The Treasury

Proactive Release of the Business Finance Guarantee Scheme (BFGS) Interim Evaluation

December 2022

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Business Finance Guarantee Scheme evaluation

The Treasury

June 2022

Making sense of the numbers

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Executive summary

The Business Finance Guarantee Scheme (BFGS) was implemented by the Treasury with the objective to facilitate the provision of credit to cushion the impact of COVID-19 on small-to-medium sized enterprises (SMEs). This was in response to the potential tightening of credit conditions resulting from COVID-19.

Under the BFGS, the Crown guaranteed 80 percent a loan's default risk, with the intention to support the flow of credit by reducing the credit risk which banks face when lending. It covered overdrafts, revolving credit facilities and term loans.

The BFGS encouraged lenders to look beyond the current economic cycle, and take the uncertainty into account when making lending decisions. The initial uptake was sluggish. Some lenders actively promoted the scheme, while others took an alternative approach to support customers. The parameters of the BFGS were relatively restrictive and quite narrow. When combined with an uncertain environment where many businesses were intending to pay off debt, not take on more, uptake was below expectations. Additionally, the Government offered a variety of other support measures to assist businesses through COVID-19, for example the wage subsidy.

Changes to the BFGS

To increase uptake and effectiveness, the BFGS went through phases of review and development, which resulted in an expansion of the scope. In May 2020, The Treasury commissioned TDB Advisory to conduct an external review of the BFGS settings against its objective. The review was completed in June 2020 and changes were adopted in August 2020.

The review shone light on aspects of the BFGS that were limiting uptake and the ability to achieve its objective. Changes were made to address the aspects slowing utilisation of the BFGS including: extending the availability period, increasing borrower annual revenue limit to $200 million, increasing the maximum loan limit to $5 million, extending the loan term to five years, removing the restriction on capital investments, and allowing re-financing of existing indebtedness.

In 2021, to expand the pool of available applicants, the BFGS was extended to include Non-deposit taking lenders (NDTLs). In February 2021 UDC Finance were brought into the scheme, followed by Prospa NZ, FlexiGroup, ZIP and Speirs Finance in April 2021.

Evaluation of the BFGS

The Treasury engaged Business and Economic Research Limited (BERL) to undertake a post implementation review of the BFGS. The scope of the evaluation focussed on five key questions:

1) Did the BFGS achieve its objective?
2) Did changes made to the scheme contribute to an uptake in utilisation?
3) Could the process to establish the BFGS have been improved?
4) What aspects of the BFGS were effective in achieving its objective, and what can be learned from the less effective aspects of the scheme?
5) How effective is the on-going management of the scheme, and guarantees issued under it?

In order to answer these five key questions, BERL conducted semi-structured interviews with all BFGS participants, and other related stakeholders.

Did the BFGS achieve its objective?

The general consensus from lenders was that the BFGS achieved the objective of facilitating the provision of credit to cushion the impact of COVID-19 on otherwise viable SMEs facing temporary financial distress. The majority view from participants was that the BFGS ensured lending to marginally viable firms and reduced the risk of banks not lending to these firms. However, lenders noted that they were committed to supporting their customers through this difficult period. Many interviewees expressed a view that the majority of lending would have likely occurred anyway to support their customers, and many of the loans made did not require a guarantee, but it gave lenders additional confidence

Use of the BFGS varied between lenders. Some were enthusiastic and actively promoted it internally and externally, while other lenders did not issue any loans. Rather choosing to offer their own support packages. Reasons lenders gave for not taking up the BFGS included: the risks of lenders being non-compliant, the requirements not aligning with the lenders' business and finance structures, the BFGS not meeting customer needs, and cost of internal structures required to set up and manage the BFGS outweighing the benefits.

With a number of investigatory clauses and cross-default provisions applying, some lenders were reluctant to participate. Instead, many continued offering products they saw as more appropriate at the time. For some borrowers, predominantly SMEs, obtaining a BFGS guaranteed loan required them meet more rigidly applied credit policies for loans that were not initially intended to meet their needs. This made other products outside BFGS more appropriate and appealing for some borrowers.

Did changes made to the scheme contribute to uptake in utilisation?

Stakeholders were clear that the changes made to the BFGS significantly contributed to an uptake in utilisation. The changes increased the number of borrowers as well as the value of lending the BFGS covered. Lending data supports that the changes made to the BFGS made a significant contribution to uptake.

With the first round of changes occurring in August 2020, the number and value of loans guaranteed under the BFGS increased significantly, and loans were being supported at a much faster rate than previously. The value of lending made from August 2020 to March 2021, was 65 percent of BFGS guaranteed bank lending. With the inclusion of NDTLs in April 2021, loans supported increased again. Despite the short timeframe NDTLS were able to issue impactful lending to their SME customer base. NDTLs made 218 loans, which accounted for five percent of all BFGS loans. The value of loans distributed by NDTLS was $81.6 million, which accounted for three percent of the total value of BFGS loans.

The factors identified which increased uptake were the changes made to the criteria for borrowing, the extension of the loan period, increasing the loan value, widening the scope to include refinancing, including NDTLs, and clarifying personal guarantees.

These changes contributed to a significant uptake in borrowing covered by the BFGS. In June 2021, the availability period of the BFGS came to a close. At the time, there were 4,305 loans supported to a value of $2.86 billion.

Could the process to establish the BFGS have been improved?

The process to establish the BFGS could have been improved. A reoccurring observation was that the changes that were made should have been included from the outset. In particular, the inclusion of NDTLs.

Lenders noted that other schemes available from the Government provided similar support, and these schemes were simpler, and had reporting requirements that were easier to meet. Some viewed that the Treasury could have taken longer to plan and implement a more targeted scheme, knowing more general support was available to businesses.

Additional improvements suggested by lenders included delaying the announcement of the BFGS until it was ready to launch, and clarifying the initial requirements. This lack of clarity made lenders cautious.

While these improvements would have initially slowed getting lending to businesses it would have allowed the BFGS to reach more businesses, increased awareness, and resulted in greater effectiveness. Although, an important aspect of the scheme was sending a signal to lenders and borrowers that the Government was prepared to help.

What aspects of the BFGS were effective in achieving its objective, and what can be learned from the less effective aspects of the scheme?

The BFGS resulted in many loans with reduced interest rates and restructured debts. Such loans reduced financial burdens, interest rates and anxieties for firms. Many interviewees expressed a view that the majority of lending would have likely occurred anyway. However, this is not able to be validated. The guarantee was the support lenders required to put some borrower's applications over the line. It was necessary to cast a wide net to ensure that the support made it to those who needed it most. In the eyes of participants many of the loans made did not require a guarantee, but it gave lenders additional confidence.

Initiatives to promote and package the BFGS varied. Some lenders took advantage of the BFGS and others indicated that it was not fit for their books. Lenders felt it would have been beneficial if the Treasury marketed the BFGS more aggressively through government business advisory channels.

The BFGS was written in a confusing way ("by and for lawyers") which meant lenders were required to put in an onerous amount of policy work to make the BFGS workable. When NDTLs were included, smaller companies struggled as they lacked in-house legal teams to decrypt the BFGS into financial products. What would have been helpful to lenders and borrowers would have been a plain English companion document, or checklist, to streamline the decryption process.

Feedback from lenders and the lending data show that changes made during its operation were the most effective aspects for attracting the customers of banks and NDTLs to take advantage of the BFGS. However, the decision to allow borrowers to refinance 100 percent if they changed lender, compared to 20 percent if they remained with the same lender was seen as unfair. There were instances reported of businesses refinancing their debts from NDTLs with banks that were able to offer lower interest rates through the BFGS and RBNZ's Term Lending Facility (TLF).

Lenders indicated that the 80/20 percent split was appropriate to reduce the risk of lending and explore credit options with firms which otherwise would not have been able to secure finance.

How effective is the on-going management of the BFGS and guarantees issued under it?

The overall view of BFGS participants was that the management of the BFGS has been effective since the changes were made. Participants were pleased with how the BFGS was being managed. However, few claims from lenders have been made on BFGS loans. Those who have had to make a claim have indicated the process is clear and painless. Lenders expect that the number of claims will increase as BFGS loans near the end of their term. It was suggested that because COVID-19 has had a longer lasting impact than many initially thought, the BFGS should be reviewed as loans reach maturity with the potential to extend the loans' terms and the guarantee.

The ongoing reporting, audit and investigation requirements are seen as somewhat onerous for some banks and lenders. For lenders which have limited labour capacity, these tasks add a burden to operations. The threat of investigation has made some lenders feel unduly distrusted. Lenders questioned whether reporting could be eased further now that the BFGS has closed.

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1 Introduction

Established in March 2020, the Business Finance Guarantee Scheme (BFGS) was implemented by the Treasury in response to the potential tightening of credit conditions resulting from COVID-19. The BFGS had the objective of facilitating the provision of credit to cushion the impact of COVID-19 on otherwise viable SMEs facing temporary financial distress.

Under the BFGS, the Crown guaranteed 80 percent of the loans default risk, with the intention of supporting the flow of credit by reducing the credit risk which banks face when lending, particularly in an on-going pandemic environment. It covered overdrafts, revolving credit facilities, and term loans. If a business defaults on a BFGS loan, the lender must take action that it considers commercially reasonable to recover the debt. The lender can then make a claim to the Crown for 80 percent of any residual shortfall, even if they have agreed to write off, cancel, or not recover loan debt and/or any other indebtedness.

The BFGS encouraged lenders to look beyond the current economic cycle, and take account of the uncertainty, when making decisions about supporting their customers. The BFGS was administrated by banks, and required them to assess credit risk through their own credit policies, modified with a COVID-19 lens. With the Government guarantee, and the low cost funding available from the related Reserve Bank of New Zealand's (RBNZ) Term Lending Facility (TLF), lenders were able to offer significantly competitive low interest rates.

However, the initial uptake was relatively slow, with some lenders actively promoting the scheme and others not. Given the uncertain environment many businesses were looking to pay off debt, not take more on. Additionally, the Government offered a variety of other support measures to assist businesses through COVID-19, for example the wage subsidy. To increase uptake and effectiveness the BFGS went through phases of review and development, which resulted in an expansion of its scope.

1.1 Scope of evaluation

The Treasury engaged Business and Economic Research Limited (BERL) to undertake a post implementation review of the BFGS. The scope of the evaluation focussed on five key questions:

1) Did the BFGS achieve its objective?
2) Did changes made to the scheme contribute to an uptake in utilisation?
3) Could the process to establish the BFGS have been improved?
4) What aspects of the BFGS were effective in achieving its objective, and what can be learned from the less effective aspects of the scheme?
5) How effective is the on-going management of the scheme, and the guarantees issued under it?

In order to answer these five key questions BERL conducted semi-structured interviews with all BFGS participants, and other related stakeholders, to build a strong understanding and evidence base. Additionally, with data provided by the Treasury, BERL analysed the performance of the BFGS, breaking it down by pre and post-changes.

BERL would like to extend our thanks to the banks and non-deposit taking lenders (NDTLs) that contributed to this evaluation.

2 The history of the BFGS

In March 2020 New Zealand, and the world, was in a period of great economic uncertainty, so the prompt establishment of the BFGS came with good intentions. However, as time went on, the BFGS's performance, and thus the appropriateness of the design, was questioned. In response to this, the BFGS was expanded and adjusted to better respond to the on-going uncertainty in the economy. The following section details important periods when it was developed, and how it performed before and after these developments.

2.1 Establishment of the BFGS

March 2020

The BFGS was established at pace in response to COVID-19 in March 2020, acting as a short-term mechanism to encourage lending from banks to marginally viable SMEs. Its primary objective was to facilitate the provision of credit to cushion the impact of COVID-19 on otherwise viable SMEs facing temporary financial distress. This was intended to allow banks to look beyond the economic cycle, and take account of the uncertainty, when deciding to support their customers. As 80 percent of the risk of lending under the BFGS was guaranteed by the Crown, banks had the ability to offer competitive low interest rates.

For SMEs which were disrupted by COVID-19, the BFGS provided a valuable channel to low interest rate finance to assist them through a period of economic uncertainty. However, when it was established, the Government released a variety of other support measures which may have been more appropriate for them at the time.

2.1.1 Parameters of the BFGS at establishment

Initially, the BFGS allowed for businesses with annual revenue between $250,000 and $80 million to apply to banks for loans of up to $500,000 for a period of up to three years.

The loans could only be used for working capital for businesses. They were broad based, focussed on commercial lending, and no specific industries were targeted. Certain activities were excluded from the scheme, such as lending directly to farms. However horticulture, aquaculture, viticulture and agriculture servicing was included. Furthermore, residential and commercial property development and investment was excluded and non-bank lending entities (NDTLs) were excluded from participating.

Additionally, if a loan was on a bank's credit watch list as at 28 February 2020, then the loan could not be included in the BFGS.

2.2 Improving the scope of the BFGS

July 2020

2.2.1 Uptake of the BFGS was slow

With the initial parameters relatively restrictive and quite narrow, uptake of the BFGS was below expectations. In July 2020, 571 loans were supported through the BFGS, with the total value lent $98 million.[1] Given COVID-19 had a much greater impact on certain industries, the industry spread

[1] This data is most likely under the actual total as not all BFGS participants' provided data for the analysis.

of loans largely affirmed the need for credit for SMEs in these industries. The following industries accounted for the largest proportions of BFGS loans, as at July 2020:

- Retail trade (19 percent of BFGS loans)
- Accommodation and food services (16 percent)
- Construction (13 percent).

The combined value of BFGS loans distributed to these three industries accounted for just under half of the value of all BFGS loans distributed at the time. Although general uptake might have been slow, and below expectations, the BFGS instantly played a critical role in financing many businesses operating in industries hit hard by COVID-19. However, it was not operating at its full capacity, and the Treasury took action to improve the BFGS and commissioned an external review of the BFGS.

2.3 External review of the BFGS's performance

August 2020

The Treasury commissioned TDB Advisory to conduct an external review of the BFGS settings against its objective in May 2020.[2] The review was completed in June 2020 and adopted August 2020. The review shone light on particular restrictions which were limiting uptake and the ability for it to achieve its objective. The main findings were:

- The Deed of Indemnity leaned towards protecting the Crown's interests, with a number of investigatory clauses which were discouraging the banks' participation
- Banks were required to apply their normal lending criteria, modified to look through a COVID-19 lens. This typically required borrowers to have two repayment paths; cash flow or security. Generally banks tried to avoid the second path, and during COVID-19 cash flow was difficult to assess. In view of these difficulties, banks seemed to be more rigidly applying their credit criteria to BFGS applications
- Normal cross-default provisions applied which meant that if borrowers, who likely had other loans with the banks, had to default on their BFGS loan their other loans would also default. Therefore, banks held 20 percent of the risk on BFGS loans and 100 percent of the risk on the borrowers' other loans
- The repayment period of a BFGS loan was three years. This was different to the usual repayment period of around five years in the small business market
- The watchlist exclusion cut-off date did not make sense to many banks, as they felt it excluded borrowers who they would have otherwise lent to through the BFGS
- Not including NDTLs limited the ability for the BFGS to reach businesses that were not able to borrow from banks, albeit a small portion of the lending market
- No rationale could be identified for excluding lending to the commercial property sector.

For banks, the BFGS did not necessarily encourage participation or lending, which was one of the overall aims. With a number of investigatory clauses and cross-default provisions still applying, some banks were reluctant to participate. Instead, many continued offering other financial products which were more appropriate at the time.

[2] TDB Advisory (2020). *Review of the Business Finance Guarantee Scheme*.

On the other side, borrowers were required to meet more rigidly applied credit policies for loans that did not exactly suit the SME sector, in terms of the loan term. Furthermore, many borrowers were completely excluded, whether it be because of the watchlist cut-off, sector exclusion or inability to access credit through mainstream banks. These restrictions were hindering the BFGS's ability to fully facilitate the provision of credit to SMEs who were disrupted by COVID-19. Given these restrictions, businesses were opting into other support measures to assist them through the challenging economic environment.

Therefore, although the BFGS had good intentions, the scheme did not perfectly align with its objective.

2.3.1 Proposed suggestions to improve the BFGS

The TDB review suggested multiple changes to the settings to ensure the BFGS was most suited to meeting its objective. Following this, the Treasury proceeded to implement some of the suggestions made, and acted to further improve the effectiveness of the BFGS.

To align the BFGS with its objective, the purpose of the BFGS was changed to "provide funding to eligible businesses facing hardship as a consequence of COVID-19 to enable the businesses to respond to, position themselves for recovery, and recover from the impacts of COVID-19." The following changes were implemented:

- Availability period was extended to 31 December 2020
- Maximum borrower annual revenue was increased from $80 million to $200 million to encourage more medium sized enterprises
- Maximum loan limit was increased from $500,000 to $5 million, and the loan term was extended to five years
- Direct lending to farms was now included
- The restriction which limited borrowers from using the BFGS loan on capital investments was removed
- BFGS loans could now be used to re-finance up to 20 percent of a borrower's existing indebtedness
- Personal guarantees were clarified – The Crown will pay a claim even if personal guarantees were either not taken or not enforced
- Discretion was available for banks to act outside Supported Loan Policies, Practices and Processes (SLPPP)
- The watchlist criteria were relaxed.

Given the large amount of uncertainty in the economy, and the on-going pandemic, the decision to extend the availability period was sensible. This change also served to allow more SMEs to access working capital through the BFGS, as did increasing the maximum borrower annual revenue cap and the maximum loan limit.

To encourage banks to lend more actively under the BFGS, the Government reviewed the Crown's right of investigation and allowed for banks to have discretion to act outside Supported Loan Policies, Practices and Procedures (SLPPP), removing any unnecessary barriers for banks to lend.

One key recommendation, made by TDB Advisory, was to extend the BFGS to include NDTLs as their core operation is small business lending. The initial decision to leave out NDTLs was a result of the BFGS being rolled out quickly and the proportion of lending made by NDTLs being small. The possibility of this was being explored, with the engagement of key industry stakeholders.

2.4 Resulting performance of the BFGS

March 2021

Following the review and expansion of the BFGS up to August 2020, uptake began to increase in the following months. By September 2020, loans supported through the BFGS grew by 26 percent. It was evident the BFGS benefitted from expanding the available pool of loan applicants, particularly through increasing the maximum borrower annual revenue cap and maximum loan limit. These changes also acted to increase, by 84 percent, the value of loans supported. Over the following months, the number of loans supported through the BFGS continued to grow as more businesses remained under pressure from COVID-19.

In March 2021, 2,560 loans were supported through the BFGS, with a total value of $1.91 billion. Most of the loans supported were term loans, at an average value of $701,400.[3]

The BFGS continued to support the flow of credit to SMEs, particularly to the industries hardest hit by COVID-19. Construction, retail trade, and accommodation and food services accounted for 36 percent of all BFGS loans as at March 2021. When the BFGS expanded in August 2020, the concentration of loans in these three industries reduced, before the changes they accounted for nearly half of all BFGS loans. A main driver in reducing the high industry concentration of BFGS loans was the inclusion of lending directly to farms in the BFGS. As the farming sector is largely composed of SMEs, there was quick uptake once they were included. As at March 2021, 144 BFGS loans were supplied to SMEs in the farming and other crop growing industry.

The changes implemented in August 2020 expanded the scope, and allowed for many more SMEs, across a more diverse range of industries, to receive necessary financial support through the BFGS.

2.5 Including Non-Deposit Taking Lenders

April 2021

The TDB advisory review identified the exclusion of NDTLs from the BFGS was an area where the scheme could be enhanced. Traditionally NDTLs predominantly lend to SMEs which are either unable or chose not to use banks for their financing requirements, and this is a very small portion of the total lending market. The value of lending provided by NDTLs may not compare to lending from banks, but a significantly larger proportion of their lending book is made up of much smaller enterprises. NDTLs act as a crucial component in the lending market, providing credit to enterprises which are unable to meet the stricter requirements of banks. With this in mind, the Treasury engaged and negotiated with the NDTL sector to further examine if it was advisable to extend eligibility of the BFGS to NDTLs.

The BFGS was extended to NDTLs in February 2021, at which point UDC Finance joined the scheme. UDC Finance was followed by Prospa NZ, FlexiGroup, ZIP and Speirs Finance in April 2021. The addition of NDTLs enabled the BFGS to access an important part of the SME sector which was not initially included.

[3] 2,238 term loans with a total value of $1.57 billion.

Within the first month of inclusion, $41.2 million worth of loans were supported under the BFGS by NDTLs. This figure may have only accounted for two percent of the total value of loans supported by the BFGS at the time, but, provided a key channel to credit for smaller enterprises disrupted by COVID-19.

2.5.1 Closing of BFGS availability period

June 2021

In June 2021, the availability period of the BFGS came to a close. At the time, there were 4,305 loans supported at a value of $2.86 billion. The BFGS, after changes were made, was able to provide necessary finance to SMEs disrupted by COVID-19 in very tough economic conditions. The industry spread of loans remained a reflection of the nature of COVID-19, with the following industries accounting for 31 percent of all BFGS loans as at June 2021:

- Construction
- Retail trade
- Accommodation and food services.

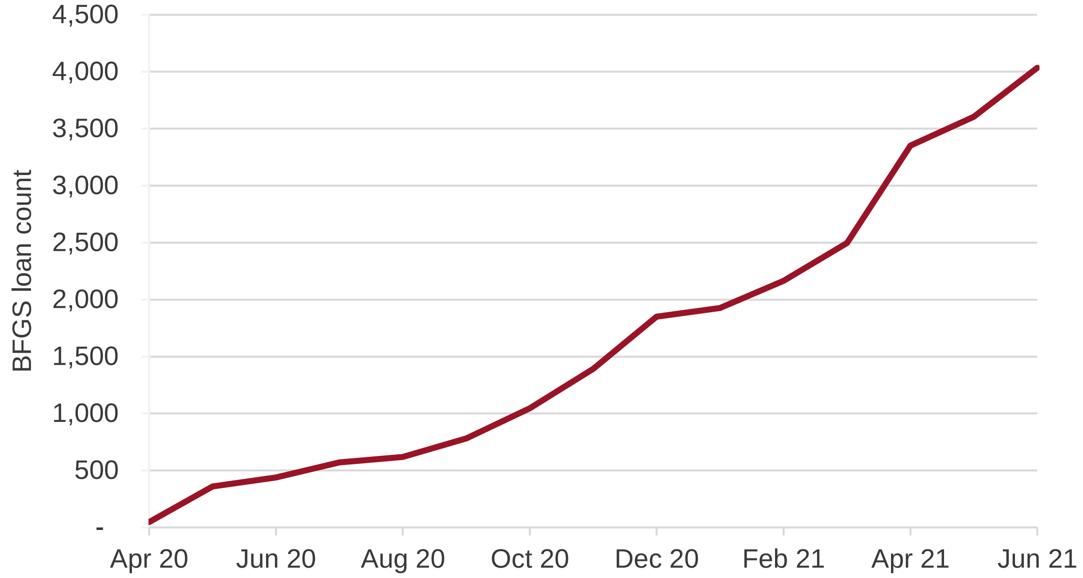
Furthermore, BFGS loans were well distributed around New Zealand, but particularly in Auckland, with 32 percent of loans distributed in Auckland as at June 2021. This was most likely a result of the large number of businesses operating in Auckland due to the scale of its economy.

NDTLs accounted for five percent of the 4,305 loans supported through the BFGS and for three percent of the total value of the loans. As at June 2021, 38 percent of loans distributed by NDTLs had a probability of default rate between 5.9 percent and 16 percent, while only three percent of BFGS loans distributed by banks had a probability of default rate in this range. This is a reflection of the slightly more risky market NDTLs operate in, and their different credit policies, but also shows the importance of their participation in terms of the BFGS reaching marginally viable SMEs.

2.6 The BFGS across its availability period

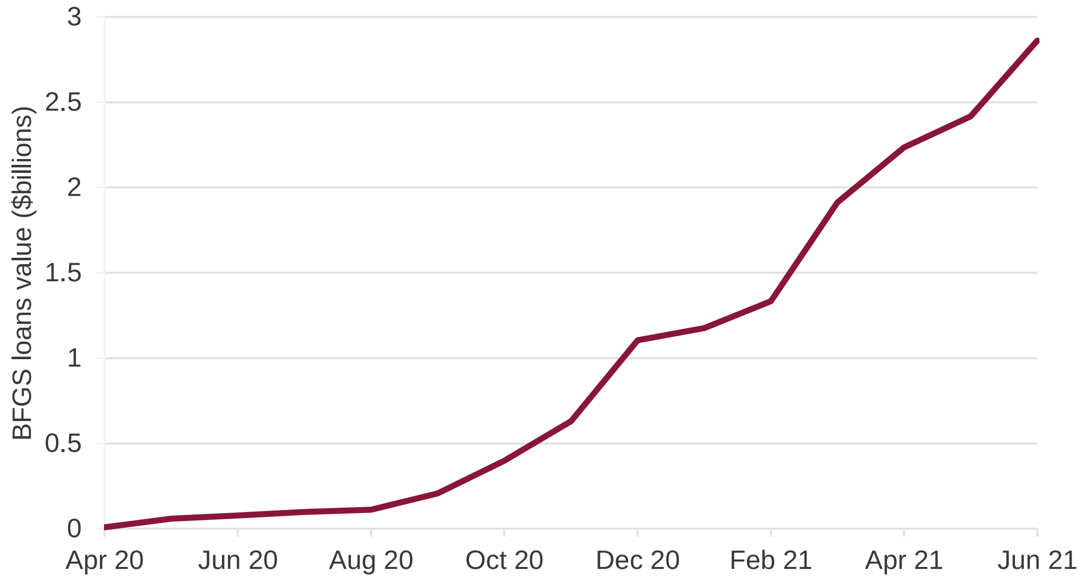
In the early stages of the BFGS, uptake was slow, it was restrictive, and there was a lack of clarity around the scope. However, in August 2020, following the TDB Advisory review, changes were implemented to make the scheme more effective. As presented in Figure 2.1, following the changes adopted in August 2020, the number of loans supported under the BFGS began to increase at a much faster pace than in previous months.

Figure 2.1: Total count of loans supported under the BFGS



Additionally, another spike in loans occurred in the later stages of the BFGS as businesses prepared for another wave of COVID-19, and with the inclusion of NDTLs. Following a similar trend, Figure 2.2 shows the total value of loans supported under the BFGS across its availability period.

Figure 2.2: Total value of loans supported under the BFGS



3 Evaluation of the BFGS

To understand the level of success the BFGS had in achieving its objective and meeting the needs of lenders and borrowers, BERL interviewed key BFGS stakeholders. These included banks, NDTLs and the RBNZ. Our evaluation of the BFGS is structured around each of the high-level questions Treasury sought to answer. It should be noted that one of the key pieces of feedback from interviews was the effectiveness of the Treasury BFGS team in engaging, understanding, and communicating with stakeholders to get the BFGS working effectively in a time of significant and unprecedented uncertainty.

3.1 Did the BFGS achieve its objective?

The general consensus from lenders was that the BFGS achieved the objective of facilitating the provision of credit to cushion the impact of COVID-19 on otherwise viable SMEs facing temporary financial distress.

However, this success was limited in the beginning due to the tight restrictions that were placed on accessibility to the BFGS and the criteria banks were required to use to assess loan applications. After significant adjustments to the BFGS requirements and objective, the BFGS resulted in more lending for some lenders, while for other lenders its effect was negligible.

Key findings

- The majority view of lenders was that the BFGS achieved its objective of facilitating the provision of credit to cushion the impact of COVID-19 on otherwise viable SMEs facing temporary financial distress.
- It took time for the BFGS to achieve its objective. The changes made helped to redefine the objective and increased the number of businesses accessing BFGS borrowing
- The majority of banks and NDTLs were committed to assisting their customers through the pandemic. The BFGS was another tool available to enable lenders to do this. Most lenders took advantage of the BFGS and made loans. However, some lenders reported that the BFGS did not fit their business structure, policies or customer needs, and they did not offer it
- While the RBNZ TLF initially provided banks the ability to offer BFGS lending at lower interest rates, the introduction of the Funding for Lending Programme, which offered the same rate of funding but was not tied to the BFGS, negated this initial advantage
- There was a high degree of uncertainty around what the COVID-19 disruption would be, and for how long it would last
- Many businesses were in survival mode and did not see more debt as the answer. Other support measures the government put in place were more attractive and appropriate for these businesses

3.1.1 The BFGS reduced the risk of banks and NDTLs not lending

The primary objective of the BFGS was to facilitate the provision of credit to cushion the impact of COVID-19 on otherwise viable SMEs facing temporary financial distress. This required creating a clear line of finance for businesses struggling due to the impacts of COVID-19 by reducing the perceived risk of lending for banks, and later NDTLs. The BFGS wanted to reach small to medium enterprises (SMEs) which were marginally viable due to pandemic disruption. It took a significant amount of time for the BFGS to achieve its outcomes, and changes had to be made to push it towards meeting its objective. For some lenders the BFGS saw little uptake even after the changes.

The majority of lenders that participated in the evaluation reiterated that they were committed to supporting their customers through this difficult period, as they have done during other periods of difficulty, such as the 2008 global financial crisis.

Some lenders expressed the view that Treasury, before engaging with banks, had pre-determined that banks would be reluctant to lend and that this was a necessary intervention. However, that said, many lenders confirmed that the government guarantee was often the deciding factor where banks and NDTLs may have been reluctant to lend. A number of lenders referred to the BFGS as the tipping point that gave them the confidence to make a loan.

The BFGS aligned well with RBNZ's TLF. The TLF enabled banks to offer lending at lower rates, which were attractive to customers. When combined with the BFGS this proved attractive to both borrowers, who could now access lower interest rates, and lenders who could reduce their risks. They could continue to lend during higher risk uncertain times, when lending would traditionally tighten, and the risk cost included in lenders' interest rates would be expected to increase.

The use of the BFGS varied between lenders. Some lenders were enthusiastic and actively promoted it both internally within the business and externally to customers, while other lenders did not issue any loans and instead chose to offer their own support packages for customers. Participants reported that the BFGS supported zero to 30 percent of lending made to SMEs over the period.

Lenders gave varying reasons for not taking up the BFGS. Some of the common reasons for not lending were: the risks of lenders being non-compliant, the requirements not aligning with the lenders' business and finance structures, the BFGS not meeting customer needs, and cost of internal structures required to set up and manage the BFGS outweighing the potential benefits.

3.1.2 Strength of the recovery increased uptake

During the early stages of the COVID-19 pandemic, New Zealand businesses and banks were uncertain what impacts would be seen on the economy. Such uncertainty meant many businesses were focused on reducing costs as much as possible and paying off debt. There was little appetite for businesses to take on more debt at this time.

The BFGS started at the beginning of the financial year, and lockdown conditions made it difficult for businesses to prove their viability. However, the New Zealand economy bounced back remarkably well after the initial March 2020 lockdowns. This positive economic outlook increased businesses' confidence to take on more debt as the "new normal" was taking form and vaccine roll-outs were on the horizon. A notable exception to this positivity was from businesses operating in the tourism, hospitality and events industries.

It is difficult to identify at this time how many businesses would have failed without the BFGS, as the BFGS loans may have been delaying the inevitable failure of some businesses. However, the stories of success outnumbered stories of speculative "zombie businesses" from lenders. Lenders noted the BFGS was useful for businesses seeking to adapt to the pandemic disruption, which required significant amounts of capital outside the scope of other support schemes.

3.2 Did changes made to the BFGS contribute to uptake in utilisation?

Participants were clear that the changes made to the BFGS significantly contributed to an uptake in utilisation. The changes increased the number of potential borrowers as well as the value of lending the BFGS could cover. This is supported by the data shown in Table 3.1.

The data clearly shows that the changes made had a significant contribution to uptake. The first round of changes came into effect during August 2020. NDTLs were able to issue loans under the BFGS from April 2021. The changes led to more loans and a higher proportion of high-value loans.

The first round of changes, introduced in August 2020, had the number of loans guaranteed by the BFGS increase by almost 350 percent compared to the April 2020 to July 2020 period when the original rules were in place. The value of loans guaranteed over the August 2020 to March 2021 period following the first round of changes saw the value of loans made increase by over 1,850 percent. The value of lending made in this period was 65 percent of all bank lending made under the BFGS, compared to just 3.5 percent under the initial original structure.

Table 3.1: BFGS guaranteed lending by period

	Bank		NDTL's	
Period	Count	Amount ($)	Count	Amount ($)
April 2020 - July 2020	571	97,996,241		
August 2020 - March 2021	1,989	1,814,505,434		
April 2021 - June 2021	1,257	866,978,538	218	81,636,092
Total at June 2021	3,817	2,779,480,213	218	81,636,092

Source: The Treasury

The changes in April 2021 led to increased lending. Bank lending, following the second round of changes, saw an additional 1,257 loans made, which was a third of all bank loans as at June 2021 and was 31 percent of the value of bank lending. Despite the short timeframe, NDTLs were able to issue impactful lending amounts to their SME customer base. The four NDTLs who opted to utilise the BFGS made 218 loans, which was five percent of total loans. The $81.6 million loaned was three percent of the total guaranteed by the BFGS. The NDTLs were of the view that had they been included from the beginning they could have lent substantially more, and targeted a different customer group from the banks.

Key findings

- Changes made achieved an uptake in utilisation as it increased the pool of possible applicants
- Higher loan limit meant more medium businesses could access the capital
- Inclusion of NDTLs opened the BFGS to more SMEs who did not use banks to access finance
- If changes were made earlier the BFGS could have had greater utilisation. Once admitted NDTLs did not have time to maximise its potential
- Refinancing made the BFGS more attractive as a cost-cutting tool
- Longer term made the BFGS more attractive
- Increased clarity of investigation clause reduced lender reluctance
- The BFGS helped businesses to adapt to the COVID-19 market environment when the lending criteria were broadened.

3.2.1 Criteria for borrowing extension

The extension for the borrowing conditions to include general purpose and capital investment borrowing allowed the BFGS to take off for many lenders. The previous condition limited the BFGS to liquidity support and bridging finance which was not useful for most businesses, particularly as there were other support options available from the Crown and banks. The new criteria allowed businesses to explore ways they could adapt to the pandemic impacts. Often adaptation required significant capital investment, such as new logistics, products, or manufacturing equipment. The expanded criteria also opened the BFGS to businesses that were in acquisition mode, which coupled with the increased loan limit led to larger businesses utilising the BFGS to buy out struggling firms.

3.2.2 Including NDTLs

The changes made significantly increased uptake. The inclusion of NDTLs meant firms which were not able to access finance from banks, or who were more comfortable with NDTLs' lending policies, were able to access the benefits of the BFGS. Even though NDTLs hold a relatively small share of the lending market, for some industries most of their lending comes from non-bank sources. The books of NDTLs typically have a higher proportion of small businesses compared with the books of banks.

3.2.3 Increasing the loan limit and widening the scope

The increase of the $500,000 loan limit to $5 million meant that the BFGS was more viable for medium-sized firms wanting to completely shift their operations or product line to suit the pandemic market environment. Businesses that were in acquisition mode were more agreeable to the BFGS due to this loan cap increase. The maximum borrower annual revenue limit change from $80 million to $200 million made it open to many more larger-scale businesses.

3.2.4 Refinancing

The change to allow up to 20 percent refinancing of existing debts made the BFGS more attractive to firms seeking to reduce their costs in the pandemic. For many firms the prospect of taking on more debt was unattractive, but being able to refinance some their existing debts made more sense and allowed them to survive through the pandemic. Combined with the extension of the BFGS term, it provided a viable way for businesses to reduce finance costs. However, many lenders have noted that this approach may only be prolonging the inevitable failure of some firms, which will likely become evident as the end of the BFGS loans come closer. Businesses were able to refinance 100 percent of their existing debt if they moved to a different lender. This aspect allowed businesses to shop between different providers to secure the most favourable interest rate which led to increased competition between lenders.

3.2.5 Clarifying personal guarantees

Clarifying the terms reassured lenders that they did not have to enforce a personal guarantee in order to claim for the Crown to cover the shortfall. This meant lenders were less nervous to offer the BFGS, and customers were more confident borrowing under it. Enforcing personal guarantees would strain relationships between lenders and businesses, and negate the intention of the BFGS to reduce the perceived risk of lending to marginally viable firms.

3.3 Could the process to establish the BFGS have been improved?

The view of participants was that the process to establish the BFGS could have been improved. The most common feedback was that the changes that were made should have been included at the outset. Participants recognised that the government and Treasury were under pressure to respond to COVID-19, and that this needed to be done quickly.

A common view expressed was that although the BFGS was effective, there were other schemes in place at the time that provided support for businesses struggling because of COVID-19. In some cases lenders noted that some of these schemes had different information provision and reporting requirements that were inconsistent with the requirements of the BFGS, and were often easier to meet. The view was that the Treasury could have taken longer to plan and implement the BFGS. While this would have slowed getting lending to businesses it could have allowed the BFGS to reach more businesses sooner, increasing the awareness and overall effectiveness.

Key findings

- The changes made once the BFGS was operational could have been made earlier
- NDTLs should have been included from the outset
- Announcement was public before it was in place. This caused the BFGS to lose momentum before it started
- Perception that it was difficult to meet the BFGS' requirements to guarantee a loan
- Legal documents made the BFGS more complex than necessary, and difficult for some to understand and implement
- Treasury sought information that the banks were already providing to the RBNZ. Lenders thought there could have been better general communication between the RBNZ and Treasury
- Initial consultation was with high-level managers from institutions which didn't always understand the needs of SMEs and lending at an operational level.

3.3.1 Timing of announcement could have been delayed

To maintain confidence in the lending market, the BFGS was announced before banks knew what exactly it would consist of, and who would qualify. This led to banks turning away initial enquiries from customers. This impacted early take up of the BFGS. The pre-announcement was problematic for communications with customers. A lack of clarity in the scheme inhibited banks' ability to offer solutions or clarity to business seeking access to the scheme.

Potential take up was restricted when the BFGS, in its first instance, was too narrow for many businesses to be covered. In this period banks provided alternative COVID-19 finance recovery or bridging packages, which further reduced ongoing interest in the BFGS.

3.3.2 Lack of clarity of initial requirements made banks cautious when lending under BFGS

The BFGS was hampered in the beginning by banks' perception that securing a BFGS loan guarantee would be difficult. The requirements of the BFGS lacked clarity and exhibited "narrowness" which increased reluctance to issue loans under it. Banks felt there was a concern from the Treasury that the BFGS would be used as a "dumping ground" for failing businesses because the initial requirements were too narrow to be usable at the bottom end of lender's books.

The Deed of Indemnity between the Crown and the banks included a number of investigatory clauses that allow the Crown to actively use those clauses to review the provision of the indemnity in certain circumstances. Those provisions appeared to discourage the banks' participation. Due to the lack of clarity and narrow terms, banks were worried if their debtors defaulted the government would not cover 80 percent of the loss due to a potential misunderstanding of BFGS terms. As such the BFGS lacked the 'bite' in its first aspect to reduce the perceived risks of lending during COVID-19.

Although the banks and Treasury were clear in their understanding of the structure of the BFGS, the terms in the legal documents complicated the BFGS, and made it difficult for lenders to integrate with their existing business, including ensuring those approving lending had a clear understanding its requirements. A common theme amongst participants who were pleased with BFGS, and took advantage of, it was a good relationship with Treasury and a willingness to work together to improve the BFGS. Early and continued engagement allowed lenders and Treasury to make the BFGS more usable for lenders and more attractive to borrowers.

3.3.3 Engagement and including NDTLs earlier would have improved early take up

Initial consultation between Treasury and lenders was with high-level managers. There was a view amongst some participants that those involved in these conversations didn't always understand the needs of SME lending on the ground. Participants would have liked to have seen greater engagement with staff at lower levels who had a greater understanding of what was required to implement and issue lending covered by the BFGS.

Though NDTLs were engaged during the establishment of the BFGS, they were not able to issue loans under it until much later. Feedback was that the NDTLs should have been included from the outset.

Some participants felt the BFGS wasn't necessary because they believed they were already committed to helping their customers. Most lenders were happy with the engagements from the Treasury BFGS team, though they felt some of the information could have been extracted from correspondence already sent to RBNZ.

Once positive NDTLs experienced from the Treasury's engagement with them was a better understanding of their position in the lending market. The NDTLs expressed the opinion that the BFGS might be the starting point for a closer relationship with Treasury in the future.

3.4 What aspects of the BFGS were effective in achieving its objective and what can be learned from the less effective aspects of the scheme?

The overall view of BFGS participants was that most of the lending would have continued without the support of the BFGS. However, this claim was not able to be validated. Interviewees were of the view that BFGS was effective in ensuring that the marginally viable firms received the borrowing they required to allow them to navigate a difficult period for their business.

While the BFGS no doubt has captured the borrowing of some firms that did not require the government guarantee, it was necessary to cast a wide net to ensure that the support for borrowers made it to those who needed it most. In the eyes of participants, these firms that may not have required the guarantee were low risk. Given the economy's strong performance during the recovery, lenders see it as unlikely they will require the BFGS to cover the losses from the vast majority of these businesses. However, the guarantee was the support lenders required to put a marginal borrower's application over the top.

What was clear in the TDB Advisory review and during interviews with stakeholders was that the initial design of the BFGS restricted the scope of business and lending types it would cover. The changes made, as addressed in earlier sections, were the most effective elements in attracting the customers of banks and NDTLs to take advantage of the BFGS, and ensure it was effective in achieving its objective. The increased uptake shown in the data supports this.

Key findings

- The majority of lending would have occurred with or without the BFGS, but it ensured lending got to marginal firms. However, this is not able to be validated
- Changes made the BFGS made it effective in achieving its objective
- Government-backing provided confidence to the market
- The BFGS reduced the cost of funding for borrowers
- Restructuring debt eased burdens on businesses
- For many lenders the BFGS was the deciding factor to lend on 50/50 decisions
- There was a perception of unfairness from NDTLs that were excluded when the BFGS was established
- There was the perception that some lenders took advantage of the BFGS to compete for business and attract new customers, particularly the refinancing change that meant 100 percent could be refinanced if a borrower changed lender. There were instances of this occurring. Although NDTLs reported the majority of borrowers who took debt elsewhere for re-financing returned
- There was inconsistency around BFGS promotion and how it should fit into other funding or support packages
- Clarity was required as early as possible so lenders could prepare for the BFGS launch
- Complexity of the BFGS and reporting requirements reduced uptake.

3.4.1 The BFGS benefitted marginally viable firms, but the initial scope was too tight

The BFGS resulted in many loans with reduced interest rates and restructured debts. Such loans reduced financial burdens, interest rates and anxieties for firms. Though not as widespread as expected, for some lenders, particularly NDTLs, the BFGS was the extra weight which tipped the decision to lend to marginally viable firms. Lenders felt that 80 percent was an adequate number to reduce the risk of lending, and explore credit options with firms which otherwise would not have been able to secure finance. If the guarantee was lower it might not have been strong enough to encourage such lending.

For other lenders the effect of the BFGS on the decision to lend to marginally viable firms was negligible due to already existing COVID-19 recovery packages. Some lenders did not lend to marginally viable firms as part of their policy, so the BFGS was not applicable to changing these lending decisions.

3.4.2 Government backing gave lenders confidence, but unclear for borrowers

The government-backed aspect of the BFGS provided lenders and borrowers with the confidence to finance under the BFGS, once it was clarified that a business met the requirements to be guaranteed. Given this was the primary objective of the BFGS it was effective.

Initially there was concern that it was written in a confusing way ("by and for lawyers") which meant banks were required to put in an onerous amount of policy work to make the BFGS workable. When NDTLs were included, smaller companies struggled as they lacked in-house legal teams to decrypt the BFGS into financial products for customers. What would have unanimously helped lenders and borrowers would have been a plain English companion document or checklist to streamline the decryption process. Such clarity would have led to earlier understanding amongst bank and NDTLs as to what kind of products they could offer, and what kind of competition could be expected. The Treasury BFGS team was effective at explaining the terms when lenders sent through enquiries.

Some banks believed that the insistence on rolling out the BFGS indicated a lack of trust from the Crown that lenders had a genuine interest to support businesses through the immediate challenges of the pandemic, and that lenders would operate the BFGS in line with the Crown's intentions. Some banks were of the opinion that the energy put into establishing the BFGS would have been more effective if put into efforts already underway by lenders to support their customers.

3.4.3 Uneven outcomes for lenders

The initiatives to promote and package the BFGS varied between lenders. Some took advantage of the BFGS and others felt that it was not fit for their books, even after the changes. When NDTLs were included, they only had a short window (April 2021 – June 2021) to issue loans guaranteed under the BFGS. Some NDTLs had experience with similar schemes in Australia, so they were able to design products under the BFGS earlier than others. A common factor that contributed towards high uptake was the lender's capability to dedicate teams and outreach streams to package and market the BFGS to customers.

Lenders felt it would have been beneficial if the Treasury marketed the BFGS more aggressively through government business advisory channels, including the Ministry for Business, Innovation and Employment (MBIE).

Given that banks were able to access the BFGS from the start, and access the RBNZ TLF programme, banks could advertise much lower interest rates than NDTLs outside of the BFGS. This resulted in some banks' lending to businesses in industries outside of their usual portfolios. The perception from NDTLs, who were the majority lenders in these industries, was that this was an unfair advantage. Because borrowers could refinance 100 percent if they changed lender, compared to 20 percent if they remained with the same lender, there were instances of businesses refinancing their debts from NDTLs with banks that were able to offer lower interest rates through the BFGS and the TLF.

3.5 How effective is the on-going management of the BFGS and guarantees issued under it?

Key findings

- Treasury's ongoing management of the BFGS has been very good
- Many lenders have not had BFGS defaults
- There is a reporting burden on some lenders.

3.5.1 Management of the BFGS has been effective

The overall view of BFGS participants, who have made loans guaranteed by the BFGS, was that the management has been effective since the changes were made. As noted earlier one of the common pieces of feedback from interviews was the effectiveness of the Treasury team in engaging, understanding, and communicating with stakeholders to get it operational in a time of significant and unprecedented uncertainty. This has continued in the on-going management.

Participants were pleased with how the BFGS was being managed by Treasury. However, almost all of the lenders that engaged with this review have not had to make a claim under the guarantee. Those who have had to make a claim have indicated the process is clear and effective. It is expected that claims are likely to increase as the BFGS nears its end. Some noted that the true test would come when the loan terms ended and full repayment was required.

Some lenders suggested that because COVID-19 has had a longer lasting impact than many initially thought, including the second extended lockdown in Auckland and higher than usual levels of working from home, the BFGS should be reviewed as loans reach maturity with the potential to extend the loan terms and the guarantee.

3.5.2 Reporting is a burden for some lenders

The ongoing management of the BFGS is seen as somewhat onerous on some banks and lenders. As well as monthly reporting, lenders are required to engage an external auditor on an annual basis to support the preparation of the Crown's annual accounts, and be subject to a potential annual investigation by the Crown. For some lenders which have limited labour capacity, these tasks add a stronger burden to operations. The threat of investigation has made some lenders feel unduly distrusted by the Crown.

Other lenders have not had an issue with reporting, and are happy with the speed Treasury responds to technical issues or requests for clarification.

4 Lessons learned

While the BFGS was successful in achieving its objective, in the course of this evaluation we have identified a number of lessons that Treasury, banks and NDTLs could take from the BFGS that could be addressed in the immediate future, or could be applied if a scheme like this is again required.

4.1 Positive relationships with industry increases chances of success

During engagement with participants it became clear that the lenders with the greatest engagement with Treasury had the clearest understanding of the BFGS were able to communicate it clearly to customers and maximise the guaranteed lending they made.

Utilisation of the BFGS improved when changes were made. Earlier engagement with lenders to consider the strengths and weaknesses of the BFGS was identified as an area where it could have been improved. Additionally, improved targeting and better links with other government support packages could have made the BFGS more effective.

4.1.1 Work closer with industry to develop a solution and engage as much as possible

A common comment was that banks would always support their customers through similar times, and have done so previously. Lenders intended to help their customers through COVID-19 regardless of the support available. Most also had their own support programmes. Lenders were willing and open to engage with the Crown on finance support schemes but wanted them to be easier to integrate with their other offers.

Banks and NDTLs who had a dedicated team and a plan for implementing BFGS loans were more successful generating customer interest and uptake. Greater engagement with participants, and working closer with them in development, could increase future uptake.

4.1.2 Engagement with NDTL sector

There was a view form the NDTL sector that Treasury was not initially aware of their role and importance to commercial lending and were too focussed on banks. There was a view from some in the NDTL sector that this was a missed opportunity at the beginning of the scheme. The relationship between Treasury and the NDTL sector during the BFGS process has improved each other's knowledge and understanding, and enhanced their relationship.

If a scheme like this is considered in the future, in order to reach as many SMEs as possible, NDTLs should be included in the scheme from the outset and, along with banks, should be included in determining the structure of the scheme. This would also ensure fairer competition between banks and NDTLs.

4.1.3 Greater consideration to targeting and impacts of other programmes

BFGS participants provided feedback that it was similar to other government programmes that were easier to access. Debt was also not a priority for many businesses. In addition, businesses in industries hit hard by the pandemic were still not able to secure funding. Targeted packages with greater benefits for struggling sectors might be a future alternative.

4.2 Keep schemes simple and easy to comply with

A common criticism of the BFGS was its complexity and the difficulties lenders had understanding and meeting compliance and reporting requirements. Lenders would have preferred a scheme that was easier to understand and implement, with lower compliance and repotting requirements.

4.2.1 Clarity of requirements and communications

A key finding was that clarity around the BFGS requirements' would have increased uptake earlier. Banks and NDTLs both commented about the difficulties for non-lawyers to understand it. An early, clear outline would have helped lenders prepare to roll-out the BFGS.

Plain English documents, and information that makes the scheme easier for more people to understand, would improve knowledge and understanding for lenders and borrowers.

BFGS participants with the greatest engagement with the Treasury had the clearest understanding it and maximised their share of the scheme's total lending. Active engagement with lenders to provide support would increase future uptake.

4.2.2 Consider reducing reporting and information requirements from banks

Despite reduced risk, lenders will still adhere to lending policy and intend to avoid bad loans. Lenders did not see why reporting, audit and investigation requirements needed to be so high. This made the BFGS overly complex. A simple, easier to understand scheme with less stringent information and reporting requirements would increase participation. However, this would increase scheme risk.

Banks commented that a lot of the information Treasury required was already provided to the RBNZ. They questioned whether there could have been greater information sharing to speed the processes.

4.3 The 80/20 split was attractive to lenders

80 percent was an effective level to set the guarantee and reduce lending risk. This attracted the interest and engagement of New Zealand's largest commercial lenders. The reasons for the lack of guaranteed lending under the BFGS were not related to the proportion of the loan guarantee offered.