We spoke to Don Brown, partner at law firm Stephenson Harwood LLP, about how the Bank of England's Term Funding for SMEs is designed to function in the current climate.

Q: From what I understand, borrowing under the TFSME is structured as a series of incentives for participating financial institutions. The more institutions lend to businesses, the cheaper they can borrow from the Bank of England and lending to non-bank credit providers (NBCPs) is valued or incentivised less than lending directly to SMEs under the scheme. Is this a correct characterisation of the scheme?

A: Broadly, yes. participants in the scheme are required to provide the BoE with data on what proportion of their loans have been made to SMEs / non-SMEs. Participants can then draw up to the 'borrowing allowance' for their group, which comprises the 'initial allowance' plus the 'additional allowance'.

The 'initial allowance' is 10% of new loans (net of repayments) made by the group to UK resident households, private non-financial corporates and certain NBCPs since 31 December 2019.

However, the calculation for the 'additional allowance' rewards lending made to SMEs as it is calculated by adding together (i) 1 x non-SME lending over the relevant period to UK resident households (excluding unincorporated businesses) and (ii) 5 x net lending to SMEs.

In other words, loans made by the group to SMEs are rewarded with five times as much 'additional allowance' as loans made to non-SMEs.

Participants are penalised with higher interest charges if they borrow from the scheme but do not lend. The interest charged by the BoE is the bank rate plus the TFSME fee. If the group's total net lending over the relevant period as a whole is positive, the TFSME fee is 0bp.

However, if net lending over the relevant period is negative, the TFSME fee will increase linearly (to the nearest basis point) from 0bp per annum if the lending is unchanged to 25bp per annum if lending falls by 5%.

Q: How are NBCPs defined under the scheme?

A:NBCPs are defined as UK resident "financial leasing corporations", "factoring corporations" and "mortgage and housing credit corporations (excluding SPVs related to securitisation)". ■