UK vs France: staggering divergence in expected losses on Covid loan schemes

Banks and governments are facing a mounting bad-debt burden as the Covid crisis continues. But recent disclosures from the French and UK governments point to a staggering difference in expected loss experience.

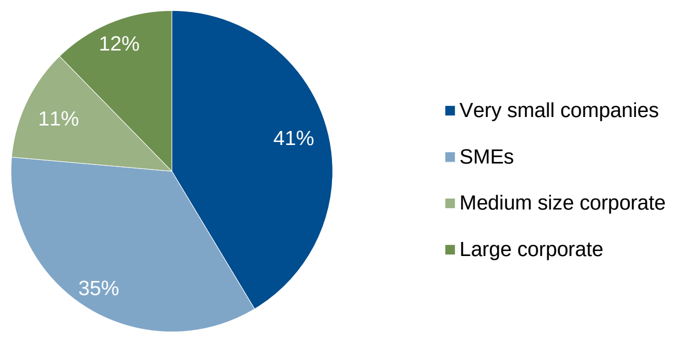
The French government is anticipating that the guarantee will be called under its PGE loan programme (prêts garantis par l'Etat) for up to EUR 1.3bn next year, or 1% of outstanding guarantees. The UK government, however, has put upper estimates of lifetime losses under its loan schemes at 40%. The underwriting criteria explain most of the differences. Banks may end up shouldering only a small part of those losses, but the loans banks extended before the crisis may not fare much better.

The French PGE programme had an outstanding amount of EUR 121.2bn as of September 25 (against a maximum size of EUR 300bn). The total share of guarantees expected to be invoked over the life of the scheme, which is scheduled to close at the end of the year, is estimated at 4.6%. Whether this is a realistic proxy for potential future corporate loan defaults in France is a key input into assessing French banks' credit resilience through this crisis.

Scope considers this amount to be low but reflective of government measures to postpone the emergence of problem loans. It factors in the expectation of a less severe downturn for 2020 than initially thought post-lockdown and a marked rebound in 2021. And the fact that the burden-sharing rules between the State and the banks are pushing banks as intermediaries to perform due diligence before granting loans.

The PGE burden-sharing regime allocates more losses to banks for loans granted to larger companies. It ranges between 10% and 30% for small companies. So far, small and medium-sized enterprises (SMEs) and very small and micro enterprises (VSMEs) account for 75% of total loans granted (see Figure 1).Only a small percentage (2.7%) of eligible companies has been rejected so far, indicating a rigorous selection process.

Figure 1: breakdown of PGE loan portfolio by company size



Source: French Ministry of Economy, Banque de France, Scope Ratings

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August 2020

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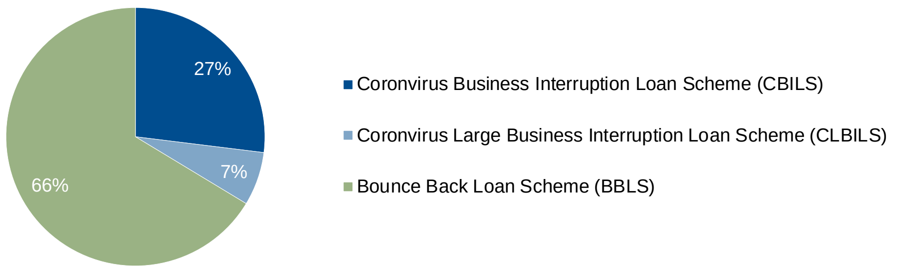
This restrictive approach partly explains the sharp contrast with the UK Department for Business, Energy & Industrial Strategy's (BEIS) best-case estimates of GBP 14.7bn of losses (or 26%) and its worst-case estimates of 46%, or GBP 26.5bn, from close to GBP 60bn in loans granted through various schemes to the end of September. These are at-best preliminary figures and are likely to be revised but they are not far off from estimates by TheCityUK's Recapitalisation Group that put the level of unsustainable debt between GBP 20bn and GBP 23bn as of September 2020.

Unlike the French programme, the bulk of the UK's exposure (GBP 38bn) consists of loans to micro companies (1.3m advances as of end-September) that are fully underwritten by the government (Figure 2). These are hard to value even under normal circumstances – including the impact of possible fraud. We are not surprised to see that the UK recently extended the maturity of these loans from six to 10 years, including payment holidays and interest-only options.

Figure 2: breakdown of UK government-guaranteed loan schemes



CBILS: companies with <GBP 45m turnover, CLBILS: companies with >GBP 45m turnover, BBLS loans up to GBP 50k or 25% of turnover. Source: Scope Ratings

On fraud, the National Audit Office's investigation into the UK's Bounce Back Loan Scheme for micro businesses cited British Business Bank and BEIS estimates that up to 2.3% of approvals were duplicates before the solution went live, while BBLS default estimates range between 35% and 60%. There are also question marks over banks' incentives to collect BBLS loans.

Banks' exposure is limited to 20% of the much smaller Coronavirus Business Interruption Loan Scheme (CBILS), which has a 10-year maximum maturity, and loans under the Coronavirus Large Business Interruption Loan Scheme (CLBILS), where we estimate the banks' share of losses to be no more than GBP 1bn.

In France, assuming small enterprises invoke guarantees (for up to 4.6% of total loans), the cost for banks would be manageable at about EUR 600m and would span several years (although most defaults will likely be concentrated in 2021 and 2022).

The total amount of loans to resident enterprises in France stood at EUR 1.17trn at the end of July. Applying a similar loss rate to the non-PGE portion suggests a provisioning effort in 2021 of about EUR 10bn. In comparison, the six largest French banks generated EUR 48bn of pre-impairment operating profits in 2019. Even with a 20% haircut, the corresponding provisioning effort, albeit low in our view, appears manageable and supports our view on the French banks' resilience.

Additional losses could arise from equity-focused programmes, In France, State-backed equity loans (prêts participatifs) are supposed, among other things, to support companies that do not meet PGE eligibility criteria. But the target amount is much smaller: State exposure is capped at EUR 2bn and these loans are intended to help corporates borrow from banks on the basis of an improved equity position. A similar scheme exists in the form of the UK Future Fund, from which GBP 720m has been drawn so far.

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