager to manage the administration of this process and coordinate Limited Partners. It would have been an overstep of the Holding Fund's responsibilities to act unilaterally in this respect. The other Limited Partner, as parent company to the Fund Manager, did help rectify this issue by ensuring communication was restored.

The progress made in the operational delivery of the Fund from 2019 should not be discounted due to the issues experienced prior to its closure. These issues however do present the clear need for more defined roles and responsibilities for such a Fund during its closure if performance is below expectations.

### **5.3. How did the Holding Fund manage the termination of the Partnership?**

**Terms of reference:** Detail the intended process for termination of the Partnership as outlined in the contractual requirements.

Detail the process of termination in practice.

Evaluate the Holding Fund's role in executing the termination process.

### **5.3.1. Termination and liquidation clauses**

As per the clause 14 of the LPA, the Partnership was to automatically terminate and liquidate at the end of February 2023.

There was an opportunity to liquidate the Partnership on the third anniversary of the LPA following the Regeneris report. This was not utilised due to the findings of the Regeneris report.

Within the LPA a clause gave the Holding Fund authority to extend the duration of the Partnership for a period of up to two years. This was not utilised due to value for money considerations.

Clause 15 of the LPA details the process of terminating the activities of the partnership. This includes strict clauses that no further businesses is conducted except for winding-up of the affairs of the Partnership.

The LPA does not cover in depth what the exact liquidation process is as it is a standard practice and it details under clause 3 of schedule 1 that investments which extends beyond the termination date of the Partnership shall be transferred in specie at the Partnership termination date. Transfer in specie clause includes reference to the transfer at an appropriate valuation to another fund specified by the Holding Fund. Reference to in specie refers to the applicable proportion of assets entitled to the Holding Fund based on total commitments from the Limited Partners.

There is no requirement to conduct an audit of the investments or further checks which the Fund Manager would have undertaken at point of investment.

Under the Finance Award letter, the Holding Fund is to distribute any returns from the Fund and its investments to the Welsh Government by 31 March 2025, if still applicable and opportune.

Governing documents for the Fund do not require the Holding Fund to conduct an impact assessment for transfer in specie of assets on behalf of the Welsh Government but to report the financial position of the Partnership in regular correspondence.

### **5.3.2. Closure of the Fund**

An overview of the closing process for the Fund and subsequent termination of the Partnership is detailed in section 4.1. and section 5.2. Further administrative information is detailed below.

The Limited Partners and Fund Manager decided the best value for money option for the Fund was to transfer in specie all assets of the Partnership in termination and liquidation of the Fund.

The Development Bank's status as a wholly owned subsidiary of Welsh Government and Regulation 12 of the *Public Contract Regulations (2015)*, enables Welsh Government to mandate that the Development Bank manages the remaining investments without the need to undertake procurement for the required services. This allows implementation management processes to commence as soon as the assets are transferred.

Through transfer in specie, 50/55ths of the assets remaining in the Partnership transfer to DBW Investments (9) Limited as an entrusted entity. The 5/55ths will transfer to Arix Bioscience PLC as the other investor and Limited Partner. This separates the Limited Partners whereby neither will have a call on the assets, nor future proceeds derived from those assets, distributed in specie to the respective parties.

The fair value of the remaining assets in the Partnership will be detailed in its final audited accounts and report. Transfer in specie crystallised the value of the assets and therefore the loss of the Fund. This resulted in a £27.1m RDEL/RAME impact. Welsh Government chose to realise the £26.4m RDEL in the single year rather than utilising the In 2021/22 a £10.5m Expected Credit Loss provision was posted to the core account.

Welsh Government Central Finance preferred to crystallise the £27.1m loss in 2022/23 rather than the spread the losses further. In any event, the full value of the realised losses would have had to be budgeted within the next two years with the majority being in 2022/23.

The remaining assets transferred were reviewed. The Special Situations Manager ("SSM") manages all non-listed assets with focus on returning value to Welsh Government. Each asset investment document was reviewed, with challenge given to the Fund Manager on the impact of Swiss law and naming of third parties. This was based on legal advice attained by the Holding Fund.

Listed investments were transferred to a Portfolio Development Executive which also managed the Holding Fund's separate investment in Intelligent Ultrasound. The transfer was actioned through a brokerage and required a change of ownership.

Following transfer of the assets, they are subject to the Development Bank of Wales' portfolio management procedures. This includes asset health grading used by the Development Bank. The Development Bank operates a central Investment Management System ("IMS") to manage the investments for different stakeholders, which the investments will be incorporated into. The IMS ensures that the Bank's Finance team can manage all investments appropriately including equity returns, capital and interest payments, risk ratings, dividend payments, profit premiums, fees and interest rates.

### **5.3.3. Evaluation of closure process**

Section 5.2 gives an overview of the issues with the process leading to the Fund's closure.

Upon triggering the liquidation of the Partnership, the Holding Fund used a governance document to detail the work required. This served to coordinate the multiple teams within the Development Bank to close the Partnership, from approach to market communications to handling of losses of the Fund and risk management.

By documenting the various issues to resolve and decisions taken, the Holding Fund ensured that its teams did not act in silos and coordinated work required with the involvement of the Senior Responsible Officer for the project. This document then served to inform the PAPAC appearance on the progress to date on the liquidation and covered:

- i. **Procurement** the administrative details of transfer in specie to Limited Partners.
- ii. **Service Agreements** detailed the distribution expectations of the Funds assets and requirements on the Holding Fund to transfer returns to Welsh Government by March 2025.
- iii. **Regulation** assets being managed in compliance with UK Subsidy Control Regime and a risk register was detailed.
- iv. **Project Management** the budgetary impact, communication approach and asset review process for the transfer in specie.

Of the issues identified in the governance document, the budgetary impact was highlighted and a focal point of the PAPAC appearance.

As stated in the committee, the provisional figures for the valuations and therefore expected losses for the Fund before closure were generated by the Fund Manager in February 2023. These provisional figures had to be incorporated into the Development Bank of Wales plc accounts and audited following the entities year-end from April onwards. Although Welsh Government were notified of the losses in February, once those were confirmed in June, Welsh Government was immediately informed. The Minister for Economy issued a written statement in July 2023 updating on the closure of the Fund.

Development Bank of Wales has had ongoing dialogue with the Welsh Government on the Fund's performance due to continued public scrutiny of the Fund and high-profile parties involved in the investments.

Prior to the reclassification of the Development Bank of Wales, Welsh Government would consolidate the Wales Life Sciences Investment Fund into its accounts manually. This had resulted in Welsh Government providing for a £10.5m Expected Credit Loss against the £42.4m Financial Transaction Capital in 2020/21 demonstrating this ongoing dialogue on the Fund.

The Development Bank continued this close working with Welsh Government teams on the termination of the Partnership and transferring the remaining assets. Although the Fund featured on FTC repayment schedules since 2018, and losses were notified to Welsh Government in 2021/22 through the £10.5m Expected Credit Loss, the Holding Fund, was not able to report the provisional losses until February due to the Fund Manager not providing its audited accounts.

Section 5.2 details how the Holding Fund had issues dealing with the Fund Manager in the closing year of the Partnership and that it taking more of a lead in the closure of the Fund was not within the governance arrangements. This did impact the Holding Fund's ability keep Welsh Government informed of latest developments and the further expected losses. While reporting to Welsh Government continued in the

usual reporting processes, as the Fund was coming to a close and represented a significant project, an exception report should have been made in order to make them aware of the issues and their impact rather than when it crystallised.

Over the course of 2023, the Fund Manager, with input from Arix as a private investor, did improve their communication to carry out the winding up of the Partnership. This included an in depth review of the final fee to be charged, final distribution to the Limited Partners and review of investment documentation to assets being transferred. The in-depth review of fees was conducted to ensure that the Holding Fund had complete transparency over the value of assets being distributed to the Limited Partners and ultimately returned to Welsh Government. This is more proactive than the governance arrangements detail but represents increased scrutiny to ensure the returns to the Welsh Government were maximised. This included the foregoing of the Holding Fund fee which accumulated to £500,000.

## 6. Stakeholder management

### 6.1. Conclusions and recommendations from the 2018 Review

**Terms of reference:** Provide overview of recommendation and conclusions of the report and update.

Detail specific and relevant updates to the recommendations and conclusions.

Evaluate continuing validity of conclusions and recommendations.

In 2018, the Welsh Government requested a report on the future of the Fund and whether the Holding Fund would advise terminating the Fund Manager's contract and liquidating the Partnership. This was not a scheduled report detailed within the governance requirements but a request for advice from the Welsh Government so that they could consider the future of the project.

#### 6.1.1. Findings

The 2018 Mid-point review conclusions and recommendations are summarised as:

- i. **Outputs** KPI performance varied with jobs on track, but it seemed likely several firms would fail. Further, the current valuations were deemed high and therefore it was uncertain whether the Fund would make a positive return.
- ii. **Fund Manager** There continued to be some issues with Fund Manager approach to the Fund with the assumption of further investment leading to an overconcentration of funds and use of investment structured which seemed nonoptimal.
- iii. **New Structure** Structure and personnel changes within the Fund Manager prompted a refocus on generating value but the portfolio valuation still dropped to below £50m in early 2019.
- iv. **Fees** The new fee structure ensured a performance-based reduction. This, coupled with the reputational risk for underperformance of the Fund Manager would drive a greater focus on generating value.
- v. **Recommendations** Performance and the new approach from the Fund Manager led the Holding Fund to recommend that the current arrangement was continued, as opposed to terminating the contract with the Fund Manager. The Holding Fund also recommended that it instruct the Fund Manager to sell all shareholdings in InterRad and Verona Pharma at the earliest sensible opportunity.
- vi. **Further advice** The Holding Fund provided further advice to Welsh Government on the economic development impacts of the Fund and the Wales relocation obligations of the portfolio companies. Within this, the Holding Fund recommended that any future and similar project the Welsh Government launches have restrictive covenants to ensure investees deliver their obligations in full. Concerning InterRad, the Holding Fund recommended that with future funding decisions, businesses such as InterRad are funded through a different vehicle and the restrictive covenants for relocation obligations are made stronger.

### 6.1.2. Updates to findings

- i. **Outputs** As detailed in section 4.2, the jobs KPI was attained but others were not and returns were below expectation. Several companies did fail before the end of the Fund with two of these being in the year following the report.
- ii. **Fund Manager** The personnel taking these actions were no longer involved with the Fund from 2019. New personnel were more responsive and this was demonstrated in late 2017 when Welsh Government requested advice on additional investments for completion of the GMP element of the ATMP facility working with ReNeuron. With support of the Fund Manager, the Holding Fund was able to advise that any further investment would be considered high risk to the point of a 'gamble'.
- iii. **New structure** The Fund Manager's new approach enabled the Fund's most profitable exit and ensured that the Holding Fund could keep Welsh Government more aware of updates to performance. This included impairments to the Fund value to below £50m from 2019.
- iv. **Fees** The new fees structure aided an in depth review into the final fees charged for the Fund as it required more transparent reporting to the Holding Fund.
- v. **Recommendations** The Fund Manager's contract was not terminated and continued as envisaged. As noted the Holding Fund instructed the Fund Manager to exit Veron Pharma and InterRad at the earliest commercial opportunity. This did not materialise for InterRad due to the liquidity of the holding.
- vi. **Further advice** No new and similar project has been launched with the opportunity for the Holding Fund to again share the recommendations for restrictive relocation covenants.

### 6.1.3. Continued validity

- i. **Outputs** As no new activity took place after the report, and the Fund Manager was no longer fundraising, it was unlikely that the remaining KPIs were to be attained. This materialised and was exacerbated by the failing of a third of the portfolio.
- ii. **Fund Manager** These behaviours changed when the new personnel and structure fully embedded with the Fund Manager. While similar issues did arise in the closing year of the Fund, the Limited Partner as a parent company to the Fund Manager, did step in to help rectify this.
- iii. **New Structure** The Fund Manager continued to be proactive with the portfolio and its communication with the Holding Fund. While this did not prevent Ruthford Heath's liquidation, it did improve performance reporting shared with Welsh Government.
- iv. **Fees** The new fee structure resulted in the net fees being below the industry standard of 2% due to the Fund's performance.
- v. **Recommendations** Termination of the Fund Manager at the time of the report would not have represented value for money for the Welsh Government. It was highly likely that termination would have resulted in legal challenge on how under performance was determined at the time

and therefore did not have represent value for money. Further, the investee's were underperforming and any replacement Fund Manager would have focused on immediate liquidation which would have impacted returns from Simbec and Verona Pharma.

- vi. **Further advice** The commercially opportune exit point for the Fund's holding in Verona Pharma was in 2022. This opportunity was taken by the Fund Manager. The performance of the non-listed assets did not facilitate liquidity..

## 6.2. Holding Fund other Limited Partners

**Terms of reference:** Evaluate the Holding Fund's working relationship with the other Limited Partners (Arix Biosciences plc) within the context of the Limited Partnership Agreement during the period.

Upon becoming a Limited Partner, Arix BioSciences signed a deed of adherence to the terms of the LPA. Obligations on the Fund Manager towards the Holding Fund as Limited Partners were also extended to Arix BioSciences. There were few / limited obligations on the Limited Partners towards each other which required actioning in the duration of the project.

Consents for amendments to the LPA or termination of the Partnership required the Holding Fund consent following agreement with other Limited Partners.

Following the £5m investment from Arix BioSciences, a transfer of rights amendment was required. The Limited Partners worked together to detail the impact and course of action for the transfer. This rectified the unlimited liability placed on the General Partner.

As detailed in sections 5.2 and 5.3, there were a number of issues arising in the closing year of the Fund. Arix BioSciences as a Limited Partner was proactive in the management of the partnership due to it being a parent company to the Fund Manager. The Limited Partner aided in resolving issues in the closing year of the Fund concerning reporting by communicating staff changes and supporting information requests.

This proactive involvement by Arix as Limited Partner continued past the closure of the Fund in support of providing transparency on the fees charged and final distribution. This is more than that required in the governance arrangements. Although boundaries between the Fund Manager and Limited Partner were permeable at times, the separation aided in ensuring the Holding Fund had a responsive partnership.

## 6.3. Holding Fund resolution approach to issues arising from the Partnership

**Terms of reference:** Evaluate the Holding Fund's power and use of this power in supporting the resolution of issues arising from the Partnership in the period and their communication to relevant parties.

Evaluate specific issues arising in closing years of the Partnership and the Development Bank's role in providing a solution to these issues and their communication to relevant parties.

### **6.3.1. Holding Fund's authority and actions**

Authority of the Holding Fund as detailed in LPA is summarised in section 5.1.1. Due to its discretionary nature, the notification of events which required Holding Fund involvement were limited to breaches in the LPA, issues in management of the partnership as detailed in clause 5, and the immediate notification of any events which are expected to materially affect the Partnership, its assets, or the Holding Fund. These clauses fed through from the Finance Award letter which stipulated notification events requiring the Holding Fund to report to Welsh Government.

As the LPA was designed around a discretionary fund management contract, and as mentioned previously, the Holding Fund involvement in resolving issues was limited. There was provision in the LPA for resolving disputes between the Fund Manager and investee businesses. This involved notifying the Limited Partners and consulting them on the issue. If the issue arose from a dispute concerning the LPA itself then a mediator can be used with a clear route of escalation.

Issues arising from delivery of the Fund which were managed by the Fund Manager were detailed in the periodic reporting. These were shared with Welsh Government when received. Issues arising in delivery of the Fund which were escalated for consideration by the Holding Fund were consulted on with the other Limited Partner. These were then reported to the Welsh Government when resolved or if they required further action.

As detailed in both the Auditor General and Regeneris report, issues arising in the early stages of the Fund's delivery were often referred directly to Welsh Government which often excluded the Holding Fund from the resolution process.

Changes as a result of these issues being resolved directly between the Welsh Government and the Fund Manager did have a lasting impact on the Fund which materialised in 2019.

As noted in the 2016 Regeneris report, follow-on investment into ReNeuron was in part to avoid dilution and to demonstrate credibility in supporting a significant co-investor, Woodford Investment Management. Supporting Woodford Investment Management was also a driving rationale behind authorising the £3m loan issued by the Holding Fund in order for the Fund Manager to invest in CeQur and Apitope.

Co-investors are crucial to Funds such as this one being a success and having a lasting impact on the target sector. Co-investors are a key deal source and their support is a means of ensuring future funding is available. While it is a positive that the Fund was able to invest with such prominent FCA regulated investors in the sector which demonstrated the outlook of investments at that time, changing the fundamental governance controls of a Fund to accommodate supporting them in this way was detrimental.

Variation to invest 20% of the Fund into one company and loan money to invest above the commitment amount in order to support a co-investor led to a

concentrated risk profile and no available funding for further follow-on investment amongst other portfolio companies. This was then compounded when Woodford was suspended, removing that investment pipeline from the sector which contributed to the closure of Sphere Medical as the Fund had no means to invest the capital the company needed to survive. However, when the Partnership functioned as intended, the Holding was able to work collaboratively with the Welsh Government and the Fund Manager, escalating issues when necessary.

An example of this process working well is when the Fund Manager escalated an issue with a portfolio company. The management team required advice and finance to continue trading. The Fund Manager was able to utilise the network of support which the Fund facilitated to deliver the support needed. While the details of this cannot be disclosed due to commerciality concerns, this support included the participation of Limited Partners to the Fund, private investors and Welsh Government teams. This is a positive lesson to be learned from the Fund in managing issues. Importantly, working collaboratively on issues related to the Partnership and its investments, was not only in one direction. The Partnership structure provided a reference point for advice for Welsh Government, especially on its investments in ReNeuron.

In October 2017, Welsh Government requested that the Holding Fund revalidate their previous advice concerning additional investments for completion of the GMP element of the ATMP facility working with ReNeuron. Previously, the Holding Fund worked with the Fund Manager to consider the proposal for further investment in the ATMP facility which they described as a 'gamble' due ReNeuron's potential to fail raising capital, experience bad trial results and roadblocks to commercialisation. These issues all materialised following this advice.

Collaborative working is a benefit of using such as structure. While it can be lead to the conflation of roles and responsibilities, if the integrity of governance arrangements are maintained as seen in the examples of ReNeuron and other interventions, a positive outcome can be achieved.

### **6.3.2. Issues arising during closure**

As detailed throughout section 5, whilst the issues experienced during 2022 caused a shortened timeframe for preparatory work, the losses experienced would not have changed. Retrospectively, the Holding Fund could have driven the process to prepare for closure of the Fund when it became clear that the Fund Manager was not reacting to its requests. Importantly however, is that the LPA required the Fund Manager to manage the administration of this process and coordinate Limited Partners. It would have been an overstep of the Holding Fund's responsibilities to act unilaterally in this respect.

As stated in the committee, the provisional figures for the valuations and therefore expected losses for the Fund before closure were generated by the Fund Manager in February 2023. These provisional figures had to be incorporated into the Development Bank of Wales plc accounts and audited following the entities year-end from April onwards. Although Welsh Government were notified of the losses in

February, once those were confirmed in June, Welsh Government was immediately informed who then made a statement thereafter.

Development Bank of Wales has had ongoing dialogue with the Welsh Government on the Fund's performance due to continued public scrutiny of the Fund and high-profile parties involved in the investments.

## **7. Concluding the Development Bank's involvement**

### **7.1. Remaining milestones**

**Terms of reference:** What are the remaining processes to undertake and expected outputs prior to full conclusion and exit of any remaining interests?

Following the transfer of assets and final distributions, the remaining processes are aimed at meeting the Finance Award letter requirements of paying the final fund returns to Welsh Government no later than 31 March 2025. The Development Bank will review the repayment schedules and communicate to Welsh Government if the 2025 date is no longer suitable.

### **7.2. Lessons learnt**

**Terms of reference** Summarise the conclusion of all specific requirements and recommend actions for the Holding Fund in its role as a Limited Partner.

Make recommendations, if any are relevant, for consideration by the Development Bank concerning potential future roles as General Partner or Fund Manager in similar funding models or Limited Partnership Agreements.

As shown in section 5.1, management of the contractual requirements, specifically in the early stages of the Fund were not always as envisaged. This was highlighted by recommendation 5 of the Auditor General report and the 2016 Regeneris report. The 2017 Contracts review process rectified this deviation and demonstrated a satisfactory delivery by the Holding Fund.

These early changes however, impacted the Fund's performance and as detailed in section 5.2, required the Holding Fund to be more engaged in management of the Partnership than envisaged. This caused a conflation of roles and responsibilities between the Holding Fund and the Fund Manager in terms of delivery of the Partnership. It also caused a conflation of roles and responsibilities for the Holding Fund and the Welsh Government on change control until early 2017.

For future similar projects, governance arrangements should more clearly reflect the separation of responsibilities and authorities for the Holding Fund. Clear separation between Welsh Government and management of such a Partnership should also be maintained. This would facilitate greater governance oversight through more stringent change control.

Governance arrangements for closure of such projects should also be strengthened. Whilst the issues experienced during 2022 caused a shortened timeframe for preparatory work, the losses experienced would not have changed. Within the governance arrangements it would have been an overstep of the Holding Fund's responsibilities to act unilaterally in closing the partnership and liquidating its assets.

The other Limited Partner, as parent company to the Fund Manager, did help rectify issues by ensuring communication was restored as detailed in section 5.3 and 6.2. It is recommended that a future project using external Fund Manager have a longer preparatory timeframe built into governance arrangements. This can be based on standard project closure process used in the delivery of past-EU funds. Furthermore, to enact these controls, the Holding Fund should foster strong engagement and collaboration with the other Limited Partners.

Strong engagement and collaboration has additional benefits. Section 6.3 details that the Holding Fund acted as a conduit for advice and support. While it can lead to the conflation of roles and responsibilities, if the integrity of governance arrangements are maintained a positive outcome can be achieved.

## **8. Structure and Governance**

### **8.1. Welsh Government in the Limited Partnership Agreement**

**Terms of reference:** Evaluate the Holding Fund’s working relationship with the Funder within the context of the Limited Partnership Agreement during the period.

Welsh Government were not party to the LPA. The terms and conditions of the Finance Award letter and discretionary limits set out in the ODP were transferred directly to LPA upon procuring Fund Management services. This ensured that the procured Fund Manager operated within these governance arrangements.

The LPA sets out various aspects for the operation of the WLSIF, including the Investment Operating Guidelines (the “IOGs”). These IOGs limited the Fund Manager’s discretion to the objectives of the Fund.

The LPA in itself did not create contractual obligations on the Holding Fund in relation to Welsh Government which were not already detailed elsewhere. The LPA enabled the Fund Manager to have full visibility on what constituted a notification event, performance and reporting expectations, and the powers and authority it had in complying with Welsh Government requirements as represented by the Holding Fund.

Outlining these to the Fund Manager ensured that the Holding Fund could act as layer of governance as to keep Welsh Government informed on the Fund and to assist Welsh Government in making decisions in relation to the Fund. This happened throughout the life of the Partnership as the Holding Fund reported potential notification events following portfolio issues and sharing variations requests for approval.

The LPA underwent variations in 2017 as detailed in section 5.1.2. This had no impact on the obligations on the Holding Fund to the Welsh Government.

### **8.2. Finance Award letter**

**Terms of reference:** Did the fund meet the conditions of the Finance Award letter?

The Holding Fund utilised its current practices for drawing Welsh Government finance to establish the Fund. This included a Finance Award letter and an ODP which were then codified into the LPA when the Partnership was formed to deliver the Fund.

The Holding Fund delivered its contractual requirements to Welsh Government through codifying these into the LPA, adhering to the conditions of the original Finance Award letter and reflecting agreed amendments in the LPA.

As part of drawing down the £50m Welsh Government Holding Fund Loan commitment, Welsh Government issued two Finance Award letters relating to £25m each. These are standard practice for the creation of investment Funds.

The Finance Award letter issued by Welsh Government in 2013 for the Fund set out the quantum, purpose and conditions of receiving the investment from Welsh Government. This detailed the Fund being targeted at providing mainly equity funding to fast-growing established companies.

This funding was to increase access equity finance for Life Sciences businesses in Wales, attract Life Science businesses into Wales; increase employment in the Life Sciences sector in Wales; and increase the commercialisation of Life Sciences Wales. This was to raise the profile of Welsh Life Sciences, attracting quality managers, entrepreneurs, and significant additional private sector funding to Wales.

The Finance Award letter also detailed that the Fund would have a target size of £100m by the end of 2015, no more than 10% of the total value of the Fund being invested in any one business, spread investments into thirds for high-risk businesses, medium-risk and low-risk businesses and leverage significant private sector leverage. It also stated that following the discharge of obligations to the Fund's private investors, returns from the funding invested under this Fund will either be distributed back to Welsh Government or recycled to be used for future investment as directed by Welsh Government.

Conditions for the finance were also set out in the Finance Award letter which included monitoring and reporting requirements and outlined notification events considered requiring immediate attention of the Welsh Government. Monitoring, reporting and notification events detailed related to the Partnership structure, KPIs, legal and state aid compliance, and Fund performance data as outlined in the Operational Development Plan.

The Holding Fund satisfied the conditions set out in the Finance Award letter by codifying them into the Limited Partnership Agreement. This ensured that it met the monitoring and reporting requirements with the Fund Managers support and that notification events, such as underperformance in achieving the Key Performance Indicator targets and requested variations to the Fund's discretionary limits were reported for approval.

#### **8.2.1. Operational Development Plan**

To hold the £50m investment, following a Finance Award letter, the Holding Fund agreed an Operational Development Plan (ODP) with Welsh Government. This set out the envisaged legal structure for the Fund, indicative investment and KPI profile, governance and state aid arrangements, terms of appointment for the Fund Manager, terms of additional investment, terms in the event of underperformance, and terms of use for returns.

Governance arrangements within the ODP highlight Development Bank (then Finance Wales) board, with WG participation, oversight enabling the Holding Fund to utilise its risk management, conflicts and audit committees. It further detailed that the day-to-day management and responsibility for investment compliance is with the Fund Manager along with the reporting and performance update requirements. Terms which apply in the event of underperformance only referred to the amount deployed within the early years and the run rate of delivery consistently underperforming.

This ODP set the boundaries for the discretionary fund management contract. The term "discretionary" refers to the fact that investment and realisation decisions are made at the Fund Manager's discretion in accordance with the Fund's IOGs. IOGs

limit the fund manager's discretion as they must revert to the fund holder for a decision if a proposed investment is outside these parameters.

Underperformance as defined in the ODP, related to the Fund Manager not meeting its run rate targets in the early investment phase. Continued and severe underperformance was to be remedied through discussions between the Fund Manager, Holding Fund and Welsh Government with the option to change the Fund Manager.

The Holding Fund performed its obligations to the Welsh Government as set out in the ODP. These were met by delivery of procurement services, setting up the Partnership structure as detailed and included relaying monitoring and reporting information to Welsh Government at specified intervals.

### **8.2.2. Finance Award variations**

As noted above, the 2013 Finance Award letter was codified by the LPA. In 2014 there were a number of variation to the LPA and the Finance Award letter. Variation to the Finance Award letter was primarily to convert £42.4m of the £50m Welsh Government commitment to Financial Transaction Capital (FTC), leaving £7.6m of non-repayable public equity.

The executed 2014 Finance Award side letter could not be sourced in Welsh Government and Development Bank of Wales has no record of the updated, executed, 2014 Finance Award letter being issued.

A further request from the Holding Fund to strengthen reporting responsibilities was made following an internal review of the Fund's contractual arrangements in 2017. This was approved but no updated Finance Award letter was shared. The request related to the Variation process not being explicit enough in the LPA. Provisions within the LPA were a reflection of the requirements in the Finance Award letter which weakened roles and responsibilities in relation to changes to the Fund.

Consequently, the Fund Manager had conducted parallel but separate discussions with the Holding Fund and Welsh Government on a numerous variation requests. This led to the Holding Fund being instructed to approve variations before it had been able to fully detail its view to Welsh Government in escalating the request. Specifically, these variations related to the provision of a £3m loan to the Partnership for investment and the 10% threshold.

To reaffirm responsibilities for variations and close recommendation 2 of the 2017 Contract obligations review, the Holding Fund requested the following amendment to the Finance Award letter:

"If any Variation proposal from the Fund Manager or General Partner materially changes the purpose for which the funding is used, Finance Wales Investments (9) limited (FWI(9)L) will formally notify Welsh Government of the variation. This will give the Welsh Government opportunity to consider the proposal and decide whether to accept the change."

This variation was approved but no updated Finance Award letter was provided. As no letter was provided, recommendation 1 of the 2017 Contract obligations review,

which related to document custodianship being a weakness for the Fund, was again relevant.

Having no record of updated Finance Award letters was raised with Welsh Government due to a consequent tax penalty relating to repayments, which crystallised in the Group's annual accounting process in 2022. Therefore a new Finance Award side letter was agreed in 2022. This confirmed the status of the finance as £42.4m of FTC with the following terms set on its repayment:

- Arix Capital Management Ltd is the Fund manager for the fund.
- DBW Investments (9) Ltd is the Fund holder for the fund.
- Development Bank of Wales plc will pay the final fund returns to Welsh Government upon the end of the realisation term of the fund or at a date which would be agreed by Development Bank of Wales plc and Welsh Government, which is no later than 31 March 2025.
- Development Bank of Wales will submit a bi-annual report to Welsh Government on the Finance repayment schedule by 30 April and 31 October each year and meet with us for an annual review of the Finance repayment schedule at a date to be agreed.

## 9. Delivery Objectives

### 9.1. Delivery against key performance indicators

The Fund achieved a number of its KPIs, it also raised the profile of life sciences in Wales and increased the availability of finance for the sector.

Its impact was not just at point of investment. The fund supported the wider ecosystem, for example, through cross-pollination as investees conducted trials with established life sciences businesses in Wales.

The Fund met its revised jobs target. Whilst it did not meet the co-investment target at Fund level the co-investment at deal level was very high. This indicates that the private sector recognised the potential of these investments at the time the Government fund was investing.

Deal level co-investment was not a Key Performance Indicators (KPI) for the Fund. Excluding Welsh Government and Finance Wales amounts, co-investment when accounting for the entire activity of the Fund was over £270m. Businesses raising Venture Capital funding often source it from multiple investors and co-investment was required to satisfy the State Aid requirements for the Fund. Therefore, a high degree of co-investment at deal level was expected but the primary ambition was to raise investment at Fund level.

Below is a table setting out the agreed KPIs and the Fund Manager's reported performance against these.

KPI	Target	Actual	Performance
Number of companies receiving investment	12	9	75%
Value of private sector co-investment at Fund level	£60m	£5m	8%
Number of jobs created/safeguarded in Wales (includes SMEs relocating)	300	311	104%
Number of registered patents	100	59	59%

The total level of employment in Wales from the Fund reached a peak of 311 jobs in 2021. During that peak, 16% of those jobs in Wales were held by a person with PhD or MD.

Creation of high value jobs is traditionally more expensive in terms of Government economic intervention. In this case the cost is primarily driven by the Funds financial performance whereby the cost of £87k per job reflects the loss made by the fund.

Approximately 100 jobs were safeguarded, and the rest were created. Simbec had the largest proportion of jobs created and safeguarded (140) and the majority of the rest were split between Rutherford Health, ReNeuron and Intelligent Ultrasound.

## 9.2. Delivery learnings

**Terms of reference:** Cross-refer to lessons learned from previous reviews into the Fund holder contract management which were shared with WG.

Annex 1 gives an overview of reports on the Fund and includes the resolution to each report as a summary of action taken. This includes recommendations from the 2018 Mid-point report that Welsh Government ensure strengthened relocation covenants for future similar projects.

From the reports summarised in Annex 1, it is clear that parties to such projects need clear roles and that governance arrangements relating to significant changes are both understood and maintained.

Recommendation 1 and 2 of the 2017 Contract obligations review, and the need for a further Finance Award letter in 2022, demonstrates a clear weakness in both defining the roles and responsibilities between the Holding Fund and Welsh Government, which impacted change control on the project.

Recommendation 8 and recommendation 5 of 2016 Regeneris report and 2016 Auditor General report respectively further supports the requirement to maintain clear responsibilities and change control governance.

All recommendations made from these reports were actioned by the Holding Fund as it sought to continually improve how the Partnership performed against the Welsh Governments requirements.

## **10. Conclusion**

Section 4 details key events which impacted the performance of the Fund and what the partnership achieved. The Fund achieved a number of its KPIs, it also raised the profile of life sciences in Wales and increased the availability of finance for the sector.

The Fund met its revised jobs target. Whilst it did not meet the co-investment target at Fund level the co-investment at deal level was very high. This indicates that the private sector recognised the potential of these investments at the time the Government fund was investing.

Its impact was not just at point of investment. The fund supported the wider ecosystem, for example, through cross-pollination as investees conducted trials with established life sciences businesses in Wales.

Governance arrangements setting out the Holding Fund's contractual requirements were standard practice for such a Partnership structure. As detailed throughout section 5, Governance arrangements underwent multiple rounds of amendments. Amendments included changes to KPIs in 2014 and opening the Fund for further investment in 2017.

Multiple rounds of amendments resulted in a conflation of roles and responsibilities for the Holding Fund and the Fund Manager in terms of delivery of the Partnership. These amendments also caused a conflation of roles and responsibilities for the Holding Fund on change control as the Welsh Government was directly dealing with the Fund Manager.

Amendments impacted the Fund outputs, facilitated several key events as highlighted in recommendation eight of the Regeneris report and increased the Fund's exposure to externalities. In such a project, governance controls and responsibilities should be safeguarded to prevent such conflation. While more robust change control may not have changed the decisions taken at the time, it may have reduced impact when risk materialised.

The final year of the Fund saw the re-emergence of legacy issues when dealing with an external Fund Manager. Subsequent delays in the accounting process impacted the preparations for the closure. The Holding Fund however was able to conduct an in-depth review of fees and investments being transferred during 2023 before winding up of the Partnership.

A more managed closure can be facilitated by ensuring a strong degree of engagement and collaboration from Limited Partners and the Fund Manager. Strong engagement and collaboration has additional benefits throughout the life of such a project. Section 6.3 details that the Holding Fund acted as a conduit for advice and support. Success of the Fund in this respect should be encouraged in future projects and can be facilitated through the inclusion of relevant requirements within governance documents.

## **Appendix 1: Terms of Reference - Closure Review of the Wales Life Sciences Investment Fund**

### **1. Background**

In 2013, the Welsh Government appointed Finance Wales (now the Development Bank of Wales) to be the Fund holder for the Wales Life Sciences Investment Fund (WLSIF).

The WLSIF was awarded, through a full and open procurement, to Arthurian Life Sciences SPV GP Ltd as the General Partner with Arthurian Life Sciences Ltd (later to become Arix Capital Management Ltd) acting as Fund manager.

The fund was capitalised to £55m (£50m Welsh Government investment plus £5m from Arix) and was fully invested by the Fund manager by 2017. The fund invested in 9 companies.

On 28 February 2023, the fund's 10-year term ended and DBW terminated its Partnership Agreement with Arix, and the fund subsequently closed.

DBW is to undertake a review of the fund, which it will submit to the DBW Partnership Team (PT) by 30 September 2023.

### **2. Scope**

The scope of the review will have 2 main aspects:

1. DBW's role as Fund holder, and how it operated with ACM as the Fund manager.
2. DBW's role as Fund holder and how it operated with the Welsh Government

The review will provide consolidated lessons learnt and recommendations for both aspects.

This closure review follows a number of prior reviews undertaken during the fund's lifetime, and although they will be listed (See annexe), no detailed commentary is required.

As a result of the fund's closure, budgetary and accounting issues for 2022/23 have materialised. The purpose of this review is not to go into detail on technical accounting issues, however, there will be a cross referencing to other documents which have addressed those financial issues, as noted in the fund summary in annexe 1 of these ToR.

The review will not report on matters already evaluated by either DBW or external parties and summaries in Annex 1.

The detailed scope of the review is shown in sections 3 and 4.

### **3. Objectives – Fund Holder and Fund Manager governance arrangements**

The report objectives and specific requirements to achieve these are detailed below.

<b>End position of the Partnership</b>	
<b>Provide a summary of the Fund and Partnership to date</b>	Detail key events affecting the Partnership and Fund delivery during the period with particular focus on events triggering enhanced stakeholder engagement by the Holding Fund such as the closure of Woodford Funds. It will not include evaluation of the materiality for these events, nor a counterfactual should these events not have materialised.
<b>Partnership attainment</b>	Summarise the outputs from the Partnership in relation specifically to investment of the Holding Fund Loan Commitment. This will not include commentary of the Partnership's, nor its related parties, efficacy in relation to the Fund's objectives or key performance indicators.
<b>Governance</b>	
<b>How did the Holding Fund meet its contractual requirements of the Partnership?</b>	<p>Detail initial contractual requirements and governance expectations for the Holding Fund.</p> <p>Detail any changes to obligations and its delivery against these and how they were implemented in the relevant period.</p> <p>Evaluate the Development Bank's management of Holding Fund obligations and whether this was in accordance with what was set out.</p>
<b>How did the Holding Fund work with the General Partner and Fund Manager?</b>	Evaluate the Holding Fund's working relationship with General Partner and Fund Manager within the context of the Limited Partnership Agreement during the period.
<b>How did the Holding Fund manage the termination of the Partnership?</b>	<p>Detail the intended process for termination of the Partnership as outlined in the contractual requirements.</p> <p>Detail the process of termination in practice.</p> <p>Evaluate the Holding Fund's role in executing the termination process.</p>
<b>Stakeholder management</b>	

<p><b>Did the conclusions and recommendations from the 2018 End of Investment Review (and further advice document) remain valid?</b></p>	<p>Provide overview of recommendation and conclusions of the report and update.</p> <p>Detail specific and relevant updates to the recommendations and conclusions.</p> <p>Evaluate continuing validity of conclusions and recommendations.</p>
<p><b>How did the Holding Fund work with other Limited Partners?</b></p>	<p>Evaluate the Holding Fund’s working relationship with the other Limited Partners (<i>Arix Biosciences plc</i>) within the context of the Limited Partnership Agreement during the period.</p>
<p><b>How did the Holding Fund approach resolutions to issues arising from the Partnership?</b></p>	<p>Evaluate the Holding Fund’s power and use of this power in supporting the resolution of issues arising from the Partnership in the period and their communication to relevant parties.</p> <p>Evaluate specific issues arising in closing years of the Partnership and the Development Bank’s role in providing a solution to these issues and their communication to relevant parties.</p>
<p><b>Concluding the Development Bank’s involvement</b></p>	
<p><b>Remaining milestones</b></p>	<p>What are the remaining processes to undertake and expected outputs prior to full conclusion and exit of any remaining interests?</p>
<p><b>Lessons learnt</b></p>	<p>Summarise the conclusion of all specific requirements and recommend actions for the Holding Fund in its role as a Limited Partner.</p> <p>Make recommendations, if any are relevant, for consideration by the Development Bank concerning potential future roles as General Partner or Fund Manager in similar funding models or Limited Partnership Agreements.</p>

**4. Objectives: Fund Holder – Welsh Government governance arrangements**

Section	Comments
<b>Structure and Governance</b>	
<b>How did the Holding Fund work with the Funder (Welsh Government)?</b>	Evaluate the Holding Fund’s working relationship with the Funder within the context of the Limited Partnership Agreement during the period.
<b>Did the fund meet the conditions of the Finance Award letter? (compliance)</b>  <b>2012-2014 original letters and 2022 side letter</b>	Detail initial requirements and governance expectations for the Holding Fund issued by the Welsh Government Finance award letters of 2012 and 2013 and any changes to these during the period.  Evaluate the Holding Fund’s delivery of its requirements and governance expectations as set out in the most recent Welsh Government Finance award side letter of 2022.  Review should highlight: <ul style="list-style-type: none"> <li>• The governance arrangements within the Operational Development Plan (ODP) and sections which remained relevant to the fund.</li> <li>• Any non-compliance with the conditions of the Award letter to be noted.</li> </ul>
<b><u>Delivery Objectives</u></b>	
<b>What has the fund delivered against the key performance indicators?</b>	. To include consideration of: <ul style="list-style-type: none"> <li>• Actual Investments versus profile</li> <li>• Jobs safeguarded and created</li> <li>• Number of businesses supported</li> <li>• Psl</li> <li>• Summary of wholistic impact</li> </ul>
<b>Delivery learnings - are there any specific lessons learned?</b>	<ul style="list-style-type: none"> <li>• Cross-refer to lessons learned from previous reviews into the Fund holder contract management which were shared with WG.</li> </ul>

## 5. Outputs

- 5.1 DBW to prepare a closure review report for submission to the PT by 31 October 2023. This is subject to the scope being agreed by 14 July and the provision of necessary documents by the General Partner.
- 5.2 PT to assess the review and record its assessment in an end of fund audit trail report, which will collate references to key related documents.
- 5.3 PT to share the assessment and end of fund audit trail report with DBW for comments and discuss as necessary.
- 5.4 PT to endorse the review and recommend approval to the Head of Access to Finance.
- 5.5 PT will confirm approval of the review and fund closure to DBW by 31 December 2023.
- 5.6 PT to submit a fund briefing to the Minister for Economy by 31 January 2024.

## **ToR Annexe one: Wales Life Sciences Investment Fund summary**

1. In 2012, Welsh Ministers launched the Wales Life Sciences Investment Fund (WLSIF) to support the development of the sector. The fund invested £55m from 2013 to 2018. (£50m Welsh Government and £5m Arix).
2. On 28 February 2023, the fund's 10-year term ended and the Development Bank of Wales (DBW), the Fund holder, terminated its Partnership Agreement with Arix Capital Management Ltd. the Fund manager.
3. DBW and Welsh Government agreed that the best option was to transfer the fund's remaining 4 investments to DBW, who became the Fund manager.
4. This option avoided disruption to the investee businesses and provided a longer period to realise returns (rather than a 'fire sale').
5. The closure of the fund triggered the need for the realisation of fair value losses, previously unrealised but documented in accounts, to be recognised in Welsh Government and DBW's accounts. As a result, WG needed to account for a £27.1m loss from its original investment of £50m.
6. Welsh Government Finance decided to fully realise the loss via its RDEL budgets in 2022/23, although the actual budget pressure reduced to £16.65m. This being the net of the £27.1m realised loss and the £10.45m budget credit for the Expected Credit Loss (ECL) against the fund from 2020/21.
7. On 5 May 2023, the Head of Access to Finance submitted a briefing on this matter to the Minister for Economy for him to note.
8. In June 2023, the DBW Board will consider a write-offs paper and then notify the AAO (Andrew Slade) of the write-offs in DBW 2022-23 accounts.
9. Subsequently, during July 2023, the Minister will then issue a Written statement to the Senedd on the closure of the WLSIF, including a disclosure of the losses / write-offs, ahead of the publication of the DBW or WG accounts.
10. DBW's responsibility is to pay the final fund returns to Welsh Government upon the end of the realisation term of the remaining investments at a date to be agreed by DBW and Welsh Government, which is no later than 31 March 2025.
11. DBW will undertake an end of realisation review at that point.

**Annex 1: Overview of Wales Life Sciences Investment Fund reviews (2013 – 2020)**

Review	Conclusion	Resolution
WG Internal Audit Department review 2013/14	11 recommendations concerning WG’s Sector Panel, conflicts of interest and governance arrangements with FW (DBW) called to review if responsibilities outlined in LPA match the original tender specification, its procurement practices and clarify fees and payments rationale.	WG’s Jan-2015 Lessons Learned and action taken report demonstrating resolution of recommendations
FW (DBW) Internal Audit Report 2014/15	Partial assurance was given to the adequacy of the control environment and to the risk areas of procurement processes’ in relation to the Fund with recommendations to improve the wider procurement processes of the group.	All recommendations were accepted and implemented.
Wales Audit Office 2013-16	The period from establishment to early operation included flaws and was poorly documented by both WG and FW, highlighting COI management being weak in the early stages of the Fund by both WG and FW. Report also highlighted the variation to remove the ‘Termination without cause’ clause which was based on advice attained in 2014.	FW(DBW) enacted new COI procedures before the report was published and WG, under recommendation 5, requested a contract review of contractual obligations.
DBW options paper for WG 2015	Options paper to the existing WLSIF portfolio and associated economic outputs for Wales.	Continue as planned and promote additional funds being secured by the Fund Manager.
Contracted external mid-investment term review 2016	The Fund made progress, raising the profile of Wales as an investment location but the fund being fully invested ahead of schedule in a smaller number of companies is a risk threatening momentum and future financing must be considered alongside strengthening compliance requirements. This was the only review which was contacted to be conducted in relation to the Fund and Partnership.	Reporting requirements strengthened and clarity on protocols of engagement between Fund Manager, FW & WG included in contract review (2017)
Contract obligations review by DBW 2017	FW’s (DBW) ability to actively manage the contract is limited by the nature of the Fund but all requirements were satisfactorily met. Although documentation custodianship remained an issue, variations requests required stricter compliance, with FW requesting WG to amend the Finance Award letter to achieve this.	Director of Sectors and Businesses confirmed this concluded WAO requirements and stricter engagement process implemented.

Fund review by DBW 2017	To outline inflection points such as Arix's £5m investment in Fund, the report clarified variations to the contract and performance of the Fund Manager.	Outlined a change to the fee structure to reduce in line with down-valuations.
Mid-point review 2018 (and further advice document)	An options paper in response to WG questions, the Fund Manager should remain in post but for them to exit several assets at the earliest sensible opportunity.	WG requested further information with DBW providing detail on portfolio health and exit routes.
Woodford review	FCA suspension of Woodford funds impacted the Fund Manager, due to its shareholding in Arix plc and portfolio companies however the Fund Manager is an FCA regulated entity and will monitor impact on portfolio due to Woodford co-investment.	Clarification of Partnership structure, portfolio impact along with COI process to PAC and First Minister.
Covid-19 half year review 2020	Fund Manager has charged fees to the Fund and realisations based on the contracted fee structure. The pandemic created operational and liquidity challenges for the portfolio.	Reported to Sectors and Businesses in response to their questions.

## Annex 2: Key events prior to 2019

### 1. 2012 to mid-2016

The first period saw enhanced Welsh Government interacting, external oversight and profile for the Fund due to key events which impacted its delivery and the operation of the Partnership during the period. The period this extended up to the full investment of the original £50 million and £3 million loan in mid-2016.

During this period the material variations to the LPA, such as the change in Key Performance Indicators were also made.

Four reports were published during this period. These reports were key events for the Fund. The reports also captured and detailed the key events that had occurred from inception to full investment of the original £50 million which impacted both the Fund's delivery and operation of the Partnership.

These reports are summarised below.

Report	Summary
Welsh Government's Internal Audit Department review 2013/14	Review of Welsh Government's Life Sciences Sector Panel and its involvement with establishing the Fund, particularly the conflicts of interest considerations and process to launch the fund with recommendations to review the responsibilities and actions of parties reflect the governing documents.
FW (DBW) Internal Audit Report 2014/15	Partial assurance given on the adequacy of controls and procurement in relation to the Fund with recommendations to improve the wider procurement processes of the group being implemented.
Wales Audit Office's Auditor General Report 2013-16	Establishment, procurement, governance and oversight arrangements in the early stages of the fund with further detail on the conflicts of interest considerations, procurement and payment processes.
Holding Fund options for Welsh Government 2015	Options paper for the Fund's existing portfolio and associated economic outputs for Wales.
Independent, external mid-investment term review by Regeneris (now Hatch) 2016	Evaluation of objectives, delivery and performance of the Fund and the functionality of the Partnership. As a mid-term evaluation it made recommendations to strengthen compliance, highlighting where governance was circumvented which increased the risk profile of the Fund and it's economic output requirements.

Summary conclusions and resolution to recommendations made by these reports are included in Annex 1: Overview of Wales Life Sciences Investment Fund reviews (2013 – 2020).

As a result of these reviews, the Holding Fund made two interventions to address early concerns with the Fund and the actions of the Fund Manager concerning conflicts of interest. These interventions were made despite Finance Wales attaining

legal advice in early 2013 which supported the robustness of the existing governance arrangements.

The Holding Fund implemented an enhanced conflicts of interest process within the investment approval process. This ensured that the drawdown documentation included reference to conflicts of interest declarations and how, if any, they were resolved. Intervention on the conflict of interest issues was documented in the Wales Audit Office Report.

The Holding Fund required that the Fund Manager increase the coverage of the Fund's operations within its monitoring reports. Enhanced reporting requirements ensured that the Holding Fund had increased visibility on each portfolio assets and the wider economic outputs. This intervention is captured in the Mid-term Evaluation by Regeneris.

The independent, external mid-investment term review by Regeneris details the investments made and a chronology of updates for these assets during this period and so will not be detailed here. The relevant information is detailed throughout section 5 of the review with table 5.3 detailing investment rationale and required governance variations for specific investments.

## 2. Mid 2016 – 2018

Following the reports highlighted above, their recommendations triggered changes which established the second phase of the Fund delivery and Partnership's functionality.

Key events during this period and their outcomes are outlined below.

- i. **Fund Manager acquired** – In June 2016, the Fund Manager was acquired by Aris Biosciences plc with the ambition to be the new cornerstone investor in the Fund.
- ii. **Loan settlement** - In August 2016 the General Partner wrote to the Holding Fund to request an extension to the £3 million loan issued. This 12-month extension was granted but with the notification that this had triggered the interest calculation. By September 2016 a further request for extension of the loan was declined. The Fund Manager consequently sold £3 million of shares in Verona Pharma to repay the loan. This sale left £29,000 of interest to be repaid upon Partnership termination.
- iii. **Contract review** – Reporting in March 2017, the Holding Fund undertook a full review of its contract management arrangements in response to further queries regarding recommendation 5 of the Auditor General report. This review covered the Limited Partnership Agreement, subsequent variation agreement, the Management Agreement and Loan Agreement. In reviewing the contract agreements, all applicable clauses were collated, detailing the systems and processes in place and then compliance was tested. Annex 1 details the conclusion and resolution of this review following the Holding Fund's statement in writing to both Welsh Government and Fund Manager to cease circumventing communication

- protocols of the legal agreements. This resulted in more stringent time and event-based reporting by the Fund Manager.
- iv. **Variations** - In May 2017, the Fund Manager submitted a request for variation to the LPA with changes which were conditional for Arix's investment in the Fund. These included a change to the investment period, key man clauses, reinvestment abilities and fee structure. Several variations such as those concerning reinvestment were denied by the Holding Fund. The Holding Fund also inserted variations to ensure that the new fee structure which included a rebate to the Holding Fund was not counted towards repayment of the £50 million Welsh Government commitment and was not revised upwards based on valuations. This is outlined in the 2018 Mid-point report.
  - v. **Private Investment** – By May 2017, Arix BioSciences PLC signed the Deed of Adherence to enter the LPA as a Private Investor to a quantum of £5 million following an equalisation payment £479,394.95 to the Holding Fund. Arix clearly communicated that this £5 million investment would be the full extent of their additional monies for the Fund. Variation to the fee structure removed the automatic halving of General Partner Share that could be charged and linked made it index based linked to the performance of the assets. These variations were notified to Welsh Government and provided again in further detail in the 2018 report.
  - vi. **Partnership restructure** – Between September and December 2017, in rectifying the unlimited liability erroneously created by the Private investor, [REDACTED] resigned from the Fund Manager and General Partner without notice to the Holding Fund and replaced. The Fund Manager become [REDACTED] under Arix Capital Management and the General Partner assigned its rights to ALS SPV Limited to rectify the unlimited liability created. As highlighted in the letter to the Director of Business and Regions in July, [REDACTED] was brought onto the Fund to scope and implement the exit strategy for the Fund while providing clear and consistent engagement with the Holding Fund for it to manage stakeholders. This restructure is detailed in the 2018 report.
  - vii. **Portfolio updates** - Throughout this period, several significant events occurred within the portfolio which are detailed in the Fund Manager reports for 2016/17 and 2017/18. The Holding Fund became more active in supporting the Fund Manager and gaining clear communication on the portfolio performance. These events were presented and shared via the Holding Fund to Welsh Government and included Verona Pharma posting positive trial outcomes and listing on the NASDAQ, raising over \$90 million; RutherFord Health established and started treatments in the first ever beam therapy centre for the UK, in Newport; Sphere Medical's delisted from AIM in late 2017 despite a £5 million fundraise to survive; ReNeuron's share price dropped with liquidity issues resulting in a 100 to 1 share consolidation and both the Fund Manager and Fund Holder agreed and advised that further Welsh Government intervention was very high risk; CeQur acquired Calibra Medical from J&J but then failed a

fundraising round in 2018; and a significant event was a portfolio company requesting urgent need for intervention, which due to risk, was declined by the Development Bank but eventually met with a loan from Arix outside the Fund.

- viii. **Mid-point review** – The second phase concluded with the Holding Fund delivering a review at the halfway point in the Partnership’s term in 2018. This was requested by Welsh Government as a means to further action a 2017 report on the Holding Fund gaining more clarity on the realisation plans for the Fund but following the significant updates to the Partnership and the portfolio. The conclusion and resolution of this mid-point review are summarised in Annex 1.