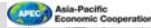




THE ADVISORY GROUP ON APEC FINANCIAL SYSTEMS

First Meeting 2012
23 February 2012
Hong Kong, People's Republic of China



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Draft: **FIRST**

Source: Asia Pacific Credit Coalition

Date: 20 February 2012

Meeting: Hong Kong, China

Meeting Paper 5-F

Promoting Legal Architecture for SME Finance
(Asia-Pacific Credit Coalition)

Purpose: For information

Issue: Promoting Legal Architecture for SME Finance

Background:

The ABAC 2010 Report to Leaders, Report to Finance Ministers called for Capacity Building to promote improvement of legal architecture for secured lending as driver of inclusive growth and was endorsed by APEC Finance Ministerial Statement in Kyoto. The ABAC 2011 Report to Leaders, Report to Finance Ministers noted specific impediments to SME financing in the legal architecture, made recommendations for initiatives to address as part of broader Financial Inclusion Initiative ("FII"). It also noted that increasing transparency and predictability of legal architecture and information availability is critical and that improving Full File Credit Information Systems and Legal Architecture for Secured Lending are "Two Sides of the Same Coin" -- it's all about improving informational and regulatory transparency to allow better risk decisions, improve credit access, and avoid misallocation of liquidity. The APEC FII endorsed by APEC Finance Ministerial Statement in Honolulu.

Proposal/Recommendation:

- Develop Model Elements for "APEC Code" of Security Interest Creation, Perfection and Enforcement as Part of APEC Regulatory Coherence Initiatives: Clear Perfection Rules; Broad Coverage of Collateral Types; Exclusivity (Eliminate "Hidden Liens"); Improve Ease of Lien Searches; Promote Broad Licensing Authority for Commercial Finance
- Continue Public/Private Dialogue to Validate Improvements
- New Round of Capacity Building to Include Relevant Stakeholders: Justice, Law Ministries (where Civil Code reforms needed); Information Ministries (where central e-databases needed); SME ministries (to educate; build support for needed measures); Agree on 2-3 Pathfinder pilots for 2012

Decision Points: Note the presentation.



THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM
CAPACITY-BUILDING

A Public-Private Sector Initiative

First Meeting 2012
23 February 2012
Hong Kong Exhibition and Convention Center
Hong Kong SAR

Meeting Paper 5-[F]

Financial Inclusion Initiative 2012
Work Plan:
Promoting Legal Architecture for SME Finance

APEC Role in Promoting SME Finance

- ABAC 2010 Report to Leaders, Report to Finance Ministers
 - Called for Capacity Building to promote improvement of legal architecture for secured lending as driver of inclusive growth
 - Endorsed by APEC Finance Ministerial Statement in Kyoto
- ABAC 2011 Report to Leaders, Report to Finance Ministers
 - Noted specific impediments to SME financing in the legal architecture, made recommendations for initiatives to address as part of broader Financial Inclusion Initiative ("FII")
 - Noted that increasing transparency and predictability of legal architecture and information availability is critical
 - Improving Full File Credit Information Systems and Legal Architecture for Secured Lending are "Two Sides of the Same Coin" -- it's all about improving informational and regulatory transparency to allow better risk decisions, improve credit access, and avoid misallocation of liquidity
 - FII endorsed by APEC Finance Ministerial Statement in Honolulu.

APEC initiatives can support pillar of Inclusive Growth

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Draft of 20/02/2012

Credit Gap for SME: Overview

- McKinsey & Company estimates SMMEs in emerging markets face an unmet need for capital of over US\$2 Trillion.
- 85% of these SMME's face credit constraints
- 70% have no access to credit
- The smaller the company, the less access to credit
- Two Policy interventions to support MSME's include:
 - 1) Government Guarantee or Incentive Schemes
 - 2) Regulatory and Legal System Improvements
 - Improve Property Registry Systems
 - Reduce Enforcement Costs for Lenders
 - Improve Financial Transparency and Credit Rating Systems

Source: "Two trillion and counting", McKinsey & Company and IFC, Oct. 2010.

Secured Lending Helps Companies Access Capital and Reduces Relative Cost of Capital

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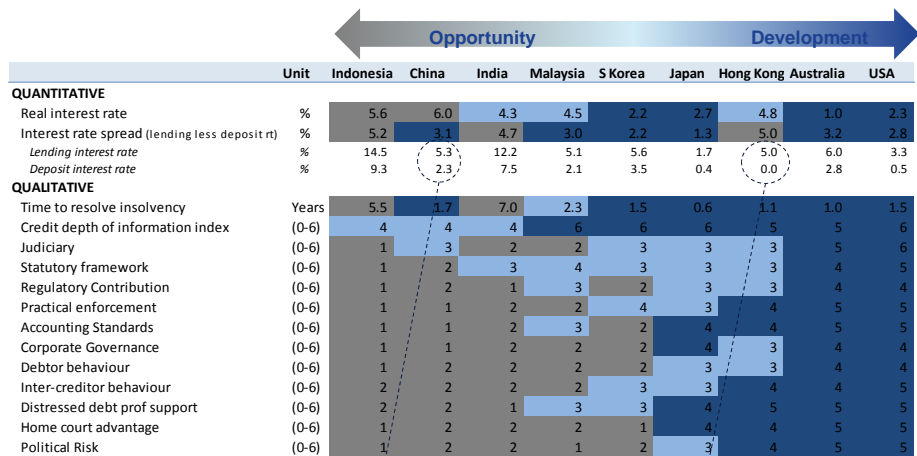
SME Financing: Secured Lending

- Examples of Current Gaps in Legal and Regulatory Architecture
 - Lack of Security Interest Registry
 - Absence of Exclusive Security Interest Registry
 - i.e. "Hidden Lien" Problem
 - Voidable Conversion/Preference
 - Unclear Perfection Rules or Lack of Coverage for Certain Types of Collateral (Movables, Receivables, IP, etc.)
 - Absence of Blocked/Pledged Account Security
 - Untested or Non-Transparent Legal Systems
 - Treatment of Floating Charges
 - Lack of Broad Licensing Authority for Commercial Lending
- These gaps have been recognized by ABAC as impediments to improved access to a diverse range of financing opportunities.

APEC initiatives addressing these gaps can facilitate innovative financing options for SMME's in the region

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Lending Landscape in Asia



Source: Asian Restructuring and Insolvency Review - White and Case; World Bank report on Interest rate, 200

Gov't mandated rates

Deposit rate unusually low because of excess liquidity

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Leveraging Best Practices from Around the APEC Region

- The bankruptcy and enforcement regimes in Hong Kong, Singapore, Japan, Korea, and India generally recognise and protect the 1st lien priority interest of senior-secured lenders
 - Singapore and Hong Kong are arguably the most protective of creditor expectations (even more than the US in reorganization contexts).
- A number of APEC economies have introduced or modernized Property Registration and Collateral Laws and/or Bankruptcy Codes over the past few years, making improvements.
 - Japan's decade-old Perfection Law and moves to register digital promissory notes
 - China's Property Law and Bankruptcy Law reforms
 - Korea's new Property Registration Law.
- However, important structural impediments remain in various degrees to be addressed in each economy across the APEC region.

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Next Steps:

- Develop Model Elements for "APEC Code" of Security Interest Creation, Perfection and Enforcement as Part of APEC Regulatory Coherence Initiatives
 - Clear Perfection Rules
 - Broad Coverage of Collateral Types
 - Exclusivity (Eliminate "Hidden Liens")
 - Improve Ease of Lien Searches
 - Promote Broad Licensing Authority for Commercial Finance
- Continue Public/Private Dialogue to Validate Improvements
- New Round of Capacity Building to Include Relevant Stakeholders
 - Justice, Law Ministries (where Civil Code reforms needed)
 - Information Ministries (where central e-databases needed)
 - SME ministries (to educate; build support for needed measures)
 - Agree on 2-3 Pathfinder pilots for 2012

APEC Can Make A Positive Difference in Promoting Access to Financing for SMMEs and Entrepreneurs

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