HM Treasury

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Rt Hon. Mel Stride MP
Treasury Committee
House of Commons
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Dear Mr Stride,

Thank you for your letter of 16 February.

Before answering your specific questions, I would like to set out the general approach the government took to fraud and error in the Covid economic support schemes, in the context of the economic circumstances at the time.

In the spring of 2020 there was a very broad consensus on the need for immediate support to the economy at very large scale. There was a very strong public policy rationale: to prevent a potentially catastrophic wave of millions of business failures and job losses. This was widely feared at the time, following the near total lockdown of the economy, and a failure to act at speed would have had severe consequences for the economy, the public finances, and the wellbeing of millions of people. In taking difficult decisions on these unprecedented schemes, the government had to balance the strong public interest in providing immediate support against the inevitable fiscal and fraud risks in doing so.

The government provided almost £400bn of support. The Coronavirus Job Retention Scheme (CJRS) protected nearly 12 million jobs: today payrolled employee numbers are at record levels, and unemployment, which in the spring of 2020 was predicted to rise to 12%, is at 4.1%. The Government also acted rapidly to provide loans and grants to over 1.5 million businesses, helping to avoid hundreds of thousands of bankruptcies and laying the foundations for the economic recovery from the pandemic.

As a result, the economy has returned to its pre-pandemic size quicker than expected and Britain's economy is set to grow at the fastest rate in the G7 this year. The government's economic response to the pandemic has been praised internationally, with the IMF describing it as "one of the best examples of coordinated action globally – it has helped mitigate the damage, holding down unemployment and insolvencies".

In taking this action to protect the economy, speed was of the essence, since with every day that passed, more and more jobs and businesses were being lost. The government aimed to design, launch and implement these schemes as quickly as possible. But the government was also acutely aware from the outset of the fiscal and fraud risks, and was determined to do as much as possible to protect the taxpayer, so counter-fraud experts were involved right from the beginning.

Several of the schemes – including the CJRS, the Self-Employed Income Support Scheme (SEISS), and Eat Out To Help Out (EOTHO) – were implemented by HMRC. The government put fraud prevention at the heart of the policy design process, taking expert advice and designing the policy, systems and processes to minimise the risk of fraud. HMRC compliance and fraud experts were fully embedded in the scheme design teams, including experts from the HMRC Risk and Intelligence Service, Fraud Investigation Service, and colleagues with a deep understanding of compliance risks in the tax system. The Risk and Intelligence Service carried out a full and detailed analysis of the likely risks in the schemes. These were tested by senior colleagues in both the HMRC Customer Compliance Group, and the scheme design teams. By building automated controls into the digital claim process, HMRC prevented more than 100,000 ineligible or mistaken claims on the employment support schemes. And by carrying out pre-payment checks based on risk and intelligence profiles, HMRC additionally blocked more than 29,000 claims and registrations in 2020-21.

A central principle of the CJRS and SEISS – to provide the strongest possible protection against fraud – was that the information submitted by a claimant had to be matched against information already held on HMRC's systems before the scheme was announced. This principle was tested as soon as the schemes were launched, with calls to make them more generous – particularly the SEISS, where a number of commentators called for company owner-managers, for example, to be brought within the scope of the scheme. HMRC did not hold the information which would have been required to implement these proposed extensions to the schemes and, without this, the taxpayer would have been exposed to unacceptable risks of error and fraud which HMRC would not have been able to mitigate. For this reason the government decided that it could not support these proposals.

Turning to business loans, the reason for the introduction of the Bounce Back Loan Scheme (BBLS) was the more or less universal perception in the spring of 2020 that the previous scheme (CBILS) was paying out loans too slowly, putting the survival of hundreds of thousands of businesses at risk. This in part was because lenders under the scheme were required to carry out all the usual credit checks before making loans, which typically delayed loan approval by several weeks. Faced with the likelihood of bankruptcies of UK businesses on a very large scale, particularly of SMEs, the government introduced Bounce Back Loans to channel finance very rapidly to SMEs in desperate need. This could only be achieved by adopting a process relying on borrower self-certification and dropping many of the usual procedures for assessing loan applications. This inevitably significantly increased the likelihood of fraud (because, for example, it meant dropping the standard credit checks which would usually help to determine indicators of fraud, such as if the company was pending dissolution or had disqualified directors). In addition, many businesses seeking Bounce Back Loans had never borrowed, meaning they didn't have a credit history, credit rating or an established relationship with a lender.

Incorporating counter-fraud checks in a scheme required to disburse loans very rapidly on a large scale to many businesses who had never borrowed before was inevitably challenging. The government commissioned expert advice from one of the leading external consultancies on the key fraud risks associated with BBLS. The firm undertook pre-launch workshops with the counter-fraud experts in the seven main lenders to develop an understanding of their fraud processes and residual fraud risks, to inform advice on counter-fraud measures. This produced a number of recommendations, and the government incorporated (prior to launch) all those that were consistent with the over-riding need for speed. Others were adopted as soon as circumstances allowed.

Lenders were required from the outset to make certain counter-fraud checks and know-your-customer checks under the scheme (for example, using a reputable fraud bureau to screen against potential or known fraudsters and seeking evidence that the applicant was carrying on their business by the required date of establishment to be eligible for the scheme). Under the schemes rules, failure by lenders to take the appropriate steps would result in a claim on the guarantee for the loan(s) in question being invalid. Lenders have reported stopping nearly £2.2bn in potential fraud.

Since the initial launch of the scheme, the government has taken further measures to protect against fraud, including introducing a check for duplicate applications, a flag on inactive companies which had undergone a change of director recently, and a flag highlighting companies incorporated after 1 March 2020.

Despite doing everything possible in the circumstances to protect the taxpayer, the government always expected a higher than normal degree of fraud and error. This was inevitable when launching schemes whose essence was to pay significant sums of money, as quickly as possible, to millions of economic actors, both individuals and businesses. This risk was explicitly factored into the decision-making at the time, where ministers had to judge the overall public interest in providing support, while also considering the risks to the economy and the public finances of a failure to act, or a delay in acting. The actual incidence of fraud and error has in almost every case been within the original estimate, as set out in the annex.

The government takes fraud extremely seriously, and has been consistently clear that fraud is never acceptable, and that those who have defrauded the government will be subject to vigorous criminal and commercial recovery efforts. The annex sets out the action the government is taking and the results to date. At the same time the instances of fraud need to be seen in the context of the circumstances at the time of the launch of the schemes, as an inevitable consequence of the speed and scale of the support which the government had to provide urgently to the economy. That support protected millions of jobs and businesses and has enabled the economy to recover rapidly as the UK emerges from the pandemic. The government believes that the right balance was struck.

We continue to learn lessons from the response to Covid, including on approaches to managing fraud risk. We engaged our internal auditors to provide a thematic cross-cutting review of Covid schemes in 2021, with a particular focus on fraud, and we have established a central fraud team as a result. As the government has previously stated, we will review the operation of the Covid economic support schemes, and we will include the issue of fraud and error as part of that.

I have provided responses to your specific questions in the annex to this letter.

Tom Scholar

Annex

Could the Treasury provide the Committee with an estimate of sums lost purely through fraud (as opposed to sums lost to "fraud and error"), across the entire range of coronavirus support schemes (whether furlough, other grants or loans), as well as latest estimates of the amounts recovered so far and of those expected to be recovered in the future?

Each department is responsible for the estimates of fraud and error in the schemes they administer. Departments report identified loss from fraud and error and associated recoveries quarterly to the Cabinet Office Centre of Expertise for Counter Fraud.

Departments report on whether an identified loss is considered to be fraud or error using a civil not criminal test. This means that they consider on the balance of probabilities whether or not an action or inaction was likely to have been taken with the intention of defrauding the taxpayer. The key criterion is intent. In the context of the Covid support schemes, this can be very difficult to assess, particularly since some of the eligibility requirements were based on self-certification and estimation.

We set out below the latest available data from departments, who are ultimately responsible for reporting estimations of fraud and error. In some instances departments have not disaggregated fraud and error figures in reporting for the last financial period.

HM Treasury has required departments to publish their estimates of fraud and error in their Covid-19 support schemes in their 2021-22 annual reports and accounts

<u>HMRC-administered schemes</u>

HMRC assessed and reported rates of fraud and error very early on for all their Covid-19 support schemes, using the best available evidence. Provisional estimates show the following breakdown for the financial year 2020-21[1] (compared against the original planning assumption, at the time of the launch of the schemes):

Scheme	Organised crime	Opportunistic fraud*	Error	Total	Original planning assumption
CJRS	0.3%	6.1%	2.3%	8.7%	5-10%
SEISS	0.7%	1.8%	Neg.	2.5%	1-2%
EOHO	0.6%	6.3%	1.5%	8.5%	5-10%

*Note that the balance between opportunistic fraud and error is uncertain.

[1] HMRC Annual Report and Accounts 2020 to 2021 (Web) (publishing.service.gov.uk)

HMRC recovered £536m of overclaimed grants in 2020-21. HMRC expects to recover another £800m to £1 billion from fraudulent or incorrect payments during 2021-22 and 2022-23. Updated information and estimates relating to 2021-22 will be included in HMRC's next Annual Report and Accounts.

BEIS-administered schemes

The BEIS Annual Report and Accounts 2020-21[2] (ARA) show the following estimated level of fraud and error at year end within the Bounce Back Loan and Grants schemes.

Scheme	Value of schemes	Fraud and error range
Bounce Back Loans	Total value guaranteed of £46 billion	£3.6 billion to £6.3 billion
Covid-19 Business Support Grants	Value of grants schemes is £19.1 billion	£0.5 to £1.6 billion

At the time of the scheme launch, BEIS provided an estimate for total losses under the scheme, including credit losses as well as those due to fraud and error. This preliminary total loss rate was a range of 35-60% (as a result of both credit and fraud risks), later revised down to 31-48%.

As noted in the BEIS 2020-21 Annual Report and Accounts (ARA), the British Business Bank (BBB) and BEIS commissioned external experts to produce a statistical estimate of the rate of occurrence of fraud in the Bounce Back Loan Scheme. The results of this work were used to estimate the range in the above table, with a central estimate of 11.15% or £4.9bn. More recent information indicates that fraud occurrence for the Bounce Back Loan Scheme is lower than original estimates, at 7.5% (£3.3bn). BEIS and the BBB are working to improve their understanding of the links between the fraud risk indicators, fraud occurrence and fraud loss, which will help to refine these estimates. As more repayment data becomes available, it should be possible to make more accurate estimates of the extent of likely fraud loss for different fraud typologies.

The Coronavirus Business Interruption Loan Scheme (CBILS) and the Coronavirus Large Business Interruption Loan Scheme (CLBILS) were not subject to the same rapid disbursement requirement, and the processes for assessing loan applications were much closer to normal commercial practice. As a result, and as set out in the BEIS ARA 20-21, the Department expects these to be subject to normal levels of fraud and error, similar to levels observed in previous support schemes of this sort. BEIS have commissioned external advisers to carry out a more in-depth assessment of the potential levels of fraud in CBILS and CLBILS. This will feed into BEIS' reporting for its ARA 21-22.

Recoveries on the Covid loan guarantee schemes are in the early stages – particularly given that the vast majority of borrowers benefitted from a 12-month payment holiday following receipt of the loan. As set out in the British Business Bank's data publication which accompanied the BEIS 2021-21 ARA, as of 30 September 2020, 2.8% of BBLs,

[2] BEIS annual report and accounts 2020 to 2021 - GOV.UK (www.gov.uk)

0.5% of CBILS and 0.2% of CLBILS loans had defaulted. Lenders are required to pursue recoveries from borrowers in line with scheme rules. Given the unique nature of the loanbooks, particularly BBLs, the current estimates of expected credit losses (which also incorporate expected recoveries) remain highly uncertain and may change significantly as the available data on repayments and recoveries matures further. Recoveries for the vast majority of cases are expected to be conducted by lenders but in some cases, notably in the case of serious fraud, enforcement agencies will also have a role.

Other schemes

We do not expect material fraud and error losses to occur with the Covid Corporate Financing Facility. This facility was designed to support liquidity among larger firms during the pandemic and closed to new purchases in March 2021. The Bank of England conducted comprehensive checks on a case-by-case basis for applicable companies to ensure they were investment grade and made a material contribution to the UK economy.

In evidence to the Committee on 2 February 2022, Jim Harra, Chief Executive of HMRC, told us there was £2.5 billion of fraud and error in certain Covid support schemes that it would be challenging to recover. What plans does the Treasury have for the recovery of that £2.5 billion, and has it undertaken any work of its own to challenge HMRC's estimate?

In the March 2021 Budget, the Government provided £100 million for the Taxpayer Protection Taskforce. Has the Treasury made any estimates of how much additional revenue might be recovered if there were to be further investment in the Taxpayer Protection Taskforce? If so, can it supply them?

In line with the general principles set out in *Managing Public Money*, each department is responsible for estimating and tackling its own level of fraud and error, and ensuring it has the capability to do so effectively. The Treasury and Cabinet Office monitor departmental performance through the GCFF. The Treasury has no reason to doubt HMRC's estimates for fraud and error, which will be reviewed and updated as more evidence becomes available. HMRC have set out their plans for recovery in their 2020-21 Annual Report & Accounts, which was laid before Parliament in November 2021[3].

The government has invested over £100m in a Taxpayer Protection Taskforce of 1,265 HMRC staff to combat fraud on the HMRC Covid-19 schemes. The Taskforce is expected to recover £800m to £1 billion from fraudulent or incorrect payments during 2021-22 and 2022-23. This is in addition to the £536m recovered in 2020-21.

The government reviewed the funding of the Taskforce during the 2021 Spending Review (SR2021), and HMT and HMRC continue to work together to monitor estimates of error and fraud, and consider options for adapting HMRC's response in light of new data and new understanding. As HMRC have set out, it is not possible to recover all money lost to

[3] https://www.gov.uk/government/publications/hmrc-annual-report-and-accounts-2020-to-2021/hmrcs-annual-report-and-accounts-2020-to-2021-performance-overview

error and fraud, and the Taskforce will not investigate every instance of potential error and fraud. In many cases it will not be proportionate or viable to do so. Attempting to identify and correct every genuine mistake would be excessively resource-intensive and deliver poor value for money. HMRC's compliance efforts are therefore focusing on those who sought to defraud the schemes intentionally, including the actions of organised criminals.

On 1 May 2020, the BEIS Accounting Officer requested a Ministerial Direction to proceed with the Bounce Back Loan Scheme. In that request, she referred to "recommendations from appointed external advisers on measures to try and minimise fraud – which we are working through with HMT and BBB [British Business Bank]". Can the Treasury provide the Committee with the recommendations made by those external advisers, and an account of what action has been taken to implement them?

External advisers were commissioned in April 2020 to advise the British Business Bank, HMT and BEIS on the key fraud risks associated with the scheme, and counter-fraud measures. They undertook pre-launch workshops with the seven main lenders in order to develop an understanding of their fraud processes and residual fraud risks (and, following launch, all remaining accredited lenders also had their fraud processes reviewed in a similar way). Their risk assessment was shared with Ministers as part of the decision-making process on the Bounce Back Loan Scheme and was used to inform future counter-fraud activity for the scheme. Each of the four recommendations made by the advisers ahead of scheme launch proposing enhancements to scheme design was taken forward. These were:

- *The introduction of statements on the standardised Bounce Back Loan application form making clear that the information provided will be used for the purposes of mitigating fraud and may be shared with other relevant parties*: This language was included in the data protection declaration on the loan application form completed by borrowers.

- *The development of mechanisms across lenders to identify multiple applications from a single business*: A duplicate application check was introduced on 26 June 2020, enabling lenders to check whether any pending (as well as past) loan applications came from applicants who had already approached another lender for a Bounce Back Loan. The time to implement the check reflected the extensive operational work needed to build an industry-wide reporting system and to get over 1 million data points from over 20 lenders up and running. Work is ongoing to deal with any duplicate applications which were put through ahead of the introduction of the check.

- *The introduction of a mechanism for more rapid information sharing across lenders*: Weekly forums were established, hosted by UK Finance and the British Business Bank, and attended by all lenders, as well as HMT and BEIS as observers. These enabled lenders to share intelligence on the types of fraud typologies being identified and counter-fraud measures, and to check with the British Business Bank where they sought guidance on the approach to specific issues.

- *The development of further guidance on the minimum standards required in the context of fraud mitigation processes*: The guarantee agreement included an overview of the appropriate standards required in terms of anti-money laundering, know-your-customer and fraud checks. In addition to ad hoc guidance provided in response to queries raised in the lender forum referenced above, as part of the major work on the approach to recoveries which culminated in detailed guidance in December 2020, lenders were also provided with further fraud principles which supported lenders in dealing with cases of suspected or actual fraud. The British Business Bank's audit and assurance programmes engage and where necessary challenge lenders to ensure they take all steps necessary to recover loans and tackle fraud as required of them through their contractual commitments and regulatory obligations.

How has the Government strengthened law enforcement for Bounce Back Loans, which was stated as an aim in the March 2021 Budget*?*

The government has always been clear that any individual who knowingly defrauds the scheme is at risk of prosecution and/or enforcement action. Together with lenders under the scheme, the British Business Bank (who implement the scheme) is taking action to identify fraud and is working with enforcement bodies to investigate the most serious cases.

The government has strengthened law enforcement powers both by funding law enforcement activity and by making legislative changes.

On funding, the government has invested over £6 million in the National Investigation Service (NATIS), a law enforcement agency specialised in investigating fraud and financial crime, to boost their capacity to investigate cases of serious fraud against the scheme. NATIS have so far made 49 arrests. Additionally, work by the National Crime Agency has resulted in 17 arrests in relation to BBL fraud, either in stand-alone investigations or as support to NATIS. NATIS are currently targeting nearly 1400 company entities and 205 suspected criminals involved in Bounce Back Loan fraud. NATIS are also targeting organised criminal networks in relation to Bounce Back Loan fraud.

In addition to its powers to disqualify directors of insolvent and live companies, the Insolvency Service now has retrospective powers to seek disqualification of directors of dissolved companies and seek compensation in appropriate cases. As of 16 February 2022, the Insolvency Service have achieved the following outcomes in relation to Bounce Back Loans: 106 director disqualifications, 48 bankruptcy restrictions and 13 companies wound up in the public interest. A further 925 director disqualification cases and 46 criminal cases have been targeted for investigation, of which 68 director disqualification cases and 1 criminal case have been given authority to proceed.

Beyond law enforcement, the government is working closely with lenders to identify and tackle fraud. The Government Counter Fraud Function's data analytics programme uses government data to identify areas of fraud risk. This helped lenders to prevent fraud loss while the scheme was still open to new loan applications and has identified over £1.4bn in high-risk loans which have been provided to lenders for investigation. Lenders are engaging proactively in this process, and withdrawing potential guarantee claims where they recognise there has been a failure in their own processes (with guarantees on over 7500 loans already withdrawn across the scheme for a range of reasons).

When Lord Agnew resigned on 24 January, he claimed that the Treasury "appears to have no knowledge of, or little interest in, the consequences of fraud to our economy or society", and he wrote in the Financial Times that "Fraud in Government is rampant. Public estimates sit at just under £30bn a year. There is a complete lack of focus on the cost to society, or indeed the taxpayer." I would be grateful if you could provide the Treasury's response to these statements.

The Treasury takes fraud extremely seriously and has been consistently clear that fraud is never acceptable and that those who have defrauded the government will be subject to both criminal and commercial recovery efforts.

The primary responsibility for tackling for fraud is with departments, in line with the principles in *Managing Public Money*. The Treasury and Cabinet Office have an important role to play in establishing guidance, setting standards, monitoring performance and providing expertise.

In 2021, HM Treasury and the Cabinet Office Government Counter Fraud Function (GCFF) agreed that Fraud Impact Assessments should be in place early in development for new major spend initiatives, not restricted to Major Project Portfolio programmes. *Managing Public Money* is being updated to reflect this, and strengthened Counter Fraud requirements are being added to the *Green Book*.

The GCFF are leading a review into Counter Fraud Workforce and Performance, delivered jointly with HM Treasury. The aim of this review is to map counter fraud workforce and capability across central government and selected arm's length bodies to identify current resources and how this links to each department's ability to prevent, detect and recover fraud and error losses.

In 2021 HM Treasury commissioned a cross cutting internal audit review of all Covid schemes to provide thematic insight into how departments were managing risk and providing assurance by scheme in line with Managing Public Money requirements.

HM Treasury has fully engaged in the cross government ministerial fraud board, established and initially chaired by Lord Agnew, and has supported its work in developing post event assurance plans. The Fraud Ministerial Board has set the direction on the COVID fraud response, with this work being coordinated by the Government Counter Fraud Function.

HMT is also leading a series of actions with financial services firms and regulators, in support of the government's wider strategy to tackle fraud against consumers. This work includes working with regulators to reduce opportunities for payments fraud, removing barriers to regulatory action to support victims of Authorised Push Payment scams, making it more difficult for fraudsters to advertise investment scams online and reducing pensions fraud.

Lord Agnew recommended in his article in the Financial Times that "there should be no more grant, loan or state assistance packages without pre-clearance by counter-fraud experts (this would delay things by about five days — just so we kill off the excuse that this would be unduly time-consuming)". Do you agree both with his recommendation and his assertion that there would be minimal potential delay?

The Treasury agrees on the critical role which counter-fraud experts should always play in the design of economic support packages, and incorporated such expertise from the outset in the design of the Covid economic support schemes. As set out in the covering letter, the design of the schemes had to balance the need to protect against fraud and error against the need to disburse significant levels of economic support very rapidly to millions of individuals and businesses. And wherever possible the government introduced further protections against the possibility of fraud once the schemes were up and running, and the immediate urgency had passed.