

Submission: Making changes to the regulation of small business lending under CBILS

To: Cx, EST

You have received representations through UK Finance that a combination of the Consumer Credit Act and FCA rules are preventing some of the big banks from lending to sole traders in amounts below £25k for the CBILS guarantee scheme. We have investigated whether it would be possible to take away some or all of the provisions of the CCA/FCA rules in order to speed up this lending. **Our conclusions are that you could use legislation to remove sub £25k lending to sole traders from protections under the CCA or FCA rules but making such a change would not be a game changer in terms of freeing up this lending under the CBILS scheme.**

This note covers the mechanism for how would could make the CCA change, the risks it would open up for sole traders and comments on whether making such a change for CBILS achieve the sort of results you are looking for in terms of small loans. **Separate advice on what a fast, 100% guarantee for micro loans could look like will be provided by close of play tomorrow,**

Details

[OFFICIAL SENSITIVE]

1. As we discussed last week, UK Finance (representing the views of some but not all of the big banks) have raised concerns that making loans of under £25k to sole traders, unincorporated businesses and partnerships of fewer than four people is too difficult under CBILS due to the Consumer Credit Act and FCA rules.
2. The main problems UK Finance raise are that the CCA rules are complex, highly prescriptive and, as the big banks don't normally do much if any business lending in the sub £25k category, unfamiliar to them.
3. Lending to sole traders in this sub £25k space also requires firms to comply with FCA rules which include affordability and creditworthiness assessments which inevitably take time and are burdensome for sole traders applying for loans and for banks making the loans.
4. Since the meeting on Friday evening, we have been working on how you could legislate to remove the sub £25k loans to sole traders from the vast majority of the protections provided in the CCA and taking them out of reach of the FCA. Our conclusion is that you could achieve this by enacting a piece of secondary legislation. This would be an SI introduced under the negative process which would mean it could come into immediate effect from the day it was laid (but could not apply to loans which have already been made).
5. However, as soon as you start to scratch the surface of the UK Finance position that removing the CCA and the FCA rules would make a material difference to the speed and ease of small CBILS

loans other problems quickly emerge. We think there are two sets of issues here. The first set of issues consider how much of the problem changing the CCA would solve, the second consider how much surgery you would need to undertake to CBILS to make these changes work.

Would changing the CCA solve the problems for sole traders seeking small loans from CBILS?

6. Although UK Finance are currently saying that the CCA/FCA rules are the main issue preventing banks lending small sums to sole traders, it is difficult to find evidence that this is definitely the case. The UK Finance arguments have been fluid and are often aimed at deflecting the blame for lending moving slowly. Although the CCA is an issue, as set out above, because the banks do not traditionally lend into this space there are other issues to contend with in terms of getting CBILS lending really working at the sub £25k level. We are also addressing all the other operational issues that UK Finance are raising (these were set out in Name Redacted note on the BBB processes sent up on Thursday 16th) so there is a case for seeing the impact on those changes on volumes before moving to quite a radical change on the CCA.

7. It is also clear that several of the big banks are already finding ways to make loans in the sub £25k category work for sole traders. RBS, for example, are already lending sub £25k, Santander are entering the market together with Barclays and HSBC. And despite the approval rates for the applications in the CBILS system being high, there are also the other very valid

arguments that are made that the smallest of businesses are often put off by the thought of the paperwork that is entailed in applying for a business loan.

Other issues to consider

8. As you know, the present CBILS guarantee is designed to work with the grain of the existing lending policies for banks. Under CBILS, lenders therefore have to make a viability assessment which tests whether a business was viable coming into the coronavirus crisis and whether a loan will help it to continue to trade once the crisis starts to ease. To make sub £25k loans work quickly and easily, you would need to remove this test which is one of the most fundamental pieces of the CBILS architecture and helps to protect businesses from entering into borrowing they can't afford and makes it more likely, therefore, that they repay the loans without the guarantee being called (in research earlier today some of the banks thought that around 50% of applications for small loans from the smallest businesses would be likely to fail any sort of affordability check)
9. There is also a danger that a move to take protections away from small businesses taking out small loans could be perceived as a negative step for the 3.5 million sole traders who are within the scope of the CCA when they borrow less than £25k. The reason that previous governments have retained protection for small businesses taking out small loans is that they often behave in a similar fashion and have similar levels of sophistication to individual consumers. The CCA protections are therefore there to help to make sure businesses do not take out loans that they

cannot afford to repay and help to protect them in the event of default. Stepping in to take these protections away under CBILS to help the banks to make faster lending decisions could therefore be portrayed as acting in the favour of banks at the expense of small businesses.

Alternative Proposal for an instant loan scheme – CSBILS

10. Our initial conclusion, therefore, is that it is hard to see that the upside benefits of making such a significant change to take out protections for small businesses borrowing small amounts through CBILS outweigh the downside risks.
11. However, it is clear that, for some of the smallest firms seeking small loans, the eligibility and process barriers for the existing CBILS scheme are too high. We would therefore propose focussing an instant loans scheme specifically on this cohort with a more targeted approach that incorporates disapplying the CCA together with a 100% guarantee. We are still working on a detailed term sheet which we should have with you by close tomorrow.