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

Dear Chair,

Treasury Minute Response – "Bounce Back Loans Scheme: Follow-up" (50th Report of Session 2021-22)

Thank you for your letter dated 3 November 2022 with respect to the Government's response to the Committee's 50th Report of Session 2021-22. I will answer each of the points raised in turn.

In the first instance, I want to assure you that the Department is committed to addressing the challenges associated with the Bounce Back Loan Scheme (BBLS) and taking robust action to safeguard the public money that stands behind the guarantees. Our counter fraud programme is an integral part of this, and we have continually sought to develop our approach over the past two and a half years as our understanding of the risks in the scheme has matured.

Recommendation 1a: You concluded: *"on putting in place a clear strategy to manage the long-term legacy of the Scheme within a month of the publication of its evaluation report. You did not meet our timescale and instead expect to formalise a strategy by the end of 2022. You also explained that your strategy for managing the long-term legacy of the scheme will develop as your understanding of the scheme's impact matures. This did not give us confidence that you are acting in an urgent manner to address significant challenges facing the Scheme."*

We have worked diligently to ensure the BBLS Counter Fraud Strategy addresses the points the Committee has raised in its hearings, including via ongoing engagement with the National Audit Office. I do want to emphasise that although we have not yet published a strategy document, the programme of work that underpins it is live and we regularly monitor progress through senior governance processes. This includes a monthly Counter-Fraud Programme Board (which has a specific focus on the implementation of the Strategy), the monthly Lender Performance Advisory Board, and quarterly Business Finance Assurance Board.

There are five objectives which guide our counter-fraud programme and form part of our strategy. These are:

i) Deterring and disrupting crime, including by prosecuting those committing fraud and financial crime.
ii) Minimising loss and maximising recoveries related to fraud and taking a fair and appropriate approach to ensure borrowers fulfil financial covenants.
iii) Mitigating risks and harms related to financial crime.
iv) Identifying, measuring, and monitoring fraud and financial crime risks and ensuring timely, transparent information sharing across stakeholders.
v) Learning and applying lessons to support and deliver continuous improvement.

We are engaging with our new ministers with a view to placing a version of the Strategy in the public domain. There is some information that may not be in the public interest to publish, because of the risk it will hamper the effectiveness of our enforcement activities.

An important part of any strategy or programme is being clear on what we are aiming to achieve and measuring progress. As you are aware, we have made estimates of the scale of potential fraud and fraud loss in the scheme but doing so is complex and there is a high degree of uncertainty. We are developing our methods for assessing whether our counter-fraud activities are having the intended impact of identifying and establishing fraud occurrence and thereby potentially reducing fraud loss. This is important for determining the value for money of our activities.

Recommendation 4a: You concluded: "*on setting out how the Department will use legal, regulatory and contractual incentives to improve the lenders' performance in managing the loans. You list arrangements already in place at the time we took evidence, such as an ongoing lender audit and assurance programme. You do not set out how you will use powers but mention that you are looking at where regulatory powers can add value. It is disappointing that you appear to repeat existing arrangements in your response and that new powers remain under consideration."*

We have continued to build on our programme in relation to lender performance, notwithstanding the unique design of the scheme and the challenges and limitations.

<u>Scheme design, lender and regulator engagement</u>

BBLS was designed to facilitate delivery of funds to borrowers at pace and to give lenders the confidence to lend to borrowers outside of their "business as usual" processes (and risk appetite). It is a delegated scheme, as the guarantee is provided to the lender rather than the borrower, which means that borrower relationships (and the underlying loan contract) are owned and managed by the lenders and not by the BBB/BEIS.

The guarantee agreements contain clear obligations on the Guarantor around payment of eligible claims within a specified period provided certain conditions. This was to ensure that the guarantee agreements are eligible for recognition as unfunded credit risk protection. The contract cannot be unilaterally amended by the BBB/BEIS to impose additional contractual obligations on lenders. However, lenders are required to follow scheme guidance and the BBB has consistently sought to ensure coherence and consistency of approach between lenders, including through publication of regular scheme guidance addressing matters such as cases of change of legal entity and specific queries in relation to recoveries, responding to lender FAQs and fortnightly meetings with lenders. This is an ongoing process.

Outside of lender engagement, we look to maximise the efficacy of our controls and leverage relationships with other organisations, for example the FCA. We continue to meet regularly with the FCA and work with them wherever possible to ensure that borrowers receive the protections to which they are entitled and that FCA rules are applied as intended; as well as supporting the national economic crime goals.

<u>Enhanced audits</u>

We have commissioned a small number of enhanced audits where current audits findings, or other contemporaneous data, suggest further investigation is required. This is to ensure that we direct resource efficiently and effectively on matters where there are concerns or inconsistences (within a lender, or between lenders) in relation to lender behaviour. This could lead to required management actions by the lender (to change or check processes, or remove guarantees or, the BBB taking other action should the lender not have followed the terms of the guarantee agreement.

<u>Assurance of claims</u>

The Guarantee Assurance Programme (GAP) encouraged lenders to review certain fraud risk indicators (e.g. companies formed after 1 March) to ensure their internal standards had been met and they had complied with the Guarantee Agreement provisions, which led to lenders voluntarily removing a number of guarantees. In addition to GAP, and as a result of ongoing checks by lenders and BBB's own lender engagement programme, a substantial number of loans recorded in the portal have been removed for a variety of reasons, including simple errors as well as ineligibility.

We are now developing our post-claims assurance process, which will provide additional assurance by applying a targeted validation process to the settled claims which may, where appropriate, lead to further investigation with lenders or a range of other potential actions. If claims had been made where lenders have not met their obligations under the guarantee agreement, BBB/BEIS has a contractual right to require the lender to repay claims paid out by BBB/BEIS.

Recoveries

We have commissioned a series of enhanced recoveries activities where wrongdoing is suspected, starting with an involuntary liquidation pilot, an enforcement pilot and a pilot involving a private debt management specialist. We have already seen success from this programme of work, and we are planning the next steps. In addition, we continue to engage with UK Finance and BBLS lenders on the wider recoveries process and associated guidance.

Data publication

Data on the performance of BBLS is published regularly. The most recent publication (5 September 2022) provided substantially more data points compared to that of 28 July 2022 and featured a lender-by-lender breakdown, including levels of suspected fraud. The next data publication is expected in early 2023.

Legal levers

BBB/BEIS have various contractual rights under the guarantee agreements, including the right to refuse claims on ineligible facilities, cancel guarantees and require a lender to reimburse claims that have been paid should it later be discovered that a facility was ineligible. When and how we exercise these rights (where and when they have arisen) is considered on a case-by-case basis depending on the facts and circumstances of a particular lender.

Recommendation 7b: You concluded: *on developing a business case for an emergency loan scheme for future crisis within 6 months of publication of the Committee's report. You argue that the department has an approved business case for the Recovery Loan Scheme, which you believe may act as a template if a future emergency loan scheme is deemed an appropriate economic response. The Recovery Loan Scheme is not tailored to large volumes of small businesses or a situation where a 100% guarantee is needed. You risk, therefore, making the same missteps as when you deployed the Enterprise Finance Guarantee Scheme as the basis for the Bounce Back Loans Scheme. I would therefore ask you to reconsider your rejection of the recommendation, and to provide assurance on how you will be prepared to act in a similar crisis.*

Whilst we understand and accept the need to be prepared for future economic shocks, no two crises are the same. A 100% guarantee scheme would only be considered in extraordinary circumstances, and it is hard to imagine how, without the context of the first lockdown imposed at the onset of the pandemic, we would have planned for that.

As you would expect, we continually monitor the current financial health of businesses and warning signs of future issues around business financial vulnerabilities, and assess the potential implications for policy. However, it would not be effective use of time and resources to design a full business case for a future crisis based on the variables encountered in 2020.

The lessons learnt report we are presenting to the Committee alongside this letter sets out what we have learnt from evaluating the design and delivery of the COVID-19 loan schemes. This report is intended to complement the findings from the first phase of the BBB's formal evaluation, which was published in June 2022.

We have made considerable progress in ensuring all lessons learnt are implemented. For example, learnings on counter-fraud have been integrated into the delivery of each phase of the Recovery Loan Scheme, and the recent Energy Bill Support Scheme, with further expert engagement and use of fraud risk assessments from the outset. Since the launch of BBLS, we have improved our infrastructure and processes including via increased counter-fraud expertise in BEIS and the BBB. The improvements we have made would mean in the event of a crisis with similar characteristics in the future, we would be better placed to deploy similar schemes to the COVID-19 loan schemes quickly if required, while putting in place appropriate fraud controls to reduce the residual risk to taxpayers.

Sarah Munby