TDB ADVISORY

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Review of the Business Finance Guarantee Scheme

A report prepared for The Treasury

TE TAI ŌHANGA
THE TREASURY

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1 Executive summary

1.1 Scope of the review

TDB Advisory Limited (TDB) has been engaged by Treasury to review the Business Finance Guarantee Scheme (the BFGS or the scheme).

The terms of reference were to consider if a scheme such as the BFGS has a role to play in providing working capital to businesses-in-need in a COVID-19 affected environment given the other business support packages introduced by the Crown. If it has, are any modifications to the BFGS required? If so, what are they?

The scheme's primary stakeholders are the Crown (represented by Treasury and the RBNZ), the approved participating banks and businesses with turnover of up to $80 million. We interviewed representatives of all three groups.

Alongside the BFG scheme the government has launched a number of other initiatives designed to assist businesses and their employees affected by COVID-19. The initiatives include wage subsidies, the small business cash flow loan scheme (through the IRD) and a range of tax relief measures.

1.2 Primary objective

The primary objective of the BFGS is to facilitate the provision of short-term credit to solvent firms to cushion the financial distress that may arise from a temporary delay in receipts arising directly or indirectly from the COVID-19 virus.

1.3 Findings

The principal findings of our review are summarised below.

1. Everybody agrees that the scheme is well-intentioned, the implication being that the primary objective of the scheme is well-considered and appropriate.

2. The scheme needs to be a high-trust scheme.

    a. The Crown wants to encourage banks to lend to customers in a difficult business and therefore lending environment. However, the Deed of Indemnity between the Crown and the banks includes 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 appear to be discouraging the banks' participation.

    b. Similarly, the banks are required to use their normal lending criteria, adjusted as they think fit to take into account the COVID-19 environment, to assess an application from a customer for a loan. The intent is that the provision of a Crown guarantee should allow the banks to approve lending to more (but not all) businesses than they would otherwise lend to. However, modifying normal lending criteria to look through COVID-19 is easier said than done given the uncertain impact timeframes and the uneven impact of the virus across different business sectors. The original intention appears to have morphed so that some of the banks' lending criteria for scheme loans are tougher than for non-scheme loans. The evidence suggests that banks have continued to lend to customers but have done so largely outside of the scheme.

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3. Some of the communication associated with the scheme has been inconsistent. Borrowers' perceptions of what the scheme is often don't match reality. The reality is that it is a loan. The perception is that it is a grant. Borrowers' advisors indicate that they can't reconcile their expectations of the scheme with what the banks are offering. For example, the information required to accompany a BFGS loan application is more extensive than for normal bank lending.

4. For their part, banks are finding it difficult to reconcile the requirement to be responsible lenders[1] with the Crown's request that they take more risk.

1.4 Take-up of the BFG scheme

The New Zealand Bankers Association (NZBA) states that the total take-up for BFGS loans is $60 million for 376 customers as of May 25, 2020.[2] This is well below the take-up envisaged for the scheme, being only 1% of the maximum allowable loans. The average approved loan is $160,000 which is significantly lower than the maximum loan cap under the scheme of $500,000.

The scheme has faced criticism over how few applications are being approved by the banks. We estimate that the probability that an application under the BFG scheme is approved is around 16%.[3]

The table below compares the take-up rates in New Zealand under the BFGS with that of similar schemes in other comparable countries.

Country	***Name***	***GDP per capita ($NZD)***	***Approved ($NZD)***	***Approved as % of GDP***	***Loans approved***	***Number of people per loan***	***Loan applications***	***Approval success rate***
NZ	Business Finance Guarantee Scheme	$66,554	$60 million	0.02%	376	12,995		
Australia	Coronavirus Guarantee Scheme	$91,033	~$1 billion	0.04%	11,000	2,272		
Canada	Emergency Bank Account	$73,357	~ $3.5 billion	0.13%	~120,000	313		
Singapore	SME Working Capital Loan	$102,471	~$2.2 billion	0.38%	~2,300	2,452	2,500	90-95%
Switzerland	State Guaranteed Loan Programme	$131,371	$25 billion	2.23%	123,000	70		
UK	Coronavirus Business Interruption Loan Scheme	$68,138	$12 billion	0.26%	36,000	1,851	62,674	~55%
	Coronavirus Large Business Interruption Loan Scheme		$718 million	0.02%				
	Bounce Back Loan		$16.6 billion	0.36%	268,000	249		

[1] Strictly, the requirement under the *Credit Contracts and Consumer Finance Act 2003 for banks to be responsible lenders does not apply to business lending.*
[2] The NZBA records loans that have been drawn-down. The NZBA figures do not take into account loans that have been approved but yet to be drawn-down.
[3] This probability has been determined by taking a weighted average across aggregated data from several banks to determine the percentage of loans approved.

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As the table shows, the take-up of loans in New Zealand has been well below that achieved in the other countries.[4] The approval rate in New Zealand for the government-guaranteed loans is approximately 1 for every 13,000 people. This is a significantly lower approval rate than the next closest country of Singapore with 1 loan per 2,500 people. When comparing the approved loan amounts in different countries relative to their GDPs we find Switzerland to be the highest with the amount of loans approved equalling 2.2% of their GDP. New Zealand has the lowest percentage value sitting at 0.02% of GDP. Switzerland has had an impressive take-up of its government-guaranteed scheme with 1 loan being approved for every 70 people, with a total approved amount of $25 billion.

Our review of the key features of the schemes in other countries (refer section 6 and Appendix 3) indicates that at a high level New Zealand's scheme is not out of line with the broad features seen in other comparable countries. The key differences appear to be in the detail, with countries that have seen a high take-up having schemes that are simple to access, require no personal guarantees and operate on a "high trust" basis.

1.5 Recommendations

Based on our analysis of the New Zealand BFG scheme and our review of similar schemes in comparable countries we consider a number of amendments that could be made to the BFG scheme to increase the scheme's attractiveness to borrowers and lenders without increasing the Crown's risk significantly. These changes may not lead to a major increase in take-up of the scheme given the depressed macroeconomic outlook but they would remove a number of impediments to the efficient operation of the scheme.

The changes we recommend are listed below.

Scheme structure

1. The banks' scheme loans should be partially subordinated to their non-scheme loans. That is, the banks' standard cross-default provisions should be one-directional: non-scheme loan defaults should be an event of default for scheme loans but scheme loan defaults should not necessarily be an event of default for non-scheme loans.

2. To be consistent with the standard terms in the SME sector, the maximum term should be extended to five years.

3. The intention of the scheme is that the banks make the lending decisions and on that basis the watch-list exclusion should be deleted.

4. Property investors and developers who need working capital funding should be included in the scheme.

5. Non-deposit taking lenders (NDTLs) should be included in the scheme.

Alterations to the Deed

6. Any wording that refers to what banks should have known should be deleted.

[4] We have no reason to believe the results from the international comparison are biased, but it is based on a small sample size and may not be representative of all government-guarantee schemes.

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7. The condition precedent should be deleted.

8. Other than what is required for the Crown to meet its own monitoring and reporting requirements, the compliance and monitoring clauses should be kept to a minimum.

9. To the maximum extent possible, the investigatory clauses should be deleted.

Transparency

10. The scheme should be rebranded so that the name of the scheme doesn't risk conveying the impression that businesses' loans are guaranteed by the government.

11. The final versions of the Term Sheet, the Deed and the side letter from the Minister of Finance of 1 May should be made public, subject to any commercially confidential information being redacted.

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2 Introduction

On 24 March 2020, the Minister of Finance announced the introduction of a loan scheme, the Business Finance Guarantee Scheme (BFGS). The scheme was designed to provide emergency liquidity and working capital to small and medium-sized businesses impacted by the COVID-19 pandemic and the subsequent lockdown in New Zealand.

The BFGS is a partnership between the Crown and participating approved banks. The scheme is intended to support the provision of new bank loans to viable businesses by the Government taking on the default risk of up to 80% of the loan. The Crown's fiscal risk is intended to be protected by the banks' retaining the remaining 20% of the default risk of the loan.

The size of the scheme is capped at $6.25 billion with the Crown's exposure capped at $5 billion. The scheme currently runs until 30 September 2020.

2.1 Objective of the scheme

The broad objective of the BFGS is to provide finance to protect jobs and support the economy[5].

The specific objective of the scheme is to facilitate the provision of short-term credit to cushion the financial distress on solvent (non-financial) firms with viable business models that may arise from a temporary delay in receipts arising directly or indirectly from the COVID-19 virus[6].

To be specific, the objective of the scheme is to prevent business failures caused by a temporary lack of access to working capital as a consequence of COVID-19. The objective is not to prevent business failures caused by COVID-19 or any other reason. Businesses will fail as a consequence of COVID-19 because the world has changed. For example, it would now be very hard to lend to a company whose viability is for the large part dependent on international tourism.

2.2 Scope of the review

TDB Advisory Limited (TDB) has been engaged by the Treasury to review the Business Finance Guarantee Scheme.

The terms of reference were:

1. From this point moving forward, what should the objectives of the scheme be? Given the introduction of other business support packages by the Crown, does this scheme have a role to play and, if so, what is it?

2. What specific changes, if any, should be made to the scheme to meet those objectives?

3. How should success be measured?

4. What should governance be for the ongoing policy work for the scheme?

[5] https://www.business.govt.nz/COVID-19/business-finance-guarantee-scheme/

[6] Business Finance Scheme Finalised Term Sheet

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In addressing these questions, we were required to take into account:

- The overall (and expanding) package of Government initiatives being implemented to support businesses, and how the BFG Scheme nests as one element within that.
- Realistic expectations about what a working capital guarantee product like the BFG Scheme can achieve, relative to other support initiatives.
- Experience to date with the BFG Scheme as a bank-led product, compared with alternative delivery channels (e.g. IRD, NZ Export Credit Agency).
- Our evolving understanding of firms' needs (and lenders' needs) for this particular initiative as the economy moves into a recovery phase.

2.3 Background

On 31 December 2019, the World Health Organisation (WHO) was informed of cases of pneumonia of unknown cause detected in Wuhan City, Hubei Province of China. By 7 January, the Chinese authorities had identified a new type of coronavirus. The WHO declared COVID-19 a global pandemic on 11 March 2020. Since then, the pandemic has spread to more than 200 countries and territories, has infected more than 4.3 million people, and has killed more than 300,000 people[7].

On 23 March 2020, New Zealand's Prime Minister announced that the country would move to alert level 4 within 48 hours – essentially a stay-at-home notice for everyone other than those people providing essential goods and services.

On 24 March 2020, the Minister of Finance announced the introduction of the Business Finance Guarantee Scheme. The scheme was in place by mid-April. The time taken to develop the scheme and execute the deed and indemnity (around six weeks) was in line with that advised in Treasury reports T2020/707 and T2020/642 of 20 and 22 March. However, the expectations of at least some in the business community were that finance would be available as soon as the scheme was announced.

On 1 May, the Minister of Finance announced a number of changes to the original scheme, such as extending eligibility to businesses with turnover of less than $250,000, deleting the requirement that scheme loans be secured via a General Security Agreement (GSA) and including the originally excluded parts of the agricultural sector in the scheme. The changes increased the flexibility of the scheme and the pool of potential borrowers.

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[7] https://www.who.int/docs/default-source/coronaviruse/situation-reports/20200514-COVID-19-sitrep-115.pdf?sfvrsn=3fce8d3c_4

3 The Business Finance Guarantee Scheme

3.1 Eligibility

To be eligible to apply for a loan under the scheme, businesses must be New Zealand-based with annual turnover of less than or equal to $80 million, not be on a bank's credit watchlist as at 31 January 2020, and not be engaged in certain excluded activities[8].

Eligibility requires viability. That is, the banks are required to assess scheme applications using their normal lending criteria, adjusted to look through COVID-19, to make their final lending decision.

3.2 Key terms

The key terms of loans under the scheme are:

- each loan can be up to $500,000;
- the maximum tenor is three years and the loan must be repaid during that time; and
- loans can only be used to meet liquidity and bridging finance needs while businesses deal with the disruption to their business caused by COVID-19.

In addition, loans cannot be used for:

- financing capital assets or projects (other than business-as-usual expenditure which does not exceed 5% of the principal amount of the loan);
- distribution of dividends or on-lending outside the customer's guaranteeing group; and
- refinancing certain existing debt (except if the relevant loan already meets the scheme criteria, was advanced on or after 16 March 2020 and has a term of no more than 180 days).

3.3 Deed of Indemnity

The Deed of Indemnity (the Deed) between the Crown and the individual banks is the document that establishes the indemnity granted by the Crown to the individual banks to give effect to the BFGS. The Deed is specific to the BFGS and BFGS loans and is summarised as follows:

- the Crown indemnifies the banks against 80% of any shortfall arising from a scheme loan default (clause 2);

[8] Excluded activities include: property development and property investment; the manufacture of cluster munitions, civilian automatic or semi-automatic firearms, magazines or parts, and anti-personnel mines; the manufacture or testing of nuclear explosive devices; the manufacture of tobacco; the processing of whale meat; recreational cannabis; and any other activity notified by the Crown in writing to the approved banks. Certain agricultural sectors were initially excldued but the exclusion was removed under the changes to the scheme on May 1.

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- a scheme loan is one that is being provided to a business for the purpose of obtaining liquidity and bridging finance while the business deals with the disruption caused by COVID 19 (clause 3);

- there are a number of uses to which the proceeds of a scheme loan cannot be applied;

- a scheme loan cannot exceed $500,000 and there can be only one loan in place at any one time between a bank and a borrower (and guaranteeing group);

- all scheme loans must be repaid by the third anniversary of the loan;

- a bank's decision to enter into a scheme loan is to be made in accordance with its standard loan policies, practices and processes as modified to allow the bank to give effect to the scheme and to allow the bank to look through the economic cycle to sensibly take account of the uncertainty of the current economic conditions caused by COVID-19;

- each scheme loan will be documented in accordance with each bank's standard terms and conditions as modified to allow the banks to sensibly take into account the uncertainty of the current economic conditions caused by COVID-19;

- the banks can rely on certification provided by a borrower that it is eligible for a scheme loan unless the banks knew or should have known that the borrower was not eligible;

- the total amount that banks can advance under the scheme is limited (clause 4);

- if a scheme loan defaults, the banks are entitled to use recoveries to repay other loans to the borrower before being used to repay the scheme loan (clause 5);

- the banks must have systems and controls in place designed to ensure that a scheme loan actually is a scheme loan (clause 6);

- the banks must manage each scheme loan as they would any loan taking into account any modifications made to take into account COVID-19;

- in the event of default, the banks must take whatever action they think is commercially reasonable;

- the banks must report monthly to the Crown. Amongst other things, the banks must certify monthly that they have the appropriate systems and controls in place to manage scheme loans, that the systems and controls are the same as the banks use in the ordinary course of business, and that the systems and controls work effectively (clause 7);

- the banks must agree to have an audit of their financial information relating to a sample of their loans and to provide a copy of the audit report to the Crown;

- the Crown has the right to investigate the banks' compliance with the obligation to have appropriate systems and controls and whether or not any loan qualifies as an eligible scheme loan (clause 8);

- if an investigation reveals that a loan in respect of which the Crown has made a payment to a bank under the Deed is not an eligible scheme loan, the bank must refund the payment;

- if an investigation reveals that loans that have been represented as scheme loans are not scheme loans, those loans will not be entitled to a payment from the Crown under the Deed;

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- if an investigation reveals that a material number of loans have been mis-classified or that the bank is not complying with its systems and controls requirements, the Crown may review that bank's participation in the BFGS and may terminate the Deed;
- the banks can make a claim against the Crown only once they have completed their usual arrears management and enforcement processes and have determined that they do not expect to make any additional recoveries (clause 9);
- the banks must repay (with interest) all amounts received from the Crown under the Deed in excess of what they were entitled to receive (clause 10);
- both the Crown and the banks can terminate the Deed. Any termination does not affect any rights and obligations established prior to termination (clause 13); and
- the banks must provide the Crown with certain information including a summary of their standard loan policies, practices and processes as modified to allow them to look through the economic cycle to sensibly take account of the uncertainty of the current economic conditions caused by COVID-19, which is a condition precedent (clause 17).

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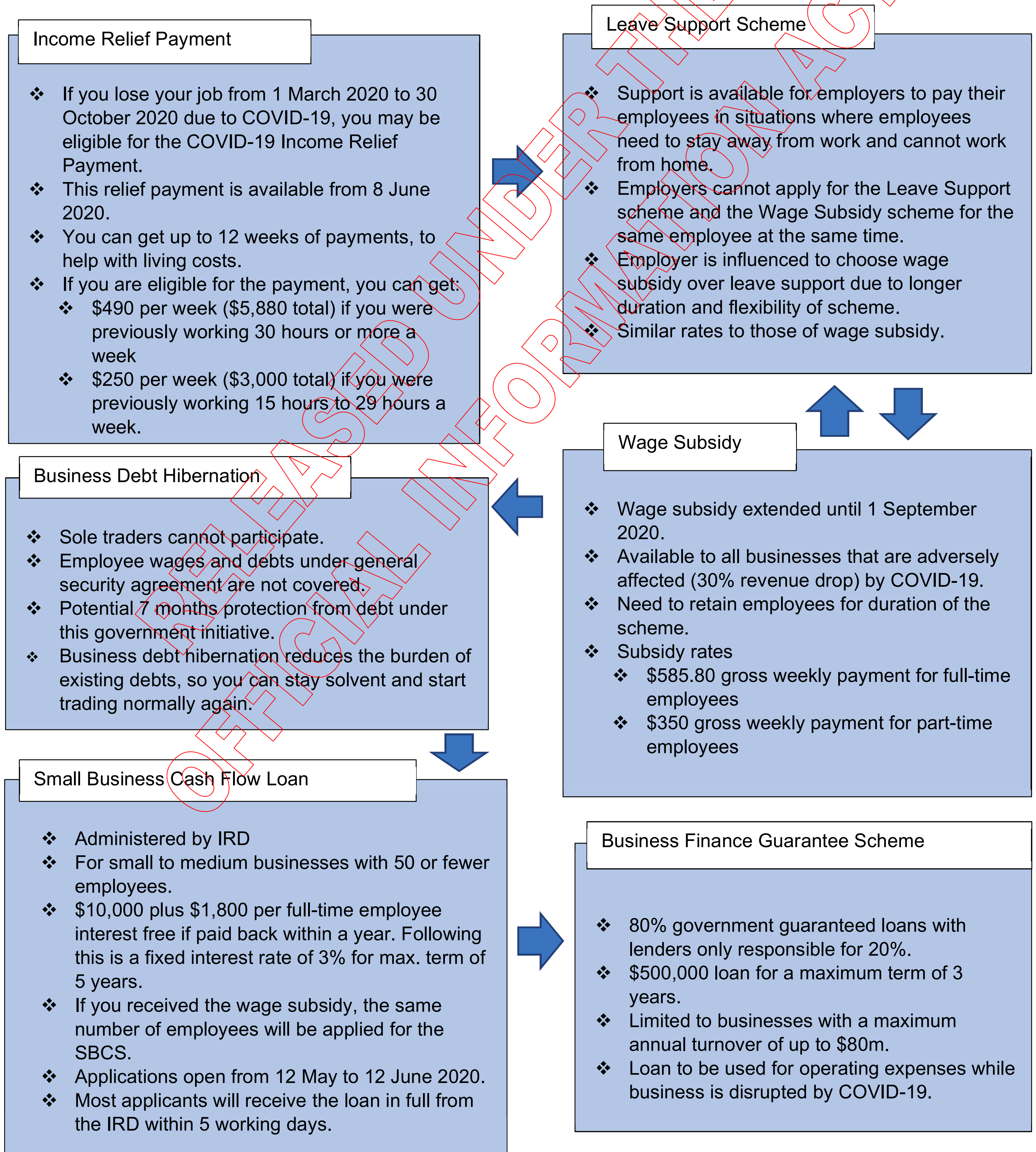
4 Other support measures introduced by the Crown

Along with the BFG the government has introduced a number of other schemes. These include wage subsidies, the small business cash flow loan scheme (through the IRD) and a range of tax relief measures. The diagram below shows the key terms and the likely path businesses will take when applying for the different government initiatives.



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5 Issues with the Business Finance Guarantee Scheme

5.1 Commercial context

The Crown wants the banks to do something for it, that is, get cash to where it is needed and wouldn't otherwise get to, to try and reduce the negative economic impacts of COVID-19. The Crown wants to use the banks because they will be effective:

- they have got the required reach;
- they have already got the necessary systems and processes in place to distribute / lend cash and manage risk; and
- they are under the prudential supervision of the RBNZ.

The Crown wants the banks do something that they wouldn't otherwise choose to do. That is, to take more risk.

The commercial reality is that the banks are in a position of strength from a document-negotiating perspective.

5.2 Measures of success

There are two primary success measures for the BFGS. Both are partial measures. The two success measures are:

1. The size of the Crown's exposure under the scheme. The primary objective of the scheme is to provide a liquidity cushion to solvent businesses that need it. If the Crown's exposure is $5 billion, the scheme could be judged to be at least partially successful – liquidity has been provided but it will be difficult to determine whether or not it went to the right places. If the Crown's exposure is not $5 billion, it would be incorrect to conclude that the scheme has been unsuccessful. It could in fact mean that the scheme wasn't actually required.

2. Claims against the guarantee. This measure helps answer the question about whether the liquidity went to the right places. The provision of the guarantee is intended to encourage banks to lend to businesses that they otherwise would not lend to. The more claims there are against the guarantee, the more confident the Crown can be that the banks did what was intended and increased their risk appetites. It is also only a partial measure because low claims do not necessarily mean that the banks did not increase their risk appetites. It could instead mean that the credit environment ended up being relatively benign.

The first cannot be fully measured until the availability period finishes on 30 September 2020 and the second cannot be fully measured until the scheme expires in three years' time.

5.3 Issues

As part of our review of the BFGS, we interviewed a cross-section of stakeholders including most of the large participating banks, a number of industry organisations and a number of people who had input on behalf of the Crown. A summary of their comments can be found in Appendix 1. From our examination of the scheme and from our interviews with various stakeholders, the material issues we have identified are discussed below.

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High-trust

The commercial reality is that the scheme needs to be a high-trust scheme – in both directions. The banks need to trust that the Crown will let them get on and do what they do best without transferring risk to them and the Crown needs to trust that the banks will manage its exposure appropriately with minimum checks and balances.

However, the Deed of Indemnity between the Crown and the banks contains a number of safeguards that seek to protect the Crown's interests but which serve to undermine the primary objective of getting liquidity to otherwise solvent businesses. For example, the Deed includes a number of investigatory clauses that appear to allow the Crown to review the provision of the indemnity in certain circumstances. Those provisions appear to be discouraging the banks' participation.

The intention of the scheme is to provide working capital to those businesses that don't meet the normal lending criteria of the banks. In other words, those businesses that couldn't otherwise access credit. It is easy for the banks to distinguish one group of borrowers from the other but it is not clear how the Crown will ensure that scheme loans are going to businesses that need support and not those that don't.

The RBNZ has determined banks should treat BFGS exposures as claims on corporates, risk-weighted at 20%. The RBNZ funds the banks at an interest rate of 0.25% for scheme loans. It would be a perverse outcome if the cost of debt to scheme loan borrowers was less than the cost of debt to non-scheme loan borrowers. Businesses that don't need the support of the Crown to borrow would rationally try and crowd those that do out of the scheme.

Normal lending criteria

To be eligible to make a claim under the Deed, the banks are required to apply their normal lending criteria as modified in order to look through the uncertainty associated with the COVID-19.

Normal lending criteria fundamentally requires that borrowers have two repayment paths. The first path is cash flow – the business must be profitable and / or generating enough cash to be able to service and repay (or refinance) the loan when it falls due. The second path is security – if the business fails to generate sufficient cash, the banks will look to realise their security to repay the loan. In a COVID-19 world, the first path is very difficult to assess and, in any circumstances, banks tend to try and avoid the second path if at all possible.

That said, the BFGS guarantee does give banks the required second way out in some circumstances in which they wouldn't otherwise have it and therefore, by definition, increases the potential pool of borrowers.

However, modifying normal lending criteria to look through COVID-19 is easier said than done. There are two particular issues: time and sector exposure:

- The impact of COVID-19 is expected to be temporary but nobody knows how long its impact will be felt by borrowers.

- COVID-19 is going to impact some industries more than others. The sectors that appear to be the most immediately and worst affected are tourism, hospitality, and retail. These are the sectors that might be expected to apply for a loan under the scheme sooner rather than later. However, unless, in the banks' assessments, these sectors have a future, the banks will not lend to them.

The banks say that they are prepared to take more risk. Feedback from potential borrowers is that the information that the banks require to support a scheme loan application is more than what they would

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normally require and is "too hard". Some, for example, claimed that businesses are being required to provide shareholder guarantees for scheme loans, scenario analysis in their applications and that loans have to be for a fixed three year term. In fact, while some banks may be requiring such terms, none of them is required under the Term Sheet or the Deed with the Crown. Some in the business sector suggest that the banks should not have to apply their normal lending criteria, even if it is modified, and that the businesses should be able to just apply for and then receive support.

Our observation would be that given the Crown wants to / needs to cap its exposure to businesses in order to achieve some balance between its fiscal and economic/social objectives, the only way to try and ensure that limited funding gets to those businesses that have a future is to apply some sort of criteria and the banks are best placed to apply that criteria. Having said that, in our opinion the clauses in the Deed that allow the Crown to review its obligations on an ex-post basis have had an unintended consequence. That being that the banks' credit criteria, if not being tougher for scheme loans than non-scheme loans, at least is being more rigidly applied.

Responsible lending

Banks state that they are required to be responsible lenders. Lender responsibilities are defined in the Credit Contracts and Consumer Finance Act (CCCF Act) and apply to consumer lending. However, the banks appear to choose to apply the responsibilities more widely and to include business lending. The lender responsibility principles impose obligations on lenders when dealing with borrowers and guarantors.

There are two lender responsibility principles:

- Principle 1: a lender must exercise the care, diligence and skill of a responsible lender in all its dealings with borrowers and guarantors.

- Principle 2: a lender must comply with the specific listed lender responsibilities set out in the CCCF Act. These responsibilities include lenders making reasonable enquiries before entering into a loan or taking a guarantee to be satisfied that:

  - the credit provided will meet the borrower's needs and objectives; and

  - the borrower or guarantor will be able to make the payments under the loan, or comply with the guarantee, without suffering substantial hardship.

Lenders must also help borrowers and guarantors make informed decisions about whether to enter into the loan or to give the guarantee.

Given COVID-19, how do lenders satisfy themselves that borrowers will be able to make repayments under the loan without suffering substantial hardship? The banks' caution here is understandable: they are big and profitable and therefore easy targets. Having said that, according to the New Zealand Bankers Association[9], since going into lock-down, the banks have made new loans totalling $8.9 billion and have provided other assistance[10] totalling $18.1 billion. In other words, the banks appear to have been able to satisfy their responsible lending concerns with respect to non-scheme lending but not scheme lending.

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[9] https://www.nzba.org.nz/consumer-information/COVID-19/business-lending-data/ Last accessed on 25 May 2020.

[10] Other assistance includes reduced loan repayments, deferred loan repayments and restructured loans.

As noted above, responsible lending is only regulated when it is consumer lending. The responsible lending regulations do not apply to business lending. Although banks do not want to be irresponsible lenders to businesses, the definition of "responsible" is in their own hands.

Cross default

On the face of it, lending under the scheme means that the Crown takes 80% of the credit risk and the banks take 20%. However, most scheme borrowers are likely to have other debt with the banks. If a scheme loan defaults, normal cross-default provisions mean that the borrower's other loans also default. The banks are 20% exposed to scheme loans and 100% exposed to their other loans.

Prior to claiming under the indemnity, the banks are required to do everything that they consider to be commercially reasonable to recover the outstanding debt. Once they have a reasonable expectation that no other money is recoverable then they can claim against the indemnity.

It is reasonable to assume that businesses would prefer not to take on additional debt in a difficult trading environment and would not were it not for COVID-19. Not only is there the additional debt in conjunction with a more difficult trading environment but, on top of that, if one loan defaults they all default.

In our opinion, the scheme would be more attractive to both lenders and borrowers if it included some level of subordination (or isolation). In other words, if the scheme were modified so that scheme loan defaults wouldn't necessarily lead to a cross-default on non-scheme loans but non-scheme loan defaults would lead to cross-default on scheme loans. That would mean that the banks would be able to call on the Crown guarantee and recover 80% of what they are owed (and lose 20%). It would also mean that the affected businesses probably were viable other than for the impact of COVID-19 (which aligns with the intention of the scheme).

The implications of this suggestion are:

- It reduces the banks' risk on the one hand and therefore allows them to take more risk on the other. That's what the scheme intends.

- Banks are probably more likely to claim against the guarantee. At the same time it would mean that the banks have decided to write off 20% of the debt and so their first preference would remain repayment.

- Borrowers are probably more likely to try and borrow the maximum of $0.5 million, but it also means that the banks have to be prepared to lend the maximum and risk the maximum.

- Banks are probably more likely to encourage borrowers to repay non-scheme loans in preference to scheme loans but the Deed already contemplates that and it is specifically permitted.

- The Crown's losses will probably be higher than they otherwise would have been, but at the same time the Crown's losses are limited to $5 billion.

Transparency

It has been suggested that the lack of transparency with respect to the agreement between the Crown and the banks has led to an element of suspicion in the business and advisory sectors.

In our opinion, to debunk any myths and clarify any misinterpretation about the scheme, the final versions of the Term Sheet and Deed of Indemnity should be made public, subject to redacting any commercially confidential information. Other than the amount of the specific indemnity between the

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Crown and the individual banks, there appears to be little, if anything of a commercially sensitive nature in the documentation.

Misinterpretations

A number of businesses that applied for a scheme loan seem to have thought that it was effectively a grant and that they had a right to receive it. According to the banks, it has taken a considerable amount of re-education for some to understand the true nature of the scheme. The misinterpretation seems to have been linked to the use of the word "guarantee" in the name of the scheme.

The nature of this misinterpretation is temporary but there could be advantages in rebranding the scheme if the scheme is continued beyond 30 September.

A number of the banks mentioned that a three-year term loan was not a suitable product for a working capital facility. In our opinion, these banks have misinterpreted the documentation. The Term Sheet and Deed state that the loans can have a maximum term of three years, which means that they could be shorter. It is not clear why a borrower would opt for a shorter term in the circumstances given there is nothing to stop the borrower repaying early. Similarly, the Term Sheet states that scheme loans can be term loans or revolving facilities. In our opinion, those options give banks all the tools they need to meet borrowers' requirements.

This misinterpretation needs to be corrected as it has apparently inhibited applications.

Some banks suggested that it would be better to qualify each loan for the guarantee as it was approved rather than when it defaults and that the Crown should trust that the banks will act appropriately given the amount of "skin they have in the game". However, it must be the case that each loan is qualified for the guarantee as it is approved otherwise the banks and the Crown would not be able to quantify their exposures.

It is more likely that these banks were referring to the Crown's ability to review the eligibility of loans on an ex-post basis. On this point we agree with the banks. In our opinion it is very unlikely that a bank would systematically include ineligible loans in the scheme given a) it is taxpayers via the Crown who are providing the guarantee and b) the reputational damage associated with systematic abuse being discovered would be significant. In addition, a loan review would be a very low value proposition given the likely cost of any review versus the size of any one loan.

Commercially reasonable – intention versus ability

We understand it is the Crown's intention that it will meet its 80% commitment when called upon to do so. The Deed of Indemnity gives the Crown the ability to review its commitment on the basis of the following:

- Eligibility
  - Under the Deed the banks can rely on certification provided by a borrower that it is eligible for a scheme loan unless the banks knew or should have known that the borrower was not eligible.
  - The intention of the scheme is to get liquidity into the hands of small and medium sized businesses quickly by allowing banks to rely on businesses certifying their eligibility. In the event of there being a claim under the Deed and it being discovered that a business is ineligible, this clause gives the Crown the ability to look back and challenge what the bank should have known. The implication is that the Crown will use the clause to review its obligations under the Deed.

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- It is reasonable that non-eligible loans not be entitled to payment from the Crown under the Deed. However, given the banks have financial and reputational "skin in the game", the Crown should be confident that the banks will comply with the scheme's eligibility requirements and that any non-compliance would be in error rather than intended. The eligibility criteria are clear. The banks' approval processes usually separate the client relationship function from the credit risk assessment function. Therefore, for each loan, at least two people in each bank will have signed off on the eligibility of a loan.

- In our opinion, the words "or should have known" should be deleted.

- Compliance

  - The banks must report monthly to the Crown. Amongst other things, the banks must certify monthly that they have the appropriate systems and controls in place to manage scheme loans, that the systems and controls are the same as the banks uses in the ordinary course of business, and that the systems and controls work effectively.

  - The banks must agree to have an audit of their financial information relating to a sample of their loans and to provide a copy of the audit report to the Crown.

  - The Crown made a deliberate decision to use only registered banks to give effect to the scheme precisely because the banks are monitored by the RBNZ and have well-established and appropriate systems and controls in place. In other words, the Crown already knows that the banks are good at what they do.

  - In our opinion, other than the agreed upon procedures engagement contemplated in clause 7.2 of the Deed, the compliance aspects of the Deed should be kept to a minimum.

- Investigations

  - The Crown has the right to investigate the banks' compliance with the obligation to have appropriate systems and controls and whether or not any loan qualifies as an eligible scheme loan. If an investigation reveals that a loan in respect of which the Crown has made a payment to a bank under the Deed is not an eligible scheme loan, the bank must refund the payment. If an investigation reveals that loans that have been represented as scheme loans are not scheme loans, those loans will not be entitled to a payment from the Crown under the Deed. If an investigation reveals that a material number of loans have been mis-classified or that the bank is not complying with its systems and controls requirements, the Crown may review that bank's participation in the BFGS and may terminate the Deed.

  - The intention is that the Crown only pays those claims that it is required to pay. These investigatory clauses give the Crown the ability to satisfy itself that the banks have complied. The implication is that the Crown will actively use these investigatory clauses and that the banks could find themselves more exposed to this new lending than they had anticipated.

These clauses may be well-intentioned but are commercially unreasonable and are unnecessary:

- These clauses will probably constrain the ability of the Crown to achieve the primary objective of the scheme. The primary objective of the scheme will be achieved if the banks collectively lend close to $6.25 billion to businesses that they wouldn't have otherwise lent to. To the extent that the banks assess that the look-back nature of these clauses to mean that they

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could end up being more exposed to this additional lending than they intended, they will be more cautious in their lending under the scheme.

- Unless the Crown is actually uncertain about the ability of the banks to apply their normal processes and practices and is not confident that the banks actually already have the appropriate systems and controls in place, the benefit of these clauses to the Crown is in our view out-weighed by the cost of these clauses to the banks. The banks are well-established businesses with strong credit ratings that managed their way through the global financial crisis in 2008-09 very well. To comply with the clauses noted above, some of the banks have indicated that they will have to set up new processes and procedures and deploy staff specifically. We don't think that that was what the Crown intended.

- The relatively small size of each loan means that the investigatory clauses are low value-for-money propositions.

- The clauses assume that the banks have some incentive to game the scheme. That assumption is not unreasonable. The banks have the ability to decrease their risk by applying the Crown guarantee to loans that don't require it: ie, to loans that they would have advanced in any case. However, we doubt that there is any practical way of policing that without compromising the primary objective of the scheme.

Appendix 2 of this report discusses our concerns with the current wording of the deed in relation to ex-post investigations in more detail.

Term

The requirement that scheme loans be repaid within three years is reportedly tough. The banks would prefer that businesses had more time. They suggested lending in the small business market was more usually five years.

Given it is the Crown's expectation that the banks will employ normal practices and procedures, if five years is a standard term in the sector then it's reasonable that the scheme's term also be a subject to a maximum of five years.

Watch-list

Some banks argued that the watch-list exclusion doesn't make sense. A borrower could be on a watch-list as at the end of February as a result of the timing of receipts over the Christmas period but not be on the watch-list as at the end of March. The banks argued (reasonably) that the scheme wants them to apply their normal lending criteria but then specifically excludes borrowers whom they might otherwise have lent to. It is a reasonable argument. Given that the banks are 20% exposed to scheme loans and 100% exposed to any non-scheme loans, the Crown should let the banks decide who they are going to lend to under the scheme.

Non-deposit taking lenders

There was some suggestion that non-deposit taking lenders (NDTLs) should also be included in the scheme. The argument for their inclusion was that there are a large number of businesses that don't borrow from banks but only from finance companies and therefore these businesses are being excluded from the scheme. On the other hand, the logic for excluding NDTLs is that they are a small proportion of the business lending market (approx. 4%) and they are not subject to the same prudential regime as the banks.

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In our opinion, if the NDTLs were included, the Crown's Deed of Indemnity with them would have to be different from the Deed with the banks. To be specific, the Deed would need to include most if not all the monitoring and compliance components that we have recommended be removed from the Deed between the Crown and the banks.

It should be noted that businesses that lend from NDTLs are not excluded from the scheme. They might not borrow from banks currently but they will definitely have bank accounts and therefore have been through the "know your customer" aspects of the banks' account opening processes. To the extent that scheme loans can be unsecured their existing loan arrangements with NDTLs do not need to be compromised.

Excluded sectors

A number of sectors were excluded from the original BFGS. The previously excluded parts of the agriculture sector were included in the scheme under the May amendments. Another sector that could be included in a modified scheme is the commercial property sector. We are not aware of any rationale for excluding the working capital requirements of the property investment and development sectors from the scheme, especially as the commercial rental property market is likely to be one of sectors most impacted by COVID-19 and the lock-down.

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6 International comparison of business finance guarantee schemes

We have investigated several countries regarding their business finance guarantee schemes in response to COVID-19. The information that we have gathered considers the terms and take-up of the different guarantee schemes. We have endeavoured to determine potential insights and lessons to assist in developing the New Zealand BFG scheme to better support small and medium businesses.

The countries examined are Australia, Canada, Finland, Hong Kong, Singapore, Switzerland, Sweden and the United Kingdom. These countries have been chosen because, like NZ, they are small developed countries or in the case of the UK because of the common institutional heritage.[11]

The following conclusions and insights can be drawn from our review of other countries:

- The schemes vary widely across the different countries with:
  - government guarantees typically around 80% but ranging from 50% (Australia) to 100% (Hong Kong, and for some schemes in Canada, Switzerland and United Kingdom);
  - the loans are generally terms loans with a term of around 3 years but Canada offers finance with terms also of 1 and 10 years;
  - the maximum size of the business loans range from around $47,000 (a Canadian scheme) to $100m (a UK scheme). Australia's maximum is $270,000 and a new highly successful scheme in the UK (the Bounce Back Loan Scheme) has a maximum of $100,000;
  - the schemes' current availability typically extends from around Sept 2020 to as far as December 2021 but the Finnish scheme is available till December 2025; and
  - loans are generally provided through banks though Australia also has made offers to five non-bank lenders.
- The Bounce Back Loan Scheme in the UK has experienced significant uptake since it was introduced earlier this month. The uptake probably reflects a combination of low fixed interest rates, no personal guarantees and an easy application form that ensures small businesses receive fast approval.
- The Emergency Bank Account scheme in Canada has had significant uptake also. It features a forgiveness clause where if the loan is paid back early there is a 25% forgiveness of the debt.
- Switzerland has also seen significant uptake in its government guarantees. The Swiss scheme is also reportedly very easy to access.

[11] A more in-depth description of each scheme is provided in Appendix 3 of this report.

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- Several countries have built on the existing experience exporting agencies have with guarantees. Granting domestic powers to these state-owned enterprises (as seen in countries such as Finland and Canada) have allowed these schemes to develop from existing institutions with established relationships with banks.

- Sweden is one of the few countries that allows the state guarantees to be for either working or investment capital purposes. Other countries generally restrict loans primarily to working capital purposes.

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7 Options for improving the BFG scheme

In our opinion, the key change required is for the Crown to make it as simple as possible for the banks to actively participate in the scheme by removing from the Deed anything that implies that the Crown will or could look back and challenge its obligations under the Deed. The basic structure of the scheme is sound: the banks have sufficient incentive to continue to apply their standard lending practices, which is all that the Crown requires. Errors will be made and scheme loans will inevitably be advanced to ineligible businesses but the banks' standard systems and procedures are such that, in our opinion, errors will be few and non-compliance will be low.

Changes to the scheme that should be considered are:

Scheme structure

1. The banks' scheme loans should be able to be isolated from their non-scheme loans.
2. The maximum term should be extended to five years.
3. The watch-list exclusion should be deleted.
4. Property investors and developers should be included in the scheme.
5. The list of approved lenders should be expanded to include non-deposit taking lenders.
6. The Crown should guarantee 100% of the banks' exposures.

Alterations to the Deed

7. Any wording that refers to what banks should have known should be deleted.
8. The condition precedent should be deleted.
9. The compliance and monitoring clauses should be kept to a minimum.
10. The investigatory clauses should be deleted.

Transparency

11. The scheme should be rebranded so that the name of the scheme doesn't risk conveying the impression that businesses' loans are guaranteed by the government.
12. The final Deed and Term Sheet should be made public.

Each of these options is discussed in turn in Section 8 below.

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8 Assessment of the options

8.1 Partial subordination

In our opinion, the scheme would be more attractive to both lenders and borrowers if it included some level of subordination (or isolation). What we mean by that is that scheme loan defaults wouldn't necessarily lead to a cross-default to non-scheme loans but non-scheme loan defaults would lead to cross-default to scheme loans. That would mean that the banks would be able to call on the Crown guarantee and recover 80% of what they are owed (and lose 20%). It would also mean that the affected businesses probably were viable other than for the impact of COVID-19 (which aligns with the intention of the scheme).

The implications of this suggestion are:

- It reduces the banks' risk on the one hand and allows them to take more on the other. That's what the scheme intends.
- Banks are probably more likely to claim against the guarantee. That might be true but it also means that the banks have decided to write off 20% of the debt and so their first preference would remain repayment.
- Borrowers are probably more likely to try and borrow the maximum of $0.5 million. That might be true but it also means that the banks have to be prepared to lend the maximum and risk the maximum.
- Banks are probably more likely to encourage borrowers to repay non-scheme loans in preference to scheme loans. That is might true but the Deed already contemplates that and it is specifically permitted.
- The Crown's losses will probably be higher than they otherwise would have been. That might be true but the Crown's losses are limited to $5 billion.

This suggestion does not preclude the Crown from then making a decision to try and recover what it is owed from the borrower. Recovery could be, for example, via the Inland Revenue Department a la the student loan scheme.

8.2 Maximum term – 5 years

The requirement that scheme loans be repaid within three years is apparently tough. The banks would prefer that businesses had more time. They suggested lending in the small business market is more usually for a term of five years.

Given it is the Crown's expectation that the banks will employ normal practices and procedures, if five years is a standard term in the sector then it's reasonable that the scheme's term also be able to be extended to five years.

The implication of this suggestion is that the Crown's risk increases but so does the banks'. This term is a maximum. It is not mandatory; however, borrowers would likely take the option of the longer term knowing that they can repay early if they want to.

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8.3 Watch list

The banks argued (reasonably) that the Crown wants them to apply their normal lending criteria but then specifically and arbitrarily excludes borrowers whom they might otherwise have lent to. It is a reasonable argument. Given the banks are 20% exposed to scheme loans and 100% exposed to any non-scheme loans, the Crown should let the banks decide who they are going to lend to under the scheme.

8.4 Property investors and developers

It is not clear to us why these sectors are eligible to participate in the scheme. They are just as likely to need a working capital cushion as any of the other eligible participants, especially those investors who have needed to give their tenants rental relief as a consequence COVID-19. On the basis that there doesn't seem to be any compelling reason to exclude these sectors, we think they should be included.

8.5 Non-deposit taking lenders

The inclusion of non-deposit taking lenders (NDTL) would expand the reach of the scheme to include those borrowers who borrow from asset lenders rather than from banks.

NDTLs are not prudently regulated by the RBNZ and generally do not have the same quality systems and processes as the banks.

The implications of this suggestion are that the Crown's Deed of Indemnity with the NDTLs would have to be different from the Deed with the banks and to be specific, it would need to include most if not all the monitoring and compliance components that we are recommending be removed from the Deed between the Crown and the banks.

8.6 100% guarantee

The Crown's liability under the Deed is limited to 80% of the banks' total exposure to scheme loans. The 20% liability of the banks plays an important role by ensuring the banks have some "skin in the game" when making loans under the scheme. Interestingly, none of the stakeholders we spoke with suggested the 20% guarantee was an impediment to the success of the scheme. The banks that we did discuss it with raised the issue of moral hazard if the 20% requirement was dropped. Given that none of the stakeholders suggested that it was required or that the lack of a 100% guarantee was an impediment, in our opinion it doesn't need to be considered any further.

8.7 The Deed

There are a number of aspects of the Deed that could be changed to encourage greater take up of the loans without necessarily exposing the Crown to greater fiscal risk.

New policies, processes and procedures

We understand that the Crown does not intend that the banks should develop any new policies, processes and procedures but the Deed requires it. The Deed refers to them as Supported Loan Policies, Practices and Processes. Further, the Deed requires the banks to send copies of these new policies, processes and procedures to the Crown so that the Crown can understand them. Sending them to the Crown is a condition precedent.

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- The requirement for the banks to develop new policies, processes, and procedures should be deleted as should the provision of any such documents to the Crown.

The implications of this suggestion are that the banks can apply their normal lending practices as intended. The Crown chose to offer the scheme through the banks precisely because they are prudently regulated by the RBNZ and because the Crown is already comfortable that the banks have already got the appropriate systems and controls in place.

What the banks should have known

The banks are able to rely on certification from borrowers that the borrowers are eligible to participate in the scheme unless the banks know that the borrowers aren't or should have known. The problem with what the banks "should have known" is that it is not able to be assessed objectively.

- Any wording that refers to what banks should have known should be deleted.

The implications of this suggestion are that it removes one of the ways in which the Crown could reduce its obligations under the Deed. Given there can only be one loan to each borrower and the maximum size of that loan is $0.5 million, we think it unlikely that the Crown would challenge a bank on the point and therefore there is little point in including it in the Deed. On the other hand, it increases the confidence of the banks to lend under the scheme, which is what the Crown wants.

Compliance and monitoring requirements

The compliance and monitoring requirements of the Deed are continuous and extensive. They relate to the banks continuing to apply their normal policies, processes, and procedures. They add cost to the banks and imply that a Crown representative will be checking compliance, which we think is unlikely.

- Beyond the banks being required to supply the Crown with sufficient detail for the Crown to monitor its exposure accurately and meet its financial reporting obligations in a timely fashion the compliance and monitoring clauses should be kept to a minimum.

The implications of this suggestion seem material but are effectively none. The Crown chose to offer the scheme through the banks precisely because they are prudently regulated by the RBNZ and because the Crown is already comfortable that the banks have already got the appropriate systems and controls in place.

Investigatory clauses

The investigatory clauses in the Deed give the Crown the ability to review its obligations under the Deed. The investigatory clauses have caused the banks to be more careful / sensitive / cautious to the way that they apply their normal lending criteria and systems and processes such that both their lending criteria is more rigidly applied and therefore tougher and they apply a higher level of compliance standard to their systems and processes such that it has inhibited their ability to lend under the scheme.

- To the maximum extent possible, the investigatory clauses should be deleted.

The implications of this suggestion are that the banks are able to apply their normal lending practises with confidence as intended without the threat of having to defend their position. Because of that, it reduces the reticence of the banks to lend under the scheme, which is what the Crown wants. Given there can only be one loan to each borrower and the maximum size of that loan is $0.5 million, we think it unlikely that the Crown would investigate any one loan in any case and therefore there is little point in including it in the Deed.

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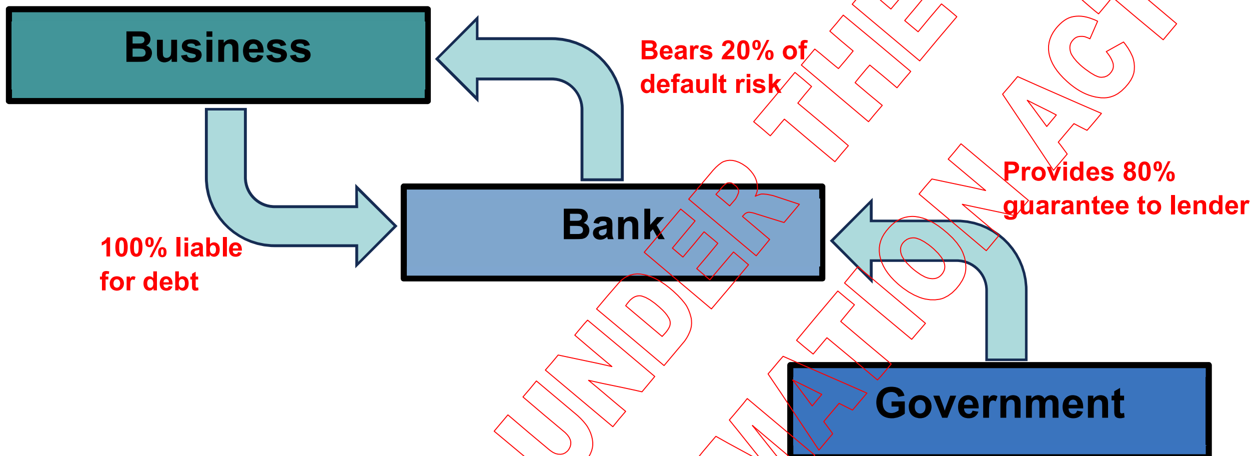
8.8 Transparency

For whatever reason, there seems to be an unusual degree of suspicion amongst industry commentators about what the agreement between the Crown and the banks contains. The suspicion appears to have arisen as a consequence of there being a gap between how borrowers and their advisers expected the scheme to be structured and how it was actually structured.

Figure 1: Business finance guarantee scheme



Note: There is no direct relationship between the New Zealand Government and businesses. The guarantee is for the lender should the business default on the loan under the scheme.

As noted above, in our opinion, other than any commercially sensitive aspects, the Deed, Term Sheet and side letter from the Minister of Finance to the banks of 1 May should be made public. Having the documents public would remove suspicion about the contents of the agreement. Other than the amount of the specific indemnity between the Crown and the individual banks, there does not appear to be anything of a commercially sensitive nature in the documents.

8.9 Extension of the scheme

As the current termination date for the scheme of 30 September 2020 approaches the government will want to consider whether the scheme should be extended and if so on what terms. Issues to be considered will include whether the take-up of the scheme picks up over the next few months, the nature and success of any future amendments to the scheme and the availability and success of other assistance products. Given the BFG scheme is in place and will by then be increasingly familiar to the banks and their clients the marginal costs of extending the scheme may be quite low.

One option may be to extend the scheme to cover not just working capital but also the financing of new investment as the economic recovery picks up. However, that would be a significant change in the nature of the scheme and the role of the government that would require a considered evaluation.

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9 Recommendations

In our opinion, the following changes to the BFGS should be considered.

Scheme structure

1. The banks' scheme loans should be partially subordinated to their non-scheme loans.

2. The maximum term should be extended to five years.

3. The watch-list exclusion should be deleted.

4. Property investors and developers that need working capital funding should be included in the scheme.

5. Non-deposit taking lenders should be included in the scheme.

Alterations to the Deed

6. Any wording that refers to what banks should have known should be deleted.

7. The condition precedent should be deleted.

8. Other than what is required for the Crown to meet its own monitoring and reporting requirements, the compliance and monitoring clauses should be kept to a minimum.

9. To the maximum extent possible, the investigatory clauses should be deleted.

Transparency

10. The scheme should be rebranded so that the name of the scheme doesn't risk conveying the impression that businesses' loans are guaranteed by the government.

11. The Deed, the Term Sheet and the side letter should be made public.

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Appendix 1. Stakeholder feedback

As part of the review of the BFGS, a cross-section of stakeholders was interviewed including most of the largest participating banks, a number of industry organisations and a number of people who had input on behalf of the Crown. A summary of their comments follows.

Well-intentioned

Everyone agreed that the scheme is well-intentioned. The banks are supportive of the scheme.

Normal lending criteria

To be eligible to make a claim under the Deed, the banks are required to apply their normal lending criteria as modified in order to look through the uncertainty associated with COVID-19.

Normal lending criteria fundamentally requires that borrowers have two repayment paths. The first path is cash flow – the business must be profitable and / or generating enough cash to be able to service and repay (or refinance) the loan when it falls due. The second path is security – if the business fails to generate sufficient cash, the banks will look to realise their security to repay the loan. In a COVID-19 world, the first path is very difficult to assess while in any state the banks tend to try and avoid the second path if at all possible.

That said, the BFGS guarantee does give banks the required second way out in some circumstances in which they wouldn't otherwise have it and therefore, by definition, should increase the potential pool of borrowers.

However, modifying normal lending criteria to look through COVID-19 is easier said than done. There are two particular issues: time and sector exposure:

- The impact of COVID-19 is expected to be temporary but nobody knows how long its impact will be felt by borrowers. How do banks make a three-year loan to a business if the impact of the virus could or is expected to last more than three years?

- COVID-19 is going to impact some industries more than others. The sectors that appear to be the most immediately and worst affected include tourism, hospitality and retail. These are the sectors that might be expected to apply for a loan under the scheme sooner rather than later. However, unless in the banks' assessments, these sectors have a future, the banks will not lend to them.

The banks say that they are prepared to take more risk as is intended. Feedback from potential borrowers is that the information that the banks require to support a scheme loan application is more than what they would normally require and is "too hard". Feedback from the business sector also is that the banks should not have to apply their normal lending criteria, even if it is modified, and that the businesses should be able to just apply for and then receive support.

Responsible lending – reputational risk

Banks state that they are required to be responsible lenders. Lender responsibilities are defined in the Credit Contracts and Consumer Finance Act (CCCF Act) and apply to consumer lending. However, the banks appear to choose to apply the criteria more widely and to include business lending. The lender responsibility principles impose obligations on lenders when dealing with borrowers and guarantors.

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There are two lender responsibility principles:

- Principle 1: lenders must exercise the care, diligence and skill of a responsible lender in all its dealings with borrowers and guarantors.

- Principle 2: lenders must comply with the specific listed lender responsibilities set out in the Credit Contracts and Consumer Finance Act (CCCF Act).

These responsibilities include lenders making reasonable enquiries before entering into a loan or taking a guarantee to be satisfied that:

- the credit provided will meet the borrower's needs and objectives; and

- the borrower or guarantor will be able to make the payments under the loan, or comply with the guarantee, without suffering substantial hardship.

Lenders must also help borrowers and guarantors to make informed decisions about whether to enter into the loan or to give the guarantee.

Given COVID-19, how do lenders satisfy themselves that borrowers will be able to make repayments under the loan without suffering substantial hardship?

Cross-default

On the face of it, lending under the scheme means that the Crown takes 80% of the credit risk and the banks take 20%. However, most scheme borrowers are likely to have other debt with the banks. If a scheme loan defaults it means that the borrower's other loans also default. The banks are 20% exposed to scheme loans but 100% exposed to their other loans in a heightened credit risk environment.

Prior to claiming under the indemnity, the banks are required to do everything that they consider to be commercially reasonable to recover the outstanding debt. Once they have a reasonable expectation that no other money is recoverable then they can claim against the indemnity.

Communication

It appears that a number of businesses that applied for a scheme loan thought that it was effectively a grant and that they had a right to receive it. The confusion may arise from the use of the term "guarantee" in the scheme name, where borrowers not unreasonably thought they (rather than the banks) were being guaranteed. It has taken a considerable amount of re-education for some to understand the true nature of the scheme.

Misinterpretation

A number of the banks mentioned that a three-year term loan was not a suitable product for a working capital facility. In our opinion, these banks have misinterpreted the documentation. The Term Sheet and Deed state that the loans can have a maximum term of three years, which means that they could be shorter. It is not clear why a borrower would opt for a shorter term in the circumstance given there is nothing to stop the borrower repaying early. Similarly, the Term Sheet states that scheme loans can be term loans or revolving facilities. In our opinion, those options give banks all the tools they need to meet borrowers' requirements.

Some banks suggested that it would be better to qualify each loan for the guarantee as it was approved rather than when it defaults and that the Crown should trust that the banks will act appropriately given the amount of "skin they have in the game".

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Commercially reasonable – intention versus ability

The Crown's intention is that it will meet its 80% commitment when called upon to do so. The Deed of Indemnity gives the Crown the ability to review its commitment on the basis of the following:

- Eligibility
  - The banks can rely on certification provided by a borrower that it is eligible for a scheme loan unless the banks knew or should have known that the borrower was not eligible.
  - The intention is to get liquidity into the hands of small and medium sized businesses quickly by allowing banks to rely on businesses certifying their eligibility.
  - In the event of there being a claim under the Deed and it being discovered that a business is ineligible, this clause gives the Crown the ability to look back and challenge what the bank should have known. The implication is that the Crown will use the clause to review its obligations under the Deed.
- Compliance
  - The banks must report monthly to the Crown. Amongst other things, the banks must certify monthly that they have the appropriate systems and controls in place to manage scheme loans, that the systems and controls are the same as the banks uses in the ordinary course of business, and that the systems and controls work effectively.
  - The banks must agree to have an audit of their financial information relating to a sample of their loans and to provide a copy of the audit report to the Crown.
- Investigations

The Crown has the right to investigate the banks' compliance with the obligation to have appropriate systems and controls and whether or not any loan qualifies as an eligible scheme loan. If an investigation reveals that a loan in respect of which the Crown has made a payment to a bank under the Deed is not an eligible scheme loan, the bank must refund the payment. If an investigation reveals that loans that have been represented as scheme loans are not scheme loans, those loans will not be entitled to a payment from the Crown under the Deed. If an investigation reveals that a material number of loans have been mis-classified or that the bank is not complying with its systems and controls requirements, the Crown may review that bank's participation in the BFGS and may terminate the Deed.

Term loan

The requirement that scheme loans be repaid within three years is tough. The banks would prefer that businesses had more time. They suggested lending in the small business market was more usually five years.

The banks noted that a decision about how a borrower will exit the scheme will have to be made well before the three-year term expires. Either the borrower will need to be able to repay the loan or the bank will have to be willing to refinance it.

Watch-list

Some banks argued that the watch-list exclusion doesn't make sense. A borrower could be on a watch-list as at the end of February as a result of the timing of receipts over the Christmas period but not be

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on the watch-list as at the end of March. The banks argued (reasonably) that the scheme wants them to apply their normal lending criteria but then specifically excludes borrowers whom they might otherwise have lent to. It is a reasonable argument.

Compliance

The banks argued that the scheme requires them to get compliance right 100% of the time, which means that it is not business-as-usual for them. Some have set up specialist units, which has added extra costs.

Non-deposit taking lenders

There was some suggestion that non-deposit taking lenders should also be included in the scheme. The argument for their inclusion was that there are a large number of businesses that don't borrow from banks but only from finance companies and these businesses are being excluded from the scheme.

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Appendix 2. Ex-post investigations

This appendix discusses the scope and role of ex-post investigations under the deed. The key terms of the deed in relation to ex-post investigations are summarised in the table below. We then provide our assessment of the key issues that arise in relation to ex-post investigations from the deed.

<u>Key terms in the deed</u>

Deed clauses	Summarised translation
8.1	The Crown can investigate: 1. That the banks have the appropriate systems and controls in place to ensure a Supported Loan (SL) is a SL. 2. That the banks have administered the SL in accordance with the Supported Loan Policies, Practices and Processes (SLPPP). 3. That the action taken on a Defaulted Supported Loan is commercially reasonable. 4. That loan agreement was entered into during the Availability Period (AP). 5. That the Borrower was a Borrower at the time that the loan was entered into. 6. That the Borrower had confirmed that the SL was to be used for the right purpose. 7. That the loan was less than $500k. 8. That the SL was entered into during the AP. 9. That the interest rate was reasonable. 10. That the decision to approve the SL was made in accordance with the SLPPP.
8.5	Consequences If an investigation reveals that a SL is not a SL and the Crown has made payment under the Deed, the Crown is entitled to a refund. If an investigation reveals that a SL is not a SL, the Crown has no obligation under the Deed.
3.1-3.9	A loan is a SL if: 1. The Borrower is a Borrower. 2. That the Borrower has confirmed that the SL was to be used for the right purpose. 3. That the loan was less than $500k. 4. That the SL was entered into during the AP. 5. That the interest rate was reasonable. 6. That the decision to approve the SL was made in accordance with the SLPPP.
Defined term	A Borrower is a person who is eligible – is a NZ business, has revenue less than or equal to $80m etc.

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3.10	The banks can rely on confirmation from the Borrower that it is a Borrower and therefore the loan is a SL unless the banks knew or should have known that the Borrower wasn't a Borrower.

TDB commentary

A Supported Loan (SL) is only a SL if the decision to approve it was made in accordance with the SLPPP. The four issues that arise are:

1. to what degree are some any of these areas of investigation subjective;
2. what are the consequences of errors;
3. what is the point of being able to investigate so broadly; and
4. how reasonable are the consequences.

Addressing each issue in turn:

1. The question of whether a SL has been made in accordance with the SLPPP is subjective to the extent that lending is not a tick-the-box exercise – it always includes an element of judgment. In any case, if a SL wasn't made in accordance with the SLPPP it could only have been made in accordance with the banks' own loan criteria, which by definition, are tougher than the SLPPP.

2. It doesn't look like there is any room for error at all. If an error has been made and a SL is not a SL, the banks have to face the consequences.

3. We agree that the minimum audit requirements should be met but other than that the ability to investigate seems excessive – especially given the role of the RBNZ.

4. We consider the consequences may well be unreasonable. Not only do the banks become 100% exposed but they become 100% exposed to a loan that they, by definition, would not have otherwise approved.

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Appendix 3. International comparisons

Summary

This Appendix presents the key features of business finance guarantee schemes introduced or extended in selected countries since the COVID-19 crisis. All currency numbers presented are in New Zealand dollars.

The countries examined are Australia, Canada, Finland, Hong Kong, Singapore, Switzerland, Sweden and the United Kingdom. These countries have been chosen because, like NZ, they are small developed countries or in the case of the UK because of the common institutional heritage.[12]

The following conclusions and insights can be drawn:

- The schemes vary widely across the different countries with:
  - government guarantees typically around 80% but ranging from 50% (Australia) to 100% (Hong Kong, and for some schemes in Canada, Switzerland and United Kingdom);
  - the loans are generally terms loans with a term of around 3 years but Canada offers finance with terms also of 1 and 10 years;
  - the maximum size of the business loans range from around $47,000 (a Canadian scheme) to $100m (a UK scheme), with Australia's maximum $270,000 and a new highly successful scheme in the UK (the Bounce Back Loan Scheme) having a maximum of $100,000;
  - the schemes' current availability typically extends to around Sept 2020 as far as December 2021 but the Finish scheme is available till December 2025; and
  - loans are generally provided through banks though Australia also has made offers to five non-bank lenders.
- The Bounce Back Loan Scheme in the UK has experienced significant uptake since it was introduced earlier this month. The uptake probably reflects a combination of low fixed interest rates, no personal guarantees and an easy application form that ensures small businesses receive fast approval.
- The Emergency Bank Account scheme in Canada has had significant uptake also. It features a forgiveness clause where if the loan is paid back early there is a 25% forgiveness of the debt.
- Switzerland has also seen significant uptake in its government guarantees. The Swiss scheme is also reportedly very easy to access.
- Several countries have built on the existing experience exporting agencies have with guarantees. Granting domestic powers to these state-owned enterprises (as seen in countries such as Finland and Canada) have allowed these schemes develop from existing institutions with established relationships with banks.
- Sweden is one of the few countries that allows the state guarantees to be for either working or investment capital purposes. Other countries generally restrict loans primarily to working capital purposes.

[12] All figures are presented in $NZ terms.

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Australia

Introduction:

The government introduced the Coronavirus Small and Medium Enterprises (SME) Guarantee Scheme in April 2020. Loans taken out under the scheme must be used to support current and future cash flow needs only. This includes working capital, liquidity and operating expenditure. Loans cannot be used to refinance existing loans.

Terms of guarantee:

Guarantee coverage:

The Government guarantees 50 per cent of new loans issued by eligible lenders to SMEs.

The scheme will support up to $43.3 billion of lending to SMEs (including sole traders and not-for-profits). This suggests the government will guarantee up to $21.6 billion (50% of $43.3 billion) of new loans issued under the scheme.

Interest payments:

The first 6-months will not feature any interest payments.

The SME will only incur interest on the amount drawn down. The SME will retain the option to draw down funds should the need arise.

Loan caps:

The maximum total loan is $270,000 per borrower.

Turnover caps:

SMEs, including sole traders, with a turnover of up to $54 million are eligible to receive a loan under the scheme.

Duration:

The scheme is available for new loans until 30 September 2020.

The loan under the scheme has a maturity of 3 years.

Collateral/security requirement:

There is no requirement for businesses under the scheme to provide assets as security for the loan.

Lenders:

The Australian Government has made offers to 29 banks and five non-bank lenders (Get Capital, Liberty Financial, Moula Money, On Deck Capital, and Prospa) to access $36.8 billion of lending capital for SMEs via the loan guarantee scheme. The remaining $6.5 billion is currently under negotiation between several other lenders. In total 40 lenders have been approved to participate in the scheme.

Uptake:

As of 6 April 2020, $162.2 million in loans had been approved for more than 1,850 businesses by the Commonwealth Bank of Australia. A Ministerial Statement on the Economy was released on the 12th May 2020 that stated approximately $1 billion in loans were approved under the scheme for 11,000 businesses.

Legislation:

The SME Lending Guarantee Bill introduced in late March 2020 enabled the Australian Government to enter into risk sharing agreements (guarantees) with financial institutions. The loans under these guarantees are intended to ensure SMEs are able to meet their immediate financing needs during the uncertain economic conditions caused by the Coronavirus.

Comparison of schemes	New Zealand	Australia
Total allowed lending	$6.25 bn	$43.3 bn
Govt. guaranteed	$5 bn	$21.6 bn
Max. loan size	$500,000	$270,000
Loan duration	3 years	3 years
No. of lenders	~10	~40

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Canada - BDC Co-lending Program

Introduction:

Under Canada's BDC Co-lending Program, SMEs can get support for their operational cash flow requirements.

Any money advanced under this program must be used for operational and liquidity needs, which could include interest payments on existing debt.

Prior to advancing funds under this program the financial institution assesses the company's risk rating and provides its underwriting report to the BDC.

Terms of guarantee:

Restrictions:

The Co-Lending Program is available to Canadian businesses impacted directly or indirectly by COVID-19 until or before September 30, 2020. To qualify, companies must have been financially viable and in good standing prior to the impact of the pandemic.

Guarantee coverage:

The BDC and financial institutions co-lend term loans of incremental credit amounts up to $7.41 million to eligible businesses. The BDC provides 80 percent of each loan and the bank provides the remaining 20 percent.

Loan caps:

Eligible companies can obtain up to $14.7 million through the BDC col-lending and EDC guarantee lending streams (see next page).

The amount of the loan eligibility varies depending on a company's revenue thresholds, as follows:

- businesses with revenues under $1.2 million can receive loans of up to $367,100;
- businesses with revenues between $1.2 million and $58.7 million can receive loans of up to $3.67 million; and
- businesses with revenues over $58.7 million can receive loans of up to $7.41 million.

Duration:

Loans under the BDC co-lending program have a maximum term of 10 years.

Interest payments:

There is an option to only pay the interest for the first 12 months after the initial advance. The interest rate will depend on Canadian prime as well as the risk profile of the business and the size of the loan.

Legislation and regulation:

On March 12 2020 the Office of the Superintendent of Financial Institutions (OSFI) mandated how financial institutions should treat new capital made available to SMEs through the coronavirus response government programs.

Under the BDC Co-lending Program, only the portion of the loan made by the financial institution (20%) will receive the risk weight attributable to the exposure of the borrower. Financial institutions, when calculating the required leverage ratios, are able to exclude the BDC portion (80%) of the loan. This is designed to incentivise the financial institutions to provide additional liquidity to Canadian businesses affected by the coronavirus outbreak.

Comparison of	New Zealand	Canada (BDC)
Total allowed lending	$6.25 bn	$29.6 bn
Govt. guaranteed	$5 bn	$23.7 bn
Max. loan size	$500,000	$7.41 million
Loan duration	3 years	1 year
No. of lenders	~10	

Canada - EDC guarantee

Introduction:

Through the Business Credit Availability Program (BCAP), Export Development Canada (EDC), a state-owned corporation, guarantees 80% of new operating credit and cash flow term loans of up to $7.41 million to small and medium-sized enterprises (SMEs).

This financing support is to be used for operational expenses and is available to both exporting and non-exporting companies.

Terms of guarantee:

Restrictions:

To be eligible for the SME Loan and Guarantee program a Canadian business must have been financially viable and revenue generating prior to the COVID-19 outbreak. According to the federal government there are no restrictions based on which sector the business resides in.

In order to qualify for the guarantee a business must satisfy its financial institution's normal due diligence and underwriting process.

Guarantee coverage:

EDC provides an 80% guarantee to financial institution's on the money they lend to business in need due to Covid-19. This is to provide them an incentive to increase business' access to credit. The financial institution takes on the remaining 20% of the risk.

The program cap for the guarantee totals $23.7 billion for the export sector and domestic companies.

Loan caps:

Qualified applicants can access up to $7.41 million in credit through their bank or credit union to cover rent, payroll and operating costs.

Duration:

The EDC loan guarantee is available to businesses for one year, with the potential to renew for another year.

Collateral/security requirements:

EDC's trade financing solutions eliminate the need for collateral. This is intended to help businesses free up their working capital.

Legislation:

The Government of Canada has temporarily enabled domestic powers for Export Development Canada (EDC) during COVID-19 crisis. This means guarantees are now open to all Canadian businesses, whether they export or not. The EDC will have expanded domestic capabilities until December 31, 2021. A broader mandate and scope ensures the EDC has the ability to provide liquidity for micro-, small- and medium-sized domestic companies through Canadian financial institutions and private credit insurers during recovery from Covid-19.

On March 12 2020 the Office of the Superintendent of Financial Institutions (OSFI) mandated how financial institutions should treat new capital made available to SMEs through the coronavirus response government programs. With respect to the EDC guarantees, the guaranteed portion of the loan (80%) is treated as an exposure to the Government of Canada (as the EDC is a state-owned corporation), thereby benefiting from a "AAA" credit rating and a 0% risk-weighting under the capital adequacy requirements guidelines. The remaining 20% of the loan is treated as an exposure to the borrower. This elevates the credit worthiness of the guaranteed portion of the loan which in turn decreases the amount of regulatory capital that the institution needs to hold with respect to the loan. This makes it more likely for the loan to be approved by the lender.

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Canada - Emergency Business Account Loans

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Introduction:

This loan guarantee is targeted at small businesses and not-for-profits to help cover their non-deferrable operating costs. A unique feature of this scheme is that if the borrower repays the balance of the loan on or before 31 December 2022, 25 percent (up to $11,800) of the loan will be forgiven.

Terms of guarantee:

Restrictions:

When the scheme was first announced the borrower was required to have paid employment costs of between $23,400 and $1.5 million in 2019.

This was revised on May 19, 2020 when it was announced that borrowers with a payroll lower than $23,400 may qualify if they have:

- a business chequing account at a participating financial institution;
- a Canada Revenue Agency (CRA) business number;
- filed a 2018 or 2019 tax return; and
- operating costs between $47,000 and $1.76 million.

Reasons for being deemed ineligible for the scheme can include:

- businesses behind on their payments for existing loans as of 1 March 2020;
- being registered as a sole proprietor; and
- businesses owned by a government body or an elected official.

Guarantee coverage:

CEBA loans are fully backed by the government (100%).

Loan caps:

The Canada Emergency Business Account (CEBA) loans are interest-free loans of up to $47,000. These loans are offered through banks and credit unions.

Duration:

This scheme is a revolving line of credit which means there are no minimum payments until Dec 31, 2020. For those unable to repay the loan in its entirety by 21 December 2022, the loan is converted into a three-year term loan at an interest rate of five per cent.

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Finland

Introduction:

Finnvera Plc is a state-owned financing institution that provides financing for SME's. The packages offered are not new products, but credit processes and terms have been modified to support the COVID-19 situation.

Terms of guarantee:

Purpose:

Start guarantee package:

- SMEs operating no longer than 3 years.
- Farming and forestry are excluded from all guarantee packages.

SME guarantee:

- SMEs that have operated longer than 3 years.
- Originally intended to finance R&D, capex and working capital needs but has been extended to include financing of COVID-19 induced immediate cash needs.
- M&A activities, construction sector and acquiring premises or vehicles are excluded.

Finnvera guarantee:

- Intended as security for various SME financing that include capex, exports, working capital and M&A activities.
- Property development is excluded.

Guarantee coverage:

The government guarantee is 80% of the facility and each business may have only one guarantee.

Start guarantee package:

- Loan: $21,800 - $181,800 bank loan.
- Guaranteed: $18,200 - $145,400.

SME guarantee:

- Loan: $181,801 - $272,651 commercial bank loan.
- Guaranteed: $145,401 - $218,100.

Finnvera guarantee

- Loan: $272,652 - $1,820,000 working capital loan.
- Guaranteed: $281,101 - $1,454,000.

Collateral/security requirement:

Start guarantee package

- The business owners need to make a personal guarantee for 25% (Min. $5,500) of Finnvera's risk.

SME guarantee

- Does not require any guarantees from business or business owners.

Finnvera guarantee

- Due to Covid-19 the need for collateral has been waived.

Legislation:

Before Covid-19 Finnvera was limited by law to only authorise up to $7.6 bn. The Government has now enabled additional financing of $18 billion to businesses through Finnvera by increasing its domestic financing. The additional financing is mainly targeted towards guarantees in light of the coronavirus situation. The temporary increase will be in effect until the end of December 2025.

Alongside additional financing, the Government has agreed to increase its commitment to partially cover any losses arising from Finnvera's guarantees. The state's coverage increased from 50% to 80%.

Comparison of	New Zealand	Finland (Finnvera)
Total allowed lending	$6.25 bn	$27 bn
Govt. guaranteed	$5 bn	$21.6 bn
Max. loan size	$500,000	$1,820,000
Loan duration	3 years	
No. of lenders	~10	

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Hong Kong

Introduction:

The Hong Kong Mortgage Corporation Insurance Limited (HKMCI) has introduced a new 100 percent loan guarantee under the Hong Kong SME Financing Guarantee Scheme (HKSFGS) to absorb some of the economic shock felt by businesses affected by the coronavirus outbreak.

Prior to the outbreak of the COVID-19, the Government has previously offered 50-90% guarantee products, which are similar to the Special 100% Loan Guarantee, and they are still available.

Terms of guarantee:

Restrictions:

SMEs from all sectors are eligible to apply, particularly those most affected by the coronavirus outbreak – such as retail outlets, travel agencies, restaurants, cinemas, entertainment facilities, and transport operators.

Eligibility for the loan requires that enterprises have been operating for at least three months, as at the end of December 2019, and have proof of at least a 30 percent decline in turnover since February 2020.

The borrowing company cannot have any of its shares listed on the Stock Exchange of Hong Kong Limited or any similar exchange in or outside Hong Kong.

Guarantee coverage:

Under the 100% Loan Guarantee Scheme, the guarantee commitment is $10.8 billion. SMEs that are eligible for the loan can receive a maximum of $860,000 of a non-revolving nature. The credit facility is granted on a one-off basis and disbursed fully.

Loan caps:

The loan available to SMEs affected by Covid-19 is either the total amount of employee wages and rents for 6 months, or $860,000, whichever is lower.

If a business does not have employees and rented offices, then a nominated amount of 50% of the highest monthly net income in 2019 is applied.

Duration:

Maximum guarantee period is 3 years (with optional principal moratorium for the first 12 months).

Interest payments:

Each SME can apply for a loan of up to $860,000 at an interest rate of 2.75% p.a.

Collateral/security requirements:

Any individuals or groups who hold over 70% equity interest in the borrowing company will have to enter into a legally binding personal guarantee holding them personally responsible for repayment in the event of default.

Lenders:

According to the conditions of the Special Guarantee Loan Scheme (SPGS) of 2011, all authorised institutions under the Banking Ordinance, including banks, restricted licence banks and deposit-taking companies, are eligible to participate in the Scheme.

Response from SMEs:

A poll conducted by Phil Aldridge, who chairs the SME and Start-up Committee for the British Chamber of Commerce in Hong Kong, found that about 60 per cent of the 350 companies covered said they were very dissatisfied by the government support measures. When asked what they wanted from the government most of all, more than 40 per cent said they wanted a grant scheme rather than a loan scheme.

Comparison of	New Zealand	Hong Kong
Total allowed lending	$6.25 bn	$10.8 bn
Govt. guaranteed	$5 bn	$10.8 bn
Max. loan size	$500,000	$860,000
Loan duration	3 years	3 years
No. of lenders	~10	

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Singapore - SME Working Capital Loan

Introduction:

Following the third budget announcement (Solidarity Budget 2020) in two months, the SME Working Capital Loan scheme was enhanced to help SMEs with their working capital needs. The maximum loan was raised from $350,000 to $1.2 million. Risk-share was also increased to 90% (from 50% and 70% for young companies) for new applications until 31 March 2021.

Terms of guarantee:

Restrictions:

Capital loan eligibility:

- Local company operating and registered in Singapore;
- Group annual turnover of <$118m or group employment size < 200.
- 30% of equity held directly by Singapore citizen.

Guarantee coverage:

The Government will provide 90% risk-share on these loans. The borrower is responsible for repaying 100% of the loan amount. When defaults occur, the Participating Financial Institutions (PFIs) are obligated to follow their standard commercial recovery procedure, including the realisation of security, before they can make a claim against Enterprise Singapore for the unrecovered amount in proportion to the risk-share.

Interest payments:

The interest rate for the SME Working Capital Loan differs for the various participating banks and financial institutions and is dependent on their risk assessment.

Loan caps:

Up to $1.2 million per borrower group, valid until 31 March 2021.

Duration:

Duration of up to 5 years. SMEs may request deferment of principal repayment for one year, subject to assessment by participating financial institutions.

Collateral/security requirement:

No collateral is required for loans under this scheme.

Lenders:

Approximately 14 banks and financial institutions are participating in the government guaranteed financing schemes. All of the banks and financial institutions have credit risk assessments, interest rates and criteria which are determined by them and may vary between the entities.

Legislation:

The SME Working Capital Loan has been subsumed under the Enterprise Financing Scheme.

The Monetary Authority of Singapore (MAS) launched the Working Capital Loans in partnership with Enterprise Singapore (ESG), to lend Singapore Dollars at an interest rate of 0.1% per annum to eligible financial institutions. Participating financial institutions will then pass the lower funding cost to SMEs.

Comparison of	New Zealand	Singapore (WCL)
Total allowed lending	$6.25 bn	
Govt. guaranteed	$5 bn	
Max. loan size	$500,000	$1.2 million
Loan duration	3 years	5 years
No. of lenders	~10	~14

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Singapore - Temporary Bridging Loan Programme (TBLP)

Introduction:

The TBLP provides access to working capital for business needs. The TBLP started in March 2020 and is available until 31 March 2021. This financing scheme is now eligible to all sectors (previously only applicable to tourism industry) after the Solidarity Budget enhancements.

Terms of guarantee:

Restrictions:

To be eligible:

- The business must be an Accounting and Corporate Regulatory Authority of Singapore (ACRA) registered sole proprietorship, partnership, limited liability partnership or company.
- The business must be physically present and have at least 30% of equity held directly or indirectly by a Singapore citizen.

Guarantee coverage:

The government will provide 90% risk-share on these loans. Borrower remains 100% liable for repaying the loan amount.

Interest payments:

Interest rates begin at 2.5% and capped at 5% p.a.

Loan caps:

Approved and eligible businesses can borrow up to $5.8 million. This is an increase from the previous loan cap of $1.16 million.

Duration:

Maximum repayment period of 5 years.

Collateral/security requirement:

No collateral is required, but banks and financial institutions may still require a personal guarantee from company directors.

Lenders:

Approximately 14 banks and financial institutions are participating in the government guarantee financing schemes. All of the banks and financial institutions have credit risk assessments, interest rates and criteria which is determined by them and may vary between entities.

Comparison of	New Zealand	Singapore (TBLP)
Total allowed lending	$6.25 bn	
Govt. guaranteed	$5 bn	
Max. loan size	$500,000	$5.8 million
Loan duration	3 years	5 years
No. of lenders	~10	~14

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Singapore - Trade Loan

Terms of guarantee:

Restrictions:

To be eligible:

- The business must be an Accounting and Corporate Regulatory Authority of Singapore (ACRA) registered sole proprietorship, partnership, limited liability partnership or company.
- The business must have at least 30% of its equity held directly or indirectly by a Singapore citizen.
- There is a maximum borrower group revenue cap of $582 million for all businesses.

Guarantee coverage:

The government will provide 90% risk-share on these loans. Borrower remains 100% liable for repaying the loan amount.

Interest payments:

Interest rates begin at 2.5% and is capped at 5% p.a.

Loan caps:

Eligible businesses may borrow up to $11.5 million.

Duration:

Maximum repayment period of 1 year.

Collateral/security requirement:

Personal guarantees are up to the financial institution's discretion.

Lenders:

Approximately 14 banks and financial institutions are participating in the government guarantee financing schemes. All of the banks and financial institutions have credit risk assessments, interest rates and criteria which are determined by them and may vary between entities

Legislation:

Following the Solidarity Budget 2020, the maximum loan cap under the Trade Loan scheme was raised from $5.8 million to $11.5 million. The risk-share was also increased to 90% (from 50% and 70%) for new applications initiated from 8 April 2020 until 31 March 2021.

Comparison of	New Zealand	Singapore (TL)
Total allowed lending	$6.25 bn	
Govt. guaranteed	$5 bn	
Max. loan size	$500,000	$11.5 million
Loan duration	3 years	1 year
No. of lenders	~10	~14

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Sweden

Introduction:

Companies can apply for a State Credit Guaranteed Loan by contacting their bank or other credit institute. The banks or credit institutes take part in the loan guarantee programme by signing an agreement with the Swedish National Debt Office (Riksgälden).

Terms of guarantee:

Restrictions:

For a company to be eligible for a state guaranteed loan the companies may not, throughout the life of the loan, pay dividends, bonuses or variable remuneration to senior management.

There is no formal requirement surrounding the size of the company seeking the guaranteed loan.

Guarantee coverage:

The programme will offer a guarantee of 70% of new loans to companies affected by COVID-19 but which are otherwise robust. The guarantee will be issued to the bank that provides the loan to the company, and the government will compensate the bank for up to 70% of any credit loss arising on a guaranteed loan.

Banks pay a risk-based guarantee fee to the Swedish National Debt Office. The fee is determined on the basis of the borrower's current risk class, which is set by the credit institution. The risk assessment is carried out in accordance with the credit institution's credit assessment process.

Loan caps:

The maximum loan per company is $12.5 million.

In exceptional cases, higher loan amounts may be allowed after approval by the National Debt Office but shall in no event exceed $41.7 million.

All financings backed by a state guarantee cannot exceed:

- 25% of the beneficiary's 2019 annual revenue; or twice its 2019 employment costs; or
- for companies started from 1 January 2019, the estimated annual salary costs for the first two financial years.

Duration:

- The maximum duration of this loan is 3 years.
- The scheme is available from 1 April to 30 June 2020.

Interest payments:

The interest rate is determined by the bank based on its credit assessment of the company. The borrowing company may defer paying interest on the loan for the first 12 months.

Lenders:

A state credit guaranteed loan is available from select banks or other credit institutes.

Legislation:

The European Commission has adopted a Temporary Framework to ensure Member States have complete flexibility under State aid rules to support the economy in the context of the COVID-19 outbreak. The Temporary Framework includes a number of safeguards to ensure the integrity of guaranteed loans. The Framework links the guarantees to businesses to the scale of their economic activity either through annual turnover or wages/employment costs. The state guarantees are for working or investment capital purposes only.

Comparison of	New Zealand	Sweden
Total lending	$6.25 bn	$24.3 bn
Govt. guaranteed	$5 bn	$17 bn
Max. loan size	$500,000	$12.5 million ($41.7m)
Loan duration	3 years	3 years
No. of lenders	~10	

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Switzerland

Introduction:

Under the Swiss federal government's State Guaranteed Loan Program loan guarantee cooperatives are supported by the federal government with the purpose of making it easier for SMEs to access bank loans. In Switzerland there are three regional loan guarantee cooperatives, as well as a national loan guarantee organisation for women (SAFFA).

Terms of guarantee:

Restrictions:

Only SMEs can obtain a state guaranteed loan. Enterprises with turnover of more than $840 million in 2019 are excluded from the state guaranteed loan program.

For loans up to $846,000, SMEs are only required to fill out the federal government's application form. The SME must also prove:

- it was established in Switzerland before COVID-19;
- it has suffered considerable economic losses due to COVID-19;
- it must not be in bankruptcy, in debt restructuring proceedings or in liquidation; and
- it has not received financial support from other COVID-19 support programs.

In addition to the application forms, the bank performs an audit to determine whether a loan of more than $846,000 should be granted.

Guarantee coverage:

For loans up to $846,000, the Swiss government covers 100%.

For loans between $846,000 and $34 million, the Swiss government covers 85% while the bank bears the remaining 15%.

The 85% government guarantee is via the four guarantee organisations:

- BG Mitte;
- BG OST-SÜD;
- Bürgschaftsgenossenschaft SAFFA; and
- Cautionnement romand (Bürgschaft Westschweiz).

The banks thus have 100% or 85% guaranteed by the cooperatives. The cooperatives, in turn, have 100% coverage from the government for all guarantees received as part of this programme.

Loan caps:

The loan amount is calculated on the yearly turnover of an enterprise and is capped at 10%. For companies that do not have this data, an estimated turnover will be used. The limit for one loan is $34 million.

Duration:

These loans have a maturity of 5 years.

Interest payments:

For loans up to $846,000, the interest rate is 0%.

For loans between $846,000 and $34 million, an interest rate of 0.5% will be applied to the amount covered by the government. For the other 15%, the enterprise and the bank negotiate an appropriate interest rate.

Legislation and regulation:

The Swiss Financial Market Supervisory Authority (FINMA) has granted the banks a temporary exemption from being required to calculate a leverage ratio. The Swiss National Bank (SNB) is looking to introduce a SNB Covid-19 Refinancing Facility (CRF) that will allow banks to obtain liquidity from the SNB against federally guaranteed loans.

Uptake:

Between March 2020 and 12 May 2020, 123,000 Swiss companies have received approval for bridging loans totalling around $25 billion.

Comparison of	New Zealand	Switzerland
Total allowed lending	$6.25 bn	
Govt. guaranteed	$5 bn	$33.85 bn
Max. loan size	$500,000	$34 million
Loan duration	3 years	5 years
No. of lenders	~10	

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United Kingdom

Introduction:

To protect businesses negatively affected by COVID-19 three schemes have been introduced: Coronavirus business interruption loan schemes (CBILS and CLBILS), the Bounce Back Loan Scheme (BBLS). The CBILS is for SMEs while CLBILS caters to medium and large businesses. The BBL was added following initial criticism that the CBILS and CLBILS were excluding too many small businesses and lenders had approved too few loans. Regardless of which scheme a business falls under, the borrower remains 100% liable for the debt.

Terms of guarantee:

Guarantee coverage:

The government guarantees 80% of the finance to the lender under the CBILS and CLBILS. The BBL will be 100% guaranteed by the government.

The UK Government has confirmed that the total amount of funding available under the schemes will be demand-led. There is no defined cap on the amount the government will guarantee.

Interest payments:

The government pays interest and any fees for the first 12 months for CBILS and CLBILS.

Loans under the BBLS will be interest free for the first 12 months. Following this the interest rate is fixed at 2.5% till maturity of the loan.

Loan caps:

The CBILS helps small and medium-sized businesses to access loans and from $101,001 and up to $10.2 million.

The CLBILS provides loans of up to $100 million for businesses.

The BBLS is focused on SMEs and ensures businesses are able to borrow between $4,000 and $101,000.

Turnover caps:

Applications for loans under CBILS are limited to businesses based in the UK that have an annual turnover of less than $91.6 million.

Businesses with turnover from $90 million to $500 million can receive up to $50 million. Those businesses with turnover over $500m can receive a loan of up to $100 million.

There is no turnover cap for small businesses applying for a BBLS.

Duration:

The length of the BBLS is for 6 years with early repayment being possible.

The maximum maturity for loans under the CBILS and CLBILS is 6 and 3 years respectively.

Collateral/security requirement

Under CBILS and CLBILS personal guarantees are only allowed for facilities above $505,000. With the BBLS the government has ensured no personal guarantees are required or even allowed.

Lenders:

The total number of CBILS lenders is just over 60. Due to the BBLS having just been introduced only approximately 16 lenders have been approved.

Legislation:

Bounce Back Loans of less than $50,500 have been excluded from the Consumer Credit Act 1974 in order to speed up implementation. The government is intending to introduce legislation to waive sections 140A-140C of the Consumer Credit Act for BBLS lending. Bankers were worried that they could fall foul of the Consumer Credit Act requirement that they cannot lend money knowingly to failing businesses.

Summary features of countries' schemes

Comparison of	New Zealand	UK
Total allowed lending	$6.25 bn	-
Govt. guaranteed	$5 bn	-
Max. loan size	$500,000	$101,000 - $100 m
Loan duration	3 years	3 or 6 years
No. of lenders	~10	~60

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Country	Name	Scheme commenced	Scheme finishes	Guarantee	Max total size of loan ($NZD)	Loan term	Turnover cap ($NZD)	Total available lending ($NZD)
NZ	Business Finance Guarantee Scheme	1 April 2020	30 September 2020	80%	$500,000	3 years	$80 million	$6.25 bn $5 bn guaranteed
AUS	Coronavirus SME Guarantee Scheme	April 2020	30 September 2020	50%	$270,000	3 years	$54 million	$43.3 bn $21.6 bn guaranteed
Canada	EDC Guarantee	Mid-April 2020	31 December 2021	80%	$7.41 million	1 year	n/a	$58.8 bn $47 bn guaranteed
	BDC Co-lending	24 April 2020	30 September 2020	80%	$7.41 million	10 years	n/a	
	Canada Emergency Bank Account	9 April 2020	No fixed date	100%	$47,000	5 years	$1.8 million (annual payroll)	$29.4 bn $29.4 bn guaranteed
Finland	Finnvera Guarantee Packages	n/a	December 2025	80%	$181,000 or $272,651 or $1.82 million	n/a	No cap	n/a
Hong Kong	100% SME Financing Guarantee Scheme	20 April 2020	19 April 2021	100%	$860,000	3 years	No cap	$10.8 bn $10.8 bn guaranteed
Singapore	SME Working Capital Loan	8 April 2020	31 March 2021	90%	$1.2 million	5 years	$118 million	n/a
	Temporary Bridging Loan	March 2020	31 March 2021	90%	$5.8 million	5 years	No cap	n/a
	Trade Loan	8 April 2020	31 March 2021	90%	$11.5 million	1 year	$582 million	n/a
Switzerland	State Guaranteed Loan Programme	7 May 2020	31 August 2020	85% or 100%	$846,000 or $34 million	5 years	$340 million	$33.85 bn guaranteed
Sweden	State Loan Credit Guarantee	1 April 2020	30 June 2020	70%	$12.5 million ($41.7 million)	3 years	$50 million or $167 million	$24.3 bn $17 bn guaranteed
UK	Coronavirus Business Interruption Loan Scheme	23 March 2020	No fixed date	80%	$10.2 million	6 years	$91.6 million	No fixed available lending
	Coronavirus Large Business Interruption Loan Scheme	20 April 2020	No fixed date	80%	$50 million or $100 million	3 years	$500 million	
	Bounce Back Loan	4 May 2020	No fixed date	100%	$101,000	6 years	No cap	

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Uptake of guarantee loan schemes

Australia:

A Ministerial Statement on the Economy released on the 12th May 2020 stated approximately $1 billion in loans were approved under the scheme for 11,000 businesses. The Commonwealth Bank of Australia had the largest proportion of these loans with more than 6,500 approved totalling more than $536 million.

UK:

As of the 12 May, HM Treasury stated 268,000 bounce back loans worth $16.6 billion had been approved. 36,000 loans worth $12 billion through the CBILS and $718 million through CLBILS had also been approved.

Singapore:

Based on Enterprise Singapore's data on the 4th May 2020, SME borrowers have applied for more than 2,500 loans amounting to nearly $2.2 billion since the beginning of March. This data refers to all three guarantee loan schemes with an aggregated approval rate of between 90-95%.

Switzerland:

Between March 2020 and 12 May 2020, 123,000 Swiss companies have received approval for bridging loans at an estimated total value of $25 billion.

Canada:

As of the 13th April 2020 the uptake for emergency bank account loans can be summarised as:

- Bank of Montreal having processed more than 10,000 applications as of the 13th April, and approved $500 million in CEBA loans;
- Royal Bank of Canada having approved 35,439 applications, each for $40,000, totalling $1.4 billion as of 13th April;
- CIBC having issued $846 million in loans under the program to 21,150 clients; and
- Toronto-Dominion Bank, while not providing the worth of loans approved, said it had received 70,000 applications, of which approximately 50,000 were set to be approved under the schemes requirements.

Despite this uptake in CEBA loans The Canadian Federation of Independent Business found that as many as one in five firms don't qualify for a CEBA loan due to the payroll requirements. Criticism has arisen over the federal government's schemes for entrepreneurs being focused on loans that add to a company's debt. This is compared to other countries such as Australia and Britain, that have set up grant programs alongside government guarantees to cover fixed costs such as commercial rent.

Table summary: uptake of guarantee loans

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Country	Name	Approved ($NZD)	Loans approved	Loan applications	Approval success rate
NZ	Business Finance Guarantee Scheme	$60 million	376		
AUS	Coronavirus Guarantee Scheme	~$1 billion	11,000		
Canada	Emergency Bank Account	~ $3.5 billion	~120,000		
Singapore	SME Working Capital Loan Temporary Bridging Loan Trade Loan	~$2.2 billion	~2,300	2,500	90-95%
Switzerland	State Guaranteed Loan Programme	$25 billion	123,000		
UK	Coronavirus Business Interruption Loan Scheme	$11 billion	36,000	62,674	~55%
	Coronavirus Large Business Interruption Loan Scheme	$718 million			
	Bounce Back Loan	$16.6 billion	268,000		