National Audit Office

The Bounce Back Loan Scheme: an update

HM Treasury, Department for Business, Energy & Industrial Strategy, British Business Bank plc

REPORT

by the Comptroller and Auditor General

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Key facts

1.5 million
total number of loans issued under the Bounce Back Loan Scheme (the Scheme)

£47 billion
total value of loans issued under the Scheme

£17 billion
the Department's estimated, but highly uncertain, value of losses from loans that will not be repaid (31 March 2021)

£4.9 billion the Department for Business, Energy & Industrial Strategy's (the Department's) most likely, but highly uncertain, estimate of the value of fraudulent loans in the Scheme as of 31 March 2021, based on a sample of 1,067 loans

£6 million the minimum value of fraudulent loans that the Department expects the National Investigation Service (NATIS) to recover from organised crime over three years

£67 million forecast administrative costs for the Scheme for 2020-21 to 2024-25, as of September 2021

£32 million the Department's forecast additional budget to cover the costs of its 'enhanced' counter-fraud operations, regardless of the scale of fraud

What this report is about

1 The Chancellor of the Exchequer announced the Bounce Back Loan Scheme (the Scheme) on 27 April 2020. The Scheme was the largest of three COVID-19 related business support loan schemes (see Appendix Three) and sought to provide to the smaller end of small and medium-sized enterprises (SMEs) a "simple, quick, easy solution for those in need in of smaller loans". The Department for Business, Energy & Industrial Strategy (the Department) launched the Scheme on 4 May 2020, offering loans of up to £50,000, or a maximum of 25% of annual turnover, to support businesses during the pandemic.

2 The loans were provided by commercial lenders (for example, banks, building societies and peer-to-peer lenders) directly to businesses who are expected to repay the debt in full. Government provided lenders a 100% guarantee against the loans (both capital and interest). This means if the borrower does not repay the loan, government will step in and pay the lender. The loans have a fixed interest rate of 2.5% and a maximum length of 10 years. In the first year of the loan there are no capital repayments due, and the government pays the interest – making it interest-free for the borrower.

3 HM Treasury developed the Scheme with the Department and the British Business Bank (the Bank), which the Department owns. HM Treasury and the Department monitor the Scheme and set its overarching terms. The Bank was responsible for implementing the Scheme, for example accrediting lenders to the Scheme before they made loans, and its ongoing administration in consultation with HM Treasury and the Department.

4 We reported on the Scheme in October 2020.[1] At that point, it had delivered more than 1.2 million loans totalling around £37 billion. We concluded that government moved very quickly to set up the Scheme, prioritising one aspect of value for money – payment speed – over all others and was prepared to tolerate a potentially very high level of losses as a result. The Scheme aimed, in most cases, to deliver money to borrowers within 24 to 48 hours of application. It achieved this by removing the requirement for banks to conduct credit and affordability checks before making loans and allowing potential borrowers to 'self-certify' the information they provided on their application. Lenders were required to conduct some counter-fraud checks before making loans.

1 Comptroller and Auditor General, *Investigation into the Bounce Back Loan Scheme*, Session 2019–2021, HC 860, 7 October 2020.

5 The Department recognised the risks to the taxpayer of prioritising speed. Its Accounting Officer (AO) sought and received a Ministerial Direction on the grounds that the spending proposal would breach HM Treasury rules on regularity, propriety, value for money and feasibility. On 1 May 2020, the Secretary of State for Business, following approval from the Chancellor, directed the AO to proceed with the Scheme. The Bank raised similar concerns in a Reservation Notice to the Department and received a written directive from the Department to proceed with the Scheme on 3 May 2020.

6 The Department, with the Chancellor's agreement, extended the original closing date for loan applications from 4 November 2020 to 31 March 2021 to support businesses during the ongoing pandemic. It also introduced options for borrowers to increase the size of existing loans to the maximum amount to which they are eligible ('top-up'), as well as providing the borrowers more time and flexibility to repay ('Pay As You Grow'). These repayment options include extending the duration of the loans from six to 10 years, moving to interest-only payments for six months, and taking a repayment holiday for six months. The Scheme closed for new applications on 31 March 2021, and repayments for the first borrowers started in May 2021. The Department sought, and was granted, approval to amend the Scheme using the same Ministerial Direction and written directive as at Scheme launch.

Report scope

7 This report follows on from our October 2020 investigation into the Scheme. In Part One, we provide a factual update on the Scheme performance information. This includes, for example, the number of loans issued, their total value, borrower characteristics and the Department's estimate of potential Scheme losses. This section does not evaluate the Scheme's performance as the full repayment of loans will not be known for some time.

8 In Part Two, we review the Department's activities to protect public money through its counter-fraud activity for the Scheme. This section provides an update on the Department's latest estimates of Scheme fraud, drawing upon our financial audit of the Departmental accounts. It also evaluates the government's counter-fraud strategy for the Scheme and its activities to date against: our good practice guide on fraud and error;[2] and the guidance from the Government Counter Fraud Function. This section is primarily evaluative in nature because since we last reported the government set out how it will pursue fraud and we have some evidence of how its approach is working.

2 National Audit Office, *Good practice guidance: Fraud and error*, March 2021.

9 In Part Three, we report factually on the process to recover outstanding loans, which had not been finalised when we last reported. We update on the costs of administering the Scheme and the Department's and Bank's plans to evaluate scheme performance. We also draw together information, where available, on the borrower's experience of the Scheme, which was a particular area of interest when the Committee of Public Accounts reported on this Scheme in December 2020. The report does not assess the Scheme's value for money as the outcome for businesses, lenders, and the taxpayer will not be known for some time.

10 The study draws on six main datasets from three different sources, including the Department, the Bank and the Government Counter Fraud Function. These datasets differ in nature and timing and are described in the Appendix One (Figure 15). As a result, not all figures in our report reconcile.

Summary

Key findings

Loans and repayments

11 **The Scheme made 1.5 million loans worth £47 billion, mainly to small and micro-businesses, as of 13 September 2021.** This exceeds the Department's and Bank's estimates at launch that the Scheme would support between 800,000 and 1.2 million businesses with between £18 billion and £26 billion of loans. Around one quarter of all UK businesses received a Bounce Back Loan. Most of the loans – more than 90%, or £39.7 billion – went to micro-businesses (turnover below £632,000), a similar rate to when we reported in October 2020. The seven main UK banks provided most of the loans (90% of the total value of loans made). The remaining 10% of loans by value were provided by other banks and non-bank lenders, such as peer-to-peer lenders (paragraphs 1.3 to 1.5, 3.9 and Figures 3 and 12).

12 **The Department and the Bank have limited evidence on how businesses have used the loans, and their experiences of the application process.** Anecdotal evidence from business representative groups suggests that businesses have found the loans useful to address cashflow shortages during the pandemic but there were delays in the administration. In March 2021, the Bank surveyed 1,700 borrowers, finding that about 70% used the funds for working capital and day-to-day expenses, and about 30% took out the loans for 'financial security'. Around 2,000 businesses complained to the Financial Ombudsman in August 2021, with more than one third of complaints being about a delayed administration of their loan application (paragraphs 3.6 and 3.7).

13 Most businesses have started to repay loans, but as of March 2021, the Department estimated that 37% of loans worth £17 billion will not be repaid, although this estimate is highly uncertain. The Department estimated in March 2021 that between 31% and 48% of loans will not be repaid, with its 'most likely' estimate of 37%. This represents both credit losses – among borrowers who want to repay but are unable to – and fraud losses – among those who either were not eligible for a loan or took out a loan with no intention of paying it back. Credit losses are the greatest component. The estimate is highly uncertain as it is based on modelling assumptions with limitations: there is no credit score data for the borrowers as this was not a scheme requirement; not much repayment data are yet available; and repayment rates will be affected by future macroeconomic conditions, which are themselves uncertain. As of 30 September 2021, Bank data shows that borrowers have repaid £2 billion worth of loans and have defaulted on £1.3 billion of loans; the Department has paid lenders £19 million in guarantee claims. These data, however, are used to manage the guarantees rather than monitor loan performance and are not real-time, but are the best information available to us. The same data show that 73% of the 1.5 million loans have either made repayments as planned or not yet reached the date to start repayments, and around 21% of loans have taken-up a 'Pay As You Grow' option (paragraphs 1.11 to 1.13, and Figure 7).

14 The Department estimates, as of 31 March 2021, that 11% of loans, worth £4.9 billion, are fraudulent but this estimate is highly uncertain. The Department recognised before launching the Scheme that its design, with limited verification and no credit checks performed by lenders, made it vulnerable to losses, including fraud. As the Scheme progressed and the immediate need for finance lessened, the Scheme continued to rely on businesses self-certifying their application details. In October 2020, the Department stated that the Scheme was "currently the leading public sector fraud risk". The Department in its audited annual report estimated that the level of Scheme fraud was 11% of loans, equal to £4.9 billion at 31 March 2021 – based on a sample of 1,067 loans. The estimate assumed that any fraud leads to a total loss of the loan, which is likely to overestimate losses as some funds should be recoverable. The estimate excludes some types of possible fraud – for example, where an applicant overstates its turnover and gets a larger loan either deliberately or inadvertently. In October 2021, the Department's advisers, PricewaterhouseCoopers LLP (PwC), revised down this estimate to 7.5% of loans by looking more closely at the evidence on those loans previously classified as 'possible' fraud including repayment data only available from May 2021; we provide no assurance on this revised estimate as it only became available to us in late October 2021. Where borrowers have made no attempt to repay, the Department has started to review the loans for fraud risk indicators to help it focus its recovery efforts on the loans at highest risk of fraud (paragraphs 2.5 to 2.11 and 2.25 to 2.26).

Scheme counter-fraud measures

15 At the start of the Scheme the priority was to deliver loans as quickly as possible, and the Department's strategy was for the lenders to tackle fraud. The Department is responsible and accountable for counter-fraud activity, and the Bank manages most of the fraud risks on its behalf. At Scheme launch, in May 2020, the Department recognised that prioritising payment speed by allowing potential borrowers to self-certify application details made the Scheme vulnerable to fraud. The Bank required lenders to make counter-fraud and 'know your customer' checks, and to make loans within 24 hours, or in some cases 48 hours if additional counter-fraud checks were required. These lender checks of applications were the only counter-fraud activities in place when the Scheme launched. In December 2020, the Department advised HM Treasury that there was still a high level of residual fraud risk even after lenders had conducted these up-front checks (paragraphs 1.4, 2.5, 2.22 and 2.29).

16 As the Scheme progressed government departments introduced 13 additional counter-fraud measures, but most came too late to prevent fraud and were focused instead on detection. It is better to prevent fraud than to seek to recover funds later. However, the Bank did not introduce straightforward measures to identify duplicate applications until June 2020 after 61% of the loans by value had already been made. This meant most of the additional counter-fraud activity was focused on the detection of fraud that has already taken place, for example creating a fraud hotline. The Department stated that introducing more counter-fraud checks at the start of the Scheme would have slowed the delivery of loans to businesses. It also told us it did not begin to analyse fraud data until several months after Scheme launch because its focus was on getting loans to businesses quickly. Delivering financial support quickly to smaller SMEs was the main objective at the outset of the Scheme (paragraphs 2.22 to 2.25, and Figure 10).

17 The Department's counter-fraud strategy evolved over time but lacked clear governance at the outset and sufficient resources. We did not find any documents which set out the Department's long-term ambitions, objectives, or financial metrics to measure the impact of counter-fraud activity. In October 2020 – five months after Scheme launch – the Department set out in a ministerial submission the resources it would need to expand its counter-fraud activity. It requested an additional £32 million, or 0.07% of the total value of loans, to cover the costs of enhanced counter-fraud operations within the Department. In the same month, the Bank created its first fraud risk assessment, to identify in detail the Scheme risks. The Bank's internal audit of fraud, in July 2021, concluded that the way it manages fraud was "reasonable" but found issues with oversight and governance of the Scheme's fraud risk reporting processes, and slow progress with establishing internal fraud responsibilities. It took some time for the Department and Bank to build capacity, initially reallocating internal resources and using secondees and external parties: since March 2021 the Bank has a dedicated financial crime team and is aiming for six full-time equivalent staff by the end of 2021; the Department is increasing its counter-fraud team from two to 10 full-time equivalent staff by January 2022 (paragraphs 2.12 to 2.14, 2.19 to 2.21, and Figures 9 and 10).

18 **Owing to the scale of possible fraud, and limited resources, the Department is prioritising the pursuit of organised crime.** The Department prioritised its fraud response by grouping loans into three tiers and concentrating on the highest risk areas. Top-tier loans are those involving organised crime groups with sums of more than £100,000; mid-tier – some evidence that borrowers acted dishonestly but not on a large scale; and bottom-tier – where individuals might have dishonestly received loans. The Department could not tell us how many cases were in each tier. It decided not to focus its investigative resource on borrowers who overstated turnover by less than 25%, provided there were no other fraud risk indicators. It expects lenders to pursue upfront recovery where feasible and cost-effective to do so, and to always seek recovery action where loans are not repaid. This prioritisation approach risks diminishing the deterrent effect of counter-fraud activity (paragraphs 2.13 to 2.15 and Figure 8).

19 **The Department uses enforcement agencies to investigate, prosecute and recover funds for large-scale fraud cases, but the agencies' capacity is stretched.** The Department uses enforcement agencies, such as the National Investigation Service (NATIS), to investigate, prosecute, and recover funds for top-tier and the 'higher end' of mid-tier loans. Given the potential fraud levels across all COVID-19 schemes, however, enforcement agencies are stretched. NATIS, for example, received more than 2,100 intelligence reports by October 2021 but only had capacity to pursue a maximum of 50 cases per year. The Department set NATIS a target of recovering at least £6 million of fraudulent loans from organised crime over three years, equal to the amount the Department has invested into NATIS. NATIS' work up to October 2021 has resulted in 43 arrests across 33 investigations and more than £3 million of recoveries (paragraphs 2.16 to 2.18).

20 **The Department relies on lenders to investigate 'mid-tier' and 'bottom-tier' fraud, but lenders' commercial incentives to do so are limited**. If a lender follows the Scheme rules, including regulatory obligations, and makes a loan which is subsequently identified as fraudulent, it can reclaim the funds through the government guarantee. This offers limited commercial incentive for the lender to go beyond the Scheme rules in seeking a full recovery of overdue loans, fraudulent or otherwise. HM Treasury has asked lenders to prioritise investigating those applications which appear deliberately intended to mislead the Scheme over those who overstated turnover by less than 25%. As of April 2021, lenders claim to have prevented £1.97 billion of fraudulent applications and detected £5.3 million of fraudulent loans. We can provide no assurance over these figures. In July 2021, the Financial Conduct Authority, the main regulator for lending, reminded Scheme lenders of their wider obligations to report fraudulent activity, and highlighted the importance of keeping resourcing levels under review. The Department does not know how much lenders are spending on counter-fraud activity (paragraphs 2.13, 2.15 and 2.27 to 2.31).

Scheme changes, administrative costs and evaluation

21 **The new repayment options will benefit both borrowers and the taxpayer, but increase the overall costs to borrowers and lenders.** Around 21% of eligible borrowers have taken advantage of at least one of the new measures to delay or reduce loan repayments as at 30 September 2021. The two most popular options were to extend the term of their loan from six to 10 years (14% of borrowers), and taking a repayment holiday (9%). These measures offer borrowers more choice on how to repay their loans and increase the chances of business survival, which benefits the taxpayer by reducing the potential Scheme losses. However, it creates extra ongoing costs – for borrowers who are repaying loans over a longer period and thus accruing more interest, and for lenders who must administer the loans over a longer period and who already make a lower profit on each loan compared with their standard loans. The Department did not quantify these costs and benefits when it introduced the new repayment options. It extended the timetable for closing the Scheme under the same Ministerial Direction issued when the Department launched the Scheme in May 2020 (paragraphs 1.6 to 1.10, and Figures 6 and 7).

22 **The process for recovering overdue loans means borrowers with different lenders may be treated differently.** Lenders are responsible for collecting capital and interest payments and recovering any overdue loan repayments. In doing so, lenders must follow the Scheme's detailed recovery principles, set in December 2020, and industry regulations. Each lender is also able to follow their 'business as usual' approach where it does not contravene the Scheme principles. For example, a lenders' usual approach may include using debt collection agencies, which the Scheme also allows if it does not include doorstep visits. A borrowers' experience on loan default will depend, therefore, on their lender's standard approach, which differs across the industry. Most lenders we surveyed said that these Scheme principles are clear and that their internal business-as-usual recovery policies were appropriate. The Bank audits the lenders for compliance with Scheme principles and can claw back any guarantee payments where errors are found, for example where the lender has not followed the correct recovery protocols before claiming on the guarantee. The Bank has engaged RSM and KPMG to conduct these audits on its behalf (paragraphs 3.2 to 3.5 and Figure 11).

23 **The Bank's Scheme administration costs for 2020-21 are expected to double because of the extension to the Scheme, additional repayment options, and the increased cost of lender audits.** When we reported in October 2020, the Bank forecast the Scheme administration costs at £32 million by 2024-25; the Bank estimated in September 2021 that this will double to £67 million. The Bank said that the flexible repayment options have added extra costs, including more extensive lender audit work and additional counter-fraud analysis. The Bank expects the cost of lender audits and external operational support across all three COVID-19 debt schemes to rise to £75 million by the end of 2024-25; compared with £55 million in its October 2020 forecast. HM Treasury agreed to cover "all direct and 'reasonable and justifiable' indirect operational expenditure" in relation to the Scheme (paragraphs 3.11, 3.12, Figures 13 and 14).

24 **The Department and the Bank have developed some metrics for measuring the Scheme's impact.** Our previous report found that the Scheme did not have a business case and lacked, at its launch, clear objectives beyond the aim of fast financial support for smaller SMEs. When we reported on the Scheme in October 2020, the Bank told us that it was in the process of developing metrics for measuring the performance of the loan support schemes. The Bank has since commissioned an external evaluation study, which will report in stages over the next three years. This has some metrics for measuring Scheme impact, including business survival rates. It will be challenging for the Bank to measure survival rates, as there is a lack of reliable data to compare the recovery of businesses that used the Scheme with a similar group that did not (paragraphs 3.13 and 3.14).

Concluding remarks

25 To achieve the policy intention of supporting small businesses quickly during the pandemic, the government prioritised payment speed over almost all other aspects of value for money. The Scheme facilitated faster lending by removing credit and affordability checks and allowing businesses to self-certify their application documents. As the Scheme progressed, it continued to rely on businesses self-certifying their application details, even as the urgent need for finance reduced. Government ruled out options for additional upfront counter-fraud measures when the Scheme was extended. The impact of prioritising speed is apparent in the high levels of estimated fraud. Counter-fraud activity was implemented too slowly to prevent fraud effectively and the Department's focus is now on detection and recovery of fraudulent loans.

26 The Department needs to improve upon its identification, quantification, and recovery of fraudulent loans within the Scheme. Compared with the scale of its 'most likely' estimate of £4.9 billion of fraudulent loans, both the £32 million additional budget for counter-fraud operations, and its target to recover at least £6 million of fraudulent loans from organised crime, are inadequate. The Department has given low priority to tackling 'bottom-tier' fraud, including those loans where borrowers misstated turnover by less than 25%, owing to resource constraints. It expects lenders to focus on this fraud tier, but they have limited commercial incentives to do so.

Recommendations

27 In managing the Bounce Back Loan Scheme, by April 2022 the Department should:

a produce a formal strategy that sets out the longer-term ambitions, objectives and metrics for the impact of successful counter-fraud activity, and brings together its existing fraud risk assessment and counter-fraud actions; fraud risk appetite; and prioritisation of counter-fraud activities and resources based on evidence of cost-effectiveness – updating it as required to take account of any new fraud risks;

b develop a robust business case for detecting, preventing, and recovering fraudulent loans, including the economic rationale of its choices for counter-fraud activity; and the scale of resources needed for each activity;

c publish the level it is aiming to reduce fraud losses to, and report against this metric. This level should be based on the Department's expectation of the intended impact of its counter-fraud controls for the detection, prevention and recovery of fraudulent loans over time;

d refresh its fraud risk assessment at least every six months using the best available evidence, including with input from the Government Counter Fraud Function;

e evaluate options for controls against any new fraud risks on a cost-benefit basis, using this evidence to introduce controls within two months of identifying any new fraud risks; and

f set-out key performance measures for each fraud control, and measure performance against them regularly, adapting the approach where necessary.

In making changes to business support schemes the Department should:

g revisit the scheme's business case, paying particular attention to the impact of changes on fraud and value for money. Where the Department accepts an increased risk of fraud and error as a trade-off with other policy objectives, the Department must lay this out explicitly. The requirement to consider trade-offs applies equally to new schemes.