Department for
Business, Energy
& Industrial Strategy

To: Secretary of State

From: Alex Chisholm, Permanent Secretary and Accounting Officer

Date: 2 April 2020

Dear Secretary of State

CHANGES TO CORONAVIRUS BUSINESS INTERRUPTION LOAN SCHEME

Further to my letter of 22 March I am writing regarding the further proposed changes to the Coronavirus Business Interruption Loan Scheme (CBILS). The proposed updates to the scheme cover changes to the requirement for a personal guarantee (PG) for loans and broadening the scope of small and medium-sized enterprises (SMEs) that are eligible for the scheme. This letter sets out my position as Accounting Officer.

The PG changes will mean lenders will no longer be permitted to require a PG for loans or other facilities in the CBILS under £250,000; and for loans over £250,000, lenders would be free to seek a PG. In event of default, the lender would first seek to recover it from business assets and then would look to the PG for a maximum of 20% of the remaining debt, and after that claim 80% of the residual loss under the guarantee agreement.

These PG changes are being made to make CBILS more attractive to company owners and directors, which should encourage take-up. The changes are also likely to lead to an increase in the proportion of facilities that result in a claim on the guarantee and an increase in the value of those claims as a proportion of the total amount advanced.

Some of this should be offset by an increase in benefits through more businesses being preserved by the increased take-up. However, there remains no evidence on which to provide an analysis of this. Whilst the PG changes do impact on value for money, in themselves I do not believe they represent a material change to my original assessment.

However, the broadening of CBILS to include SMEs that would otherwise have access to commercial loans does represent a material change to the original scheme. The intention is to introduce these changes so that we do not create a situation where some SMEs are able to access a loan with an interest free period of 12 months, whilst others that are also being impacted by coronavirus cannot because they are considered lower risk by lenders and could obtain finance on normal commercial terms. This might seem to penalise them unfairly and whilst they might be in a better position currently to cope with the impact, their resilience is limited and could be eroded the longer the crisis persists, increasing the risk to jobs. The intention is therefore to pre-empt a spread in financial distress to more businesses as the impact of the pandemic increases.

Set against the benefits intended by this change in policy I must consider the further implications for value for money, regularity, propriety and feasibility. Whilst total demand remains difficult to predict at this stage, the changes mean that it is reasonable to assume that nearly all new SME lending will be subject to a guarantee. Consequently, the increase in funding required to cover the guarantee represents a material change.

Bank lending to SMEs last year was £57bn and the total stock of SME lending is £168bn. The implication of the change is therefore to increase the likely scale of the scheme by an order of magnitude, from £3-6 billion to £30-60 billion. For planning purposes, we are using an upper estimate of £100bn, which means that the taxpayer could incur a contingent liability of up to £60bn reflecting the 60% effective portfolio cap that is a feature of the scheme.

The economic benefits continue to be difficult to assess, but the expected increase in costs and the risk that the expanded scope will see CBILS being used where lending would have taken place in any event, means I must also assume that the broadening of the scope may lead to a further reduction in value for money.

There are also potential behavioural risks that impact on propriety. In particular, the design of the scheme with the proposed changes provide a strong incentive for banks and businesses to refinance borrowing onto the CBILS. Whilst this is mitigated to a certain extent by including a refinancing cap of 20% in the agreement with each lender, it does not stop a business from seeking finance with another lender and using some or all of this to repay existing debt. This will further reduce the additionality and value for money of the scheme.

The pace of delivering further changes to the scheme means there is also a real risk that lenders and the BBB's own systems have not had adequate time to prepare, ultimately impacting on the feasibility and effectiveness of the scheme. In the time available it has also not been possible to complete consultation with the European Commission to confirm that the proposals remain State Aid compliant. We cannot assume that the Commission will approve our revised application for State Aid clearance, and we should obtain sufficient comfort from the Commission that they would expect to approve the changes to the Scheme before proceeding.

There are a number of ways in which the regularity, feasibility and value for money of the scheme could be improved if the Business Secretary and Chancellor were willing to accept a short delay:

1) we could confirm that the new scheme is consistent with the temporary State Aid scheme of the European Commission, rather than taking the risk we are currently running;

2) we could test the scheme further with BBB and their financial partners, in particular regarding the deliverability through the portal and the consequences of removing certain current requirements e.g. to update for 'in-life events' which may have implications for managing scheme risks;

3) we could consider adopting alternative ways to remove the perceived distortion between commercial and non-commercial borrowers, notably by applying the BIP to all qualifying SMEs as set out in the attached note, which would achieve a similar effect but with much lower risks to additionality and 'deadweight' costs; and

4) we could provide this 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.

While fully understanding the severity and urgency of the situation facing SMEs and the good intent behind the proposed changes to the CBIL scheme, I strongly recommend all four of these steps are taken before the scheme is announced in detail and taken live.

In light of all of these considerations, I cannot, as Accounting Officer, support the specific proposals to change the eligibility criteria. *Managing Public Money* therefore requires that if you wish to progress with the further changes to CBILS as detailed above, I will require a written direction from you to do so. On receipt of your direction I will then proceed accordingly to implement the changes.

I would suggest that you share this letter and the attached note on an alternative approach with the Chancellor this morning.

Under *Managing Public Money* the contingent liability 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 Committee and the Committee of Public Accounts with a Written Ministerial Statement and Departmental Minute to follow 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 in due course) and the Treasury Officer of Accounts.

There will be significant public interest in the 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.

Alex Chisholm

CBILS: SUMMARY OF AN ALTERNATIVE PROPOSAL

1. The Chancellor's primary objective as we understand it is to address the unfairness that some businesses will bear the cost of interest on new borrowing and others will not.
2. This objective could be met by specifying that <u>all</u> businesses that meet the sectoral and turnover criteria for CBILS will qualify for a Business Interruption Payment (BIP) on new borrowing made necessary by the impact of Covid-19, whether or not they benefit from a government guarantee.
3. The BIP is a grant paid for the benefit of businesses to cover lenders' fees and interest on their borrowing, up to the maximum specified in State aid regulations, which is enough to cover those costs for 12 months on all but the largest loans.
4. If those businesses were able to access finance on commercial terms, the BIP would be paid on the commercial facility. If the lending proposal did not meet the criteria for commercial lending, it would be considered for the CBILS as now. In either case, the businesses would benefit from the same level of BIP.
5. This ensures that help with interest costs is given immediately to as many businesses as possible, which is the policy intention.
6. While addressing perceptions of fairness, this alternative also:
    - preserves additionality, since a government guarantee is only given to businesses that need it to secure finance;
    - greatly reduces the scale of the contingent liability assumed by the Department;
    - reduces the risk of distorting the finance market as a result of squeezing out lenders not accredited to deliver CBILS; and
    - reduces the operational load on the BBB since it is the guarantees that are processed through the BBB portal (the BIP is calculated independently).
7. This proposal may not address the divergence in approaches to personal guarantees between CBILS and commercial lending, although the largest lenders have already relaxed their position on personal guarantees for smaller loans. It should be possible to negotiate a voluntary moratorium on personal guarantees, so that no borrower benefiting from a BIP has to give a personal guarantee, on loans under £250,000.