

**Grwp yr Economi, y Trysorlys a'r Cyfansoddiad**  
**Economy, Treasury and Constitution Group**

**Cyfarwyddwr Cyffredinol - Director General**



**Llywodraeth Cymru**  
**Welsh Government**

Mark Isherwood MS  
Chair  
Public Accounts and Public Administration  
Committee  
Welsh Parliament  
Cardiff Bay  
Cardiff CF99 1SN

18 September 2023

Dear Chair

In advance of the Committee's session on 27 September relating to the Wales Life Sciences Investment Fund (WLSIF), I attach an evidence paper that provides detailed information in areas of specific interest to PAPAC, as well as some supplementary information to help explain technical aspects of WLSIF. This evidence paper has been produced jointly with the Development Bank of Wales and agreed by Giles Thorley, who will be in attendance alongside me on the day.

I also attach a copy of the report produced by Regeneris in 2016, which has been requested by the Committee.

With best wishes.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Andrew Slade'.

Andrew Slade  
**Director General**  
Economy, Treasury and Constitution

cc Giles Thorley, Development Bank of Wales

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## **Public Accounts and Public Administration Committee**

### **Evidence Paper: Wales Life Sciences Investment Fund**

This paper addresses specific areas of interest raised by the Committee, following the Minister for the Economy's statement to the Senedd on 11 July 2023.

#### ***Background and Context***

The Welsh Government named Life Sciences as one of its priority economic sectors in 2010. Life Sciences was, and still is, seen as important driver of economic growth and improved well-being serving large global markets. Welsh Government's then approach focused on four key elements: establish a Life Sciences Ecosystem; place a tangible Life Sciences Hub at its core; underpin the approach with a commercially managed Life Science Fund; and (taking together these three elements) form the nucleus of a credible Life Sciences Brand.

Attached to this evidence paper is an annex detailing the legal structure and Financial Transactions Capital financing of the Wales Life Sciences Investment Fund (the "Fund") and its place within wider Development Bank of Wales (DBW) activity.

The Life Sciences Investment Fund was created following the formal procurement of an appropriately experienced fund manager in 2013. Utilising Financial Transactions Capital<sup>1</sup>, the £55m Fund made 11 investments in nine companies, supporting over 300 jobs and generating over £270m deal level co-investment. Co-investment at these levels reflects the broader market confidence in the investments at that time. The Fund has returned £20m to Welsh Government to date, from an investment which safeguarded over 100 high quality jobs in a clinical research business and which brought its ownership back to Wales.

The assets from the Fund were transferred to DBW upon liquidation. DBW holds a portfolio of funds valued at over £1.9bn. The ability of the Welsh Government to service Financial Transactions Capital repayment obligations to HM Treasury is a strategic priority. Across their portfolio (that includes the Fund), DBW is forecast to achieve its required Financial Transactions Capital repayment target while actively delivering in line with its remit.

The WLSIF was relatively small, geographically locked and had a short life span for the targeted sector. This had a bearing on the level of risk associated with the Fund. External events also had a significant impact. Global market visibility of, and demand for, research and products generated by the portfolio did not always react as envisaged to the progress made by the businesses. This was compounded by macro-economic events such as the Covid-19 pandemic which destabilised the sector and impacted key investments.

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<sup>1</sup> Financial Transactions Capital (FTC) is repayable funding allocated to Welsh Government by the United Kingdom (UK) Government. Welsh Government has discretion over FTC allocation to projects. However, FTC can be deployed only as a loan to or equity investment in a capital project delivered by a private sector entity.

There are no other externally managed discretionary funds of this nature currently operating. Contemporary investments into the life science sector are now managed within DBW's Wales Flexible Investment Fund, a £500m fund which brings together both lower risk debt with higher risk equity investment activities, helping mitigate risks arising from individual investments within a wider portfolio context.

## **1. Details about:**

- **arrangements for overseeing and influencing the management and performance of the Fund over the period since the Auditor General's 2016 report (both the Finance Wales/DBW arrangements and how performance has been reported back to the Welsh Government);**
- **whether changes in the company arrangements for fund management following previous acquisitions had any bearing on those arrangements.**

### Oversight and influencing the management and performance of the Fund over the period since the Auditor General's 2016 report

Following the then Auditor General's report, actions were taken by Welsh Government to review adherence to governance arrangements, clarify responsibilities relating to the management and performance of the Fund, and steps taken to improve their effectiveness. These actions are set out in the final section of this evidence paper.

Below is a summary of oversight and management of the Fund.

Arix Capital Management Ltd (ACM) was the discretionary fund manager appointed. In this context, the term "discretionary" refers to the fact that investment and realisation decisions are made at the Fund Manager's, in this case ACM's, discretion in accordance with the Fund's Investment Operating Guidelines (IOGs). IOGs limit a fund manager's discretion as they must revert to the fund holder for a decision if a proposed investment is outside these parameters. The Fund Manager is regulated by the Financial Conduct Authority (FCA).

DBW acts as Holding Fund for the Wales Life Sciences Investment Fund. The Holding Fund's responsibility outlined in the LPA is to hold Welsh Government monies only to be released against certified drawdown requests with suitable notice period, consolidate the financial reporting requirements and notify Welsh Government of key events or Fund Manager requests outside of the LPA.

### How performance was reported back to the Welsh Government

The reporting requirements are set out in the Welsh Government Finance Award Letters which detail the Holding Fund's obligations.

Quarterly reports were produced by the Fund Manager during the investment period and on an annual basis since the fund entered realisation. Annual reports were produced in tandem with the Partnership's financial statements and presented to the Holding Fund. These were shared with Welsh Government officials and Fund valuations consolidated into the Welsh Government Annual Report and Accounts.

As stated elsewhere, the independent mid term investment review report in 2016 concluded that “the reporting process to Finance Wales has been strengthened substantially and is now considered adequate.”

### Impact of changes in the company arrangements for fund management following previous acquisitions

Changes in company arrangements had no material bearing on the governance arrangements of Fund and Partnership.

The most significant changes relating to the Fund were: Arix Biosciences plc acquired the Fund Manager, Arthurian Life Sciences, in June 2016. Between June 2016 and September 2017, several changes were made to the Limited Partnership Agreement to enable an additional £5m investment into the fund by Arix BioSciences plc, implement some procedural updates and reflect new company structures.

#### **2. Details about:**

- **the financial performance and outcomes from the Fund overall (for example, concerning jobs), and in respect of each of the individual investments;**
- **details of the level of private sector co-investment per investment;**
- **a timeline of significant events since early 2016.**

### Financial Outcomes

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.

Below is a history of valuations and forecast of returns for the Fund’s investments. These valuations are from audited accounts submitted by the General Partner and do not reflect any further adjustments made by DBW’s accounting team in preparation of its consolidated accounts which were submitted to Welsh Government.

<b>Headline financials</b>	<b>£ million</b>
Total investment	50
Returns to date for Welsh Government	20
Current valuation of remaining assets	1.8

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

- ReNeuron is a publicly listed asset subject to daily fluctuations in its value which has been impacted by negative results from clinical trials.
- Rutherford Health announced its intention to liquidate in 2022 without prior notice to the Fund Manager and was therefore written down to zero. The business was negatively impacted by the Covid-19 pandemic and its effect on the UK's health system, when cashflow was already a major issue. More than £240m was spent creating four therapy centres between 2015 and 2019.
- Simbec-Orion 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. Further information on significant events concerning the Fund is given below.

### Economic Development outcomes for the Fund

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 at 540% of the capital invested by the fund. This indicates that the private sector recognised the potential of these investments at the time the Government fund was investing.

Most of the Fund's Economic Development targets were achieved by 2016 and are outlined in the mid term investment review report by Regeneris.

<b>Headline Key Performance Indicators</b>	<b>Target</b>	<b>Actual</b>	<b>Performance</b>
Number of companies receiving investment	12	9	75%
Value of private sector co-investment at Fund level	£60m	£5m	8%
Private sector co-investment at deal level	N/A	£273m	540%
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.

### 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. However, a number of these companies did not fully deliver their plans.

### Significant events

Below is a timeline of significant events for the Fund and its assets post publication of the AGW report to the end of 2019.

2016	No significant events impacting valuation of the Fund.
2017	Aug: Arix invest £5m bringing total value of the Fund to £55m.
2018	Nov: Rutherford Health's Newport centre takes first customers.
2019	<ul style="list-style-type: none"> <li>- Feb: Simbec exit and £20m realisation.</li> <li>- April: Apitope announced its intention to liquidate after failing to raise funds.</li> <li>- July: Suspension of Woodford Fund a major UK investor in Life Sciences and co-investor for the Fund.</li> <li>- Sept: Sphere Medical filed for administration as it struggled to raise funds was exacerbated by the closure of Woodford Investment Management.</li> </ul>

As 2019 was the last full year of operation prior to the Covid-19 pandemic, the years following 2020 are separated and included below.

2020	- March: COVID-19 Pandemic causing disruptions in the sector and the portfolio.
2021	<ul style="list-style-type: none"> <li>-April: CeQur raised \$115m equity financing with the Fund did not participate and its holding was therefore severely diluted.</li> <li>-May: Rutherford Health signs £40m infrastructure investment and signed several NHS diagnostic contracts.</li> </ul>
2022	<ul style="list-style-type: none"> <li>- Jan: ReNeuron discontinues trials after inconclusive data causing a share price drop.</li> <li>- Jun: Rutherford Health announces its intention to liquidate.</li> </ul>
2023	- Feb: Limited Partners close the Fund and distribute the Welsh Government's holdings in the remaining assets to DBW.

### **3. Details of the current value of the investments and the Welsh Government/DBW role in holding those investments.**

The value of investments being transferred to DBW in 2023 is approximately £1.8m.

The Partnership was terminated in February and the remaining investments transferred are to be managed by DBW. Privately held investments are managed in DBW's Special Situations team and listed investments by DBW's Portfolio Development team.

The investments are subject to DBW's portfolio management procedures. Exiting investments by no later than 31 March 2025 is a requirement of the existing Finance Award letter. If this deadline is no longer relevant after the review of assets, the Welsh Government Sponsor Team will be consulted. This is all within business-as-usual reporting requirements.

### **4. Details of any further direct costs to the Welsh Government/DBW associated with oversight of, or the Fund manager's management of the Fund, since early 2016.**

The fees related to the contract are detailed below.

<b>Transaction</b>	<b>Total Amount</b>	<b>Annual fee as percent of Fund</b>
<b>General Partner (Fund Manager) fee</b>	Circa £7.7m	1.7%

A market standard fee for Venture Capital funds is known as '2 and 20'. The 2 represents a 2% management fee which is applied annually to the total assets under management. The 20 represents a 20% fee which is charged on the profits the fund generates, beyond a specified minimum value. The 2% fee is charged regardless of the performance of the investments under the fund manager. However, the 20% fee is only charged when the fund achieves a certain profit level. The Fund's average fee of 1.7% is in line with the market; however, the mid term investment review (2016) did state the original fee structure was on the higher end for the set-up and realisation phases. Ultimately, due to lower than anticipated realisations, the actual realisation fees are lower than was anticipated in the mid term investment review report in 2016.



## **5. A summary of action taken in response to the Auditor General's recommendations in the 2016 report in respect of the Fund itself (recommendations 5, 6, 7 and 8).**

Following the publication of the Auditor General's report in 2016, the Holding Fund worked with the Welsh Government Life Sciences team to satisfy the recommendations. In August 2016, the Holding Fund wrote to Welsh Government's Head of Life Sciences with responses drafted in collaboration with its sector team to address the Auditor General's recommendations. The detail of that correspondence is included below:

Under recommendation six and seven regarding conflicts of interest within the Simbec-Orion investment and the seven investments not reviewed (with confirmation of action taken if there were any conflicts and whether they were reported to the Holding Fund):

- the Holding Fund confirmed that it had implemented an improved 'investment request form' and a new process to identify and manage conflicts of interest prior to the report's publication.
- The independent mid term investment review report in 2016 found "that Investment Committee members have been consistent in identifying potential conflicts of interest and ensuring that conflicted members of the committee do not vote on particular investments."

Under recommendations seven and eight concerning arrangement fees:

- The Auditor General Wales acknowledged arrangement fees were a standard practice as part of a commercial negotiation between the Fund Manager and the investee companies.
- The independent mid term investment review report in 2016 also highlighted that arrangement fees are standard practice in private sector funds.
- As the Fund Manager did not charge arrangement fees on the additional investments, the average arrangement fee was 4%. The highest single fee was charged on the first ReNeuron investment at £500,000 (10%). The arrangement fee for ReNeuron was an outlier as it made up a significant proportion of the £2.1m in total charged to the investee businesses as arrangement fees by the Fund Manager.

Under recommendation 5 concerning Welsh Government setting out clearly its expectations with regards to Finance Wales's role in managing its contract with the Fund Manager. Finance Wales wrote to the Welsh Government highlighting the progress made to improve clarity around communication between the parties to the Fund with the independent mid term investment review report in 2016 concluding that "the reporting process to Finance Wales has been strengthened substantially and is now considered adequate by Regeneris."

The Welsh Government Director of Sectors and Business requested further action to satisfy recommendation 5. The Holding Fund conducted a contract review to evidence that all obligations under the Limited Partnership Agreement including the systems and procedures in place used to meet them. In May 2017, Welsh Government accepted the review findings, which were in place by June 2017. The then Welsh Government Director of Sectors and Business wrote to confirm that the actions concluded recommendation five. The specific actions were:

- i. The Holding Fund introduce a more stringent communication and documentation processes between parties named in the LPA to ensure the obligations on Fund Holder can be monitored more effectively. This was implemented firstly by utilising dedicated digital document storage with controlled access to ensure relevant persons from across the Fund Holder could access all relevant information; and secondly by writing to reaffirm the reporting requirements to the Fund Manager in June 2017.
- ii. There should be a formal variation to the notification process concerning proposals which will materially change the purpose for which the funding is used. This was actioned in June 2017. The Holding Fund wrote to the Fund Manager in June 2017 to state that variation proposals are issued to them exclusively and sent to Welsh Government at their discretion.
- iii. Ensure future marketing of the Fund is in compliance with Welsh Language Standards. The Holding Fund wrote to the Fund Manager in June 2017 stating that they must liaise with the Holding Fund to ensure compliance with the Welsh Language Standards. This was accepted by the Fund Manager in June 2017.

**6. A summary of findings from any further internal audit work completed since early 2016 on the Fund (covering the Welsh Government or Finance Wales/DBW).**

A summary of DBW's internal audit findings and actions concerning the Fund are found in Appendix 4 to the 2016 AGW report. Following this, the Holding Fund undertook further reviews which are summarised below.

<b>Review</b>	<b>Conclusion</b>	<b>Resolution</b>
Contract obligations review 2017	Finance Wales (later DBW) ability to actively manage the contract is limited by the nature of the Fund and all requirements were satisfactorily met.	Director of Sectors and Businesses confirmed this report concluded recommendation 5 and stricter engagement process implemented.
Fund report by DBW 2017	Outlined inflection points such as Arix's £5m investment in Fund, and 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.
End of investment phase, mid-point review 2018	An options paper in response to Welsh Government questions concerning the future of the Fund. It recommended that the Fund Manager should remain in post but for them to exit some assets at the earliest sensible but commercial opportunity.	Welsh Government requested further information with DBW providing detail on portfolio health and exit routes.
Woodford Suspension impact review	FCA suspension of Woodford funds impacted the Fund Manager, due to its shareholding in Arix plc and co-investment in its portfolio companies however the Fund Manager is an FCA regulated entity and monitored the impact on portfolio.	Clarification of Partnership structure, portfolio impact along with conflict of interest 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.

In addition to the evidence provided relating to those areas of interest to the Committee, Welsh Government and DBW have included this supplementary information to explain the technical aspects of the Wales Life Sciences Investment Fund's ("WLSIF"). This is to explain WLSIF's legal structure, financing, place within the wider DBW activity and ensure a more effective use of the committee's time.

### **1. Wales Life Sciences Investment Fund structure**

Following transition from Finance Wales to DBW, a subsidiary of Development Bank of Wales, DBW Investments (9) Limited, acted as the holding fund for the Welsh Government's investment into WLSIF (the "Holding Fund"). The Holding Fund provided a key point of governance and communication between the Fund Manager and the Welsh Government.

The Holding Fund's responsibility was to hold Welsh Government's investment, only releasing funds following certified drawdown requests. It also consolidated the financial reporting requirements and notified Welsh Government of key events or Fund Manager requests outside its authority.

Following a formal OJEU Tender exercise, an industry standard Limited Partnership structure was adopted for WLSIF. This comprises one or more limited partners (generally the investors), a general partner (generally representing the fund manager), and often includes a carried interest partner (generally responsible for holding profits which exceed a set rate of return – "carry").

This structure enables Fund Managers to aggregate funding from any number of investors. It also proportionally limits the liability of investors to the amounts they have committed.

In the case of this fund, Arthurian Life Sciences SPV GP Ltd was appointed as the General Partner, representing Arthurian Life Sciences Ltd as Fund Manager. This appointment was for a discretionary Fund Management Contract (the "FMC"). Arthurian Life Sciences Carried Interest Partner LP acted as the carried interest partner. These parties signed the Limited Partnership Agreement (the "LPA") together with the Holding Fund.

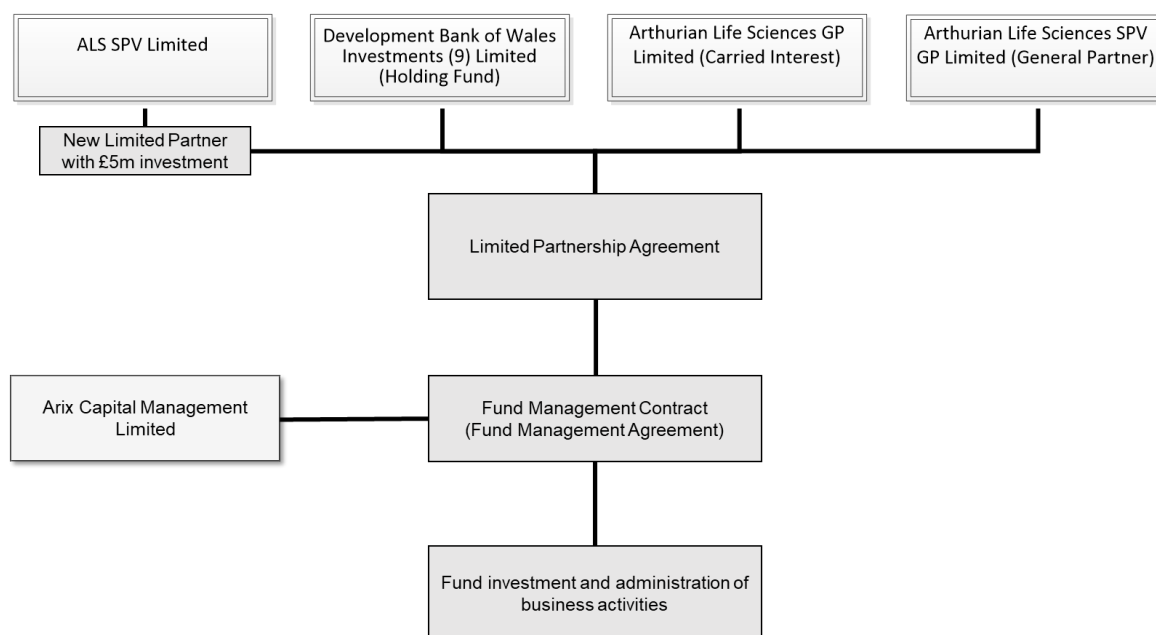
The LPA sets out various aspects for the operation of the WLSIF, including the Investment Operating Guidelines (the "IOGs"). These IOGs limited the Fund Manager's discretion to the objectives of the WLSIF via the FMC.

As a discretionary fund, 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, DBW had no role in the investment or exit decisions made by the Fund Manager.

In June 2016, the Fund Manager and General Partner were acquired by Arix Biosciences plc (“Arix”). This included a simple name change of the Fund Manager from Arthurian Life Sciences Ltd to Arix Capital Management Ltd.

As part of this transaction Arix agreed to invest £5m in WLSIF. This was done by way of a legal agreement called a Deed of Adherence. As a result of this agreement, a subsidiary of Arix (ALS SPV Limited) became a limited partner in the LPA. The final structure for WLSIF is detailed 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.

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 DBW 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.

## 2. Wales Life Sciences Investment Fund financing model

Of the £50m Fund commitment made by Welsh Government, £42.4m was converted to Financial Transaction Capital (“FTC”) in 2014, with £7.6m of non-repayable public equity.

The use of FTC to deliver financial instruments in pursuit of economic development objectives is now a well-developed practice across the UK and beyond. It was, and remains, a legitimate approach to supporting economic development at scale. Scalable investment in economic development using capital which if not invested in the private sector, would be lost to Wales and returned to HM Treasury.

## 3. Specific investment detail

Included in the table below is the summary of specific investments made through the Fund.

<b>Company</b>	<b>Total Investment</b>	<b>End point update</b>	<b>Activity in Wales</b>
<b>Apitope</b>	£4,537,847	Business closed in 2019.	Chepstow headquarters until purchase and closure.
<b>CeQur SA</b>	£3,380,000	Transferred to DBW.	Senior roles in Life Science Hub.
<b>InterRad</b>	£3,642,407	Transferred to DBW.	Sales office in the Life Sciences Hub.
<b>Intelligent Ultrasound</b>	£600,000	Transferred to DBW.	Existed in Wales pre-investment.
<b>ReNeuron</b>	£10,000,000	Transferred to DBW.	Headquarters and operations relocated.
<b>Rutherford Health</b>	£10,000,000	Business closed in 2022.	Located headquarters and operations in Wales.
<b>Simbec-Orion</b>	£8,750,000	2019 exit and £20m returned.	Existed in Wales but brought ownership back to Wales.
<b>Sphere Medical</b>	£5,000,000	Business closed in 2019.	Manufacturing operations moved to St. Asaph.
<b>Verona Pharma</b>	£4,260,000	2022 exit and returns to be distributed.	UK registered office in Wales.

#### 4. DBW overview

With a mission to unlock potential in the Welsh economy by increasing the supply and accessibility of sustainable, effective finance, DBW manages over £1.9bn of funds. These funds invest in businesses with a benefit for Wales by identifying market gaps, catalysing a dynamic and competitive Welsh economy, creating financial solutions in support of wide-ranging government policy in a way that demonstrates ongoing value for money in the use of public funds:

- i. Loans: Flexible business loans that can support the full business lifecycle from start-ups and growing businesses, to succession transactions including employee buy-outs, with investments ranging from £1k to £10m over terms of up to 15 years.
- ii. Equity: Equity funding from £50k to £10m for early stage tech startups, ambitious businesses looking to grow and the support for management buy-outs.
- iii. Property: Property development loans supporting residential, mixed use and commercial developments with funding from £150k to £6m.
- iv. Services: This includes the Angel Invest Wales which connects business seeking private investment with a network of Angel investors, personal lending for solutions for homes which includes Help to Buy – Wales, and administration of the Mutual Investment Model.

DBW undertakes these activities through a delivery model supported by ongoing commitments from the Welsh Government. These commitments are gained through the submission of full business cases demonstrating the value for money of these interventions, delivery models and prudent forecast of outcomes.

Delivery of business finance through loans and equity is directed by six core investment principles:

- i. Economic opportunity: Responding to market failure in Wales.
- ii. Commercial terms: Pricing and managing the investment fairly to reflect the risk.
- iii. Environmental, social and governance: Invest for positive financial and non-financial impact in Wales' regional communities.
- iv. Expert, independent investment management services: Adding value to businesses for the life of the relationship.
- v. Patient investing: Providing accessible funding to support the long-term sustainability of the businesses.
- vi. Crowd-in private sector co-investment: increase the flow of funds in Wales.

The Wales Life Sciences Investment Fund is not part of the funds or services that DBW manages or delivers. The Wales Life Sciences Investment Fund was not subject to DBW's investment principles and was not established on the basis on the delivery model of DBW's other funds and services.

At the time of inception, DBW had limited funding and expertise available which was comparable to the objectives and requirements of the Wales Life Sciences Investment Fund.

Since its launch in 2017, DBW has grown its equity delivery for Wales and can now deliver comparable equity funding for businesses which provide a benefit to Wales and align with the six investment principles. This ranges from the £20m Wales Technology Seed Fund II to the £500m Wales Flexible Investment Fund.