



Unlocking finance for
smaller businesses

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19 March 2020

Alex Chisholm
Permanent Secretary
Department of Business, Energy and Industrial Strategy
1 Victoria Street
London
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Dear Alex

Covid-19 response and potential impacts

I am writing to update you on the British Business Bank's role in delivering the government's immediate response to the Covid-19 outbreak to support small businesses. You will be aware that the Chancellor used the March Budget to announce a new 'Coronavirus Business Interruption Loans Scheme (CBILS) managed by the British Business Bank, to support the continued provision of finance to SMEs during the Covid-19 outbreak.

The Bank's mission is to make finance markets work better for smaller businesses at any stage of their development. This mission is particularly important at a time of potential economic downturn and the Board is eager to ensure that any response it agrees with the shareholder is counter-cyclical and supportive of SMEs at what might be a time of significant financial stress.

The new scheme will be delivered through temporary amendment and adaptation of our well-established Enterprise Finance Guarantee (EFG) Scheme for a finite period (expected to be 6 months), offering more attractive terms to both lenders and businesses.

My officials have been working at pace with yours 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.

You will likely have already received advice from your own officials on a number of potential changes we could make to our existing programmes. This expands on the set of proposed changes that were considered and ultimately subjected to BEIS' PIC process as part of our preparations for EU Exit, back in November. However, I am aware that any response the Bank provides in the current environment is subject to established governance processes, both as an operationally independent plc and as a BEIS Partner Organisation of which I am Accounting Officer. For this reason, I am writing to set out the relevant issues we will need to address now to put the Bank in the position to respond, fulfilling the Chancellor's expectations around speed of implementation.



British Business Bank plc is a public limited company registered in England and Wales. (registration number 08616013, registered office at Steel City House, West Street, Sheffield, S1 2GQ). As the holding company of the group operating under the trading name of British Business Bank, it is a development bank wholly owned by HM Government which is not authorised or regulated by the Prudential Regulation Authority (PRA) or the Financial Conduct Authority (FCA). It operates under its own trading name through a number of subsidiaries, one of which is authorised and regulated by the FCA. British Business Bank plc and its subsidiary entities are not banking institutions and do not operate as such. A complete legal structure chart for British Business Bank plc and its subsidiaries can be found at www.british-business-bank.co.uk

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The Bank's targets

In line with previously discussed shareholder priorities, the Bank has been set six strategic objectives with associated targets. Many of these are not inconsistent with responding to the wider impacts of the Covid-19 outbreak and increased activity in an economic downturn. However, we are concerned that of our objectives, (i) to enhance the diversity of provision in the small business finance market and (ii) to provide a return equivalent to the Government's medium-term cost of borrowing, will require targets to be relaxed.

In the case of our **diversity target**, we believe that increased guarantee activity under CBILS in response to Covid-19 outbreak will most effectively be focused on the larger banks among our delivery partners, placing pressure on our target for more than 85% of our financial support to be provided outside of the big five UK banks. In the case of our **return target**, there is a clear shared understanding between the Bank, BEIS, UKGI and HMT that, in times of stress or market downturn, the Bank will lose money and that this is necessary for its activities to have a countercyclical, catalytic effect when private sector financial intermediaries pull back. This is all the more likely to be the case given the parameters of CBILS represent a material shift of additional risk onto the programme, and ultimately BEIS' balance sheet. We are also likely to miss a third specific target associated with increasing **awareness of information** and encouraging SMEs to seek the finance best suited to their needs as the growth focus of the Finance Hub is not relevant in the current environment, so satisfaction measures are falling.

The Bank's control totals – which contribute to BEIS' overall control totals – will also likely come under pressure due to revenue shortfalls, impairment of assets and increased guarantee claims. In particular, increased EFG/CBILS guarantee claims will cause the Bank to breach its Fiscal CDEL control total. Unlike FT, there is no mechanism agreed with HMT for managing this issue.

To provide an indication of the potential impact on our return target, our annual business plan, which the BBB Group Board approved on 5th March 2020, includes projections under several stress test scenarios. The more plausible downside scenario (based on the 2019 Bank of England macroeconomic stress test guidance) results in possible gross cumulative stress losses of £358m (13% losses against the Bank's average capital deployed over the next 5 financial years). However, there is a possibility that the Bank could lose £1.1bn in gross cumulative stress losses (39% losses against average capital deployed over the next 5 financial years) should a severe 1 in 20 year downside scenario occur in Year 1 of the plan, or as much as £1.43bn at the start of Year 3 of the Business Plan (April 2022). Please note that these are pre-Covid-19 calculations and the potential impact could be higher as the emerging economic situation is factored in. Please note these business plan figures also exclude the new CBILS programme impact.

As some compensation, you should be aware that, over its five years of operations and during relatively benign economic conditions, the Bank has performed strongly against all its objectives, including its financial return target where it has made a cumulative return that is £195m ahead of its long-term target.

The Board believes that it is not the Government's intention that the current targets should prevent it from acting counter-cyclically and that the Government would wish it to continue to deploy finance and to respond to current priorities. **As such, I would welcome your confirmation in your capacity as Principal Accounting Officer for the Bank that you will, with immediate effect:**

- a) suspend the Bank's targets concerning its diversity of provision, with an approach to be agreed in 6 months' time;**
- b) suspend the Bank's financial returns target, with an approach to be agreed in 6 months' time;**

- c) amend the Bank's control totals with respect to RDEL and CDEL where required;
and
- d) consider amendments to the Bank's 2020/21 business plan in order to achieve the required counter-cyclicality.

Overall, it would also be helpful to confirm that you are content that the Board should not prioritise meeting the return target over other objectives.

Alongside the CBILS launch, this would provide us with the necessary flexibility to consider ways to introduce additional forbearance into our other programmes e.g. Start Up Loans and our Regional Funds, where borrowers are already under immediate pressure. It would also enable us to engage in an unfettered way in developing potential further crisis response options from next week onwards.

Coronavirus Business Interruption Loans Scheme

In this context, in the days following Budget, my officials have worked quickly and constructively with government officials, in conjunction with accredited EFG lenders, to finalise the set of specific parameters and eligibility criteria for the new scheme to best deliver the Chancellor's policy objectives. Relative to EFG, this concerns the following temporary changes which of course remain provisional and subject to Ministerial approval:

1. removal of the two percent facility fee on all variants;
2. an increase of the loan-level guarantee from 75% to the maximum of 80% allowable;
3. an increase of the gross portfolio level cap on losses from 20% to 75% (*which taken together with the loan-level guarantee increase, would take a lender's net portfolio cap on losses from 15% to 60%*);
4. an increase in the annual delegated lending capacity from £500m to £1.2bn, whilst stating publicly that there is no limit to the lending that may be supported under the scheme;
5. an increase in the maximum loan size from £1.2m to £5m (*which will require a new State aid notification*);
6. a six-month "fee free" period for businesses (covering interest and any lender fees) from the point of facility drawdown (*also subject to the state aid notification*); and
7. an expansion of the scheme's eligibility criteria to include the following:
 - o **Viability:** *You must still establish that the SME borrower has a viable business proposition assessed according to your normal commercial lending criteria. However, where there are some concerns over the short-to-medium term business performance due to the uncertainty and impact of the coronavirus, provided you reasonably believe that (a) the finance will help the SME trade-out of any short-to-medium term cashflow difficulty, and (b) if the facility is granted, the SME should not go out of business in the short-to-medium term, then the proposition may be considered eligible under the CBIL Scheme; and*
 - o **Lack of Security:** *(A) for facilities above £250k, the eligibility criteria for a lack or absence of collateral will continue to apply; (B) for facilities up to £250k, the CBILS Guarantee may be used for unsecured lending at the discretion of the Lender, providing the lender has confirmed that the use of the CBILS Guarantee has enabled them to provide a facility to the business that it otherwise would not have been able to provide.*

In addition to this, we seek the same additional re-financing flexibility as sought in the less extensive package of changes to EFG you considered in preparation for EU Exit, and on which you received additional advice:

8. Flexibility for the Bank to approve increases to lenders' refinancing limits from the current 20% up to 40% of their portfolios on a case by case basis (although this proportion is not to be made public).

The case-by-case nature of our discretion means we can review how a particular delivery partner is using the scheme and consider if this remains appropriate. You were previously concerned about allowing this increase in re-financing on additionality grounds, but in the current circumstance it could act as a brake on lending particularly for existing bank customers who run into difficulty – and some refinancing of existing lending onto the more generous terms of CBILS is in line with the policy intention. We would therefore ask for this discretion subject to ongoing review of how it is used by banks.

You may soon be asked by officials to approve advice granting additional RDEL, CDEL and RAME budgets for all these changes. Such additional budgets are necessary, however due to the interaction of the various parameter changes under CBILS and the uncertainty around the nature or length of this economic shock, I should warn you that it is impossible to accurately predict the behavioural impact on lenders, or to forecast likely demand or claims.

In the meantime, in the current situation where speed of response is paramount, I can confirm that it is the Bank's intention to commence implementation of the measures in relation to CBILS announced by the Chancellor, if necessary, before formal budget cover/delegation has been provided to the Bank. Even when that Budget cover arrives, it will not cover the full potential exposure if demand exceeds £1.2bn aggregate portfolios and the size of the scheme is increased. In this circumstance, we are proceeding under your instruction on the understanding that further budget cover will be forthcoming if it is required to honour the commitments we have been requested to make. We would be grateful if you could confirm that you are content with this course of action.

I would also be grateful if you would confirm that the Bank's targets for diversity of provision and financial return will be revised to exclude the impact of these changes for the duration that the new scheme is in place and for any subsequent unwinding of exposures. For clarity, we are requesting this in addition to the above request for our diversity and return targets to be suspended across our programmes more generally.

It is the scheme's accredited lenders who will be formally responsible for decisions concerning credit quality and affordability in line with their own policies. However, ultimately, there is a reputational risk for the Bank and government if it is seen to be acting irresponsibly through the new scheme e.g. by facilitating unaffordable lending. It will also be paramount that we are very clear in any customer communication that the CBILS guarantee applies to the lender rather than the SME to minimise the risk of mis-selling.

Lastly, I understand that your team is working to confirm the State Aid position regarding this scheme and, as part of that, officials are submitting a notification concerning the increase in maximum loan size up to £5m and the 6 month interest and fee free period, possibly amongst other things. We have been told that the intention is for a notification to be submitted and turned around by the European Commission within 24 hours, though there is a real chance approval is not granted ahead of planned launch (on Monday 23rd March). BEIS lawyers have confirmed that it is in fact unlawful to implement any changes in advance of Commission approval. HMT have been clear that the Chancellor is fully aware of the State Aid risks and is willing to go ahead with launching the scheme, subject to the State Aid notification being submitted ahead of launch.

Noting the Chancellor's stance, your confirmation that you are content to progress despite the clear State Aid risk borne by BEIS and the uncertainty as to the eventual budget cover that may be required is then very important. While we are content with delivering at the government's request, given the legal issues and, in the case of a gross portfolio level cap significantly exceeding the current level in the EFG scheme, the difficulty of making a value for money case for that incremental expenditure, we require formal instruction to implement the scheme with the desired parameters set out above. We have discussed these matters in detail with your officials and we understand that you plan to request a Ministerial Direction before instructing us. That is our

preferred course of action as it will obviate the need for us to consider whether we should provide a Reservation Notice as described in our Company Operational Independence Undertaking.

More generally as we work in the spirit of crisis resolution I would welcome your assurance that whilst the Bank is making its best efforts to adhere to all appropriate governance we are, ultimately, acting at Whitehall's request and will not be criticised after the fact for the collective decisions being made.

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.

If there are further changes to other Bank programmes, similar assurances to those requested above will be necessary.

I am copying this letter to Charles Roxburgh, Second Permanent Secretary to the Treasury, as HMT is also responsible for approving the Bank's annual Business Plan (including its targets) and to the private secretaries of the Secretary of State and the Chief Secretary to the Treasury.

Yours sincerely,

Personal Data

Keith Morgan CBE
Chief Executive Officer & Accounting Officer