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Access to credit for micro, small and medium-sized enterprises (MSMEs)

Note by the Secretariat

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Introduction

1. This document replaces document A/CN.9/WG.I/WP.119/Add.1 that was prepared as an addendum to document A/CN.9/WG.I/WP.119 which discusses – in the form of an annotated list of contents – possible topics to be addressed in a future text (the "Future Text") on access to credit for micro, small and medium-sized enterprises (MSMEs) for consideration by the Working Group. The document illustrates how the Future Text may address all topics in A/CN.9/WG.I/WP.119 and suggests a revised order for their discussion.

2. The draft Future Text is reproduced as an annex to this Introduction and is preceded by some preliminary considerations regarding its purpose, intended audience and working method. The Working Group may wish to discuss those preliminary considerations and whether the approach proposed by the Secretariat is appropriate for the preparation of the Future Text.

1. Purpose

3. The aim of the Future Text is to provide guidance on the adoption or reform of domestic legal frameworks to facilitate MSMEs' access to credit also in light of the difficulties that many MSMEs around the world are currently facing and will continue to face as a result of the coronavirus disease (COVID-19) pandemic. For this reason, the Future Text will also point to new areas that States could regulate or legislate on in order to facilitate MSMEs' access to credit and it will discuss relevant policy and operational interventions to the extent they can ensure effectiveness of the legislative measures in reducing MSMEs' constraints to access credit.

2. Intended audience

4. The Future Text will be addressed both to States lacking a specific legal framework supporting MSMEs access to credit as well as to States aspiring to modernize their existing laws with a view to facilitating access to credit for MSMEs including on a transnational basis. In addition to national legislators and policymakers from all geographic regions and legal traditions, international organizations, non-governmental organizations (NGOs), chambers of commerce and other stakeholder associations that are interested or actively involved in improving the legal framework of access to credit for MSMEs may also benefit from the Future Text.

5. At its fifty-second session in 2019, the Commission agreed that the materials prepared by the secretariat should draw as appropriate on the *UNCITRAL Model Law on Secured Transactions* (see document A/74/17, para. 192(a)). However, users of the Future Text need not be fully conversant with the Model Law. Even those unfamiliar with the regime contemplated in the Model Law – which addresses secured lending using movable assets as collateral – should be able to use and rely on the recommendations of the Future Text.

3. Working method

6. Following the approach taken by UNCITRAL Working Group V in the preparation of a simplified insolvency regime for micro and small enterprises, the discussion on secured lending using movable assets as collateral will build upon the existing UNCITRAL instruments on this topic. These are: the *UNCITRAL Model Law on Secured Transactions* (2016), the *UNCITRAL Legislative Guide on Secured Transactions* (2007) and the *UNCITRAL Legislative Guide on Secured Transactions and its Supplement on Security Rights in Intellectual Property* (2010); the *UNCITRAL Guide on the Implementation of a Security Rights Registry* (2013); as well as the *UNCITRAL Guide to Enactment* (2017) and *Practice Guide to the Model Law* (2019). The Future Text will refer to and discuss the recommendations and principles provided for in those texts that are the most relevant to facilitate MSME access to credit.

7. Similarly, the parts of the Future Text touching upon personal guarantees and restructuring support will cross-refer to the *Legislative Recommendations on Insolvency of Micro and Small Enterprises* (adopted by the Commission during its fifty-fourth session, in 2021) and the draft commentary to the *Legislative Recommendations* (adopted in principle by the Commission).

Annex

I. Access to credit for MSMEs and related challenges

A. MSMEs and the importance of access to credit

Significance of MSMEs worldwide

1. MSMEs represent the vast majority of business types in all regions. They account for around 55 per cent of the gross domestic product (GDP) in developed economies and 35 per cent in developing economies.[1] Worldwide, they make up more than 90 per cent of businesses (in some countries they constitute about 90 per cent of the domestic productive sector)[2] and 60–70 per cent of total employment when both formal and informal MSMEs are considered.[3] While MSMEs account for around two thirds of employment in the global economy, their social and economic importance becomes starker in terms of job creation in low-income economies, as much as 95 per cent.[4] As it has been noted,[5] they offer employment and entrepreneurship opportunities for young people, women and disadvantaged groups including migrants, ethnic minorities and persons with disabilities and are therefore crucial in increasing incomes for the poorest 40 per cent of the world's population. The World Bank forecasts that around 600 million jobs will be needed to absorb the youth entering the labour market over the next 15 years. Not surprisingly, several governments have prioritized MSMEs' roles in job creation.

MSME characteristics and challenges[6]

2. Since the criteria used to identify MSMEs vary according to the economic, legal, political and sociological context of each State, and in certain States they are not clearly established, there exists no internationally standardized definition of MSMEs. Indeed, while the number of employees, turnover, and assets are the more commonly used criteria, other variables, such as formality, years of experience, initial investment amount are also used to define and identify MSMEs.[7] Ultimately, it is for each economy to define its own parameters. Mindful of these differences among States, the UNCITRAL legislative texts on MSMEs do not include a definition for each category of MSMEs, since States will apply the texts in accordance with their own definitions.

3. Despite their disparate nature and size, some possible characteristics of MSMEs may be broadly identified. They include the following:[8] (a) small size and often family-run; (b) few or no employees and difficulty in hiring and retaining staff; (c) reliance on kinship networks for loans or risk-sharing; (d) limited access to capital; (e) difficult access to banking services; (f) disproportionate impact of regulations (e.g., business registration procedures and cost); (g) limited markets (for micro and small businesses, often only local markets); (h) limited access to formal dispute settlement mechanisms; (i) difficulty to partition assets, so business failure often directly impacts personal and family assets; (j) vulnerability to financial distress; and (k) difficulty in transferring or selling a business.

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[1] WTO, World Trade Report 2016, (2016), p. 18.

[2] See for instance Colombia, UNCITRAL 54th Commission session, TAC panel on 16 July 2021.

[3] ITC, SME Competitiveness Outlook 2015: Connect, Compete and Change for Inclusive Growth, (2015), p. 1.

[4] Ibid., p. 13.

[5] UNDESA, Micro, Small and Medium-Sized Enterprises (MSMEs), and their role in achieving the Sustainable Development Goals, pp. 4 and 22.

[6] Given that MSMEs may range from small family businesses to larger enterprises with several employees (e.g., in the European Union the category includes enterprises with up to 250 persons), the Working Group might wish to consider whether the focus of the Future Text on MSME access to credit should be on MSMEs or micro and small enterprises (MSEs) only.

[7] IFC, MSME Country Indicators 2014: Towards a Better Understanding of Micro, Small, and Medium Enterprises, (2014), p. 5 et seq.

[8] A/CN.9/941, para. 12.

4. As concerns MSMEs' access to credit specifically, two observations can be made, which are linked to the above listed characteristics. First, for many MSMEs, in particular for micro and small businesses, often there is no separation of assets between the entrepreneur and the business nor does the business have a distinct legal personality. Second, the limited access to banking services often results in MSMEs' strong reliance on support from family and friends.[9] From the lenders' point of view, limited access to information on MSMEs and their business operations, or information asymmetry, is one of the most significant problems that frustrates external financing, since it is often too costly for them to collect the information that is needed to assess MSMEs' creditworthiness.[10]

MSME finance gap

5. Over the last decade, many studies have analysed the issue of MSME access to finance, noting that many MSMEs were severely underfunded and emphasizing their dependence on credit, including informal sources of credit, and cash-flow difficulties. These studies highlighted that MSMEs face numerous obstacles in borrowing funds because they are small (or relatively so), less diversified, and have weaker financial structures and that it is difficult for MSMEs to provide high-quality collateral and occasionally transparent information with respect to their creditworthiness (e.g. lack or insufficient financial reporting).[11] These obstacles are exacerbated for all those MSMEs operating in the informal sector. UNCITRAL's work[12] on reducing the legal obstacles faced by MSMEs in their life cycle aims at facilitating migration of those businesses to the formal sector, which in turn should permit MSMEs to access credit more easily.

6. The considerable mismatch between the need for MSME finance and the actual funding has been defined as the finance gap. The International Finance Corporation (IFC) defines this gap as the difference between the current supply and potential demand which can potentially be addressed by financial institutions.[13] An IFC working paper estimates the unmet demand for financing from formal MSMEs in developing countries, revealing a gap of USD 5.2 trillion.[14] According to the study, there are 65 million credit-constrained formal MSMEs, representing 40 per cent of all enterprises in the 128 reviewed countries, and the potential demand for finance from informal enterprises in developing countries is valued at another USD 2.9 trillion. While East Asia and the Pacific account for the largest share of the total gap, Organisation for Economic Co-operation and Development (OECD) countries are not

[9] In low-income economies, it is estimated that about 1.7 billion adults who may be already or potentially running MSMEs are excluded from the formal financial system, because they do not have an account at a financial institution or a mobile money provider. These excluded adults amount to 30 per cent worldwide and women are overrepresented among these unbanked.

[10] World Bank, International Committee on Credit Reporting (ICCR): Facilitating SME financing through improved credit reporting, 2014, p. 1.

[11] IFC, MSME Finance Gap, Assessment of the shortfalls and opportunities in financing micro, small and medium enterprises in emerging markets, 2017.

[12] At its forty-sixth session, in 2013, the Commission agreed to commence work on reducing the legal obstacles faced by MSMEs throughout their life cycle and, in particular, those in developing economies, and that such work should start with a focus on the legal questions surrounding the simplification of incorporation. Working Group I was given a mandate to carry out such work. At its forty-ninth session, in 2016, the Commission agreed that Working Group V should develop appropriate mechanisms and solutions to resolve the insolvency of MSMEs. The deliberations of working groups I and V have resulted in the following texts: the *UNCITRAL Legislative Guide on Key Principles of a Business Registry* (2018), the *UNCITRAL Legislative Guide on Limited Liability Enterprises* (2021) and the *UNCITRAL Legislative Recommendations* on *Insolvency of Micro and Small Enterprises* (2021), which are accompanied by the draft commentary to the *Legislative Recommendations*.

[13] Ibid., p. 2.

[14] This figure is the difference between the potential demand of USD 8.9 trillion minus the credit supply of USD 3.7 trillion. See IFC, MSME Finance Gap (supra footnote 11), pp. 27 et seq.

entirely free from such gap as a sizeable share of MSMEs finds it more difficult to access credit from banks, capital markets or other suppliers of finance.[15]

7. Studies have shown that finance gaps are likely to be greater for women-run MSMEs than for men-owned ones because of cultural biases or economic, social and legal constraints. For instance, in some jurisdictions women are said to have less access to credit since they have less physical and reputational collateral, particularly as their microfinance repayment rates are often not captured by credit bureaux.[16]

8. While the reduction, or ideally closure, of the MSME finance gap matters, a balance should, however, be sought between the lending risk of financers providing credit to MSMEs and the need to protect these latter, in particular the most unsophisticated ones, against onerous loans, heavy interest fees or other onerous conditions to access credit. States may thus wish to adopt measures aimed at addressing MSME financing constraints specifically and economic conditions in general so that credit remains at affordable rates without giving up any necessary protection or jeopardizing sound banking operations. These actions would provide an incentive to the financial institutions to lend to this segment of the economy.

9. Improving financing for MSMEs may also make a considerable impact on achieving the sustainable development goals (SDGs).[17] Through the business practices they adopt, the sectors in which they operate and their impact on the broader economy, the International Trade Centre (ITC) suggests that stronger MSMEs can contribute to achieving SDGs 8 and 9.[18] It further emphasizes that MSMEs can have a positive impact on 60 per cent of the individual SDG targets with sufficient funding in place.[19] Improved access to credit for MSMEs would allow their great potentialities to grow and scale up. This would likely help advance women's economic empowerment and help alleviate poverty.

B. Challenges faced by MSMEs to access credit

10. While MSMEs may be varied in nature and scope, the importance of financing for MSMEs at all stages of their business life cycle is common to all MSMEs. MSMEs usually need different sources of financing during their different stages of development. In the initial stages, when MSMEs generate little revenue and lack a reliable credit record, access to formal credit is often limited and MSME entrepreneurs often rely on their own savings or support from family and friends. Start-up MSMEs with growth potential and innovative features may attract business angel investors. In some jurisdictions, credit cards, microfinance credit facilities and crowdfunding platforms are also heavily relied upon by start-up MSMEs. As MSMEs grow and build a reliable credit record, other sources of financing such as bank credit, trade finance and venture capital (VC) may become increasingly available. Finally, mature MSMEs may access capital markets and issue debt and equity through stock exchange markets or private placements.[20]

[15] OECD, Financing SMEs and Entrepreneurs 2020: An OECD Scoreboard, pp. 26–27; OECD, The SME Financing Gap (vol. I): Theory and Evidence, (2006), p. 15 et seq.

[16] ITC, Unlocking Markets for Women to Trade, (2015), pp. 23 and 25.

[17] Inter-agency Task Force on Financing for Development, Financing for Sustainable Development Report 2020, (2020), p. 8, box I.2.

[18] ITC, SME Competitiveness Outlook 2019: Big Money for Small Business – Financing the Sustainable Development Goals, 2019, p. xvi. SDG 8 relates to the promotion of sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all. SDG 9 relates to building resilient infrastructure, promoting inclusive and sustainable industrialization and fostering innovation.

[19] Ibid., p. xv.

[20] IMF, Financial Inclusion of Small and Medium-Sized Enterprises in the Middle East and Central Asia, (2019), p. 21.

1. Start-up

Support by family and friends

11. Micro-businesses often rely on family and friends for initial capital.[21] Based on a survey of the Consultative Group to Assist the Poor (CGAP), it is common for small businesses to borrow money from family and friends.[22] In a survey of women-run businesses in the Middle East and North Africa, the World Bank revealed that most women-owned enterprises do not have access to formal credit, and financed their business mainly through loans from family and friends as well as personal savings.[23]

12. Family and friends support can come in the form of debt, equity or guarantee. For debt, quite often the terms of the support are verbalized and not written down, which makes borrowing a delicate situation. Oral agreements often lack clarity on the terms and conditions of the loan, repayment schedules and remedies for defaults. In comparison, equity is usually associated with decision-making rights in the business. Sometimes family and friends may prefer equity investment in start-up MSMEs because they are part of the entrepreneur's close social network. They do not have the same approach as professional investors in terms of risk assessment.[24] Finally, support from family and friends may also take the form of guarantees or suretyship, which give lenders some comfort that the debt will be repaid in case the MSME borrower fails to pay (see chapter II, section C on personal guarantees for MSMEs' loans below).

13. For start-up MSMEs in the United States of America, for example, the amount of funds raised through family and friends generally exceeds other private equity sources (e.g., VC and business angel investments).[25] According to a survey of the European Central Bank, 18 per cent of European small and medium-sized enterprises (SMEs) surveyed between April and September 2019 identified funds from family, friends or related companies as relevant sources of financing for them.[26] In developing countries, it is likely that MSMEs rely more on family and friends.[27] Notably, in some countries in Africa, community members also gather together to help each other access credit through informal credit and savings arrangements.

14. Support from family and friends is rarely a guaranteed source of financing for all types of businesses. In this regard, MSMEs do not face challenges substantially different from those faced by large firms, except that MSMEs are more vulnerable economically, more dependent on such financing and may be less aware of their rights and obligations in relation thereto.

Business angel investment

15. Business angel investment represents one main category of formal sources of private equity, which includes a broad range of external financing instruments, whereby enterprises obtain funds from private sources in exchange for an ownership interest.[28] Business angel investment is a valuable source of funds for MSMEs,

[21] Inter-agency Task Force on Financing for Development (supra footnote 17), p. 67; UNESCAP, Small and Medium Enterprises Financing, (2017), p. 3.
[22] CGAP, Executive Summary – CGAP National Surveys of Smallholder Households, (2018), p. 15.
[23] World Bank Group, Secured Transactions, Collateral Registries and Movable Asset-Based Financing, (2019), p. 23.
[24] Ibid., p. 24.
[25] Ibid., p. 21.
[26] European Central Bank, Survey on the Access to Finance of Enterprises in the euro area: April to September 2019, (2019), p. 18.
[27] ITC, SME Competitiveness Outlook 2019 (supra footnote 18), p. 21.
[28] OECD, New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments, (2015), para. 332.

especially those that are not yet ripe for VC funding.[29] Business angel investors[30] are usually actively involved in business management, and can offer business expertise, access to a network and other non-financial benefits to enterprises they invest in (including MSMEs), which enable them to scale up to a stage where VC fund managers may step in.[31] It is difficult to estimate the size of business angel investments because such investors often stay anonymous and rarely disclose the details of their investments.[32]

16. Similar to family and friends support, business angel investment is rarely a guaranteed source of financing for all types of businesses. Business angel investors typically invest in early-stage, innovative MSMEs.[33]

Credit cards

17. Credit cards are generally available for MSMEs and are not new in many jurisdictions. While in some jurisdictions MSME entrepreneurs tend to use personal credit cards for business purposes, in other jurisdictions business credit cards are more widely used. Business credit cards can be issued by commercial banks or development banks. The credit limit granted on a business credit card is often higher than a personal credit card. Certain credit cards issued by development banks offer relatively low charges and low interest rates for MSMEs and in some cases are subsidized by the government. In general, it can be easier for small business owners to qualify for a credit card rather than a bank loan due to the former's less strict qualification criteria.

18. Although credit cards issued by development banks for MSMEs are generally tailored to accommodate the financing needs of small business owners, commercial banks may impose high interest rates and high default charges for credit cards issued to MSMEs. Moreover, many small business credit cards require a personal liability agreement to hold business owners liable for any late or missed payments. Small business credit cards also often carry less protection than consumer credit cards (e.g., no guaranteed service when disputing billing errors). In some cases, lack of recourse mechanisms for credit card holders to file a complaint raises additional concerns.

Microfinance credit

19. Although most microfinance institutions (MFIs) are designed for small loans to micro borrowers, they are not strictly limited to micro borrowers and may impose different eligibility conditions. MFIs are less demanding in terms of collateral and guarantee requirements and offer more personal, tailor-made and simple financial products, but they do not always charge lower interest rates than other sources.[34] Loans are often the first product that MFIs offer to clients.[35] Microfinance has made a major contribution to improve MSMEs' access to credit particularly for businesses run by women. Eight out of every ten microfinance clients in the world are likely to be women entrepreneurs.[36]

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[29] VC fund managers make direct investment in unlisted MSMEs, with the aim of bringing capital, technical and managerial expertise to raise the enterprise's value and make a profit at the exit (e.g., by selling the enterprise after some years). See Inter-agency Task Force on Financing for Development (supra footnote 17), p. 67.

[30] Business angel investors tend to be wealthy individuals, or groups of them, who provide financing, typically their own funds, in exchange for ownership equity (sometimes also convertible debt). Generally, the term "investors" refers to persons or entities who commit capital with the expectation of receiving financial returns.

[31] OECD, Financing SMEs and Entrepreneurs (supra footnote 15), p. 43.

[32] European Investment Fund (EIF), European Small Business Finance Outlook, 2019, p. 32.

[33] OECD, Financing SMEs and Entrepreneurs (supra footnote 15), p. 43.

[34] European Investment Fund (supra footnote 32), p. vi.

[35] Other products MFIs may offer to micro-businesses include savings, micropensions, microinsurance, emergency loans, leasing and grants. See International Labour Office, Making Microfinance Work: Managing Product Diversification, (2011), p. 112.

[36] World Bank Group, Secured Transactions (supra footnote 23), p. 23.

20. According to the Microfinance Information Exchange (MIX), the gross loan portfolio for micro-businesses in 2017 (i.e., 762 financial service providers operating in the microfinance sector of 103 developing markets) was around $34 billion.[37] Importantly, the MIX data differentiated the financing needs of micro-businesses from the financing needs of the owners of such businesses. The gross loan portfolio for household financing[38] constituted a separate category, amounting to roughly $29 billion.[39] In Europe, the latest market survey data showed that total microenterprise loan portfolio outstanding in 2017 reached €3.1 billion reported from 136 MFIs.[40]

21. Challenges faced by micro-businesses seeking affordable financing have been identified when exploring legal and regulatory issues surrounding microfinance. They include: (i) a lack of transparency in microfinance product pricing; (ii) the absence or lack of government intervention, in particular in setting limits on the interest rate charged on loans; (iii) disproportionate collateral requirements, resulting in abusive collection practices by some MFIs; (iv) absence of or poor measures to ensure client protection and prevention of unscrupulous practices; (v) poor financial literacy in the community generally; and (vi) lack of regulation on the wide range of institutions that provide microfinance services.[41]

22. In addition, the strict payment structures of some microenterprise loans may also prevent micro-businesses from using them for the higher-risk and longer-term investments essential to their growth. Furthermore, while digitalization of microfinance operations proves to be efficient, MFIs are only partially digitalized across the world. Moreover, in some countries digital transactions may be stalled by poor infrastructure.[42] The *CGAP National Surveys of Smallholder Households* (2018) reveals, for example, that mobile money is the most important formal financial tool, yet few smallholder households in the surveyed countries own smartphones.[43]

Crowdfunding

23. Crowdfunding refers to a technique aimed at raising external finance from a large audience, rather than a small group of specialized investors, where each individual provides a small amount of the funding requested. Crowdfunding has gained popularity among enterprises (including MSMEs) in many countries. It comprises different kinds of activities, broadly organized in three categories (debt-based, equity-based and non-investment).[44] Over time, crowdfunding has been increasingly managed by online platforms, which typically allow applications to be completed within a few hours.[45] Debt-based activities in 2018 accounted for a very significant portion (96.4 per cent) of online crowdfunding volumes globally.[46]

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[37] Microfinance Information Exchange, Global Outreach and Financial Performance Benchmark Report – 2017–2018, (2019), p. 36.

[38] Household financing is defined as loans that finance household purchases not related to an individual's or household's business.

[39] Microfinance Information Exchange, Global Outreach and Financial Performance Benchmark Report – 2017–2018, (2019) (see supra footnote 37), pp. 36 and 38.

[40] European Investment Fund (supra footnote 32), p. 98.

[41] A/CN.9/727, paras. 29–52; A/CN.9/780, para. 37.

[42] European Investment Fund (supra footnote 32), p. vi.

[43] This survey studied the financial lives of smallholder households in Bangladesh, Côte d'Ivoire, Mozambique, Nigeria, Tanzania and Uganda. See CGAP, Executive Summary (supra footnote 22).

[44] The non-investment category includes reward-based crowdfunding, whereby backers provide funding to individuals, projects or companies in exchange for non-monetary rewards or products, and donation-based crowdfunding, whereby donors provide funding to individuals, projects or companies based on philanthropic or civic motivations with no expectation of monetary or material return. See ITC, SME Competitiveness Outlook 2019 (supra footnote 18), p. 72.

[45] World Economic Forum, The Future of FinTech: A Paradigm Shift in Small Business Finance, (2015), p. 13.

[46] OECD, Financing SMEs and Entrepreneurs (supra footnote 15), p. 45.

24. ITC statistics suggest that crowdfunding has grown rapidly (from $1 billion in 2011 to $34 billion in 2015), notably in Asia and Africa.[47] Although the crowdfunding market in developing countries is estimated to total $96 billion per year by 2025,[48] online debt-based crowdfunding activities continue to be strongly concentrated in a few countries. China still has the largest market by far, despite a sharp decline in 2018, representing 62.5 per cent of global volumes, followed by the United States (20.5 per cent) and the United Kingdom of Great Britain and Northern Ireland (7.5 per cent).[49]

25. Given its design and due to regulatory limitations, crowdfunding is suitable for start-ups that require relatively small amounts of funding. It may be less suitable for MSMEs based on complex innovations in very high-tech and cutting-edge areas requiring specific knowledge on the side of investors. It can be very costly to convince people to participate in crowdfunding, especially through cutting-edge communications and outreach involving pitches and social media.[50] Indeed, according to ITC, roughly two out of three crowdfunding campaigns failed to raise the target investment.[51] Institutional investors are unlikely to use online platforms and may still prefer in-person meetings for the extensive information exchange necessary for them to feel comfortable with providing large amounts of credit.[52]

26. In many developing countries, MSMEs face more obstacles in raising funds through crowdfunding due to interrupted access to electricity and the Internet. The need to make online payments presents another challenge in countries with underdeveloped formal financial sectors. Moreover, concerns about protecting contributors from fraud and the lack of a specific legal and regulatory framework for crowdfunding do not help improve the business environment for crowdfunding.[53] In order for MSMEs to attract funds and facilitate crowdfunding, it is crucial to adopt legislation protecting contributors (e.g., investment caps and reflection periods during which contributors may revoke their offers). Notably, several domestic markets (e.g., China and the Republic of Korea) shrank significantly due to concerns about dubious or outright fraudulent behaviour and insufficient guarantees in terms of capital requirements and loss provisions for investors.[54]

2. Growth

Bank credit

27. Bank credit in this context refers to the extension of credit by banks or other financial institutions primarily based on the overall creditworthiness of enterprises, and their expected future cash flow is usually considered as the main source of repayment (sometimes also known as "traditional lending"). According to OECD, the

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[47] ITC, SME Competitiveness Outlook 2019 (supra footnote 18), pp. 72–73.

[48] Information for Development Program and World Bank, Crowdfunding's Potential for the Developing World, (2013).

[49] Notably, the share of volumes in continental Europe remained relatively modest, with France the most active market (with a global share of 0.6 per cent), followed by Italy (0.6 per cent) and the Netherlands (0.5 per cent). Latin America accounted for a small share of global online alternative finance volumes: Peru (0.4 per cent) and Chile (0.2 per cent). OECD, Financing SMEs and Entrepreneurs (supra footnote 13), p. 47.

[50] World Bank Group, Crowdfunding in Emerging Markets: Lessons from East African Startups, (2015), p. 3.

[51] ITC, SME Competitiveness Outlook 2019 (supra footnote 18), p. 78.

[52] Ibid.

[53] Information for Development Program and World Bank, Crowdfunding's Potential for the Developing World, (2013); UNDP, "Crowdfunding", website, available at https://www.sdfinance.undp.org/content/sdfinance/en/home/solutions/template-fiche12.html#mst-4.

[54] In 2016, the Chinese Banking Regulatory Commission found that about 40 per cent of existing online platforms were fraudulent, and authorities began to tighten regulations. Only 427 P2P platforms were still operating as of October 2019, against 6,000 in 2015. The market in the Republic of Korea, another relatively developed market, also plummeted by 77 per cent in 2018. See OECD, Financing SMEs and Entrepreneurs 2020 (supra footnote 15), pp. 46–47.

demand from SMEs for bank credit in the form of traditional lending varied significantly from country to country in 2018, even in the same geographical region.[55] The share of outstanding SME loans to total business loans also varied materially across countries.[56]

28. Specific challenges that limit this form of bank credit to MSMEs in some countries largely relate to the difficulties that financers encounter in assessing and monitoring the creditworthiness of MSMEs. Firstly, information asymmetry due to MSMEs' lack of supporting financial information infrastructure limits financers' ability to lend.[57] MSMEs often lack the expertise and skills needed to produce adequate financial statements. As a result, financers only have access to limited documentation on the activities and financial status of MSMEs. They are also likely to incur high due diligence costs relative to the size of the loan.[58] Financers typically lend based on an enterprise's credit history but if an enterprise cannot access credit in the first place, it becomes very challenging to build the necessary credit history and profile.

29. In order to mitigate credit risk, financers often impose strict collateral and guarantee requirements on MSMEs. As cited by one IFC report, data from the World Bank Enterprise Surveys show that nearly 79 per cent of loans or lines of credit required collateral. This figure was similarly high in most regions of the world.[59] In some jurisdictions, land is one of the collaterals used in financing for MSMEs, especially for farmers. Whereas movable assets (e.g., machinery, equipment or receivables) may account for most of MSMEs' capital stock, financers are often reluctant to accept them as collateral where secured transactions laws and collateral registries are outdated, non-existent or where it is otherwise difficult to identify or seize collateral.[60] Credit guarantees in support of loans extended to MSMEs are difficult to obtain in the absence of public guarantee schemes and a network of local or sectoral guarantee institutions for MSMEs[61] (see chapter II, section D on credit guarantee schemes below).

30. Last but not least, a lack of competition among financers reduces access to credit for MSMEs.[62] In many developing countries with less competitive banking sectors, banks are more likely to charge higher service fees and have fewer incentives to service MSMEs.[63] Notably, the establishment of digital challenger banks in several countries (e.g., Brazil, China, Germany and the United Kingdom) has attracted more MSMEs by charging transparent and low fees, providing faster services, and enhancing user experience through their digital interfaces.[64] Nevertheless, compared with larger enterprises, interest rates still remain high for MSMEs.[65]

31. As explained in paragraph 7 above, women entrepreneurs may face more difficulties in accessing credit in the form of traditional lending due to legal, institutional and socio-cultural factors. Internationally collected data reveal that women are less likely than men to have bank accounts. Restrictions on opening or

[55] In 2018, for example, Chinese SMEs were far more likely to apply for credit (58.36 per cent) than SMEs in Indonesia (3.35 per cent). Ibid., p. 33.

[56] In 2018, the share of outstanding SME loans to total business loans varied significantly across countries, ranging from around 20 per cent or less in Canada, Chile, France, Indonesia, Peru, the Russian Federation and the United States, to levels of more than 70 per cent in Latvia, Portugal, the Republic of Korea and Switzerland. Ibid., p. 26.

[57] World Economic Forum, The Future of FinTech: A Paradigm Shift in Small Business Finance, (2015) (supra note 45), p. 9.

[58] Inter-agency Task Force on Financing for Development (supra footnote 17), p. 64.

[59] IFC, MSME Finance Gap (supra note 11), p. 44.

[60] Ibid.

[61] European Investment Fund (supra footnote 32), p. 62.

[62] IMF, Financial Inclusion of Small and Medium-Sized Enterprises (supra footnote 20), p. 13.

[63] Inter-agency Task Force on Financing for Development (supra footnote 17), p. 64.

[64] OECD, Financing SMEs and Entrepreneurs 2020 (supra footnote 15), p. 50, box 1.2.

[65] In 2018, for instance, SME interest rates in a number of middle-income countries (e.g., Brazil, Colombia, Mexico, Peru and Ukraine) were near 17 per cent, and even in high-income countries (e.g., Chile and New Zealand) the SME interest rates were close to 10 per cent. Ibid., pp. 28–29.

using a bank account, such as the requirement for a male family member's permission or authorization, limit women's access to bank accounts. Moreover, partly due to limited financial or formal education, women often lack access to other formal financial services, such as savings, digital payment methods, and insurance.[66] Because of such constraints, the finance gap for women entrepreneurs in emerging markets is estimated at $1.5 trillion.[67]

Trade finance

32. Trade finance is the term used to describe the arrangements available to buyers (importers) and sellers (exporters) that are used to mitigate risks and ensure that the terms and conditions of an underlying commercial contract are met, so that the exporter receives payment and the importer receives the goods or services. A broad range of trade finance arrangements are available to all types of companies, including MSMEs.

33. **Factoring** is traditionally used to finance the activities of SMEs by purchasing receivables. As explained in the *UNCITRAL Legislative Guide on Secured Transactions* (2007), factoring is a form of receivables financing which generally involves the outright sale or assignment of receivables by the grantor as seller (commonly called the assignor) to the factor (commonly called the assignee).[68] In order to decide whether to purchase receivables, the factor primarily focuses on the creditworthiness of the grantor's customers and the enforceability of rights to payment evidenced by the invoices rather than on the financial statements, fixed collateralizable assets or credit history of the seller.[69] Given that MSMEs may have more creditworthy enterprises as customers, the factor can purchase receivables at better terms than it would if the exposure were on the riskier MSMEs.[70]

34. **Supply chain finance** is defined as the use of financing and risk mitigation practices and techniques to optimize the management of the working capital and liquidity invested in supply chain processes and transactions.[71] It is likely to be used in relation to "open account" trade where the buyer and seller have an existing business relationship[72] and the supply chain finance "add-on" is the interposition of a bank or fintech company as a financing intermediary. Supply chain finance solutions encompass a combination of technology and services that link importers, exporters and banks or fintech companies to facilitate financing during the life cycle of the open account trade transaction and repayment. In practice, MSMEs are often exporters based in a developing country, supplying to a large buyer in North America, Europe or Asia. Supply chain finance provides MSME suppliers with a range of options for accessing affordable financing (such as receivables discounting, forfaiting, distributor finance and pre-shipment finance),[73] thereby reducing the time taken to collect

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[66] World Bank Group, "Expanding Women's Access to Financial Services", website, available at https://www.worldbank.org/en/results/2013/04/01/banking-on-women-extending-womens-access-to-financial-services.

[67] IFC and Goldman Sachs, IFC and Goldman Sachs 10,000 Women: Investing in Women's Business Growth, (2019), p. 4.

[68] UNCITRAL Legislative Guide on Secured Transactions, para. 31.

[69] There are a number of different types of factoring arrangement. The factor (assignee) may pay a portion of the purchase price for the receivables at the time of the purchase (discount factoring), it may pay only when the receivables are collected (collection factoring), or it may pay on the average maturity date of all of the receivables (maturity factoring). Ibid., para. 32; see also OECD, New Approaches (supra footnote 28), para. 97.

[70] IFC, MSME Finance Gap (supra footnote 11), p. 45.

[71] ICC, Standard Definitions for Techniques of Supply Chain Finance (2016).

[72] ICC Academy, "Supply Chain Finance: An Introductory Guide", website, available at https://icc.academy/supply-chain-finance-an-introductory-guide.

[73] Receivables discounting refers to the financing technique under which companies discount all or part of their receivables (represented by outstanding invoices) to a financer to provide a one-off cash injection for a particular purpose; forfaiting refers to the purchase of a future payment obligation without recourse; distributor finance is generally made available to the distributor of a large manufacturer to cover the holding of goods for resale and to bridge the liquidity gap until

payment and thus significantly improving MSME suppliers' cash flow. Notably, reverse factoring is also a key component in supply chain finance as a means for creditworthy buyers to facilitate favourable financing options for their MSME suppliers, by explicitly confirming deliveries and resulting payment obligations to a factor.[74]

35. In recent years, financial technology (fintech) companies[75] have increasingly relied on the use of technologies (such as blockchain) for securing rights and title and securing trade finance. For example, these companies have developed software especially designed for factoring, allowing applications to be processed online automatically and payment to be made instantly.[76] (see chapter II, section I on digital financial services below).

36. Based on a World Trade Organization (WTO) report (2016), it was estimated that half of SMEs' trade finance requests globally were rejected, compared to only 7 per cent of finance requests sought by multinational companies.[77] According to the International Chamber of Commerce (ICC) (2018), although SMEs accounted for more than 80 per cent of businesses in Africa, on average they represented only 28 per cent of the trade finance portfolios of banks.[78] A more recent survey by the Asian Development Bank (ADB) (2019) indicated that SMEs accounted for 37 per cent of trade finance demand based on the proposals received by banks surveyed worldwide (51 per cent for banks in Asia and the Pacific). The rejection rate of SME applications was much higher than multinational enterprises.[79]

37. The challenges faced by SMEs to access trade finance mainly relate to (i) lack of additional collateral, (ii) possible know-your-client concerns, (iii) requests for credit with insufficient information, (iv) requests not profitable enough to process, (v) complex or onerous legal requirements creating uncertainty as to enforcement of rights against local exporters, and (vi) requests not profitable to process due to regulatory capital constraints.[80] The low share of SME trade finance was partly explained by the higher risk perception and cost of doing business associated with SME financing.[81]

Venture capital

38. As a form of private equity, VC is an important source of funds for MSMEs in developed economies and economies in transition. VC fund managers make direct investment in unlisted MSMEs, with the aim of bringing capital, technical and managerial expertise to raise the enterprise's value and make a profit at the exit (e.g., by selling the enterprise after some years).[82] In addition to start-ups, VC fund managers also provide funding to an operating enterprise.[83]

39. While private equity could potentially narrow the financing gap for MSMEs, it is not suitable for all. VC fund managers are often interested only in a small group of MSMEs with (at least) a rapidly scalable business model.[84] Moreover, fund managers in Europe identified the exit environment (including the validity and enforceability

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they receive funds following the sale of goods; and pre-shipment finance, also known as purchase order finance, is commonly provided against purchase orders on a transactional basis but can also be made against demand forecasts or underlying commercial contracts.

[74] OECD, New Approaches (supra footnote 28), para. 92.

[75] For an in-depth discussion of fintech companies and other digital credit approaches see chapter II, section I on digital financial services.

[76] World Economic Forum, The Future of FinTech: A Paradigm Shift in Small Business Finance, (2015) (supra note 45), p. 20. For a definition of "fintech" see A/CN.9/WG.I/WP.119, para. 55.

[77] WTO, Trade finance and SMEs: Bridging the gaps in provision, (2016), p. 23.

[78] ICC, 2018 Global Trade – Securing Future Growth, (2018), p. 98.

[79] ADB, ADB Briefs No. 113, 2019 Trade Finance Gaps, Growth, and Jobs Survey, (2019), p. 4.

[80] ADB, ibid, p. 5, figure 5.

[81] ICC, 2018 Global Trade – Securing Future Growth, 2018 (supra note 78), p. 98.

[82] Inter-agency Task Force, Financing for Sustainable Development (supra footnote 17), p. 67.

[83] EIF, European Small Business (supra footnote 32), p. 25.

[84] ITC, SME Competitiveness Outlook 2019 (supra footnote 18), p. 25.

of exit clauses), fundraising, high investee company valuations and the limited number of high quality enterprises to be the biggest challenges in the VC business.[85]

40. In some economies, the underdevelopment of private equity markets constitutes the main challenge for MSMEs to access VC funds. For instance, in Africa, about half of respondents to an industry survey cited the limited number of established private equity fund managers as a deterrent to investment.[86] The lack of an enabling regulatory framework, training and industry data also discourages VC investments in these countries.[87]

3. Maturity

Capital markets

41. Capital markets are a key source of equity and debt finance but remain underdeveloped in many countries and are mostly inaccessible to small businesses at a relatively early stage of development. Public listing and corporate bonds are two types of capital market instruments potentially accessible to mature small and medium-sized enterprises, but not micro-businesses.

42. **Public listing** on stock exchange markets could play a significant role in countries that have developed specialized stock markets for SMEs.[88] As part of the listing process, enterprises are usually required to disclose basic information about their activities and financial situation through a prospectus. Once listed, they are requested to provide regular disclosure and trading takes place under rules and procedures set out by the respective stock exchanges.[89] Public listing may allow mature SMEs to attract external financing, improve their creditworthiness, and enhance brand recognition and visibility. In turn, this could open up other sources of finance.[90] Specialized stock markets are important for the development of capital markets for SMEs.[91] Compared to the main stock exchanges, specialized platforms for SMEs could offer reduced listing fees and discounts on annual fees, relaxed entry requirements, business development assistance, and/or less frequent reporting requirements.[92]

43. Due to the fixed costs of due diligence and listing, the process of public listing at main stock exchanges is typically less affordable for SMEs than for larger firms. Other than costs, the disclosure and reporting requirements set out by these main stock exchanges also present challenges for many SMEs. Despite the remarkable growth in specialized platforms for SMEs worldwide, low-income countries have significantly fewer SME platforms than high-income countries.[93] Furthermore, in many instances, socioeconomic and cultural factors as well as management practices either discourage, prevent or make MSMEs reluctant to consider public listing (e.g., poor or limited knowledge about the listing processes and limited access to legal advice, cost of acquiring such knowledge or advice, low confidence towards the listing process, fear of being exposed to or vulnerability to stock price volatility, reluctance to share sensitive information, and concerns for the loss of control implied by the wider equity ownership).[94] Last but not least, in some jurisdictions the different tax

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[85] EIF, EIF VC Survey 2019 – Fund managers' market sentiment and policy recommendations, (2019), p. iv.

[86] Inter-agency Task Force on Financing for Development (supra footnote 17), p. 67.

[87] ITC, SME Competitiveness Outlook 2019 (supra footnote 18), p. 27.

[88] Ibid., p. 13, box 3.

[89] OECD, New Approaches (supra footnote 28), para. 413.

[90] OECD, Financing SMEs and Entrepreneurs 2020 (supra footnote 15), p. 44.

[91] Several jurisdictions have laid down special regulatory frameworks for SME stock exchanges with relaxed conditions for public listing, including the United Kingdom (AIM), Canada (TSXV), Hong Kong, China (GEM), Japan (Mothers), the Republic of Korea (KOSDAQ) and the United States (NASDAQ).

[92] UNCTAD and World Federation of Exchanges, The Role of Stock Exchanges in Fostering Economic Growth and Sustainable Development, (2017), p. 12.

[93] Ibid., p. 13.

[94] OECD, New Approaches (supra footnote 28), para. 426.

treatment between equity and debt financing negatively affects the development of public equity markets for SMEs.[95]

44. **Corporate bonds** are debt obligations issued by private and public enterprises, including some sophisticated mature SMEs. By issuing corporate bonds, the enterprise makes a legal commitment to pay interest on the principal, independent of their performance, and to repay the principal when the bond matures. The issuer may have the option to buy back the bond before the maturity date.[96] Corporate bonds can be either secured over specific assets or unsecured, and the credit quality of such bonds is often determined by credit rating agencies.[97] In most jurisdictions, enterprises (including SMEs) that intend to issue corporate bonds must file a prospectus with the relevant authority (describing the financial conditions of the enterprise, the terms of the bond, the risks of investing, and how the enterprise plans to use the bond sale proceeds).

45. In some countries, the regulatory framework also allows private placements of corporate bonds, i.e. the offer of bonds to only a few selected investors by unlisted enterprises (including SMEs). Private placements are subject to less stringent reporting requirements and do not need a formal credit rating. It is particularly relevant for larger and more mature SMEs facing a major transition, such as a change in ownership, expansion into new markets and activities, or acquisitions.[98] Although the private placement market is well developed in the United States and Europe, it remains relatively underdeveloped in other regions of the world.[99]

46. Similar to those challenges faced by SMEs in relation to public listing, the issuance of corporate bonds is likely to be more burdensome for SMEs than for larger firms due to the fixed costs of due diligence (the issuance costs may be as high as 10 per cent of the issued amount).[100] The disclosure and reporting requirements set out by relevant authorities also present challenges for many SMEs lacking the expertise and experience in drafting prospectuses. The rigidity implied by the fixed schedule of interest and principal repayments may also discourage some SMEs from issuing corporate bonds as such repayment schedule requires a relatively stable cash-flow pattern.[101]

II. Improving access to credit through enhanced legal and other infrastructure

47. As explained in chapter I, section B, MSMEs face various obstacles when trying to access credit at different stages of their business life cycle, such as start-up, growth and maturity. While a few obstacles are generally not MSMEs specific, MSMEs are more vulnerable economically, more dependent on certain types of financing (e.g., family and friends support) and may be less aware of their rights and obligations compared with larger enterprises. Moreover, the unavailability of certain financial products in some jurisdictions (e.g., capital markets) also has a negative impact on the prospect for some MSMEs to access affordable credit. There are also a number of obstacles that are specific to MSMEs, such as lack of credit history, lack of the expertise and skills needed to produce adequate financial statements, lack of collateral and limited financial or formal education.

48. In this context, it should be noted that many of these obstacles cannot be removed by legal measures, and therefore regulatory measures and policy considerations also need to be taken into account when necessary. Chapter II provides an overview of initiatives to improve access to credit for MSMEs by way of

[95] Ibid., para. 429.
[96] Ibid., para. 177.
[97] Ibid., paras. 181–182.
[98] OECD, Financing SMEs and Entrepreneurs 2020 (supra footnote 15), pp. 42–43.
[99] Ibid.
[100] OECD, New Approaches (supra footnote 28), para. 191.
[101] Ibid.

background (at global, regional and national levels), and then looks into some of those legal, regulatory and policy interventions that create the infrastructure through which MSMEs can access credit.

A. An overview of initiatives to improve access to credit for MSMEs

49. Access to credit depends on a number of factors, a holistic approach should thus be considered, with conducive legal frameworks and legislative reform being only one aspect of promoting access to credit for MSMEs. For some time, efforts have been made at global, regional and national levels to achieve this goal. Some have been broader in scope and focused on promoting access to finance for MSMEs, for example through digitization and the use of financial technologies applications operated by fintech companies. Others have focused on measures more specific to facilitate access to credit, such as establishing guarantee schemes in relation to bank loans and beyond or promoting the use of smart contracts in relation to secured transactions. Some governments have sought to enable rapid and easy access to new funding and setting up further financial support, such as direct loans and grants.

50. While the summary of policy initiatives and measures below is not meant to be exhaustive, it shows that those initiatives and measures are widespread. To a certain extent, it also shows a degree of commonality in the approaches that permits the identification of several best practices independent of the variety of challenges faced by MSMEs and the circumstances in which they operate.

1. Global level

51. In 2015, the Group of 20 (G20) endorsed the Action Plan on SME financing aiming at ensuring SME access to credit and improving existing credit infrastructures. The plan focused on three priority areas: improvement of the credit reporting systems for SMEs, reforms to modernize the domestic legal framework on secured transactions and insolvency law reforms. The Action Plan was directed to non-G20 countries as well "in order to increase the availability of finance for SMEs to grow and create jobs".[102] The G20 2020 Financial Inclusion Action Plan, that builds upon previous G20 action plans, identifies SME finance as one of the two priority topics (the other one being digital financial inclusion) and aims at promoting national and global policy options and good practices to facilitate expansion and diversification of financial services for SMEs.[103]

52. Other global efforts have considered the role of the public sector in reforming the institutional environment around MSME access to financial services and outlined key market-enabling policies that governments might pursue to close the MSME finance gap. For example, in a 2017 report,[104] the IFC advocated for the adoption of policies such as: improving competition within the financial system and allowing a variety of financial institutions to operate; establishing directed lending programmes and risk-sharing arrangements; and developing solid credit information systems, movable collateral frameworks and registries, and efficient insolvency regimes.

53. Many global level efforts in recent years have drawn particular attention to the promotion of digital financial services. This trend has gained further importance during the COVID-19 pandemic since those services have allowed users to access financial resources despite lockdowns and social distancing. While presenting risks, digital financial services have a strong potential to bridge financial inclusion gaps, as two thirds of the unbanked globally have a mobile phone.[105] As recognized by the

[102] https://www.gpfi.org/publications/g20-action-plan-sme-financing-implementation-framework.

[103] GPFI, GPFI, G20 2020 Financial Inclusion Action Plan, 2020. Available at: https://www.unsgsa.org/sites/default/files/resources-files/2021-02/G20%202020%20Financial%20Inclusion%20Action%20Plan.pdf.

[104] IFC, MSME Finance Gap (supra footnote 11).

[105] Inter-agency Task Force on Financing for Development, Financing for Sustainable Development Report 2021, p. 66.

G20, the digitalization of financial services is a potential game changer for small business financing since financial processes, including lending, are significantly cheaper, faster and easier.[106] In addition, digital payments can help informal businesses without credit history to establish one, thus facilitating access to formal financing.[107]

54. The United Nations Secretary-General's Special Advocate for Inclusive Finance for Development (UNSGSA) has acknowledged the importance of fintech services and promoted the use of good regulatory practices so that fintech is inclusive, safe and responsible.[108]

55. Similarly, the World Alliance of International Financial Centers[109] in order to support SME recovery from the COVID-19 pandemic has recommended leveraging the digitalization of financial services so that "sustainable finance is fully embedded into the financial industry of the future". In addition, the Alliance has recommended facilitating collection of operational and financial information for commercial and development banks to support SMEs' credit applications, requesting credit institutions to design special products tailored for SMEs and considering expanding adoption of the World Bank's Credit Guarantee Scheme for SMEs.[110]

2. Regional level

56. One of the initiatives of the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) to facilitate MSME access to credit is the Catalysing Women's Entrepreneurship programme which aims at advancing women entrepreneurship and market participation in the Asia-Pacific region. The Innovative Financing component of the programme undertakes its activities through partnerships aimed at leveraging public and private capital to pilot, test and scale financing models that support women entrepreneurs. Currently, the following three key financing mechanisms are implemented: a fintech innovation fund, a women's livelihood bond and an impact investment fund. The Innovative Financing component also involves collaboration with policymakers and regulators to support the creation of an enabling policy and regulatory financial environment for women entrepreneurs.[111]

57. The Asia-Pacific Economic Cooperation (APEC) launched the Financial Infrastructure Development Network (FIDN) in 2015 as an APEC subgroup with the goal to promote an enabling financing environment for MSMEs to improve their access to finance, among others through the development of effective credit information systems, secured transactions and insolvency frameworks. The Network has implemented several activities in those areas; for example, in the area of secured transactions it has promoted law reform following primarily the UNCITRAL Model Law on Secured Transactions, reform of movable asset collateral registries and capacity-building. In the area of credit information FIDN has promoted the development of comprehensive credit reporting (collection and sharing of alternative data, e.g., utilities, rents, mobile phone payments), establishment of credit registries and licensing of credit bureaux, adoption of legal and regulatory frameworks around credit information and data and cross-border arrangements between credit

[106] World Bank Group, Promoting digital and innovative SME financing, 2020, p. 9. Available at: https://www.gpfi.org/sites/gpfi/files/saudi_digitalSME.pdf.

[107] Ibid., p. 10.

[108] UNSGSA FinTech Working Group and Cambridge Centre for Alternative Finance, Early Lessons on Regulatory Innovations to Enable Inclusive FinTech: Innovation Offices, Regulatory Sandboxes, and RegTech, (2019), p. 9.

[109] The World Alliance of International Financial Centers (WAIFC) is a non-profit association established in 2018 and registered in Brussels, which represents leading international financial centres and facilitates cooperation and the exchange of best practices. Further information is available at: https://waifc.finance/.

[110] The World Alliance of International Financial Centers, Supporting SMEs with sustained post-pandemic economic recovery, pp. 5 and 6. Available at: https://downloads.waifc.finance/publications/WAIFC%20SME%20Finance%20Report.pdf.

[111] For further information, see https://www.unescap.org/projects/cwe.

registries/bureaux to share credit scores of entrepreneurs and migrants seeking financial services in host jurisdictions.[112]

58. In the Latin America and Caribbean region, the United Nations Economic Commission for Latin America and the Caribbean (UNECLAC) in past years carried out a project to identify and promote the development of a wide set of financial instruments to enable development banks to better assist SMEs.[113] In UNECLAC's view, development banks have a role to play in promoting SMEs' use of financial services since they can better evaluate SMEs' payment capacity, help reduce information asymmetries and facilitate monitoring.[114] More recently, a study published under the aegis of UNECLAC recommended addressing reform of the collateral lending system and properly instituting guarantee schemes in the Caribbean subregion.[115] The Inter-American Development Bank (IDB) has established partnerships with development banks as well in order to facilitate MSMEs' access to credit. Moreover, IDB supports a fintech initiative in the Latin America and Caribbean region aimed at creating a conducive environment for fintech development while protecting its users.[116]

59. The European Union has developed several programmes to support access to finance for MSMEs through local financial institutions in its member States. The programmes include, among others, loans, microfinance and guarantees or equity funding through venture capital funds, business angels or social investors. The local financial institutions determine the exact financing conditions – the amount, duration, interest rates and fees applicable to the MSMEs applying for those funds. Reduced interest rates, larger financing volumes or smaller collateral requirements are among the advantages of the European Union support.[117]

3. National level

60. In recent years, several countries have developed strategies to promote access to credit for MSMEs through legal and regulatory frameworks and policy measures aimed at lowering the cost of credit and also at otherwise facilitating access to financial services. Policy measures adopted by States are often of two complementary types: "hard support" measures, such as subsidies for MSMEs, financing through State funds or State-owned development banks, and public loan guarantee systems; and "soft support" measures, such as implementing capacity-building programmes for MSMEs (see chapter III on capacity-building for MSMEs and financers below) and credit reporting systems that provide detailed breakdowns of MSMEs' credit history in order to determine their creditworthiness (see chapter II, section E on credit reporting below).

61. For example, Bangladesh launched its first comprehensive SME policy in 2019 with a focus on gender and consideration of access to financial and business-related services for disadvantaged groups.[118] Key elements of these policies include, among others: introducing an "SME Bank" in the country; strengthening the existing refinancing scheme to provide loans at a reduced interest rate to SMEs; ensuring easy access to credit and lowering the interest rate for SMEs by

[112] APEC, 2019 Progress Report – Asia-Pacific Financial Forum, Asia-Pacific Financial Inclusion Forum, Asia-Pacific Infrastructure Partnership, pp. 5 ff.

[113] The UNECLAC Project for promoting financial inclusion of SMEs focused on the experience of Argentina, Brazil, Colombia, Costa Rica, Ecuador, Mexico and Peru, with the goal of identifying best practices that allow for the formulation of policy recommendations to strengthen the role of development banks.

[114] UNECLAC, "Background", website, available at https://www.cepal.org/en/inclusion-financiera-pymes/background.

[115] UNECLAC, A preliminary review of policy responses to enhance SME access to trade financing in the Caribbean, (2020), p. 35.

[116] See https://www.iadb.org/en/financial-markets/access-finance.

[117] See https://ec.europa.eu/info/business-economy-euro/growth-and-investment/financing-investment/financing-programmes-smes_en.

[118] Ministry of Industries of the People's Republic of Bangladesh, SME Policy 2019, p. 5.

strengthening a credit wholesaling programme and launching an SME Credit Guarantee Fund.

62. China has created various funds to support SMEs. In addition to the Special Funds for SME Development that support financing guarantees, a National Financing Guarantee Fund with a registered capital of around $9 billion was established in 2018 to support the national financing guarantee system, an essential part of facilitating SME financing.[119] The Chinese government has encouraged financial institutions to expand SME credit and to use new technologies to innovate SME financial services. SME loans in total are currently estimated to exceed $4.3 billion in China and the application of fintech is also expanding.[120]

63. India initiated the creation of the SME Rating Agency of India (SMERA) in 2005. This is the first agency of its kind in the world. Its purpose is to provide comprehensive ratings for use by financial institutions in the assessment of credit,[121] and it has completed more than 50,000 ratings of SMEs ever since.[122] SMERA recently launched a fintech platform that facilitates credit flow to MSMEs by providing enterprise-level information. In 2017, the Small Industries Development Bank of India (SIDBI), a financial institution for developing and financing MSMEs, launched a digital MSME lending aggregator and matchmaking platform. In 2018, it launched a contactless lending platform building on the information provided and lessons learned from the aggregator. To date, the contactless lending platform has sanctioned about 130,000 loans, worth $2 billion, and reduced turnaround time and credit cost, leveraging fintech solutions and data analytics tools.[123]

64. Since 2016, as part of its vision for 2030 in order to increase SME contribution to GDP to 35 per cent, Saudi Arabia has promoted business-friendly regulations and easier access to funding and further aims to see its financial institutions allocate up to 20 per cent of overall funding to SMEs by 2030. Specifically, one programme is committed to increasing by 2020 the share of SME financing at banks to 5 per cent and that of non-cash transactions to 28 per cent. An SME authority has been established to review laws and regulations and facilitate access to funding.

B. Secured lending

65. The term “secured lending” refers to all types of lending that involves secured credit. As noted in the *UNCITRAL Legislative Guide on Secured Transactions*, secured credit could allow businesses to use the value inherent in their assets as a means of reducing the creditor’s risk, because credit secured by assets gives creditors access to the assets as another source of recovery in the event of non-payment of the secured obligation.[124] In light of a reduced risk, creditors are more likely to be willing to extend affordable credit.

66. Secured credit could be extended using either movable assets or immovable assets as collaterals. Key aspects of using movable and immovable assets as collaterals are discussed below.

[119] OECD, Financing SMEs and Entrepreneurs 2020 (supra footnote 15), p. 168.
[120] Mintai Institute of Finance and Banking, China MSME Finance Report 2018 (Compact Edition), (2018), p. 9.
[121] IFC, SME Finance Policy Guide, (2011), p. 35.
[122] Acuité Ratings and Research, “WHO WE ARE”, website, available at https://www.acuite.in/who-we-are.htm.
[123] World Bank, Group Implementation Completion and Results Report No. ICR00004943, (2019), pp. 17–18.
[124] UNCITRAL Legislative Guide on Secured Transactions (supra note 68), p. 2.

1. Movable assets as collateral

(a) Types of assets

67. Movable assets are the main types of asset that many MSMEs can offer as collateral. Some legal systems allow businesses to grant a security right in movable assets only to a limited extent or only in a very restrictive way. Even where a legal system allows movable assets to be used as collateral, the rules may be outdated, fragmentary, complex or unclear for the persons who manage and operate MSMEs. Similarly, creditors may be hesitant to provide secured credit to MSMEs because of this lack of certainty.

68. Readily available credit at a reasonable cost helps MSMEs grow and prosper. Therefore, a legal framework – that makes it possible and easy to use movable assets as collateral in such a way that lenders can determine their priority with respect to those assets when entering into the transaction and can be assured that realizing the collateral will be simple and economically efficient – would greatly assist MSMEs. The *UNCITRAL Model Law on Secured Transactions* (the "Model Law") provides a sound basis for reforms to provide a legal framework for secured transactions involving most types of movable assets.

69. A conducive legal framework can alleviate unnecessary burdens in granting a security right in the movable assets. Under the Model Law it is easy to grant a security right; the parties only need to enter into a security agreement satisfying basic and limited requirements. Sample security agreements are provided in the *UNCITRAL Practice Guide to the Model Law on Secured Transactions* (the "Practice Guide"). More importantly, under the Model Law a person may grant a security right in an asset without having to give possession of the asset to the secured creditor.

70. A comprehensive legal framework can make the process of granting a security right easier for MSMEs. A single set of rules should ideally cover all transactions where financers take proprietary interest in collateral. It should be possible for an MSME (acting as "grantor") to grant a security right in almost any type of movable asset, including inventory, equipment, receivables, bank accounts and intellectual property. The MSME may also grant a security right in an asset that it may acquire in the future, as well as all of its movable assets, both present and future. In order to simplify the creation of a security right in all assets of an MSME where the financer is financing its ongoing operation, it suffices to conclude a single-document and all-asset security agreement should be permitted.[125]

71. MSMEs may need to rely on assets that they will acquire at a later stage (e.g., future receivables) or assets they will acquire using the financing provided. The provisions in the Model Law concerning future assets (i.e., assets with respect to which the grantor expects to acquire rights in the future) are particularly relevant for MSMEs. In a similar case, for future assets, the security right is created if and when the grantor acquires such rights or power to encumber.[126] The creation of a security right over future movable assets, however, may not override statutory limitations on the creation or enforcement of a security right in specific types of movable asset (e.g., employment benefits in general or salaries up to a specific amount). Those limitations should be described in the law in a clear and specific way.[127]

72. MSMEs may agree with financers that the asset will be only partially encumbered (e.g., only to the extent of an undivided 50 per cent interest) or that the asset will be encumbered only for a limited amount (e.g., a granted security right may be enforceable up to a specific amount).[128] In the absence of such agreement, however, the security right should encumber the entirety of the asset, the entirety of the

[125] Ibid., p. 81.
[126] Ibid., p. 79.
[127] UNCITRAL Model Law on Secured Transactions: Guide to Enactment, para. 93.
[128] UNCITRAL Legislative Guide on Secured Transactions (supra note 68), p. 77.

MSME's rights as grantor in the asset and the entirety of the value of the asset at the time the security right is enforced.[129]

(b) Security rights registries

73. Under the Model Law, there is no need for the secured creditor to take possession of the assets in order to create a security right. Instead, the secured creditor can simply register a notice in the registry to make its security right effective against third parties. Commonly referred to as a non-possessory security right, this allows the grantor to continue to make use of the encumbered asset even after granting a security right. The existence of a comprehensive and central registry system facilitates such non-possessory transactions. In many jurisdictions, this is done through establishing a general security rights registry. The registration process should be fully automated, accessible, usually conducted by the secured creditor, and cheap given that any related costs could have a negative impact on the cost of financing.

74. A security right in an encumbered asset can be made effective against third parties by registering a notice with respect to the security right in the security rights registry (Model Law, article 18).[130] As a general rule, the time of registration constitutes the basis for determining the order of priority between a security right and the right of a competing claimant (Model Law, article 29).[131] This priority rule provides financers with certainty, thus encouraging the granting of credit to MSMEs.

75. The security rights registry should have a number of features aimed at facilitating secured transactions and making it easier for MSMEs to gain access to credit. Firstly, the legal and operational guidelines governing registry services, including registration and searching, should be simple, clear and certain from the perspective of all potential users.[132] Secondly, registry services, including registration and searching, should be designed to be as fast and inexpensive as possible, while also ensuring the security and searchability of the information in the registry record.[133] Thirdly, a "notice registration" system (rather than a "document registration" system) should be adopted, not requiring the underlying documentation to be registered or even tendered for scrutiny by registry staff.[134] A "notice registration" system reduces transaction costs for registrants.[135]

76. A security rights registry should be fully electronic, permitting information in registered notices to be stored in electronic form in a single database, so as to ensure that the registry record is centralized and consolidated.[136] Furthermore, access to registry services should also be electronic so as to permit users to submit notices and search requests directly over the Internet or via networking systems.[137] Electronic access to registry services helps to eliminate the risk of registry staff error in entering the information into the registry record. It also facilitates speedier and more efficient access to registry services by users, and greatly reduces the operational costs of the registry, leading to lower fees for registry users.[138]

77. In recent years, the potential of distributed ledger technology (DLT) has been examined within the context of security rights registries. Due to the structure of security rights registries as centralized institutions (typically controlled by a governmental body or a central bank), permissioned (rather than permissionless)

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[129] Ibid.
[130] UNCITRAL Model Law on Secured Transactions: Guide to Enactment (supra note 127), para. 143.
[131] Ibid.
[132] UNCITRAL Guide on the Implementation of a Security Rights Registry, para. 10.
[133] Ibid.
[134] Ibid., para. 57.
[135] Ibid., para. 59.
[136] UNCITRAL Model Law on Secured Transactions: Guide to Enactment (supra note 127), para. 145.
[137] Ibid., para. 146.
[138] Ibid. See also UNCITRAL Legislative Guide on Key Principles of a Business Registry (2019) and the work of Unidroit on best practices in the field of electronic registry design and operation.

blockchain systems are considered as more appropriate platforms for security rights registries.[139]

(c) Obstacles faced by MSMEs, particularly micro-businesses

78. Despite the obvious advantages that MSMEs may benefit from the existence of a legal framework based on the Model Law, this by itself may not remove all of the obstacles that MSMEs may face in obtaining access to credit, in particular those faced by micro-businesses as listed below.

Lack of collateral

79. Micro-businesses face financing constraints as banks and other financial institutions are usually reluctant to extend uncollateralized credit to them, even at high interest rates, because credit assessment reveals high risk of default by the micro-businesses. Many of them do not have the necessary amount and type of assets that could serve as collateral. Household goods owned by micro-businesses are often not accepted as effective collateral given that they generally have low value and depreciate too quickly, and may even be exempted from judicial enforcement processes.

80. Microlenders sometimes may accept jewellery and even household furniture and appliances as collateral.[140] From the perspective of microlenders, these forms of collateral serve primarily to demonstrate the micro-business's commitment, rather than as a secondary repayment source.[141]

81. Collateral requirements under financial regulations are quite high worldwide for borrowers (including micro-businesses). In Asia and the Pacific, financial regulations in many countries require collateral to be at least 125 per cent of loan value.[142] In other countries, collateral requirements are even higher and can be as high as 250 per cent of loan value.[143] According to one ADB survey (2019), lack of collateral was cited as the top challenge for SMEs to access trade finance.[144] Compared with SMEs, micro-businesses are likely to have even less assets that could serve as collateral.

82. While high collateral requirements constrain micro-businesses in accessing credit in general, in certain jurisdictions this issue is particularly significant for women entrepreneurs as any asset/property is often owned or registered in the spouse's name. In certain States, for example, unequal inheritance rights and work restrictions limit women's access to collateral.[145] In the Middle East and North Africa region, female entrepreneurship rates are the lowest worldwide, partly due to women's limited rights to family assets for collateral and the associated difficulties in accessing credit.[146] In some States of that region, women do not have the right to administer marital property, including property that they brought into the marriage and property acquired during the marriage.[147]

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[139] While a permissioned system "enables the registry operator to determine which nodes can read the ledger and submit and validate registrations, thus ensuring the integrity of the data", in a typical permissionless system "the persons responsible for a node are not generally known". World Bank Group, Distributed Ledger Technology and Secured Transactions: Legal, Regulatory and Technology Perspectives – Guidance Notes Series, Note 1: Collateral Registry, Secured Transactions Law and Practice (May, 2020), p. 14.
[140] ILO, Making Microfinance Work, p. 120.
[141] Ibid.
[142] ADB, Thematic Evaluation: ADB Support for SMEs, (2017), p. 3, footnote 12.
[143] IMF, Financial Inclusion (see footnote 20), p. 16.
[144] ADB, ADB Briefs No. 113, p. 5, figure 5.
[145] ITC, Unlocking Markets (supra footnote 16), p. 22.
[146] Ibid.
[147] World Bank Group, Secured Transactions (supra footnote 23), p. 22.

Asset valuation

83. Lending based on movable assets requires their valuation, and valuation processes are generally quite complex despite the existence of international valuation standards.[148] In practice, there are many ways to determine the value of the assets to be encumbered and the chosen method often differs depending on the specific type of asset. For instance, if the assets are receivables, their value will usually be based on the amount that the financer would expect to collect from the debtors of the receivables.[149] If the asset is inventory (e.g., clothing), its value will normally be calculated based on prices in the relevant secondary market.[150] The financer, however, may not be able to recover the current market value as the realizable value may be affected by deteriorating market conditions. In cases where assets need to be disposed of urgently, buyers often expect to acquire the asset at a substantially lower price.[151] Accordingly, the advance rates are calculated as a percentage of the assets' value (e.g., 40 per cent of the market value of the clothing inventory).

84. Furthermore, specific expertise is often required for financers to perform reliable valuations of the assets to be encumbered. The value of certain assets – such as manufacturing and industrial equipment, and agricultural products – can be affected not only by their condition but also by market conditions and trends.[152] For example, equipment in good working condition may have little resale value if a more efficient model is available or market trends favour a newer design.[153]

85. For financers lending to micro-businesses, asset valuation presents more challenges because certain valuation methods may be too costly relative to the value of the asset. Leaving valuation of encumbered assets to financers (rather than independent appraisers) seems to be a more efficient and less costly mechanism.[154] As noted in the Practice Guide, it may also be particularly difficult to determine the value of the asset if it is a type that is not regularly traded in the given market.[155]

Overcollateralization

86. Financers may not be equipped with inexpensive and effective tools for risk assessment, and micro-businesses often lack credit history and transaction records to show their creditworthiness. This may lead financers to require collateral, the value of which significantly exceeds the amount of the loan (often referred to as "overcollateralization").[156] While financers cannot claim more than the loan amount plus interest and expenses (and perhaps damages upon default), overcollateralization may create problems for micro-businesses. For example, due to the costs and difficulties involved in asset valuation, financers may simply require micro-businesses to grant a security right over all their assets. This would make it difficult for micro-businesses to obtain secured credit from another financer granting a second-ranking security right in the same encumbered assets, which is possible under the Model Law.[157] In addition, because all the assets of a micro-business are encumbered, enforcement by its unsecured creditors may be made more difficult or even impossible.[158] Furthermore, the enforcement of an all-asset security may result in the

[148] See https://www.ivsc.org/standards/international-valuation-standards/IVS.
[149] UNCITRAL Practice Guide to the Model Law on Secured Transactions, para. 121.
[150] Ibid.
[151] Ibid., para. 122.
[152] World Bank Group, Secured Transactions (supra footnote 23), p. 104.
[153] Ibid.
[154] UNCITRAL Legislative Guide on Secured Transactions (supra note 68), p. 70.
[155] UNCITRAL Practice Guide (supra footnote 149), para. 123.
[156] In practice, overcollateralization may be in combination with requests for issuance of personal guarantees (see chapter II, section C on personal guarantees for MSMEs' loans below).
[157] UNCITRAL Legislative Guide on Secured Transactions (supra note 68), p. 82. It should be noted that under the Model Law, a financer who provides credit for the business to acquire an asset could have priority over another secured creditor that has created a security right over all assets of the micro-business.
[158] Ibid.

micro-business being taken over by the secured creditor, sometimes in a hostile manner.

87. To address overcollateralization, courts in different jurisdictions have developed various solutions summarized as follows: (i) declaring void any security right that encumbers the value of an asset to an extent that is grossly in excess of the secured obligation plus interest, expenses and damages; (ii) giving the grantor a claim for release of such excess security; and (iii) upon the grantor's request, requiring the secured creditor to negotiate in good faith with the grantor.[159] It is worth noting that the *UNCITRAL Legislative Guide on Secured Transactions* does not recommend that courts be given the authority to declare a security right void or to reduce the scope of a security right by means of a judicial declaration of overcollateralization.[160]

88. The appropriate response to overcollateralization is likely to vary from State to State and may sometimes be addressed in other areas of law. For example, the law of some States may also provide for the reduction of the scope of assets that can be encumbered if their value substantially exceeds the amount of the secured obligation.[161]

Enforcement

89. In the event of default, a security right makes it possible for a financer to recover what it is owed from the value of the encumbered asset. For micro-businesses, relevant legislation in some jurisdictions does not impose any limit on what can be seized by the secured creditor for enforcement. Importantly, essential personal assets would need to be protected and excluded from the scope of enforcement by relevant legislation, particularly in the context of a sole entrepreneur. The laws of some States may restrict the creation of security rights in household goods, the seizure of personal assets, or may limit the amount for which a security right in those assets can be enforced. In the context of judicial enforcement processes, courts may have the power to impose certain protection on essential personal assets or up to a certain minimum amount of personal assets of micro-business owners under relevant national laws. Difficulties faced by secured creditors regarding enforcement may discourage them from lending to MSMEs.

2. Immovable assets as collateral

(a) Legalization of property rights over immovable assets

90. Secured credit allows MSMEs to use the value inherent in their assets as a means of reducing the creditor's risk of not being paid, thus resulting in prospective creditors being more willing to extend credit to MSMEs. However, in order to be used effectively, in most economies rights over assets (including customary rights) need to be formally recognized by a property rights system. Once fully recognized, the possibility is opened for MSMEs to use assets as collateral for obtaining credit. There is growing evidence that expanding the types of assets that can be used as collateral reduces the cost of credit.

91. However, in several economies businesses lack formal recognition of their property rights over their immovable assets. This is particularly relevant in the context of micro-businesses in the agricultural sector that often cultivate and use land for which they have no formal ownership title. As a result, they often cannot offer the land as collateral to obtain credit. Sometimes they may not even be able to offer movable assets placed on the land (e.g., growing crops and machinery) as collateral because the law treats such assets as part of the land. In some economies, financers may accept a simple certificate of customary interests and rights in land (rather than a formal ownership certificate) as collateral. The recent land reform in Ghana, for example, required the establishment of customary land secretariats to keep accurate

[159] Ibid.

[160] Ibid., p. 83.

[161] UNCITRAL Practice Guide (supra footnote 149), para. 25.

and up-to-date records of land transactions and to provide a list of existing customary interests and rights in land.

92. According to a recent study carried out by the International Fund for Agricultural Development (IFAD), there are a variety of land tenure contexts across the world which are defined by policy and legal choices as well as by cultural, historical, religious and gender dynamics. In those contexts, there are many types of tenure security (defined by the customary nature of tenure and challenges relating to conflict resolution and the enforcement of rights) and some types are less lengthy and costly to implement, which may be even more effective than recording formal rights over land, such as "fit for purpose" land certification systems, recognition of community forest rights and community-based management of land.[162]

93. Adopted by the United Nations General Assembly in 2018 (A/RES/73/165), the United Nations Declaration on the Rights of Peasants and Other People Working in Rural Areas declares that "States shall take appropriate measures to provide legal recognition for land tenure rights, including customary land tenure rights not currently protected by law, recognizing the existence of different models and systems." The Declaration also stresses that peasant women and other rural women play a significant role in the economic survival of their families and in contributing to the rural and national economy but are often denied tenure and ownership of or equal access to land. In this respect, it should be noted that the UNDP Commission on Legal Empowerment of the Poor listed, as a legal empowerment measure, promoting an inclusive property rights system that will automatically recognize immovable assets bought by men as the co-property of their wives or partners.

(b) Immovable registries

94. In most jurisdictions, immovable registration systems operate as the legal basis for recording with certainty ownership and other interests in immovable assets such as land. In some jurisdictions, however, the ownership of only a small percentage of land is registered, with a significant portion of properties in the countryside as well as urban centres being held in precarious possession but unregistered. In some economies, the limited access to registered land remains one of the largest impediments to economic growth. Moreover, the value of unregistered land as potential collateral might often be underestimated.

95. The World Bank's Doing Business website contains a topic on "registering property" and measures the quality of the land administration system in each economy based on five dimensions: reliability of infrastructure, transparency of information, geographic coverage, land dispute resolution, and equal access to property rights. In this respect, according to the Doing Business tools, recent country reforms on "registering property" often included increasing the transparency of information (e.g., publishing the fee schedule and the commitment to deliver services) and improving administrative efficiency by reducing the time to transfer property. Decreasing the registration and notary fees and establishing a one-stop shop for submission of transfer documents and payment of registration fees were also considered important features of such reforms.

96. Based on the different legal effect of the information recorded in property registries, property registries across the world are generally divided into two categories, that is, a deed system and a title system. Under a deed system, property registries only keep a record of property transactions (i.e., transfer of deeds). By contrast, under a title system, property registries usually provide conclusive proof of property ownership and record the changes in the holders of rights or title. Both systems can be equally efficient if they adopt the following common good practices identified in the Doing Business tools: introducing time limits and compliance, setting low fixed fees (e.g., property transfer taxes and other government fees), streamlining

[162] G. Barbanente, H. Liversage, J. Agwe and M. Hamp, IFAD report on "Tenure Security and Access to Inclusive Rural Financial Services for Smallholder Farmers: Challenges and Opportunities in Rural Development Projects" (forthcoming), pp. 13–14 and 18.

procedures (e.g., one-stop shops for property registration), and using electronic services (e.g., information and communication technology).

97. The use of DLT has been more promising in installations of land registries compared with security rights registries (see blockchain-based land registry projects in Fiji, Georgia and Sweden).[163] The DLT ledger need only store the hash of the data (e.g., concerning the proof of ownership) and the prospective creditor may use the hash to search for the DLT ledger to verify whether the registry operator created that hash and then conduct a corresponding search of the land registry.[164] Importantly, the matching of the hash helps ensure that the record has not been tampered with.[165]

C. Personal guarantees for MSMEs' loans

98. When collateral assets are not available at the level required by the financers' risk assessment, financers would typically supplement the gap by demanding personal guarantees from small businesses requesting a business loan, as they reduce the risk in lending. The guarantees are usually provided by the owners, directors, members of the MSMEs, their family members or other related persons. They may be unsecured, meaning that they are not tied to any specific assets of the guarantor and any of its private assets can be seized by the financers (while a secured guarantee only relates to the specific assets against which it is raised). The guarantees not only ensure that the business loan will be repaid in a timely manner, they also build trust between the financers and the MSMEs, since they indicate to the financers that the small entrepreneurs will be more likely to treat the repayment of the loan as a priority as their income or property (or that of individuals close to them or associated with the business) is at risk.[166]

99. If the MSME keeps up with the loan payment according to the terms of the loan, there is usually not much risk for the guarantors. In the event of a loan default by the MSME, the guarantors will need to repay the debt and will likely become subrogated to the financers' rights against the MSME including the right to enforce the loan.

100. In many States, personal guarantees are divided into two general categories depending on the linkage between the guarantee and the underlying contractual relationship.[167] Under the first category, where the guarantee is linked to the underlying contractual relationship, the guarantor's obligation is accessory to the debtor's main obligation and the guarantor acts as a secondary obligor for the principal in case of default.[168] Therefore, the creditor may first have to request repayment from the main debtor (however, see para. 102), and the guarantor, once requested to pay, can refer to all defences that the principal debtor has against the creditor.[169] Under the second category, where the guarantee is independent from the underlying contractual relationship, the guarantor is obliged to perform after receiving from the creditor a demand for performance that complies exactly with the terms set out in the contract or other juridical act creating the guarantee (standby letters of credit are usually considered an example of such independent guarantees).[170] Since the guarantee is independent from the obligation of the main debtor, the guarantor cannot reject the demand for performance on the ground that the underlying

[163] World Bank Group, (supra note 139), pp. 8 and 20.
[164] Ibid., p. 19
[165] Ibid., p. 19
[166] T. Wolff, Look before you sign… the pitfalls of personal guarantees, 2018, available at The National Law Review (https://www.natlawreview.com/article/look-you-sign-pitfalls-personal-guaranties).
[167] M. Damjan, A. Vlahek, The protection of consumers as personal security providers under the DCFR and EU consumer law, 2018, p. 21, available at https://www.researchgate.net/.
[168] C. Henkel, Personal Guarantees and Sureties between Commercial Law and Consumers in the United States, The American Journal of Comparative Law, vol. 62, 2014, p. 337.
[169] M. Damjan, A. Vlahek, The protection of consumers (supra footnote 167), p. 23.
[170] See also the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (New York, 1995).

obligation does not exist or that the debtor has already settled it. The personal guarantor can only invoke its own defences against the creditor (e.g., a set-off objection when the personal guarantor has another claim against the creditor).[171] In most countries the second type of personal guarantees are not sufficiently regulated by law and are mainly created through contract practice. The guarantors should thus have a strong bargaining position to negotiate more favourable terms, such as a right to reverse their performance after their payment if the secured claim has been held invalid or unenforceable.[172]

101. The legal nature of the liability of the personal guarantor is also to be considered. For example, the personal guarantor may be liable only for a certain amount of debt, or up to a certain point in time; or its obligation may not be limited to a particular time period or amount. In certain countries (e.g., Demark), unlimited liability of the guarantors is allowed only within commercial relationships.

102. Another aspect of the legal nature of the personal guarantor's liability refers to the subsidiarity or solidarity of the liability. In the former instance, which seems to be the most common, the creditor must first require the main debtor to perform, although in certain States the parties can agree that the financers seek direct repayment from the guarantor without first requesting the debtor. In the case of solidary liability, the creditor can claim performance from the debtor or the guarantor (within the limit of the guarantor's obligation). That principle also applies among several personal guarantors that may have secured the performance of the same obligation. In that respect, it should be noted that most guarantee agreements nowadays contain a "joint and several" clause pursuant to which each personal guarantor is both jointly liable as a member of the group of guarantors and individually liable on its own to the financers for the repayment of the borrower's debt.[173]

103. Issuing a personal guarantee for a business loan is actually quite common for many MSMEs across different regions of the world.[174] It allows MSMEs, in particular start-ups and smaller businesses, to secure financing that would otherwise be out of reach for many of them, which helps the businesses to establish a position in the market and eventually grow. Very often, the alternative may be not getting credit at all because the risk of loss from default would otherwise be too large for the financer to bear. A personal guarantee could also improve the conditions of the loan, such as ensuring a lower interest rate, a larger loan amount, or a longer payoff term.[175] However, the provision of personal guarantees often raises an issue on the limited liability nature of the MSME, when the business is incorporated. It actually means that the MSME will have to forego the shield of limited liability, since either the owner or another person who is closely related to the MSME will become personally liable for the debt. Moreover, the default of an MSME may cause dramatic financial problems for the guarantors[176] and their households and in some countries this may lead to strong social stigma.

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[171] M. Damjan, A. Vlahek, The protection of consumers (supra footnote 167), p. 24.

[172] A. Schwartze, Personal Guarantees Between Commercial Law and Consumer Protection, in General Reports of the XIXth Congress of the International Academy of Comparative Law (M. Schauer, B. Verschraegen, eds.), 2017, p. 375.

[173] Ibid.

[174] For example, a survey released in 2020 by the regional federal reserve banks in the United States reported that nearly 60 per cent of small businesses with employees used personal guarantees to secure business debt. See R. Simon and H. Huddon, in Wall Street Journal, 4 April 2021, Small-business owners feel weight of personal debt guarantees.

[175] L. Ward, What Is a Personal Guarantee?, March 2021, available at https://www.lanterncredit.com/learn/what-is-a-personal-guarantee.

[176] The COVID-19 pandemic has exacerbated the risks for personal guarantors and in certain States programmes have been launched to mitigate such risks. For example, in 2020 the United Kingdom banned banks from requesting personal guarantees for emergency loans to small businesses and combined this with a new loan scheme to support small businesses affected by the pandemic. See https://www.theguardian.com/politics/2020/apr/02/uk-banks-banned-from-requesting-personal-guarantees-for-loans.

104. A legal regime that protects the rights of the guarantors without discouraging financers from providing credit is thus key. First, it should ensure that the guarantors are aware of the risks when they agree to take up the obligation to repay the MSMEs' debts. For this reason, most domestic laws require that a guarantee satisfies certain formal requirements in order to be enforceable, such as written form, the capacity of the guarantor to enter into a contract, an intention to be legally bound and the guarantor's signature.[177] While this latter requirement is quite common across States, some States (e.g., Poland) require an additional declaration of responsibility by the guarantor. As to the meaning of "written form", not all States may accept signed agreements sent by fax (e.g., in Austria, in 2013, the Oberster Gerichtshof recognized the validity of this method of transmission while the German Bundesgerichtshof, in 1993 and 1996, rejected it)[178] or agreements signed electronically (e.g., Germany). In other States, electronically signed agreements are accepted (e.g., Switzerland) or are considered valid for "those acting in the course of their business" as long as this is consistent with the domestic legal regime on electronic signatures (e.g., in Austria). Blank forms are usually regarded as not sufficient (e.g., in Austria and Germany).[179]

105. The requirements described above, however, might not be sufficient to protect the guarantor. For example, in 2016, a survey carried out by an SME loan provider, found that most of the entrepreneurs did not fully understand what a personal guarantee was and how it could affect their business.[180] To improve such situation, States may require notarized written agreements (with an explicit limit of the amount of a guarantee for the guarantor to realize the risk the guarantor is taking, as in Japan); or that the guarantors acknowledge their obligation under the guarantee before a lawyer, who must then confirm the acknowledgement by endorsement on the guarantee agreement (for example the Canadian province of Alberta); or a limitation on the amount of the guarantee (such as the proportionality required between the amount of the guarantee to guarantors' assets, in France),[181] or an obligation of the financers to explain the risks of the guarantee when concluding the agreement with the guarantor. It should be noted that in many States these forms of protection seem to be mainly directed at consumers rather than legal entities, although in certain States legislation concerning the duty of disclosing pre-contractual information applies beyond the consumer area (e.g., in Greece, Denmark and France).[182]

106. This may raise the issue of whether personal guarantees of owners, directors or members of MSMEs may be qualified as consumers' guarantees and thus fall under the relevant legislation. There seems to be no harmonized approach across States on this question. For example, in certain States (e.g., France) personal guarantees of owners or members of incorporated commercial entities are qualified as given by natural persons and consumer protection laws may be applicable to them. In other States (e.g., Israel), the guarantees of principal shareholders in favour of their corporation are excluded from the application of the special rules protecting "single guarantors".[183]

107. Second, depending on who provides the personal guarantee for the MSME's loans, other issues may arise. For example, when the personal guarantee is provided by the MSME owner or a member of its family (often the spouse), issues of overindebtedness, limitations on attachment of family property, or requirements of spouse consent might be considered. For the MSME owner to issue a personal guarantee, it seems quite common for financers to require that the consequence of such guarantee must be explained to the spouse of the MSME owner or even the

[177] L. Ellis, Where are the loopholes in Guarantees?, 2019, in https://hallellis.co.uk/unenforceable-guarantees-legal/.
[178] A. Schwartze, Personal Guarantees (supra footnote 172), p. 376.
[179] Ibid.
[180] See, SMEs don't understand personal guarantee in business loans, 2016, in https://smallbusiness.co.uk/smes-personal-guarantee-business-loans-2535607/.
[181] A. Schwartze, Personal Guarantees (supra footnote 172), p. 377.
[182] Ibid., p. 379.
[183] Ibid.

written consent of the spouse must be obtained before issuance (e.g., Austria, Brazil, the Netherlands and Switzerland).[184] In certain countries, there are exceptions to this rule and no consent is needed if the guarantee is given by a business owner or a company director (e.g., the Netherlands and Turkey). When family members are requested to provide personal guarantees in favour of the MSMEs, it puts the personal assets of family members at risk and may also cause considerable stress to the financial stability of a household and the interpersonal relations of its members. Only a few countries, however, seem to have laws concerning guarantees provided by family members of the MSME's owners. In some countries, courts protect those vulnerable guarantors applying violation of morality, or unconscionability[185] or undue influence principles. In one country, several courts, on the basis of a federal regulation that provides for a wide definition of "applicant for a credit", have held that it is illegal for a financer to require a spousal guarantee given that the prospective guarantor is married to the person seeking the loan.[186]

108. Third, when an MSME is in financial distress, the solvency of the personal guarantors goes through a severe stress test. If the guarantor is unable to repay the debts, enforcement of the guarantee may result in a lifetime of debt for the guarantor and their family, depending on domestic legislation, and strong social stigma in certain countries. In some States, disproportionate hardship on the personal guarantor can be mitigated by personal insolvency regimes that relieve the guarantors of their unpaid claims after partial payment or instalment payments over time.[187] Such debt discharge allows the guarantors to continue their regular economic life and when the guarantor is the MSME's owner, such discharge facilitates its return to activity and may also enhance its willingness to do so.[188] However, not all countries have personal insolvency laws, and some of those that have them may have no discharge mechanisms or have a long waiting period before discharge, as well as heavy penalties for personal bankruptcy.[189]

109. Adopted at the fifty-fourth session of UNCITRAL (2021), the *UNCITRAL Legislative Recommendations on Insolvency of Micro and Small Enterprises* (the "Legislative Recommendations") recommend the adoption of a simplified procedure to address personal guarantees provided for business needs of the MSE by individual entrepreneurs, owners of limited liability MSEs or their family members when invoking the personal guarantee would likely result in the personal insolvency of the guarantor. This may be achieved through procedural consolidation or coordination of the relevant proceedings, that is insolvency proceedings against the MSE and insolvency or enforcement proceedings against its guarantors. When no proceeding against the guarantor has commenced, the draft commentary to the Legislative Recommendations clarifies that the law may allow the guarantor to bring potential claims of creditors for consideration in the insolvency proceeding commenced against the MSE so that those claims could be accorded appropriate treatment with the purpose of preventing potential insolvency of the guarantor. For example, the law may permit imposing a stay on the enforcement against personal guarantors of the MSE for a limited duration on a case-by-case basis. When approving or confirming a reorganization plan of an insolvent MSE, the competent authority may accord special treatment to a guarantor's claim against the MSE vis-à-vis other claims in the plan. The insolvency law may permit MSE' guarantors to petition for a reduction or discharge of their obligations under the guarantee if those obligations are disproportionate to the guarantor's revenue and may also permit the guarantor to pay

[184] Ibid., p. 380.

[185] In Canada's common law "a transaction is unconscionable where a stronger party has exploited the weakness of another in order to obtain a benefit at the weaker party's expense", see Canadian Centre for Elder Law Studies, Financial Arrangements Between Older Adults and Family Members: Loans and Guarantees, 2004, p. 9.

[186] See for example Hawkins v. Community Bank of Raymore (United States Court of Appeals for the Eighth Circuit and Supreme Court).

[187] D. Hahn, "Velvet Bankruptcy", in Theoretical Inquiries in Law, 2006, vol. 7, p. 541.

[188] Ibid., p. 540.

[189] World Bank Group, Report on the Treatment of MSME Insolvency, 2017, p. 34.

in instalments for an extended period. The competent authority or another relevant State body may be allowed to exercise discretion in favour of the guarantor's discharge or the reduction of the obligation to the part of the debt not covered by the MSE's repayment obligations. These measures may alleviate a disproportionate hardship on the guarantor.[190]

110. The draft commentary to the Legislative Recommendations also suggests that special measures of protection may be envisaged in the law, other than insolvency law, for especially vulnerable guarantors, e.g., those who are found to have provided guarantees under duress or those who are dependent on or have strong emotional ties with the debtor (see para. 107 above).

D. Credit Guarantee Schemes

111. In many States, credit guarantee schemes (CGSs) represent a key policy tool to address the financing gap of small businesses. They lower the risk of financial institutions since they guarantee, usually in return for a fee, repayment of all or part of the loan in case of default. As noted by OECD,[191] they can reduce information asymmetry by aiding accurate identification of lending risks. They also help the institutions gain experience in managing loans for MSMEs, thus encouraging further developments of this market segment.[192] Further, CGSs may also improve the terms of the loan for MSMEs, since they can alleviate high collateral requirements thus facilitating MSME access to formal credit. They also help MSMEs that would have been excluded from the lending market to establish a repayment reputation that can facilitate future lending from financial institutions.

112. OECD describes four major types of CGSs: (i) public schemes established by public policy, which usually involve State subsidy and may also be managed by a private entity. An advantage of this scheme is that the guarantee is paid out directly from the government budget which gives the scheme higher credibility within the banking sector; (ii) corporate guarantee schemes, usually established by the private sector (e.g., banks and chambers of commerce) which generally benefit from the direct involvement of the banking sector; (iii) international schemes established by bilateral or multilateral government or IGO/NGO initiatives, which often combine a guarantee fund with technical assistance to MSMEs; and (iv) mutual guarantee schemes that are private and independent organizations formed and managed by borrowers with limited access to bank loans. Although they are largely funded from membership fees, in many instances, they operate with some form of government support.[193] This working paper will focus on public guarantee schemes since corporate and mutual guarantee schemes are mainly private initiatives subject to the applicable contract, commercial and corporate laws of the State where they operate[194] and the international guarantee schemes described in subparagraph (iv) above are outside the scope of this text.

Public Credit Guarantee Schemes

113. As it has been noted,[195] effective CGSs require a number of preconditions, including: (i) a system of enforceable business laws (e.g., corporate, insolvency, contract, secured lending laws) and a reliable public registry system; (ii) mechanisms

[190] A/CN.9/1052, annex, para. 93 and A/CN.9/WG.V/WP.172/Add.1, paras. 330–335.
[191] OECD, Discussion Paper on Credit Guarantee Schemes, p. 4.
[192] Ibid., pp. 4–5.
[193] Ibid., pp. 8–9.
[194] For example, in certain States, corporate guarantee schemes are considered as specialized financial institutions and their regulation is aligned with that of the banks. Mutual guarantee schemes often take the legal form of cooperatives and are governed by those laws.
[195] The World Bank and FIRST Initiative, 2015, Principles for Public Credit Guarantee Schemes for SMEs, p. 8.

for the fair resolution of disputes, including out-of-court proceedings; and (iii) an independent and efficient judiciary.[196]

114. While commercial laws play a key role in creating an enabling environment where CGSs can operate, the design and operation of efficient CGSs rely on a mix of legislative and regulatory measures that should at least take into account the legal foundations of the scheme, MSMEs' eligibility criteria and loan coverage, risk-sharing, collateral requirements, fees and sustainability and repayment rules.

Legal foundations of CGSs

115. CGSs should be established on the basis of appropriate and specific legislation that clearly defines all aspects of the scheme. The World Bank and FIRST Initiative *Principles for Public Credit Guarantee Schemes for SMEs*, prepared in 2015 (hereinafter the Principles), indicate that such legal or regulatory framework could be a part of corporate or banking legislation or institution-specific legislation. In States where the guarantees are provided directly by the central government, the State's liability with respect to the provision of the service should be addressed in the applicable laws.

116. The Principles suggest that a CGS should be established as an independent entity with legal personality, while allowing the government to retain ownership and control over it and the legal and regulatory framework should not only establish the CGS's mandate, but also clarify issues concerning the structure and operation of the CGS such as: (i) how the State will exercise its ownership; (ii) who will represent it (e.g., ministry, agency etc., also defined as "ownership entities") and which government body will supervise the CGS; (iii) general terms and conditions that apply to the government investment; (iv) the relationship between the State as shareholder and the CGS's board and management; and (v) the CGS's funding sources.

117. The mandate of CGSs should at a minimum specify the MSME sector(s) targeted by a CGS and its main line(s) of business. The mandate should be broad enough to accommodate cyclical developments in the targeted sector(s) and indicate a desired level of efficiency for the CGS. In order to assess its continuing validity over time, it would be important to establish mechanisms for its periodic review. In addition to the provision of credit guarantees, the mandate may include other services, such as provision of information, technical assistance, training and counselling.[197]

118. In order to ensure the managerial autonomy and accountability of CGSs in implementing the mandate, it would be important to separate the government oversight from the day-to-day operations of CGSs (see subparagraph (iv) above).[198] This would also facilitate decision-making on the basis of economic and financial considerations, while still ensuring alignment with a CGS's mandate and policy objectives.[199] The legal or regulatory framework establishing CGSs should provide that they have adequate funding determined in accordance with the policy objectives of CGSs and the volume of business they must generate to remain current on their financial obligations while ensuring their long-term financial sustainability.[200] The framework should specify the responsibilities of the State (or other ownership entity) with regard to the provision of initial capital or subsidies during the lifespan of CGSs and clarify that information on the sources of funding should be transparent and publicly disclosed.[201] The legal and regulatory framework should also set minimum capital adequacy standards for CGSs.[202]

119. The State may choose a private sector partner to invest in CGSs or establish them in partnership with the private sector in order to increase the funding sources of

[196] Ibid.
[197] Ibid., p. 15
[198] Ibid., p. 12.
[199] Ibid., p. 16.
[200] Ibid., p.13.
[201] Ibid.
[202] Ibid.

CGSs to benefit from knowledge of target markets or to introduce good governance practices based on experience from the private sector.[203] In such cases of mixed ownership the State often retains a high degree of control of the CGS either directly or indirectly (e.g., through government-linked investors, other State-owned enterprises) that it may exercise to the disadvantage of the minority shareholders. The legal and regulatory framework should thus assign clear responsibility for protecting the basic rights of minority shareholders and for promoting their active participation in the governance and decision-making processes of CGSs.[204]

Eligibility

120. According to the Principles, efficient CGSs should rely on clear and transparent eligibility criteria concerning borrowers, lenders and loans. With regard to borrowers, it would be important to clarify whether the eligible borrower could be an MSME or a sole proprietor as well as the target sector where they operate. In the case of MSMEs, additional criteria may include the size, the subsector, and the age of a sole proprietor. In certain States, legal requirements may include a link with the jurisdiction where the guarantee is provided, for example the place where the business is conducted. It should be noted that during the COVID-19 pandemic, many States broadened the eligibility criteria to include specific industries or businesses, even large companies, operating in strategic sectors.[205]

121. Consistent with the applicable legal and regulatory framework, CGSs could establish programmes dedicated to subclasses of firms as start-ups, exporters, and high-tech firms or target specific entrepreneurs' groups such as women or youth in order to encourage entrepreneurship in those segments. Conversely, CGSs may create a list of ineligible MSMEs (on the basis of their credit profile and repayment reputation, for example) or may explicitly exclude some subsectors from its scope of operations.

122. Eligibility criteria for lenders should also be clearly defined, possibly on the basis of objective indicators such as their interest and capacity in serving small businesses and their risk management capabilities.[206] As noted by the International Monetary Fund (IMF), eligible lenders typically include commercial banks, but to address the need for quick provision of liquidity during the COVID-19 pandemic, some States have included in the lenders' category non-bank financial entities (for example, electronic money entities and payment service providers in Spain).[207]

123. Further, the legal or regulatory framework should clarify which types of loans are eligible for coverage.[208] In this respect, it would be desirable that both loans for operational expenses (e.g., salaries, rent, utilities) and for investment finance be included, since the former help sustain jobs in MSMEs that are vulnerable to

[203] Ibid., p. 14.
[204] Ibid.
[205] IMF, Special Series on COVID-19, 2020, Legal Considerations on Public Guarantees Schemes Adopted in Response to the COVID-19 Crisis, p. 2.
[206] The World Bank and FIRST Initiative (supra footnote 195), p. 18.
[207] IMF, Special Series on COVID-19 (supra footnote 205), p. 2.
[208] CGSs usually extend guarantees through two modalities: the individual method and the portfolio method. In the individual method, guarantees are provided on a loan-by-loan basis and the CGS assesses all loan applications and selects those to guarantee; there is thus a direct relationship between the MSME and the CGS. In the portfolio method, the criteria of the portfolio are previously negotiated by the lenders and the CGS, and the lenders can then attach the guarantee to the loan without consulting the CGS. There is thus no direct relationship between the CGS and the MSME. The World Bank and First Initiative Principles note that a portfolio approach may be useful for the promotion of certain types of MSMEs – for example, start-ups or women-owned MSMEs, regardless of the specific project presented. A World Bank study in 2008 found that only 14 per cent of the 76 schemes studied used a portfolio model; 9 per cent of schemes used a combination of the loan-level/individual model and portfolio model (see T. Beck, ,L. Klapper, J.C. Mendoza, The Typology of Partial Credit Guarantee Funds around the World, The World Bank Development Research Group, November 2008).

insolvency because of insufficient short-term credit, and the latter assist job creation and long-term economic growth.[209]

124. Finally, to minimize or avoid cash-flow problems, the legislation may set a cap to the size of the loan guaranteed under a CGS. During the COVID-19 pandemic, many States temporarily increased the cap on the size of loans using criteria such as the type and size of the business, or the revenues of the borrower. In certain States, applicable laws allowed case-by-case exceptions in case of national security interest, job protection, or relevance of the business for the national economy.[210]

Risk-sharing

125. Risk-sharing is a key element to ensure the success of CGSs, since it limits the moral hazard of the lenders and MSMEs alike and provides incentives to both these groups thus ensuring that default and claim rates are kept as low as possible. The legal and regulatory framework can distribute risk to lenders through the coverage ratio, i.e. the share of the loan that is guaranteed by the CGS. As it has been noted, a high coverage ratio can be very attractive to lenders, since they would be protected from credit risk and they may not have an incentive to engage in proper monitoring activities, leading to excessive risk-taking and thus endangering the schemes' sustainability.[211] On the contrary, if the CGS bears only a small share of the risk, lenders might disregard the programme.[212] Policy needs would usually drive the decision of the State on the coverage ratio, for example in response to the severity of the COVID-19 pandemic, some States increased the ratio to 100 per cent in certain cases (for example, vulnerable borrowers, such as the smallest businesses).[213] The coverage ratio should be clearly indicated in the contractual agreements between the CGS and the lenders and the agreements should also clarify how the losses are shared between the CGS and the lenders.

126. Since the allocation of risks between the CSG and the lenders is affected by the roles and responsibilities of the lenders and the CGS, it is important that the legal framework clearly defines such roles and responsibilities. In particular, it should clarify that the lending decisions rest on the sole discretion of the lender and the criteria on which such decisions should be based (e.g., the borrowers' creditworthiness; how the guaranteed loan fits into the lender business and risk appetite; whether the guaranteed loans could be used as collateral to access central bank liquidity facilities) and that the CGS is responsible for approving the specific guarantees.[214]

127. There may be moral hazard on the part of the MSME borrowers as well, since they might provide misleading information or not disclose sensitive information to the lenders and risk-sharing practices may help prevent it. In countries with efficient CGSs, requiring MSMEs to supply collateral is one of the most used practices, as it demonstrates an MSME's commitment to repayment. However, excessive collateral requirements can defeat the purpose of the guarantee and the CGS should work with the lender to determine an appropriate level of collateral requirement that limits the moral hazard of MSMEs but does not disincentivize them to apply for loans.[215]

Fees

128. The guarantee fee is usually established in the legal or regulatory framework of the CGS rather than on a case-by-case basis, usually by having a fixed flat fee or a variable one. When determining the size and structure of the fees, a balance should

[209] The World Bank and FIRST Initiative (supra footnote 195), pp. 18–19.
[210] IMF, Special Series on COVID-19 (supra footnote 205), p. 3.
[211] Ibid., p. 2.
[212] R. Ayadi and S. Gadi, Access by MSMEs to Finance in the Southern and Eastern Mediterranean: What role for credit guarantee schemes?, MedPro Technial Report, 2013, p. 11.
[213] IMF, Special Series on COVID-19 (supra footnote 205), p. 4.
[214] Ibid., p. 4.
[215] The World Bank and FIRST Initiative (supra footnote 195), p. 20.

be struck between the goals of the guarantee programme and its financial sustainability. Fees, along with the income that the CGS may derive from its investment activities and any government subventions, should cover the cost of the operations and the expected cost of credit risk (or claims). The pricing policy should be transparent and CGSs should be able to adjust it on the basis of their credit loss history and market developments, [216] as well as on the country's specific circumstances. For example, in response to the crisis generated by the COVID-19 pandemic, certain States set caps on the amounts of fees that can be charged or prohibited the charging of fees.[217]

Default and claim

129. The legal or regulatory framework and the contractual arrangements should clarify the legal relationship among the CGS, the lender and the MSMEs and in particular the precise circumstances that prompt the CGS's intervention, for example the opening of insolvency proceedings against the MSMEs or the MSME's late repayment of the loan.[218] A common practice is to specify a minimum mandatory waiting period before a claim can be made to a CGS after loan disbursement and it has been suggested that the maximum period after a missed payment(s) should also be specified and should not be conditional on initiating legal action against the MSME.[219]

130. As the IMF notes, in some States (e.g., Italy and the United States) the guarantees issued by CGS are considered independent guarantees, where the guarantor's obligation is not linked to the underlying debt. In others, the CGS has a subsidiary liability (e.g., France and the Netherlands), whereby the enforcement and/or validity of the guarantee is dependent on that of the principal debt, but a provisional payment by the CGS to the lender may be made based on expected losses after a default. If the enforcement of guarantees by the lenders is linked to the occurrence of "losses", clarity is needed on when and how such losses will be deemed to exist and borne by the lenders. [220] It would however be desirable that before submitting their claims lenders proactively explore alternative solutions, including loan rescheduling, to receive payment from the MSME. [221]

131. Guarantee payment procedures should be settled in a clear and transparent way to avoid costly disputes between the lender and the CGS. Contractual agreements between the CGS and the lender should clearly state the conditions under which a claim is acceptable, the maximum amount of unpaid interest covered by the guarantee and a time limit for the settlement of claims. In addition, a detailed written explanation should accompany the refusal of a claim. [222]

132. Finally, the legal and regulatory framework should specify the CGS rights once it has paid the guarantee and establish a clear and efficient process for post-claim loss recovery.[223] The general legal principle is that the CGS is entitled to claim the paid amount from the borrower (statutory subrogation). In this respect, it would be important that the subrogation of the loan is documented and legally enforceable. However, for improved efficiency, the contractual agreement might specify whether the lender or the CGS are responsible for debt recovery from the borrower. In certain States (e.g., Chile), for example, the lender is required to act as the agent of the CGS during the enforcement stage. [224]

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[216] Ibid., p. 21.
[217] IMF, Special Series on COVID-19 (supra footnote 205), p. 3.
[218] Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH (GIZ), SMEs' Credit Guarantee Schemes in Developing and Emerging Economies: Reflections, Setting-up Principles, Quality Standards, 2014, p. 59.
[219] The World Bank and FIRST Initiative (supra footnote 195), p. 22.
[220] IMF, Special Series on COVID-19 (supra footnote 205), p. 5.
[221] The World Bank and FIRST Initiative (supra footnote 195), p. 22.
[222] Ibid.
[223] Ibid.
[224] IMF, Special Series on COVID-19 (supra footnote 205), p. 5.

E. Credit reporting

133. Access to credit for MSMEs is generally hindered by the lack of sufficient information to assess their creditworthiness and ability to repay their debts. Problems of information asymmetry are compounded by the absence of a supporting financial infrastructure to make such information available. The collection and distribution of financial information on potential borrowers are known as “credit reporting”. This service allows financers to learn more about borrowers’ characteristics, past behaviour, repayment history and current debt exposure. Credit reporting facilitates access to credit as it can reduce the cost of financers to conduct due diligence. For example, the World Bank *Doing Business Report 2020* notes that the launch of a credit reporting service in Kenya has helped reduce interest rates, collateral, and default rates for loans at commercial banks.[225]

134. Credit bureaux and credit registries are the two main types of credit reporting service providers. Credit bureaux are usually privately owned and operated companies which tend to cater to the information requirements of financers. Credit registries are public entities whose data are geared towards use by policymakers, regulators, and other public authorities and entities. In both cases, the service is structured around databases of information on debtors and information flows, which may raise similar procedural, technological and legal issues in relation to the collection and processing of data, their quality and protection and the access to information by users as well as the data subjects (i.e., the individuals or commercial entities to which the data refer).[226]

135. As noted by the International Committee on Credit Reporting (ICCR), addressing the issues mentioned in the paragraph above requires a regulatory and legal framework that is clear, predictable, non-discriminatory, proportionate and supportive of data subjects and their rights and should also include effective judicial or extrajudicial dispute resolution mechanisms.[227] In this respect, ICCR further notes the absence in many States of specific laws addressing commercial credit reporting, in contrast with the more developed and specific legal framework for consumer credit reporting. Laws protecting consumer rights may not necessarily be applicable to commercial credit reporting, since concerns in relation to commercial credit reporting might be different. For example, information needed to assess the risk of commercial transactions generally includes significantly more data concerning payment and financial performance than is required for individual consumers.[228] Further, protection of data subjects’ privacy may be less relevant in the case of commercial credit information, and the underlying regulations may not applicable to MSMEs.[229] In this regard, OECD notes that overly strict privacy laws can limit the amount of information that is used in the credit decision process, thus hindering the ability of the financers to identify the higher quality borrowers.[230]

136. In order to facilitate the implementation of legal and regulatory frameworks specifically concerning credit reporting systems for small businesses, the ICCR, in 2014, prepared ad hoc guidance based on the 2011 World Bank *General Principles for Credit Reporting* (the General Principles) that have a broader scope. This section is largely based on those two publications and discusses key aspects to facilitate the information flow across the credit reporting system and ensure its effective functioning.

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[225] World Bank Group, Doing Business 2020, p. 48
[226] World Bank, General Principles for Credit Reporting, 2011, p. 7.
[227] World Bank, ICCR, Facilitating SME financing (supra footnote 10), p. 19.
[228] World Bank, General Principles (supra footnote 226), p. 13.
[229] World Bank, ICCR, Facilitating SME financing (supra footnote 10), p. 20.
[230] OECD, Discussion Paper on Credit Information Sharing, p. 12

Reporting obligations

137. There seem to be no standard requirements across States for small businesses to submit financial information to public agencies and other entities. In many States there are no reporting obligations and in others the information required is often not sufficient for a robust assessment of the business creditworthiness as some States have adopted policies to reduce reporting obligations for MSMEs. While this may contribute to the formation and growth of MSMEs since it reduces some of the administrative burdens they face, it does not facilitate credit reporting and thus access to credit. Moreover, when MSMEs do not have financial reporting obligations, their creditors may not be willing to share detailed credit performance information about them, since that information may include underlying financial data that may be considered sensitive. It would thus be important that a legal or regulatory framework providing clear guidance on this matter be in place.[231]

138. Similarly, States should have laws that specify which type of business information and data required from MSMEs should be considered confidential and not subject to reporting. Several MSMEs are concerned that disclosing financial and other business-related data may hinder their ability to compete, since it would allow competitors to access sensitive information. Such laws should balance the right of MSMEs to protect their know-how with that of their creditors to collect, analyse and distribute credit-related data.[232]

Integrating available information with public agencies' records

139. The most common sources of data, usually the only one for credit registries performing commercial credit reporting, are banks and other regulated financial institutions which are usually required by law or regulation to provide the information needed by the registry. This might be different in the case of credit bureaux, since there seem to be no laws mandating disclosure of information to credit bureaux. Therefore, some banks may provide them with information on a voluntary basis, others may do so on a limited basis only (for example, not allowing the credit bureau to disclose the name of the bank or the details of the loan), and still others may refuse to share information because of bank secrecy obligations.[233]

140. Other sources of data and information can include commercial entities such as factory and leasing companies and non-bank financial institutions, although the majority of these entities seem to not share information with credit bureaux. Similarly, even trade creditors do not seem to provide as much data as expected.[234] Moreover, credit registries do not collect data from trade creditors and the latter cannot use the data in the credit registries since they are mainly for the use of regulated financial institutions.[235]

141. In order to offset the scarce or inadequate information from the sources mentioned above (see paras. 139 and 140), credit reporting service providers (whether credit registries or credit bureaux) rely on information from public sector sources which may include, among others, official identification data for MSMEs, data that contribute to determining the MSME's behaviour (e.g., bankruptcy information from the courts) and financial information.[236] However, accessing that information may be difficult due to legal and practical issues. First, not all States may have laws or regulations that facilitate access to the information maintained by public agencies. Moreover, in some cases, some or all of the data maintained by the public agency may be considered confidential and access might be restricted.[237] Alternatively, existing

[231] World Bank, ICCR, Facilitating SME financing (supra footnote 10), p. 20.
[232] Ibid., p. 21.
[233] Ibid., p. 18.
[234] For example, in the United States it is estimated that less than 50 per cent of B2B suppliers share trade credit information with commercial credit information companies. Ibid.
[235] Ibid.
[236] Ibid., p. 19.
[237] Ibid.

laws or regulations may not clarify whether entities or individuals other than the data subjects may access the data maintained in the public agencies and reuse it for commercial purposes. Finally, laws or regulation may simply not require public agencies to share the data they maintain. In addition to an inadequate legal or regulatory framework, practical impediments may also affect the collection of data. For example, public agencies often lack sufficient human and financial resources to maintain the data stored in their records in as current a state as possible, which results in outdated data of very little use for the purposes of credit reporting.[238]

Data quality

142. High data quality is the cornerstone of an effective credit reporting system: it means that relevant, accurate, timely and sufficient data, both negative and positive, are collected on a systematic basis from reliable, appropriate and available sources, and are retained for a sufficient length of time.[239] Inaccurate data can result in unjustified loan denials, higher borrowing costs, and other unwanted consequences for debtors, data providers (e.g., banks and financial institutions) and credit reporting service providers. The accuracy of data depends on how they are gathered, usually through loans and contracts (see para. 139 above), and how the credit reporting service providers process the raw data received by data providers in order to convert them into the final products that will be accessed by the users.[240]

143. In order to ensure the high quality of the data, the legal and regulatory framework should thus specify the purposes for which data may be collected, the circumstances in which they can be used, the required quality and accuracy, and the timeliness.[241] Any limits concerning data collection, such as those based on race, gender, etc., and any time limits during which the data may be maintained should also be specified.[242] These requirements should be applicable to both data providers and credit reporting service providers. The collection of high quality data would also require data subjects to provide accurate and truthful information when interacting with data providers (e.g., banks, financial institutions, commercial companies). The law should thus require data providers to collect the data subjects' consent for collecting, storing as well as distributing their data.[243]

144. In order to ensure the accuracy and reliability of the collected data, the data subjects should have the right to access their own data in order to correct or update it or dispute its accuracy and completeness and have those complaints investigated and any errors corrected.[244] The legal and regulatory framework should thus establish that the credit reporting service providers and data providers adopt clear, effective and streamlined procedures and tools to handle and solve complaints relating to errors in the stored information.[245]

145. Finally, technology can also play an important role in preserving the high quality of the information, given that the most current means of storing and accessing credit reports is through databases and online electronic data transfers. While this topic mainly concerns the operation, safety and technical reliability of the technology used, an effective legal framework should nevertheless consider the appropriate level of security safeguards required to protect data. For example, the OECD suggests that the International Standards Organization ISO 27000 (ISO17799) series – which identifies the systems, processes, infrastructure and checks required to protect data from threats, including theft and destruction – should be taken into account.[246] The use of DLT (such as blockchain technology) could be explored in this context, given that DLT has

[238] Ibid., p. 21.
[239] See General Principle 1 in World Bank, General Principles (supra footnote 226), p. 25.
[240] World Bank, General Principles (supra footnote 226), p. 26.
[241] OECD, Discussion Paper on Credit Information Sharing (supra note 230), p. 12.
[242] World Bank, General Principles (supra footnote 226), p. 37.
[243] Ibid., p. 41.
[244] OECD, Discussion Paper on Credit Information Sharing (supra note 230), p. 12.
[245] World Bank, General Principles (supra footnote 226), p. 37.
[246] OECD, Discussion Paper on Credit Information Sharing (supra note 230), pp. 10–12.

several inherent features that align well with the requirements for security and integrity of stored data.[247]

Alternative data

146. In recent years, the use of alternative data, which the Global Partnership for Financial Inclusion (GPFI) defines as data generated by the increasing use of digital tools and information systems,[248] has gained increased relevance in credit reporting. Such data may include online banking transactions, digital payments, and automated utility payments as well as data created outside the financial system. For example, when MSMEs or their customers use cloud-based services, browse the Internet, use their mobile phones, engage in social media, use ecommerce platforms, ship packages, or manage their receivables, payables, and record-keeping online, they create digital footprints.[249]

147. It has been suggested[250] that using alternative data to enhance credit reporting can represent a large opportunity to expand MSME access to finance, especially for those small businesses operating in the informal economy that have no or "very thin credit files".[251] However, the absence of a supportive legal and regulatory environment challenges the effective use of alternative data as it may result in data inaccuracies; the use of data that are based on uninformed consent and heightened exposure to cyberrisks. For example, social media data are used by credit reporting providers without the data subject's consent thus exposing the credit reporting providers to potential legal risks since those data are usually not collected and consented to be used for credit reporting purposes. The use of alternative data is also susceptible to risk of discrimination of the data subject since some of the attributes of the data that are collected, including race, colour, sex and marital status, can result in discriminatory scoring practices if unmonitored.[252]

148. To address the above concerns, GPFI and ICCR thus recommend that domestic laws or regulations should "clarify how alternative data may be sourced and processed, taking into consideration privacy and data protection international standards".[253] This may involve updating and adapting privacy laws and/or laws requiring MSMEs' consent for data collection and use; ensuring standards for the accuracy and reliability of the alternative data collected; recognizing the right of data subjects to object to the processing of their information, to correct the data or request their deletion where appropriate; avoiding discriminatory practices in the use of alternative data.

149. The international flow of alternative data also raises issues of how data are treated in different jurisdictions. There may be differences in the specific data that the credit reporting service providers collect, difficulty in identifying MSMEs in different countries due to inconsistent or non-standardized identification systems and different enforcement regimes or redress mechanisms for MSMEs, in particular when the alternative data are stored in the cloud or are based on unstructured data such as emails, websites or multimedia content. GPFI and ICCR thus recommend that States, in cooperation with relevant international bodies, should harmonize different aspects

[247] These features include (i) tamper resistance; (ii) a tamper-detection process of independent data verification; (iii) a distributed and redundant system architecture; and (iv) a network of heterogeneous nodes. World Bank Group (supra note 139), p. 17.

[248] GPFI, Use of Alternative Data to Enhance Credit Reporting to Enable Access to Digital Financial Services by Individuals and SMEs operating in the Informal Economy, Guidance Note prepared by the International Committee on Credit Reporting, 2018, p. 14. GPFI is a forum for all G20 countries, interested non-G20 countries and other relevant stakeholders to carry forward work on financial inclusion, including implementation of the G20 Financial Inclusion Action Plan, endorsed at the G20 Summit in Seoul on 10 December 2010. For more information see https://www.gpfi.org.

[249] Ibid., p. 12.

[250] Ibid.

[251] Ibid., p. 5.

[252] Ibid., p. 6.

[253] Ibid., p. 18 [Policy recommendation 1].

of their legal regimes applicable to cross-border data flow, such as MSMEs' rights, dispute-resolution mechanisms, accountability for data errors, and data-security measures.[254] Moreover, States should consider the adoption of a global unique identifier for MSMEs that would facilitate cross-border data-sharing.[255]

Access to credit reporting services

150. All interested users (e.g., current and potential MSME financers) should have easy and timely access to MSME data. This will facilitate assessment of MSMEs' creditworthiness and improve their chances of access to credit. As noted by the World Bank, the legal and regulatory framework should ensure that data access should respond to impartial rules regardless of the nature of the participants.[256] For example, credit registry service providers should not impose conditions (e.g., access fees or access to certain information only) that favour certain groups of users without justification.[257] Nonetheless, there may be exceptions to the principle of non-discrimination due to the purpose of the credit reporting service provider. For example, some credit registries created to support banking supervision and improve the availability and quality of credit data for supervised intermediaries require data from and provide access to regulated financial institutions only.[258]

Dispute resolution

151. As noted above (see para. 144), disputes may arise between MSMEs and credit reporting service providers (or data providers) because of inaccurate data, their misuse, or adverse decisions made about an MSME based on the data. Mechanisms that allow an MSME to rectify errors or decisions or delete certain data as well as claim compensation for any damage incurred are essential for the protection of the business.

152. An efficient credit reporting system should not only rely on judicial mechanisms to solve disputes with MSMEs, but it should also include other faster, less formal and expensive redress methods.[259] In certain States, the applicable laws require credit reporting service providers to establish in-house dispute resolution mechanisms as a first step to address MSMEs' claims. Such mechanisms should be easily accessible, with specific deadlines and provide clear guidance to MSMEs on how to dispute an error.[260] Should the dispute not be resolved through those in-house mechanisms, the MSME should be able to seek redress in court or through appropriate alternative dispute resolution mechanisms (e.g., arbitration, mediation, a supervisory authority) that can function with minimum procedural requirements while ensuring impartiality and effectiveness.[261] It should be noted that quantifying damages due to errors or inaccuracy of data maintained in a credit registry and the resultant compensation might be difficult to do in practice and the law or regulation could provide guidance on this matter.[262]

F. Safeguards for MSMEs, in particular micro and small enterprises

153. Because of the imbalance in size between large financers and MSMEs, the latter, particularly micro and small enterprises, are often offered contracts for financial transactions on a "take it or leave it" basis, meaning that they have limited or no

[254] Ibid., p. 26.
[255] Ibid.
[256] World Bank, General Principles (supra footnote 226), p. 35.
[257] Ibid., p. 42.
[258] Ibid., p. 35.
[259] Ibid., p. 38.
[260] Ibid., p. 45.
[261] Ibid.
[262] Ibid., p. 22.

bargaining power to negotiate their terms and conditions.[263] Moreover, certain types of contracts, such as those for credit cards, are usually not customized to individual consumers, including smaller enterprises that in several States are treated in the same way as individual consumers since they face the same issues.[264] Small businesses' acceptance of these standard contract terms may also depend on the nature of competition in a given credit market. For example, even though they have unequal bargaining power, many micro and small businesses may shop around for the best available interest rate, but few of them may shop around for better contract terms, since the terms may be completely standardized.

154. It is current practice that the procedural terms (e.g., limitations in the methods of drawdown and repayment, the methods whereby the borrower is notified of changes, how and where disputes are resolved) and substantive terms (such as the level of interest after default or the way "default" is defined) in a financing contract are weighted in favour of the financers. As noted, the financers are the "repeat players" and have the greater bargaining power. Further, the use of standard term contracts contributes to reduce their transaction costs; negotiation and any resulting variation of the standard contract would result in an increase of the transaction costs that the financer may not consider economical.[265]

155. In order to ensure that micro and small businesses are treated fairly and offered products and services at conditions appropriate to them, States should consider reducing any risk of financers' abuse of their dominant position. This might easily happen, since many micro and small businesses may not be able to identify or fully understand potential detrimental contractual conditions,[266] partly because the clauses are often in small print and in technical and complicated language and partly because many micro and small enterprises often have little or no financial literacy. Protecting those businesses from unfair contract terms and practices is also of particular importance in an era of increasing digital online lending, given the speed with which contracts are electronically concluded, often without prior or sufficient review of their terms and conditions.[267] A survey carried out by a national small businesses' organization in the United States, found out that 74 per cent of the respondents felt that online lending should be regulated to ensure that small businesses were protected from predatory online practices.[268]

156. In order to tackle unfair contract practices, several States have adopted laws or regulations to protect users of financial services. Although the frameworks are mainly addressed to individual consumers, in certain States they are extended to micro and small businesses as well. For example, Australia has extended the regime on unfair contract terms provisions applying to consumers under the Australian Consumer Law to cover standard form small business contracts, including contracts in the financial service sector. The legislation specifies what a small business is and clarifies the parameters according to which a contract term can be deemed unfair. This occurs when the term: (i) would cause a significant imbalance in the parties' rights and obligations arising under the contract; (ii) is not reasonably necessary to protect the legitimate interests of the party that would benefit from its inclusion; and (iii) would

[263] Australian Security and Investment Commission (ASIC), Report 565, Unfair contract terms and small business loans, 2018, p. 4, available at https://smallbusinessmajority.org/sites/default/files/research-reports/121217-Small-Business-Access-To-Capital-Poll.pdf.

[264] World Bank, Good Practices for Financial Consumer Protection, 2017 edition, p. 4.

[265] L. Gullifer, I. Tirado, A global tug of war: a topography of micro-business financing, 2017, pp. 12–13.

[266] World Bank, Good Practices (supra footnote 264), p. 34.

[267] Ibid.

[268] Small Business Majority, Opinion Poll Small Business Owners Concerned with Predatory Lending, Support More Regulation of Alternative Lenders, 2017, available at https://smallbusinessmajority.org/our-research/access-capital/small-business-owners-concerned-predatory-lending-support-more-regulation-alternative-lenders.

cause financial or other detriment (e.g., delay) to a small business if it were to be applied or relied on.[269]

157. The World Bank *Good Practices for Financial Consumer Protection* (the "Good Practices")[270] suggest that an appropriate legal or regulatory framework on fair contractual treatment should prohibit financers to use any unfair term or condition in their customer contracts and that, if used, such terms or conditions should be void and legally unenforceable and any ambiguity in the interpretation of a contract should be construed in favour of the customer.[271] In this regard, it has been noted that the fairness of a contract term, in particular when such term is a non-financial one, should not be assessed in isolation but in the context of the other terms of the contract.[272]

158. Fair treatment of micro and small enterprises would also require that in the process of contract formation the financer clarifies to the small business the meaning of the contractual terms, in particular the financial terms such as those concerning interest rates, in a way that they are understandable and comparable to the terms used by other financers. To facilitate comparison, States may require that the information is disclosed in a prescribed form that may include standardized methods of displaying charges. In addition, States may require that financers allow for a reflection period before the conclusion of the contract or a period for exercising a right of withdrawal after the conclusion of the contract or a combination of the two to ensure that the small business has fully understood the contract terms and assessed the consequences of their application. States might also protect small businesses by establishing legislative caps on certain rates and charges imposed in the contract: for example, Germany and Spain have established caps on default rate clauses.[273]

159. In addition to fair contract terms, financers should ensure that also their relationship with the micro and small enterprises is fair, non-abusive and non-discriminatory. Unfair practices, such as unsolicited SMS loan offers, sending credit cards without a customer's prior request, discriminating on the basis of sex, may be in place even when contract terms and conditions are fair and balanced. In certain States for example (the United Kingdom and Malaysia), regulated financial entities must demonstrate how the concept of fair treatment is embedded in all their customer-related practices.[274] The Good Practices suggest that States should set a minimum threshold to identify whether a practice is unfair or not. With regard to credit products, financers could be required to use interest rates applied over the declining balance of the loan instead of flat rates; adopt opt-in clauses for facilities that auto-deduct payments and fees; and refrain from using abusive loan collection practices.[275]

160. Defining certain fair practice standards might be influenced by domestic social and cultural norms, for example in certain countries requiring women entrepreneurs to have a spousal consent to get a loan might be considered an acceptable practice.[276] States should, however, address in the applicable legal or regulatory framework the needs and difficulties of particularly vulnerable groups such as women, youth, indigenous people and rural communities and provide appropriate safeguards for these groups. It should be noted that discrimination and unfair practices may easily

[269] Australian Security and Investment Commission (ASIC), Report 565, Unfair contract terms and small business loans, 2018, p. 8.

[270] The Good Practices for Financial Consumer Protection are a compilation of good practices drawing on successful policy, legislative and regulatory initiatives around the world that consolidate, complement, and expand international principles and guidance on that matter – such as the G20 High-Level Principles on Financial Consumer Protection. The Good Practices can also apply to micro and small businesses since those businesses usually face the same challenges as individual consumers and require the same basic protection.

[271] World Bank, Good Practices (supra footnote 264), p. 34.

[272] L. Gullifer, I. Tirado, A global tug of war (supra footnote 265), p. 14.

[273] Ibid., pp. 14–15.

[274] World Bank, Good Practices (supra footnote 264) p. 35.

[275] Ibid., p. 36.

[276] World Bank, Good Practices (supra footnote 264), p. 36.

be embedded in the algorithm supporting digital credit scoring models too, which may result in bias against certain groups of customers. States should thus ensure that their laws or regulations on fair practices are also applicable to providers of digital financial services.

161. Finally, as it has been noted, it would be important that when creating a legal or regulatory framework on fair contractual terms and other service provision practices States should achieve a balance between protecting the needs of small businesses and those of financers (see also para. 8 above). Safeguards designed to facilitate access to credit for micro and small businesses might exceed their goal of ensuring protection against abusive practices as the businesses might use them to avoid repayment, or prolong or avoid disputes, which can disincentivize financers from lending.[277] Monitoring by States would be key to outweighing these risks.

G. Restructuring support for MSMEs in financial distress

162. When facing financial difficulties, MSMEs often do not have the resources to cope with high restructuring costs (including seeking professional advice). According to some studies, the costs of financial distress represent 10 per cent to 20 per cent of the market value of the firm.[278] Many viable small enterprises are thus being forced into insolvency because adequate restructuring options are not available at an early stage of their financial difficulties. If an efficient restructuring framework has been put in place, financers might be more likely to extend credit to MSMEs because such framework could reduce the number of unnecessary liquidations of viable MSMEs, thereby maximizing value for creditors, owners and the economy as a whole. Furthermore, such framework might also contribute to the efficient management of defaulting loans and avoiding the accumulation of such loans on banks' balance sheets. The high level of non-performing loans in some parts of the banking sector limits banks' capacity to offer loans to MSMEs.

163. The Legislative Recommendations recommend that the law facilitate and provide incentives for finance to be obtained by those businesses in financial distress before commencement of insolvency proceedings for the purpose of rescuing businesses and avoiding insolvency. Such incentives should include appropriate protection for the providers of such finance (including the payment of the finance providers at least ahead of ordinary unsecured creditors) and for those parties whose rights may be affected by the provision of such finance.[279]

164. Further, the draft commentary to the Legislative Recommendations highlights three mechanisms that may be of particular assistance to ensure early rescue of micro and small enterprises. First, early warning tools may be put in place by the State or private entities to detect circumstances that may trigger insolvency and could signal to the businesses the need to act without delay. Second, educational tools should be made available to micro and small enterprises to improve their financial and business management literacy and skills (see also paras. 195–199 below). Lastly, micro and small enterprises' access to professional advice on debt restructuring options or matters relating to insolvency commencement, which may be provided by public or private organizations, should be promoted.[280]

165. In addition to early rescue mechanisms, States can use other measures to address MSMEs' financial distress and provide adequate support to limit unnecessary liquidations of viable companies, thus preserving jobs, contracts, customer goodwill, and economic stability more generally. Those measures may include laws or regulations that allow MSMEs to restructure or reschedule their debts, although their implementation might result in highly indebted MSMEs that operate only to service

[277] L. Gullifer, I. Tirado, A global tug of war (supra footnote 265), p. 1.

[278] A. Gurrea-Martinez, Implementing an Insolvency Framework for Micro and Small Firms, 2020, footnote 49.

[279] A/CN.9/1052, annex, para. 107.

[280] A/CN.9/1052, annex, para. 103 and A/CN.9/WG.V/WP.172/Add.1, paras. 368 to 372.

their debts but are unable to pay off the debt ("zombie companies"). The Legislative Recommendations recognize the importance of informal debt restructuring negotiations as a means to prevent the build-up of non-performing loans and overindebtedness of micro and small enterprises and recommend to States appropriate interventions to create an enabling environment for holding such negotiations.[281]

166. Other measures addressing MSMEs in financial distress may include direct financial help by the State, for example through funds that support business revitalization, or the establishment of ad hoc bodies for the provision of dedicated services to those businesses. For example, in Japan the SME Revitalization Support Council, which is run by the Chamber of Commerce and exists in every prefecture, acts as a support mechanism in creating plans for restructuring (including follow-up, once the plan is implemented) and as an intermediary in negotiating with lenders and financers. MSMEs in need of assistance will contact the Council and receive support from a team of professionals including lawyers and accountants.

Measures to address the effects of the COVID-19 pandemic on MSMEs

167. The implementation of measures such as debt restructuring or rescheduling, allocation of revitalization funds or similar other measures has considerably increased as a consequence of the COVID-19 pandemic in an effort to mitigate its effects on MSMEs, at least in the short term. For example, in Myanmar the State's COVID-19 Economic Relief Plan (CERP) allows banks to restructure and reschedule MSME loans that regularly pay interest and principal. In March 2020, the Indonesian Financial Services Authority (OJK) allowed the immediate restructuring of debt to MSMEs, with payment of interest or principal (or both) delayed for a maximum period of one year. In Jamaica, the government has encouraged banks to reschedule loans and mortgages.[282]

168. Further, in the United States, the American Rescue Plan established the Restaurant Revitalization Fund in order to support restaurants, bars, and other similar places of business that suffered revenue losses because of the pandemic.[283] In Nigeria, a small business support fund was announced in October 2020 to assist small business owners: 45 per cent of the fund was allocated to women-run businesses and another 5 per cent to businesses run by people with special needs.[284] In April 2020, the Plurinational State of Bolivia's Financial System Supervisory Authority (ASFI) issued the Supreme Decree 4216 which established a special support fund for MSMEs.[285] In the same period, the Reserve Bank of India announced a dedicated line of funding for several commercial entities including SMEs and MSMEs.

169. The financial sector has responded to the COVID-19 pandemic with dedicated initiatives. For example, in Singapore the Association of Banks, together with several member banks, and the Ministry of Law, launched the Sole Proprietors and Partnerships Scheme in November 2020 to help eligible businesses in financial distress restructure their unsecured business debts. Under the Scheme, businesses operating as sole proprietors or in partnerships may seek the assistance of a dedicated non-governmental organization that will help them restructure their debts owed to lenders participating in the Scheme.[286]

[281] A/CN.9/1052, annex, paras. 104 to 106 and A/CN.9/WG.V/WP.172/Add.1, paras. 373 and 374.
[282] The Economist Intelligence Unit, Global Microscope 2020, pp. 25 (Indonesia), 36 (Myanmar), and 49 (Jamaica).
[283] See https://www.sba.gov/funding-programs/loans/covid-19-relief-options/restaurant-revitalization-fund.
[284] See https://www.bloomberg.com/news/articles/2020-10-05/nigeria-starts-195-million-small-businesses-support-fund.
[285] The Economist Intelligence Unit, (supra footnote 282), p. 48.
[286] Further information available at: https://www.mlaw.gov.sg/news/press-releases/2020-11-01-sole-proprietors-and-partnerships-scheme.

H. Financial ombudsman and other redress mechanisms

170. As CGAP has noted, the power imbalance between providers and users of financial services, including MSMEs, is acute in financial transactions.[287] In an effort to provide incentives for access to credit, since the early 2000s several States have thus introduced redress mechanisms to protect clients of financial service providers. Usually, such mechanisms function on a dual level. Complaint-handling procedures implemented by the financial institutions themselves are the first type of mechanism. Depending on the country's situation, third-party dispute resolution mechanisms may also be established, which can include financial ombudsman services, expedited commercial mediation and arbitration or simplified court procedures.[288] These mechanisms are not mutually exclusive and in some countries more than one mechanism can address clients' complaints.[289] It should be noted that with the increase of digital financial services in the last decade, complaint-handling mechanisms and online dispute resolution (ODR) systems are also implemented in certain crowdfunding platforms and other fintech models though improvements are needed (see para. 190 below).

171. It seems that in most States, third-party dispute resolution mechanisms serve both individual consumers and small businesses and that there is no dedicated mechanism for small businesses only. For example, the Australian Financial Complaints Authority (AFCA)[290] assists consumers and small businesses to resolve their complaints, including on credit and loan products, with financial firms. Similarly, the Office of the Banking Services Ombudsman in Trinidad and Tobago investigates complaints from individuals and small businesses in respect of financial services provided by the banks and their subsidiaries[291] and in the United Kingdom, the Financial Ombudsman Service deals with individual consumers' and small businesses' complaints about financial products (e.g., business loans, mortgages, overdrafts) and services provided by banks and other financial institutions. In the Republic of Korea, however, the ombudsman programme for SMEs was established, among others, to handle complaints against those financial institutions designated by the government to support small businesses on the basis of various government programmes and projects.

172. Regardless of how broad their scope is, States should ensure that redress mechanisms are an integral part of their legal and regulatory framework and that they should be accessible, affordable, independent, fair, accountable, timely and efficient and not impose unreasonable cost, delays or burdens on the users.[292]

173. The Good Practices support a dual-track dispute resolution system where every financial service provider should have an internal structure and written policies regarding their complaints handling procedures and if customers are unsatisfied with the decision resulting from the internal complaints system they can have the opportunity to appeal to an out-of-court alternative dispute resolution (ADR) mechanism.[293] This would be particularly important in those cases where the domestic judicial system is too burdensome or expensive for MSMEs, or cannot operate in a timely manner.[294]

174. The internal policies and procedures should comply with minimum standards such as those requiring the provision of clear information on how customers can submit a complaint and through what channels. In this respect, adequate channels (including working hours) for submitting the complaints should be in place so that

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[287] CGAP, Financial Access 2010, p. 31.

[288] A/CN.9/780, para. 21.

[289] CGAP, Financial Access (supra footnote 287), p. 31.

[290] AFCA was established in 2018 to replace the Financial Ombudsman Service and the Credit and Investments Ombudsman. For further information, see https://www.afca.org.au.

[291] For further information, see https://www.ofso.org.tt/index.php/about-us/.

[292] OECD, G20, G20 in its High Level Principles on Financial Consumer protection (2011), p. 7.

[293] World Bank, Good Practices (supra footnote 264), pp. 49–50.

[294] Ibid., p. 51.

remotely located clients can register their complaints and specially tailored channels should be available for selected groups of clients, such as illiterate clients or clients who speak only local dialects.[295] Receipt of the complaints by the financial entities should be acknowledged in a durable medium, for example in writing or in another form that the MSME can store. Financial entities should also inform the MSME about the maximum period within which they will give a final response, which should not be longer than the maximum period applicable to a third-party external ADR mechanism, and by what means. If ADR schemes exist, throughout their complaints-handling process customers should be informed about the possibility to seek redress through such schemes.[296]

175. As noted above (para. 173), if a customer's complaint is not resolved under the internal procedures of the financial entities, the MSME should be able to access ADR mechanisms. The Good Practices note that such mechanisms could be established by industry or associations or by a government agency created by law.[297] In several countries, industry schemes are created under a general legal framework that establishes minimum standards.[298] Regardless of whether they have a statutory or industry-based nature, ADR mechanisms should follow clear minimum standards in accordance with the law or regulation and be monitored by an independent body that is accountable to the government or the regulatory authority.[299]

176. An important aspect of these mechanisms is whether they can render binding decisions as some of them may rely more on voluntary compliance although reputational risks may often pressure the financial entities to comply. For example, in Italy if a financial institution does not comply with the decisions of the *arbitro bancario finanziario* a notice of non-fulfilment is made public.[300] To ensure MSME protection, it would be important that the decisions of the ADR mechanism are binding on financial entities and that financial entities are not allowed to appeal against those decisions, as this could easily result in costly and lengthy processes in court where MSMEs will be highly disadvantaged.[301] There are, however, examples of countries where decisions can be appealed by both parties (e.g., Malta, or Armenia, although in the latter country appeals are allowed only in a few circumstances, such as if procedural rules were violated, or the prejudice of the mediator was demonstrated).[302]

177. Other key features to consider are the independence of the ADR mechanisms and the impartiality of their decision-making process which contribute to the customers' and financial entities' trust in the mechanisms. According to the Good Practices, independence can be ensured by an equal representation of the public sector, the industry and the customers in the mechanism's governing body regardless of whether the mechanism is of a statutory or industry-based nature. In addition, as noted by the International Network of Financial Services Ombudsman Schemes, that independence should be established in the law or in a constitution that is approved by a public entity. Other safeguards could be established to strengthen independence, for example, that the financial ombudsman or the members of the decision-making panels

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[295] Ibid., pp. 49–50.

[296] Ibid.

[297] It should be noted that the Good Practices do not seem to consider arbitration as one of the main methods for dispute resolution in this type of dispute. While they recognize that arbitration may be in place and used by consumers, they caution against its compulsory use, as it may limit MSMEs' redress choices. See Good Practices (supra footnote 264), p. 52.

[298] By way of example, the Good Practices cite the microfinance or industry associations' schemes such as MFIN and Sa-Dhan in India, ALAFIA in Benin, AMFIU in Uganda. See Good Practices (supra footnote 264), p. 52.

[299] World Bank, Good Practices (supra footnote 264), p. 51.

[300] A/CN.9/780, para. 22. The term "arbitro bancario finanziario" can be roughly translated as "banking financial arbitrator".

[301] World Bank, Good Practices (supra footnote 164), p. 52.

[302] Art. 17, The Republic of Armenia Law on Financial System Mediator, available at: https://www.fsm.am/media/2398/law-on-fsm.pdf.

have not worked in previous years in a financial entity covered by the ADR mechanism.[303]

178. The ADR mechanisms' independence and the impartiality of their decision-making process might be affected by their sources of funding which may include different types of contributors.[304] In certain countries, for example, the mechanisms are supported through public funds allocated either by the central government (e.g., Lithuania) or a specific authority such as a central bank or a financial regulator (e.g., in Spain and Poland). In other countries, the mechanisms are supported by the industry or the members of the ADR scheme (e.g., Armenia, Australia, Canada, Trinidad and Tobago and the United Kingdom).[305] Funds may also be provided by a combination of private and public sources. Regardless of their source, safeguards should be in place to avoid undue influence of the fund providers.

179. The funding arrangements should permit the mechanism to effectively meet its goals and exercise its functions so that MSMEs are not required to pay any fees (or they should pay only minimal fees), since this may discourage them from using the service.[306] In this respect, it could be considered whether fees could be used as a disincentive to prevent frivolous complaints. It seems, however, that granting the authority to the ADR mechanism to reject complaints that are frivolous, vexatious or misconceived may be more effective (see for instance, Australia, Armenia and Malta).

180. Finally, principles of accessibility, transparency and accountability, effectiveness and fairness should guide the activities of ADR mechanisms. For example, complaints could be filed in different ways, complainants should have access to online dispute resolution methods and communications should be made in multiple languages.[307] Further, they should regularly publish reports with information on their activities and their annual financial accounts; they should provide a clear definition of what constitutes a complaint and they should inform the complainants of their decision in writing and with reasons.

I. Digital financial services

181. As noted in paragraph 49 above, rapid advances of digital technology in the last decade have resulted in new financial services and products (e.g., mobile money, online accounts, electronic payments, insurance and credit, and newer "fintech apps") that can greatly facilitate MSMEs' access to credit. The use of digital financial services has increased during the COVID-19 pandemic with the need to access credit and other financial services more rapidly and at less cost, and with the difficulties posed by generalized lockdowns and curfews that have resulted in the closure of bank branches and, in many emerging economy countries, have halted operations of mobile money agents.

182. The delivery of these new digital services and products relies not only on banks and financial institutions, but also on new players such as: (i) financial technology (fintech) firms, which generally focus on a particular financial product or service and utilize new technologies and ways of doing business; (ii) BigTech firms, large technology companies with dominant positions in the digital services market, which now offer digital financial products and services; and (iii) mobile network operators.[308] The technological innovations not only allow those financial service providers to offer different types of credit products in a faster, more convenient, and sometimes cheaper way than the traditional methods, but also to develop new credit scoring and risk models, often based on alternative data (see para. 146), to assess

[303] Network of Financial Services Ombudsman Schemes, Effective approaches to fundamental principles, 2014, p. 2.
[304] Ibid., p. 4.
[305] World Bank, Good Practices (supra footnote 264), p. 52.
[306] Ibid.
[307] Ibid.
[308] GPFI, Promoting digital and innovative SME financing, 2020, p. 9.

MSME creditworthiness that may facilitate their access to credit. As noted by GPFI, new technologies and credit models enable better data collection and credit assessments since, among other methods, they offer more data points to evaluate credit risks, and provide online information on clients' behaviour and controls on how clients will use lending.[309] The GPFI, however, warns against possible risks related to the use of alternative data in credit assessment models which may result in potential discrimination; opaqueness and challenges in explaining how the credit risk assessment was determined; and non-compliance with certain credit laws and regulations.

183. The GPFI reports four major categories of digital lending products: (i) uncollateralized loans that are not secured by any type of capital, which tend to be short to medium term and are mainly used for working capital purposes; (ii) payment card receivables, sometimes referred to as merchant cash advances (MCAs), i.e. a form of collateralized credit that provides an upfront advance of cash to a business with variable, short-term maturity dates, and with payments typically deducted from the inflow of sales; (iii) supply chain finance, such as invoice factoring, reverse factoring, and inventory financing where the loans are secured by collateral such as accounts receivable or inventory; and (iv) trade finance, i.e. credit facilities for SMEs in order to guarantee the exchange of goods from one country to another.[310]

184. These products are delivered mainly in two ways: through online balance sheet and peer-to-peer (P2P)/marketplace platforms. In the former model, fintech companies, BigTech companies, or traditional financial institutions provide digital lending products using their own capital and hold the loans/debt instruments in their own balance sheets. Partnerships can also be established between banks and fintech companies, where the fintech company serves as the distribution channel for MSME borrowers, while the bank provides the balance sheet. In the P2P/marketplace platform model, the platform functions as an intermediary connecting MSMEs in need of capital with potential investors. The platform evaluates the credit risk of MSMEs in order to determine the appropriate interest rate to charge. Initially, borrowers and investors in the P2P/marketplace platforms were individuals (hence the definition "peer-to-peer"); however, over the years the model has evolved and investors in most platforms are now banks and other financial institutions (e.g., asset managers, pension funds). In recognition of this shift in the investor base, the term "marketplace" has been added.[311]

185. There are challenges and risks in the use of digital lending products. In particular, the following can be noted: (i) the risk of MSMEs' overindebtedness, given the ease of applying and quick approval process for obtaining digital loans, combined with limited information about the digital loans; (ii) the lack of transparency in disclosures and lack of recourse mechanisms for MSMEs; (iii) the lack of credit information-sharing; (iv) the potential bias in the data used for credit risk assessment that could lead to exclusion of specific types of MSMEs; and (v) fraud or malpractice by the platform, which might include money-laundering and terrorist financing.[312] Current legal frameworks might not be adequately equipped to deal with those risks and more generally with the modalities by which digital lending products are provided that often blur jurisdictional borders. A legal framework that is supportive of digital lending and protects MSMEs might thus require adoption or refinement of laws such as those governing e-contracts, data privacy and ownership, information disclosure, dispute resolution and insolvency.[313]

186. As noted by the IMF, an effective legal framework for digital lending and financial services should include laws that ensure the formation, validity and enforcement of contracts concluded through technological means, such as electronic

[309] Ibid., pp. 22–23.
[310] Ibid., p. 23.
[311] Ibid.
[312] Ibid.
[313] IMF Policy Paper, the Bali FinTech Agenda, 2018, p. 26.

signatures and automated processes like "smart contracts". A preliminary step would be the adoption of laws that establish the functional and legal equivalence of electronic and paper-based documents, ensure the legal validity of electronic signatures and electronic records, address issues such as authentication, time and place of dispatch and receipt of electronic messages. In this respect, UNCITRAL legislative texts on electronic data transactions, digital identity and trust services can provide solutions appropriate to different legal traditions and States at different levels of economic development.

187. Use of technology such as smart contracts or robo-advisors might require additional legal clarity. The use of smart contracts, for example, may raise the issue of their validity and enforceability since the terms of the agreement between the parties are directly written into the lines of a digital code and the execution of the contract may be irrevocable once the borrower has clicked "I agree" to website terms and conditions. As to robo-advisors, i.e. online platforms that use algorithms to automatically build and manage clients' portfolios, their use raises issues such as the criteria the robo-advisors should fulfil, whether MSMEs can receive financial advice through them, the legal obligations of the robo-advisors (e.g., whether they owe fiduciary duties to the MSMEs) or issues of liability for errors in which they may incur as well as available redress mechanisms for the MSMEs. As it has been noted, these areas are still under development, both at the national and international level.[314]

188. The use of digital financial services increases the economic value of personal and institutional data, which in turn increases the need for their protection. The IMF has emphasized the importance of a legal framework that provides clear guidance on data ownership; protects privacy as well as data confidentiality, availability and integrity, while allowing information-sharing; ensures the ethical use of data and assigns accountability to those entities controlling and processing data for data breaches. In particular, States should clarify in their laws whether ownership of derived data resides with the owner of the underlying data or the party that has created the derived data.[315] Given that digital financial services are often provided across States, international legal harmonization on issues of data ownership, usage and privacy would facilitate the adoption of such services and provide further clarity and protection for their users.[316]

189. Domestic laws should also address issues of transparency and disclosure of information to MSMEs, since in certain States digital financial service providers that are not regulated (e.g., fintech companies in several countries) may not be required to disclose specific product terms, such as the loan terms, which may be incomplete or unclear; annual percentage rate; or transaction fees, which may result in MSMEs unknowingly paying higher fees than expected. A sound legal framework should ensure that information on all those terms and conditions is disclosed clearly and in a way that is understandable to micro and small businesses that may not often have adequate financial literacy.[317] Transparency and disclosure duties should also be established in respect of issues concerning the technology used to support digital lending. Digital financial service providers should thus be required to disclose any significant change in the hardware or software components of the platform that may affect the MSME's ability to access its records, or whichever digital operations are permitted.

190. Issues of data ownership and protection, lack of transparency in contract terms, contract enforceability, among others, may result in complaints or disputes between MSMEs and digital financial service providers. However, in many countries digital financial service providers not regulated by financial sector authorities do not have to

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[314] For example, the EU Commission Staff Working Document on Liability for Emerging Digital Technologies (issued on April 25, 2018) underlines the existence of a legal and regulatory gap. For further information see https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018SC0137&from=en.

[315] IMF, The Bali FinTech Agenda (supra footnote 313), p. 26.

[316] For a more in-depth analysis of this topic, see also A/CN.9/1064/Add.2.

[317] GPFI, Promoting digital and innovative SME financing (supra footnote 308), p. 84.

comply with the same regulations as banks, and thus they may not have internal dispute resolution mechanisms.[318] Further, not all countries may have external redress mechanisms, such as Portugal where it is possible to lodge a complaint with the Central Bank against all providers of financial products or services, irrespective of the distribution channel used, or a financial ombudsman.[319] Moreover, even if a financial ombudsman exists, it might not address complaints against providers of digital financial services. For example, in 2014 the Central Bank of Ireland clarified that since P2P platforms were not regulated activities, the Financial Services Ombudsman could not investigate complaints concerning those platforms.[320] In order to provide some protection to users of digital financial services, in some countries (e.g., Kenya and Indonesia), the digital financial services industry has thus developed codes of conducts that address irresponsible providers' behaviours. Although those tools cannot replace an appropriate legal regime, they can prompt the providers to improve their consumer protection practices.[321]

191. It should be noted that in many countries settling disputes against digital financial service providers in court may not be a viable option for most MSMEs since this may be too complex and usually more expensive than the loan value and MSMEs may often lack the necessary financial means for lengthy processes as well as the skills required to deal with their difficulties. It has thus been suggested that alternative dispute resolution mechanisms, including online mechanisms, may be a more efficient and effective way to resolve such disputes.[322] In this regard, the UNCITRAL Technical Notes on Online Dispute Resolution (2017) may provide relevant guidance to States. Further, in 2022 the UNCITRAL secretariat should organize a colloquium to further explore relevant legal issues, and identify the scope and nature of possible legislative work in the area of dispute resolution in the digital economy. Among others, issues to discuss would include: technology-related dispute resolution; legal standards for online platforms for dispute resolution; impact of the use of technology in dispute resolution and the need for new standards; and means to preserve the core principles of international dispute resolution in light of technological developments.[323]

192. Finally, domestic legislation should also address the issue of insolvency of the digital financial service providers that may preclude MSME borrowers from receiving the committed loan funds. The use of non-traditional account arrangements (e.g., special deposit account arrangements where a third party merely holds and releases funds subject to certain conditions) may pose additional challenges due to legal uncertainty as to the treatment of balances held under such arrangements, particularly under insolvency law.[324] In the case of P2P platforms, MSMEs might lose their repayments of the digital loan as they may fail to reach the financers that provided it through the platform. In several countries, regulatory safeguards are in place to mitigate the risks of the providers' insolvency. For instance, providers are often requested to segregate customers' funds from their funds so as to ensure that their creditors cannot seize customers' money (e.g., China has recently adopted reforms on this issue). In some countries (e.g., India and Indonesia) the financial authorities request the financial digital service providers to operate escrow accounts

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[318] ASBFEO, https://www.asbfeo.gov.au/sites/default/files/documents/ASBFEO-fintech-borrowing-guide.pdf.

[319] OECD, Effective Approaches for Financial Consumer Protection in the Digital Age: FCP Principles 1, 2, 3, 4, 6 and 9, 2019, p. 46.

[320] World Bank, Consumer Risks in Fintech, 2021, p. 78. As noted at page 13, the publication focuses on retail consumers a category that also includes micro, small, or medium-sized enterprises.

[321] Ibid., p. 68.

[322] S.W. Gumbira, D. Puspitawati, K. Tejomurti, Unefficiency Settlement Of Fintech Lending Disputes And How Legal Framework To Settle It: Indonesia Perspective, in Journal of Contemporary Issues in Business and Government vol. 27, No. 2, 2021, available at https://cibg.org.au/article_10434_f4063b7afe88371d27bbb968ca21e39d.pdf.

[323] Draft Report of UNCITRAL 54th session (CRP.1/Add.22 limited circulation).

[324] IMF, The Bali FinTech Agenda (supra footnote 313), p. 26.

for this purpose. In the United Kingdom, providers are required to deposit customers' funds at a bank, keep all necessary documents and adopt all necessary measures in order to be able to distinguish the funds of various customers.[325]

III. Capacity-building for MSMEs and financers

193. Once access to credit for MSME reform has been initiated, an important aspect of the process is improving financial literacy of MSMEs so as to help them understand the various types of financial products available, approach the relevant institutions, make informed and effective decisions with their financial resources and prepare a good loan proposal. Financial education may also need to be provided for MSMEs to fully understand the advantages and the consequences of granting a security interest over their assets.

194. Another important aspect of the process is developing the capacity of financers so that they become attuned to the financial needs of MSMEs. They need to know which types of financial products to offer and how to address the difficulties that MSMEs face in approaching financers, preparing necessary documentation, and meeting relevant criteria. They also need to know how to enter into transactions made profitable by legal reforms (such as secured transaction law reform). This applies particularly to financers catering to women entrepreneurs, many of whom have limited access to information and financial literacy at the outset of entrepreneurial activity.

1. Capacity-building initiatives for MSMEs

195. As reported by OECD,[326] in several States national strategies for financial education have been implemented with the expectation that they will encourage entrepreneurship and reduce the demand-side barriers to finance for all sizes of enterprises. Those strategies can be either directed at MSMEs only or at businesses and citizenry as well, with MSMEs being one of the beneficiaries. In certain countries, financial education for MSMEs is also used to increase formal sector employment.[327] In countries with comprehensive financial education programmes, microenterprises are usually the most targeted segment of MSMEs.[328] Certain countries pursue MSME financial education through national strategies with a broader scope, such as promoting financial inclusion, which also includes elements of financial education.[329]

196. The national strategies usually cover general elements of financial literacy as well as topics relevant to building the MSME capacity to interact with financers such as knowing who to approach for assistance on financial matters; recognizing the interplay of personal and business finances; awareness of financing opportunities, financial risks and managing them effectively; knowing how to interact with investors and lenders; and how to meet loan requirements.

197. In addition to the national strategies, other initiatives coordinated by industry organizations and trade unions, the financial sector and NGOs are often implemented at the local and national level.[330] For example, the London Stock Exchange Group has launched the ELITE programme to help SMEs deal with the next stage of growth through access to long-term financing opportunities. In particular, ELITE provides training and tutorship to MSME managers so that they can improve their skills and

[325] World Bank, Consumer Risks (supra footnote 320), p. 25.

[326] The OECD International Network on Financial Education (INFE) created a dedicated working group dealing with MSME financial education. At the end of 2015, OECD/INFE carried out a survey among its members to gather information on efforts at country level on MSMEs' financial education. The results of that survey are summarized in: A. Atkins (OECD), Financial Education for MSMEs and Potential Entrepreneurs, 2017.

[327] Ibid., p. 33.

[328] Ibid.

[329] Ibid.

[330] Ibid., pp. 34–35.

networking capacity in order to facilitate a future possible listing in the public equity market. Finally, several tools and programmes developed by international organizations to support entrepreneurship include elements of financial literacy.[331]

198. Financial education is provided through different channels, such as schools or universities, coaching for start-ups, seminars or advice programmes depending on the nature of the providing entity, whether the State, NGOs, and/or the industry sector. The programmes can be fee-based or without fees and in certain cases they are designed for the different types of MSMEs. Depending on the nature and scope of the programme, different delivery methods are used ranging from leaflets to online courses, or other forms of digital delivery, including social media or mobile applications. More traditional media (e.g., TV, radio and magazines) are also employed, which may facilitate reaching larger audiences compared to using social media that may require more advanced technological skills.

199. In order to facilitate MSME financial capacity-building at the national level, in 2018 OECD designed a framework[332] addressing policymakers, business associations, chambers of commerce, NGOs and other similar entities engaged in supporting entrepreneurship to assist them in developing or improving strategies for MSME financial education and for assessing MSMEs' financial literacy. The framework addresses different aspects of financial literacy, such as how to finance the business, the required competencies and how entrepreneurs should manage the main stages of the business life cycle, including any transition from the informal to the formal economy.

2. Capacity-building initiatives for financers

200. As noted above (para. 194), improving the capacity of financers to understand and respond to MSMEs' financial needs is also important. The Alliance for Financial Inclusion (AFI), for example, recommends financers develop ad hoc internal programmes, such as workshops or on-the-job training, to build staff knowledge of and skills in providing improved services to MSMEs. Financers should also be equipped for creating a more conducive environment for MSME's access to credit, for example having a dedicated manager responsible for MSMEs, designing products and services for different types of MSMEs and organizing workshops or seminar to help MSMEs improve their financial literacy.[333] Other international organizations work to improve financers' capacity to serve MSMEs and facilitate their access to credit: for example the European Bank for Reconstruction and Development (EBRD) has supported bank capacity-building in certain countries and the IFC has set up global advisory programmes for financial institutions with the same purpose.

201. Some emerging economies have also launched programmes to provide financers with appropriate tools and knowledge to serve MSMEs. For example, the Reserve Bank of India has launched a National Mission for Capacity Building of Bankers for Financing MSME sector which involves training initiatives, including training of trainers, for those in charge of MSME divisions and specialized branches for MSMEs in commercial banks.[334] In Zambia, one of the objectives of the National Financial Inclusion Strategy 2017–2022 is to build the capacity of financers to lend to MSMEs, in particular farmers.[335] Financial institutions are also encouraged to improve their knowledge of MSMEs and their needs in order to offer them dedicated products and services.[336] In the Lao People's Democratic Republic, the government, with the support of the World Bank, has established a programme to support small and

[331] OECD/INFE, Progress report on financial education for MSMEs and potential entrepreneurs, p. 17.
[332] OECD/INFE, Core Competencies Framework on Financial Literacy for MSMEs, 2018.
[333] AFI, Financial Education for the MSMEs: Identifying MSME Educational Needs, 2020, p. 7.
[334] See https://www.bis.org/review/r170629g.htm.
[335] See https://www.boz.zm/National-Financial-Inclusion-Strategy-2017-2022.pdf.
[336] AFI, Financial Education (supra footnote 365), p. 12.

medium-sized enterprises' access to finance that also aims at strengthening the capacity of banks and other financial intermediaries to better serve those businesses.