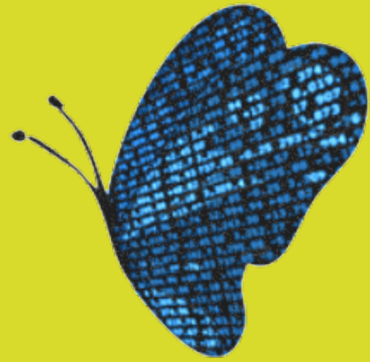
FINANCE INNOVATION LAB

Policy responses to C-19 and the financial system



THE FINANCE INNOVATION LAB

This document aims to summarise the policy responses to C-19 that work through the financial system, such as via bank loans, financial regulations, and new financing facilities. It also lists civil society assessments of those policies, and alternative proposals.

It was created by the Finance Innovation Lab, in collaboration with members of the Transforming Finance Network (TFN).

We will regularly update the document. If you would like to add to it, email Marloes Nicholls, Head of Programmes at the Lab: marloes@financeinnovationlab.org.

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1. Policy responses

POLICY:	DESCRIPTION:	CIVIL SOCIETY RESPONSE:
Monetary Policy (BoE, March, June, August, October 2020)	The Bank of England (BoE) cut the Bank Rate to 0.1% (from 0.25%) and Quantitative Easing (QE) expanded by £200bn, bringing the total size of the asset purchasing scheme to £645bn. The majority of asset purchases will be government bonds. In June, it was agreed that QE should be expanded by another £100bn by the end of the year, taking the programme to £745bn. In October, the BoE wrote to banks to ask them how ready they would be for negative interest rates, and what they might need to prepare. The BoE have said that this does not mean rates will necessarily shift into negative territory; but policy-makers needed to know whether there were operational or technological challenges involved in such a move. The BoE is cautious about this move as the implications of a negative interest rate could be substantial. It could reduce bank profitability, squeeze savers, and adversely affect pensions funds. However, it could also reduce mortgage rates for some. (Next Monetary Policy Committee meeting is 5/11/20)	Positive Money called for the BoE to buy gilts directly from the government, as opposed to from financial markets, and has criticised corporate bond purchases for supporting some of the biggest polluters. NEF uncovered a significant carbon bias in 'corporate QE' too.
Expansion of the 'Ways and Means' mechanism (BoE, April 2020)	The Ways and Means facility is designed to provide temporary, short-term financing to Government in order to smooth cashflows and support market functioning by minimizing the immediate impact of raising additional funding in gilt and sterling money markets (shorter-term debt instruments).	Positive Money welcomed the announcement: "Politicians will be left with no recourse to claw coronavirus spending back with draconian austerity measures once this crisis is over. We already knew that austerity was a deeply misguided economic project, this move further strengthens the argument that it should never be considered an economic

	The BoE expanded the overdraft facility, but the Government (HMG) has said it will continue to use the markets as its primary source of financing, and its C-19 response schemes will be fully funded by additional borrowing via normal debt management operation. Andrew Bailey, governor of the BoE, has stated that the measure would only be 'temporary and short-term' (The FT).	necessity, while conclusively proving the existence of a magic money tree once and for all." Lord Adair Turner, Frances Copola and Frank van Lerven joined the Economic Change Unit to discuss: How to pay for the crisis? Debt, the BoE and monetary financing.
Term Funding Scheme with additional incentives for SMEs (BoE, March 2020)	The Term Funding Scheme (TFS) will, over 12 months, offer four-year funding of at least 10% of participants' stock of real economy lending at interest rates at, or very close to, Bank Rate (0.1%). This aims to help banks and building societies pass the reduced Bank Rate on to their customers via lower interest rates. Additional funding will be available for banks that increase lending, especially to small and medium-sized enterprises (SMEs).	Positive Money and NEF are keen to explore how the Term Funding Scheme can be adapted so that it functions as a form of green credit guidance.
Dividends, share buybacks and cash bonuses (BoE, March 2020)	UK banks have agreed to calls from the BoE's Prudential Regulatory Authority (PRA) to suspend dividends, share buybacks and cash bonuses to senior staff.	
Regulatory measures for PRA firms (BoE)	Capital requirements for banks were reduced, with the aim of helping them to expand lending to UK businesses and households. Countercyclical capital buffers have been reduced to 0%. Stress tests planned for 2020 have been cancelled to allow lenders to focus on meeting the needs of households and businesses via the continuing provision of credit.	

	Other reporting requirements have also been postponed, including liquidity reports and climate risk reports. The Financial Policy Committee (FPC) and PRA assess banks to be entering this period with strong balance sheets and capital positions, with sufficient capital to accommodate the impacts of a UK/global recession and a financial markets shock.	
Coronavirus Future Fund (HMT, April 2020)	This scheme offers government convertible loans between £125,000 and £5,000,000 to innovative companies which are facing financial difficulties due to C-19. The funding must be at least equally matched by funding from private investors. These loans are an option for businesses that rely on equity investment and are unable to access other government business support programmes because they are either pre-revenue or pre-profit. The company must be UK based, have raised at least £250,000 in equity investment from third party investors in the last 5 years, none of its shares are traded publicly, and was incorporated before 31 Dec 2019. The total size of the funding pot is £250m (but an expansion may be considered). Innovate Finance advocated for this, with the hope that the fintech sector would benefit.	Studies by the LSE offer 2 key lessons for the Future Fund: 1. Subsidizing third-party investment leads to high start-up growth that would otherwise not occur, so restricting the Future Fund eligibility to those that have already secured private funding will help the government identify the right set of businesses: those with high growth potential. However, incompatibility with tax incentives from alternative schemes such as SEIS may lead to underutilization of the Future Fund, as investors are unwilling to forgo the private equity tax incentives to provide the private sector match funding for the Future Fund. 2. The debt contracts of the Future Fund might be hard to swallow for existing investors, since they are high interest (8%) and highest seniority, if conversion to equity does not occur. Therefore, existing investors need to have a high degree of confidence in order to find this condition palatable. This may also undermine demand. Several concerns have been raised by the tech sector that the conditions of the fund would exclude underrepresented founders. Diversity data about applicants and awardees to the fund is available here.
Bounce Back Loan Scheme (HMT, May, September 2020)	Loans of £2,000 - £50,000 (up to a maximum of 25% of annual turnover) to help viable SMEs manage cashflow problems. They are provided by private lenders, and 100% guaranteed by HMG.	Introduced following criticism that the Business Interruption Loan Scheme (see below) was not accessible enough to struggling companies. This scheme has been outperforming the CBILS – in terms of usage, money lent, and feedback. Independent retailers (Drapers) have cautiously welcomed the micro-loan scheme – especially the lack of forward-looking eligibility tests and a simple,

	They are 6-year loans with no early repayment charges. 0% interest and no repayment required for the first 12 months of these loans - 2.5% interest thereafter. In April, the eligibility criteria was expanded. In September, it was announced that the maturity period of these loans would be increased to up to 10 years, and the application deadline was extended until the end of November.	quick and standard application form (loans arrive within 24 hours of approval for most firms). However, they are concerned about taking on additional debt in a highly uncertain future. Positive Money called for such loans to take the form of grants instead, or for the UK government to follow Switzerland in making such loans interest free, noting that the current 2.5% cap is more than a lot of banks are charging for mortgages. Otherwise there is a risk that we could be sleepwalking into an implicit bank bailout for these government guaranteed loans.
Coronavirus Large Business Interruption Loan Scheme (HMT, April 2020)	An alternative lending solution (provided by private lenders and banks) for viable larger UK-based businesses suffering C-19 disruption. Provides facilities of up to £25m for businesses with a turnover between £45m-£250m and up to £50m for businesses with a turnover above £250m. From 26 May, this expanded, so businesses can borrow up to 25% of turnover or £200m. Loans are issued by banks and lenders accredited by the British Business Bank, and HMG guarantees 80% of the finance to the lender. Companies borrowing over £50m on the scheme are subject to restrictions: – Cannot pay dividends – Limits to share buybacks – No cash bonuses or pay rises for senior management Does not have a Business Interruption Payment to cover interest and fees for first 12 months (like the CBIL for SMEs). In May, this scheme was expanded significantly in scope. In September, the scheme was extended again, such that the application period for loans will last until the end of November.	In the report Who wins and who pays? (May 2020) IPPR notes that this calls into question whether these loans will evolve into grants in the future. Many of the companies who access these loans might become financially unviable as a result of C-19, and therefore would either have to default on the loan and go bust, or the government would have to forgive/write-off the loan (i.e. allow the funding to become a grant). This would place significant strain on public finances, which will ultimately have to be borne by the taxpayer. IPPR also argues that there is potentially an implicit bailout guarantee. HMG will not allow these companies to fail, since they are systemically important to the economy (see the Birch Plan below) – therefore, these companies might assume that they will be bailed out (i.e. their loan obligations forgiven) if they come into financial distress. This could create perverse incentives for companies to take unnecessary risk, since they know they will be bailed out should they fail (i.e. a moral hazard problem). IPPR estimate that up to 45% of emergency payments made during the C-19 crisis, including the Job Retention Scheme, go back to landlords, banks, and other lenders.

Coronavirus Business Interruption Loan Scheme (HMT, March 2020)	Another support measure for SMEs to manage their finances and cashflow if they are experiencing lost or deferred revenues due to C-19. Provides lenders with a government-backed guarantee of 80% on losses that may arise on facilities up to £5m. Lenders can use their discretion in deciding sizes of loans and collateral required. Accessible to UK-based and financially viable SMEs (turnovers less than £45m) impacted by C-19. Government will make a Business Interruption Payment to cover the first 12 months of interest payments and any lender-levied charges. In May, the scope of this scheme was expanded. The portfolio-level cap on the lender's claim to the government guarantee was also removed, meaning that lenders were eligible for the 80% government guarantee regardless of the volume of funds loaned out. In September, it was announced that the maturity period of these loans would be increased to up to 10 years, and the application deadline was extended until the end of November.	IPPR argues that state loan guarantees protect lenders, not businesses, who remain fully liable for their debts and bear the full risks of defaulting. In addition, despite this state support, banks have been criticized widely for failing to rapidly scale up access to affordable credit.
Covid-19 Corporate Financing Facility (HMT/BoE, March 2020)	Provides funding to businesses by purchasing commercial paper (i.e. unsecured, short term debt issued by the business) of up to 1 year maturity, issued by firms making a material contribution to the UK economy and that had an investment grade credit rating at 01 Mar 2020. Aims to help businesses to pay wages and suppliers while experiencing severe disruption to cashflows.	The Covid Corporate Financing Facility: What are the conditions for the billion bailouts? (Positive Money, July 2020) - The report proposes five recommendations to improve the Covid Corporate Financing Facility (CCFF) and align it with efforts to build back better. It outlines how the BoE and HMT can strengthen the existing conditions of the scheme, introduce new conditions that protect both workers and environment, implement mechanisms to ensure compliance, and enhance the transparency of the scheme.

	Financing terms will be comparable to those in markets just before C-19. Open to firms that can demonstrate sound financial health prior to shock. Scheme will operate for as long as steps are needed to relieve cash flow pressures. Commercial paper would be issued by a financial institution, and purchased jointly by HMT and BoE. The funds raised must be used for business continuity – they cannot be leveraged to make financial investments. In May, several updates (as summarised by Deloitte) to this scheme were made and implemented. Firstly, businesses that wish to access this facility for a term extending beyond 19 May 2021 will need to send a letter to HMT that commits to showing restraint in the payments of dividends and senior pay during the period in which their commercial paper is outstanding. Secondly, businesses which have used the facility will be able to repay their drawings early if they choose to do so. Finally, HMT and the BoE have decided to publish the names of the businesses that have used the facility, as well as the amounts borrowed. Further updates were announced by the BoE in September. Specifically, the closure date for purchase of new commercial paper was set at 23 March 2021	
Personal Loans and Credit Cards (FCA, April 2020)	The Financial Conduct Authority (FCA) has issued guidance about how firms can support consumers in relation to a number of products. This includes that consumers can ask for a freeze on repayments for up to 3 months on personal loans, credit cards, store cards or catalogue credit, without consequence for longer term credit ratings (until 31 October).	The Centre for Responsible Credit highlights that while payment deferrals are not supposed to have impacted credit scores, the question arises as to whether borrowers impacted by C-19 who struggle to make payments after the deferral period comes to an end should have their credit records negatively affected for years into the future.

	Interest will usually continue to be charged over the freeze period, but it is at the discretion of the lender.	
Overdrafts (FCA, April 2020)	Consumers can ask the provider of their main current account for up to £500 of overdraft borrowing with no interest for 3 months (until 31 October). Measures from individual banks can vary, but this is a minimum measure that should be offered.	
Other forms of credit (FCA, April 2020)	- 3 month payment freeze for motor finance. - 1 month payment freeze for high-cost short-term credit loans (e.g. payday loans). - 3 month repayment freeze on rent-to-own agreements. - 3 month repayment freeze on buy-now-pay-later agreements. - 3 month repayment freeze on pawnbroking agreements. - (All until 31 October).	
Mortgages (FCA, March, September 2020)	Payment holidays' can be agreed with lenders (not making repayments for a set amount of time) as well as 'partial payment holidays' (reduced payments). This is accessible for people up to date on their mortgage payments, and also to buy-to-let landlords whose tenants have lost income due to C-19. Payment holidays should not impact your credit rating, but interest will continue to be charged over the period. Consumers will still be liable to pay the full mortgage amount, so they will have to make up the missed payments by increasing monthly payments or adding a short extension to the loan term.	IPPR notes that payment holidays amount to households taking on additional private debts, rather than a sacrifice on the part of creditors: payments are deferred rather than waived, so must be repaid with added interest in the future. Additionally, renters have not been given the right to this benefit, leaving many in significant financial hardship. There are also some concerns that payment holidays could in fact hurt mortgage applications (Money Saving Expert) and other forms of credit in some cases, despite promises that credit scores won't be affected. This is because many new lenders don't just rely on credit files and application forms (which are unaffected by the payment holiday) to assess creditworthiness. They can use Open Banking and a range of other methods to assess people's finances which can indicate that no payments are temporarily being made, thus allowing lenders to infer who is on a payment holiday.

	Mortgage holders have until 31 October to apply or reapply for a payment holiday. Lenders are also temporarily stopping repossession actions (to 31 October 2020)	The FCA have confirmed that lenders are able to utilise this information to inform their lending decisions, thus it is entirely possible that payment holidays will adversely impact access to future credit for many borrowers.
Insurance (FCA, March 2020)	Insurers can offer a range of options to people struggling to pay for insurance, including: - Reviewing your cover based on risk and needs to reduce premiums - Premium payment deferrals - Waiving administration and cancellation fees - Relaxing interest or charges on missed payments - Extending cooling off periods - Partly refunding premium payments where the whole amount had been paid up front.	
"Project Birch" (HMT, May 2020)	A bailout plan for strategically important companies – it will inject equity into companies that are struggling with debt. Sectors that fall under consideration include: aviation, aerospace, and steel – all of which are facing acute problems and are important to the UK economy. However, the offer would apply across sectors, extending existing commitments to act as a Lender of Last Resort. This project increases the capacity of HMT to handle bespoke bailouts of viable firms which have exhausted all other options, including government loan schemes. There are already considerations of extending these support measures into a medium term solution to part-nationalise companies in order to prevent their collapse in the wake of the massive debt mountains that they have accumulated.	Charities and lobby groups have called for transparency and conditions for companies to tackle global heating, protect jobs, and reduce inequality (Guardian, 2 July).

Credit Union Resilience Loan Fund (Social Investment Scotland - Scottish Government, April 2020)	A new fund to help Scotland's credit unions that are suffering as members struggle to meet loan repayments. Credit Unions can apply for an interest-free loan of between £50,000 and £250,000, repayable over an 8-year term. The loan will reduce by 20% from year 4 onwards, but will be repaid when the credit union is able to.	The Association of British Credit Union (ABCUL) has welcomed the funding packages.

2. Alternative civil society proposals

REPORT/PUBLICATION:	DESCRIPTION:
Own the Future (CLES, July 2020)	This guide from the Centre for Local Economic Strategies (CLES) sets out a vision for the just recovery and social, democratic and economic reform of localities, led by local authorities (LAs). To do so, it uses the framework of community wealth building, and includes recommendations for how LAs could maximise their financial power - using pension funds, regional banks, mutual credit, municipal bonds, buyouts, and advocating for national policy change.
The road to resilience (RSA, June 2020)	The RSA outlines 12 recommendations to fund and support community stakeholder banks to prosper.
The case for a British Development Bank (UK Onward, October 2020)	This report calls for HMT to create a national development bank to unlock £16 billion in capital for investment in SMEs, municipal infrastructure and project finance to level up the UK's regions. The report finds that, despite London's deep and mature financial markets, the UK suffers competitive weaknesses linked to investment in businesses and infrastructure, including: - A wide infrastructure financing gap of £8 billion a year and weak infrastructure stock compared to other European nations. - A large SME financing gap, equivalent to £22 billion in foregone funding for growth and jobs, despite increasing lending to large businesses. - Regional disparities: according to BoE data, 25% of all SME loans are lent in London versus just 2.8% in the North East and 3.5% in Wales. - These issues have been exacerbated by the sale of the Green Investment Bank (GIB) and the departure from the European Investment Bank (EIB). The GIB catalysed £15 billion of green infrastructure spending by 2015. In the same year the EIB invested £5.6 billion in UK projects, equivalent to approximately a third of infrastructure spending under the remit of the National Infrastructure Commission. The creation of a British Development Bank would address these market failures and provide financing at scale to level up the UK. The new institution would be modelled on the successful German bank, KfW, which was established in the aftermath of the Second World War.

Calls for green bank mount amid UK recovery plans (FT, 2 July 2020)	E3G, and 100 mayors/ local officials call for a Green Infrastructure Bank to be established.
Unlocking Britain (Social Market Foundation, June 2020)	Recommendations for an economic recovery post C-19 include: - Creating a Recovery Fund to provide capital to British SMEs – and once recovery is complete, the fund should be floated on the London Stock Exchange. Shares in the Fund should be issued at a heavy discount to frontline NHS workers and people aged 18–30, in both respects targeted to those who earn less than £30,000. - Making it easier for people to invest their savings into UK businesses – this could inject £6 billion into British SMEs without raising new money from the public or private sector. - The BoE setting a nominal GDP level target.
The Colour of Money: How racial inequalities obstruct a fair and resilient economy (Runnymede, April 2020)	The report reveals gross levels of economic and racial inequality in Britain. For example, Black African and Bangladeshi households have 10 times less wealth than White British people. Recommendations from the report include include strengthening discrimination law, as well as the need for targeted policies to tackle longstanding inequalities, and for ensuring racial inequalities are considered in thinking about how to design a fairer, more resilient economy.
Cash during and after COVID-19 (RSA, April 2020)	The RSA raises the question of whether cash can survive C-19, and the need for a more inclusive digital economy. In addition to ensuring that everyone has access to a bank account, the RSA highlight 4 further ideas: 1. Banking levies should be reformed to tax the beneficiaries of an increasingly cashless system (e.g. Visa, Mastercard and Apple) to support those who are currently underserved digitally – funding improved internet connectivity, enhanced digital capability, and fostering inclusive innovation from fintechs. 2. Banks should make a concerted effort to ensure all customers are signed up to an alternative to physical banking. The government should work with the FCA and the banks to ensure a digital transition strategy is developed. 3. Open Banking is a huge opportunity to give people more control over their financial data and drive digital innovation, so products work better for customers. However, limited public awareness is leaving its potential unfulfilled, so a public information campaign should be launched. 4. Governments and central banks globally are exploring the idea of issuing their own electronic currencies. It's essential that one dominant digital currency does not emerge as a monopoly, eroding competition and privacy.

Coronavirus and personal debt: a financial recovery strategy for households (StepChange, June 2020)	This report argues that although the government has implemented a series of unprecedented measures to protect incomes and businesses during the outbreak period, they have not protected all households against loss of income. StepChange estimate that 4.6m people negatively affected have accumulated £6.1bn of arrears and debt, averaging £1,076 in rent arrears and £997 in debt per adult affected. These figures could inflate substantially as lockdown continues - causing a debt 'tsunami'. The people affected by these issues face substantial housing insecurity. In addition, 44% of those affected with an income of less than £30,000 have fallen behind or borrowed to pay for essentials, compared to 25% for those with an income of £50,000-£60,000. The report recommends that policy makers should turn their attention to prevention of potential evictions once temporary protections expire through a financial recovery strategy for households, addressing three key priorities: 1. Strong protections against housing insecurity and unaffordable repayment demands. 2. Grants to address debts accumulated to pay for essentials during the crisis. 3. Investment and reforms to the social safety net to help struggling households recover.
Calls for debt reforms (Finance Innovation Lab, April 2020, Finance Innovation Lab, April 2020, Reset the Debt, October 2020)	Jubilee Debt Campaign published an open letter calling for an urgent, interest-free freeze on personal debt payments and a write-off of existing council tax and social security debts for people affected by C-19. This call has been supported by The Finance Innovation Lab. Responsible Finance highlighted the need for immediate hardship funding for vulnerable households affected by C-19 and offered the support of the responsible finance network and infrastructure to deliver it. This call has been supported by The Finance Innovation Lab. Reset the Debt is a campaign advocating for a Jubilee Fund to provide grants to pay off and cancel unavoidable debt accrued by households during the lockdown period, giving them a more stable platform from which to face the future.
Decarbonising the BoEs QE policy (NEF)	NEF sheds light on how the BoEs QE programme is implicitly subsidising some of the most environmentally damaging activities by buying the corporate bonds and subsequently reducing the cost of borrowing for large polluting companies, incentivising them to borrow and invest even more, thereby expanding their polluting activity even further. Since QE does not directly reach SMEs, it disproportionately incorporates a carbon bias. QE can support companies in polluting sectors such as fossil fuels, energy-intensive manufacturing, utilities, and transport. NEF offers a framework to support the BoE to reduce the carbon impact of corporate QE. They argue that there is more they can do by restricting purchases of bonds issued by carbon intensive sectors, and replacing them with bonds that can be conducive to a greener economy while still meeting the Bank's key eligibility criteria. This would have to form part of a broader fiscal package to stimulate a greener economy.
C-19 Policy Watch	This lists the C-19 policy responses of governments around the world.