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Draft Guide on access to credit for micro, small and medium-sized enterprises (MSMEs)

Note by the Secretariat

Contents

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Background information

1 At its fifty-second session, in 2019, the Commission agreed to strengthen and complete Working Group I's work on reducing the legal obstacles faced by micro, small and medium-sized enterprises (MSMEs) throughout their life cycle with guidance on access to credit for MSMEs and requested the secretariat to start preparing draft materials with a view to their consideration by the Working Group.[1]

2 At its thirty-sixth session (Vienna, 4 to 8 October 2021), the Working Group commenced its deliberations on the topic on the basis of a preliminary draft text contained in a Note by the Secretariat (A/CN.9/WG.I/WP.124). The Working Group continued such work at its thirty-seventh session (New York, 9 to 13 May 2022) and thirty-eighth session (Vienna, 19-23 September 2022) on the basis of revised Notes by the Secretariat (A/CN.9/WG.I/WP.126 and A/CN.9/WG.I/WP.128, respectively). At all sessions, the Working Group examined the scope and structure of each section of the draft text rather than providing detailed guidance on individual paragraphs, unless there were specific concerns or need to correct inaccurate information.[2]

3 The annex to this document contains a revised version of the draft text which reflects the deliberations of the Working Group at its last session, in September 2022,[3] including (i) reorganization of content; (ii) retaining the term "micro, small and medium-sized enterprises (or MSMEs)", although the focus is on micro and small enterprises; and (iii) amending the final title of the text as "Guide on access to credit for MSMEs".[4] For consistency with the structure of UNCITRAL legislative guides, the secretariat has relocated the sections on "Purpose" and "Intended audience" of this "Background Information" (A/CN.9/WG.I/WP.128, paras. 5 and 6 respectively) to the introductory chapter of the draft Guide, with the necessary revisions. The secretariat has also made additional adjustments to improve the readability and consistency of the text. Where necessary, paragraphs have been moved and renumbered and any cross references have been modified accordingly.

Working method

4 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 (2016)* (the Model Law). The discussion on secured lending using movable assets as collateral thus builds upon the Model Law as well as other existing UNCITRAL instruments on this topic (see https://uncitral.un.org/en/texts/securityinterests). The draft Guide will refer to and discuss the recommendations and principles provided for in those texts that are most relevant to facilitate MSMEs' access to credit.

5 Similarly, the parts of the draft Guide addressing business formation and registration as well as business operation make references to the *UNCITRAL Legislative Guide on Key Principles of a Business Registry* (2018) and the *UNCITRAL Legislative Guide on Limited Liability Enterprises* (2021). In addition, the parts of the draft Guide touching upon personal guarantees and restructuring support cross-refer to the *UNCITRAL Legislative Guide on Insolvency Law for Micro- and Small Enterprises* (2021), and the section relating to electronic environment cross refers to UNCITRAL's texts on electronic commerce, including the *UNCITRAL Model Law on Electronic Transferable Records* (2017) and the *UNCITRAL Model Law on the Use and Cross-border Recognition of Identity Management and Trust Services* (2022).

[1] *Official Records of the General Assembly, Seventy-fourth Session, Supplement No. 17* (A/74/17), para. 192(a). See also A/CN.9/WG.I/WP.125, para. 5 for the verbatim decision of the Commission.
[2] See A/CN.9/1084, paras. 18 and 19 and A/CN.9/1090.
[3] See A/CN.9/1122.
[4] A/CN.9/1122, para. 106 and Annex.

Annex

I. Introduction[1]

1. Micro, small and medium-sized enterprises (MSMEs) represent the vast majority of business types in all parts of the world, contributing to job creation and preservation, supply chain development, entrepreneurship, innovation and economic and social welfare.[2] As it has been noted,[3] 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.[4] Not surprisingly, several governments have prioritized MSMEs' roles in job creation.

2. There is no global standard definition of MSMEs, as many criteria may be used to identify them depending on each country's economic, legal, political and social context. Indeed, while the number of employees, turnover, and assets are the criteria more commonly used, other variables, such as formality, years of experience, initial investment amount are also used to define and identify MSMEs.[5] Mindful of these differences among countries, the UNCITRAL legislative texts on MSMEs do not include a definition for MSMEs, and States will apply the texts in accordance with their own definitions.

3. Despite their varying nature, size and country of operation, most MSMEs broadly share certain characteristics, some of which would mainly apply to micro and small enterprises, while others would be relevant for all types of MSMEs.[6] These characteristics include the following: (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 finance or risk-sharing; (d) limited access to finance (e) difficult access to financial services; (f) disproportionate impact of regulations (e.g. business registration procedures and cost); (g) limited markets (for micro and small enterprises, often only local markets); (h) limited access to formal dispute settlement mechanisms; (i) difficulty to partition assets (particularly in the case of sole proprietorship or when the business does not have a distinct legal personality) so business failure often directly impacts personal and family assets; (j) vulnerability to financial distress or natural disasters[7]; and (k) difficulty in transferring or selling a business.

4. Access to finance (e.g. credit, savings, payment, insurance) is essential for MSMEs throughout their life cycle. It enables entrepreneurs to start, innovate, improve efficiency and productivity and eventually expand their businesses. As noted

[1] The secretariat has relocated the discussion about MSMEs and their financing needs (Chapter II in A/CN.9/WG.I/WP.128) to this Chapter (Introduction) with necessary revisions, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 23). The Working Group may wish to note that the secretariat has deleted part of the discussion on MSMEs financing needs at various stages of their life cycle to avoid redundancy.

[2] At its thirty-eighth session, the Working Group requested the to highlight the economic importance of MSMEs (A/CN.9/1122, para. 20) The secretariat has implemented that revision at the opening of the draft Guide to further stress the concept.

[3] UNDESA, Report on Micro, Small and Medium-Sized Enterprises (MSMEs), and their role in achieving the Sustainable Development Goals, 2020, pp. 4 and 22.

[4] See www.worldbank.org/en/topic/smefinance.

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

[6] The secretariat has included this phrase ("some of which… all types of MSMEs") in line with the deliberations of the Working Group at its thirty-eighth session (A/CN.9/1122, para.21). The Working Group may wish to note the suggestion of the secretariat to revise the first instead of the second sentence of the paragraph (para. 17 of A/CN.9/WG.I/WP.128).

[7] The secretariat has added reference to "natural disasters" as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 17).

by the World Bank, lack of or limited access to finance is the second most cited obstacle small businesses face in emerging markets.[8] In particular, access to credit enables MSMEs to make productive investments, which are instrumental in generating income and gaining access to additional resources. Various factors may affect access to credit and the type(s) of available credit, including age of the enterprise, gender of the entrepreneur, account history of personal and business bank accounts owned by the entrepreneur, and availability of business records.

(i) MSME finance gap

5. MSMEs may access credit through financial institutions operating within the domestic legal and regulatory framework of the financial system. However, small businesses often fail to meet the conditions imposed by financial institutions for granting loans. Even when MSMEs meet those conditions, financial institutions might still be reluctant to grant loans to micro and small enterprises because those loans are often too small to be profitable.[9] The difference between the current supply of finance to small businesses and their potential demand which can be addressed by financial institutions is known as "the finance gap".[10]

6. Studies have shown that in most countries the finance gap is likely to be greater for women-owned businesses than for men-owned ones because of cultural biases or economic, social and legal constraints.[11] For instance, in some countries women are reported to have less access to affordable credit since they have less physical and reputational collateral,[12] particularly as their microfinance repayment rates are often not captured by providers of private credit reporting service.[13] Women-owned micro and small enterprises may also be more affected than those owned by men by the loan requirements of formal financial institutions. For example, service fees or interest rates may be too high in comparison to the sum they wish to borrow, or it may be too difficult for them to meet loan repayment conditions. As a result, women entrepreneurs are often largely dependent on informal sources of credit, including family and friends support.[14]

7. Measures aimed at reducing MSMEs' financing gap should consider all these aspects and strike a balance between the credit risk faced by financers and the need to protect MSMEs, especially the most unexperienced and unskilled ones. Such measures will also make an impact on achieving the sustainable development goals (SDGs).[15] The International Trade Centre (ITC) suggests that stronger MSMEs can contribute to achieving SDGs 8 and 9 through the business practices they adopt, the

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[8] See www.worldbank.org/en/topic/smefinance.

[9] Z. Chen and M, Jin, Financial Inclusion in China: Use of Credit, 2017, p. 3.

[10] The International Finance Corporation (IFC) estimates that the unmet demand for financing from formal MSMEs in developing countries reveals a gap of USD 5.2 trillion.[10] According to IFC, there are 65 million, or 40 per cent of credit constrained formal MSMEs, and the potential demand for finance from informal enterprises in developing countries is valued at another USD 2.9 trillion (see IFC, MSME Finance Gap, Assessment of the shortfalls and opportunities in financing micro, small and medium enterprises in emerging markets, 2017, p. 2). 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 entirely free from such gap as a sizeable share of MSMEs in those countries find it difficult to access credit from banks, capital markets or other suppliers of finance.

[11] The gap is currently estimated at $1.5 trillion. See IFC and Goldman Sachs, IFC and Goldman Sachs 10,000 Women: Investing in Women's Business Growth, 2019, p. 4.

[12] Reputational collateral (also known as reputation collateral) refers to the ability of the borrower to access credit without providing collateral but based on the borrower's recognized reputation as a good payer.

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

[14] The World Bank reports that according to a survey of women-run businesses in the Middle East and North Africa, most women owners did not have access to formal credit and financed their businesses mainly through savings, loans from family and friends, and by reinvestment of their business earnings. See World Bank, Secured Transactions, Collateral Registries and Movable Asset-Based Financing (2019), p. 23.

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

sectors in which they operate and their impact on the broader economy.[16] It further emphasizes that MSMEs can have a positive impact on 60 per cent of the individual SDG targets with sufficient funding in place.[17] Improved access to credit for MSMEs would allow their potentialities to grow and scale up. This would likely help advance women's economic empowerment and help alleviate poverty.

(ii) Reform trends[18]

8. For some time, efforts have been made at global, regional and national levels to facilitate MSMEs' financing which have generated several best practices equally beneficial for countries with different needs and economic conditions. Some initiatives have been broader in scope and focused on promoting MSMEs' access to multiple financial services, for example, facilitating establishing saving accounts or making payments and devising new insurance products. Others have focused on measures particularly tailored to facilitate access to credit. Many of those efforts have prioritized the promotion of policies and regulations promoting financial assistance to MSMEs (often defined as hard support policies), such as establishing credit guarantee schemes,[19] or direct lending programmes to MSMEs[20] (e.g. allocating a percentage of the bank's loan portfolio to the MSME segment)[21] or have facilitated the adoption of measures to improve competition within the domestic financial systems and allow a variety of financial institutions to operate.[22] Others have favoured the adoption of soft support measures including capacity-building programmes for MSMEs, financers and regulators and strengthening of credit reporting systems.[23] Recognizing that women-owned MSMEs often face higher

[16] 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.

[17] Ibid., p. xv.

[18] The secretariat has moved the discussion on the coordination between regulatory and private or commercial law instruments (A/CN.9/WG.I/WP.128, paras. 12 and 13) to the introductory part in Chapter III which helps explain how different measures can contribute to develop a legal framework that removes obstacles MSMEs face when accessing credit.

[19] For example, the European Union has developed several guarantee schemes to support financial institutions in Member States lending to MSMEs (see https://ec.europa.eu/info/business-economy-euro/growth-and-investment/financing-investment/financing-programmes-smes_en). The World Bank and the Asian Development Bank have established technical assistance programmes to improve countries' credit guarantee schemes in support of MSMEs (see for example, www.adb.org/news/adb-loan-help-expand-sme-financing-through-credit-guarantees). China has created a Special Fund for SME Development that supports financing guarantees and a National Financing Guarantee Fund to support the national financing guarantee system (see OECD, Financing SMEs and Entrepreneurs 2020: an OECD scoreboard, p. 168). Bangladesh has also launched an SME Credit Guarantee Fund (see Ministry of Industries of the People's Republic of Bangladesh, SME Policy 2019, p. 5).

[20] The European Union has designed several direct intervention programmes that operate through the local financial institutions that determine the exact financing conditions for the MSMEs (see https://ec.europa.eu/info/business-economy-euro/growth-and-investment/financing-investment/financing-programmes-smes_en). Bangladesh has established an SME Bank (see Ministry of Industries of the People's Republic of Bangladesh, SME Policy 2019, p. 5).

[21] The European Union has designed several direct intervention programmes that operate through the local financial institutions that determine the exact financing conditions for the MSMEs (see https://ec.europa.eu/info/business-economy-euro/growth-and-investment/financing-investment/financing-programmes-smes_en). Bangladesh has established an SME Bank (see Ministry of Industries of the People's Republic of Bangladesh, SME Policy 2019, p. 5). [21] For example, see the Philippines. The "Magna Carta for MSMEs law" also imposed fines on banks for failure to comply with such mandatory credit allocations.

[22] For example, the IFC has advocated for the adoption of policies to improve competition within the financial system and allow a variety of financial institutions to operate as well as to establish government direct lending programmes to MSMEs. See IFC, MSME Finance Gap, (supra, footnote 10).

[23] For example, India has established a national SME Rating Agency that provides comprehensive ratings for use by financial institutions in the assessment of credit. The Agency has recently launched a FinTech platform that facilitates credit flow to MSMEs by providing enterprise-level information (see IFC, SME Finance Policy Guide, (2011), p. 35).

barriers than those owned by men in accessing credit, global and regional organizations as well as States have implemented many ad hoc policy initiatives to support this category of MSMEs.[24]

9. Many global and country level efforts in recent years have also drawn particular attention to the role digital financial services and products, including those resulting from the use of modern technology, can play in facilitating access to credit for MSMEs. For example, in certain countries regulatory authorities have developed projects to test and further research on the use of technology such as blockchain and smart contracts in order to improve access to credit for unfunded or underfunded MSMEs.[25,26] As recognized by the Group of 20 (G20),[27] 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.[28] In this regard, it is worth noting that the United Nations through the Task Force on Digital Financing for the Sustainable Development Goals has recommended, among others, legal reforms to support the digitalization of the financial system, for example defining the legal nature of digital assets or improving private law regimes governing relations between commercial parties.[29]

10. Finally, several initiatives, in particular at the global and regional levels, have encouraged the adoption of modern laws in areas that are instrumental in facilitating access to credit for MSMEs, including secured transactions and insolvency proceedings.[30] Other reforms have pursued formalization of small businesses through simplified incorporation and streamlining business registration (see paras. 60 to 69), which facilitate MSME formation and operation and their access to formal credit sources.[31]

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[24] For example, the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) has developed the Catalysing Women's Entrepreneurship programme which includes an Innovative Financing component for the implementation of three key financing mechanisms: a FinTech innovation fund, a women's livelihood bond and an impact investment fund. The component also involves collaboration with policymakers and regulators to support the creation of an enabling policy and regulatory financial environment for women entrepreneurs. See www.unescap.org/projects/cwe.

[25] For example, the Hong Kong Monetary Authority and the Innovation Hub of the Bank of International Settlements have launched Project Dynamo with the goal to help policymakers and financial services better understand how modern technology can reduce transactions and borrowing costs in MSME access to credit. See: https://www.bis.org/about/bisih/topics/open_finance/dynamo.htm.

[26] The secretariat has added this sentence in keeping with suggestions of the Working Group at its thirty-eighth session (A/CN.9/1122, para. 20).

[27] The Group of 20, usually known as the G20, is an intergovernmental forum comprising the world's major economies. It started in 1999 as a meeting for the finance minister and central bank governors and has evolved into a yearly summit involving the Heads of State and Government.

[28] GPFI, Promoting digital and innovative SME financing, 2020, p. 9. Available at: www.gpfi.org/sites/gpfi/files/saudi_digitalSME.pdfwww.gpfi.org/sites/gpfi/files/saudi_digitalSME.pdf.

[29] In 2018, the United Nations Secretary-General established the Task Force on Digital Financing for the Sustainable Development Goals as part of its Roadmap for Financing the 2030 Agenda for Sustainable Development: 2019–2021.for Financing the 2030 Agenda for Sustainable Development: 2019–2021. One of the Task Force's objectives is to ensure that digital financing becomes an integral part of the sustainable development strategies. In its report "People's Money" (2020), the Task Force provides several recommendations to harness digitalization to accelerate financing of the SDGs.

[30] The Financial Infrastructure Development Network established by the Asia-Pacific Economic Cooperation (APEC) actively promotes the development of secured transactions and insolvency frameworks as key elements of an enabling financing environment for MSMEs, including through the promotion of the UNCITRAL Model Law on Secured Transactions (APEC, 2019 Progress Report – Asia-Pacific Financial Forum, Asia-Pacific Financial Inclusion Forum, Asia-Pacific Infrastructure Partnership, pp. 5 ff). In 2015, the G20 identified secured transactions and insolvency frameworks as priority areas to ensure MSMEs' access to credit (see www.gpfi.org/publications/g20-action-plan-sme-financing-implementation-framework).

[31] The secretariat has moved the discussion on the coordination between regulatory and private or commercial law instruments (paras. 12 and 13 of A/CN.9/WG.I/WP.128) to the introductory part

(iii) Focus of the Guide

11. Drawing on the best practices described in the previous paragraphs and on several international standards (such as the UNCITRAL texts on secured transactions), the draft Guide aims to assist States to adopt or modernize their domestic legal framework facilitating MSME's access to credit. International inter-governmental organizations, non-governmental organizations (NGOs), chambers of commerce and other stakeholders that are interested or actively involved in technical assistance to support MSMEs' formation and operation may also benefit from this text.

12. The draft Guide recognizes that due to their features (e.g. smaller size, limited human and financial resources, lack of legal personality), it is often more challenging for micro and small enterprises to obtain credit than for medium-sized ones and they are also more vulnerable to financial, environmental (e.g. climate change) and other crises. While a number of obstacles can be the same for both micro and small enterprises and medium-sized enterprises, these latter usually face less and different constraints in their access to credit. Consistent with the principle "think small first", the draft Guide thus mainly focuses on micro and small enterprises (while retaining the acronym MSME(s)), although it does not completely exclude medium-sized ones and differentiates, as appropriate, the provisions and policy measures respectively applicable to each of these two categories.

13. Further, in keeping with the mandate of UNCITRAL, the draft Guide mainly focuses on the legal framework relevant to access credit and its improvement. Legal reforms in this area are complementary to microeconomic (e.g. State subsidies) and macroeconomic measures (e.g. market structure) as well as regulatory tools. Therefore, the draft Guide also considers the relevant policy and support measures to the extent they can ensure effectiveness of the legal framework in reducing MSMEs' constraints to access credit. The draft Guide, however, does not discuss measures such as direct State support to MSMEs or taxation policies, which are common tools in many countries, and leaves them for States to decide.[32]

II. Sources of credit available to MSMEs[33]

14. Sources of credit for MSMEs include various debt tools listed in this chapter as well as equity tools such as business angel investments (i.e., investment made by wealthy individual(s) who provide financing, typically their own funds, in exchange for ownership equity) and venture capital (i.e., investment in unlisted enterprises, with the aim of bringing capital, technical and managerial expertise to raise the enterprise's value and make a profit at the exit). While some of them may be relevant at all stages of MSMEs' life cycle, others are more attractive to MSMEs at a particular stage of development. The lack of tax incentives and public co-investment funds which match public funds with those of business angel investors may present challenges that could discourage the use of such tools. Considering that the notion of "credit" is generally associated with debt, this chapter focuses on relevant debt tools and challenges faced by MSMEs when accessing such debt tools, and only touches

in Chapter III in order to better explain how different measures can contribute to develop a legal framework facilitating access to credit for MSMEs.

[32] The secretariat has clarified that the draft Guide does not discuss interventions such as direct support and taxation policies as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 43).

[33] As requested by the Working Group at its thirty-eighth session, the secretariat has revised this chapter (chapter III of A/CN.9/WG.I/WP.128) by: (i) reorganizing the order of the various sources of financing (A/CN.9/1122, para. 28); (ii) shortening and simplifying their description as appropriate (A/CN.9/1122, para. 18); (iii) removing the subheading "working capital finance" to discuss the various sources described under that subheading (paras. 56–63 of A/CN.9/WG.I/WP.128) in stand-alone subsections (A/CN.9/1122, para. 45); and (iv) mentioning in the introduction (see para. 15) that payment schedules may determine the use of certain debt tools (A/CN.9/1122, para. 28).

upon equity in the context of family and friends support given its significant relevance for MSMEs and, shortly, in that of Islamic finance. Certain debt tools, such as receivable financing, warehouse receipts and letters of credit, are useful options for MSMEs to obtain credit quickly in light of the long-term payment schedules in some of their customer contracts which may considerably reduce their cash flow. Without these tools, MSMEs may need to request for credit and pay interests on such credit until they receive payment of their invoices to customers.

15. Rapid advances of digital technology in the last decade have resulted in new financial services and products as well as new business models that can facilitate MSMEs' access to credit in a faster, more convenient, and sometimes cheaper way than the traditional methods (although in some regions the high cost of internet might actually result in an increased cost of credit). Partly due to the low cost of mobile phones and their data networks in some regions, the use of mobile phones has expanded to more advanced transactions concluded via mobile applications, such as digital credit that is often instant, automated and remote.[34,35] For women, who tend to combine household chores with work or other activities outside home and have to face the resulting time constraints, digital financial services are instrumental in improving access to credit for them, especially when geographical distance to markets and financial services is also a challenge.[36]

A. Family and friends support[37]

16. In addition to their own financial resources (e.g. savings), MSMEs' owners often rely on family and friends for initial capital[38] and sometimes continue such reliance even beyond that stage.[39] Given their personal relationship with the owner, family and friends are often more willing to provide direct financing to the business, usually through gift, debt or equity, especially when other financial sources (e.g. commercial credit) are not accessible at affordable conditions. Alternatively, family and friends may guarantee the financial obligations of the MSMEs with their properties or assets, often upon request of the financer.

17. From the perspective of MSMEs, direct financing support from family and friends offers advantages in comparison with conventional sources of funding, in particular short to medium-term borrowing. Family and friends often are less concerned by the MSME lack of credit history and do not require collateral or detailed business plans or other documentation (in the case of equity). In addition, the loan or investment terms may be flexible and often cover a longer period as compared to commercial credit which will facilitate repayment by MSMEs. Further, the timely repayment of the loan may help MSMEs to build credit history and obtain commercial credit more easily. As noted earlier (see para. 6),[40] support from family and friends

[34] GSMA, Digital credit for mobile money providers, 2019, p. 4. See also CGAP Four Common Features of Emerging Digital Credit Offerings, 2016, available at www.cgap.org/blog/four-common-features-emerging-digital-credit-offerings.

[35] The secretariat has deleted the subsection on digital mobile credit (A/CN.9/WG.I/WP.128, paras. 94–97) and included a short description in this introductory part, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 50).

[36] The secretariat has revised this sentence as suggested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 51).

[37] As agreed by the Working Group at its thirty-eighth session (A/CN.9/1122), the secretariat has emphasized the nature and reasons of family and friends support, including in respect of the challenges women and other vulnerable groups face.

[38] Inter-agency Task Force on Financing for Development (supra, footnote 15), p. 67; UNESCAP, Small and Medium Enterprises Financing (2017), p. 3.

[39] A survey by the Consultative Group to Assist the Poor (CGAP) indicates this this practice is common for small businesses. See CGAP, Executive Summary – CGAP National Surveys of Smallholder Households (2018), p. 15. The Working Group may wish to note that the secretariat has deleted the second sentence ("Based on … and friends") of this paragraph (para. 26 of A/CN.9/WG.I/WP.126) for improved clarity of the text.

[40] The secretariat has included reference to para. 6 as agreed by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 25).

plays an important role for women entrepreneurs as well as other vulnerable groups (e.g. ethnic minorities) as they may face high barriers, for example low creditworthiness, to access formal credit. In some countries barriers are also created by certain challenges of the legal and regulatory environment such as lack of property rights or limited legal capacity.

18. In most countries there are no specific laws or regulations applicable to family and friend's debt and equity support and they are generally subject to existing rules governing commercial contracts, corporate law (in the case of equity) and dispute resolution (to the extent that some kind of oral or written agreement can be proved for informal debt and investor's rights and obligations are set out in a contract in the case of equity investment). Moreover, direct support often comes on an informal basis. Terms are often agreed orally rather than being written down which may easily make this source of financing unreliable and untimely and also result in significant non-financial costs.[41] Oral agreements often lack clarity on the terms and conditions of the loan, repayment schedules and remedies for defaults. They may also be misleading as in some cases a loan may be taken for a gift and in certain countries this might have tax implications for the MSME recipient or the donor or both. When family and friends' support is in the form of equity, which is usually associated with decision-making rights in the business, informal agreements on the terms of the investment may affect the MSME governance and the liability of its members, including whether and how the funds' provider(s) can modify or sell their stake. Even when the parties are aware of their mutual rights and obligations, personal ties, local customs and practices might still lead entrepreneurs and family and friends to forego an accurate assessment about the risks they are assuming or neglect to formalize their agreements in a manner that provides adequate record for future reference.

B. Commercial credit

19. Commercial credit in this context refers to credit provided by banks or other regulated financial institutions (including investment funds)[42] primarily based on the overall creditworthiness of enterprises, with their expected future cash flow being usually considered as the main source of repayment. Most often, commercial credit is secured by assets of the borrower that the financer can seize in case of the borrower's default (opposite to unsecured credit that is based on the borrower's creditworthiness and commitment to repayment). As discussed in detail in the draft Guide (see the section on secured transactions in this chapter), secured loans are particularly important to facilitate access to credit for MSMEs since they reduce the financer's risk in lending and often provide for more favourable loan conditions.[43] Domestic laws governing contracts[44] and dispute resolution, as well as the domestic regulatory framework concerning the operation of banks need to be taken into account when extending commercial credit.

20. Specific challenges that limit this form of credit to MSMEs in many countries largely relate to the difficulties that financers encounter in assessing and monitoring the creditworthiness of MSMEs and the MSMEs' lack of adequate collateral to secure the loan. Financers are also likely to incur high due diligence costs relative to the size of the loan[45] usually resulting in high interest rates and high service fees, which may

[41] See S. Djankov, I. Lieberman, J. Mukherjee, and T. Nenova, 2002, "Going Informal: Benefits and Costs." In Boyon Belev, ed., The Informal Economy in the EU Accession Countries. Sofia: Center for the Study of Democracy, pp. 63–80.

[42] The secretariat has added reference to "investment funds" as suggested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 36).

[43] The secretariat has clarified the difference between secured and unsecured loans and the importance of secured loans in line with the Working Group deliberations at its thirty-eighth session (A/CN.9/1122, para. 29).

[44] As agreed by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 39), the secretariat has replaced "commercial contract(s)" with "contract(s)" here and elsewhere in the draft Guide in light of the special meaning of that term in certain jurisdictions.

[45] Inter-agency Task Force on Financing for Development (supra, footnote 15), p. 64.

also discourage MSMEs from applying for commercial credit. Although in recent years digital challenger banks[46] charge lower fees to customers due to their features (e.g. they offer services through digital interfaces instead of physical presence), interest rates still remain high for MSMEs compared with larger enterprises.[47] It has been observed that in some countries, a less competitive banking sector may also contribute to the high cost of credit, although competition per se does not necessarily mean cheaper credit. Because of lack of competition, banks and other similar financial institutions often have fewer incentives to service MSMEs and develop adequate products for that market segment.[48] In this respect, the absence of State's support measures to incentivize bank lending to MSMEs (e.g. increases in the coverage of public credit guarantee schemes or strengthening banks' lending capacities with more direct measures such as flexibility in loss accounting)[49] may also affect banks' propensity to support MSMEs.

21. As discussed earlier, women entrepreneurs may face more difficulties in accessing commercial credit due to legal, institutional and sociocultural factors. Internationally collected data reveal that women are less likely than men to own bank accounts. Restrictions on opening or 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.[50] It was reported that due to a lack of formal financial transaction records, there is frequently no credit information about women entrepreneurs for the purpose of risk assessment, which further restricts their ability to obtain commercial credit.[51] In some countries, there exists a mistrust among women with respect to banks that also affects their willingness to use services of banks and other regulated financial institutions.

C. Credit cards

22. Credit cards are not new and are generally available in most jurisdictions for those MSMEs with access to bank accounts.[52] 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 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.

23. The issuance of credit cards is usually subject to existing laws and regulations on contracts and dispute resolution, as well as existing regulatory systems concerning the operation of banks (including specific rules for services provided by development banks). Although credit cards issued by development banks for MSMEs are generally

[46] For example, Brazil, China, Germany and the United Kingdom of Great Britain and Northern Ireland. See OECD, Financing SMEs and Entrepreneurs 2020 (supra, footnote 19), p. 50, box 1.2.

[47] 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.

[48] Inter-agency Task Force on Financing for Development (supra, footnote 15), p. 64.

[49] OECD, Financing SMEs and Entrepreneurs 2022: an OECD scoreboard, p. 33.

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

[51] IFC, MSME Finance Gap (supra, note 10), p. 44.

[52] As agreed by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 30), the secretariat has revised this sentence to clarify that credit cards may be generally available for those MSMEs with access to bank accounts.

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 the issuance of personal guarantee 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.

D. Platform-based lending[53]

24. Digital products enabled by FinTech and the underlying business models cover a wide spectrum of financial services and are in constant evolution. Platform-based lending is one key credit product that addresses basic needs of the businesses (especially young entrepreneurs) and is relatively simple to use. In platform-based lending, a web platform functions as an intermediary connecting MSMEs in need of capital with potential financers. In many countries, the two most common types are lending crowdfunding (also known as peer-to-peer lending) and investment-based crowdfunding. The two models are quite similar and sometimes certain aspects may overlap. The main difference is that lending crowdfunding is loan-based, while investment-based crowdfunding aims at raising credit by issuing securities.

(i) Lending crowdfunding (Peer-to-peer lending)

25. Lending crowdfunding is usually described as the provision of credit through online platforms that match borrowers with lenders. Loans obtained through the platforms are usually unsecured. Lending crowdfunding platforms can range from platforms where an individual lender act as direct lender for an individual loan to platforms where the lender can invest in pools or portfolios of loans indirectly.[54] Lenders may bid for the loans by offering an interest rate at which they would lend. Borrowers then accept loan offers at the lowest interest rate. Such flexibility with interest rates is one of the benefits for MSMEs, another one is the possibility of obtaining loans of very small size that financial institutions may refuse to provide.

26. The platform can provide various services to assist matching lender(s) with the small business and facilitate the provision of the loan, for example it can assess information on the loan applicant, provide the contractual framework for the loan contract and setting loan pricing. It can also ensure loan servicing and collect lenders' funds for disbursement to borrowers, repayments from borrowers to lenders and deal with loan defaults.[55] Characteristics of lending crowdfunding platforms may vary significantly internationally and within domestic markets. There can be some overlaps between those platforms and investment-based crowdfunding platforms offering debt-based crowdfunding because of the variety of offers and business models (see para. 24).

27. Lending crowdfunding is generally regulated by existing commercial laws and regulations governing electronic contracts and dispute resolution, as well as specific regulatory measures. The growth of lending crowdfunding platforms in recent years[56] has increased the need to ensure protection of the platforms' users, both financers and MSME borrowers, as several countries have experienced platform failures resulting in major financial losses for the users. Many of the risks relating to lending

[53] The secretariat has retained the general discussion on platform-based lending and placed it after the sub-section on "credit cards" and removed references to equity crowdfunding, as suggested by the Working Group at its thirty-eighth session (A/CN.9/1122, paras. 50 and 104).

[54] See World Bank, Policy Research Paper on "Consumer Risks in FinTech – New Manifestations of Consumer Risks and Emerging Regulatory Approaches", 2021, p. 74.

[55] Ibid.

[56] Ibid. According to the World Bank, in 2018, peer-to peer lending represented the largest online alternative finance model by market segmentation, facilitating 64 per cent of the total global volume for the alternative finance industry.

crowdfunding platforms are not different in nature from those in traditional lending, but they are amplified by the medium and the modality through which credit is provided. Many of those risks are also similar to those of investment-based crowdfunding. They can range from technology related risks (e.g. inability of the platform) to management related risks (e.g. misconduct, negligence and insolvency, or in certain cases even fraud, of the platform operators), to deficiencies of the business model (e.g. lack of adequate information on the terms and conditions to access the platform, inadequate credit assessment and conflict of interests between the platform operators and the lenders or borrowers).

(ii) Investment-based crowdfunding

28. Crowdfunding refers to a technique aimed at raising external finance from a large audience (often known as the "crowd"), rather than a small group of specialized investors, where each individual provides a small amount of the funding requested. Investment-based crowdfunding is typically offered through a FinTech platform model which connects investors with MSMEs wishing to borrow money by issuing securities, including debt securities. The platform usually allows applications to be completed within a few hours,[57] which is one of the reasons crowdfunding has gained popularity among MSMEs in many countries.[58]

29. Given its design and due to regulatory limitations, crowdfunding is suitable for MSMEs (in particular micro and small enterprises) at their initial stages 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.[59] 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 loans.[60]

30. Existing laws and regulations governing electronic contracts and dispute resolution usually apply to crowdfunding activities. As crowdfunding is usually exempted from the application of traditional capital markets rules (e.g. publishing a prospectus, obtaining necessary authorizations, complying with reporting and corporate-governance requirements), certain limitations and thresholds are introduced in many jurisdictions to regulate the activities of issuers, platform operators and investors.[61] In order to develop enabling rules for crowdfunding, regulators generally have introduced or are in the process of introducing a specific

[57] World Economic Forum, The future of FinTech: a paradigm shift in small business finance 2015, p. 13.

[58] ITC statistics suggest that crowdfunding has grown rapidly (from $1 billion in 2011 to $34 billion in 2015), notably in Asia and Africa. Although the crowdfunding market in low-income countries is estimated to total $96 billion per year by 2025, online debt-based crowdfunding activities continue to be strongly concentrated in a few countries. Relatively large crowdfunding markets exist in the United States (20.5 per cent) and the United Kingdom (7.5 per cent). 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 2020 (supra, footnote 19), p. 47.

[59] World Bank, Crowdfunding in Emerging Markets: Lessons from East African Start-ups, (2015), p. 3. According to ITC, roughly two out of three crowdfunding campaigns failed to raise the target investment. See ITC, SME Competitiveness Outlook 2019, p. 78. The secretariat has moved this reference to ITC's figures to this footnote in order to limit time-bound references in the main text.

[60] ITC, SME Competitiveness Outlook 2019, p. 78.

[61] World Bank, Consumer Risks in FinTech (supra, footnote 54), p. 107.

crowdfunding exemption in the existing capital markets regulatory framework or a customized stand-alone crowdfunding regulation.[62]

31. MSME borrowers and investors face several obstacles to crowdfunding. Firstly, investors may not have sufficient information or be misinformed about the operation of the platforms, or the risk profiles of projects intermediated through such platforms. Secondly, issues concerning data security and the use of crowdfunding for illicit activities may pose additional legal risks.[63] Thirdly, the lack of a specific legal and regulatory framework for crowdfunding specifying the legal nature of crowdfunding and the default legal regime applicable to it does not help improve the business environment for crowdfunding.[64] In some jurisdictions, the relevant legal and regulatory framework may put in place measures protecting investors (e.g. investment caps, and reflection periods during which contributors may revoke their offers, disclosure, due diligence, conflict of interest, insurance and reporting requirements for platform operators, as well as complaints handling procedures).[65] Notably, several domestic markets[66] ceased operations or shrank significantly due to concerns about dubious or outright fraudulent behaviour and insufficient guarantees in terms of capital requirements and loss provisions for investors.[67] It is worth noting that, while the lack of crowdfunding regulation can leave investors and MSME borrowers unprotected, excessive regulation can make implementation of the crowdfunding platform difficult.

E. Leasing[68]

32. Leasing is an asset-based financing tool that businesses in many countries utilize to fund the use and possible ultimate[69] purchase of equipment or other assets. Under an "operating lease" agreement, the owner (i.e., lessor) of the asset grants the business (i.e., the lessee) the right to use it for a given period of time against (usually) monthly lease payments. Generally, operating leases are effective against third parties without any requirement of registration. While the *UNCITRAL Model Law on Secured Transactions* does not apply to operating leases, some secured transactions laws do and thus operating lessors are incentivized to register their interests (for instance, this is the approach of the *Convention on International Interests in Mobile Equipment*, 2001, also known as "Cape Town Convention").[70]

33. In a "financial lease" (or "finance lease"), the lessee benefits from the economic life of the asset similarly to a legal owner and takes on the related obligations such as maintenance and insurance.[71] Typically, the lessee has the option to purchase the asset for a nominal price at the end of the lease term. Under some forms of financial lease,

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[62] For example, Australia, Brazil, the European Union, Mexico, Nigeria, the United States and the Russian Federation. Ibid., p. 107.

[63] European Commission report on "Inception impact assessment: Legislative proposal for an EU framework on crowd and peer to peer finance" (October 2017), p. 2.

[64] Information for Development Program and World Bank, Crowdfunding's Potential for the Developing World, 2013; available at https://openknowledge.worldbank.org/handle/10986/17626.

[65] As examples of legislation concerning investment platforms and their use, see Russian Federation – Federal Law No. 259-FZ of 2 August 2019; Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937.

[66] For example, China and the Republic of Korea.

[67] In China, as of November 2020, all peer-to-peer lending platforms ceased operations. 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 19), pp. 46–47.

[68] The secretariat suggests referring to "Leasing" instead of "Financial lease" (see A/CN.9/WG.I/WP.128) for improved clarity.

[69] The secretariat has replaced "eventually purchase" with "possible ultimate purchase" as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 40).

[70] The Convention was adopted in Cape Town on 16 November 2001 under the joint auspices of ICAO and UNIDROIT. Further information available at: www.unidroit.org/instruments/security-interests/cape-town-convention/.

[71] OECD, New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments, 2015, para. 128.

the title to the asset is transferred to the lessee automatically at the end of the lease term.[72] The *UNCITRAL Model Law on Secured Transactions*[73] treats a financial lease as an acquisition security right (see article 2(b)), which could benefit from a special priority subject to meeting the applicable requirements, especially the timely registration. Accordingly, the lessee is considered to be the owner of the leased object and the lessor has an acquisition security right. This allocation of property rights applies under the secured transactions law, while for accounting, tax and other purposes the lessor may be treated as the owner.

34. Financial lease is a form of short to medium-term financing that businesses use to acquire durable assets,[74] instead of loans to purchase them.[75] It allows MSMEs to preserve cash resources as it requires no or limited down payment or security deposit. This feature makes it a valuable option for start-ups without the necessary funds to buy equipment or MSMEs that do not qualify for commercial credit (see para. 20). Financial lease can also be profitable for MSMEs in financial difficulties, in particular when the leased asset (e.g. equipment) generates cash flow.[76] Leasing, however, can become more expensive than an outright purchase due to the cost of the leased asset over its economic life. Furthermore, MSMEs' failure to comply with its monthly lease payment may result in the asset loss, which could compromise the MSME's business operations.

35. Leasing may become expensive for MSMEs also if rules on repossession are inadequate (or there are no grantor-based registries that mitigates risks of illegal selling of the leased assets) since this can undermine the ability of the lessor to repossess the asset in case of MSME default.[77,78] Similarly, inadequate norms on the formation, licensing and operation of leasing companies may also result in high leasing costs. Leasing companies are often non-deposit taking institutions and they are subject to less stringent capital requirements than banks. While this may afford them more flexibility, it may also constrain them to source funds from more volatile and expansive markets that may affect the terms and conditions under which MSMEs can lease equipment or assets. One of the major constraints for the ability of regulated financial institutions to provide SME financing in the form of leasing (or loans) may be the limitations resulting from local prudential regulations regarding minimum regulatory capital to be retained by such lenders. This may make leasing not profitable for such institutions, thus limiting MSMEs' options to access credit.

F. Receivable Financing[79]

36. Receivable financing refers to any financing arrangement that uses an amount payable by one party to another for goods or services. There are many different types of receivable financing, including, but not limited to, factoring and supply chain finance which are widely used for MSMEs. In some jurisdictions, MSMEs may sell non-performing receivables to obtain immediate liquidity. Such receivables are sold at a discount, and the purchase price is paid immediately, regardless of debt collection success.

[72] See UNCITRAL Legislative Guide on Secured Transactions, 2007, Introduction, para. 26.
[73] The UNIDROIT Model Law on Leasing (2008) applies to "financial leases" that do not create a security right.
[74] The secretariat has replaced "long-lived assets" with "durable assets" as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 40).
[75] OECD, New Approaches (supra, footnote 71), para. 128.
[76] Ibid., para. 136.
[77] Ibid., para. 139.
[78] The secretariat has (i) deleted the opening sentence of this paragraph (para. 51 of A/CN.9/WG.I/WP.128) for lack of clarity; and (ii) clarified that grantor-based registries can mitigate risks in financial leasing, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 40).
[79] The secretariat has placed the discussion on factoring and supply chain finance under the new subheading "receivable financing", as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 45).

37. Factoring is traditionally used to finance the activities of small and medium-sized enterprises by purchasing receivables. It 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), but may also include the creation of a security right over receivables.[80,81] 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, as evidenced by the invoices, rather than on the seller's financial statements, fixed collateralizable assets or credit history.[82] 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.[83] In some other jurisdictions where it often takes a long time for government agencies to pay suppliers, certain factors with knowledge and experience to collect payment from government agencies also help MSMEs resolve their cash flow challenges when getting a government contract, often referred to as "government factoring".[84]

38. 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.[85] It is likely to be used in relation to "open account" trade where the buyer and seller have an existing business relationship[86] 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 buyers, sellers and banks or FinTech companies to facilitate financing during the life cycle of the open account trade transaction and repayment. 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),[87] thereby reducing the time taken to collect 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 approach their own financial institutions to facilitate favourable financing options for their MSME suppliers.

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

[81] The secretariat has revised this sentence to include reference to the creation of a security right over receivables, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 21).

[82] 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 71), para. 97.

[83] IFC, MSME Finance Gap (supra, footnote 10), p. 45.

[84] The secretariat has included a reference to government factoring, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 45).

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

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

[87] 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 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.

G. Warehouse receipt financing[88]

39. Warehouse receipt financing is a mechanism whereby a receipt representing goods received by a bailee for storage is used as collateral to secure loans. Warehouse receipt financing is appropriate for all types of goods, but it is particularly suitable for agriculture products. It can especially benefit small farmers as it enables the farmers to sell the goods on the market when the prices are higher. Warehouse receipt financing effectively manages price seasonality and positively affects financial and planting decisions. [89] Warehouse receipt financing is also advantageous for financers, since it helps reduce their lending risks with marketable collateral. In certain countries, financers participate in the management of the warehouse jointly with the farmers' organization, which improves mutual trust between them and the farmers and might help them to better monitor the credit transaction.

40. However, lack of modern legislation which (i) recognizes warehouse receipts as documents of title; (ii) clearly identifies rights and obligations of all parties; (iii) establishes procedures for transferring the receipts; (iv) specifies the rights of the transferees; (iv) provides for simple and speedy enforcement processes markets may thwart farmers' and financers' use of this tool. In addition to the adequate private law framework and effective regulation, including the licensing of warehouses and the systems to guarantee their performance, countries should have in place adequate infrastructure and secondary markets for warehouse receipts or commodities. Studies have shown that in countries where those elements are absent, high transaction costs and interest rates do not make warehouse receipt financing suitable for accessing credit.[90]

H. Letters of credit

41. Letters of credit incorporate a commitment by a bank on behalf of the buyer that payment will be made to the seller, provided that the terms and conditions stated in the letters of credit are met. When a bank issues commercial letters of credit, it commits to pay the beneficiary upon presentations of the required documents. Banks may also issue stand-by letters of credit that are only called when the main obligation is not paid (see para. 104).[91] Most letters of credit are governed by the *Uniform Customs and Practice for Documentary Credits*, promulgated by the International Chamber of Commerce (ICC).

42. Letters of credit are mainly used by businesses engaging in cross-border trade, subject to the distance between traders, the type of the goods traded and availability. For dynamic MSMEs, often medium-sized ones, integrated in global value chains as partners rather than mere suppliers of components and operating in emerging markets, letters of credit may be a more reliable tool than inter-company loans since MSMEs do not have to employ complicated risk management practices.[92] However, for a bank to issue a letter of credit, the MSME may not have sufficient coverage for the amount

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[88] The secretariat has deleted the subheading "working capital finance" and placed the discussion on warehouse receipt financing in a stand-alone subsection, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 45).

[89] In countries with warehouse receipt financing systems, it was noted that price seasonality was reduced and financial and planting decisions were also positively influenced. See International Food Policy Research Institute, Strengthening storage, credit and food security linkages – The role and potential impact of warehouse receipt systems in Malawi, 2015, p. 22.

[90] For example, see M. M. Danga, M. J. Kaudunde, P. B. Kadilikansimba, Factors Affecting the Effectiveness of Warehouse Receipt, System in Tanzania 2020, available at: http://ijeais.org/wp-content/uploads/2020/11/IJAMR201126.pdf; or S. M. Deshpande, D. Pillai, Warehouse Receipt Financing for Farmers: Challenges and Way Ahead, in Journal of Rural Development, volume 40, issue 5, October-December 2021.

[91] The secretariat has added this sentence for further clarity of the text.

[92] As requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 45), the secretariat has deleted reference to (i) factoring as an example of intercompany loan; and (ii) letters of credit being a cheap tool from this paragraph (para. 62 of A/CN.9/WG.I/WP.128).

of the letter of credit and the bank's fee. Moreover, letters of credit require very accurate documentation concerning the underlying transaction that the bank needs to review, which makes them a quite labour intense tool.[93] For this reason, they are preferably used for larger-scale transactions[94] and may not be considered a viable option by small businesses engaging in more limited cross-border transactions. It should also be noted that from a risk perspective, in a letter of credit transaction the creditworthiness of the bank and not of the MSME is relevant, which makes information asymmetry a core aspect. The difficulty to verify and assess the MSME's creditworthiness may inhibit a bank from issuing a letter of credit.[95]

I. Collective credit and savings arrangements[96]

43. As a popular type of collective savings arrangement for MSMEs, credit co-operatives (also known as credit unions or credit associations) are non-profit associations whose members deposit their savings in a common pool with the aim of creating a fund to satisfy the credit needs of their members. While some credit co-operatives are non-registered[97] and only consist of a few members in the same neighbourhood, other credit co-operatives are registered associations with their own statutes, some even with banking license. For example, in Europe, co-operative banks are a popular form in the co-operative sector, which often provide credit to households, individual entrepreneurs and local small and medium-sized enterprises.[98]

44. Other collective savings arrangements used by MSMEs include rotating savings and credit associations (ROSCA), and accumulating savings and credit associations (ASCRA). In Francophone countries of Africa, *tontines* constitute an important source of financing for micro enterprises. *Tontines* may take the form of ROSCA, ASCRA or a hybrid of both types. Under the ROSCA arrangement, a small group of individuals form a group and select a leader who periodically (e.g. daily, weekly) collects a given amount from each member, and the money collected is given in rotation to each member of the group. In comparison, the ROSCA arrangement allows the money collected to be invested thus yielding a net return to members' savings.[99] Traders in Africa, particularly women, often participate in one or more *tontines* in order to finance their businesses. In some countries, there also exist a form of individual *tontines* (known as "mobile bankers") where monetary contribution is made by one person to a *tontine* who typically visits the person to collect contribution, thus saving their time to deposit their savings elsewhere.

45. Debts extended by credit co-operatives are also subject to the existing rules of commercial law concerning contract formation and dispute resolution.[100] In some jurisdictions, the operation of credit co-operatives is also subject to specific laws and regulations. Credit co-operatives are generally used by micro and small enterprises to obtain credit and often do not allow savings to be collected from more than a small group of individuals well known to one another. The functioning of such co-operatives is built upon trust among members, and the funds collected cannot be

[93] C. L. Van Wersch, Statistical Coverage of Trade Finance – Fintechs and Supply Chain Financing, 2019, p. 10.
[94] See OECD, Trade finance for SMEs in the digital era, 2021, p. 20.
[95] The secretariat has revised the final part of this paragraph (para. 62 of A/CN.9/WG.I/WP.128) for improved clarity.
[96] The secretariat has changed the heading of this section and revised its content to explain the key features of credit cooperatives and other collective savings arrangements, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, paras. 32 and 33).
[97] The secretariat has replaced the word "informal" with "non-registered", as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 33).
[98] European Investment Fund Working Paper 2016/36, The Role of Cooperative Banks and Smaller Institutions for the Financing of SMEs and Small Midcaps in Europe, p. 14.
[99] See generally International Labour Office (ILO) Working Paper INT/92/M01/FRG, Tontines and the Banking System – Is There a Case for Building Linkages?
[100] The secretariat has deleted the phrase "to the extent… can be proved" (para. 44 of A/CN.9/WG.I/WP.128), as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 34).

moved over large distances which limits the supply of credit, especially in rural areas where local markets may be segmented from national markets. Moreover, there is a risk of potential breakdown of certain co-operatives if a member defaulted.[101] Even for cooperative banks, membership may[102] be restricted to employees of a particular company, residents of a defined neighbourhood, members of a certain labour union or religious organizations, and their immediate families.[103]

J. Microcredit

46. Microcredit is a common form of microfinance that involves an extremely small loan often given to an individual or microenterprise to start and operate a business.[104] These borrowers tend to be low-income, especially from low-income countries. The structure of microcredit arrangements frequently differs from traditional banking and there might not be a written agreement at all. In some instances, the microcredit was guaranteed by an agreement with the members of the borrower's community, who would be expected to compel the borrower to work towards repaying the debt. The borrower may become eligible for loans of larger amounts after it successfully pays off the microcredit. Given that many borrowers cannot offer collateral, microcredit providers often pool borrowers together which creates a form of peer pressure to help ensure repayment.

47. Microfinance institutions (MFIs) constitutes one key category of microcredit providers. Although most 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.[105] Loans are often the first product that MFIs offer to clients.[106] Microfinance has made a major contribution to improve microenterprises' access to credit,[107] particularly for businesses run by women. Eight out of every ten microfinance clients in the world are likely to be women entrepreneurs.[108]

48. Generally, less stringent prudential regulations apply to MFIs compared with traditional financial institutions. The extension of microcredit is mainly subject to existing laws and regulations governing contracts and dispute resolution, and certain specific laws or regulations concerning the operation of MFIs (if any). Challenges faced by micro-enterprises seeking affordable financing have been identified when exploring legal issues surrounding microfinance. They include: (i) a lack of transparency in microfinance product pricing; (ii) disproportionate collateral requirements, resulting in abusive collection practices by some MFIs; (iii) absence of

[101] IFC, Research and Literature Review of Challenges to Women Accessing Digital Financial Services (2016), p. 10.

[102] The secretariat has replaced the words "is typically" with "may", as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 33).

[103] European Central Bank Working Paper Series No. 1568, Bank Lending and Monetary Transmission in the Euro Area, 2013, p. 7, footnote 4.

[104] The secretariat has revised this sentence to clarify that microcredit is also used to operate a business, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 31).

[105] European Investment Fund, European Small Business Finance Outlook, 2019, p. vi.

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

[107] According to the Microfinance Information Exchange (MIX), the gross loan portfolio for microenterprises in 2017 (i.e. 762 financial service providers operating in the microfinance sector of 103 developing markets) was around $34 billion. Importantly, the MIX data differentiated the financing needs of microenterprises from the financing needs of the owners of such businesses. The gross loan portfolio for household financing constituted a separate category, amounting to roughly $29 billion. In Europe, the latest market survey data showed that total microloan portfolio outstanding in 2017 reached €3.1 billion reported from 136 MFIs. See Microfinance Information Exchange, Global Outreach and Financial Performance Benchmark Report – 2017–2018 (2019), pp. 36 and 38.

[108] World Bank, Secured Transactions (supra, footnote 14), p. 23.

or poor measures to ensure client protection and prevention of unscrupulous practices; and (iv) poor financial literacy in the community generally.[109]

K. Public financial institutions

49. In many countries, there are public financial institutions (or, State-owned financial institutions) that supply financial services to underserved groups, including small businesses, and play an important countercyclical role to mitigate financial markets' crises.[110] Some of these institutions act as commercial banks mandated to directly lend to MSMEs; others are "second-tier" lenders which fund commercial banks and other financial institutions that will then extend credit to MSMEs; yet others combine both direct and indirect lending functions.[111]

50. Public financial institutions often have different goals than commercial banks (e.g. they are not market-driven) which may make it possible for MSMEs to access credit more easily. For example, to help contain effects of domestic or global financial crisis, in certain countries public financial institutions have offered short-term interest-free delays in repayments of loans; the opportunity to restructure loans with long grace periods; or increased credit limits in particular to those MSMEs that needed to preserve staff employment.[112] However, public financial institutions may be subject to strict audit, reporting and documentation requirements that may make them less agile than commercial banks in satisfying MSMEs' applications.[113] For States, excessive reliance on public financial institutions to support vulnerable market sectors might involve high financial and fiscal costs with risk for domestic financial stability which might discourage certain of them to continue supporting this banking sector.[114]

L. Islamic Finance[115]

51. Notably, other forms of financing may be relevant throughout a MSME's lifecycle, such as Islamic financial products. Islamic financial products are governed by rules and practices[116] that prohibit interest payments or impose strict limits to the right to charge interest, leading to other forms of consideration for the borrowed money (e.g. profit-sharing or direct participation in the results of the transactions).[117] Islamic financial products in the market can be divided into two broad categories: asset-based and equity-based financial products.[118] *Murabaha* is the most commonly used asset-based financing method for MSMEs, under which the financer purchases assets required by the client and then sells them to the client at a cost that includes a disclosed profit margin to be paid back, usually in instalments.[119] As regards equity-

[109] A/CN.9/727, paras. 29 to 52; A/CN.9/780, para. 37.
[110] OECD, Evolution and Trends in SME Finance Policies since the Global Financial Crisis, 2020, p. 20.
[111] Ibid.
[112] IMF, Fiscal Affairs, Public Banks' Support to Households and Firms, 2020, p. 2. Available at: www.imf.org/en/Publications/SPROLLs/covid19-special-notes#fiscal.
[113] GPFI and IFC, SME Finance Policy Guide 2011, sp. 50.
[114] In line with the deliberations of the Working Group at its thirty-eighth session, the secretariat has made the following revisions: (i) combined paragraphs 54 and 55 of A/CN.9/WG.I.WP.128 into one (para. 50 above); (ii) clarified that the scope of public financial institutions is different from that of commercial banks (A/CN.9/1122, para. 44); (iii) deleted generalizations (A/CN.9/1122, para. 43); and (iv) revised the last sentence of the paragraph for improved consistency.
[115] The secretariat has relocated the discussion on Islamic Finance here, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 23).
[116] The secretariat has deleted reference to "Islamic legal tradition" in the opening sentence of the paragraph (par. 22 of A/CN.9/WG.I.WP.128) as suggested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 22).
[117] UNCITRAL Legislative Guide on Public-Private Partnerships (2021), chapter A "Introduction", para. 65.
[118] World Bank – Islamic Development Bank Policy Report: Leveraging Islamic Finance for Small and Medium Enterprises (2015), p. 11.
[119] Ibid., pp. 11 and 13.

based Islamic financial products, *Diminishing Musharaka* has been designed as a model under which the entrepreneur promises to buy the investment shares of the other partner(s) over time until the entrepreneur owns 100 percent of the venture.[120]

52. In recent years, Islamic financial products have also been developed in some jurisdictions in the context of crowdfunding[121] and factoring.[122] One example of debt-based Islamic crowdfunding is a platform that finances the purchase of solar home systems – the *Murabaha* model, under which the financer purchases assets required by the client and then sells them to the client at a cost that includes a disclosed profit margin to be paid back, usually in instalments.[123] This is also the model offered by most crowdfunding platforms in the market.[124] Given the similarities between *Murabaha* and factoring, the *Murabaha* model also makes factoring an acceptable instrument of Islamic finance.[125]

53. The main challenges for wider use of Islamic financial products for MSME financing include: (i) Islamic financing is not available in all markets; (ii) there is a lack of diversity in offering different financial products to support MSMEs' needs (i.e. the products offered to MSMEs generally concentrate on debt financing such as *Murabaha*, which is more suitable for specific financing purposes while more equity-based Islamic financing could be explored and offered to MSMEs); (iii) transaction costs are relatively high and often only immovable assets can be accepted as collateral; (iv) MSMEs' low Islamic financial literacy, partly because in many countries this industry is still at a beginning stage; and (v) there is a lack of collaboration (e.g. shared capital, risk, training) between public and private sectors that offer Islamic financial products. Enhanced collaboration could help attract more stakeholders to participate as capital providers.[126] Moreover, many countries without a tradition of Islamic financing have not put in place a regulatory framework for Islamic financial products. As a result, such products are less standardized and often need to follow the conventional banking rules and regulations.[127]

III. Measures to facilitate MSME's access to credit

54. Chapter II discusses various sources of credit available to MSMEs and obstacles that MSMEs face when accessing those sources. While a few of them are generally not MSME-specific, MSMEs are more vulnerable economically and may be less aware of their rights and obligations compared with larger enterprises. There are also a number of obstacles that are specific to MSMEs, such as lack of reliable credit history (in particular young entrepreneurs),[128] lack of the expertise and skills needed to produce adequate financial statements, lack of collateral and limited financial or formal education.

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[120] Ibid., p. 17.

[121] Indonesia, the United States, the United Arab Emirates, the United Kingdom and Malaysia. See IBRD, Leveraging Islamic FinTech to Improve Financial Inclusion (2020), p. 27.

[122] EBRD, Smart Contracts, Blockchain and Crowdfunding: How the Law is Getting to Grips with Technology, p. 30.

[123] Islamic Development Bank, The Road to the SDCs – The President's Five-Year Programme: Progress and Achievements, pp. 50–51.

[124] For example, Ethis Group (Malaysia), Kapital Boost (Singapore) and Beehive (United Arab Emirates).

[125] The secretariat has included a reference to Islamic factoring model, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 45).

[126] Asian Development Bank Institute Working Paper Series: Leveraging Islamic Banking and Finance for Small Businesses – Exploring the Conceptual and Practical Dimensions (2020), pp. 18–19. For an overview of the recent development in the Islamic Financial Services Industry in general, see Islamic Financial Services Industry Stability Report (2020), prepared by the Islamic Financial Services Board.

[127] Ibid., p. 18.

[128] At its thirty-eighth session, the Working Group agreed to include reference to young entrepreneurs in the second sentence of paragraph 21 of A/CN.9/WG.I/WP.128 (A/CN.9/1122, para. 25). Since the secretariat has reorganized the Introduction of the draft Guide and deleted that paragraph, it has implemented the decision of the Working Group in paragraph 55 (para. 98 of A/CN.9/WG.I/WP.128).

55. As many of those obstacles cannot be addressed by legal measures alone, States need to consider adopting regulatory and policy measures when necessary. In this respect, the importance of coordination between regulatory and private or commercial law instruments to facilitate MSME access to credit should be emphasized.[129] It is important that private and commercial law instruments and regulatory measures should be employed in a complementary and mutually reinforcing way in order to maximize their benefits. They may intersect in their effects and strongly influence the lending behaviour of financial institutions. For example, in several countries, prudential regulation does not permit financial institutions to accept certain types of movable assets as collateral (e.g. pieces of equipment, raw materials, receivables) which are the assets more likely to be available to MSMEs. At the same time, however, current law reform initiatives permit the use of a wide variety of movable assets as collateral (see para. 77). Lack of coordination may thwart the effectiveness of such reforms as it may make uneconomical any secured lending for regulated financial institutions. Hence, the importance for legislature and regulatory authorities to recognize the interplay of the frameworks under their purview to ensure protection of the financial markets does not undermine the legislative instruments that facilitate access to credit and vice versa.

56. This chapter examines legal, regulatory and policy interventions that help create the legal framework through which MSMEs can access credit. For example, the creditworthiness of MSMEs could be improved through enhanced conditions for business formation and registration, business operation, secured transactions using movable and immovable assets as collateral, issuance of personal guarantees, and credit guarantee schemes. The transaction costs incurred by financers when lending to MSMEs could be reduced through measures to facilitate assessment of their creditworthiness, rules to ensure effective enforcement of financers' rights, as well as adequate mechanisms for resolving disputes. Other measures concerning support to MSMEs in financial distress, fair lending practices (including transparency), electronic environment and financial literacy could help build a more friendly environment for MSME's access to credit. While most of these measures could benefit all types of MSMEs (e.g. secured transaction reforms), some other measures (e.g. public credit guarantee schemes) may impose eligibility requirements.

Equal access to credit[130]

57. In order to fully support MSMEs, the legal, policy and regulatory infrastructure should create a level playing field where all potential borrowers have equal chances to obtain credit. That is, financial providers should assess loan requests only on the basis of the MSME creditworthiness and ability of repayment and not on grounds such as race, colour, gender, marital status, language, religion, political or other opinion, national or social origin, property, birth or other status, disability.

58. Discrimination may take different forms and range from open discriminatory behaviour (e.g. financers may discourage MSMEs from applying for credit or they may deny it without a reason) to indirect discrimination, such as treating certain MSMEs differently based on one of the grounds listed above (e.g. the MSME request for a loan may be rejected even if it meets the advertised requirements or it can be offered credit with worse terms, even if it qualifies for more favourable ones). Neutral practices or policies may also result in discrimination if they burden or exclude certain MSMEs on prohibited grounds. For example, establishing a minimum

[129] Private and commercial law instruments (e.g. contractual safeguards or secured transactions) govern the contractual relationship between financial service providers and MSMEs. Financial regulations are sector-specific rules, often of public law nature, imposed by the State to ensure the safety and soundness of the financial institutions and markets as well as the protection of their customers (e.g. the requirement for financial institutions to disclose information in a standardized format on their products or services).

[130] The secretariat has added this commentary on equal access to credit and two recommendations (on discrimination on a general basis and on discrimination against women entrepreneurs) as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, paras. 53 and 54).

threshold for loans may exclude MSMEs with low-income levels such as those operating in poor areas or owned by minorities. Similarly, reducing bank locations may impact on those MSMEs highly dependent on local-level banking relationship. To ensure equal credit opportunities to all borrowers, certain countries[131] have thus adopted laws prohibiting discrimination in any aspect of a credit transaction that also apply to small businesses. It should be noted that discrimination may easily be embedded in the algorithm supporting digital credit scoring models too, which may result in bias against certain groups of customers. Best practice in this respect would call for laws or regulations prohibiting discrimination to be also applicable to providers of digital financial services.[132]

59. In several countries, women owned MSMEs are among those facing the highest discrimination. Barriers for women entrepreneurs' access to credit results not only from the difficulty to meet the requirements of formal financial institutions (see para. 6) but also from the lack of suitable credit products (women may operate in sectors with low profit margins or may run very small-scale businesses not profitable for financial institutions) or the lack of an affirmative gender policy by financial institutions to favourably consider women's loan applications. Moreover, credit products generally do not account for the restricted access of many women to traditional forms of collateral or assets (e.g. land and title) or do not consider more general constraints women may face in certain countries, such as the difficulty to meet documentation requirements (e.g. business registration documents, or formal financial records) to obtain credit. Recognizing that women's poverty is directly related to inequal access to economic opportunities, United Nations Member States have expressed their commitment in different forums[133] to undertake legislative and administrative reforms in various areas of their domestic framework and enforce non-discriminatory laws that give women equal access to economic resources, including credit.

Recommendation 1:

The law should ensure that MSMEs have access to credit without discrimination based on any ground such as race, colour, gender, marital status, language, religion, political or other opinion, national or social origin, property, birth or other status, disability.

Recommendation 2:

The law should ensure that:

(a) Women have equal and enforceable rights to access credit in order to start and operate a business; and

(b) The requirements for access to credit do not discriminate against potential borrowers based on their gender.

A. A legal framework to enhance MSME's access to credit

1. Formalization[134]

60. Many of the obstacles MSMEs experience in accessing credit are exacerbated by operating in the informal economy. Without a formal status, MSMEs have no

[131] E.g. see the United States of America, The Equal Credit Opportunity Act (ECOA).

[132] For improved consistency of the text, the secretariat has relocated here reference to discrimination that may be produced by the algorithm supporting digital credit scoring models (previously in para. 259 of A/CN.9/WG.I/WP.128).

[133] See for example the Beijing Declaration and the Platform for Action (1995) adopted unanimously by 189 States or A/RES/66/288 – The Future We Want.

[134] As agreed by the Working Group at its thirty-eighth session (A/CN.9/1122, paras. 52 and 84–85), the secretariat has reorganized this section as follows: (i) placed the discussion on business formation and registration and operation at the opening of this chapter; (ii) merged the discussion

access to the banking sector and must rely on family and friends support, or other informal channels[135] which are rarely a guaranteed source of financing. In several countries, business formalization may be an expensive and burdensome process with entry requirements that particularly micro and small enterprises cannot meet, thus preventing the formalization of many potentially viable businesses. Several countries of different legal tradition have reformed their laws and adopted simplified legal forms for the MSME category to facilitate their migration to the formal economy. Other countries have promoted formalization also by making their system of business registration more user-friendly and time and cost efficient.

61. It should be noted that domestic laws may use criteria such as the size of the business, registration with the social security system or tax authority or business registry to establish the boundaries between formal and informal economy. Consistent with the *UNCITRAL Legislative Guide on Key Principles of a Business Registry (2018)* (the "Business Registry Guide"), the draft Guide considers an MSME that has not complied with all mandatory registration and other requirements of the jurisdiction in which it is established as operating in the informal economy.

(a) Business formation and registration

62. An efficient legal framework that minimizes the cost and burden of business formation, operation and closure may encourage MSMEs to register, since overly burdensome registration procedures may outweigh the MSME interest in operating in the formal economy. Reliable and easy-to-access business registries are also expected to improve MSMEs' visibility to the public and the market, including potential partners and clients from foreign jurisdictions, and increase their opportunities to obtain financing from regulated financial institutions.

63. To simplify and streamline business registration, the "Business Registry Guide" addresses different aspects of registration from the establishment and operation of the business registry to the cost of its services and the requirements for businesses to register. In keeping with the principle that registration should be as simple as possible, the Business Registry Guide identifies minimum information that businesses should submit without affecting transparency and legal certainty. In the context of access to credit, although the Guide does not recommend that MSMEs submit their financial information to the registry, as it may prove particularly burdensome, it encourages them to do so in a simplified form. Supplying information on, for example, their financial position and capital needs (including profits and dividends), and their management structure[136] would signal MSMEs' accountability and improve their access to credit to further develop and progress.

64. To further encourage MSME registration, the Business Registry Guide also suggests incentives, such as promoting access to credit and government subsidies or programmes for registered MSMEs to foster their growth. Government subsidies or programmes may become particularly important during emergencies (e.g. a pandemic or a natural disaster) or global financial crisis. Experience shows that in several countries unregistered MSMEs are likely to miss out on such benefits.

65. The Business Registry Guide recognizes the many challenges women entrepreneurs experience to establish their business and the resulting high percentage of women owned MSMEs operating in the informal economy. It thus specifically recommends that women should have equal and enforceable rights to register their business and the requirements for registration should not discriminate against

on business formation and operation; (iii) addressed the topic of business operation separately; (iv) deleted reference to equity investors; (v) streamlined the section to avoid duplications; and (vi) added two recommendations to encourage the enactment of provisions based on the UNCITRAL Business Registry Guide and LLE Guide. For improved clarity, the secretariat suggests including the discussion under the heading "Formalization".

[135] The secretariat has deleted reference to microcredit, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 85).

[136] UNCITRAL Legislative Guide on Key Principles of a Business Registry footnote 20, p. 63.

potential registrants due to their gender.[137] To help States establish a gender-neutral business registration framework, the Guide further recommends the collection of sex-disaggregated data for business registration.

Recommendation 3:

The law should:

(a) Facilitate the formation of a business, including MSMEs, in the formal economy; and

(b) Give due consideration to existing international standards (such as the *UNCITRAL Legislative Guide* on Key Principles of a Business Registry) that provide for an efficient and simplified system of business registration.

(b) Business operation[138]

66. Policies to promote the formalization of MSMEs should not only facilitate their formation and registration. They should also pay attention to easing their organization and operation and adequately protecting their rights. The *UNCITRAL Legislative Guide on Limited Liability Enterprises (2021)* (the "LLE Guide") proposes a flexible and simplified legal business form to achieve those objectives.[139]

67. The simplified limited liability enterprise entails legal personality[140] of the MSME – a protective measure that MSMEs in several countries cannot enjoy – and separation of its assets (e.g. bank accounts) from the personal assets of its owners. As such, the MSME can access financial institutions in its own name and benefit from business loans and other adequate financial products (e.g. business credit cards) whose conditions are often more favourable than those offered to individual consumers. Legal personality also allows the MSME to be shielded from potential claims by the personal creditors (including financers) of its owners, which may negatively affect its credit history and scores.

68. An essential consequence of the MSME's legal personality is that its owners enjoy limited liability (i.e., they are not personally liable for the MSME obligations and debts solely by reason of being owners of the MSME).[141] The MSME itself is liable to its creditors with all its assets. In the context of access to credit, if financers are satisfied with the assets the MSME can offer, the owners may not have to offer personal assets as collateral to secure an MSME loan (although they may provide personal guarantees in support of the loan, see paras. 103 and 107). This might free up resources that the owner may invest in the business or use to support additional loan requests. Limited liability and separation of assets may also make convenient for the owners to lend money to the MSME which reduces dependency from external financers and may provide for more flexibility in the terms of the loan.

69. A recommendation of the LLE Guide which also facilitates access to credit is that the MSMEs must keep certain records concerning their structure, activities and finances. This not only signals transparency and accountability of the MSME but permits it to build a good record of information. Particularly, financial statements and other records of finances (e.g. tax returns or reports) can help access more easily formal financial institutions in the light of the increased credibility of the MSME and reduced costs associated with due diligence or other assessments financial institutions may have to conduct (e.g. information businesses are required to provide information

[137] Ibid., recommendation 34.
[138] In line with the deliberations of the Working Group at its thirty-eighth session (A/CN.9/1122, para. 85), the secretariat has emphasized those aspects of the limited liability enterprise that would facilitate access to credit.
[139] UNCITRAL Legislative Guide on Limited Liability Enterprises, para. 4: available at https://uncitral.un.org/en/texts/msmes.
[140] Ibid., recommendation 3.
[141] Ibid., recommendation 4.

for anti-money laundering purposes). The obligation of keeping records can also help MSMEs to strengthen their financial literacy and managerial skills.

Recommendation 4:

The law should:

(a) Provide for simplified legal forms for MSMEs that facilitate their operation in the formal economy; and

(b) Give due consideration to existing international standards (such as the *UNCITRAL Legislative Guide on Limited Liability Enterprises*) that provide for a simplified incorporation regime for MSMEs.

2. Secured transactions[142]

70. In practice, financers often subject the opening of credit (including, but not limited to, commercial credit or microcredit) to the borrower providing adequate collateral to secure its obligation. When a borrower and lender have agreed that certain assets of the borrower (the "collateral") will "secure"[143] the borrower's payment obligation – i.e., that in the event of the borrower's default the lender may seize, dispose of or foreclose on those assets and apply the proceeds to the borrower's obligation - the credit is often referred to as "secured credit" and the credit transaction is often referred to as a "secured transaction." In a secured transaction, the collateral can be movable or immovable, tangible or intangible.[144] Secured credit allows 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. In light of a reduced risk, creditors are more likely to be willing to extend affordable credit.[145]

71. For secured transactions to reduce credit risk, however, not only must the collateral have sufficient value, but the legal framework governing secured transactions must enable the creditor to realize on the collateral in an economically efficient manner that provides certainty and predictability. This section discusses possible improvements to existing rules governing secured transactions through highlighting relevant existing international and regional standards and identifying possible areas for future improvements.

(a) Existing international and regional standards

a. Movable assets as collateral

72. Over the years, UNCITRAL has produced several legislative texts dealing with the use of movable assets as collateral,[146] including the *UNCITRAL Legislative Guide*

[142] The secretariat has replaced the heading "collateral" with "secured transactions" as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 104). The secretariat has also revised this section for improved clarity.

[143] The secretariat has replaced the word "guarantee" with "secure", as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 59).

[144] The term "collateral" has the same meaning as the term "encumbered asset" used in the *UNCITRAL Model Law on Secured Transactions*.

[145] The secretariat has revised this paragraph to better explain the economic nature of the issues concerning access to credit for MSMEs, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 59).

[146] According to information received from the secretariat, in the few years since its adoption, legislation based on, or taking the same approach as, the Model Law has already been adopted in nine States (Australia, Colombia, Fiji, Kenya, New Zealand, Nigeria, Papua New Guinea, Philippines and Zimbabwe). See A/CN.9/1097 and https://uncitral.un.org/en/texts/securityinterests/modellaw/secured_transactions/status. Other States that may have enacted laws based on the Model Law and participate in the deliberations of Working Group I may wish to provide that information to secretariat. The secretariat has added reference to the status of the Model Law as suggested by the Working Group at its thirty-seventh session (A/CN.9/1090, para. 45).

on Secured Transactions (2007), the *UNCITRAL Guide on the Implementation of a Security Rights Registry* (2013), the *UNCITRAL Model Law on Secured Transactions* (2016) with its Guide to Enactment (2017) and the *UNCITRAL Practice Guide to the Model Law on Secured Transactions* (2019).

73. The paragraphs below discuss (i) the criteria for a secured transaction regime that facilitates credit for MSMEs and (ii) key features of an efficient registry system, both drawn from the recommendations and guidance provided in the UNCITRAL legislative texts concerning secured transactions.

(i) A secured transaction regime that facilitates credit for MSMEs

74. Movable assets (tangible and intangible), in particular future assets, may be the only type of asset that some MSMEs own and, thus, are the only assets that would be available to serve as collateral.[147] Yet, some legal systems allow businesses to grant a security right in movable assets only to a limited extent. Even where a legal system allows movable assets to be used as collateral, the rules may be inadequate, outdated, fragmentary, complex or unclear. This can create significant uncertainty for the MSME owners and managers. Moreover, creditors may be hesitant to provide secured credit to MSMEs because of the shortcomings of these rules.

75. Readily available credit at a reasonable cost helps MSMEs grow and prosper. Therefore, a secured transaction regime that (i) facilitates the easy creation of security rights in movable assets, (ii) ensures that a security right can easily be made effective against third parties (such as by registering a notice in an inexpensive public registry),[148] (iii) enables lenders to determine the priority of their security rights when entering into the transaction, and (iv) enables simple and economically efficient realization[149] on the collateral in the event of default – would greatly assist MSMEs.

76. Firstly, in a regime that facilitates credit, it should be easy to create security rights over movable assets. As indicated in the *UNCITRAL Model Law on Secured Transactions* (the "Model Law"), in order to create a security right the parties only need to enter into a security agreement that satisfies the simple requirements of the Model Law (art. 6). A person should be able to grant a security right in an asset without having to give possession of the asset to the secured creditor, as the asset may be needed for the operation of the business of the borrower.[150] In addition, the law should enable a security agreement to be used to provide for the creation of a security right in a future asset (i.e., an asset that MSMEs may acquire in the future) (art. 6 (2)). Similarly, it should be simple to create a security right in all movable assets of an MSME with a single security agreement.[151]

77. As regards the types of movable assets which can be used as 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, negotiable instruments and documents,[152] bank accounts, intellectual property and digital assets. Allowing granting a security right in receivables may be particularly beneficial for MSMEs with very little assets other than receivables. Rules on digital assets (not addressed separately in the *Model Law*) carry great importance for MSMEs that own

[147] The secretariat has revised this sentence to reflect that movable assets (in particular future assets) may be the only type of assets that some MSMEs could offer as collateral, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 59).

[148] The secretariat has added the reference to third-party effectiveness achieved through registry systems as an additional key feature for an effective secured transactions regime, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 59).

[149] The term "realization on the collateral" has the same meaning as the term "disposition of the encumbered asset" used in the *UNCITRAL Model Law on Secured Transactions*.

[150] UNCITRAL Practice Guide to the Model Law on Secured Transactions, para. 11.

[151] UNCITRAL Legislative Guide on Secured Transactions, chapter II, para. 81.

[152] The secretariat has added the reference to negotiable instruments and documents, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 59).

digital assets such as cryptocurrency or asset-backed tokens.[153] It should also be possible for an MSME with a limited right in an asset to grant a security right in that limited right even though it is not the owner of the asset, for example, a security right may be granted in the right to use an asset under a lease agreement or intellectual property under a licence agreement.[154]

78. Secondly, given that a security right that is effective only against the grantor has little practical value, it should be easy to ensure that a security right is effective against third parties. Third parties that may seek to assert a claim against the encumbered assets include other creditors of the grantor, parties to whom the grantor may have transferred the assets, and, if the grantor has become insolvent, an insolvency administrator or the like. The method provided in the *Model Law* for achieving third party effectiveness of security rights is the registration of a notice with respect to the security right in a public registry. This method, because it allows the grantor to remain in possession of and to continue to use the collateral, facilitates the use of property such as inventory and equipment as collateral.[155]

79. Thirdly, it should also be easy to assess *ex ante* the ranking of claims with a degree of certainty. The most critical issue for a creditor that is considering extending credit secured by particular assets is what the priority of its security right will be in the event the creditor seeks to enforce the security right (either within or outside the grantor's insolvency proceedings).[156] A secured transactions regime that facilitates credit for MSMEs should include clear priority rules that lead to predictable outcomes in any competition between claimants to the collateral, including those that arise in the context of insolvency, and properly protect the interests of all competing claimants.[157] As a general rule, the *Model Law* provides that the time of registration of the notice constitutes the basis for determining the priority of a security right as against the right of a competing claimant, with priority as between parties that have security rights in the same collateral generally determined by the order of such registration.[158]

80. Lastly, it should be easy, quick and inexpensive to enforce security rights over movable assets. Generally, a secured creditor should be able to quickly obtain possession of tangible assets that are collateral and be allowed to realize on the collateral in a variety of ways, including selling the collateral and recovering what it is owed from the proceeds, leasing or licensing the collateral and recovering what it is owed from the rent or royalty payments, and acquiring the collateral in total or partial satisfaction of the amount due.[159] In addition, a secured creditor should be able to obtain possession of, or dispose of, a collateral not only through judicial proceedings but also extrajudicially, provided that the rights of the borrower and other creditors are adequately protected.[160] Extrajudicial enforcement can make it possible for a secured creditor to recover what it is owed more quickly and more efficiently.[161] Thus, a regime that permits extrajudicial repossession and disposition is likely to have a positive impact on the availability and the cost of credit.

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[153] The secretariat has touched upon the issue of digital assets and clarify that the Model Law does not address this issue separately, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 59).

[154] Ibid., paras. 35 and 36. For a lease that does not function as security right, please refer to the UNIDROIT Model Law on Leasing, 2008.

[155] UNCITRAL Model Law on Secured Transactions: Guide to Enactment, para. 124.

[156] UNCITRAL Legislative Guide on Secured Transactions, chapter V, para. 18.

[157] Ibid.

[158] UNCITRAL Model Law on Secured Transactions: Guide to Enactment, para. 143.

[159] UNCITRAL Practice Guide (supra footnote 150), para. 305.

[160] Since 2020, UNIDROIT is carrying out work on "Best Practices for Effective Enforcement", with the aim to prepare an international instrument for national legislators which can assist them addressing issues of enforcement of commercial unsecured and secured debts. For further information, see www.unidroit.org/work-in-progress/enforcement-best-practices/#1644493658763-89df3b2e-4a80.

[161] UNCITRAL Practice Guide (supra, footnote 150), para. 304.

(ii) Key features of an efficient registry system[162]

81. The *Model Law* and comparable modern secured transactions regimes propose the use of a registry as the primary method of making a security right effective against third parties without the need for the secured creditor to take possession of the encumbered assets. A well-designed notice registry system not only provides a simple method of achieving third-party effectiveness and facilitates non-possessory security rights but also makes it simple and inexpensive for potential competing claimants to find out about security rights in assets of the grantor before entering into transactions with respect to those assets.[163]

82. An efficient registry system should have a number of key features aimed at facilitating secured transactions and making it easier for MSMEs to gain access to credit.[164] Firstly, 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.[165] Such "notice registration" system reduces transaction costs for registrants and allows parties to preserve confidentiality of details of their transactions.[166] Secondly, 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.[167] Thirdly, registry services, including registration and searching, should be designed to be as fast, simple and inexpensive as possible, and accessible to the public, while also ensuring the security and searchability of the information in the registry record.[168] Fourthly, registration should be a requirement for the third-party effectiveness and priority of a security right, not its creation. For creation of a security right over movable assets, as described above the parties only need to enter into a security agreement that satisfies the simple requirements of the *Model Law* (art. 6). Fourthly, the information entered in the registry should be indexed and become searchable mainly by the grantor's name. This is important to facilitate the use of multiple assets as collateral in the same transaction and is essential in light of the fact that most movable assets do not have only one description, making a system indexed by asset impractical. Last, but not least, the registration of successive security rights in the same collateral in the security rights registry should be allowed.[169]

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[162] In 2013, UNCITRAL adopted the UNCITRAL Guide on the Implementation of a Security Rights Registry (the Registry Guide) which builds on the UNCITRAL Legislative Guide on Secured Transactions and its Supplement on Security Rights in Intellectual Property. The Registry Guide addresses the legal, technological, administrative and operational issues relating to the establishment and functioning of a collateral registry for movable assets. It is difficult for the secretariat to estimate how many States have implemented the recommendations in the Guide to design or improve collateral registries. Chapter IV of the Model Law on Secured Transactions includes Model Registry Provisions, aligned with the Registry Guide, that are intended to take effect simultaneously with the enactment of the Model Law. Presumably, the nine States that have enacted legislation based on, or taking the same approach as, the Model Law, have also implemented the Model Registry Provisions, see footnote 8 of the Model Law. The secretariat has added this information on the status of jurisdictions that have adopted international standards on security rights registries in line with a suggestion of the Working Group at its thirty-seventh session (A/CN.9/1090, para. 45).

[163] The secretariat has revised this paragraph to distinguish issues concerning third-party effectiveness achieved through registry systems from the operation of such registry systems, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 60).

[164] It should be noted that the UNIDROIT Guide on Best Practices for Electronic Collateral *Registries* also provides useful guidance to the designers and operators of electronic collateral registries, such as establishing a standard for accountability of registrars. See UNIDROIT Guide on Best Practices for Electronic Collateral Registries, p. 69.

[165] Ibid., para. 57.

[166] Ibid., para. 59.

[167] UNCITRAL Guide on the Implementation of a Security Rights Registry, para. 10.

[168] Ibid.

[169] The secretariat has (i) moved discussion concerning the notice registration system to the beginning of this paragraph, (ii) clarified the features of the registry under the Model Law, and (iii) explained that the Model Law allows the registration of successive security rights in the same collateral in the security rights registry, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, paras. 61–62). The secretariat did not mention registration as the

83. A general security rights registry should also 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.[170] 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.[171] 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.[172]

Recommendation 5:[173]

The law should:

(a) Give due consideration to existing international standards (such as the *UNCITRAL Model Law on Secured Transactions*) that provide for a modern and comprehensive secured transaction regime;

(b) Apply not only to transactions in which the grantor grants a security right in an asset that it already owns, but also to transactions that take the form of the creditor retaining title to an asset to secure performance of an obligation; and

(c) Provide a secured transaction regime that:

(i) Facilitates the easy creation of security rights in movable assets;

(ii) Ensures that a security right can easily be made effective against third parties;

(iii) Enables lenders to determine the priority of their security rights when entering into the transaction; and

(iv) Enables simple and economically efficient realization on the collateral in the event of default.

b. Immovable assets as collateral

84. As mentioned earlier, 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, rights over immovable 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.[174] For MSMEs with very few or no movable assets, the possibility of using immovable assets as collateral is particularly important as a means of gaining access to affordable credit.

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method for achieving third party effectiveness in this paragraph as it is not a feature of the registry system as such and already addressed earlier as one of the criteria for a secured transaction regime that facilitates credit for MSMEs.

[170] UNCITRAL, Model Law on Secured Transactions Guide to Enactment, para. 145.

[171] Ibid., para. 146.

[172] 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.

[173] The secretariat has merged draft recommendations 1 and 2 of A/CN.9/WG.I/WP.128 into one single recommendation, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 57).

[174] Commission on Legal Empowerment of the Poor, Making the Law Work for Everyone, Volume I, Report of the Commission on Legal Empowerment of the Poor (2008), pp. 6–7. The Commission was an independent international forum made up by policymakers and high level practitioners of countries in different regions of the world and hosted by the United Nations Development Programme (UNDP). Established in 2005, the Commission ceased to exist in 2008 after issuing its report "Making the Law Work for Everyone". Work on legal empowerment of disadvantaged people is carried on by UNDP.

85. The paragraphs below discuss (i) issues concerning legalization of property rights over immovable assets, and (ii) key features of an effective legal framework for secured transactions involving immovable assets. While there are no global standards on the use of immovable property as collateral equivalent to those prepared by UNCITRAL on the use of movable asset as collateral, the Core Principles for a Mortgage Law, a regional standard developed by the European Bank for Reconstruction and Development (EBRD),[175] can provide useful reference in respect of key features of an efficient legal framework.

(i) Legalization of property rights over immovable assets

86. In several countries, businesses (including MSMEs) lack formal recognition of their property rights over immovable assets in both urban and rural areas. Lack of proper title or inefficient registration systems could make granting security right over immovable assets impossible or very expensive for MSMEs. This is also particularly relevant in the context of microenterprises in the agricultural sector that often cultivate and use leased land or 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 countries, financers may accept a simple certificate of customary interests and rights in land (rather than a formal ownership certificate) as collateral. Recent land reforms, for example, required the establishment of special agencies to keep accurate and up-to-date records of transactions related to customary land and to provide a list of existing customary interests and rights in land.[176] In addition, discriminatory laws (e.g. inheritance) in some countries may be biased towards men, which restrain the ability of women to own land that could be used for collateral.[177]

87. 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.[178]

88. 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 calls upon States to "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 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.[179]

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[175] EBRD also published a Model Law on Secured Transactions which does not make any distinction between pledges of movable assets and mortgages. In the view of the secretariat, the Core Principles for a Mortgage Law provides more relevant guidance as it is tailored to mortgages.

[176] For example, Ghana.

[177] IFC, Research and Literature Review (supra, footnote 101), p. 9.

[178] 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.

[179] Commission on Legal Empowerment of the Poor, Making the Law Work for Everyone (supra, footnote 174), p. 7.

(ii) Key features of an effective legal framework

89. Facilitating access to credit could be regarded as the primary objective of modernizing the legal framework for secured transactions involving immovable assets. In this respect, the objectives of the *Model Law on Secured Transactions* to enable the use of movable assets as collateral can equally apply to a regime on immovable assets,[180] although the norms governing immovable assets have their own specificities. While in some countries the rules governing the creation, validity and enforcement of security right apply to both movable and immovable assets, other countries have adopted a system with specific types of security right for specific assets. For example, different from those rules for movable assets, the creation of security right is generally limited to existing immovable assets, not future assets. In addition, while the information in movable registries could be searchable by debtor name, the information in immovable registries often needs to be located by reference to the specific assets.[181] Nevertheless, the functional approach adopted by the *Model Law on Secured Transactions* can arguably be adapted to the context of immovable assets. In keeping with this approach, an effective legal framework for secured transactions involving immovable assets should apply to all transactions under which a property right is created to secure payment or other performance of an obligation, regardless of the terms used by the parties to describe the transaction, or whether the assets are owned by the grantor or the secured creditor.

90. An effective secured transaction regime involving immovable assets should include at least the following three key features. First, it should be easy to create security rights over immovable assets. An efficient secured transactions regime should establish streamlined procedures for obtaining security rights over immovable assets. As listed in the EBRD Core Principles for a Mortgage Law, the law should enable the expeditious and inexpensive creation of a proprietary security right without depriving the person giving the mortgage of the use of his/her property. Mortgage should be granted (i) over all types of immovable assets, (b) to secure all types of debts and (c) between all types of persons. In addition, the parties should be able to adapt a mortgage to the needs of their particular transaction as far as possible.[182] As noted earlier, norms concerning immovable assets have their own specificities and in many countries the creation of a security right over an immovable asset often requires various formalities (such as the execution of a public deed, notarization of conveyance documents and registration in the land registry) that are not required for most categories of movable assets. Ease in creating a security right over immovables does not necessarily mean abolishing all formalities justified in the interest of legal certainty or extending to immovable collaterals the same rules applicable to movable ones.

91. Secondly, it should be easy to enforce security rights over immovable assets. A security right will have little value to a secured creditor unless it can be enforced effectively and efficiently. An effective secured transactions regime should include procedures that precisely describe the rights and obligations of grantors and secured creditors upon enforcement. It should provide for expeditious court enforcement at reasonable costs as enforcement costs will reduce the proceeds on realization. Consideration could also be given to allowing secured creditors to enforce their security rights out of court, subject to judicial or other official control, supervision or review of the enforcement process when appropriate. For mortgages, the EBRD Core Principles for a Mortgage Law provide that enforcement procedures should enable prompt realization at market value of the mortgaged property. Delays in realization

[180] Encumbrances on immovable assets are, in principle, excluded from the scope of the UNCITRAL texts on secured transactions because they raise different issues (e.g. subject to a special document registration system and indexed by asset, not by grantor).

[181] The secretariat clarified the key difference between registry systems used for movable assets and those in the context of immovable assets, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 64).

[182] EBRD Core Principles for a Mortgage Law, Principles 2, 7 and 10.

are likely to bring uncertainty and increase costs. Any surplus proceeds beyond those needed for satisfying the secured claim should return to the mortgagor.[183]

92. Finally, it should be easy to assess *ex ante* the ranking of claims over immovable assets with a degree of certainty. A prospective creditor must not only be able to ascertain the rights of the grantor and third parties in the assets to be used as collateral, but it must also be able to determine with certainty, at the time it agrees to extend credit, the priority that its security right in collateral would enjoy relative to the rights of other creditors (including an insolvency representative in the grantor's insolvency). The EBRD Core Principles for a Mortgage Law stipulate that the law should establish rules governing competing rights of persons holding mortgages and other persons claiming rights in the mortgaged property.[184] Priority should be determined according to the order of registration as opposed to the time of creation of a security right. For mortgages, in most countries they are registered in the same registry as the title to the property so that anyone searching the title can see the mortgages immediately.[185] While registration is intended to "authenticate" the mortgage in most traditional systems which requires the registrar to conduct his/her own enquiry or to rely on notarization that the mortgage has been validly created, the registration process could be more simple and quick if registration is merely intended to publicize the mortgage claim.[186]

(b) Possible areas for future improvement[187]

93. While the *Model Law* is designed to improve access to credit and to lower the cost of credit for all kinds of businesses, it is particularly well suited for small and medium-sized enterprises. Its norms can also enable secured lending to microenterprises.[188] Despite the obvious advantages of the existence of a legal framework based on the *Model Law*, this by itself may not remove all obstacles that MSMEs may face in obtaining access to credit, in particular those faced by micro and small enterprises. In this context, it should be noted that the *Model Law* provides limited guidance on issues concerning over-collateralization and does not address economic issues such as lack of collateral and valuation of the asset offered as collateral.

94. One of the main reasons why micro and small enterprises have difficulty obtaining credit is that banks and other financial institutions are usually reluctant to extend uncollateralized credit to them even at high interest rates.[189] Collateral requirements are relatively high worldwide for borrowers (including microenterprises)[190] and many micro and small enterprises do not have the necessary amount and/or type of assets that could serve as collateral. In certain jurisdictions this issue is particularly significant for women entrepreneurs as any asset or property is often owned or registered in the spouse's name. For example,[191] women do not have the right to administer marital property, including property that they brought into the

[183] Ibid., Principle 4.
[184] Ibid., Principle 9.
[185] EDRB, Mortgages in transition economies – The legal framework for mortgages and mortgage securities, p. 21.
[186] Ibid., p. 22.
[187] The secretariat has (i) deleted the discussion on regulatory issues (e.g. prudential capital requirements) in this sub-section, and (ii) moved the discussion on enforcement to the new standalone section on enforcement, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, paras. 66 and 102).
[188] UNCITRAL Practice Guide (supra, footnote 150), para. 26.
[189] The secretariat has deleted the reference to high risk of default by MSMEs, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 66).
[190] In Asia and the Pacific, financial regulations in many countries require collateral to be at least 125 per cent of loan value. See ADB, Thematic Evaluation: ADB Support for SMEs, (2017), p. 3, footnote 12. In other countries, collateral requirements are even higher and can be as high as 250 per cent of loan value. See IMF, Financial Inclusion (see footnote 49), p. 16. According to one ADB survey (2019), lack of collateral was cited as the top challenge for small and medium-sized enterprises to access trade finance. ADB, ADB Briefs No. 113, p. 5, figure 5.
[191] World Bank, Secured Transactions (supra, footnote 14), p. 22.

marriage and property acquired during the marriage[192] which considerably limits their ability to offer collateral in order to access credit.

95. Household goods owned by micro and small enterprises are often not accepted as effective collateral given that they generally have low value, depreciate too quickly, and may even be exempted from judicial enforcement processes. Microlenders sometimes may accept jewellery and even household furniture and appliances as collateral.[193] From the perspective of microlenders, these forms of collateral serve primarily to demonstrate the microenterprise's commitment, rather than as a secondary repayment source.[194]

96. One possible measure to tackle the lack of collateral would be to support the use of alternative sources of credit such as credit guarantee schemes, peer-to-peer lending or family and friends support. Peer-to-peer lending and family and friends support (see above, paras. 25 to 27 and 16 to 18) might prove particularly useful when an micro and small enterprise has no assets at all to offer as collateral, a circumstance that no legislative or regulatory reform can effectively address. Another measure would be to encourage the development of enhanced tools to assess creditworthiness of micro and small enterprises (see paras. 157 to 176), thereby reducing overall transaction costs.

97. Another obstacle micro and small enterprises often face in the access to secured credit is the difficulty of financers to determine the value of the asset offered as collateral,[195] which provides the basis for making rational predictions as to how much can be realized from the collateral(s) in the event of default. The value assessment is an economic issue[196] and may be a rather complex process despite the existence of relevant standards.[197] It may become even more complex for loans to micro and small enterprises as the replacement value of certain assets (from the perspective of micro and small enterprises) may be much higher than the actual market value. In other cases, the value of some assets – such as manufacturing and industrial equipment, and agricultural products – can be affected not only by their condition but also by market situation and trends.[198] 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.[199] Sometimes it may be particularly difficult to determine the value of the asset if it is a type that is not regularly traded in the given market.[200] In addition, the absence of appropriate valuation methods or the fact that available methods are too costly relative to the value of the asset may also negatively affect the financers' ability to engage in a proper valuation of the collateral.

98. One option is for the States to increase the availability of independent appraisal mechanisms for financers. Developing financers' expertise to perform reliable valuations of the assets offered as collateral and leaving valuation of the collateral to them (rather than independent appraisers) seems to be a more efficient and less costly mechanism.[201] Another option is to develop a robust public auction system that would

[192] Ibid.
[193] ILO, Making Microfinance Work (supra, footnote 106), p. 120.
[194] Ibid.
[195] In practice, there are many ways to determine the value of the collateral assets 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. If the asset is inventory (e.g. clothing), its value will normally be calculated based on prices in the relevant secondary market. See UNCITRAL Practice Guide (supra, footnote 150), para. 121.
[196] The secretariat has clarified that valuation is an economic rather than legal issue, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 66).
[197] See https://www.ivsc.org/standards/.
[198] World Bank, Secured Transactions (supra, footnote 14), p. 104.
[199] Ibid.
[200] UNCITRAL Practice Guide (supra, footnote 150), para. 123.
[201] UNCITRAL Legislative Guide on Secured Transactions, chapter VIII, para. 70.

help establish valuations in a real market context and also provide lenders with an efficient process by which to liquidate recovered collateral.[202]

99. Sometimes, financers require micro and small enterprises to provide collateral, the value of which significantly exceeds the amount of the loan (often referred to as "overcollateralization"),[203] either because of uncertainty as to how much may be realized from the collateral(s) in the event of default or because a financer with greater bargaining power insists on a higher-value collateral.[204] While the financer usually cannot claim more than the secured debt (plus interest and expenses), overcollateralization may limit businesses from utilizing the maximum value of their assets and obtaining secured credit from another financer using the residual value.

100. The *Model Law* provides limited guidance on this issue through offering an option under which the State would require that the maximum amount for which the security right can be enforced is included in the security agreement (art. 6(3)(d)). Whether a State may enact this option will depend on what it considers as the most efficient financing practice and on reasonable expectations of local credit market participants. The rationale for this option is to facilitate the grantor's access to secured credit from other creditors in situations where the value of the assets encumbered by the prior security right exceeds the maximum amount agreed to by the parties in their security agreement.[205]

101. As noted by the World Bank, the existence of liquid secondary markets where the asset provided by the micro and small enterprises as collateral can be disposed of would permit financers to assess its value more accurately when determining how much credit to extend[206] and could thus reduce the risk of overcollateralization. This would be of critical importance to incentivize secured lending to micro and small enterprises, since the assets provided by those businesses are likely be tangible rather than intangible. As it has been said, if secondary markets do not exist, they can be created, mainly by the private sector but also by the State, in a creative way, for example online auctions provided that there is demand from potential buyers.[207] It would also be important to establish some basic safeguards to ensure that these markets operate in accordance with transparent pricing mechanisms. In this respect, the *Model Law* sets out a general obligation to act in good faith and in a commercially reasonable manner (art. 4).[208] It should be noted that, however, even when secondary markets exist the financer may not always be able to recover the expected 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 them at a substantially lower price.[209]

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[202] The secretariat has highlighted the importance of developing a robust public auction ecosystem, as suggested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 67).

[203] In practice, overcollateralization may be in combination with requests for issuance of personal guarantees (see chapter IV, section 1 (b) on personal guarantees).

[204] The secretariat has added this sentence to distinguish two situations, namely, overcollateralization caused by the uncertainty of how much may be obtained from disposition of the collateral and overcollateralization due to creditors with greater bargaining power insisting on collateral with greater value than the amount of the secured debt, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 66).

[205] The secretariat has elaborated the option under which the State would require including the maximum amount for which the security right can be enforced in the security agreement, with reference to the Model Law, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 66).

[206] World Bank, Secured Transactions (supra, footnote 14), p. 40.

[207] L. Gullifer, I. Tirado, A global tug of war: a topography of micro-business financing, in law and contemporary problems, No. 1, 2018, p. 130.

[208] The secretariat has clarified that issues concerning the duty of good faith is addressed in the Model Law, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 65).

[209] UNCITRAL Practice Guide (supra, footnote 150), para. 122.

3. Personal guarantees[210]

102. Personal guarantees permit MSMEs to secure financing that would otherwise be out of reach for many of them. Very often, the alternative may be not getting credit at all because the risk of loss from the MSME's default would be too high for the financer to accept it. Although they should not replace a proper credit risk analysis, personal guarantees incentivize financers to extend credit to MSMEs – often at more affordable conditions such as a lower interest rate, a larger loan amount or a longer repayment term. This can support and further improve MSME's competitiveness on the market. In countries with weak secured transaction regimes, personal guarantees may represent an effective alternative providing that the guarantor has valuable personal assets. In addition to supporting a loan request, MSMEs may provide a personal guarantee to another MSME in order to guarantee the payment of debt owed to that business for the supply of goods or services.

(a) Types of personal guarantees

103. Personal guarantees create an additional obligation by a third person (i.e., the guarantor) that is distinguishable from the main obligation of the MSME. The guarantor will be obliged to perform its obligation and pay the MSME debt[211] if the MSME defaults and will likely become subrogated to the financers' rights against the MSME, including the right to enforce the loan.[212] To further reduce credit risk, financers might also request to obtain a security right against specific assets of the guarantor, and in the event of default of the guarantor they can enforce their security right by seizing those assets.[213]

104. The guarantor's obligation can be either "independent" or "dependent" from the underlying transaction between the creditor and the principal debtor. Under the first category (e.g. standby letters of credit), the guarantor is obliged to perform upon the creditor's request and cannot reject the demand for performance on the ground that, for example, the debtor's obligation is not yet due or the debtor has already settled it.[214] Mature medium-sized enterprises active in cross-border transactions may prefer independent guarantees, which are effective in building the MSME creditworthiness, as they can afford their additional cost (these guarantees are usually provided by financial institutions given their considerable level of risk). In many countries, independent guarantees are not specifically regulated by law and are mainly created through contract practice. The *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit* (New York, 1995) may assist States in developing an effective legal regime that applies to those guarantees. The Convention supports the use of general conditions or usages such as the Uniform Rules on Demand Guarantees and the Uniform Customs and Practice for Documentary Credits

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[210] As requested by the Working Group at its thirty-eighth session, the secretariat has reorganized and simplified this section (A/CN.9/1122, para. 70). Footnotes indicating specific changes are included in the various paragraphs; in addition, the Working Group may wish to note that the secretariat has" (i) relocated the discussion on dependent and independent personal guarantees (paras. 137 to 141 of A/CN.9/WG.I/WP.128) under "Types of personal guarantees" with necessary revisions; (ii) deleted the discussion on personal guarantees of MSMEs' owners and their family members (paras. 155 to 158 of A/CN.9/WG.I/WP.128) and relocated certain aspects in paragraphs 107 and 108 (A/CN.9/1122, para. 81); and (iii) moved paragraphs 134 to 136 of A/CN.9/WG.I/WP.128 to paragraphs 107 to 109.

[211] The secretariat has revised the phrase "repay the main obligation" with the current wording for further clarity, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 71).

[212] The secretariat has deleted the penultimate sentence of this paragraph ("Guarantees are… its private assets") (para. 133 of A/CN.9/WG.I/WP.128) as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 71).

[213] The secretariat has revised this sentence as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 71).

[214] See also the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (New York, 1995).

(prepared by the International Chamber of Commerce and endorsed by UNCITRAL) that the parties may wish to incorporate in the guarantee.[215]

105. Under dependent guarantees (also known as suretyships), the guarantor acts as a secondary obligor for the principal debtor in case of default, since its obligation is accessory to the debtor's main obligation.[216] Therefore, in most jurisdictions the creditor must request repayment from the principal debtor first, and the guarantor, once requested to pay, can refer to all defences that the principal debtor has against the creditor.[217] Dependent guarantees are usually provided by non-professional guarantors who are typically the owners of the MSME, if the MSME is incorporated,[218] their family members or other related persons.

106. In certain jurisdictions, there may be an additional type of personal guarantees that combine features of independent and dependent guarantees. Such guarantees are often available only to natural persons acting in their professional capacity and businesses of all sizes and forms and provide them with greater contractual freedom. For example, parties can have the ability to guarantee (current or future) specific payment obligations or determine the extent to which the guarantor can waive its rights for recourse Such instruments may also allow for references to the guaranteed obligation without the risk of being requalified as a suretyship.[219]

(b) Suretyships for MSMEs[220]

107. A request for personal guarantees may be more common when MSME's collateral assets are not available at the level required by the financers' risk assessment. Financers may also demand personal guarantees when the collateral provided by the MSME is commensurate with the risk they assume in order to further reduce it. In this regard, personal guarantees provided by the owner[221] can supplement the security rights granted by the MSME and they may also reduce the need to offer additional business assets as collateral. Indeed, the personal assets of the owner could be equal to or of greater value than those of the MSME, in particular if the MSME is a start-up.[222] Personal guarantees provided by the owner would also signal to the financers that the MSME will be more likely to treat the repayment of the loan as a priority given that the owner income or property is at risk.[223,224]

108. Financers might expect the same level of commitment when a family member (often the spouse) or a friend provides the guarantee given their strong personal ties

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[215] The secretariat has added reference to the international standards prepared by the International Chamber of Commerce, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 71).

[216] 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.

[217] M. Damjan, A. Vlahek, The protection of consumers as personal security providers under the DCFR and European Union consumer law, 2018, p. 23, available at: www.researchgate.net/.

[218] The secretariat has clarified that personal guarantees from the owner, make sense only if the MSME is a separate legal entity as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 71).

[219] See Luxembourg, Loi du 10 juillet 2020 relative aux garanties professionnelles de paiement. Available at https://legilux.public.lu/eli/etat/leg/loi/2020/07/10/a582/jo.

[220] The secretariat as replace the title (former "The relevance of dependent personal guarantees for MSEs") for improved consistency.

[221] The secretariat has clarified that guarantees provided by the owner could supplement the security rights granted by the MSME, as agreed by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 71).

[222] In certain countries, merchant cash advance is an alternative option to personal guarantees and collateral where the financer provides an upfront lump sum in exchange for a percentage of future credit and debit card transactions processed by the business. Approval is based on the current performance of the business. See www.smeloans.co.uk/blog/personal-guarantees-by-directors-the-ultimate-guide/.

[223] T. Wolff, Look before you sign… the pitfalls of personal guarantees, 2018, available at: The National Law Review (www.natlawreview.com/article/look-you-sign-pitfalls-personal-guaranties).

[224] The secretariat has added this sentence in line with the deliberations of the Working Group at its thirty-eighth session (A/CN.9/1122, para. 71).

with the MSME owner. Family members or friends of the entrepreneur, however, may grant a personal guarantee against their better judgment or under an emotional state, without full knowledge of the implications or of the MSME financial situation, thus putting their personal assets at risk. Only a few countries seem to have laws concerning guarantees by family members or other vulnerable guarantors (e.g. those who are dependent on the MSME owner or who have provided the guarantee under duress) in order to limit risks of over-indebtedness or attachment of their personal property. In some countries courts protect those vulnerable guarantors by applying the doctrines of violation of fiduciary relationship, unconscionability[225] or undue influence whose application is not limited to personal guarantees. In other countries, the courts have held that it is illegal for a financer to require a spousal guarantee for the sole reason that the prospective guarantor is married to the person seeking the loan.[226,]

109. Although issuing a personal guarantee is common for many MSMEs across different regions of the world,[227] personal guarantees may run counter the objective of statutory limitation of liability for incorporated MSMEs since either the owner or a family member will become personally liable for the MSME's debts. As noted earlier, the default of an MSME may cause dramatic financial problems for the guarantors and their households.[228] In certain countries, surety bonds may provide an alternative to guarantees for MSMEs engaged in certain commercial sectors (for example construction or public procurement). Surety bonds are usually issued by a professional insurer (the surety) and incorporate a promise that the insurer will pay to a third party (e.g. a financer) an agreed amount in the circumstances set out in the bond itself and in line with an underlying contract between the third party and the principal debtor. Surety bonds have the same scope as the guarantees, but they do not require collateral, including cash collateral. This permits MSMEs to enhance their working capital and liquidity to finance their activities. Moreover, surety bonds can help MSMEs to gain contracts as they provide the other party with the security of contract performance. In certain countries, surety bonds are presented as cheaper tools for MSMEs than guarantees.[229] The experience in other countries indicates that they may not be appropriate for such small businesses given their high costs (e.g. expensive premiums for issuance of the bonds by private companies).[230,231]

Key features of a personal guarantee regime

110. While some countries have enacted legislation on personal guarantees for small business loans, most countries do not provide a specific regime and general guarantees' law thus apply.[232] Several provisions (e.g. protection of the guarantors or the rights and duties of parties of the guarantee agreement) are equally relevant for guarantees provided for small businesses' loans. Given the differences among domestic laws, the following paragraphs do not intend to prescribe detailed rules on

[225] 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.

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

[227] 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.

[228] The secretariat has deleted reference to "social stigma" (para. 142 of A/CN.9/WG.I/WP.128) as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 71).

[229] For example, India. See Working capital crisis: Can surety bonds assure MSMEs freedom from hassle of expensive bank guarantees, February 2022, available at Complete education to MSME&startup|MSME Ki Pathshala.

[230] For example, the United States.

[231] The secretariat has not been able to find adequate information on the cost of surety bonds in different countries (see A/CN.9/1090, para. 60).

[232] The secretariat has revised this sentence as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 71).

personal guarantee but simply outline certain features of a legal regime that can ensure the protection of the guarantor and at the same time provide certainty to all parties of the agreement.

a. Form of the personal guarantee

111. It is important for guarantors, particularly unexperienced ones, to properly assess their risk exposure when agreeing to assume the obligation to repay the MSMEs' debts.[233] To minimize risks relating to the guarantor's lack of awareness, in most jurisdictions the law requires that a guarantee needs to satisfy certain formal requirements in order to be enforceable, such as the legal capacity of the guarantor to enter into a contract, written form,[234] an intention to be legally bound and the guarantor's signature.[235]

112. To further minimize the risks of unawareness, in other jurisdictions the legislation has established additional safeguards such as an explicit declaration of responsibility by the guarantor,[236] or notarized written agreements (which may include an explicit limit of the amount of a guarantee for the guarantor to realize the risk at stake).[237] In addition, the guarantors may be required to acknowledge their obligation under the guarantee before a lawyer, who must then confirm the acknowledgement by endorsement on the guarantee agreement.[238, 239] Balanced domestic regimes also ensure transparency and legal certainty for both the financer and the guarantor by clearly establishing the moment at which the offer of a guarantee becomes effective.

Recommendation 6:[240]

The law should subject the validity of a guarantee to an unequivocal expression of intent of the guarantor, which the law may subject to specific formal requirements so as to ensure that guarantors are aware of their rights and obligations.

b. Rights and obligations of the parties

(i) Pre-contractual and contractual disclosure of information

113. In order to help guarantors make an informed decision as well as facilitate a relationship based on trust and confidence between the parties, certain information should be disclosed to the guarantor before the issuance of the guarantee and throughout its term.

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[233] See for example "SMEs don't understand personal guarantee in business loans", 2016, in https://smallbusiness.co.uk/smes-personal-guarantee-business-loans-2535607/. The results of this 2016 survey found that most of the entrepreneurs did not fully understand personal guarantees and their implications for their business and their personal finances.

[234] As to the meaning of "written form", it should be noted that not all States seem to accept electronic signatures (e.g. Germany). Instead, in certain States (e.g. Austria), electronically signed agreements are valid for those acting in the course of their business subject to the domestic legal regime on electronic signatures. See 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. 376.

[235] L. Ellis, Where are the loopholes in Guarantees?, 2019, in https://hallellis.co.uk/unenforceable-guarantees-legal/.

[236] For example, Poland as cited in A. Schwartze, Personal Guarantees (supra, footnote 234), p. 376.

[237] For example, Japan.

[238] For example, the Canadian province of Alberta.

[239] It should be noted that in many countries these forms of protection seem to be mainly directed at consumers rather than legal entities. This may raise the issue of whether personal guarantees of owners, directors or members of micro and small enterprises 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. See A. Schwartze, Personal Guarantees (supra, footnote 234), p. 379.

[240] The secretariat has included this recommendation on the validity of a personal guarantee as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 75).

114. In several countries, financers are required to explain to the guarantor the conditions of the guarantee (e.g. whether it is limited (by amount or time) and its general legal and economic risks, including whether it is accompanied by a security right on the assets of the guarantor or whether the guarantor needs to cover the financer's fees and expenses associated with either the underlying obligation, enforcement of the guarantee, or both.[241] Information on any security interest linked to the main obligation of the MSME and on its general financial conditions such as its assets and any debts owed by the business[242] may also help the guarantor make a deliberate decision. The fact that certain information may be confidential does not affect the duty to inform, as the financer should obtain the MSME's consent for disclosure.[243] General principles of fair contract practices (see para. 210), require that information is provided in a way that it is understandable and comparable to the terms applied by other financers.

115. It is also important that the guarantor is aware of specific risks linked to the guarantor's personal ties, if any, with the business (e.g. a member of the owner's family or a friend). For example, in some countries, insolvency law treats the claims of family member guarantors against the insolvent MSME as subordinated to the claims of other classes of creditors. To ensure that the guarantor is fully aware of the potential risks of the guarantees, it has been suggested that financers advise the guarantor to seek independent legal and financial advice on the effects of the guarantee, in particular if the guarantor is strictly connected to the business.[244]

116. In order to be reminded of the long-term commitment and its potential risk, in several countries the guarantor receives regular communications during the guarantee period about the state of the guarantee, including on the main obligation and any other ancillary obligations linked to it (see para. 122). Balanced regimes ensure that periodic disclosure of relevant information is not too burdensome and costly to financers. For example, information can be provided at no cost on an annual basis, while the guarantor can request for additional reports subject to a fee.[245]

117. To enhance its effects, the duty of disclosure can be complemented by a risk-warning duty, so that the guarantor is notified of any circumstances that may affect its obligation to perform, such as the MSME's default. For transparency and fairness, the risk-warning should at least include information about the secured amount of the main obligation and any other ancillary obligations of the guarantor. In certain jurisdictions if the terms of the underlying obligation change in a way that may be prejudicial to the guarantor, the guarantor is not bound by such changes unless it has expressly consented.[246]

(ii) Nature and scope of the liability

118. The nature and scope of the guarantor's liability determine the extent of the guarantor's obligations in case of the MSME's default and the financer duties when seeking to recover the loan. Clarity of the law on these aspects promotes mutual confidence of the parties (as in the case of disclosure of information) and reduces risks of contract abuse.

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[241] The secretariat has revised the second part ("accompanied by … or both") of this sentence (para. 147 of A/CN.9/WG.I/WP.128) for further clarity.

[242] The secretariat has added this additional example concerning information that may be disclosed to the guarantor as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 77).

[243] M. Damjan, A. Vlhek, The protection of consumers (supra, footnote 217), p. 35.

[244] Ibid., pp. 35–36.

[245] As requested by the Working Group at its thirty-eighth session, the secretariat has: (i) revised the prescriptive language of the `penultimate sentence of the paragraph (last sentence of para. 148 in A/CN.9/WG.I/WP.128) (A/CN.9/1122, para. 78) and (ii) clarified that the guarantor can receive information more frequently upon payment of additional fees (A/CN.9/1122, para. 78).

[246] The secretariat has revised the prescriptive language of this sentence (para. 149 of A/CN.9/WG.I/WP.128) as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 77).

119. When the nature of the guarantor's liability is subsidiary, the financer must first seek satisfaction from the MSME before requesting the guarantor's performance. If solidary liability is established, the financer can claim performance from either the MSME or the guarantor (within the limit of the guarantee). Protection of the guarantor would advocate for the law to specify whether a presumption of subsidiarity or solidarity exists[247] and whether the parties can modify such presumption and by which means (i.e., explicit agreement). Requiring the parties to expressly agree on the nature of the liability in their contract might not be an adequate alternative since it may result in the guarantor's disadvantage due to unequal bargaining power. Further, in the case of subsidiary liability, the financer might not undertake appropriate attempts to obtain satisfaction from the principal debtor. To mitigate such risk, it is good practice for the law to specify the types of remedies against the principal debtor that need to be exhausted before requesting the guarantor's performance. Such remedies could include, for example, written notices, out of court demands, suing the debtor in court or failed enforcement.[248]

120. Many guarantee agreements nowadays contain a "joint and several" liability clause pursuant to which each 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 MSME's debt. This type of clause may easily become a cause of indebtedness for a guarantor who is requested to repay the full amount of the guarantee. That guarantor will have to recover the other guarantors' portion of the guarantee and face the risk of long and expensive court proceedings if the other guarantors cannot or refuse to pay. To limit individual guarantor's over-indebtedness and distrust among the co-guarantors which may negatively affect the MSME's operation, the law can specify the rights of each guarantor against the co-guarantors, the rights of the financer against the guarantors and the guarantors' defences against the financer.

121. As to the scope of the guarantor's liability, it is possible to limit it to a particular period or amount of debt.[249] A guarantee that is not limited may be particularly risky for a guarantor who may become liable for multiple MSME's loans with the same financer without realizing that its personal liability is increasing. Moreover, when the guarantor is the MSME owner, it might also be held liable for loans taken by the MSMEs even after the business has been transferred to another entrepreneur. Many countries allow unlimited guarantees (in rare cases unlimited liability is allowed only in commercial relationships), while others only permit guarantees with a certain maximum amount.[250] To mitigate risks for the guarantor, domestic laws can clarify whether limited and unlimited guarantees are permitted, and specific requirements apply (e.g. an explicit agreement between the financer and the guarantor) in the case of unlimited guarantees.

122. Lastly, the guarantor's liability might also cover accessory obligations, such as interests on the main obligation, damages for non-performance by the principal debtor, costs of legal remedies for the financer against the principal debtor. For transparency, it is advisable that mechanisms are in place to ensure that the guarantor is aware of such additional obligations the guarantee will cover.[251] For example, in certain countries the cost of legal remedies is not covered by the guarantor unless

[247] As requested by the Working Group at its thirty-eighth session, the secretariat has removed reference to "joint and several" liability from this paragraph (para. 152 of A/CN.9/WG.I/WP.128) as it presented issues different from subsidiarity or solidarity of the liability (A/CN.9/1122, para. 80).

[248] See A. Schwartze, Personal Guarantees (supra, footnote 234), p. 375.

[249] See M. Damjan, A. Vlahek, The protection of consumers (supra, footnote 217), p. 39.

[250] I.e., Denmark. See A. Schwartze, Personal Guarantees (supra, footnote 234), p. 378.

[251] As agreed by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 81), the secretariat has deleted the discussion on personal guarantees provided by MSME owners or family members. Certain aspects of the discussion have been moved to other parts of this section (e.g. in the subsection on disclosure of pre-contractual and contractual information).

there is an agreement between the parties.[252] The guarantor might also have contractual defences (e.g. extension of time on principal debtor's obligation) not available to the principal debtor. For the purposes of clarity, it is advisable to identify them in the law and specify if such defences can be waived and to what extent.

Recommendation 7:

The law should require the personal guarantee agreement to spell out clearly the rights and obligations (including the obligation to disclose information) of the financer(s) and the guarantor(s), including by reference to applicable laws and regulations.

c. Treatment of the guarantors

123. If the MSME keeps up with its payment obligation according to the terms of the loan, there is usually not much risk for the guarantors. However, when an MSME is in financial distress and unable to perform its obligations, the guarantor will be obliged to repay the debt or face enforcement actions by the financers.[253] Enforcement methods and protection measures for the guarantor available under the domestic law will apply. When the guarantor is the owner of the MSME or a family member, however, those standard mechanisms might not be adequate and special procedures may be needed to alleviate disproportionate hardship for the guarantors' household that may have to face claims from the repayment of the guarantees as well as the consequences of the MSMEs' financial distress (e.g. insolvency).

124. Adopted at the fifty-fourth session of UNCITRAL (2021), the *UNCITRAL Legislative Guide on Insolvency Law for Micro- and Small Enterprises* (the *Legislative Guide*) recommends a simplified procedure to address personal guarantees provided by individual entrepreneurs, owners of limited liability micro and small enterprises 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 micro and small enterprise and insolvency or enforcement proceedings against its guarantors. When no proceeding against the guarantor has commenced, the *Legislative Guide* clarifies that the law may allow the guarantor to bring potential claims of creditors for consideration in the insolvency proceeding commenced against the micro and small enterprise 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 micro and small enterprise for a limited duration on a case-by-case basis. When approving or confirming a reorganization plan of an insolvent micro and small enterprise, the competent authority may accord special treatment to a guarantor's claim against the micro and small enterprise vis-à-vis other claims in the plan. The insolvency law may permit guarantors of the micro and small enterprise 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 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 micro and small enterprise's repayment obligations. These measures may alleviate a disproportionate hardship on the guarantor.[254]

125. The *Legislative Guide* also suggests that special measures of protection may be envisaged in the law, other than insolvency law, for especially vulnerable guarantors,

[252] For example, Austria, Denmark and Greece. See A. Schwartze, Personal Guarantees (supra, footnote 234), p. 378.

[253] As requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 80), the secretariat has simplified the introductory paragraph (para. 159 of A/CN.9/WG.I/WP.128) of this subsection to eliminate reference to social stigma against the guarantor and its household and debt discharge.

[254] A/CN.9/1052, annex, para. 93 and A/CN.9/WG.V/WP.172/Add.1, paras. 330 to 335.

for example those who are found to have provided guarantees under duress or those who are dependent on or have strong emotional ties with the debtor.

Recommendation 8:[255]

The law should:

Give due consideration to relevant international standards concerning the treatment of personal guarantees provided by MSME owners or their family members in the context of the personal insolvency of the guarantor, such as those of the *UNCITRAL Legislative Guide on Insolvency Law for Micro- and Small Enterprises*.

4. Credit guarantee schemes

126. In many countries, in particular those with emerging economies or economies in transition, credit guarantee schemes represent a key policy tool to address the financing gap of MSMEs and in particular of micro and small enterprises that are usually the main beneficiaries of such schemes. Credit guarantee schemes lower the risk in lending of financial institutions since they guarantee, usually in return for a fee paid by the financial institution or MSME or both, repayment of all or part of the loan to the MSME in case of the MSME default. The payment of the defaulted loan entitles the credit guarantee scheme to claim the paid amount back from the MSME (see paras. 145 to 150).

127. As additional benefits, credit guarantee schemes may reduce the low profitability of lending to MSMEs[256] and incentivize financial institutions to extend credit to valuable small businesses that otherwise may not meet credit requirements.[257] They may also facilitate MSME access to formal credit, since they either eliminate or alleviate the need for collateral, which an MSME may not have, thus improving the terms of the loan. Other benefits have been noted, although their extent is still debated. That is, credit guarantee schemes may help the financial institutions gain experience in managing loans for MSMEs, thus encouraging further developments of this market segment; and they may help MSMEs that would have been excluded from the lending market to establish a repayment reputation that can facilitate future lending from financial institutions.[258]

128. In order to leverage their full benefits, however credit guarantee schemes must be sustainable and operate efficiently. Experiences[259] in countries or regions have shown that weak cooperation between the credit guarantee schemes and lending financial institutions, complicated procedures, strict requirements for MSMEs applying to the scheme, among other constraints, may easily hinder their effectiveness.[260]

129. OECD describes four major types of credit guarantee schemes: (i) public credit guarantee schemes where the guarantee is paid out directly from the government budget which gives the scheme high 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) mutual guarantee schemes that are private and independent

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[255] The secretariat has added this recommendation as agreed by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 83).

[256] OECD, Discussion Paper on Credit Guarantee Schemes, 2010, p. 4.

[257] In response to a concern of the Working Group at its thirty-eighth session (A/CN.9/1122, para. 86), the secretariat has deleted the phrase “overcome the problem of information asymmetry” in the opening of this paragraph (para. 174 of A/CN.9/WG.I/128) as it might suggest that financial institutions participating in credit guarantee schemes do not have to carry out due diligence.

[258] OECD, Discussion Paper on Credit Guarantee Schemes (supra, footnote 256) pp. 4–5.

[259] For example, see ADBI Working Paper Series (authored by Le Ngoc Dang and Anh Tu Chuc), Challenges in implementing the credit guarantee scheme for small and medium-sized enterprises: the case of Viet Nam, 2019; or EBCI/Vienna Initiative, Credit Guarantee Schemes for SME lending in Central, Eastern and South-Eastern Europe, 2014.

[260] The secretariat has added reference to some drawbacks of credit guarantee schemes as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 86).

organizations formed and managed by MSMEs with limited access to bank loans; and (iv) international schemes established by bilateral or multilateral government or IGO/NGO initiatives, which often combine a guarantee fund with technical assistance programmes.[261] In several countries, export credit guarantee schemes have also been established to support businesses, including MSMEs of all sizes and types, trading across borders. Such schemes may have different natures ranging from State-owned institutions (e.g. banks) to public-private partnerships.[262]

(a) Public credit guarantee schemes

130. Public credit guarantee schemes are one of the main public support mechanisms to facilitate MSMEs' access to credit. Other mechanisms with a similar scope include direct lending programmes, facilities for the pledging of MSME loans as collateral against refinancing from central banks, tax and interest rate subsidies.[263] Different objectives may motivate those State's interventions, for example closing the financing gap of MSMEs, improving the productivity and welfare of certain entrepreneur groups, or supporting employment. National or international financial crisis or other extraordinary events that negatively affect the capacity of the market to supply credit to MSMEs are often the main motivating factor behind a State's direct support to MSMEs. Public credit guarantee schemes have proven to be a particularly effective countercyclical tool to address the negative consequences of the credit market failure resulting from those crises or events.[264]

131. Neither public credit guarantee schemes or other public support mechanisms, however, may be a substitute for an efficient market-based lending, as they may create markets distortions (in particular when market-based lending mechanisms are effectively in place)[265], such as channel funds to unproductive MSMEs or prolong the existence of companies that should be liquidated or prevent the diversification of financing sources.[266] Public credit guarantee schemes in particular may disadvantage companies that are ineligible to access the guarantee schemes; disincentivize financial institutions to carry out proper due diligence, especially when the credit guarantee scheme covers the full amount of the loan loss; create risk of improper use of taxpayers' money which funds such guarantee schemes; and disincentivize micro and small enterprises to grow into medium-sized enterprises given that they may no longer be eligible for public credit guarantee schemes.[267] To avoid such risks and maximize their benefits, it may be advisable to use public credit guarantee schemes and other public support mechanisms as supplementary measures to market-based lending in order to correct those problems that private lending mechanisms cannot address. This would also permit countries to widen the opportunities for MSMEs and financers to engage in financing transactions. For example, public credit guarantee schemes can motivate a financer to extend additional unguaranteed credit to an MSME that has already obtained a loan covered by a credit guarantee scheme from the financer.

(i) Foundations of public credit guarantee schemes

132. The principles of accountability and transparency as well as the efficient and proper use of public resources should guide the operation of the credit guarantee scheme. States can ensure them through the following criteria: establishing ex ante the credit guarantee schemes' objectives and performance criteria, regularly

[261] OECD, Discussion Paper on Credit Guarantee Schemes (supra, footnote 256), pp. 7–8.
[262] See for instance, www.oecd.org/mena/competitiveness/ismed-export-credit-agencies.htm.
[263] M. Dubovec and S. Owada, Secured Lending Stimulants: the Role and Effects of Public Credit Guarantees in Japan, U. PA. ASIAN L. REV. Vol. 16, 2021, p. 378.
[264] Ibid., pp. 374–427.
[265] At its thirty-eighth session, the Working Group noted that in emerging economies with no mature market-based lending, credit guarantee schemes did not create market distortions (A/CN.9.1122, para. 88). The secretariat has thus added this phrase "(in particular… in place)" to address this comment.
[266] M. Dubovec and S. Owada, Secured Lending Stimulants (supra footnote 263), p. 416.
[267] The World Bank and FIRST Initiative, 2015, Principles for Public Credit Guarantee Schemes for SMEs, p. 120.

evaluating the performance of the schemes[268] and their positive and negative impact on the market. While commercial laws and mechanisms for the fair resolution of disputes, including out-of-court proceedings, play a key role in creating an enabling environment for credit guarantee schemes to operate, the design and operation of efficient schemes rely on a mix of legislative and regulatory measures that usually take into account the legal foundations of the scheme, eligibility criteria for micro and small enterprises and financial institutions and loan coverage, mitigation of risk, collateral requirements, fees and sustainability and recovery of any loan loss by the credit guarantee schemes. The World Bank and FIRST Initiative *Principles for Public Credit Guarantee Schemes for SMEs* (2015),[269] indicate that such legal and regulatory framework could be a part of corporate or banking legislation or institution-specific legislation.

133. In States where the guarantees are provided directly by the central government, and not by independent entities established for that purpose, it is desirable that the State's liability with respect to the provision of the service be addressed in the applicable laws. Public credit guarantee schemes can also be established as an independent entity with legal personality, while allowing the government to retain ownership and control over it. In this case, the applicable legal and regulatory framework should clarify (i) how the State will exercise its ownership; (ii) who will represent it (e.g. a ministry or an agency etc.) and which government body will supervise the scheme; (iii) general terms and conditions that apply to the government investment; (iv) the relationship between the State as shareholder and the scheme's board and management; and (v) the scheme's funding sources. If the State chooses to establish the credit guarantee scheme in partnership with the private sector, clearly defined responsibilities and obligations of both parties would help protect the rights of the minority shareholders, often the private sector entities, and promote their active participation in the governance and decision-making processes.[270]

134. In order to operate efficiently, it is important that the mandate specifies the MSME sector(s) targeted by a credit guarantee scheme and its main line(s) of business, defined broadly enough to accommodate cyclical developments in the targeted sector(s).[271] Equally important is to have in place mechanisms for the periodic review of the mandate in order to assess its continuing validity over time. In addition to the provision of credit guarantees, the mandate may include other services, such as provision of information, technical assistance, training and counselling.[272] Managerial autonomy and accountability of the credit guarantee schemes in implementing the mandate are key and they can be better ensured if the day-to-day operation of the credit guarantee scheme is not subject to political influence. Further, without adequate funds, a credit guarantee scheme cannot implement its mandate effectively. To ensure that funding is available at an adequate level best practice would advocate that the legal or regulatory framework establish the amount required and specify the responsibility of the State with regard to the provision of the initial capital and additional subsidies during the life of the credit guarantee scheme.[273]

135. As contingent liabilities, public credit guarantee schemes can expose the State to significant budget risks resulting in unanticipated cash outflows and increased debt. To mitigate such risks, it is important that the State carries out a long-term assessment of the budgetary implications before establishing a credit guarantee scheme. A thorough fiscal risk assessment usually considers the factors that are likely to affect the overall financial balance of the scheme as well as the options for risk allocation

[268] See, EBCI- Vienna Initiative, Credit Guarantee Schemes for SME lending in Central, Eastern and South-Eastern Europe – a report by the Vienna Initiative Working Group on Credit Guarantee Schemes, 2014, p. 55.

[269] The principles cover four areas: (i) legal and regulatory framework; (ii) corporate governance and risk management; (iii) operational framework; and (iv) monitoring and evaluation. This section of the draft Guide focus on those aspects of the principles that are relevant for its scope.

[270] The World Bank and FIRST Initiative (supra, footnote 268), p. 14.

[271] Ibid., p. 15.

[272] Ibid.

[273] Ibid., p. 13.

between the parties (i.e., credit guarantee scheme, lending financial institutions and borrowers) involved in the scheme.

(ii) Eligibility

136. Efficient credit guarantee schemes rely on clear and transparent eligibility criteria concerning MSMEs, lending financial institutions and loans that should be publicly available and regularly reviewed. Transparency and clarity of such criteria also allow the State to avoid an improper use of the public funds invested in the operation of the credit guarantee scheme. With regard to MSMEs, it would be important to clarify whether the eligible MSME could be incorporated or a sole proprietor as well as the sector where they operate. Additional criteria may include the size (typically defined by the maximum number of employees, value of assets, and sales), the subsector,[274] or a minimum operation time.[275] 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.[276] It is advisable that States can broaden the eligibility criteria of the businesses benefiting from the scheme in case of major financial crisis or other emergencies that have an impact on the domestic economy.[277]

137. Consistent with the applicable legal and regulatory framework, credit guarantee schemes could establish programmes dedicated to subclasses of firms[278] such 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, the schemes may create a list of ineligible MSMEs (on the basis of their credit profile and repayment reputation, for example)[279] or may explicitly exclude some subsectors from their scope of operations.[280]

138. Lending financial institutions also benefit from clear eligibility criteria, possibly determined on the basis of objective indicators such as their capacity in serving small businesses and their risk management capabilities.[281,282] Typically,[283] eligible financial institutions include, but are not limited to, commercial and development banks, licensed credit institutions or supervised non-bank financial service providers,[284] credit cooperatives,[285] or not-for-profit entities with the primary purpose of supporting small

[274] Ibid., p. 18.

[275] See for instance the Malaysian BizSME scheme that requires a minimum time in operation often ranging from 1–5 years.

[276] In certain cases, see the United Arab Emirates, an ownership or management by nationals of that jurisdiction is also required in order to avoid disbursing guarantees to enterprises without a genuine link to the supporting jurisdiction. In other cases, for example Ireland, the credit guarantee scheme may exclude enterprises which are part of a wider corporate group or a significant share of which is owned by public bodies or foreign investors.

[277] For example, during the COVID-19 pandemic, many countries broadened the eligibility criteria to include specific industries or businesses, even large companies, operating in strategic sectors. See IMF, Special Series on COVID-19, 2020, Legal Considerations on Public Guarantees Schemes Adopted in Response to the COVID-19 Crisis, p. 2.

[278] Some credit guarantee schemes are designed specifically to aid enterprises conducting business in certain sectors considered vulnerable or disadvantaged with regard to credit access, such as farming or manufacturing businesses (see for example the Nigerian Agricultural Credit Guarantee Scheme Fund).

[279] In Malta and Ireland, businesses which have been declared bankrupt, or have entered into restructuring agreements with creditors or whose managerial or executive staff have been convicted of professional misconduct such as fraud, corruption or money-laundering may be excluded.

[280] For example, in Lithuania support is not granted to firms operating in gambling, ammunition, tobacco and alcohol production and sales.

[281] The World Bank and FIRST Initiative (supra, footnote 267), p. 18.

[282] Some countries do not explicitly set or publish general eligibility criteria for lending financial institutions (for example, Slovenia), whereas others designate eligible lending financial institutions by means of general-abstract criteria (e.g. Chile) or through an (exhaustive) list of accredited institutions which have undergone a screening procedure (e.g. India or New Zealand).

[283] The secretariat has improved this sentence for further clarity of the text.

[284] For example in the Philippines.

[285] For example in Brazil.

businesses' development.[286] The possibility to include other categories of eligible financial institutions would help countries to address the need for quick provision of liquidity during major natural disasters or financial crisis.[287]

139. Finally, clear laws or regulations on which types of loans are eligible for coverage would avoid discretionary or arbitrary decisions by the credit guarantee scheme that might jeopardize its effectiveness. 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 micro and small enterprises that are vulnerable to insolvency because of insufficient short-term credit, and the latter assist job creation and long-term economic growth.[288]

(iii) Mitigating risks

140. As noted above, public credit guarantee schemes may expose the governments to high fiscal risks since the State may lack the necessary funds to service the obligations arising from invoked guarantees, in particular in times of crises. As a general principle, decisions to establish a public credit guarantee scheme should thus follow a process that ensures that policymakers understand the risks associated with the credit guarantee scheme. This could range from informing the parliament about the type and implications of the scheme and how they could affect the public budget to receive parliament approval on establishing the scheme. In addition, when designing the credit guarantee scheme, States may use different mechanisms to mitigate the risks of its functioning. For example, they may introduce a maximum ceiling, either as a fixed sum or as a percentage, on the overall exposure of the scheme. The ceiling can be standing or revised at defined intervals. Alternatively, they may decide to set a cap to the size of individual loans guaranteed under the credit guarantee scheme.[289] States may also opt to implement a risk-based fee policy where higher guarantee fees are to be paid for riskier loans. This may involve defining different risk categories, with each category having a standard predetermined fee.

141. One of the most common ways to limit the risk of moral hazard of the lending financial institutions is through the establishment of partial guarantees that use the mechanism of the coverage ratio to determine the percentage of the loan exposure that is guaranteed by the credit guarantee scheme. These mechanisms require careful design so that they can afford adequate protection to the lending financial institutions in the event of MSME default, while encouraging them to regularly monitor the MSME performance. For example, a high coverage ratio can be very attractive to lending financial institutions, since they would be protected from credit risk and may not have an incentive to engage in proper risk screening and monitoring activities thus leading to excessive risk-taking (e.g. extending credit to high-risk MSMEs) and endangering the schemes' sustainability.[290] On the contrary, if the credit guarantee scheme bears only a small share of the risk, financial institutions might disregard the

[286] For example in Egypt, where the SEB programme is implemented through contracting NGOs.

[287] For instance, during the COVID-19 pandemic, some States have included in the lenders' category non-bank financial entities (such as electronic money entities and payment service providers in Spain or the national postal service in Switzerland). See IMF, Special Series on COVID-19 (supra, footnote 277), p. 2 and M. Dreyer and K. Nygaard, 2020, Lessons Learned in Designing and Implementing Support for Small Businesses, available at: https://som.yale.edu/blog/lessons-learned-in-designing-and-implementing-support-for-small-businesses. See also the examples of the Philippines, Canada or Australia. To be considered eligible for participation in such credit guarantee schemes, applicants may be required in some way to demonstrate that they have been affected by COVID-19, e.g. through non-materialization of expected and regular cashflows or turnover or by additional operating costs under the conditions imposed by the pandemic.

[288] The World Bank and FIRST Initiative (supra, footnote 267), pp. 18–19.

[289] 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 MSE revenues. 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. See IMF, Special Series on COVID-19 (supra, footnote 277), p. 3.

[290] IMF, Special Series on COVID-19 (supra, footnote 277), p. 2.

programme.[291] Policy needs would usually drive the decision of the State on the coverage ratio. A balanced risk sharing between the credit guarantee scheme and the lending financial institution would certainly incentivize this latter to accurately monitor the MSME's credit performance. The coverage ratio should be clearly indicated in the contractual agreement between the credit guarantee scheme and the financial institution and the agreement should also clarify how the losses are to be shared between the two parties.

142. Since the allocation of risks between the credit guarantee scheme and the lending financial institutions is affected by their respective roles and responsibilities, it is important that the legal framework clearly defines such roles and responsibilities. Good practice would be to clarify that the lending decisions rest on the sole discretion of the financial institution and the criteria on which such decisions should be based (e.g. the MSMEs' creditworthiness; how the guaranteed loan fits into the financial institution business and risk appetite; whether the guaranteed loans could be used as collateral to access central bank liquidity facilities) and that the credit guarantee scheme is responsible for approving the specific guarantees.[292]

143. There may be moral hazard on the part of the MSME too, since it might provide misleading information or not disclose sensitive information to the lending financial institution and risk-sharing practices may help prevent it. A recommended practice is to require the MSME to supply collateral as it demonstrates its commitment to repayment. However, excessive collateral requirements can defeat the purpose of the guarantee and the credit guarantee scheme together with the lending financial institution should determine an appropriate level of collateral requirement that limits the moral hazard of MSMEs but does not disincentivize them to apply for loans.[293] It should be noted that the decision of whether to impose or not a collateral requirement to MSMEs has fiscal policy implications for a State, since absence of collateral may increase the unexpected costs ("fiscal risks") a State may have to cover for the losses of the credit guarantee scheme.[294]

(iv) Fees

144. The guarantee's fee is usually established in the legal or regulatory framework of the credit guarantee schemes rather than on a case-by-case basis, usually by having a fixed flat fee or a variable one. When determining the fees, it is good practice to strike a balance between the goals of the guarantee's programme and its financial sustainability. Fees, along with the income that the credit guarantee scheme may derive from its investment activities and any government subventions, should cover the cost of the operations and the expected cost of credit risk. Transparency of the pricing policy helps make the credit guarantee scheme attractive to its potential users. The possibility to adjust fees on the basis of the country's specific circumstances ensures the sustainability of the scheme. For example, in response to major crisis affecting their overall economic structures, certain States set caps on the amounts of fees that can be charged or prohibited the charging of fees.[295]

(v) MSME default and loan loss recovery

145. A timely and transparent process to manage MSME default and subsequent claims from the lending financial institutions is key for an efficient operation of the credit guarantee scheme and to build and maintain the confidence of the lending

[291] R. Ayadi and S. Gadi, Access by MSMEs to Finance in the Southern and Eastern Mediterranean: What role for credit guarantee schemes?, MedPro Technical Report, 2013, p. 11.
[292] IMF, Special Series on COVID-19 (supra, footnote 277), p. 4.
[293] The World Bank and FIRST Initiative (supra, footnote 267), p. 20.
[294] The secretariat has added this reference to the fiscal implications for States on the requirement of collaterals in credit guarantee schemes in line with discussions of the Working Group at its thirty-eighth session (A/CN.9/1122, para. 87).
[295] For example, the crisis generated by the COVID-19 pandemic. With this regard see IMF, Special Series on COVID-19 (supra, footnote 277), p. 3.

institutions in it.[296] This can be achieved when the legal or regulatory framework and the contractual arrangements clarify the precise circumstances that prompt the credit guarantee scheme's intervention, for example the opening of insolvency proceedings against the MSME or the MSME's late repayment of the loan.[297]

146. In some jurisdictions,[298] the guarantees issued by credit guarantee schemes are considered independent guarantees, where the guarantor's obligation is not linked to the underlying debt (see para. 104). In others, the credit guarantee scheme has a subsidiary liability[299] (see para. 119) whereby the enforcement or validity of the guarantee is dependent on that of the principal debtor, but a provisional payment by the scheme to the financial institution may be made based on expected losses after a default. If the enforcement of guarantees by the financial institutions 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 financial institutions.[300] It would however be desirable that before submitting their claims, lending financial institutions proactively explore alternative solutions, including loan rescheduling, to receive payment from the MSME.[301]

147. Clear and transparent payment procedures of the guarantee can avoid costly disputes between the lending financial institutions and the credit guarantee schemes. Contractual agreements between the scheme and the financial institution stating 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 are a preliminary step to preserve a healthy relationship between these two parties. A common practice is to specify a minimum mandatory waiting period before a claim can be made to a credit guarantee scheme 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.[302] In addition, it is advisable that the agreements require a detailed written explanation if the claim is refused.[303]

148. Finally, clarity is required in relation to the credit guarantee scheme's rights once it has paid the guarantee.[304] The general legal principle is that the rights or claims of the lending financial institution against the MSMEs or other obligors are assigned to the credit guarantee scheme (statutory subrogation). To ensure that all parties are apprised, it is important that the subrogation right be explicitly set out in the terms and conditions of the guarantee and that the provision will clearly stipulate that the credit guarantee scheme can exercise such right without waiting for the financial institution to receive payment of any other amounts not guaranteed. An underlying condition for the effective implementation of the statutory subrogation, it is of course that the domestic legal framework recognizes the subrogation of the public credit guarantee scheme as legally enforceable. To reinforce their subrogation rights, certain credit guarantee schemes may conclude a separate agreement with the MSME under which this latter agrees to indemnify the scheme in respect of any payment made.

149. A public credit guarantee scheme may be subrogated to the rights of too many lending financial institutions, which may pose a threat to its financial sustainability. In order to mitigate such risk, it has been suggested that the credit guarantee schemes could convert guaranteed loans into equity or quasi-equity instruments and transfer the exposures to other public institution (such as development banks) or specialized

[296] The World Bank and FIRST Initiative (supra, footnote 267), p. 22.
[297] 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.
[298] For example, Italy and the United States. IMF, Special Series on COVID-19 (supra, footnote 277), p. 5.
[299] For example, France and the Netherlands. Ibid., p. 5.
[300] Ibid.
[301] The World Bank and FIRST Initiative (supra, footnote 267), p. 22.
[302] Ibid.
[303] Ibid.
[304] Ibid.

investment vehicles, which can better manage those positions. In the case of guaranteed loans of micro enterprises, converting the debt into a quasi-equity instrument, for example a future tax obligation, might be a more viable option, given the high costs of monitoring an equity investment.[305]

150. If the credit guarantee scheme provides only partial guarantees, both the scheme and the lending financial institution may have a claim against the defaulted MSME. For improved efficiency, the contractual agreement might specify whether the financial institution or the credit guarantee scheme or both are responsible for debt recovery from the MSME. To maximize the results, it may be convenient for the credit guarantee scheme to entrust the financial institution with this task, since financial institutions have typically more tools to acquire information about the MSME and potentially stronger incentives to recover the debt. In certain States,[306] for example, the lending financial institution is required to act as the agent of the credit guarantee scheme during the enforcement stage.[307]

(b) Private guarantee schemes

151. As noted above (see para. 129), credit guarantee schemes may also be directly funded and operated by the private sector and they can take the form of corporate guarantee or mutual guarantee schemes. The former can be limited liability companies or public limited companies governed by company law. In certain jurisdictions, corporate guarantee schemes are considered as specialized financial institutions and their prudential regulation is aligned with that of the banks.[308]

152. Mutual guarantee schemes are usually established by independent MSMEs or their representative associations for the purpose of providing guarantees only to their members.[309] They often take the legal form of cooperatives and are governed by the relevant domestic legislation. When the schemes are directly established by the MSEMs, these latter contribute to capital formation, participate in decision-making and take joint responsibility for outstanding credits. When business representative associations establish the scheme, they are responsible for its operation.[310] Although they are largely funded from membership fees, in certain countries mutual guarantee schemes operate with some form of State support.[311]

153. Financial institutions may find lending under mutual guarantee schemes profitable since risk assessment and follow-up on loan repayment may be facilitated by the entity overseeing the mutual guarantee scheme. This may considerably lower the financial institution's administrative costs. On the demand side, borrowing through a mutual guarantee scheme may enhance access to credit for viable MSMEs since mutual guarantee schemes may be better equipped to assess their loan applications than public credit guarantee schemes. In addition, due to their bargaining position, mutual guarantee schemes can negotiate with lending financial institutions lower loan interest rates than individual MSMEs.

154. There are, however, challenges in the operation of mutual guarantee schemes that may affect their long-term sustainability. In particular, high level of fragmentation, as most of such schemes serve a limited range of businesses; a low degree of economies of scale in the provision of guarantees, with relatively high operational costs; and high-risk exposure, due to their limited geographic and sectoral coverage. In several countries, these challenges have triggered mergers or consolidations of different mutual guarantee schemes to reduce the cost of service

[305] See https://blogs.worldbank.org/psd/protection-reallocation-public-credit-guarantee-schemes-post-pandemic-world.
[306] For example, Chile. See IMF, Special Series on COVID-19 (supra, footnote 277), p. 5.
[307] Ibid.
[308] GIZ, SMEs' Credit Guarantee Schemes in Developing and Emerging Economies, 2014, p. 22.
[309] Ibid., p. 15.
[310] L. Cusmano, SME and Entrepreneurship Financing: The Role of Credit Guarantee Schemes and Mutual Guarantee Societies in supporting finance for small and medium-sized enterprises, in OECD SME and Entrepreneurship Papers No. 1, 2013, p. 24.
[311] OECD, Discussion Paper on Credit Guarantee Schemes (supra, footnote 256), pp. 8–9.

and broaden the offer of guarantee instruments. In turn, this has also led to an upgrade of the technical competences of the entities overseeing the schemes and of their skills and strategies.[312]

(c) International schemes for credit guarantees

155. International assistance to set up and operate credit guarantee schemes may be needed in countries where they do not exist (due to lack of resources or in fragile and conflict-affected countries) or previous similar schemes did not succeed in the past and need to be re-oriented. Several international or regional organizations, including global and regional development banks (e.g. the World Bank, [313] the Asian Development Bank, [314] the African Development Bank), have thus launched international credit guarantee schemes in partnerships with a local entity, whether a public authority (e.g. a ministry), a financial institution, a private association or an NGO. Among the international organizations, it can be noted that UNDP[315] and the United Nations Capital Development Fund are engaged in the promotion of international guarantee schemes either in cooperation with national governments or with development banks. There are also privately funded credit guarantee schemes which operate on a regional or international level, such as those administered by the Grameen Foundation which provides assistance to local and regional microfinance institutions and other similar organizations.

156. International credit guarantee schemes are usually established in conjunction with technical assistance packages in order to facilitate their design and implementation.[316] They can have different goals, such as support the development of MSMEs in general[317] or of specific groups of entrepreneurs (e.g. women, youth, minority groups etc.) or of MSMEs working in specific sectors (e.g. digital or rural).[318]

5. Assessment of MSMEs' creditworthiness

157. The crucial element of any lending agreement is the financer's decision on whether or not to extend credit to the borrower. Prudent management requires that financers properly assess the borrower's creditworthiness, i.e., level of risk, capacity and willingness to repay the loan. This may not pose difficulties in the case of large companies, for which details on the company's commercial performance, financial statements, exposure to financial risks may be easily made available. In turn, it may become demanding and more expensive (compared to the value of the loan) with regard to MSMEs, in particular micro and smell enterprises whose data may be inadequate or unreliable, if at all available.

158. Due to such information asymmetry, financers are often more reluctant to lend to MSMEs than to bigger companies and, as noted earlier, they typically impose collateral and personal guarantee requirements on MSMEs to mitigate their credit risk. This often reduces MSMEs' options to access credit given their inability to comply with such requirements. In order to minimize information asymmetry, the G20 and OECD have recommended (i) developing information infrastructures for

[312] L. Cusmano, SME and Entrepreneurship Financing (supra, footnote 310), pp. 67–68.
[313] See www.worldbank.org/en/topic/smefinance.
[314] See for example "ADB to Provide Local Currency Lending to Support MSMEs Growth in Kazakhstan | Asian Development Bank".
[315] For example, UNDP has supported the Ministry of Tourism, Commerce, and Industry (MTCI) and National Commercial Bank of Timor-Leste to establish a loan guarantee facility for MSMEs in need of financial assistance.
[316] A. Green (2003), Credit Guarantee Schemes for Small Enterprises – An Effective Instrument to Private Sector-led Growth, p. 19.
[317] For example, the African Guarantee Fund (AGF), created under the leadership of the African Development Bank, is aimed at boosting access to finance for SMEs. See www.iadb.org/en/idb-finance/guarantees.
[318] See, for example, the USAID and Development Finance Corporation (DFC) programme in Zambia, where they partner with three different banks to provide guaranteed loans across different sectors and purposes, www.usaid.gov/documents/development-finance-corporation.

credit risk assessment that support an accurate evaluation of the risk in financing small businesses; (ii) standardizing credit risk information and making it accessible to relevant market participants and policymakers, to the extent possible and appropriate, and (iii) making credit risk information accessible at the international level so as to foster small businesses' cross-border activities and participation in global value chains.[319] In certain countries, the legal and regulatory framework has created information-sharing mechanisms consisting of multiple and complementary sources through which financers can gather information on a potential borrower before extending credit. This ensures that financers can properly assess the MSME's creditworthiness and any potential credit risk. The tools presented in the following paragraphs are examples of how information asymmetry can be reduced.

(a) Credit reporting

159. Credit reporting systems, where they are in place, play a key role in addressing the problem of information asymmetry as they enable the collection and distribution of financial information on potential borrowers thus allowing financers to learn more about the MSME characteristics, past behaviour, repayment history and current debt exposure. This can reduce the cost for financers to conduct due diligence and result in lower interest rates for MSMEs.[320] Credit reporting, however, may be less relevant in assessing the creditworthiness of the MSME in the context of relationship lending where interactions between the financer and the MSME over time allows the former to collect the information necessary to assess the creditworthiness of the latter. In that case, credit reporting may rather play a supplementary role to fill any residual gaps.

160. Credit reporting providers can be either public entities or privately owned companies: the latter tend to cater to the information requirements of financers, while the data collected and provided by the former are geared towards use by policymakers, regulators, and other public authorities and entities. In both cases, the service is often provided in a similar way and may raise similar procedural, technological and legal issues in relation to the collection and processing of data, their quality 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).[321] In recent years, some private credit reporting providers also offer additional services such as building credit risk databases. Credit risk databases collect anonymous information focusing on data regarding borrowers' present ongoing business rather than their past loan performance. They share information on the creditworthiness of the average borrower in the group having the same attributes and enable the building of statistical models.[322]

161. The International Committee on Credit Reporting (ICCR) has noted the absence in many countries of specific laws addressing commercial credit reporting. In certain cases, some provisions of the legal regimes for consumer credit reporting may fill that gap. However, not all such provisions may be applicable to commercial credit reporting given the different context. For example, information needed to assess the risk of commercial transactions generally includes significantly more data concerning payment and financial performance than that is required for individual consumers.[323] Further, protection of data subjects' privacy may be less relevant in the case of commercial credit information, and the underlying provisions may not be relevant to MSMEs.[324]

162. There are, however, certain legal and regulatory aspects that concern the general operation of a credit reporting system or facilitate gathering and sharing information

[319] G20/OECD High Level Principles on SME Financing, 2015, p. 6.
[320] For example, in Kenya the launch of a credit reporting service has helped reduce interest rates, collateral requirements, and default rates for loans at commercial banks.
[321] World Bank, General Principles for Credit Reporting, 2011, p. 7.
[322] Asian Development Bank Institute's publication on "Role of the Credit Risk Database in Developing SMEs in Japan: Lessons for the Rest of Asia, October 2015, pp. 10–11.
[323] Ibid., p. 13.
[324] World Bank, International Committee on Credit Reporting (ICCR): Facilitating SME financing through improved credit reporting, 2014, p. 20.

that are important for MSMEs' credit reporting.[325] In this regard, this section will briefly discuss: (i) MSMEs' reporting obligations; (ii) access to credit reporting services; and (iii) data quality. As a preliminary consideration, it should be noted that women entrepreneurs often face more obstacles than men to build their credit history as they may lack the identification documents required by the credit reporting providers, or they may not have an account with a formal financial institution or hold a credit card, which may prevent them from being considered by the credit reporting providers. An effective credit reporting system for MSMEs would profit from a legal and regulatory framework that remove those obstacles and support women to build their credit history.[326]

(i) Reporting obligations

163. There seem to be no standard requirements across jurisdictions for MSMEs to submit financial information to public agencies and/or other entities. Whereas in many countries there are no reporting obligations, in others the information required is often not sufficient for a robust assessment of the business creditworthiness. While this may ease the formation and initial growth of MSMEs through reducing administrative burdens associated with reporting, it does not facilitate credit reporting and thus access to credit. In addition, absence of mandatory reporting obligations may prevent small businesses from engaging in good financial reporting practices which would be in their interest as it would provide evidence of their accountability and transparency of their operations and help them attract investments as they further progress. 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. [327] As noted earlier, recognizing that publicly available information (e.g. on working capital or capital needs) may help strengthen market reputation, both the UNCITRAL LLE Guide and the UNCITRAL Business Registry Guide (see paras. 63 and 69) advise States to encourage small businesses' voluntary submission of financial information to the relevant authorities.[328]

164. A domestic legal framework that addresses transparency requirements and specifies which type of business information and data should be considered confidential and not subject to reporting obligations would encourage and greatly facilitate MSMEs' financial reporting. Several MSMEs are in fact concerned that disclosing financial and other business-related data may hinder their ability to compete in the market, since it would allow competitors to access sensitive information. To ensure equal consideration given to the needs of creditors, it would also be important for the legal framework to balance the right of MSMEs to protect their know-how with that of their creditors to collect, analyse and distribute credit-related data.[329]

(ii) Access to credit reporting services[330]

165. Public and private credit reporting providers serve different beneficiaries. Therefore, different rules may govern access to their services. Credit risk databases are often maintained by associations formed by financial institutions, credit guarantee corporations and others, and[331] access to their services may be limited to members. In

[325] Ibid.
[326] N. Almodóvar-Reteguis, K. Kushnir, and T. Meilland, in Women, Business and the law, Mapping the Legal Gender Gap in Using Property and Building Credit, p. 6.
[327] World Bank, ICCR, Facilitating SME financing (supra, footnote 324), p. 20.
[328] See UNCITRAL Legislative Guide on Key Principles of a Business Registry (2018), para. 155 and UNCITRAL Legislative Guide on Limited Liability Enterprises (2021), para. 142.
[329] World Bank, ICCR, Facilitating SME financing (supra, footnote 324), p. 21.
[330] The secretariat has expanded this subsection and also clarified that MSMEs should be allowed to access information about themselves and to request correction of errors, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 91).
[331] Asian Development Bank Institute's publication on "Role of the Credit Risk Database in Developing SMEs in Japan: Lessons for the Rest of Asia, October 2015, p. 4.

general, MSMEs should be allowed to access their own data in order to correct or update it as necessary.

166. As noted by the World Bank, the legal and regulatory framework supporting credit reporting should provide that data access responds to impartial rules so that all users of either private or public services have access to information under the same conditions established for that type of service (e.g. access fees or access to the same information).[332] There may be exceptions to this principle of non-discrimination depending on the objective of a particular credit reporting provider. For example, those public credit reporting providers mainly created to support banking supervision and improve the availability and quality of credit data for supervised intermediaries may serve regulated financial institutions only.[333]

(iii) Data quality

167. High data quality is the cornerstone of an effective credit reporting system. Data quality is considered high when 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.[334] Inaccurate data can result in unjustified loan denials, higher borrowing costs, and other unwanted consequences for MSMEs, data providers (e.g. banks, financial institutions or commercial companies) and credit reporting providers. The accuracy of data depends on how they are gathered, usually through loans and contracts (see para. 170), and how credit reporting providers process the raw data received in order to convert them into the final products that will be accessed by the financers.[335]

168. High quality data may be achieved by means of a legal and regulatory framework that specifies the purposes for which data may be collected, the circumstances in which they can be used, the required quality and accuracy, the timeliness[336] as well as any limits concerning potential grounds for discrimination (e.g. race, gender, language) and any time limits during which the data may be maintained.[337] For effectiveness of the credit reporting system, these requirements should be applicable to both data and credit reporting providers.

169. Accuracy and reliability of the information provided by the MSMEs when interacting with data providers contributes to data quality. MSMEs should be allowed to dispute the accuracy and completeness of their own data and have those complaints investigated and any errors corrected.[338]

(b) Public agencies: a complementary source of relevant information

170. The most common sources of data on MSMEs' creditworthiness are banks and other non-bank financial institutions that are small businesses' most common creditors. While these entities are usually required by law or regulation to provide the information to public credit reporting providers, there seem to be no laws mandating disclosure of information to private credit reporting providers[339] or non-traditional financers (e.g. business angel investors) that might have an interest in extending credit to MSMEs. Other potential sources of data and information can include commercial entities such as factoring and leasing companies and non-bank financial

[332] World Bank, General Principles (supra, footnote 321), p. 42.
[333] Ibid., p. 35.
[334] See General Principle 1 in World Bank, General Principles (supra, footnote 321), p. 25.
[335] Ibid., p. 26.
[336] OECD, Discussion Paper on Credit Information Sharing, p. 12.
[337] World Bank, General Principles (supra, footnote 321), p. 37.
[338] OECD, Discussion Paper on Credit Information Sharing (supra, footnote 337), p. 12.
[339] In practice, some banks may provide private credit reporting providers with information on a voluntary basis, others may do so on a limited basis only (for example, not allowing the private credit reporting provider 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. See World Bank, ICCR, Facilitating SME financing (supra, footnote 324), p. 18.

institutions, as well as trade creditors. It seems that, however, none of these entities provide as much data as expected.[340]

171. In order to offset the scarce or inadequate information from all those sources, public sector agencies, such as taxation and social security or the business registry, may represent an additional and valuable source of information. Among others, they may provide official identification data for MSMEs, data that contribute to determining MSME's behaviour (e.g. bankruptcy information) and financial information.[341] In countries where they are established, security rights registries may provide information on the registration[342] of a security right on assets that MSMEs may use to secure a loan.

172. However, allowing access to information maintained by public agencies requires striking a balance between facilitating the assessment of MSMEs' creditworthiness and protecting sensitive or confidential data relating to the MSMEs so there is no infringement of their privacy or rights. In this respect, good practices suggest that laws or regulations may clarify (i) if and which data public agencies can share and under which conditions; (ii) whether financial institutions or credit reporting service providers can reuse accessible data, if any, for commercial purposes; and (iii) specific provisions for the protection of the MSME privacy.[343]

173. Even when an adequate legal framework is in place, practical impediments may affect the collection of data from public agencies. 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.[344] Because of budget and other constraints, States may not be able to provide financial support to all public agencies that collect data relevant for assessing MSMEs' creditworthiness. A viable strategy would thus be to prioritize resources to first assist those agencies (e.g. tax authorities) whose records are key to carry out such evaluation.

(c) Alternative data

174. When MSMEs or their clients use cloud-based services, their mobile or smartphones, engage in social media, sell or buy on electronic commerce platforms, ship packages,[345] make e-payments, conclude an online transaction or manage their receivables, payables, and record-keeping online, they create digital footprints.[346] In recent years, such footprints, defined as alternative data,[347] have gained increased

[340] For example, in the United States it is estimated that less than 50 per cent of business-to-business suppliers share trade credit information with commercial credit information companies.

[341] Ibid., p. 19.

[342] The secretariat has replaced the words "potential existence" with the current drafting to clarify that security rights registries do not provide evidence of the existence of a security right, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 93).

[343] As requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 92), the secretariat has revised this paragraph (para. 218 of A/CN.9/WG.I/WP.128) in order to (i) ensure a more balanced drafting given the nature of the information maintained by public agencies; and (ii) delete embedded recommendations.

[344] World Bank, ICCR, Facilitating SME financing (supra, footnote 324), p. 21.

[345] For example, a US-based FinTech company uses, among other sources of information, the shipping records of international freight forwarders to assess the risk and creditworthiness of businesses seeking a loan. See GPFI, Alternative Data Transforming SME Finance, 2017, p. 12.

[346] OECD, Discussion Paper on Credit Information Sharing (supra, footnote 336), p. 12.

[347] The Global Partnership for Financial Inclusion (GPFI) defines as "alternative" the data generated by the increasing use of digital tools and information systems. See 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 www.gpfi.org.

relevance in credit reporting.[348] This trend towards the proliferation of alternative data can facilitate access to credit, especially for those small businesses operating in the informal economy that have no or "very thin credit files".[349] Alternative data can also prove beneficial for financers[350] as it allows a more comprehensive assessment of the business's creditworthiness, which is not only linked to conventional information such as financial data, but also to data created outside the financial system and may thus result in an improved credit scoring[351] for the business. Moreover, since the data comes from digital sources, it makes it easier to monitor the MSME's conditions, detect fraud and adopt the relevant risk mitigation measures. This may also encourage positive financial behaviours of the MSME.[352] Finally, since alternative data is usually generated by third-party providers, they may be more reliable than asset value information and financial statements provided by the MSME, which also contributes to reduce the lending risk of financers.[353]

175. However, in many countries the absence of a strong legal and regulatory framework may pose obstacles to the effective use of alternative data which may result, for example, in data inaccuracies, privacy and personal data protection[354] and intellectual property issues. For example, social media data is often collected without the MSME's consent which may result in their unlawful use since that data is usually not meant to be used for credit reporting purposes. In addition, if collection is not properly monitored, alternative data may lead to discriminatory credit scoring practices based on the race, colour, sex, marital status or other similar attributes of the MSME's owner.[355] International expert forums[356] suggest that in order to support an effective and transparent use of alternative data countries may reform their laws to clarify how to collect and process such data in a way that preserve their accuracy and integrity (in line with privacy and data protection international standards), ensure their compliance with credit laws or regulations, and avoid potential discrimination.

176. Given the flow of alternative data across borders, issues of how data is treated in different countries may also easily arise. There may be differences in the specific data that can be collected for lending purposes and shared cross-border, or difficulty in identifying MSMEs in different countries due to inconsistent or non-standardized identification systems. For example, international experts forums recommend that States cooperate with relevant international bodies to harmonize different aspects of their legal regimes applicable to cross-border data flow,[357] including the adoption of a global unique identifier for MSMEs that could greatly facilitate cross-border data sharing.[358] So far as the collection of alternative data involves the identification of MSMEs and the flow of data between credit reporting providers, and financers, the work of UNCITRAL on legal issues related to the digital economy, notably on identity

[348] For example, a small business digital lending platform uses alternative data such as business volume, number of UPS packages a business sends and receives over time, or social media activity to underwrite MSMEs' loans. See https://yabx.co/2020/08/04/use-of-alternative-data-to-revolutionize-digital-sme-lending/. As another example, in Chile a major credit-scoring agency has partnered with a start-up in order to use cell phone data to provide a "Predictor Inclusion Score" for those without credit history. See World Bank, Credit Reporting Knowledge Guide 2019, p. 110.

[349] GPFI, Use of Alternative Data (supra, footnote 347), p. 5.

[350] See for example www.datappeal.io/5-benefits-of-alternative-data-for-banks-and-financial-institutions-from-enriched-credit-scoring-to-lead-qualification/.

[351] Credit scoring is a statistical analysis to determine the creditworthiness of individual consumer or small business borrowers. Its results determine financers' decision on whether to extend or deny credit.

[352] GPFI, Use of Alternative Data (supra, footnote 347), p. 5.

[353] See Hong Kong Monetary Authority, Alternative Credit Scoring of Micro-, Small and Medium-sized Enterprises, p. 29.

[354] See for instance the Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data (ETS No. 108), 1985, available at www.coe.int/en/web/conventions/full-list?module=treaty-detail&treatynum=108.

[355] GPFI, Use of Alternative Data (supra, footnote 347), p. 6.

[356] Ibid.

[357] GPFI, Use of Alternative Data (supra, footnote 347), p. 26.

[358] Ibid.

management and trust services and on data transactions, may be relevant. Work of UNCTAD on the role and value of digital data in electronic commerce and its advocacy efforts for a system of global data governance may also contribute to enhance MSMEs' access to credit.[359]

Recommendation 9:[360]

The law should specify the nature and scope of obligations for commercial credit reporting as a measure to facilitate the assessment of MSMEs' creditworthiness.

6. Support for MSMEs in financial distress[361]

177. An effective and efficient insolvency facilitates access to credit not only through reorganization[362] and supporting pre-commencement out-of-court debt restructuring options, but also by ensuring reallocation of resources for productive uses through appropriate business viability verification mechanisms and speedy liquidation of non-viable businesses.

178. Debt restructuring options provided in an effective and efficient insolvency regime are key to any support to MSMEs in financial distress. When facing financial difficulties, MSMEs often do not have the resources to cope with high restructuring costs (including seeking professional advice), although the use of technology (e.g. artificial intelligence and big data) may potentially reduce restructuring costs.[363] 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 is adopted, financers might be more likely to extend credit to MSMEs as such framework could avoid 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.

Mechanisms under insolvency law

179. Although not specifically tailored to the needs of MSMEs, parts one and two of the *UNCITRAL Legislative Guide on Insolvency Law* (2004) offer useful guidance for building a support system for MSMEs' access to credit. For example, financers may be more willing to lend when there are transparent and certain rules on (i) the treatment of claims and recognition of their rights and claims arising under law other than the insolvency law, such as secured transactions law;[364] (ii) treatment of contracts under which both the debtor and its country have not yet fully performed their respective obligations;[365] and (iii) the exercise of set-off rights existing under

[359] See for example the work of the Intergovernmental Group of Experts on E-commerce and the Digital Economy at UNCTAD (https://unctad.org/meetings-search?f%5B0%5D=product%3A335 instance) or the Digital Economy reports series (https://unctad.org/webflyer/digital-economy-report-2021).

[360] The secretariat has included a recommendation inviting States to consider addressing commercial credit reporting in their laws without prescribing how such issue could be addressed, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 90).

[361] The secretariat has revised this section to reflect that general insolvency law framework also offers useful guidance for building a support system for MSMEs' access to credit, with reference to parts one and two of the *UNCITRAL Legislative Guide on Insolvency Law* (2004).

[362] The term "reorganization" refers to the process by which the financial well-being and viability of a debtor's business can be restored and the business continue to operate, using various means possibly including debt forgiveness, debt rescheduling, debt-equity conversions and sale of the business (or parts of it) as a going concern.

[363] According to some studies, the costs of financial distress represent 10 per cent to 20 per cent of the market value of a small business. See A. Gurrea-Martinez, Implementing an Insolvency Framework for Micro and Small Firms, 2020, footnote 49.

[364] UNCITRAL Legislative Guide on Insolvency Law (2004), recommendations 3, 4 and 188.

[365] Ibid., recommendations 69–86.

the law other than the insolvency law.[366] Moreover, financers may be further incentivised to lend after the commencement of insolvency proceedings when rules establish priority for new finance provided after the commencement of insolvency proceedings (at least ahead of ordinary unsecured creditors) and allow granting a security right on both unencumbered assets and already encumbered assets.[367] Last but not least, an expedited procedure for court confirmation of a restructuring plan negotiated between the debtor and creditors may also encourage creditors to participate in such negotiations.[368]

180. The *UNCITRAL Legislative Guide on Insolvency Law for Micro- and Small Enterprises* (the *"Legislative Guide"*) is designed to address the unique circumstances of micro and small enterprises.[369] Provisions concerning new financing, informal restructuring and early rescue mechanisms are particularly relevant in this context. The *Legislative Guide* recommends facilitating and providing incentives for new 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.[370]

181. The *Legislative Guide* also recognizes the importance of informal debt restructuring negotiations. States are encouraged to provide appropriate incentives for the participation of creditors in informal debt restructuring negotiations (e.g. tax incentives, exempt transactions arising from informal debt restructuring negotiations from avoidance proceedings).[371] They are also encouraged to identify and remove disincentives for the use of informal debt restructuring negotiations (e.g. an obligation to file for formal insolvency within a certain period after the occurrence of certain events, insolvency law provisions on avoidance of transactions concluded during a certain period before filing for insolvency).[372] Furthermore, institutional support with the use of informal debt restructuring negotiations (e.g. involvement of a competent public or private body to facilitate negotiations) is also recommended.[373]

182. Further, the *Legislative Guide* envisage establishing mechanisms for providing early signals of financial distress to micro and small enterprises, increasing financial and business management literacy among micro and small enterprises' managers and owners and promoting their access to professional advice.[374] The *Legislative Guide* highlights three mechanisms that may be of particular assistance to ensure early rescue of such small businesses. 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 para. 225). 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.[375]

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[366] Ibid., recommendation 100.
[367] Ibid., recommendations 63–68.
[368] Ibid., recommendations 160–168.
[369] UNCITRAL Legislative Guide on Insolvency Law for Micro- and Small Enterprises (2021). It is also published as part five of the *UNCITRAL Legislative Guide on Insolvency Law* and is intended not to replace but to supplement the guidance given in other parts of the *UNCITRAL Legislative Guide on Insolvency Law*.
[370] Ibid., recommendation 107.
[371] Ibid., recommendation 105 and related commentary.
[372] Ibid., recommendation 104 and related commentary.
[373] Ibid., recommendation 106 and related commentary.
[374] Ibid., recommendation 103.
[375] Ibid., recommendation 103 and related commentary.

Recommendation 10:[376]

Legislative measures addressing support for MSMEs in financial distress should give due consideration to existing international standards, such as the *UNCITRAL Legislative Guide on Insolvency Law and the Legislative Guide on Insolvency Law for Micro- and Small Enterprises.*

7. Enforcement[377]

183. One major challenge in extending credit to MSMEs is the inadequacy of available enforcement mechanisms in relation to recoverable amounts. A timely, predictable and affordable enforcement of contractual rights could help develop credit market and improve access to credit. Conversely, cumbersome enforcement processes may discourage financers from lending to MSMEs.

184. The issue of enforcement is important for both secured debt and unsecured debt. In either case, typically a creditor can obtain a judicial decision against a defaulting obligor, which will trigger a procedure to allow the creditor to obtain satisfaction, usually by applying to assets of the obligor. Some legal systems may also allow a creditor to proceed to execution against a defaulting obligor without having to first obtain a judicial decision on the merit. A wide variety of approaches for extra-judicial enforcement exist in different jurisdictions.

185. Section 3 above (on secured transactions) already highlights the importance of effective enforcement for a secured transaction regime that facilitates credit for MSMEs in respect of both movable and immovable assets (see paras. 80 and 91). Complex enforcement procedures may have a negative impact on access to credit for MSMEs. For example, the financer may be required to bring a court action in order to have its security right recognized and to seize and sell the encumbered asset under strict rules and the supervision of a public official.[378] On the other hand, availability of effective and cost-efficient enforcement mechanisms, including out-of-court enforcement, as provided in the *Model Law* is likely to encourage financers to lend based on MSMEs' assets. While out of court enforcement may be more advantageous for financers, it may however pose risks of misuse. To minimize any such risks, the *Model Law* imposes conditions on how financers can undertake out of court enforcement (arts. 77 to 80).[379] It should be noted, in particular, that the *Model Law* does not restrict access to judiciary. Where a party to a security agreement does not comply with the law and the other party has a complaint, the aggrieved party retains the right to seek judicial relief (art. 74).

186. It should be noted that laws other than the secured transaction law could impact a financer's enforcement options in respect of secured debt. For example, certain laws 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. Whether certain assets (e.g. essential personal assets, household goods) should be exempt from enforcement is a policy question for each individual State. The *Model Law* does not override these provisions (art. 1(6)). Financers can deal with such restrictions as long as they are set out in a transparent way in the law.

187. At the national level, many jurisdictions have introduced mechanisms that may serve as an incentive not to default on obligations, thereby limiting the need to resort

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[376] The secretariat has included a general recommendation encouraging the enactment of legislative provisions based on the UNCITRAL Legislative Guide on Insolvency Law for Micro- and Small Enterprises, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 94).

[377] The secretariat has added a new standalone section on enforcement (not limiting to the enforcement of security rights over movable assets) and placed it before the section on dispute resolution mechanisms, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 102).

[378] UNCITRAL Legislative Guide on Secured Transactions, Chapter VIII, para. 1.

[379] See also UNCITRAL Practice Guide (supra, footnote 150), para. 304.

to enforcement proceedings, such as public or private debtor registries. While these mechanisms could serve to facilitate compliance with enforcement orders, they are often not considered as part of the enforcement procedure as such.[380] In addition, recent reforms of enforcement laws[381] have introduced more specific tools that could be used by bailiffs to enforce claims, such as authorizing bailiffs to obtain information about the debtor's financial circumstances and requiring a defaulting debtor to disclose his or her income and financial situation at the beginning of the enforcement proceedings.[382] Last but not least, the use of digital technology in the enforcement of debt (including the digital management of enforcement activities, and the use of artificial intelligence to set up automated enforcement) also merits consideration.[383]

8. Dispute resolution mechanisms[384]

188. An effective dispute resolution system is critical in determining the decision of MSMEs[385] to borrow and of financial service providers, including credit reporting providers, to extend their services to the small businesses. Disputes may arise about excessive fees or interests, use of specific products (e.g. credit cards, mortgages etc.), rejections of loan requests or poor financial advice.[386] In the relation between the small businesses and credit reporting providers (or the data providers) complaints may range from requesting to rectify errors or adverse decisions based on inaccurate data, to deleting certain data or to claiming compensation for any damage incurred.

189. In many countries settling financial disputes in court may not be a viable option for most MSMEs, particularly micro and small enterprises, 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 (mature medium-sized enterprises may have the necessary skills and financial resources). The existence of redress mechanisms outside the court system, which can solve such disputes effectively and at low cost, may thus encourage MSMEs to apply for a loan. Efficient redress mechanisms would be beneficial for financial service providers as well. Financial institutions are generally more willing to lend to MSMEs ex ante when adequate redress mechanisms are in place to allow them to recover the loan[387] in the event of default, thereby providing better creditor protection. Financial institutions' decisions to lend are often affected by several aspects of the judicial system including (i) the number of procedural steps required to enforce a contract and (ii) the time and costs for resolving a dispute in court. A cumbersome judicial procedure requires additional effort and resources to recover the credit and it may even result in a financial loss for the financial institution in case of the MSME's default, given the low amount of the credit usually granted to the MSME. The length of dispute resolution often affects the cost of lending for the financial institutions and their disposition to lend since fast resolution allows a faster loan recovery. Finally, high costs of court proceedings and attorney fees make the providers of financial services more reluctant to grant small loans to MSMEs. As the

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[380] See Issues Paper for the first session of the UNIDROIT working group on Best Practices for Effective Enforcement, Study LXXVIB – W.G.1 – Doc. 2, para. 43.

[381] Drawing on countries' best practices, UNIDROIT is carrying out work on "Best Practices for Effective Enforcement" since 2020, with the aim to prepare an international instrument for national legislators which can assist them addressing issues of enforcement of commercial unsecured and secured debts. For further information, see www.unidroit.org/work-in-progress/enforcement-best-practices/#1644493658763-89df3b2e-4a80.

[382] See UNIDROIT Issues Paper (supra footnote 380), para. 44.

[383] See generally the International Union of Judicial Offers (UIHJ) publication on Global Code of Digital Enforcement, November 2021.

[384] The secretariat has revised the heading of this section as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 97).

[385] Medium-sized enterprises and micro and small enterprises often face the same problems in relation to disputes with financers.

[386] CGAP, Financial Access, The State of Financial Inclusion Through the Crisis, 2010, p. 32.

[387] The secretariat has deleted the phrase "control borrower risk" (para. 228 of A/CN.9/WG.I/WP.128) as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 97).

Consultative Group to Assist the Poor (CGAP) has noted, availability of redress mechanisms for financial disputes thus is not just a matter of fairness to address the power imbalance between MSMEs and financial service providers, but it is beneficial to the credit industry overall as it enhances its sustainability.[388]

(a) Dual-track dispute resolution systems

190. To solve disputes between MSMEs and financial service providers in an efficient way, in many States, laws or regulations[389] set forth a dual-track dispute resolution system, as in other types of disputes between service providers and customers. The system usually provides for internal complaints handling procedures implemented by the financial providers and external redress mechanisms that address those complaints that are not resolved through the internal procedures. Best practices in the operation of such mechanisms would ensure that they are accessible at a reasonable cost, independent, fair, accountable, timely and efficient and do not impose burdens on the MSMEs.[390] It should be noted that while internal complaint handling mechanisms are available to medium-sized enterprises as well, certain external redress mechanisms may not be available to them but to micro and small enterprises only (see para. 196).

a. Internal complaint handling procedures

191. In countries reflecting good practices, internal complaint handling procedures usually comply with minimum standards such as those requiring the provision of clear information on the grounds the small businesses can submit a complaint and through which channels. Accordingly, adequate channels (including working hours) for submitting the complaints are in place and address the needs of remotely located MSMEs too. Best practice would encourage to make available specially tailored channels for entrepreneurs with specific needs, such as illiterate ones or entrepreneurs who speak only local dialects.[391] Additionally, it is important that the financial service provider acknowledges receipt of the complaints in a durable medium, for example in writing or in another form that the MSME can store. Efficient internal complaint procedures also require that the financial service providers 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 an external redress mechanism (e.g. a financial ombudsman, a mediator etc.). Finally, if external redress mechanisms exist, throughout their complaints-handling process the small businesses should be informed about the possibility to seek redress through such schemes.[392]

(b) External redress mechanisms

192. If the MSMEs are unsatisfied with the decision resulting from the internal complaints system they should have the opportunity to appeal to external redress mechanisms such as the financial ombudsman services, commercial mediation and arbitration. These mechanisms are not mutually exclusive as they have different scope and, in some countries, more than one mechanism can address customers' complaints.[393] For example, the financial ombudsman not only investigates and

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[388] CGAP, Financial Access (supra footnote 386), p. 31.

[389] As agreed by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 97), the secretariat has clarified that the dual-track system is regulated by the law. The Working Group may wish to note the revised heading of this sub-section.

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

[391] World Bank, Good Practices for Financial Consumer Protection, 2017, pp. 49–50. The Good Practices is a compilation drawing on successful policy, legislative and regulatory initiatives around the world that consolidates, complements and expands 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 enterprises since those businesses usually face the same challenges as individual consumers and require the same basic protection.

[392] Ibid.

[393] CGAP, Financial Access (supra, footnote 386), p. 31.

resolves disputes between financers and MSMEs, but can also provide business support to prevent disputes through initiatives ranging from regular communications to advisory groups or ad hoc meetings. On the other hand, ombudsman decisions are often not binding on the parties and the ombudsman may not provide a quick solution to more complex claims. There might also be time limits affecting the possibility for a small business to bring a complaint to the ombudsman.

193. When the financer and MSME wish to minimize conflict, mediation may be a more appropriate mechanism to help them preserve their relationship. Mediation is a consensual, informal and flexible process, quicker than litigation and gives parties the chance to understand each other's point of view and to craft tailor-made solutions. However, parties can terminate the mediation process at any time, thus jeopardizing the possibility to reach an amicable settlement. Moreover, mediation may not necessarily lead to a binding decision, since the mediator, like the ombudsman, does not have such power.[394] The *UNCITRAL Model Law on International Commercial Mediation and International Settlement Agreements Resulting from Mediation* (2018) and the *United Nations Convention on International Settlement Agreements Resulting from Mediation* (New York 2018) (the "*Singapore Convention on Mediation*") provide internationally harmonized rules, also applicable in the context of financers' and MSMEs' disputes, to assist States in reforming and modernizing their laws on mediation. In several countries ad hoc banking mediation services exist, which can either offer specific services for small businesses, or be open to businesses of all sizes, including MSMEs, and legal status.[395] Banking mediation may be particularly suitable for small businesses since it does not only foster amicable settlement of disputes with financers, but also facilitates mutual exchange of financial information and strengthens MSMEs' capacity to supply adequate information in a financial transaction.[396] As it has been noted, the benefits of banking mediation often extend beyond the individual loan case assisted.[397] Financers and MSMEs may be encouraged to have prior recourse to mediation and banking mediation (where it is in place) before considering adversarial dispute resolution options such as arbitration.[398]

194. If the dispute cannot be resolved amicably and requires a more formal resolution, arbitration may be a preferable choice to litigation, particularly for small loan disputes since it is time and cost efficient. In certain countries, mandatory arbitration clauses to solve disputes arising between financers and MSMEs are included in the loan agreement. Good practice, however, discourages such policies as they limit MSMEs' relief options.[399,400] While arbitration is less formal than court proceedings (thus less intimidating for a small business), follows simpler procedural rules adaptable to the needs of the parties and is flexible in scheduling and location of the hearings, as an adversarial proceeding it requires lawyers and sometimes other experts. It can thus be an expensive and a non-viable option for an MSME, in particular given the low value of the loan. Moreover, recourse against an arbitral award can usually be made only in court. UNCITRAL legislative and contractual texts on international commercial arbitration provide a comprehensive set of rules to assist

[394] The secretariat has emphasized the consensual nature of mediation (opening sentence of the paragraph) and its non-binding nature (third sentence) as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 97).

[395] For example, in France, where a banking mediation service operates under the supervision of the National Bank. See https://mediateur-credit.banque-france.fr/.

[396] See for example the *service de médiation crédit bancaire* in Belgium. Further information available at: Conseils et médiation: améliorez vos perspectives d'accès au crédit, available at www.1890.be/solution/mediation-creditwww.1890.be/solution/mediation-credit.

[397] OECD (authored by L. Cusmano), Credit mediation for SMEs, 2013, p. 29.

[398] At its thirty-eighth session, the Working Group agreed that parties could consider mediation as a first step to solve their disputes (A/CN.9/1122, para. 97). The secretariat has implemented that decision by adding this final sentence (para. 232 of A/CN.9/WG.I/WP.128).

[399] World Bank, Good Practices (supra, footnote 392), p. 52.

[400] As requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 97), the secretariat has: (i) added reference to time and cost efficiency of arbitration and (ii) clarified that arbitration should never be mandatory.

(i) States also in strengthening the domestic arbitration regime, and (ii) arbitral institutions in drafting rules for arbitration proceedings.

195. To increase MSMEs' access to dispute resolution mechanisms, regional organizations and States are increasingly supporting the use of online dispute resolution mechanisms. They are easy-to-use, fast and low-cost platforms and do not require the physical appearance of the parties. These and other features make them particularly suitable for low value disputes and disputes arising out of cross-border transactions. For example, the Asia Pacific Economic Cooperation (APEC) has launched the Collaborative Framework for Online Dispute Resolution of Cross-Border Business to Business Disputes with the scope of helping small businesses to resolve cross-border low value disputes. Online dispute resolution mechanisms require a conducive legal environment that permits, for example, choice of forum and does not require physical appearance of the parties or physical written submission of documents. States may thus have to amend domestic laws accordingly. The *UNCITRAL Technical Notes on Online Dispute Resolution* (2017) may provide guidance to States, ODR platforms and administrators regarding how to develop and use such mechanisms.

196. As noted earlier, in many countries certain external redress mechanisms, for example the ombudsman,[401] serve both individual consumers and micro and small enterprises as they usually face the same challenges and require the same protection in their disputes with banks, their subsidiaries and other financial intermediaries. In order to determine the eligibility of a business to access those services, States typically use criteria such as the number of employees or its annual turnover that are set at a level which de facto excludes medium-sized enterprises.

b. Features of external redress mechanisms

197. In accordance with good practices, external redress mechanisms are usually established by industry or associations or by law.[402] Regardless of whether they have a statutory or industry-based nature, it is advisable that the mechanisms 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.[403] Further, it is also important that they operate in a cost-efficient way in order to minimize any financial burden on their users, in particular the smaller businesses, as well as taxpayers in general if they are public entities. Cost-efficiency can be achieved through regular assessment of available human and financial resources so to plan in advance their allocation and reduce any potential misuse. Regular monitoring of case handling permits to improve procedures and their user-friendliness. Public funds, public-private partnerships or requiring financial institutions to meet the cost of the services can ensure the sustainability of the redress mechanisms[404] while at the same time increasing MSME's accessibility (see para. 201).

198. As noted earlier (paras. 192 and 193), an important aspect of these mechanisms is whether they can render binding decisions as some of them (e.g. ombudsman or mediation) may rely more on voluntary compliance, although reputational risks may

[401] For example, the Office of the Banking Services Ombudsman in Trinidad and Tobago (www.ofso.org.tt/index.php/about-us/) or the Financial Ombudsman Service in the United Kingdom or the Australian Financial Complaints Authority (AFCA). AFCA was established in 2018 to replace the Financial Ombudsman Service and the Credit and Investments Ombudsman. Further information available at: www.afca.org.au.

[402] By way of example, the World Bank cites the microfinance or industry associations' schemes such as MFIN and Sa-Dhan in India, ALAFIA in Benin and AMFIU in Uganda. See World Bank, Good Practices (supra, footnote 392), p. 52.

[403] Ibid., p. 51.

[404] 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 alternative dispute resolution scheme (e.g. Armenia, Australia, Canada, Trinidad and Tobago and the United Kingdom). See World Bank, Good Practices, Ibid. p. 52.

often pressure the financial entities to comply. For example, if a financial institution does not comply with the decisions of the relevant redress mechanism a notice of non-fulfilment may be made public.[405] To ensure protection of the small business, in certain countries the decisions of the external redress mechanism are binding on financial entities[406] and financial entities are not allowed to appeal against those decisions, as this could easily result in costly and lengthy processes in court where small businesses will be highly disadvantaged.[407] In some countries, however, restrictions on the right to appeal against decisions of the external redress mechanism may be unconstitutional[408] and yet in other countries appeals may be allowed only in a few circumstances, such as if procedural rules were violated, or the prejudice of the mediator was demonstrated.[409]

199. Other key features to consider for the efficient functioning of the external redress mechanisms are their independence and the impartiality of their decision-making process which contribute to build trust in their operation. For example, the International Network of Financial Services Ombudsman Schemes notes that the independence should be established in the law or in a constitution that is approved by a public entity, the parties should not be able to influence the service directly or indirectly and the ombudsman or the members of the decision-making panels should have not worked in previous years in a financial entity covered by the service.[410] The mechanisms' independence and the impartiality of their decision-making process should also be preserved from any undue influence of their sources of funding, regardless of whether they are public or private or a combination of both. It should be noted that in certain cases (e.g. errors or inaccuracy of data maintained in a credit registry) quantifying damages and the resultant compensation might be difficult to do in practice and the law or regulation could provide guidance on this matter.

200. As noted earlier (see para. 190), in best practice countries, the principles of accessibility, effectiveness, fairness and transparency and accountability also guide the activities of the external redress mechanisms. The following paragraphs provide a short account of how they are implemented.

(i) Accessibility

201. The law usually ensures that the mechanisms provide information in a plain and understandable language, users have easy access to the mechanisms, both online and face to face, and can file complaints through different media. In addition, complainants are not required to pay any fees (or they pay only minimal fees), since this may discourage them from using the service.[411] While at times fees might be considered as a disincentive to prevent frivolous complaints, it seems that granting the authority to the external redress mechanism to reject complaints that are frivolous, vexatious or misconceived may be more effective.[412]

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[405] See the *arbitro bancario finanziario* in Italy in A/CN.9/780, para. 22. The term "arbitro bancario finanziario" can be roughly translated as "banking financial arbitrator".

[406] For example, in the Russian Federation, the Federal Law 4 June 2018 #123-FZ lists organizations that are obliged to comply with the decisions of the commissioner for the rights of consumers of financial services (also including MSMEs). If those organizations are non-compliant, the decision of the Commissioner can be enforced by the court executive authorities.

[407] World Bank, Good Practices (supra, footnote 392), p. 52.

[408] At its thirty-eighth session the Working Group agreed to clarify in paragraphs 199 and 200 (paras. 237 and 238 of A/CN.9/WG.I/WP.128) that in some countries restrictions on the right to appeal against decision of the external redress mechanism may be unconstitutional (A/CN.9/1122, para, 97). The secretariat has implemented that decision in this paragraph (para. 236 of A/CN.9/WG.I/WP.128) for improved consistency of the text.

[409] For example, Malta and Armenia. As to limitations on the scope of an appeal see art. 17. The Republic of Armenia Law on Financial System Mediator, available at: www.fsm.am/media/2398/law-on-fsm.pdf.

[410] Network of Financial Services Ombudsman Schemes, Effective approaches to fundamental principles, 2014, p. 2.

[411] See World Bank, Good Practices (supra, footnote 392), p. 52.

[412] For example, Australia, Armenia and Malta.

(ii) Effectiveness

202. The law includes a clear definition of what constitutes a complaint and clarify that it will be dealt with no delay through a flexible and informal process for which the parties will not need a lawyer or an advisor. Further, the parties are notified when documents are received by the redress mechanism and the mechanism's decisions should be taken and made available within a specified time.

(iii) Fairness

203. Best practice countries usually ensure that the procedures of the redress mechanism allow the parties to receive all documents submitted, to express their arguments and respond to the other party's arguments, as well as to have access to any statements made and opinions given by experts and be able to comment on them.

(iv) Transparency and accountability

204. Finally, best practice suggests that the redress mechanisms inform the parties of their scope, the types of disputes they are competent to deal with, including any threshold if applicable, the procedural rules governing their activities and the type of rules they may use in their dispute resolution activity and any requirement the parties may have to meet before the procedure can be instituted.

a. Resolving disputes between MSMEs and providers of FinTech products

205. The increased use of FinTech services by MSMEs, has led to a rapid increase of disputes between MSMEs and FinTech providers, for example on data ownership, lack of transparency in contract terms or contract enforceability. Owing to the fact that in many countries FinTech providers are not regulated by financial sector authorities and do not have to comply with the same regulations as banks may result in the absence of internal complaint handling procedures to address MSMEs' complaints.[413] Moreover, not all countries may have external redress mechanisms where it is possible to lodge a complaint against FinTech providers[414] and, as noted above (see para. 189), settling financial disputes in court may not be a viable option for MSMEs in many countries.

206. In order to provide some protection to MSME users of FinTech services, in some countries[415] the FinTech industry has thus developed codes of conducts addressing irresponsible providers' behaviours. Although those tools cannot replace an appropriate redress system, they can prompt FinTech providers to improve their protection practices for the users of their services. States seeking to strength the efficiency of the codes of conduct may consider requiring mandatory membership in the industry associations that have issued them and strong self-enforcement mechanisms.[416] As a general measure, it would however be advisable to ensure that the requirement of establishing internal complaints procedures apply equally to all providers of financial products or services, including FinTech, and that external redress mechanisms address complaints concerning all financial service providers.[417] Since several FinTech transactions concern low-value services and products and take place cross-border, it has been suggested that online dispute resolution mechanisms

[413] Australian Small Business and Family Enterprise Ombudsman, www.asbfeo.gov.au/sites/default/files/2021-11/ASBFEO-fintech-borrowing-guide.pdf.

[414] For example, in Portugal this role is performed by the Central Bank. See OECD, Effective Approaches for Financial Consumer Protection in the Digital Age: FCP Principles 1, 2, 3, 4, 6 and 9, 2019, p. 46. On the contrary, in 2014 the Central Bank of Ireland clarified that since peer-to-peer platforms were not regulated activities, the Financial Services Ombudsman could not investigate complaints concerning those platforms. See World Bank, Consumer Risks in FinTech (supra, footnote 54), p. 78. As noted on page 13, the publication focuses on retail consumers, a category that also includes MSMEs.

[415] For example, Kenya and Indonesia. See World Bank, Consumer Risks in FinTech (supra, footnote 54), p. 68.

[416] Ibid.

[417] See OECD, Effective Approaches for Financial Consumer Protection (supra, footnote 415), p. 45.

may also be an efficient and effective option to resolve disputes arising out of those transactions (see para. 195).[418]

9. Fair lending practices, including transparency[419]

207. Fair contract terms and business practices are necessary to limit the risk of unsuitable credit arrangements for MSMEs and build trust between financers and MSMEs. While it is important for domestic laws to address unfair contractual terms and practices, it should do so in a balanced way that protects MSMEs and motivates financers to lend (see also para. 7). Sometimes, safeguards against abusive practices might exceed their goal of ensuring MSME protection as the businesses might use them to avoid repayment or disputes, which can disincentivize financers from lending. The appropriate balance will be a matter of policy and will depend on the country's needs as well as social and economic conditions.[420] The paragraphs below discuss transparency and other fair lending practices concerning contract formation, contract terms and business practices.

(a) Transparency

208. Transparency is essential in the relationship between financers and MSMEs: it contributes to mitigate financers' risks in lending while making it easier for MSMEs to find the most suitable products in terms of quality and costs, and to make informed choices. This helps reduce the cost of credit and at the same time strengthens the mutual understanding of the parties which can facilitate lending related decisions.

209. In addition to availability of sufficient information for financers to assess MSMEs' creditworthiness (see paras. 157 to 176), two other dimensions of transparency are particularly relevant in the context of access to credit: (i) clear and transparent terms and conditions for credit products and services; and (ii) availability of sufficient information for MSMEs on different means to access credit (see paras. 225 and 228).

(i) Clear and transparent terms and conditions

210. In most jurisdictions, the rules on the transparency of contractual terms and fair relations with customers generally apply to banking and financial products and services (e.g. current accounts, deposits, loans and payment services). For example, financers may be required to disclose the information in a prescribed form including standardized methods of displaying charges. Disclosure should especially highlight key features of the credit such as access, risks, restrictions to induce MSMEs to pay attention to them.[421] Such clarity permits MSMEs to make informed decisions and ensures them a certain degree of protection, while minimizing the risks of MSME's misuse of loans. At the same time, clarity of contractual terms and conditions benefits financers too as it helps strengthen their position on the market and attract new customers.

211. Transparency and disclosure of information are of great importance also in the contractual relation between MSMEs and non-bank institutions given that in certain countries digital financial service providers that are not regulated (e.g. FinTech companies) may not be required to disclose specific product terms, such as the loan

[418] 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: www.cibgp.com/article_10434.html.

[419] The secretariat has revised the heading and the introductory paragraph in order to better illustrate measures to safeguard against unfair practice are not limited to ensuring transparency and transparency can be discussed in a subsection, as requested by the Working Group at its thirty-seventh session (A/CN.9/1090, para. 89).

[420] L. Gullifer, I. Tirado, A global tug of war (supra, footnote 207), p. 1. The secretariat has moved this discussion here (para. 260 of A/CN.9/WG.I/WP.128) for improved consistency of the text.

[421] The secretariat has added this sentence and revised the second sentence of this paragraph (para. 247 of A/CN.9/WG.I/WP.128) for improved consistency.

terms, which may be incomplete or unclear; annual percentage rate; or transaction fees, which may result in MSMEs unknowingly paying higher fees than expected.[422] International experts' forums thus recommend that States also require non-bank institutions to disclose information in a way that is clear and understandable to small businesses that may not often have adequate financial literacy.[423] It would be equally important that digital financial service providers disclose information on the technology used to support the operation of online platforms and in particular any significant change in hardware or software components that may negatively affect the MSME's ability to access its records or perform digital operations.[424]

212. Further, lack of transparency may concern microfinance institutions too, since it has been found that certain among them may price their products in a non-transparent manner, obscuring the true price of loans and confusing clients through techniques such as "flat" interest and complex fee structures.[425] Although important for any financing agreement, transparent pricing is of most concern to unsophisticated MSME borrowers who cannot afford legal advice.[426] Among other things, international experts' forums recommend that microfinance institutions should be required to adopt standard pricing formulas (with appropriate disclosure standards) as well as standard repayment schedules.[427]

(ii) Easy access to information

213. Transparency in MSME financing can also be improved through easing MSME access to information on suitable sources of financing and adequate means to access them. In certain countries, the problem might be the low level of information available in general; in others, the creation of unnecessary barriers to access available information. For example, information services may charge access fees, or their users may have to register or otherwise provide information on their identity or, if the information is available online, they may be required to install specific software. Awareness raising campaigns with the support of industry associations (both financial institutions and MSMEs) and the use of diversified media (e.g. TV, radio, press, social media) would be first steps to facilitate information sharing about financing solutions for MSMEs and their terms and conditions (including interest rates). Regular dialogue and cooperation between the financer and MSME sector could also result in initiatives (e.g. help desks) that can assist MSMEs in making informed choices.

Recommendation 11:[428]

The law should ensure that financers disclose information on terms and conditions of credit agreements clearly and in a way that is understandable to MSMEs without adequate financial literacy.

(b) Other fair lending practices

(i) Contract formation[429]

214. Fair treatment of MSMEs would *in primis* require that in the process of contract formation the financer explains the different types of credit suitable to the MSME and

[422] GPFI, Promoting digital and innovative SME financing (supra, footnote 28), p. 72.
[423] Ibid., p. 84.
[424] J. Ballard, C. Brennan, C. French, E. Johnson, Exploring the Legal Issues Relevant to Online Small-Business Lending, 2017 available at: www.americanbar.org/groups/business_law/publications/blt/2017/08/02_ballard/.
[425] A/CN.9/780, para. 37.
[426] Ibid., para. 40.
[427] Ibid.
[428] The secretariat has included a recommendation along the lines of the penultimate sentence of paragraph 211 (para. 248 of A/CN.9/WG.I/WP.128) as agreed by the Working Group at its thirty-eighth session, (A/CN.9/1122, para. 99).
[429] The secretariat has moved here the discussion on contract formation, as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 98). In addition, the secretariat

their implications for the business,[430] and clarifies the meaning of the contract terms, in particular technical terms and 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 ensure that MSME can appreciate all potential detrimental conditions, it would be advisable that small print clauses be subject to a user agreement. Since In addition, fair treatment would also 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. In case the MSME's credit application is rejected, applicable laws or regulations may require financers to provide the reasons for rejection in a clear and understandable way.

(ii) Contract terms

215. As "repeat players" and in order to reduce transaction costs, financers tend to use standard term contracts for financial transactions with counterparts (including MSMEs).[431] Negotiation and any resulting variation of the standard term contracts would result in an increase in the transaction costs that financers may not consider economical when the requested loan amount is relatively small (e.g. in the context of MSME financing). Personalization of contracts may also result in higher borrowing costs for MSMEs.[432] Due to their limited bargaining power, MSMEs, in particular micro and small enterprises , often enter into contracts for financial transactions on a "take it or leave it" basis.[433]

216. Given the limited financial literacy of many MSMEs, they may not be able to identify or fully understand the potential detrimental contractual conditions and may thus suffer from certain financers who abuse their stronger bargaining position. For example, certain clauses may give the financers a broad power to vary the contract without the MSME agreement; other clauses may entitle the financer to call a default based on a breach of some financial indicators such as loan-to-valuation ratio. The risk of abuse is particularly high in the context of FinTech products and services,[434] given the speed with which contracts are concluded electronically, often without prior or sufficient review of their terms and conditions.[435] There is also a risk that second-level financial entities may use unclear or deceptive contract terms since they are largely unregulated and can leverage the fact that they can provide loans more promptly than regulated financial providers, which easily attract MSMEs. For example, it has been reported that small print clauses in their documentation stipulate higher interest rates than what is advertised in their marketing materials or that they impose "capital repayment fees" that allow the financial entity to claim a percentage of capital at loan settlement.

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has relocated reference to small print clauses here from paragraph 210 (247 of A/CN.9/WG.I/WP.128) for improved consistency.

[430] For example, Belgium. See Loi relative à diverses dispositions concernant le financement des petites et moyennes entreprises, 21 Decembre 2013, available at: www.ejustice.just.fgov.be/cgi_loi/change_lg_2.pl?language=fr&nm=2013003461&la=F.

[431] It is quite common 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 interest rate after default or the way "default" is defined) in a financing contract are standard terms of the financers.

[432] L. Gullifer, I. Tirado, A global tug of war (supra, footnote 207), pp. 12–13.

[433] Australian Security and Investment Commission (ASIC), Report 565, Unfair contract terms and small business loans, 2018, p. 4, available at: https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-565-unfair-contract-terms-and-small-business-loans/.

[434] A survey carried out by a United States small businesses' association 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. See 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.

[435] Ibid.

217. In order to tackle unfair contract practices, some countries[436] have extended to MSMEs domestic legislation that protects weaker individuals negotiating contracts with parties who enjoy a stronger bargaining position, including financial transactions. Such legislation may specify what a small business is and clarify the parameters according to which a contract term can be deemed unfair (e.g. high default interest rates, unfair termination clauses or disadvantageous definitions of events of default). [437] In other countries the goal of ensuring fair contract terms and conditions has been achieved through policy measures enacted by central banks,[438] or voluntary codes of conduct or practice standards in the financial industry sector set the benchmark for fair lending practices.[439] Although such tools might be more rigid than certain regulatory or legal standards and afford high levels of protection to small businesses, they cannot be an alternative to appropriate and enforceable laws that set out the obligations of the financers.

218. In countries that wish to reform their legal framework in line with international best practices, the law would, for instance, prohibit unfair terms or conditions in standard financial contracts and, if used, such terms or conditions would be considered void and legally unenforceable.[440] Another good practice often used by the law is to construe any ambiguity in a standard contract against the interests of the party that proposed the ambiguous term, thus leading to an interpretation more favourable to the weaker party of the contract, i.e. the MSME.[441] In this regard, it has been noted that the fairness of a contract term, in particular when such term is a non-financial one, would not be assessed in isolation but in the context of the other terms of the contract.[442] In specifying types of clauses that the law declares unfair and therefore invalid or not effective, legislators and policymakers may wish to consider the possible impact that an overly restrictive approach might have on the availability of credit. Finally, States might also protect small businesses by establishing legislative caps on certain rates and charges imposed in the contract: for example, in certain countries the applicable laws or regulations establish caps on default rate clauses.[443,444]

219. Supervisory authorities can play a key role in ensuring fairness of contract terms and it would be important for the domestic legal framework to clearly establish their responsibility, especially to assess compliance of the lending agreements with the established legal requirements. This would include the ability to clarify the meaning and scope of unfair contract terms in a transparent manner (e.g. in certain countries the threshold for unfairness of terms may be higher for commercial lending contracts than for individual consumers) so to ensure commercial certainty. In some countries, for example, supervisory authorities analyse MSME lending agreements on a regular basis in order to identify abusive terms and clauses and take appropriate actions. In others, they also maintain registries that display abusive contract clauses which allows MSMEs to ascertain whether their agreement with the financer includes abusive or unfair terms.[445]

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[436] For example Australia, Australian Security and Investment Commission (ASIC), Report 565 (supra, footnote 433).
[437] A/CN.9/913, para. 42.
[438] For example Malaysia. See the policy Fair Treatment of Financial Consumers, 6 November 2019, issued by Bank Negara Malaysia (i.e. the Central Bank), available at www.bnm.gov.my/documents/20124/761679/FTFC_PD_028_103.pdf/f83853d4-7146-9842-a40c-7e20bf0c9b75?t=1590696786502. The term "financial consumer" also includes "a micro or small business as defined in the notification on Definition of Small and Medium Enterprises (SMEs) issued by the Bank on 27 December 2017 (BNM/RH/NT 028–51)".
[439] E.G. United Kingdom. The Standards of Lending Practice for business customers (2020) which were formally recognized by the Financial Conduct Authority (FCA) in 2020.
[440] World Bank, Good Practices (supra, footnote 391), p. 34.
[441] Ibid., p. 34.
[442] L. Gullifer, I. Tirado, A global tug of war (supra, footnote 207), p. 14.
[443] For example, Germany and Spain, Ibid., pp. 14–15.
[444] The secretariat has relocated this sentence here from paragraph 214 (para. 257 of A/CN.9/WG.I/WP.128) for improved consistency.
[445] World Bank, Good Practices, p. 35 (supra, footnote 391).

(iii) Business practices[446]

220. Even when contract terms and conditions are fair and balanced, unfair practices, such as unsolicited SMS loan offers, sending credit cards without a customer's prior request and charging the customer, bundling and tying different credit products may be in place and undermine the mutual trust between the MSME and the financer and also pose risks of over-indebtedness for the MSME. In certain States the legal and regulatory framework provides consequences for relationships that are unfair. For example, regulated financial entities must demonstrate how the concept of fair treatment is embedded in all their customer-related practices.[447] Another good practice is for States to set a minimum threshold to identify whether a practice is unfair or not.[448] With regard to credit products, financers may be required to use the so-called reducing interest rates (i.e. calculated on the outstanding loan amount) instead of flat interest rates (i.e. calculated on the full loan amount). As flat interest rates do not take into account the fact that each repayment instalment gradually reduces the full loan amount, customers may end up paying more interests compared with reducing interest rates. In addition, financers may also be required to adopt opt-in clauses for facilities that auto-deduct payments and fees, and refrain from using abusive loan collection practices.[449]

10. Electronic environment[450]

221. A legislative framework supportive of platform-based lending consists mainly of regulatory measures or laws that do not fall under what may be regarded as general commercial law. For example, data protection laws address the duty of the platform to protect data of its users; general banking laws deal with "know your customers" obligations; and laws on anti-money laundering and countering the financing of terrorism may apply to platform's operators. Commercial or contract laws that are relevant in this context primarily include laws that ensure the formation, validity and enforcement of contracts concluded through technological means. In this respect, UNCITRAL legislative texts on electronic data transactions, digital identity and trust services can provide solutions appropriate to different legal traditions and countries at different levels of economic development.

222. For example, the *UNCITRAL Model Law on Electronic Commerce* (1996)[451] (MLEC) establishes rules for the equal treatment of electronic and paper-based information, as well as the legal recognition of electronic transactions and processes, based on the fundamental principles of non-discrimination against the use of electronic means, functional equivalence of electronic and paper-based records, and technology neutrality.[452] The *UNCITRAL Model Law on Electronic Signatures* (2001)[453] (MLES) complements MLEC through establishing criteria of technical

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[446] As agreed by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 98), the secretariat has removed reference to the influence of social and cultural norms on unfair practices. In addition, the secretariat (i) has deleted reference to safeguards for the protection of vulnerable groups, since already addressed in paragraph 58; and (ii) moved reference to discrimination resulting from the use of the algorithm in digital credit scoring models to paragraph 58 for improved coherence. Following these revisions the second paragraph of this subsection (para. 259 of A/CN.9/WG.I/WP.128) has been deleted.

[447] For example the United Kingdom and Malaysia as cited in World Bank, Good Practices (supra, footnote 391) p. 35.

[448] Ibid., p. 36.

[449] Ibid.

[450] The secretariat has moved the discussion on the importance of an enabling legal environment for digital credit here (paras. 78 to 82 of A/CN.9/WG.I/WP.128) for improved consistency of the text. The opening paragraph (221) combines into one (and simplifies) paragraphs 78 and 79 of A/CN.9/WG.I/WP.128 for improved coherence.

[451] See UNCITRAL Model Law on Electronic Commerce with Guide to Enactment 1996, with additional article 5 bis as adopted in 1998.

[452] The principle of "technological neutrality" means that the law does not presuppose the use of particular types of technology. The principle of "functional equivalence" establishes the criteria under which electronic communications may be considered equivalent to paper-based communications.

[453] See UNCITRAL Model Law on Electronic Signatures with Guide to Enactment (2001).

reliability for the equivalence between electronic and hand-written signatures. Based on the same principles of MLEC, the MLES also establishes basic rules of conduct that may serve as guidelines for assessing duties and liabilities for the signatory, the relying party and trusted third parties intervening in the signature process. In the context of electronic records, the *UNCITRAL Model Law on Electronic Transferable Records* (2017)[454] (MLETR) aims to enable the legal use of electronic transferable records both domestically and across borders. The MLETR provides that an electronic transferable record satisfying the conditions of the MLETR shall not be denied legal effect, validity or enforceability on the sole ground that it is in electronic form. Furthermore, the *UNCITRAL Model Law on the Use and Cross-border Recognition of Identity Management and Trust Services*[455] addresses various obstacles to the broader use of identity management and trust services, including across borders.

223. Additional legal clarity may be needed for certain technological developments that introduce non-traditional contractual arrangements (for example, smart contracts[456] or robo-advisors[457]). Such new contracts may raise issues of validity, binding nature, enforceability or liability for errors that domestic current laws may not properly address. These issues are being considered by UNCITRAL as part of a new project of its Working Group IV on the topic of automated contracting, which will examine gaps in the current law and possible legal solutions.

224. It should be noted that several countries have established legally and regulatory protected environments (i.e., regulatory sandboxes) to test in a time-bound manner and under the control of regulatory authorities' new products and services developed by FinTechs (including in the context of platform-based lending) in order to determine whether they can be brought to the mass market. Sandboxes permit regulators to identify any associated risks with these innovations[458] and introduce new laws or regulations, or enhance existing ones, to better address them.[459] Certain countries, for example, have enacted laws to facilitate the establishment of regulatory sandboxes as a key element of their domestic fintech system.[460] Regulatory sandboxes are advantageous for FinTechs too, since they can receive advice from regulators on how to navigate the regulatory environment and obtain authorization for the new products.[461]

[454] See UNCITRAL Model Law on Electronic Transferable Records (2017).

[455] UNCITRAL adopted the Model Law at its fifty-fifth session, in July 2022.At the date of this draft Guide, the final version of the Model Law is not yet published. The Model Law builds upon and complements existing UNCITRAL texts on electronic commerce, in particular their provisions dealing with electronic signatures. Trust is a fundamental element of trade and is particularly important online since electronic means allow transactions without prior personal interaction. Identity management aims to provide sufficient assurance of the online identification of physical and legal persons. Trust services aim to provide sufficient assurance of the quality of data, e.g. origin, integrity and point in time of transmission. The Model Law identifies the legal requirements to achieve that level of assurance and it sets a legislative standard not only for the use of electronic transactions and documents, but more generally for data exchanges.

[456] For a brief discussion on the different meanings of the term "smart contract", see A/CN.9/1012/Add.1, para. 24. In the context of FinTech transactions, the term "smart contract" may be used to refer to situations in which the contractual obligations of the parties are discharged through the automated performance of the software, once the borrower has agreed to the terms and conditions with one click ("I agree"), and the contracts are unalterable: see World Bank, Smart Contract Technology and Financial Inclusion, 2020, p. 6.

[457] Robo-advisors are online platforms that use algorithms to automatically build and manage clients' portfolios.

[458] G. Cornelli, S. Doerr, L. Gambacorta and Q. Merrouche, BIS, Working Paper No. 901, Inside the regulatory sandbox: effects on fintech funding, 2020, p. 2.

[459] World Bank, Global Experiences from Regulatory Sandboxes, 2020, p. 2.

[460] See Mexico in World Bank, ibid. p. 20.

[461] G. Cornelli, S. Doerr, L. Gambacorta and Q. Merrouche, BIS, Working Paper No. 901 (supra, footnote 458), p. 2.

B. Other measures to enhance MSME's access to credit: financial literacy[462]

225. An important aspect of facilitating access to credit for MSMEs is improving their financial literacy 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 right over their assets and the legal requirements of a security agreement (e.g. how to create a security right, rights and obligations of the grantor, enforcement). Further, MSMEs may need a wider set of skills to operate proficiently within their business environment and to improve their transparency on the finance market. For example, businesses in the initial stages of their lifecycle may need to know how to identify markets, introduce appropriate costing methodologies, enhance their accounting practices or comply with government regulations. More established businesses may need to improve their internal organization or the quality of processes and products (e.g. from the introduction of regular maintenance programmes to the adoption of quality certification schemes) or their skills in marketing and exporting and to be fully aware of International Financial Reporting Standards and the benefits they can bring in terms of access to credit.[463] Financial education may thus be complemented by programmes[464] aiming at strengthening the managerial and technical skills of MSMEs. Finally, in countries with external redress mechanisms for financial disputes (see paras. 192 to 200), MSMEs are often unaware that they can resolve their disputes with financers through those channels. MSMEs eligible to use redress mechanisms could thus benefit from training on their scope and functioning (e.g. claim submission and handling, decision-making process), which may also be an additional incentive to access financial services.

226. Another important aspect is enhancing financers' capacity to properly assess the financial needs of MSMEs and any particular requirements of lending to such small businesses. 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 may apply particularly to financers catering to women entrepreneurs, many of whom have limited access to information and financial literacy at the outset of entrepreneurial activity. Finally, capacity-building is key to help regulators keep abreast of new laws and regulations applicable to MSMEs' financing in order to assist financial institutions in their implementation and ensure adequate supervision. Financial institutions facing constraints in extending credit to MSMEs would also benefit from training knowledge on how legal reforms can facilitate the efficiency of credit transactions, such as secured transactions law reform (e.g. easier creation of security rights, improved asset valuation, effective enforcement).[465]

(a) Capacity-building for MSMEs

227. In several countries, 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 and types of MSMEs (i.e., regardless of whether they are natural or legal persons). Those strategies can be either directed at MSMEs only or at MSMEs and citizenry as well. Regardless of the scope of the

[462] The secretariat has revised this heading as requested by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 101).

[463] OECD and G20, Effective Approaches for Implementing the G20/OECD High-Level Principles on SME Financing, 2018, pp. 30–31.

[464] For example, Italy provides financial support to those MSMEs that are using consulting services to improve production processes and management and organizational structures.

[465] The secretariat has added this last sentence in line with the deliberations of the Working Group at its thirty eighth session to highlight the benefits for financers' training on how legal reforms can facilitate credits transactions (A/CN.9/1122, para. 101).

education strategy, micro and small enterprises are often the most targeted segment within the MSMEs' group. Certain countries pursue MSMEs' financial education as part of broader strategies aiming at promoting financial inclusion[466] or increasing formal sector employment.[467]

228. Effective strategies at country level may be provided through different channels such as formal education in schools or universities or ad hoc government programmes that may be offered in partnership with the private sector or universities (e.g. university MSME centres)[468,469] The 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; and knowing how to meet loan requirements. The long-term sustainability of the strategies not only requires the allocation of sufficient funds, but it is equally important that diagnostic tools to assess MSME's literacy needs and adequate monitoring and evaluation of strategy implementation are in place and that the strategies are independent from a country's political cycles.

229. In addition to government strategies, other initiatives coordinated by industry organizations and trade unions, the financial sector or NGOs may be implemented at the local and country level.[470] For example, the stock exchange industry can launch programmes to help small and medium-sized enterprises deal with access to long-term financing opportunities. Training and tutorship can help those businesses to improve their skills in order to facilitate a possible listing in the public equity market.[471]

230. Depending on the nature of the financial education initiatives, and in order to reach the widest group of beneficiaries possible, different delivery methods can be used ranging from leaflets to coaching, seminars or advice services, online courses, or other forms of digital delivery, including social media or mobile applications. In certain countries, online platforms have been set up to facilitate exchanges and mutual learning between small businesses.[472] Other countries, recognizing the great challenges faced by women-run MSMEs, have established dedicated online hubs to advance women entrepreneurship, including their access to financial services. More traditional media (e.g. TV, radio and magazines) can be employed to reach out to larger audiences compared to those using social media that may require more advanced technological skills. Depending on the nature of the providing entity, whether the State, NGOs, or the industry sector and the scope of the initiatives, they may be fee-based, or without fees, although it is desirable that given the financial limitations of MSMEs paid-for initiatives be limited. It should be noted that both the government-led strategies and the initiatives coordinated by the private sector often

[466] OECD (authored by A. Atkinson), Financial Education for MSMEs and Potential Entrepreneurs, 2017, p. 31.
[467] Ibid., p. 33.
[468] For example, Argentina and Dominican Republic have established a certain number MSME university centres. In Jordan the central bank has partnered with other financial stakeholders and NGOs (see Alliance for Financial Inclusion, Financial Education for the MSMEs: Identifying MSME Educational Needs, 2020, p. 13 ff).
[469] The secretariat has added this reference to government partnerships in line with the Working Group deliberations at its thirty-eighth session (A/CN.9/1122, para. 101).
[470] OECD (authored by Atkinson), Financial Education (supra footnote 466), pp. 34–35.
[471] See the ELITE programme launched by the London Stock Exchange Group. See www.aimlisting.co.uk/lse-elite-programme/.
[472] See Chile and Singapore, respectively as cited in OECD (authored by A. Atkinson), Financial education (supra, footnote 466), pp. 52 and 58.

benefit from tools and programmes[473] developed by international organizations or networks[474] that reflect global best practices.

(b) Capacity-building for financers

231. As noted above (see para. 226), it is important to improve the capacity of financers to respond to MSME's financial needs and understand how to enter into profitable transactions with them. For example, certain countries have adopted policies to address the information gap between financers and small businesses by facilitating their direct interaction through awareness-raising campaigns, brokerage and match-making.[475] More generally, financers should be equipped with tools to understand the sectors in which MSMEs operate and how to assess loan applications against the background of those sectors; identify the best customers to serve; carry out market analysis to optimize the products and services offered, including designing new products and services specifically tailored to MSMEs, or particular groups of MSMEs; develop an appropriate sales culture and distribution channels as well as appropriate risk management strategies to sustain solid MSMEs in critical moments of their life cycle.[476]

232. As noted earlier, it is important that financers receive guidance (e.g. code of conducts, coaching, training) on best lending practices applicable to their transaction with MSMEs so they can limit their risks without reducing protection for the MSME. For example, financers should be able to effectively advise MSMEs on the most suitable products given their needs and financial situation, monitor their loans in order to avoid the risk of default and promptly respond with appropriate solutions when MSMEs experience payment difficulties. In some jurisdictions, financial providers are required to adopt certain measures (also known as responsible lending practices) to ensure enhanced protection of non-commercial borrowers as those borrowers might be less familiar than businesses to lending processes. Although some of those practices may result in longer credit processing time, they ensure that financers act in the best interest of the borrower. Raising financers' awareness on the application of responsible lending practices also in their transactions with MSMEs might well be another element of financers' capacity building.

233. Capacity-building initiatives for financers may be organized under the aegis of central regulators[477] or the relevant government authorities[478] and include training programmes for those in charge of MSMEs' departments, including training of trainers; peer-to-peer learning or advisory services. Moreover, financial service providers should develop their in-house programmes, such as workshops or on-the-

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[473] These tools and programmes either focus on financial literacy needs of micro and small enterprises or have a broader goal (e.g. support entrepreneurship) with financial literacy being one of the components of the programmes.

[474] For instance, the OECD/International Network on Financial Education (OECD/INFE), with members from 130 countries, has taken stock of best practices around the world and has produced a framework for policymakers and other entities engaged in promoting entrepreneurships (e.g. NGOs, chambers of commerce) in order to assist them in developing or improving strategies for MSE financial education and for assessing their financial literacy. See OECD/INFE, Core Competencies Framework on Financial Literacy for MSMEs, 2018. Further, an international forum specializing in MSMEs access to finance has developed a platform to promote knowledge exchange, research and best practice sharing in SME finance. See SME Finance Forum at www.smefinanceforum.org/about/what-we-do.

[475] See OECD, Discussion Paper, SME Ministerial Conference, 22–23 February 2018, Mexico City, Enhancing SME access to diversified financing instruments, p. 19.

[476] IFC/World Bank, Closing the Credit Gap for Formal and Informal Micro, Small, and Medium Enterprises, p. 17.

[477] For example, the Reserve Bank of India has launched a National Mission for Capacity Building of Bankers for Financing the 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. See www.bis.org/review/r170629g.htm.

[478] For example, in Zambia the National Financial Inclusion Strategy 2017–2022 among others aims to build the capacity of financers to lend to MSMEs, in particular farmers. See www.boz.zm/National-Financial-Inclusion-Strategy-2017-2022.pdf.

job training, to ensure regular improvement of staff expertise and skills in dealing with MSMEs.[479]

234. As in the case of financial literacy for MSMEs, international organizations[480] are also active in offering support to improve financers' capacity to serve MSMEs through technical assistance activities[481] ranging from face-to-face or web-based workshops, on-the-job training for branch managers, loan and other officers on all relevant aspects of MSME lending, global advisory programmes for financial institutions, to ad hoc guidance materials. The *UNCITRAL Practice Guide to the Model Law on Secured Transactions* can be cited as an example of such guidance that, among others, well explains to lenders and borrowers, including smaller businesses, how secured transactions can facilitate access to credit at a reasonable cost.

(c) Capacity-building for regulators

235. Regulatory and supervisory bodies play a leading role in facilitating access to credit for MSMEs. They must be able to create and maintain a conducive environment for MSME lending, foster competition among financial institutions to serve MSMEs and oversee the application of regimes on credit information and payment systems, or transparency in lending. Further, in the past years an emerging global reform trend has increasingly moved financial institutions away from relationship-lending to transaction-based lending, thus requiring regulators to develop additional technical skills to oversee the conduct of the financial institutions. Finally, the increasing preparation of financial standards in international forums, in order to ensure global financial stability, also calls for regulators' improved knowledge and ability to effectively implement those standards once they are adopted by the State.

236. In order to adequately respond to the multiple demands of the financial sector, regulators must thus have a diverse set of skills and the capacity of keeping abreast of developments. To support regulators, States can thus put in place mechanisms to regularly assess regulators' changing capacity-building needs and tackle any gap with a variety of complementary tools. For example, participation in international forums allows peer-to-peer learning as it facilitates the dissemination of international standards and the exchange of best practices. Preparation of technical guidelines is particularly effective when new financial products enter the market or after the implementation of legal and regulatory reforms. As noted earlier (see para. 224), regulatory sandboxes also provide a valuable protected environment for regulators where they can learn from new products and credit providers, in particular FinTechs related, and enhance their capacity to adjust the existing regulatory framework to the evolving needs of the financial sector. Workshops and seminars, whether online or in presence, permit to improve regulators' knowledge with the assistance of experts and to delve into specific topics in greater depth. Again, international organizations and networks[482] can play a key role in complementing country specific and regional

[479] See the Alliance for Financial Inclusion, Financial Education for the MSMEs: Identifying MSME Educational Needs, 2020, p. 7.

[480] See for example, the capacity-building initiatives of the World Bank, the International Finance Corporation and the European Bank for Reconstruction and Development, cited in paras. 200 and 201 of A/CN.9/WG.I/WP.124.

[481] For example, the World Bank, among others, has supported the Lao People's Democratic Republic, in establishing a programme that supports small and medium-sized enterprises' access to finance and strengthens the capacity of banks and other financial institutions to serve those businesses.

[482] Regional cooperation has also recently emerged for regulatory capacity-building on MSE access to credit. For example, an international capacity-building event conducted by Costa Rica's Superintendencia General de Entidades Financieras (SUGEF) and the Alliance for Financial Inclusion (AFI) in late 2020 involved 89 senior officials from 44 AFI member institutions and was based around several knowledge products on SME finance, including a guideline note and a factsheet on COVID-19 in AFI member countries. The Asia-Pacific Economic Cooperation (APEC) has instituted an Advisory Group on Financial System Capacity Building which since 2011 publishes annual reports on policy reforms by member economies, including regulatory developments to improve MSMEs' access to finance (cf. APEC, 2021 Progress Report of APFF, APFIF and APIP, *passim*).The European Union has been cooperating with the Organisation of

initiatives. In addition to organizing seminars, conferences, preparing technical guidance and publications, they can facilitate international cooperation among financial regulators[483] and partner with States and regional entities to offer technical assistance and advisory programmes tailored to the needs of a specific country or region.

Recommendation 12:[484]

States should further enhance the legal and policy measures supporting MSME access to credit with relevant programmes and policies for improving the financial literacy of MSMEs, financers and regulators.

African, Caribbean, and Pacific States in a string of projects including the ACP-EU Microfinance Program, the EU Support to Policy Dialogue on Investment Climate or the European Investment Bank's SME Access to Finance Initiative.

[483] See for instance, Bank for International Settlement, The policy life cycle and capacity-building needs of financial sector authorities, keynote address, by Agustín Carstens, 2018, available at: www.bis.org/speeches/sp180208.htm.

[484] The secretariat has added this recommendation as agreed by the Working Group at its thirty-eighth session (A/CN.9/1122, para. 100).