Fiftieth Report of Session 2021-22

Department for Business, Energy & Industrial Strategy

Bounce Back Loans Scheme: Follow-up

Introduction from the Committee

The Department for Business, Energy and Industrial Strategy (the Department) launched the Bounce Back Loan scheme (the Scheme) in May 2020. It is the largest of three Covid-19 related business loan support schemes. The Scheme targeted the smallest businesses and sought to provide them with loans of up to £50,000, or a maximum of 25% of annual turnover, to maintain their financial health during the pandemic. The loans have a fixed interest rate of 2.5% and a maximum length of either six or ten years. In the first year of the loan there are no capital repayments due, and Government pays the interest—making it interest-free for the borrower. The Scheme closed for new applicants in March 2021 and in total it has provided 1.5 million loans worth £47 billion to businesses across the UK. We examined the Scheme in December 2020 and warned that the Department's focus on the speed of delivery had exposed the taxpayer to potentially huge losses. In addition, we concluded that Government lacked data to assess the levels of fraud. The Department estimated in its Annual Report and Accounts 2020–21 that it would lose £17 billion as a result of the Scheme, of which £4.9 billion was because of fraud.

The Scheme aimed, in most cases, to deliver money to borrowers within 24 to 48 hours of applying. To make the process as fast as possible, the Scheme did not require lenders to check the information on the loan application form or to perform credit and affordability checks. Borrowers are expected to repay the loans in full and lenders are required to conduct basic counter fraud tests. But owing to the absence of credit checks, Government provides lenders a 100% guarantee on the loans. In practice, this means that if the borrower does not repay the loan, Government will.

The British Business Bank (the Bank) manages the Scheme on the Department's behalf and the loans are delivered through 24 commercial lenders such as banks and building societies. The commercial lenders are also responsible for administering loan repayments and pursuing borrowers for missed repayments for up to 12 months after the issue of a formal demand. There is no minimum on the amount of time lenders need to pursue borrowers before claiming on the guarantee and lenders can claim on the guarantee before they complete pursuing borrowers for the full 12 months. Because loans did not begin repayment until May 2021, and borrowers can seek a further six-month repayment holiday, there is limited repayment data to analyse.

Based on a report by the National Audit Office, the Committee took evidence on 10 January 2022 from HM Treasury, the Department for Business, Energy and Industrial Strategy, the British Business Bank and the Financial Conduct Authority. The Committee published its report on 27 April 2022. This is the government's response to the Committee's report.

Relevant reports

- NAO report: The Bounce Back Loan Scheme: an update – Session 2021-22 (HC 961)
- PAC report: Bounce Back Loans: Follow-up – Session 2021-22 (HC 951)

Government response to the Committee

1: PAC conclusion: The Department and The Bank delivered the Scheme at breakneck speed, but the long-term impact of the Scheme is uncertain.

1a: PAC recommendation: The Department should put in place a clear strategy to manage the long-term legacy of the Scheme within a month of the publication of its evaluation report.

1.1 The government agrees with the Committee’s recommendation.

Target implementation date: Autumn 2022

1.2 The ongoing management of the Bounce Back Loan Scheme (BBLS) remains one of the highest priorities for the department. A key component of this is the work being undertaken to tackle fraud in the scheme, and the department is currently formalising a strategy that will set out its long-term approach to counter fraud in the BBLS, building on work to date. The strategy will reflect recent developments in the government’s counter fraud landscape, including how additional funding made available by the Chancellor in the Spring Statement will be deployed. The department expects to finalise the strategy by Autumn 2022.

1.3 More broadly, the department’s strategy for managing the long-term legacy of the scheme will develop as its understanding of the scheme’s impact matures. The first evaluation report published in June 2022 provided an indication of the short-term impact of the scheme on business outcomes, though the longer-term impact will only become apparent in time and will depend in large part on wider economic conditions. The economic impact of the scheme will be explored further in subsequent phases of the evaluation, which will also include a value for money assessment.

1.4 Regular monitoring of data about loan facilities provided by lenders enables the department to assess the health of the loan book on an ongoing basis. Amongst other things, this information gives an indication of the proportion of borrowers who are experiencing difficulty in making their repayments. Meanwhile, the British Business Bank’s expected credit loss models provide a longer term forecast of the eventual level of defaults. BEIS reports on expected credit losses in relation to the scheme via its Annual Report and Accounts.

1.5 Finally, the department undertakes regular analysis to understand the financial health of the wider UK small and medium-sized enterprises (SME) population, which helps to inform ongoing policy development.

1b: PAC recommendation: The Bank should also write to us with details of its plans to measure the Scheme’s long-term impact, including identifying a reliable control group, within a month of the publication of Department’s strategy.

1.6 The government agrees with the Committee’s recommendation.

Target implementation date: Summer 2022

1.7 The department and the Bank have commissioned London Economics and Ipsos to undertake a multi-year evaluation of the COVID-19 loan guarantee schemes, including the BBLS. The evaluation will assess whether the objectives of the COVID-19 loan guarantee schemes were satisfied. It will be a multi-phase evaluation and therefore the conclusions will be published across three iterations rather than one report. The first report has recently been published.

1.8 There will be a process, impact, and economic evaluation. The process evaluation will focus on scheme design, scheme delivery, debt recovery processes, and variations in processes. The impact evaluation will focus on the extent to which the schemes affected business outcomes such as business survival and turnover. The economic evaluation will focus on the value for money of the schemes, taking into account both its costs and benefits.

1.9 To identify a reliable control group, the evaluation will use statistical methods to select a sample of businesses that did not access the schemes with similar pre-pandemic characteristics, such as turnover, sector, and credit score to those businesses that did access the schemes. The evaluation's findings on the impact of the COVID-19 loan guarantee schemes will be validated using multiple data sources to ensure they are robust.

2: PAC conclusion: The potential Scheme losses are eye-watering, and we are not convinced the Department has the data it needs to manage the risks to the taxpayer.

2a: PAC recommendation: The Department should, within the next 3 months, develop a strategy setting out the increase needed in Scheme counter-fraud resources for all relevant government stakeholders to both reduce fraud levels to a tolerable level and to maximise recoveries.

2.1 The government agrees with the Committee's recommendation.

Target implementation date: Autumn 2022

2.2 BEIS has continued to invest in its counter-fraud function in order to tackle fraudulent activity in the Bounce Back Loan Scheme (BBLS) and other COVID-19 support schemes. At Spring Statement, the Chancellor announced almost £50 million of additional funding for counter-fraud work, of which over half related to Bounce Back Loans, namely:

- £13.2 million for the National Investigation Service (NATIS) which will almost double their capacity tackle fraud in COVID-19 business support schemes;
- £10.9 million to enhance the Bank's counter-fraud and assurance work programme; and
- £9 million to support the Government Counter Fraud Function's data analytics work (on BBLS and more widely).

2.3 The department will continue to take forward action to tackle BBLS fraud, working with lenders, law enforcement bodies and a range of partners across government. As mentioned in response to recommendation 1a above, the department is currently working to formalise a strategy to manage the long-term approach for tackling BBLS fraud. This will ensure that existing resources are used in the most effective way and will set out how the impact of government and stakeholder counter fraud activities will be measured to support the reduction of suspected fraud loss and maximise recoveries. The strategy will be iterated on an ongoing basis to reflect evolving intelligence about the nature of the fraud risk, and the impact of our mitigation approaches.

2.4 The department, working with other government and non-governmental bodies, collects an extensive amount of data resources for fraud risk assessment and identification analysis. The Bank receives significant volumes of data on lender performance and each borrower, which informs the fraud analytics work done on behalf of the department by the Government Counter Fraud Function. Outputs include, for example: analysis to identify high-fraud risk facilities for lenders to investigate further; data enrichment such as data matching with Companies House; inter and intra scheme analysis to identify suspected fraudulent actors across BBLS and other schemes; and network analysis which has resulted in details of high-risk networks of associated individuals or companies being passed onto law enforcement agencies. Data sharing with lenders also helps them with their internal fraud risk profiling and identification. Data also aids the Bank to enhance their lender management programme. The department is also collaboratively working with HMRC to improve its risking analysis and identify cross schemes fraud.

2b: PAC recommendation: As part of its Treasury Minute response, the Department should explain how it intends to improve the accuracy and timeliness of its estimates of losses within the Scheme.

2.5 The government agrees with the Committee's recommendation.

Recommendation implemented

2.6 The department has worked with the Bank to develop analytical and forward-looking expected credit loss models that are compliant with International Financial Reporting Standards (IFRS 9). These models provide a sophisticated approach to forecasting expected credit losses across the COVID-19 loan guarantee schemes, utilising granular data from lenders and other sources.

2.7 For BBLS, the models include a specific input to reflect the probability that a loan facility may have been contracted fraudulently by the borrower. The fraud input is based on the results of sampling work completed by PwC in 2021. The department will continue to work with the Bank and Cabinet Office to better understand the links between fraud risk indicators, fraud occurrence and fraud loss, which will help to refine our methodology.

2.8 The accuracy of the models will improve over time as more information becomes available. However, there will continue to be a high degree of uncertainty and actual losses will depend to a significant extent on the wider performance of the economy over the next decade. The department is committed to providing regular updates on these estimates via its Annual Report and Accounts and supplies estimates to the National Audit Office to inform their regular Covid Cost Tracker publications.

3: PAC conclusion: The Department has been complacent in preventing Scheme fraud and its prioritisation of 'top tier' fraudsters puts other government Schemes at risk.

3a: PAC recommendation: Next time the Department launches an emergency business support scheme, it should be explicit on the trade-offs and level of fraud it is prepared to tolerate from the outset.

3.1 The government agrees with the Committee's recommendation.

Recommendation implemented

3.2 The economic crisis brought about by the COVID-19 pandemic required an extraordinary response from government. The BBLS was devised to address the urgent cashflow needs of the UK's smallest businesses. The department was clear at the outset that the scheme's design would create a heightened vulnerability to fraud and there would be a significant risk of credit losses. The scheme was implemented under Ministerial Direction, and the exchange of letters that were published in June 2020 shows that these risks were acknowledged at the outset.

3.3 In the event of another crisis similar in scale to the COVID-19 pandemic, the government would again need to consider the trade-offs between the generosity and speed of a loan guarantee scheme, and the consequent risks for value for money. There is now increased Fraud and Financial Crime resource in the Bank. Additionally, the launch of the Public Sector Fraud Authority this year (announced in the Spring Statement) will further strengthen the ability of the government to manage and mitigate fraud risks, deal with vulnerabilities, and overall increase its counter fraud capacity and capability.

3b: PAC recommendation: The Department should urgently outline how it will change its plans to adopt a more robust approach to reducing all types of fraud, and should commit to including anti-fraud measures from the outset so that it acts as a deterrent effect for other schemes.

3.4 The government agrees with the Committee's recommendation.

Target implementation date: Autumn 2022

3.5 As mentioned above, the department is currently working with the Bank to formalise a long-term approach to counter fraud for the BBLS. The department is investing in its counter-fraud team and is developing its overall approach to fraud as a department.

3.6 Through the Cabinet Office fraud analytics programme and its work with the Bank on extensive fraud risk assessment procedures, the department has significantly increased its understanding of the nature and extent of BBLS fraud and has developed its response accordingly.

3.7 The department has used data from a wide range of sources to assist lenders with fraud detection and investigation. The lessons learned in developing this capability will inform the design of and response to potential fraud in future schemes.

3.8 The department's forthcoming fraud strategy review will also include a new triage system which will enable a more agile enforcement response to those cases considered to be fraudulent. The criteria for selection will be flexible to address government priorities including pursuing more 'low level' fraud through a range of mechanisms. It is the objective to use this function to create an increased deterrent for this and other schemes whilst creating a template for the future.

3.9 The department considers if or when a further emergency scheme is launched, any fraud threat will be better understood from the outset, enabling a more comprehensive assessment of the level of risk and the impact of any trade-offs required, whilst also being in a strong position to set a deterrent to those who attempt to defraud it.

4: PAC conclusion: We are concerned that the Department is placing too much reliance on lenders to minimise taxpayer losses without incentivising them to do so.

4a: PAC recommendation: The Department should, as part of its Treasury Minute response, set out how it will use legal, regulatory and contractual incentives to improve the lenders' performance in managing the loans and the risks to the taxpayer.

4.1 The government agrees with the Committee's recommendation.

Recommendation implemented

4.2 The ongoing management of the BBLS and associated financial risks remains one of the highest priorities for the department and the Bank.

4.3 The primary means by which the Bank assesses lenders' compliance with the terms and conditions of the Guarantee Agreement is through its ongoing lender audit and assurance programme. This includes examining the effectiveness and adequacy of lender recovery efforts. Where issues are identified, the Bank can take remedial action, ranging from creating an action plan with the lender's management team through to cancellation of a guarantee. Experience from the first round of audits showed it was effective in remedying identified issues and ensuring lenders took action to improve compliance under the scheme. The Bank is held to account on the effectiveness of its audit programme through its annual business plan, ensuring it is incentivised to work with lenders to improve their management of the schemes when issues are identified.

4.4 Moreover, the Bank has been sharing outputs from fraud analytics work with lenders to support their efforts to identify and recover fraudulent loans. At Spring Statement, the Bank received an additional £10.9 million to deliver further enhancements to its lender management programme. The department will continue to work with the Bank to help strengthen protections for the taxpayer as part of the ongoing management of the scheme

4.5 The Financial Conduct Authority (FCA) is working collaboratively with the Bank, the department and HM Treasury to find areas where regulatory powers and tools can add value. The FCA also has access to the Bank's audits. For example, the FCA has worked with the Bank, the department and HM Treasury to ensure lenders continue to provide protections to borrowers in financial distress, as they are required to do in a business-as-usual environment. The FCA produced guidance on this in January 2021. The FCA have also carried out work on range of lenders assessing how SMEs are treated in the collections and recoveries process, and for some firms this has included Bounce Back Loans.

4b: PAC recommendation: Furthermore, it should report to the Committee on individual lender performance using the dashboard data which was due to be presented to the new cross-Whitehall counter fraud board.

4.6 The government agrees with the Committee's recommendation.

Recommendation implemented

4.7 The Bank has committed to publish data relating to the performance of the COVID-19 loan guarantee schemes. The next round of data to be published will include the amount that has been drawn and settled as this applies to each lender for the BBLS.

4.8 The Bank's lender performance dashboard has been produced for internal reporting purposes. The Bank has approached the Committee to arrange an opportunity for members to review the dashboard.

5: PAC conclusion: It is unacceptable that the Department has no plans to recover outstanding debt after lenders have pursued borrowers for up to 12 months.

5a: PAC recommendation: The Department should, as part of its Treasury Minute response, set out its strategy for collecting overdue payments after the lenders have completed their 12-month requirements.

5.1 The government agrees with the Committee's recommendation.

Target Implementation Date: Winter 2022

5.2 The Guarantee Agreement for the BBLS stipulates that lenders should pursue recoveries for up to 12 months after they have made an initial repayment demand or up until the point at which their business-as-usual recovery processes would conclude. As repayment plans may be negotiated during the 12-month period following a repayment demand being issued, lenders' recovery efforts might well continue for considerably longer in many cases. Any recoveries made after a lender has made a claim must be paid to the Guarantor in accordance with the terms and conditions set out in the Guarantee Agreement, even if these recoveries are made after the 12-month period has elapsed.

5.3 Additionally, the department's long term BBLS counter fraud strategy – currently in development – will address the Committee's recommendation regarding the department's strategy for enforcement and recoveries in cases of suspected fraud. The strategy will take into account additional funding secured in the Chancellor's Spring statement to bolster counter fraud work and response: £13.2 million for the National Investigation Service; additional £11 million for the Bank and £9 million for the Cabinet Office's Data Analytics Programme.

5b: PAC recommendation: In addition, the Department should write to the Committee and provide further information on what the shortest time period has been for a lender to claim on their guarantee to date and how this compares to the average.

5.4 The government agrees with the Committee's recommendation.

Target implementation date: Summer 2022

5.5 The Bank holds this information and will write to the Committee, providing full context for the figures, in due course.

6: PAC conclusion: The Scheme has distorted the Small and Medium Enterprise (SME) lending market in favour of the largest UK banks, which goes against the Bank's objective of creating a diverse finance market for SMEs.

6a: PAC recommendation: The Bank should develop a strategy to mitigate the negative impact of the Scheme on the SME lending market and publish its findings in its next Small Business Finance Market report.

6.1 The government agrees with the Committee's recommendation.

Target implementation date: Spring 2023

6.2 As highlighted in the Bank's most recent Small Business Finance Market Report, the provision of alternative finance recovered somewhat in 2021-22, reflecting the ending of the COVID-19 loan guarantee schemes in March 2021. Challenger banks regained the market share they had pre-pandemic, asset finance and invoice lending grew but was still below 2019 levels, and marketplace lending began to increase again.

6.3 The Bank has an explicit objective to improve the diversity of finance products and providers. It continues to monitor trends in the small business finance market and engages closely with stakeholders across the landscape. The next iteration of the Small Business Finance Market report, expected in Q1 2023, will continue to report on the evolution of the small and medium-sized enterprises (SME) lending market.

6.4 The Bank's existing programmes continue to help challenger and specialist banks to make the SME banking market more diverse, for example through ENABLE Guarantees, the British Business Investments subsidiary, the Regional Funds, and the Recovery Loan Scheme.

6b: PAC recommendation: The Department should, alongside its Treasury Minute response, identify the unintended consequences of the scheme and what impact these have had.

6.5 The government agrees with the Committee's recommendation.

Recommendation implemented

6.6 As mentioned in response to recommendation 6a, the Bank ’s most recent Small Business Finance Market Report indicates that the SME ending market has essentially been restored to its pre-pandemic state, reversing the market distortion the COVID-19 loan guarantee schemes might have introduced. The Bank will continue its efforts in improving the diversity of finance products and providers.

7: PAC conclusion: The Department has not yet identified how it will share the lessons from the Scheme.

7a: PAC recommendation: The Department and The Bank should establish a strategy on how it intends to share lessons from the scheme within a month of the publication of their first evaluation report.

7.1 The government agrees with the Committee’s recommendation.

Target implementation date: Summer 2022

7.2 In its Treasury Minute response to the Committee's Twenty-Sixth Report of the Session 2021-22, the department agreed to work in conjunction with HM Treasury and the Bank to produce a report covering lessons learned across the COVID-19 loan guarantee schemes, which it intends to do by Summer 2022.

7b: PAC recommendation: The Bank should develop a business case for an emergency loan scheme for future crisis within 6 months of publication of this report.

7.3 The government disagrees with the Committee’s recommendation.

7.4 The Bank, BEIS, HM Treasury and UK Government Investments have developed an Agile Cooperation Framework which sets out the approach for determining whether a downturn response is required and the governance approach to implementing any response.

7.5 The Bank’s products are developed to address specific market failures in SME finance markets, with business cases developed for all interventions as standard practice. Since economic crises can arise in a multitude of ways, it is hard to predict what the most appropriate response would be for the Bank. In the event of future crises, the Bank will assess which levers it can use to mitigate the specific impacts on SMEs and their access to finance. As part of this process the Bank will undergo steps required for business case development such as identifying the underlying market failure(s) and objectives of the intervention, designing a scheme to meet these objectives, and modelling the scheme’s ability to demonstrate value for money.

7.6 The Bank has an approved business case for the Recovery Loan Scheme, which may act as a template if a future emergency loan scheme is deemed an appropriate economic response.