Project April - Fraud Risk Review

INITIAL DRAFT REPORT
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We cannot guarantee that we have had sight of all relevant documentation or information that may be in existence and therefore cannot comment on the completeness of the documentation or information made available to us. Any documentation or information brought to our attention subsequent to the date of this report may require us to adjust and qualify our report accordingly.

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Background

On 27 April 2020, the Chancellor announced the coronavirus Bounce Back Loans ("BBLs or "the Scheme"), a new fast-tracked finance scheme which is intended to help small and medium-sized businesses affected by coronavirus (COVID-19) to apply for loans of up to £50,000. The government will guarantee 100% of the loan and no fees or interest will be payable for the first 12 months.

BBLs will be administered by the British Business Bank plc ("BBB") although applicants will apply directly to an accredited lender. There are currently 7 accredited lenders [redacted] ("the Lenders").

Our role

We have been instructed by BBB to support it in understanding and articulating, based on the views of the banks who are participating as lenders in the Scheme, the potential fraud risks that may crystallise in the Scheme.

We conducted an initial structured workshop with the Lenders on 27 April 2020. Each of the Lenders articulated their envisaged applicant journey at that date. Following the workshop, meetings were conducted with each individual Lender on 28 and 29 April 2020 to validate our understanding of their approaches and to elicit their views on the residual fraud risks.

We validated the applicant journey with each Lender by email on 30 April 2020.

Limitations

- Our work was conducted remotely.
- All of the Lenders are in the process of developing their applicant journey for the BBLs at the time of our meetings and processes may be subject to change and further development, both prior to launch of the Scheme and post launch.

Caveats

Our work has not assessed the design effectiveness or operational effectiveness of fraud controls at any of the Lenders.

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Applicant journey

We have considered the applicant journey in the context of three potential categories of applicant:

- Existing Business Current Account ("BCA") holder
- Existing Personal Current Account ("PCA") holder
- New to Bank applicant

Key themes

We have set out on slide 5 the controls designed to mitigate fraud that the Lenders are developing. There were a number of consistent themes across the Lenders, these are set out below:

Design Principle

The Lenders expressed the view that the most appropriate approach was for an applicant to apply to their main business banking partner (if an accredited Lender). Where no business banking relationship exists (e.g. a sole trader operating a PCA or a BCA with a non-accredited financial institution) then the applicant will be required to open a BCA with a Lender.[1]

Existing Business Customers

- Many of the Lenders have developed new processes or architecture for this product. [redacted] Transaction monitoring controls, including those to identify potential fraud, will apply over the operation of the BCA.[3]

This is expected to be the principal route by which applicants access the Scheme.

[1] Some of the Lenders noted that they cannot require an applicant to open a BCA but that in essence applicants would go through a BCA onboarding process
[2] Cifas is a non-for-profit fraud prevention service in the United Kingdom representing organisations from across the public, private and voluntary sectors
[3] The Lenders informed us that in certain circumstances, drawdown may be permitted to an account with another institution, however this would be subject to validation processes

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Existing Personal Customers

- With the exception of one institution[4] , Lenders will require applicants with PCAs who declare that they are operating a business to complete BCA onboarding processes.[5] The Lenders all confirmed that sufficient resources were available to conduct these processes and estimated between two and five days to complete, if applicants were able to provide the necessary information.
- Drawdown will only be permitted to the account (BCA or PCA with additional AML/KYC) with the Lender.[6] Transaction monitoring controls, including those to identify potential fraud, will apply over the operation of the account.
- In respect of Self Assessment ("SA") tax returns and UTR[7], the Lenders were all unclear what information they would check or the purposes for which they [redacted]
- The Lenders have concerns that the historic operation of a business through a PCA is in breach of account terms and conditions. Many Lenders expressed the view that the disclosure of business activity was a trigger event defined by regulatory guidance requiring additional AML/KYC checks.

All of the Lenders informed us that the treatment of applicants with PCAs was the most challenging area of the Scheme, given the need to consider internal policy requirements, their interpretation of regulatory communications and the objectives of the Scheme (to deliver loans quickly and with minimal interventions).

New to bank customers

- The majority of Lenders intend to prioritise existing customers. New to bank customers applying for a BBL will be required to follow business as usual BCA onboarding processes. This aligns to the FCA's 'Statement on the UK Coronavirus Business Interruption Loan Scheme (CBILS) and the new Bounce Back Loan scheme (BBL)' published on 27 April 2020 which sets out "*The financial crime risks may be significantly higher for new customers and authorised firms should carry out the normal CDD process in accordance with the Money Laundering Regulations*."
- [redacted] will not permit new to bank customers to access the Scheme.

[4] For Existing PCAs whose business started before 6 April 2019, [redacted] follow the same process as for Existing BCAs.
[5] [redacted] does not currently offer new BCAs, will require an uplift of AML/KYC information to an equivalent BCA level. This is in the process of development
[6] The Lenders informed us that, in certain circumstances, drawdown may be permitted to an account with another institution, however this would be subject to validation processes.
[7] [redacted]

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[redacted]

	[redacted]			[redacted]		[redacted]	
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

[redacted]

- [redacted]

[redacted]

[redacted]

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Residual Fraud Risk

In the course of our work the Lenders expressed a number of areas of fraud risk that they were working to mitigate. Some of these were able to be addressed by individual Lenders, some at industry level and some that certain Lenders considered were incapable of mitigation and remain residual fraud risk.

[redacted]

Whilst the likelihood of fraud risk crystallising is very high, it is very difficult to quantify the impact (values and volumes affected) in order to evaluate the remaining residual risk. Further detail in respect of identified fraud risk and mitigating controls is set out in Appendix 1.

The areas of residual risk arise from the following eight categories. While we have highlighted some potential mitigants below, by definition the mitigants do not fully eliminate the fraud risk, leaving residual risk:

1. Self certification

Reliance on self certification, in the absence of any verification, leads to the residual fraud risk that lending is being made to businesses which are not eligible for the Scheme, amounts in excess of that to which they are entitled are lent or whose difficulties do not relate to Covid-19. The approach by Lenders to PCA applicants requiring completion of BCA onboarding processes may partially mitigate this risk.
An example of this risk crystallising would be an individual self certifying that they meet the eligibility criteria for the Scheme when business as usual underwriting processes may have identified that these criteria were not met.

2. Multiple applications

[redacted]

3. Lack of legitimate business

Lenders were concerned that the Scheme may be abused by individuals in distress (opportunistic) with no real business and inactive or dormant accounts, or by companies being used to facilitate fraud. Many Lenders commented on the recent spikes in company formations and the timing parameters of company set up for eligibility under the Scheme. This risk stems significantly from reliance on self certification and is therefore an inherent risk of the scheme.

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Residual Fraud Risk (cont)

4. Internal fraud (business)

[redacted]

5. Internal fraud (Lender)

[redacted]

6. Impersonation / Forged / fake documentation

While this remains a constant risk with any BCA application, Lenders will be applying BCA onboarding processes which are designed to mitigate such risks where possible.

7. Organised crime

[redacted]

8. Other considerations

[redacted]

Several of the Lenders were also concerned with sectoral lending and in particular the reputational impact of lending to, for example, adult entertainment or gambling organisations that ordinarily those Lenders would not deal with.

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Challenges

In the course of our work the Lenders expressed a number of challenges that they were working to address. Some of these the representatives of the Lenders informed us were able to be addressed by individual Lenders, some at industry level and some are incapable of resolution.

Departure from ‘normal’ lending processes

- [redacted]
- The Lenders noted that the speed of the implementation of the Scheme and the required turnaround time from application to drawdown posed additional fraud risk.
- Many Lenders commented that the reliance on self-certification was a challenge given they may have information in their possession which would contra-indicate the self assertions. However, they noted that implementing additional checks would slow down the process and undermine the purpose of self-certification and the objectives of the Scheme.
- [redacted]

[redacted]

Definition of minimum standards

- [redacted]
- A Lender noted that in their existing BCA population the exit rate for fraud related activity (given the Lender’s knowledge of the customers and ability to monitor transactions) was very low. This was cited as an example of why it is preferable for applicants to remain with their primary banking partners.

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Challenges (continued)

Balancing the objectives of the Scheme with existing Regulatory requirements

- Lenders informed us that, in respect of PCA holders, in their view regulatory requirements (or internal policy requirements) for AML/KYC would not be met by reliance on SA and UTR information.
- Several Lenders expressed the view that they would like it to be mandatory for all new to bank customers applying for the Scheme to be taken on as business banking customers. [redacted]
- There was discussion by the Lenders about when additional AML/KYC checks should be performed. There was consensus that these checks needed to be completed prior to any drawdown.

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For future consideration

In the course of workshops, Lenders suggested a range of possible enhancement to the operation of the Scheme. These have been summarised below:

Defined guidance/minimum standards

[redacted]

Multiple applications

One of the key residual fraud risks is the possibility of multiple applications from a single business. All of the Lenders commented that they are looking at ways to identify multiple applications within their organisations. [redacted]

Information sharing

[redacted]

Anti-fraud statements on BBL application form

[redacted], the application form should include statements that the information will be used for the purposes of mitigating fraud and may be share with other relevant parties.

[redacted]

1	[redacted]
2	[redacted]
3	[redacted]
4	[redacted]
5	[redacted]
6	[redacted]
7	[redacted]
8	[redacted]

The upfront controls and post-event assurance procedures in the table represent an aggregated view across the Lenders, and not all controls will be implemented by all Lenders pwc.com