



HM Treasury

From: NR
 Team:
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Submission: Exploring case for a 100% guaranteed instant loan scheme for small business (the ‘Coronavirus Small Business Interruption Loan Scheme’)

To: CX
 Cc: EST, CST

Summary

The main Coronavirus Business Interruption Lending Scheme (CBILS) has now approved over £2.2bn of government-backed lending through making over 13,000 loans to SMEs in the less than 4 weeks it has been up and running. We would expect this number to continue to rise rapidly, particularly as more and more banks come onstream to offer sub £25k lending through CBILS.

With the exception of Lloyds who are still a few weeks away from being able to integrate this lending into their IT platform for sole traders and small partnerships, all of the other big 5 banks are now offering lending to firms below £25k (Barclays are not yet offering it to sole traders and small partnerships but expect to be able to do so by the end of the week).

However, as flagged in last night’s advice on the Consumer Credit Act, it is clear that for some of the smallest firms seeking small loans, the unfamiliarity with bank processes for lending combined with eligibility and process barriers for the existing CBILS scheme are still hampering volume lending at speed. Rather than making further significant architectural changes to the CBILS scheme, last night’s advice proposed focussing a new quick loans scheme specifically on this cohort (small firms seeking small loans) that incorporates a 100% guarantee.

The rest of this submission sets out what such a scheme could look like and seeks your steers as to whether you would like us to continue to work this up. If you are minded to pursue this proposal, which we propose calling the Coronavirus Small Business Interruption Loan Scheme (CSBILS), we will need to engage in urgent work with lenders and business representatives to undertake the detailed design in order to enable you to launch a scheme that works effectively.

We propose that CSBILS would:

- operate through a simple online form for applicants similar to the Swiss model: lenders would rely only on firms’ self-certification that their business was not in difficulty before Covid-19, and look to rapidly disburse loans within 24 hours of application
- offer 100% government guarantees on small loans of up to 10% of the turnover of small firms, capped at £25,000 (or if you’d like to go further – up to a 25% turnover limit capped at £50,000);
- apply 0% interest rates and fees for the first year for firms as with CBILS; and
- be administered by the British Business Bank. To find another administrator would be a lengthy process, undermining the purpose of the scheme.

Designed as such, with loans available for a maximum of 6 years as in CBILS, our preliminary costing estimates suggest this could cost c.£6bn over 6 years. The scheme could present a

significant financing pressure in the short-term and significant fiscal risk in the medium term coming on top of the wider policy support and economic impact of COVID-19. There is a very high risk that a significant proportion of this guarantee crystallises over the medium term, given the level of guarantee and cost of collection. You will want to take this into account when deciding whether you wish to intervene.

Annex A includes a full draft term sheet for CSBILS. The rest of this submission takes you through some of these key design questions.

Key Design Questions

Interaction with CBILS

1. We propose that CSBILS would not replace CBILS for the smallest businesses, **but that businesses would only be able to apply for a loan through one or the other**. This therefore takes away any need for a turnover cap as part of CSBILS (were you minded to pursue this idea) as larger firms will prefer to continue to seek the larger loan amounts offered by CBILS.
2. We are cognisant however of the potential for comparisons to be made between the two schemes and have designed CSBILS with this in mind.

Streamlined self-certification process that removes need for checks

3. Our discussions with the banks and UK Finance suggest that loans of up to £25,000 are difficult to deploy at pace, particularly to sole traders. We believe that to lend at pace sub £25,000 would require:
 - A government guarantee of 100% removing any 'skin in the game' for the banks (this should include having no portfolio cap so that in theory the 100% guarantee could be called against the whole of the portfolio);
 - Removing any need for a bank to assess viability of the firm pre Covid-19 or that the loan will help the business to trade out of the crisis; and
 - Removing almost all of the upfront paper work so that all that is left is a short, standardised online form in which the borrower self certifies they were not a business in difficulty prior to the Covid-19 outbreak (which you could specify as being December 2019). In order to facilitate rapid disbursement of the loan this would not be subject to independent verification by the lenders.
4. With such a streamlined process we think it could be possible to get loans out of the door in 24 hours, although the view of UK Finance is that banks would still need to conduct Anti Money Laundering checks in relation to both existing and new customers. Reduced checks do however come with heightened fraud risks, particularly where lenders are dealing with new customers.
5. We have not yet engaged with banks on the operational questions and would need to explore with them at pace the implications of this approach, including the scale of the challenge in terms of how hard they would find it to integrate a short-standardised form of this type into their lending platforms.

Are you interested in pursuing a CSBILS scheme? If so would you like us to explore the implications of this approach with lenders, including both the question of having a standardised form, and the implications of complying with AML regulations plus a series of questions about how quickly the lenders could stand such a scheme up operationally?

Administration of the scheme: As for all guarantee schemes you would need a body sitting in the middle of the scheme to administer the guarantee. In the interests of standing any CSBILS scheme up at pace this would need to be the British Business Bank with the loans then disbursed by its accredited lenders. **Do you agree?**

Other key design choices

6. **Size and duration of the loans:** We recommend targeting this scheme at the smallest loans. Feedback from the banks suggests that it is loans of up to £25k where they are struggling most to operationalise at scale (particularly in relation to the 3.5million sole traders), although you could go to £50k if you were minded to go higher than this. (We would not recommend going beyond £50k as that would move away from the rationale of having a scheme aimed at small firms requiring small loans and would create overlap with the existing CBILS scheme).
7. We also recommend applying a limit relative to a firms' turnover. The aim would be to help guard against the risk that we are seen as allowing the most vulnerable SMEs to load themselves up with too much debt. 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).
8. We also recommend making the loans available for a maximum of 6 years, in line with CBILS. This will allow firms to spread the cost of borrowing over the lengthy period. You could increase the loan period to a maximum of 10 years under the state aid rules but we would recommend starting at 6 and gathering feedback on this point.

Do you agree we should set the maximum loan amount at £25,000 and that we should explore with banks a cap of 10% of turnover? Do you agree that the maximum loan length should be for 6 years as with CBILS?

9. Products: Given the focus on small businesses, including sole traders, overdrafts and loans are likely to be the most useful products. However, it seems reasonable to allow lenders to offer the full spectrum of CBILS products (i.e. including invoice and asset financing) if they would like as part of CSBILS.

Do you agree that the product range should be the same as for CBILS?

10. Interest and fees: Like CBILS, we suggest that the government pays the interest for the first year so CSBILS would be interest-free for the borrower with no fees for the first year. This will be essential to avoid CSBILS being portrayed as an inferior alternative.
11. There is then an interesting question to consider regarding the interest rate that businesses will pay after the interest free period expires. Given that the proposal is for the loans to be offered on a standardised template with no checking of creditworthiness or risk from the banks and a 100% guarantee, there is an argument that the banks are being used simply as a distribution mechanism and therefore a single price should be charged (or maybe one price for loans and one price for overdrafts which are more expensive ways of borrowing) across the CSBILS scheme. This would mean there was no market for these loans as the price would be set centrally – it would make it more likely that a business would simply take a CSBILS loan from the bank with which they have an existing relationship (and indeed some banks may only have the capacity to serve their own customers). However price setting is a very unusual step to take and we have little to draw on in terms of how we could arrive at a suitable price at speed.
12. The alternatives would be either to take the same approach as for CBILS and let each accredited lender set their own interest rate after the initial 12 month period (taking into

account the benefit of the guarantee and passing that benefit on) or to limit interest rates to being within a particular range. This would be a more straightforward proposition and would avoid some of the issues that we would run into if we were to try and find a way to set a central price. It would see a spread of different interest rates be offered for CSBILS loans (although, given these types of small loans are not the usual territory of the big banks, we are unlikely to see strong competition on price for customers).

13. On balance, we are inclined to think setting a range for pricing for CSBILS is probably the right balance to strike. In thinking about this, we will need to take into account of the alternative lenders who are accredited to act as lenders under CBILS (for example, Funding Circle has just become accredited). Given alternative lenders' business models, which normally entail higher funding costs and taking on the riskier end of the market than banks, we would need to explore whether they would be able to provide the loans if a range was set too low. We can return with further advice on this pricing question if you are interested in proceeding with CSBILS.

Do you agree that there must be an interest free period of 12 months? Do you also agree that we should explore the question of dictating a range within which banks should price loans under CSBILS?

14. Personal Guarantee: We recommend this should mirror CBILS, that bans personal guarantees for all lending of this size. However, recognising that sole traders have no legal business entity separate from the individual, we would also need to include a clause within the contract that lenders would not be able to pursue primary residences or a firm's primary vehicle in the event of default.

The Consumer Credit Act

15. Consumer Credit Act: as per the separate advice you received last night, feedback from lenders would suggest that as well as having a simple self-certification process for eligibility, to get the loans out at speed, the scheme would need to remove a number of hurdles and protections intended to protect borrowers from unscrupulous lending – namely by disapplying the Consumer Credit Act. Disapplication of the CCA is necessary in order to ensure the banks don't need to undertake creditworthiness or affordability checks before making loans (in other words, this is necessary to make the self-certification process work). Were you minded to pursue a CSBILS **we would therefore recommend turning off the Act for the purposes of the CSBILS scheme only.**
16. When removing the CCA for sole traders borrowing less than £25k under CSBILS we would also be removing a number of other protections that such borrowers have under the CCA such as:
- Early settlement rights, permitting borrowers to settle early if their business recovers better than expected and restricting the amount that can be charged for early settlement.
 - Information: Lenders are required to provide regular statements and notices when something changes to help borrowers stay informed about the status of their loan.
 - Arrears management, imposing restrictions on the lender's rights when a borrower defaults, including against raising interest rates
17. We can include these sorts of protections in the CSBILS contract. Despite this, there could be criticism from small businesses groups or parliamentarians about removing protections for small businesses borrowing small amounts so we will need to work hard to try to have sufficient protections in place without the CCA applying.

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Do you agree that in the interests of being able to lend at speed we will need to disapply the Consumer Credit Act from lending under CSBILS? If so, we will work up the necessary legislation and engage with BEIS on securing space in the Insolvency Bill. We will also need provide advice in the next iteration of the scheme about what protections can be put in place under the CSBILS contract to ensure that firms taking out small loans are treated properly by the banks for the duration of the loan.

Pursuing loans under CSBILS

19. While CSBILS would not be intended to be a grant scheme, naturally the 100% government guarantee entails the risk that (i) banks provide loans liberally and do not actively pursue repayments; and (ii) borrowers do not feel they need to try overly hard to make repayments.
20. The first risk could potentially be addressed by taking a similar approach to the German scheme, that is, incentivising banks to pursue repayments even after the government guarantee has been paid out by allowing them to retain up to 10% of the total. This also helps reduce the second risk by focusing borrowers' attention on expectations around lending, thereby reducing the chance of borrowing with little intention of making repayments and helping avoid any perceptions that the scheme might have offered poor taxpayer value. However, big lenders may feel uncomfortable aggressively pursuing loans due to potential negative reputational effects.
21. To deal with this, as for CBILS, we suggest there should be an emphasis on banks taking a fair approach to seeking to collect debts (i.e. pursuing those which may be gaming the system by hiding extensive personal assets/gains at the cost of the taxpayer, but not those genuinely in difficulty). We would also suggest time limiting how long the banks should pursue recoveries for. You may for instance want to specify that recoveries can only be pursued for 18 months after the date of repayment has passed and that the guarantee must also be called in this time.

Do you agree that banks should be able to pursue loans for no more than 18 months after the loan expires?

Would you like us to explore giving the banks any incentives to seek recovery as in the German scheme?

Cost of the Scheme

22. If you are minded to pursue CSBILS we will need to do further work on the costings for the scheme, so you can consider the fiscal impact of this scheme in the round alongside other interventions.
23. The table below shows our initial estimates depending on whether you set the cap at £25k or £50k (including breaking this down if all SMEs were allowed to borrow under the scheme and then, by way of comparison, a lower costing if you were to exclude sole traders who don't have any employees from borrowing under CSBILS (to note, that would be cheaper but would exclude a large number of sole traders (around 3.3 million) who we suspect would be

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vocal in their disapproval at being omitted for a scheme aimed at supporting small firms receiving small loans). We have assumed for these costings a take up rate of 30% and (that owing to the 100% guarantee and the challenges around collection) the guarantee is called in up to 40% of loans by volume.

Cap		Max contingent liability (£bn)	Expected contingent liability based on 30% take-up	Expected total cost (over 6 years) based on the guarantee being called in 40% of cases
£25k / 10% turnover	All SMEs (c.5.8m)	47.8	14.3	6.0
	Excluding non-employing sole traders / partnerships (c.500k)	33.6	10.1	4.2
£50k / 10% turnover	All SMEs (c.5.8)	60.3	18.1	7.6
	Excluding non-employing sole traders / partnerships (c.500k)	46.0	13.8	5.8

Next Steps

24. If you are interested in pursuing a new scheme for small firms seeking small loans (CSBILS) we will need the rest of this week to hold extensive discussions with the banks (and the BBB) to ensure this is a design they could operationalise and that it would enable them to lend at pace to small SMEs. We would then revert with further advice next week (Tuesday 28 April), with a view to allowing you to make a high-level announcement of the key parameters of the scheme around 1st May (using a similar staged approach as for CLBILS).
25. We believe we would then need two weeks to get this fully operational, meaning targeting a launch date of the 15th May at the earliest.
26. We have also spoken to BEIS about the State Aid implications of a 100% government guarantee. We think this is likely to be deliverable as *de minimis* aid for the smallest firms: however the scheme design will need to focus on ensuring we are not giving indirect aid to lenders with no skin in the game: lenders will need to be able to demonstrate that the full benefit of the guarantee has been passed through to the borrower. There will also be an issue about cumulative aid levels for businesses who may have accessed other sources of state support. We will continue to work through these issues at pace and will provide further advice on how to mitigate these risks (including engagement with the Commission as needed).

Annex A – Draft CSBILS Term Sheet

	CBILS Terms
Administration and Distribution	For speed and ease of rollout, maintain existing arrangements of loan being administered by BBB and distributed by accredited lenders
Eligibility Criteria and verification	Applicants complete self-declaration that they were not in difficulty in Dec 2019 - standardised one-page form. Minimal eligibility checks by banks, i.e. not verifying creditworthiness or affordability, in the interests of speed. However, still assessing that business has been impacted by CV-19 (again self-certified).
Business size	No need to have turnover cap as requirement that you can't benefit from both CSBILS and CBILS stops larger firms from wanting to benefit.
Eligible sectors	All sectors except banks/building societies, insurers/reinsurers in line with CBILS.
Amount of finance to be offered	Maximum of 25k / 50k plus we recommend you consider a cap of 10% of turnover as with the Swiss scheme
Products to be offered	Loans, overdrafts, invoice finance, and asset finance as with CBILS
Length of loan	6 years (to match CBILS)
Interest and product fees paid by the borrower	Interest rate of 0% for 1 year. After that proposal is to set a range within which lenders have to stay.
Guaranteed amount per facility, subject to annual claim limit	Increase from 80% to 100% per loan/overdraft/facility
Portfolio Cap	None to get banks to lend at speed
Total amount available to lenders	Uncapped, demand driven.
Banks' ability to pursue loan	Banks able to pursue loans for up to 18 months after loan expires. After guarantee from HMG has been called, any extra recoveries should be returned to HMG (unless you allow banks to keep a percentage as in the German model).
Personal guarantees	Keep CBILS condition: No personal guarantees below £250k

Key Differences from CBILS:

-No viability assessment including no need to confirm lending will help business to trade out of the crisis.

-stipulate the reversion rate at the end of the interest free period. We will need to explore what this means for the banks' willingness to offer.

-no portfolio cap (CBILS has a portfolio cap of 60%).

-only limited paperwork up front, self-certifying that the business is not in difficulty (a state aid requirement)