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THE CORONAVIRUS BUSINESS INTERRUPTION LOAN SCHEME (CBILS) – REVISING THE SCHEME

Summary

1. The Chancellor proposes to announce a series of changes to the CBILS scheme on Friday this week. The changes include: a) **revisions to the rules on personal guarantees** (as set out in our previous submission of 30 March, attached as Annex A), and b) the **extension of eligibility for CBILS to cover any SME adversely affected** by Covid-19, even if they could obtain finance on normal commercial terms.
2. We are providing revised advice to the Permanent Secretary in his role as Accounting Officer to reflect the greater uncertainty and worse value for money of the revised scheme. Subject to his views, **a further direction from you will be required** given the significant legal, financial, operational and value for money risks associated with the broadening of eligibility to any SME adversely affected by Covid-19. These include the likelihood that Government will incur significantly increased liabilities in relation to loan defaults.
3. The Chancellor is strongly in favour of these changes. They are designed to remove what he sees as perverse effects of the current CBILS scheme (lower risk businesses facing less favourable terms when accessing finance) and to preempt a spread in financial distress to more businesses as the impact of the pandemic increases.
4. The changes will significantly increase the Government's liabilities under the guarantee, because the scheme will be open to a much wider range of businesses and on more attractive terms than commercial finance offers. In effect, CBILS will become the default for new SME lending (including the refinancing of existing facilities). We expect that that nearly all new SME lending will now fall within the scheme and much of the stock of lending could be brought within it. Other implications include heightened legal, operational and financial risks, lower additionality and reduced value for money to the taxpayer.
5. **In addition to the changes above the Chancellor would also like to announce the intention to launch a new version of the scheme for those businesses with a turnover over £45m, the 'stranded middle'.** You will receive separate advice on this in parallel.

Timing

6. **The Chancellor currently plans to announce these changes on Friday, and they would be briefed to media Thursday afternoon.** This means that we need to work quickly in order to give the banks as much notice as possible and so that we can prepare an effective communications plan. Before the changes can come into effect, the following steps will need to take place:
- Your private office writes to Chancellor's private office seeking formal consent to the changes (draft at Annex A)
 - Treasury PO response received
 - Sufficient assurance is received from the European Commission to allow the changes to proceed (this is in hand)
 - The Permanent Secretary writes to you to seek a new direction in relation to the changes
 - You issue the direction to the Permanent Secretary
 - The Permanent Secretary instructs the British Business Bank to proceed, including authority to increase allocations to lenders
 - The British Business Bank writes to CBILS accredited lenders to inform them of the changes

Recommendations

7. Whilst recognising the very valid reasons for widening eligibility, and the extraordinary economic circumstances, the pace at which this has been developed leaves us with significant concerns about affordability, value for money and deliverability. We have strived, as far as possible, to improve the design of the proposal to mitigate these risks but significant concerns remain.
8. We recommend that you note:
- the Chancellor's decision to implement the changes as described;
 - that the expansion of the scheme will address the situation that lower-risk borrowers are currently offered less favourable terms when accessing finance;
 - that the expansion will increase the likelihood that significant liabilities for the government are realised, since the changes mean that nearly all new SME lending (including refinancing) will now be covered by the guarantee – the condition of having been affected by COVID-19 is easy to meet and there is a strong incentive;
 - the likelihood that the expansion will mean greater uncertainty (no UK lender has offered terms such as this previously) and worse value for money to the taxpayer given the greater scale and lack of additionality of the scheme;

Financial considerations

27. We have assumed that the lending under the proposed version of CBILS could reach up to £100bn in the first year, meaning that up to 2m SMEs could apply for it. This is based on the 2019 estimates of flow of bank lending (£57bn), asset backed finance (£20bn) and bank overdraft (£5bn) and assuming that the flow of lending in 2020 would increase due to economic shock resulting from the Coronavirus and some of the current stock of lending (£168bn) would also be refinanced via CBILS.
28. Overall, the BCR of the CBILS with the new parameters is assumed to be between 0.4 and 3.9, with the former assuming £100bn take-up with maximum government liability of 60% and the latter assuming £30bn take-up with 20% default rates. These are largely rudimentary estimates.
29. However, **large uncertainties remain around take-up, the default rates of the scheme and the economic benefits** especially around finance additionality (i.e. a large proportion of these loans could have happened anyway without this scheme). In the time available, we have not been able to provide reliable estimates of value for money and as such the figures above are only indicative.
30. So far, allocations totalling £2.5bn have been issued under the CBILS. Limiting lender allocations is an effective way to control the size of the guaranteed portfolio. We recommend putting in place a process that gives the opportunity for ministers to pause and take decisions before authorising the next tranche of funding. We will specify the controls and information to be provided when additional capacity is requested by BBB to pass on to lenders. The BBB's Investment Committee will also take a view from the bank's perspective and could be asked to provide an independent assessment.
31. **We would need to secure agreement from HMT that BEIS budgets will be held harmless, across all budget categories, from the consequences of the proposed changes.**

Refinancing risk

32. There is a **strong incentive for banks and businesses to refinance borrowing onto the CBILS**. For the business, it is an opportunity to convert existing interest-paying debt to interest-free for a year. For the lender, it enables lending that may be of doubtful quality to benefit from an 80% guarantee at a modest premium that will in any case be passed on to the borrower. Refinancing has the scope to increase the taxpayer's exposure even beyond the current annual new lending of c£60bn (£57bn in 2019).
33. In effect, the new scheme would invite banks to recycle the weakest portion of their current SME portfolio - existing loans with now struggling SMEs - through CBILS, and thereby redistribute 80% of future losses to taxpayers, until they hit their portfolio cap (which does limit the government's aggregate exposure to 60%). Borrowers would be only too happy to go along with this and save

ANNEX B – ALTERNATIVE PROPOSAL

1. The Chancellor's primary objective appears to be addressing the unfairness that some businesses will bear the cost of interest on new borrowing and others will not.
2. This objective could be met by specifying that all businesses that meet the sectoral and turnover criteria for CBILS will qualify for a Business Interruption Payment (BIP) on new borrowing made necessary by the impact of Covid-19, whether or not they benefit from a government guarantee.
3. The BIP is a grant paid for the benefit of businesses to cover lenders' fees and interest on their borrowing, up to the maximum specified in State aid regulations, which is enough to cover those costs for 12 months on all but the largest loans.
4. If those businesses were able to access finance on commercial terms, the BIP would be paid on the commercial facility. If the lending proposal did not meet the criteria for commercial lending, it would be considered for the CBILS as now. In either case, the businesses would benefit from the same level of BIP.
5. While addressing perceptions of fairness, this alternative also:
 - preserves additionality, since a government guarantee is only given to businesses that need it to secure finance;
 - reduces the scale of the contingent liability assumed by the Department;
 - reduces the risk of distorting the finance market as a result of squeezing out lenders not accredited to deliver CBILS; and
 - reduces the operational load on the BBB since it is the guarantees that are processed through the BBB portal (the BIP is calculated independently).
6. This proposal may not address the divergence in approaches to personal guarantees between CBILS and commercial lending, although the largest lenders have already relaxed their position on personal guarantees for smaller loans. It could be possible to negotiate a voluntary moratorium on personal guarantees.