



HM Treasury

From: NR
 Team: CBEIS
 Ext: I&S
 Date: 09/03/20

Submission: Covid-19: SME lending

To: CX, cc EST

Recommendation: You give steers on the CV-19 lending Budget announcement

Timing: Budget

Summary: We have progressed work with lenders and the BBB on the CV-19 lending scheme. The quickest approach will be to change the parameters of the existing EFG scheme. We recommend you make an initial announcement of £1bn additional headroom to support businesses affected by CV-19.

Detail

1. This note updates you on work to develop a loan guarantee scheme to respond to CV-19 business finance pressures, and suggests language for a Budget announcement.
2. Since your steers on Sunday night, we have had constructive discussions with Lloyds Bank, UK Finance and the BBB on operationalising a loan guarantee scheme to respond to business pressures raised by Covid-19. The advice below takes these discussions into account.
3. A draft term-sheet for the new loan is annexed.

Creating a new guarantee scheme

4. Discussions today confirmed the message at the weekend that **we can move quickest if we build the new guarantee out of the existing Enterprise Finance Guarantee (EFG) scheme rather than creating a new scheme.** In practice, this means:
 - a. **Adding a temporary new 'CV-19' eligibility criterion to the existing EFG scheme** – so EFG loans and overdrafts could be accessed by firms who would otherwise meet bank lending criteria but for lack of collateral (as now), *but*

also by firms facing CV-19 related challenges that just fall outside bank lending criteria as a result of CV-19 impacts.

- b. Making significant changes (increase in headroom, removal of fee, change in % guaranteed) across the whole of EFG**, not just lending under the new CV-19 eligibility criterion. We tested whether it was possible to limit this additional generosity to only businesses meeting the CV-19 criterion – BBB advised that it was possible, but this would add significantly to delivery times.
 - c. Leaving the loan type / business type criterion broad.** BBB advise it would add considerable time to limit loan availability to e.g. small businesses or loans/overdrafts under £100k.
5. **These changes would create a scheme that is much more suited to overdrafts**, a key consideration given the need to ensure that businesses can continue to access working capital.
 6. **BBB expect that it may take a week or two of discussions with banks to work up a new CV-19 eligibility criterion.** BBB will need to work with banks on issues such as how to describe changes in risk appetite in a way that is compliant with banks' responsibilities on not advancing credit to unsuitable borrowers (whether legally under the Consumer Credit Act, or more generally in line with proper standards of market conduct), and how to establish a simple mechanism for establishing that a business is affected by CV-19. (Lloyds have advised us that for their own support for CV-19 impacted businesses, they expect to allow self-certification.)
 7. **However, both BBB and Lloyds advise that other changes to EFG (e.g. making the guarantee more generous, removing the fee, increasing headroom) can be operationalised in a matter of days.** Any increase in the contingent liability (which would arise if we moved the portfolio cap or increased headroom) would need to be notified to parliament.

Finding the right size for the new EFG

8. The economic impacts of CV-19 will depend on the nature of the outbreak, and therefore potential demand for the scheme is extremely hard to predict.
9. We have done some preliminary analysis on what sectors we expect to be most severely affected by the combination of supply-side and demand-side shocks. These include retail, hospitality, wholesale and travel.

10. 13% (400,000) of the 3.2m VAT / PAYE registered businesses in the UK have 10–49 employees. Early indications are that there are higher proportions of these businesses in some of the sectors that are expected to be most severely affected e.g. high street retail, bars and restaurants.
11. 3% (8,200) of the VAT / PAYE registered businesses in the UK have 50–249 employees. Early indications suggest that they are not disproportionately represented in the sectors expected to be most affected.
12. Given the degree of uncertainty about demand and how banks will respond to the changed parameters, and given it is relatively easy to increase the available EFG headroom, we recommend taking a staged–approach in which you **announce that a further £1bn is available to address CV–19 related lending needs**. This equates to adding c. £800m to the existing headroom (£500m total headroom, o/w c. £200m is currently used). £1bn headroom would be enough to support 10k £100,000 loans and overdrafts). **You could then return to questions of whether to make more headroom available if there is significant demand for lending and once lender behaviour is clearer.**

Fiscal impact

13. The total fiscal impact of the measure will depend on the amount of lending drawn under the guarantee and the loss rate. The total contingent liability is determined by the overall portfolio cap – for example, a 33% portfolio cap on £1.2bn lending would be £396m (over the 10 year duration of the loans). In other words, £396m of government exposure would support £1.2bn of lending.
14. **We do not recommend setting the new portfolio cap at this stage** – we would want to set the cap in a way that incentivises banks to take more risk without fully socialising the risk. This is to some extent a matter of art – but parameters will be clearer once we have more developed conversations with banks about the new eligibility criterion.
15. Wherever the portfolio cap is set, we would expect actual losses are likely to be lower (banks have good commercial incentives to undershoot the cap), but given the uncertainty over both the scale of any economic downturn and how lenders would respond to the EFG changes proposed, we would expect BEIS to ask for budget cover to absorb the maximum contingent liabilities of the scheme. We would look to provide this cover as ringfenced budget so we could bank any underspends when actual losses become easier to predict. BEIS would also need

Budget cover for non-fiscal AME (reflecting accounting rules) and a relatively small RDEL budget (<10m) to cover admin costs.

Presentation

16. **You have asked that we give the guarantee a new name, which makes it clear it is to support businesses through the Coronavirus outbreak.** We will come back on a new name tomorrow following further engagement.
17. We are confident that we and the BBB can work up a new CV-19 eligibility criterion, but won't have all of the details this week. As such, we don't recommend giving details of the new criterion at Budget to allow maximum flexibility once we've engaged with banks. This also allows a further announcement once the criterion is worked up.
18. To go further at Budget, you could announce the initial headroom and a timeframe for delivery. We think on the basis of conversations with BBB that starting from 1 April is deliverable. This does rely on several big lenders quickly coming on board, but conversations with the banks suggest that they will be squarely behind this. You could announce:

To help businesses impacted by CV-19, we will launch a new government guarantee to support up to a further £1bn lending to SMEs [from 1 April].

Are you content with this announcement at Budget? If so, we will work with BEIS to agree the text (ministerial and accounting officer responsibility lies with BEIS).

Next steps

19. We understand that on Thursday afternoon you are likely to host a **roundtable** with the Governor/Deputy Governor of the Bank of England and the Chief Executives of the largest banks, along with the EST and UK Finance. The focus of that meeting would naturally be wider than the EFG, but would allow you to position this intervention alongside the Bank of England's proposed SME Lending Facility and the voluntary commitments that the banking industry are making. **This would allow you to make a joint statement, with the Governor and the banking industry, outlining a substantial multi-billion pound commitment** being made by all parties to support UK SMEs affected by CV-19.

20. Following this roundtable, we would convene a working-level roundtable at the end of this week with BEIS, the BBB and the banks to make swift progress in making the new CV-19 EFG operational.
21. Separately, the Governor raised the correspondence sent to him by the peer-to-peer (P2P) lending platform Funding Circle. While we do not recommend pursuing Funding Circle's specific offer of distributing Government funds directly to SMEs, we agree that it is important to consider the increasingly important role that challenger banks and non-banks have played in the SME lending market since the financial crisis. Many challenger banks already partner with the BBB in offering the EFG, and we will explore options for HMG to work with non-bank lenders to a post-Budget timetable. Non-bank lenders such as Funding Circle are represented on the joint-HMT/BEIS 'Business Finance Council', which included representatives from banks, lenders, the BBB and business representative organisations such as the FSB. BEIS are likely to request that we reconvene the Council in the coming weeks.

Annex - draft term-sheet

DRAFT TERMSHEET	CV-19 EFG
Purpose	Support working capital for CV-19 impacted businesses
Eligibility	<p>Businesses which one or both:</p> <ul style="list-style-type: none"> i) Lack sufficient collateral but otherwise meet lending criteria]; or ii) [To be agreed with banks]Fall just short of meeting risk appetite, but would have met risk appetite in January 2020, and are impacted by CV-19 <p>Not companies in distress</p> <p>Businesses <41m turnover</p>
Size	<p>£1bn additional guarantees</p> <p>(this is c. £700m additional headroom – £500m current headroom ow c. £200m used)</p>
Availability	At least 6 month initial period (i.e. temporary – revert to regular EFG after)
Loan % guaranteed	75% [tbd – currently set at 75% but could be operationally more effective to leave loan guarantee % the same, while increasing portfolio cap]
Portfolio cap	33% [to be determined following discussions with banks]
Fees	0%
Type of products available	As regular EFG. Loans up to £1.2m.

OFFICIAL – MARKET SENSITIVE

Partners	Focus roll out on those with greatest reach / regional impact, but open to all
State Aid	de minimis