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BOUNCE BACK LOANS

A FINE BALANCING ACT FOR LENDERS

Introduction and overview

Back in 2020, the Government introduced a number of schemes to enable businesses to continue trading during the Covid-19 pandemic.

These Whitehall-led initiatives, designed for business survival, recovery and growth, included the Bounce Back Loan Scheme (BBLS), the Coronavirus Business Interruption Loan Scheme (CBILS), the Coronavirus Larger Business Interruption Loan Scheme (CLBILS), and the start-up focused, Future Fund.

Across all four schemes, over £76 billion worth of loans have since been approved up to March 2021. The BBLS represents the largest proportion with a value of £46.5 billion and £1.5 million worth of loans being approved. The BBLS has been recognised as a success as it has helped to stave off the initial economic shock of lockdown by providing a lifeline for many SMEs.

It has, however, also built mountains of debt for SMEs and there remains significant concerns about how borrowers will be able to meet their repayment obligations.
The BBLS was established in response to wide criticism of the other larger schemes, the CBILS and the CLBILS, which typically require personal guarantees and a lengthy application process.

What made the BBLS scheme more appealing was because they were intended for SMEs, micro businesses and other organisations requiring smaller loans of between £2,000 and £50,000. With an interest rate of 2.5% per annum, and repaid over a six-year period, there are no set-up fees and no repayments or interest payments during the first year.

These loans will also be 100% backed by the Government Guarantee to the Scheme lenders, unlike the CBILS and CLBILS versions which are only 80% backed.

A series of further measures were also implemented later under the Pay as You Grow Scheme which was designed to further help borrowers, including extending the term of the loan from six to 10 years and allowing for interest-only payments and payment holidays.

So, what are the next steps for these complex schemes? How can a balancing act be struck between the Government and lenders as we move forward?

There are vital questions to be asked and answered and this whitepaper aims to provide the key talking points, the background on the current landscape, the risks, and the potential solutions.

An uncertain landscape for borrowers and lenders and evolving risks

The full economic cycle impact of the pandemic has yet to hit, primarily due to the support measures such as these Government-backed loan schemes, as well as furlough, VAT and rent deferrals – not forgetting restrictions on statutory demands and winding up petitions. As well as needing to start repayments on Bounce Back Loans, many SMEs have also built up significant additional liabilities, such as delayed tax payments, deferred rent arrears and trade debts.

The Government Guarantee means Bounce Back Loan Scheme lenders are not taking the credit risk themselves on failed loans but as administrators of the scheme, lenders face significant administrative costs, reputational concerns, and refinancing risks. Lenders also face the implied public expectation to assist the economic recovery by helping SMEs to best manage all options available to them and ultimately to try help them transition back to growth.

The National Audit Office has said that: "lenders are required to pursue 'appropriate recovery tprocesses' and the scheme terms give lenders a 12-month time limit after they have issued a formal demand on the borrower to pursue outstanding amounts … claiming on the Government Guarantee is not conditional on having completed the recoveries process – lenders are able to make a claim on the Government Guarantee 'within a reasonable time period' following the first formal demand date, or sooner, if lenders believe no further payment is likely."

HM Treasury and the British Business Bank (BBB), the Government's development bank which is administering the scheme, have advised lenders to use their normal approach to collections on the loans and made it clear that banks will bear the responsibility of pursuing delinquent borrowers. However, the Treasury initially also instructed banks not to perform their standard credit checks, apart from basic viability and fraud screening, to speed up the payments and help stave off bankruptcy for companies.

Because of this approach, a significant number of Bounce Back Loans granted would not normally have passed the credit vetting processes of the 29 accredited scheme lenders. The high level of fraud associated with the BBLS is also a concern. Meanwhile, a third-party review commissioned by the BBB found that there is a 'very high' level of fraud risk, caused by multiple applications, lack of legitimate business impersonation, self-certification and organised crime which has also blighted other sectors in the past 12 months. Additionally, the Department for Business, Energy and Industrial Strategy and the BBB also originally estimated that between 35% and 60% of borrowers may default on their Bounce Back Loan.

Key considerations for lenders

Conversations continue between lenders, Government representatives and regulatory bodies to standardise the lending approach to deal with BBLS defaults but these discussions are far from concluded.

Moving forward, lenders will face a significant administrative burden which will require a considerable amount of resources and time - even if they do not pursue the normal full cycle recovery process.
At a time when earnings remain under pressure and credit provision levels remain high, they will need to hire a considerable amount of collections experts. Lenders are feeling the pressure due to the economic downturn, and this will only increase in the coming months as defaults rise and difficult decisions are made. Vitally, lenders will require a more direct approach to hundreds of small businesses who are under the threat of liquidation – but will be expected to do so with more care and consideration.

Whilst lenders will be indemnified from credit risk pursuing debts through the courts for hundreds of thousands of small, often family-run businesses, would be a logistical nightmare and fraught with reputational risk. Lenders will therefore have to formulate a clear view on the target operating model to efficiently service paying BBLS loans for up to 10 years from now. The approach towards first party fraud , bona fide non-paying loans, process to follow before calling on the government guarantee and the duty of care to continue collecting post that require careful planning an consideration.
The accounting treatment of impairment on these loans and the recognition of government guarantees can also be complex.

A consideration for lenders could be outsourcing to provide flexibility as immediate demand and ongoing support requirements are difficult to estimate.
Long term servicing of paying loans and early arrears can also potentially be done offshore at much reduced cost as part of this consideration.

The need for a nuanced approach to identify vulnerability

The FCA Financial Lives coronavirus panel survey conducted last year indicate that many more consumers find themselves in vulnerable circumstances due to the pandemic, with 53% of adults displaying one or more characteristics of vulnerability.
BBLS borrowers will contain a disproportionate high level of financially vulnerable customers compared to the norm due to the nature of the offering designed to help cushion the severe impact of the Covid pandemic on small and medium size businesses.

This will require a high level of care as part of clearly considered approach.
Many of these businesses will have limited funds available and will have some difficult choices to make as to whom and what they pay back – such as choices between a key supplier to keep the business

afloat, pay HMRC or their lender. Very often these customers are not aware of the range of options available to them when experiencing hardship both from their lender and from external free advice and support services. The ability to signpost these options and to maintain customer engagement despite the challenges faced will be paramount to keep engagement. Providing the right level of customer service to support these vulnerable customers and clear communications through multiple channels is expected under the FCA vulnerability guidelines. Many of these owners run businesses also have staff that depend on the continued survival of the business further highlighting the importance to have the right conversations,provide the righ support and present appropriate options to drive the right outcomes.

Summing up

More than anything, there is a huge balancing act to be struck to manage the Government and Lenders interests, ensuring accountability for the repayment BBLS debt, and protecting financial vulnerable individuals and businesses from further harm.
Lenders need to define and implement simplified processes that balance all these needs to ensure a clear and consistent approach for borrowers and taxpayers.
The servicing of these BBLS loans will remain relevant for the next 10 years and lenders will have to try and optimise the quality and the cost of service.
The ability for lenders to identify hardship and vulnerable customers amongst these BBLS borrowers is difficult but critical to get right. Lenders require the right resources, skills and clear customer communication to help provide the right support and options to these borrowers. This can help avoid further harm and any unintended knock-on consequences like further job losses as there is no one-size-fits-all strategy.

About the author

Jaco Snyman is Director of Financial Services at the award-winning Sigma Connected Group.

The Sigma Connected Group offers customer contact centre services across the energy, water, retail, financial services and telecommunications sectors as well as the specialised vulnerability service Reach:Out and the debt control agency Maclaren Credit Services.

Reach:Out is a service that re-connect disengaged and vulnerable customers with their lenders and/or external support and advice services to help them understand the range of options available to drive the right customer outcomes.

Jaco joined Sigma, which has contact centre operations in the UK, South Africa and Australia, in January 2021.

He has held a variety of leadership roles in the financial and consumer finance sectors in the UK and South Africa - including senior positions with PriceWater-houseCoopers and more recently, as Chief Operating Officer of the UK Personal Finance arm of BNP Paribas.

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