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UK COVID-19 INQUIRY

MODULE 9 (ECONOMIC RESPONSE)

**CORPORATE WITNESS STATEMENT
OF THE DEPARTMENT FOR BUSINESS AND TRADE
(ON BEHALF OF THE FORMER DEPARTMENT FOR BUSINESS, ENERGY AND
INDUSTRIAL STRATEGY)**

STATEMENT OF GARETH DAVIES: PART B

PART B LOANS AND COUNTER FRAUD

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SECTION 1: INTRODUCTION

- 1.1. As set out at Section 3 of Part A, the Department worked closely with HMT and BBB to establish a number of government-backed loan schemes. The first three were announced in March and April 2020 and were the Coronavirus Business Interruption Loan Scheme (**CBILS**), the Coronavirus Large Business Interruption Loan Scheme (**CLBILS**) and the Bounce Back Loan Scheme (**BBLs**). Those schemes were all closed on 31 March 2021. Subsequently, on 6 April 2021, the Recovery Loan Scheme (**RLS**) was launched.
- 1.2. The Future Fund was launched on 20 May 2020. As explained in Section 2 of Part A, it was not a loan scheme as such. More information on the Future Fund is in Section 5 below.
- 1.3. Although the loan schemes had different features and eligibility criteria, their overarching objective was to support businesses, and consequently the UK economy, successfully to navigate the economic challenges presented by the Covid-19 pandemic.
- 1.4. A key part of the Government's objective was to offer businesses swift access to finance, without burdensome and time-consuming application processes, in circumstances in which businesses might otherwise have had difficulties obtaining finance. As I have already highlighted, CBILS, CLBILS and BBLs were developed and launched against a demanding timetable.
- 1.5. The table below sets out an overview of the key features of each of the loan schemes and the Future Fund.

Loan	Relevant dates	Eligibility criteria	Key features of the scheme
Coronavirus Business Interruption Loan Scheme (CBILS)	<p>Announced on 11 March 2020.</p> <p>Opened to applications on 23 March 2020.</p> <p>Closed to applications on</p>	<p>Businesses were required to meet the following cumulative criteria:</p> <ul style="list-style-type: none"> • Based in the UK; • Annual turnover of up to £45 million; • Evidence that the business would be viable in the absence of the pandemic; and • Had been adversely impacted by Covid-19. 	<p><u>Amount of loan:</u> A lender would provide finance up to £5 million.</p> <p><u>Term length:</u> For overdrafts and invoice finance facilities, finance was available for up to three years.</p> <p>For loans and asset finance facilities, finance was available for up to six years.</p> <p><u>Interest:</u> Charged at commercial rates.</p>

	31 March 2021.	Initially, businesses also had to demonstrate that they had been turned down for commercial finance. However, this requirement was removed in April 2020.	<p>A business interruption payment was available to cover the first 12 months of interest payments and any lender-levied charges associated with the CBILS loan.</p> <p><u>Government Guarantee:</u> The Government guaranteed 80% of the loan. Initially, a 75% portfolio cap was applied to the lender's whole CBILS portfolio. However, the portfolio cap was removed in April 2020.</p> <p><u>The level of fraudulent or erroneous claims flagged by lenders as at 23 July 2021:</u> Lenders reported 39 CBILS facilities with an aggregate drawn value of £19 million as fraud based. {GD(B)/001 – INQ000596711}</p> <p><u>The level of fraudulent or erroneous claims flagged by lenders as at 31 March 2022:</u> Lenders identified c.100 CBILS loans as suspected fraud. {GD(B)/002 – INQ000593149}</p> <p><u>The level of fraudulent or erroneous claims flagged by lenders as at 31 December 2022:</u> Lenders identified 151 CBILS loans with an aggregate drawn value of £34.18 million as suspected fraud. {GD(B)/003 – INQ000585864}</p>
Coronavirus Large Business Interruption Loan Scheme (CLBILS)	<p>Announced on 3 April 2020.</p> <p>Opened to applications on 20 April 2020.</p> <p>Closed to applications on 31 March 2021.</p>	<p>Businesses were required to meet the following cumulative criteria:</p> <ul style="list-style-type: none"> • Based in the UK; • Annual turnover of over £45 million; • Had not received support under the HMT/Bank of England's Covid-19 Corporate Financing Facility (CCFF)¹; • Evidence that the business would be viable in the absence of the pandemic; 	<p><u>Amount of loan:</u> A lender would provide up to 25% of a business' annual turnover. The maximum amount a business could borrow was £200 million.</p> <p><u>Term length:</u> Finance was available to businesses with terms of between three months to three years.</p> <p><u>Interest:</u> Charged at commercial rates.</p> <p><u>Government Guarantee:</u></p>

¹ The Covid Corporate Financing Facility (CCFF) was an HMT and Bank of England lending facility made available to companies to support liquidity among larger firms, helping them to bridge disruption to their cash flow through the purchase of short-term debt.

		<ul style="list-style-type: none"> • Had been affected by Covid-19; and • Evidence that the loan would enable the business to trade out of any short-term to medium-term difficulty resulting from Covid-19. 	<p>The government guaranteed 80% of the loan.</p> <p><u>The level of fraudulent or erroneous claims flagged by lenders as at 23 July 2021:</u> Lenders reported they had not identified any suspected cases of fraud in their CLBILS portfolios {GD(B)/001 – INQ000596711}</p> <p><u>The level of fraudulent or erroneous claims flagged by lenders as at 31 March 2022:</u> N/A {GD(B)/002 – INQ000593149}</p> <p><u>The level of fraudulent or erroneous claims flagged by lenders as at 31 December 2022:</u> Lenders reported they had not identified any suspected fraud for CLBILS loans. {GD(B)/003 – INQ000585864}</p>
Bounce Back Loan Scheme (BBLs)	<p>Announced on 27 April 2020.</p> <p>Opened to applications on 4 May 2020.</p> <p>Closed to applications on 31 March 2021.</p>	<p>Businesses were required to meet the following cumulative criteria:</p> <ul style="list-style-type: none"> • Based in the UK; • Established before 1 March 2020; and • Had been adversely impacted by the Covid-19 pandemic. 	<p><u>Amount of loan:</u> The maximum loan available was £50,000. The amount a business could borrow was between £2,000 and 25% of their turnover.</p> <p><u>Term length:</u> The length of the loan was six years. Early repayment was permitted without any fees.</p> <p><u>Interest:</u> There were no fees or interest to be paid on the loan for the first 12 months. After 12 months, the interest rate was set at 2.5% per year.</p> <p><u>Government Guarantee:</u> HMT guaranteed 100% of the loan should the lender default.</p> <p>No portfolio cap.</p> <p><u>Anticipated level of fraud and error at the time the scheme was designed:</u> 30% to 50%, or £3 billion to £5 billion {GD(B)/004 – INQ000585607}.</p> <p><u>The level of fraudulent or erroneous claims which materialised as at July 2022²:</u></p>

² Data is as at 31 July 2022 from the information continuously submitted to the Scheme portal by accredited scheme lenders.

			<p>£1.1 billion {GD(B)/005 – INQ000585860}.</p> <p><u>The level of fraudulent or erroneous claims flagged by lenders to date:</u> £1.88 billion {GD(B)/006 – INQ000593148}.</p>
The Future Fund	<p>Announced on 20 April 2020.</p> <p>Opened to applications on 20 May 2020.</p> <p>Extended on 20 May 2020 to 30 November 2020 and again from 30 November to 21 January 2021.</p> <p>Closed to applications on 31 January 2021.</p>	<p>Businesses were required to meet the following cumulative criteria:</p> <ul style="list-style-type: none"> • Based in the UK (if part of a corporate group, only parent company would be eligible); • Incorporated on or before 31 December 2019; • Business had raised at least £250,000 in equity investment from third-party investors in the last five years; • None of the business' shares were traded on a regulated market, multilateral trading facility or other listing venue; and • At least one of the following was true: <ul style="list-style-type: none"> • 50% or more of employees UK-based; or • 50% or more of revenue from UK sales. 	<p><u>Amount of loan:</u> The amount of loan provided was between £125,000 and £5 million, matching the investment made by the private investors.</p> <p><u>Term length:</u> The finance would mature after a maximum of 36 months.</p> <p><u>Interest:</u> 8% per annum (non-compounding) interest would be paid on maturity of the loan. If the loan was converted, the company could either pay accrued interest or have it converted to equity.</p> <p><u>Government Guarantee:</u> N/A.</p> <p><u>The level of suspected fraudulent payments recognised by the Department as at November 2021:</u> £29 million in relation to nine suspected fraudulent payments (further detail provided at paragraph 5.102).</p> <p><u>The level of suspected fraudulent payments recognised by the Department as at November 2022:</u> In addition to the above a further £9 million in relation to 13 suspected fraudulent payments (further detail provided at paragraph 5.102).</p> <p><u>The level of suspected fraudulent payments recognised by the Department as at November 2023:</u> In addition to the above a further £4 million in relation to two suspected fraudulent payments (further detail provided at paragraph 5.102).</p>
Recovery Loan Scheme (RLS)	<p>Announced on 3 March 2021.</p>	<p>Businesses were required to meet the following cumulative criteria:</p>	<p><u>Amount of loan:</u> The amount of the loans available to businesses were as follows:</p>

	<p>Opened to applications on 6 April 2021.</p> <p>Closed to applications on 30 June 2022.</p>	<ul style="list-style-type: none"> • Based in the UK; • Annual turnover of £45 million or less; • Evidence that the business was viable; and • Evidence that the business was not in difficulty. 	<ul style="list-style-type: none"> • Term loans or overdrafts of between £25,001 and £2 million per business group; • Term loans or overdrafts of between £25,001 and £1 million for businesses in scope of the Northern Ireland Protocol; • Invoice or asset finance of between £1,000 and £2 million per business group; and • Invoice or asset finance of between £1,000 and £1 million for businesses in scope of the Northern Ireland Protocol. <p><u>Term length:</u> For overdrafts and invoice finance facilities, finance was available for up to three years.</p> <p>For loans and asset finance facilities, finance was available for up to six years.</p> <p><u>Interest:</u> Interest rates were capped at 14.99%.</p> <p><u>Government Guarantee:</u> The Government initially guaranteed 80% of the loan. This was later reduced to 70%.</p> <p><u>The level of fraudulent or erroneous claims flagged by lenders between 1 April 2021 and 30 June 2022:</u> Lenders flagged 90 FLS facilities with an aggregate drawn value of £32.49 million as suspected fraud. This equates to 0.45% of the total number of drawn facilities and 0.75% of the total drawn value.</p> <p><u>The level of fraudulent or erroneous claims flagged by lenders between 1 August 2022 and 20 August 2024:</u> Lenders flagged 8 RLS facilities as fraud with an aggregate drawn value of £2 million as suspected fraud. This represents 0.09% of the total number of drawn facilities and 0.14% of the total drawn value.</p>
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Coronavirus Business Interruption Loan Scheme (CBILS)

- 1.6. CBILS was announced on 11 March 2020 and opened to applications on 23 March 2020. CBILS offered loans to small and medium-sized businesses of up to £5 million backed by a government guarantee of 80% of the loan value. To be eligible for CBILS, a business had to self-certify that it was adversely affected by the pandemic. Applicants were also asked to present a borrowing proposal demonstrating that, were it not for the pandemic, the business would have been viable.
- 1.7. The key elements of CBILS were as follows:
- a) A government guarantee for lenders of 80% against the outstanding balance, but the borrower remained liable for repayment of the loan;
 - b) A Business Interruption Payment (**BIP**) was available, to cover the first 12 months of interest payments and any lender-levied charges; and
 - c) For term loans and asset finance facilities, the term was up to six years; for overdraft and invoice finance facilities, the term was up to three years.
- 1.8. Following changes to the scheme announced on 3 April 2020, lenders were not permitted to seek personal guarantees for facilities under £250,000. Personal guarantees continued to be permitted, at the lender's discretion, for facilities above £250,000. However, the borrower's principal private residence was excluded, and recoveries under personal guarantees were capped at 20% of the balance.
- 1.9. Under this scheme, businesses have drawn a total of £25.83 billion. The available data, as at 31 December 2024, is as follows³ {GD(B)/006 – INQ000593148}:
- d) 45.43% of CBILS facilities by volume are fully repaid;
 - e) 43.57% are on schedule to be fully repaid;
 - f) 1.25% are in arrears (but not yet in default);
 - g) 0.88% are in default (but have not yet progressed to be reclaimed by lenders);
- and

³ See Exhibit {GD(B)/006 - INQINQ000593148} where Figure 2 shows the volume of CBILS loans, per lender, with the furthest life event reached. This data adds up to 100% because it is based on the volume of loans drawing on individual loan level data from lenders which reports the status of each loan – rather than the value of the loans (where, there may be small discrepancies in the total depending on the precise payment status of the loans).

- h) 8.34% of the total CBILS facilities have been settled via the Government guarantee.

Coronavirus Large Business Interruption Loan Scheme (CLBILS)

- 1.10. CLBILS was announced on 3 April 2020 and opened for applications on 20 April 2020. This scheme offered loans of up to £200 million and was open to medium and large-sized businesses which were not eligible for CBILS.
- 1.11. As with CBILS loans, applicants needed to (i) self-certify that they were adversely affected by the pandemic and; (ii) demonstrate that they would have been viable were it not for the pandemic. Participating lenders under CLBILS were backed by a government guarantee of 80% of the outstanding loan balance. The borrower remained liable for repayment of the entire loan.
- 1.12. Under this scheme, businesses have drawn a total of £4.54 billion. The available data, as at 31 December 2024, is as follows⁴ {GD(B)/006 – INQ000593148}:
 - a) 95.83% of CLBILS facilities by volume are fully repaid;
 - b) 1.81% are on schedule to be fully repaid;
 - c) 0.14% are in arrears (but not yet in default);
 - d) 0.28% are in default (but have not yet progressed to be reclaimed by lenders);
and
 - e) 1.81% of the total CLBILS facilities have been settled via the Government guarantee.

Bounce Back Loan Scheme (BBLs)

- 1.13. BBLs was announced on 27 April 2020 and opened to applications on 4 May 2020. In contrast to CBILS and CLBILS, loans under BBLs had a 100% government guarantee against the outstanding balance (both capital and interest), although the borrower remained liable for the entire loan.
- 1.14. The key elements of BBLs were as follows:

⁴ See Exhibit {GD(B)/006 - INQ000593148} where Figure 3 shows the volume of CLBILS loans, per lender, with the furthest life event reached. This data adds up to 100% because it is based on the volume of loans drawing on individual loan level data from lenders which reports the status of each loan – rather than the value of the loans (where there may be small discrepancies in the total depending on the precise payment status of the loans).

- a) Loans ranged from a minimum of £2,000 up to 25% of business' turnover (to a maximum of £50,000) with a government guarantee for lenders of 100% of the loan amount;
- b) Funds were to be disbursed to businesses within 24 to 48 hours of a successful application;
- c) A BIP was available to cover the first 12 months of interest payments;
- d) A business did not have to make repayments on the loan for the first 12 months;
- e) Interest rates were set at 2.5% per annum;
- f) The loans were for a term of six years, however early repayment was allowed without early repayment fees;
- g) Lenders were not permitted to take personal guarantees or take recovery action against a borrower's personal assets;
- h) There was no fee to access the scheme for either businesses or lenders;
- i) Later amendments to BBLS included an extension of the loan term from 6 to 10 years if desired, repayment holidays, interest-only periods, and allowing 'top-ups' to borrower's loans. These changes are detailed in paragraphs 7.41-7.43; and
- j) To be eligible for BBLS, applicant businesses needed to be established prior to 1 March 2020 and accordingly be engaged in trading or commercial activity as at that date. Other than charities and further education colleges, applicants were required to receive more than 50% of their income from trading activity. If applicants were in bankruptcy, liquidation or debt restructuring then BBLS was not available {GD(B)/007 – INQ000585862}.

1.15. Under BBLS, businesses have drawn a total of £46.52 billion. The latest available data, as at 31 December 2024, is as follows⁵ {GD(B)/006 – INQ000593148}:

- a) 14.64% of BBLS facilities by volume are fully repaid;
- b) 55.04% are on schedule to be fully repaid;

⁵ See Exhibit {GD(B)/006 - INQ000593148} where Figure 1 shows the volume of BBLS loans, per lender, with the furthest life event reached. This data adds up to 100% because it is based on the volume of loans drawing on individual loan level data from lenders which reports the status of each loan – rather than the value of the loans (where, there may be small discrepancies in the total depending on the precise payment status of the loans).

- c) 4.67% are in arrears (but not yet progressed to default);
- d) 0.87% are currently defaulted (but have not yet progressed to be claimed by lenders); and
- e) 23.65% of the total BBLS facilities have been settled via the government guarantee.

The Future Fund

1.16. The Future Fund was announced on 20 April 2020 and opened to applications on 20 May 2020. It offered funding to innovative businesses that relied on equity investment and were unable to access other government business support programmes, typically because they were either at the pre-revenue or pre-profit stages {GD(B)/008 – INQ000576423}. Funding ranged from £125,000 to £5 million and was subject to equal match funding being provided from private investors {GD(B)/009 – INQ000576424}.

The Recovery Loan Scheme (RLS)

1.17. The RLS was announced on 3 March 2021 and launched on 6 April 2021. The RLS was renamed the Growth Guarantee Scheme on 1 July 2024.

1.18. Initially, loans offered under the RLS were also backed by an 80% government guarantee for the lenders against the outstanding balance, but the borrower remained liable for repayment of the entire loan (this was amended late in 2021 to 70%). Loans were offered from £25,001 up to £10 million for asset and invoice finance, and from £1,000 to £10 million for asset and invoice finance. Eligibility and lender arrangements were similar to the CBILS scheme, however there were some differences, namely {GD(B)/010 – INQ000585863}:

- a) Businesses that had received support under the earlier loan schemes could still apply for the RLS;
- b) Businesses were responsible for meeting fees associated with the loans; and
- c) Businesses in financial difficulty were excluded.

1.19. The RLS was closed to new applications on 30 June 2022. Between 6 April 2021 and 30 June 2022, businesses had drawn down approximately £4.33 billion through the RLS. As of 31 March 2024, lenders had successfully claimed approximately £204.67 million against the government guarantee, equating to approximately 4.72% of the total drawn down value {GD(B)/011 – INQ000564281}.

- 1.20. The RLS successor scheme (described on BBB's website as its 'third iteration' or 'RLS 3') commenced on 1 August 2022. Between 1 August 2022 and 30 June 2024, businesses had drawn down approximately £1.45 billion. Lenders had claimed just £2.06 million against the government guarantee, equating to approximately 0.14% of the total draw down value {GD(B)/012 – INQ000543845}.
- 1.21. Originally due to end on 30 June 2024, the RLS was extended until 31 March 2026 and renamed as the Growth Guarantee Scheme, which launched on 1 July 2024. The terms of the scheme have remained broadly unchanged from the RLS terms {GD(B)/013 – INQ000564283}.

SECTION 2: CORONAVIRUS BUSINESS INTERRUPTION LOAN SCHEME (CBILS)

Introduction

- 2.1. In this section I provide information about the policy objective and design of CBILS, together with information relating to the implementation and development of the scheme. At Section 9 below, I set out my reflections on CBILS in further detail, as well as lessons learned within the Department for any future emergencies.

Economic Policy Objectives of CBILS

- 2.2. CBILS was launched on 23 March 2020. The policy objective of this loan scheme was to stimulate the provision of debt finance to businesses in the UK that were otherwise viable. The Government guaranteed the lending, with some of the risk of defaulting on the loans being transferred from lenders to the Government.

Scheme Design

Initial Policy Development of CBILS

- 2.3. The policy objective for, and an overview of, the loan schemes has been addressed in Part A of this statement. This section will look at the policy development and implementation following the announcement of measures to support businesses secure lending.
- 2.4. In the Budget on 11 March 2020, the Chancellor announced that CBILS would be launched and delivered by BBB to support businesses to access bank lending and overdrafts {GD(B)/014 – INQ000236913}. The Chancellor set out that lenders would offer no-fee loans of up to £1.2 million through the scheme to small and medium-sized businesses, which were 80% guaranteed by the Government.
- 2.5. On the same day, following earlier email correspondence from Philip Duffy to Jo Shanmugalingam dated 9 March 2020 regarding the Chancellor's intention to announce an EFG type scheme (as detailed in paragraph 5.25 of Part A), the Chancellor's private office emailed the Secretary of State's private office highlighting the content of the Budget relating to CBILS {GD(B)/015 – INQ000563870}. The email confirmed, amongst other things, that "...the scheme [would] launch 'in a matter of weeks'", with 1 April 2020 being proposed as the launch date. It was further suggested that "...if we can act faster, we should." CBILS was a temporary expansion of the existing loan scheme for SMEs, the Enterprise Finance Guarantee (EFG), and HMT

would “...now work closely with BEIS, BBB and lenders to agree the exact terms of the new scheme.” The scheme was expected to include:

- A raised portfolio cap (taking more risk on the HMG balance sheet);
- Expanded eligibility criteria – to support businesses who may temporarily fall outside bank risk appetite as a result of CV-19 (but are otherwise viable)
- Work to streamline the process between lenders/BBB to make the scheme attractive to use for banks”

2.6. In addition to the above, HMT would provide the necessary ring-fenced budget cover, to be agreed with BEIS officials, once the exact design of the scheme was finalised. Following this email, BEIS did not raise any concerns with HMT about BEIS’ capability to work at speed or meet the CBILS launch timeline. Given the pace of the pandemic and the economic threats it posed, BEIS officials shared the Chancellor’s sense of urgency. BEIS’ response was to strengthen its delivery capability by supplementing teams with additional resources to support the response effort. In common with so many others delivering services across the country, BEIS officials were working long hours every day to seek to do this.

2.7. A portfolio cap was a limit on the total amount of losses or risks that the Government would cover for a lender’s group or portfolio of loans, in this context a portfolio of CBILS loans. The portfolio cap was applied to CBILS to limit the Government’s exposure to losses by limiting the total amount lenders could claim back on the government guarantee.

CBILS and the European Union State aid Rules

2.8. As will be familiar to the Inquiry, the UK officially left the EU on 31 January 2020 but remained subject to the EU framework during the transition period until 31 December 2020. At the start of the Covid-19 pandemic in early 2020, the UK’s obligations to the EU remained and as such the UK was bound by the European Commission State Aid rules.

2.9. Prior to March 2020, Article 107 of the Treaty on the Functioning of the European Union prohibited EU Member States from providing economic support “...in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods...”. These rules restricted the Government’s ability to provide direct funding or financial incentives to lenders, as was later seen in the loan and grant schemes and meant a cap was set on the level of

government-backed loan schemes. Of particular relevance to the schemes, and addressed in further detail below, government-backed guarantees would not constitute State aid under Article 107(1) if it was for a fixed amount and did not cover more than 80% of the outstanding loan or financial obligation.

- 2.10. On 13 March 2020, the European Commission published a communication noting that Covid-19 was “... a severe public health emergency for our citizens, societies and economies with infections in all Member States.” {GD(B)/016 – INQ000564280}. The Commission stated that it was therefore presenting, “an immediate response to mitigate the socio-economic impact of the COVID-19 outbreak, centred on a European coordinated response.” As a result, on 17 March 2020, the Commission proposed a State aid Temporary Framework to support the economy in the context of the Covid-19 outbreak, noting that:

“The economic impact of the COVID-19 outbreak is severe. We need to act fast to manage the impact as much as we can. And we need to act in a coordinated manner. This new Temporary Framework enables Member States to use the full flexibility foreseen under State aid rules to support the economy at this difficult time.” {GD(B)/017 – INQ000563911}

- 2.11. On 19 March 2020, the European Commission adopted the Temporary Framework for State aid.
- 2.12. The Temporary Framework recognised the EU economy was experiencing a serious disturbance and provided for five types of aid that would not have previously been permitted under State aid rules {GD(B)/018 – INQ000563880}:
- a) Direct grants, selective tax advantages, and advance payments – Member States were able to set up schemes to grant up to €800,000 to a company to address its urgent liquidity needs;
 - b) State guarantees for loans taken by companies from lenders – Member States were able to provide State guarantees to ensure lenders continued providing loans to the customers who needed them;
 - c) Subsidised interest rates for public loans to companies – Member States were able to lend with favourable interest rates to companies. These loans could help businesses cover immediate working capital and investment needs;
 - d) Safeguards for banks that channel State aid to the real economy – Some Member States planned to build on lenders' existing lending capacities and use

them as a channel for support to businesses, in particular to small and medium-sized companies. The Framework made clear that such aid was considered to be direct aid to the lenders' customers, not to the lenders themselves, and gave guidance on how to ensure minimal distortion of competition between lenders; and

- e) Short-term export credit insurance – The Framework introduced additional flexibility on how to demonstrate that certain countries were not marketable risks, thereby enabling short-term export credit insurance to be provided by the State where needed.

Discussions on the Expansion of CBILS following the Budget Announcement

- 2.13. On 13 March 2020, BEIS officials prepared a draft note to assist discussions at the Covid-19 Economic Impact/Response meeting scheduled for later that day {GD(B)/019 – INQ000563871}. The note summarised the impact of Covid-19, set out the specific budget measures already announced, and considered what else might be needed to supplement those measures. The note stated that, *“Budget measures were welcomed by representative bodies and must now be implemented as soon as possible.”* It explained that BEIS and HMT were *“...working at pace with the banks and BBB to design and implement the new loan scheme...”*. The measures announced in the Budget (which also included local authority grant schemes) were expected to have a significant impact, particularly for SMEs. However, business feedback received during calls with Business Representative Organisations (**BROs**) that week, led by the Secretary of State, had concentrated on:

“...the limited measures available for larger businesses, limited measures available for larger SMEs particularly in supply chains of larger companies affected, lack of support for small retailers in expensive sites, and on those sectors already acutely affected who are reporting existing measures do not go far enough.”

- 2.14. On 14 March 2020, following feedback from businesses, the Secretary of State asked BEIS officials if there were any existing BBB schemes that could be expanded to support larger businesses and if not, what schemes could be established quickly {GD(B)/020 – INQ000563872}. The following day, BEIS officials responded by email and confirmed that as BBB was restricted by the State aid framework, existing schemes were limited to SMEs and a maximum loan size of £1.2 million {GD(B)/021 –

INQ000563873}. There was scope to modify the eligibility criteria to be more helpful to SMEs (and BEIS and BBB were working together to consider those options) but the State aid provisions did not allow it to extend to larger businesses. The two options under consideration were whether to include a BIP for 12 months and how high to set the government guarantee (potentially up to 90%). In the response, BEIS officials noted that the European Commission defined SMEs “...as having fewer than 250 employees and **either** turnover of up to EUR 50 million (£45m) **or** a balance sheet total of no more than EUR 43 million (£39m)” (Original emphasis).

- 2.15. Notwithstanding those restrictions, BEIS officials explained that they were exploring two options that would better allow the Government to support loan finance to larger firms, as follows:

“After the financial crisis, the British Finance Partnership (now part of BBB) provided loans to mid-cap firms up to 500 employees. These were made to viable businesses on a commercial basis at a time when commercial investors were unwilling to lend. The scheme gradually withdrew as the market returned to normal.

The Regional Growth Fund has in the past given loan guarantees to some large companies in distress, to support borrowing from commercial lenders, although not on a large scale. Under existing State Aid rules, all such loans would have to be on a commercial basis...” {GD(B)/021 – INQ000563873}

- 2.16. It was explained that the Government could not support all large firms in distress, but that BEIS and HMT had been revisiting their intervention principles as a framework for determining which strategically important firms could be supported. They were to work urgently with BBB and HMT on the case for each of the above options and would submit advice in the following few days. As noted in the email, BEIS officials discussed the two options with HMT as part of the broader policy making process. Whilst BEIS officials are not able to confirm HMT’s specific response to the options, any response from HMT would have formed part of the early policy discussions.
- 2.17. On 17 March 2020, an HMT official emailed BEIS and BBB officials. The email explained the Chancellor had expressed a strong interest in finding a way to use measures such as CBILS to support lending in excess of the £1.2 million loan cap {GD(B)/022 – INQ000563875}. The email indicated that a range of £1 million to £5 million had been suggested, and the Department acknowledged the requirement to notify the Commission to ensure continued compliance with the EU Temporary

Framework. The Inquiry has specifically asked for BEIS' understanding of why the Chancellor/ HMT adopted such an approach. HMT would be best placed to answer this but the understanding of BEIS officials working at the time was that this was an entirely reasonable request. CBILS was already in place, but its loan limit was too low to meet the needs of some companies. Given this, the logical first step would be to explore how CBILS could be adapted, rather than developing an entirely new scheme. The loan cap under CBILS had been set by State aid rules. However, BEIS officials were aware that the European Commission had indicated a willingness to adjust these limits under the Temporary Framework. In this context, the Chancellor/ HMT's request appeared entirely sensible. As such, BEIS officials did not ask for the rationale behind the request.

Implementation and Delivery of CBILS

Policy Development and Implementation of CBILS

- 2.18. In light of the changes to the State aid Framework, on 17 March 2020, the Chancellor announced that the Government would be providing additional support to protect businesses, with changes to the initial parameters of CBILS {GD(B)/023 – INQ000585498}. The changes to CBILS were:
- a) The maximum amount that businesses could borrow was increased from £1.2 million to £5 million; and
 - b) A six-month interest-free period was made available to businesses. The Government would cover the first six months of interest payments.
- 2.19. On 18 March 2020, Gemma Peck emailed the Permanent Secretary providing an update on CBILS {GD(B)/024 – INQ000563877}. She stated that they were moving at pace to deliver CBILS and following the Chancellor's announcement on expanding the scheme. BEIS had "*... been doing urgent further work with HMT, BBB and legal advisors to pin down the parameters.*" The email further stated that the Chancellor was "*...determined to launch on Monday [23 March 2020], come what may.*" She confirmed that the Chancellor wanted to proceed with guaranteeing loans up to £5 million even though this was above the limit in the EU Temporary Framework which allowed State aid up to £3.25 million. Therefore, as Gemma Peck explained, the Government was required to seek State aid approval from the European Commission. HMT officials were providing further advice to the Chancellor later that day and if the European Commission did not approve the scheme, money would need to be clawed back.

- 2.20. On the same day, Gemma Peck provided the Secretary of State with an update note on CBILS in advance of a meeting with him the following day {GD(B)/025 – INQ000543080}, {GD(B)/026 – INQ000543081} and {GD(B)/027 – INQ000543082}. The note explained that BEIS had been working with HMT, BBB, and lenders to finalise the parameters of CBILS, and the Chancellor felt very strongly that CBILS should be implemented on 23 March 2020. It confirmed that BBB and lenders thought that was deliverable. As for the outstanding policy choice as to whether some currently excluded sectors (such as agriculture, fishing, and private schools) should be brought into the scope of CBILS, the note explained that the Chancellor had received advice on that issue that evening. This advice would have been provided by HMT officials directly to the Chancellor, and therefore BEIS does not have knowledge of further advice that may have been provided to the Chancellor about excluded sectors.
- 2.21. The note stated that BEIS officials were still developing the value for money analysis. It advised that the value for money analysis “... *requires us to make several assumptions about take-up and defaults and relies on current financial and macroeconomic forecasts, all of which have a wider than usual margin for error in these unprecedented conditions.*” BEIS’ view was that CBILS could be delivered either on 23 March 2020 or very shortly afterwards (likely within a week), with the timing largely dependent on the process that had to be followed. CBILS involved significant public spending, therefore it was essential to follow proper governance and obtain accounting office advice, while also ensuring lenders were ready. Minimum necessary steps were being taken to ensure ministers were making decisions based on proper advice and the scheme was delivered as quickly as possible.
- 2.22. Also on 18 March 2020, BEIS officials sent a submission to Minister Scully and Parliamentary Under Secretary of State, Minister for Climate Change and Corporate Responsibility, Lord Callanan, seeking their approval to present a Written Ministerial Statement and a departmental Minute to Parliament in respect of CBILS {GD(B)/028 – INQ000543086}. BEIS officials were aiming to arrange “*a grid slot for the [Written Ministerial Statement] from No. 10*” so that the scheme could be launched on 23 March 2020.
- 2.23. On 19 March 2020 BEIS officials met the Secretary of State to discuss CBILS in detail. Discussions took place in relation to communication, delivery and legal risks of the scheme {GD(B)/029 – INQ000563878}. In overview:

- a) Communication – the Secretary of State asked how businesses would be made aware of the scheme, determine whether it was available to them and where they should be directed for further information. BEIS officials advised that a communications plan was being developed and the key message to businesses would be to contact their bank directly to enquire about CBILS;
- b) Delivery – the Secretary of State noted, based on his experience, there was often a significant disconnect between the scheme’s overall objectives and its delivery in practice. He wanted to carry out a “mystery shop” on 23 March 2020 to establish if lenders had briefed their staff appropriately and whether the processes in place for discussing about the loans were adequate; and
- c) Legal risks – BEIS officials highlighted the legal implications for proceeding with the scheme, noting there was a risk that money may need to be clawed back from businesses at a later stage. The Secretary of State acknowledged this risk but emphasised the urgent need for cash flow support to businesses. He was happy to proceed with the risk, even if that risk was a claw back later.

2.24. Following this meeting, on 20 March 2020, BEIS officials sent an urgent submission to the Secretary of State (dated 19 March 2020) seeking his in principle agreement to the scheme in advance of the proposed launch of CBILS on 23 March 2020 {GD(B)/030 – INQ000585501}. The submission presented the parameters of the scheme and the State aid assessment, together with the costs and value for money assessment, which was described as “...*necessarily speculative given the pace and paucity of data, and the risks, which [were] significant.*” The submission advised further that, “*Owing to this... the Permanent Secretary has judged that he will require a [Ministerial] direction.*” The Secretary of State was asked to advise whether he wanted to proceed and launch CBILS, with the parameters set out in the submission, after having set out the associated value for money and legal risks.

2.25. The submission updated the Secretary of State on the design of CBILS and the key differences when compared to the EFG loan scheme, which were as follows:

- a) The maximum loan size supported would be £5 million for terms up to five years (EFG supported loans up to £1.2 million);
- b) Businesses would not be required to pay a premium to access a CBILS loan (there was a 2% premium for accessing EFG loans);

- c) The percentage of the remaining balance of each loan that was guaranteed by the Government increased to 80% (from 75% under EFG). The increase was to encourage lenders to deploy more loans by increasing their risk appetite. A higher guarantee (at 90%) was dismissed as it created insufficient risk sharing with the lenders;
- d) The cap on gross government liability at the level of the lender's whole CBILS portfolio would be increased to 75% of losses (under the EFG this had been capped at 20% of losses across each lender's whole EFG portfolio);
- e) The net effect of the above was an effective portfolio cap of 60%, comprising 75% of the lender's overall portfolio cap multiplied by 80% of the government guarantee ($75\% \times 80\% = 60\%$). This meant the Government's liability under each lender's CBILS portfolio could not exceed 60% due to the portfolio level cap in place for every lender. The effective portfolio cap of EFG was 15%, comprising 20% of the lender's overall portfolio cap multiplied by 75% of the government guarantee ($20\% \times 75\% = 15\%$);
- f) In return for lenders offering interest-free loans to businesses for 12 months, lenders would be charged a graduated fee. This would apply to the guaranteed portion of the loan offered. The submission stated that BBB and UK Finance thought lenders would view this positively because the fee would be modest and, in return, the Government would have extended the interest-free period from six to 12 months, thus reducing the risk of default. This was marked in the submission as a new feature, and the inclusion of a fee for lenders was included in response to concerns from the European Commission that a fee-free scheme would not be compatible with the temporary State aid framework. This was set out in emails between officials on 19 March 2020 {GD(B)/031 – INQ000585500};
- g) Access to CBILS was wider than under the EFG – only viable businesses that had some, albeit insufficient, security could access the EFG scheme. Businesses would be able to apply for unsecured CBILS loans up to a value of £250,000 at the discretion of the lender (the EFG was only available for secured loans);
- h) With CBILS, the lender was required to establish that the business had a viable business proposition when assessed according to its normal commercial lending criteria. However, where there were concerns regarding its short-term

business performance due to the impact of Covid-19, the business would be considered eligible for CBILS provided the lender reasonably believed the finance would help the business trade out of short-term cashflow difficulties; and

- i) Some protected sectors were excluded under the EFG, such as agriculture and aquaculture, insurance hauliers, and private schools. These sectors would be brought into scope of CBILS, although on limited terms, benefitting from loans of up to around £1 million.

2.26. In the same submission, BEIS officials advised the Secretary of State on the value for money analysis of CBILS stating that the pandemic represented a major shock to the UK economy and should be treated as an exceptional occurrence which justified government intervention to support firms. In particular, BEIS officials explained:

- a) In the absence of any intervention, the outbreak could lead to a “*supply-demand doom loop*” as more businesses closed and/or jobs were lost, disposable incomes would go down leading to a decrease in demand, which would lead to more businesses closing;
- b) The market could not be expected to provide material improvements to the situation as the causes of the demand and supply shocks were out of the control of the business; and
- c) The financial sector on its own could not take on the risks associated with providing a vast amount of liquidity to businesses suffering from a sudden loss of cashflow.

2.27. Despite the clear rationale for intervening, the submission acknowledged that there was significant uncertainty as to whether the economic benefit of the full package of scheme changes would justify the likely costs. In particular, the interest-free period represented an additional cost to the taxpayer that it had not been possible to assess in the time available.

2.28. On 20 March 2020, following a call between the Secretary of State and Gemma Peck, the Secretary of State’s private office responded to the above submission {GD(B)032 – INQ000563881}. The email confirmed that the Secretary of State acknowledged the outstanding legal risk in relation to EU State aid rules and that Alex Chisholm, the Accounting Officer, had signalled that a ministerial direction would be needed. It also

stated that the Department would seek HMT approval ahead of receiving Accounting Officer advice and the direction letter.

Role of British Business Bank

- 2.29. On 19 March 2020, Keith Morgan, Chief Executive Officer of BBB, sent a letter to the Permanent Secretary about BBB's role in delivering CBILS {GD(B)/033 – INQ000563879}. The letter explained:

“My [BBB] officials have been working at pace with yours [BEIS] and others across HMT and UKGI to finalise and prepare to implement the necessary changes to the existing EFG scheme to launch the new scheme as soon as possible. The overriding policy objective when considering what changes to make to both the parameters and the eligibility criteria of the EFG scheme, was how to most appropriately support the continued provision of finance to UK SMEs while they may face temporary performance or cashflow issues.”

- 2.30. Keith Morgan recorded the relevant issues that BBB needed to address to ready itself to implement CBILS at the speed expected by the Chancellor. He expressed concern that due to the speed of implementation, BBB would need to relax its targets in relation to two of the six strategic objectives, namely, to enhance the diversity of provision in the small business finance market and to provide a return equivalent to the Government's medium-term cost of borrowing. Accordingly, CBILS represented a material shift of additional risk onto the programme, and ultimately BEIS' balance sheet.
- 2.31. Keith Morgan sought confirmation that the Permanent Secretary, in his capacity as Principal Accounting Officer for BBB, would, with immediate effect, temporarily suspend certain targets and consider amendments to BBB's business plan.
- 2.32. Notably, the letter also stated:

“Speed of delivery on behalf of government remains our priority. It is for that reason, that we have been unable to follow the governance and approvals procedures, such as completing a five-case business case, that would be routine in normal times. So, while we are carrying out economic analysis of the effectiveness of the CBILS measure, this work is not complete. In any case, due to the interaction of the various parameter changes under CBILS and the uncertainty around the nature or length of an economic shock, the value of

quantitative assessment is limited. As a result, the Bank is unable to give assurance to BEIS that the CBILS initiative provides value for money.”

- 2.33. On 20 March 2020, BEIS officials sent an Accounting Officer Assessment of the scheme to the Permanent Secretary in his role as Accounting Officer {GD(B)/034 – INQ000563882}. The note summarised the budgetary and value for money implications of the proposed scheme including the intended changes to the original design. In the note, the Accounting Officer was asked to consider whether he felt a ministerial direction was required to implement CBILS. As the lenders were preparing to offer the scheme from 23 March 2020, the ministerial direction would need to be requested and accepted to meet the target delivery date.
- 2.34. BEIS officials advised that the scheme carried risks with respect to each component of the tests under Managing Public Money, an HMT guidance document that sets out the main principles for dealing with resources in public sector organisations in the UK {GD(B)/035 – INQ000496882}. The budgetary and value for money implications were particularly concerning given the uncertainties in the analysis and whether additional costs would be outweighed by the benefits. The legal risk was also significant.
- 2.35. In relation to value for money of CBILS, BEIS officials had to consider whether an alternative proposal, or doing nothing, would offer better value for money when looking to achieve the policy objective, which was to increase the availability and take-up of financing by SMEs in an economic downturn. As increased take-up of the scheme was economically beneficial, not acting provided worse value. However, there was significant uncertainty as to whether the economic benefit of CBILS would justify the likely costs. The increase in the effective portfolio cap to 60% (compared to 15% with EFG) was designed to encourage lenders to deploy more loans by increasing the lenders’ risk appetite and supporting them to take a more flexible view of SME viability. However, this change represented significant additional risk transfer from the lenders to the taxpayer as compared to the lower effective portfolio level cap of EFG (15%) at which lenders would have remained willing to participate.
- 2.36. BEIS understood that the likely demand for the scheme would be significant. However, there were no precedents on which to base a forecast as the lending conditions were unprecedented. EFG was the most relevant precedent available, but BEIS recognised that the demand during the pandemic would greatly exceed business-as-usual demand. In addition, there was no benefit in seeking to estimate the number of organisations that would take-up the scheme. Lenders were exposed to a proportion

of any losses and therefore had every incentive to only lend to viable businesses. Accordingly, there were no suggestions that the scheme should be rationed, and the demand would depend on circumstances as the pandemic unfolded.

- 2.37. In the absence of detailed financial and macroeconomic forecasts, large uncertainties remained around take-up rates, default rates, and the economic benefits of CBILS, which were critical parameters for the value of money assessment. For example, if BEIS assumed that between 25% and 75% of businesses (that would have otherwise failed) survived because of CBILS funding and proceed to generate economic benefit, then even if the 60% effective cap was reached, CBILS would still have offered value for money. However, these calculations were acknowledged to be very rudimentary.
- 2.38. On 21 March 2020, the Permanent Secretary responded to Keith Morgan's letter of 19 March 2020 {GD(B)/036 – INQ000563883}. He confirmed that a more formal response would be sent in the coming days and gave reassurance the Business Finance Team in BEIS would be working with UKGI, HMT and BBB to work through the delivery concerns.
- 2.39. Later that day, Keith Morgan emailed the Permanent Secretary to confirm a few points prior to BBB issuing any legally binding documentation to the lenders regarding CBILS {GD(B)/037 – INQ000563884}. Keith Morgan sought confirmation on the following:
- a) CBILS had been modified since Keith Morgan's letter of 19 March 2020. Keith Morgan wanted clarification that BBB was instructed to proceed with the modified CBILS and not the previous iteration of CBILS as set out in his letter of 19 March 2020;
 - b) BEIS's instruction to deliver CBILS was supported by a ministerial direction. In the absence of a ministerial direction, BBB Board would need to consider if it could act on BEIS's instruction without raising a Reservation Notice (a mechanism in BBB's constitution through which it could raise concerns on particular grounds); and
 - c) BEIS would be responsible for the State aid risk of proceeding.
- 2.40. On 22 March 2020, the Secretary of State's private office emailed HMT seeking agreement to introduce CBILS {GD(B)/038 – INQ000563890}. The Secretary of State anticipated that he would need to issue a ministerial direction to the Accounting Officer to introduce the scheme. CBILS was a demand-led scheme, and the Secretary of State also sought confirmation that given the uncertainties around the scheme (including the

eventual costs and potential losses), HMT would continue to honour the assurances that it would provide the additional budget cover required to meet all immediate and future costs.

- 2.41. An HMT official replied to the Secretary of State's private office the same day to confirm that the Chancellor was content for the Secretary of State to introduce CBILS based on the parameters set out {GD(B)/038 – INQ000563890}.
- 2.42. After considering the Accounting Officer advice, on 23 March 2020, the Permanent Secretary wrote to the Secretary of State requesting a ministerial direction (dated 22 March 2020) in the event the Secretary of State wished to progress with CBILS {GD(B)/039 – INQ000065992}.
- 2.43. In response on the same day, 23 March 2020, the Secretary of State issued a ministerial direction (dated 22 March 2020) formally directing the Accounting Officer to proceed with CBILS {GD(B)/040 – INQ000064753}. This ministerial direction stated:

“As you rightly highlight in the current circumstances there are a number of good reasons to justify the introduction of this scheme. Without the Government intervening, there are very real risks faced by a large number of businesses in the UK. This would result in a large number of jobs being lost, which would have a significant long-term impact on the national economy. As you note in your letter, the speed at which events have unfolded has not allowed sufficient time for a full value for money assessment to be undertaken. Nonetheless I believe the economic case for action is compelling.

Whilst agreement for some of the elements of this Scheme are subject to State Aid approval, I believe in the current set of circumstances that we cannot afford to delay introduction of this scheme even for a few days. I note that these are temporary measures, being implemented in extraordinary circumstances. In light of this, and of the advice I have received from officials, I believe that there is sufficient likelihood that the Commission will ultimately support the steps that the Government is taking to provide support to businesses affected by the Coronavirus pandemic.

As a result, I am prepared to provide support for the introduction of this scheme. I am therefore formally directing you as Accounting Officer to take this forward with immediate effect.”

- 2.44. Also on 23 March 2020, the Permanent Secretary responded to Keith Morgan's email of 21 March 2020 and instructed BBB to deliver CBILS, authorising it to award up to £2.5 billion of allocations to delivery partners {GD(B)/041 – INQ000563889}.
- 2.45. Later the same day, BBB wrote a detailed letter to existing accredited lenders under the EFG to formally inform them about CBILS {GD(B)/042 – INQ000563893}. BBB explained that CBILS would be delivered through amendment and adaptation of EFG, the related EFG Guarantee Agreement and EFG processes and that the lenders' *"...internal operational processes relating to the origination of facilities ... should remain largely unchanged."* BBB also identified where CBILS was different from EFG, such as in relation to eligibility criteria, rules for assessing the viability of the borrower, and that there was no requirement under CBILS for security for loans of £250,000 and under (although this was at the discretion of the lender). The changes were set out in detail in an annex to the letter.
- 2.46. CBILS was launched on Monday 23 March 2020, in accordance with the Chancellor's proposed timetable. To help businesses understand if they would be eligible for CBILS, the Department prepared an eligibility checklist {GD(B)/043 – INQ000563886}. This stated that all lending decisions remained fully delegated to the accredited lenders.
- 2.47. The Written Ministerial Statement was subsequently presented to Parliament on 24 March 2020; by the Secretary of State to the House of Commons, and to the House of Lords by Lord Callanan {GD(B)/044 – INQ000543105}.

Accredited Lenders

- 2.48. As detailed at paragraph 30, BBB implemented the loan schemes, and accredited commercial lenders delivered them directly to the borrower. Businesses applied for lending from an accredited lender via the lender's own website. BEIS and BBB had no direct role in the application process. When CBILS was launched, the scheme took on as accredited lenders those that were already accredited for the pre-existing EFG Scheme, which amounted to 40 accredited lenders {GD(B)/045 – INQ000563876}.
- 2.49. In early April 2020, various BROs fed back to the Department concerns about the capacity of the scheme's delivery partners to respond to demand {GD(B)/046 – INQ000563933}. They were especially concerned about the ability of the lenders to provide service to all the potential businesses affected.
- 2.50. Indications from UK Finance were that although initially only 40 lenders were accredited to offer CBILS, hundreds more would like to be involved. BBB therefore

needed to “...make its processes simple to help mobilise this scheme and get the money out” {GD(B)/047 – INQ000585534} and {GD(B)/048 – INQ000543145}.

- 2.51. In response, BBB accelerated their process for adding new accredited lenders to increase their ability to meet demand for CBILS.
- 2.52. An update on lender accreditation by BBB ahead of a meeting with Minister Scully in early April 2020 set out that following the launch of CBILS on 23 March 2020, by 31 March 2020, BBB had received 120 enquiries from lenders wishing to become accredited. Approximately 50% of these enquiries led to formal expressions of interest/formal proposals {GD(B)/049 – INQ000563919}. Given this high level of interest, BBB implemented four measures to improve efficiency of accreditation, as follows:
- a) Creation of a two-tier accreditation process – Prioritising proposals from ‘low-risk’ applicants, i.e. existing BBB delivery partners with risk and compliance profiles known to BBB or regulated by the Prudential Regulation Authority;
 - b) Further prioritisation/segmentation of applicants – Rather than ‘first-come, first-served’, BBB proposed to segment and prioritise applicants into: (i) priority cases, applicants whom the bank believed had a big impact in their respective market and based on the speed with which BBB believed accreditation could be completed; (ii) complex cases, for lenders whose business model did not neatly fit with existing CBILS legal documentation and/or operating systems for which further design/legal work would be required; and (iii) the remaining applications;
 - c) Increase delegation limits – This resulted in fewer cases needing to be approved by BBB’s full investment committee. The pool of approved individuals with delegated authority was also expanded; and
 - d) Increased resource – The team responsible for accreditation increased from 2 to at least 21, all individuals with previous banking expertise/experience, sourced from across BBB. Four secondees also joined to bring the total number of staff to 25.
- 2.53. BEIS officials also explored options for prioritising lenders that supported specialist sectors, for example, creative industries that were typically less able to access CBILS through other routes. One example of issues identified with accessing CBILS arose from the Department’s engagement with businesses in the agriculture and events

sector, both of which were recognised as having specific cashflow issues due to lower demand, and utilising specialist financing vehicles which could not be easily repurposed for other uses {GD(B)/050 – INQ000564094}.

- 2.54. BEIS and BBB officials considered it was likely that existing accredited lenders would have been prioritising larger loans, and that new lenders would assist in approvals for lower-value loans which would be desired by smaller businesses and were not otherwise being catered for {GD(B)/046 – INQ000563933}. The Inquiry has asked if this assumption materialised in practice. BEIS does not hold, nor have BEIS officials been provided with any data on loan size distribution by lender. BBB would be best placed to provide this information. BBB published aggregated data only. BEIS officials did not request to see the detailed data because they were satisfied that the entry of new lenders into the market would provide businesses more options and these lenders would have capacity to process lower-value loans. BEIS did not seek to monitor this data internally. This was because BBLs was introduced shortly afterwards. BBLs effectively resolved the issue of access to lower-value loans. In BEIS' view, once BBLs was introduced, there was no longer any reason to monitor lower-value loans issued under CBILS. The terms of BBLs were so attractive that any eligible business seeking £50,000 or less would have applied for it. Lenders were not obliged to provide finance under CBILS, it was at their discretion. CBILS eligibility criteria did not lead to any types of businesses (including microbusinesses, freelancers and sole traders) being excluded. However, lenders would have had reasons for not wishing to lend to certain types of businesses, which likely included regulatory constraints, credit risks and the costs of the transactions relative to the loan amounts. Further, some lenders chose not to provide business finance that fell under the scope of the Consumer Credit Act (CCA).
- 2.55. As detailed at paragraph 2.25, CBILS benefitted from a 12-month interest-free period. Once the interest-free year ended, businesses and lenders were free to negotiate interest rates, which could be at fixed or floating rates. Given that loans under CBILS were partially guaranteed, the Government was not in a position to dictate the terms, nor did it seek to do so. The Government was expecting lenders to lend outside their normal credit risk appetite, to businesses facing significant disruptions including to their immediate prospects of raising revenue. These were businesses that lenders would not normally have within their credit risk appetite to lend to. Considering that lenders retained 20% of the risk of each loan and the uncertainty in lending to these businesses

when the economic climate was unpredictable for the foreseeable future, it was commercially reasonable that lenders' interest rates reflected those risks.

- 2.56. By 3 June 2020, there were 83 accredited lenders for CBILS, 12 accredited lenders for CLBILS and 20 accredited lenders for BBLs {GD(B)/051 – /INQ000596681}. By 19 November 2020, BBB had accredited 74 lenders in addition to those automatically eligible due to being EFG-accredited, totalling 117. A further eight lenders had been approved for accreditation but were not yet operational {GD(B)/052 – INQ000585719}. Accreditation for CBILS closed on 26 February 2021 following the announcement of the last extension of CBILS to 31 March 2021 {GD(B)/053 – INQ000564191}.

Communication with SMEs and Large Businesses

- 2.57. Key information about CBILS and other Covid-19 loan schemes was communicated to businesses through multiple channels. These included the usual government communication channels, trade associations, media reports and the websites of BBB and the lenders.
- 2.58. As well as public announcements relating to CBILS, in March 2020 separate guidance was sent out at various times to businesses with details of a range of business support measures including CBILS {GD(B)/054 – INQ000585509}, {GD(B)/055 – INQ000543127} and {GD(B)/056 – INQ000563887}. There was strong media interest in the loan schemes, so awareness was high, as shown by the unprecedented number of loans issued.
- 2.59. In addition to this, BEIS expanded the existing business support helpline as a means to provide advice to businesses on issues they may have experienced in relation to Covid-19. It officially launched on 9 March 2020 {GD(B)/057 – INQ000543052}. Temporary call handlers were recruited to supplement and support the permanent team. The helpline offered information and guidance on the Covid-19 loan schemes. Any business could contact the helpline for assistance in accessing the schemes, including those from socially and economically vulnerable groups. The demand for Covid-19 specific advice through the business support helpline was continually monitored and reviewed to ensure resourcing met demand. The demand for advice declined during April 2020 and May 2020, and consequently, resource was scaled down from 52 to 31 call handlers in early June 2020 {GD(B)/058 – INQ000564057}. The resource was then further reduced from 31 to 21 call handlers by the end of June 2020.

Experience of Accessing Finance

- 2.60. BBB collated frequently asked questions from SMEs, and the issues and questions asked are evidence of the experience of SMEs in accessing CBILS. As at 27 March 2020, this included issues and questions about accrediting new lenders, personal guarantees, and examples of lenders advising businesses that they were not eligible for CBILS for various reasons {GD(B)/059 – INQ000563904}.
- 2.61. Other issues and concerns encountered by businesses and lenders at this stage are illustrated in an email from an official at Department for International Trade, as well as views direct from an SME {GD(B)/060 – **INQ000596659** and {GD(B)/061 – INQ000563927}. The concerns noted in the correspondence from the Department for International Trade and an SME included:
- a) The ability of the 40 lenders to service all potentially affected businesses, and newer entrants to the market who were likely to need the most help;
 - b) The BBB's administration of the schemes and selection of lenders and partners, including:
 - i. that schemes were often closed to new lenders or partners, even when announced, as they were either full or the BBB could not meet the 'considerable demand'; and
 - ii. that the process was not transparent. While criteria for selection was clear and guidance was provided, the decision to invite applicants to progress was made on a 'risk and judgement-based approach'. This approach suggested that there was significant discretion in the selection process, rather than an adherence to strict, objective criteria;
 - c) The lack of clear guidance for businesses and advisors. Decision making on whether businesses were eligible for CBILS was fully delegated to the 40 accredited CBILS lenders. While some guidance was provided on the BBB website and the government published eligibility criteria, the requirements for each lender beyond the government's requirements could differ. Further, many of the lenders didn't publish information about updates to the scheme or the eligibility of businesses on their websites;
 - d) Lenders had made it clear to businesses that they could "...*only have CBILS loans if [businesses] don't need them or will give a 100% guarantee, personally or with assets.*"; and

- e) SME start-ups faced difficulties, as they often invested heavily in R&D and as a result had poor balance sheets. The undertaking in difficulty rules could prevent start-ups from obtaining CBILS.

Review of CBILS and Proposed Changes in Early 2020

- 2.62. Shortly after the launch of CBILS, the Department received feedback from businesses that lenders were consistently demanding personal guarantees, even for small loan amounts. As set out above, the scheme had been launched with no requirement for lenders to obtain security for lending up to £250,000 but gave lenders a discretion on this. BEIS officials' understanding was that lenders were requesting personal guarantees because they remained liable for 20% of the loan in the event of default. A personal guarantee increased the likelihood of recovering that amount. This created a clear commercial incentive for lenders to secure a guarantee whenever possible. Businesses also reported that lenders were only offering CBILS to businesses unable to access regular commercial financing, whilst pushing other businesses to take-up more expensive commercial products.
- 2.63. On 26 March 2020 a market intelligence report was prepared by BEIS officials summarising the initial ad hoc findings on CBILS, drawing together feedback from stakeholders including the Federation of Small Businesses, the Confederation of British Metalforming and The London Chapter of EO Entrepreneurs Organisation {GD(B)/062 – INQ000596664}. It summarised concerns that had been raised, including by businesses, for example:
 - a) Confusion over the need for personal guarantees, and many lenders asking for personal guarantees, even though this was not required under the scheme. Nevertheless, personal guarantees had been envisaged at the earliest stages of development of the scheme as an alternative to providing security for loans below a certain size {GD(B)/063 – INQ000563874};
 - b) The processes and administration of CBILS, such as whether the existing accredited lenders had sufficient capacity to respond to all potential businesses seeking loans, the process for becoming an accredited lender not being sufficiently transparent, and guidance on eligibility for CBILS not being sufficiently clear;

- c) Lenders asking businesses for cash flow forecasts as part of the application process. There was feedback that forecasts were difficult to prepare at that time and would not, in any event, look positive;
 - d) Lenders rejecting loans for companies; and
 - e) Concerns that accessing CBILS would affect a company's credit rating and that credit insurers would penalise businesses which had been unable to deliver goods or had had cash issues as a result of Covid-19.
- 2.64. The same report contained some feedback from a lender, NatWest, which had reported that there was a “[c]hallenge for banks to support as companies not looking attractive as have reduction in orders and have high levels of debt”. NatWest had suggested that new forms of government guarantee were needed to help de-risk the debt.
- 2.65. On 27 March 2020, BEIS officials provided a submission to the Secretary of State in response to this feedback {GD(B)/064 – INQ000563900}. The submission updated the Secretary of State on the roll-out of CBILS, including lenders’ approach to personal guarantees. There was significant interest in the scheme from both businesses and lenders. The volumes of approved loans were low but were expected to increase significantly in the following days.
- 2.66. The submission explained that, under CBILS, lenders were allowed to obtain personal guarantees against any of the borrower’s assets, except for the borrower’s primary residential property. The five major lenders had removed the requirement for personal guarantees on CBILS loans under £250,000. Given the lenders’ approach to personal guarantees, BEIS officials asked the Secretary of State if he wanted BEIS to work with HMT and BBB urgently on plans to amend the rules concerning personal guarantees, namely:
- a) Prohibiting personal guarantees for CBILS facilities under £250,000; and
 - b) Changing scheme rules for facilities over £250,000 so that, if a business defaults on a CBILS loan, the lender would be entitled to claim the 80% government guarantee before turning to any personal guarantees in place. This would limit the personal guarantee to 20%.
- 2.67. Later that day, the Secretary of State’s private office responded to the submission indicating that the Secretary of State was supportive of the recommendations {GD(B)/065 – INQ000563903}. However, the email stated “...in discussion with BBB

we need to understand what impact there will be on the number of lenders.” The Secretary of State asked BEIS officials for a note detailing lenders’ current approaches to personal guarantees. The email also explained that the Secretary of State had agreed to send a joint letter with the Chancellor to the lenders, but the private office understood the Chancellor had already sent the letter and requested a copy.

- 2.68. On 28 March 2020, Gemma Peck emailed the Secretary of State’s private office and Alex Chisholm providing an urgent update on changes to CBILS {GD(B)/066 – INQ000563905}. The email stated:

“HMT officials have been in touch to say CX wants to announce two changes to CBILS rules on Personal Guarantees (PGs) on Monday [30 March 2020]. I recommend that, via private office, SoS push back firmly on this to CXO this morning, on the basis that we need more time to properly understand the impacts, and prepare the BBB and the banks to operationalise it effectively. As we have seen this week, there are risks with launching major schemes like this at pace and without chance to really prepare and test deliverability.” (Original emphasis)

- 2.69. The email summarised the changes to the personal guarantees rules and the issues that required discussions before launch, full details of which were set out in a later submission (paragraph 2.71, below).
- 2.70. Later in the evening on 28 March 2020, officials from BEIS, HMT and BBB held a discussion on the changes to the personal guarantee rules for CBILS {GD(B)/067 – INQ000563906}. It was noted that, “*CX very firmly of view he wants these changes made.*” The BEIS, HMT and BBB officials agreed that the changes could not be launched “*...in any sensible fashion for Monday*” (30 March 2020) and they instead proposed to aim for 31 March 2020. HMT officials would advise the Chancellor of delaying launch until 31 March 2020, and BEIS officials informed the Secretary of State’s private office and the Permanent Secretary that they would shortly be sending a submission and an addendum to the original Accounting Officer advice regarding the proposed changes.
- 2.71. Accordingly, on 30 March 2020, BEIS officials sent a further submission to the Secretary of State, detailing the two changes to CBILS that the Chancellor wanted to announce concerning personal guarantees and the implications of these changes {GD(B)/068 – INQ000563909}. The first change was as set out in the earlier submission of 27 March 2020, namely that lenders would not be permitted to require

a personal guarantee for loans or other facilities under £250,000. The second was that, for loans over £250,000, lenders could seek a personal guarantee. In the event of default, the lender would first seek to recover from business assets before then looking to the personal guarantee for a maximum of 20% of the remaining debt, and thereafter claim 80% of the residual loss under the government guarantee. This differed to the original proposal set out in the submission of 27 March 2020, which was not permissible under State aid rules since the proportions of liability under the guarantee would no longer be 80/20 between the Government and the lender, therefore could be viewed as State aid to the lenders.

- 2.72. The submission explained that the Chancellor was strongly in favour of the proposed changes on the basis that they were likely to be more attractive to business owners and company directors, “...*who may feel that a [personal guarantee] heightens the personal consequences of failure to an unfair extent.*” The changes were also designed to address the criticism that the lenders were not taking on enough risk.
- 2.73. As set out in the submission dated 30 March 2020, BEIS officials advised that the proposed changes to the CBILS scheme gave rise to “*a risk of perverse incentives for company directors. An unscrupulous director could potentially access a CBILS - backed loan, take funds out of the business (either as salary or potentially as loan repayments, if they had previously lent money to the business) and then put the business into liquidation with limited personal consequences. PGs are in part designed to prevent this type of behaviour.*”. The proposed changes in respect of personal guarantees were likely to increase the size of claims under the guarantee because the contribution from private assets to making up any shortfall would be reduced. The proposals would therefore require additional budgetary cover for the financial year 2020/2021. The Secretary of State was advised that BEIS officials had not been able, in the time available, to carry out a reliable analysis of additional budget cover or of the economic impacts of the scheme, including value for money estimates. Two example scenarios had been prepared to illustrate how the proposed amended CBILS could impact on government finances, but it was stressed that this was not a full analysis.
- 2.74. On the same day, 30 March 2020, BEIS officials sent supplementary Accounting Officer advice to the Permanent Secretary {GD(B)/069 – INQ000563910}. The advice summarised the Chancellor’s plans for further adjustments to CBILS in relation to personal guarantees and stated that BEIS officials believed:

"...these changes increase the likelihood and amount of losses that will be called on under the guarantee and therefore worsen the value for money of the scheme".

- 2.75. BEIS officials advised that the *"judgement on [value for money] is subject to the same limitations as the original assessment, that there has been insufficient time and data for a full analysis"*.
- 2.76. The need for a ministerial direction had been considered and BEIS officials had consulted the Treasury Officer of Accounts. As the BEIS officials did not believe the proposed changes materially altered the first ministerial direction issued on 22 March 2020, they recommended that a second ministerial direction was not needed. BEIS officials explained that, although the proposals would likely lead to a further reduction in value for money, uncertainty remained as this effect could be offset by the positive impact of widening access to finance for a greater number of businesses that would not otherwise have applied for support due to the requirement for personal guarantees.
- 2.77. Also on 30 March 2020, David Raw (Deputy Director, Financial Services Group, HMT) sent a submission to the Chancellor and Economic Secretary to the Treasury to seek their views on expanding the eligibility criteria for CBILS {GD(B)/070 – INQ000563908}. David Raw explained that under CBILS, if a bank could offer a loan without using the scheme (without needing the government guarantee), they were obliged to do so. This approach seems to have been included for guidance for lenders early in the life of CBILS {GD(B)/071 – INQ000563895}.
- 2.78. The submission stated this was causing significant problems for SMEs seeking finance as a result of Covid-19 as they did not want to take an ordinary loan from a bank on which they would have to pay interest, and SMEs were clear that they wanted a CBILS loan to benefit from the 12-month interest-free period. The submission explained that there had been recent press coverage criticising the unfairness for businesses in a more solid financial position who were not eligible for CBILS, but were impacted by the pandemic. The submission drew the Chancellor's attention to significant pressure from SMEs, feeling that they were being punished for being too financially strong compared to their less financially strong competitors. It explained that the MPs were communicating concerns to the Economic Secretary to the Treasury.
- 2.79. As a result of this, the Economic Secretary to the Treasury asked for advice on expanding CBILS so that a bank would have to offer a CBILS loan to any viable SME

facing cashflow issues as a result of Covid-19 regardless of whether or not their chosen bank felt able to lend to them outside the CBILS scheme.

- 2.80. BEIS officials believed this change would address the problem that had been identified. However, the Chancellor was advised about the “...*significant fiscal consequences of the change together with the risk of setting a precedent for public funds being used to support businesses who are able to access lending on normal commercial terms.*” {GD(B)/070 – INQ000563908}.
- 2.81. On 31 March 2020, the Chancellor confirmed his intention to proceed with an expansion to CBILS, and BEIS officials prepared advice to their Ministers, updating them on the proposals {GD(B)/072 – INQ000563912}.
- 2.82. On 1 April 2020, BEIS officials sent a submission to the Secretary of State setting out the Chancellor’s proposed changes to CBILS as described above, which he planned to announce the same week {GD(B)/073 – INQ000563918}. It explained that the Chancellor was strongly in favour of these changes and they were designed to remove “...*perverse effects of the current CBILS scheme (lower risk businesses facing less favourable terms when accessing finance) and to pre-empt a spread in financial distress to more businesses as the impact of the pandemic increases.*”
- 2.83. BEIS officials explained that a further ministerial direction from the Secretary of State may be needed 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. This included the likelihood that the Government would incur significantly increased liabilities in relation to loan defaults. BEIS officials advised that in effect, CBILS would become the default for new SME lending (including the refinancing of existing facilities), and expected that nearly all new SME lending would fall within the scheme, and much of the stock of lending could be brought within in.
- 2.84. BEIS officials advised that:
- “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.”*
- 2.85. The submission also explained that:

“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.” (Original emphasis)

- 2.86. The submission set out that the Department needed “...to secure agreement from HMT that BEIS budgets would be held harmless, across all budget categories, from the consequences of the proposed changes.”
- 2.87. Other risks were identified and expanded on. For example, BEIS officials advised that the Department could not be certain that BBB systems had the capacity to absorb many new applications, and there were already significant new pressures on BBB to accredit new lenders at speed, which would intensify.
- 2.88. The Secretary of State was asked if he wished to approve the changes and seek HMT consent to implement them. Consent was required as HMT would provide the budgetary cover to the Department.
- 2.89. In this submission BEIS officials also presented an alternative proposal to the Secretary of State, namely to approach the Chancellor with a scheme aimed at reducing the risk and offering better value for money. An option was set out in Annex B to the submission, which would widen the availability of Business Interruption Payments. A BIP was a grant paid for the benefit of businesses to cover lenders’ fees and interest of their borrowing, which would be enough to cover those costs for 12 months on all but the largest loans. That proposal had been shared with HMT officials during a meeting on 31 March 2020, which included officials from BBB, BEIS and HMT. At the meeting, Gwyneth Nurse of HMT had indicated that the proposal would not deliver the Chancellor’s policy objectives, however, no further explanation was provided GD(B)/074 – INQ000610529} {GD(B)/075 – INQ000610528}.
- 2.90. On the same date, 1 April 2020, BEIS officials sent an Accounting Officer note to the Permanent Secretary in relation to the Chancellor’s proposal to remove the requirement for borrowers to show that they would have been unable to secure finance on commercial terms {GD(B)/076 – INQ000563917}. The note explained that the change would have “...the effect of removing a condition that safeguarded the additionality of the scheme.” BEIS officials expected that nearly all SME lending would now fall within CBILS. The note also advised that, through refinancing (either with an

existing or new lender), the stock of existing SME lending could be brought within CBILS, i.e. businesses could use CBILS loans to pay off some or all of their existing commercial loans.

- 2.91. The note summarised the budgetary and value for money implications of the proposed change and provided an Accounting Officer Assessment for consideration. This categorised the risks to regularity and propriety as high and the risk to value for money as very high. The note also set out the alternative proposal detailed in the 1 April 2020 submission to the Secretary of State (as discussed in paragraph 2.89 above) with an indication that HMT officials did not think that alternative proposals would deliver the Chancellor's policy objectives. In light of the risks highlighted, BEIS officials recommended that the Accounting Officer should request a ministerial direction.
- 2.92. On 2 April 2020, the Permanent Secretary (in his capacity as Accounting Officer) wrote to the Secretary of State seeking a ministerial direction {GD(B)/077 – INQ000065315}. The letter set out:
- a) That the proposed changes to rules on personal guarantees would make CBILS more attractive to company owners and directors, which should encourage take-up and so likely lead to an increase in the number of claims on the government guarantees. Some of that should be offset by an increase in benefits through more businesses being preserved by the increased take-up, but there was no evidence to provide an analysis of this. The advice was that whilst these changes impacted value for money, the Accounting Officer did not believe that they represented a material change to the original assessment provided for CBILS;
 - b) That the broadening of CBILS to include SMEs that would otherwise have access to commercial loans did represent a material change to the original CBILS (for which a ministerial direction had been provided). The Accounting Officer explained that the businesses able to obtain finance on normal commercial terms considered the current scheme to be unfair and “...*whilst they might be in a better position currently to cope with the impact, their resilience is limited and could be eroded the longer the crisis persists, increasing the risk to jobs. The intention is therefore to pre-empt a spread in financial distress to more businesses as the impact of the pandemic increases*”;
 - c) It was reasonable to assume that nearly all new SME lending would be subject to a government guarantee, and so the increase in funding required to cover

the guarantee did represent a material change. The Accounting Officer set out an estimate that the taxpayer could incur a contingent liability of up to £60 billion;

- d) The letter outlined that:
- e) *“The economic benefits continue to be difficult to assess, but the expected increase in costs and the risk that the expanded scope will see CBILS being used where lending would have taken place in any event, means that I must also assume that the broadening of the scope may lead to a further reduction in value for money”;*
- f) Potential risks impacting on propriety were identified, for example the proposed changes would provide a strong incentive for lenders and businesses to refinance borrowing onto CBILS. This was said to be mitigated to a certain extent by the inclusion of a refinancing cap of 20% in the agreement with each lender, but did not stop a business from seeking finance with another lender and using some of all of this to repay existing debt. It was said that this would reduce the additionality and value for money of the scheme;
- g) There was a risk that BBB and lenders’ systems had not had adequate time to prepare for the changes;
- h) It had not been possible to complete consultation with the European Commission in relation to State aid; and
- i) There were options for improving the regularity, feasibility and value for money of the scheme if the Chancellor and Secretary of State were willing to accept a short delay. Four options were set out and the Accounting Officer strongly recommended that all four of these steps were taken before the scheme was announced in detail. These four options were:
 - i. Confirming that the new changes were consistent with the temporary State aid scheme of the European Commission;
 - ii. Testing the changes further with BBB and their financial partners;
 - iii. Considering adopting alternative ways to remove the perceived distortion between commercial and non-commercial borrowers, notably by applying BIP to all businesses that met the sectoral and turnover criteria for CBILS; and

- iv. Providing funding in tranches and subject to an overall cap.
- 2.93. The Permanent Secretary confirmed that he fully understood the severity and urgency of the situation facing SMEs and the good intent behind the proposed changes to CBILS. However, he concluded that he could not “...as *Accounting Officer*, support the specific proposals to change the eligibility criteria. **Managing Public Money** therefore requires that if you wish to progress with the further changes to CBILS as detailed above, I will require a written direction from you to do so.” (Original emphasis)
- 2.94. On the same day, the Secretary of State and the Permanent Secretary discussed the contents of this letter. The Secretary of State requested further information about how confident BEIS officials could be about the likely future financial losses and countervailing economic benefits, and the strength of current demand from the business community for loans.
- 2.95. The Permanent Secretary responded later that day with further advice {GD(B)/078 – INQ000064864}.
- 2.96. The Permanent Secretary explained that BEIS officials had not been able to put together reliable estimates on either the costs or benefits of the intended scheme in the time available. Even with more time, BEIS officials would not be able to provide reliable data until they could see the take-up of the scheme from businesses and, in particular, the use businesses made of the finance and their subsequent trading performance. He explained his concerns about the additionality of the scheme with the proposed changes to eligibility. BEIS officials also found it very hard to assess the extent to which lenders would seek to make a changed CBILS their main instrument for lending to SMEs, but could point to a surge in new lending after the introduction of a guaranteed lending scheme in response to the financial crisis. He explained how attractive CBILS was likely to be and described it as unprecedented.
- 2.97. The Permanent Secretary continued, explaining that it was even harder to estimate the economic benefits of businesses where the business was preserved through a CBILS loan. It would often be difficult to determine what role a loan played on the future performance of a business. He appreciated that this “...*large range and weak data support does not provide as solid a basis for a decision you would wish, but [that] was the reality of the situation today.*”
- 2.98. In relation to the strength of demand from the business community for loans, the Accounting Officer thought there was:

“...strong if early evidence about the severity of the economic impacts of Covid-19. In some sectors of the economy, notably non-food physical retail, business activity has been terminated. In other sectors such as construction, all sites across the country have experienced interruption and many have had to cease work.”

- 2.99. The tourism and hospitality sectors had been very severely impacted by the non-pharmaceutical interventions. There had also been severe impacts on transport, logistics, and associated businesses. Much of manufacturing capacity had also been closed. In addition, consumer confidence had fallen dramatically. The Accounting Officer stated that the Secretary of State had seen much evidence recently and heard from businesses and BROs, and *“[t]he common picture presented show[ed] that the economic impacts [were] orders of magnitude greater than that experienced during the financial crisis...”*. He explained that severe reduction in economic activity had put the business community under huge stress, particularly for SMEs which, in many cases, lacked the financial and other resources to be able to deal with the economic storm. His advice was that there was no question as to the urgent and significant need for additional government liquidity to be provided through the banking sector with the support of the Government and, without such help, many otherwise viable businesses would undoubtedly fail with all the associated costs and other harms in terms of both economic and social welfare.
- 2.100. Also on 2 April 2020, the Secretary of State wrote to the Chancellor about the proposed changes to CBILS {GD(B)/079 – INQ000563921}. The Secretary of State acknowledged the Chancellor’s intention to announce the changes to CBILS the following day, and recognised that the changes were intended to mitigate the potentially severe economic consequences of the pandemic. The Secretary of State did, however, caution that the proposed changes to the scheme had been put together very rapidly, introducing new risks in terms of value for money and feasibility of delivery. There were ways in which those risks could be addressed but these would inevitably take time. As such, the Secretary of State explained:

“There is a judgement to be made about how realistic it is to take further time in re-designing and testing the scheme as my Accounting Officer has proposed to me, or to proceed with these important changes tomorrow as planned.

I wanted you to be aware of the concerns raised by officials in my Department before you finalise your formal decision to allow us to proceed.

My current understanding is that you wish to proceed at this time, and in order to be able to do so I will need to issue an Accounting Officer Direction. I also need confirmation that the Treasury gives its consent to proceed with these changes to the existing CBILS scheme, which my officials inform me are novel, contentious and repercussive under the terms of Managing Public Money. I would also be grateful for formal confirmation that the consequential costs for BEIS and BBB will be met by the Treasury.”

2.101. On 2 April 2020, the Chancellor's private office communicated the Chancellor's agreement to expand the eligibility of CBILS and confirmed that HMT would provide the necessary budget cover to meet costs resulting from these changes {GD(B)/080 – INQ000563925}.

2.102. As a result, on 2 April 2020, the Secretary of State wrote to the Permanent Secretary stating that the Chancellor had given him approval to proceed with the proposed changes to CBILS and therefore the Secretary of State was prepared to support these changes {GD(B)/081 – INQ000064780}. He advised that he was providing a formal ministerial direction to introduce the changes as soon as practicable. The Secretary of State confirmed as follows:

“The overall reason for the proposed changes to the scheme is therefore to mitigate the potential severe economic consequences across the economy and, in the current circumstances, I believe this justifies the immediate introduction of these changes to CBILS. The overwhelming feedback from the business community is that even a few days will make a real difference to many SMEs in getting the support they need. I therefore concur with the Chancellor that in the present circumstances it is necessary to launch this amended scheme without delay to support businesses struggling to survive from day to day.

As you note in your communications, the speed at which events have unfolded has not allowed sufficient time for a full value for money assessment to be undertaken and there remain risks around the ability to deliver at this volume. However, I have confidence in officials to be able to manage down this risk.”

2.103. These changes were announced on 3 April 2020, along with the amendments to prevent lenders from obtaining personal guarantees and further details of the new CLBILS scheme.

2.104. On 6 April 2020, BEIS officials informed the Secretary of State's private office about two issues being raised about the operation of CBILS, and how the Department was responding {GD(B)/046 – INQ000563933} and {GD(B)/082 – INQ000585539}. These issues were:

- j) Some trade associations had expressed concerns about confusion regarding the terms of CBILS following its launch on 23 March 2020. These included: (i) some lenders requesting personal guarantees; (ii) members of a trade association inferring that lenders would require personal guarantees for the full amount of the loan; (iii) lenders asking some businesses to provide six months' cash flow forecast, and refusing the loan when they were unable to provide this; and (iv) a business had been advised it was ineligible for CBILS because a significant proportion of its trade was carried out overseas. The Department acknowledged that lenders had been given very little notice of the new scheme, ahead of its launch. BEIS, HMT, and BBB were working together with lenders to address any confusion; and
- k) Businesses had identified concerns about the capacity of the existing accredited lenders to respond to demand for CBILS. The submission stated that BBB's process for adding new accredited lenders had been sped up, which would increase the ability to meet demand for CBILS. The Department recognised that, with limited capacity, lenders had been prioritising larger loans and alongside working to accredit new lenders as quickly as possible, work was ongoing with existing lenders to speed up approvals, for example, through automated credit checks for lower-value loans, and improving the guidance provided by BBB to lenders to help them take decisions on eligibility.

Further Amendments to CBILS

2.105. On 17 April 2020, BEIS officials sent a submission to the Secretary of State seeking approval for an extension to CBILS to allow charities and further education (FE) colleges to access the scheme, regardless of the level of their trading activity {GD(B)/083 – INQ000563967}. It explained that charities and FE colleges were only able to access CBILS if at least 50% of their income came from trading activity and, in practice, this prevented a lot of large organisations, e.g. arts and cultural organisations like the English National Opera, from accessing support. The submission made the same request in relation to CLBILS, which had been launched on 20 April 2020.

- 2.106. On 23 April 2020, BEIS officials sent a further submission (dated 21 April 2020) to the Secretary of State about further potential amendments to CBILS and about a potential new loan scheme for smaller value loans {GD(B)/084 – INQ000563987}.
- 2.107. The submission updated the Secretary of State on the performance of CBILS. Media coverage of CBILS had focused on the low level of loans approved compared to the number of applications and enquiries, but recent figures had shown that the rate and volume of lending was increasing. The submission explained that the Chancellor wanted to make two changes to CBILS to speed up lending: removing the portfolio cap for lenders, and simplifying the viability test by removing the criteria that a CBILS facility must enable the business to trade out of short-term difficulty. BEIS officials advised that removing the portfolio cap would bring CBILS into line with CLBILS, would make the 80% guarantee more generous for lenders and may also provide them with capital relief. This was considered likely to increase the risk appetite of lenders meaning more loans were granted. Removing the cap would increase the Government's contingent liability. The Secretary of State was advised that if he supported the change, the Department would need HMT to give assurances about continuing to fund the costs associated with CBILS.
- 2.108. The proposed amendment to the viability test was considered to be justifiable on the basis of feedback from lenders that it was difficult for them to make a future assessment of the viability of a business given the unpredictability of the pandemic and its impacts. Trying to collect this information was often burdensome to SMEs, who were being asked to provide business plans and projections, and lenders had argued this was leading to delays and applications being rejected which might otherwise not be. BEIS officials pointed out that this amendment could remove a barrier for businesses seeking a loan but it came with risk that some businesses which had significant concerns about their ongoing viability could be approved for lending. As such it would have a negative impact on value for money for the Government insofar as it increased the likely default rate for CBILS loans. However, the lenders would still retain 20% of the risk of each loan which, BEIS officials said, should act as a “...*break on the riskiest lending*”. In addition, this change could result in businesses that were never likely to survive receiving loans “...*with the potential for accusations that Government should have protected them from irresponsible lending.*” BEIS officials advised that, in the context of the crisis, and given the Government's stated intention to do whatever it took to support the economy, this might be considered an acceptable risk.

- 2.109. The submission stated that HMT planned to explore these options with lenders before taking a final view. BEIS officials stated that they did not recommend removing the portfolio cap without robust evidence that this would have a material impact on lending behaviour, or the Government would just be taking on “...*greater downside risk with very little upside.*”
- 2.110. BEIS officials also recommended two other ways of increasing access to CBILS that would have lower additional risk for the Government. The first was to encourage lenders to accept more use of self-certification for the ‘undertaking in difficulty’ test. This was an accounting test used for the purposes of State aid rules and adding time to the processing of applications. BBB had informed lenders that applicants could simply self-certify eligibility but, in practice, lenders doing this was ‘patchy’ because they were worried that the Government would disapply the loan guarantee if it turned out that self-certification proved unreliable. BBB was preparing to issue new guidance to lenders offering more clarity on the approach and officials advised working with lenders to find out what assurances they might need.
- 2.111. The second was to write to lenders to reassure them that the Government would not seek to disapply the guarantee in relation to a defaulted loan where it was clear that the lender had acted in good faith.
- 2.112. As stated, the submission also informed the Secretary of State that the Chancellor had asked for advice on establishing a new loan scheme with a 100% guarantee for smaller value loans. This ultimately became the BBLs, which I explain in detail in Section 4 of this statement. The submission explained that the “...*objective for this proposed new scheme was to address the initial slow rate of progress on CBILS although recent figures had shown a substantial improvement.*”
- 2.113. On 24 April 2020, HMT emailed BEIS officials to explain that the Chancellor had, the previous night, committed to the CEOs of the seven largest SME lending banks that amendments to CBILS would be made and implemented on 27 April 2020 {GD(B)/085 – INQ000543174}. The Secretary of State’s decision was sought on the proposed amendments. These were:
- a) Lifting the portfolio cap;
 - b) Removing the ‘forward-looking’ element of the viability test;
 - c) Removing or redrafting references to both ‘standard of care’ and ‘normal commercial lending practices’ in the CBILS rules/legal agreement. This was a

new proposed amendment raised by lenders (although it had similarities to an option set out in the submission dated 21 April 2020, described above). It was aimed at reassuring lenders that the Government would take a pragmatic approach to the guarantee agreements, thereby aiming to increase lenders' appetite to take on risk to support businesses; and

d) Widening eligibility to CBILS for charities.

2.114. HMT asked for the Secretary of State's urgent decision on these proposed amendments.

2.115. Later that day, the Secretary of State sent a letter to the Chancellor about the proposed changes to CBILS and establishment of BBLS (the introduction of BBLS is covered in detail in Section 4 of this statement) {GD(B)/086 – INQ000563988}. The Secretary of State recorded that helpful discussions had taken place between BEIS, HMT, and BBB at official level to identify further measures to support businesses as they dealt with the impact of Covid-19.

2.116. On the proposed changes to CBILS, the Secretary of State agreed that the Government should consider practical steps to streamline the application process and support good, quick lending decisions. He supported the proposal to amend the viability test for CBILS by removing the forward-facing element and stated that he was prepared to consider changes to the CBILS guarantee to remove the portfolio cap for lenders, but stated this would inevitably increase the risk to the Government associated with the scheme. As such, he was keen that before any final decisions were made, BEIS and HMT should have a discussion with lenders to understand the likelihood of a material increase in their lending if the cap was removed. The Secretary of State wrote:

"It is possible that despite the proposed amendment to the viability test, some lenders may remain reluctant to lend to firms without their own internal assessment of ongoing viability. As part of these discussions, officials should explore whether banks need further assurance on the Government's approach to applying the guarantee where CBILS loans default.

When a decision on these changes has been reached, I would welcome the opportunity to write to CBILS lenders jointly with you to inform them of these changes."

- 2.117. The Secretary of State explained that the proposed changes in relation to CBILS and introduction of BBLS carried significant risks regarding value for money and uncertainty based on Managing Public Money principles. On this basis, the BEIS Accounting Officer had informed him that subject to decisions on the final design parameters, a ministerial direction from him may be required in relation to some or all of the new proposals.
- 2.118. On 25 April 2020, Laurence Pawley updated the Secretary of State on developments regarding the proposed changes to CBILS {GD(B)/087 – INQ000543178}. He explained that the Chancellor intended to make the changes as set out in HMT's email of 24 April 2020 and wished to announce these changes on 27 April 2020. As the changes impacted the contingent liability incurred by BEIS, the Secretary of State was required to notify Parliament.
- 2.119. On 26 April 2020, the Secretary of State's private office responded to the submission dated 17 April 2020 {GD(B)/088 – INQ000563992}. The Secretary of State was content to proceed with the proposed changes relating to charities and FE colleges, provided that HMT was also content, which was understood to be the case.
- 2.120. Later that day, BEIS officials provided the Secretary of State with an update note on the changes to CBILS in advance of the announcement of 27 April 2020 {GD(B)/089 – INQ000585592}. The update stated that as part of the announcement, the lenders would be informed of the changes to CBILS as detailed in paragraph 2.121. In addition, lenders would also receive a letter from the Secretary of State and the Chancellor reassuring them that the Government would not seek to disapply the guarantee in relation to a defaulted loan where it was clear that the lender had acted in good faith. The Secretary of State was advised that although the changes increased the potential liability, they did not materially change the considerations on value for money in the existing Accounting Officer Assessment of the scheme. As such, another ministerial direction was not required to implement these changes.
- 2.121. On 27 April 2020, the Government announced further changes to CBILS as follows {GD(B)/090 – INQ000593159}:
- e) Removing the portfolio cap so that the Government would provide a 80% guarantee across each CBILS' lender's entire portfolio of lending (compared to previous effective portfolio cap of 60% explained at paragraph 2.25e). This was intended to give lenders further confidence to supply finance through the scheme;

- f) Removing the 'forward looking' element of the viability test, as explained above; and
- g) Charities and FE colleges were no longer required to show that at least 50% of their income came from trading activity to be eligible for CBILS (and CLBILS). This requirement had excluded a large number of organisations in these sectors from accessing support through these schemes {GD(B)/091 – INQ000543180}.

The Outcome of the Implementation of CBILS

- 2.122. As explained in paragraphs 7.26 and 7.27 below, the application period for CBILS was extended on three occasions and only closed to new applications on 31 March 2021. BEIS worked with BBB to improve accessibility to CBILS funding and ensure there were accredited lenders in all regions.
- 2.123. Analysis of final CBILS data, published by BBB on 6 July 2021, provided the following statistics on the distribution of CBILS funds by region {GD(B)/092 – INQ000236943}:
- a) East Midlands received 7% of the overall CBILS funding and accounted for 7% of the UK business population;
 - b) East of England received 10% of the overall CBILS funding and accounted for 10% of the UK business population;
 - c) London received 17% of the overall CBILS funding and accounted for 19% of the UK business population;
 - d) North East received 3% of the overall CBILS funding and accounted for 3% of the UK business population;
 - e) North West received 11% of the overall CBILS funding and accounted for 9% of the UK business population;
 - f) Northern Ireland received 2% of the overall CBILS funding and accounted for 2% of the UK business population;
 - g) Scotland received 6% of the overall CBILS funding and accounted for 6% of the UK business population;
 - h) South East received 15% of the overall CBILS funding and accounted for 16% of the UK business population;

- i) South West received 9% of the overall CBILS funding and accounted for 9% of the UK business population;
- j) Wales received 3% of the overall CBILS funding and accounted for 3% of the UK business population;
- k) West Midlands received 8% of the overall CBILS funding and accounted for 8% of the UK business population; and
- l) Yorkshire & the Humber received 8% of the overall CBILS funding and accounted for 7% of the UK business population.

2.124. The data suggested that the distribution of CBILS funds in each of the nine English regions and three devolved administrations matched closely their respective share of the UK business population. The regional disparities in the distribution of CBILS funds could also be linked to the business density, sectoral differences, and the type and size of the businesses

SECTION 3: CORONAVIRUS LARGE BUSINESS INTERRUPTION LOAN SCHEME (CLBILS)

Introduction

3.1. In this section I provide information about the policy objective, design, and implementation of CLBILS and early developments to the scheme. At Section 10 below, I set out my reflections on CLBILS in further detail, as well as lessons learned within the Department for any future emergencies.

Economic Policy Objectives of CLBILS

3.2. Shortly after the launch of CBILS on 23 March 2020, the Government received a growing number of requests from businesses and BROs for additional government support for larger companies. On 25 March 2020, the Permanent Secretary attended an Extraordinary Business Investment Committee meeting to discuss business investment issues in the UK {GD(B)/093 – INQ000563894}. At the meeting, officials from various government departments including BEIS reported that businesses in some key affected sectors had raised concerns that they were too large to benefit from CBILS and not able to access the CCFF. The CCFF was an HMT and Bank of England business support scheme for larger companies, helping them to bridge disruption to their cash flow through the purchase of short-term debt. In simple terms the CCFF was open to a small number of companies which had a very large turnover and a low expected risk of default.

3.3. At the daily ministerial call held on 26 March 2020 and attended by the Secretary of State, Sarah Munby raised the concerns regarding the companies who were not eligible for CBILS and the CCFF {GD(B)/094 – INQ000563896}. She explained that they fell into two main categories:

- a) Healthy companies who were not eligible for the schemes due to their size; and
- b) Companies who were not investible as of 1 March 2020, irrespective of their size. Those companies were being considered on an individual basis as by definition they were not in a sound financial position before the pandemic. As a result, officials were considering the public policy rationale for providing support.

3.4. On 27 March 2020, BEIS officials sent a submission to the Secretary of State, to provide an update on the handling of these larger companies, noting the Department

had received a growing number of requests for additional support {GD(B)/095 – INQ000596661}. The submission provided the following updates:

- a) The processes BEIS established to collate and monitor requests for government support for large companies in response to Covid-19;
 - b) An update on the requests for government support BEIS had received or of which it was aware. An excel spreadsheet of requests from large companies was attached to the submission at Annex A {GD(B)/096 – INQ000563901};
 - c) An overview of known sector vulnerabilities. This was an analysis BEIS had started to prepare to establish the main issues facing businesses. The analysis was also prepared to determine whether an in-depth analysis of all the companies which fell outside the eligibility for SME support and CBILS was required. This analysis was attached to the submission at Annex B {GD(B)/097 – INQ000596660}; and
 - d) HMT's proposed Principles for Intervention {GD(B)/098 – INQ000563899}. At this point, HMT was taking a case-by-case approach to requests for company support and HMT officials had prepared the principles as these were likely to be the basis on which requests for large company support (not covered by existing schemes) were assessed. The submission explained that the proposed principles set a high bar for government intervention. This approach was very labour intensive, limiting the number of companies that could receive support, and was due to be discussed at the Covid-19 Economic and Business Response Implementation Group (EBRIG) meeting the following week.
- 3.5. On the same day, BEIS officials sent a parallel submission to be considered by the Secretary of State, recommending that BEIS should continue to work urgently with HMT to look at options for further government support outside the current mechanisms detailed above {GD(B)/099 – INQ000563902}.
- 3.6. The submission informed the Secretary of State about the growing concern that businesses with a turnover above £45 million (the upper limit for CBILS) did not have access to finance under the CCFF or CBILS. This impacted approximately 5,000 businesses in the UK, accounting for around 21% of the turnover and 20% of the employment of all UK incorporated firms. Around 10% of these were listed public companies. While these businesses represented a very small percentage of UK firms by number, they were significant employers and generators of wealth and were

referred to as the 'missing middle' as they did not have access to finance. BROs, businesses and the media had started asking questions about the 'missing middle' at that time.

3.7. The submission advised that HMT and the Chancellor were working on a possible solution to support this group of businesses. But HMT officials had suggested that any solution was likely to be "...weeks' away" and had indicated there were substantial challenges due to limited finance for further interventions. The submission set out a number of potential solutions that could be considered, subject to HMT approval. These were:

- a) Increasing CBILS turnover limit, although BBB and lenders were already facing challenges in implementing CBILS;
- b) Reducing the threshold of the CCFF scheme. This was made challenging by the fact the 'missing middle' businesses were not likely to qualify if eligibility depended on investment grade status;
- c) Creating a new scheme that would be run either through banks or specialist lenders, or directly from the Government. Timescales and deliverability would likely be challenging; or
- d) If no scheme was developed or extended, the submission advised that the Government would have to respond to these businesses on a case-by-case basis. She explained there was a concern about the ability of Departments, UKGI and HMT to handle a potential "...flood of medium sized cases".

3.8. The submission explained that BEIS officials had raised concerns with HMT about the lack of support for the 'missing middle' and also that HMT was being directly lobbied by businesses. The submission recommended that the Secretary of State should consider writing to the Chancellor to record his concerns and offer to work collaboratively to find a solution.

3.9. BEIS liaised with BBB to analyse this group of businesses. On 1 April 2020, BBB provided some analysis on what demand could look like for a scheme for businesses turning over between £45 million and £100 million {GD(B)/100 – INQ000585518}. The analysis indicated that the demand for these businesses could be between £6 billion and £88 billion (based on the Business Finance Survey method) or £14 billion and £147 billion (based on the FAME method). FAME is a database containing financial and geographical data for SMEs. BBB was clear that the analysis had been produced

at speed and, given this, there was a risk of modelling errors {GD(B)/101 – INQ000585519}.

3.10. On 1 April 2020, officials from BEIS and HMT met to discuss the scheme design for this group of businesses {GD(B)/102 – INQ000563916}. An HMT official emailed the readout to BEIS officials, including the following:

- a) The Permanent Secretary was concerned about the delivery capacity of BBB, which was already under huge pressure to deliver and administer CBILS. BEIS officials indicated a ministerial direction may be requested regarding BBB's delivery challenges and other issues. There were discussions about whether other organisations could deliver the new scheme. However, HMT officials explained that *"...the Chancellor's priority is to get the scheme up and running as quickly as possible, which meant plugging into existing structures wherever possible, and effectively ruled out any other options, such as schemes delivered via BEIS or BoE"*;
- b) Both BEIS and HMT wanted any scheme to be separate to CBILS. This was largely for presentational reasons and to make clear CBILS+ would require businesses to pay interest and any fees. The scheme would offer loans between £100,000 and £25 million to businesses with turnover between £45 million and £250 million; and
- c) BEIS and HMT were to collaborate on further analysing the number of businesses that would be captured by the new scheme and identify any impact on the numbers by changing the turnover cap. The loan guarantee would range from 60% to 80%, and HMT officials would test the impact of different guarantee levels with lenders. HMT officials anticipated pressure from lenders for a higher guarantee. Although a high guarantee would lead to more businesses meeting lenders' lending criteria, this also increased the size of the contingent liability and possible fiscal risks.

3.11. Following this email, on 1 April 2020, Laurence Pawley responded to clarify the Permanent Secretary's concerns {GD(B)/102 – INQ000563916}. He explained that the Permanent Secretary's concerns were not solely about the operational capacity of BBB, but also related to the capacity of BEIS teams to carry out sufficient policy and analytical work in the timescales proposed for the new scheme, and changes to CBILS simultaneously. HMT acknowledged the concerns raised by the Permanent Secretary

but explained that the Chancellor planned to announce loans for businesses with a turnover of above £45 million by the end of that week.

- 3.12. Later on the same day, 1 April 2020, the BBB provided views on the deliverability of the new scheme stating that it “...cannot develop policy of this sort rigorously in an afternoon, so we’ve simply done our best to identify red flags that could manifestly cause insoluble implementation problems...” {GD(B)/103 – INQ000585523} and {GD(B)/104 – INQ000585524}. The comments from BBB had not been approved by its Chief Executive or the BBB Board. Key concerns in delivering the new scheme included:
- a) The BBB Board would have to accept BBB was allowed to operate outside its risk management framework; and
 - b) BBB could not implement the scheme on Friday 3 April 2020. It required a separate team to develop CBILS+, and the significant issue being the same people who were working on CBILS had to work on the new scheme until a new team was established. BBB advised that if the Government instructed them the following day and provided up to £5 million funding to deliver CBILS+, it could aim to deliver the scheme on 20 April 2020.
- 3.13. On 2 April 2020, BEIS officials sent a submission to the Secretary of State about the proposed new loan scheme {GD(B)/105 – INQ000064782}. The submission explained that the Chancellor intended to announce limited details of the scheme on 3 April 2020, namely that loans up to £25 million would be available for businesses with a turnover of between £45 million and £500 million, with a government guarantee. BEIS officials had not seen the details of the proposed announcement at this point. However, HMT had indicated that the only delivery route available in the timescale envisaged by the Chancellor was BBB. As a result, the Secretary of State’s agreement was needed.
- 3.14. At that time the proposal was for each loan to be backed by a 60% government guarantee and there would be no interest relief to the borrower.
- 3.15. The submission advised that BEIS officials had significant concerns about the pace at which this scheme had been developed, which had limited the Department’s ability to test the design of the scheme with BBB and lenders, and also to assess affordability, value for money, feasibility and regularity. BEIS officials also stated that the proposed new scheme would increase operational pressures and risks on BBB, as it was also being asked to implement significant changes to the original CBILS. In addition, the

proposed new scheme would take BBB further out of its area of expertise. BBB was established to support the provision of finance to SMEs, and so did not typically work with the kinds of businesses that would be targeted by the new scheme.

- 3.16. The submission stated that BEIS officials were providing advice to the Permanent Secretary in his role as Accounting Officer, but it was anticipated that a further ministerial direction would be sought once the final scheme parameters were set.
- 3.17. Later that day, BEIS officials notified the Secretary of State's private office that some changes to the new scheme had been confirmed by HMT {GD(B)/106 – INQ000563926}. The new scheme would be called CLBILS, and the agreed changes were:
 - a) HMT agreed it would announce its intention to implement the new scheme on 3 April 2020, but it would not provide details of when or how CLBILS would be implemented. This allowed BEIS more time to work with HMT and BBB on implementation and address any outstanding policy issues. It also meant there was no need to seek an immediate ministerial direction, but this could still be required before implementation;
 - b) The level of government guarantee for CLBILS was increased to 80%, to bring it in line with CBILS. Although this change made the scheme more attractive to lenders, it also increased the Government's liability for each individual loan in the event that a business defaulted; and
 - c) CLBILS would have an additionality element which meant the scheme would only be available to businesses which were unable to access a loan on commercial terms. The addition of this criteria lowered the volume of lending under the scheme and as a result, lowered the Government's potential liability. However, businesses which were eligible for CLBILS were therefore likely to be higher risk businesses and this could impact the expected default rates.

Scheme Design

Announcement and Design of CLBILS

- 3.18. On 3 April 2020, the Chancellor announced the Government would launch the new loan scheme. The announcement stated that:

“The new Coronavirus Large Business Interruption Loan Scheme (CLBILS) will ensure that more firms are able to benefit from government-backed support

during this difficult time. It will provide a government guarantee of 80% to enable banks to make loans of up to £25 million to firms with an annual turnover of between £45 million and £500 million. This will give banks the confidence to lend to more businesses which are impacted by coronavirus but which they would not lend to without CLBILS. Loans backed by a guarantee under CLBILS will be offered at commercial rates of interest and further details of the scheme will be announced later this month.” {GD(B)/107 – INQ000593136}

- 3.19. The Chancellor also explained that CLBILS was being introduced following feedback and discussions with business groups and lenders. The Government would continue to consult with these business groups and lenders before further details of the scheme were announced.
- 3.20. Following the announcement, on 3 April 2020, the Secretary of State's private office emailed HMT about working together on CLBILS {GD(B)/108 – INQ000563928}. The email highlighted that the Secretary of State was keen to be involved in the development of CLBILS from an early stage and in the decisions relating to the scheme design, operation, and timing of the launch. If CLBILS was to be delivered by BBB, ultimately the Secretary of State was responsible for the risks and deliverability of the scheme. BEIS was therefore keen to be involved in decisions as they developed rather than when a ministerial direction was due. The email recorded that the Secretary of State and the Chancellor had spoken the day before and had agreed to hold a call with the lenders shortly and send a joint letter.
- 3.21. On the same day, 3 April 2020, HMT emailed BEIS and BBB officials seeking further comments on the latest version of the term sheet for CLBILS in order to work through the details {GD(B)/109 – INQ000594635} and {GD(B)/110 – INQ000594636}. CLBILS was largely based on the existing CBILS framework with some amendments due to the speed at which the scheme needed to be implemented. BEIS officials reviewed and responded on 7 April 2020 with three key proposed amendments {GD(B)/111 – INQ000563936}. These were:
 - a) Increasing the loan size cap from £25 million to £50 million to reflect the needs of larger businesses and deliver as much impact as possible from the scheme. Large businesses had asked BEIS if loans under CLBILS would be larger than £25 million. In contrast to small businesses, potential CLBILS applicants often had existing lenders or shareholders which could contribute to recovery costs.

CLBILS was unlikely to be the only source of funding for these large business, reducing the risk of default to the Government;

- b) Increasing the upper limit of the turnover cap which was £500 million. BEIS was concerned that a number of businesses key to the UK had a turnover of above £500 million and these businesses were not able to benefit from CLBILS due to the turnover cap. BEIS recognised the increase could be unrealistic given the turnover cap had already been increased from £250 million. There was also the related issue of defining and calculating turnover since many large businesses' turnover had collapsed in recent weeks; and
- c) Clarifying that the government guarantee could be applied to individual businesses with common private ownership as long as they were independently financed, operated, and managed to ensure UK businesses were supported. The turnover eligibility for CBILS was assessed at a group level rather than individual level. This meant UK subsidiaries of large international businesses were not eligible for CBILS. Additionally, many lenders were interpreting group turnover to include businesses owned on a portfolio basis by a private company or by Venture Capital or Private Equity funds.

3.22. On 5 April 2020, BBB sent BEIS and HMT an analysis of product development of CLBILS {GD(B)/112 – INQ000563929}. The analysis included policy requirements, parameters and implementation routes for CLBILS. BBB outlined two delivery routes (CBILS and ENABLE) which could viably support the policy requirements and provided their analysis to help decide which one could best deliver the objectives. These were:

- a) Increasing lenders appetite to lend to mid-sized companies;
- b) Operational simplicity with a quick launch;
- c) No portfolio cap for lenders;
- d) Minimising Resource Departmental Expenditure Limits (**RDEL**)⁶;
- e) Additionality (CLBILS loans were only available to businesses which were unable to access a loan on commercial terms); and
- f) Ensuring State aid compliance.

⁶ Within Department Expenditure Limits, departments are set separate limits for resource (current, or day-to-day) and capital (investment) spending. These are referred to as resource DEL (RDEL) and capital DEL (CDEL).

- 3.23. On 7 April 2020, an HMT official responded in relation to points on loan size and turnover cap {GD(B)/113 – INQ000585549}. In relation to loan size, HMT stated that the £25 million loan size had been tested with the Confederation of British Industry (CBI) who were content that this maximum amount would be sufficient to cover businesses with a turnover of between £45 million and £500 million, assuming a disruption of 3 months. The HMT official asked for an estimate of the number of firms for whom £25 million would be insufficient. In relation to turnover cap, the HMT official asked where BEIS would set the limit and stated that HMT were keen to mitigate any eligibility gap between the two schemes.
- 3.24. On 8 April 2020, and in response to the above, Alasdair Grainger (Deputy Director, Corporate Finance Advisory and Investor Relations, BEIS) confirmed that BEIS had been approached by a number of businesses indicating a funding need of more than £25 million, especially in the retail and hospitality sectors {GD(B)/114 – INQ000585550}. He also noted that if CLBILS was launched as planned it would be insufficient for a number of key firms and sectors for which BEIS ministers were concerned. He explained that company directors and lenders were not just looking for enough support to cover direct costs for a 3-month period. It was suggested that in order to cater for this aspect, lenders could allow a loan to be drawn down in two tranches, with the second drawn only as needed. Separately, on 6 April 2020, BEIS officials had highlighted that BBB did not have any data on which to estimate demand by medium-sized businesses and that BEIS had not had the time to assess an upper limit of the turnover cap {GD(B)/115 – INQ000563934}.
- 3.25. On the same day, 8 April 2020, BEIS officials sent a submission to the Secretary of State providing an update on the design and implementation of the new loan scheme, and seeking the Secretary of State's view on the proposed parameters for CLBILS {GD(B)/116 – INQ000563938}. The submission advised that the Permanent Secretary was likely to seek a ministerial direction before the scheme could be launched, and that BEIS officials had provided Accounting Officer advice to the Permanent Secretary.
- 3.26. The submission stated that the Chancellor was due to receive further advice the same day on:
- a) Eligibility for the scheme – It was expected that the Chancellor would wish to align CLBILS with the terms of CBILS by making it available to any business meeting the eligibility criteria, even if that business could access lending on commercial terms. BEIS officials advised the Secretary of State that this would

open up relatively cheaper finance to more businesses, as lenders would be expected to pass on the benefit of the guarantee to borrowers. Therefore, this could benefit more businesses. But incentivising businesses to use CLBILS over commercial lending would significantly increase the overall liability for the Government; and

- b) **Maximum loan size** – It was anticipated that the Chancellor may wish to increase the maximum loan size from £25 million (the sum in the announcement on 3 April 2020) to £50 million, to reflect the needs of companies with turnovers of between £250 million to £500 million. BEIS officials supported an increase in the maximum loan size to £50 million. This would make the scheme a more effective intervention by meeting the needs of a set of companies with turnovers closer to £500 million which would otherwise be unable to benefit from government support (or would require bespoke support).
- 3.27. On the same day, 8 April 2020, Angelina Cannizzaro (Deputy Director SME Finance (Policy and Analysis), BEIS) and another BEIS official sent a note attaching an Accounting Officer Assessment of the scheme {GD(B)/117 – INQ000563939}. BEIS officials explained that the scheme design may change due to further feedback from lenders and decisions made by HMT. However, based on the scheme design at that time, the Permanent Secretary was advised to request a ministerial direction before 15 April 2020 to meet the target date for scheme delivery. BEIS officials advised that, while lending volumes would be lower than under CBILS, loan values would be much higher and expose the Government to further liabilities with a lack of robust value for money assessment. CLBILS also represented another operational challenge to BBB which was not experienced in this segment of the market and uncertainty remained around State aid. As such, the scheme carried risks with respect to each component of the tests under Managing Public Money. The budgetary and value for money implications were particularly difficult given the uncertainties in the analysis and whether additional costs would be outweighed by the benefits.
- 3.28. In relation to value for money of CLBILS, BEIS officials explained that increasing the availability and take-up of financing by medium-sized businesses in an economic downturn was economically beneficial and offered better value for money than taking no action, for a number of reasons. For example, in general large businesses were less at risk of running into economic difficulties than SMEs and therefore less likely to incur a liability under the guarantee.

- 3.29. However, BEIS officials explained the Government's total exposure was proportionally higher under CLBILS and there was also uncertainty around the likely demand for the scheme. Moreover, the removal of additionality test meant that CLBILS would be available to all businesses including those which could access lending on commercial terms, and therefore there was a "...*considerable deadweight*" risk. In the case of CBILS, the argument for removing the additionality test was clearer. By removing the additionality test, all SMEs could benefit, not just the businesses unable to obtain finance on commercial terms. However, with CLBILS, the scheme would only be more attractive to businesses able to secure finance on a fully commercial basis if the interest rates charged by the lenders were lower due to the effect of capital relief. As lenders' interest rates were not confirmed, the argument for removing the additionality test was arguably weaker for CLBILS.
- 3.30. The advice noted the Chancellor said the scheme was "...'*unlimited*' and *delivery [was] being progressed with that policy intent in mind. However, given the scale of the contingent liability that [could] be taken on (which [was] exacerbated given the absence of a portfolio cap as a stop-loss mechanism), it [was] essential to manage taxpayer's exposure as closely as possible.*" BEIS officials then set out proposals to manage the financial exposure under CLBILS:
- a) Limiting lender allocations of CLBILS loans under their delivery contract to effectively control the size of the guaranteed portfolio. BBB would take a view on further allocations to each lender, taking into account the estimated financial risk presented;
 - b) Putting an overall cap on the size of the scheme which would make it easier to consider a pause in allocating new capacity and would also allow proper modelling of the Government's maximum exposure. However, this would be in contrary to the Chancellor's commitment. BEIS's approach to reviewing allocations was in effect trying to manage risk proportionately within this policy commitment; and
 - c) Regular checkpoints to review credit quality and loan book performance. The practical limitation of this was that the taxpayer's liability would not be confirmed for months or years after the loans were drawn. There would be limited visibility of the likely outcome when a review was undertaken.

3.31. On 9 April 2020, Angelina Cannizzaro emailed the Secretary of State's private office and the Permanent Secretary providing an update on the changes to the parameters of CLBILS following the Chancellor's feedback {GD(B)/118 – INQ000563940}:

- a) The Chancellor wanted CLBILS to be open to all viable businesses affected by Covid-19 as he did not want a repeat of CBILS criticism in respect of alleged unfairness. He was worried about attaching conditions (i.e. no dividends or bonuses) given that the Government had not placed these conditions around the CCFF and there would be a perception of treating medium-sized businesses unfairly. The Chancellor also wanted to think about implications for partnerships and sole traders, highlighting that there might be implications for capital relief for banks. Accordingly, the Chancellor was not ready to make a judgement on attaching conditions to CLBILS but believed that conditions needed to be imposed consistently across all schemes; and
- b) The Chancellor wanted to remove the turnover limit of £500 million and introduce a staggered approach to the maximum loan size (i.e. maximum loan amount of £25 million for turnover up to £250 million and maximum loan amount of £50 million for turnover above £250 million). This limited the contingent liability and reached most of the businesses in the 'missing middle' who could be helped by a loan. The analysis required further work, but there were approximately 5,000 businesses in the 'missing middle' and around 3,000 were creditworthy. If the turnover cap was removed, CLBILS would be available to all of these businesses compared to approximately 2,600 with the turnover cap.

3.32. At a BEIS meeting on 9 April 2020, the Secretary of State raised several queries concerning the scheme design of CLBILS as set out in the submission dated 8 April 2020 {GD(B)/119 – INQ000585553}. Later that day, Angelina Cannizzaro and Laurence Pawley provided responses to the Secretary of State's queries along with recent updates from HMT {GD(B)/120 – INQ000585554}. These were as follows:

- a) Coverage of UK business support schemes – the Secretary of State had asked for figures setting out what proportions of the UK corporate population were covered by the various Covid-19 support schemes (CBILS, CLBILS and the CCFF) and what the gap would be. BEIS had been working with HMT and BBB to finalise the population figures for each scheme and the potential overlaps. More than 99% of the UK business population had turnover up to £45 million per annum and could seek business finance under CBILS. For CLBILS, the

working assumptions were that the revised scheme design would bring approximately 5,000 to 7,000 businesses into scope. Approximately 3,000 to 4,500 businesses would apply and approximately 2,500 to 4,000 of these businesses would be assessed creditworthy and successful in their applications;

- b) Turnover cap – the Secretary of State had expressed concern that some UK businesses could be excluded from accessing CLBILS support either because they exceeded the turnover cap or they were part of a larger group and therefore exceeded the turnover cap at group level. The Chancellor had now confirmed that he wished to remove the turnover cap at group level. This change meant CLBILS was available to businesses with turnover of above £45 million and there should be no cohort of businesses excluded from applying to at least one of the Covid-19 schemes on the basis of turnover. However, not all businesses would be successful in their applications and the specific sectoral exclusions still applied;
- c) Conditionality – the Secretary of State had expressed a preference for clear wording in loan documentation and political messaging around expectations from businesses benefitting from CLBILS, including limitations on dividend payments. The Chancellor wished to consider this matter further and BEIS officials would provide further advice to the Secretary of State the following week. There were significant issues to be resolved including potential accusations of unfairness (such conditions were not imposed on other schemes like the CCFF) and how the conditions would be applied for different company structures (partnerships and sole traders);
- d) Maximum loan size – the Secretary of State had indicated he would be content with a stepped maximum size, increasing the maximum size to £50 million for larger businesses. The Chancellor wished to proceed with this proposal;
- e) Minimum loan size – the Secretary of State had asked why HMT had proposed a minimum loan size of £100,000 for CLBILS. HMT had clarified there would be no minimum loan amount;
- f) Term limits – the Secretary of State had indicated he was content that term limits for CLBILS should be limited to two years. The Chancellor had agreed this position;

- g) Interest treatment – the Secretary of State had expressed a view that businesses should be able to delay interest payments in relation to their CLBILS loans. BEIS officials advised that CBILS rules did not prevent this and they expected the same would apply to CLBILS. However, there were no current plans to compel lenders to offer this option to businesses; and
 - h) BBB resources – the Secretary of State had asked whether BBB had sufficient resources and capacity to deliver CLBILS by the proposed date of 20 April 2020. BBB had advised that based on the additional funding recently confirmed by HMT, it believed it was able to deliver CLBILS on 20 April 2020.
- 3.33. On 14 April 2020, BEIS officials prepared a revised note for the Accounting Officer in relation to CLBILS {GD(B)/121 – INQ000563950}. BEIS officials advised that, while there would be fewer loans than under CBILS, loan values would be significantly higher, and the Government's exposure would be proportionally greater due to the lack of a portfolio cap. Due to the significant uncertainties, BEIS officials were unable to confirm with any confidence that the scheme would represent value for money. Accordingly, the Accounting Officer was advised that a ministerial direction should be sought.
- 3.34. BEIS officials advised that CLBILS carried risks with respect to each component of the tests under Managing Public Money. The most significant concerns related to value for money. Key concerns included affordability and budget cover, managing the Government's overall liability and value for money concerns.
- 3.35. The advice contained possible options to mitigate the overall risk of CLBILS further if time allowed:
- a) Considering alternative measures to reduce incentives to use CLBILS as a potentially cheap source of finance. Suggestions included reducing the loan cap, i.e. to 75%, reinstating the additionality test or attaching conditions around dividends or executive pay;
 - b) Providing funding in tranches and subject to an overall cap. This would allow the Government to review the actual market impact of the scheme progressively, and if necessary, introduce refinements or act to limit further losses to the taxpayer;
 - c) Confirming with the European Commission that the scheme was consistent with the temporary State aid framework; and

- d) Testing the scheme further with BBB and their delivery partners, providing more time to accredit new lenders and test the revised approach to uploading loan information.
- 3.36. The note included an assessment of the equality impacts of CLBILS, determining it to be 'low impact' from an equality standpoint. Ultimately, because the scheme was designed to be universally available to businesses of a certain size, regardless of regional prosperity or deprivation, rural or urban, it was anticipated that CLBILS supported the broader 'levelling-up' policy agenda. As the scheme limited use of personal guarantees, personal wealth was not a factor in implementation of the scheme. The Department determined that it would work with BBB to collect data on characteristics of beneficiaries of CLBILS to monitor the impact on equality.
- 3.37. On 15 April 2020, BEIS officials sent a submission to the Secretary of State seeking his steers on outstanding policy issues in order to finalise the parameters of the scheme {GD(B)/122 – INQ000563954}. The submission outlined the proposed amendment to the parameters of the scheme as follows:
- a) Conditionality – the Chancellor had shown interest in attaching conditions to CLBILS facilities, specifically to prevent businesses receiving CLBILS loans from paying dividends. Several potential consequences to this approach were identified including the impact on take-up and on different company types, parity of treatment and setting precedent that could lead to demands for other conditions;
 - b) Seniority of debt – while CBILS facilities were sub-ordinated to pre-existing senior debt, the same was not proposed for CLBILS. The recommendation was that CLBILS facilities be treated 'side by side' with other senior debt. The rationale for this reflected the relative risk to government. The large businesses which would access CLBILS were more likely to have existing senior debt and other layers of capital. If CLBILS loans were subordinate to these, the Government would be taking on a disproportionate level of risk compared to other lenders and would have a reduced chance of recovering any losses in the event of default;
 - c) Group structures – the proposal was to limit loan sizes for CLBILS to £50 million across the whole group in the case of firms owned or part owned by private equity funds. This approach had the advantage of simplicity and avoided the

risk of being seen to give preferential treatment to private equity companies;
and

- d) Term limits – following feedback from lenders, officials recommended that the term limit for CLBILS facilities was increased from two years to three years. This would benefit businesses by enabling them to spread CLBILS repayments over a longer period and avoid the risk that the businesses had to seek to refinance these facilities in 12 months' time. While this change had a negative impact of extending the period of government exposure to CLBILS, this could be mitigated by a reduced risk of default caused by reducing the short-term repayment burden on businesses.

3.38. The submission confirmed that the Permanent Secretary, as Accounting Officer, had determined that a ministerial direction from the Secretary of State was required to implement the scheme for the reasons set out at paragraph 3.34.

3.39. On 16 April 2020, a further submission (dated 15 April 2020) was sent to the Secretary of State confirming that the Chancellor had agreed with the Secretary of State's approach on each of the outstanding policy issues {GD(B)/123 – INQ000563959}. The outstanding parameters of CLBILS had been finalised, as follows:

- a) A maximum term limit of three years;
- b) CLBILS facilities would be ranked with equal standing to existing senior debt;
- c) Businesses accepting CLBILS facilities would be restricted from paying increased dividends, making new capital withdrawals or implementing share buybacks unless they could show these actions would not negatively impact their ability to repay CLBILS loans. Similar restrictions were expected to be implemented for businesses accessing the expanded CCFF but would not apply to the original CCFF as it was not felt possible to retrospectively apply these changes; and
- d) Firms owned by private equity companies would be able to access the available maximum loan size on a firm-by-firm basis rather than a shared allocation between the group.

3.40. BEIS officials confirmed that the revised terms of CLBILS had been shared with the main retail lenders and they were broadly welcomed. There was particular support for the changes in relation to private equity group turnover. HMT would be making an

announcement the following day on 17 April 2020 giving more details of the scheme including the role of BBB.

- 3.41. Later the same day and in accordance with advice from BEIS officials, the Secretary of State's private office emailed HMT seeking approval to introduce CLBILS {GD(B)/124 – INQ000563958}. The Secretary of State acknowledged that he would need to issue a ministerial direction to the Accounting Officer to introduce the scheme, and he would do so following the Chancellor's agreement to introduce the scheme. Further, given that CLBILS was a demand-led scheme and there was uncertainty around the scheme (including the eventual costs and potential losses), the Secretary of State sought confirmation that HMT would continue to honour the assurances that it would provide the additional budget cover required to meet all immediate and future costs.
- 3.42. The Chancellor's private office replied to the Secretary of State's private office on the same day to confirm that the Chancellor was happy to proceed with CLBILS based on the parameters set out. The approval was provided on the following conditions:
- a) An effective monitoring system was to be established and agreed with HMT officials; and
 - b) The final value of the budgetary cover required would be informed by the monitoring system and would be agreed at Supplementary Estimates. It would be strictly ring-fenced for CLBILS and could not be used for any other purposes.
- 3.43. On 16 April 2020, the acting Permanent Secretary, Sam Beckett, wrote to the Secretary of State, seeking a ministerial direction {GD(B)/125 – INQ000563960}. The acting Permanent Secretary informed the Minister that the Government continued to see strong evidence about the severity of the economic impacts of Covid-19 and that many medium-sized businesses were experiencing acute trading pressures. She explained Covid-19 was a major shock for the UK economy and that:

“The financial sector alone is unlikely to accept the risks associated with providing significant amounts of liquidity to firms suffering from a sudden loss of cashflows. It is legitimate for the Government to consider intervening by absorbing a significant proportion of the lending risk. Business interactions over the last few weeks have illustrated a strong sense of pent-up demand for bank loans and we can see how attractive a scheme underwritten by government at the level of 80% is likely to be.”

3.44. The letter set out features of CLBILS and stated:

“The lack of a portfolio cap means that the Government’s total exposure is proportionally higher under CLBILS than under CBILS (80% compared with 60%). This decision has been made to increase our confidence that delivery partners will be sufficiently incentivised to increase their risk appetite, and that businesses will be able to access finance on sufficiently attractive terms. The inclusion of a portfolio cap would have prejudiced the lender’s ability to claim capital relief for the guaranteed portion of each loan, potentially leading to higher interest rates.

However, due to the speed with which this intervention has been developed in order to respond to the crisis in a timely fashion, there is currently very little robust data that I can rely upon to judge that these scheme parameters are optimal. In particular, the absence of reliable forecasts of take-up and default rates makes it difficult to assess ex-ante whether value for money is likely to be achieved. This means there are currently a wider range of outcomes, including very substantial losses in the worst cases. That is not a scenario we anticipate and there will be opportunities to take action if there are signs that we might be heading in that direction.

Set against this, the benefits from preserving businesses through CLBILS are reasonable to assume in principle but are difficult to compute with any certainty. It will be difficult to determine what part a CLBILS loan played amongst other factors on future performance of a business. What we can determine ex-ante is that the absence of an additionality test creates a considerable ‘deadweight’ risk in terms of value for money. I appreciate that these weak data and therefore large range of possible outcomes does not provide for a solid basis for a decision, but reflects the position we find ourselves in.”

3.45. The acting Permanent Secretary stated that additional potential safeguard measures had been considered. These included reducing the level of guarantee to 75%, or re-introducing the additionality test, or announcing funding in tranches to review the impact on the market progressively. However, the acting Permanent Secretary advised that:

“...the above do carry additional downside risk either in terms of requiring additional time or reducing the attractiveness of the scheme to recipients or lenders. Given the severity and urgency of the situation facing businesses, I

accept that these steps cannot be considered any further before the scheme is announced in detail and taken live.

To sum up, the potential for economic damage created by the coronavirus pandemic creates a strong case for Government intervention. My assessment is that risks around regularity, propriety and feasibility are manageable. However, the uncertainty around value for money and risks regarding additionality of the proposed scheme means that Managing Public Money requires that I ask for a written direction from you if you wish to proceed with CLBILS. On receipt of your direction I will then proceed accordingly to implement the scheme."

- 3.46. On the same day, 16 April 2020, the Secretary of State responded and formally directed the acting Permanent Secretary, as Accounting Officer, to take the scheme forward with immediate effect {GD(B)/126 – INQ000563962}. The letter stated:

"We both continue to see strong evidence about the severity of the economic impacts of COVID-19 and the feedback from the business community leaves us in no doubt as to the gravity of the situation and the amount of economic and financial stress being borne by different sectors of the economy. As you outline, this includes the termination of business activity in some sectors, for example in non-food physical retail, and significant disruption in other sectors such as construction. As you note, the tourism and hospitality sectors have been very severely impacted, as well as transport, logistics, and other associated businesses. Much of the UK's manufacturing capacity has also suffered, with automotive and aerospace facilities unable to operate normally due to a combination of workforce availability, supply chain disruption and restraints in the working environment.

Whilst I note your suggestion of potential additional safeguards for the scheme, I agree with your assessment that given the severity and urgency of the situation facing businesses, these proposals cannot be considered any further before the scheme is announced in detail and taken live. As you note in your letter, to respond to the crisis in a timely fashion, this intervention has been developed at speed and currently there is not enough robust information that you can rely upon to judge that the scheme parameters are optimal. As you say, the prospect of very substantial losses in the worst cases is not a scenario

you anticipate and there will be opportunities to take action if there are signs that we might be heading in that direction.

The Chancellor has given me approval to proceed and I am prepared to provide support for the introduction of this scheme as soon as practicable. I am therefore formally directing you as Accounting Officer to take this forward with immediate effect.”

Implementation and Delivery of CLBILS

- 3.47. On 16 April 2020 the acting Permanent Secretary wrote to Keith Morgan, instructing BBB to establish CLBILS {GD(B)/127 – INQ000563963}. The acting Permanent Secretary confirmed that in line with the instruction for CBILS, BBB would be expected to ensure robust controls and governance were in place around the financial commitments from HMT. As far as reasonably practicable, BBB were to ensure public funds were being used appropriately.
- 3.48. CLBILS opened to applications on 20 April 2020.
- 3.49. CLBILS was included in the CBILS data plan developed by HMT and circulated on 20 April 2020 {GD(B)/128 – INQ000585579}. The aim was for a BBB owned portal, on which lenders registered facilities they had issued, to be the main data source combined with data from UK Finance members.
- 3.50. An official from HMT emailed BEIS officials regarding the CLBILS data collection process and said the following, “We are proposing that the biggest seven lenders report a number of key metrics on a daily basis, as well as reporting more detailed information alongside the remaining CBILS/CLBILS lenders on a weekly basis... We are planning for the Chancellor to write to all CBILS/CLBILS lenders later in the week with this data request” {GD(B)/129 – INQ000585578}.
- 3.51. On 23 April 2020 an official at BBB confirmed there was no formal ‘delivery plan’ for CLBILS (or CBILS) in place. They confirmed they were working with the 5 main lenders to develop Application Programming Interfaces (**APIs**) to automate the interaction with BBB systems and this was due to complete for CLBILS by late-May 2020. They also confirmed there were no firm milestones to design the systems required to process lender fees and guarantee claims (and that the design was still at the scoping stage); lender information; the accreditation of new lenders; or processing volumes of applications for CLBILS applications. Although there were no firm milestones in place,

BBB was working on its assigned tasks as fast as possible {GD(B)/130 – INQ000563986}.

- 3.52. BBB first provided figures on CLBILS applications from the large lenders (Barclays, CYBG/Virgin, HSBC, Lloyds, RBS and Santander UK) on 7 May 2020 {GD(B)/131 – INQ000564011}. The report was circulated by UKGI and specified where no data had been received. As at 7 May 2020, 292 applications had been received with a value of £3.1795 billion; 14 applications had so far been approved with a combined value of £111.1 million. By June 2020, the reports were provided daily by UKGI to BEIS and HMT. On 8 June 2020, BBB provided a report with data from seven large lenders (now including NatWest) as at that date, which recorded 612 applications received; 239 loans had been offered with a value of £1.4884 billion {GD(B)/132 – INQ000564054}. By July 2020, the reports (known as the GWS CLBILS Lender Summary) were considerably more detailed and now included data from the large lenders as well as the portal. The reports contained breakdowns of loans offered, including by lenders, regions, sectors, and loan size. In the report summary from 7 July 2020, 769 applications had been received with a value of £6.7804 billion {GD(B)/133 – INQ000564074}.

Subsequent Developments of CLBILS in May 2020

- 3.53. On 12 May 2020, an HMT official emailed BBB and BEIS officials, explaining that HMT had engaged with lenders and businesses and it had become clear that there was a need for further government support {GD(B)/134 – INQ000564025}. The Chancellor was minded to increase the loan size cap under CLBILS, from £50 million to between £100 million and £200 million and to accredit more lenders.
- 3.54. Later that day officials from BEIS, HMT, and BBB held a discussion about the potential changes to CLBILS, possible restrictions that could be applied and accreditation of lenders {GD(B)/134 – INQ000564025}. HMT was concerned about outsourcing decisions for such large loans entirely to lenders. Since BBB did not usually work with such large businesses, it was suggested there should be consideration about how to ensure accredited lenders had an appropriate “track record” for this kind of lending.
- 3.55. On 14 May 2020, BEIS officials sent a submission to the Secretary of State seeking his agreement to increase the maximum loan size to in excess of £50 million and impose tighter restrictions on businesses receiving loans above £50 million {GD(B)/135 – INQ000564026}. The submission advised that the Chancellor was

planning to announce the key headline changes on 15 May 2020, and required the Secretary of State's approval on these proposed headline parameters by early 15 May 2020. BEIS officials would then provide further advice on some of the more detailed terms the following week and in advance of the changes coming into effect.

- 3.56. The submission set out the following proposed changes to the scheme:
- a) Increase the maximum loan size to £200 million (up from £50 million) with a cap at 25% of turnover;
 - b) Remove the £25 million cap for businesses with a turnover of up to £250 million and replace this with the 25% turnover cap; and
 - c) For loans greater than £50 million, impose tighter conditions during the life of the loan including a complete ban on dividend payments, prohibition of pay rises or cash bonuses for executives, and prohibition of share buybacks.
- 3.57. BEIS officials advised that CLBILS addressed the problem of the lack of support for the 'missing middle' businesses by ensuring that all viable businesses were eligible to access government-backed loan schemes regardless of their turnover. However, there were businesses whose cashflow issues had not been addressed by CLBILS because they required more finance than the maximum loan limits. This included both businesses who wanted to borrow more than £50 million and businesses with a turnover of £250 million or below who needed more than £25 million. Based on Bank of England estimates, there were around 280 businesses who would seek to borrow more finance than they were offered under CLBILS and who could not access the CCFF scheme. Of this cohort, around 150 to 200 businesses were likely to be considered creditworthy.
- 3.58. The increase in the maximum loan size to £200 million and removal of the £25 million cap for businesses with a turnover of up to £250 million would capture a large proportion of these businesses who were restricted by the CLBILS lending cap. There were businesses in strategically important sectors, such as steel, which were keen to access CLBILS, but were not able to because their borrowing needs significantly exceeded the cap. It was also likely that raising the loan cap would attract some new providers into the CLBILS market which usually operated at these higher levels. However, the higher loan cap exposed the Government to greater losses in relation to individual businesses. At an average loan size of £150 million, it only required eight CLBILS loans to create a liability of around £1 billion.

- 3.59. In relation to the changes on restrictions, BEIS officials advised that there was a reasonable proprietary and value for money case for imposing such restrictions where businesses were accessing this high level of taxpayer support. However, it was stated that more severe restrictions would act as a disincentive to take-up a CLBILS loan.
- 3.60. BEIS officials did not believe the changes proposed required a new ministerial direction as:
- “The direction...already provided takes account of the inherent uncertainties in demand and default rates, which means a robust assessment of value for money continues to be challenging. This proposal is unlikely to change that position and indeed the conditions highlighted under restrictions are designed to help protect value for money and ensure propriety.”*
- 3.61. On the same date, 14 May 2020, BEIS officials sent Accounting Officer advice to the acting Permanent Secretary which provided an update on further changes to CLBILS {GD(B)/136 – INQ000564027}.
- 3.62. The advice explained the impact of the scheme changes on the original Accounting Officer Assessment, including on value for money. The higher loan cap exposed the Government to greater losses, but these larger maximum loans would allow more businesses to meet their financing needs without recourse to other support. BEIS officials advised that the same uncertainties over value for money in terms of economic benefits and eventual liability as detailed in the original Accounting Officer Assessment therefore remained. As such, it was reasonable to conclude that another ministerial direction was not required.
- 3.63. The acting Permanent Secretary responded to the advice the same day confirming her agreement that, given the very wide range of uncertainty in terms of government costs in the original direction, she did not need to request another direction {GD(B)/137 – INQ000564028}.
- 3.64. HMT subsequently announced the broad outline of changes to CLBILS on 19 May 2020 {GD(B)/138 – INQ000593144}.
- 3.65. In accordance with the earlier submission of 14 May 2020, on 20 May 2020 a further submission was sent to the Secretary of State to seek his approval to implement the amendments to CLBILS {GD(B)/139 – INQ000564039}. The submission set out the detailed scheme parameters of CLBILS as amended, and also included further changes, namely:

- d) A maximum loan size of £200 million, capped at the higher of: (a) 25% of turnover, (b) twice the annual wage bill, or (c) 12 months' liquidity needed;
- e) Lowering the seniority of debt to ensure that the scheme was attractive to borrowers. As a result of these changes, loans under CLBILS would rank at the equivalent level as debt at the level of the individual borrower and would be treated in the same way. Feedback from lenders and businesses suggested that this had been a significant barrier to businesses taking up loans under CLBILS, when they were part of multi-national groups, because lenders to the wider groups were unwilling to dilute their security by accepting new senior debt;
- f) Permitting a lender to make a claim on the government guarantee in the event that a borrower entered into a restructuring agreement (for example by converting debt to equity). This change enabled the lender to claim on the guaranteed portion of any loss it incurred as a result of the restructuring. Restructuring also allowed for an extension of the term of CLBILS loan from three years to up to six years. Enabling restructuring to take place allowed CLBILS loans to function more like commercial loans of this size. It also helped to reduce losses for the Government, as a restructure would provide an alternative to default (which would trigger a claim on the guarantee for the entire CLBILS loan amount). This was an important consideration given the size of CLBILS loans. However, the restructuring event increased the length of the Government's exposure to CLBILS debt where a restructure involved an increase in the term. To prevent this mechanism from being misused by lenders and borrowers to extend the life of CLBILS and create partial payouts, restructuring was only permissible where the intent was to minimise the expected loss;
- g) For CLBILS loans of £50 million and above, lenders would be prevented from immediately claiming the full guarantee in the event of a default; and
- h) Further clarifying that, for CLBILS loan of £50 million or more, the business would be prevented (during the life of the facility) from making any new dividend payments, underlying any share buybacks, paying any cash bonuses to senior management, or increasing total cash remuneration to individual members of the senior management team except in certain circumstances.

- 3.66. On 21 May 2020, the Secretary of State's private office confirmed that he was content with the recommendations set out in the submission and agreed to implement the amendments to CLBILS {GD(B)/140 – INQ000564045}.
- 3.67. In response, Laurence Pawley updated the Secretary of State's private office on discussions that had taken place that day with HMT and BBB following feedback from lenders on the terms for CLBILS {GD(B)/140 – INQ000564045}. He explained that in relation to the restructuring proposal as detailed at paragraph 3.65f), HMT officials were *“concerned about the risk to Government interests in restructuring events (e.g. through the extension of exposures to CLBILS, and because we would not currently be represented in those negotiations)”*. HMT officials would be recommending HMT ministers to postpone including this change in the launch package until they had considered the full implications. He confirmed that BEIS agreed with removing this provision for the time being.
- 3.68. As BBB had been actively involved in discussions about the proposed amendments, on 22 May 2020 Keith Morgan sent a letter to the acting Permanent Secretary pre-empting her instructions to proceed with the extension of CLBILS loans up to £200 million. He confirmed the BBB Board agreed to accept the instruction without raising a formal reservation notice. However, he explained that, as HMT had announced the proposed extension on 19 May 2020 prior to any instructions, BBB was in an uncomfortable position and emphasised the importance of being fully engaged in policy development before announcements were made {GD(B)/141 – INQ000564043}.
- 3.69. BBB then highlighted a number of key risks to the acting Permanent Secretary, noting their potentially significant consequences for BBB and the Government. The proposed amendments required BBB to operate outside its remit as defined in the Shareholder Relationship Framework Document, supporting SMEs and small mid-cap businesses. CLBILS loans would be more complex and there was greater risk that lenders and businesses would design bespoke structures which could seek to unduly transfer risk to the Government. One option to mitigate this risk would be to carry out an 'ex ante' check within Government before a guarantee was approved. However, this proposal was viewed to be time intensive, requiring expertise which was not within BBB's core skills and involved the Government at the inception of major transactions. Keith Morgan advised that BBB would likely need to recruit additional staff with financial restructuring expertise to scrutinise any claims on the government guarantee and sought assurances from BEIS that there would be additional funding.

- 3.70. The letter set out BBB's views on value for money in relation to the scheme changes. Whilst initial work suggested value for money may be acceptable, the size of individual losses could be significant and high profile. BBB confirmed all lending decisions would be made in accordance with lenders' normal practices and risk appetite, but this was a complex area of lending and the Government was at risk of taking greater losses in ways that were not achieving the policy objective.
- 3.71. Later that day, on 22 May 2020, the Secretary of State's private office emailed HMT seeking approval to introduce the changes to CLBILS {GD(B)/142 – INQ000564046}. The Chancellor's private office replied the following day and confirmed the Chancellor was happy to proceed with CLBILS based on the parameters and amendments set out.
- 3.72. On 24 May 2020, the acting Permanent Secretary wrote to BBB instructing it to implement the changes to CLBILS from 26 May 2020 {GD(B)/143 – INQ000564047}. The acting Permanent Secretary acknowledged BBB's letter of 22 May 2020 which (as described above) had set out some of the risks attached to the proposed amendments. The acting Permanent Secretary agreed with BBB's assessment that the value for money of the proposal was subject to significant uncertainties, as had been the case for the original CLBILS, but she did not consider the nature of those uncertainties had significantly changed. She also acknowledged BBB's concerns that it would be operating outside its usual operational remit, and this would present challenges for the team. BBB was given assurances that HMT would meet the costs associated with the scheme, and BBB were invited to work with BEIS officials to forecast those costs and the resource needed as soon as possible.
- 3.73. In accordance with the acting Permanent Secretary's instructions, BBB implemented the changes to CLBILS on 26 May 2020 {GD(B)/144 – INQ000543844}.

The Outcome of the Implementation of CLBILS

- 3.74. In Section 7, below, I set out later amendments and extensions to the loan schemes, including CLBILS, before the eventual closure on 31 March 2021.
- 3.75. As highlighted at paragraphs 1.9 and 1.12, the uptake for CLBILS was lower than that of CBILS. This was because CBILS targeted SMEs, which make up most of the businesses in the UK. As explained at paragraph 5.12 in Part A, SMEs were disproportionately impacted by Covid-19. As such, they relied on CBILS loans to maintain cash flow. In contrast, CLBILS received fewer applications because there was

a smaller pool of eligible businesses, and these large businesses were also more likely to have access to alternative funding options.

SECTION 4: BOUNCE BACK LOAN SCHEME (BBLs)

Introduction

- 4.1. In this section I address the objective for the introduction of BBLs, the aims of the scheme, and the policy process undertaken collaboratively by the Department, HMT and BBB to design and implement the scheme at pace. At Section 9 below, I set out my reflections on BBLs in further detail, as well as lessons learned by the Department for any future emergencies.
- 4.2. BBLs was introduced to address a gap in the market that had arisen due to the difficulties faced by SMEs in accessing finance through CBILs, for the reasons detailed below. BBLs fundamentally changed the way in which the Department and lenders balanced the risk of fraud and was unprecedented in the UK, because it was the first loan scheme introduced with a 100% government guarantee for lenders.
- 4.3. As I have addressed in Part A of this statement, I am very conscious of the significant losses due to fraud of this loan scheme in particular. The factual chronology of the consideration given to fraud risk is covered in this section, but I return to the wider issues of counter fraud in Section 6 of this Part, and this also forms a key part of the critical reflections in Part A, Section 6.
- 4.4. For clarity, I refer to this scheme as BBLs throughout this statement but in the early stages of its development, the proposed name for this scheme was Coronavirus Small Business Interruption Loan Scheme (**CSBILs**). Accordingly, the acronym CSBILs will appear in many of the early underlying documents and some quotations from the same.

Economic Policy Objectives of BBLs

- 4.5. The objective for the introduction of BBLs was to respond to the concern raised by the business community that CBILs was not doing enough at sufficient pace to provide necessary financial support to smaller enterprises. There were further concerns surrounding the initially slow rate of applications being processed and negative comparisons were made to similar international schemes. This included the German and Swiss schemes which both included a 100% guarantee and are discussed further in paragraphs 4.9-4.15.
- 4.6. Feedback suggested that smaller SMEs were experiencing problems in accessing CBILs, either because lenders were still hesitant to take on the risk of lending to them,

or because the application process was too difficult (e.g. smaller SMEs simply did not have all the relevant data required). The administrative obligations of the lenders in processing CBILS applications (e.g. their usual security and viability checks) and resulting capacity issues, had led to a substantial backlog of applications to be processed, of approximately 15,000 by late April 2020 {GD(B)/145 – INQ000543164}. This inevitably led to significant delays in approving loans and distributing the funds. BBLS was a scheme formulated and led by the Chancellor and HMT in response to these issues {GD(B)/146 – INQ000563984}.

4.7. The Department received feedback from a range of sources following the launch of CBILS. The feedback came from management consultancies, BROs and SME business owners, for example:

a) BEIS officials approached numerous management consultancies, law firms and financial advisors in March 2020 including Lazard, Oliver Wyman, Slaughter and May and Enterprise Nation, to provide views on how to best support SMEs during the pandemic. On 24 March 2020, the Business Finance team summarised the feedback received from these firms in an email and circulated the same to Business Growth Team officials {GD(B)/147 – INQ000585506}:

- i. Financial advisory firm Lazard raised concerns that the SMEs and the private sector would need cheaper and longer-term financial support of around 10 years to both survive, recover from and thrive after the pandemic. Lazard accordingly recommended that the Government enable cheaper finance with longer maturity by establishing a 10-year government-backed credit facility;
- ii. Law firm Slaughter and May recommended a simplified process for firms to raise equity finance;
- iii. Management consultants Oliver Wyman flagged in relation to CBILS that, although lenders were willing to extend the scheme to all viable businesses, this may not happen fast enough at delivery level due to risk aversion fuelled by the pandemic and the 20% liability still being a material risk for lenders. Oliver Wyman recommended asking BBB for its views on accrediting additional lenders to deliver the scheme. Further and more broadly, Oliver Wyman produced a paper entitled, '*Sustaining Credit Capacity in UK SMEs*' dated March 2020 {GD(B)/148 – INQ000596658}. It included analysis on why SME access to finance was most urgent to

address. In their view, this was because SMEs were, “*More vulnerable than larger corporates, due to typically lower liquidity, lower access to alternative finance and higher concentration in a smaller number of buyers and suppliers.*” The report emphasised the need to keep a watchful eye on vulnerable areas of the economy to see if they were benefitting from the CBILS roll-out and if additional financial support schemes were required; and

- iv. Enterprise Nation, business support platform and provider, raised concerns about the banks’ operational processes being able to cope with the volume of applications and suggested adding alternative accredited lenders.
 - b) On 25 March 2020, Eoin Parker (Director, Cabinet Office), forwarded an email chain to Sarah Munby (then Director General, Business Sectors Group, BEIS) regarding the perceived lack of loan help for small businesses under CBILS {GD(B)/149 – INQ000563892}. The feedback had been provided by Stephen Murphy of Rally Capital. In his view, the banks were taking ‘no risk’ and the existing loan scheme was not likely to result in *any* support being extended to small businesses. He considered it a ‘disgrace’ that the banks were asking for personal guarantees in order for companies to access CBILS;
 - c) At the end of March 2020, emails relating to CBILS’ support for SMEs from business-owning constituents were forwarded to the Business Growth Team {GD(B)/150 – INQ000563935}. The constituents were also critical of lenders requiring personal guarantees from businesses and the struggle to access funds due to lenders requesting onerous security and using normal criteria to assess applications in abnormal times; and
 - d) Feedback on CBILS and advice for potential other schemes was also received from UK Finance. In a BEIS document dated 1 April 2020 collating stakeholder comments on the schemes, Stephen Jones (Chief Executive, UK Finance), was quoted as saying: “*The terms require the loan to be viable for the lender. Clearly, it’s debt that needs to be repaid, and the key will be to assess whether a business can support such debt.*” {GD(B)/151 – INQ000563913}.
- 4.8. On 5 April 2020, Stephen Jones emailed the Permanent Secretary and Charles Roxburgh (Second Permanent Secretary, HMT), with his concerns regarding

the ability of CBILS to cope with anticipated volumes of applications {GD(B)/152 – INQ000563930}. He stated:

“There seems no good reason why a simple checklist and self-certification from customers with sampled assurance cannot be housed on a customer accessible portal at BBB end providing a unique reference to the lender to enable them to apply CBILS to their customers ... I will be speaking to Keith Morgan at BBB this evening but am concerned that the BBB will not be able to deliver the capability to process perhaps a million CBILS loans over the next 4 weeks without a fundamental change of approach, to the detriment of the reputation of both the banking industry and government.”
(Original emphasis)

- 4.9. On 7 April 2020, a BEIS official asked the British Embassy in Bern for information on the implementation of the Swiss Covid-19 loan scheme and how the application process for businesses operated so quickly, with payments transferred within the hour {GD(B)/153 – INQ000596724}. The official stated in their correspondence that BEIS were facilitating biweekly calls between the Secretary of State, the large BROs and trade associations, and UK finance regarding the Covid-19 loan schemes, and that on these calls, the speed of payments being made to businesses came up regularly. The response from the British Embassy official emphasised the overall performance and cooperation of different government departments, as well as *“...cooperation with the banks on the basis of a common understanding that this is an emergency situation. On top of that there was a clear political will to develop a solution and ensure a fast and effective implementation.”* The ‘political will’ included the state’s willingness of offering 100% guarantees. Switzerland also had a pre-existing loan guarantee system for SMEs which the official considered might have played a role. The Swiss banks were conducting identification and money laundering checks, but *“...no in-depth credit assessment”*.
- 4.10. On 11 April 2020, the Shadow Secretary of State, the Rt Hon Ed Miliband, wrote to the Secretary of State regarding CBILS {GD(B)/154 – INQ000563951}. Ed Miliband outlined that data had suggested that *“...a relatively small number of UK businesses [were] accessing funds, as low as 1% in some surveys.”* As such, he considered there were five main issues with CBILS which required ‘urgent resolution’:
- a) The 80% guarantee should be raised thereby expediting applications by removing or reducing the remaining risk borne by financial institutions. He cited

Germany as a comparator, which had moved from an 80% to a 100% government guarantee;

- b) The loan process was not 'simple or speedy enough' and suggested the implementation of "...a simpler, standardised application process ... so businesses can access funds much more quickly" similar to Switzerland's form;
- c) The lender accreditation process must be accelerated to reduce the backlog in financial institutions awaiting approval to become CBILS lenders and consequently ease the burden on the larger banks;
- d) More transparent and regular data should have been published on the take-up of CBILS; and
- e) There must be a mechanism of support for businesses not in profit, but which were crucial to the future of the economy.

- 4.11. On 15 April 2020, a call took place between the BROs and the Secretary of State. The call summary noted that some of the lenders had called for the Government to consider 100% guarantees for lenders and potentially restrict this to smaller loans {GD(B)/155 – INQ000596725}. The Secretary of State gave the following response:

"...Switzerland and Germany particularly have 100% guarantee loan schemes. If you look at different elements of different types of schemes that other jurisdictions have, you could do a mix and match, but if you look at what we are offering, it's not as if we are not stepping up. We are always open to looking and learning, but my sense of it right now is that the reason that CBILS is not moving as fast as we would like, it's for other reasons, eg a bunch of providers that have come in that aren't used to dealing with the BBB, lots of new staff in the banks, and so on. I'm not speaking on behalf of the banks, but there are other reasons. Germany has a model completely different to ours where historically the government is able to give loans direct to businesses. Personally, what I would like is to see if we can get this model to work, whether we will see an acceleration of loans going out of the door."

- 4.12. On 16 April 2020, the acting Permanent Secretary asked Gemma Peck and other BEIS officials how the Department could assess, from an Accounting Officer perspective, changing CBILS to a 100% guarantee scheme {GD(B)/156 – INQ000563961}. In this email, the acting Permanent Secretary said that she was aware the Chancellor had

raised this potential amendment to CBILS in the preceding 48 hours and wanted to ensure that the Department was prepared.

- 4.13. On 17 April 2020, Laurence Pawley emailed BEIS officials with the following instruction {GD(B)/157 – INQ000563964}:

“You will have seen speculation in the press this week about the potential for amending CBILS to mirror the schemes offered in other European countries based on a 100% guarantee ... the Chancellor indicated he would look at considering this in some circumstances. Accordingly, it would be good now to start thinking about what that might mean for the contingent liability and risk under CBILS, and how that would translate into revised advice.”

- 4.14. From this point, the Department, HMT and UK Finance began discussions at pace as to the potential amendments to the scheme.

- 4.15. On 17 April 2020, Gemma Peck circulated two papers produced by UK Finance to the acting Permanent Secretary and BEIS officials {GD(B)/158 – INQ000585567}. The papers were entitled ‘Operational improvements that could be made to the CBILS to accelerate access to funding’, and a draft proposal dated 16 April 2020 titled ‘A proposal for temporary financial support for smaller SMEs pending more comprehensive roll-out of CBILS’ {GD(B)/159 – INQ000596667} and {GD(B)/160 – INQ000596668}. In her email, Gemma Peck analysed the problem relating to CBILS as primarily being money not getting to SMEs quickly enough. She then presented three proposals to address this, which were to:

- a) Speed up the loans. She explained that finance under CBILS was slower than comparative schemes in Germany and Switzerland because the eligibility tests were simplified for those schemes, the lenders did not have to take a risk judgment and the CCA did not apply to small business lending in those countries. She also considered that if the Government did move to provide a 100% guarantee they would need to consider whether to do so for all CBILS loans or just for smaller amounts. This would then introduce complexity that BBB and bank systems may not be able to support;
- b) Increase supply of loans to those requiring smaller amounts of support by accrediting more providers willing to offer these smaller loans more quickly and at greater risk (at higher rates/fees); and

- c) Consider alternative ways to get money to SMEs quickly, including through a government underwritten temporary overdraft extension. This was considered to be potentially quicker to operationalise than amending CBILS, as set out in the *'Proposal for temporary Financial Support for smaller SMEs'* {GD(B)/160 – INQ000596668}.
- 4.16. In its paper *'Operational improvements that could be made to the CBILS to accelerate access to funding'*, UK Finance proposed a number of operational improvements that could be made to CBILS to accelerate access to funding {GD(B)/159 – INQ000596667}. The top five recommendations were to:
- a) Empower lenders to use existing processes, scoring systems and customer data to determine viability;
 - b) Remove the requirement for lenders to undertake the Undertaking in Difficulty test and instead rely on bank credit assessment;
 - c) Simplify the documentation/paperwork;
 - d) Remove eligibility ambiguities and implement radically simpler eligibility assessment at pace; and
 - e) Provide operational flexibility around use of the scheme.
- 4.17. On 20 April 2020, Stephen Jones circulated to the Department and HMT the final draft of the proposal now titled, *'A proposal for temporary financial support for smaller SMEs complementing CBILS and the Job Retention Scheme'* {GD(B)/161 – INQ000596670}. The email chain discussed the pressure mounting to move CBILS to a 100% guaranteed scheme. In this regard, Stephen Jones held concerns, *"...about the damage this [would] do to continued successful and wider deployment of the existing CBILS scheme and the assumption that proponents for 100% guarantees make that somehow money will flow straight out of the door."* {GD(B)/162 – INQ000585577}. This was in view of the CBILS eligibility parameters that were in place at that time, and if the CCA could not be disapplied, he considered that 100% guaranteed CBILS loans would not work to get funds to businesses significantly faster.
- 4.18. Stephen Jones explained that UK Finance had discussed the above proposal with two of the big four banks (they did not say which). The proposal detailed UK Finance's views on the 'problem':

- a) Short-term cash-flow pressure was mounting on SMEs, and if SMEs were to fail, it would be significant economically, in terms of the cost of unemployment and other benefits, lost economic capacity, and socially;
- b) CBILS deployment at scale was complex and UK Finance invited the reader to "...see separate UK Finance paper making suggestions to improve efficiency of deployment and under discussion with BBB and officials" (i.e. the paper titled 'Operational improvements that could be made to the CBILS to accelerate access to funding' referenced in paragraph 4.16);
- c) Smaller CBILS loans were difficult to deploy because smaller SMEs were treated as consumers for regulatory and legal purposes in the UK under the CCA. As a result, a number of CBILS lenders were not operating in the sub-£25,000 loan space;
- d) Pressure was mounting for the Government to move to a 100% guaranteed scheme similar to the German scheme, "...but without real consideration of the consumer credit difficulties of deployment specific to UK, not EU, rules and volume process constraints of existing British Business Bank EFG rails"; and
- e) UK Finance was of the view that if the Government were to move CBILS to be 100% guaranteed, they would need to allow self-certification by applicants and suspend consumer credit regulations and laws, for credit to be able to flow faster to applicants.

4.19. The following solutions were proposed:

- a) Government-guaranteed overdraft facility attached to SMEs' business current accounts on application;
- b) Eligibility based solely on self-certification with no further bank due diligence required for the applicant to qualify, and no security required;
- c) A maximum loan term of 12 months, with a maximum guaranteed limit of 25% of 2019 turnover (self-certified) with a cap of £25,000 in total, including previous borrowings;
- d) 100% coverage of losses on default by HMT, and "...no quibble refund with no material recovery/enforcement against defaulting borrower by banks required";
- e) No requirement for BBB involvement; and
- f) No State aid issues warranty from the Government.

- 4.20. UK Finance set out the key questions for the Government to consider before introducing a scheme. These included:
- a) Moral hazards (e.g. fraud relating to self-certification eligibility criteria);
 - b) State aid limits;
 - c) Scheme terms (deployment may be delayed if the product was not an existing product);
 - d) Level of guarantee (likely to be necessary for an entire overdraft to be 100% government guaranteed with uniform pricing);
 - e) Upper threshold (to consider whether the maximum of 25% of 2019 turnover up to £25,000 cap addressed the majority of the problem for SMEs to whom financial assistance had not arrived quickly enough); and
 - f) Equity gap for loss-making companies (not addressed by the proposed scheme “...other than possibly as a bridge to more permanent funding”.)
- 4.21. On 20 April 2020, the Secretary of State responded to Ed Miliband’s letter dated 11 April 2020, referenced at paragraph 4.10 above. The Secretary of State’s reply addressed the five issues that Ed Miliband had raised in his letter and agreed the following:
- a) The core issue was “...the flexibility of bank systems and the ability to ramp up capacity to deal with the applications.” He stated that commentators who believed a 100% guarantee was the solution to capacity issues were misinformed although some lenders had over interpreted the viability requirement of CBILS;
 - b) The application process was not simple or speedy enough and that changes had been approved to allow lenders to use automated credit scoring and streamline their processes; and
 - c) It was crucial to approve more lenders to offer CBILS so as to add capacity and serve all parts of the SME market {GD(B)/163 – INQ000563978}.
- 4.22. Having considered the reports from UK Finance, BEIS and HMT continued discussions on the proposal for a 100% guarantee scheme. On 21 April 2020, Gemma Peck wrote to Gwyneth Nurse (Director, Financial Services Group, HMT) {GD(B)/164 – INQ000563980}. She confirmed she preferred the idea of “...tweaking CBILS (eg. changing terms so those under eg £30k are 100% guarantee) rather than creating a

new scheme, which would have same problems with roll-out.” Gwyneth Nurse responded with the following:

“Will come back in more detail but, on the question of just removing CCA for CBILS we have become a little nervous following further work yesterday. As we dig into it it appears that although the CCA would remove hassle for the banks, having to do the viability test means that they would still be tangled up in what they consider red tape so we are concerned that we make the change (with the downsides that brings in terms of small business protection) and it doesn’t make a material difference. Wanted to mention now before that gets a head of steam. I basically think where we are trying to get CX is if he really wants a speedy scheme a la Swiss then CCA is one feature but quite a few other features need to be different so CCA removal on its own in CBILS as it stands not a good option.”

- 4.23. Later the same day HMT confirmed that its priority was that to ensure speed of delivery of finance. Therefore, it was necessary to introduce a separate loan scheme rather than amending CBILS {GD(B)/165 – INQ000543163}. The Chancellor modelled this new scheme on the Swiss scheme, including a standardised one-page form involving a self-declaration {GD(B)/166 – INQ000543160}.

Scheme Design

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- 4.24. Later on 21 April 2020, HMT advised the Chancellor on the potential new 100% guaranteed instant loan scheme for small businesses {GD(B)/167 – INQ000563981}. At this stage, over 13,000 loans to SMEs had been approved under CBILS, and HMT anticipated this figure would continue to rise as more lenders came onstream to offer loans below £25,000. However, for some of the smallest businesses seeking small loans “...*the unfamiliarity with bank processes for lending combined with eligibility and process barriers for the existing CBILS scheme [were] hampering volume lending at speed.*” It was explained that the scheme could present a significant financing pressure to the Government in the short-term and significant fiscal risk in the medium term, in addition to the wider policy support and economic impact of Covid-19.
- 4.25. HMT proposed the following scheme design to the Chancellor:

- a) Applications to be made through a simple online form, relying on applicants to self-certify that their business was not in difficulty before Covid-19 (similar to the Swiss model);
- b) Loans to be disbursed to businesses within 24 hours of application;
- c) Government to guarantee 100% on small loans of up to 10% of the business' turnover, capped at £25,000 (or up to a turnover limit of 25% capped at £50,000);
- d) 0% interest rates and fees for the first year for the borrower, to avoid BBLs being portrayed as an inferior alternative to CBILs;
- e) Scheme to be administered by BBB; and
- f) Maximum loan term of six years (with a preliminary cost estimate of £6 billion over the six year period).

4.26. HMT advised that its discussions with lenders and UK Finance had led it to conclude that loans below £25,000 were difficult to deploy at pace. They considered that to do so would require:

- a) The Government to provide a 100% guarantee for the loans to remove any 'skin in the game' for the lenders;
- b) The removal of the need for the lenders to assess viability of the applicant businesses by simplifying the application form and including the self-certification mechanism which would not be subject to independent verification by the lenders; and
- c) Disapplication of the CCA, legislation that was intended to protect borrowers from unscrupulous lending, but which was an incumbrance to lenders getting loans out at speed.

4.27. This advice highlighted for the Chancellor numerous risks that could be associated with the scheme, including that:

- a) Reduced checks would mean heightened fraud risks particularly in relation to new customers; and
- b) Issues could arise with pursuing the repayment of loans in view of the 100% government guarantee, because there were risks that (i) lenders would provide

loans liberally and not actively pursue repayments; and (ii) borrowers would not feel they needed to try overly hard to make repayments.

4.28. HMT's submission addressed a number of similar schemes internationally that featured a 100% guarantee. Comparisons were made as follows:

- a) HMT officials recommended limiting the amount of finance that businesses could access based on their turnover, stating, the "German and French schemes' limit is 25%. However, a more reasonable starting point might be to explore a 10% limit with business groups and the banks (as in the Swiss scheme)...";
- b) The simple application form for BBLs was to be similar to the Swiss model; and
- c) The German scheme was incentivising lenders to pursue repayments even after the government guarantee had been paid out by allowing them to retain up to 10% of the total. This was proposed as an option for the Chancellor to pursue for BBLs. HMT officials proposed that there should however be a time limit on how long the lenders should pursue recoveries for, for instance 18 months after the date of repayment had passed.

4.29. HMT recommended an announcement around 1 May 2020 and anticipated that it would take two weeks to get the scheme fully operational and therefore proposed targeting a launch date of 15 May 2020 at the earliest. HMT officials shared the submission with the Department on 22 April 2020, and relayed that the Chancellor was very interested in the proposal. The loan schemes of other countries, such as that of Switzerland and Germany, informed the formulation of the BBLs to some extent. The stakeholder feedback set out in paragraph 4.7 and 4.10 led HMT to consider the design of European schemes and particularly, whether adopting similar approaches would address the issues discussed above with the CBILs. The final design of the new BBLs scheme is set out below in paragraph 4.107 and was similar in some ways (i.e. 100% government-backed guarantee) to schemes in other countries.

Ongoing Consideration of Risks and Scheme Design Ahead of the Announcement of BBLs

4.30. As outlined above, the protections provided to businesses taking out smaller loans (ss 140A-140C of the CCA) were considered to be impacting the ability of lenders to disburse funds quickly to SMEs, and some were hesitant to lend at this level at all. On

20 April 2020, Gwyneth Nurse emailed BEIS officials again regarding the proposed new scheme and HMT's proposal to disapply these provisions of the CCA. She said:

“Our analysis is that to make a 100% guarantee small loans scheme work, alongside the provision of a 100% guarantee, the government would also have to ensure that other regulatory and legal requirements on lenders to conduct responsible lending tests up front would need to be removed. Our view at this stage is that this will require some change to primary legislation. While we can use secondary to change the scope of regulation, so that small (currently regulated) business loans are put onto a similar footing as most unregulated business lending, based on discussions with lenders we believe we need to go further and make urgent changes both to the Consumer Credit Act and the Financial Services and Markets Act.

There is a risk that such changes are controversial given that they remove quite long standing protections for micro businesses taking on lending. However, in order to allow loans to be made under CSBILS as quickly as is being achieved in other countries and bearing in mind the scale of the crisis, removing protections is a necessary part of the process.”

- 4.31. On 23 April 2020, Angelina Cannizzaro provided advice for the Secretary of State in advance of a meeting he was due to attend with the Chancellor at midday that day on the proposals for the new scheme, including on the potential need to disapply the CCA and on various decisions that the Chancellor had made in relation to the scheme {GD(B)/168 – INQ000585581}. In this advice, she commented that the Chancellor was keen to proceed with BBLs and that:

“Our main concern at this point is that the removal of CCA protections increases the risk of loans being given to businesses who shouldn't be getting loans, particularly when this is combined with the 100% guarantee (though we can see why Cx would want to speed up processing in as many ways as possible). The other major issue is that we do not have a sense of demand in this space and so cannot assess the vfm of the scheme. We cannot assess the benefits this will bring.”

- 4.32. In addition, she set out the difficulties associated with achieving the necessary changes by way of primary legislation and explained there was a question of deliverability and aiming for a sensible launch date to ensure an effective roll out of the scheme. The only realistic delivery mode for the new scheme would be through BBB, and they were

working at capacity to deliver the existing schemes, and rapidly working up the convertible loan scheme announced that week (the Future Fund, discussed in more detail in Section 5). Although BBB had shown their ability to work at pace, BEIS officials considered it unlikely that they could deliver this scheme to the timetable the Chancellor wanted, alongside the existing schemes, with a proposed launch date in May 2020.

- 4.33. Later that day, BEIS officials provided advice to the Secretary of State on the evolving HMT proposals for the new scheme by way of a written submission⁷ {GD(B)/169 – INQ000610530} and {GD(B)/084 – INQ000563987}. Given the challenges of delivering a new scheme at pace, the advice of BEIS officials was against committing to a date at this point and they cautioned against the making of any announcement until further work had been done on delivery options. On the BBLs aspects of this submission, it was noted that a further ministerial direction may be required. The overall recommendation was to invite the Secretary of State to note the following points:

“That criticism of CBILS has been primarily focussed on the time taken to process applications, but that the rate and volume of lending is now increasing;

That the provision of a new scheme (CSBILS) offering 100% guarantee for small loans would likely enable faster processing of smaller value loans by lenders, but at the cost of elevated risk on a per loan basis to Government as compared to the main CBILS;

That the Chancellor is separately pressing for changes to CBILS to remove the portfolio cap and simplify the viability test, which has implications for the liability incurred by BEIS;

That there are several other routes which could be explored to further simplify the scheme or otherwise increase pace – these could be delivered instead of, or alongside, a new scheme;

That there are significant doubts about the capacity of the British Business Bank to implement a new scheme at the pace proposed, and a range of delivery options which merit exploration in pursuit of the policy objective to deliver lending to smaller businesses; and

⁷ It should be noted that the submission appears on its face to be dated 21 April 2020, but the associated covering email shows that it was sent to the Secretary of State’s private office late on 23 April 2020 {GD(B)/169 - INQ000610530}.

Delivering the new scheme would require amendments to the Consumer Credit Act, and Financial Services and Markets Act. HMT want to use the Insolvency Bill for this which carries some risk.”

- 4.34. The Secretary of State was asked whether, bearing in mind these points and noting the risks explored in the advice, he agreed that the Government should devise a new 100% guarantee scheme for smaller loans. The submission also set out further analysis of the case for the new scheme and the risks involved, including in relation to:
- a) Impact on borrowers. It would enable some businesses to access finance who were previously unable to do so, however the self-certification mechanism also carried risk that non-viable businesses might obtain funds;
 - b) Impact on lenders. Lenders would potentially have minimal incentive to pursue recovery due to the Government’s 100% guarantee, which could again lead to lending to businesses who are not capable of repaying the loan. The impact of this would be exacerbated by the disapplication of the CCA;
 - c) Delivery. BBB was identified as *“The only realistic, and certainly the fastest delivery mode.”* However, it was explained that BBB was already working at full capacity delivering the existing schemes. The Chancellor’s preference was for a single portal that businesses apply to which would then allocate out the loans to lenders. It was set out that while this may simplify the scheme for borrowers it would introduce a new level of delivery complexity as no such portal existed at the time;
 - d) Financial considerations. The advice was that at that stage there was no estimate of the impact that the new scheme might have on demand and therefore on the lending and liability borne by the taxpayer, but BBB and the Department were working to deliver estimates as quickly as possible. It was anticipated that a move to 100% guarantee could lead to a major increase in demand and it would only need a proportion of the estimated 3.2 million unregistered companies (2.6 million registered) to apply to drive a significant liability. There would be fewer controls in place, reducing value for money and increasing the overall risk;
 - e) Fraud risk. It was emphasised that consideration would need to be given during the scheme design on how to minimise fraud risk, including how authenticity of the business would be demonstrated, how to deal with multiple applications and

design of a cut-off point, with only businesses that were established before that point being eligible to apply; and

- f) State aid. It was explained that the scheme would fall within the permitted amounts that could be lent under a 100% guarantee (under the State aid de minimis regulation and the Temporary Framework) provided that arrangements were in place to ensure that any benefit lenders get from the guarantee were passed through to the borrower. That would require lenders to reflect the lower risk profile in the costs charged to borrowers.

4.35. Based on these factors, in this submission BEIS officials recommended:

"Introducing a new scheme based on a 100% guarantee would be a high impact and high visibility intervention, particularly if combined with disapplication of the CCA for loans under £25,000. However, it comes with significant financial and reputational risk for Government and would add further complexity for delivery. Furthermore, statistics for CBILS are improving and it is difficult to quantify the additional benefit this scheme would provide. We are also concerned about BBB's ability to deliver a new scheme and that banks will still struggle to process loans swiftly despite the streamlined scheme design."

4.36. On 23 April 2020, after the submission was sent to the Secretary of State, Gemma Peck shared further concerns with his private office (alongside other senior BEIS officials as well as the private offices of Special Advisers, Minister Zahawi and Minister Scully) regarding the pace at which the scheme development was moving {GD(B)/170 – INQ000543170}. Specifically,

"...Secretary of State has barely had chance to consider the quite considerable risks of this and the wider CBILS changes CX is pushing for. This is starting to look like a fait accompli (and maybe Secretary of State is content with that?) but if he does want some space to consider this properly and also kick the tyres on a sensible delivery timetable, please can you reinforce this point with HMT Special Advisors?"

4.37. Also on 23 April 2020, BBB responded to the Department and HMT with a draft note on alternative delivery options for BBLs {GD(B)/171 – INQ000543166} and {GD(B)/172 – INQ000543167}. BBB acknowledged the difficulties with CBILS, noting lenders had been slower than expected to grant new loans, some large lenders had made decisions not to offer CBILS below £25,000 and many lenders were prioritising

existing customers and/or not taking new customers. However, improvements had been made to the processes and lending volume was increasing rapidly with the number of SMEs supported almost doubling in the week up to April 2020. BBB therefore proposed several delivery options for consideration:

- a) Using existing accredited CBILS lending partners operating under the CBILS framework. This would be fast but might risk excluding many non-banks which could risk distorting the market and be confusing for SMEs. BBB suggested the consistency of using CBILS lending partners and CBILS framework would reduce coordination costs. There was concern that, depending on the interest rate that was fixed, some CBILS lending partners would decline to participate, particularly larger lenders. Alternative finance providers who focused on smaller loans would be excluded depending on the speed of lender accreditation. There was also concern about lenders' capacity to deal with the volume of loans under both programmes and the risk of undertakings in distress applying to both CBILS and BBLs;
- b) Using an entirely new, separate partner accreditation process. BBB took the view that this would be inclusive, levelling the playing field amongst lenders and allowing lower cost, technology-enabled lenders to be at an advantage. However, it was identified that "*...the enhanced inclusivity would come at the cost of operational speed and risk.*" BBB considered that accrediting a broad and diverse set of lenders quickly would necessitate a relatively minimalist set of checks, which would carry "*...the risk of having lenders with poor or sharp practices, as well as a greater risk of large-scale fraud.*" Accrediting so many lenders from scratch would require significant time and effort and, as the market of lenders increased, there would be a confusingly large number of potential lenders with a variable quality of 'customer journey';
- c) Using existing Bank Referral Scheme (**BRS**) Finance platforms and existing CBILS/BRS/BBB/Start Up Loan partners to operate the scheme, whilst introducing a new lighter touch accreditation scheme. This would fast-track all lenders with an existing relationship with BBB and the platforms. By fast-tracking lenders that had been previously vetted by BBB, and using the BRS platform, it could reduce the administrative burden to accredit new lenders. Fewer lender candidates seeking accreditation could also allow BBB more time to do a slightly more thorough check on each, thus reducing fraud risk (albeit

still lighter touch than for CBILS). As with previous options, BBB accepted this would still carry operational risk particularly around the speed of deployment; and

- d) Creating a direct model through a procured agent, a 'one stop shopfront' for the new scheme that would be entirely within Government control and could bring potential benefits in terms of collecting the money after the loans were granted. It was not clear that such a service was immediately available, and the time it would take to identify and procure a suitable provider was a significant risk to the proposed launch date. It would also focus the operating risk into a single point of failure and have an 'on or off' speed of deployment rather than a ramping up timeline as more lenders come online. Further, it would risk crowding out the private lending market to the extreme point of eliminating it entirely.

- 4.38. BBB also stated that in the first three options above, it would be possible to have a government-owned lender operating alongside the private-sector lenders, to ensure the widest possible reach for the scheme and provide a 'safety net'.
- 4.39. BBB concluded that the 100% government guarantee of the proposed scheme "...risks wiping out anyone in the SME lending market not accredited for and supported to deliver the Scheme. Simple and fast accreditation that can cover the market is critical."
- 4.40. On the evening of 23 April 2020, the Chancellor held discussions with the Chief Executives of various accredited lenders (Lloyds, HSBC, Nat West, Santander UK, Virgin Money, Dankse Bank, Barclays) at which the potential scheme was discussed.
- 4.41. On 24 April 2020, the Secretary of State wrote to the Chancellor on BBLs proposals {GD(B)/173 – INQ000543175} and {GD(B)/086 – INQ000563988}. He commented on the helpful discussions that had taken place between HMT, the Department and BBB at official level, with the aim of identifying further measures to support UK businesses as they deal with the impacts of the Covid-19 pandemic. The Secretary of State welcomed the Chancellor's proposal for BBLs, "...which would offer loans of up to £25,000 to small businesses and would benefit from a government guarantee to lenders of 100%." The Secretary of State also recognised the need for the two departments to work urgently together alongside BBB to consider issues of scheme design and delivery.

- 4.42. On scheme design the Secretary of State stated, "...we need to recognise the additional risks to the Exchequer that would result from a full guarantee and the absence of credit checking by lenders and should ensure we take proportionate decisions on eligibility and measures to guard against fraud."
- 4.43. On delivery, the Secretary of State said, "...we need to ensure that in parallel to developing a small business loan scheme, we have assessed the other routes to deliver the policy objective, including whether grants (for example delivered by HMRC or local authorities) could be a viable route in some cases. With regard to the loan scheme we will need to ensure that the British Business Bank is fully engaged in the development of a workable delivery plan and timetable."
- 4.44. The Secretary of State cautioned against providing announcements on the detail of the scheme before such issues were finalised. He commented on the need for primary legislation if it proved necessary to disapply aspects of the CCA. Having addressed the potential changes to CBILS also under consideration at this time, the Secretary of State concluded:
- "Finally, I should inform you that while my department recognise the economic and social rationale for these proposed changes, they nonetheless carry significant risks regarding value for money and uncertainty based on Managing Public Money principles. On this basis, my Accounting Officer has informed me that, subject to decisions on the final design parameters, a direction from me may be required in relation to some or all of these new proposals."* (Original emphasis)
- 4.45. With BBLs plans evolving at pace, the Department was keen to obtain external advice around how to assess the validity of claims for BBLs, and what checks could be put in place to limit fraud. On 24 April 2020, in liaison with HMT, the Department commissioned PwC to carry out this work. On the same day, a PwC team was stood up to address this task {GD(B)/174 – INQ000563989}. I return to the PwC work from paragraph 4.62 below.
- 4.46. Following on from the discussions between the Chancellor and accredited lenders on the evening of 23 April 2020, HMT arranged a follow up meeting on 25 April 2020. This was attended by HMT, BBB, accredited lenders and BEIS officials, in order to discuss the scheme design and parameters. Ahead of the meeting, the updated proposals were shared by way of BBB's product development slides which outlined the policy requirements, product parameters and implementation route for the scheme

{GD(B)/175 – INQ000543176} and {GD(B)/176 – INQ000543177}. The purpose of the meeting was “...to clarify and take any questions on the top line policy, take any high level comments on the application form and then ... run through the way the BBB plan to operationalise the scheme.”

- 4.47. Later the same day, Name Redacted (Head of Business Finance, Business Growth Directorate, BEIS) provided the acting Permanent Secretary with an update on a number of developments including BBLs {GD(B)/177 – INQ000585587}. Regarding BBLs, the update stated, “*The Chancellor has proposed a new scheme to address the failure of lending institutions to deliver sub-£25k loans through the CBILS.*” He also attached the updated BBB product development slides (addressed further below), the proposed application form (which had been prepared by HMT and circulated to BEIS officials the day prior) and the Secretary of State’s letter to the Chancellor of 24 April 2020 {GD(B)/178 – INQ000585584}, {GD(B)/179 – INQ000543165} and {GD(B)/180 – INQ000543173}.
- 4.48. The update confirmed that the Chancellor intended to announce the new scheme the following week, with a launch date of 4 May 2020. It advised that the new scheme would have a 100% guarantee, minimal checks on applicants and would be eligible to all with a maximum loan size of £25,000. BBB had confirmed they would not deliver the scheme as currently constituted without an instruction backed by a direction.
- 4.49. Later the same afternoon, Laurence Pawley sent an update to the Secretary of State on developments with CBILs and BBLs {GD(B)/087 – INQ000543178}. On BBLs, the update explained that calls were taking place with the major lenders over that coming weekend to develop the scheme parameters, in advance of the proposed announcement on 27 April 2020. It summarised the key changes on the scheme terms since the advice of 23 April 2020, with the maximum loan size capped at 25% of turnover rather than 10% to give borrowers more flexibility, and a restriction on borrowers to prevent them paying unusual or increased dividends whilst in receipt of the loan.
- 4.50. From the discussions with the lenders on the proposed scheme terms, the update advised the Secretary of State on key issues that had emerged, including in relation to:
- a) Fraud risk. Lenders had highlighted several fraud risks which largely stemmed from the Government’s instructions that the loans should be offered at pace and with minimal checks, which included the risk of businesses applying for

multiple loans from different banks, challenges associated with confirming the legitimacy of businesses, and the use of scanned documents;

- b) Recovery. Lenders had indicated that they were likely to seek clearer guidance from the Government about what steps they were expected to take to recover funds on defaulted loans, and accordingly expected the Government to set expectations in this regard in order to mitigate reputational risk for the lenders;
- c) Refinancing. Lenders argued that having a refinancing cap for this scheme was incompatible with the intent that borrowers should self-certify the need for a loan;
- d) Interest rate. Lenders were seeking clarity on the proposed interest rate; and
- e) Customer journey. Lenders were seeking confirmation about how much they would be able to adapt the proposed application form's format to align with their digital platforms and whether there would be a standard loan agreement.

4.51. The update stated that there was tension between the imperative to deliver finance at pace, and nervousness around risks relating to fraud, regulatory requirements, and reputational risk. It considered that before BBLS could be launched, advice would need to be provided to the acting Permanent Secretary in her capacity as Accounting Officer and a ministerial direction would likely be required.

4.52. Finally, Laurence Pawley explained that the Department and BBB had met for a planning session, after which BBB produced a set of slides to facilitate a discussion with HMT, BBB and the lenders on the proposed scheme {GD(B)/176 – INQ000543177}. In the slides, BBB set out the following principles:

- a) The objectives of the scheme included speed of deployment (scheme to be up and running by early May 2020); volume (BBLS needed to be able to serve a large market of c. 800,000 SMEs who would require finance within the following three months); a simple 'customer journey'; and inclusivity (to be available to as many businesses and lenders as possible, provided lenders seek accreditation and abide by the scheme terms) so as to avoid bias and minimise market distortion;
- b) Given the speed with which the scheme needed to be deployed, it was acknowledged it would run on existing CBILS structures, but with a 100% guarantee;

- c) The product characteristics of BBLs were broadly set, for example applicants would complete a self-declaration that they met the eligibility criteria, there would be no maximum turnover limit, and loans would be offered for a period of six years;
- d) State aid considerations remained subject to confirmation;
- e) There would be specific customer-type considerations for the application process and the checks that each would be required to undergo depending on whether an applicant was an existing customer or a new customer and if they had a business account or a personal account. For example, borrowers who did not have a business current account would be required to present their HMRC unique taxpayers' reference and latest filed self-assessment tax return; and
- f) Borrowers' self-certification forms would be standardised, and applicants would need to confirm the following:
 - i. They were not a business in difficulty in receipt of aid, and if they were how much aid they had been in receipt of;
 - ii. They were impacted by Covid-19;
 - iii. They understood they did not have CCA protections but confirmed their obligation to pay the debt; and
 - iv. They did not have a CBILS loan and had made no other BBLs applications.

4.53. On 26 April 2020, Keith Morgan wrote to the acting Permanent Secretary copying in HMT's Permanent Secretaries and the private offices of both the Secretary of State and the Chancellor {GD(B)/181 – INQ000563990}. BBB's letter was intended to record a number of risks BBB considered needed further consideration before any scheme could be launched. He cautioned that, "*...if not properly mitigated these could have profound and long-term impacts on the market.*" Keith Morgan raised the concern that the policy objectives behind the scheme had not been clearly articulated to BBB, though it was understood that the prime motive behind the proposal was to rapidly and substantially increase the volume of loans being delivered at the lower end of the market. BBB also understood that HMT sought ways to ensure loans were swiftly delivered, ideally within 24 hours. He then highlighted three central concerns:

- a) The significant risk of fraud and abuse, stressing that anyone with a business current account or HMRC self-employment registration could utilise the scheme, possibly through multiple business entities. He also noted that the loans could be used to pay off existing more expensive borrowing, creating significant deadweight costs;
 - b) The UK's alternative finance sector could be negatively impacted, and competition in the SME finance market distorted; and
 - c) Setting up the scheme would be an additional implementation challenge for lenders on top of CBILS.
- 4.54. Keith Morgan drew attention to alternative options that had been discussed with officials that he considered would address many of the remaining obstacles to swifter delivery of loans through CBILS. He stated:
- “On our side, work is already well progressed to remove obstacles, and we understand Ministers are considering further modifications and reassurances for providers to facilitate take-up of the scheme. We are also working with your officials on complementary ideas to support the funding of alternative lenders. If completed, this work could rapidly deliver many of the benefits sought in this area of the market while still encouraging a diversity of supply.”*
- 4.55. He nevertheless recognised the risk of doing too little too late and suggested that the acting Permanent Secretary and ministers would need to weigh up the risks of the new scheme and the risks of not taking sufficient action. He indicated that BBB would need a ministerial direction if ministers did decide in favour of the new scheme.
- 4.56. The acting Permanent Secretary emailed her counterparts in HMT referring to BBB's letter as being a good synopsis of the risks {GD(B)/182 – INQ000585590}. She explained the risks of an early announcement leading to a deluge of queries to the lenders, a slowing of CBILS lending and scrutiny before the final terms had been decided. Charles Roxburgh replied noting that, *“The BEIS and HMT teams [were] working hard on these issues [fraud risks] and have flagged to the CX that speed is only possible where there is an existing account relationship”* {GD(B)/183 – INQ000563993}.
- 4.57. Later on 26 April 2020, Gemma Peck emailed the Secretary of State {GD(B)/184 – INQ000576393}. This email attached a note containing an update on developments in the schemes, the draft term sheet, Keith Morgan's letter, and the draft scheme press

announcement {GD(B)/089 – INQ000585592}, {GD(B)/185 – INQ000585589} and {GD(B)/186 – INQ000585593}. On BBLs, the update stated that BBB's role was not to be announced in the press release to be made the next day. The note alerted the Secretary of State to some of the updated key terms of the proposal. The note referred to BBB's letter regarding the risks with BBLs and confirmed that they agreed with BBB's assessment. The update explained that it was important that the Secretary of State was made aware of the risks prior to the announcement. The risks were then summarised under headings for fraud and deadweight; concentration (i.e. market concentration crowding out alternative finance providers) and customer journey. The Secretary of State was advised that with the lenders being very alive to the fraud risks, BBB was organising a fraud and risk workshop with the lenders to take place the next day. The press notice was intended to be sufficiently high level to allow some time and space to agree the terms and approach in light of the risks and challenges that had been identified. The risks of an early announcement were outlined, and it was explained that the Department had urged HMT officials to reconsider the timing. It was recommended that the Secretary of State reiterate the Department's concerns about timing, despite the fact that the Chancellor was very determined to proceed.

The Announcement of BBLs: 27 April 2020

- 4.58. On 27 April 2020, the Chancellor's private office sent final details of the high-level terms of the scheme that would be announced later that afternoon {GD(B)/187 – INQ000563994}. The Treasury had decided that the cap on loan size should be £50,000, capped at 25% of turnover. This was the first time the Department had been notified that the cap on loan size was to be £50,000, as discussions prior to this date between the Department and HMT had been regarding a £25,000 loan cap {GD(B)/188 – INQ000543179}. This change did not add any additional administrative burden for BEIS officials and once the guidance for businesses was published, the distinction between CBILS and BBLs was clear to businesses.
- 4.59. The announcement of the scheme was made later that day both in Parliament and in a media release.

Ongoing Consideration of BBLs Design and Associated Risks Between the Announcement and its Launch

- 4.60. Between the announcement of BBLs on 27 April 2020 and the scheme's launch on 4 May 2020, the Department continued to work closely with HMT, BBB and through them the lenders to finalise the terms of the scheme.
- 4.61. On 28 April 2020, David Raw emailed the Department with final decisions on some of the details of the scheme and “...a very clear steer...” on the application form (with the latest draft at that stage attached to the email) following Treasury officials' discussions with the Chancellor earlier that day {GD(B)/189 – INQ000585600} and {GD(B)/190 – INQ000543184}. These decisions were as follows:
- a) The Chancellor's inclination was for no fees;
 - b) The loan was to be non-transferable once the lender had claimed on the guarantee and sought recovery of the funds. The Chancellor's view was that for the Government to seek to recover in this way, it would have been at odds with the nature of the scheme;
 - c) The Chancellor wanted to allow 'flipping' between CBILs and BBLs. However, he was clear that if someone took out a loan under BBLs and repaid it early, they should not then be able to take out a loan under CBILs⁸;
 - d) The Chancellor wanted CBILs and BBLs to be kept separate, “...but for asset finance and invoice finance to be carved out and continue to operate below £50k in CBILs.”;
 - e) HMT was to check the sectors that the lenders were reluctant to lend to due to corporate responsibility reasons, so that the Chancellor could confirm that the lenders were not “...just using it as an excuse...”;
 - f) The Chancellor agreed that Personal Current Account customers should face extra Anti-Money Laundering (AML) checks;
 - g) The Chancellor was content for there to be nothing on the form about County Court Judgments (CCJs). He wanted lenders to take a proportionate approach in line with that discussed at the fraud workshop (see paragraph 4.62 below on the PwC fraud workshop); and

⁸ Ultimately, borrowers were not permitted to have a BBL and any of a CBIL, CLBIL or Covid Corporate Financing Facility for the business unless those facilities were to be financed in full by the BBL.

- h) On the application form, the Chancellor thought there was a case for lending to undertakings in difficulty where they were not insolvent, with the suggestion of extra questions linked to the main form.

PwC Fraud Risk Assessment

- 4.62. As explained above, given the significant fraud risks identified with BBLs, the Department sought input from external consultants at an early stage and PwC was asked to design {GD(B)/174 – INQ000563989}:

“...a simple framework which illustrates, for different borrower segments ... what a no check, minimal check and moderate check approach could look like. And for each approach and segment, an assessment of how much additional assurance the check provides and the degree of risk that remains (for fraudulent or poor vfm lending) and the amount of friction the checks would add into the system.”

- 4.63. On 27 April 2020, PwC facilitated a fraud workshop with seven accredited lenders to administer BBLs at that time. This workshop was also attended by officials from both the Department and HMT, and BBB representatives. The workshop was designed to gain an overview of the main fraud concerns associated with BBLs and to identify ways of addressing them {GD(B)/191 – INQ000585597}:

“Areas highlighted by the lenders included: individuals approaching multiple providers, the application of CCJs, the need for banks to establish sources of funding (as part of their BAU) being more challenging when individuals don’t have business accounts.”

- 4.64. Following the initial fraud workshop, meetings were conducted on 28 and 29 April 2020 between PwC and each of the major accredited lenders, in order to validate PwC’s understanding of each lender’s approach and to elicit the lenders’ views on the residual fraud risks.
- 4.65. BBB instructed PwC to prepare a report to support it in understanding and articulating, based on the views of the accredited lenders, the potential risks that may crystallise in BBLs. PwC was not instructed to assess the design or operational effectiveness of fraud controls at each of the lenders.
- 4.66. On 1 May 2020, Keith Morgan emailed the PwC Fraud Risk Review initial draft report to the Department and HMT ({GD(B)/004 – INQ000585607} and {GD(B)/192 – INQ000596671}, email and report respectively). In forwarding the initial draft report

Keith Morgan emphasised that “...PwC’s assessment is that the residual fraud risks should be categorised as ‘Very High.’” Keith Morgan then highlighted the key risk areas, being multiple applications; self-certification by businesses leading to lending being made to businesses which were not eligible for the scheme or amounts in excess of that to which they were entitled; applications from businesses that were inactive, dormant or being used for fraud; and organised crime (see the further detail on these below). These risks were highlighted with a view to ensuring that ministers had full knowledge of these risks before issuing any instruction to BBB.

- 4.67. Further, Keith Morgan remarked that in addition to the fraud risks identified by PwC, there was also an enhanced credit risk (associated with the removal of elements of the usual credit check processes) and reputational risk (associated with lending to industries that the lenders would not ordinarily lend to). BBB estimated that the combined estimate for fraud and credit losses on BBLs ranged from between 30% and 50% albeit that this was based on high level assumptions. To enumerate this Keith Morgan set out that, of the circa 800,000 smaller businesses in the UK that were estimated to be facing liquidity issues, 50% would borrow £25,000 on average (from the £50,000 limit) leading to a total value of approximately £10 billion. As a result, combined fraud and credit risk losses could be between £3 billion and £5 billion.
- 4.68. In relation to fraud controls, none of the seven lenders were intending to implement additional AML or Know Your Customer (**KYC**) checks for existing business current account holders. It was explained that many of the lenders had developed new processes for the implementation of BBLs, driven by the requirement to remove credit and affordability decisioning processes. That had resulted in a removal of the integrated fraud checking processes; some but not all lenders intended to use existing processes with Credit Reference Agencies, others had designed processes to access fraud data separately, while the remainder did not intend to conduct additional checks on existing Business Current Account customers. All were implementing additional AML and KYC checks for existing personal current account holders. New customers would be subject to full AML and KYC checks (with the exception of Santander and Lloyds Banking Group who were not lending to new customers).
- 4.69. PwC assessed from their consultation with lenders and BBB that a consistent set of tests was emerging across the majority of the lenders, but it was not universal. These fraud checks were summarised in the report as follows:

- a) Use of external fraud databases such as Credit Industry Fraud Avoidance System (**Cifas**) (or equivalent) to screen against known fraudsters;
 - b) Reasonable levels of internal fraud check/using internal fraud lists; and
 - c) Ongoing transaction monitoring controls.
- 4.70. It was explained that for some lenders, this combination of fraud checks might cause an operational challenge.
- 4.71. The report stated that it was unlikely that the residual fraud risks identified could be categorised as anything but 'Very High'. It explained that whilst the likelihood of the fraud risk crystallising was very high, the impact of this was difficult to quantify. PwC identified eight areas of residual fraud risk:
- a) The self-certification mechanism. The risk was that this could lead to lending being made to businesses who were not eligible for the scheme, amounts in excess of those to which businesses were entitled or whose difficulties were irrelevant to the pandemic. It was noted that the lenders' approach to Personal Current Account applicants, being that the businesses were required to complete the joining processes ('onboarding processes') that would normally be required of new Business Current Account customers, may partially mitigate this risk;
 - b) Multiple applications. Businesses could submit multiple applications to different lenders, or multiple applications to the same lender as it was identified that the speed of delivery for BBLS was such that lenders may be unable to identify if this was occurring (all lenders were considering approaches to prevent this). There was also the risk that businesses could submit multiple applications to different Covid-19 loan schemes concurrently, for example applications could be made to both BBLS and CBILS;
 - c) Lack of legitimate business. The risk was that the scheme might be utilised by opportunistic individuals in distress with no real business and inactive or dormant accounts, or by companies being used to facilitate fraud. Lenders commented on the recent spike in company formations. PwC stated that "*[t]his risk stems significantly from reliance on self certification and is therefore an inherent risk of the scheme.*";
 - d) Internal fraud (business). Individuals might have access to business details but no authority to apply on behalf of the business. Lenders believed that this would

be mitigated through current online banking access procedures, and by mandate requirements. PwC, however, reported that, "...the Scheme rules require the Lender to assume the applicant has the power to act on behalf of the business and thus this risk is inherent in the design of the scheme.";

- e) Internal fraud (by personnel of the lender). The risk was the potential for fraud to occur as a result of the speed of delivery of the scheme, the incorporation of manual processes, and the movement of personnel within operations. It was explained that lenders were developing controls to mitigate this risk, but the volume of applications and the need to work from home during the pandemic might still mean that there was a residual fraud risk;
- f) Impersonation/forged/fake documentation. This was stated to be an existing risk with any business current account application, not exclusive to BBLs (lenders were applying processes designed to mitigate such risks where possible through the Business Current Account 'onboarding processes' if the applicant did not already have a business current account);
- g) Organised crime. The risk was of exploitation of 'desperate' individuals with valid existing accounts who may be induced by organised criminals to provide their account details to fraudsters, and for 'mule accounts', i.e. personal and business current accounts set up specifically to access the loans, the latter "...a risk particularly exacerbated by the high incidence of company formations in recent months."; and
- h) Other considerations. Lenders informed PwC that the analytical capabilities under development would provide only a retrospective review. They separately expressed concern on the reputational rather than fraud risk, that lending may go to certain sectors (such as adult entertainment or gambling organisations) that they may not normally deal with.

4.72. The report further stated that whilst many of the lenders were developing analytic capabilities to review the available data and identify issues, any such review and any actions taken by the lenders would be retrospective in nature and would therefore not prevent the payment of money under the scheme, but rather enable the lenders to identify instances of fraud at a later stage.

4.73. The lenders flagged a number of challenges associated with BBLs that they were working to address, some of these "...were able to be addressed by individual Lenders,

some at industry level and some are incapable of resolution.” These challenges included:

- i) The departure from normal lending process (the disregard of credit and affordability concerns) as, “[The lenders’] *systems and processes were built around these concepts which ... also provide information to enable fraud risks to be identified and mitigated.*”;
- j) The speed with which the lenders were required to implement BBLs and the turnaround time from application to drawdown;
- k) The reliance on self-certification, in circumstances where the lenders may hold information which would contradict the self-certifications;
- l) Some of the lenders were concerned that “*...flaws in the Scheme design would not become apparent until ‘month 13’ i.e. when institutions attempted to begin collection of the loans.*”;
- m) Most of the lenders were designing post scheme launch analytics to quantify the potential impact of fraud and loan default. One lender commented that similar schemes in the past had incurred default ratios in excess of 30%;
- n) The definition of minimum standards. The lenders remarked that they would like clearer minimum standards/guidance on the checks that they were expected to perform to mitigate fraud; and
- o) Balancing the objectives of BBLs with existing regulatory requirements. The lenders were concerned that for personal current account holders, relying on Self Assessment or Unique Taxpayer Reference numbers would not meet the usual regulatory requirements or internal policy requirements for AML/KYC information. Lenders considered that these checks needed to be completed prior to any drawdown of the loan.

4.74. Lenders suggested a range of possible enhancements to the operation of BBLs, as follows:

- a) Further guidance on the minimum standards required in the context of fraud mitigation processes for BBLs would be beneficial. Specifically, more clarity on eligibility criteria and alignment of defined dates for elements such as self-certification of businesses’ ‘not in difficulty’ status and date of incorporation; minimum fraud controls e.g. Cifas checks, internal fraud lists, and transaction

monitoring controls; and clarity on when it was permissible to decline an applicant;

- b) Implementation of one central data clearing house as a potential solution to facilitate identification of multiple applications from a single business. All of the lenders were looking at ways to identify multiple applications within their organisations, but they had no mechanism for identification across lenders;
 - c) Mechanism for more rapid information sharing across accredited lenders, such as for loans declined or approved and abusive applicants, to increase awareness and provide actionable intelligence; and
 - d) Including a statement on the application form that the information would be used for the purposes of mitigating fraud and may be shared with other relevant parties (in line with the Cabinet Office Counter Fraud Measures Toolkit).
- 4.75. Later the same day, the acting Permanent Secretary emailed BEIS officials regarding Keith Morgan's email and wanted to ensure that HMT officials were bringing the risks raised in the same to the Chancellor's attention {GD(B)/193 – INQ000543196}. In reply, BEIS officials said they would take it up with HMT immediately, which was done that day and HMT confirmed that they had seen Keith Morgan's letter and advised the Chancellor accordingly {GD(B)/194 – INQ000543197}, {GD(B)/195 – INQ000543199} and {GD(B)/196 – INQ000543200}.

Further Consideration of BBLs Terms with BEIS Ministers, HMT and BBB

- 4.76. On 27 April 2020, Laurence Pawley emailed the Secretary of State and other BEIS officials noting that the Chancellor had made a statement in Parliament that day confirming both the changes to CBILS and the proposed launch of the new 100% guaranteed loan scheme for small businesses (by now branded as 'Bounce Back Loans') scheduled for a launch date of 4 May 2020 {GD(B)/197 – INQ000585596}.
- 4.77. The summary of the announcement, attached to the email, included key details of BBLs including that the scheme would offer loans from £2,000 up to £50,000, capped at 25% of businesses' turnover {GD(B)/191 – INQ000585597}. It stated that the upper limit of £50,000 was a new announcement and that the Department had not been informed of this parameter of the scheme in advance. The update again set out the outstanding issues in relation to fraud risk, pricing, State aid and the interaction with CBILS. The update included the fraud risks highlighted by the lenders during the PwC workshop.

4.78. On 28 April 2020, Gemma Peck emailed the acting Permanent Secretary, forwarded Laurence Pawley's update note for the Secretary of State from the previous day, and confirmed that the Department's work with HMT and the lenders on the term sheet for BBLs was ongoing {GD(B)/198 – INQ000585598}. She advised that there was significant deadweight and fraud risk and that the acting Permanent Secretary would be required to seek a direction prior to implementation. The email stated further:

“The CX has a very high tolerance for these risks and SoS has limited appetite to challenge the CX's views, so I'm afraid the direction will likely be a difficult one. We will necessarily need to flag the ways in which we think vfm could be improved and which ministers have declined to take-up.”

Ongoing Consideration of BBLs Design and Associated Risks Between the Announcement and its Launch

4.79. On 28 April 2020, BEIS officials sent a submission to the Secretary of State. The submission reflected discussions with the Secretary of State earlier that day and the Chancellor's position on the proposed BBLs parameters and policy areas {GD(B)/199 – INQ000585601} and {GD(B)/200 – INQ000585602} (to note that, in error, the submission on its face was dated 21 April 2020). The Department, HMT, and BBB had been working together to develop the policy terms for BBLs. The submission explained that there were some areas where either the Department had taken a different view to HMT (as set out in the sub-paragraphs below), or where they wished to highlight the current proposals and resultant risks for BEIS and made some recommendations in relation to specific policy parameters. It sought the Secretary of State's view on these areas of difference and suggested further discussion with the Chancellor, including in relation to the following:

- a) Recoveries. It was noted that ministers wanted a simple scheme which was focused on getting money quickly to businesses in need, at the expense of the lender's ability to conduct detailed checks. Lenders were expected to attempt recovery of defaulting loans for a period of 12 months, but after this period, there was no obligation on the lender to take further action. The submission stated that this created a significant risk. The submission recommended that the Secretary of State write to the Chancellor to seek inclusion of a provision for the Government to enable further action to recover outstanding debt after the lender claims on the guarantee. The Chancellor had confirmed earlier that evening that he did not want to make such a provision as he considered that it

would be at odds with the nature of the scheme. Angelina Cannizzaro sought to confirm whether the Secretary of State was content with the Chancellor's decision or would push for the inclusion of the provision in line with BEIS officials' recommendation;

- b) Standards of Care. The proposal included that the CCA would be partially disapplied with respect to BBLs, which removed some protections for borrowers taking loans of under £25,000. To address this, HMT had been developing bespoke requirements around standards of care in conjunction with the Financial Conduct Authority (FCA). Lenders were also required to provide information to borrowers to help protect them, and lenders would have to comply with FCA rules on debt collection;
- c) Fraud. The submission stated that the lenders and BBB had raised concerns that the scheme design created a significant opportunity for fraudulent applications. As outlined, the PwC report concluded that early analysis suggested that it would not be possible to fully mitigate the risk given the imperative that applications were dealt with quickly and with minimal checks by lenders and no checks across lenders. The submission recommended that the Secretary of State write to the Chancellor to confirm the Department's position that, as a minimum, work should be done with HMT officials to implement the recommendations of the PwC report (in relation to mitigation of fraud risks) which would not compromise the policy objectives of the scheme;
- d) Financial considerations. Initially it was thought that around 800,000 businesses would access BBLs. With an assumed average loan size of £22,000, it was estimated that for every 45,500 loans approved there would be a potential liability of around £1 billion. It was estimated that upwards of £18 billion of loans would be guaranteed, with a significant proportion of those at risk of defaulting if the risks created by the simplification of checks and application were to materialise. Further, it was explained that *"There is also a significant deadweight issue, as the lack of checks on business activity mean that these loans could be used to pay off existing facilities which could be personal in nature."* I have outlined the parallel Accounting Officer advice below in paragraph 4.88; however, it was considered that a further direction would highly likely be required, in view of the significant risks around value for money and propriety e.g. scope for fraud; and

e) State aid. Consideration was given to State aid compliance risks, noting the minimums that the State aid de minimis regulation and UK's pre-approved 'Umbrella Scheme' (which mirrored the European Commission's Temporary Framework) permitted a business to receive no more than €200,000 and €800,000 respectively, over three fiscal years (with lower limits for the agricultural, fisheries and aquacultural and haulage sectors). The 100% guarantee for BBLs meant the entire principal value of the loan would count towards these amounts. The larger scheme was therefore the preferred option, however, the disadvantage was that it required the use of the 'business in difficulty' test, which would "...rule out some businesses that we may otherwise want to support, such as those with limited share capital and some historical losses." The policy intention was to allow businesses to access either the de minimis regulation or the Temporary Framework, but this increased the complexity of the application form, so BEIS was still working with HMT on that issue. BBLs reliance on self-certification also raised a State aid compliance risk, if a business was to misstate its eligibility. The submission referred to the German scheme and how they adopted the same approach. It concluded that this was within the Department's risk appetite.

4.80. On 29 April 2020, HMT prepared a Contingent Liabilities Checklist and recorded that removing significant elements of the credit checks that would ordinarily be performed would "...exacerbate the credit risk: credit histories and credit reference assessments [would] not be required to be checked and therefore many people with poor credit histories, and even multiple County Court Judgements (CCJs), [would] be permitted access to credit." As such it would be "...vital for BBB, BEIS and HMT to monitor these risks closely for the lifetime of the scheme, by ensuring that there are effective processes in place for reporting from lenders and using existing governance to review the level of risk."⁹ {GD(B)/201 – INQ000563996}

4.81. On 30 April 2020, the Secretary of State wrote to the Chancellor with respect to BBLs, highlighting two issues on which HMT needed to make careful decisions to balance the imperative to provide finance at pace, with the desire to ensure the scheme delivers

⁹ A Contingent Liabilities Checklist is a document that is prepared by the government to outline the rationale for incurring a contingent liability (in this case, BBLs and in particular the Government's 100% guarantee for the scheme), an assessment of the same and discussion of any risks.

benefits to those who really need it {GD(B)/202 – INQ000585605} and {GD(B)/203 – INQ000585604}.

- 4.82. Firstly, they should take sensible steps to mitigate the risk of fraud. The Secretary of State explained that PwC was preparing a report on the main risks, and this should be carefully considered to implement the recommendations where possible. He acknowledged that for some borrowers this would slow down the application (for example those currently without a business account), but this would protect the taxpayer.
- 4.83. Secondly, the requirements put on lenders to seek to recover the loans in default should be proportionate, and the Secretary of State welcomed the proposal to time-limit the obligations to 12 months. The Secretary of State explained that “...*my officials and yours have discussed mitigation options which could make provision for Government to continue recovery proceedings after 12 months, but this is not HMT’s preferred option.*” He therefore emphasised that the Department, HMT and BBB should work with lenders to ensure that borrowers are given clear messaging about their obligations to repay loans.
- 4.84. As I outlined above, consideration was given to the appropriateness of disapplying sections of the CCA for BBLs, to ensure that the lenders were able to issue loans as quickly as possible to smaller businesses to achieve the BBLs policy objectives. On 30 April 2020, EBRIG prepared a report for HMT in relation to the proposal to disapply sections of the CCA {GD(B)/204 – INQ000083339}. The report gave the following recommendations:
- a) The Committee agreed that Government should legislate to disapply relevant sections of the CCA, those dealing with unfair relationships between lenders and borrowers, to all loans made under BBLs;
 - b) Following a further update from the Chancellor on discussions with the lenders on the jurisdiction of the Financial Ombudsman Service (**FOS**), the Committee should either:
 - i. Agree that the FOS should have jurisdiction over BBLs (and to ensure that it will view lender actions in providing BBLs with reference to the Government’s clear policy intention); or

- ii. Agree that the Government will bring forward primary legislation which will retrospectively disapply the FOS's jurisdiction in relation to loans made under BBLs; and
- iii. The Committee agree that the Chancellor will inform lenders of the intended changes ahead of the scheme's launch date.

4.85. This report was used by the Secretary of State to support discussions around the legislation required to disapply the CCA for BBLs. See email chain at {GD(B)/205 – INQ000585614}.

Implementation and Delivery of BBLs

Final Decision and Direction by the Secretary of State to Proceed with BBLs: Exchanges on 1 May 2020

4.86. On 1 May 2020, significant exchanges took place between stakeholders in relation to BBLs ahead of the planned launch of the scheme on 4 May 2020.

4.87. First, as outlined at paragraphs 4.66 and 4.67 above, Keith Morgan emailed the acting Permanent Secretary and set out his concerns following the PwC assessment concluding that the residual fraud risks should be categorised as very high {GD(B)/004 – INQ000585607}.

4.88. Second, on 1 May 2020, Angelina Cannizzaro and a BEIS official sent advice to the Accounting Officer regarding the establishment of BBLs {GD(B)/206 – INQ000563995} and {GD(B)/207 – INQ000543190}. They advised that there were several Accounting Officer risks associated with this scheme as mentioned in the preceding paragraphs of this statement, including those around value for money and propriety (fraud risk, removal of normal commercial controls, and consumer protections) that may also impact regularity, as well as feasibility and concerns regarding competition. In advising that a further ministerial direction should be sought, they explained that BBLs arguably went further in terms of some of the risks that had led to ministerial directions being issued for CBILs and CLBILs. Officials also advised that the pace at which the Chancellor wished to introduce BBLs was potentially problematic for the lenders and BBB to implement successfully, given the other schemes that were being delivered in parallel. Several risks were associated with BBLs, including in relation to:

- a) Value for money. Officials highlighted that they could not provide a robust estimate to conclude that BBLs would represent value for money and advised

that the 100% guarantee and lack of viability test would “...*undoubtedly result in lending to businesses which were unviable pre-COVID-19...*”. The submission reflected officials’ belief that faster lending would have a positive impact on the scheme’s effectiveness and on value for money by reducing the chance of businesses failing whilst awaiting a loan. However, it was also explained that CBILS was functioning more effectively at that time and there was a lack of evidence that the time taken to process loans was fundamentally restricting CBILS’ impact. It was explained that the lack of restrictions on refinancing also created a significant ‘deadweight risk’;

- b) Propriety, in particular fraud risk. The submission stated that “[*t*]he proposed self-certification approach will increase the risk of fraud. Areas so far highlighted by lenders include individuals approaching multiple providers, applicants with multiple County Court Judgements against them, the need for banks to establish sources of funding ... being more challenging when individuals do not have business accounts.” Regarding the PwC report, “...it will be important to implement these recommendations to the extent that they do not compromise the policy objectives of the scheme.” The submission recorded that the “Secretary of State [*had*] written to the Chancellor to make this point.” However, even if the recommendations were adopted it remained impossible to fully mitigate the risk due to the imperatives of the speed of dealing with applications and the minimal checks by and between lenders. It was further explained that substantial fraud risk mitigation could only be achieved through slowing down the application process, though “...*the Chancellor [*had*] clearly signalled he want[ed] to prioritise speed and [*was*] willing to accept an elevated risk of fraud as a consequence.*” Disapplication of the CCA safeguards was also highlighted as a risk that facilities would be offered to high-risk businesses;
- c) Recoveries. The submission reiterated the concerns set out previously in this statement in respect to recoveries. Officials predicted that the limited incentive for businesses to repay these loans (being that the lenders’ exposure was covered by the 100% government guarantee, leading to the possibility loan repayments would not be pursued by lenders as they otherwise would be), created a significant risk for BEIS, as claims made under the guarantee would “...*crystallise as liabilities for the Department with no scope for us to reduce them via further recovery activity.*”;

- d) Competition. BBLs was considered likely to have a negative effect on competition in the SME lending sector, with the standard interest rate pricing out smaller lenders. Mitigations suggested by BEIS officials had been rejected by the Secretary of State and the Chancellor in order to prioritise simplicity and affordability for borrowers. The Competition and Markets Authority had suggested further mitigations; and
- e) Financial impact. The submission stated, “[t]he uncertainty around demand and defaults will inevitably have an impact on BEIS’s ability to forecast and plan accurately, creating potential risks against budgets”. The submission reiterated the assumptions detailed in paragraph 4.79d) relating to estimated liability figures. Another uncertainty was the scale and timing of defaults. Consequently, emphasis would be put on reporting and monitoring of the scheme to assess liabilities and risks.

4.89. Third, the acting Permanent Secretary wrote to the Secretary of State with advice in her role as Accounting Officer and as required by the Managing Public Money principles, formally requested a written ministerial direction from the Secretary of State if he wished to proceed with BBLs {GD(B)/208 – INQ000064863}. This advice set out a number of factors for the Secretary of State to consider and highlighted the significant risks in some detail.

4.90. The Accounting Officer assessed that there was a strong argument that the Government should go further than CBILs and CLBILs did in accepting additional risk for small businesses, and “[o]ne way to do this is for the Government to assume 100% of the lending risk, as has been the case in other countries such as Germany and Switzerland.” She also explained that it would be “...helpful to simplify the application process as far as possible for loans to the smallest businesses, who typically find it especially difficult to access finance. While CBILs is open to these businesses, some of the major lenders have been reporting that they face particular challenges in offering CBILs facilities at low levels.” She explained that BBLs was designed to address these issues, and the scheme should therefore ensure that caution on the part of lenders did not prevent smaller businesses from accessing the finance they needed and should also significantly speed up lending for these businesses, reducing the likelihood that a business fails while awaiting support.

4.91. The Accounting Officer went on to state:

“These are convincing arguments in favour of introducing the scheme.

However, whilst I can see the clear benefits of introducing BBL, as Accounting Officer I must also consider its introduction against the standards that I am responsible for safeguarding. In common with CBILS and CLBILS it is difficult to be sure that the proposed scheme parameters are optimal, with a lack of data available to undertake a robust value for money assessment.

The 100% guarantee and lack of a viability test beyond self-certification will undoubtedly result in lending to businesses that were already unviable pre-COVID-19, which raises concerns around value for money. The lack of restrictions on refinancing also creates a significant 'deadweight' risk, in that lending may not be genuinely additional. I understand that your letter to Chancellor on April 29¹⁰ highlighted the importance of messaging to borrowers about their obligations to repay loans. I agree that this is a pragmatic step to help manage risks to the taxpayer, although a residual risk is likely to remain that will drive higher costs to the taxpayer. Ultimately, we lack the evidence to say that the benefits of faster approval times and elimination of lender caution as a factor will compensate for these issues.

[...]

...whilst the policy aim is to speed up the availability of funding for businesses, this means loosening some controls and protections that we might expect in ordinary times. You have noted to the Chancellor that the recommendations from appointed external advisers on measures to try and minimise fraud – which we are working through with HMT and BBB – will need careful consideration as part of finalising how lenders must operationalise the scheme.

The risk in relation to regularity and propriety depends upon the eventual level of fraud and error, which cannot be reliably estimated in advance – however the report we have now received suggests that even with mitigation steps in place, the residual risk remains “very high”. Although we will expect banks to take all reasonable and practicable steps (within the parameters of the scheme) to avoid this, should there be material levels of fraud and error then this is likely to be deemed irregular in terms of spending authority.

...

¹⁰ I note for completeness that this reference to a letter of 29 April 2020 from the Secretary of State to the Chancellor should read 30 April 2020, as it was sent on that date and is the letter referenced above in paragraph 4.81 {GD(B)/202 - INQ000585605}.

*To sum up, the potential for economic damage created by the coronavirus pandemic continues to create a strong case for Government intervention, and we know there is a risk that some businesses that would otherwise survive are in danger of missing out on support if a further intervention is not introduced. Given the degree of uncertainty and risks involved with the scheme **Managing Public Money** requires that I ask for a written direction from you if you wish to proceed with the BBL scheme...” (Original emphasis)*

- 4.92. Fourth, BEIS officials sent a submission to the Secretary of State, including advice relating to the potential risks associated with the scheme, the need for formal consent to be obtained from HMT, and a direction letter to be provided to the Accounting Officer in reply to her earlier letter {GD(B)/209 – INQ000563997}. The submission noted that the parameters of BBLs were close to finalisation and the scheme was scheduled to come into effect on 4 May 2020 in line with the Chancellor’s prior announcement. The submission advised the Secretary of State that in order for the next announcement to proceed regarding the launch of the scheme, by 1 May 2020 the Secretary of State would need to have:
- a) Sought formal consent from HMT to launch the scheme; and
 - b) Exchanged direction letters with the Permanent Secretary.
- 4.93. The submission confirmed there would be no provision for lenders to continue attempts to recover defaulted loans after 12 months and businesses would not be required to make any repayment on capital during the first 12 months of the loan. In terms of practical mitigations, agreement had been reached for the draft application form for the scheme to ask borrowers to confirm their ability and willingness to repay the loan, and to make it clear that a failure to do so could negatively impact their ability to obtain credit in the future.
- 4.94. Despite this, it was again advised that significant residual risks remained with the scheme, as set out in previous advice dated 28 April 2020. These risks related to fraud (citing the fraud risks identified in the PwC report and providing a copy of the same with the advice), recoveries (limited obligations placed on lenders to seek to recover loans which enter default, and inability of the Government to seek assignment of loan books) and competition (although the interest rate was yet to be confirmed at that time, they expected it to be set at a level which would have the effect of pricing out a range of smaller lenders, which could lead to a distortion of the SME lending market and further concentrated lending with the main retail banks). The advice referred to Keith

Morgan's correspondence to the acting Permanent Secretary (detailed above at paragraphs 4.66 and 4.67) which outlined the risks and the suggested range of credit and fraud losses. The advice sought confirmation from the Secretary of State that he was content to proceed with the expected final terms for BBLs.

- 4.95. The expected final terms of the scheme were set out as follows:
- a) The borrower must confirm that they had been impacted by Covid-19, that they were not in financial difficulty as at 31 December 2019 and that they were not receiving funding under any of CBILS, CLBILS or the CCFF schemes (unless refinancing all of that lending);
 - b) The business must have been established by 1 March 2020;
 - c) The loan would be between £2,000 and £50,000 (with a limit of 25% of the borrower's turnover through self-certification) available for a term of six years. No repayments of capital in the first year;
 - d) 100% government-backed guarantee;
 - e) No personal guarantees permitted, and a borrower's principal private residence and principal private vehicle could not be taken as part of the recovery process; and
 - f) In the event of a default the lender would only be required to seek recoveries for a period of up to 12 months.
- 4.96. In relation to the acting Permanent Secretary's request for a direction, the submission advised that, "*The direction is justified on the grounds that, given the pace of implementation of the scheme and the limited data available, it is impossible to make an assessment of the value for money of the proposal – while recognising the policy imperatives behind its introduction.*" The Secretary of State was advised however, that prior to exchanging such letters on a direction, his private office needed to seek formal consent from HMT to launch the scheme. This was highlighted as, "...an important step to secure the necessary funding from HMT in relation to the liabilities that the scheme will generate for BEIS." Draft responses were proposed and annexed to the advice for the Secretary of State to send to the acting Permanent Secretary and HMT on these matters.
- 4.97. Fifth, later the same day, and in accordance with the advice from BEIS officials set out in the above submission, the Secretary of State's private office emailed HMT seeking

approval to introduce BBLs {GD(B)/210 – INQ000563998}. The Secretary of State acknowledged that he would need to issue a direction to the Accounting Officer to introduce the scheme, which he said he would do following confirmation of the Chancellor's agreement to introduce the scheme.

4.98. The email concluded by saying:

"...given the uncertainty around the scheme and the eventual cost and potential losses – in particular recognising that the report the BBB commissioned (as requested by BEIS) and received today from PriceWaterhouse Coopers indicates a very high residual risk of fraud – SoS BEIS trusts that HM Treasury will continue to honour the assurances that the additional budget cover required to meet all costs now and in the future will be provided. SoS BEIS will need confirmation that this is the case before the British Business Bank can be instructed to implement the scheme. BEIS officials will continue to work with colleagues at HM Treasury and the British Business Bank to monitor the impact of the scheme and provide advice to Ministers, including ongoing assessment of the potential liabilities incurred by Government."

4.99. The Chancellor's private office replied to the Secretary of State's private office on the same day to indicate that, given the significant economic challenges faced by small businesses and the importance of ensuring they could quickly access capital, the Chancellor was content to agree to introduce the scheme {GD(B)/211 – INQ000563999}. The email also confirmed that the Chancellor had seen the findings of the PwC report on fraud risk and that BEIS would be provided with the necessary budget cover to accommodate losses under the scheme. However, it would be important for BEIS teams to work closely with HMT in the coming weeks to establish robust monitoring of the scheme to ensure its effectiveness and its fiscal implications were understood. In addition to BBB governance, BEIS set up the Business Finance Assurance Board (**BFAB**) in June 2020 to oversee and monitor the loan schemes. BFAB and its effectiveness as a monitoring mechanism is discussed in further detail in 6.42.

4.100. Sixth, later on 1 May 2020, the Secretary of State responded to Sam Beckett's Accounting Officer advice {GD(B)/212 – INQ000064823}. He formally directed her, as Accounting Officer, to take BBLs forward with immediate effect, stating:

“I note the BBL scheme risks highlighted in your letter, however I believe that these risks are outweighed by the need to get support to small businesses as quickly as possible, which the BBL scheme will aim to deliver.

The Chancellor and his officials have given me approval to proceed and I am prepared to provide support for the introduction of this scheme as soon as practicable. I am therefore formally directing you as Accounting Officer to take this forward with immediate effect.”

- 4.101. Finally, late on the evening of 1 May 2020 the acting Permanent Secretary emailed Keith Morgan to confirm that the ministerial direction had been issued and to instruct BBB to proceed with BBLs {GD(B)/213 – INQ000564002}¹¹. In her email, the acting Permanent Secretary acknowledged that it would be *“...vital for the BBB, BEIS and HMT to monitor these risks closely for the lifetime of the scheme, by ensuring there are effective processes in place for reporting from lenders and using existing governance to review the level of risk.”* The acting Permanent Secretary also stated that BBB would need to ensure there were *“...robust controls and governance around these financial commitments that, as far as reasonably practicable, ensure public funds are being used appropriately in the context of the agreed parameters of the scheme.”*
- 4.102. On 1 May 2020, the Chancellor wrote to accredited lenders clarifying a number of matters relevant to the design and operation of BBLs ahead of its launch {GD(B)/214 – INQ000543201}, {GD(B)/215 – INQ000543202} and {GD(B)/216 – INQ000543203}.

Concerns/Reservation Notice: Exchanges on 2-3 May 2020

- 4.103. The BBB Board met on 2 May 2020 to consider the instruction to proceed with the implementation of BBLs following the direction letter issued the night before. In this meeting, the BBB Board concluded that they should issue a reservation notice, reflecting their concerns on fraud, credit risk, and the SME finance market. On 2 May 2020, Angelina Cannizzaro emailed the Secretary of State to advise that such a letter was coming {GD(B)/217 – INQ000564003}. She highlighted their concerns but stated that they were *“...absolutely prepared to implement the scheme, whilst also feeling it is their responsibility to alert [Secretary of State], as their shareholder, to the risks inherent in what is proposed.”* She explained the reservation notice process in the following terms:

¹¹ The email also addressed changes to CBILS which are addressed at paragraph 2.105 to 2.121.

“The reservation notice is a provision in the BBB framework that has not been previously used. It is similar in principle to a request from the BEIS Accounting Officer for a direction ... Either way, once the board receives your instruction in response to their reservation notice, that resolves the matter. The BBB framework says: “upon receipt of a Written Direction or an Oral Direction [the CEO shall] inform the Company Board who shall undertake the Instructed Matter or procure that the Instructed Matter shall be undertaken by any relevant Affected Company, without delay.” An Affected Company is any subsidiary company of BBB.”

4.104. That day, BBB raised a formal reservation notice with the Secretary of State following discussions with its Board {GD(B)/218 – INQ000564005}. This was the first time BBB had taken this step. BBB raised concerns on the grounds of propriety, value for money, and feasibility. The reservation notice explained the BBB Board's position as follows:

- a) On propriety, primary concerns related to the extensive reliance on customer self-certification, the corresponding fraud risk, and the potential market distortion. With an interest rate for BBLs being set at a uniform 2.5% across the market, it was very likely that many small providers would not be able to compete with BBLs in the sub £50,000 lending market. This left the large banks as the main providers and raised questions about the potential lack of diversity this would create across lenders in the SME finance market;
- b) On value for money, concerns were that the scheme would be vulnerable to abuse by individuals and organised crime groups, and that there would be considerable credit risk in the current economic environment. This was exacerbated by the removal of significant elements of the credit checks that would otherwise have been undertaken; and
- c) On feasibility, BBB quoted the acting Permanent Secretary's instruction, that BBB would *“...need to ensure that there are robust controls and governance around these financial commitments that, as far as reasonably practicable, ensure public funds are being used appropriately in the context of the agreed parameters of the scheme.”* In response to this BBB stated, *“Given the pace at which decisions are being made and processes built, and the imperative for simplicity throughout, it is not feasible for us to achieve this to the standard implied by any ordinary interpretation of what is either “robust” or “reasonably practicable”.*” Keith Morgan highlighted, as an example of the compromises that

had to be made to meet the timetable, that it had been impossible to agree a methodology to prevent duplicate applications.

4.105. On 3 May 2020, at the request of the Secretary of State, the acting Permanent Secretary (in her position as Accounting Officer) responded to BBB and provided a Written Direction to them to take all necessary actions to take forward the implementation of BBLs with immediate effect {GD(B)/219 – INQ000564006}. In doing so, she expressly stated that the Secretary of State had read the PwC report and had considered the value for money, propriety and feasibility risks highlighted in BBB's letter dated 2 May 2020, but had reached the view that notwithstanding those risks, the unprecedented situation facing the country at the time meant it was essential to proceed with the scheme. The letter stated, "*In issuing a direction to me on 1 May, the Secretary of State received prior approval to proceed from the Chancellor and his officials.*"

Launch of the Bounce Back Loan Scheme on 4 May 2020

4.106. BBLs launched on 4 May 2020, just two weeks after announcement. See written ministerial statement at {GD(B)/220 – INQ000564007}.

4.107. The final terms were as follows:

- a) 100% government-backed guarantee;
- b) Facilities available were between £2,000 and 25% of a business' turnover (up to a maximum of £50,000), repayable over a period of six years. The interest rate was 2.5% per annum although in the first 12 months of the lending, interest was covered by the Government and no capital repayments were required. The consumer protections that would ordinarily apply to loans of less than £25,000 were disapplied. See also BBLs launch communications question and answer sheet at {GD(B)/221 – INQ000564008}; and
- c) To qualify, the borrower had to self-certify to the lender that the business:
 - i. Had been impacted by the Covid-19 pandemic;
 - ii. Did not have existing CBILS lending; and
 - iii. Was not experiencing difficulty (per self-certification) as at 31 December in the year prior to application.

4.108. The scheme operated through an online portal allowing the BBB to collect the data needed to administer guarantees in the event of borrower default. Lenders were

required to manually upload data on individual applications as it was not possible to create an automatic reporting system in the short timeframe, but the portal was not designed to monitor risks or prevent fraud. A bulk upload system for this data was created after the scheme was in operation.

- 4.109. To expedite the loans process, the lender was not required to undertake any credit or affordability checks on the borrower. Lenders would not be compelled to conduct additional credit checks beyond checking that the borrower had completed their self-certification. The scheme operated with a streamlined application process, which relied on borrower self-certification {GD(B)/222 – INQ000564004}. To mitigate the risk of this reduced process to a limited extent, borrowers were still subject to KYC and AML checks.
- 4.110. As set out in the BBLs Term Loan Lender Manual, lenders were required to make and maintain appropriate AML and KYC checks for each borrower as set out in the BBLs Legal Agreement, in line with their legal and regulatory obligations and taking into account the Financial Conduct Authority's 'Statement on the UK Coronavirus Business Interruption Loan Scheme (CBILS) and the new Bounce Back Loan Scheme (BBLs)' of 27 April 2020 {GD(B)/223 – INQ000564245} and {GD(B)/224 – INQ000543846}.
- 4.111. The exact processes for KYC checks varies between lenders, but typically involves customers providing proof of identity, proof of address, and other appropriate documentation as required. See 'What is a know-your-customer (KYC) check?' by LexisNexis {GD(B)/225 – INQ000543848}. AML checks include reviewing personal data such as name, address, bank account details and employment information against relevant databases and other sources to ensure that customers are not engaging in illicit financial activities such as terrorist financing and other criminal activities which could put organisations at risk. See 'AML Checks: The Ultimate Identity Assessment' by LexisNexis {GD(B)/226 – INQ000543847}.
- 4.112. In the first week of operation, 268,000 loans were approved, totalling £8.4 billion. By 4 June 2020, having been in operation for a month, the scheme had seen 699,000 loans approved, totalling £21.3 billion. As of 18 October 2020, 1,336,320 loans had been approved worth £40.2 billion.
- 4.113. Having worked with lenders and anti-fraud groups to develop a methodology to prevent duplicative applications, BBB implemented their multiple application check on 2 June 2020. There was a requirement that lenders have membership of the 'CIFAS FIND BBLs' closed user group to assist in identifying multiple applications from borrowers.

The BBLS Term Loan Lender Manual states that this was communicated to lenders as a mandatory requirement on 25 June 2020, although some lenders later argued that the email created the impression that it was not mandatory until September 2020. {GD(B)/223 – INQ000564245}.

SECTION 5: FUTURE FUND

Introduction

- 5.1. This section provides detail on the background to the Future Fund, its objectives, its design and implementation, the issues it encountered, and its impacts. At Section 9 below, I set out my reflections on the Future Fund in further detail, as well as lessons learned within the Department for any future emergencies.

Economic Policy Objectives of the Future Fund

- 5.2. The Future Fund was intended to support businesses that could not access mainstream bank funding because they were pre-profit (and therefore not attractive to lenders), and to provide such businesses with access to the finance they needed, despite the impact of Covid-19 on equity finance {GD(B)/227 – INQ000564040}. There were other potential objectives or outcomes of the Future Fund, which were not quantified but considered to be potentially significant, such as demonstrating that the venture capital could continue to function through the challenging conditions caused by Covid-19 {GD(B)/228 – INQ000564017}.

Scheme Design

- 5.3. In late March 2020, the Department established a team to consider how best to support R&D intensive businesses {GD(B)/229 – INQ000563897}. The team was led by Angelina Cannizzaro {GD(B)/230 – INQ000564042}. However, leadership was occasionally delegated to other Deputy Directors for short periods of time during the duration of the project {GD(B)/231 – INQ000563914}.
- 5.4. On 26 March 2020, Mark Walport of UK Research & Innovation (**UKRI**) emailed the Department stating that while the government had moved swiftly to support business there was a gap in support for R&D intensive companies, which needed to be quickly addressed. He attached a paper from Innovate UK which set out a proposal for a dedicated fund, alongside a broader support package, for such companies {GD(B)/232 – INQ000585510} and {GD(B)/233 – INQ000563898}.
- 5.5. On 31 March 2020, BEIS hosted a meeting with BBB, UKRI, DCMS and HMT to discuss the Covid-19 issues faced by innovative SMEs and R&D intensive businesses {GD(B)/234 – INQ000563907} and {GD(B)/235 – INQ000585516}. The key objectives of the meeting were to:

- a) form a common understanding of the Covid-19 related issues facing innovative SMEs and R&D intensive businesses, taking account of the market intelligence that had been gathered by the attendees;
 - b) consider the extent to which existing and recently introduced business support measures could assist these businesses, and what gaps remained; and
 - c) ensure a collaborative and joined-up approach in developing response options {GD(B)/236 – INQ000585517}.
- 5.6. A background paper circulated to all attendees prior to the meeting set out two types of business which would need to be considered: R&D intensive businesses requiring significant long-term capital or grant funding; and equity-backed businesses, which were on fast-growth trajectories and had a high failure rate. The paper identified the areas of most concern as being early stage and R&D businesses that were pre-profit or pre-revenue that were unsuitable for CBILS and typically could not obtain support from banks and other mainstream debt providers. The challenges experienced by these businesses, including issues with cashflow and maintaining their growth trajectory, meant there was risk of a long-term detrimental impact on the wider UK innovation and technology environment.
- 5.7. Following the meeting, BEIS and DCMS set up a small team to work on the issue. This team was asked by Gemma Peck to coordinate a paper to cover the evidence base on the different types of companies the government should be most concerned about. The paper would also consider the economic costs of not intervening and include an appraisal of existing BBB and UKRI schemes which could be adapted to address the issues faced by these companies. Alongside consideration of the adaptability of existing schemes, which could be announced and delivered quickly, the paper was to also briefly note more radical solutions requiring new programmes or new money, which could be returned to at a later stage {GD(B)/237 – INQ000585520} and {GD(B)/231 – INQ000563914}.
- 5.8. The final paper, dated 2 April 2020, included a review of existing Covid-19 related interventions, highlighting challenges in using these to support innovative tech-led businesses, encompassing digital start-ups, R&D intensive scale-ups and businesses developing deep-tech propositions {GD(B)/238 – INQ000563923}. The paper concluded that while the previously announced Covid-19 measures might assist with short-term cash flow, they did not address the concern that early-stage SMEs would face difficulties securing follow-on equity funding in the current climate. The paper also

considered whether additional funding from HMT was necessary for innovative businesses, or if the required resources could be sourced from within BEIS.

- 5.9. The paper was produced for discussion at a meeting on 3 April 2020 attended by the Department, DCMS, HMT, UKRI and BBB {GD(B)/239 – INQ000563931}. Following the meeting, Gemma Peck emailed colleagues with a summary of the issues discussed and proposed next steps. She explained that the consensus was that there were specific issues facing around 2,000 innovation or tech-led businesses which were pre-profit and therefore unable to access CBILS or traditional loans. The rationale for supporting these firms was to avoid losing potential sources of new technology and innovation and prevent a shift of tech investment away from the UK. While there was discussion around medium and large R&D intensive companies and the challenges that they were encountering, the pre-profit nature of early-stage firms meant that they had a unique set of problems. Gemma Peck suggested putting together advice for ministers setting out the nature of the companies affected and the problems they faced, as well as some immediate actions UKRI could take which would be broadly within existing budgets. As these firms were still likely to experience cashflow issues, the advice was also to include an outline of a potential UKRI and/or BBB loan product {GD(B)/239 – INQ000563931}.
- 5.10. BEIS prepared a table capturing the detail of BBB and UKRI proposals discussed during the meeting {GD(B)/240 – INQ000585542}. This was shared with UKRI, BBB and HMT {GD(B)/241 – INQ000585541}. On 3 April 2020, **Name Redacted** advised HMT that BEIS would be working together with BBB and UKRI to prepare advice for their ministers. **Name Redacted** asked HMT to confirm how they wanted to be involved in the process so that, “(a) any advice going to your ministers can take account of the work being done and (b) we can give our ministers accurate information on the likelihood of those options that need funding being implemented?”. Later conversations on 6 April 2020 indicated that HMT officials were reluctant to share their formal advice to the Chancellor with BEIS. However, HMT did provide BEIS with a summary of a potential scheme that would be submitted for the Chancellor’s approval {GD(B)/242 – INQ000563932}.
- 5.11. On 6 April 2020, **Name Redacted**, Director General of the British Private Equity & Venture Capital Association (**BVCA**), emailed the Permanent Secretary a proposal for emergency bridge funding for venture capital backed early-stage companies in the digital economy, which industry figures had been finalising following discussions with

HMT {GD(B)/243 – INQ000596663}. The proposal included £500 million of support from government alongside additional money from the private sector to provide £625 million capital to these companies. The product outlined in the proposal was bridge funding in the form of a convertible loan of up to £5 million per company, with government funding supplemented by existing investors on a 4:1 basis. This would be deployed rapidly into the market by BBB as the government institution with the most appropriate skillset and ability to supervise the portfolio of bridging loans. shared this summary with BEIS colleagues and stated that there had been discussions between BBB and HMT over the weekend {GD(B)/244 – INQ000585536}.

- 5.12. The following day, Joshua Fleming (Deputy Director, HMT) sent Gemma Peck a note setting out HMT's latest thinking on options to support the venture capital financed SME sector. He noted that they had not yet received ministerial steers on the options set out in the note but that it would be good to compare HMT's thinking with the work being carried out by BEIS. The note considered a number of options including a co-investment bridging fund, amendments to existing BBB equity investment programmes, and increasing innovation support provided by Innovate UK. The note included input and suggestions from BVCA and BBB {GD(B)/245 – INQ000585544} and {GD(B)/246 – INQ000585545}.
- 5.13. BEIS subsequently prepared two submissions for the Secretary of State:
 - d) The first submission outlined the potential impact of Covid-19 on R&D intensive organisations, drawing parallels with the 2008 financial crisis {GD(B)/247 – INQ000585547}. It highlighted a likely decline in investment by R&D intensive companies as they cut costs, reduced staff and delayed new product launches. The submission confirmed that there would be an opportunity for BEIS to provide an update at the next Ministerial EBRIG about its response to this challenge (discussed further at paragraphs 5.15, 5.17, and 5.25 below). The submission also indicated that HMT officials would not provide additional funding for interventions but expected BEIS to finance them from its existing R&D or business finance budgets. Given the existing pressures on R&D budgets, concerns were raised about the potential impact of this approach on BEIS' other priorities and commitments. Further discussions with HMT were recommended to discuss re-prioritisation options, budget flexibility or additional funding methods.

- e) The second submission outlined potential interventions to assist equity backed, high growth businesses remain financially viable in the short term and to support seed and venture capital markets over the medium to long term {GD(B)/248 – INQ000585548}. Short-term proposals included adapting existing measures, such as the CBILS, to support revenue-generating businesses with debt financing, creating a new convertible debt fund for Series A and later businesses, and establishing an equity co-investment fund for early-stage companies. For the medium to long term, the submission recommended modifying the existing Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) tax schemes¹², compensating for liquidity withdrawals by providing additional subscriptions to equity funds partnered with BBB, and advancing planned future investments.
- 5.14. These submissions were sent to Special Advisers for comment on 7 April 2020 before discussion with the Secretary of State the following day {GD(B)/249 – INQ000585546} and {GD(B)/250 – INQ000563937}.
- 5.15. In a meeting on 8 April 2020, a range of interventions including the co-investment bridging loans proposal were put to the Secretary of State and BEIS Ministers. Ministers asked for the focus to be on initiatives that could be delivered quickly and at scale, primarily through tax measures, especially around EIS and SEIS, rather than a new fund which they felt would take too long to set up. A letter to this effect, also addressing wider R&D angles, was being prepared for HMT for the following day {GD(B)/251 – INQ000563942}.
- 5.16. Separately, BEIS was commissioned to write a detailed paper for EBRIG on the impact of Covid-19 on R&D activity and provide recommendations for prioritising public funding in response {GD(B)/252 – INQ000585555}.
- 5.17. On 14 April 2020, the Secretary of State wrote to the Chancellor stating that the Department was gathering evidence of Covid-19 impacts on R&D activities and would share this with HMT over the coming weeks and months. He recognised that innovative, pre profit firms, including start-ups, could derive little benefit from financial interventions to date, given that they often had few employees and were geared towards equity so unable to generate cashflow to repay borrowing. The Secretary of

¹² The EIS and SEIS schemes are tax-based venture capital schemes designed to assist smaller, higher-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new full-risk ordinary shares in those companies.

State set out his view that while Government intervention was necessary it involved practical difficulties:

“[i]n particular that any scheme to provide bridging finance from government (whether in the form of a loan or some form of equity arrangement) would take some time to stand up, and add operational complexity to the market.” In his view the most appropriate and effective way to support these companies was “...to encourage and incentivise VC funds to release capital, in a way that can be speedily implemented and easily reversed when the current challenges have passed. This works with the market, instead of the state directing it too heavily, through direct investment. Time-limited changes to the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) seem the most apparent option...” {GD(B)/253 – INQ000585559} and {GD(B)/254 – INQ000563941}.

- 5.18. On the same day, a draft of the EBRIG paper was sent to Special Advisers, the Chancellor and the Secretary of State for review {GD(B)/255 – INQ000585561}. The covering email to the Secretary of State confirmed that the paper would be presented at the Officials EBRIG the following day, followed by the Ministerial EBRIG the day after {GD(B)/256 – INQ000585560}. It also indicated that the paper’s contents could change following discussions at the Officials EBRIG. In respect of pre-profit firms, the draft paper proposed that the best way to quickly provide support would be to encourage and incentivise venture capital and private equity funds to release capital. The paper suggested that time-limited changes to the EIS and SEIS schemes would be an effective approach.
- 5.19. On the same day, in emails from BEIS to DCMS, updates were provided on the continuing work around potential support for pre-profit start-ups underlining that the preference of BEIS Ministers remained exploring EIS and SEIS options rather than considering a new fund. In an email from Gemma Peck to Gila Sacks (Director Digital & Tech, DCMS) she confirmed that while she had heard that the Chancellor was *“...considering [the] role of SEIS/EIS, he still wants a new co-financed fund to support pre-profits and to announce it this week”*. Details had not been shared with BEIS at this stage but a call had been arranged with John Staples of HMT later that day. {GD(B)/251 – INQ000563942}.
- 5.20. A call between HMT, BBB and BEIS took place that afternoon. A partial readout from the call indicates that the meeting addressed, amongst other things, ramping up

existing BBB venture capital and angel investor schemes (where an investor invests their own money into a small business in exchange for a minority stake); how any increase in BBB funding should be presented; and HMT's need for further advice on the impact and timings around BBB enhancing existing schemes {GD(B)/257 – INQ000563945}.

- 5.21. Immediately following this meeting, [Name Redacted] of BBB spoke with a BEIS official about rumours that HMT were considering a new fund that did not involve BBB. [Name Redacted] cautioned against creating a new fund that bypassed existing BBB-backed investments or overlooked moral hazards. She suggested a brief follow-up call later that afternoon to discuss next steps for adapting existing BBB funds and the new proposal {GD(B)/257 – INQ000563945}. The follow-up call was scheduled for 5.45pm and is discussed further at paragraph 5.24 below {GD(B)/258 – INQ000563947}.
- 5.22. Gemma Peck requested a separate meeting that same afternoon to discuss the Chancellor's preference for a new fund for pre-profit firms, independent of BBB {GD(B)/259 – INQ000563944}. A meeting between HMT, BEIS and UKGI was scheduled for 4pm. BEIS was represented by Gemma Peck, and [Name Redacted] alongside junior policy officials. John Staples and two HMT junior officials represented HMT whilst [Name Redacted] attended on behalf of UKGI {GD(B)/260 – INQ000563943}.
- 5.23. Following the 4pm call, [Name Redacted] sent an email to Ceri Smith (Director, UKGI) copying in Gemma Peck and [Name Redacted]. He advised that the Chancellor was clearly still interested in a BBB convertible loan scheme despite the reservations from BEIS Ministers. He stated that, "*HMT are pretty alive to the delivery risks and think the solution is for BBB to outsource and procure as much as possible. They have obviously been speaking to BBB directly and as ever I think there is a danger that BBB are slightly over-promising and underplaying quite how different a proposition this is from what they've done before.*" He also suggested that it may be helpful for the risk committee to look at potential impacts in order to inform BEIS Ministers. The main questions for BBB were:
- f) Whether BBB had sufficient expertise in delivering direct to consumer equity products to enable them to design the product, and sufficient procurement experience;
 - g) What was a realistic timeframe; and

- h) Whether there was the bandwidth within BBB to carry this out without impacting on CBILS and CLBILS. {GD(B)/261 – INQ000563946}
- 5.24. A call took place at 5.45pm between BEIS and UKGI to further discuss the convertible loan scheme for pre-profit businesses. Following the meeting, Gemma Peck circulated a list of next steps and action items. Amongst other things, the list set out that BEIS had asked BBB to draft a submission on the fund proposal, including any suggested amendments from BBB, any delivery considerations and what could be done with existing programmes to support these businesses {GD(B)/262 – INQ000563949}.
- 5.25. Later that evening, Jo Shanmugalingam wrote to the acting Permanent Secretary to say that the Chancellor wanted to announce, at the end of the week, a new convertible loan scheme for pre-profit companies delivered through BBB. She felt that a ministerial direction would possibly not be needed as the main issue would likely be delivery risk rather than value for money. The question was whether any announcement could be kept sufficiently broad that it did not trigger the need to take Accounting Officer advice in advance. The need for a ministerial direction could be avoided if Accounting Officer judgement followed after the announcement when the scheme was further developed {GD(B)/263 – INQ000563952}.
- 5.26. Additionally, Gemma Peck wrote to the Secretary of State's private office noting that while the clear steer from the Secretary of State was to explore tax incentives rather than establishing a new fund, the Chancellor was "...***nonetheless of the view that a new convertible loan scheme is the right solution and has commissioned rapid work from the BBB to develop this, ahead of an announcement on Friday***" (Original emphasis). The current proposal was for "*50:50 (government:VC) match-funded loans, which the government could opt to convert to equity at the next funding round.*" BEIS were working with BBB and UKGI on policy and delivery questions and would provide fuller advice to the Secretary of State the following day. Given these developments in respect of the convertible loan scheme, Gemma Peck suggested that reference to pre-profit firms be removed from the EBRIG paper on R&D {GD(B)/264 – INQ000563953}.
- 5.27. On 15 April 2020, BEIS officials sent a submission to the Secretary of State and acting Permanent Secretary with an update on proposals for the new convertible loan scheme for pre-profit venture backed businesses {GD(B)/265 – INQ000585565} and {GD(B)/266 – INQ000585566}. The submission stated that the Chancellor wanted to establish a new convertible loan scheme and proposed to announce it on 20 April

2020. The scheme would offer bridging loans to equity backed pre-profit businesses that could either be repaid or converted into an equity stake at the company's next equity financing round. HMT had asked BBB to help design and administer the programme, and BBB was convening its Risk Committee that week to discuss the implications. While BBB would oversee the scheme, they would procure a specialist market provider to establish the scheme, process applications and administer the loans. The submission discussed the need to bring budget allocations to BBB forward from future years and to increase the Bank's resourcing to ensure pre-existing objectives could be met. It also confirmed that BBB were engaging in informal market testing with potential providers ahead of an expedited procurement process. BEIS also became involved in the informal market testing.

5.28. The submission summarised the current proposal and the potential longer-term implications, alongside the policy, financial and delivery risks as they were understood, which included State aid rules, value for money, the impact on BBB and the Government's exit strategy. BEIS had cautioned HMT that any announcement should be sufficiently high level to allow room for scheme design to be developed and tested over the coming weeks. It was explained that alongside the new scheme, BBB were pursuing changes to existing programmes, within their existing remit, to support venture backed firms. The submission set out several recommendations for the Secretary of State namely:

- a) Any announcement of the scheme should be sufficiently high level, to not limit options;
- b) Fundamental design and delivery choices needed to be worked through and tested on the market;
- c) BBB would need an instruction from the Secretary of State to proceed further in developing options; and
- d) A comprehensive communications plan with HMT, BBB and DCMS would need to be worked up to manage shareholder expectations.

5.29. The same day, Gemma Peck held a discussion with Keith Morgan and Graeme Fisher of BBB on the Government support schemes generally, including the proposed convertible loan scheme. BBB raised concerns about delivery risks and set out that the terms of the scheme should be tested on the market before finalisation. A dedicated BBB Risk Committee would meet the following day to discuss the proposal. It was

explained that once the scheme was publicly in the frame BBB would likely need an instruction {GD(B)/267 – INQ000563955}.

- 5.30. The following morning, John Staples of HMT confirmed to Gemma Peck that HMT were discussing the convertible loan parameters with the Chancellor later that day {GD(B)/267 – INQ000563955}.
- 5.31. BBB's Risk Committee met on 16 April 2020 to discuss the bridge financing convertible loan scheme proposal. A covering paper was circulated prior to the meeting that set out that BBB had been conducting its own research and analysis of the issue, drawing on views from a wide range of stakeholders, and had used these insights to inform daily discussion with HMT. BBB concluded, "...we are supportive of a bridge funding intervention that is temporary in nature and targeted in its reach and scope and HMT are now focused on a convertible loan note as their policy response." It was stated that as BBB did not have a direct to SME loan delivery model, or infrastructure in place to provide this, an agent would be appointed for provision and administration of the product. Given the timescales a fully outsourced solution was preferred to attempting to build the capabilities in house. See agenda and paper for the meeting at {GD(B)/268 – INQ000563956}.
- 5.32. UKGI emailed Gemma Peck following the meeting, advising her of the outcome and issues raised {GD(B)/269 – INQ000563957}. The meeting had raised "...quite substantial concerns about the scheme" and that in UKGI's view "*the main sentiment was 'if we had a choice we wouldn't do this' although of course they are aware that they don't have a choice if instructed (although they can send a reservation notice which would then be made public).*" The principal concerns were that the scheme:
- a) would be easy for disreputable venture capital funds to game;
 - b) amounted to more of a bail-out for the venture capital market (as opposed to the underlying companies) given that funds would have adequate money to invest if they wanted; and
 - c) did not address early-stage companies.
- 5.33. Gemma Peck sent an update to the Secretary of State and acting Permanent Secretary's private offices that evening setting out the concerns raised by the BBB's Risk Committee {GD(B)/270 – INQ000563965}. She stated that:

"The BBB risk committee met today and discussed the proposals for a Convertible Loan Scheme (CLS). Overall, they had substantial concerns.

As a result, Keith Morgan is going to write to SoS, copied to HMT, setting out these concerns and how the board think the scheme should be altered – with an overall engaged and positive tone and a desire to help improve it. The letter will also make the point, which SoS agrees with, that there are other instruments on the tax side that would have a more immediate impact. The main request in the letter will be that the Monday announcement offers sufficient space to allow for changes to the scheme, and ideally not to link it to BBB at this stage.

...In the event that the announcement is very detailed and positions BBB as leading the CLS, the BBB may require an instruction from BEIS, and could ultimately issue a reservation notice (which would be made public). This can hopefully be averted by keeping the announcement sufficiently high level. An instruction, and possibly an [Accounting Officer] direction, may be required in due course, but with a little more time to design and test this we should be able to reduce the vfm and delivery risks, although it is not possible to say by how much at this stage and the CX is personally very engaged in the scheme design.” (Original emphasis)

- 5.34. On 17 April 2020, in response to the above, the acting Permanent Secretary's office advised Gemma Peck to, "...strongly encourage HMT to keep any announcement on the new scheme high-level so as to avoid committing to something that is ultimately undeliverable / carries unmanageable risks" {GD(B)/270 – INQ000563965}.
- 5.35. On the same day, BBB's Director Keith Morgan wrote to the Secretary of State to raise the BBB Board Risk Committee's concerns with the proposal for the scheme to date {GD(B)/271 – INQ000563966}. The letter set out the following concerns:
- a) That the policy objectives of the intervention were not yet clearly articulated which could lead to a risk of government funds flowing to companies which did not need the support or were not the intended target.
 - b) The scheme could be seen to support the venture capital industry as opposed to the underlying businesses in which they were investing.
 - c) The Committee agreed that the scheme's term sheet was "*well-written and commercial in focus*", but there were concerns about the proposed terms including a view that the maximum loan size (£25 million) was too high given the availability of alternative financing options for larger growth companies, and

the worry that the requirement for a minimum of £1 million of equity to have been raised would disqualify a significant number of early stage businesses.

- d) There were significant implementation details which were yet to be sufficiently developed to enable a comprehensive assessment of the risks. Much of the design and implementation of the scheme would be undertaken at pace outside the usual processes and controls that BBB would follow in launching a product independently.
- e) As the proposal developed consideration would be needed about what was required to provide assurance to the Board that BBB was best positioned and sufficiently resourced to deliver the programme in both the short and longer term.

5.36. On 18 April 2020, HMT circulated proposed press release wording for a press release to announce the scheme, which set out that the Government would provide eligible companies with between £250,000 and £5 million in support with private investors providing at least 50:50 match funding. Companies were required to be UK based and to have previously raised at least £500,000 in equity investment, with further eligibility criteria to be announced in due course. The scheme would be delivered in partnership with BBB and would launch in May 2020 {GD(B)/272 – INQ000563968}.

5.37. **Name Redacted** later wrote to HMT with comments on the proposed thresholds of £500,000 minimum equity raised and a £250,000 minimum government loan contribution. He set out the BEIS view that these should be lowered to £250,000 and £125,000 respectively. The current thresholds were expected to rule out a substantial fraction of the early-stage companies that the Government was seeking to assist {GD(B)/273 – INQ000585568}. **Name Redacted** stated that even these amendments to the thresholds would exclude a significant proportion of firms and this was where investment finance (including State aid finance) raised under SEIS and EIS would come in. These recommendations were subsequently accepted by the Chancellor and confirmed by HMT on 18 April 2020 {GD(B)/274 – INQ000563970}.

5.38. On the same day, Keith Morgan wrote to the acting Permanent Secretary, repeating his concerns and advising, now that he had viewed the latest press release, that a ministerial direction would be required ahead of the proposed announcement {GD(B)/275 – INQ000563969}. If BBB were instructed without a direction, they would feel obliged to ask their Board whether to respond with a formal reservation notice. The two key issues that led to the need for an instruction were:

- a) In the time available it had not been possible to determine whether the proposed intervention represented the best value for money, particularly as the underlying policy objectives had not been clearly articulated; and
 - b) BBB had been unable to confirm if it was possible to deliver the scheme according to the May 2020 timeline envisaged by the Chancellor, particularly given the outstanding questions about its operation. Including a timescale in the proposed announcement fell outside the risk appetite for non-directed activity of this scale, scope and novelty.
- 5.39. On 19 April 2020, the Secretary of State's private office wrote to HMT thanking them for the constructive and collaborative way they were working with BEIS and BBB on the scheme, including the agreement to change the scheme thresholds the previous day {GD(B)/276 – INQ000563973}. BEIS sought agreement on some final points, which the Secretary of State had discussed with [Name Redacted] Special Adviser, HMT earlier that day, namely:
- a) That the announcement retained sufficient flexibility to allow policy or operational amendments to the scheme following further analysis, given the rapid pace of work. It was important that the best advantage was taken of BBB as the Government's centre of expertise in SME finance and it should be given a lead role in designing the final scheme parameters; and
 - b) While BEIS and BBB accepted a scheme launch in May, as set out in the press release, BBB had advised that this was a "very challenging timescale" and BEIS sought confirmation that the Chancellor had been advised of this.
- 5.40. In response, HMT confirmed that the Chancellor had been fully advised of the risk in terms of timescale and was keen for HMT officials to work closely with BBB to finalise the details of the scheme.
- 5.41. Gemma Peck sent a detailed update to the Secretary of State {GD(B)/277 – INQ000563972}. She stated that, in light of the correspondence from BBB setting out its concerns, "[t]here has been extensive engagement with HMT since to shape the proposed term sheet and a press notice. HMT have moved on two substantive policy points covered in Keith's letters, as well as adapting to other BBB feedback. Following the SoS' discussion with [Name Redacted] this morning, private office have formally noted BBB's concerns and conveyed these to HMT private office. This is all good progress. Nonetheless, the BBB Board may be concerned that the bank is being publicly

positioned to deliver a risky scheme at pace. The press notice was adjusted to reflect their concerns but we do not know if it has gone far enough.”

- 5.42. The acting Permanent Secretary wrote to BBB that afternoon, highlighting the value for money and feasibility concerns and instructing them to rapidly work up how they would deliver the scheme alongside a more detailed assessment of feasibility and State aid risks. This would enable BEIS officials to work with BBB on a full Accounting Officer Assessment to inform whether the acting Permanent Secretary ultimately required a direction to instruct BBB to deliver the scheme. The letter would instruct BBB to assess how they would deliver the scheme and would therefore stop short of actually instructing them to deliver it, meaning it would be disproportionate for BBB to issue a Reservation Notice in response {GD(B)/278 – INQ000585572}.
- 5.43. As agreed, on 19 April 2020, the letter was sent to BBB on behalf of the acting Permanent Secretary {GD(B)/279 – INQ000585571} and {GD(B)/280 – INQ000563976}, stating that the proposed Coronavirus Bridge Scheme had been named the Future Fund. The acting Permanent Secretary noted BBB’s concerns and confirmed the understanding that HMT and the Chancellor wanted to work constructively, stating:

“I have noted your concerns and that of your board on the risks around value for money and feasibility of the scheme. You suggested that “many of the key decisions have been taken” and that these decisions do not take proper account of the bank’s analysis of the market, or the need for consultation. I believe this may be too pessimistic a reading of the situation. There was substantial movement yesterday and this morning we received further assurances. The press notice describes ‘headline terms’, the intention being to indicate a degree of flexibility to amend the scheme following further analysis. The Secretary of State also noted that we extended CBILS when it was clear that this was needed. All of this suggests that Treasury colleagues may be more willing to accept future changes than you anticipate.”

- 5.44. At this stage the timing for launch was viewed as a declaration of intent which left open the possibility of the scheme launching in May but not becoming fully operational until June. BBB was instructed to rapidly develop proposals for how the Future Fund would be delivered if BEIS were to instruct them to do so. The letter was to be taken, “...as an instruction to carry out this development work, including an assessment of the feasibility and State aid risks of the delivery model that you recommend. This will

enable my officials to work with yours on a full Accounting Officer assessment, which in turn will allow me to decide whether I would need to seek a Ministerial Direction in order to instruct you to deliver the scheme". The acting Permanent Secretary set out that, at that stage, she did not consider a direction to be required given the uncertainties that remained around the final scheme parameters and delivery.

- 5.45. The acting Permanent Secretary then wrote to Charles Roxburgh, Second Permanent Secretary, HMT, setting out her position on the Future Fund before its official announcement the following day {GD(B)/281 – INQ000585573} and {GD(B)/282 – INQ000585574}. In her capacity as Accounting Officer, she set out the reservations that both she and BBB had expressed over the current design and deliverability of the scheme. She viewed the target launch date in May to be challenging but confirmed that given the acute nature of the emergency, BEIS and BBB appreciated the need to finalise any proposals as soon as possible and would continue working together at pace, alongside HMT, to consider options for implementation. The acting Permanent Secretary recorded that she may need to seek a direction from the Secretary of State given the concerns around feasibility, as well as pointing out the right of the BBB Board to issue a reservation notice. If options could be left open at this stage it would enable her to *"...make a full and proper [Accounting Officer] assessment of the plans and ensure that the scheme has the best possible chance of delivering the outcomes intended"*.
- 5.46. Following this Name Redacted emailed Keith Morgan to advise that HMT had agreed that the headline terms of the Future Fund, which would be published the following morning, may change following further analysis. He also confirmed that BBB would play the lead role on scheme design in close collaboration with HMT and BEIS. Following a call with BBB, it was confirmed that Keith Morgan was no longer recommending a reservation notice be raised given the narrow scope of the instruction from the acting Permanent Secretary {GD(B)/283 – INQ000563974}. BBB still intended to send a letter highlighting delivery and feasibility risks and it was remarked that the *"[g]eneral mood of the board is that there remain serious concerns, timing is extremely problematic, and they fear expectations will be raised in the market that will be difficult to meet, with a significant amount of backlash being directed at the bank. They are unhappy, but pragmatic."* Ceri Smith went on to say that actual implementation of the scheme would require a future instruction at which point a reservation notice was highly likely.

- 5.47. In parallel with the above, BEIS, HMT, UKGI and BBB discussed the wording of the press release to announce the Future Fund. BEIS expressly requested that HMT await its final sign off it was issued. Notwithstanding the request, on 20 April 2020, HMT issued the press notice without obtaining final BEIS sign-off {GD(B)/284 – INQ000585569}, {GD(B)/285 – INQ000563971} and {GD(B)/286 – INQ000585570}.
- 5.48. In response to BEIS’s email stating that the press release had been issued without their sign off, BBB confirmed that, having taken advice, it would not be issuing a press notice or promoting the scheme. BBB further confirmed that all media enquiries would be passed on to HMT {GD(B)/285 – INQ000563971}. A brief statement was, however, provided on BBB’s website confirming the establishment of a new fund to be developed by Government in partnership with BBB with the intention of launching for applications in May and running until the end of September {GD(B)/287 – INQ000563975}.
- 5.49. On 20 April 2020, Keith Morgan responded to the acting Permanent Secretary’s letter in which BBB was instructed to continue working on the development of the Future Fund. Following a meeting of the BBB Board, Keith Morgan stated that although they recognised some progress had been made, the announcement of the scheme with the detail provided had put BBB in an extremely uncomfortable position. “*With significant questions still outstanding around the feasibility of delivery, the Board is of the view that the Bank is already highly exposed to reputational risks at a point where we do not yet have a clear idea of how the Future Fund will be delivered.*” Ordinarily BBB would have worked with officials across BEIS, HMT, UKGI and any other relevant departments to progress proposed schemes to a much greater level of detail ahead of a public launch {GD(B)/288 – INQ000563979}. The BBB Board remained of the view that it may need to raise a reservation notice once the planned delivery was clearer and further instruction was received but would rapidly develop proposals as instructed for how to deliver the Future Fund. Keith Morgan reiterated the Bank’s concerns regarding the proposed timescales and said that in order to achieve these with a well-designed scheme, they would require the requisite resources. The BBB Board was therefore requesting a commitment that BBB would not be cost constrained in its efforts to deliver the Future Fund as quickly as was feasible.

Work Following the Announcement of the Future Fund

- 5.50. Following the announcement of the Future Fund, there remained outstanding policy questions regarding the scheme’s parameters alongside clarification of the headline terms. Key outstanding decisions included the:

- a) extent of (if any) interaction between the fund and CBILS/other government support;
- b) extent of (if any) interaction between the fund and EIS and SEIS;
- c) allocation of capital within the scheme; and
- d) restrictions on investors, companies, or investment.

Decisions also needed to be taken in relation to the application process including whether this should be investor or company led {GD(B)/289 – INQ000563983} and {GD(B)/290 – INQ000585580}.

5.51. On 26 April 2020 the acting Permanent Secretary wrote to BBB stating “[t]he progress that has been achieved in one week is remarkable” {GD(B)/291 – INQ000563991}. As a result of BBB’s prompt work, the acting Permanent Secretary confirmed her understanding that BBB could be ready to appoint the delivery agent on 27 April 2020, which would put the resources and systems of a much larger organisation at BBB’s disposal during the scheme’s preparatory phase. She advised that an Accounting Officer Assessment would be prepared when the scheme’s design had been further advanced. After the Accounting Officer Assessment had been prepared, the acting Permanent Secretary would consider, in advance of the launch date, if a ministerial direction was required. In addition to this, the letter was to be taken by BBB as an instruction to continue to the next phase of the development work by:

- a) Appointing the delivery agent;
- b) Working with the appointed delivery agent to ensure that the necessary operational systems and procedures were put in place before the May 2020 decision to launch the scheme;
- c) Undertaking an assessment of the feasibility and State aid risks of the delivery model; and
- d) Continuing to work with BEIS and HMT in finalising the programme design and development of a coordinated communications plan.

5.52. In her letter, the acting Permanent Secretary recognised the concerns previously raised by BBB including the risks around reputation and feasibility of delivery. The acting Permanent Secretary considered that the appointment of the delivery agent would reduce the project risk at this stage of its development. In relation to BBB’s concerns that the scheme may benefit the venture capital industry as opposed to the

underlying businesses in which they were investing, the acting Permanent Secretary considered that this was an area to be addressed in the Accounting Officer Assessment. On resourcing, the acting Permanent Secretary confirmed that funding would be forthcoming as required and asked the Bank to provide BEIS with a weekly report on expenditure incurred given that, due to time pressures, the final costs could differ from those originally estimated.

- 5.53. By 1 May 2020, a target launch date of 20 May 2020 had been set and stakeholders from the digital and technology sectors had been consulted. A submission was sent to the Secretary of State with a detailed update on the implementation of the Future Fund and confirmation that HMT Officials were advising the Chancellor in parallel {GD(B)/292 – INQ000543195} and {GD(B)/293 – INQ000585612}. The submission acknowledged the encouraging progress to date, and that BEIS were working with HMT and BBB to finalise the scheme's parameters and application mechanisms. BBB had selected PwC as the delivery partner who were building a platform for the applications process and were supporting detailed design point discussions.
- 5.54. Although stakeholders broadly welcomed the Future Fund, the submission noted issues they raised and perceived as potential flaws. Most significantly the proposed terms prevented private investors, who were using EIS tax relief, from providing the scheme's private co-investment element. As it stood the convertible loan note (CLN)¹³ on which the Future Fund was based did not allow the investment to qualify for EIS tax relief as loan products generally were not eligible for EIS investment. BEIS were discussing options with HMT and a solution would require one of the following:
- a) changes to the EIS rules to allow relief for loan products generally, or the Future Fund specifically;
 - b) changes to the Future Fund rules so that the private co-investment need not be made using a CLN but could utilise an EIS-compliant instrument; or
 - c) establishing a separate product within the Future Fund in which both public and private investments used the same EIS-compliant instrument.

¹³ CLNs are a form of finance provided to businesses that give the investor the option of converting the debt into equity at a future date, often at a discounted rate compared to that offered to new investors. Unlike other loans, which typically involved the business owner paying back the original funding with interest, CLNs include an agreement for the investor to convert the loan into equity shares in the business when certain events occur, such as another round of funding or an acquisition.

- 5.55. While it was difficult to reach a firm view on these options without a more detailed examination of their technical implications, the initial thinking from BEIS was that the third option would provide the “*cleaner solution*” and would enable clear communication to the sector that the issue was being addressed.
- 5.56. Prior to the launch of the Future Fund, BEIS prepared a Delivery Plan for No 10 to assess whether the scheme was meeting its objectives {GD(B)/227 – INQ000564040}. It set out the timetable for completion of different milestones and listed short, medium and long-term success criteria, plus the scope of the Monitoring and Evaluation approach to be developed and regularly updated by the team {GD(B)/294 – INQ000564022}.
- 5.57. During this time BBB provided BEIS with regular project delivery updates. In an update sent to BEIS on 6 May 2020, BBB stated that they had been advised by HMT that the Chancellor was now aiming for a launch on 18 May 2020.

Work with External Consultants in the Development of the Scheme

- 5.58. In late April 2020, the Secretary of State was informed that, subject to Board approval BBB intended to appoint PwC as the delivery agent for the Future Fund. Administrative operations would be outsourced to PwC who, in addition to designing and building the online application process, would be responsible for processing applications, portfolio administration, risk and control, and valuation services. The Secretary of State was advised that PwC’s appointment had occurred earlier than anticipated and would help de-risk project delivery {GD(B)/197 – INQ000585596} and {GD(B)/191 – INQ000585597}. On 27 April 2020, the BBB Board appointed PwC as the delivery agent for the Future Fund.
- 5.59. On 6 May 2020, BBB sent an email to HMT and BEIS providing an update on the status of the Future Fund {GD(B)/295 – INQ000564012}. Amongst other things, it was confirmed that PwC was continuing due diligence on escrow account¹⁴ options for the Future Fund. It was also confirmed that PwC had, working on steers from Government, built the scheme rules, although there remained outstanding points. PwC had discussed their risk and control process with BBB, and a key risk was the fact that

¹⁴ An escrow account is a segregated account opened and operated by a third party (the escrow agent) for the purposes of holding cash on behalf of two or more contracting parties until certain agreed contractual conditions for release of the funds from the account have been met. The use of an escrow account in this instance would enable funds to be prepositioned to execute deals, whilst ensuring that public funds remained ring-fenced and protected until a deal was fully documented and completed.

there was a reliance on a high degree of self-certification which created credit or fraud risks which could only be partially mitigated. The following day, BBB sent an email to HMT and BEIS to provide a further update {GD(B)/295 – INQ000564012}. It noted that PwC was working on an updated operational process for the Future Fund, and that BBB was working on a paper that would address PwC's work on the risk and controls framework and operational process flows.

- 5.60. On 7 May 2020, the acting Permanent Secretary was sent advice on the structure of the Future Fund and the work that had been undertaken with external consultants {GD(B)/296 – INQ000585618} and {GD(B)/297 – INQ000585619}. The submission confirmed that BBB, BEIS and HMT had been working with PwC to finalise the scheme parameters, eligibility criteria, the legal structure and the applications mechanism. PwC had created an online portal to receive applications. The portal would collect information from the co-investors and link to the proposed investee company.
- 5.61. In an update to the acting Permanent Secretary on 11 May 2020, Name Redacted confirmed that the application system for the Future Fund was being built and tested ahead of the launch date. PwC had taken the Future Fund project to their UK board who had confirmed they were comfortable with where the project was in terms of deliverability {GD(B)/298 – INQ000564015}.
- 5.62. BBB updated the Department on 12 May 2020 noting that they were continuing to work with PwC and other third parties to set up all elements of the scheme in time for the scheduled 20 May 2020 launch {GD(B)/299 – INQ000564018}. The design and build phase contract had been signed off and BBB were working with PwC on the delivery contract.
- 5.63. On 13 May 2020 BBB wrote to the Department to advise that they were working with PwC on testing the platform {GD(B)/300 – INQ000564023}. PwC staff had been appointed to support service delivery. It was also explained that BBB and PwC were working to agree an operating model for the second line of defence for the scheme alongside the risk and control framework.
- 5.64. On 15 May 2020, BEIS officials sent a submission to the Secretary of State on the launch of the Future Fund {GD(B)/301 – INQ000585638} and {GD(B)/302 – INQ000585639}. The submission included the fact that PwC had finished building the application portal to process applications. Whilst some delivery risks remained, they were being managed appropriately and the involvement of PwC was removing any

concerns surrounding BBB's capacity. The submission also recorded that PwC's UK board had confirmed that they were comfortable with the deliverability of the project.

- 5.65. PwC would continue (post-launch) to manage the ongoing operations and delivery of the scheme. This included undertaking fraud and financial crime checks, customer support, execution of the convertible loan and cash management.
- 5.66. Separately, around this time, HMT sought advice from various external advisors as to whether any time-limited tax relief measures could be provided to matched co-investors who were to invest in the Future Fund. This included consideration as to whether the scheme could offer similar tax relief to that being offered to investors as part of the EIS. In particular, HMT was seeking advice on whether any such offering would be compliant with the Market Economy Operator Principle (**MEOP**).¹⁵
- 5.67. Expert economics and finance consultancy firm Oxera was commissioned to provide advice on this issue. Oxera initially provided a benchmark report on 4 May 2020, later classified as the 'base case', which considered MEOP compliance in circumstances where investment in the Future Fund scheme would be through private matched investors who did not have any form of EIS-like relief. Oxera was later commissioned to provide supplementary advice on whether their MEOP assessment in relation to the 'base case' would hold for various other circumstances including co-investment by private matched investors who would otherwise be eligible for tax relief under the EIS.
- 5.68. Oxera's supplementary advice issued on 8 May 2020 concluded that providing EIS-like tax relief to investors in the Future Fund could prejudice the MEOP justification for the scheme. Despite this, the Chancellor expressed his preference for enabling EIS investors to use the Future Fund. As such, the Chancellor asked for further economic advice prior to coming to a final view {GD(B)/303 – INQ000564016}.
- 5.69. HMT subsequently instructed Ernst & Young (**EY**) to complete a secondary opinion on the issue. In particular, HMT asked EY to consider whether a strong economic argument could be made to the European Commission to justify compliance with the

¹⁵ The European Commission, confirmed by the Court of Justice, set up the market economy operator principle (MEOP) to identify the presence of State aid in cases of public investment in the form of capital injections. To determine whether a public investment constitutes State aid, the public operator must examine whether, in similar circumstances, a private investor of a comparable size operating in normal market economy conditions would have made the same investment. The principle has subsequently been applied to different types of economic transactions including capital injections, loans, guarantees, sale and purchase of assets, goods and services etc.

MEOP test in circumstances where: (a) the Future Fund was used in conjunction with the EIS or (b) there were to be a mix of EIS and other investors.

- 5.70. EY completed their report on 13 May 2020 {GD(B)/304 – INQ000596673}. In summary, the report concluded that:
- a) it would be difficult to justify the Future Fund’s compliance with the MEOP test when used alongside the EIS due to the close alignment of these interventions and their combined functioning; and
 - b) there may be a case for limited EIS investor involvement, provided there were enough non-EIS investors to demonstrate market interest and any aid component was minor.
- 5.71. On 17 May 2020, a submission to the Secretary of State provided an update on the design and implementation of the Future Fund and outlined the remaining steps required to enable the launch to take place {GD(B)/305 – INQ000585640} and {GD(B)/306 – INQ000585641}. The submission noted that BEIS had “*not been successful in persuading Treasury of the case for making time-limited changes to these reliefs as a way of stimulating investment, or of introducing a separate EIS-compatible offer within the Future Fund. The Chancellor has instead asked for CLN investments to be made eligible for the EIS*”. The submission highlighted that external advisors had been commissioned to comment on the position of State aid and accommodating EIS investors in the scheme however this would not be resolved in time for the launch.

Value for Money Considerations Leading up to the Launch of the Future Fund

- 5.72. The question of whether the Future Fund represented value for money became a central issue in the discussions leading up to the launch. The BBB’s Shareholder Relationship Framework entitled them to issue a reservation notice on value for money grounds {GD(B)/307 – INQ000596650}. Time considerations were also an issue, and on 6 May 2020 Name Redacted wrote in an email to senior BEIS colleagues that “[t]he worries we had with the other schemes (propriety, deliverability) are much less... The PWC system has strong anti-fraud and Know Your Customer checks built-in. It is really whether we have the time to assess VFM thoroughly enough before launch... that is the outstanding question. Unlike the loan schemes there is [an] upside, the taxpayer might eventually make a profit out of this.” {GD(B)/308 – INQ000564010}
- 5.73. Gemma Peck wrote to Keith Morgan on 7 May 2020 and stated “*I understand that the Bank has reservations about the FF and so may ask to be directed to implement it. For*

the benefit of advising the SoS and Permanent Secretary, I would be grateful if the risk committee could consider the project against the criteria at para 4 [of the Shareholder Relationship Framework] and set out exactly what their concerns are (with direct reference to these criteria) and what options there are for mitigation. For example, if feasibility is a concern would another week allow the outstanding issues to be resolved? If it is value for money, what changes to the programme's terms would resolve the concern? This will enable us to discuss the risk committee's concerns and potential mitigations ahead of the board meeting." {GD(B)/309 – INQ000585620}. Gemma Peck explained that if BBB had concerns that the instruction triggered one or more of the criteria of the framework it would be a highly relevant factor in the Department's Accounting Officer assessment.

- 5.74. The BBB Board's Risk Committee met on 11 May 2020 to discuss progress since the announcement of the Future Fund. The Committee was to discuss the key outstanding concerns that would inform the Board's decision in relation to BBB's preferred response to the expected instruction to deliver the scheme {GD(B)/228 – INQ000564017}. The Committee was informed that BEIS had requested BBB's assessment of the scheme before any instruction would be issued.
- 5.75. An overview paper prepared by BBB for the meeting set out in detail their assessment against the seven criteria in the framework agreement. The central scenario for its economic assessment suggested that the scheme potentially offered good value for money but highlighted that the estimates on which this had been calculated were highly sensitive to assumptions and if the downside scenarios of these assumptions were combined calculations showed poor value for money. The report explained "*We have not had the opportunity to undertake a comprehensive options analysis on other interventions to address the target market. We therefore cannot be sure that, if a formal business case approval process were undertaken, that another option would not produce better value for money. The main objective of the intervention is to help start-ups survive until the next round of equity finance and the [Benefit Cost Ratio] method captures this reasonably well. There are other potential objectives, such as demonstrating that the VC funding market can continue to function through these difficult times, which are not quantified but may also be significant.*"
- 5.76. In internal correspondence, BEIS officials noted that on the Covid-19 loan schemes, given the pace at which they were developed had resulted in details not being finalised until very close to launch, the acting Permanent Secretary had taken the view that it

was not practical to engage the Industrial Development Advisory Board (**IDAB**).¹⁶ However, in respect of the Future Fund, officials felt that there was a window of opportunity to engage IDAB to garner their views on the robustness of the scheme and the risk levels {GD(B)/310 – INQ000585632}.

- 5.77. On 12 May 2020, Name Redacted sent papers for consideration at an IDAB board meeting on 14 May 2020, including an IDAB Scheme Assessment Form and a value for money assessment from BBB {GD(B)/310 – INQ000585632}, {GD(B)/311 – INQ000585634}, {GD(B)/312 – INQ000585635}, and {GD(B)/313 – INQ000585633}. The value for money assessment set out a cost benefit analysis estimating that the Future Fund could generate net economic benefits of around £360 million from the £250 million the Government would invest in the scheme. The Net Present Value (**NPV**) was calculated to analyse the profitability of the project and suggested potential for good value for money (£3.10 per total pound invested). However, these NPV estimates were observed to be highly sensitive to assumptions made regarding business turnover and the likely number of loans/investments written off due to business closure. The BBB paper found the NPV of net economic benefits to economic costs would fall if the businesses supported had lower business turnover and would fall further still if the number of write offs increased. As a result, the NPV per total pound in this scenario indicated poor value for money (£0.10 per total pound invested).
- 5.78. Upon consideration, IDAB's advice was that it was "unable to recommend this proposal for Future Fund as presented, noting concerns about VFM. However, the Board recognises the need for financial support where there is poor liquidity and supports the principle of the Future Fund. The Fund should be managed with a view to a target VFM, and consideration should be given to independent verification of the investment and assessment of the return for Government" {GD(B)/306 – INQ000585641}.
- 5.79. On 17 May 2020, BEIS officials sent a submission to the Secretary of State to provide an update on the design and implementation of the scheme, and outlined the remaining steps required to enable the launch to take place. The submission noted that an Accounting Officer Assessment had been submitted in parallel, based on which the acting Permanent Secretary, as Principal Accounting Officer, would request a ministerial direction. Annexed to the submission was an equalities assessment and a

¹⁶ IDAB is a statutory body established under the Industrial Development Act 1982 (**IDA**). It sat under the former BEIS (and now sits under the Department for Business and Trade) and provides commercial views to Ministers on various industrial strategy proposals, including relevant proposals to support industry and financial assistance under the IDA.

draft email to be sent to HMT seeking full budget cover {GD(B)/306 – INQ000585641}. Once the budget cover was agreed, the submission set out that the Secretary of State would be in a position to issue an oral direction to the Accounting Officer, who would then instruct BBB to proceed. The exchange of direction letters was due to take place shortly after.

- 5.80. The submission gave detailed advice on the discussions that had been taking place in respect to value for money, and stated:

“Concerns about VfM came to a head last Thursday, following the input and views from the BBB Board on the assumptions made by the BBB analytical team. The BBB Board members, who have extensive expertise in this area of investment, felt that the commercial assumptions made by their analysts were too optimistic. In particular, that these assumptions – based on ‘normal’ interventions – needed to better reflect the particular set of incentives that HMT had incorporated into this scheme’s design and the current market environment. As a result, the BBB team adjusted their analysis. The new analysis showed poor VfM and negative returns to the Future Fund.”

- 5.81. The submission also stated that the acting Permanent Secretary had considered the full Accounting Officer Assessment and concluded that she would need to seek a ministerial direction. This was based on the uncertain position on value for money, and particularly the IDAB assessment. BEIS officials confirmed their ability to address the issues raised by IDAB were limited in a scheme that was purposely rules-based but thought there would be scope as part of monitoring the scheme to potentially make changes later should HMT make more funding available for further investments.

- 5.82. On 15 May 2020 BEIS officials sent a detailed Accounting Officer Assessment to the acting Permanent Secretary {GD(B)/314 – INQ000564029}. In the note, BEIS officials set out their advice against the Accounting Officer standards and recommended a ministerial direction would be necessary due to the high level of uncertainty in making a value for money assessment. The assessment stated in particular that:

- a) ultimately the value for money assessment concluded that the scheme did not represent value for money;
- b) the scheme did not need to be notified under the EU State aid provisions;
- c) real time management information would be available from launch; and

- d) assurance should be sought from HMT in advance of the scheme going live for costs associated with the operation of the scheme and the valuation of assets.

Reservation Notice

5.83. On 18 May 2020, BBB sent a reservation notice to the Secretary of State setting out their concerns with the Future Fund {GD(B)/315 – INQ000564030}. The BBB's Board Risk Committee had several concerns about the overall design of the scheme and had worked with BEIS and HMT officials to shape its design to address its concerns as far as possible. However, the changes made were not sufficient to allay the Board's concerns, which are set out in further detail as follows:

“The overriding fact is that the value for money outcome from this scheme is highly uncertain. Based on the industry experience around the Board table, the central scenario upon which our value for money assessment has been based yields a negative Benefit Cost Ratio (BCR). That view was driven by concerns that the best companies will not use this funding route, as investors will fund those companies without HMG support. This will result in HMG investment going to the second tier of companies, which will likely result in higher associated loss rates...

While the Board's overarching concern is value for money, there are two further criteria that raise concerns, although they would not, by themselves, trigger this course of action. However, for completeness, I set them out below.

On the matter of propriety, the difficulty arises in reconciling the Chancellor's announcement of a fixed budget (an initial £250m allocation) with a rules-based scheme. The Future Fund will not be making individual assessments of investment viability and there is no other mechanism for managing to the specified quantum of funding within the announced timeframe. Whilst I note the recognition of this issue in your instruction and your assurances that additional allocation decisions will be made promptly, it remains the case that with an application period open until the end of September there is a high risk that delivery will need to be halted before the end date, with reputational and market consequences, if further budget cover cannot be provided in advance...

On the interaction with the Bank's overarching objectives, the scheme arguably runs counter to both the Bank's objectives on regionality, as recipients are more

likely to be based in London and the South East, and on operating within a robust risk management framework.”

- 5.84. Following verbal confirmation from the Secretary of State to proceed, on 18 May 2020 the acting Permanent Secretary formally directed BBB to implement the scheme despite the Bank’s concerns {GD(B)/316 – INQ000564031}. The direction stated as follows:

“You have highlighted concerns around value for money, including the difficulty of modelling forecast outcomes in current economic conditions, the novelty and lack of precedent for the Future Fund and the impact of behavioural effects that may arise from its rules-based design. These risks have been raised with the Secretary of State in our formal advice to him and they were also detailed in my Accounting Officer assessment. He took the view that these risks notwithstanding, the unprecedented situation facing the country meant that it was essential to introduce this scheme and issued me with a Direction to proceed, to be recorded in a formal exchange of letters. The Secretary of State received prior approval to proceed from the Chancellor and his officials.

We should monitor use of the scheme closely in the coming days and weeks. We should be particularly alert for any evidence of adverse behavioural effects as raised in your letter and be prepared to propose changes to Ministers if it becomes evident that the scheme is not operating as intended. You also noted the difficulties that your board has had in reconciling the Chancellor’s announcement of an initial £250m allocation to the Future Fund with a rules-based scheme. This risk should be mitigated by close monitoring of demand for the scheme, so that the Chancellor is well-informed and able to respond in a timely way. As regards the lack of commitment to provide funding for follow-on investments, I would not expect such a commitment to be made by HM Treasury at this stage. These opportunities will not arise for some time and it is always open to us to make a reasoned case for future investment. We have left open the question of how best to manage the equity holdings that Government will own after conversion. I would expect to address the question of follow-on investments as part of the same conversation.”

- 5.85. On 19 May 2020 the acting Permanent Secretary wrote to the Secretary of State recording her reasons for seeking a direction for the scheme. The acting Permanent Secretary highlighted that both Oxera and BBB’s value for money assessments had

observed the unprecedented nature of the economic conditions and hence the uncertainty surrounding the assessments. The range of plausible outcomes presented by BBB and Oxera illustrated the sensitivity of the assumptions underpinning the results and the uncertainty of the economic context. As such, the acting Permanent Secretary was unable to conclude that the scheme represented value for money and sought a ministerial direction. She stated that, given more time, it was possible that alternative options for delivering the policy intent could have been developed that may have offered better value. However, she recognised that the Secretary of State and Chancellor could take into account wider considerations, including possible further adverse impacts on businesses that a delay in implementing the scheme might have.

- 5.86. The Secretary of State responded later that day confirming he supported the introduction of Future Fund despite the uncertainties around value for money and formally directed the acting Permanent Secretary as Accounting Officer to take it forward {GD(B)/317 – INQ000564033}.
- 5.87. HMT also provided confirmation of full additional budgetary cover for the Future Fund and acknowledged the concerns that had been raised by the Secretary of State. HMT confirmed that the Chancellor agreed with the Secretary of State's assessment of the need for the fund and confirmed HMT would continue to work with BEIS to consider the specific issues outlined in the Accounting Officer note, including whether the initial allocation to the Future Fund may need to be increased {GD(B)/318 – INQ000564038}.

Implementation and Delivery of the Future Fund

Launch of the Future Fund Scheme and Ongoing Monitoring

- 5.88. The Future Fund was launched on 20 May 2020. HMT announced the Future Fund on the gov.uk website, with supporting statements from the Chancellor, the Secretary of State for Digital, Culture, Media and Sport, and the Secretary of State {GD(B)/319 – INQ000576422}. The original allocation of funding from HMT was £250 million. The loans converted into equity stakes for the Government at a 20% discount if not repaid within three years {GD(B)/320 – INQ000564044}.
- 5.89. Forty-five minutes after going live, the Future Fund portal had received approximately £76 million worth of applications (with an additional £79 million from match funders). BEIS and HMT immediately discussed oversubscription concerns {GD(B)/321 – INQ000564034}. In correspondence between BEIS and HMT it was highlighted that if BBB did not get additional cover, they would switch off the application system once the

£250 million total was reached {GD(B)/322 – INQ000564035}. An update was sent to the acting Permanent Secretary and Secretary of State the same day, confirming the launch had exceeded expectations, and HMT were working to secure additional funding cover {GD(B)/323 – INQ000585643}.

- 5.90. By 10:25am the same day, BBB confirmed they had received £250 million worth of applications and had put a queuing system in place to ensure they did not breach their delegations {GD(B)/324 – INQ000564036}. BBB stated that their preference going forward was for the Future Fund to be subject to unlimited delegations, as was the case for the other Covid-19 loan schemes {GD(B)/325 – INQ000585644}.
- 5.91. At 11:13am, the Assistant Private Secretary to the Chancellor wrote to the Secretary of State to confirm that, if required, an additional £750 million in budget cover, ring-fenced for Future Fund investments, would be made available (in addition to the £250 million already agreed). The email confirmed that the additional funding should not be made public {GD(B)/326 – INQ000564037}. He requested that HMT and BBB provide hourly updates on the volume and value of the applications.
- 5.92. BBB sent BEIS daily updates on the status of Future Fund applications. The daily update sent at 9.00am on 21 May 2020 indicated that the Future Fund portal had received £523 million worth of applications, with an additional £585 million from match funders {GD(B)/327 – INQ000564041}. BBB stated:

“...the figures below relate to the applications that have been made through the platform. This does not mean that the funding has been approved. As you know, following the investor and company submitting their application, a number of processes are then undertaken to approve the funding. These include: KYC and Sanctions checks, validation of solicitors details, creation of the Convertible Loan Note Agreement and then the distribution of funds. It is possible therefore that some of the demand will not translate into actual investments. It is too early to estimate the percentage that may drop out as they progress through to approval. The Future Fund platform will be tracking applications and be able to provide internal [management information] on these.”

- 5.93. That evening, Name Redacted emailed the acting Permanent Secretary to provide an update on the Future Fund {GD(B)/328 – INQ000585647}. Amongst other things, the email stated that:

- a) The most recent figures indicated that the total application to the Future Fund was just over £600 million;
- b) BBB had conducted an analysis on the figures from the first day and prepared a report {GD(B)/329 – INQ000585648}. In summary, the report indicated that the size, geography and diversity of the companies was broadly in line with expectations. With respect to the quality of investments, the report stated that the policy intent was to invest in 'second tier' companies to ensure additionality and returns for the taxpayer. A sample taken from the portfolio indicated that 16 companies were 'potential stars', 42 were part of the target group whilst 7 were considered weaker performers. The report also discussed potential options for increasing BBB's delegations for the Future Fund and, if so, whether this took the form of a capped or uncapped amount (discussed further below);
- c) A joint BEIS/HMT/BBB group had met to consider the best approach to increased delegations. The group discussed two options being: (a) whether to continue on the current basis with a fixed cap (increasing periodically at the Ministers' discretion); or (b) to take an open approach without a cap and set internal review points so that the scheme could be reviewed and paused if it was found to be steering away from policy intent. The group agreed that the better option was the former, to set a cap and be transparent that applications would be dealt with in date order until the cap amount was exhausted;
- d) BEIS had prepared an analysis of the potential size of the fund, to be used as a comparison to previous work done by BBB {GD(B)/330 – INQ000585649}. In comparison to BBB's estimate of £1.7 billion, BEIS' analysis estimated the headline government funding requirement for the Future Fund to be £1.5 billion; and
- e) The Chancellor was due to receive advice later that evening on the overall size of the fund and two potential approaches to limiting the amount of funding depending on number of applications over the coming weeks.

5.94. Following the launch, PwC undertook a data validation exercise to eliminate duplicate and abandoned applications. PwC also provided initial data on the preparation of applications successfully passing each stage of the application process {GD(B)/331 – INQ000564048}.

- 5.95. During various Covid-19 Quadrilateral meetings held with the devolved administrations in late May 2020, concerns were raised about some Scottish businesses not reaching the private match funding required for the Future Fund scheme, which was causing an inbuilt imbalance {GD(B)/332 – INQ000538842} and {GD(B)/333 – INQ000538844}. At the meeting held on 27 May 2020, Minister Zahawi agreed to raise this point with BBB, acknowledging the importance of ensuring funding was spread fairly across the four nations (rather than being London focused).
- 5.96. The scheme was not designed to address wider imbalances in equity provision given the eligibility requirements, and so officials recognised that investments made by the fund were likely to reflect existing disparities. Data was collected on the scheme, which was monitored by BBB, to flag if the distribution of investment was inappropriately concentrated in specific areas, and whether it was disadvantaging certain groups. The eventual spread of funding was in line with the wider market trends for equity investments.
- 5.97. On 12 June 2020, BEIS officials sent the Secretary of State a submission regarding additional allocation for the Future Fund {GD(B)/334 – INQ000585653} and {GD(B)/335 – INQ000585654}. The submission confirmed that since launch, £100 million worth of new applications were coming in each week, with the total being close to the £1 billion capacity. The submission confirmed that assessments carried out by both BEIS and BBB indicated that the scheme was broadly reaching target companies and potential demand from such companies was likely to be in the range of £1.5 to £1.7 billion. As such, the submission requested a further allocation of £500 million. {GD(B)/335 – INQ000585654}. The Secretary of State agreed to this request on 22 June 2020 {GD(B)/336 – INQ000564064}.
- 5.98. On 26 June 2020, BEIS officials sent a submission to the Secretary of State regarding the eligibility of companies with an overseas parent for the Future Fund {GD(B)/337 – INQ000585662} and {GD(B)/338 – INQ000585663}. The submission stated that the Future Fund currently required parent companies to be in the UK. The Chancellor wished to widen the eligibility of the scheme to include UK-based companies whose parent company was established overseas, in cases where this was required by an accelerator programme as a condition of participation. The expectation was that this expansion would result in less than 100 applications. The submission noted that the further allocation of £500 million that was recently requested would provide sufficient capacity to accommodate the additional demand.

- 5.99. On 29 June 2020, an email was sent by HMT to the Secretary of State, confirming that it would provide up to an additional £500 million for the Future Fund and agreed that eligibility should be expanded to include UK-based companies with a non-UK parent company in cases where this was required by an accelerator programme as a condition of participation {GD(B)/339 – INQ000564069}. Gemma Peck wrote to BBB to confirm that the extension to the scheme and additional funding had been approved, and to instruct BBB to proceed {GD(B)/340 – INQ000564070}.
- 5.100. Changes to the Future Fund's eligibility criteria were announced on 30 June 2020.
- 5.101. The Future Fund closed to new applications on 31 January 2021. In an update to the Secretary of State on 10 December 2021, BEIS officials confirmed that by the closure date a total of £1.137 billion in funding had been provided to businesses through CLNs {GD(B)/341 – INQ000585790}. An application for closure of the project was made on 5 March 2021 {GD(B)/342 – INQ000564198}. The closure form listed the top outstanding risks faced by the project as being the Government having no control over the quality of companies in which it invested, and a good return on investment in the portfolio being dependent on follow-on funding being available to firms that had converted and wished to raise further finance.

Monitoring the Future Fund and Identification of Fraud and Error

- 5.102. Current indications are that fraud levels have been relatively low in the operation of the Future Fund, but the situation remains under review. In the BEIS Annual Report and Accounts for 2020-2021, the Department recognised £29 million in relation to nine suspected fraudulent payments within the Future Fund Scheme (approximately 2.8% of the £1.03 billion Future Fund fair value in the same report). In 2021-2022, the Department recognised a further £9 million in relation to 13 suspected fraudulent payments within the Future Fund Scheme (approximately 0.9% of the £1.1 billion fair value of Future Fund at that point). Losses flagged in the Annual Report for 2022-2023 include a further £4 million in relation to two suspected fraud payments within the Future Fund (approximately 0.04% of the now-reduced £851 million fair value of the Future Fund).
- 5.103. BBB completed a three-stage fraud and error risk assessment (**FRA**) for each of the BBLs, CBILs, CLBILs, RLS and Future Fund COVID-19 schemes during 2020-2021 which were approved by BEIS. The purpose of the FRA was to identify the number, type and level of fraud risk within the respective portfolios.

- 5.104. In April 2021, following a request from BEIS, BBB completed a baseline FRA for the Future Fund. The baseline FRA aimed to identify inherent risks within the Future Fund scheme design, describe the controls including any limitations, and provide a qualitative assessment for each risk.
- 5.105. Beginning in May 2021, BBB began to update the baseline Future Fund FRA. The updated assessments included consideration of the Future Fund's financial impact, any reputational and legal consequences and also looked at the potential risks of fraud based on the design of the scheme and controls put in place and intelligence gathered during the operation of the scheme. Various updates were made to the Future Fund FRA between May and September 2021.
- 5.106. On 13 September 2021, BBB circulated an updated Future Fund FRA to various BEIS officials {GD(B)/343 – INQ000585779} and {GD(B)/344 – INQ000585780}. The FRA identified 135 fraud risks from the Future Fund and concluded that the risk rating for the Future Fund was high/very high. Each risk was assessed on a residual basis taking into account the contemporaneous controls (to the extent they existed and/or were evidenced).
- 5.107. The risks identified included:
- a) Third party risks – for example impersonation of investor, investee or solicitor, collusion/manipulation or coercion;
 - b) First party risks – for example the investor or investee failing to disclose information or artificially building their portfolio;
 - c) Internal risks – for example process abuse, deception/impersonation, data abuse or misappropriation of funds; and
 - d) Organisational actor risks by the lender or administrator – due to reduced or inadequate controls, collusion, misreporting, speed to market, scheme delegation or inadequate oversight.
- 5.108. A Future Fund workshop took place on 15 September 2021 to discuss the updated Future Fund FRA. The workshop was attended by various officials from BEIS, Cabinet Office, UKGI and BBB. During the meeting, the group discussed each of the risks in the Future Fund FRA, their scoring and which risks ought to be accepted or not accepted {GD(B)/345 – INQ000585781} and {GD(B)/346 – INQ000564221}.

- 5.109. On 30 September 2021, a slide pack providing a Covid-19 Schemes Fraud Update, prepared by BBB, was circulated ahead of the Covid-19 Loan Scheme Counter Fraud Strategy Board meeting scheduled for 4 October 2021. The slide pack noted that, of the open residual risks, BBB was proposing to accept 50 risks. The slide pack also stated that BBB were seeking approval for 22 Post Event Assurance Plan (**PEAP**) activities aimed at mitigating any risk through prevention and detection, intelligence gathering, investigation recovery, and prosecution and programme management.
- 5.110. The updated Future Fund FRA was approved at the Covid-19 Loan Scheme Counter Fraud Strategy Board meeting on 4 October 2021 {GD(B)/347 – INQ000564223}.
- 5.111. BBB produced further Covid-19 Schemes Fraud Updates on:
- a) 1 November 2021 {GD(B)/348 – INQ000564233};
 - b) 6 December 2021 {GD(B)/349 – INQ000564237};
 - c) 13 January 2022 {GD(B)/350 – INQ000564246};
 - d) 7 February 2022 {GD(B)/351 -INQ000564249}; and
 - e) 14 April 2022 {GD(B)/352 – INQ000564264}.

In respect of the Future Fund, these updates tracked the progress of the 22 proposed activities within the PEAP.

- 5.112. In 2022, a Future Fund pilot was set up to identify potential fraud between HMRC and British Business Financial Services Limited (**BBFSL**), a subsidiary of BBB, which was appointed in relation to the administration of the scheme.
- 5.113. In cases of confirmed fraud by Future Fund CLN recipients, BBB has subsequently issued default notices which prevent the Government from receiving equity stakes in businesses that have committed fraud. For example, BBB instigated an investigation into start up investment group Nova Group after they received intelligence relating to potential contractual breaches {GD(B)/353 – INQ000585822}. Following investigations, HMRC accused Nova of a £3.5 million VAT scam and breaching various scheme rules that led to BBB issuing Nova with a default notice in January 2024.¹⁷

Proposed Sale of the Future Fund Portfolio and Follow-On Investment

- 5.114. On 3 August 2021, HMT circulated a draft commission to BEIS that confirmed that the Chancellor had tasked HMT and UKGI officials with exploring the potential sale of the

¹⁷ See Times article: {GD(B)/354 – INQ000576440}

Future Fund portfolio in the short term. As part of the commission, BBB was also asked to analyse and model the investment needed to provide follow-on funding and generate a return should the portfolio be held in the short to medium term {GD(B)/355 – INQ000538920}.

- 5.115. In November 2021, Gemma Peck requested clarification on the next steps of the Future Fund. In particular, she asked whether the UKGI's consideration of selling the Future Fund portfolio and HMT's review of capital recycling would be resolved in time to inform BBB's business planning. In response, [Name Redacted] stated, amongst other things, that an answer on follow-on investment was expected within six weeks (due to resourcing issues at BBB). He also stated that all indications were that it would not make sense to sell the Future Fund until the loan notes had converted (i.e. after another two to three years) {GD(B)/356 – INQ000564231}.
- 5.116. On 3 December 2021, [Name Redacted] circulated a draft submission to Gemma Peck regarding options for the sale of the Future Fund Portfolio {GD(B)/357 – INQ000585788}. Gemma Peck approved this submission on 6 December 2021 and it was sent to the Permanent Secretary and Secretary of State on 10 December 2021 {GD(B)/358 – INQ000564238} and {GD(B)/359 – INQ000585789}. The submission included a recommendation to engage external advisers who would report to BEIS and HMT and conduct a feasibility study exploring strategic options for the Future Fund. This would include consideration of the potential transfer of all or part of the fund to the private sector, comparing these options with the current management approach, considering the need for follow-on funding, and advising Ministers and the Accounting Officer on the best course of action {GD(B)/359 – INQ000585789} and {GD(B)/341 – INQ000585790}. The submission recommended that UKGI act as the agent for BEIS in procuring the advice. On 16 December 2021, the Secretary of State indicated that he was happy with the submission's recommendations {GD(B)/360 – INQ000585793}.
- 5.117. In January 2022, the Future Fund Project Board was established for the purposes of discussing strategic options for the Future Fund. See the draft Terms of Reference for the Future Fund Project Board at {GD(B)/361 – INQ000585799}. These meetings occurred monthly and were attended by various members of BEIS, HMT and UKGI.
- 5.118. Ahead of the first meeting scheduled on 6 January 2022, [Name Redacted] circulated various briefing materials. In his covering email, he indicated that the first meeting would discuss the governance arrangements and scope of the UKGI's procurement of external advisers {GD(B)/362 – INQ000585797} and {GD(B)/363 – INQ000585798}.

Included in the briefing material was a paper prepared by UKGI that set out the scope and questions that UKGI intended to ask prospective bidders in the process of locating an advisor to carry out a feasibility study of the Future Fund {GD(B)/364 – INQ000585800}.

- 5.119. On 6 January 2022, the first Future Fund Project Board meeting took place. Amongst other items, the group discussed amendments to the draft Terms of Reference (including the scope of procurement) and agreed to assess information provided by BBB about follow-on funding {GD(B)/365 – INQ000585801}.
- 5.120. A further Future Fund Project Board meeting took place on 1 February 2022 {GD(B)/366 – INQ000585803} and {GD(B)/367 – INQ000585804}. UKGI provided an update during the meeting on the governance of the project and indicated that they would be in a position to proceed with the procurement once funding had been confirmed by BEIS. The Board also considered a proposal that BEIS commission Oxera to prepare an updated (from the work done in May 2020) advice on the likely returns from the Future Fund portfolio. It was intended that this work would form a 'base case' valuation against which to assess the estimated value of alternative options arising from the Future Fund feasibility study. In this regard, it was agreed that Oxera's work would be conducted separately to the feasibility study, which would be completed by a separate advisor (GD(B)/368 – INQ000585810). The Board also discussed Oxera's ability to provide an independent estimate of the total capacity for follow-on funding. See email from Name Redacted dated 1 March 2020 that contains summary of the meeting {GD(B)/369 – INQ000585805}.
- 5.121. On 1 March 2022, Name Redacted circulated the project scope for Oxera's engagement and requested the Board's approval of the quoted price and scope for both the baseline valuation and advice on the optimal approach to follow-on investment {GD(B)/369 – INQ000585805}, {GD(B)/370 – INQ000585806} and {GD(B)/371 – INQ000585807}.
- 5.122. A further Future Fund Project Board meeting was scheduled for 2 March 2022. See agenda and briefing papers at {GD(B)/372 – INQ000585808}, {GD(B)/373 – INQ000585809}, and {GD(B)/374 – INQ000585811}. The meeting was cancelled but the project scope for Oxera's engagement was approved by Gemma Peck on 3 March 2022 and by Minister Scully and Lord Callanan on 24 March 2022 {GD(B)/375 – INQ000564256} and {GD(B)/376 – INQ000564259}.
- 5.123. On 14 March 2022, Daniela Guzzardo (Executive Director, UKGI) emailed officials in BEIS and HMT with an update on procurement for the Future Fund feasibility study.

She indicated that all potential bidders had withdrawn from the feasibility study tender process, citing factors such as resource constraints and the complexity of the task. No bids were submitted. UKGI did not recommend launching a broader procurement process {GD(B)/377 – INQ000564258}.

- 5.124. Prior to the Future Fund Project Board meeting on 6 April 2022, a briefing paper prepared by UKGI updated the Board on the outcome of the procurement process to appoint a feasibility study advisor on strategic options for the Future Fund, as well as on feedback from invited parties to the procurement, and next steps {GD(B)/378 – INQ000564262}. The paper confirmed that whilst the procurement exercise resulted in no bids, the work undertaken and the feedback received provided a helpful perspective on the feasibility of a sale of the Future Fund. The paper concluded that “...a sale of the whole portfolio in its current state would likely not achieve value for money at this time. There are risks around the type and nature of potential buyers were a sale to take place now, particularly around the treatment of portfolio companies post-sale. Furthermore, there is a reputational risk and embarrassment factor around selling a company now that has the potential to be high value in future”. In terms of next steps, the paper recommended that the Government conduct a portfolio due diligence exercise if it ever considered selling the Future Fund at some point in the future. It further recommended some form of portfolio segmentation (i.e. by status of investment) to make the Future Fund more attractive to potential buyers.
- 5.125. Oxera’s baseline valuation report was finalised on 28 April 2022 and was circulated to the Future Fund Project Board the same day {GD(B)/379 – INQ000538929}. The report concluded that the Government’s expected financial returns in respect of the Future Fund portfolio were likely to range from 1.26x to 1.62x. This estimate assumed that there would be no follow-on investment by the Government into Future Fund companies.
- 5.126. Oxera’s second valuation report was finalised on 23 May 2022 and was circulated to the Future Fund Project Board the next day {GD(B)/380 – INQ000538935}. The purpose of the second report was to comment on the optimal follow-on investment strategy, with a view to maximising the Government’s expected returns, based on the current portfolio data and assuming in-house management of the portfolio. In summary, the second report concluded that the optimal follow-on investment strategy for the Future Fund was to rely on the due diligence conducted by professional investors or investors with a proven investment track record, provided that the funding

round was not a down round. Using a random sample of 106 Future Fund investors, the report concluded that the Government should follow-on with 41% of the investors, potentially follow-on with 18% of the investors, and not follow-on with 42% of the investors. The report estimated that the Future Fund would require approximately £184 million in additional capital for follow-on investments, projected to generate an incremental return of £352 million for the Government. The Department acknowledged the value of follow-on funding to maximise returns and submitted two funding bids to HMT, the first during the 2021 Spending Review and the second at the end of 2022. HMT rejected both bids and deemed follow-on funding a lower priority compared to broader fiscal demands. At the October 2024 International Investment Summit, the Chancellor announced financial reforms for BBB, putting its £7.9 billion commercial programmes on a permanent footing. This may enable BBB to independently pursue follow-on investments in the future, where aligned with its investment strategy and merit is demonstrated.

- 5.127. On 30 May 2022, a meeting took place between members of BBB, BEIS, HMT and UKGI to discuss Oxera's second valuation report {GD(B)/381 – INQ000564266}.
- 5.128. On 13 June 2022, BBB circulated an email outlining their proposed approach to the follow-on investment process and selection criteria. The email stated that BBB was largely supportive of Oxera's approach and agreed that investment decisions should be subject to an initial set of criteria to filter out weaker propositions. Building on Oxera's proposal, BBB developed four key criteria to filter companies and produce the best possible shortlist of propositions: the quality of the investor, commercial performance, prioritising innovative companies and meeting Government policy priorities. In terms of resourcing, BBB indicated that the follow-on investment project could not be covered from existing RDEL budgets {GD(B)/382 – INQ000543829}. Further, BBB estimated the capital requirements of a follow-on funding programme to be £206 million over six years, with a projected total return on capital of 1.5x (£100 million). This would equate to investments in 154 companies across 247 funding rounds {GD(B)/383 – INQ000543830}.
- 5.129. On 23 June 2022, the Department provided input on BBB's advice to help inform the advice being prepared for BEIS Ministers {GD(B)/384 – INQ000564273}. BEIS stated that Oxera and BBB agreed that the ideal quantum amount for follow-on investments was in the region of £200 million. BEIS agreed that £200 million was suitable to maximise value for money. HMT stated that the programme was scalable, and that the

quantum could be reduced if Ministers determined it to be too high. However, BEIS suggested that £50 million was the minimum amount to ensure that the programme was worthwhile. The BEIS advice also reinforced that BBB could not implement a follow-on programme with no running costs, so in the absence of additional RDEL budget, the program could not be implemented.

The Outcome of the Implementation of Future Fund

5.130. BBB data collated in July 2021 provided statistics on the Future Fund's inclusivity {GD(B)/385 – INQ000585866}:

- a) 41% of companies with completed funding through Convertible Loan Agreements had their headquarters located outside of London – 14% were headquartered in the South of England, 11% in the North of England, 8% in the East of England, 4% in the Midlands and 3% in the devolved administrations;
- b) 78% of funding was to companies with mixed gender senior management teams; and
- c) Senior management teams consisting solely of team members from a Black, Asian or Other Ethnic Minority background and those with team members from a Black, Asian or Other Ethnic Minority background and White team members accounted for 61.6% of funding received through Convertible Loan Agreements.

5.131. In terms of eligibility for the Future Fund, the Ipsos Report, stated that the review of BEIS's overarching response to Covid-19 did not highlight any group that remained ineligible for support except for pre-revenue start-ups without any history of equity fundraising. The impact of this apparent gap in the support package was not explored in the evaluation, although it was noted that overall equity fundraising by SMEs rebounded rapidly after an initial decline following the introduction of non-pharmaceutical interventions, so any impacts may have been relatively short lived.

SECTION 6: COUNTER FRAUD CONCERNS AND RESPONSES

The Counter Fraud Entities and Parties Operating in Respect to the Covid-19 Loan Schemes

- 6.1. Before I discuss how the fraud risks relating to the various schemes were addressed after their launch, in particular with regards to BBLS, I set out here, in relation to counter fraud, a summary of the organisations involved, the capability within BEIS and the responsibilities held by BEIS.
- 6.2. Several organisations and departments had roles and responsibilities in the management of fraud risk in the delivery of the Covid-19 loan schemes. They included BBB, HMT, Cabinet Office and BEIS.
- 6.3. BEIS was the overall policy lead for the Covid-19 business support loan schemes within Government. BEIS was also jointly responsible, with HMT, for ensuring the schemes were delivered as per the ministerial directions and other political instructions provided by ministers, with responsibility for the operational side (e.g. direct interface with lenders) delegated to BBB {GD(B)/386 – INQ000564090}. Similarly, the BEIS Accounting Officer (in practice, the Permanent Secretary) was ultimately responsible for managing the fraud risk of BBLS, as well as the other Covid-19 business support schemes. This was the basis upon which the Accounting Officer sought a ministerial direction to proceed to scheme launch in light of the fraud and other significant risks inherent in the design of the scheme.
- 6.4. Prior to the pandemic, and the implementation of the Covid-19 business support schemes by BBB, the BEIS counter fraud team had two full-time staff advising the Department on counter fraud matters and delivering relevant training. The work of these officials was largely focused on preventative measures to mitigate fraud risk to government grants and related schemes, and other areas of counter fraud incidental to the Department's work. This level of resource reflects the relatively low level of fraud risk and exposure across the Department as well as the reality that, prior to the pandemic, BEIS was primarily a department focused on policy rather than delivery and was certainly not in the practice of delivering large business support schemes in the way that was necessitated during the pandemic. Prior to BBLS, partner organisations handled fraud-prone financial activity, in turn relying on delivery partners (such as bank and non-bank lenders) to apply credit and affordability checks, and anti-money laundering measures.

- 6.5. To ensure clarity on the respective roles, BBB prepared regular risk and compliance reports (referred to as “RACI” reports) clarifying and defining the roles and responsibilities of key government departments and BBB in the management of fraud risk in the delivery of a number of Covid-19 loan schemes {GD(B)/387 – INQ000564104}.
- 6.6. BEIS responsibilities were listed in the RACI report as follows:
- “1. To promote effective counter-fraud measures which support taxpayer interests in line with the Managing Public Money Principles, while ensuring the schemes are delivered as instructed/intended by ministers;*
 - 2. To advise Ministers on the implications of any proposed changes in counter-fraud measures, particularly where they might influence the operation of the schemes, or our relationship with lenders or businesses, and secure agreement as required;*
 - 3. To help co-ordinate work across different partner organisations within BEIS, BBB, Insolvency Service and Companies House, to identify and manage fraud risks;*
 - 4. To help co-ordinate work with other partners outside BEIS, including law enforcement agencies; and*
 - 5. Where new counter-fraud proposals in relation to the schemes have funding implications for BEIS or BBB, to develop business cases as appropriate to secure required approval for spending as required.”*
- 6.7. The RACI report reiterated HMT’s usual specific priorities like spending taxpayers’ money responsibly, creating stronger and safer banks, and protecting both legitimate customers and the economy. It stated that *“[a] Ministerial Board ha[d] been created to focus specifically on the risk of fraud as a result of Covid-19, in particular the risk of fraud against the stimulus measures. EST attend[ed] this board on behalf of HMT and ma[de] decisions alongside CX on any measures being proposed on the loan schemes to future mitigate fraud risks.”*
- 6.8. Cabinet Office led the Government Counter Fraud Function, which involved stewardship of one of a series of functional standards across Government departments that existed prior to the pandemic concerning counter fraud activities. The general mandate of the Counter Fraud Function was ensuring cross-government management of counter fraud and determining compliance by government departments against this

functional standard, through an annual assurance process, supervised by part of Cabinet Office known as the Counter Fraud Centre of Expertise {GD(B)/388 – INQ000563868}. In contrast to BEIS's co-ordinator role during the pandemic, the RACI report set out that Cabinet Office responsibility was a standard setting one, to provide analytics as well as an intelligence support function {GD(B)/389 – INQ000564095}. BEIS and Cabinet Office worked together in a variety of ways. I have summarised the key working groups and their responsibilities below, and then address the work undertaken by BEIS in further detail.

- 6.9. In April 2020, the National Economic Crime Centre (**NECC**)'s Covid-19 Fusion Cell (also known as OTELLO, NECC Fusion or more commonly the Fusion Cell) was established in response to Covid-19 as a public and private information and intelligence sharing joint-initiative that included the NECC, banking sector, UK Finance, and central government departments including BEIS and Cabinet Office {GD(B)/390 – INQ000563977}. Its aim was to create a single picture of Covid-19 related fraud and it operated through a weekly Steering Group call {GD(B)/391 – **INQ000594749** }.
- 6.10. The Cabinet Office Covid-19 Fraud Response Team, set up by the Counter Fraud Function in March 2020, led a working group to bring together lenders, local government and central government intelligence with the aim of understanding the scale of fraud in the Government Covid-19 support programmes and developing a strategic and tactical response {GD(B)/392 – INQ000563891}. It worked with BEIS, the NECC, the National Investigation Service (**NATIS**), and local authorities on identifying cross-sector wide fraud threats in the UK and countermeasures to address them {GD(B)/393 – INQ000563948}.
- 6.11. BEIS also participated in information sharing initiatives following the launch of the loan schemes. The Bank Fraud Collaboration Working Group was developed in May 2020 by BBB and chaired by UK Finance, with Angelina Cannizzaro and the seven accredited lenders at that time (Barclays, Danske, HSBC, Lloyds, RBS, Santander and Virgin Money) in attendance {GD(B)/394 – INQ000596675}. It took the form of weekly meetings between accredited lenders in addition to Cifas and Cabinet Office {GD(B)/395 – INQ000564021}. The purpose was for lenders to share their experiences of the BBLs and fraud related intelligence with the members of the working group to assist with developing good practice, and appropriate mitigation measures.

- 6.12. BBB/BEIS/Cabinet Office-led Covid-19 Counter Fraud Forum was operational from 10 June 2020 and met on a weekly basis. Its Terms of Reference set out that it was intended to provide oversight, challenge and support to the implementation of BBB's Covid-19 support schemes Counter Fraud Measures Plan {GD(B)/396 – INQ000564058}. It discussed items such as the BBB PEAP, the Fraud Analytics Proposal and the RACI report referenced above {GD(B)/397 – INQ000585669}.
- 6.13. The Covid-19 Fraud Ministerial Board was set by Cabinet Office to oversee the response to Covid-19 related fraud. The Board was jointly chaired by Cabinet Office, HMT and the Home Office and held its first meeting on 16 July 2020. Lord Agnew, who acted as co-chair invited the Minister for Business and Industry, Nadhim Zahawi, along with ministers from HMT, DWP, DHSC, DCMS, and the Home Office {GD(B)/398 – INQ000564073} and {GD(B)/399 – INQ000564123}. The Terms of Reference stated that the Board was to coordinate and advise on the response to fraud during Covid-19 with a focus on the public sector. In particular the Board was to; understand fraud and irregularity in the stimulus packages and repurposed grants, review the need for new legislation for public bodies, wider law enforcement and the banking sector to counter fraud in response to Covid-19, review opportunities to increase fraud intelligence sharing, and oversee a 'lessons learned' exercise of the public sector fraud response {GD(B)/400 – INQ000564072} and {GD(B)/401 – INQ000564184}. The Terms of Reference stated that all Departments were to develop a PEAP to set out how they proposed to manage fraud and error, which were considered by the Ministerial Board {GD(B)/402 – INQ000564071}. The Department had a working draft of its PEAP developed by the start of June 2020 {GD(B)/403 – INQ000564051} and completed later in June 2020 {GD(B)/404 – INQ000543254}. The Fraud Ministerial Board then reported to the Covid-19 Ministerial Board, whose remit extended beyond counter fraud activities and who met monthly to monitor how recommendations were being actioned.
- 6.14. The Covid-19 Counter Fraud Strategy Board sat for the first time on 3 November 2020 and then met fortnightly. Its aim was to provide cross-Government coordination to the counter fraud response for BBLS {GD(B)/405 – INQ000564147}. It was composed of representatives from BBB, BEIS, HMT, Cabinet Office, Home Office, HMRC, NATIS and the National Crime Agency (**NCA**).
- 6.15. In addition to these cross-government working groups, the Department worked with government and external organisations with knowledge and expertise of counter fraud prevention and identification, including with the INSS, and Companies House. Further

detail of collaboration with these, as well as external organisations, is described in the following paragraphs.

- 6.16. NATIS, a law enforcement body specialising in financial crime and fraud based within Thurrock Council, was commissioned to support central government in an initiative known as Operation CULVERIN. Developed in conjunction with the Government Counter Fraud Function and BEIS following the launch of the grant schemes, the proposal was for NATIS to investigate and prosecute fraudulent applications for Covid-19 Business Grants (where subsequent payments were made) supported by the Crown Prosecution Service. It later expanded from its original focus on grants to include loans. NATIS is discussed in further detail at paragraph 6.68 and the subsequent paragraphs 6.68.
- 6.17. Cifas, a not-for-profit organisation working to prevent fraud and financial crime, was involved with facilitating the cross-sector sharing of fraud databases, including for instance discussion of Cifas recording of lending data at a Bank Fraud Collaboration Working Group meeting {GD(B)/406 – INQ000596723}. Similarly, the counter fraud response involved PwC who, as detailed below at paragraph 6.22, were instructed to support BBB in understanding the potential fraud risks presented by BBLs.
- 6.18. NCA was, and is, tasked with investigating and prosecuting the most serious fraud cases involving serious or organised crime. It provided intelligence indirectly to BEIS via UK Finance to the Bank Fraud Collaboration Working Group of which BEIS was a member {GD(B)/403 – INQ000564051}.
- 6.19. The National Anti-Fraud Network (**NAFN**), a membership organisation made up of local authorities, with a mission to protect the public interest and based within Tameside Metropolitan Borough Council, received Suspicious Activity Reports (**SARs**) from the NCA. NAFN provided data and intelligence services to support local authorities {GD(B)/407 – INQ000564053}.
- 6.20. UK Finance is a member-based banking and finance trade association. Through its Financial Fraud Panel, it fed intelligence to the NECC Fusion Cell providing a basis for law enforcement to undertake several investigations.

Consideration of Counter Fraud Risks Relating to CBILS and CLBILS

- 6.21. As discussed in Sections 2 and 3, CBILS and CLBILS were built on the established infrastructure, processes, and legal documents of EFG. The accredited lenders were responsible for deciding whether an applicant business was eligible for the schemes

and lending was appropriate. The lenders had delegated responsibility to carry out sufficient counter fraud checks and were still required to follow their standard commercial lending criteria to assess a business' viability, turnover and other eligibility criteria. In addition, the long-established principle (concerning EFG and earlier loan schemes) was that any potential bad debts that were guaranteed by the government should be pursued by the lenders applying their own set of recovery processes, as they would for any amounts owed to them without a guarantee.

- 6.22. However, to ensure the risks of fraud were fully understood, and mitigated where possible, BBB commissioned PwC to carry out an initial fraud risk assessment of the scheme prior to its launch. As set out in the Terms of Reference, on 17 April 2020 PwC confirmed they had been instructed to {GD(B)/408 – INQ000596669}:
- a) Review the existing position of the scheme's operational deployment across UK banks;
 - b) Review the existing operational processes relating to the administration of CBILS applications; and
 - c) Identify potential options which might help increase the rate at which CBIL applications were considered, decisions made, and funds drawn down.
- 6.23. PwC began work on 20 April 2020, while discussions continued to finalise the engagement letter {GD(B)/409 – INQ000543181}.
- 6.24. A business case for a long-term credit guarantee scheme, which would eventually become RLS, dated 15 February 2021, considered lessons learned from previous schemes, including CBILS. It explained that PwC had concluded the residual risk of CBILS was 'high' when assessed against Cabinet Office guidelines {GD(B)/410 – **INQ000609053**}.
- 6.25. On 23 November 2020, BBB also commissioned PwC to undertake fraud analysis work on CBILS and CLBILS portfolios, described as Project Tapestry Phase 1. The overall objective of the project was to assist BBB and BEIS in estimating the potential levels of fraud in CBILS and CLBILS. The results were provided in a report dated 17 August 2021 and based on data as at 23 July 2021 {GD(B)/001 – INQ000596711}. The lender survey received responses from lenders representing a book value of approximately £22 billion. In respect of CBILS, lenders reported low levels of identified fraud with only £19 million having been reported externally as fraud based on the responses to PwC's lender survey (however, this represents responses from lenders only covering

approximately 54.8% of the total book value of lending). It was noted that there were some discrepancies in lender responses and that levels of fraud reported in the survey were likely to change as these discrepancies were resolved. With regard to CLBILS, lenders consistently reported that they expected very low or negligible levels of fraud, and they had not observed any cases of fraud in CLBILS.

- 6.26. On 2 March 2022, BBB commissioned PwC to perform a further analytical review of the entire population of CLBILS facilities to identify those with characteristics that could potentially be indicative of higher risk of fraud or error, described as Project Tapestry Phase 2. The findings of the review were provided in July 2022 {GD(B)/411 – INQ000596712}. The review identified indicators of potential occurrence of fraud or error, however, it said that resulting losses were likely to be limited as they would only arise in the event of CLBILS facilities going into default and, at the time of review (6 March 2022) it was noted that the CLBILS portfolio had very low levels of defaults and arrears.

Levels of Fraud Encountered under CBILS and CLBILS

- 6.27. Following the launch of CBILS, BBB continued to assess and monitor the fraud risks across the Covid-19 schemes and was responsible for undertaking and maintaining the FRA and providing periodic updates to the Board Risk committee. Each FRA included a scheme overview, scoring for particular risks, a detailed assessment of each risk with the likelihood of occurrence, frequency and impact to provide a total risk score. For those residual risks, the FRA set out planned action, prevention and detection measures where relevant. Finally, the FRA stated where risks had been ‘closed’ and gave an assessment of any residual risks.
- 6.28. On 15 February 2021, BEIS officials prepared a business case for a new long term loan scheme which eventually became RLS, covered in detail in Section 8 of this statement {GD(B)/410 – INQ000609053}. The business case explained that the new scheme would have several key features in common with CBILS, with some key differences. The fraud risk for the new scheme was comparable to that for CBILS, rather than BBLs, due to the operational similarities.
- 6.29. In relation to the level of fraud for CBILS, the business case stated:

“The incidence of CBILS fraud or alleged fraud reported to the BBB, either by lenders or other parties, is currently infrequent. Anecdotal evidence suggests that while fraud is certainly being experienced at the application stage,

detection and prevention by lenders is effective, meaning that the level of post-lend fraud experienced by lenders is nominal. We anticipate that the same will be true of the new scheme.”

- 6.30. The residual risk of fraud for CBILS was expected and understood to be substantially mitigated. This was primarily because, “...accredited lenders will always have 20% ‘skin in the game’, but also through the controls and countermeasures established within the scheme rules.” These controls and countermeasures included:
- a) BBB’s accreditation procedure for scheme lenders;
 - b) Relevant scheme legal agreement and obligations;
 - c) Lenders’ appropriate fraud checks (customer due diligence, KYC and AML), credit checks (credit decisioning and credit reference agency) and lenders knowledge of their customers;
 - d) Ongoing obligations under the scheme legal agreement;
 - e) BBB’s Audit assurance programmes; and
 - f) Ongoing lender and scheme portfolio or allocation monitoring control and reporting.
- 6.31. As outlined in Section 1, DBT publishes quarterly updates on the performance of CBILS and CLBILS {GD(B)/006 – INQ000593148}. As of 31 December 2024, lenders had flagged £60 million of the £25.83 billion of CBILS drawn value as suspected fraud. Of the £940 million total settled amount, £20 million had been paid out to lenders against loans with a suspected fraud flag. Lenders had not flagged any CLBILS loans subject to the guarantee as suspected fraud.

Fraud in Respect of BBLs

- 6.32. BEIS worked closely with BBB on counter fraud measures, relying heavily on their capability to manage the BBLs anti-fraud programme with lenders {GD(B)/412 – INQ000564062}. The self-certifying design of BBLs, with the objective of distributing finance within 24-48 hours, represented a significant shift in the Department’s fraud risk and exposure, and reflected the extraordinary circumstances of the Covid-19 crisis in attempting to provide finance to businesses unable to benefit from CBILS. As detailed in the table in paragraph 1.5, as of 31 December 2024 lenders had flagged £1.88 billion of the £46.52 billion of BBLs drawn value as suspected fraud {GD(B)/006 – INQINQ000593148}. For BBLs, £1.56 billion has been paid out to lenders against

loans with a suspected fraud flag. Of note, however, is the 'front-loading' of fraud encountered within BBLs. In the first week of operation, 268,000 loans were approved, totalling £8.4 billion. By 4 June 2020, having been in operation for a month, the scheme had seen 699,000 loans approved, totalling £21.3 billion. As of 18 October 2020, 1,336,320 loans had been approved worth £40.2 billion. Accordingly, a significant proportion of the total fraud that occurred may have already occurred by the time the more effective countermeasures were able to be introduced.

- 6.33. In June 2020 and throughout the pandemic, BEIS officials were involved in supporting the detection of fraud in BBLs {GD(B)/389 – INQ000564095}. The team provided policy advice and oversight of the counter fraud work, on behalf of Ministers, in relation to the operation of the loan schemes. BEIS officials undertook further activities aimed at fraud prevention and detection as discussed below beginning at 6.43.
- 6.34. As set out above, BEIS and BBB were also supported by external consultants. On 1 June 2020 PwC prepared an addendum to their report {GD(B)/413 – INQ000594764}. BBB had instructed PwC to prepare the additional report to support it in understanding and articulating, based on the views of the lenders, the experiences of BBLs to date and possible improvements in fraud controls. PwC held another workshop with the lenders on 6 May 2020, at which time Cifas presented a proposal about assisting the lenders to identify multiple applications across different lenders. See an update from BBB to BEIS and HMT officials from 9 May 2020 for further details {GD(B)/414 – INQ000564013}.
- 6.35. Following this workshop, between 11 and 13 May 2020 PwC held meetings with each lender to explore their experiences further, consider ongoing improvement plans and obtain their thoughts on the Cifas proposal. On 13 May 2020, PwC hosted a follow up workshop, which Starling Bank also attended, having recently become an accredited lender {GD(B)/415 – INQ000596674}. A separate meeting was also held with Starling Bank on 15 May 2020 {GD(B)/394 – INQ000596675}. The discussions from these workshops were collated and summarised in the addendum to the PwC report and are set out below.
- 6.36. The addendum to the PwC report stated that all lenders were in favour of proceeding with the Cifas proposal to assist them in identifying multiple applications across lenders, but they identified a number of issues to be addressed, including but not limited to:

- a) Lenders were accessing the Cifas database through different means e.g. credit agency searches, direct access APIs or through fraud tools. It was considered that for the Cifas proposal to be successful, all access mechanisms would need to be considered;
- b) Some lenders considered that the utility of the Cifas proposal was time limited, as the majority of applications had already been made by their customer base;
- c) Operational matters, such as the uploading of application data and turnaround time to receive any potential matches. Lenders were concerned that to meet the requirements of the scheme, the funds may have already been paid and it would be difficult to recover the funds after that time; and
- d) What action the lenders should take when the Cifas system flagged multiple applications.

6.37. PwC's 1 June 2020 report stated that as at 28 May 2020, the Cifas proposal was in the process of being implemented with the focus being to prevent future occurrences of multiple applications, although the data could also be used to identify historic multiple applications. The consensus among the lenders was that this was useful, but there were unresolved issues about the backward-looking capabilities of the Cifas system.

6.38. Key themes common to all the lenders were:

- a) Multiple applications – several lenders reported that they had identified over 1,000 instances of multiple applications. The lenders had been investigating the causes of multiple applications including whether they were a result of fraud;
- b) Cifas referral rates – most lenders reported Cifas referral rates in the region of 2%-5%. Of those referred for further investigation, approximately 5%-10% had been declined for potential fraud;
- c) Actual fraud identified – lenders considered it was too early in the life of the loan scheme to have a clear view on where fraud was occurring, but there was some anecdotal evidence provided of applications being denied for suspicious applications. However, with the passage of time, specific fraudulent attacks were being identified which targeted a number of lenders and had the characteristics of organised crime. One example, involving multiple lenders, related to motor vehicle businesses and their business current accounts. Many

of the lenders advised PwC that there was a tension between the BBLs objective of delivering funds quickly, and effective mitigation of fraud risk;

- d) Inactive account fraud controls – some lenders were incorporating checks on account activity during the application process and some had identified inactive accounts applying for BBLs that would be further scrutinised before any funds would be issued;
- e) Timing – several lenders confirmed that they could significantly enhance their anti-fraud processes if the BBLs rules were to be amended to allow drawdown to take place within 48 or 72 hours. This would have allowed for additional checks and enhanced the effectiveness of multiple application controls such as the Cifas proposal;
- f) Fraud checks on data not requiring customer outreach – PwC noted lenders' inconsistent approaches regarding using information already in their possession that may have indicated a potentially fraudulent application, such as a business current account that did not reflect the claimed turnover. However, some lenders informed PwC that they understood that they could not make use of that information for anti-fraud purposes and decline applications on that basis anyway;
- g) Transaction monitoring – the lenders considered their transaction monitoring controls operating over the accounts into which the loans were drawn down. The lenders had identified examples of funds being immediately paid away to purchase vehicles, fund gambling or investments which were not purposes consistent with the objectives of the BBLs or the self-certification that the funds would only be used to provide an economic benefit to the business. Whilst there was no obligation under the scheme on the lenders to identify these behaviours, there was no consensus on how to approach the issue once identified; and
- h) Emerging issues – one lender highlighted that its Financial Intelligence Unit was reporting significantly increased trading of Business Current Accounts on the Dark Web. PwC reported that Cabinet Office were considering the issue at the date of the report.

6.39. The following enhancements were proposed by lenders:

- a) For lenders accepting applications from Personal Current Account holders, a service provided by HMRC in respect of mortgage applications called the

Mortgage Verification Scheme could enhance the anti-fraud controls for Personal Current Account holder applicants. The report does not provide any further information about this scheme or how it could be used for BBLs;

- b) Customer awareness controls to address the susceptibility of the financially vulnerable to fraudsters and scams; and
- c) Greater industry information sharing to assist in the combatting of fraud, but there was no consensus on how this could be achieved.

6.40. In addition to this work, BEIS established close links with the Cabinet Office Counter Fraud team to monitor indications of fraud. Between May and July 2020, they were alerted to 2,000 suspicious activity reports (**SARs**) relating to Covid-19 business loan schemes, this was rising as a proportion of total national reports (from 2% in May to 8% in June) {GD(B)/416 – INQ000065188}.

6.41. From June 2020 meetings between the Cabinet Office Counter Fraud Team, BEIS Counter Fraud Team and BBB started taking place on a weekly basis through the o {GD(B)/417 – INQ000585658}.

6.42. In June 2020, BEIS also began working to establish the BFAB. A BEIS initiative, it was initially set up to “...provide senior oversight and challenge on the four BBB delivered Covid-19 debt schemes”. As the schemes had been established at pace and represented major financial interventions, they inevitably came with significant risk for BEIS as the responsible department, particularly in relation to potential losses from default and fraud. BFAB sought “...to bring together a set of senior experts from across the Department...with a particular focus on finance, risk and performance” {GD(B)/418 – INQ000564083}. Officials who did not have executive responsibility for any elements of the schemes were deliberately included to provide independent challenge and fresh perspectives. BFAB was comprised of representatives from the Government Actuary’s Department (**GAD**), UKGI, and directors of different teams within BEIS. The first meeting took place on 30 July 2020 and the intention was for BFAB to look ahead to upcoming issues and events such as scheme closures and repayments as well as fraud risks {GD(B)/419 – INQ000564084}. The initial draft Terms of Reference dated July 2020 set the Board’s objectives including to monitor risk in the Department’s current operation, determine an appropriate external assurance programme, and inform recommendations to Ministers on the loan schemes {GD(B)/420 – INQ000564085}. The BFAB was a second line of assurance beyond BBB’s governance and ensured risks and issues were appropriately considered by BEIS

senior officials. As set out in more detail below in Section 10: Lessons Learned, there were a number of learnings from the set up and design of the BBLs and other loan schemes, however, the BFAB was a useful mechanism for BEIS officials to monitor these risks. In September 2020, its remit expanded to include the grants schemes and Trade Credit Reinsurance schemes {GD(B)/421 – INQ000585827}.

Initial Activities Aimed at Fraud Prevention

Duplicate Applications

- 6.43. Following the launch of BBLs, action was taken to identify multiple applications from borrowers. As discussed earlier, in a submission to the Secretary of State on 28 April 2020 concerning BBLs scheme design, officials identified that early analysis suggested it would “...*not be possible to fully mitigate the risk [of fraud] given the imperative that applications are dealt with quickly and with minimal checks by lenders and no checks across lenders*” {GD(B)/200 – INQ000585602}. The risk of multiple duplicate applications being filed with different lenders was also highlighted as a key risk by PwC’s Fraud Risk Review of BBLs, recognising that while lenders were considering approaches to prevent this, it would not be solved prior to the launch of BBLs {GD(B)/004 – INQ000585607}.
- 6.44. By 13 May 2020, BBB, lenders, and BEIS officials had identified that duplicate applications were an issue and were working with Cifas on a project to build new functionality into Cifas’ Fraud Investigation Database. Cifas built extra elements into their system to allow automatic detection of previous applications as part of fraud checks. It would be immediately available for banks to use, as they already had a connection with Cifas. It was explained that Cifas’ IT constructor estimated ‘*a build time of up to 3 weeks.*’ {GD(B)/422 – INQ000543218}. The team considered ways to speed up this process, but the process did result in a delay in getting the duplicate system set up.
- 6.45. The Cifas system was intended to flag where an applicant for BBLs had already applied or been accepted by another lender as the accredited BBLs lenders did not have a detection system in place. Lenders were asked to send data to Cifas to assist with understanding the scale of duplicates {GD(B)/423 – INQ000585650} and {GD(B)/424 – INQ000596676}.
- 6.46. Draft guidance on the initiative was circulated to the Bank Fraud Collaboration Working Group on 20 May 2020 {GD(B)/423 – INQ000585650}. In these emails Cifas explained

that early analysis had already demonstrated a reasonable volume of duplicate loan applications in terms of matches on company name, email address and bank account details.

- 6.47. The duplications functionality was launched on 2 June 2020 and discussed at the Bank Fraud Collaboration Working Group meeting on 3 June 2020 where it was highlighted that levels of duplicate email addresses and multiple applications were higher than expected {GD(B)/425 – INQ000594750}. Database results were to be shared and monitored on a weekly basis via the Working Group {GD(B)/404 – INQ000543254}.
- 6.48. Officials submitted advice to the Secretary of State on 11 June 2020 providing an update on fraud within BBLs and made several recommendations to prevent multiple application fraud {GD(B)/426 – INQ000576399} and {GD(B)/427 – INQ000564055}. In a summary of the 8 July 2020 Working Group meeting, Cifas confirmed that:
- a) The BBLs duplicates list had been circulated;
 - b) There were now 1.2 million records in the duplicate search facility from 15 lenders; and
 - c) A Cifas analysis exercise was underway and would be completed within the following three weeks {GD(B)/406 – INQ000596723}.
- 6.49. Following a Cifas duplicate application check, where lenders were presented with an alert flag, they were to contact the BEIS counter fraud department {GD(B)/223 – INQ000564245}. From 1 September 2020, further fraud reporting protocols were agreed and mandated and “...a requirement was introduced to report prevented fraudulent applications and detected fraudulent loans. For the latter category any Recoveries on such facilities [were] also to be reported” {GD(B)/214 – INQ000543201}.

Post Event Assurance Plans

- 6.50. On 18 May 2020, government departments, including BEIS, were instructed by Cabinet Office to develop PEAPs related to their Covid-19 stimulus spend {GD(B)/428 – INQ000543227}. The delivery of the PEAPs was to provide assurance to the Covid-19 Fraud Ministerial Oversight Board that departments were taking appropriate actions to ensure fraud was detected, prevented, and recovered {GD(B)/429 – INQ000585666}. The Department developed a working draft of the action plan by the start of June 2020 to cover all the loan schemes and updated it when additional information was required {GD(B)/430 – INQ000543245} and {GD(B)/403 – INQ000564051}.

6.51. By 11 June 2020, BBB's activities aimed at fraud prevention for BBLs, included the following {GD(B)/427 – INQ000564055}:

- a) Running weekly workshops with the lenders, UK Finance, and government officials to obtain feedback on fraud experience, best practice, and possible industry wide solutions;
- b) Instigating a voluntary Cifas solution, with all current lenders committed to taking part, to reduce multiple application fraud as discussed above at 6.45 and 6.45;
- c) Engaging with Cabinet Office and the National Fraud Initiative to provide a bespoke fraud data matching solution, which looked to identify fraud from a number of data sources across Covid-19 schemes;
- d) Instructing PwC to conduct a post-implementation review;
- e) Developing plans for PwC to co-ordinate further information gathering and identify and build further measures that could be put in place; and
- f) Commencing procurement for auditing scheme lenders.

6.52. Despite these actions aimed at fraud prevention, the Department continued to receive intelligence on actual, and anticipated, fraud under BBLs. On 16 June 2020, the Covid-19 Programme Board met to discuss updates and programme risks in respect to a range of programmes within the Department. Papers prepared for this meeting identified as a cross programme theme the *"...increase in the reported risk around fraud due to pressure on delivery partners and speed of checks."* It was stated that mitigations were in place, and this was being closely monitored {GD(B)/431 INQ000538911} and {GD(B)/432 – INQ000564060}. There was a risk that BEIS would be exposed to high levels of fraud when delivering financial support schemes and key mitigating actions were identified, including:

- a) Working with UK Finance and lenders to improve process. BBB had been allocated an additional £5 million by HMT in May 2020 to upscale their accreditation resource from two to 25 staff to deal with the increase in loan applications and its capacity to process them {GD(B)/433 – INQ000564024}.
- b) Loss estimates were to be reviewed at regular review points – proposals included introducing a new BEIS Assurance Board (**BFAB**) to provide regular scheme review checkpoints and independent challenge {GD(B)/434 –

INQ000564087}. BFAB was established in July 2020, and its first meeting took place on 30 July 2020.

- c) Graduated risk-based approach to lender accreditation – new lenders were riskier because they were less experienced with the schemes and potentially had less proven credit risk models. While everyone had to be accredited, it was sensible to take a risk-based approach rather than undergoing the same process regardless of their familiarity with the schemes.
- d) Commissioning PwC to prepare the fraud risk report for BBLs including the creation of minimum standards. This was finalised on 1 May 2020.
- e) Anti-fraud measures had been built into the scheme portal designed by PwC, using third-party validation.
- f) Beginning a programme of anti-fraud workshops with lenders and BBB to address residual issues. On 27 April 2020 the first fraud workshop convened by BBB took place. Seven different lenders attended to discuss risks and mitigation. Weekly workshops hosted by BBB followed, attended by the Department and Cabinet Office and all participating lenders for workshops that took place in May 2020 {GD(B)/435 – INQ000564050}.

6.53. On 19 June 2020 Rich Wentel (Deputy Director, Data Analytics and NFI, Cabinet Office Counter Fraud Centre of Expertise) highlighted to Gemma Peck that a Fusion Cell meeting that day had discussed the high likelihood that BBLs would be targeted by Organised Crime Groups {GD(B)/436 – INQ000564063}. He commented that:

“[t]he banks are beginning to see the same accounts (mule accounts) receiving funds from ... BBL[S] before moving funds offshore, into private accounts or into criminal property ... From a banking perspective they are seeing significant risk in the BBL[S] with over 300 SARs (Suspicious Activity Reports) being logged by the banks this week on top of 270 last week. Even if the only frauds being seen were these (and assuming all BBL[S] payments were £50k), then this alone could represent a fraud loss to Organised Crime of £28.5 million. Any investment into the investigation of these cases would be tiny in comparison but would demonstrate a real strength in your response.”

6.54. A Bank Fraud Collaboration Working Group threat log circulated prior to a meeting of the group on 24 June 2020 identified a series of associated fraud risks with CBILS and BBLs applications {GD(B)/437 – INQ000596683}:

- a) Application Fraud where a legitimate business applies for a CBILS or BBLs loan and has no intention to repay;
- b) Multiple applications for CBILS/BBLs by an organisation either within one financial institution or across multiple institutions;
- c) Applications where a new business account is specifically opened to request a CBILS/BBLs;
- d) Impersonation/third-party fraud where fraudsters impersonate a legitimate customer to make a fraudulent CBILS/BBLs application;
- e) Account takeover and/or misuse where an account is taken over by fraudster to receive funds and/or accounts in receipt of a loan are traded on the Dark Web;
- f) False claims where a loan is received into a mule account, and funds are then paid out. False fraud/dispute claims are then raised by the account holder;
- g) False turnover provided by an applicant to receive a maximum loan pay out; and
- h) Director taking a loan and then liquidating the company.

- 6.55. Over the weeks that followed mitigation strategies were implemented to handle some of the risks presented. For example, multiple applications were mitigated by data sharing with Cifas to alert institutions to duplicate applications {GD(B)/438 – INQ000596687}.
- 6.56. On 8 July 2020 Cabinet Office confirmed it was working with Companies House to identify directors who had become new directors for more than five companies since early May 2020. The initial data indicated that this applied to about 1400 companies. Companies House had provided this data to BBB and it appeared that there were at least 50 companies amongst these that had received funding under BBLs {GD(B)/439 – INQ000585665}.
- 6.57. On 10 July 2020, BEIS officials provided a submission to the Secretary of State with an update on fraudulent activity in the loan schemes that had been committed since May {GD(B)/416 – INQ000564114}. The submission set out that the loan schemes were developed at extreme pace, prioritising quick access to finance over lenders' capacity to identify and block fraudulent applications particularly for BBLs. In some cases, there had been a necessary trade-off between distribution of loans and fraud

prevention activity. As expected, BEIS was seeing increased evidence of attempts to defraud the schemes. Estimated levels of fraud in respect to CBILS, CLBILS and BBLs was between 0.1 and 10% of spend. BEIS's work with the Cabinet Office Counter Fraud Team was highlighted and it was reported that since May there had been 2,000 SARS, rising as a proportion of total national reports (from 2% in May to 8% in June). Intelligence showed four broad categories of potentially fraudulent activity:

- a) Fraudulent applications by directors of companies not trading;
- b) Loans lawfully acquired but not used for the reasons declared;
- c) The use of 'phoenix'¹⁸ companies and applicants fraudulently obtaining loans knowing a company will not be sustained; and
- d) Fraudulent applications where applicants have dishonestly misrepresented their turnover or company performance to qualify for the loan.

6.58. The submission explained that BBB had implemented measures to weed out fraudulent applications and confirmed the Department's intention to provide specific guidance on measures lenders should take to recover funds where they knew or suspected that fraud had occurred.

6.59. To tackle low to medium severity fraud BEIS were working closely with other government agencies, such as the INSS. The submission indicated that, subject to business case approval, for more serious cases, it was expected that NATIS would undertake criminal investigations on behalf of BEIS and lenders. A BEIS memorandum of 24 June 2020 proposed that NATIS could lead on receiving, evaluating and delivering operations to tackle the four categories of fraudulent activity listed above at paragraph 6.57 {GD(B)/440 – INQ000596684}. After internal deliberation on how to present the business case to HMT, ongoing email correspondence with HMT officials, and revisions made to the NATIS proposal (including developing separate loans and grants proposals), eventual CST sign-off took place on 3 August 2020 at which point the BEIS Commercial Team began developing the Service Level Agreement with NATIS {GD(B)/441 – INQ000543300} and {GD(B)/442 – INQ000564093}. This was signed by BEIS and NATIS by 22 September 2020 {GD(B)/443 – INQ000564105}. Further detail on the work with NATIS is set out at paragraphs 6.68 to 6.82, below.

¹⁸ A company created after buying out the assets of an insolvent company while in administration.

- 6.60. By mid-July 2020 the INSS was developing proposals to support BEIS with fraud cases of medium severity {GD(B)/444 – INQ000564081}. INSS was considered likely to offer support with two kinds of cases:
- a) Newly insolvent companies: where fraudsters entered companies into insolvency having recently taken out a BBL; and
 - b) Live companies not genuinely running business: where fraudsters produced false bank accounts for the purpose of obtaining goods on credit. This often involved using stolen identities or paying front men/women to act as stooge directors.
- 6.61. On 24 July 2020, the INSS indicated that it could look at Covid-19 fraud cases involving activities in which it was already routinely engaged. However, it indicated that if the number of referrals exceeded the business as unusual amounts, it would need to re-prioritise resources and/or seek additional funds and specialist staff. The lack of detail on the numbers or types of Covid-19 fraud cases meant that it could not provide a meaningful casework bid for the resources needed at that time. It was able to assist on appropriate data analysis, lines of investigation and likelihood of success in civil or criminal litigation. BEIS officials therefore considered that the Department should develop a more detailed understanding of the resources required, and then re-engage with INSS {GD(B)/445 – INQ000564110}. Later correspondence with INSS on 5 August 2020 indicates that at that stage the position had not changed, and that INSS found it difficult to quantify how it could assist without some indication of the numbers and complexity of the cases likely to be involved {GD(B)/446 – INQ000576394}.
- 6.62. At a BEIS meeting on 7 October 2020, officials updated the Secretary of State on fraud in BBLs {GD(B)/447 – 6.62}. BEIS officials were focussing on expanding their approach across ‘tiers’ of fraud and considered seeking assistance from INSS. At the meeting, the Secretary of State had “...requested a programme of ambitious, costed proposals for enhancing our counter-fraud work.” {GD(B)/448 – INQ000585688}.
- 6.63. Development of policy involving a role for INSS was also influenced by an understanding that “[Cabinet Office] and [Home Office] Ministers (as well as the NECC) ha[d] complained strongly to HMT and BEIS Ministers that they [we]re not doing enough to tackle fraud in HMG’s flagship but high risk £40 bn Bounce Back Loan Scheme” {GD(B)/449 – INQ000585684}.

- 6.64. In a submission dated 8 October 2020 (discussed in detail at paragraph 6.85), BEIS officials recommended funding the INSS to investigate suitable cases where the INSS, rather than other bodies, had the relevant expertise {GD(B)/450 – INQ000543382}. There would be some benefits in terms of direct return to BEIS but also much wider benefits relating to boosting public confidence that fraudsters and directors who had committed misconduct would face the appropriate justice. The estimated costs were £1 million in 2020 to 2021 and £4 million in 2021 to 2022.
- 6.65. The Secretary of State met with BEIS officials on 15 October 2020 to discuss proposals for enhancing the counter fraud response in BBLs. In relation to the INSS, a briefing for the meeting, prepared by BEIS officials for Gemma Peck and Kim Humberstone, stated:
- “[The INSS] already have powers to apply civil sanctions and prosecute offences. With funding of approx. £5 million, we advise the Insolvency Service could pursue mid/low-tier fraudsters and demonstrate they will face the appropriate justice. However, there will be limited VFM in terms of direct returns to BEIS because of the constraints on the civil courts.”* (Original emphasis)
{GD(B)/451 – INQ000564195}
- 6.66. The meeting with the Secretary of State on 15 October 2020 and the work leading up to it is addressed further at paragraphs 6.83 to 6.98 below.
- 6.67. The following day, Laurence Pawley emailed David Raw confirming that the Secretary of State had asked the Department to *“[f]und the Insolvency Service to offer a mid tier enforcement facility, with the options to scale up further in future years based on results”* {GD(B)/452 – INQ000564121}. This was confirmed at a BFAB meeting on 21 October 2020 {GD(B)/453 – INQ000538876}.

The Decision to Work with National Investigation Service (NATIS) and the Process for Formally Instructing them on the Counter Fraud Work

- 6.68. In May 2020, NATIS and NAFN (Data and Intelligence Services) were engaged by BEIS to respond to reports that the Covid-19 grant schemes were subject to fraud. This work became known as Operation CULVERIN {GD(B)/454 – INQ000585657}.
- 6.69. Operation CULVERIN was conceived originally to investigate fraud into the following government support schemes which are addressed in more detail in Part C:
- a) Small Business Grant Fund;

- b) Retail, Hospitality and Leisure Grant; and
 - c) Local Authority Discretionary Grants Fund {GD(B)/455 – INQ000585656}.
- 6.70. When it became clear the Department would have to outsource or contract other organisations or bodies to assist with intelligence and investigations relating to potential BBLS fraud, the Department discussed NATIS providing investigative services in relation to BBLS {GD(B)/412 – INQ000564062}. Due to the subject matter, the Department was restricted to working with entities that were sufficiently authorised and accredited by the Proceeds of Crime Act 2002 (**POCA**). Given these requirements, private organisations and employment agencies were unable to provide staff (unless these staff were to be employed directly by the Department), and the pool of authorised organisations with the desire to offer their services to external bodies was very limited¹⁹. NATIS was therefore likely to be considered the only viable alternative organisation to provide these services at the time {GD(B)/456 – INQ000585655} and {GD(B)/455 – INQ000585656}.
- 6.71. On 19 June 2020, Rich Wentel emailed Gemma Peck noting the lack of BEIS and BBB investigative resources to undertake criminal investigations. He identified the suitability of NATIS to assist with the extended Operation CULVERIN investigative work given its policing capabilities and involvement in investigating fraud against the grant schemes {GD(B)/457 – INQ000564061}.
- 6.72. In a further reply on the same day, Rich Wentel reiterated NATIS as a viable option for consideration, noting in particular NATIS' capabilities for investigations, and the utility of intelligence obtained by NATIS even where criminal investigations were not progressed {GD(B)/436 – INQ000564063}.
- 6.73. By 22 June 2020 conversations about expanding Operation CULVERIN to include loans had begun between the Cities and Local Growth Unit, BBB, the Counter Fraud Centre of Expertise and BEIS {GD(B)/458 – INQ000585660} and {GD(B)/459 – INQ000564065}.
- 6.74. Formally engaging NATIS took some time. As described later, in a briefing for the Permanent Secretary as Accounting Officer, work began on the NATIS contract as

¹⁹ The authorisation requirements under the Proceeds of Crime Act 2002 are set out at The Proceeds of Crime Act 2002 (References to Financial Investigators) (England and Wales) Order 2015. An earlier version of this order was in force at the time NATIS was engaged, later amended by The Proceeds of Crime Act 2002 (References to Financial Investigators) (Amendment) (England and Wales) Order 2021 on 28 June 2021.

early as June 2020, but it took time due to the novel and contentious nature of the procurement. {GD(B)/460 – INQ000128460}.

- 6.75. From the beginning of July 2020, discussions were ongoing between BEIS and HMT as to where the funding would come from and who would be responsible {GD(B)/461 – INQ000585664}. Whilst awaiting confirmation from BEIS as to funding and approval, NATIS commenced a discrete investigation into an instance of identified possible BBLs fraud to demonstrate their capabilities and assist with any funding proposals {GD(B)/462 – INQ000564067}. Gemma Peck, in internal BEIS correspondence, recognised the vulnerability of this position and the exposed position BEIS was in by “...not having any intelligence gathering, investigation and prosecution capacity formally in place for BBLs.” {GD(B)/463 – INQ000564079}.
- 6.76. On 15 July 2020, the Covid-19 Programme Board met again to discuss financial exposure and fraud posed by the business grant and loan schemes. In advance of this meeting, BEIS prepared a summary of the top risks and mitigating actions undertaken with respect to the loans and grants schemes {GD(B)/464 – INQ000538858}.
- 6.77. BEIS officials explained the resource constraints within the Department which meant they could not do all they would like in relation to loan recovery {GD(B)/465 – INQ000538858}. The meeting slides stated that BEIS was undertaking actions across prevention, intelligence gathering, risk assessment, investigation, and recovery to manage the fraud risks but did not have the resources “to mitigate or respond to all the financial risks”.
- 6.78. On 16 July 2020, Tom Taylor (Co-Director, Finance and Portfolio & Chief Financial Officer, BEIS) gave approval to proceed to engage NATIS. HMT highlighted issues on BEIS’ draft business case concerning CO/BEIS’s wider fraud mitigation plans and how the plan interacted with the other Covid-19 schemes {GD(B)/466 – INQ000564080} and {GD(B)/467 – INQ000564082}. A revised proposal was therefore submitted on 28 July 2020 reflecting a proposed second year of funding, and a wider ambit for NATIS to investigate fraudulent activity across the schemes including the BBLs {GD(B)/468 – INQ000564088} and {GD(B)/469 – INQ000564086}.
- 6.79. In early August 2020, the Chief Secretary to the Treasury approved the business case from BEIS, albeit with an expectation that the funding would be drawn from the existing £5 million budget for Covid-19 related operating costs {GD(B)/470 – INQ000564089} {GD(B)/471 – INQ000564091}. NATIS accepted a proposal to provide these services from the Department on 18 August 2020 (pending agreement to cover personnel and

software costs of approximately £750,000) {GD(B)/472 – INQ000564092} and {GD(B)/473 – INQ000596686}.

- 6.80. By way of an agreement dated 21 September 2020, NATIS's role was defined as *“leading the national operation to identify and respond to fraud identified in the COVID-19 loan schemes...”*. It was also to pursue identified criminality applying criminal and civil sanctions, and use its statutory powers to prevent dissipation of criminally obtained property and recover losses from fraudulent use of the schemes {GD(B)/443 – INQ000564105}.
- 6.81. BEIS contracted NATIS to lead on identifying and minimising potential losses through investigations for the most serious cases of fraud, such as those with links to organised crime {GD(B)/474 – INQ000564124}. NAFN was also involved, providing assistance by collating intelligence and passing it on to NATIS {GD(B)/475 – INQ000564075}. NATIS worked alongside senior officials from across government (BEIS, HMT, Cabinet Office and Home Office) and other interested parties such as BBB, HMRC and NCA on the Counter Fraud Strategy Board. The Bank Fraud Collaboration Working Group was established, and meetings were held weekly during which updates were given by NATIS on the work they were completing.
- 6.82. At the 2022 Spring Statement, the Department secured additional funding for NATIS and BBB to target abuse of BBLS. This funding enabled NATIS to increase its investigative capability and establish a unit targeting higher volume but lower value fraud whilst the core investigations continue to target high value fraud involving organised crime.

Enhancing Counter Fraud Measures – October 2020 onwards

- 6.83. I have referred at paragraph 6.62 above to the meeting on 7 October 2020 at which the Secretary of State had instructed BEIS officials to produce, *“... ambitious, costed proposals for enhancing our counter fraud proposals in relation to Bounce Back Loans. This was to include radical proposals that we might not necessarily recommend but would demonstrate what we **could** do if ministers wished and there was funding”* (Original emphasis) {GD(B)/451 – INQ000564195}.
- 6.84. At this time, the following fraud prevention measures had been implemented {GD(B)/476 – INQ000596704}:

- a) The Cifas database of loan applications used by all accredited lenders to identify and prevent multiple application fraud (seeking multiple loans from different lenders);
- b) The 'Change in Director Flag' launched on 15 July 2020 to identify previously registered companies (before 1 March) that were inactive and had been subject to a director change since the BBLs was launched;
- c) Lenders performing KYC and AML checks when reviewing all loan applications including use of a reputable fraud bureau to screen against potential or known fraudsters;
- d) Weekly fraud workshops with all accredited lenders to discuss the nature and scale of fraud, share intelligence and discuss mitigations. These were hosted by BBB with Cabinet Office representation;
- e) Lender reporting – BEIS commissioned BBB to set up monthly fraud reporting via lenders to gather data on prevented fraud, discovered losses, recovered fraud and errors;
- f) BEIS had been working with Cabinet Office to develop a fraud analytics programme which matched data on BBLs applications to date from across government to identify suspicious applications for further investigation;
- g) Cabinet Office fraud hotline, launched on 12 October 2020. The hotline was run in conjunction with Crime-Stoppers and the public could report fraud in relation to the Government's support schemes. Intelligence from the fraud hotline was triaged by Cabinet Office and provided to BEIS/NATIS;
- h) In May 2020, following PwC's pre-scheme launch work to assess the risks of BBLs, BBB completed an FRA to identify vulnerabilities of BBLs to fraud. The FRA was regularly reviewed and updated; and
- i) NATIS operated as BEIS' primary vehicle to investigate and pursue serious and organised crime fraud in respect to BBLs. At this point NATIS had £1.2 million of funding for 40 full-time officers in the 20/21 financial year; HMT was developing a framework for how government would approach loan repayment recoveries once lenders made a claim on the government's guarantee; the Insolvency Service was identified as potentially being able to assist BEIS in investigating and prosecuting mid/low tier fraud.

- 6.85. Officials scheduled a meeting with the Secretary of State for 15 October 2020 to discuss their response to the Secretary of State's instruction to produce further proposals. Ahead of that meeting, the proposals that had been worked up by officials were provided to the Secretary of State in a submission dated 13 October 2020 {GD(B)/477 – INQ000543381} and {GD(B)/450 – INQ000543382}. The submission explained that an operating model had been developed which prioritised activity within the 'Top Tier' which involved organised crime groups. This had been the focus to date given the public interest in investigating and prosecuting these criminals, although it was noted that it could be harder to recover funds in such cases due to money laundering or other means through which funds were made inaccessible at pace.
- 6.86. The submission explained that the design of BBLs, which stemmed from the original policy objective to prioritise pace and simplicity of applications, meant it was inherently vulnerable to fraud. PwC had been engaged to review a large sample of loans to produce a statistically valid estimate of the scale of fraud. However, by scheme design successful fraud would often not be confirmed until after a first loan payment was missed, with the borrower not having to make any repayments for the first 12 months, meaning it would be a challenge to identify the precise scale of fraud for some time. The submission explained that the taxpayer would not be responsible for all fraud losses, as lenders that had not carried out their obligations would not be able to claim on the guarantee. The extent to which BEIS investigated whether lenders had failed in their duties would have a significant impact on the losses borne by the taxpayer. The Government had adopted a "3-pronged" approach to tackling fraud, with counter fraud activity split into three strands: prevention; identification and investigation; and recovery and prosecution. However, despite these extensive measures, the residual risk remained very high.
- 6.87. The submission set out a number of recommendations for enhancing counter fraud measures (at Annex A) and stated that every effective step to tackle fraud should be taken. Nevertheless, there were realities that would limit the overall impact that even an enhanced programme of measures could achieve, given that most fraud is never recovered, particularly for older cases and losses from organised criminal fraud due to limitation periods and monies being moved abroad and split across multiple accounts. There was also limited court capacity with a significant back log of cases in the criminal and civil courts.
- 6.88. The recommendations for enhanced counter fraud measures were as follows:

- a) Improve reporting from lenders – BEIS officials stated in the submission that the Department's intelligence capability was currently hampered by inconsistent use of reporting mechanisms such as SARs and the Cifas database. Officials recommended that Ministers should write to BBL lenders via UK Finance to urgently agree a coordinated industry approach, including an agreement for lenders to share suspected fraud cases with other lenders in the BBLS;
- b) Expediting the conclusion of HMT's recoveries framework – HMT was developing a framework for how government should approach loan repayment recoveries once lenders claimed on the government's guarantee. This was expected to conclude by 30 November 2020, but officials thought it may be possible to finalise the guidance in advance and recommended that the Secretary of State ask HMT ministers to pursue this approach;
- c) A new optional lender fund was proposed – it was envisaged that lenders could access this fund if they wished to increase their fraud investigation capacity. Cabinet Office estimated this could cost approximately £6.3 million. This could mitigate lenders' "*historic reluctance to dedicate more resource to investigating fraud*". The option did carry some risk of State aid to lenders which would need to be assessed however, officials recommended that BBB be asked to develop a proposal;
- d) Expanding the BEIS Counter Fraud team – officials recommended that three to five new staff would enable the Counter Fraud team to comprehensively focus on workstreams of central coordination, prevention, triage and reporting. Officials further proposed approximately five other staff, with capability in investigations, to focus on triaging intelligence coming in to the Department from external sources including lenders and law enforcement;
- e) "*Nudge*" communications to businesses – officials set out that HMRC had found that a combination of nudge letters followed by a period of amnesty, encouraging those who have overclaimed to repay without penalty, was the "*single most effective*" measure in recouping funds and recommended targeting around 10,000 mid-and bottom-tier cases. It was noted that one-off letters would not always incentivise action;
- f) Civil litigation – to complement the 'nudge' programme, officials recommended the use of civil litigation in cases where lenders had attempted and failed to

recover loan repayments due to suspected fraud. They advised that these cases were likely to be mid-tier fraud and that the precedent for this would be the Department's normal debt recovery processes;

- g) Expediting sampling – officials stated that PwC had been contacted to undertake a “*statistically significant sampling exercise of around 1,100 successful BBLs applications, to identify what proportion of successful BBLs applications are fraudulent*”. PwC had indicated that the initial sample may not be complete until January 2021 and officials recommended increasing funding for the initial exercise by an additional £1 million to enable PwC to expedite this work for completion in 2020. Expediting the process would mean the Department had better information to target their counter fraud activities;
- h) Insolvency Service investigations – officials advised that, subject to resources, the Insolvency Service would be willing to take on suitable cases where it had the relevant expertise. They stated that this would increase public confidence that fraudsters would face justice;
- i) Improving Companies House data – officials advised that more investment into Companies House would be an effective preventative measure across multiple frauds, including BBLs. In addition, they advised that the Cabinet Office Data Analytics Programme, discussed in the cross-Whitehall counter fraud projects section, would likely require significant data from Companies House. Officials therefore recommended increased funding for Companies House to develop costed proposals;
- j) Increased funding for NATIS – officials recommended increasing NATIS funding to enable NATIS to investigate mid-tier fraud;
- k) NCA support – the NCA had recently begun supporting BEIS and NATIS with high-priority serious and organised crime cases including using their considerable data exploitation capabilities. The NCA would develop proposals for BEIS if they felt they required investment for further support;
- l) Covid-19 Fraud Taskforce – officials explained that Cabinet Office's spending review bid was seeking HMT funding to develop a Covid-19 Fraud Taskforce to provide expertise and resources to departments across government, including BEIS. If funded, this would be live from April 2021 and departments would be

able to outsource work on sampling, data analytics, intelligence and investigations for mid-tier fraud; and

- m) Deterrent communications strategy – officials updated that BEIS communications would seek to proactively push counter fraud messaging. Officials advised this risked drawing attention to the scale of the fraud already committed, which could result in further negative media coverage and risked undermining other messaging about the positive impact of these schemes.
- n) Cabinet Office planned to launch a Covid-19 fraud hotline on 12 October. Other communications strategies were recommended such as a 'name and shame' list and online videos.

6.89. Annex B to the submission set out “*more radical*” proposals but these were not recommended by officials. These included:

- a) Increasing fraud checks for new applications: officials outlined that this could include explicitly requiring lenders to check self-certifications, mandatory updating of KYC checks for all applicants, confirmation of director status via Companies House, and turnover activity confirmation. The submission stated that many lenders were already performing some, or all, of these activities but that making them mandatory would ensure consistency. Officials advised against this approach, saying that lenders would likely be opposed and HMT would have serious reservations, given that it would be a change to the Chancellor's original steer to have a quick and simple application process. Further, BBB had advised it was unlikely that these changes could be implemented long enough before 30 November 2020 to have a real impact, however, some bodies in government, including Cabinet Office, HMRC and the NCA, had been advocating for increased restrictions to mitigate risk for the remainder of the scheme's duration;
- b) A substantial BEIS counter fraud unit: another approach was to establish a large BEIS counter fraud unit such as that in HMRC for high value, high risk fraud schemes. This was not recommended for various reasons, including because it was said this model would only work when the scheme and data was also administered within the organisation, and due to the fundamental principle agreed between BEIS and HMT that lenders should take all reasonable steps to recover sums owed by borrowers until BBLs debts were reassigned to BEIS; and

- c) New legislative powers: officials advised that BEIS could seek new powers to investigate fraud, like those of law enforcement agencies such as the Serious Fraud Office. This approach was not recommended given they were politically controversial and would require primary legislation.
- 6.90. On 14 October 2020, the Secretary of State's private office indicated that in his view the proposals in the submission did not go far enough {GD(B)/478 – INQ000564118}.
- 6.91. In a briefing prepared for Gemma Peck and Kim Humberstone in advance of the meeting with the Secretary of State on 15 October 2020, officials confirmed they needed HMT support in relation to funding and action by lenders and that the Chancellor took a strong interest in BBLs, particularly changes that might affect speed of loan approvals or increased burdens on lenders. The briefing also pointed out the limits of media campaigns and that they should push back on any such campaigns being led by BEIS giving that "*[c]ounteracting fraud is not our area of expertise as comms unit, but there are other parts of the public sector and law enforcement whose expertise it most definitely is.*" (Original emphasis) {GD(B)/451 – INQ000564195} and {GD(B)/479 – INQ000564119}.
- 6.92. The meeting with the Secretary of State took place as planned on 15 October 2020. The Secretary of State's private office provided a summary of actions from the meeting {GD(B)/480 – INQ000564122}. This confirmed:

"[The Secretary of State] believes we should get going with NATIS and use BEIS funds to demonstrate the level of recovery that can be achieved through NATIS (i.e. for every £1 invested, £7 was recovered); Perm Sec agreed and opined that we should let NATIS know that we will invest more if they can demonstrate impact/results...

[He] asked for data on recoveries from LA grants fraud; he supported the idea of doing a comms campaign to say 'we've cracked down on fraud of LA grants, we're now doing the same for BBLs' – SpAds opined that any comms campaign should be supported by case studies rather than numbers/figures...

[He] asked that we convene a roundtable with the banks, BEIS Perm Sec and EST to discuss the response to BBLs fraud. This has been provisionally scheduled for Mon 2nd Nov – please could the team send up an agenda and detailed attendee list to SpAds PO by COP Monday? This should include HMT and HMRC officials who have an interest in this work.

On mandatory reporting, [the Secretary of State] would prefer to discuss this with the banks rather than mandate it.” (Original emphasis)

- 6.93. Following the meeting, key actions were shared among officials {GD(B)/481 – INQ000564120}. In addition to the points set out above, the notes mentioned that the Secretary of State had stated explicitly that he did not wish to introduce more stringent checks for new applications. In addition to the above, the Secretary of State gave the following steers:
- a) Lessons from BBLs should be taken into account in the new scheme to be launched in January 2021, with implementation of a robust counter fraud response ready for the launch; and
 - b) A BEIS task force should be established by expanding the BEIS counter fraud team to 10 members of staff.
- 6.94. On 19 October 2020, the Covid-19 Fraud Ministerial Board, chaired by Lord Agnew, met to discuss intelligence sharing, international lessons learned and the BBLs Threat Assessment, looking specifically at criminal exploitation of the BBLs {GD(B)/399 – INQ000564123}. The Ministerial Board considered the tension between the “*political imperative of rapid delivery*” and the ability to carry out additional checks which may delay payments. Lord Agnew asked, “[w]hy don’t we do a job properly and get money out a bit later but carry out two or three more checks?” It was commented by HMT that the main challenge was “...*the gap left by the credit check which was intentionally designed out of the scheme at the start for political reasons.*” The point was raised that while urgency was required and understandable at the outset, movement into a different stage of the pandemic should see a tightening up of procedures. The Board requested that HMT and BEIS look at what further checks could be taken on those applying for loans through BBLs.
- 6.95. The Ministerial Board also considered a paper which set out lessons learned from an international perspective following a meeting of the International Public Sector Fraud Forum which consisted of counter fraud experts from the governments of Australia, Canada, New Zealand, UK and US (the ‘Five Eyes’) on 18 August 2020 {GD(B)/482 – INQ000585677}.
- 6.96. BFAB met on 21 October 2020. The papers prepared for the meeting are provided at {GD(B)/483 – INQ000543396} and {GD(B)/453 – INQ000538876}. At this stage, BBB forecasted lifetime losses of between £25 billion and £45 billion across BBB’s pre-

Covid-19 products, the loan schemes and Future Fund. These estimates took into account the extension of BBLs and CBILs, and the overwhelming majority of the estimated loss related to BBLs (between £20.5 billion to £36 billion).

6.97. In an update on fraud efforts at the BFAB meeting, BEIS officials confirmed the Secretary of State, “*categorially did not wish to introduce checks on new loan applications*” (Original emphasis) {GD(B)/453 – INQ000538876}. However, he had approved the following responses:

- a) Establishing a BEIS Task Force which would expand the BEIS counter fraud team to 10, enabling them to more quickly triage intelligence from sources including the Cabinet Office fraud hotline;
- b) Expediting PwC’s data sampling to give more accurate estimates of the scale of fraud, at a cost of £1 million;
- c) Funding for the INSS to offer a mid-tier enforcement facility, with the option to scale up further in future years based on results, at a cost of £1 million;
- d) Developing a counter fraud communications strategy;
- e) Doubling NATIS funding to £2.5 million in 2020/21, with the option to scale up based on results. NATIS had indicated that these funds could double their organised crime unit would require more to expand into mid-tier fraud;
- f) Setting up a round table with BBL lenders to discuss options to further mitigate fraud; and
- g) Supporting Cabinet Office’s spending review bid for a cross-Whitehall taskforce.

6.98. BEIS officials stated that despite the proposed changes listed above, persistent challenges remained in respect of counter fraud. Without more stringent application checks, new BBLs fraud was considered inevitable until scheme closure. It was recognised that a substantial portion of funds would never be recovered, particularly from top-tier fraud, and with limited court capacity convictions could take years. As a result, it was likely the Department would see diminishing marginal returns for further counter fraud activity as time went on, impacting any value for money assessment on the work undertaken {GD(B)/453 – INQ000543397}.

Actions Taken in Light of the Secretary of State's Decision – Incorporation

Date Check

- 6.99. On 28 October 2020, BEIS officials sent a submission to the Secretary of State seeking agreement for proposals developed by Cabinet Office to introduce a new counter fraud measure to identify BBL applications whose company incorporation date was after 1 March 2020, making them ineligible for the loan {GD(B)/484 – INQ000564125}. Lenders were already required to undertake upfront checks to confirm this, given that companies which were incorporated more recently could indicate fraud. However, an analysis of drawn loans as of 15 September 2020 had shown that lenders had interpreted the requirements differently. Some were running checks against Companies House, whilst others were relying on the account opening date or other checks. BEIS officials assured the Secretary of State that if the lender could not demonstrate they had checked the incorporation date, they would not be able to claim against the government guarantee.
- 6.100. A simple 'flag' had been developed using Companies House data to check the incorporation date. It was capable of being implemented within days using the Cifas system. This would have minimal burden on lenders and no impact on time taken to approve the loans. There was agreement across the Government that this was a positive change. Engagement with lenders indicated they would also welcome the change. BEIS officials recommended the change was implemented as soon as possible in advance of a potential spike in applications as the scheme came towards its end.
- 6.101. The Secretary of State approved the proposal on 30 October 2020 {GD(B)/485 – INQ000564126} and the checks were introduced on 6 November 2020 {GD(B)/486 – INQ000564152}.

Actions Taken in Light of the Secretary of State's Decision – Roundtable with Lenders

- 6.102. On 2 November 2020, the Secretary of State held a roundtable with the lenders on fraud reporting and counter fraud measures {GD(B)/487 – INQ000596688} and {GD(B)/488 – INQ000576398}. Other attendees included Lord Agnew, the Economic Secretary to the Treasury, the Permanent Secretary, other senior BEIS officials, Catherine Lewis la Torre (CEO of BBB), the six largest BBL retail lenders, and

representatives from UK Finance. The Department's stated objectives for the meeting were to:

- a) Secure lenders' support for more standardised and stronger fraud reporting;
- b) Secure wider support for counter fraud measures already used by some lenders; and
- c) Understand what support lenders wanted from government to achieve the previous stated objectives.

6.103. At the meeting Lord Agnew emphasised the need for good data, particularly in respect of SARs. The lenders remarked that there was good cooperation between banks on fraud which minimised differences in approach and stated that the Cifas database and weekly lender workshops had been effective. The lenders recognised that counter fraud work would not end after scheme closure and that recovery efforts would be difficult. A concern was raised that there were a lot of grey areas where ordinary people may have committed fraud but without material and dishonest intent and therefore focus should be on organised crime. In response, Lord Agnew said that "*...mid-tier fraud e.g. a material and dishonest overstatement of turnover, is still fraud – as it is with other government schemes (e.g. Universal Credit).*"

6.104. UK Finance agreed to share the proposals from lenders to government for greater action on counter fraud with BEIS, HMT, BBB and the Cabinet Office by 16 November 2020.

Actions Taken in Light of the Secretary of State's Decision – PwC Statistical Analysis

6.105. In November 2020, BBB contracted PwC to undertake statistical analysis on a random sample of 664 successful BLS applications to identify what proportion of successful BLS applications were fraudulent. This was expected to help refine the fraud approach and loss estimated in advance of the end of the financial year when the Accounting Officer was obliged to report on this to Parliament {GD(B)/489 – INQ000564145}.

Actions Taken in Light of the Secretary of State's Decision – Additional Checks on Applications

6.106. On 19 November 2020, BEIS officials sent a submission to the Secretary of State's private office addressing the BLS fraud recoveries framework and turnover

verification {GD(B)/490 – INQ000543507} and {GD(B)/491 – INQ000564150}. The submission confirmed Cabinet Office had developed a proposal whereby applications identified as high-risk by lenders could be submitted to a specialist team at HMRC to verify turnover quickly. This would mirror the process used for some mortgage applications. Cabinet Office believed this new process could be delivered within 24 to 48 hours and could be implemented and live by 30 November 2020 subject to funding agreements and redeployment of staff within HMRC. This was only a partial solution as it targeted a subset of applications and could not be used for recently formed companies that did not yet have a suitable tax footprint. However, BEIS officials recommended moving forward with the approach, which was approved by the Secretary of State the following day (as set out at paragraph 6.111 below).

Actions Taken in Light of the Secretary of State’s decision – Expansion of NATIS Work

6.107. By 26 November 2020, the Department had developed a draft business case relating to the expansion of NATIS’ work {GD(B)/492 – INQ000089925}. It sought approval for an additional £966,882 of funding in 2020/21 to expand NATIS’ capacity to investigate and recover money from fraudulent activity in BBLs. The funding was to be used to grow NATIS’ BBLs team by 24 new employees, including the addition of a Disruption Unit “...to disrupt Organised Crime Groups and mid-tier fraudsters, helping secure the ‘quick wins’ and deterrent effect Secretary of State [was] keen on” and expand BBLs focused investigative resource, such as accredited financial investigators to liaise directly with the lenders. It was later determined that the increased investment in NATIS could be absorbed within BEIS existing funding, and extra HMT funding was not required {GD(B)/493 – INQ000585723}.

6.108. A working group was set up with NATIS, the National Anti-Fraud Network and BEIS for weekly reporting and intelligence sharing {GD(B)/494 – INQ000585681}.

Ongoing Review of Counter Fraud Actions

6.109. The BFAB met again on 17 November 2020. BEIS officials provided an update on BBLs fraud {GD(B)/495 – INQ000538883}. BEIS had expanded its counter fraud team from two permanent staff to six, and secured HMT agreement to explore additional checks pre-loan approval, where this did not put at risk the processing of loans within 24 hours and did not change the self-assessed nature of the application form.

- 6.110. BEIS officials observed that challenges with fraud persisted, with a key gap in the approach being mid-tier fraud (i.e. where there is evidence of small-scale dishonesty rather than organised crime or individuals dishonestly receiving loans). The Insolvency Service had limited capacity to deal with BBLs fraud, even with additional investment because of competing priorities. This was also not an area of focus for the lenders. It was noted that upscaling activity in respect to mid-tier fraud would take time and could have funding challenges and diminishing marginal returns.
- 6.111. As set out at paragraph 6.1066.106, on 19 November 2020, the Department sent a submission to the Secretary of State's private office for consideration. The submission sought agreement from the Secretary of State for additional fraud checks to be carried out in relation to BBLs applicants. The submission recognised the proposal was only a partial solution, as it targeted a subset of applications – it could not be used for recently formed companies that did not have a suitable tax footprint. On 20 November 2020, the Secretary of State approved the proposal to introduce the additional checks as quickly as possible {GD(B)/496 – INQ000564154}.
- 6.112. On 14 December 2020, at the BBLs CF Strategy Board Meeting, Cabinet Office confirmed the HMRC Turnover check was nearly in place and HMRC had updated their data sharing agreement.
- 6.113. As mentioned in paragraphs 6.102-6.105, a ministerial roundtable was held with lenders regarding fraud reporting. UK Finance shared the proposals from lenders mentioned in paragraph 6.105 in a letter to the Secretary of State, Lord Agnew, the Economic Secretary to the Treasurer, and the COO of BBB on 20 November 2020 {GD(B)/497 – INQ000610534}. One of the recommendations regarded data and intelligence sharing between lenders and NATIS. A series of workshops were set up in early 2021 to discuss lender cooperation with NATIS {GD(B)/498 – INQ000610531} {GD(B)/499 – INQ000610532} {GD(B)/500 – INQ000610533}.
- 6.114. The first of these was held on 29 January 2021 with attendees from the lenders, BBB, BEIS, HMT, Home Office, Cabinet Office, UK Finance, and NATIS {GD(B)/501 – INQ000610536}, {GD(B)/502 – INQ000564176}. Topics focused on standardising reporting to NATIS and confirming the process for lenders to share intelligence. A list of actions was circulated to attendees and noted clarity was needed on processes for lenders to report cases of suspected public sector fraud {GD(B)/503 – INQ000610538}. An internal BEIS readout of the meeting noted that lenders already reported cases of

fraud to Action Fraud²⁰ but information relating to public sector fraud was not flowing to NATIS {GD(B)/504 – INQ000610535}.

- 6.115. A further two workshops were held on 12 February and 26 February 2021²¹ {GD(B)/505 – INQ000610541}. Following this, the meeting was merged into the pre-existing Bank Fraud Collaboration Working Group meeting, discussed at paragraph 6.81, which by this time was held on a fortnightly basis {GD(B)/506 – INQ000564192}.
- 6.116. Further meetings discussing NATIS reporting were held between BEIS, Cabinet Office and NATIS on 8 March, 25 March and 7 May 2021 {GD(B)/507 – INQ000610537} {GD(B)/508 – INQ000610539} {GD(B)/509 – INQ000610540}. These meetings discussed the appropriate process to ensure NATIS received intelligence on suspected cases of public sector fraud. It was agreed that for private sector fraud,²² lenders would continue to report to Action Fraud. For instances of public sector fraud, an alternate process was established and lenders reported direct to NATIS.
- 6.117. This was communicated to lenders on 26 May 2021 and NATIS led on managing this process {GD(B)/510 – INQ000610542} {GD(B)/511 – INQ000610543}.

Recovery of Funds

- 6.118. As set out above, in the early stages of the pandemic as the loans and grants schemes were rolled out, the focus for the Department was prevention and identification of fraud and error. It became clear that, due to the level of fraud encountered, significant resource would be required to support lenders in recovering funds. BEIS worked closely with HMT, BBB and the lenders to develop a process for recovery, which is addressed in further detail at paragraphs 6.83 to 6.98. In December 2020, principles for BLS collections and recoveries were developed, which addressed how the Department would consider lender fault {GD(B)/512 – INQ000651726}.

²⁰ Action Fraud is the UK's national reporting centre for fraud and cybercrime.

²¹ The Department has been unable to locate a readout for the meeting held on 26 February 2021. By this stage, it was already known that the meetings would be combined with the Bank Fraud Collaboration Working Group, so while the meeting was held we understand it was brief. The Department will continue to seek records related to this meeting.

²² Private sector fraud occurred when the loan guarantee defaulted (such as when certain checks failed). In which case, the 'victim' of the fraud became the lender rather than the Government. If the guarantee was still in place, it was considered public sector fraud as the Government was providing the guarantee.

Action to suspend borrowers being struck off the Company Register

- 6.119. In February 2021, the Government launched an initiative to prevent companies that had a BBLs facility from being struck off the Company Register. The bulk objection process was set out in a submission cleared by Jo Shanmugalingam to Minister Scully on 11 February 2021 {GD(B)/513 – INQ000585737} and {GD(B)/514 – INQ000585738}. The Registrar of Companies would be notified to prevent strike-offs from happening where the company had existing unpaid BBLs loans. There were estimated to be approximately 20,000 companies that had a strike-off application pending and outstanding BBLs loans. An objection from the Registrar would suspend any strike off action for six months.
- 6.120. Minister Scully approved implementation of the scheme on 22 February 2021 {GD(B)/515 – INQ000564189}. A signed Data Sharing Agreement between Cabinet Office and BEIS dated 15 March 2021 covered the sharing of information with respect to the process {GD(B)/516 – INQ000564263}. A later draft submission to Minister Scully on the process dated 14 June 2021 stated that the scheme had prevented 26,500 companies from being dissolved and proposed that BEIS' role in objecting to the dissolution of these companies now be made public {GD(B)/517 – INQ000564217}. Ultimately, Minister Scully's private office notes that the change to make public BEIS' role did not require ministerial oversight, and the change was implemented shortly afterward {GD(B)/518 – INQ000564218}
- 6.121. The scheme was later expanded to CBILS, CLBILS, RLS and Future Fund, as approved by Minister Scully on 28 July 2021 {GD(B)/519 – INQ000564219} and {GD(B)/520 – INQ000564220}. In the submission to Minister Scully, officials calculated that the process had prevented 34,123 companies from being dissolved and prevented £1.2 billion in outstanding loans from being lost.

Lender Performance Advisory Board

- 6.122. On 22 February 2022, Catherine Lewis La Torre wrote to the Permanent Secretary to outline BBB's views on various proposals put forward by Cabinet Office and No 10 in respect of the governance of the loan schemes {GD(B)/521 – INQ000564250}. She noted BBB's concern with one of No 10's proposals concerning lender performance on BBLs fraud, namely, to implement an independent panel to review lenders' proposals with respect to the loan scheme. She advised that the Bank considered that it already administered schemes with structured and robust scrutiny of lender performance.

- 6.123. Following review of the letter, Laurence Pawley updated the Secretary of State and Minister Scully on the Department's view. The email noted that while an independent panel could be beneficial, it should be aligned with the existing governance structures. In addition, however, BBB should draw on "*independent technical expertise*" in its lender performance management body {GD(B)/522 – INQ000543818}. This proposal was intended to mitigate the potential to undermine the Bank's operational independence while addressing the intent of the steers from No 10.
- 6.124. Later the same evening, Jo Shanmugalingam responded to Catherine Lewis La Torre's letter outlining BEIS' proposals in respect to Cabinet Office and No 10's proposals {GD(B)/523 – INQ000564251}. On the next day, 23 February 2022, Catherine Lewis La Torre responded advising that BBB officials were reviewing the existing governance structures along with the proposals offered, and a meeting was organised between Catherine Lewis La Torre, the BBB Chair Lord Smith of Kelvin, and the Secretary of State {GD(B)/524 – INQ000564252} and {GD(B)/525 – INQ000564253}.
- 6.125. Following queries from No 10 as to the progress of earlier proposals, BEIS and HMT officials committed to holding the first meeting of the proposed advisory board in the third week of March, and a meeting invite was later sent for a meeting of "Lender Performance Advisory Board (LPAB)" for 23 March 2022 {GD(B)/526 – INQ000564254} and {GD(B)/527 – INQ000564257}. BBB subsequently informed BEIS of its internal responses to the No 10 proposals, which included an internal governance structure to improve lender performance, as well as interface with the LPAB {GD(B)/528 – INQ000543821}. The final BBB proposal for this advisory board was sent to BEIS officials on 14 March 2022 {GD(B)/529 – INQ000543822} and {GD(B)/530 – INQ000543823}.
- 6.126. Agenda and papers for the first LPAB meeting were sent to attendees from the Bank, BBB, HMT, and Cabinet Office on 22 March 2022 {GD(B)/531 – INQ000543824}. The minutes for the meeting suggest that the draft terms of reference were largely agreed at the meeting, with BBB to add their governance framework before they would be finalised {GD(B)/532 – INQ000543825} and {GD(B)/533 – INQ000543826}.
- 6.127. The next LPAB meeting was set for 6 April 2022, and meetings were subsequently held when required, usually with 2-3 weeks between meetings. LPAB meetings were ongoing as at the start of the Inquiry's specified period, and the ninth meeting (and the last for 2022) was held on 14 December 2022 {GD(B)/534 – INQ000564260} and {GD(B)/535 – INQ000543836}. LPAB meetings are ongoing.

SECTION 7: AMENDMENTS TO CBILS, CLBILS, BBLs AND THE FUTURE FUND, AND EXTENSIONS TO THE CLOSING DATE

Increase in Accredited Lenders

- 7.1. After the three schemes were operational, and especially following the introduction of BBLs, it was apparent that it would be beneficial to accredit additional lenders to deliver the schemes, so that there was sufficient supply reaching the market (i.e. the lenders could keep up with demand) and to ensure that there was a diversity of finance available to businesses through the schemes.
- 7.2. On 6 May 2020, BEIS officials sent a submission to the Secretary of State to this effect, regarding the steps that BBB proposed to take regarding the accreditation of new lenders for CBILS and BBLs {GD(B)/536 – INQ000564009}. In the submission, it was explained that when CBILS was launched on 23 March 2020, 40 existing lenders from EFG were automatically moved over to become CBILS lenders. Since then, approximately 160 new lenders had applied to become accredited lenders for CBILS, and approximately another 20 new lenders had applied to join CLBILS. It was further explained that:

“Applicants for accreditation differ greatly in size, scale, experience and effectiveness and many have little or no existing relationship with the BBB. In normal times the BBB would typically undertake due diligence on such applicants, to satisfy itself regarding the risk profile of the applicant and its suitability to become a delivery partner for these schemes. Accrediting such a high volume and diversity of applicants across three new schemes, using the same approach as the past, is challenging and resource intensive.

In a bid to handle this extra volume and pace, the Bank has already streamlined its existing accreditation process to the maximum of its usual operational and reputational risk appetite and has also increased the size of the accreditation team significantly, from two people under EFG to ca. 30 presently. Notwithstanding these changes, a significant volume of applicants remains at various stages in the accreditation process and is likely to grow with the addition of BBLs from 4th May.

Without further streamlining its current accreditation processes, and without adding resource, the Bank might only be able to accredit all new lenders by mid-August. That pace would limit the scope and diversity of

lenders that are available to SMEs seeking finance in this period – supporting diversity is an original objective of the BBB. It would also raise the prospect of ongoing complaints that the Bank's processes are too slow, which will in turn undermine the schemes' credibility; and that new lenders are being excluded from delivering BBLs and CBILs with detrimental impacts on their ability to remain in business themselves.

The Bank could instead adopt a new approach with fewer upfront checks and rely more heavily on lenders self-certifying that they meet the required standards. Self-certification would include, for instance, if the applicant is PRA-regulated and FCA-approved. This approach would be quicker in the short-term while opening up risks that would need to be resolved at a later date. (Original emphasis)

- 7.3. The submission set out that such risks included:
- a) Unsatisfactory approaches to the approval, pricing and servicing of loans and reporting under the scheme;
 - b) Increased fraud and credit losses resulting in higher guarantee claims;
 - c) Failure of the lender;
 - d) Borrower complaints and adverse publicity; and
 - e) More BBB time and resource required to manage underperforming delivery partners.
- 7.4. To mitigate the risks resulting from self-certification, BBB was proposing to rely on risk-based and independent audits and performance checks. Work was ongoing on the design of those checks and remained subject to the Secretary of State's approval of the overall approach.
- 7.5. On 11 May 2020, the Secretary of State's private office responded by email and noted that the Secretary of State had reviewed the submission and wished to seek HMT's views, specifically concerning how the expanded accreditation and expedited process would be perceived, and what level of loan take-up was expected to result from making the proposed amendments {GD(B)/537 – INQ000564014}.
- 7.6. On 12 May 2020, Name Redacted emailed HMT and BEIS colleagues and advised that the Secretary of State wanted to know HMT ministers' views on this issue before making a decision {GD(B)/538 – INQ000538821}. The email noted that the Secretary

of State was sceptical of accreditation of lenders offering higher-interest products and whether it was worth the reputational risk.

- 7.7. On 13 May 2020, an email between BEIS officials and the Secretary of State's private office indicated that BEIS officials understood the HMT position on the expanded accreditation was that the Economic Secretary to the Treasury was "...100% positive on accelerated accreditation." {GD(B)/539 – INQ000564019}. As quoted in the email, the Economic Secretary to the Treasury had stated: "*He [was] firmly of the view that accreditation need[ed] to happen faster and was encouraged to hear of the proposal*". The Economic Secretary to the Treasury was however ambivalent on higher-interest products and wanted clarification on whether BBB's proposed mitigations really would ensure that the products were used appropriately.
- 7.8. The issue was discussed later the same day in a call between BEIS officials and the Secretary of State. The Secretary of State's position was that he was "...100% for speeding up accreditation on condition there is audit put in place quickly" and "...within a maximum of 6 weeks from the date of accreditation where the accelerated process [had] been used" {GD(B)/540 – INQ000538824} and {GD(B)/541 – INQ000564020}. The Secretary of State also remained 'very sceptical' of the high-interest issue. The Secretary of State sought additional information on how other countries had treated high-interest lenders and what the real impact of including those lenders would be in terms of additional number of facilities and loans likely to be advanced {GD(B)/542 – INQ000543223}.
- 7.9. On 15 May 2020, BBB confirmed that the Secretary of State's request for BBB to implement independent audits within six weeks of accrediting lenders had been agreed {GD(B)/543 – INQ000543225}. New lenders were to be accredited within two weeks on a best-case scenario basis.
- 7.10. BEIS, HMT and BBB continued to work together on streamlining the accreditation process and to seek agreement on the issue of high-interest lenders. On 27 May 2020, BBB confirmed that they were implementing the streamlined accreditation process from the next day {GD(B)/544 – INQ000543235}.
- 7.11. On 3 June 2020, BBB emailed BEIS and HMT colleagues regarding the proposed amendments to the accreditation process and higher-interest lenders {GD(B)/545 – INQ000585652}. This email stated: "*...it seems BEIS and HMT ministers have a difference of opinion. EST appears to have approved the proposed BBB Investment Committee approach (keeping the "all in" 15% cap but Investment Committee having*

discretion to approve beyond this in specific cases where specialised lenders (invoice finance and asset finance) apply reasonable lender-based fees).” The email concluded by asking whether the Economic Secretary to the Treasury’s acceptance of BBB’s proposed approach would change BEIS ministers’ minds.

- 7.12. On 10 June 2020, Name Redacted confirmed to BBB by email that despite the approval from the Economic Secretary to the Treasury, the Secretary of State remained sceptical of the policy benefits of taxpayer-funded higher-interest funding products without evidence that the proposed change would significantly increase the number of companies likely to get finance {GD(B)/546 – INQ000585651}. BEIS officials, therefore, prioritised other decisions and the 15% cap on loan products remained in place. Name Redacted confirmed that BBB’s summary of the difference of opinion between HMT and BEIS, as quoted in the preceding paragraph of this statement, was an accurate summary.

Assignment of the Scheme Guarantees to Wholesale Lenders

- 7.13. Wholesale funding is used by lending institutions, especially alternative finance providers, to raise funds to finance operations and manage risk. This is done by selling bonds to investors based on the finance provider’s loan portfolio. The rules of the loan schemes at the time meant that alternative finance providers could not access the government guarantees in the event the businesses became insolvent or otherwise had loans in default.
- 7.14. On 29 May 2020, BEIS officials sent a submission to the acting Permanent Secretary in her capacity as Accounting Officer on this issue {GD(B)/547 – INQ000543239} and {GD(B)/548 – INQ000564049}. The acting Permanent Secretary’s agreement was required before advice could be submitted to the Secretary of State. The submission explained that:

“...most alternative finance providers rely on wholesale funding facilities from larger financial institutions such as banks. However, the scheme guarantees cannot be accessed by the wholesale finance provider in the event the alternative finance provider becomes insolvent or otherwise defaults on its facility.”

- 7.15. The advice to the acting Permanent Secretary set out that in a typical wholesale finance arrangement, if a lender became insolvent or otherwise defaults, the wholesale funder would ‘step in’ and ‘manage out’ the portfolio of receivables that they have

ultimately financed. However, at the date of the advice, in the event of any of the underlying guarantee-backed loan recipients defaulting, the wholesale lender would be unable to directly claim under the guarantee agreement with the government. Instead, they may face a potential 100% loss instead of the previously non-guaranteed 20% exposure in CBILS and CLBILS or 0% exposure in BBLs.

- 7.16. BBB had reported to BEIS that the inability to assign guarantees was having a 'significant, material and immediate' impact on the level of funding for alternative finance providers, particularly those lenders wishing to deploy CBILS facilities. This had a knock-on effect on the availability of finance to SMEs. The proposal was therefore to permit the assignment of CBILS, CLBILS and BBLs guarantees to selected third parties. The proposed changes were "*...likely to impact on demand and risk of ensuring facilities supported by government-backed guarantees are managed appropriately*". This impacted the assessment of value for money and propriety, but the advice from BEIS officials to the acting Permanent Secretary was that:

"...the degree of residual risk should be immaterial in the context of the overall scheme and that a new direction to take account of the changes is not required, with the current directions remaining extant." (Original emphasis).

- 7.17. Following Accounting Officer approval, on 22 June 2020, BEIS officials sent a submission to the Secretary of State on the proposals {GD(B)/549 – INQ000564066}. The submission also stated that permitting wholesale lenders to access the scheme guarantees could incentivise them to make funding available to alternative finance providers, thereby ensuring that a greater range of finance products was available to businesses. The submission further detailed the issues with alternative finance providers accessing wholesale funding facilities at the time:

"Most alternative finance providers rely on wholesale funding facilities from larger financial institutions such as banks. However, these facilities are now being restricted due to the high risks associated with business lending in the current economic circumstances and typically come at a higher price than the funding available to the major banks (e.g. BBLs pricing of 2.5% is too low for the vast majority of alternative finance providers to maintain viable business models)."

- 7.18. The submission recommended that the Secretary of State "*...agree to the proposal that CBILS, CLBILS and BBLs guarantees can be assigned to selected third parties*

to facilitate access to wholesale finance.” The proposal was implemented following Secretary of State agreement on 25 June 2020 {GD(B)/550 – INQ000564068}.

Consideration of vulnerable groups

- 7.19. The BEIS Diversity and Inclusion team began working on an analysis of adherence to the Public Sector Equality Duty (**PSED**) during April and May 2020. The resulting PSED Analysis of the three Covid-19 loan schemes, undertaken in accordance with BEIS’ obligations under section 149 of the Equality Act 2010 is dated 18 June 2020 {GD(B)/551 – INQ000564059}.
- 7.20. The PSED analysis considered the impacts of the loans schemes on groups and individuals with protected characteristics, and concluded there was *“no reason to think that there would be direct discrimination as a result of schemes designed to be open to the whole market.”*
- 7.21. In relation to direct and indirect discrimination, the analysis highlighted that there were considerable gaps in the evidence base making it difficult to conduct a full assessment of the issues. Whilst there was a risk of increasing some existing inequalities, there was also potential for advancing equality and the benefits that arose from providing liquidity to businesses during Covid-19 crisis and therefore outweighing the potential negative impacts. BEIS developed a monitoring and evaluation plan, which was peer reviewed by a BEIS internal analysts evaluation group. Although no changes were made to the schemes as a result of the plan, it was the basis for the invitation to tender for the BBB three-year evaluation, discussed at paragraphs 7.97 to 7.110 below, which included analysis on the equality impacts of the Covid-19 loan schemes.

Objectives of Covid-19 Loan Schemes

- 7.22. On 16 July 2020, at a Covid-19 Business Governance meeting, there was discussion of setting seven overarching objectives for the three loan schemes (CBILS, CLBILS and BBLs). BBB circulated a set of slides in advance of the meeting and sought agreement on the objectives amongst HMT, BEIS and BBB {GD(B)/552 – INQ000564078}. These objectives were agreed at the meeting {GD(B)/553 – INQ000543312}. BBB’s slides acknowledged that objective setting was complicated by the evolving nature of the pandemic and Government response. The objectives would deviate slightly from ‘SMART’ (Specific, Measurable, Attainable, Relevant, Time-bound) best practice for three reasons: first, while the products shared consistent core underlying objectives, each was a different product in its own right; secondly, the

programmes had and would evolve as wider government policy and the pandemic fluctuated; thirdly, the ability for each programme to achieve its objectives was partially contingent on the state of the economy.

7.23. The proposed short-term objectives were:

- a) To offer businesses access to finance schemes complementing other government support and incentives; and
- b) To unlock finance at scale and pace such that businesses disrupted by Covid-19 continued to have access to finance.

7.24. The proposed medium-term objectives were:

- a) To give businesses maximum opportunity to maintain liquidity until lockdown measures were lifted (given knowledge about the pandemic at the time when the Covid-19 loan schemes were launched); and
- b) To incentivise appropriate risk taking by lenders.

7.25. The proposed long-term objectives were:

- a) To offer a debt structure that considered long-term business survival;
- b) To offer a debt structure that allowed businesses with long-term growth potential to continue growing; and
- c) To realise long-term economic benefits from the above two objectives that delivered value for money against any government incurred losses.

First Extension of CBILS, CLBILS and BBLs and Amendments to BBLs

7.26. When CBILS, CLBILS and BBLs were first launched, they were intended to be temporary loan schemes to meet the immediate need to assist businesses struggling as a result of the pandemic. CBILS was originally due to close on 30 September 2020, CLBILS on 20 October 2020 and BBLs on 4 November 2020. As the pandemic continued, the schemes were kept under review by BEIS, HMT and BBB to ensure that the economic interventions remained appropriate as lockdown restrictions changed.

7.27. Between September 2020 and March 2021, the schemes were extended on three occasions. The Permanent Secretary as Accounting Officer (by then, Sarah Munby) considered the various risks and benefits of each extension and approved each one under the relevant existing ministerial directions.

- 7.28. On 3 September 2020, BEIS officials sent advice to the Secretary of State seeking instruction as to whether to extend the schemes past their original closure dates or whether they should be closed as planned {GD(B)/554 – INQ000564096}. BEIS officials recommended extending the schemes to allow applications into November and for loan agreements to be finalised up to the end of December. This advice was provided with a view to counteracting uncertainty in the market due to a potential winter Covid-19 resurgence and to provide the Government with more time to prepare a follow-up loan scheme. The submission noted the Chancellor had expressed scepticism about extending the schemes but had not yet received detailed advice. BEIS officials explained any decision would need to balance value for money considerations and ensure continued business support, but the pragmatic approach recommended was to:
- a) Extend the closing date for CBILS to 31 December 2020, with an application deadline of 30 November 2020. This change would make maximum use of the EU's Temporary Framework which required all offers of State aid to be made by the end of that year, and was in line with the approach taken by other EU countries;
 - b) Close applications for BBLS as planned on 4 November 2020. Although demand for BBLS remained steady, officials acknowledged the significant credit and fraud risks inherent in the design of BBLS that meant the scheme should not be a long-term feature of the market; and
 - c) Close applications for CLBILS on 20 October 2020, with loan agreements to be finalised on 31 December 2020 as planned.
- 7.29. At this stage, BEIS officials confirmed they lacked evidence on which to confidently assess the success of CBILS to date and were unlikely to be able to accurately forecast the actual impact of extending the schemes.
- 7.30. Officials also advised they were working with BBB to consider longer-term options for economic interventions, to align with the Government's wider plans for recovery as early indications from BBB and lenders was that simply reinstating the EFG would be unlikely to fill the ongoing market gap as businesses recovered from the pandemic. BBB recommended any announcement on closure dates should therefore be combined with a statement regarding a new loan scheme to assist businesses moving forward. This was likely to be challenging given the need to reach an agreement with HMT on any future scheme in the Spending Review.

- 7.31. On 7 September 2020, the Secretary of State's private office responded to BEIS officials' 3 September 2020 advice. The Secretary of State's inclination was to align the closing dates for new applications to CBILS and CLBILS to the end of October, with the schemes fully ending at the end of December. The Secretary of State agreed that BBLS should close as initially planned on 4 November 2020. The Secretary of State also requested a meeting with BEIS officials to discuss replacements for the Covid-19 loan schemes {GD(B)/555 – INQ000564097}.
- 7.32. On 8 September 2020, HMT officials provided advice to the Chancellor on the same subject {GD(B)/556 – INQ000564098}. This advice acknowledged the Chancellor's previous indications that the schemes would close on the dates initially planned, and that this position was still defensible, in light of demand plateauing and that the Chancellor had always been clear that the schemes were temporary measures. In this regard, HMT stated that *"While the economic impacts of Covid will continue for some time, borrowers have had six months to make use of the emergency liquidity the schemes provided if they needed to – and still have some time in the final weeks of the scheme."* HMT, like BEIS above, also considered the longer-term picture of the support that would be needed by businesses on an ongoing basis beyond 2020.
- 7.33. Despite this, HMT ultimately recommended that if the Chancellor was minded to extend the schemes, he should do so for all three schemes, to the end of November 2020, being the latest available date, in compliance with the EU's Temporary Framework for State aid. HMT further said, *"This would bring the UK in line with the likes of France and Germany, and would be better than the banks' favoured approach of an extension just to CBILS that would open you up to criticism from smaller SMEs for which it is less suited."* If this proposed course of action was chosen, it was recommended that an announcement be made in mid-September to provide lenders and businesses with clarity.
- 7.34. On 12 September 2020, senior BEIS officials became aware, via the BEIS Press Office, that HMT were planning to announce an extension of the schemes on Tuesday of the following week {GD(B)/557 – INQ000543324}. Accordingly, on 14 September 2020, an email between senior officials in BEIS explained this fact and advised that they were urgently preparing a submission and Accounting Officer advice for the Permanent Secretary and Secretary of State on this proposed extension to the three loan schemes {GD(B)/558 – INQ000585672}. This had not yet been confirmed by HMT, but BEIS officials had 'had indication' from HMT that an announcement would

be happening shortly. BEIS officials highlighted that work was needed to prepare announcements and advice for the Accounting Officer and Secretary of State.

- 7.35. BEIS officials considered the extension to the schemes should be covered by existing ministerial directions but prepared an updated Accounting Officer Assessment to consider value for money, regularity, propriety and feasibility for the Permanent Secretary to consider in her role as Accounting Officer.
- 7.36. On 18 September 2020, the Accounting Officer advice was sent to the Permanent Secretary's office with the original direction letters for the schemes and the Reservation Notice that BBB had issued on BBLs, under cover of email {GD(B)/559 – INQ000585676} and {GD(B)/560 – INQ000585675}. Officials stated there was no indication from BBB that they planned to issue another reservation notice on BBLs if instructed to extend the scheme, so appeared to hold the view the existing notice was extant, and the level of risk was materially unchanged (with the risks around deliverability reduced as the scheme was now up and running).
- 7.37. Notwithstanding the significant risks that remained outstanding, in the Accounting Officer advice officials recommended that the Permanent Secretary, in her capacity as Accounting Officer, clear the recommendation in the advice for the Secretary of State to approve the extension to the three schemes under the cover of the existing directions. This was:

“...on the basis that the nature of the risks [were] materially unchanged and some of the risks identified ahead of implementation [had then] been partially mitigated. Meanwhile, economic conditions remain[ed] extremely challenging, with considerable uncertainty around the future spread of the virus, the status of Non-Pharmaceutical Interventions which could impact on business income, and the shape of the economic recovery.”

- 7.38. There was no evidence to indicate that either the actual or potential risks were more severe than those identified when the schemes were launched, and the extension did not mark a further departure from the four Accounting Officer standards. Officials also stated that HMT was keen to announce the extension the following week, subject to the Accounting Officer's assessment and the agreement of the Secretary of State.
- 7.39. BEIS officials sent advice to the Secretary of State on the same day however it was stated that the recommendations were dependent on clearance from the Permanent Secretary before the advice should be passed on to the Secretary of State {GD(B)/561

– INQ000585673}, {GD(B)/562 – INQ000064925}, {GD(B)/563 – INQ000543340} and {GD(B)/564 – INQ000543339}.

- 7.40. This advice sought the Secretary of State's agreement to the Chancellor's proposal to extend all three loan schemes, to keep them open for applications up to 30 November 2020 and allow loan agreements to be finalised up to 31 December 2020. The advice stated that the Chancellor wanted to make an announcement on this as soon as the next business day, being 21 September 2020.
- 7.41. Later, on 18 September 2020, the Permanent Secretary, in her role as Accounting Officer, cleared the advice and approved the recommendation to extend the three schemes without direction {GD(B)/565 – INQ000564099}.
- 7.42. Subsequently that same evening, the Secretary of State confirmed his agreement to the proposed extension date {GD(B)/566 – INQ000564100}.
- 7.43. The extension of the schemes was one part of the announcement made by the Chancellor on 24 September 2020. The Chancellor announced that:
- a) CBILS lenders would be entitled to extend the length of their loans from a maximum of six years to a maximum of 10 years when deemed necessary; and
 - b) The deadline for applications for all four schemes (BBLs, CBILs, CLBILs and Future Fund) would be extended to 30 November 2020 {GD(B)/567 – INQ000564107}.
- 7.44. In the same announcement, the Chancellor outlined a variety of Pay as You Grow (**PAYG**) options, designed to afford BBLs borrowers more time and flexibility to repay their loans {GD(B)/568 – INQ000564106}. Under PAYG, BBLs borrowers would be able to repay their loans on the terms which would work best for them. BBLs borrowers had the option to:
- a) Extend their loan term from six years to 10 years;
 - b) Reduce payments, temporarily, for six months by paying interest only; and
 - c) Take a single full repayment holiday of six months (which would only be available to borrowers who had made at least six repayments, including interest-only repayments).
- 7.45. The first BBLs repayments were due to begin in May 2021. As such, BBLs borrowers would have had the opportunity to request the PAYG measures before their first repayments fell due.

Further Extension of the Loan Schemes

- 7.46. Prime Minister's announcement that the loan schemes would be extended only on the day of the announcement, having talked to officials at HMT {GD(B)/569 – INQ000564129} (I note that the email erroneously states '31 December'). It does not appear that BEIS played any role in advising on the benefits and risks of this further extension, other than previous advice provided to BEIS ministers and HMT which may have influenced this decision.
- 7.47. The next day, BEIS officials sent the Secretary of State a submission about the newly announced changes {GD(B)/570 – INQ000564133}. The submission sought the Secretary of State's agreement to recommendations on various policy questions in relation to the changes, including:
- a) How to implement the top-ups;
 - b) That lenders should be asked to re-check original applications to prevent unjustified increases in turnover at the 'top-up' application stage (and if any further checks were desired, correspondence should be sent to the Chancellor as soon as possible to press for this); and
 - c) The impact of the amendments and next steps including the possibility of a new direction.
- 7.48. On 4 November 2020, BEIS officials sent a submission to the Secretary of State concerning both the extensions and the top-up mechanism, as well as seeking clarification on the policies and their intended effect {GD(B)/571 – INQ000564134}. The submission stated

“The extension of the schemes inevitably increases the taxpayer’s exposure to fraud. Additionally, the ‘top-up’ could create new vulnerabilities to fraud without appropriate checks in place (because borrowers who had overstated their turnover could increase their loan size).”
(Original emphasis)

BEIS officials advised the most robust way to minimise fraud would be to require lenders to verify borrower turnover by checking Companies House data or business bank accounts. This could, however, cause delay to applications and lenders would incur additional cost. As such, there was a clear trade-off between speed of delivery and the ability to prevent fraud.

- 7.49. BBB and UKGI had opportunities to contribute to this advice, which was provided in advance of the Accounting Officer consideration due to the small window in which the Secretary of State had an opportunity to influence the policy direction {GD(B)/572 – INQ000564131}.
- 7.50. On 5 November 2020, HMT agreed with BEIS' assessment that a new ministerial direction was not required for the extension of the loan schemes {GD(B)/573 – INQ000564136}.
- 7.51. Later that same day, the Secretary of State's private office emailed HMT with the Secretary of State's views in relation to prevention of fraud with the 'top-up' mechanism for BBLs {GD(B)/574 – INQ000564137}. Specifically:

"It is important that we continue to take all reasonable steps to protect taxpayer's money by bearing down on potential fraud.

Specifically, recent information we have received today from the National Investigation Service suggests that 61% of Suspicious Activity Reports received from lenders in relation to the scheme relate to inflated turnover. As currently constituted, the scheme does not require lenders to verify the turnover of an applicant, and the same would be the case under the proposed top-up mechanism unless we choose to act.

This risk could be mitigated by asking the British Business Bank to work with lenders to develop additional checks to verify the turnover of an applicant before a loan or top-up is offered. This could be done in a number of ways, such as cross-referencing a borrower's claimed turnover against data held by Companies House or HMRC. For maximum impact, this check could be extended to all new applicants for the remainder of the scheme."

- 7.52. The email concluded by noting that the Secretary of State recognised that the above proposed actions could lead to applications being processed more slowly. However, the Secretary of State was of the view, at that stage of the scheme's operation and given the evidence that was now to hand regarding fraud in BBLs, that it was *"...prudent to intervene in [that] way to mitigate a known vulnerability. By not acting, we could risk undermining the important contribution that Bounce Back Loans have made to supporting UK businesses through the pandemic."*
- 7.53. On 9 November 2020, HMT responded to this email {GD(B)/575 – INQ000564138}. HMT's email stated that where counter fraud measures could be put in place whilst

also maintaining the policy intent (e.g. for BBLS, getting the finance rapidly out the door to borrowers), HMT remained committed to exploring such options. In relation to BEIS' proposals, HMT said that they were open to exploring:

- a) Additional checks pre-loan approval, provided this did not risk the processing of loans within 24 hours, or the self-assessed nature of the application form, and
- b) Additional checks post-approval, in recognition of the tight approval timeframes and to identify cases of fraud that lenders should seek to recover.
- c) They said further:

"We also note that the scheme rules which lenders signed up to specified that this information was to be self-certified with no additional checks, therefore while we are supportive of authorities' exploring potential improvements to checks and recognise lenders have been engaging constructively in how we can go further on counter-fraud measures, we note the importance of bringing lenders along with these discussions."

7.54. Later that evening, the Secretary of State's private office responded to HMT's email and sought the Chancellor's approval to implement the extension to the schemes as well as the BBLS 'top up' mechanism {GD(B)/576 – INQ000564142}. The Secretary of State reiterated BEIS' position on fraud mitigation, as follows: *"The Secretary of State remain[ed] of the view that to maximise our impact on fraud, Government needs to be prepared to take more radical steps even where these could slow the processing of a significant number of applications. However, he nonetheless welcomes the commitment to explore what additional measures can be introduced within [HMT's] stated policy parameters, whether pre or post-application."* The Secretary of State also sought confirmation from HMT that they would agree to continue to provide additional budget cover to meet all direct and indirect costs in relation to the schemes.

7.55. The Chancellor's private office responded shortly after confirming the Chancellor's approval to extend the three loan schemes for applications to 31 January 2021, and to implement the BBLS top-up. The email also confirmed that HMT would provide the additional budget cover as necessary. He did not respond to BEIS' points on exploring further measures for fraud mitigation {GD(B)/576 – INQ000564142}.

7.56. On 9 November 2020, Catherine Lewis La Torre, Chief Executive Officer of BBB, wrote to the Permanent Secretary and advised that the BBB Board was not intending to raise

another reservation notice, but the reservations they previously expressed still held {GD(B)/577 – INQ000564139}. BBB confirmed they were working closely with officials across government to prepare to implement the changes, but still had significant concerns. BBB explained:

*“It is important to note that the combined changes to the debt schemes could, on current estimates, increase the scheme size by between £11bn and £20bn. ... In the case of the Bounce Back Loan Scheme (**BBL**S), the Bank’s Board raised a reservation notice on 2 May 2020, citing concerns with propriety, value for money and feasibility, before accepting the instruction. The Board are not raising a reservation notice again now, but given the significant increase in exposure that is likely to be created by the combination of the scheme extension and top-up option they have asked me to write and remind you that reservations they previously expressed regarding BBL*S – particularly concerning value for money – *continue to apply.”* (Original emphasis)

7.57. Despite the above, Catherine Lewis La Torre’s letter then acknowledged that, “*Significant steps have been taken to address our concerns around propriety and value for money.*” In particular:

- a) BBB had worked hard to accredit 28 lenders for BBL
S, to ensure competition within the scheme. However, she explained that the overwhelming majority of loans had been delivered by the big five banks, and further consideration was required as to how best to ensure that diversity of provider was maintained;- b) The collaboration that had that had taken place between government, BBB, lenders and law enforcement to combat and reduce fraud across the schemes, particularly in relation to BBL
S, but she confirmed that there remained a high level of residual fraud risk within BBLS due to the self-certified nature of the scheme. BBB considered that the proposed extensions and top-up options would increase the government’s exposure and fraud losses; and- c) There had been significant progress made with regards to feasibility, “*...with more robust governance procedures put in place internally, across government and with lenders, for example through the commencement of our lender audits.*” Catherine Lewis La Torre said that BBB had “*...much greater confidence that delivery is feasible than we did in May.*” However, the speed at which the BBL
S ‘top-up’ mechanism was required to be implemented came with heightened risk.

- 7.58. After receipt of the Chancellor's approval, the Permanent Secretary sent letters to Catherine Lewis La Torre advising BBB that the Chancellor had agreed for the scheme changes and extensions to go ahead for all three schemes and that the necessary budget cover would be provided from HMT {GD(B)/578 – INQ000543490}, {GD(B)/579 – INQ000564141}, {GD(B)/580 – INQ000543491} and {GD(B)/581 – INQ000564143}. Addressing the concerns set out by BBB in their letter, the Permanent Secretary stated that although the risks remained significant, the economic circumstances of the time continued to justify the need for the amendments. The risks and concerns were not new and the risks around value for money, propriety and feasibility taken together meant it would likely still not be possible to reconcile the scheme with the standards set out in Managing Public Money.
- 7.59. The Permanent Secretary's letter also provided an update on mitigations that had been carried out to address the risks and concerns. At this stage BEIS had seen the overall level of risk reduce in certain areas, in part due to the introduction of lenders' fraud checks and the duplicate application checks. While the Permanent Secretary stated that the speed at which the BLS 'top-up' mechanism was being launched meant that it carried some degree of risk, BBB's track record delivering the scheme since May 2020 gave her confidence that the risks could be effectively managed. Accordingly, in this letter the Permanent Secretary then directed BBB to proceed with the implementation of the top-up mechanisms and extension to 31 January 2021 for the three schemes.
- 7.60. Following receipt of the Permanent Secretary's letter, that evening BBB advised the lenders to go ahead with the changes (see for example, email from BBB to Barclays {GD(B)/582 – INQ000564166}).
- 7.61. On 8 December 2020, the Permanent Secretary sent another letter to BBB directing them to proceed with the implementation of the PAYG measures {GD(B)/583 – INQ000564144}.
- 7.62. In February 2021, the option to take a six-month holiday under the PAYG measures was amended. The amendment removed the need for BLS borrowers to wait until they had made six payments before they could opt for the payment holiday. This is detailed in the email from BEIS to BBB, directing BBB to implement this amendment, dated 6 February 2021 {GD(B)/584 – INQ000564183}. The further changes came into effect on 8 February 2021.

Extension of the Future Fund

- 7.63. The Future Fund was originally due to close on 30 September 2020. On 19 September 2020, further advice was sent to the Permanent Secretary in her role as Accounting Officer, with the proposal to extend the closing date for the Future Fund to 30 November 2020 in line with the three loan schemes {GD(B)/585 – INQ000564132}. The advice sought Accounting Officer agreement that the extension should be able to proceed under the cover of the existing ministerial directions and recommended that the Permanent Secretary write to BBB to instruct them to keep the Future Fund schemes open for application until 30 November 2020.
- 7.64. In the advice, BEIS officials explained that as there would be no changes to the parameters of the scheme and as no new risks had materialised, they considered that the extension was covered by the earlier ministerial direction. Extending the closure date would allow more businesses to benefit from the scheme at a time when significant uncertainty remained in the market. At that stage, BBB's view was that it was still too early to tell whether the value for money assessment should change, because the performance of these investments would take a long time to become clear. At time of conversion of the loans there would be more information available, but this would not happen immediately. As at the date of this advice, only one conversion had occurred out of 525 applications drawn down.
- 7.65. The next day, 20 September 2020, BEIS officials sent advice to the Secretary of State regarding the extension of the scheme to 30 November 2020 {GD(B)/586 – INQ000564101}. The advice indicated that the announcement of this extension was scheduled for 21 September 2020 and stated:

“The original rationale for the Future Fund remains valid and some risks that were anticipated at the outset have not materialised (such as an inability to manage the volume of applications, or applicant gaming the system). That leaves the risk of poor investment performance, which is thought to be no worse than anticipated. There is therefore no reason to object to this proposal. The Accounting Officer is content that the scheme can be extended within the terms of the original Direction.”

- 7.66. Later that afternoon, the Secretary of State's private office emailed Angelina Cannizzaro and confirmed that the Secretary of State agreed with the advice {GD(B)/587 – INQ000564102}. They also sought written confirmation from HMT that

the Chancellor wanted to extend the application deadline for Future Fund from 30 September 2020 to 30 November 2020, and that HMT would provide full additional budget cover for the related costs for the scheme and delivery, including BBB's own running costs. HMT confirmed both points by return email on the same day {GD(B)/588 – INQ000564103}.

- 7.67. On 19 November 2020, the Accounting Officer was sent a further Accounting Officer note regarding another proposed extension to the Future Fund, until 31 January 2021, again in line with the extension of the three Covid-19 loan schemes, and the Prime Minister wanting to take the same approach with the Future Fund {GD(B)/589 – INQ000564151}. BEIS officials advised of one proposed change to the rules, being that they proposed to include a new term in the Convertible Loan Agreement that would prohibit recipients from using Future Fund capital for the purposes of onward lending or investment outside the recipient company. This was designed to ensure the scheme operated as originally intended. BEIS considered that this minor change, and the extension itself, had no impact on the original assessment underpinning the need for a ministerial direction. The advice sought the Permanent Secretary's agreement to the proposed contractual change and agreement that the extension should proceed. The advice also requested that the Permanent Secretary write to BBB instructing the bank accordingly and to the Comptroller and Auditor General to notify him of the extension and Accounting Officer Assessment. The Permanent Secretary cleared this advice by return email on 20 November 2020 {GD(B)/590 – INQ000564153}.
- 7.68. On 25 November 2020, BEIS officials sent advice to the Secretary of State regarding the implementation of the further extension of the applications to the Future Fund {GD(B)/591 – INQ000564156}. Similar to the previous advice, this advice stated that, *"The original rationale for the Future Fund remains valid and some risks that were anticipated at the outset have not materialised (such as an inability to manage the volume of applications). That leaves the risk of poor investment performance, which remains a possibility given the rules-based nature of the scheme. This risk is no greater than anticipated at the outset of the scheme and the Accounting Officer is content that the scheme can be extended within the terms of the original Direction."* The Secretary of State reviewed the advice overnight, and agreed with the recommendation to proceed, as shared with BEIS officials on 26 November 2020 {GD(B)/592 – INQ000564157}.

7.69. Accordingly, on 27 November 2020, the Permanent Secretary emailed Catherine Lewis La Torre a formal instruction to extend the Future Fund scheme as agreed with HMT and BEIS officials {GD(B)/593 – INQ000564158}.

Monitoring of Covid-19 Loan Schemes

7.70. Once CBILS, CLBILS and BBLs were launched, these three schemes were monitored in real-time to ensure they were meeting their policy objectives. In or around November 2020, BEIS and BBB prepared the Monitoring and Evaluation Plan which confirmed the following monitoring and stakeholder feedback was being collected by BBB {GD(B)/594 – INQ000564155}:

- a) BBB portal data on borrowers' characteristics including the business' turnover and location, loan size distributions and sectoral splits;
- b) BEIS' SME population statistics for comparison;
- c) FAME for business characteristics;
- d) IDBR for business' turnover, employees including historical records;
- e) Existing surveys including Small Business Finance Survey, SME FM, ONS BICS, BCC Covid-19 tracker;
- f) Addressable market estimates;
- g) Monthly Insolvency statistics;
- h) Experian risk metrics;
- i) ONS business demography statistics (as a comparator);
- j) HMRC for tax data; and
- k) Loan defaults from BBB portal.

Third and Final Extension of the Covid-19 Loan Schemes until 31 March 2021

7.71. On 17 December 2020, the Chancellor announced the extension of the three Covid-19 loan schemes to support businesses through further restrictions that might be required to tackle the spread of the virus. The Prime Minister announced further restrictions on 19 December 2020 following advice from the New and Emerging Respiratory Virus Threats Advisory Group (**NERVTAG**). This was the third time the schemes had been extended. In Accounting Officer advice sent on the same day, BEIS officials confirmed that their assessment of the extension remained substantively

unchanged from previous extensions and was aligned with the advice the Permanent Secretary was given in relation to the extensions to 31 January 2021 {GD(B)/595 – INQ000564170}. The submission set out the rationale for the extension, including the impact that ongoing Covid-19 restrictions were having on businesses, and in view of the restrictions being likely to continue into 2021. The submission said further:

“In this context, the need for debt finance will remain beyond the end of January. This may disproportionately affect smaller businesses, who will find it harder to operate under restrictions, and may have more limited cashflow. Businesses are still reporting that their finances have been negatively affected by Covid-19, many have small (or no) cash buffers, and a significant proportion of such businesses need finance for immediate purposes.

In December, more than half of businesses (52%) when surveyed said their financial health had been negatively impacted by Covid-19. The most cited reason for the deterioration of their financial health remained “sales had been lower than normal” (38%). 1 in 3 businesses (33%) had less than three months cash reserves or no reserves at all. However, survey data shows that in line with rising aggregate debt levels due to uptake of loans, there has also been an increase in aggregate cash reserves amongst firms, suggesting that businesses may be taking loans in anticipation of continued financial difficulty in the new year, and have yet to spend funds they may have obtained through the schemes.”

- 7.72. The submission also advised that BBB had contracted a third-party supplier to develop a financial model to estimate potential losses more accurately, drawing on expertise from across government, as well as lenders and credit agencies. The model was due to go live in late December, with initial outputs expected in January. In the meantime, BEIS were using BBB’s central estimates of losses, being 17.5% on CBILS, 10% on CLBILS and 45% on BBLs. Based on these figures and the additional lending estimated above, BEIS considered this would mean around £1.7 billion of additional guarantee claims across all three schemes in a central scenario.
- 7.73. Officials’ assessment of the risk of the latest extension remained substantially unchanged from the previous assessment, with the caveat that overall volumes of lending would inevitably rise across the schemes, as would the volume of losses. As a result, the advice was that a further ministerial direction was not required. In relation to propriety, it was noted that:

“Even with the mitigations we have put in place, the residual fraud risk is significant and it will remain so for the lifetime of the scheme.” (Original emphasis)

It was further noted that the BBLs fraud risk was primarily a result of issuing the loans themselves, rather than any changes to the workings of the loan top-up structure. The lack of evidence available to determine fraud risk was also highlighted.

- 7.74. On 22 December 2020, BEIS officials sent an update to the Secretary of State on the proposed extension and sought his consent so that the Permanent Secretary could formally instruct BBB, allowing them to communicate with lenders {GD(B)/596 – INQ000089923}. On 23 December 2020, the Secretary of State’s private office emailed HMT seeking the Chancellor’s approval for the extension and again seeking confirmation that HMT will continue to provide the additional budget cover required to meet all direct and ‘reasonable and justifiable’ indirect operational expenditure. That same day, the Chancellor approved the further extension to the three schemes and the additional budget cover {GD(B)/597 – INQ000564173}.
- 7.75. On 23 December 2020, the Permanent Secretary’s private office sent instructions on her behalf to Catherine Lewis La Torre to proceed with implementation of the loan scheme extensions {GD(B)/598 – INQ000585725}, {GD(B)/599 – INQ000585726} and {GD(B)/600- INQ000585727}.
- 7.76. Although the Future Fund was closed to new applications at the end of January 2021, BBB continued to manage the Government’s investment in companies that had accessed investment through the Fund. BBB continued operations of the fund based on the terms of the CLNs, an administrative task that did not involve judgements about the underlying investments. In late 2021, the Chancellor asked his officials to work with UKGI to test the market for a sale of the portfolio and develop options (e.g. for potential follow-on investments) {GD(B)/360 – INQ000585793}.

Forbearance Measures

- 7.77. Alongside the extensions to the loan schemes, on 24 September 2020, the Chancellor had also announced the forbearance measures for businesses repaying loans under BBLs and CBILs. These measures were detailed in paragraph 7.447.44 above and in summary borrowers could opt to:
- a) Extend their loan term from six to 10 years (BBLs and CBILs);
 - b) Make interest-only payments (BBLs); and

- c) Take a single full repayment holiday of six months (BBLs).
- 7.78. From a review of the correspondence between BEIS officials and BBB, I understand that BEIS was involved in this policy development along with HMT and BBB over the summer of 2020, but BEIS and BBB were not consulted as to the timing of the announcement {GD(B)/601 – INQ000564108} and {GD(B)/602 – INQ000564109}.
- 7.79. In advice sent to the Accounting Officer on 1 October 2020, BEIS officials stated that they were 'not sighted' on the forbearance measures aspect of the Chancellor's announcement (only on the extension to the three loan schemes) and therefore had not been able to seek the Accounting Officer's approval for the measures prior to this time {GD(B)/603 – INQ000564112}.
- 7.80. Accordingly, the advice sought the approval of the Accounting Officer, for the new forbearance measures, and continued:

"...we have been working with HMT, BEIS and BBB – alongside lenders and financial regulators – to develop a recoveries framework for the Covid-19 debt schemes that would seek to improve borrowers' ability to repay their debts and dampen any short-term economic shock, whilst balancing the need to protect taxpayer interests.

To date, this work has focused on BBLs, given it makes up almost three quarters of government backed Covid debt and carries a significantly higher risk of credit losses. We provided initial advice to you and the Secretary of State on this on 13 August, which set out a framework of minimum standards for recoveries, including the option to offer forbearance measures for borrowers in difficulty in the form of loan term extensions and repayment holidays. The Secretary of State had indicated that he agreed with the principles for the proposed framework, which were also supported by the Chancellor. The advice also highlighted that a final AO assessment would be provided before the approach was finalised."

- 7.81. BEIS officials considered that, although the forbearance measures (insofar as they relate to BBLs) changed the parameters of that scheme and meant considerable uncertainty regarding the potential impact of the changes on value for money, there was not a considerable increase in any of the Accounting Officer risks. Accordingly, another ministerial direction was not required. This was because the original ministerial direction was sought on the basis of the lack of certainty relating to value for money.

- 7.82. BEIS officials were unable to produce an accurate estimate of the impact of value for money due to the economic and health context of the time. Despite this, they assessed that the changes to the scheme would not drive a material increase in the level of Accounting Officer risks relating to propriety, value for money or feasibility. However, the regularity risk would be significantly heightened, given the lack of certainty around State aid. There would be a net benefit for value for money since lenders would act rationally and in their own interests.
- 7.83. The forbearance measures for BBLs were intended to relieve the pressure on businesses to service loans and provide some flexibility to businesses so that they could use resources to address recovering financially as a priority. Additionally, the forbearance measure for CBILs meant lenders were able to offer an extension to the term of lending where they considered it would assist the business to pay back the loan. Unlike the PAYG measures for BBLs, the CBILs forbearance measures were not open to all borrowers and were at the discretion of the lender to work with the borrower to ensure that loans were able to be repaid. Although this did not differ to the process that was already being undertaken about forbearance on CBILs, lenders previously were not able to offer to extend the term of the lending beyond six years if they hoped to benefit from the guarantee {GD(B)/603 – INQ000564112}.
- 7.84. On 30 October 2020, BEIS officials emailed the Secretary of State regarding implementation of the new forbearance measures {GD(B)/604 – INQ000585694}. The email attached a detailed update regarding this and confirmed the Permanent Secretary's view that the changes could be implemented under the existing ministerial direction {GD(B)/605 – INQ000585695}.
- 7.85. BEIS, HMT and BBB officials collaborated to produce a guidance document on the measures. The document was created at the request of the lenders and was intended to provide guidance for them on the new PAYG features and on dealing with debt recoveries. On 4 December 2020, BEIS officials emailed the Permanent Secretary with Accounting Officer advice regarding the PAYG measures and the recoveries framework and guidance document and annexed the draft guidance {GD(B)/606 – INQ000585720}, {GD(B)/607 – INQ000564187}, {GD(B)/608 – INQ000543540}, {GD(B)/609 – INQ000596689} and {GD(B)/610 – INQ000596690}.
- 7.86. On 4 December 2020, BEIS officials also sent advice to the Secretary of State on the PAYG measures and recoveries framework and guidance document for BBLs {GD(B)/611 – INQ000543539} and {GD(B)/612 – INQ000564161}. The advice

acknowledged that, despite being supportive of the creation of the guidance, there were limitations identified with such a document in view of the fact that it was not possible to add requirements on lenders that went beyond the guarantee agreement. In this regard, the submission stated:

*“The guidance is **non-binding** on lenders; their obligations are set out in the Guarantee agreements signed between them and BBB, and it is not possible for us to impose obligations in this guidance which go beyond those codified in those agreements.”* (Original emphasis)

7.87. The advice outlined the residual risks as advised to the Permanent Secretary and requested that the Secretary of State write to the Chancellor to note the same and seek direction from him as to how the guidance could be amended to mitigate those risks. These risks included:

- a) Lender discretion. The guidance allowed lenders to exercise discretion for various reasons, which could have led to borrowers being treated inconsistently between lenders, and could potentially have hindered some fraud prosecutions;
- b) Investigation of fraud. The guidance did not impose any particular obligations on lenders to investigate fraud and emphasised: *“By relying on lenders’ usual processes (and recognising their limited incentives to investigate fraud where they can rely on the guarantee to cover their losses), the guidance re-emphasises that it will not be possible to investigate significant volumes of fraud in relation to the scheme.”*; and
- c) Misstatement of turnover. Following BEIS’ request to the Chancellor, lenders were expected to investigate misstatement of turnover (25% or more) and treat as fraudulent if appropriate. However, lower misstatements of turnover were unlikely to be investigated, which meant that some borrowers would continue to have access to funds that they were not entitled to (notwithstanding that they would be expected to repay the funds).

7.88. Further, it was confirmed that other parts of government had also expressed concerns about the guidance not placing sufficient obligations upon lenders, including the Home Office and the National Crime Agency and:

“...in doing so could create an expectation on law enforcement to investigate fraud which is not matched by available capacity in the system, and unlikely to be. Meanwhile Cabinet Office have highlighted inconsistencies between the

approach taken in this guidance versus other forms of public sector debt, such as overpayment of benefits.

*HMT have responded to these points by clarifying that the guidance does not place any new requirements on law enforcement, and by highlighting what they see as the distinction between Bounce Back Loans (delivered by a commercial lender based on self-certified information) and other forms of public sector debt such as overpayment of Universal Credit. **They do not wish to make further substantive changes to the guidance.***

Given the non-binding nature of the guidance and its subservience to the Guarantee Agreement, we recognise the limitations that HMT are working with. However, we do consider more could have been done to promote consistency of borrower treatment, for example by providing a range of scenarios with ‘expected’ recovery approaches for each.” (Emphasis added)

- 7.89. The advice recommended that the Secretary of State write to the Chancellor and outline these limitations and ask for HMT’s collaboration in strengthening the guidance including with more detailed scenarios to support lenders.
- 7.90. On 7 December 2020, the Permanent Secretary’s office emailed BEIS officials and conveyed her approval as Accounting Officer for a draft letter to be sent to BBB requesting the implementation of the PAYG measures {GD(B)/613 – INQ000564162}. The Permanent Secretary also sought and received confirmation that the Secretary of State had been given advice on the same points and been offered the chance to push them with the Chancellor {GD(B)/614 – INQ000564163}.
- 7.91. The next day, the Secretary of State’s private office emailed HMT and sought formal approval to implement the PAYG forbearance measures for BBLS, and raised the risks associated with that and the guidance as outlined in paragraphs 7.86 and 7.87 {GD(B)/615 – INQ000564164}. HMT responded the same day, providing formal approval to implement the PAYG options and agreeing to provide the budget cover {GD(B)/616 – INQ000564165}. In relation to the issues raised by BEIS about the guidance document, HMT said as follows:

“The supporting guidance to lenders ... is the product of close collaboration across government, and with input from lenders and the regulators. It provides lenders with clear and detailed principles, to promote consistency of treatment of borrowers in similar circumstances, in line with the standard of care required

under the scheme. Lenders are required under the scheme rules to operate collections and recoveries in line with their business-as-usual processes, and this guidance helps ensure that – where there is room for discretion – lenders have a clear and detailed view of our expectations, while retaining the ability to adjust their approach for an individual’s circumstances, as is right.

You note that BEIS would like to continue discussions on counter-fraud measures, considering additional scenarios which might usefully complement the material already included in the guidance. We support this – the guidance captures the key issues around fraud at present, but of course this is a live policy issue and we recognise the importance of continuing to work with lenders if, as and when any additional issues arise.”

- 7.92. On 8 December 2020, the Permanent Secretary instructed BBB to proceed with implementation of the forbearance measures {GD(B)/617 – INQ000543548} and {GD(B)/582 – INQ000564166}. BEIS officials advised BBB by separate email that the Department was content for them to issue the guidance principles to lenders {GD(B)/618 – INQ000564167}.
- 7.93. As outlined at paragraph 7.62, the Chancellor later decided to further amend the PAYG options. From 8 February 2021, borrowers would be able to take the six-month repayment holiday immediately if they wished, rather than having to wait until after they had made six full or interest-only payments. On 4 February 2021, BEIS officials wrote to the Permanent Secretary to confirm the changes and the impact for the Department {GD(B)/619 – INQ000585734} and attached the 4 December 2020 Accounting Officer Assessment on the schemes. As the amendment did not materially change the Accounting Officer Assessment on the schemes, there was no need for a further ministerial direction, and as there was no extension to the budgetary cover already granted by HMT, there was also no need for an exchange of emails between BEIS and HMT private offices. Similar advice was provided to the Secretary of State (by then, Rt Hon Kwasi Kwarteng) on the same date and approved by Minister Scully (at the Secretary of State’s request) {GD(B)/620 – INQ000564181}. The Permanent Secretary advised that she was content with the approach the next day {GD(B)/621 – INQ000564182}.
- 7.94. On 6 February 2021, Tom Child (acting Director, Business Growth Directorate, at BEIS) emailed Catherine Lewis La Torre advising of the amendment to the PAYG

measures and instructing BBB to proceed with implementation of the same {GD(B)/584 – INQ000564183}.

- 7.95. On 23 November 2021, BEIS officials sent a submission to Minister Scully and the Permanent Secretary regarding the draw down of asset finance facilities for CBILS and seeking our approval to extend the drawdown deadline from 30 November 2021 to 31 March 2022 {GD(B)/622 – INQ000585785} and {GD(B)/623 – INQ000585786}. This request was an effort to assist businesses affected by supply chain challenges, as “...due to the [then] global supply chain problems some borrowers [would] not [have been] able to take delivery of the assets in question (e.g., machinery and equipment) until the New Year.”
- 7.96. On 30 November 2021, the Permanent Secretary approved the proposed extension as Accounting Officer while noting that the decision was subject to Ministerial and HMT views {GD(B)/624 – INQ000564234}. HMT ministers and Minister Scully also provided their approval {GD(B)/625 – INQ000564236} and {GD(B)/626 – INQ000564235}.

Evaluating the Covid-19 Loan Schemes: BBLs, CBILS and CLBILS

- 7.97. In March 2021, BBB commissioned London School of Economics and Ipsos to undertake a three-year evaluation of BBLs, CBILS and CLBILS. The aim of the evaluation was to assess whether the objectives of the Covid-19 loan schemes were met.
- 7.98. The first of the three reports as part of this evaluation was published in June 2022 and entitled ‘Evaluation of the Bounce Back Loan Scheme, Coronavirus Business Interruption Loan Scheme, and Coronavirus Large Business Loan Scheme’. It assessed the impacts of the schemes in 2020, the scheme design and the lender accreditation processes {GD(B)/627 – INQ000096931}.
- 7.99. The second of the three reports as part of this evaluation was published in November 2023 and entitled ‘Year 2 Evaluation of the Bounce Back Loan Scheme, Coronavirus Business Interruption Loan Scheme, and Coronavirus Large Business Loan Scheme’. It assessed the impacts of the schemes in 2021, the monitoring, repayment and counter fraud processes {GD(B)/628 – INQ000593115}.
- 7.100. The third and final of the three reports as part of this evaluation remains in draft form and will be published later this year, as set out in Part A, paragraph 6.20. It assessed the impacts of the schemes in the third year after the onset of the pandemic, the repayments, recoveries and counter fraud work.

7.101. The third report considered the evidence collected across the whole of this evaluation to assess the success of the Covid-19 loan schemes against their objectives (set out at paragraphs 7.22 to 7.25).

7.102. The report found that the schemes met their short-term objectives by:

- a) Providing businesses with finance at a scale and pace that could not have been otherwise achieved. In the absence of funding obtained through the Covid-19 loan schemes: (i) 74% of BBLs borrowers and 69% of CBILS and CLBILS borrowers would not have obtained any external finance or sufficient external finance for their cash flow needs, and (ii) 7% of BBLs borrowers and 8% of CBILS and CLBILS borrowers could have obtained a sufficient level of external finance but not in a timely manner; and
- b) Providing support that was complementary to other support schemes such as the Coronavirus Job Retention Scheme. Econometric analysis demonstrated a positive impact of the schemes on turnover and employment. The report estimated that nearly a million jobs could have been lost in the absence of the loan schemes. Many businesses took advantage of several other forms of government support, but indicated during the interviews undertaken as part of the evaluation that the schemes were still very important for their survival.

7.103. The medium-term objectives were met by:

- a) The schemes offering funding that in most instances would not have been obtained and was used by most businesses to continue daily operations. The report stated that (i) 81% of BBLs loans and 77% of CBILS and CLBILS were estimated to be additional (i.e. funding that would not have been provided in sufficient speed or quantity in the absence of the schemes); and (ii) 60% of BBLs borrowers and 68% of CBILS and CLBILS borrowers used their scheme funding for working capital, cash flow or day to day costs; and
- b) The design of BBLs had driven an increase in lending which would not have been provided in the absence of the scheme. The arrears rates for SMEs were higher under BBLs (approximately 27%) and CBILS (approximately 7%) than the rates typically expected in commercial lending (2%). The design of BBLs was reported to have increased the arrears and default rates.

7.104. With respect to the long-term objectives, the report recommended a further evaluation in a few years' time was required to assess how the schemes impact business survival

and growth in the long term. However, the report found that the finance provided by the schemes had played an important role in ensuring business survival and boosted the turnover of participating businesses as at the date of the report.

- 7.105. As to the benefits and costs of the schemes, the report concluded that even if there were no further benefits of the schemes beyond the evaluation period, the schemes still represented good value for money. The schemes created around £27 billion to £78 billion of benefits for UK businesses. However, the economic costs of the scheme were also very substantial, estimated to be close to £20 billion. The report set out that whilst the benefits of CBILS and BBLs were similar, CBILS offered a better value for money than BBLs. This was because of the much higher (almost ten times higher) cost of unrecovered loans under BBLs than CBILS. The high cost of unrecovered BBLs loans were likely because there was much more suspected fraud under BBLs, higher closure rates among BBLs borrowers and BBLs government guarantee is higher at 100% rather than 80% under CBILS. In relation to CLBILS, although it provided value for money, it was on a much smaller scale than for CBILS and BBLs. This was expected given that finance under CLBILS was extended to large, established businesses which typically repaid their loans quickly and without issue. Additionally, there were far fewer CLBILS borrowers than borrowers under CBILS and BBLs.

Evaluating the Covid-19 Loan Schemes: Future Fund

- 7.106. In February 2021, a submission was prepared which provided an update on the Future Fund and in particular, the work being undertaken to analyse the portfolio {GD(B)/629 – INQ000564196}. The submission stated that the Future Fund had approved a higher proportion of investment for seed and venture stage firms (23% and 43%) compared to the wider equity market (9% and 34%). It was suggested that this meant that the Future Fund had been successful in helping businesses continue to grow and secure finance when they might otherwise have struggled to access capital.
- 7.107. In 2022, BBB began a formal evaluation process of the Future Fund. RSM UK Consulting were commissioned by BBB to undertake the economic evaluation. The Future Fund evaluation adopted a three-year approach. The early assessment was to focus on immediate outputs, as well as an initial evaluation of the program's additionality and reach. The interim evaluation was to assess short-term outcomes, including a full additionality assessment and the program's success in preserving the pipeline of innovation. The final evaluation was to look at whether long-term objectives had been achieved and assess the overall value for money. Further details on this

evaluation process are set out in the draft Outcome Delivery Plan for 2022-2023 at {GD(B)/630 – INQ000564255}. These evaluations have become known as Future Fund Early Assessment Reports or Evaluation Reports.

7.108. BBB’s first report covered the period between May 2021 and April 2022 (Year 1) and the second report update covered the period from November 2022 to March 2023 (Year 2) {GD(B)/631 – INQ000146532} and {GD(B)/632 – INQ000576416}. In Year 1, the report analysis was based on self-reported survey responses and did not examine issues of debt recovery or fraud. In Year 2, the methodology relied on secondary sources and did explore issues in relation to debt recovery and fraud.

7.109. The reports considered the seven programme objectives of the Future Fund, as listed below, against the available evidence. The first two reports found the following:

<u>Section 2: Objective</u>	<u>Section 3: Progress Year 1</u>	<u>Section 4: Progress Year 2</u>
<u>Section 5:</u> Increase the supply of finance to potentially viable UK equity backed companies whom would otherwise have had problems raising finance, or been underfunded, due to adverse market conditions.	<u>Section 6:</u> At this early stage, the objective was regarded as met in most cases with some evidence of possible “financial additionality” which meant the financial support the Future Fund brought to businesses would not have been available through commercial sources elsewhere.	<u>Section 7:</u> The objective was regarded as met with fundraising growth among the firms supported by the Future Fund evidenced as significantly higher than among those equity backed firms who did not obtain Future Fund support (referred to as the “counterfactual” in the reports).
<u>Section 8:</u> Recipients have a positive experience (e.g., speed, clarity and ease of the application process).	<u>Section 9:</u> This was regarded as broadly met with results from surveys showing most recipients strongly agreed that the application process was clearly designed and well explained and that structuring the investment with a CLA rather than equity funding had helped to facilitate valuations during the pandemic.	<u>Section 10:</u> The objective was regarded as met with fundraising growth among the firms supported by the Future Fund evidenced as significantly higher than among those equity backed firms who did not obtain Future Fund support (referred to as the “counterfactual” in the reports).
<u>Section 11:</u> The fund is reducing the risk of business closures caused by potentially viable businesses running out of cash in the short run.	<u>Section 12:</u> There was some evidence that business closures may have been averted but further evidence and assessment were noted as required at this stage; and	<u>Section 13:</u> The report analysis revealed that the counterfactual sample of firms had slightly higher survivability and the higher proportion of venture and seed-stage companies in the portfolio

<u>Section 2: Objective</u>	<u>Section 3: Progress Year 1</u>	<u>Section 4: Progress Year 2</u>
		group could signal a higher risk profile.
<u>Section 14:</u> To reduce the risk of companies' long-term prospects being damaged due to adverse economic conditions relating to Covid-19 (e.g., cuts to employment/reductions in R&D and product development) and companies return to their long-term growth path once conditions stabilise.	<u>Section 15:</u> There was some early evidence that this objective was being met – both based on the survey results and the modelling work; and <u>Section 16:</u>	<u>Section 17:</u> The report analysis revealed the performance of companies funded by the Future Fund dropped below the counterfactual group in 2022 although fundraisings growth performance was comparable. The report noted it was still too early to draw conclusions on turnover performance.
<u>Section 18:</u> To help ensure the long-term pipeline of equity backed companies is not damaged due to adverse economic conditions relating to Covid-19.	<u>Section 19:</u> It was regarded as too early to tell if this objective was met; and	<u>Section 20:</u> The analysis noted a decline in portfolio growth performance in 2022 and that in absolute terms, the counterfactual has stronger growth prospects. It also noted "Year 3 qualitative research will explore and test hypotheses for the lower portfolio performance in 2022".
<u>Section 21:</u> Within the constraints of a standard set of eligibility criteria, to ensure that the funding provided is used for the purpose intended in relation to fraud, excessive risk taking, gaming of returns etc.	<u>Section 22:</u> Progress in Year 1: Early evidence suggested that the funds may have helped to directly and indirectly support R&D – but these were indicative results at this stage. <u>Section 23:</u>	<u>Section 24:</u> Progress in Year 2: This was not covered in the report. <u>Section 25:</u>
<u>Section 26:</u> Objective: The programme provides a net economic benefit to the wider economy	<u>Section 27:</u> Progress in Year 1: It was regarded as too early to tell if this objective was met; and	<u>Section 28:</u> Progress in Year 2: This was not covered in the report.

7.110. The Year Three report is in draft at the current time, so BBB have not drawn a final conclusion across the full range of objectives along with an overall value for money

assessment. A number of the objectives will require in depth market assessment before further conclusions can be made.

Cost of the Future Fund

7.111. As set out in the Ipsos Report, although a total of £1.14 billion in funding was provided to businesses through CLNs, the overall cost of the Future Fund will depend on the default rates on the convertible loans and price at which the government is able to dispose of equity stakes acquired. The BEIS Annual Report for 2022-2023 recorded the fair value of the fund as £851 million as at 31 March 2023. However, the report confirmed there is judgement and estimation uncertainty in the valuation of the Future Fund due to the significant number and diversity of borrowers, the options available to borrowers under the under the Convertible Loan Note Agreements (**CLAs**), and data limitations.

7.112. In October 2021, the expected loss resulting from insolvencies according to the Office for Budget Responsibility (**OBR**) for the Future Fund was £75 million. In June 2022, the capital forecast for the Future Fund was built on expected losses of 45%, with 5% redemption and 50% conversion {GD(B)/633 – INQ000564269}. No update on the financial costs of the scheme was provided in the Year 2 Future Fund Early Assessment Report given the early-stage nature of the portfolio. It should also be observed that some companies in the portfolio received funding later than others. As at 31 December 2024, the Future Fund held an equity interest in 680 companies from 1,192 investments. 309 of these investments are now insolvencies and 86 are “cash realisations” i.e. investments that have been realised for cash as a result of a company being acquired. Consequently, the Future Fund no longer holds an Equity Interest or a Loan in those companies.²³

²³ Future Fund Portfolio Overview, 31 December 2024, {GD(B)/634 – INQ000576426}

SECTION 8: THE RECOVERY LOAN SCHEME (RLS)

Introduction

- 8.1. In this section I address the introduction of the RLS to support businesses recovering from the impact of the pandemic and the restrictions that had been in place. I set out the objectives of the scheme, the policy rationale, scheme development and its implementation. At Section 9 below, I set out my reflections on RLS in further detail, as well as lessons learned within the Department for any future emergencies
- 8.2. RLS was not formally named as such until later in its development and only shortly prior its launch on 6 April 2021. It is therefore referred to in most of the exhibits as the ‘new guarantee scheme’ or ‘the new scheme’. However, for consistency and ease of reference I will refer to it throughout this statement as RLS.

Economic Policy Objectives of RLS

- 8.3. RLS was introduced as a means to support access to finance for SMEs in the wake of the pandemic and following the closure of the three Covid-19 loan schemes (CBILS, CLBILS and BBLS). RLS finance could be used by these businesses for any legitimate business purpose, including working capital or investment {GD(B)/635 – INQ000564279}.

Early consideration of RLS

- 8.4. As previously set out at paragraph 7.28, on 3 September 2020, BEIS officials sent a submission to the Secretary of State setting out their initial thinking on either extending the three Covid-19 loan schemes beyond the planned closure dates or closing them as planned {GD(B)/554 – INQ000564096}. In the submission BEIS officials recommended extending CBILS for a short period to the end of December 2020 to mitigate the risk of SMEs losing access to finance during a potential Covid-19 resurgence that winter, but to proceed to close CLBILS and BBLS for applications as planned on 20 October 2020 and 4 November 2020 respectively.
- 8.5. Officials stated that:

“BBB maintain[ed] an open dialogue with lenders and [had] advised that the market [would] likely consider a termination of CBILS without some form of replacement as problematic, as it could create a cliff edge effect.”

- 8.6. Accordingly, BEIS officials were working with BBB to consider longer-term options. These options were expected to align with the Government's wider plans for economic recovery, the refreshed industrial strategy, and to respond to the challenges SMEs faced as they approached the end of the transition period out of the pandemic.
- 8.7. BEIS officials considered that any longer-term successor schemes also needed to be deliverable for BBB and lenders under the current delivery approach, and it was acknowledged that this would place some constraints around the nature of schemes and the pace at which they could be introduced. BBB had suggested that any announcement on closure dates of the three Covid-19 loan schemes would ideally be combined with a statement regarding a future loan scheme to maintain business confidence.
- 8.8. A further objective to develop a longer-term and less fraud-prone loan scheme was the ongoing BBLs counter fraud work. In this regard, the submission stated:
- “When BBLs was introduced, [the Secretary of State] and the Chancellor decided to accept additional risk given the urgent need to get money out more quickly to otherwise-viable small businesses during the national lockdown. This was an exceptional scheme but comes at very high cost to HMG – owing to significant credit and fraud risks – and cannot be a long-term feature of the market.”*
- 8.9. As set out at paragraph 7.32, on 8 September 2020, HMT officials sent a submission to the Chancellor seeking his views on closing the Covid-19 loan schemes {GD(B)/556 – INQ000564098}. This submission advised that lenders and business representatives had begun to ask if there would be a new scheme to replace the Covid-19 schemes, and noted the significant limitations of the previous scheme, EFG. BEIS and BBB were starting to consider options for a new scheme beyond 2020, and HMT were to “...stay close to them on this.”

Scheme Design

Development of RLS

- 8.10. On 30 September 2020 a meeting was held between BEIS, HMT, BBB and UKGI officials to discuss the options going forward {GD(B)/636 – INQ000585682}. In advance of the meeting, attendees were provided with two documents prepared by BBB: a discussion paper titled ‘Options for future Government intervention in SME debt markets’ {GD(B)/637 – INQ000585683} and a presentation titled ‘Options for

Government intervention in SME debt markets post-CBILS' which highlighted key points from the paper to guide discussions at the meeting {GD(B)/638 – INQ000564111}.

8.11. The discussion paper provided the market context, setting out the impact of Covid-19 on SME debt markets and the likely features of the market in the coming months. These included:

- a) The unprecedented levels of SME borrowing during Covid-19 as businesses borrowed funds to meet immediate cash flow needs. The majority of this borrowing had been backed by the Government under CBILS and BBLs;
- b) Levels of borrowing by SMEs were expected to remain high in the coming months. There were at least three factors which were likely to drive demand for finance in the coming months, in addition to business-as-usual requirements:
- c) Many SMEs' resilience was expected to have been weakened by the economic disruption from the national lockdown and ongoing restrictions. There would also likely be large sectoral differences in SME resilience and need for liquidity;
- d) Some SMEs would want or need to invest in their business, to capitalise on opportunities or adjust to a 'new normal' post Covid-19;
- e) The impact of the EU Exit on business operations would likely drive further demand for finance; and
- f) The uncertain economic climate presented by both Covid-19 and EU Exit raised questions of business viability. This impacted lenders' risk appetite, with lenders likely to take an excessively risk-averse approach to SME lending. From a commercial perspective, this was a rational behaviour from lenders and highlighted existing structural failures in the SME market caused by 'information asymmetries' (the inability to efficiently price risk given high costs of due diligence relative to the lower value of transactions). Previous experience showed that this structural failure would be further exacerbated by cyclical failures as lenders pulled back from the SME market. Further, alternative lenders faced challenges and it was less certain that they would be able to fill the gap left in the market by the large lenders.

8.12. Given the market context and the cyclical and structural market failures, BBB considered that intervention would be required to ensure that viable demand did not exceed the supply of lending to SMEs. The majority of new jobs created following the

financial crisis were created by SMEs, so it was vital that they were able to access finance for ongoing liquidity needs, investment and growth. Failing to provide intervention to SMEs would have significant consequences for the economy. The paper stated:

“Without intervention from a risk neutral party (i.e. Government), the country is likely to suffer compounded economic costs due to negative externalities: higher risk (perceived or otherwise) leads to a reduction in lending, resulting in more business deaths which in turn increases aggregate risk – a vicious cycle, with severe consequences for jobs/employment.”
(Original emphasis)

- 8.13. BBB’s paper also set out numerous options for intervention in SME debt markets, with various public bodies responsible for each. These included:
- a) Amending bank capital requirements (Bank of England);
 - b) Liquidity schemes (Bank of England);
 - c) Funding of non-bank lenders (Bank of England/BBB);
 - d) Putting soft pressure on lenders (HMT/Bank of England);
 - e) Increasing BBB programmes such as Start-Up Loans, ENABLE and Investment Programme (BBB);
 - f) Offering a new debt guarantee scheme (BBB); and
 - g) Introducing new BBB products (BBB).
- 8.14. BBB considered that macro interventions led by the Bank of England, on their own, were unlikely to sufficiently address either cyclical or structural market failures in SME finance, and therefore BBB did not recommend pursuing these options. Disadvantages included a lack of targeted focus on lenders’ risk appetite for SME lending, coverage of non-bank lenders and evidence of previous pass-through of benefits into the SME market.
- 8.15. BBB considered that a 1 January 2021 implementation date for any new scheme was important to prevent a ‘cliff-edge’ in Government support once the existing schemes ended. However, the time available to design an intervention and deliver it to the market meant that any intervention commencing on 1 January 2021 would need to be based on existing schemes or products. BBB’s analysis suggested that the most

suitable and deliverable option was evolving and renaming CBILS. BBB thought this option could address the need for intervention quickly and effectively.

- 8.16. Various options were specifically proposed to amend CBILS and provide ongoing assistance to SMEs in practice in the short term. Longer-term options were also suggested, which included loans with Government support for capital repayments, perpetual bonds and merchant advance loans for retail-facing sectors.
- 8.17. At the 30 September 2020 meeting, BEIS and HMT agreed with BBB's proposal that a new loan scheme should replace EFG and CBILS {GD(B)/639 – INQ000564113}.
- 8.18. Discussion as to the design of a new scheme continued throughout October 2020, and officials obtained steers from the Secretary of State at a meeting on 12 October 2020 {GD(B)/640 – INQ000564116}. The purpose of the meeting was:

“[t]o outline what a new loan guarantee scheme to replace the Coronavirus Business Interruption Loan Scheme from 1 January could look like, and to seek [the Secretary of State’s] initial steer on four key design choices.”

- 8.19. These design choices related to:
 - a) Policy objectives for the new scheme – officials suggested the new scheme could provide support to businesses that otherwise would not have been able to access external finance, and those that lenders considered to be fundamentally viable in the long term. This was expected to increase value for money but would reduce the number of businesses eligible for the support;
 - b) Short versus long-term scheme – *“A new scheme could seek to address longstanding market failures affecting SMEs, but in a way that can be flexed in the short term to cope with ongoing economic volatility, for example resulting from a second lockdown and the end of the transition period.”* Officials suggested that in the short term, CBILS could be tapered by:

“...retaining attractive components such as the 80% lender guarantee, low guarantee premium for lenders, and broad eligibility criteria, but removing the Business Interruption Payment (i.e. interest free period) on the grounds that it does not represent value for money.”
 - c) In the medium to long term, it was suggested that the generosity of the scheme could be reduced by increasing the guarantee premium and decreasing the lender guarantee;

- d) Market segments – in moving from operating three schemes to a single scheme, the Department needed to decide which part of the market to target, and this required further economic analysis. Points raised for discussion included around support for both small businesses (“...*there are difficulties at < £25k due to the stipulations of the Consumer Credit Act. It would be simpler to exclude loans of this size, but this could leave smaller businesses without options.*”) and larger businesses (“*In normal economic circumstances, larger businesses should be able to access external finance on their own. However, we cannot rule out the possibility of further economic impacts on the level of those suffered from March, and so arguments for support in the £5m to £200m bracket may resurface.*”); and
- e) Timing and gap in provision – the Chancellor announced on 24 September 2020 that the three existing Covid-19 loan schemes would be extended until 30 November 2020, and the new scheme would operate from 1 January 2021, leaving a gap in provision of support in December 2020. However, there were challenges with introducing a new scheme sooner, whilst lenders were still struggling to process existing loan applications {GD(B)/641 – INQ000564285}.
- 8.20. Further meetings were set up on a weekly basis for attendance by officials from BEIS, HMT, BBB and UKGI to discuss the new loan scheme {GD(B)/642 – INQ000585685}, {GD(B)/643 – INQ000585686}, {GD(B)/644 – INQ000564117}, {GD(B)/645 – INQ000585693}, and {GD(B)/646 – INQ000585707}.
- 8.21. Officials and ministers recognised the need to learn lessons from BBLs and wanted to “...*implement a robust counter-fraud response ready for the launch of the successor scheme.*” See, for example, the email of 16 October 2020 following a meeting between officials and the Secretary of State {GD(B)/482 – INQ000564120}.
- 8.22. At a BFAB meeting on 21 October 2020, discussions took place regarding the design principles and the approach being taken for the ‘successor loan guarantee scheme’ {GD(B)/453 – INQ000538876} and {GD(B)/647 – INQ000564148}.
- 8.23. The three Covid-19 loan schemes and Future Fund were further extended until 31 January 2021, in turn delaying the need for a further government-backed loan scheme until after that date. A submission for the Secretary of State concerning the potential new loan scheme was updated to reflect these new dates, with the extensions meaning that there was additional time available to make the requisite decisions on RLS. On 9 November 2020, the amended submission was sent to Minister Scully and Special

Advisers {GD(B)/648 – INQ000564140}. The submission sought a response from the Secretary of State by 13 November 2020, with the scheme to be implemented by the beginning of February 2021.

- 8.24. Initial views from BEIS officials and **Name Redacted** a Special Adviser to the Secretary of State, in this period indicate that RLS was seen as the first stage of a return to 'normal', moving away from the former Covid-19 loan schemes and towards slightly more business-as-usual loan schemes {GD(B)/649 – INQ000585712}.
- 8.25. On 16 November 2020, following a conversation with **Name Redacted** shared a new shortened version of the submission with senior BEIS officials for clearance before being sent on to the Secretary of State {GD(B)/650 – INQ000585710} and {GD(B)/651 – INQ000585711}.
- 8.26. On 17 November 2020, **Name Redacted** sent this submission to the Secretary of State to confirm that the Chancellor had announced a new scheme which would be available from February 2021, and to seek his views on the design of the new scheme {GD(B)/652 – INQ000585715} and {GD(B)/653 – INQ000585714}. A response was sought by 20 November 2020 to allow BEIS officials to work with HMT on detailed scheme development including the implications of Northern Ireland Protocol, modelling of take-up, and engagement with lenders. BEIS and HMT had agreed in principle the proposed terms of the new scheme, and officials from BEIS, HMT and BBB were engaging with lenders on the details of the scheme that week.
- 8.27. On 19 November 2020, BBB provided recommendations to BEIS and HMT proposing closing the three Covid-19 loan schemes to new lenders {GD(B)/654 – INQ000585718} and {GD(B)/052 – INQ000585719}. BBB advised that given the resource intensity of the accreditation process, BBB resource would be more efficiently focused on the design and implementation of the successor scheme to CBILS, and on areas that could unlock additional lending in CBILS. Additionally, it would be 'operationally unmanageable' for the small accreditation team to manage new applications for the existing schemes and simultaneously begin preparing to accredit lenders for the new scheme.
- 8.28. In relation to accrediting lenders for the new scheme, BBB proposed a two-stage accreditation process:

“Stage one will bring across existing CBILS lenders (who opt into the new scheme and satisfy the Accelerated Accreditation Criteria ... Stage two will

involve opening the new scheme for new accreditations. We currently intend to publish the request for proposals for the new scheme in February 2021 and be open for applications from March 2021 (once existing eligible lenders have been accredited)."

- 8.29. The 17 November 2020 submission recommended a single new UK loan scheme based on the same framework as EFG and CBILS and offered to all eligible businesses across the UK. Officials advised that from 1 January 2021, the Government would follow the World Trade Organisation rules for subsidy control with exceptions for trade in goods between Northern Ireland and the EU following the end of the transition period on 31 December 2020. A single UK scheme was recommended due to the complex operational challenges of implementing a 'two-tier scheme' and the risk that this would create an 'internal border' or division between Northern Ireland and Great Britain.
- 8.30. In the submission, officials reviewed the terms of CBILS and reconfirmed whether certain aspects of CBILS should be incorporated into the new scheme. They advised that while support should be more narrowly tailored to resemble commercial lending, this new scheme should not be overly selective to ensure good businesses were not rejected. Accordingly, the additionality and viability tests that were initial features of CBILS (prior to its modification) were not part of this new loan scheme.
- 8.31. The proposed terms for the scheme at this stage differed importantly from CBILS in that:
- a) Loans would vary in size from £5,000 to up to £10 million;
 - b) No interest or fees paid by the Government;
 - c) There would be no turnover limit;
 - d) Lenders could seek personal guarantees for lending less than £250,000;
 - e) Technical changes would be made to the 80% guarantee coverage to make the product useful for invoice finance; and
 - f) No interest cap, though BEIS considered most loans would be well below the CBILS 14.99% cap.
- 8.32. Costs and risks of the scheme were considered in the submission. Officials advised that the new scheme needed:

“...to strike a balance between maximising value for money for taxpayers, managing credit and fraud risk and addressing the failure of the market to deliver sufficient volumes of commercial loans to viable businesses, at pace.”

- 8.33. Initial estimates were that if the economy recovered and the pandemic subsided quickly from early 2021, the cost of the scheme over a three-year period might be between £0.8 billion to £2.3 billion. If the pandemic was prolonged, the cost would be higher, in the range of £1.4 billion to £4.1 billion. However, the submission stress that these figures were indicative only and work was ongoing to assess potential uptake and costs. Officials were also exploring measures that could be implemented to mitigate the risk of fraudulent use of the scheme, drawing on lessons learned from BBLs. The new scheme would not rely on self-certification by borrowers, and thus it was considered that the inherent vulnerability of the scheme to fraud would be significantly reduced. Based on the terms of the new scheme at that time, no significant risks regarding Managing Public Money were identified that would require the Permanent Secretary as the Accounting Officer to seek a ministerial direction.
- 8.34. The Secretary of State continued to consider this advice through the end of November 2020. On 1 December 2020, following a meeting with the Secretary of State, BEIS officials emailed an update to HMT and BBB officials with a readout of ministerial steers {GD(B)/655 – INQ000564159}. The Secretary of State’s feedback on the proposed RLS was that he:
- a) Agreed with the recommendation for single UK-wide scheme;
 - b) Thought that a shorter business interruption payment (BIP) of six months, by which government covered interest payments, should be considered to help businesses through the first few months of 2021, because the Secretary of State *“...felt that in February the economic situation could be very poor, whereas by May/June once widespread vaccination had taken place he foresaw a boom in travel, leisure and hospitality in particular. Therefore the task of the new scheme would be to keep businesses intact for a few more months and allow them to raise working capital ahead of reopening.”*;
 - c) Considered it would be important to offer loans under £25,000, *“...and that so long as one or two market participants would offer these, such as Funding Circle, then he was relaxed about the position of the large banks.”*;

- d) Wanted to keep the 14.99% interest cap and agreed with the fixed 175 basis point fee and reduction for invoice finance and for smaller amounts; and
- e) Did not want to allow personal guarantees for loans below £250,000 and sought an assurance that security on directors' homes was not allowed, which was given by BEIS officials.

8.35. The Chancellor's views on RLS were also provided in that email, as follows:

"The Chancellor confirmed that he was still planning for a 1 February [2021] start date for the new scheme, without a BIP. He is doubtful about going below a 25k minimum loan size, given the well-known CCA issues and the fact that suspending CCA protections is not an option we can (or probably should) use again)."

8.36. At this time, the Secretary of State was not willing to finalise the terms of the scheme until they had more clarity on the economic and other conditions closer to the proposed launch date. This was because the purpose of the scheme was to be responsive and therefore greater clarity was needed about the situation to which it was responding. HMT officials agreed that the Chancellor would also be unwilling to finalise the terms of the scheme until much closer to the launch date of 1 February 2021.

8.37. BEIS officials consulted with IDAB on the development of RLS²⁴. On 4 December 2020, the Department formally requested advice from IDAB, and a meeting was held on 8 December 2020 to discuss the new scheme and obtain IDAB's views {GD(B)/656 – INQ000564160}.

8.38. On 14 December 2020, IDAB sent an email to BEIS and BBB officials with their conclusion on the new proposed scheme {GD(B)/657 – INQ000564169}. The conclusion reached at the IDAB meeting on 8 December, which was signed off by its Chair, was as follows:

"IDAB is very supportive of the British Business Bank Guarantee Scheme as the Board understands given the current circumstances that something needs to be done. A continuation of CBILS and progressing along these lines is probably a sensible approach. The project team needs to consider further all of

²⁴ IDAB is a statutory body established under the Industrial Development Act 1982 (IDA). It sat under the former BEIS (and now under Department for Business and Trade) and provides commercial views to Ministers on various industrial strategy proposals, including relevant proposals to support industry and financial assistance under the IDA.

the points raised by the Board which have hopefully provided pointers as to how to improve on this scheme before it is rolled out.”

Economic Policy Objectives of the Scheme

8.39. A BEIS submission dated 21 January 2021 sought a steer from the Secretary of State, the Rt Hon Kwasi Kwarteng, in relation to the policy objectives of RLS {GD(B)/658 – INQ000564174}. The submission set out that:

“...the choice is between a relatively generous scheme that continues to support ‘viable’ businesses to stay afloat until normal trading conditions resume, and a more ‘additional’ and targeted scheme that focuses on growth and investment.”

8.40. There were risks identified with both policy objectives:

“On the one hand, if we seek to maximise business survival we risk incurring ‘deadweight’ costs by subsidising commercial lending that would have happened anyway, as well as also propping up some ‘zombie’ companies. On the other hand, if we seek to limit the Government’s financial exposure and target growth and investment before the impacts of the pandemic have subsided, we risk spiralling insolvencies and economic ‘scarring’ if businesses cannot access the finance they need.”

8.41. Officials proposed “...a ‘two-phase’ scheme that focuses on business survival in the short-term, before ‘tapering’ to focus on growth and investment in the long-term;” and also sought a steer from the Secretary of State on the approach to subsidy control, following the UK-EU Trade and Cooperation Agreement coming into force:

“Given that loans to businesses in scope of the NI Protocol remain subject to the EU’s State aid rules, we must decide whether to mirror these rules in GB, or require that lenders operate two variants concurrently, to take full advantage of the UK’s new subsidy control flexibilities.”

8.42. The submission also recommended that the Department allow in principle for differences in scheme parameters between Great Britain and Northern Ireland to take advantage of the EU Exit.

8.43. In the submission, officials recommended that the Secretary of State note the issues around including sub £25,000 lending in RLS and, separately, the proposed launch date of 6 April 2021. Regarding the former issue, it was recommended that BEIS and

HMT Special Advisers should discuss it and agree a position. BEIS officials raised concerns that some lenders may struggle to operationalise the scheme by the proposed launch date of 6 April 2021, following announcement of the scheme during the Budget on 3 March 2021. A launch date of 12 April 2021 would reduce this risk substantially and increase the likelihood that lenders were in a position to release funds at the launch date. However, the Chancellor wanted the new scheme to follow immediately after the existing schemes closed on 6 April 2021.

- 8.44. The Secretary of State responded on 28 January 2021 and provided his views {GD(B)/659 – INQ000564177}:
- a) The Secretary of State agreed with the ‘two-phase’ approach to RLS; and
 - b) He provisionally agreed with the ‘split NI-GB’ approach, though he considered that it would create some significant challenges so wanted to be kept closely updated, including on conversations with the European Commission and lenders.

RLS and Lending Under £25,000

- 8.45. On 2 February 2021, BEIS officials sent a further submission to the Secretary of State on RLS in relation to sub £25,000 lending {GD(B)/660 – INQ000564180}. This submission outlined the likelihood that RLS would only enable partial provision of loans at sub £25,000, and that the Chancellor was therefore minded to rule out sub £25,000 lending altogether.
- 8.46. In this submission, BEIS officials outlined the difficulties with lending at sub £25,000, which were:
- a) Lending to the smaller businesses was risky, because borrower viability is difficult to assess accurately without incurring disproportionate costs; and
 - b) Lenders faced higher compliance costs at this loan size due to interactions with the CCA. As outlined earlier in this statement, the CCA provides protection to sole traders and small partnerships (but not companies) for business lending transactions of under £25,000. Ensuring compliance is costly for lenders and makes offering loans in this bracket less commercially attractive. These CCA provisions were disapplied for BBLs.
- 8.47. Despite the above, it was still recommended that the lenders should be permitted under RLS to lend at the sub £25,000 level, if they wished. This was because:

“...without an exceptionally generous grant scheme we must do all we can to support businesses whose survival is likely to be partial, it is possible that one or two of the major lenders will be happy to participate...”

8.48. In order to assist the smaller businesses that might otherwise struggle to access finance, BEIS officials recommended multiple options to the Secretary of State. These options were the following:

- a) Note that a large number of companies may have liquidity needs below £25,000, but that many of these companies were already heavily indebted and further debt may not be suitable for all;
- b) Explore the possibility with HMT of offering a new grant scheme;
- c) Incentivise lenders to lend at sub £25,000 levels by varying the pricing of the guarantee and making it more generous for sub £25,000 loans, which would compensate lenders for the compliance costs; and
- d) Expand and extend the existing Start Up Loans programme (which allowed businesses that were less than two years old to borrow up to £25,000 at a fixed interest rate of 6% per annum). The submission stated however that *“HMT would need to be persuaded of the case for any SUL extension.”*

8.49. The Secretary of State’s private office responded by email on 10 February 2021, and indicated that:

“[The Secretary of State] agreed we should avoid a gap in support for those businesses that have liquidity needs below £25k. He’s happy for SpAds to have a discussion with HMT counterparts about the different options, but he said we need to have a sense of the expected default rates on these loans as we think about this. This is partly what HMT will be concerned about.” {GD(B)/661 – INQ000564185}

8.50. BEIS responded the following day and stated that BBB’s estimate was that the default rate for the new scheme would be within a range of 10% to 25% {GD(B)/662 – INQ000564186}. However, there was considerable uncertainty around that estimate, and further,

“It is difficult to say how this may differ for sub £25k lending. In this bracket, businesses tend to be younger, which would normally translate to a higher probability of default. On the other hand, lenders tend to use automated credit

scoring systems at smaller loan sizes, which are conservative by nature. On balance, we would put sub £25k lending under the new scheme (were it to go ahead) in the top half of this range.”

- 8.51. It is not entirely clear if or when any discussions took place between BEIS and HMT Special Advisers as suggested by the Secretary of State in his response. A briefing dated 22 February 2021 ahead of a Projects and Investments Committee (**PIC**) meeting on 23 February 2021 suggests that the conversation had not taken place {GD(B)/663 – INQ000543695}. A later readout of the PIC meeting also questioned whether the conversation had taken place {GD(B)/664 – INQ000543691}. Ultimately loans of below £25,000 were not included in the final business case presented to the PIC on 23 February 2021, which stated {GD(B)/410 – INQ000609053}

“The Chancellor has given a clear steer that the minimum facility size for term loans and revolving credit facilities should be £25,001. He is concerned about the fact that many lenders do not wish to lend up to £25,000 because of the difficulties in assessing borrower viability, and the requirements of the Consumer Credit Act (CCA) for lending to sole traders and small partnerships. The Chancellor therefore wishes to avoid a repeat of April 2020, when partial provision (at this end of the market) under CBILS in the face of a massive liquidity shock created significant political pressure for a more radical measure (resulting in the introduction of BLS).”

- 8.52. The business case then stated that BBB and BEIS disagreed with this approach, and that conversations on this topic were ongoing.

Business Case for RLS

- 8.53. On 13 November 2020, BBB prepared the first draft of the business case for RLS. The business case was amended over time with input from both BBB and BEIS until the draft was finalised on 15 February 2021. On 16 February 2021, BEIS shared the final version of the business case with BBB {GD(B)/410 – INQ000609053}. It was also scheduled to go to the BEIS Projects and Investments Committee (**PIC**)²⁵ on 23 March 2020 {GD(B)/665 – INQ000585743}.

- 8.54. The business case sought approval for ‘Phase 1’ of the new credit guarantee scheme, “...designed to unlock finance for cashflow and/or investment purposes where

²⁵ PIC considers business cases for expenditure of taxpayer funds proposed to be undertaken by BEIS in circumstances where the expenditure may be significant, risky or contentious.

businesses have been impacted by Covid-19 but [were] able to afford external credit.” ‘Phase 1’ was to be continuously monitored, with a formal review point in October 2021, and a decision was to be made at that time as to whether and how to amend the scheme for ‘Phase 2’. ‘Phase 1’ was to conclude by 31 December 2021, with a transition to ‘Phase 2’ expected by 1 January 2022.

- 8.55. The business case outlined the similarities and differences between RLS and CBILS, the similarities being that RLS “[followed] CBILS in featuring an 80% guarantee for lenders on each loan, without a ‘portfolio cap’ on claims against the guarantee...fee to access the scheme paid by the lender, rather than the borrower as under EFG.” The differences between CBILS and RLS were that RLS “[featured] *a maximum facility size of £10m (up from £5m), and perhaps most significantly no interest and fee-free period.*” The business case also included a comparison between RLS and the older schemes.
- 8.56. The business case referred to several key lessons from both the EFG and CBILS that were considered in the design of the new scheme:

“a) Having wide eligibility criteria so that the scheme [would be] available to all businesses who want to access it, rather than only those businesses that have been turned down for a commercial loan for a limited number of reasons.

b) Ensuring that ‘non-commercial organisations such as charities and Further Education (FE) colleges [could] access the scheme.

c) Simplifying the ‘undertaking in difficulty’ test, to ensure that viable businesses [were] not locked out of the scheme and minimise the administrative overhead for lenders.

d) Removing the ‘portfolio cap’ on claims by lenders so they [could] benefit from capital relief, enabling them to lend to more businesses or at better rates, unlike under EFG...

e) Removing the Business Interruption Payment paid to borrowers to cover initial interest and fees, to focus the scheme on those businesses who [could] afford to take on additional debt.

f) Adding an explicit additionality requirement, to ensure that lending under the scheme represent[ed] lending that, in the absence of the scheme, either would not have been offered, or would have been offered at a higher interest rate.

g) Maintaining the requirement under CBILS that personal guarantees [were] not permitted for lending below £250,000, to avoid the risk of negative publicity.

h) Ensuring lenders [went] through a proportionate risk-based accreditation approach, unlike for the Coronavirus Business Interruption Loan Scheme (CBILS) when some lenders were automatically 'grandfathered' across.

i) Ensuring alternative finance providers [were] able, with BBB consent, to assign the guarantee to a third-party funder or investor or use ENABLE Funding to finance facilities, such that more alternative finance providers [would be] willing to use the scheme.

j) BBB and government developing and managing more robust fraud risk management processes, including fraud risk assessments and post-event assurance plans."

8.57. The business case recognised that as with other Covid-19 loan schemes, BEIS Internal Evaluation Experts Group would develop a monitoring and evaluation plan for RLS and submit it for scrutiny in mid-2021. The evaluation would include a process evaluation, impact evaluation, and an economic evaluation.

8.58. The business case stated that due to the operational similarities between CBILS and RLS, the fraud risk for RLS was comparable to that of CBILS, rather than to BBLS. The business case stated that the incidence of CBILS fraud or alleged fraud reported to BBB (either from lenders or other parties) was currently infrequent. Anecdotal evidence from a sample of accredited lenders suggested that whilst fraud was experienced at the application stage (including impersonation, 'ghost' applicant/borrower and other targeted fraud), detection and prevention by lenders was effective and the level of post-lend fraud experienced by lenders was nominal.

8.59. The business case explained that the residual risk of fraud for RLS in comparison to BBLS, was expected and understood to be substantially mitigated. This was primarily because the lenders would always have 20% 'skin in the game', and also through the fraud risk management controls and countermeasures established within the scheme rules including:

- a) BBB accreditation procedure for scheme lenders;
- b) Relevant scheme legal agreement and obligations;

- c) Lenders' appropriate fraud checks (customer due diligence, KYC and AML), credit checks (credit decisioning and credit reference agency) and lenders' knowledge of their customers;
 - d) Ongoing obligations under the scheme legal agreement;
 - e) BBB's Audit assurance programmes; and
 - f) Ongoing lender and scheme portfolio/allocation monitoring control and reporting.
- 8.60. A risk register was attached to the business case at Annex C. It identified two key risks {GD(B)/666 – INQ000564188}:
- a) Few lenders would have completed their preparations and be able to lend from 6 April 2021. This risk was rated as critical and very likely. Mitigations for this risk included adopting a 'risk-based' accreditation process and sharing as much information with lenders before the likely Budget announcement on 3 March 2021. The approach to lenders accreditation for RLS was attached to the business case at Annex F {GD(B)/667 – INQ000564146}; and
 - b) There would be significant negative stakeholder reaction to the decision not to offer the new scheme at sub £25,000 (except for asset finance and invoice finance). This risk was being discussed with ministers. The main proposed mitigation was to ensure a joined-up communications approach across the Government around the scope of the scheme. This issue was explained in more detail at Annex H {GD(B)/660 – INQ000564180}.
- 8.61. In relation to value for money of RLS, it was challenging to undertake a comprehensive, robust value for money analysis given the high level of uncertainty about the economic environment in 2021. Further, there was no historic data on the performance of loan schemes in similar economic circumstances and the impact of CBILS and BBLs at that time was unclear. Given the short timescales involved and the limited experience to draw upon, the model used to conduct the value for money assessment in the business case was assumption driven using any available evidence. The value for money assessment was summarised thus:

“The outcome of our assessment suggests that the new scheme does represent a value-for-money product given the evidence available to us in the present time. This result is driven by the expected impact of the scheme on business growth as the economy moves into recovery phase. The 80%

guarantee and lender fee are designed to ensure lender incentives remain aligned to the objectives of targeting additional and viable businesses. Beneficiaries should therefore consist of businesses with potential to grow and scale up with the support of finance.”

- 8.62. On 18 February 2021, BEIS sent the business case to PIC ahead of the meeting of PIC, BEIS, and BBB officials on 23 February 2021 {GD(B)/668 – INQ000585745}. Concerns raised by PIC related to fraud, value for money, uncapped scheme size and sub £25,000 lending {GD(B)/669 – INQ000564193}.
- 8.63. On 25 February 2021, PIC approved the scheme by email, whilst noting the need for ongoing risk management around fraud, as well as high quality monitoring, to address any future concerns. {GD(B)/670 – INQ000564190}.

Consideration of vulnerable groups

- 8.64. The business case also included a Public Sector Equality Duty (**PSED**) analysis for the RLS.
- 8.65. The PSED for RLS, set out at Annex K, discussed that:

“In the absence of any intervention, the outbreak would have led to a cascade of firm collapses, leading to unemployment, leading to further firm closures. This would have impacted on everyone and particularly for those with few other options or resources.” {GD(B)/410 – INQ000609053}

- 8.66. It went on to address that:

“Workers with fewer skills, in disadvantaged areas, or who may experience discrimination in the labour market may particularly suffer long-term scarring effects on their livelihoods and wellbeing if we did not protect businesses and jobs. Therefore, the scheme will help to safeguard existing outcomes and life chances for disadvantaged groups, at least to the extent that they are already in work.

However, as the scheme is designed to be open to the vast majority of existing businesses (excepting fraud risks and foreign ownership, etc), the schemes are not targeted in a way that would have advancing opportunity as an objective”.

- 8.67. The PSED for the RLS asserted that existing analysis of the CBILS and BBLs had not raised any PSED issues, however it indicated the Department would monitor implementation of RLS to ensure no unequal take-up or benefit of the scheme.

- 8.68. The PSED considered impacts of the RLS and, while there were gaps in the evidence base making it difficult to conduct a full assessment, concluded that:
- a) Overall the scheme would possibly advance equality of opportunity in some regards and was unlikely to reduce equality of opportunity;
 - b) The risk of discrimination was not perceived to be significant; and
 - c) The scheme would not significantly impact relations between people who share a protected characteristic and those who did not.
- 8.69. This analysis was substantially unchanged in the November 2021 PSED for the RLS six-month extension. See Annex I at {GD(B)/671 – INQ000564227}.

Final Stages of Development of Scheme

- 8.70. On 1 March 2021, BEIS prepared the contingent liabilities checklist for RLS {GD(B)/672 – INQ000564194}. The contingent liabilities checklist addressed the key parameters of the scheme, namely:
- a) Length of scheme: 6 April 2021 – 31 December 2021 (provisional end date for Phase 1 of the scheme);
 - b) Eligibility: the borrower had to confirm to the lender that it has been impacted by Covid-19 and was not in collective insolvency proceedings. Borrowers in scope of the Northern Ireland Protocol had to pass the EU ‘undertaking in difficulty’ (UID) test;
 - c) Maximum loan value: £25,001 – £10 million (loans and overdrafts; £1,000 – £10 million (asset and invoice finance));
 - d) Term limit: six years (loans and asset finance); three years (asset and invoice finance);
 - e) Guarantee level: 80%;
 - f) Scheme lender fee: 1.5% (except for invoice finance and responsible finance providers which will have a flat fee of 1%, and for non-SMEs (large enterprises) which will have a flat fee of 2%); and
 - g) Personal guarantees not permitted below £250,000.
- 8.71. On 2 March 2021, BEIS officials sent a submission to the Secretary of State on the new guarantee scheme, specifically in relation to the undertaking in difficulty test and the Northern Ireland Protocol {GD(B)/673 – INQ000564197}.

- 8.72. The submission explained that the Secretary of State had previously advised BEIS officials to take advantage of the UK's new subsidy control flexibilities and explore the potential for differences between 'GB' and 'NI' variants of the new scheme. The European Union's undertaking in difficulty test was imperfectly aligned to the UK business environment due to comparatively high levels of indebtedness among UK businesses that were considered viable propositions by lenders.
- 8.73. Following consultation with lenders, officials recommended replacing the European Union's undertaking in difficulty test with a simplified test that prohibited lending to businesses in administration or liquidation or equivalent proceedings for businesses not in scope of the Northern Ireland Protocol. The scheme's viability test and lenders' underwriting procedures would ensure that businesses with no prospect of recovery were filtered out. The new simplified undertaking in difficulty test would place a greater reliance on lenders' underwriting procedures, reducing bureaucracy and speeding up lending decisions whilst providing appropriate safeguards for the use of public money. The Economic Secretary to the Treasury had already agreed to this approach.
- 8.74. Implementing the simplified undertaking in difficulty test required lenders to identify businesses that were in scope of the Northern Ireland Protocol. Officials proposed supporting lenders to make this assessment by providing a 'low bureaucracy' questionnaire by which applicants would self-certify whether they were in scope of the scheme. This was anticipated to make the scheme easier to deliver for lenders but could also result in certain businesses being incorrectly identified.
- 8.75. Officials advised there was a substantial risk that the European Commission would consider the GB variant (simplified undertaking in difficulty test) of the scheme to be unlawful. The European Commission had indicated that it had a more expansive view than the Government of which businesses were in scope of the Northern Ireland protocol. If the Secretary of State agreed with the proposed change to the undertaking in difficulty test, officials would coordinate with the Transition Taskforce, led by the Rt Hon Lord Frost CMG, to ensure there was alignment on how to approach this difference of opinion with the European Union.
- 8.76. On 8 March 2021, the Secretary of State's private office responded to the submission confirming he agreed with the recommendations {GD(B)/674 – INQ000564199}.

Implementation and Delivery of RLS

Launch of RLS

- 8.77. In the Budget on 3 March 2021, the Chancellor announced the Government's intention to continue supporting businesses once CBILS and BBLs closed, via a new successor scheme, the RLS {GD(B)/675 – INQ000583757}.
- 8.78. On 9 March 2021, BEIS officials sought views from Lord Frost's Transition Taskforce regarding the simplified undertaking in difficulty test and the Northern Ireland protocol, to which Lord Frost agreed on 12 March {GD(B)/676 – INQ000585750} and {GD(B)/677 – INQ000585755}.
- 8.79. On 11 March 2021, the Permanent Secretary received an Accounting Officer Assessment of RLS {GD(B)/678 – INQ000564200}. The advice explained that the PIC had approved the scheme. However, PIC had not considered two significant risks:
- a) The introduction of the simplified undertaking in difficulty test and its interaction with the Northern Ireland Protocol (discussed in submission dated 2 March 2021 at paragraph 8.71); and
 - b) The issue of funding the operational costs of the scheme.
- 8.80. On the issue of funding, HMT had indicated that it would not provide additional funding for the operational costs of the scheme (estimated at £12 million in 2021 to 2022, and £9 million or lower in future years). BBB required assurance that operational costs would be funded before it could implement the scheme. As a result, officials judged the affordability risk to be 'very high'. However, the advice explained that this risk could be managed if the operational costs were incorporated into BEIS' own budgets. BEIS was assessing options to discuss with HMT about further mitigating this risk. This issue needed to be resolved before BBB could be instructed to implement the scheme.
- 8.81. On the basis of the available evidence, officials assessed RLS to represent value for money and categorised the associated risk as 'medium'. However, this assessment was subject to considerable uncertainty and was subject to change over time as the economic situation evolved and both businesses and lenders responded to potential new challenges and opportunities.
- 8.82. Officials recommended that the Permanent Secretary agree to proceed with RLS at risk to the wider BEIS budget for 2021 to 2022 and in future years whilst BEIS assessed options to inform further discussions with HMT about further mitigating this risk. The

Permanent Secretary was asked to approve the scheme by 15 March 2021 so that BEIS could instruct BBB to launch the scheme by 17 March 2021.

- 8.83. On 12 March 2021, Catherine Lewis la Torre wrote to the Permanent Secretary to set out BBB's concerns and seek assurances on the additional funding requirements relating to RLS {GD(B)/679 – INQ000564201}.
- 8.84. On 15 March 2021, the Permanent Secretary asked officials how BEIS intended to solve the funding issue in relation to RLS and if there was engagement with BEIS Finance on a reasonable plan. Later that day, BEIS Finance confirmed there was funding available to cover the operational costs of RLS for 2021 to 2022. BEIS was also seeking to demonstrate to HMT that the operational costs of RLS were reasonable and justifiable and obtain further budget cover from HMT {GD(B)/680 – INQ000564204}.
- 8.85. On 16 March 2021, the Permanent Secretary agreed with the recommendations set out in the advice dated 11 March 2021 {GD(B)/681 – INQ000564205}.
- 8.86. Ahead of the scheme's launch, on 16 March 2021, BEIS officials provided a final submission to the Secretary of State to seek his approval on the final scheme design and the associated parliamentary notifications {GD(B)/682 – INQ000564206}. The scheme parameters were in line with the Secretary of State's previous steers on objectives and subsidy control. The full list of scheme parameters including justification for each feature were attached to the submission at Annex A {GD(B)/683 – INQ000564207}. As above, the Permanent Secretary had already approved the final scheme design in her role as Accounting Officer.
- 8.87. The submission stated that the Secretary of State had previously cleared the proposal that businesses not in scope of the Northern Ireland Protocol would be subject to a simplified undertaking in difficulty test. The proposal to address this had changed in the interim in line with feedback and consultation with Lord Frost's Transition Taskforce {GD(B)/677 – INQ000585755}. The revised proposal, at Annex B, introduced questions in the lender's original application process to filter out businesses that were not within the scope of the NI Protocol. If borrowers were outside the scope of the NI Protocol, they then proceeded to the simplified undertaking in difficulty test – 'the GB test'. For those that were potentially in scope, they underwent the EU undertaking in difficulty test, and should they fail that, a more substantive questionnaire on the NI Protocol to confirm whether they were out of scope and the simplified 'GB test' could

be applied. This delivered the same result for businesses as the recommended option the Secretary of State had previously approved {GD(B)/684 – INQ000564203}.

- 8.88. In relation to value for money of the scheme, the challenges of undertaking a robust value for money analysis were identified. Officials' assessment (using the evidence available at that time) suggested that RLS could represent a value for money product. BEIS judged that RLS was "... 'medium risk' from a value for money standpoint, and the need for a Ministerial Direction is therefore not triggered."
- 8.89. Given the NAO and PAC findings against the earlier schemes, BEIS officials were keen to ensure the new scheme had more clearly defined policy objectives {GD(B)/658 – INQ000564174}. This, and the fact it had taken longer than anticipated to agree the final terms of the RLS, may have resulted in some delay in finalising the details of the new scheme and as such, in the 16 March 2021 advice, BEIS officials stated that the RLS was required to proceed with urgency to avoid a significant gap forming between the closure of existing support schemes and its launch. In line with the previous steer, the first phase of the RLS would focus on survival rather than growth and investment.
- 8.90. On 17 March 2021, the Secretary of State's private office responded to the submission confirming the Secretary of State's approval to introduce RLS as recommended {GD(B)/685 – INQ000564208}.
- 8.91. Later the same day, the Secretary of State's private office emailed HMT seeking the Chancellor's approval to introduce RLS with the following parameters {GD(B)/686 – INQ000564209}:

"a. The Government guarantees the payment of 80% of all amounts due under each Scheme Facility.

b. The minimum loan size is £25,001 for term loans and overdrafts, and £1,000 for asset finance and invoice finance facilities. The maximum loan size is £10m per business, and the maximum a group of companies can borrow is £30m.

c. The Scheme Lender Fee is 1.5%, except for invoice finance and responsible finance providers which will have a flat fee of 1%, and for non-SMEs (large enterprises) which will have a flat fee of 2%.

d. The maximum loan duration is 6 years for term loans and asset finance facilities, and 3 years for overdrafts and invoice finance facilities, in each case subject to an ability for lenders to extend up to 10 years in certain forbearance situations.

e. The borrower must have a business proposition that can reasonably be expected to enable it to meet its repayment obligations. This may, but is not required to, be determined without regard to any concerns over the borrower's short-to-medium term business performance due to the uncertainty and impact of Covid-19.

f. Borrowers must not be subject to insolvency proceedings. However, lending is permitted where an applicant is in a voluntary arrangement but has a path to viability such that the lender is happy to lend. Businesses in scope of the Northern Ireland Protocol will be subject to the full EU 'undertaking in difficulty' test.

g. No personal guarantees will be permitted for lending below £250,000.

h. Collateral is not required for lending below £250,000.

i. An annual lending limit will apply to each lender but no annual claim limit.

j. The scheme will be open for applications from 6 April 2021 to 31 December 2021, subject to a review."

- 8.92. On 18 March 2021, the Chancellor's private office responded confirming that the Chancellor was content to proceed with introducing RLS on the parameters set out {GD(B)/686 – INQ000564209}.
- 8.93. The same day, once confirmation was received from HMT, the Permanent Secretary wrote to BBB instructing it to implement the RLS {GD(B)/687 – INQ000564210}. HMT agreed to not setting a funding limit for the RLS, so BEIS agreed to provide financial cover for the scheme without limit. The Permanent Secretary stressed the need for robust controls and governance around the financial commitments to ensure that public funds were used appropriately. Any non-compliance with the UK's subsidy control commitments and State aid controls would be managed by BEIS. BBB responded the same day, accepting the instruction and confirming agreement that BEIS would take the lead on responses to queries which raised novel or unresolved issues on the application of the NI Protocol and the Temporary Framework for State aid 'undertaking in difficulty' test {GD(B)/688 – INQ000564211}.
- 8.94. On 12 March 2021, Catherine Lewis La Torre emailed the Permanent Secretary to further address the financial implications of the financial assurances sought by BBB {GD(B)/689 – INQ000564202}. Their rationale was that BBB was unable to control or manage exposure on the schemes and had limited input into the design of the schemes

(in areas such as counter fraud). The advice set out that although elements of the Covid-19 loan schemes were out of BBB's control, it had ultimate responsibility for financial management and governance {GD(B)/690 – INQ000564212}.

- 8.95. The RLS launched on 6 April 2021. The first phase, focusing on business survival, was to be open until 31 December 2021 {GD(B)/682 – INQ000564206}. At the time of launch, 18 lenders were accredited to deliver the scheme. By 22 April 2021, a further five lenders were accredited {GD(B)/691 – INQ000564215}.
- 8.96. Lessons taken from the other Covid-19 loan schemes into the RLS included continued use of the EFG lending approval infrastructure for simplicity, a fraud risk assessment in place from the outset and a privacy notice which allowed the government to access data relating to borrowers for the purposes of preventing or identifying fraud.

Later Developments to the Recovery Loan Scheme

- 8.97. Officials at BBB formed a steering group for the design of the second phase of the RLS and the first meeting took place on 23 April 2021 {GD(B)/692 – INQ000585756}, {GD(B)/693 – INQ000585757}. The agenda set out that the first phase of RLS was due to finish on 31 December 2021, and BBB's view was that the government should maintain some form of intervention thereafter due to enduring market structure failures that inhibited SME access to finance. The purpose of the steering group, therefore, was to determine the form that the second phase of RLS should take once the first phase of the scheme closed. The steering group, comprising officials from BBB, BEIS, HMT, and UKGI, agreed in this first meeting that BEIS/HMT “*should be exploring a product to address market gaps/failures once RLS Phase 1 ends*”{GD(B)/694 – INQ000585758}. The steering group meetings were to continue fortnightly, with separate working groups progressing items to bring back to the steering group. Meetings of this steering group continued until at least December 2021.
- 8.98. In November 2021, a RLS Post Event/Award Assurance Plan prepared by officials set out actions that were being carried out in relation to the operation of the RLS {GD(B)/695 – INQ000564226}. This was one of the set of documents sent to PIC ahead a meeting on 11 November 2021. These suggested actions included:
- a) BBB was to define strategies for monitoring businesses for potential abuse;
 - b) BBB to implement a system to detect (potential) duplicate loans. (While this was identified at this stage as a further action, unlike the former position with bounce back loans, where loans had to be delivered at pace, RLS already

required that lenders were required to run their full usual credit check and Know Your Customer processes when assessing loan applications. In these circumstances, the Department understands that no further action on this was deemed necessary because sufficient checks were already in place for RLS, without the use of the Cifas system that was brought in to help counteract some of that duplication for Bounce Back Loans);

- c) Cabinet Office was to implement a system to detect companies who were in receipt of RLS and pending dissolution at Companies House, and to conduct bulk objections to companies being struck off the companies register if they were in receipt of a RLS (to preserve the opportunity to engage with borrowers on repayment of loans prior to dissolution); and
- d) BBB was to monitor internal ledger activity so that irregularities were detected for investigation.

8.99. The 'bulk objection' process (referred to above at paragraph c)8.98(c)) was developed in February 2021 for use with the BBLs. In a submission dated 22 July 2021, BEIS officials proposed to extend the measure to participants in the CBILS, CLBILS, RLS and FF schemes, and this was approved by Minister Scully on 28 July 2021 {GD(B)/519 – INQ000564219}, {GD(B)/520 – INQ000564220}.

8.100. On 13 October 2021, officials proposed a 6 month extension to the RLS in a submission to the Secretary of State {GD(B)/696 – INQ000564224}. BEIS, HMT and BBB officials had conducted a review of the market and recommended extending phase one, which focused on business survival, for a further 6 months. This was on the grounds that the economic impacts of Covid-19 and other current issues in the economy continued the need for recovery finance, and without a loan scheme this need would otherwise go unmet. HMT officials prepared a submission for the Chancellor in parallel {GD(B)/697 – INQ000564225}.

8.101. In an email dated 20 October 2021, BEIS officials shared the requests by the Chancellor, who agreed to the proposed extension but wanted a number of changes to the scheme {GD(B)/697 – INQ000564225}. These changes included that: the maximum loan size should be reduced to £2 million; SMEs would be the only enterprises able to access the facilities; rules relating to personal guarantees would be retained; and the Government's guarantee coverage would be reduced from 80% to 70%. Officials' advice explained that some of the Chancellor's requests would not make a large difference to the aims of the scheme, but some of the proposed changes

would undermine the scheme's ability to meet its policy objectives. For example, the request to reduce the government guarantee from 80% to 70% had a high risk of significantly reducing the ability of SMEs to access funding. It observed that even the precursor schemes, including the EFG, had a guarantee of 75%. However, the Secretary of State ultimately confirmed they were happy to accept the Chancellor's recommendations for the change to the scheme.

8.102. At the Autumn Budget on 27 October 2021, the Chancellor announced that the RLS would be extended for an extra 6 months to run until 30 June 2022. As set out in a later (16 November 2021) Accounting Officer submission, this was intended to be simply an extension of phase one of the RLS {GD(B)/698 – INQ000564229}. The Chancellor also announced that some changes would be made to the scheme:

- a) The maximum loan size would be reduced from £10 million to £2 million;
- b) Eligibility would be restricted to small and medium-sized enterprises only (annual turnover less than £45 million); and
- c) The guarantee coverage would be reduced from 80% to 70%. See {GD(B)/695 – INQ000564232} for additional details.

8.103. A business case was drafted for the 6-month extension of the RLS, dated 3 November 2021, it identified that {GD(B)/671 – INQ000564227}:

- d) For the period 1 January 2022 to 30 June 2022, it was estimated that lending under the RLS would total £850 million and expected credit losses would be 10%. That was assumed to include losses from fraud, but fraud losses were highly uncertain and could not be separated out at the time. On those estimates the loss to government would be £60 million (based on a 70% guarantee, i.e. 70% of £85 million). In addition to lenders being required to undertake credit assessments and fraud checks for potential borrowers, the business case stated that BBB had developed an FRA and PEAP for RLS, which had been approved by BEIS' Counter Fraud Board;
- e) BBB had incorporated best practice from its existing schemes into the risk management and fraud prevention strategies of RLS, and utilised bespoke governance arrangements put in place for CBILS. RLS has not been subject to any significant delivery issues to date; and

- f) A dedicated Financial Crime Directorate had been established with BBB. This team consolidated existing fraud and financial crime activity across the various loan schemes in order to actively manage Financial Crime risk.
- 8.104. The changes to the scheme announced in the Autumn Budget were considered by the PIC. On 12 November 2021, they provided a report on the proposed changes to the RLS and requested that BEIS establish a monitoring and evaluation plan to fill any evidence gaps on scheme parameters and how BBB would be equipped with the necessary evidence for future schemes {GD(B)/700 – INQ000564228}. On 16 November 2021, officials provided the Accounting Officer with a submission about the extension and amendments to the RLS which summarised PIC's comments and set out the scheme parameters that would be in place {GD(B)/698 – INQ000564229}. On 19 November 2021, final approval was sought from ministers to implement the approved changes and extend the RLS {GD(B)/699 – INQ000564230}.
- 8.105. On 8 December 2021, BEIS officials requested permission from Lord Frost (then-Minister of State for EU Relations) to write to the European Commission to notify it about the extension to the RLS {GD(B)/701 – INQ000564239}. On 16 December 2021, officials provided a second piece of advice to the Permanent Secretary as Accounting Officer relating to the extension to the RLS. They suggested that although approval from the European Commission may not be obtained by the launch of the extension, the option to proceed 'at risk' should be pursued {GD(B)/702 – INQ000585792}. The extension of the RLS was notified to the European Commission. The Commission then entered into correspondence with BEIS concerning questions they had on the scheme, with a decision anticipated prior to the end of December 2021 {GD(B)/703 – INQ000564240}. The scheme eventually received State aid approval on 22 December 2021 prior to the relaunch of the scheme with amendments {GD(B)/704 – INQ000564244}.
- 8.106. On 17 December 2021, Jo Shanmugalingam sent a letter to BBB instructing it to implement the extension to the RLS, again with the condition that robust controls and governance around financial commitments should be in place as far as reasonably practicable {GD(B)/705 – INQ000564241}. This was to ensure public funds were being used appropriately in the context of the agreed parameters of the scheme. On the same day, BBB replied accepting the instruction {GD(B)/706 – INQ000564243}. BEIS also wrote to HMT about the adjustments to the scheme and received approval on that day {GD(B)/707 – INQ000564242}. There were no ministerial directions or reservation

notices considered necessary for the RLS because the RLS was much closer in its parameters to business-as-usual loan schemes such as the EFG. Furthermore, as normal credit checking processes had been put back in place, there was no elevated fraud risk.

Further Extension to the RLS from 30 June 2022

- 8.107. From the time that the extension to the RLS began in January 2022, officials at HMT, BEIS, and BBB began considering whether it should be further extended, or if a successor scheme should be implemented. Initially, HMT led a meeting sharing draft terms of reference with BEIS officials on 12 January 2022, with a view to complete the work and have a decision from ministers in April 2022 {GD(B)/708 – INQ000564247}. Lender engagement was due to occur with UK Finance on 24 January 2022 {GD(B)/709 – INQ000564248}. Later, on 4 March 2022, a guarantee scheme review steering group meeting between HMT and BEIS officials generated early views on key parameters of a potential RLS successor {GD(B)/710 – INQ000585812} and {GD(B)/711 – INQ000585813}. In the process of drafting a submission for ministers on the successor for the RLS scheme, BEIS officials identified issues with the European Commission's Temporary Framework also coming to an end in June 2022 and how this restricted the maximum loan size for potential borrowers in Northern Ireland as compared to potential borrowers in other nations within the Union {GD(B)/712 – INQ000564261}. On 14 April 2022, BEIS officials sent a submission to the Secretary of State and Minister Scully setting out the case for a successor scheme, which contained HMT ministers' views on the high-level design of such a scheme {GD(B)/713 – INQ000585814}. {GD(B)/714 – INQ000585815}. The submission advised there was an ongoing need to support the economy's recovery. HMT ministers wanted a successor scheme delivered by BBB and had provided views on the high-level design of such a scheme. BEIS officials commented that structural and cyclical market failures continued to affect small businesses and their ability to access debt finance, as they were unable to rely on BBB's other commercial guarantee solutions such as Community Development Finance Institutions (CDFIs) and social lenders.
- 8.108. On 3 May 2022, the Secretary of State responded to the submission. At this stage, the Secretary of State viewed the successor scheme as unnecessary and he sought further information to make a final decision {GD(B)/715 – INQ000538934}. He considered that the June 2022 end date was an opportunity to close the scheme and put the money towards more targeted support for businesses.

- 8.109. Laurence Pawley sent a note providing further information to the Secretary of State on 5 May 2022 {GD(B)/716 – INQ000585816} and {GD(B)/717 – INQ000585817}. The note set out responses to the Chancellor’s and the Economic Secretary to the Treasury’s feedback on the successor scheme. Of significance was that that the Chancellor wished to explore options for enabling an RLS extension without making any additional funding available upfront, meaning BEIS would need to fund it as far as possible within its 2021 spending review entitlement.
- 8.110. On 10 May 2022, the Secretary of State signalled his approval to the recommendations, noting that “... *the funds would not necessarily be available to be reinvested in an alternative scheme which more closely targets the cost of doing business, so agrees that this is the best option given the circumstances.*” {GD(B)/718 – INQ000564265}.

Funding of the RLS Post-June 2022

- 8.111. Following confirmation that the Secretary of State was comfortable proceeding with an extension to the RLS, BEIS officials sent a submission to the Permanent Secretary on 19 May 2022 {GD(B)/719 – INQ000585820}.
- 8.112. Later, the submission was sent on to the Special Advisers and the Secretary of State noting the Chancellor had confirmed he wished to proceed with a further extension but did not intend to make any additional funding available upfront and BEIS would need to fund it as far as possible within its spending review 2021 settlement {GD(B)/720 – INQ000585821}.
- 8.113. The Chancellor was interested in pursuing an HMT proposal to re-allocate £100 million of capital from another BBB programme (namely, ENABLE Funding – a programme aimed at improving the provision of asset and lease finance to smaller UK businesses) and to use BEIS contingencies and BBB/BEIS underspends to cover the scheme, with HMT only covering any shortfall. The recommendation was to accept the HMT proposal in exchange for firm assurances of budget cover for:
- a) Capital Departmental Expenditure Limits (CDEL) to cover expected losses if BEIS/BBB underspends proved not be sufficient;
 - b) Any further losses should they arise (i.e., losses above the current estimated level); and

- c) Written assurance that HMT would be prepared to discuss the provision of RDEL budget cover for running costs at a later date, if this could not be managed within BBB or BEIS.

8.114. On 25 May 2022, the Secretary of State agreed with asking HMT for the assurances recommended. However, he was not convinced that this would necessarily lead to HMT providing coverage for any shortfall, and that proceeding would be at the Department's risk {GD(B)/721 – INQ000564267}. Subsequent correspondence with the Chancellor's private office indicated HMT confirmation of the assurances above {GD(B)/722 – INQ000585824}.

PIC Consideration of RLS Successor Scheme

8.115. A draft business case for the successor scheme was submitted on 16 May 2022, with the final business case sent to PIC on 26 May 2022 {GD(B)/723 – INQ000585823} and {GD(B)/724 – INQ000585819}. This business case was provided for the PIC meeting scheduled for 9 June 2022. Despite being conceived of as a 'successor scheme', the measures were described in the business case as being an extension of RLS. This was because the scheme differed so little from the earlier scheme and due to the possible media risk of announcing a new scheme that was largely unchanged from the old one. To address the issue identified with the European Commission's Temporary Framework, BEIS officials proposed that businesses captured by the Northern Ireland Protocol would be limited to a reduced maximum facility amount of £1 million (as compared to £2 million for borrowers in the other).

8.116. On 15 June 2022, BEIS officials and BBB were made aware that PIC were minded not to grant clearance at that stage {GD(B)/725 – INQ000564271}. On 18 June 2022, BEIS officials shared formal notice that the business case had not been approved by PIC. PIC's reasons were that they considered there was no convincing strategic rationale for the proposal. They were concerned as to the unclear long-term benefits of the scheme and a lack of clarity that existing outsourcing contracts had the capacity to support the ongoing scheme {GD(B)/726 – INQ000585825}.

8.117. Given the lack of approval from PIC, BBB sought assurance from BEIS that its planned lender engagement (including sharing legal documentation) was acceptable, given the perceived reputational risks in doing so if the new scheme did not launch as planned. On the understanding that no legal commitments were created between BBB and lenders as a result of sharing the draft guarantee letter, BEIS gave this assurance to

BBB by email on 20 June 2022 {GD(B)/727 – INQ000564272}. In the same correspondence, BBB provided further information on their planned lender engagement throughout June and July 2022, maintaining the timing for a planned launch in late July.

- 8.118. In the meantime, the strategic case for RLS was amended and submitted to PIC members on 4 July 2022 for review {GD(B)/728 – INQ000564275}. Following some further questions from PIC members, they were ultimately satisfied with the business case and passed on their approval to the scheme on 7 July 2022.
- 8.119. On 20 July 2022, BEIS issued a press release announcing the launch of the successor scheme to the RLS (described in the press release as an extension of the RLS for a two-year period) {GD(B)/729 – INQ000564276}.

SECTION 9: THE USE OF DATA, STATISTICS AND MODELLING AS PART OF THE ECONOMIC RESPONSE TO THE PANDEMIC

The Use of Data and Statistics

9.1. In this section, I have sought to answer the Inquiry's various questions concerning the use of data and statistics to inform BEIS decision making. BEIS obtained data on businesses from numerous sources prior to and during the pandemic. The principal sources of data used by BEIS to monitor and analyse the effects of shocks to businesses, the economic outlook, and the impact of potential government policy on the economy are addressed in this section, as well as how BEIS improved their usual processes to obtain specific and relevant data during the pandemic.

BEIS Omnibus Survey

9.2. Since 2019, BEIS started 'renting' space in a monthly external omnibus survey undertaken by market research organisation BVA-BDRC to ask UK businesses questions on sensitive topics, for example, the EU Exit.

9.3. Using the business omnibus method, BEIS was able to survey 1,200 businesses per month. This survey had been chosen by BEIS because the sampling size was robust, and included appropriate samples by size, industry sector and region/country of the UK. The survey was conducted monthly and allowed for rapid adaptation, for example the ability to change our questions up to the last working day before each survey commenced. Businesses had two weeks to answer the questions.

9.4. When the pandemic began in 2020, the BEIS Business Growth Analysis Team rapidly repurposed the questions in the survey, so that almost all questions over the course of the remainder of 2020 were covering issues around the impact of the pandemic on businesses across the UK. The number of questions were expanded to enhance BEIS' monitoring and analysis, with firms self-reporting on the following themes and topics:

- a) Business financial health;
- b) Impacts on businesses and their cashflow and cash levels, for example how many months of cash businesses had left before running out;
- c) How businesses were responding to the pandemic (for example, actions and strategies they were taking to mitigate against the shock);
- d) Specific questions on demand and access to finance;

- e) Specific questions on the Government's Covid-19 access to finance interventions; and
 - f) Specific questions to help inform the ability and likelihood of businesses to repay government-backed loans.
- 9.5. Examples of the questionnaire are provided as at August 2020 and February 2021 to illustrate how the survey sought to strike a balance between:
- a) Consistency, allowing BEIS to continuously analyse developments and trends; and
 - b) Flexibility, allowing the survey to react to the evolution and nature of the shocks and resulting financial and economic changes facing UK businesses at any time {GD(B)/730 – INQ000585847}.

Experian Data

- 9.6. In late 2019, the BEIS Business Growth team started discussions about procuring Experian business data to enable BEIS to monitor the potential impact of an EU exit. The variables needed most effectively to monitor the impact of a potential big shock on businesses were developed from this time and monthly data deliveries to BEIS were started in February/March 2020.
- 9.7. At the onset of the pandemic, the data was solely aimed at monitoring businesses' financial health using Experian's company-level data, proprietary credit scores, distress scores, late payment indicators as well as data on births and deaths. The data was anonymised and was used to monitor the financial health of the UK's business population and to understand if there were any changes in trends. The monthly data was summarised, analysed and organised into a data summary table for that month and contained detailed breakdowns by:
- a) Size of business (categorisation by employment size);
 - b) Industry sector (down to four-digit Standard Industrial Classification code²⁶);
 - c) Region/individual local authority area; and
 - d) Age.
- 9.8. The key monthly metrics that BEIS received from Experian included the following:

²⁶ The four-digit Standard Industrial Classification code is used to categorise the industries that companies belong to based on their business activities.

- a) All dissolutions, including by types of insolvency plus a measure of 'hidden insolvencies' where firms dissolved without an insolvency but owing money;
- b) The 'Days Beyond Terms' late payment score;
- c) The 'Distress Warning Score';
- d) The 'Delphi' and 'Financial Strength' credit scores;
- e) Cash levels; and
- f) Debt levels.

BEIS' Monthly SME Finance Monitor Reporting

9.9. Since the summer of 2016, BEIS had also been procuring a monthly version of the SME Finance Monitor so that the Department had timely and frequent access to data in order better to monitor and understand any changes in trends in demand and supply conditions affecting UK businesses' access to finance. The SME Finance Monitor is a survey of around 1,400 businesses a month, allowing robust monthly sampling. Key metrics monitored included:

- a) The proportion of SMEs using external finance;
- b) The proportion of SMEs needing to use personal funds to keep the firm going;
- c) Businesses' demand for finance using metrics such as the proportion of 'permanent non-borrowers';
- d) The proportion of businesses reporting growth, planning to grow or willing to use finance to grow; and
- e) Barriers affecting the business such as political uncertainty or economic climate, late payment etc.

UK Finance Data

9.10. Since the financial crisis, the main UK high-street banks had already been providing data to BEIS about their SME banking business on a privileged/NDA basis. The data was being provided monthly and during the pandemic, BEIS asked UK Finance to ensure that the data being sent to BEIS was as timely as possible. The data was included in the form of aggregated SME data and individual bank aggregates.

9.11. BEIS used the data to produce charts to better understand SME business finance. Some examples include the loan to deposit ratio and utilisation of overdrafts. BEIS also

use the data during discussions with high-street banks about SME lending. For example, the data was used to inform discussions with banks, allowing comparisons of the average loan approval rate for the whole market with a specific bank's average loan approval rate. The data was available by the usual demographic breakdowns as per above (size, industry sector, region).

- 9.12. BEIS also received long run tables, covering both large businesses and those which focused on asset-based lending and invoice finance.

BEIS Analysts Working with Intuit in Use of Data from Quick Books

- 9.13. From 2021, BEIS Business Growth also started working with Intuit, an accounting software platform. BEIS received monthly data (harvested from Quick Books) and presentations which captured cash levels, revenue inflows and cost outflows by the same demographic breakdowns as above, except that the Intuit data has a focus on smaller SMEs. This allowed extra details not available from other sources. Intuit were also able to provide data on types of business expenditure, more breakdowns by demographic characteristics (e.g. sole traders or employer) and whether firms had taken BBLs or not.

- 9.14. The management data that was shared with BEIS was often supplemented by findings from a quarterly survey of SMEs that Intuit ran, and to which they gave an opportunity to BEIS to place questions.

Structures and Processes Used or Developed for Consideration, Discussion and Provision of Advice Based on Data

- 9.15. A financial vulnerabilities analysis working group was set up in February 2021 to develop a holistic assessment of business financial vulnerabilities incorporating macroeconomics, size of firm and place perspectives, and to inform policy making, for example whether sectoral support was needed in light of lockdowns. The Business Growth analytical team worked closely with the industry sector analytical teams in producing regular slide packs for circulation to policy and analytical colleagues. The analytical team met monthly, until such regularity became less necessary.
- 9.16. The Business Growth analytical team also contributed to various cross-Whitehall briefing packs that were coordinated either by BEIS teams or by Cabinet Office.

Challenges in Relation to Availability, Quality, Suitability or Use of Data and Statistics and Any Significant Data Gaps

- 9.17. Business finance analysis is a very specialist area. Most of the data and statistics used by BEIS needed to be commissioned and generated by the Business Finance team. In addition, the main purpose of the data and statistics in this area of analysis is to better understand the scope, nature and magnitude of the market failure (and hence the grounds for any government intervention). Because of this, having relevant data and statistics on what has happened in the past will not always be sufficient for analysis to effectively appraise policy changes, especially when:
- a) The economy was facing a shock not experienced for around a hundred years;
 - b) The Government had to roll interventions that had not been attempted before – either in the UK or overseas; and
 - c) Rapid policy action was needed, giving little time to design and deliver the intervention.
- 9.18. BBLS was the first time that the UK Government had offered a complete guarantee without the need for lenders to take even a small portion of the overall risk of the loan. As a result, the standard value-for-money analysis that would normally be undertaken when appraising options for interventions wasn't possible in the case of the Covid-19 loan interventions. This was because of the absence of firm-level data on business and loan characteristics that are relevant for assessing likely losses, viability of loan applicants and improvements in survival rates. There remained scope for high liabilities and defaults. This was covered in the original Accounting Officer advice.
- 9.19. The difficulties in doing a standard appraisal not only applied to the introduction of the pandemic finance interventions but also to novel changes to the financial schemes such as the introduction of the forbearance measures PAYG.
- 9.20. Because of these difficulties, in January 2021, BEIS commissioned an independent team of academics to undertake a research project titled 'Business Finance Forecasting and Policy Modelling'. This aimed to ensure the Department is analytically better equipped to respond with policy advice should similar challenges arise in the future.

The Use of Modelling

9.21. BEIS made use of various types of modelling to inform their economic response to the pandemic.

Oliver Wyman Modelling

9.22. In May 2020, BEIS commissioned Oliver Wyman to simulate the impact of the Covid-19 crisis on the UK economy based on a top-down accounting approach. The aim was to understand the impact over time of the crisis in terms of net income and liquidity requirements on UK businesses, to inform government policy decisions.

9.23. For example, the model was used in Accounting Officer advice for the forbearance measures for businesses repaying loans under the BBLS and CBILS. The modelling was used to indicate the potential aggregate impact of offering businesses a repayment term extension or an extension of the capital repayment holiday, whilst also considering how the interest-only payment option and repayment holiday might improve borrowers' ability to repay their loans.

9.24. In addition, this work was also used to support the business case for the RLS. The modelling was used to inform the demand for finance.

BEIS Analytical Work with Neuron Capital Ltd to Help Develop the OECD's CAB Modelling Approach and Produce Results

9.25. The Corporate Sector Agent-Based (**CAB**) model was developed through a collaboration between the Innovation Lab at the OECD and Neuron Capital. The BEIS team joined the project in December 2020 in response to Covid-19. The project produced analytical insights into firm, and economy-wide vulnerabilities to demand and supply shocks (e.g. lockdowns). The work started with informal engagement with Neuron in 2020 and BEIS continued to work with Neuron until 2023. The project was led by central analysis within BEIS, but Business Growth also played a key role in the project, working closely with central and sector analytical teams.

BEIS Analytical Work with Moody's Analytics

9.26. BEIS Business Growth analysts also worked closely with Moody's Analytics in developing projections and forecasts of future business financial vulnerabilities by industry sector and size. This kind of contextual analysis helped inform wider policy considerations in terms of scheme forbearance.

Structures and Processes Developed for the Provision of Advice and Consideration and Discussion about Modelling

- 9.27. BEIS formed a Business Vulnerabilities Working Group which met regularly over the period 2021 to 2023. The group included Deputy Directors, Grade 6s, Grade 7s and assistant economists and was a forum for commissioning work, presenting new analysis, receiving feedback on such analysis and informing the planning of future analytical work. It was a cross-BEIS group, with particularly close working with sector analytical teams. The work was presented to the Senior Civil Service led Economic Recovery Board throughout 2021.
- 9.28. There were more informal feedback processes on BEIS' analysis with other internal and external stakeholders – for instance, presenting at:
- a) Monthly or quarterly catch ups with HMRC and the Insolvency Service;
 - b) Weekly or fortnightly catch ups with HMT; and
 - c) One offs such as to the Chief Statistician's cross-Whitehall Directors group.
- 9.29. More generally, BEIS had meetings with academics, sometimes directly organised by BEIS and sometimes facilitated by the Enterprise Research Centre on BEIS' behalf.

Other Scenario Analyses Produced or Relied Upon

- 9.30. In addition to the above scenario analysis and projections already mentioned, and as discussed in paragraphs 7.97 to 7.110 above, BEIS worked with BBB to launch three-year evaluations of the Covid-19 loan schemes and the Future Fund.

Main Challenges in relation to the Availability or Use of Forecasting, Modelling or Other Scenario Analysis

- 9.31. The main challenge with the economic modelling and forecasting was the high level of uncertainty during the pandemic. Undertaking analysis at a time when it was not known how long restrictions would be in place or change, how the virus would evolve or what the longer-term economic impacts would be was challenging. This was an unprecedented situation, and therefore it was difficult to predict how businesses and consumers would react to the restrictions. The analysis and modelling work had to make assumptions, based on a constantly changing picture.
- 9.32. Additionally, in this type of analysis, there are large time lags between identifying there is a need for better quality data, developing new analysis, and commissioning the data

where needed. Once this data was received, there were often time lags, and so it was a challenge to get data relevant to the period needed.

Any Reviews Undertaken of its Access to Good Quality Data, Advice, or Analysis Used in the Economic Response to the Pandemic

- 9.33. The Year 1 evaluation of the Covid-19 loan schemes, conducted in collaboration with BBB, highlighted the importance of accessing real-time data. It stated that decisions had been made without comprehensive information on the financial health of firms and suggested exploring open banking data arrangements to obtain live data on cash flow and balance sheets.
- 9.34. More generally, the Business Growth Deputy Director, in conjunction with the Business Finance analytical leads, identified early in the pandemic that BEIS needed to build up its business finance modelling capability. This would allow it to be better-equipped to advise ministers and senior officials on the business finance needs of the economy in response to future shocks and what schemes and specific scheme levers would be the most effective as part of any response. This work started in late-2020 and since then the BEIS/DBT analytical team has invested significant resource in building up this capability and this workstream is still continuing.

SECTION 10: LESSONS LEARNED/CLOSING SUMMARY ON LOAN SCHEMES

- 10.1. Part A of this statement set out key general reflections on the context for, and the key lessons learned from, the Covid-19 government backed loan schemes and the Future Fund. In this section I set out, in further detail, critical reflections on these schemes specifically. Before turning to the specific lessons learned for each support scheme, I do wish to explain the challenging context of the schemes, the urgency of their introduction and the positive impact that they had.
- 10.2. Business support interventions were developed and implemented at a time when it was not known how long restrictions would be in place, how they would progress, or that there would be multiple waves of infection. When making decisions about the introduction and design of business support schemes, the counterfactual was unknown, i.e., what would happen in the short, medium and long-term if business support schemes were not introduced, or different schemes were introduced. Of course, different scenarios were considered, but the effects of alternative courses of action were themselves inevitably extremely uncertain.
- 10.3. Turning to the positive impact of the schemes, the scale of the support provided was significant and it was delivered at speed. Whilst the provision of support to businesses was substantial, providing robust, quantitative evidence of that positive impact is a complex matter. That is so not least because of the difficulty in establishing the counterfactual of the extent to which businesses would have survived (and jobs protected) if no or lesser support had been provided.
- 10.4. Over the course of the pandemic, the Government (including through the Department) provided very extensive financial support to businesses, reaching a substantial number of businesses. As set out in the Ipsos Report, which will be provided to the Inquiry following publication as stated in Part A:
 - a) 1.6 million businesses obtained government-backed loans across the CBILS, CLBILS and BBLs which is 25% of the total population of businesses in the UK. The latest evidence indicates that £77 billion of government-backed lending facilities were provided. The total costs of the loan schemes will depend on default rates in the long run;
 - b) 1,190 businesses received convertible loans through the Future Fund. A total of £1.14 billion of funding was provided. Due to the nature of the target group

(i.e. firms dependent on equity funding) it is difficult to assess how far the intended group was reached. The cost of the Future Fund will depend on the default rates on convertible loans and also the price at which the Government disposes of the equity stakes that were acquired; and

- c) From BBB's performance data, as at 31 March 2024, businesses had drawn 20,078 facilities, totalling £4.33 billion, through the RLS.
- 10.5. As stated, the initial business support interventions were developed under considerable uncertainties as to the economic consequences of the pandemic. Priority was given to implementing the schemes rapidly, so getting financial support to businesses rapidly. Prioritising speed involved trade-offs and influenced the design of the schemes, and political decisions were made to accept various risks to value for money.
- 10.6. The initial loan schemes were delivered quickly and efficiently. The Department's major business support interventions were all launched within two months of the first national lockdown on 23 March 2020. Notably, CBILS was launched on 23 March 2020, i.e. on the first day of national lockdown.
- 10.7. Stringent due diligence tests were not applied because it was considered this would slow down, to an unacceptable degree, the ability of businesses to receive funding; and would reduce the effectiveness of interventions aimed at avoiding the failure of otherwise viable businesses. The result was that cash flow support was provided to many businesses at a time of real concern in the business community, when they were facing a national lockdown and social distancing measures. The Department was also able to use the infrastructure of the pre-existing EFG scheme to deliver the loan schemes quickly. As an example, the CBILS was launched within two weeks of the Chancellor proposing it to the Department and BBB.
- 10.8. In relation to how BBB worked with lenders, some difficulties were created by the wording of the lender agreements. These were drafted broadly which allowed lenders to interpret the terms in a variety of different ways, leading to inconsistencies in the understanding of removal of guarantees. Due to this, BBB often had to rely on its existing relationship with lenders, rather than the actual contractual wording, to agree to guarantee removal. The ambiguity stemming from this made it harder for BBB to successfully challenge lenders on potentially erroneous or fraudulent claims. Lenders were able to dispute BBB's interpretation of the agreement leading to protracted negotiations and settlements which took up valuable time and resources and

settlements where lenders would not admit fault but would agree to partial guarantee removals or repayments to avoid further scrutiny.

- 10.9. By the latter stages of delivery of BBLS, a more comprehensive, data-driven post claim assurance process was introduced which involved running all claims through a data engine that identified and risk-ranked potentially problematic loans, allowing for more targeted scrutiny. This comprehensive approach incentivised lenders to be more thorough in their own internal reviews and pre-emptive identification of problematic loans. Lenders knew that assurance activities could uncover errors or fraudulent activity, potentially leading to financial penalties (guarantee removals, demands for repayment) and reputational damage. This further motivated lenders to identify and address problematic loans to avoid these negative consequences. This process, driven by BBB, played a crucial role in identifying and challenging lenders on potentially problematic loans. It has been reported that this process, combined with previous guarantee removal, has led to the government guarantee being removed from 13,288 loans to a total value of £1.10 billion assurance activities (to June 2024). This substantial figure indicates a degree of effectiveness in holding lenders accountable and recouping public funds.
- 10.10. Through the experience of developing and implementing the Covid-related business support schemes, the Department has continued to evolve its processes. In particular, the Department has integrated data sharing, lender management, and counter fraud activities into the delivery of each phase of the ongoing Recovery Loan Scheme (now known as the Growth Guarantee). As an example, engagement with experts and use of fraud risk assessments have been a component of the implementation of this scheme from the outset.

CBILS and CLBILS: Lessons Learned

- 10.11. The primary objectives of CBILS and CLBILS were to provide critical financial assistance to businesses impacted by Covid-19 at scale and speed. CBILS targeted SMEs and CLBILS targeted medium-sized and larger businesses respectively. Both schemes were built on the established infrastructure and processes of EFG, and although they were more generous than EFG, they were designed to mirror commercial lending. Due to their similarities to standard loan schemes (reasonable checks and balances remained) CBILS and CLBILS broadly worked and performed well and met their objectives. The schemes applied standard lender processes to assess eligibility of businesses and largely supported businesses with existing bank

accounts. Whilst later surpassed by BBLs, the speed of CBILs lending was impressive. Prior to the launch of BBLs, CBILs was guaranteeing over £300 million every week, which was approximately the same amount guaranteed by EFG in a whole year. There were further aspects of CBILs and CLBILs that worked well and assisted in achieving their objectives:

- a) *The scheme delivery template.* CBILs, the first of the Covid-19 loan schemes was established at rapid speed, within 12 days of its announcement. This was only possible by using the existing EFG scheme as a delivery template. EFG offered accredited lenders, a lender guarantee agreement and the internal infrastructure of the lenders. Delivering finance through the lenders was the only practical mechanism. They were the only mechanism of delivery with the systems to get finance to all businesses and recover any amounts owed. The only other route was through Local Authorities, but they could not manage loan accounts and repayments and were therefore chosen to deliver the grant schemes;
- b) *Stakeholder engagement and business intelligence.* Continuous feedback in respect of the schemes was sought and obtained from the business and lending community. There was a central team collecting and disseminating the feedback with, at one-point, daily calls with the Secretary of State. Further, lenders spoke to officials every day. Lenders also engaged Ministers when required, to enable them to obtain an accurate picture of what was happening and how the loans were performing. For example, as pressure grew on slower than anticipated initial loan approval volumes under CBILs, the Secretary of State held calls with the lenders' operations teams to establish what was happening and the reasons for the delays. A further example of the Government engaging with stakeholders is the introduction of CLBILs, having been introduced as a response to feedback from larger businesses that CBILs conditions did not meet their financial needs; and
- c) *Effective collaborative working with HMT and BBB.* CBILs and CLBILs were positive examples of BEIS, HMT and BBB working collaboratively and sharing advice and information effectively under significant pressures.

10.12. Owing to the urgent need to deliver both CBILs and CLBILs quickly and on an unprecedented scale, there were challenges during their implementations. This was particularly so during the early stages of CBILs. Take-up of CBILs was initially slow.

The challenges essentially stemmed from the unexpectedly high volume of applications with lenders struggling with the overwhelming demand. There was a lack of understanding of the limited capacity that lenders had to handle such a large volume of requests in a short timeframe and how their internal processes might cause delay in processing applications quickly. An additional, unforeseen challenge was that many lenders prioritised their existing customers, and the process of opening a new bank account proved to be time-consuming. Once these difficulties were identified, several modifications to the design of CBILS were made to stimulate faster take-up as well as accrediting new lenders to meet the demand.

- 10.13. The introduction of BBLs helped to ensure that there were no significant gaps in support, nor any exclusion of specific groups. Even businesses whose usual bank could not participate in one of the loan schemes were able to obtain a BBL loan from another lender. Further, businesses without a business bank account were eligible for BBLs. BEIS was concerned about the lack of income support to company directors who did not qualify for either the furlough or the self-employed schemes. This group continued to be excluded despite a strong media campaign.
- 10.14. The Department's view is that there were no alternative approaches that were more effective (including cost-effective) to achieve the objectives of CBILS and CLBILS, especially within the urgent timeframe required to provide financial support. BEIS was exploring ways to accelerate CBILS, however, as the narrative around CBILS being slow to deliver became widespread and there was also significant media interest and reporting on this, it was very difficult to change this perception. That was a part of the motivation for the introduction of BBLs. There were no measures available to overcome the speed and volume limitations inherent within the traditional banking systems, and as a result, BBLs was developed to bypass many of these systems. Whilst a working group of lenders was considered to facilitate delivery of the schemes, this was ultimately dismissed given BBB's close working relationship with lenders.
- 10.15. CBILS was successful and broadly worked as intended. A key policy question remains about the extent to which marginal businesses should be protected. These businesses survived the pandemic following receipt of the Covid-19 loans and may not have survived in a normal trading economy. It is perhaps impossible to remain neutral, either there is some level of economic shock and insolvencies or there is remedial action, and insolvencies are prevented.

BBLs: Lessons Learned

- 10.16. As stated above, CBILS was successful in most respects but was unable to meet expectations for volume of applications approved nor for speed of review. BBLs enabled a higher volume of applications to be approved rapidly and was designed for all eligible businesses in all parts of the economy. The demand that had not been addressed by CBILS was met by BBLs and businesses in need benefited from the scheme.
- 10.17. BBLs was an HMT-led scheme introduced at pace in order to support businesses and ensure they survived the pandemic. There were aspects of BBLs that worked well and achieved these objectives. These were:
- a) The speed of the response to the situation;
 - b) The simplicity of the rules including straightforward eligibility;
 - c) High volumes of applications processed in a short time, addressing business need; and
 - d) Wide reach to all sectors, locations and types of business.
- 10.18. However, the pandemic, and the need to introduce these loan schemes at pace, was unprecedented for the Government and accordingly there were significant learning points for the Department as they progressed through the pandemic from one scheme to the next. These learning points included:
- a) Building on existing infrastructure;
 - b) Data sharing to reduce levels of fraud; and
 - c) The importance of lender accreditation and how quickly this process was able to be rolled out.
- 10.19. In such circumstances, there were challenges associated with developing such unprecedented schemes at pace and in circumstances where the direction and parameters of the scheme were changing rapidly and often changing again in the lead-up to launch. BEIS officials were working seven days a week from March to June and having to adapt to changing needs and decisions as they were happening. The risk of fraud was inherent in the design of the parameters and objectives of BBLs. Specifically:

- a) The 100% government guarantee which took away the risk for lenders and left them with little incentive to pursue recovery of the loans;
- b) HMT's instructions that the loans should be disbursed ideally within 24 hours; and
- c) A reliance on a self-certification mechanism for the businesses with minimal checks to be conducted by lenders.

10.20. The main objectives of BBLS were to support smaller SMEs, in all parts of the economy, through the pandemic and as quickly as possible. BEIS worked with HMT and BBB at pace to deliver those objectives. As detailed at paragraph 10.16 and throughout this statement, BBLS was introduced as a solution to the issues that had arisen with CBILS, in particular the slow rate of processing applications due to the lenders having to undertake the usual checks in accordance with their usual lending practices, and a reluctance to lend in the sub-£25,000 space due to CCA implications. This led to a backlog of applications, and feedback from numerous stakeholders that smaller SMEs were unable to access the finance that they needed in order to survive.

10.21. Accordingly, in designing the new scheme the decision was made by the Chancellor to prioritise speed and have funds disbursed within 24-48 hours, to assist these struggling businesses as quickly as possible. To do so, background and counter fraud checks had to be reduced as there was not enough time to complete them. However, the necessity for speed of disbursement was also the root of most of the deficiencies of the scheme, particularly in relation to the vulnerability to fraud. In prioritising speed, it meant that lenders consequently did not have enough time to undertake in-depth checks, including in relation to duplicate applications or business turnover. While the lack of time to complete checks was raised on several occasions, the Chancellor did not want to compromise on the turnaround time given the urgency of getting finance to small businesses quickly and simply. In any event, given that 61% of all BBLS loans were distributed within the first two months of the scheme, any subsequent extension to the time afforded to lenders to process applications would have had a limited impact on the prevention of fraud. By that point, the majority of loans had already been issued, limiting the effectiveness of any further restricting of the application process. Specifically, more than 40% of BBLS loans were disbursed in the first month of operation (May 2020), 61% by the end of June 2020, and more than 90% by value by the end of November 2020 (the month that BBLS was originally due to close). These

statistics demonstrate that the scheme was successful in achieving its objective of getting finance to struggling businesses expeditiously.

- 10.22. A 100% guarantee scheme is not something that the Department would ever advise doing lightly, and former BEIS officials considered that the guarantee did not need to be 100% to disburse a higher volume of loans. DBT maintains this view. The 100% guarantee scheme was developed, by HMT, to address the concerns that CBILS was not doing enough at sufficient pace to provide necessary financial support to businesses. Taking away the risk for lenders was a significant factor, which helped to clear the backlog of applications and speed up the distribution of funds. However, once the lender has no 'skin in the game', the dynamics of the scheme were changed and was a lack of incentive for the lender to seek to recover funds beyond a certain point. This risk was raised by BEIS officials throughout the development of the scheme as detailed in Section 4 above.
- 10.23. The speed of development of these schemes made the usual policy development processes, such as equality impact assessments, difficult to complete in the usual time frame. Whilst assessments were undertaken, they were not complete until June 2020, after the schemes had launched.

Future Fund: Lessons Learned

- 10.24. The general lesson learned from all access to finance interventions was that the further the process diverged from normal market practice, the harder it became for the scheme to be secure against fraud and error, and the greater the reputational risk. In the case of the Future Fund, some investors and businesses sought to exploit the lack of due diligence, and the rules-based nature of the scheme was widely misunderstood by the public.
- 10.25. The first lesson learned was that the Future Fund rules relied heavily on the concept of an independent investor. In most cases, investors met this requirement. Co-investors included established, FCA-authorized investment funds many of which were existing delivery partners of BBB. Where the investor was an individual or unknown corporate entity, independence was much harder to establish. The risk if an investor was not independent was that they would use their link with the business to extract their investment capital.
- 10.26. A variant on this was where a genuinely independent investor used onerous contract terms, separately from the Future Fund convertible loans, to extract 'management fees'

or similar charges and hence withdraw their capital, rather than leaving it invested for the benefit of the business. A third variant was where the investor had an unknown connection with the independent solicitor, who was required to certify every transaction, and used this to their advantage in some way.

- 10.27. This is not to say that the requirements for an independent investor and solicitor should be abandoned in any future programme of this kind, rather that these safeguards cannot be relied on exclusively and should, where practicable, be backed up with other layers of defence against fraud and error.
- 10.28. The second lesson relates to the rules-based nature of the scheme. BBB, and by extension the government, was criticised for investing in companies that used the Future Fund legitimately and correctly but did not conform to the target profile of high-tech start-ups that was emphasised in official communications. This could have been avoided by giving BBB discretion to turn down investment proposals.
- 10.29. This idea was mooted but rejected on the grounds that it would delay the process. Even if that were true, it is possible that the adverse impact of any delays would in fact have been less than the financial and reputational consequences of the investments that were made but would have been prevented by BBB had it been given the authority to do so. It was reasonably straightforward to predict in advance which investments would be most controversial.
- 10.30. Related to this, it will be important in any future scheme to ensure that communications about the design of the scheme is aligned with the reality of the scheme rules. In the case of the Future Fund, the government communications suggested that the programme was aimed at innovative start-ups. While this reflected the early motivation for introducing the Future Fund, the scheme rules, once developed, did not target the Fund in that narrower way. Yet the line about innovative start-ups was used even after it was clear that a wider range of companies was accessing the Future Fund, as they were entitled to do. This risked being seen as misleading.
- 10.31. The consequence of this mismatch was reputational damage to the programme specifically and to BBB generally. The scheme attracted criticism for investments in companies that failed and were neither start-ups nor in the innovative or tech sectors.
- 10.32. The third lesson learned relates to the two extensions of the scheme. These were implemented in part so as to align the Future Fund with the loan schemes. They could have been used as opportunities to change the terms of the scheme and address some

of the difficulties that were becoming apparent after several months of operation. Alternatively, the Future Fund could have closed sooner on the grounds that if any high-quality company required equity finance and had suitable investors on board, it could have applied in advance of the closure date that was originally announced.

Potential Criticism of Investment Decisions

- 10.33. There has been some public criticism of the Future Fund. For example, a Guardian article dated 15 April 2023 commented that BBB non-executive director Dharmash Mistry warned that the Future Fund risked creating ‘zombie businesses’ kept alive artificially by taxpayers’ cash {GD(B)/731 – INQ000576427}. The article alleged that many of the loan recipients were neither start-ups nor fast-growing. Further, it confirmed that a freedom of information request was made to BBB which revealed that, “...of the £1.14bn ploughed into Future Fund companies, nearly £90m had been lost as at February 2023.” Further, the data showed that “92 companies received a total of £78.4m but went bust before the loans could convert into an equity stake. A further 12 loans, worth £11.3m, did convert into a shareholding, but the company in question went into administration afterwards.”
- 10.34. The Future Fund is distinguishable from other equity finance schemes in that it was a rules-based scheme with no due diligence on the viability of the business plan or idea. The criteria did not require businesses to be a start-up or fast growing to be eligible. The requirements for previous equity investment and for co-investors willing to commit capital alongside the Future Fund were designed to establish that the market had independently determined that the businesses being invested in were worthy of investment. The policy goal was to provide capital to an investment market that had stagnated. Accordingly, it was logical to target businesses on the basis that they were raising an investment round.
- 10.35. A degree of losses was considered inevitable, both before and after the loans made under the Future Fund converted into equity. The ultimate value for money of the scheme will depend on the balance between the increased economic activity of the successful businesses compared to: (i) the capital cost of unsuccessful investments; and (ii) the ‘deadweight’, being money provided to businesses who may not have needed it. The figure of £90 million of losses on a £1.14 billion portfolio is considered to be within the expected range and cannot be used as an indicator of the overall economic benefit of the scheme, which would require an assessment of the economic value generated by the businesses that are still trading.

RLS: Lessons Learned

- 10.36. Elements of the initial construction of the RLS necessitated changes which are appropriate learning points:
- a) The RLS initially did not allow personal guarantees for lending below £250,000. Allowing lenders to require personal guarantees encourages lenders to adopt a greater risk appetite/lend with greater confidence and reduces the risk of strike-off and corporate insolvency abuse.
 - b) The proportion of the loan guaranteed by the government started at 80% but was later reduced to 70%. A guarantee ratio should leave lenders with enough 'skin in the game' so that they are incentivised to pursue all appropriate recovery opportunities.
 - c) There was no portfolio cap on RLS lending, as a result of lessons learned from earlier loan schemes which restricted the amount lenders were willing to provide. Increasing the total proportion of a lender's portfolio that could be claimed against the guarantee removed the impact of the loans on the lenders' capital relief calculations, meaning that lenders could claim capital relief and lend more to small businesses at better rates.
- 10.37. Nevertheless, these aspects of any new emergency scheme must be balanced against whether personal guarantees and a 70% government guarantee of loans would be sufficiently attractive for borrowers and lenders. In general, in an emergency the course of action to be taken will be a political decision (likely requiring ministerial direction).
- 10.38. As with the Covid-19 loan schemes, any large-scale scheme created at pace for a bespoke crisis is likely to have considerable uncertainties about value for money and risks. Whilst the above helped to reduce some of uncertainties and risks, the trade-off between pace and mitigating risk will remain, and it will be for future ministers to decide on the balance of risk and reward.
- 10.39. RLS was designed with data protection arrangements in mind, including a privacy notice that informs borrowers of the use of their personal data for the purpose of fraud prevention. This was a direct learning from the BBLs, which sought to provide more clarity for borrowers.
- 10.40. Similarly, the dissolution objections process (by which objections could be raised to the dissolution of a company that was a recipient of a guaranteed loan) was adopted for RLS and is one that DBT will be able to apply to future schemes from the outset to

prevent dissolution and to limit government exposure where lenders do not apply personal guarantees.