Dame Meg Hillier MP
Chair of the Public Accounts Committee
House of Commons
London
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30 November 2022

Dear Chair,

In the Twenty-Sixth Report of Session 2021–22, *"Lessons from Greensill Capital: accreditation to business support scheme*", published 20 November 2021, the Committee recommended that government produce a report setting out the lessons that we have learnt in the delivery of the Covid-19 loan schemes and outlining how those lessons will be implemented. We collectively accepted your recommendation and this letter provides our formal response.

Introduction

The Department for Business, Energy & Industrial Strategy ("BEIS"), HM Treasury ("HMT") and the British Business Bank (the "BBB") have written to the Committee on several occasions on the topic of the Covid-19 loan schemes (the Coronavirus Business Interruption Loan Scheme ("CBILS"), the Coronavirus Large Business Interruption Loan Scheme ("CLBILS") and the Bounce Back Loan Scheme ("BBLS")). We have also attended your Committee, the Treasury Select Committee and the Business, Energy and Industrial Strategy Committee, to provide evidence about the design, delivery and long-term management of the schemes.

We have consistently sought to learn from our experiences in developing and implementing these schemes – seeking feedback from stakeholders and considering the recommendations from various Committee Reports. As a result, we have continued to develop our management of the schemes to enhance delivery and implement improved monitoring and new safeguards. We have also introduced the Recovery Loan Scheme ("RLS"), which featured many of these new safeguards from the initial design phase.

The first evaluation report on the Covid-19 loan schemes published by the BBB in June 2022 has demonstrated that the schemes had several major positive impacts. The report found that:

- the schemes met their primary short-term objectives of unlocking credit for businesses at scale and speed;
- although there was no explicit targeting, sectors more severely impacted by the pandemic made proportionately greater use of the schemes;
- the effectiveness of the immediate response was facilitated by the existence of a pre-existing delivery template and infrastructure and effective engagement with the lending community;

- the schemes were successfully adapted on several occasions to widen access and to increase the speed of lending decisions; and
- between 0.5 million to 2.9 million jobs and 150,000 to 500,000 businesses could have been lost in the absence of the schemes. These estimates will be refined in future evaluations.

Taking on board the learnings from the evaluation, alongside the recommendations of the Committee, we have continued to improve our capabilities in managing the long-term legacies of the schemes and increasing our preparedness for future credit guarantee scheme launches. The following report provides more details of specific lessons learnt with regards to scheme design, implementation, monitoring and data gathering, our counter-fraud approach and managing the long-term legacies of the schemes.

<u>Scheme design and parameters</u>

It was only possible to establish the Covid-19 loan schemes in such quick order by building on the rails of an existing programme, the Enterprise Finance Guarantee ("EFG") scheme, which had been in operation since 2009. When the Covid-19 pandemic struck, it was evident that each passing day would affect the survival prospects of small businesses across the UK. By drawing upon existing infrastructure, rather than looking to design something from scratch, government was able to act quickly and decisively to support businesses. This is a vital learning that will be recorded for future economic crises and planning activities.

We also learned the need for loan schemes to be adaptable to the changing requirements of businesses and lenders. Regular contact with lenders and businesses, particularly through bilateral meetings with Business Representative Organisations ("BROs") and wider forums such as the Business Finance Council, meant the schemes could be adapted at pace. For example, a series of meetings with lenders and BROs over the 2020 Easter weekend to discuss the challenges deploying finance through CBILS provided much of the evidence and rationale for launching BBLS.

In combination, CBILS, CLBILS and BBLS ultimately ensured that the government's support offer was comprehensive and reflected the urgency of the economic situation at the time. The ability to launch schemes based on existing rails, the quick response to feedback, and strong collaboration with lenders allowed us to adapt our response quickly and effectively.

However, it is worth being clear that a loan guarantee scheme such as BBLS would, and should, only be introduced in times of absolute extremis where businesses appear to be facing the immediate risk of insolvency without urgent cashflow support. Therefore, the lessons learned on the specific policy design of BBLS – although vital – will be of limited application in more stable economic conditions.

Specifically, this is because the overriding objective of BBLS was to ensure that businesses could quickly have access to finance. This required a particular set of trade-offs which were set out in the Direction letters for the scheme and have been the subject of extensive examination by the National Audit Office ("NAO") and your committee. The ongoing evaluation process for the Covid-19 loan schemes will provide further evidence on the long-term value for money of BBLS, which will be valuable for planning future responses to extreme economic shocks.

BEIS, BBB and HMT have already applied a number of lessons learned from the EFG scheme and the Covid-19 loan schemes in the design of RLS. The RLS business case was explicit in highlighting these lessons, including (but not limited to):

- Maintaining wide eligibility criteria so that the scheme is available to all businesses who want to access it, rather than only those businesses that have been turned down for a commercial loan for a limited number of reasons as was the case for the EFG scheme.

- Maintaining lenders' ability to claim against all facilities in their portfolio (in the highly unlikely event every business they lent to defaulted on their loans), rather than reinstating a 'portfolio cap' under which claims cannot exceed a fixed percentage of scheme lending, as was the case for EFG. This change means that banks can benefit from regulatory capital relief – enabling them to lend to more businesses (or lend at better rates) and continue providing funding to non-bank lenders as well.

- Ensuring the premium paid to government to provide the guarantee continued to be paid by the lender rather than by the borrower (as had been the case for EFG) to reduce complexity of the customer journey.

- Introducing a lower Scheme Lender Fee for responsible finance providers (i.e., those who are accredited for Community Interest Tax Relief or Social Investment Tax Relief) and invoice finance providers. Responsible finance providers serve those parts of the market furthest from commercial finance, so the lower scheme fee is a way of ensuring the loan remains affordable to the business given the higher costs these lenders face. Invoice finance was identified as an important way to support businesses' demand for working capital.

BEIS also ensured that, despite being developed at pace, RLS was launched after going through the usual governance routes within HMT and BEIS, including approval of a Green Book-compliant business case by BEIS' Projects & Investment Committee. These processes represent an important opportunity to test scheme design and proposed risk mitigations with a range of stakeholders, and we would expect to follow this approach in all normal circumstances.

Where the imperative to respond at pace makes this impossible, it will remain essential to take proportionate steps to mitigate and record risks associated with scheme design, for example by:

- bringing relevant experts such as counter-fraud specialists into the design process where possible;
- providing clear advice to Ministers and senior officials to set out where it has not been possible to follow established processes, and the extent to which this requires an acceptance of an enhanced degree of risk; and
- acknowledging where significant risks cannot be mitigated before scheme launch and putting into place plans to iterate the scheme design post-launch where practicable, in line with the policy objectives.

In this regard we welcome the establishment of the Public Sector Fraud Authority ("PSFA"), which will serve as the centre of expertise on the management of fraud against the public sector. We believe the processes the PSFA are putting in place to mandate particular activity in relation to fraud controls will support effective scheme design for future loan guarantee interventions. Since the launch of the Covid-19 loan schemes, BEIS has also taken steps to significantly grow its in-house counter-fraud expertise and capability, enabling better links with fraud experts across government and enforcement agencies, and providing an additional route to access counter-fraud expertise for BEIS officials engaged in policy design.

Scheme implementation

The Covid-19 loan schemes required lenders to undergo an accreditation process in order to participate. Accrediting a broad range of lenders for each of the three schemes was vital in allowing for greater access to finance for businesses.

The accreditation process was designed to approve lenders that had an appropriate track record and business model, available capital and relevant authorisations and permissions. The BBB has an objective to help create a more diverse finance market, and as such the accreditation process was designed to be sufficiently flexible to accommodate lenders with different business models. However, given the need to provide finance to businesses at speed, Ministers agreed that the process adopted by the BBB to accredit lenders should be a streamlined version of the process used for the EFG scheme.

The BBB put substantial additional resources in place to create a process to help onboard new lenders seeking accreditation as quickly as possible. This resulted in the accreditation of 117 lenders to deliver CBILS (of which 44 were lenders that were already accredited to the EFG programme), 26 to deliver BBLS and 27 to deliver CLBILS.

Even still, and as noted in the independent evaluation of the schemes, the time taken to accredit new lenders varied due to the large volumes of applications received from lenders and the use of the EFG scheme infrastructure, which needed bespoke adaptations to make it suitable for lenders with alternative business models. These could take some time to agree with lenders, with some lenders only able to enter the market at a late stage. Whilst this may have had some impact on competition in the market, the alternative would likely have involved delaying the schemes' launch (and potentially harming businesses' survival prospects) or accelerating the process further with elevated risks to value for money.

Through the accreditation process, the BBB has accumulated significant experience and learned a number of lessons with respect to accrediting and monitoring a wide range of delivery partners operating a diverse range of lending and business models. The BBB has since drawn upon these experiences in the design and delivery of the RLS accreditation processes.

1) The BBB took a risk-based approach to accreditation for RLS in March 2021, with a new, accelerated route available to existing CBILS lenders that met certain conditions, and a more intensive accreditation process for those lenders with features that meant additional diligence was required to minimise risks to public money. This includes, for example, lenders with outstanding CBILS audit actions or lenders who had changed their business structure(s) such that extra assessment was required. This approach looked to balance the needs of ensuring a large and diverse number of lenders were in place when the scheme launched (given the ongoing need for finance from SMEs), the operational costs of different approaches, and the practical and reputational risks of accrediting lenders that may subsequently become insolvent.

2) Building on this approach, the transition of lenders across to the current iteration of RLS, which went live in August 2022, was further enhanced. New eligibility criteria for lenders with respect to a lender having appropriate sources of capital (following Russia's invasion of Ukraine) and confirmations relating to a lender's fraud and financial crime and environmental, social and governance practices were put in place. For example, lenders are required to evidence as part of the accreditation process that they have a documented recoveries model in place to recover funds if fraud and / or financial crime have been detected.

3) The independent evaluation of the Covid-19 loan schemes noted that some non-banks reported challenges in completing the pricing matrix (required to demonstrate they were passing on the economic benefit of the guarantee to the borrower) and in demonstrating 30% of their funding sources were from private sources. Through its regular lender engagement, the BBB has worked with lenders to familiarise them with these concepts and scheme requirements, such that it has been much less of an issue for RLS.

We have learnt that a one-size fits all approach for lenders is not possible. Instead, there is a trade-off, such that, unless there is sufficient time for accreditation ahead of a scheme being launched, there will continue to be some lenders that are accredited later than others with potential short-term negative impacts on competition. While the BBB has maintained the overall accreditation approach, we have recognised the merit of having processes in place that allow for more detailed considerations, when necessary, with respect to accreditation. There will continue to be business models and funding structures that are more complex than others. These arrangements both require more time to appropriately scrutinise in order to protect public money and, because they do not fit the standard legal agreement, are likely to require bespoke side letter arrangements, which take additional time and resource.

<u>Scheme monitoring</u>

The BBB has put in place a range of measures in order to enhance its monitoring of lending and subsequent lender portfolio management under the Covid-19 loan schemes. These have developed over time and were incorporated into RLS from the outset. These include:

1) Development of mechanisms to share data between the BBB, lenders, BEIS and HMT. This involved some initial challenges as there was a reliance on systems developed for the substantially smaller EFG programme (which involved manual uploading of data by a lender into forms, which introduced the prospect of manual errors in data). The BBB has addressed this issue by developing an API system to support bulk uploads across all three schemes for lenders with larger lending volumes, reducing ongoing resource burdens for lenders and supporting more timely data updates on the portfolio while minimising data entry issues. The API system continues to be operational for RLS.

   Since the closure of the Covid-19 loan schemes to offers at the end of May 2021, the BBB has been the single source of data, reducing duplication of reporting to HMT that lenders may have experienced while the schemes were live. It has also been the single source for data in relation to RLS since June 2021 and data published in relation to RLS has only been taken from the BBB's portal.

   Data captured through the portal has enabled the BBB to closely monitor the activity of lenders. The data was effective in helping the BBB identify whether lenders were exceeding their individual lending allocation limit, whether loans were being offered in line with each lender’s pricing matrix and that data was entered accurately (as well as providing broader information on the delivery of the schemes to support policy development).

2) The BBB has made several iterative improvements to its credit loss and guarantee claims modelling over the course of administering the schemes. This has provided increased capability in forecasting associated costs. Improvements include the utilisation of real time data on arrears (which has greatly improved the BBB’s short-term forecasting of facilities facing imminent default) and more up to date information from Credit Reference Agencies. These capability enhancements have all been incorporated into modelling for RLS from the outset, allowing more robust forecasting at an earlier stage of the scheme’s lifecycle. Moreover, the existence of sophisticated modelling for the Covid-19 loan schemes meant that the BEIS Accounting Officer and ministers could make a more informed judgment regarding the likely value for money of RLS ahead of launch, using CBILS estimates as a comparator (given the similarities in their parameters).

3) The launch of the Covid-19 loan schemes led to a substantial increase in the number of delivery partners working with the BBB, thereby increasing the resource required to carry out audits of lenders to ensure lenders were abiding by the terms of the legal guarantee agreements. Additional external third parties were procured to support rapid development and implementation of audits, to ensure all lenders (with more than five guaranteed facilities) were audited within the first year of the schemes going live, and to monitor the implementation of any corrective action plans with lenders.

   In conjunction with the audit providers, the BBB periodically (at a minimum annually) updates the audit risk assessment, scope, approach and test plans. Our learnings throughout the audit assurance programme lifecycle have enabled us to target areas of most concern and where the risks appear greatest.

   Although the composition of the audit assurance programme has developed, from a focus on origination to a focus on claims and recoveries, results improved for lenders audited in both 2020/21 and 2021/22. This provides early indications that the programme is effective in lenders remedying identified issues and ensuring lenders take action to improve compliance. The BBB’s early assessment of the Covid-19 loan schemes did consider the audit assurance programme, but not its outcomes in detail. This will be revisited in future phases of the evaluation process, with any lessons identified as part of that process taken on board moving forwards.

4) In order to provide greater visibility of lender financial stability, identify early warning signs, and ensure better contingency planning, the BBB has put in place a new Delivery Partner Monitoring programme. All Covid-19 loan scheme and RLS lenders are monitored under this programme, which looks for ‘warning signs’ of lenders being under financial pressure by examining any part or combination of (i) publicly available information, (ii) the latest management financial information, (iii) audited accounts, (iv) portfolio performance, (v) scheme audits, (vi) operational information, and (vii) other communications with the BBB’s relationship management team. Each lender is then given a Financial Risk Rating (“FRR”) based on the BBB’s assessment of lender stability, with ongoing monitoring requirements established on a risk-based approach determined by each lender’s FRR. Importantly, the ongoing assessment of lender stability intrinsically contributes to lender accreditation for future schemes.

Fraud and mitigation of abuse

For BBLS, ministers chose to introduce a simplified application process based on self-certification to facilitate faster lending to businesses. This involved removing credit and affordability checks usually required under the Consumer Credit Act (which was disapplied) and allowing businesses to self-certify their eligibility for the scheme. An inevitable consequence of this was a heightened vulnerability to fraud, and this was documented in the direction letters exchanged before the scheme's launch, which have since been published.

It was also acknowledged in those direction letters that it would not be possible to entirely mitigate this heightened risk of fraud. Nevertheless, since BBLS was introduced, we have taken widespread and robust action to safeguard the taxpayer within the limits set by the parameters of the scheme, including drawing on extensive advice and practical support from the Government Counter Fraud Function (now the PSFA). Lessons have been learned across the breadth of our counter-fraud response – from prevention and detection, through to measurement and enforcement.

1) Prevention

   As was acknowledged at the outset, a delay in implementation of BBLS may have significantly improved fraud prevention, for example, by allowing for wider consultation and more detailed input from the counter-fraud community, including experts such as the Government Counter Fraud Function (now the PSFA). That trade-off was made explicit in advice provided to ministers and the BEIS Accounting Officer and recorded in subsequent Ministerial Direction letters. Given the economic conditions at the time, ministers felt that these risks were outweighed by the need to get support to small businesses as quickly as possible. From the outset, lenders were required to make and maintain appropriate anti-money laundering ("AML") and know-your-customer ("KYC") checks for all new customer applicants, in line with their legal and regulatory obligations (taking into account the Financial Conduct Authority's *"Statement on the UK Coronavirus Business Interruption Loan Scheme (CBILS) and the new Bounce Back Loan Scheme (BBL)"* of 27 April 2020).

   Following launch, the BBB implemented a series of additional processes to support lenders' fraud prevention efforts. This included the duplicate application check, which required the BBB to design and build an industry-wide reporting system from scratch, and then work with accredited lenders to put it into use. Though certain checks could not be implemented until after the scheme launched, the combined preventative effect of the upfront checks put in place from the outset and following launch appears to be significant, with lenders self-reporting having prevented £2.2 billion in potentially fraudulent applications (data provided as at May 2021). Stronger measurement and reporting than were possible to deliver in short timeframes around controls (e.g., on the use of the duplicate check by lenders) would have allowed for better and timelier understanding of their use and efficacy.

2) Detection and data sharing

   As mentioned above, the BBB has enhanced its monitoring of the Covid-19 loan schemes, and work continues today to further enhance the collection and sharing of high-quality data in relation to lenders' counter-fraud performance.

We have also put in place changes to enable greater sharing of counter-fraud data across organisations. For example, the original privacy notice issued as part of the application pack for BBLS did not include explicit text on use of data for fraud prevention purposes. As a result, we changed the privacy notices to cover proposed analysis in detail, and lenders communicated that to all scheme borrowers. From the outset of RLS, we have ensured that the privacy notices explicitly set out a wider range of potential future uses of data for fraud prevention, mitigation and detection measures, removing previous ambiguity.

The BBB's extensive fraud risk assessment ("FRA") procedures and the Government Counter Fraud Function's fraud analytics programme have allowed us to develop a strong understanding of the nature and extent of BBLS fraud risk. On behalf of BEIS, the Government Counter Fraud Function – now the PSFA – has used data from a range of government sources to assist lenders with more information on fraud risk indicators, including through use of the powers in the Digital Economy Act. Should another emergency financial support scheme be launched in future, fraud risk should be better understood from the outset, and we would have a stronger understanding of how to structure and use relevant data sets. For the latest iteration of RLS, the BBB developed the FRA prior to launch to ensure an assessment of fraud risks was taken into account during scheme design.

The BBB will continue improving its understanding of wider scheme risks, by undertaking financial crime risk assessments during 2023. The findings from these will help define any potential further enhancements required to the Covid-19 loan schemes, RLS and any future schemes to protect against financial crime.

3) Investigation and enforcement

We have learnt the value of having both strong mechanisms and better data for identifying appropriate enforcement routes more quickly, monitoring progress, and ensuring different branches of enforcement do not duplicate investigations or enforcement activity. As a result, BEIS is evolving the triage process for BBLS, making sure we have in place a system to better identify and target cases.

We have also learnt the importance of continually reviewing resourcing for counter-fraud work – so while the initial focus was on prevention, we have continued to update and review relevant activities even once BBLS closed to new applications. This has resulted in further funding being allocated to BBLS counter-fraud work at Spring Statement earlier this year, as follows:

- The National Investigation Service ("NATIS") received £13.2 million (in addition to a further £18.5 million allocated by BEIS for financial years 22/23, 23/24 and 24/25) which is enabling NATIS to target more lower value, higher volume cases.
- The BBB received £10 million additional funding to further enhance its lender assurance programme.
- The Counter Fraud Function (now the PSFA) received £9 million to support the fraud analytics programme.

4) Measurement, analysis and insight

The quick implementation and delegated nature of the Covid-19 loan schemes has made ensuring shared definitions of different fraud typologies and their comparability over time difficult. However, the suspected fraud flag, developed from Cabinet Office data analysis and integrated within the BBB's portal, has been made available to all lenders to indicate where potential fraud has been detected during the lifecycle of the loans. This has helped to provide valuable insight.

The BBB and government have worked closely with UK Finance and third-party suppliers (including PwC) to analyse the loan portfolios to further develop our collective understanding of fraud typologies and potential fraud occurrence. This has been done drawing on both the Government Counter Fraud Function's fraud analytics programme, BBB's audit programme and the BBB / PwC sampling exercises undertaken on BBLS, CBILS and CLBILS.

The BBB continues to develop its methodology for measuring fraud, drawing upon new data sources where these become available. However, for BBLS in particular, the design of the scheme and the complex range of fraud typologies means that a significant degree of uncertainty will remain.

5) Counter fraud capacity and capability

BEIS and BBB have substantially built out their counter-fraud and financial crime teams since the launch of BBLS. We are continuing to review the ongoing and potential future requirements for those teams, for data analytics and enforcement capacity through NATIS and other partners. In the longer-term, maintaining a higher level of in-house capacity will ensure that we can better manage risks associated with current and future programmes, and the Department is drawing upon the expanded counter-fraud team – and advice from the PSFA – in current work on energy support schemes. The PSFA continues to provide further support on improving the counter-fraud impact assessment at the outset of policy design, with significant guidance available to policy teams.

6) Working with lenders and monitoring their performance

From the outset, we have worked closely with UK Finance and other industry groups on the design and implementation of BBLS. This collaboration is particularly important for loan guarantee schemes, as government is reliant on its delivery partners to help safeguard public money, with lenders acting as the first line of defence against fraud.

It has been imperative for government to provide clear guidance to lenders around what is expected of them. The BBLS Guarantee Agreement and Lender Manual set out minimum standards for lenders to follow in respect of fraud. To assist lenders further, government worked together with the BBB, UK Finance and regulators to produce detailed guidance for lenders with respect to collections and recoveries in instances where there are suspicions of fraud. The operation of this guidance has been supported by a dedicated recoveries collaboration forum, which meets regularly and is attended by UK Finance and representatives of all accredited lenders.

Maintaining regular dialogue has meant that issues falling outside the scope of the guidance, or challenges relating to the implementation of the guidance itself, have been identified quickly and addressed in a clear manner. Direct collaboration with lenders has been reinforced by ongoing coordination with industry regulators, including the Financial Conduct Authority ("FCA"), the Prudential Regulation Authority ("PRA") and the Lending Standards Board (LSB).

The BBB and government have continually sought to improve visibility of the action lenders are taking on fraud and the outcomes arising from that. This visibility is crucial to ensuring that robust scrutiny can be applied to how lenders are performing against their obligations. There have been significant operational challenges to overcome here, given the wide range of lenders accredited under the scheme, each of whom has differing internal systems and processes.

The governance arrangements that support our counter-fraud programme have continued to evolve over time, delivering stronger coordination between the BBB, BEIS, HMT and other government partners. The Lender Performance Advisory Board ("LPAB") was established in early 2022 to offer more in-depth oversight and strategic advice to the BBB on lender performance management for BBLS. The creation of LPAB reflected a growing recognition that driving positive outcomes in lender behaviour, specifically with regard to guarantee claims and recoveries, is an important tool for mitigating the risk of avoidable losses to government. LPAB supplements the existing coordination mechanisms between government and the BBB. It meets regularly to consider the BBLS lender performance dashboard and to discuss significant performance issues relating to individual lenders (where these are escalated by the BBB). BEIS, HMT, PSFA and UK Government Investments ("UKGI") are represented at LPAB.

7) Demonstrating effective collaboration

We have learnt that as well as collaborating effectively across government in our efforts to tackle fraud, we need to be seen to do so. BEIS is leading the delivery of a consolidated Counter Fraud Strategy for BBLS, building on our work to date and collating the positive work across organisations into one cohesive document, in line with NAO recommendations. The BBLS Counter Fraud Strategy will set out the objectives of our counter-fraud work, our longer-term ambitions (notwithstanding the challenges and limitations imposed by the scheme design) and outline how we plan to monitor the impact of the government's counter-fraud activity.

To ensure we continually learn from wider expertise, we will work closely with the PSFA, which was launched on 3 August 2022. BEIS will be key contributors, having a seat at the PSFA Technical Panel, and within development of the Common Services Provision, ensuring a prominent role in the development of counter-fraud strategy for future schemes. We are also considering our wider public-facing communications approach in more detail. That is because we recognise the importance of maintaining public confidence in our approach, as well as making sure that borrowers and the wider public are clear that there are implications for non-repayment, and that those who have committed fraud in relation to the scheme are at risk of prosecution.

Conclusion

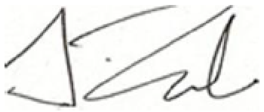
BEIS, HMT and the BBB have worked together to address the challenges presented by the unique and unprecedented circumstances the government found itself in as a result of the

Covid-19 pandemic. At every opportunity we have sought to modify the schemes to meet the needs of businesses as well as enhancing our management of the schemes to address the issues raised.

Collectively we have taken steps to learn lessons from the development of CBILS, CLBILS and BBLS and implemented these learnings during the policy development of RLS. We are committed to continually learning from the experiences of past and present to further improve any future schemes.

Yours sincerely,

Sarah Munby



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