

| SQUARING THE CIRCLE

SETTING THE STRATEGY
FOR UK BUSINESS
'BOUNCE BACK' LOANS COLLECTIONS

A CREDIT SERVICES ASSOCIATION REPORT
JANUARY 2021
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REPORT SUMMARY

- i. The rapid transit of COVID-19 and its virulence has created an enormous challenge for governments in seeking to keep their citizens safe. Restrictions on movement and on activity have created unparalleled disruption to what people would consider to be 'normal' life. Those measures designed to protect citizens, both individually and as a society, have nonetheless had their own costs. The disruption of economic activity for individuals and firms have all contributed to an unprecedented set of challenges rippling backwards and forwards across the economy.
- ii. The Government has introduced a range of economic measures in order to try to soften these effects. The Job Retention Scheme was aimed at preventing large scale redundancies as businesses unable to trade found themselves in difficulty. At its height it appears to have helped 9.6 million people¹ who might otherwise have found themselves without income at the worst time possible. Changes to benefits available, protection from eviction, the availability of deferrals on some types of debt all contributed to that softening of the blow.
- iii. The Government was similarly active in supporting business that in many cases were unable to trade or were operating at a much reduced level. It rolled out a range of measures from easing the burden of operating costs such as business rates, income tax deferrals, changes in VAT for particularly badly hit industries and income support for self employed individuals. It also took steps to make funding available easily to businesses of various sizes which, but for the advent of COVID-19 or the responses needed, would have been viable and which therefore needed to be able to smooth costs and liabilities in a safe way.
- iv. Access to funding came in several forms and varied according to the size of the business. Large businesses could potentially access the Coronavirus Large Business Interruption Loan Scheme or, sell short term debt to the Government under the COVID-19 Corporate Financing Fund. Smaller businesses could access the Coronavirus Business Interruption Loan Scheme and the Bounce Back Loan Scheme (BBLs).
- v. But by necessity, many of these responses were put together extremely quickly to deliver that support and this has led to the potential for problems in the future, some for the businesses themselves and some potentially for the taxpayer. Some estimates suggest that between 35% and 60% of BBLs may not be repaid in full.
- vi. In this paper we consider Bounce Back Loans (BBLs): what they are, how they are designed; what some of the challenges that they present might be and how Government could approach resolving these potential pitfalls to try to ensure that what was introduced as a desperately needed support mechanism for some of the six million SMEs with a turnover of £2.2 trillion contributing to the economy, does not become a burden to the taxpayer, a drag on economic recovery and a poison chalice to those that took them out.

Some estimates suggest that between **35%** and **60%** of Bounce Back Loans may not be repaid in full.

RECOMMENDATIONS

- i. Ensure that there is a consistency of policy:** There are many challenges with BBLs. While the policy, and the product, were created to address an urgent need which led to many of these problems, it is important there is consistency of policy and approach in tackling these moving forward. It is crucial that those that have taken out these loans, and those that have granted them, are not faced with a rapidly shifting and unpredictable policy environment, whether in terms of repayment or recovery.
- ii. Ensure that information is clear and unambiguous:** Clarity of understanding will be crucial both in terms of fairness to the borrower and achieving a smooth recovery of repayments from those that can do so. Emphasis on aspects that are only relevant to the relationship between lender and Government, particularly the 100% guarantee, could lead to confusion about responsibilities and undermine repayments.
- iii. Maintain a continuous dialogue:** The pressures of the present mean that what has been agreed now, in some cases in desperations, are unlikely to be remembered later. Moreover, an engaged portfolio of customers is more likely to repay all, or if in difficulty repay some, of what is owed. Our experience clearly shows this to be the case and the resultant recoveries could save the taxpayers significant sums.
- iv. Invest in engagement:** Deciding to engage in continuous dialogue needs to be properly supported especially given the low cost nature of the lending. This does not need to be in the realms of the reported £42 million spent on the Financial Conduct Authority's (FCA) campaign heralding the deadline for claiming mis-sold PPI; in this report we recommend Ministers create a 'BBL Engagement Scheme' on an invest-to-save basis of £10million annually until 2024. Our estimate is that such an effective approach to collections could yield an additional return of between £3bn and £6bn for the Exchequer. In other words, if the Government pursues an active collections strategy consistently for the next three years, it could save the taxpayer the equivalent of the NHS annual capital budget allocation, or a penny on the basic rate of income tax.

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- v. Ensure 'best practice' in recovery and forbearance standards:** It is important that there is a consistency of standards in pursuing outstanding accounts. Many SMEs will be self-employed individuals who may well be experiencing wider personal financial problems. A nuanced and flexible approach to individual circumstances will help reduce the scope for wider problems or at least contribute to a lessening of the impact. An approach that works with a borrower and is sensitive to their individual circumstances inevitably yields better returns. This will be important for the taxpayer and reflects the highly unusual situation which the BBL scheme was designed to ameliorate. Government should also avail itself of existing expertise in this respect, rather than seek to 're-invent the wheel'.
- vi. Keep dialogue going before and after a lender activates the guarantee:** It will be important not to lose any forward progress in engagement simply because the guarantee has been activated. We recommend a second round of collections post-guarantee under the auspices of the British Business Bank (BBB) prior to any book disposal.
- vii. If Government chooses to sell on portfolios, provide a warranty against fraudulent activities:** The incidence of fraud is expected to be high, so if Government considers selling on debts at some point in the future, it will have to take steps to recognise that risk when it does. Otherwise it may face reluctance from markets to share the risk in loans granted.

Ensure 'best practice' in recovery and forbearance standards: It is important that there is a consistency of standards in pursuing outstanding accounts.

BACKGROUND

- i. By April 2020, the global COVID-19 pandemic had firmly taken root in the UK. The Government and devolved administrations had introduced a national lockdown to try to limit the spread of a highly contagious and potentially lethal virus. But the virus itself and the public health measures introduced to combat it had a profoundly disruptive effect on the economy, global supply lines and on the financial position of individuals, households and businesses.
- ii. The Office for National Statistics (ONS) estimated that the UK's gross domestic product (GDP) fell by a record 19.5% in April 2020² - a much larger contraction than had occurred in any single quarter during the 2008 financial crisis. Unlike past recessions where the disruption might be said to begin in a particular sector and spread via linked activities to the wider economy, the ONS analysis suggested that a combination of the virus and the public health response affected all sectors of the economy³ almost simultaneously, though to varying degrees.
- iii. Sectors of the economy that already operated remotely or were capable of moving to such a mode of operation quickly (some service based industries) fared better than those which required a physical presence to fulfil some of the activity (construction and manufacturing) or physical proximity to the customer (bricks and mortar retail, hospitality, transport). Disruptions to global supply lines due to the pandemic also hampered economic activity in some quarters as components and restocking could be effected by disruptions beyond the UK's borders.
- iv. In a deeply interconnected world, disruption on this scale has not been seen before which leads to practical difficulties in reliably analysing the effects across the economy and therefore forecasting future trends accurately. The Office for Budget Responsibility (OBR) acknowledged this difficulty in light of the exceptional circumstances when it presented a grim forecast in November 2020. It projected that the decline in GDP would fall by 11% by the end of 2020 - 'the largest drop in annual output since the Great Frost of 1709'⁴ - with the deficit expected to reach £394 billion. Indeed, OBR's forecast does not expect the economy to recover to pre-COVID levels before the end of 2022.
- v. The restrictions on business opening and individual movement (lockdown) imposed a significant effect, in many cases completely disrupting an individual or business' ability to generate income. To address this, various initiatives and schemes were introduced with various objectives: provide support; retain jobs; broaden access to forbearance across multiple sectors and so on.

- vi. For businesses that were struggling financially as a result of the pandemic, the Government also introduced schemes to facilitate rapid and easy access to credit and conceptually similar 'protections' or concessions for existing outgoings.
 - '**CBILS**' (Coronavirus Business Interruptions Loan Scheme) was established with an 80% Government underwrite offering loans up to £5million aimed at mid-cap firms;
 - '**CLBILS**' (Coronavirus Large Business Interruptions Loan Scheme) for large cap businesses similarly underwritten for loans from £25m - £50m;
 - and a commercial paper '**Covid Corporate Financing Facility**' scheme supporting unsecured debt securities.

The high volume scheme has been the one targeted at small and medium sized enterprises - the Bounce Back Loan Scheme - which is the focus of this policy paper.



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²UK GDP Monthly estimate for [September](#), ONS - 12 November 2020

³See [Figure 2: Breakdown of GDP and its subsectors](#) for April, ONS - 12 June 2020

⁴Page 5, [Economic and Fiscal Outlook: OBR](#), November 2020

NATURE AND STRUCTURE OF BOUNCE BACK LOANS (BBLs)

Although initial official interventions focused on the larger and more vocal sizes of firm, on 27 April 2020 the Chancellor announced the Government would be launching a product aimed at providing access to finance mainly targeted at small and medium sized enterprises (SMEs).

The BBLs launched on 4 May 2020 and immediately proved extremely popular, currently accounting for 94.6% of all loans granted under the Government's three COVID-19 linked lending schemes. By 10 May 2020, some 268,173 BBLs with a combined value of £8.38 billion had been granted. As at 13 December 2020, some 1,431,987 BBLs have been granted with a cumulative value of £43.5 billion (including any 'top ups' to existing BBLs)⁵.

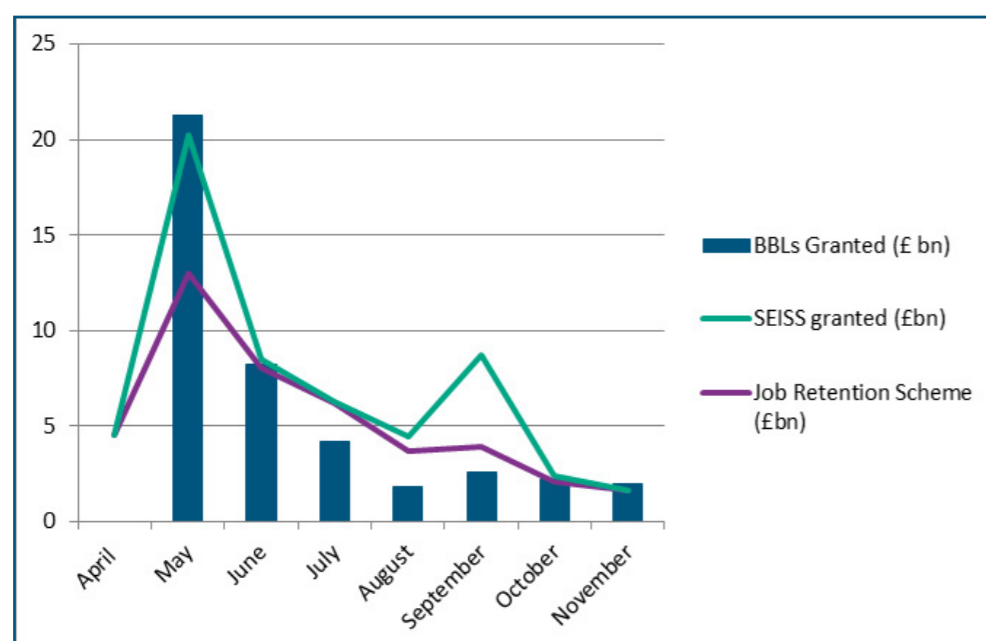


Fig 1: Illustration of BBL lending against support under the Job Retention Scheme and the Self-employed Income Support Scheme (SEISS)⁶.

In broad terms, BBLs were designed by HM Treasury, and operationalised by the British Business Bank as its agent, to provide a route for primarily smaller and micro businesses to access finance rapidly and easily, at a preferential rate to help smooth cash flow pressures. In principle, they are aimed at firms which, but for COVID-19, would otherwise be financially sound. The eligibility criteria underline this by making clear that they are not intended for firms which were already in financial difficulty as at 31 December 2019.

Firms may apply for between £2,000 and £50,000 over six years, with the total borrowed capped at 25% of the firm's turnover if less than £50,000. The loans themselves are offered on highly preferential terms. The interest rate is a flat 2.5%pa with the Government covering the interest cost in the first year. In addition, the requirements to evaluate creditworthiness for those loans regulated under the Consumer Credit Act 1974 were publicly relaxed by the FCA⁷, meaning that firms with challenged financial circumstances as a result solely of the pandemic that would otherwise struggle to access funding will be able to do so.

A further benefit to the prospective debtor is that the lender is not permitted to take personal guarantees, and options for recovery are more limited with lenders prevented from repossessing either principal private home or principal private vehicle. Further details of the general structure of the loans, including eligibility criteria⁸, can be found on the GOV.UK website⁹.

BBLs are also designed to build-in forbearance for firms that are still struggling when repayments become due. If needed, a firm can request and expect to receive any or all of the following measures¹⁰ as part of the 'Pay As You Grow' (PAYG) adjustment to the BBL scheme announced on 24 September 2020:

- Extending the term of the loan from six to ten years;
- Making interest-only payments for a period of six months - this measure may be used three times during the term of the loan; and
- Requesting a six month payment holiday, available once the firm has already completed six months of repayments.

It has been suggested in a Money Advice Trust report¹¹ that HM Treasury should introduce a 'student loan style' repayment arrangement for Government-backed COVID-19 business loans, with repayments linked to future profits. However, given the existing pricing structure is already decidedly favourable, it is not entirely clear whether such an approach in isolation, would be commercially viable or contractually feasible.

The lighter touch approach to evaluating the appropriateness of granting the credit does present a risk of lending to businesses that are unlikely to repay, whether because they are unable or because they are unwilling to do so. Moreover, restricting the use of guarantees and preventing some types of recovery action do limit a lender's ability to recover outstanding sums in the event of non-payment.

⁷[FCA Statement on the UK Coronavirus Business Interruption Loan Scheme \(CBILS\) and the new Bounce Back Loan Scheme \(BBLs\), updated 10 November 2020](#)

⁸Note: Considerable emphasis is placed on self declaration of eligibility presumably to expedite the application process.

⁹[Apply for a coronavirus Bounce Back Loan - GOV.UK \(www.gov.uk\)](#)

¹⁰Introduced for all BBLs from 24 September 2020.

¹¹December 2020 - [Back to business - Supporting people in self-employment to bounce back from Covid-19.pdf \(moneyadvicetrust.org\)](#) Note this approach has also been proposed previously by CityUK.

⁵[HM Treasury Bounce Back Loan statistics to 13 December 2020](#)

⁶ HMRC Coronavirus [statistics](#) [accessed 10 December] for the Self Employed Income Support Scheme

To mitigate this risk, the Government agreed to give a full guarantee to participating lenders covering 100% of the loan in the event of non-payment. In effect, if the debt proves unrecoverable, the Government (with the British Business Bank acting as agent) will reimburse the lender and take responsibility for recovery. This was a crucial feature of the initial discussions with the banks and secured widespread participation.

The giving of guarantees by the Government mitigates the risk to individual lenders, and the restriction on costs and recovery options makes the loans more favourable to the borrowers. **The Government, and thus the taxpayer, has in consequence assumed a considerable potential financial liability. Particularly so given the increased risk of default coupled with the decreased ability to recover outstanding sums and little practical incentive to repay in real terms.**

POTENTIAL MARKET FOR BBLs

SMEs account for some 99% of all private businesses in the UK. Their number has grown in the last 20 years from 3.5 million to nearly 6 million as at January 2020¹², employing more than 16 million individuals and contributing a turnover of about £2.2 trillion to the UK economy. They are, therefore, of immense significance to the UK economy and to the households that directly rely on them.

Small businesses have long been recognised as having a number of facets in common with consumers – vulnerability, decision-making, financial resilience and planning amongst others. This is unsurprising given that many of the 4.4 million SMEs¹³ without employees will be self-employed individuals. Predictably, there will also be a co-mingling of personal and business finances to varying degrees thereby increasing the risk of financial instability. Indeed, some pieces of consumer protection legislation do treat small businesses as at the same risk as consumers and therefore that they should have broadly comparable protections as consumers receive¹⁴.

As official statistics show BBLs have proved popular, with almost 1.4 million of SMEs having taken up the offer, or nearly a quarter of the total estimated in 2019 by BEIS¹⁵. Nevertheless, it cannot be inferred that take up of BBLs necessarily reflects financial difficulty. The loans may be used for a broad range of purposes¹⁶ and anecdotal evidence would suggest that they have not only been used for supporting businesses under COVID-19 related strain. Reports suggest that they have also been used for writing down personal liabilities. Given that SME finances are often co-mingled with personal finances, exchanging more expensive credit for cheap credit with especially favourable repayment terms would be a sensible approach even in more stable and prosperous times. Bank of England data from

October 2020 suggests that while large non-financial businesses repaid £6.7bn in loans that month, SME borrowing including BBLs has soared through 2020, up by nearly 24% in October on the same month in 2019¹⁷.

While borrowers were asked to self-certify that loans should be used for the “economic benefit of my/our business” and “wholly for business purposes and not personal purposes”, these are very broad and undefined concepts and there is as yet no oversight over the uses to which BBLs are being put, suggesting that funds can be put towards expenditures which are by choice rather than by necessity. Anecdotal evidence suggests that in a minority of instances funding may have been put to ‘elective’ uses such as acquiring new non-essential vehicles, luxury commodities and other investments. It remains unclear how or if lenders will review loan usage to verify the self-certified declaration.

What the BEIS figures do not capture is a sense of how many SMEs have left the market or have been otherwise dormant while adverse trading conditions have prevailed. The latest ‘wave’ of the ONS Business Impact of Coronavirus Survey (BICS)¹⁸ suggests that around 82% of SMEs are actively trading to some degree. 18% are either dormant, dormant with an intention to restart in the near future or have ceased trading, permanently or for the moment. These figures are described as ‘experimental’ and there may be some overlap between these and the number obtaining a BBL. At present, however, the uncertainty as to how future events and economic performance may play out means that it is impossible to forecast what the size of the SME population might be in the future. However, a MAT/Opinium Research survey in September 2020 found that 29% of self-employed and SME owners said they were “not confident they would be able to repay their loans”.

A survey of over 2000 self-employed and SME businesses by Money Advice Trust in conjunction with Opinium Research in September 2020 found that 29% of respondents said they had already “fallen behind on one or more bills”, principally in their personal finances and chiefly on credit cards. One in five of these small traders reported they had ceased trading entirely during the COVID-19 crisis. The same survey reported that 48% said they had received some form of Government support with one in ten reporting they had received government-backed loans.

The pandemic has created unique and widespread challenges. The Government has attempted to soften the blow by introducing support mechanisms on multiple fronts both for businesses and for individuals. For smaller firms this has included the introduction of BBLs. However, BBLs have significant structural weaknesses that will require careful thought to address before these weaknesses crystallise as problems. It will be critical for Government to act as swiftly as possible.

¹²Figures from the Department for Business, Energy and Industrial Strategy [Business population estimates for the UK and regions: 2019 statistical release \(HTML\) - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/statistics/business-population-estimates-for-the-uk-and-regions-2019)

¹³Ibid. See Table A – 4,457,820 estimated as having no employees.

¹⁴For example, under the Consumer Credit regime for lower value borrowing.

¹⁵BEIS – Business population estimates for the UK and regions 2019 [footnote 8 for link]

¹⁶If the borrower is an incorporated entity then the company officers will need to have regard to what is reasonable behaviour in this respect.

¹⁷<https://www.bankofengland.co.uk/statistics/money-and-credit/2020/october-2020>

¹⁸Wave 19 for the period 19 October to 1 November 2020, ONS

CHALLENGES & RECOMMENDATIONS

GENERAL

The overarching objective of BBLs, as with many of the Government's economic interventions, is an important attempt to relieve the exceptional pressures that businesses find themselves in as a result of the pandemic and which they could not have planned for. They are a counterpart to the similarly focused interventions aimed at supporting individuals in difficult circumstances: the Job Retention Scheme, additional benefits, enhanced forbearance options for a variety of costs, short term protection from eviction, and so on.

With necessary steps to protect the health of society in many cases restricting the opportunity to generate income, formal support mechanisms are absolutely the right thing to do for business. But policymakers must have an eye to 'what comes next'. **Having provided for these support mechanisms to be available, how does the Government ensure that it is also thinking of mitigating the risk to the taxpayer? Squaring this circle carefully – supporting the economy while simultaneously safeguarding the interests of the taxpayer as creditor of last resort – is the challenge facing Treasury Ministers and the British Business Bank.**

A significant part of that will be in how the Government approaches the collection of BBLs. While that was clearly, and understandably, not the only consideration in its mind at the time BBLs were designed, Government has a responsibility to ensure that public funds are well spent, not risked unnecessarily and such risks as there are, are appropriately mitigated to the furthest extent possible.

It is also important not to lose sight of the cost of indirect intervention. Requiring businesses to forego rights or defer payments for firms in difficulty, even temporarily, may seem superficially attractive, but these still carry short, medium and long term risks that need to be recognised and taken into consideration alongside the more visible risks from direct intervention.

In the consumer space the FCA¹⁹ has imposed an effective six month 'on demand, no questions asked' deferral on credit and mortgage payments. This approach has many of the same general problems, including uncertain downstream effects, as direct Government intervention in the SME space. Surprisingly for a market regulator, as yet there is no indication as to what the FCA thinks longer term effect on products, providers, markets and in the longer term future customers, might be as a result of its intervention.

Exceptional times clearly call for exceptional solutions. Prompt support where it is needed is absolutely critical, as is the moral imperative for all market participants, whether consumer or business, to support each other and the wider recovery. However, that should not prevent support mechanisms introduced in haste from being reviewed after the fact and the problems identified from being addressed quickly. We believe that there are a number of such issues in relation to BBLs.

¹⁹Press Release: [Support for consumer credit customers impacted by Coronavirus](#). Financial Conduct Authority, 19 November 2020

DEFAULT RISK

Default risk is the risk that the borrower does not repay the loan. Every loan carries the inherent risk that a loan may not be repaid though in practice lenders ordinarily use a wide range of information to determine whether a prospective borrower is likely to repay and whether they are likely to be able to do so sustainably – this is called a creditworthiness assessment. A core component of that assessment will be to consider the prospective borrower's financial position, including projected income and expenditure and the sustainability of repayments over the lifetime of the loan.

There is considerable variation in precisely how this is done under normal circumstances and what level of 'risk' an individual lender is prepared to accept in lending for the particular product. Perceived risk in the borrower will often influence price and, since non-payment normally incurs a cost to the lender in pursuing outstanding payment, a contract will normally provide for the borrower to be responsible for the cost in recovery which in turn prevents those costs from being passed to future customers.

Creditworthiness assessments are not a feature of BBLs²⁰ which is logical. The financial position of firms experiencing pandemic related difficulty might well not pass such an assessment. Those in such a situation that did pass would undoubtedly pay a higher cost for the borrowing as lenders attempted to mitigate the higher risk of default and higher costs associated with that. But 'rate for risk' is also not a feature for BBLs.

The normal mechanisms to mitigate such risks such as higher rates of interest and provision for costs in recovery are absent. As a result there are two conclusions that can be drawn: (i) that the rate of default will be substantially higher than for conventional lending and (ii) that the interest rate is less likely to cover the cost to the lender of taking steps to recover without eroding the value of the loan.

To facilitate lending under those conditions, the Government has given a guarantee of 100%. In essence, whatever is not paid to the lender by the borrower will be paid by the Government. Put another way, **if 100% of the BBLs granted to 13 December were to default without payment, the cost to the public purse would be £43.5 billion, or more than a tenth of the projected deficit at the end of 2020²¹.**

²⁰British Business Bank, FAQ information on BBLs – [Am I eligible?](#) (accessed 10 December 2020 – 'The application form also requires confirmations to be given in relation to losses that may be incurred, impact on credit rating, financial risk to personal assets (other than primary residence and primary personal vehicle), reduced consumer protection provisions, data protection consents and **that lenders will not assess affordability**'

²¹Paragraph 1.4, [Economic and Fiscal Outlook: OBR](#), November 2020

As BEIS rightly notes in its annual report²², not all loans can be expected to default. It acknowledges that the unusual design of BBLs means that projecting default rates is extremely difficult. Nevertheless, it estimates losses to be in the range of 35 – 60%. Fig2 below gives a sense of how significant this could be financially for the public purse with losses of between £15 billion and £25 billion.

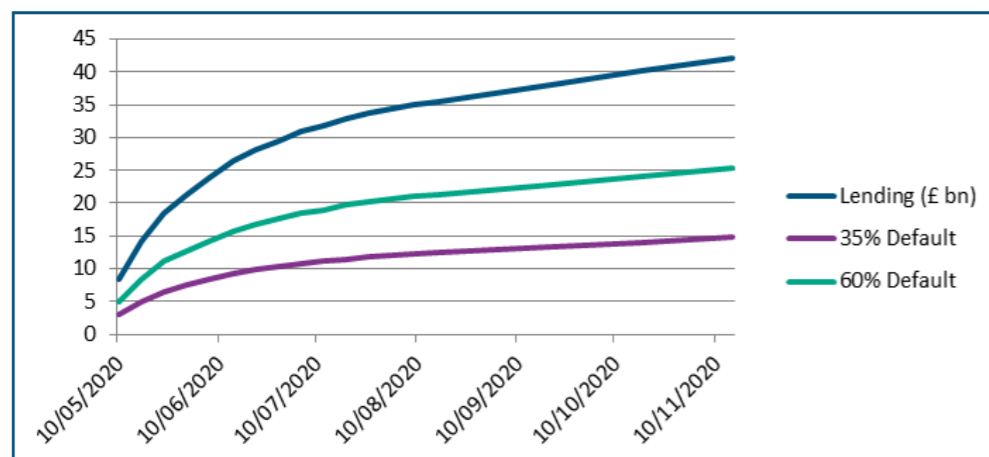


Fig 2: 35% and 60% default rates as a proportion of the total lending based on BEIS projections

A report by the CityUK Recapitalisation Group²³ takes a slightly more favourable view of default rates but still projects a potential failure rate of between 35% and 40% (£14.8 and £16.9 billion).

It is unclear whether these analyses also take into account how BBLs are viewed by those taking them out. As we have noted, small businesses can have similar behaviours to consumers and therefore can mislead themselves. There has been much online commentary on whether BBLs require repayment and what the consequences of non-payment are. As such it does seem that there are persistent perceptions of BBLs as either grants or ‘free money’ despite statements to the contrary²⁴ and a fundamental misunderstanding about the 100% Government backed guarantee.

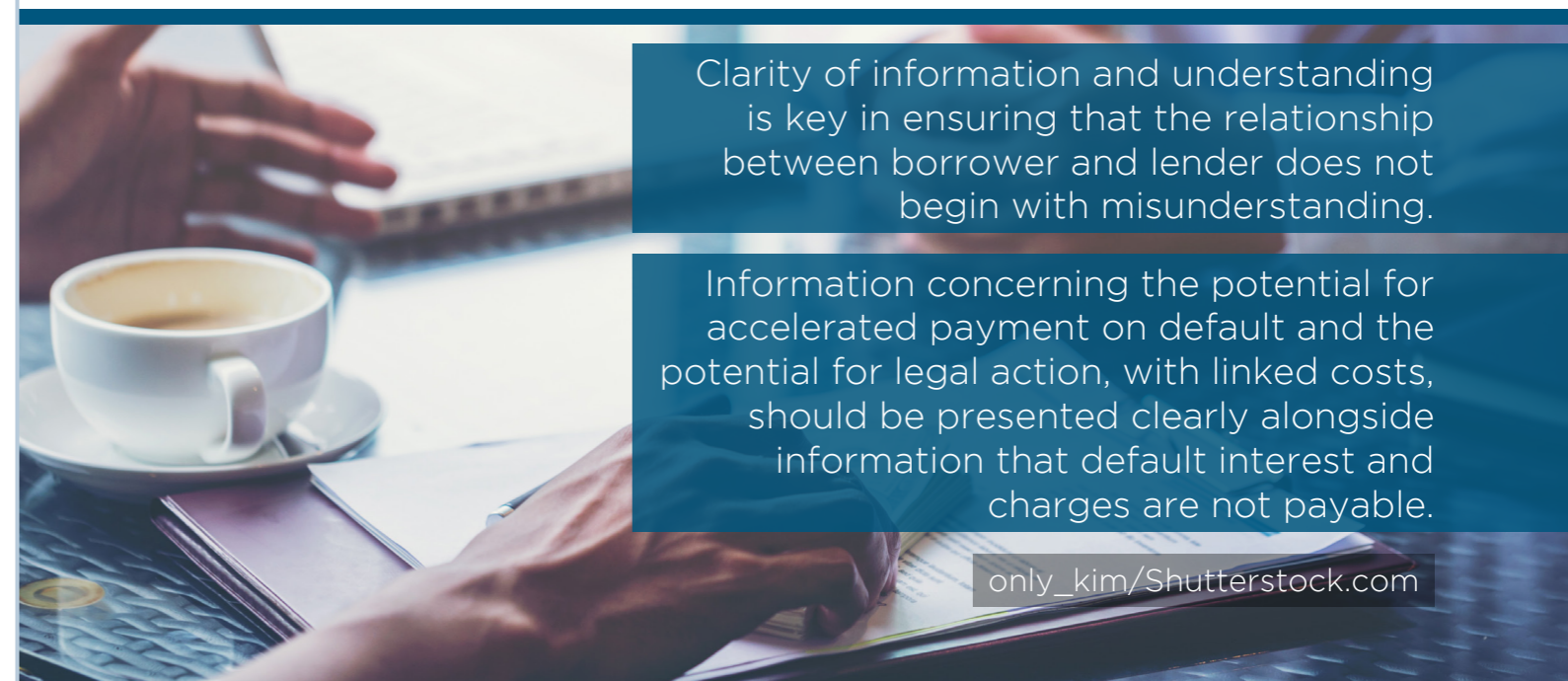
A survey of websites for six high street lenders offering BBLs showed that all six referenced the 100% guarantee, three of these did so prominently. Of these, only half noted with equal prominence that the guarantee was given to the lender not the borrower. All six emphasised that there were no fees or charges for non-payment in the key features of the loan but noted elsewhere that the borrower would be liable for costs associated with taking legal action to recover the debt. In five out of six cases, information regarding the potential for missed payments to trigger a demand for repayment in full, the potential for legal action and scope for legal costs to be identified was at some distance from statements regarding default fees or default interest.

Our recommendation: Clarity of information and understanding is key in ensuring that the relationship between borrower and lender does not begin with misunderstanding. No reference should be made to the 100% Government guarantee in marketing information for BBLs. It seems clear that there is scope for firms to misunderstand what this means in practice or to assume that this means in practice their debt would be written off.

Information concerning the potential for accelerated payment on default and the potential for legal action, with linked costs, should be presented clearly alongside information that default interest and charges are not payable. The near identical presentation and positioning of this information suggests that this is in response to a requirement imposed on lenders. If so, the Government should take steps to amend any requirement as a matter of urgency.

We also noted references to rights of set off which, bearing in mind that lenders seem to be prioritising applications from their existing customer base, presents a clear risk to the borrower if exercised injudiciously.

Our recommendation: The most critical step that Government can take in making the BBL scheme as effective as possible, and which relates to all of our recommendations, is to **ensure an absolute consistency of policy** in relation to the whole of the transaction. Controlling some aspects of information provision but not others, some aspects of contractual arrangement but not others, and so on, can result in suboptimal or inconsistent outcomes. Similarly, given the anticipated scale of delinquencies, it is crucial that the Government determines now how it intends to deal with these situations on a consistent basis, and ensuring that the best possible outcomes are achieved for those businesses that are unable to repay.



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²²Section 28, page 223 [BEIS Annual Report 2019-2020](#): 30 September 2020

²³[Updated Estimates of UK Unsustainable Debt](#): The CityUK Recapitalisation Group, September 2020.

²⁴See, for example, the Frequently Asked Questions for BBLs on the British Business Bank website or the loan characteristics explained on BBL lender websites.

COLLECTION ACTIVITIES - GENERAL

The BBLs are structured in such a way that the normal charges and interest that would cover the cost of defaults, including collection costs do not apply. Moreover, the preferential loan rate of 2.5% is unlikely to cover the cost of collection, especially given the expected scale of BBL delinquency. That creates a number of potential practical problems.

Various failure rates have been suggested: 35%, 40% and as high as 60%. Given the number of BBLs granted as at 15 November 2020, that could mean defaulting agreements between 489,000 and 838,000. While these will not fall simultaneously, it seems likely that many will appear early in the repayment cycle. Policy makers should therefore be carefully considering whether the relatively small number of accredited lenders will be able to respond to a significant influx of instances of default or difficulty over a short period.

At a practical level, lenders will normally have a finite staff resource with the requisite knowledge and skills to respond appropriately. It must be remembered that lenders will have a multiplicity of existing relationships with their business customers (for example, other lines of credit such as start-up loans, bridging loans, trade credit for cash flow, vendor finance, factoring or asset finance) and the BBL could well be merely one piece of that relationship jigsaw.

There are, of course, existing mechanisms to bring in additional trained resource as already happens from time to time. 'White labelled' or 'outsourced business processes' are a common feature of lending markets and that expertise and resource, particularly given the likely wider demands for forbearance across multiple product lines. It is important that policymakers do not cut across those existing mechanisms.

There is some anecdotal evidence to suggest that firms are using the low interest BBL facility to pay down or settle other commercial loans (and indeed personal ones), so there has already been an impact on the commercial lending market. A bank's willingness to default a customer on a BBL will therefore be considered in the wider context of other outstanding loans across the system. Some have noted that there is perhaps a greater incentive for banks to show forbearance to their existing customers and show easing on their wider exposures to protect their position in other loans, than with those for whom the BBL is their only transaction.

It is essential that Ministers and the BBB commit to a thorough collections strategy, aware that there is ample evidence of the difference made to recovery rates where an active approach is taken, engaging with borrowers early and regularly, and keeping in dialogue to ensure that all options of forbearance or repayment plans are discussed so that a shared solution can be agreed and maintained. With the scale and extent of business loans undertaken, it will be critical that policymakers deploy best practice and all endeavours in achieving a satisfactory level of BBL collections.

Our recommendation: Government must safeguard the taxpayer's interest by ensuring that a continuous dialogue is maintained with all BBL customers as much as possible, rather than leaving those customers without contact or engagement for a prolonged period. If it is true (as some estimates provided privately to us suggest) - that a fully engaged commercial collection book could yield 30p in the pound versus just 15p in the pound if that book is left with minimal contact for two years before recovery efforts are attempted in earnest - that could represent a difference of between £3bn and £6bn for the Exchequer. In other words, **if the Government pursues an active collections strategy consistently for the next three years, it could save the taxpayer the equivalent of the NHS annual capital budget allocation²⁵**, or a penny on the basic rate income tax.

A clumsy and ill-coordinated collections strategy, which is not sufficiently supportive, may merely serve to undermine the benefits of the scheme by driving firms into intractable difficulty and failure. An inability to repay does not necessarily mean that a business will fail if the collections strategy is calibrated correctly and appropriately supportive. Supporting economic activity and employment by attempting to find flexible solutions before pursuing litigation is a vital component.

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COLLECTIONS - INITIAL PHASE

It is inevitable that some loans will fail, and perhaps far more so with BBLs given both what they are attempting to achieve and their structural weaknesses. By the same token, recovery through the courts will not necessarily be the most effective or appropriate approach in every case. BBLs include some 'on demand' forbearance options but these will not necessarily be appropriate or sufficiently flexible in many cases. The ability to obtain a payment holiday might provide a brief measure of relief but could simply move the problem further into the future, potentially compounded if the borrower does not take the opportunity to carefully evaluate their situation realistically and the next steps.

A key part of an effective collections strategy is in establishing and maintaining effective communication above and beyond the formulaic presentation of account based information. This helps the lender or collector build a picture of the individual circumstances so that support can be targeted. It provides an opportunity to dispel myths and/or create a window to provide support. It can also be critical in dealing with misperceptions. We have already commented on the scope for the way that BBLs have been presented that may create misunderstandings, but an approach that does not tackle these misunderstandings will create difficulties in ensuring effective collection activity. By effective collection, we mean that the interaction is realistic but supportive, building the relationship.

So far we have only touched on communications with those unable to repay. Government must also think carefully about communications with borrowers that are unwilling to repay or believe that they do not have to. There is, for example, a common thread on internet-based commentary for BBLs that emphasises that there is little that will happen in the event of non-payment beyond a possible negative effect on credit files. A popular question on search engines is whether the Government will simply write off the loans. The marketing of BBLs has also emphasised the relatively low risk of further cost or action in the event of non-payment.

Of course, emphasising the limited consequences for non-payment does not necessarily mean that the majority have no intention to repay their BBL. But this is nevertheless a risk and one which will certainly be exacerbated by media commentary, policy inconsistencies to addressing outstanding accounts, and discussions on web forums and the like. This is not a new phenomena and similar issues and behaviours have been found in consumer markets over the last decade.

Our recommendation: In order to enhance the level of active engagement and optimise repayment levels, we recommend that **the Treasury invest £10million in a 'BBL Engagement Scheme'** in each year until 2024, to supplement the normal recovery contact processes pursued by the banks prior to the trigger of the BBL guarantee, and to ensure continuity of customer contact post-guarantee. The National Audit Office (NAO) estimate that £20million has been the cost of administering BBLs in the first year of operations²⁶ and it is reasonable to expect at least half this cost as an ongoing supplement to basic contractual recovery expenditure going forward. By taking this 'invest-to-save' approach, we believe that the taxpayer can recoup many billions more in repaid BBLs than would otherwise be the case.

²⁶<https://www.nao.org.uk/wp-content/uploads/2020/10/Investigation-into-the-Bounce-Back-Loan-Scheme.pdf> - The estimated £10m Engagement Scheme would be in addition to the Business as Usual operational cost estimates already set out in paragraph 2.13 of this NAO report.



COLLECTIONS - THE GUARANTEE

The guarantee also presents an interesting question in terms of lender behaviour. If the structure of the loan is such that it lessens the incentive to repay on the borrower side, what incentive is there for a lender to engage robustly with those that have not paid?

Agreements would normally provide for the cost dealing with non-payment to be recoverable, but this is not the case for BBLs. Indeed, there is no mechanism for lenders to recover the additional cost of pursuing outstanding debts with the exceptions of enforcing through the courts.

Put another way, **it is often forgotten that collection activities are not without cost. Ordinarily, those costs are either passed on to borrowers that generate them or can be priced into the loans generally, which necessarily makes the loans more expensive for all borrowers and therefore potentially affordable to fewer.** The structure of BBLs prevents both pricing for risk (the interest charge is already capped) and applying additional default charges is prevented thus limiting a lenders ability to address the increased cost. As such, extensive collections activity potentially erodes the value of both capital and the charge for borrowing. **Although they are expected to take their normal approaches to recovery, from a lender perspective it would be entirely rational to make relatively basic attempts, by comparison to the often extremely lengthy efforts, to engage with the borrower before turning to the guarantee.**

Setting aside the cost consideration, we believe that collection rather than litigation has the best chance of both providing ongoing support to firms with BBLs and of minimising the risk to the taxpayer. It will therefore be important to carefully consider the most efficient and effective approach to doing so.

If the structure of the loan is such that it lessens the incentive to repay on the borrower side, what incentive is there for a lender to engage robustly with those that have not paid?

Our recommendation: The approach that lenders will adopt to collection is, as yet, unclear beyond references to their 'normal approach'. However, the anticipated volume of non-payment in relation to BBLs, and at a time when lenders will also be facing increased calls for support in relation to conventional product lines, may stretch resources beyond capacity. It is important that the Government consider three points.

- First, Government should settle recovery practice clearly and transparently now so there is consistency throughout the lifecycle of the collections process. **Best practice in recovery and forbearance standards** in commercial lending should be pursued by creditors and the BBB, and any firms engaged in that collections process. This should include additional flexibility in forbearance options beyond those included in the BBL structure, supportive engagement, reasonably understanding the borrower's individual circumstances and ensuring that any escalation is reasonable and proportionate in the circumstances. Litigation should only be pursued as a last resort.
- Second, HM Treasury and the BBB should work with the banks before payments are due to commence in June 2021 on a **single consistent policy for the long term approach to collections**, from the creditor exercise, through the period after guarantees are triggered, and beyond any book sale by UK Government Investments (UKGI) thereafter. A consistent policy is essential to minimise the 'moral hazard' for the taxpayer, because if BBL customers believe that their debts are likely to be 'written off' after a particular period, this will seriously disincentivise repayments being made on time, if at all, and disincentivise effective creditor collections in turn. The Government should make clear that it will pursue repayments, subject to best practices in forbearance tailored to the individual circumstances and assessed affordability of a company or individuals to repay as part of the collections process.
- Third, **Government should engage with those that already have expertise and ability to support these activities.** While there is a need to adopt a transparent and cohesive approach to collections sooner rather than later, Government should take care not to reinvent the wheel. There is ample industry experience in working with those in difficult circumstances and Government should ensure that it engages fully with that expertise to secure the best outcome for both the borrower and the taxpayer.

The importance of clarity and consistency has been thrown into sharp relief by the somewhat confused approach adopted so far to recovery. The Government's Winter Economy Plan²⁷ very clearly paints a picture of 'pay as you grow' options being, in effect, rights that the borrower can exercise at will to access forbearance and the lender must provide. The FCA, by contrast, seems to suggest in its draft guidance for those agreements and firms it regulates, that these are options that lenders can use²⁸ to show forbearance. A further complication is that the draft FCA guidance has limited application as the document only partly acknowledges that not all BBLs are within the scope of the FCA's regulatory competence to set rules or recognise external 'proper standards of market conduct' even indirectly. Even for those situations that are within the FCA's sphere of influence, it is unclear that it has fully considered the wisdom, and indeed practicalities, of applying standards and approaches designed for purely consumer transactions to those that are purely commercial. A muddled and incomplete approach to supporting those experiencing difficulties in repayment will simply exacerbate problems further down the line.

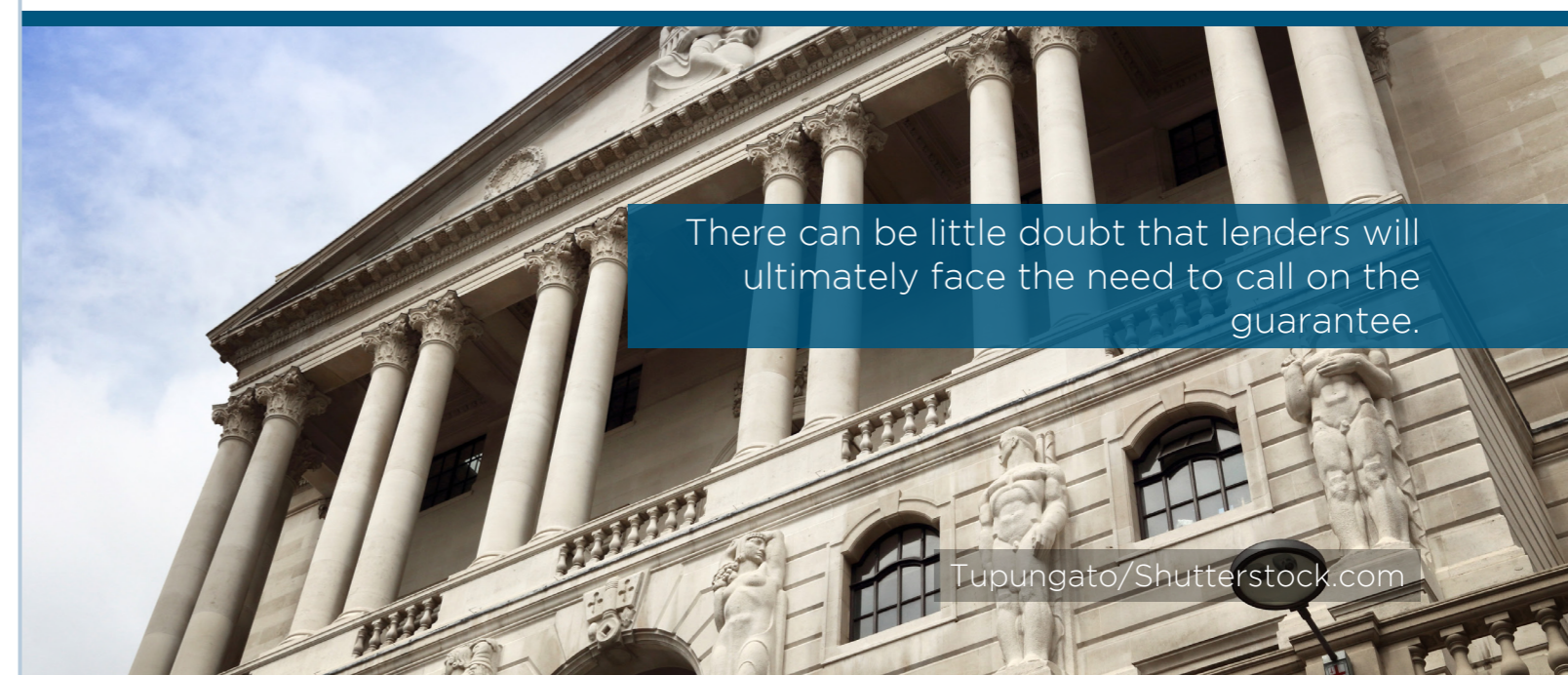
While there are fairly obvious gaps in setting of appropriate and materially practical and relevant standards in terms of recovery before the guarantee is activated, a further gap is in harmonising the approach with what happens after the guarantee is activated. At that point, Government rather than industry will be responsible for deciding collection approaches, which presents two challenges. First, as Government has tacitly acknowledged in its recent call for evidence²⁹, Government sector collection activity can sometimes be less supportive than similar private sector activity. Second, Government will by that point be faced by the need to balance the interests of the debtor with the interests of the public purse. As such, there is ample scope for divergence or inconsistency in appropriate recovery practices between pre and post guarantee activation phases.

COLLECTIONS - AFTER THE GUARANTEE

There can be little doubt that lenders will ultimately face the need to call on the guarantee. The sheer scale of lending to date will undoubtedly have had an effect on the liquidity position of the lenders themselves and the expected scale of failure will mean that there will be a need to reduce exposure to non-performing loans.

There is limited publicly available information concerning the features of the guarantee, how it will function in practice and when it might be engaged. Following the trigger of the creditor 100% guarantee, it will be important that loans reverting to the BBB continue to be engaged with and the recoveries process remains live. We believe that **the BBB should commit to a second round of collections under its auspices**, prior to any onward book transfer for sale via UKGI. Moreover, in order to maintain consistency of dialogue with customers and continuity of records and processes, it would be preferable if those Debt Collection Agencies (DCAs) engaged in collections by creditors prior to guarantee trigger could continue that second round of processes on behalf of the BBB, if that were most appropriate in the circumstances. This would help maximise the recoveries made on behalf of the taxpayer.

Retaining the involvement of any DCA already appointed may be beneficial from the perspective of ensuring continuity for the borrower. Contrary to popular myth, successful collection activities rest on developing and maintaining workable relationship rather than a single-minded dash for collection at any cost. As such, where a DCA is already involved it will likely have taken steps to build a rapport with the borrower and to understand its position. Experience shows that this approach minimises disruption to the borrower and maximises returns to the creditor, so disrupting a paying arrangement unnecessarily is usually counterproductive.



There can be little doubt that lenders will ultimately face the need to call on the guarantee.

²⁷Winter Economy Plan, section 3.2: 'The government will give all businesses that borrowed under the BBLs the option...'

²⁸Bounce Back Loan Scheme - Pay as You Grow options and CONC 7 compliance: FCA Draft Guidance for consultation, December 2020, paragraph 2.5, for example.

²⁹'Fairness in government debt management', Cabinet Office, June 2020.

FRAUD AND LOSS

The final risk that BBLs presents is that of fraudulent applications. It has been expected that, given the speed with which the BBL scheme was created and the significantly reduced vetting process that it mandated, fraud would be a significant feature of the BBL scheme. Indeed, commentators on fraudulent claims in relation to the unrelated Job Retention Scheme highlighted that other support mechanisms, including the BBLs, would likely be similarly affected though it might take more time for this to become apparent.

The NAO in its investigation of BBLs referred to the scheme as ‘the largest and most risky business loan support scheme’³⁰ though the NAO made clear that such a risk was anticipated from the outset. It does not separately estimate the scale of fraud but notes instances of fraud are factored into the Government’s wider estimate of failed agreements.

In evidence given to the Public Accounts Committee³¹, it was suggested that almost 27,000 suspected fraudulent transactions with a combined value of £1.1 billion had been rejected. Assuming that figure relates to BBLs applications made to 18 October 2020 (the next data point was 10 days after the hearing on 15 November), this would mean that of the 324,525 applications rejected, about 8% were identified as being potentially fraudulent.

There is currently no estimate for the proportion of loans granted that might ultimately be revealed to be fraudulent, though in the same hearing it was disclosed that a fraud sampling exercise was being undertaken and completion was expected before Christmas. We have noted, however, that the Government has been quick to draw on the expertise of those organisations responsible for pursuing fraudulent activities and to convene fora within which lenders and others can share expertise and experience. This is not only an important part of securing the integrity of the BBL scheme and safeguarding taxpayer resources, but also sending a clear signal that improperly obtained BBLs will not be ignored and that repayment will be pursued in such cases.

Our recommendation: In order to maximise the value for the taxpayer from any onward sale of the legacy BBL book from 2024 and beyond, assuming that there is a market for sale and purchase, it will be essential to reach a reasonable view as to what the level of fraud there was in respect of loans granted. It will be necessary to disclose such information at sale and that UKGI indemnify potential purchasers against fraud that may have occurred but not been detected at the point of portfolio sale. There is no specific estimate available for fraud but the NAO suggest that, in the case of BBLs, the level of fraud is likely to exceed the Cabinet Office upper range for similar schemes of 5%, which in the case of BBLs would be at least £2bn³². **UKGI should provide a warranty for those purchasing BBL debt from the Government against fraudulent activities.**

³²<https://www.nao.org.uk/wp-content/uploads/2020/10/Investigation-into-the-Bounce-Back-Loan-Scheme.pdf>



In order to maximise the value for the taxpayer from any onward sale of the legacy BBL book from 2024 and beyond, assuming that there is a market for sale and purchase, it will be essential to reach a reasonable view as to what the level of fraud there was in respect of loans granted.

³⁰[Investigation into the Bounce Back Loan Scheme - National Audit Office \(NAO\) Report](#) 7 October 2020

³¹Question 27 [Transcript, Public Accounts Committee hearing](#), 5 November 2020

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ABOUT THE CSA

The Credit Services Association (CSA) is the only National Trade Association in the UK for organisations active in the debt collection and debt purchase industry. The Association, which has a history dating back to 1906, has over 300 member companies which represent 90% of the industry, and employ approximately 11,000 people. At any one time its members hold up to £67 billion for collection, returning nearly £4 billion in collections to the UK economy per annum. As the voice of the collections industry, our vision is to build confidence in debt collection by making the entire process clear, easy to understand and less stressful for all those involved.



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In this paper we consider Business Bounce Back Loans (BBLs): what they are, how they are designed; what some of the challenges that they present might be and how Government could approach resolving these potential pitfalls to try to ensure that what was introduced as a desperately needed support mechanism for some of the six million SMEs with a turnover of £2.2 trillion contributing to the economy, does not become a burden to the taxpayer, a drag on economic recovery and a poison chalice to those that took them out.