Department for
Business, Energy
& Industrial Strategy

To: Secretary of State

From: Sam Beckett, Acting Permanent Secretary and Accounting Officer

Date: 16 April 2020

Dear Secretary of State,

INTRODUCTION OF CORONAVIRUS LARGE BUSINESS INTERRUPTION LOAN SCHEME

You have considered advice relating to the introduction of the Coronavirus Large Business Interruption Loan Scheme. This letter sets out my position as Accounting Officer.

COVID-19 is a severe public health emergency that represents a major shock for the UK economy. I fully support the goal of offering urgent financial relief to mid-sized businesses, many of which are experiencing acute trading pressures. The economic risks are made clear by the 'reference scenario' published by the Office for Budget Responsibility (OBR) on 14 April which includes real GDP falling by 35 per cent in the second quarter before bouncing back. The OBR notes that:

> "The Government's policy response will also have substantial direct budgetary costs, but the measures are designed specifically to support individuals and businesses through this temporary shock and so they should help prevent greater economic and fiscal damage in the long term. The immediate cost of the Government's actions may be high, but we can be confident that the cost of inaction would ultimately have been much higher."

We continue to see strong evidence about the severity of the economic impacts of coronavirus. This includes terminating business activity in some sectors, for example in non-food physical retail, and significant disruption in other sectors such as construction. The tourism and hospitality sectors have been very severely impacted, as well as transport, logistics, and other associated businesses. Much of the UK's manufacturing capacity has also suffered, with automotive and aerospace facilities unable to operate normally due to a combination of workforce availability, supply chain disruption and restraints in the working environment.

The impact on the supply side has also continued to be reflected in demand. BEIS's own intelligence gathering shows demand has and continues to be significantly impacted across a wider range of sectors. You have also seen a great deal of evidence by sector and region and heard directly from affected businesses. The common picture presented shows that the economic impacts are orders of

magnitude greater than that experienced during the financial crisis 12 years ago, as also now suggested by the OBR.

The financial sector alone is unlikely to accept the risks associated with providing significant amounts of liquidity to firms suffering from a sudden loss of cashflows. It is legitimate for the Government to consider intervening by absorbing a significant proportion of the lending risk. Business interactions over the last few weeks have illustrated a strong sense of pent-up demand for bank loans and we can see how attractive a scheme underwritten by government at the level of 80% is likely to be.

For this reason, on 3 April the Chancellor announced his intention to provide a new scheme to support firms that have a turnover of more than £45m per annum, to be known as the Coronavirus Large Business Interruption Loan Scheme (CLBILS). This scheme will complement the existing Coronavirus Business Interruption Loan Scheme (CBILS), ensuring that businesses of all sizes can access support with government-backed loans.

CLBILS has certain features in common with CBILS, with several key changes that seek to meet the needs of businesses and lenders while paying regard to value for money.

- CLBILS will not feature a turnover cap, to ensure that CBILS and CLBILS collectively cover all businesses (with the exception of banks, building societies and insurers).

- Mid-sized businesses will require larger debt facilities, because their working capital needs will be greater. It is therefore appropriate that the maximum loan size is £25m for businesses with turnover of less than £250m p.a., and £50m otherwise.

- The maximum loan term will be three years. It is reasonable to expect that mid-sized businesses can recover their cashflow position and pay off debt facilities more quickly than SMEs. Therefore, limiting loan terms to a maximum of three years is an appropriate way for government to improve value for money by exiting from the support more promptly.

- There will be no Business Interruption Payment (so that businesses do not benefit from an interest free period). Given the larger loan sizes this is important for the affordability of the scheme.

- The lack of a portfolio cap means that the Government's total exposure is proportionally higher under CLBILS than under CBILS (80% compared with 60%). This decision has been made to increase our confidence that delivery partners will be sufficiently incentivised to increase their risk appetite, and that businesses will be able to access finance on sufficiently attractive terms. The inclusion of a portfolio cap would have prejudiced the lender's ability to claim

capital relief for the guaranteed portion of each loan, potentially leading to higher interest rates.

However, due to the speed with which this intervention has been developed in order to respond to the crisis in a timely fashion, there is currently very little robust data that I can rely upon to judge that these scheme parameters are optimal. In particular, the absence of reliable forecasts of take-up and default rates makes it difficult to assess ex-ante whether value for money is likely to be achieved. This means there are currently a wider range of outcomes, including very substantial losses in the worst cases. That is not a scenario we anticipate and there will be opportunities to take action if there are signs that we might be heading in that direction.

Set against this, the benefits from preserving businesses through CLBILS are reasonable to assume in principle but are difficult to compute with any certainty. It will be difficult to determine what part a CLBILS loan played amongst other factors on future performance of a business. What we can determine ex-ante is that the absence of an additionality test creates a considerable 'deadweight' risk in terms of value for money. I appreciate that these weak data and therefore large range of possible outcomes does not provide for a solid basis for a decision, but reflects the position we find ourselves in.

There are a number of potential additional safeguards that have been considered, including that:

1) we could reduce the level of the guarantee, for example to 75%, the level used for the Enterprise Finance Guarantee;

2) we could re-instate the additionality test (i.e. by restricting eligibility to businesses who are unable to access finance on fully commercial terms); and

3) we could also announce funding in tranches and subject to an overall cap, to allow for reviewing the actual market impact of the scheme progressively, and if necessary, introduce refinements or act to limit further losses to the taxpayer.

However, the above do carry additional downside risk either in terms of requiring additional time or reducing the attractiveness of the scheme to recipients or lenders. Given the severity and urgency of the situation facing businesses, I accept that these steps cannot be considered any further before the scheme is announced in detail and taken live.

To sum up, the potential for economic damage created by the coronavirus pandemic creates a strong case for Government intervention. My assessment is that risks around regularity, propriety and feasibility are manageable. However, the uncertainty around value for money and risks regarding additionality of the proposed scheme means that *Managing Public Money* requires that I ask for a written direction from

you if you wish to proceed with CLBILS. On receipt of your direction I will then proceed accordingly to implement the scheme.

If you decide to proceed, the new contingent liability created by CLBILS will need to be declared in Parliament at the earliest suitable opportunity. As Parliament is not sitting you will need to write to the Chairs of the BEIS Select Committee and the Committee of Public Accounts, followed by a Written Ministerial Statement and Departmental Minute once Parliament resumes.

In line with the usual process for ministerial directions, I am copying this letter to the Comptroller and Auditor General (who will inform the Public Accounts Committee once Parliament returns) and the Treasury Officer of Accounts.

There will be significant public interest in this matter, which should be balanced against the potential impact that making this request public might have on the confidence and take-up of the scheme, and consequently on our efforts to support the economy. Accordingly, I propose to review the case for publication of this letter and your reply in the coming weeks, once the loan scheme is fully established.

Personal Data

Sam Beckett