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

FURTHER ADVICE ON CHANGES TO CORONAVIRUS BUSINESS INTERRUPTION LOAN SCHEME

We discussed the advice I gave to you this morning with a full AO assessment on the proposed change to the CBILS scheme and you asked for two further sets of comments from me. The first was about how confident we could be about the likely future financial losses and countervailing economic benefits. The second was about the strength of current demand from the business community for loans to help get through the current highly challenging economic circumstances. This note offers a quick response on both points.

On the first issue, we have not been able to put together reliable estimates on either the costs or benefits of the intended scheme in the time available. Even with more time, we will not be able to provide reliable data until we can see what the take-up of the scheme is from businesses and, in particular, what use they make of the finance and what their subsequent trading performance is.

The scheme on which this is loosely based, the Enterprise Finance Guarantee, has a strong Benefit to Cost Ratio (BCR) of 5.4. The changes now being made mean that the additionality of this scheme is likely to be much lower. In other words, government will be guaranteeing loans that the banks would have been making anyway and will incur losses on a proportion of these. For this reason, when the outcomes are known and the scheme is evaluated the BCR may be less than 1, in other words there will be less than £1 of economic benefit for every £1 of cost. But we cannot predict this now with any confidence.

On the supply side of the market we also find it very hard to assess the extent to which banks will seek to make the changed scheme their main instrument for lending to SMEs. However, we can see from the financial crisis how the introduction of a new guaranteed lending scheme did lead to a surge in usage, with the number of new loans per year rising from 2,000 to over 7,000, and the total value of new lending tripling to over £600m in 2019. We can also sense from business interactions over the last two weeks the strong sense of pent-up demand for bank loans and *a priori* we can see how attractive a scheme underwritten by the Government at the 80% level and with no interest rate cost for the borrower is likely to be. Such a scheme is unprecedented.

These are the factors that have played into the wide range of potential outcomes set out in the analysis, including the very substantial losses shown in the worst case scenario. That scenario is not what we expect and indeed there will be some opportunities to take action if there are signs that we are even heading in that direction. It is included in the advice as a low probability worst case scenario.

On the other side of the equation, which is expressed by the economic benefits of businesses whose preservation is achieved by means of a CBILS loan, this is even harder to estimate both now and even after the scheme has been operating for some time. As you appreciate, it will often be difficult to determine what part this loan played amongst many others in terms of impact on future performance of the business. I appreciate this large range and weak data support does not provide as solid a basis for a decision as you would wish, but it is the reality given the situation today.

Turning to the second question, I think there is strong if early evidence about the severity of the economic impacts of Covid-19. In some sectors of the economy, notably non-food physical retail, business activity has been terminated. In other sectors such as construction, all sites across the country have experienced interruption and many have had to cease work. The tourism and hospitality sectors have been very severely impacted by the non-pharmaceutical interventions taken by the UK Government and the Devolved Administrations and by countries around the world. This has also had severe impacts on transport, logistics and other associated businesses. I should highlight as well the closure of much of our manufacturing capacity, with automotive and aerospace facilities unable to operate due to a combination of workforce availability, supply chain disruption and restraints - actual and perceived - in the physical working environment.

On the demand side, consumer confidence has fallen dramatically with the GfK Consumer Confidence Barometer weakening by two points during the early part of March (when Covid-19 was headline news but not impacting the daily lives of people as it is today). BEIS' own intelligence gathering shows demand being immediately and significantly impacted across a wide range of sectors including Retail, Hospitality/Tourism, Automotive and Consumer Goods manufacture.

You have seen a great deal of detailed evidence – both sector-by-sector and region-by-region – in briefings and submissions over the recent days. You've also heard directly from businesses affected and through their representatives on the Business Representative Organisations on a daily basis. The common picture presented shows that the economic impacts are orders of magnitude greater than that experienced during the financial crisis that began 12 years ago.

How long these negative impacts last remains a matter of conjecture, however what is clear is that the severe reduction in economic activity, alleviated but not removed by the Government, has put the business community under huge stress and most especially within that the SMEs who in many cases lack the financial and other resources to be able to ride out this economic storm.

In this context, there can be no question that there is an urgent and significant need for additional liquidity to be provided through the banking sector with the support of the Government. Without such help, many otherwise viable businesses will undoubtedly fail with all the associated costs and other harms in terms of both economic and social welfare.

Alex Chisholm