Treasury's Covid-19 dilemma as it counts cost of tearing up loans rulebook

Businesses must be saved, but the risks must be balanced

Katherine Griffiths, Callum Jones, Philip Aldrick
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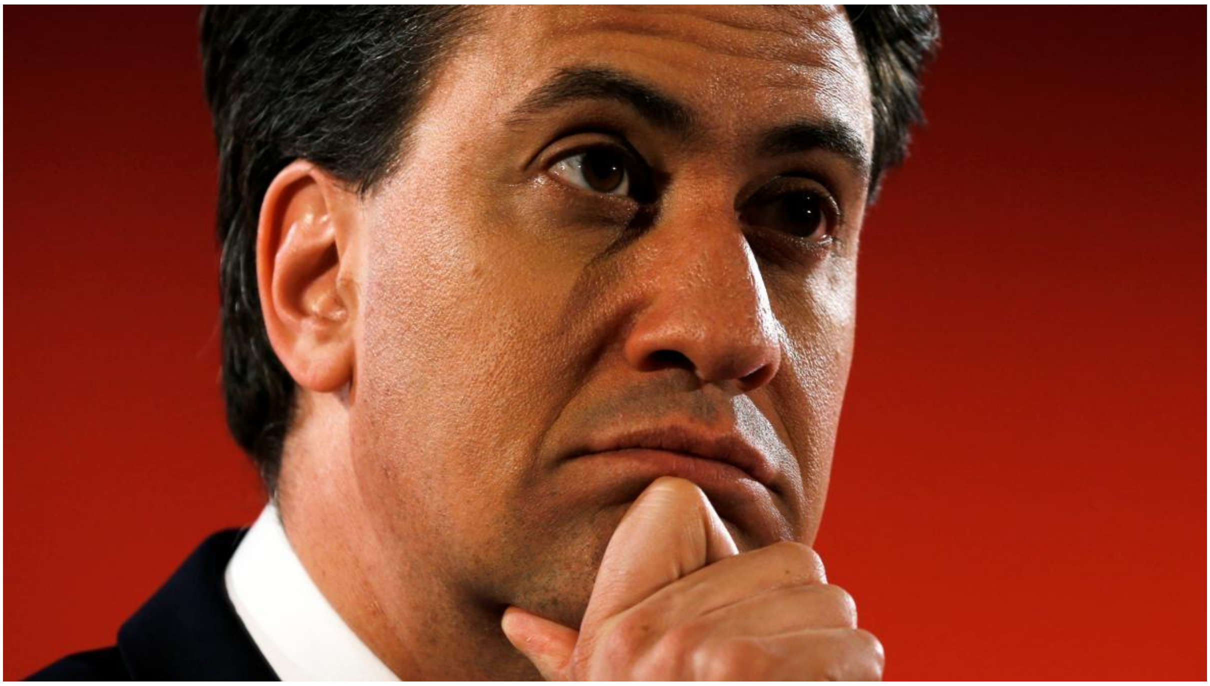
Ed Miliband called on the government to guarantee 100 per cent of loans — and three former Tory chancellors agree with him



How far should Britain go to bail out companies? With the Treasury considering calls to increase the government guarantee on loans to small businesses from 80 per cent to 100 per cent to boost the flow of urgently needed funds, it is feared that the rulebook on borrowers needing to repay their debts and banks having to assess risk will be torn up. The losers, critics say, would be taxpayers, who will be on the hook to pay for failures.

The question facing the government is one of moral hazard. "On the one hand, there is a risk of fraud and non-viable businesses approaching banks for loans; on the other, there is the opportunity cost of thousands of small and medium-sized businesses going under and being a significant burden in terms of unemployment benefits costs and a contraction to the economy from their lost productivity," Stephen Jones, chief executive of UK Finance, the banks' trade body, said. "Is that moral hazard price worth paying?"

Ed Miliband, the shadow business secretary, has called on the government to guarantee 100 per cent of loans. He said: "In normal times, the moral hazard argument would take precedence, but these are not normal times." The former Labour leader noted that it was not only his party pressing for more state support, with three former Conservative chancellors — Lord Lamont of Lerwick, George Osborne and Sajid Javid — calling for it, too.

Rishi Sunak, the chancellor, has said that Britain is studying other countries' schemes. That includes Germany's *schnellkredit*, where politicians introduced a 100 per cent guarantee on loans after it took too long to get credit out of the door.

In Switzerland banks handed out £12.4 billion to more than 75,000 businesses in the first week. That is reckoned to be because the government guaranteed 100 per cent of the exposure and borrowers filled in a one-page form.

America's paycheck protection programme is structured as a loan, but is written off if companies can prove that they used the money for payroll or other allowable expenses. That scheme has burnt through its initial $350 billion government funding.

In contrast, in Britain banks have approved only one in five of the coronavirus business interruption loans for a total of £1.1 billion, despite the fact that they come with an 80 per cent government guarantee. While the pace is increasing fast, with loans up 150 per cent in a week, it is well behind other countries.

The German scheme has generated the most interest in the UK because of the country's normal fiscal prudence and because it has managed to get the support agreed under European state aid rules, which Britain also would need.

Financiers have warned of the risk of bad debts rising. That risk had already increased, they said, when the Treasury bowed to pressure and ordered banks to stop asking for personal guarantees, including savings or second homes, on loans under £250,000.

"You will have a raft of people who go in there with no liability at all, use the money, wind up the companies and restart them through a pre-pack [administration]," one banker said. "It's free money. There's no risk to you as an individual."

If the Treasury follows other countries in shouldering all the risk, key questions will be on what size of loans, and what banks will still be required to do. No credit checks at all may seem like an abandonment of responsibility, but having strings attached, including proof of years of profitability and projections for the future in the midst of extreme uncertainty, could undermine the initiative.

The chancellor and his advisers also have to work out how much the UK's slow transmission of funds to businesses is due to banks being on the hook for some of the debt, as opposed to the cumbersome processes for booking the loans with the government-owned British Business Bank.

"The really hard part will be when loans are being called in and businesses are going under," one banker noted. Many believe that is a problem that can only be dealt with through a cushion provided by the state, no matter what the cost.