United Nations A/CN.9/WG.I/WP.119

General Assembly

Distr.: Limited
17 January 2020

Original: English

United Nations Commission on International Trade Law
Working Group I (MSMEs)
Thirty-fourth session
New York, 23-27 March 2020

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

Note by the Secretariat

Contents

Page

I. Introduction 3
II. Annotated list of contents 3
A. Access to credit for MSMEs: sources and challenges 3
1. MSMEs and the importance of access to credit 3
2. Sources of finances and related challenges 4
(a) Equity finance 4
(b) Traditional lending 4
(c) Microfinance credit and family/friend support for microbusinesses 5
(d) Crowdfunding 5
(e) Asset-based finance, alternative debt and hybrid instruments 5
(f) Supply chain financing 6
B. Improving access to credit for MSMEs 6
1. Policy initiatives for improving access to credit for MSMEs 6
2. Improving access to credit through secured lending 7
(a) Movable assets as collateral 7
(b) Immovable assets as collateral 8
3. Improving access to credit through issuance of guarantees 9
(a) Credit guarantee schemes 9
(b) Personal guarantees 9
4. Improving access to credit through enhanced infrastructure 10
(a) Credit reporting 10
(b) Financial ombudsman 11

(c) Digital financial services 11

(d) Restructuring support 12

(e) Safeguards for MSMEs. 12

5. Improving access to credit through capacity building 13

(a) Capacity building for MSMEs 13

(b) Capacity building for financers 13

I. Introduction

1. At its forty-sixth session in 2013, the Commission mandated Working Group I to work on reducing the legal obstacles faced by micro, small and medium-sized enterprises (MSMEs) throughout their life cycle, in particular in developing economies.[1] In order to strengthen and complete that work, at its fifty-second session, in 2019, the Commission requested the Secretariat to start preparing draft materials on access to credit for MSMEs, drawing, as appropriate, on the relevant recommendations and guidance contained in the UNCITRAL Model Law on Secured Transactions (the "Model Law"), with a view to their consideration by the Working Group.[2]

2. This note discusses possible topics to address in a future instrument on access to credit for MSMEs (the "Future Instrument") for consideration by the Working Group. It begins with the background and current status of access to credit for MSMEs, and then lists possible means to improve access to credit for MSMEs, including through secured lending, issuance of guarantees, enhanced infrastructure for MSME financing and capacity building.

II. Annotated list of contents

A. Access to credit for MSMEs: sources and challenges

3. This chapter of the Future Instrument will explain why access to credit is key for MSMEs, and discuss different sources of financing for MSMEs and related challenges.

1. MSMEs and the importance of access to credit

4. As noted in documents A/CN.9/941 and A/CN.9/WG.I/WP.81, MSMEs are seen as the backbone of many economies across regions. Most MSMEs share some common features, for example, there is little distinction between the business and the individual who owns and runs the business, or between the business assets and the household assets that are provided as security. Information about the legal or financial status of the business and the name and address of the individual who operates the business is unlikely to be publicly available. Accounting records may be missing, and income and expenditures of the business may have been mixed up with those of individuals.

5. As with any type of business, financing is important at all stages of MSMEs' business life cycle. Compared with bigger enterprises, MSMEs may experience a greater need of external financing not only to start but also to grow the business. Yet, MSMEs often encounter significant obstacles to obtain credit in the amounts or frequency they may need, or in conditions affordable to them.

6. This section of the Future Instrument will thus analyze the features of MSMEs, provide some figures on the current financing gap of MSMEs[3] and discuss the importance of improving access to credit to those businesses. It will also highlight how a strong MSME sector can support the creation of jobs and provide an important contribution to the achievement of the Sustainable Development Goals (SDGs).[4]

---

[1] *Official Records of the General Assembly, Sixty-eighth Session, Supplement No. 17* (A/68/17), para. 321.

[2] *Official Records of the General Assembly, Seventy-fourth Session, Supplement No. 17* (A/74/17), para. 192(a).

[3] The International Finance Corporation (IFC) estimates that 65 million firms, or 40% of formal small and medium-sized enterprises (SMEs) in developing countries, have an unmet financing need of $5.2 trillion every year. East Asia and the Pacific accounts for the largest share (46%) of the total global finance gap and is followed by Latin America and the Caribbean (23%). The financing gap is even larger when micro and informal enterprises are taken into account. See World Bank website, topic "Small and Medium Enterprises (SMES) Finance – Improving SME's access to finance and finding innovative solutions to unlock sources of capital".

[4] MSMEs have been said to be the best lever to support the creation of 600 million jobs (mainly for youth) by

2. Sources of financing and related challenges

7. This section of the Future Instrument will discuss different sources of financing for MSMEs (e.g., equity finance, traditional lending, microfinance credit and family/friends support, crowdfunding, asset-based finance, alternative debt and hybrid instruments, as well as supply chain finance) and challenges faced by MSMEs with each of them.

(a) Equity finance

8. Equity finance refers to all financial resources that are provided to MSMEs in return for an ownership interest. The main categories of equity finance are public equity (i.e., specialized platforms for public listing) and private equity (i.e., capital provided to unlisted MSMEs). Due to the fixed costs of due diligence and securities registration, the process of raising capital through initial public offering of stock is more expensive for MSMEs than for large firms.[5] MSMEs often face a problem of underpricing in capital markets, and are also reluctant to approach capital markets due to the loss of control implied by the wider equity ownership.

9. There also exist informal sources of equity financing, which come from family and friends. For start-up MSMEs, the amount of funds raised through informal sources generally exceeds other private equity sources (e.g., angel investment[6] and venture capital). However, such informal sources are rarely a guaranteed source.

10. This sub-section of the Future Instrument will thus further elaborate on the forms of equity finance available to MSMEs and challenges faced by them.

(b) Traditional lending

11. In order to obtain financing, MSMEs can resort to banks or other financial institutions. However, traditional loans (also known as “straight debt”) from banks and other financial institutions present a number of challenges, such as:

- Lack of collateral or guarantee as required by the institutions;
- High interest rates and short repayment periods;
- Limited documentation on activities of MSMEs; and
- Informal nature of MSMEs, including the lack of expertise and skills needed to produce adequate/appropriate financial statements.

12. Due to high transactional costs compared to small loan amounts, banks and financial institutions may be hesitant to provide financing to MSMEs. Women entrepreneurs may face more difficulties in accessing credit in the form of straight debt due to legal, institutional and socio-cultural factors. Internationally collected data reveal that women are less likely than men to have formal bank accounts. Restrictions on opening or using a bank account, for example the requirement for a male family member’s permission or authorization, limit women’s access to bank accounts. Moreover, partly due to lack of financial education, women often lack access to other financial services, such as savings, digital payment methods, and insurance.[7] Because of such constraints the finance gap for women entrepreneurs in emerging markets is estimated in $1.5 trillion.[8]

2030 and they can provide an important contribution to the achievement of the Sustainable Development Goals (SDGs), in particular SDGs 1, 5, 8, 9, 11 and 12. See A/CN.9/991, para 7.

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

[6] Angel investors tend to be wealthy individuals or groups who provide financing, typically their own funds, in exchange for convertible debt or ownership equity.

[7] See World Bank website, topic “Expanding Women’s Access to Financial Services”.

[8] IFC & Goldman Sachs: 10,000 Women: Investing in Women’s Business Growth, Progress Report 2019, p. 4.

13. This sub-section of the Future Instrument will thus further elaborate on traditional lending provided to MSMEs and challenges faced by them.

(c) Microfinance credit and family/friend support for micro-businesses

14. Micro-businesses often rely on microfinance institutions and/or family and friends. Although microfinance institutions are designed for small loans to very small borrowers, issues such as high interest rates, group guarantee (e.g., the formation of groups whose members jointly guarantee each other's loan) and risk of abusive collection practice may arise. The financial needs of micro-businesses and personal needs of owners of such businesses should be differentiated.

15. Borrowing money from family and friends can be a delicate situation for micro-businesses, since quite often the terms of the loan are verbalized and not written down. Oral agreements often lack clarity on the terms and conditions of the loan, repayment schedules and remedies for defaults.

16. This sub-section of the Future Instrument will thus further elaborate on the utilization of microfinance credit and family/friend support for MSMEs and challenges faced by them.

(d) Crowdfunding

17. Crowdfunding (i.e., a technique to raise 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) has gained popularity among MSMEs in some jurisdictions. The types of funding may range from donations and lending to equity. Over time, crowd-lending has become increasingly managed by online peer-to-peer lending platforms (further discussed in para. 55 below). By design and due to regulatory limitations, crowdfunding is suitable for start-ups which require relatively small amounts of funding. It may be less suitable for MSMEs that are based on complex innovations in very high-tech and cutting-edge areas, which require specific knowledge on the side of investors.[9]

18. This sub-section of the Future Instrument will thus further elaborate on the utilization of crowdfunding by MSMEs and challenges faced by them.

(e) Asset-based finance, alternative debt and hybrid instruments

19. In recent years, an increasing range of financing options has become available to MSMEs, although some of these are still at an early stage of development or, in their current form, only accessible to a small share of small and medium-sized enterprises (SMEs). These financing options include asset-based finance[10] (e.g., warehouse receipts, factoring and leasing), alternative debt (e.g., corporate bonds, securitized debt, and private placements) and hybrid instruments (e.g., subordinated loans/bonds and convertible bonds).[11] In practice, the limited use of such financing options by SMEs is due to a combination of both demand-side barriers (e.g., many SMEs lack financial knowledge, strategic vision, resources and sometimes even the willingness or awareness to successfully obtain finance other than straight debt) and supply-side barriers (e.g., potential financers are held back by the overall opacity of SME finance markets and regulatory impediments).[12]

[9] The term "investors" refers to persons or entities who commit capital with the expectation of receiving financial returns.

[10] The term "asset-based finance" refers to non-traditional forms of secured transaction and transaction using certain types of assets previously not used.

[11] OECD SME Ministerial Conference Discussion Paper on "Enhancing SME access to diversified financing instruments" (February 2018), pp. 10-11.

[12] Ibid., p. 14.

20. This sub-section of the Future Instrument will thus further elaborate on the utilization of asset-based finance, alternative debt and hybrid instruments by MSMEs and challenges faced by them.

(f) Supply chain financing

21. Supply chain finance refers to the techniques and practices used by banks and other financial institutions to manage the capital invested into the supply chain and reduce risk for the parties involved. It is typically applied to open account trade where the goods are shipped and delivered before payment is due.[13]

22. In the agriculture industry, contract farming is a mechanism that coordinates agricultural production and trade and functions as a credit vehicle as it promotes supply chain financing by facilitating the provision of credit to producers and to contractors. It is worth noting that the UNIDROIT/FAO/IFAD Legal Guide on Contract Farming provides guidance on this topic.[14] At present, such financing mechanism does not apply to all industries.

23. This sub-section of the Future Instrument will thus further elaborate on the utilization of supply chain financing by MSMEs and challenges faced by them. The UNIDROIT/FAO/IFAD Legal Guide on Contract Farming will be taken into account.

B. Improving access to credit for MSMEs

24. This chapter of the Future Instrument will present, by way of background, a summary of policy initiatives at national, regional and international levels for improving access to credit for MSMEs. While acknowledging the importance of regulatory, institutional and practical measures, this chapter will mainly focus on legal measures to improve access to credit for MSMEs in the context of secured lending, issuance of guarantees, enhanced infrastructure for MSME financing and capacity building programmes. To the extent that regulatory, institutional and practical measures play an indispensable role for the sake of completeness of the discussion, this chapter will discuss these measures on the basis of international experience.

1. Policy initiatives for improving access to credit for MSMEs

25. At the global level, several policy initiatives have been implemented to promote financial inclusion and access to credit for MSMEs. In 2018 and 2019 reports, G20 and UNSGSA highlighted their work on the promotion of the use of digital financial services.[15][16] According to a report prepared in 2017, the IFC provided investments and advisory services to financial intermediaries catering to small businesses, strengthened financial markets by supporting collateral registries and credit bureaus, invested and worked with the multiple Fintech companies, and promoted knowledge-sharing.[17] At the regional level, in Asia and the Pacific, UNESCAP highlighted in its

[13] International Chamber of Commerce Academy on "Supply Chain Finance: An Introductory Guide".

[14] UNIDROIT, FAO and IFAD, UNIDROIT/FAO/IFAD Legal Guide on Contract Farming (2015), introduction, paras. 2 and 26.

[15] The United Nations Secretary General's Special Advocate for Inclusive Finance for Development (UNSGSA) promoted the use of digital financial services and the inclusive economic growth of women and looked into several innovative regulatory initiatives such as innovation offices, regulatory sandboxes and RegTech for regulators. See UNSGSA FinTech Working Group and CCAF (2019) "Early Lessons on Regulatory Innovations to Enable Inclusive FinTech: Innovation Offices, Regulatory Sandboxes, and RegTech".

[16] G20 promoted digital financial inclusion for individuals and MSMEs in the informal economy and set out four key policies concerning digitalization (digital on-boarding, digital payments infrastructure, use of alternative data for credit reporting, as well as financial consumer protection, financial literary and data protection). See G20 Policy Guide on "Digitization and informality: harnessing digital financial inclusion for individuals and MSMEs in the informal economy" (2018).

[17] IFC Report on "MSME FINANCE GAP: Assessment of the Shortfalls and Opportunities in Financing Micro, Small and Medium Enterprises in Emerging Markets" (2017).

2017 report the importance of policy support related to financial infrastructure—such as credit bureaus, collateral registries, and credit guarantees for bank loans to SME finance.[18] In the Middle East and Central Asia, the IMF emphasized in its 2019 report the need for specific policy and regulatory frameworks to encourage the development of SME financing through greater reliance on capital markets and new technologies.[19]

26. This section of the Future Instrument will thus further elaborate on the policy initiatives for improving access to credit for MSMEs at international and regional organizations, and will also discuss, as appropriate, policy developments at the national level, for example, India, Saudi Arabia, China and Bangladesh have implemented MSME friendly policies.

2. Improving access to credit through secured lending

27. This section of the Future Instrument will discuss secured transactions using both movable assets and immovable assets as collateral, and how they could improve access to credit for MSMEs.

(a) Movable assets as collateral

(i) Types of assets

28. For many MSMEs, movable assets are the main types of asset that they can offer as collateral. Therefore, there should be a legal framework in place to make it possible and easy to use movable assets as collateral, which could reduce the cost of credit and make it possible for MSMEs to obtain credit for longer periods. Readily available credit at a reasonable cost helps MSMEs grow and prosper.

29. The legislation governing secured transactions should be simple. It should be possible for an MSME to grant a security right in almost any type of movable asset, including inventory, equipment, receivables, bank accounts and intellectual property; an asset that it may acquire in the future; and all of its movable assets, both present and future. The Model Law provides a good basis. It sets out a legislative framework for secured transactions involving all types of movable assets to facilitate their use as collateral.[20]

30. This sub-section of the Future Instrument will thus further elaborate on the types of movable assets that can be used as collateral, drawing on relevant provisions of the Model Law and guidance provided in the accompanying texts.

(ii) Security rights registries

31. Information about the existence of a security right should be publicized. In many jurisdictions, this is done through establishing a general security rights registry where notices of security right could be registered. The registration process, which is usually conducted by the secured creditor, should be cheap as any related costs could have a negative impact on the cost of financing. Under the Model Law, registration in a centralized registry (which is fully electronic and accessible online) allows the secured creditor to establish the priority of its security right over rights of competing claimants. This mechanism provides creditors with certainty about their rights in such transactions, which allows them to be more willing to lend to MSMEs.

32. This sub-section of the Future Instrument will thus discuss various features of a security rights registry that facilitate MSMEs' use of such registry, drawing on relevant provisions of the Model Law and guidance provided in the accompanying texts.

---

[18] United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) Report on "Small and Medium Enterprises Financing" (2017).

[19] IMF Report on "Financial Inclusion of Small and Medium-Sized Enterprises in the Middle East and Central Asia" (2019).

[20] General Assembly resolution 71/136 endorsing the Model Law on Secured Transactions.

(iii) Issues specific to micro-businesses

33. 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 the obstacles MSMEs may face in obtaining access to credit, in particular those obstacles faced by micro-businesses, for instance:

- Micro-businesses have insufficient or inappropriate assets to offer as security. In certain jurisdictions, this is an issue particularly for women entrepreneurs as any asset/property is often owned or registered in the spouse's name;

- Lending based on movable assets require their valuation. This raises an issue as certain valuation methods may be too costly relative to the value of the loan. It may also be difficult to determine the value of the asset particularly if it is a type that is not regularly traded in the given market;

- Financers may not be equipped with inexpensive and effective tools for risk assessment and as noted above, micro-businesses may lack credit history and transaction records. This may lead financers to require collateral, the value of which significantly exceeds the amount of the loan (often referred to as "over-collateralization"). Over-collateralization may prevent businesses from obtaining credit from another financing using their assets; and

- The enforcement remedies in most jurisdictions may be too complicated and costly for enforcing security rights securing very small loans. Relevant legislation may not impose any limit on what can be seized by the secured creditor for enforcement. Essential personal assets would need to be protected and excluded from the scope of enforcement.

34. This sub-section of the Future Instrument will thus further elaborate on the issues relevant for micro-businesses to use moveable assets as collateral.

(b) Immovable assets as collateral

(i) Legalization of property rights over immovable assets

35. Secured credit allows MSMEs to use the value inherent in their assets as a means of reducing the creditor's risk that it will not be paid, thus resulting in prospective creditors to be more willing to extend credit to MSMEs.[21] However, in order to be used effectively, assets need to be formally recognized by a legal property rights system. Once fully recognized, the possibility is opened for MSMEs to use assets as collateral for obtaining credit.[22] There is growing evidence that expanding the types of assets that can be used legally as collateral reduces the cost of credit.[23]

36. However, in several economies micro and small businesses lack formal recognition of their property rights over their immovable assets. This is particularly relevant in the context of micro-businesses in the agriculture sector, that often cultivate and use land for which they have no formal ownership title. As a result, they cannot offer the land as a collateral to obtain credit.

37. This sub-section of the Future Instrument will thus discuss issues concerning legalization of property rights over immovable assets (such as reforms in relation to land titling), and selected examples of reforms.

(ii) Land registries

[21] UNCITRAL Legislative Guide on Secured Transactions (2007), introduction, para. 5.

[22] According to Hernando de Soto, property rights are key to facilitate access to credit as assets may be collateralized. See *The Other Path: The Invisible Revolution in the Third World* (1989), p. 244.

[23] UNDP Commission on Legal Empowerment of the Poor report on "Making the Law Work for Everyone" (2008), p. 67.

38. Land registration systems operate throughout the world as the legal basis for recording with certainty ownership and other legal rights in land. In some jurisdictions, the ownership of only a small percentage of land is registered, with a significant portion of properties in the countryside as well as urban centers being unregistered. The limited access to registered land remains one of the largest impediments to economic growth. The collateral value of unregistered land worldwide is often underestimated.

39. It is worth noting that 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.[24]

40. This sub-section of the Future Instrument will thus discuss issues concerning the establishment and operation of land registries, drawing from good practices identified in the World Bank's Doing Business tools.

3. Improving access to credit through issuance of guarantees

41. This section of the Future Instrument will discuss issuances of guarantees under public and private credit guarantee schemes as well as personal guarantees, and how they could improve access to credit for MSMEs.

(a) Credit guarantee schemes

42. Governments have been a key force behind the propagation of public credit guarantee schemes in promoting the use of guarantees as a way of channeling credit toward specific sectors, geographic regions, and firms, typically MSMEs, that tend to be financially constrained. Most middle-income countries have specialized funds or agencies that offer credit guarantee schemes primarily to MSMEs, and some target women entrepreneurs.[25] Such schemes support the creditworthiness of MSMEs and help them gain access to affordable credit. Similar guarantee schemes that are funded and operated by the private sector also play an important role.

43. The design of credit guarantee schemes has an impact on the incentives financers and MSMEs have in participating in the scheme, as well as on the financial sustainability of such schemes. An improperly designed credit guarantee scheme can increase moral hazard among MSMEs by reducing the default risk they otherwise would incur, and, therefore, it is important that the risk is shared amongst the financers, MSMEs and guarantors.[26]

44. This sub-section of the Future Instrument will thus further elaborate on the features of credit guarantee schemes, and explore issues concerning the design of a legal framework within which both public and private credit guarantee schemes can operate, taking into account principles of transparency and fairness. The World Bank's "Principles for Public Credit Guarantee Schemes for SMEs" will be taken into account.[27]

(b) Personal guarantees

45. Financers often require personal guarantees in addition to collateral, as they enlarge the pool of assets available for repayment and reduce the risk in lending. However, such guarantees are provided by owners, directors, shareholders (if any) of MSMEs, or their relatives and friends. In the event of default, guarantors will need to

[24] See World Bank Doing Business website on the topic of "Registering Property".
[25] One example is the EU COSME Programme for the Competitiveness of SMEs under which the European Investment Fund offers loan guarantee facility to financial intermediaries that provide credit to SMEs. See EIF document on COSME financial instruments.
[26] See OECD Discussion Paper on Credit Guarantee Schemes (2010), pp. 12-13.
[27] See World Bank's Principles for Public Credit Guarantee Schemes for SMEs (2016).

pay the debt and will likely have the right of subrogation (i.e. subrogated to the secured creditor's rights in relation to the collateral, including the right to enforce).

46. Personal guarantees demanded by financers raise an issue on the limited liability nature of MSMEs. The provision of personal guarantees effectively means that the MSME no longer has limited liability, and default often causes dramatic financial problems in the households of the individuals involved. Rules may be put in place by regulators to coordinate the resultant insolvency proceedings of the guarantor and the MSME.[28] A number of issues from the perspective of family law and property law also merit consideration, such as legal requirements for spouses' consent to certain guarantees or to the encumbrance of certain assets, and legal limitations on the attachment of certain family assets.

47. This sub-section of the Future Instrument will thus further elaborate on the issue of personal guarantee in the context of MSME finance.

4. Improving access to credit through enhanced infrastructure

48. This section of the Future Instrument will discuss enhanced credit reporting system, redress mechanisms, access to digital financial services, restructuring support and safeguard measures for MSMEs, and how they could improve access to credit for MSMEs.

(a) Credit reporting

49. Access to credit for MSMEs is generally hindered by the lack of sufficient information or information asymmetry regarding the ability of MSMEs to repay debts, and the lack of a supporting financial infrastructure to make such information available. The collection and distribution of financial information on potential borrowers are often known as "credit reporting". This service allows financers to learn more about borrowers' characteristics, past behavior, repayment history and current debt exposure. Credit reporting facilitates access to credit as it could reduce the cost of financers to conduct due diligence.

50. Credit bureau and credit registry are the two main types of credit reporting service providers. Credit bureaus are often privately owned and privately-operated companies which tend to cater to the information requirements of financers. Credit registries tend to be public entities whose data are geared towards use by policymakers, regulators, and other public authorities. A sound legal and regulatory framework should at least specify the obligations for each participant, for example, (i) data providers should report accurate, timely and sufficient data to credit bureaus and credit registries, (ii) public record agencies should facilitate access to their databases, and (iii) credit bureaus and credit registries should ensure that data processing is secure and that all users should be able to access their services under equitable conditions.[29]

51. This sub-section of the Future Instrument will thus discuss legal issues concerning the functioning of credit bureaus/credit registries,[30] which may include

[28] On the abuse of personal guarantees for corporate business and how insolvency law may solve the problem (e.g., granting guarantor partial relief of the guarantee through an amicable procedure), see D. Hahn, "Velvet Bankruptcy", in Theoretical Inquiries in Law, 2006, vol. 7.

[29] World Bank General Principles for Credit Reporting (2011), pp. 41-43.

[30] Many countries have established credit bureaus/credit registries, and some have also introduced regulations governing the licensing and functioning of credit bureaus/credit registries. Examples include Angola (2012), Antigua and Barbuda (2019), Armenia (2010), Azerbaijan (2018), Bahamas (2019), Benin (2018), Bhutan (2014), Burkina Faso (2017), Cambodia (2012), Cameroon (2015), Côte d'Ivoire (2015), Dominican Republic (2015), Grenada (2019), Guinea-Bissau (2018), Guyana (2011), Hungary (2013), Indonesia (2014), Ireland (2015), Israel (2018), Jamaica (2014), Kenya (2010), Latvia (2016), Madagascar (2019), Mali (2016), Moldova (2009), Mongolia (2013), Mozambique (2017), Myanmar (2018), Niger (2016), Nigeria (2010), Philippines (2010), Seychelles (2013), Sierra Leone (2012), Tanzania (2014), United Arab Emirates (2011), Vietnam (2014) and Togo (2017). See World Bank Doing Business website on the topic of "Business

imposing responsibility for data accuracy, collection and disclosure, MSMEs having access to their information and being able to have erroneous information corrected, compliance monitoring and enforcement. The World Bank's "General Principles for Credit Reporting (2011)" and the International Committee on Credit Report on "Facilitating SME Financing through Improved Credit Reporting" will be taken into account.[31]

(b) Financial ombudsman

52. In an effort to provide incentives for the development of entrepreneurship, financial ombudsman initiatives have been implemented in several jurisdictions, however, the role of financial ombudsman in such initiatives differs.[32] For instance, the financial ombudsman service in the United Kingdom was established with the aim to resolve disputes between consumers and businesses that provide financial services quickly and with minimum formality. In the Republic of Korea, the ombudsman program for SME was established to improve existing regulations that affect the management of small and medium enterprises and to address the difficulties faced by them.

53. This sub-section of the Future Instrument will thus discuss issues concerning the set-up of a financial ombudsman scheme, or similar services, and how such a scheme could improve access to credit for MSMEs.

(c) Digital financial services

54. Digital financial services (e.g., mobile money, online accounts, electronic payments, insurance and credit, and newer fintech apps) can help MSMEs build payment histories and credit scores, resulting in greater access to credit.[33] Through building credit history, digital financial services may also help break down one of the remaining impediments to full financial inclusion, which is the informal nature of many MSMEs worldwide.[34]

55. "Fintech" encompasses a range of activities that use information and communications technologies to support financial transactions. Fintech credit refers to credit activity facilitated by electronic platforms. Peer-to-peer lending platforms that are set up and run by fintech companies are one example.[35] These fintech companies assess and grade each loan request made by MSMEs and then assign an interest rate. Loan requests are posted on the platform. Individuals who wish to lend can review the various loan requests, select one and provide funds through the platform. Peer-to-peer lending platforms allow MSMEs gain access to credit at a lower cost. Similar platforms (e.g., crowdfunding as explained in para. 17 above) have also been developed for individuals who wish to invest in MSMEs and become shareholders.

56. This sub-section of the Future Instrument will thus discuss legal issues related to MSMEs' use of fintech in broadening their access to credit. It would focus on exploring those issues that need to be addressed in order to create an enabling legal

Reforms in Getting Credit".

[31] See World Bank General Principles for Credit Reporting (2011) and International Committee on Credit Report on "Facilitating SME Financing through Improved Credit Reporting" (2014).

[32] For example, in the United Kingdom a financial ombudsman scheme was set up by the Financial Services and Markets Act 2000. In the Republic of Korea, an ombudsman program for SME has been in place since 2009. The European Bank for Reconstruction and Development assists countries with the establishment of Business Ombudsman Institutions.

[33] UNSGSA, United Nations Capital Development Fund (UNCDF), The World Bank and Better than Cash Alliance Report on "Igniting SDG Progress through Digital Financial Inclusion".

[34] UNSGSA Annual Report to the Secretary-General on "Financial Inclusion: Building on 10 years of progress", September 2019, p. 17.

[35] For a detailed description of peer-to-peer lending platforms, see Committee on the Global Financial System and Financial Stability Board Working Group Report on "FinTech credit – Market structure, business models and financial stability implications", pp. 11-13.

environment for fintech credit, which would accommodate technological change and support trust and reliability in financial products and services.[36]

(d) Restructuring support

57. MSMEs, especially when facing financial difficulties, often do not have the resources to cope with high restructuring costs (including seeking professional advice). Many viable enterprises are 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 unsecured 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 these banks' capacity to offer loans to MSMEs.

58. It should be noted that Working Group V is currently mandated to develop appropriate mechanisms and solutions, focusing on both natural and legal persons engaged in commercial activity, to resolve the insolvency of MSMEs.[37] At its fifty-fourth session, in December 2018, Working V decided to focus on the needs of micro and small entities (excluding medium-sized entities). More recently at its fifty-sixth session, in December 2019, Working Group V considered a draft paper on a simplified insolvency regime (A/CN.9/WG.V/WP.168), approved draft recommendations contained therein as amended at the session and requested the Secretariat, in revising that paper, to add a separate recommendation and additional commentary on zero-asset proceedings. Views differed on the role of an independent party to assist MSME debtors and the approach to revise the definition of the competent authority. Working Group V will continue deliberations on those issues, the other terms in the glossary and the commentary to its next session in May 2020.

59. This sub-section of the Future Instrument will make reference to the work of Working Group V on a simplified insolvency regime for MSMEs.

(e) Safeguards for MSMEs

60. The imbalance in size between MSMEs (particularly micro-businesses) and large financers may result in unequal bargaining power. Financers may find themselves in a position where they can unilaterally define terms of the transaction, which could be unfair for MSMEs.

61. Standard contract terms are often heavily weighted in favor of financers including 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 (including the level of interest and the level of payments after default, as well as the way "default" is defined). Moreover, the standard terms are likely to be in small print and in technical and complicated language, the individual running the micro-business probably will not appreciate the terms of the contract when signing it.

62. In order to tackle the unfairness of contract terms, this sub-section of the Future Instrument will explore safeguard measures for MSMEs, which may include mandatory disclosure of information in a prescribed form (including standardised

---

[36] IMF Policy Paper on "The Bali Fintech Agenda" (October 2018), p. 9. It should be noted that some countries have put in place rules specifically for fintech credit, such as China. See Committee on the Global Financial System and Financial Stability Board Working Group Report on "FinTech credit – Market structure, business models and financial stability implications", p. 38. Furthermore, several countries have introduced a legal framework for online crowdfunding. Examples include Malaysia (2015), Russia (2019), United Kingdom (2019) and USA (2015).

[37] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* (A/71/17), para. 246.

methods of displaying charges so as to facilitate comparison with products offered by other financers). Relevant national legislation on unfair contract terms, for instance laws that make an unfair term unenforceable by the party relying on it, will also be discussed.

63. This sub-section of the Future Instrument will thus further elaborate on the appropriate safeguard measures for MSMEs to address unfair contract terms.

5. Improving access to credit through capacity building

64. An important component of domestic policies to facilitate MSMEs' access to finance is capacity building programmes to empower MSMEs to make best use of available financing sources and mechanisms, on the one hand, as well as to enhance the financial sector sensitivity and responsiveness to the needs of MSMEs. It is acknowledged that most aspects of those programmes consist of regulatory, institutional and practical measures – rather than legal. Nevertheless, for the sake of completeness, this section of the Future Instrument will present the need for and design of capacity building programs for both MSMEs and financers, on the basis of international experience and the advice of other international organizations, and how they could improve access to credit for MSMEs.

(a) Capacity building for MSMEs

65. MSMEs often need assistance in applying for finance as they may not know whom to approach and how to choose financial products and may be unaware of those credit guarantee schemes applicable to them. Importantly, they often do not know how to put together a good financial proposal. Government agencies could – through traditional and social media outreach, information seminars and training programmes – assist MSMEs in knowing where to apply and in putting together a good proposal. Generally, these capacity building programmes could provide financial education and improve financial literacy of MSMEs (especially women entrepreneurs).

66. This sub-section of the Future Instrument will thus discuss the need for and design of capacity building programmes for MSMEs.

(b) Capacity building for financers

67. Financers need to be 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. 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. Government agencies with a mandate to expand MSME credit or broaden financial inclusion are well placed to introduce capacity building programmes to train the employee of financial institutions. Gender sensitive topics could also be built into such programmes to ensure that men and women have equal access to financial services and facilities.

68. This sub-section of the Future Instrument will thus discuss the need for and design of capacity building programmes for financers.