



From: Name Redacted / NR
Team: NR
Date: Banking and Credit Team
1 May 2020

Submission: Bounce Back Loan Scheme

To: CX
Cc: EST, CST

Summary

As you announced this week, the Bounce Back Loan Scheme (BBSL) launches next Monday at 9am. Ahead of that, this submission brings into one place the key decisions you have made about the design and operation of the scheme, and recaps on the associated risks – both in as far as mitigants have been put in place and where residual risks exist.

In summary, the key residual risks can be grouped into three categories:

- **Cost to taxpayer:**
 - **Broad uptake:** The attractive terms of the loan and ease of application, and notably the lack of creditworthiness checks meaning many borrowers ineligible for other loans may obtain loans under BBSL, could result in significant uptake of BBSL. At 30% uptake and 40% default on loans by volume, our preliminary estimates of fiscal costs are of c£14bn over 6 years.
 - **Risk of fraud:** The self-certification process creates a high risk of fraud. Banks' know your customer and anti-money laundering checks for applicants not currently holding a business current account with them should catch some fraud risks, but they've been clear that given the speed at which we're asking them to process loans, they will not catch all. And there is no safeguard yet against one business making obtaining loans from multiple banks.

- Based on the 7 big banks, the British Business Bank’s estimate of the combined fraud and credit risk losses through BBLs is of 30–50% i.e. £3–5bn on a £10bn portfolio.
- **Risks to borrowers:**
 - BBSL’s low barriers to entry may result in some businesses taking out loans which they cannot afford. For those that default, their personal finances and credit ratings could suffer. The loan application form requires the borrower to declare they understand and are able to repay the loan, but BBSL could still in future of having resulted in irresponsible lending.
 - These risks to borrowers entail potentially serious reputational and conduct risks for banks which can, as evidenced over the past ten years, threaten their ability and willingness to operate in certain segments. The low interest rates and relatively small loan sizes mitigate this conduct risk to some extent. Moreover, our guidance to lenders to bear in mind borrowers’ ability to repay when pursuing recoveries should help ensure lenders take appropriate action with regard to businesses in difficulty. But the cost to individual finances will for some be unavoidable and the removal of some consumer protections to facilitate the rapid and widespread delivery of the loans could be badly perceived.
- **Competition:** Alternative lenders are unlikely to be able to compete at the price point. The choice to set a cap of £50,000 rather than £25,000 compounds the competitive challenges for firms unable to offer BBLs as they are excluded from more of the market. This could be seen as government cutting smaller providers out in favour of the big lenders, and might undermine longer-term competition in the SME lending market.

The table overleaf sets out a detailed overview of the key design choices and associated risks in full.

Table 1: Key design choices and associated risks

Design question	Decision taken & mitigation of any associated risk	Residual risk(s)
<i>A standardised, widely-available, uniformly-priced product</i>		
Facility on offer	<ul style="list-style-type: none"> The sole product on offer through BBLs is a 100% government-guaranteed, 6-year term loan of £2k to £50k. The maximum loan size is capped at 25% of firms' self-certified turnover. Feedback from firms suggests is a reasonable number. Assuming a take-up rate of 30% of loans and defaults on 40% on loans by volume, our preliminary estimates suggest the total cost over 6 years is c.£14bn. 	<ul style="list-style-type: none"> This is a significant liability for HMG which could be magnified by fraud or businesses misstating their turnover (and getting bigger loans than intended). Recently established businesses' turnover estimates may be unreliable. The 100% guarantee and widespread access to the loan likely means the risk of default will be higher than the historical average.
Interaction with CBILs	<ul style="list-style-type: none"> BBLs will replace CBILs for sub 50k loans. At borrowers' request, existing CBILs loans may be repapered to BBLs terms. For alternative lenders which are not offering BBLs, this may mean that borrowers want to exit. In response to concerns raised by British Business Bank and others, asset and invoice financing will continue in CBILs in parallel. Overdrafts will not be allowed given operational complexity of banks' dual running. Banks generally view them as riskier products, as there is no path to exiting their debt burden through regular payments 	<ul style="list-style-type: none"> The lack of overdrafts could exclude some businesses which otherwise would have borrowed. The operationalisation of transfers from CBILs to BBLs, particularly where lenders with whom borrowers have a CBILs loan will not offer BBLs, may be operationally difficult.

OFFICIAL – MARKET SENSITIVE

		<ul style="list-style-type: none"> • The carve-out for asset and invoice financing to continue <50k in CBILS could create confusion.
<p>Eligibility for loans</p>	<ul style="list-style-type: none"> • This scheme seeks to capture as many of those businesses still struggling to obtain any/sufficient financial support as possible. • To that end, the cut-off date by which businesses need to have been established to be eligible is 1st March 2020. This reduces (but does not eliminate) the risk of lending to companies which set up to fraudulently claim on the scheme. Moreover, companies set up more recently are likely to be less viable to lend to. • As in CBILS, eligible businesses include limited liability companies, partnerships, sole traders, charities and societies. • Banks may exclude some sectors they deem as high-risk or as policy do not serve (e.g. casinos, nightclubs, etc). 	<ul style="list-style-type: none"> • With such a wide net, lenders' minimum checks to verify that applicants are in business (covered below) are our only protection against wide-scale fraud, but may leave residual fraud risk. • Given that we are not allowing them to take into account borrowers' creditworthiness, there is also a significant risk of lending to unviable businesses who cannot afford the debt. • If banks have similar lists of excluded sectors, some may uniformly struggle to access finance
<p>Pricing & competition</p>	<ul style="list-style-type: none"> • Following input from lenders accredited by the British Business Bank, HMG has set a standardised, low interest rate of [2.5%] for the life of the loan (with HMG covering the first year). While in the interest of the borrower, this will likely preclude the vast majority of non-banks from participating in the scheme, and also limit challenger banks' ability to do so. Danske has also reported they don't expect to be able to make the price work for a high volume of lending. • The choice to set a cap of £50,000 rather than £25,000 compounds the competitive challenges for firms unable to offer BBLS as they are excluded from more of the market. 	<ul style="list-style-type: none"> • This could be seen as government cutting smaller providers out in favour of the big lenders, and might undermine longer-term competition in the SME lending market. • Alternative lenders have already called out for the need for a level-playing field with banks and may become more vocal in due course.

OFFICIAL – MARKET SENSITIVE

A quick, simple application based almost entirely on self-certification

<p>Know-your-business checks</p>	<ul style="list-style-type: none"> • Where the business has a business current account (BCA), the bank has already verified they are a business, no further checks required • Where the business has a personal current account (PCA) and were established on/before 5 April 2019, they are required to provide their 2018/19 HRMC self-assessment return to evidence their business details. Banks may conduct additional know-your-business (KYB) checks. • Where the business has a PCA and was established between 6 April 2019 and 1 March 2020, they will need to discuss setting up a BCA with their lender, going through KYB checks. • Where the business is applying for a loan with a new lender or from an existing lender with whom they do not have a BCA or PCA, the banks may ask further questions as part of the application process and some may insist on applicants opening a BCA. 	<ul style="list-style-type: none"> • A 2018/19 tax form only points to the borrower having previously been in business, not right now • KYB could, in some cases, undermine HMG's objective of rapid loan delivery (but is necessary to guard against fraud risk) • Businesses using PCAs may struggle to access loans unless they are willing to open a BCA which is generally costlier (we defer to lenders' policy on this) • Some lenders, notably the bigger ones, do not intend to cater to new customers
<p>Risk of Fraud</p>	<ul style="list-style-type: none"> • The scheme is heavily reliant on borrowers providing accurate information. The lack of independent verification by banks of the following leaves significant fraud risk at the cost of the taxpayer, including as relates to: <ul style="list-style-type: none"> ○ Existence of legitimate, active business and genuine application (as opposed to one forced by organised criminal groups) ○ Eligibility for the scheme – loans could be made to businesses in excess for that they should be, or to businesses which have not been impacted by Covid-19 	<ul style="list-style-type: none"> • Banks' checks reduce but do not eliminate the risk of fraud: it remains very high. • The threat of criminal prosecution/ fines may not put off fraudsters, • Borrowers may also make honest mistakes in e.g. miscalculating turnover. • The lack of banks'/BBB's ability to check that the same business is not applying for multiple loans across lenders could increase the fiscal cost significantly.

OFFICIAL – MARKET SENSITIVE

	<ul style="list-style-type: none"> ○ No-double dipping i.e. only applying for one CBILS/BBLs loan with one lender, not making multiple applications ○ Having the authority to draw down funds on behalf of their company/partners • The application form clearly calls out the consequences of providing misinformation on the form (incl criminal prosecution, fines) • Banks will also run appropriate KYC/AML processes and, should any flags indicate fraud, explore further. (For creditworthiness flags which arise, including Country Court Judgements, they will not take these into account). 	
<p>Reduced consumer protections</p>	<ul style="list-style-type: none"> • In order to enable lenders to provide loans at the speed we intend, we are adjusting the Regulated Activities Order so that entering into a BBLs loan as a lender is not a regulated activity (currently loans of less than £25k to sole traders, unincorporated associations and partnerships of less than 4 people are regulated in the same way as consumer credit). • The amendments will however provide that the specific regulated activity of debt-collecting applies to BBLs loans, keeping requirements around arrears, default and recovery for these loans. • Retrospective changes will also be made through primary legislation to the Consumer Credit Act in order to disapply sections 140a-c which deal with unfair relationships between lenders and borrowers and entail an expectation of assessment of affordability before lending. • Borrowers will still have recourse to the Financial Ombudsman Service. It will release a statement on how it intends to view lender 	<ul style="list-style-type: none"> • The changes in protections mean that many businesses with poor credit histories will be permitted to access credit. • The reduction of consumer protections for a scheme that is targeted at small businesses – many of which are not financially sophisticated and have not been in debt before – could in future be viewed as encouraging irresponsible lending. • There is reputational risk for the lenders and possibly HMG also of having been seen to facilitate this.

OFFICIAL – MARKET SENSITIVE

	<p>behaviour under the scheme rules in future, given changes to key components of the usual responsible lending requirements such as affordability test.</p> <ul style="list-style-type: none"> • And scheme rules will incorporate expectations around treatment of borrowers. 	
<i>Post-delivery expectations of lenders and protections of borrowers</i>		
<p>Incentives around repayment and recovery</p>	<ul style="list-style-type: none"> • The existence of the 100% government guarantee may encourage lenient borrower behaviour by those who are unaware or unconcerned that the guarantee is to the lender, not to them – and either unaware or unconcerned of any impacts for their personal finances and credit ratings in due course. • The form includes a clear warning on the risks to borrowers’ financial position should they fail to repay, whether through inability or unwillingness to repay. • The scheme rules require banks to pursue “reasonable” steps to make recoveries in the event of default. It also provides guidance on circumstances in which lenders should consider adjusting repayment plans should borrowers be in financial difficulty. • We have not incentivised banks to pursue recoveries strongly (e.g. by following the German model of allowing them to keep 9% of recoveries after claiming the guarantee). This increases fiscal risk, but reduces chances of HMG being seen as over-aggressively pursuing debts which it allowed to accumulate through a generous scheme. 	<ul style="list-style-type: none"> • The default risk is undeniably higher than for other loans, given the streamlined access for many businesses which might not otherwise have obtained a loan, some of which may never have been in debt, some of why may not be viable and some of why may never intend to repay the loan. • The requirement for us to tread softly around recoveries increases fiscal risk. And the 100% guarantee disincentivises lenders from trying hard to pursue recoveries.

OFFICIAL – MARKET SENSITIVE

<p>Unsustainable debt & Litigation risk</p>	<ul style="list-style-type: none"> • Risks to personal credit score ratings, and subsequent reduced access to finance have been flagged in the application form. • The ban on personal guarantees and for those like sole traders whose personal and business assets are inextricably linked, protections of the primary residence and vehicle, safeguard borrowers against some of the more significant losses. • Claims management companies could – on the basis of the lack of standard creditworthiness and viability checks encouraging borrowers to take on debt beyond their needs and their ability to repay – make tortious claims against British Business Bank and the government (as we our legislative changes have rendered risks of claims against the Lenders very low). 	<ul style="list-style-type: none"> • Risk that this creates a cohort similar to ‘mortgage prisoners’ irrespective of mitigation. • Risk of litigation risk on the basis of irresponsible lending.
<p>Access to dispute resolution (e.g. FOS)</p>	<ul style="list-style-type: none"> • Borrowers will have recourse to the Financial Ombudsman Service. The FOS will publish a letter on Monday setting out how it will view lender behaviour under the scheme rules in future, given the self-certification approach and changes to key components of the usual responsible lending requirements such as an affordability test. 	<ul style="list-style-type: none"> • While the FOS will give weight to the scheme rules and objectives, there could still be a risk of borrowers making a case here or in other dispute resolution fora