



14 July 2020

Sir Adrian Montague CBE
Chairman of Leadership Council
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Dear Sir Adrian

RECAPITALISATION GROUP: SUMMARY OF INITIAL THINKING

Thank-you for this opportunity to comment on your initial thoughts for addressing the UK's economic challenges and helping businesses manage the significant debt burden that many will now carry. As members of CityUK, we at ICAEW have for many years supported its efforts on behalf of the UK's vital financial and professional services sector. In these unprecedented times, where UK society has to come together to develop shared solutions to power economic recovery, it is good to see the CityUK taking a lead in thinking innovatively about the challenges we face.

ICAEW's members work in and advise three million businesses across the UK. Many face crippling financial hardship. Radical action will be needed to ensure business people are positioned and can focus on the important tasks of recovery, innovation and continuing service to their communities. The innovative solutions set out in your Summary of Emerging Thinking make a valuable contribution to that debate.

We can see some enhancements that could be made to encourage broader support and bring your thinking closer to implementation.

Firstly, the solutions in the Summary should be seen alongside other, already existing, measures that could usefully be extended and developed. We look forward to further details in the final report about the use of existing tools for extension and forbearance:

- Conventional recapitalisation will be a valuable part of the toolkit, alongside the solutions your report sets out. The Covid Business Repayment Plan and Covid Business Recovery Capital are complex products that will be difficult for unlisted SMEs to understand and administer. In seeking broad 'rules based' eligibility and permitting accelerated entry before default, careful control and accountability will be needed to ensure optimum outcomes for customers.
- These proposals would also require extended government support. They will need careful costing, including administration costs, to enable their evaluation alongside other options.

- The likely costs to government of the existing loan schemes should be carefully reviewed. The cost of direct support to banks, for example to enable significant extension of term loans, or other similar forbearance mechanisms, may well deliver better economic value to the taxpayer.

Secondly, page 17 of the Summary lists criteria used to design the proposed instruments. To help policy makers make choices, there are also some open questions, which might be posed:

UK recovery corporation (UKRC)

- The Summary raises very important questions about the governance and operations of the proposed UKRC and access to valuable private sector expertise would be essential. There remain some very difficult issues to be resolved before the government is invited to commit to establishing a UKRC. These include:
- How can the UKRC be equipped and incentivised to directly catalyse enterprise and support business? What should its objectives be; should it, and the government funding it receives, be targeted primarily at businesses with 'unsustainable' debt?
- How much government support will be necessary and how can it best be contained? The Summary identifies an upper bound of £107bn of UK 'unsustainable' business debt, most of it not covered by government guarantees. This is significantly more than the £80bn identified in the Bank of England's May Financial Stability Report, of which around half was overseas and also included retail and commercial bad debt. How can the UKRC be incentivised to constrain intervention and keep the call on taxpayers to the minimum necessary?
- How can UKRC's assets best be constructed to enable onward sale? This was a valuable exit route for the government from its investment in the Northern Rock and Bradford & Bingley mortgage books. Underperforming SME loans are a significantly higher risk asset class and could prove very difficult to securitise without additional, costly government support.
- What financial reporting and audit will be expected from businesses at entry and during holding by the UKRC? Many businesses within scope of the proposals will not currently prepare audited accounts, but it is important that other creditors have transparent information about entities going into these schemes and the UKRC will itself need reliable data. Similarly, the government and public need reliable aggregate information about the position and performance of businesses in the plan.
- What public consultation process should be required in establishing UKRC?

Covid Business Repayment Plan (CBRP)

- For SME's, conversion of debt to a deferred tax liability is an innovative and arguably relatively simple mechanism to understand and administer. However, there are also some important questions the final report could pose to government:
- Is mutualisation of private sector debt, via the tax system, an economically sound and demonstrably effective public policy?
- How might HMRC be equipped to administer CBRP? What resourcing, systems and processes capabilities will need to be built? Key measures, such as whether to use taxable profits or 'another measure of business recovery' are not addressed in the report.
- How is HMRC expected to pursue CBRP and other tax debts, especially following the reintroduction of Crown preference? Pertinent questions include whether this is likely to

accelerate the recovery of tax debts, and the implications for companies and directors of swapping bank debt for a tax liability. How banks and other creditors are likely to respond to their increased risk arising from crown preference is also relevant.

Covid Business Recovery Capital (CBRC)

- Pertinent questions here are: how can risks be mitigated that CBRC leads to loss of control by current shareholders? How can the risk of inappropriate conduct be mitigated? For companies with a CBILS loan of up to £1m, longer term subordinated debt might be more appropriate.
- How will the conversion be administered? Issues around pricing, communicating with multiple shareholders, modifying memorandums and articles would all need to be managed, often presumably under pressure and to a condensed timetable. There may also be tax implications.

Covid Business Growth Shares (CBGS)

- The Summary recognises that solutions other than CBRP and CBRC already exist and also that others may become necessary. We welcome this approach. Relevant questions include whether the CBGS risks crowding out private sector funds and the extent to which public funding is needed to support investment in entities eligible for CBGS.

Finally, there are some important areas for further exploration and resolution that the final report should highlight:

- Process for handling small business failures: The report refers to the need for an 'industrial scale' process to handle small business failure. This is an important point which should be considered before the proposals are adopted, both in relation to businesses that are not accepted into the proposed support mechanisms and those that are supported but subsequently fail.
- Trigger events for scheme entry: The principle of mutual consent as set out on page 22 of the Summary is important. The Summary recognises that a transparent, standardised and programmatic process will be needed. But mechanisms for independent assessment of business viability, capital requirement, eligibility and trigger-points will all be challenging to implement fairly. Transparency on criteria applied and communication of outcomes is key.
- Fair treatment of customers: A simple oversight process is proposed to reduce conduct risk and avoid disputes. This implies modification of existing oversight and recourse mechanisms. In designing schemes to manage default at scale, customer safeguards need careful consideration. Businesses that subsequently fail may well claim unfair treatment. If the ombudsman is to be used, it will need to be adequately equipped with resources.

We welcome this opportunity to provide input to the Recapitalisation Group's emerging thinking. We're keen to continue to play our part as the CityUK develops its thinking and are willing to engage in further dialogue with you and the group to help contribute to solutions to these unprecedented challenges.

Yours sincerely

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