THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

Document: AGFSCB 32-011
Draft: **FIRST**
Source: AGFSCB Chair
Date: 20 February 2012
Meeting: Hong Kong, China

First Meeting 2012
23 February 2012
7:30 AM – 9:30 AM
Room S221, Hong Kong Convention and Exhibition Center
Hong Kong SAR, People's Republic of China

Meeting Paper 5-G

PUBLICATION OF THE FULL REPORT OF THE 2011 ASIA-PACIFIC FINANCIAL INCLUSION FORUM

EXPANDING FINANCIAL ACCESS THROUGH REGIONAL PUBLIC-PRIVATE COOPERATION

(Draft Being Finalized)

Office of the Advisory Group Chair

PURPOSE	For information.
ISSUE	Publication of the Full Report of the 2011 Asia-Pacific Financial Inclusion Forum
BACKGROUND	The full report is currently being finalized for publication. The publication is being sponsored by the Citi Foundation and being undertaken by the Institute for International Monetary Affairs.
PROPOSAL	N.A.
DECISION POINT	Endorse the publication of the report.

EXPANDING FINANCIAL ACCESS THROUGH REGIONAL PUBLIC-PRIVATE COOPERATION

6-8 September 2011
Asian Development Bank Institute
Tokyo, Japan

EXECUTIVE SUMMARY

Addressing the needs of many people living in poverty in the Asia-Pacific region through improved access to finance remains a major challenge. With growing constraints on public resources in the wake of the Global Financial Crisis, mobilizing private resources to serve financial needs of low-income households and small enterprises has become ever more important. Stronger, more balanced and more inclusive growth also requires efforts to further expand financial access through new channels, while addressing the key obstacles small enterprises face in accessing traditional sources of finance.

This Forum was held with three purposes in mind. First, it aimed to provide a venue for policy dialogue on expanding new channels to serve the financial needs of the unbanked, and how APEC can harness regional public-private cooperation to promote the sustainability and expansion of undertakings using these new channels. Second, it aimed to provide a platform for capacity building to help relevant policy makers and regulators in the region address two key issues for expanding credit to micro-, small and medium enterprises (MSMEs): credit information and legal frameworks for secured lending. Third, it aimed to provide a forum for discussion of broader institutional and economic framework conditions and policies affecting MSMEs.

Expanding access to finance for low-income households and MSMEs, which is a key issue in addressing poverty and development, is a complex task that requires comprehensive approaches and close coordination and collaboration among various stakeholders in the public and private sectors. Microfinance, originally developed as a survival strategy for the poor and attracting the attention mainly of institutions and individuals supporting charitable and social causes, has undergone a tremendous transformation into one of the most important tools for achieving sustained, balanced and inclusive economic growth and development, involving a wide range of financial markets and institutions.

Two elements that play key roles in the ongoing evolution of MSME and microfinance are innovation and globalization. Innovation, particularly the introduction of mobile and agent banking using new technologies, has enabled microfinance to overcome the barriers to commercial viability. Technology continues to provide solutions addressing various impediments to its further development, including in such key areas as financial identity and payments systems. Globalization has impacted MSME and microfinance on many fronts, from attracting global investors using microfinance investment vehicles to the cross-border linkages that are starting to develop among MFIs and related institutions on the back of the region's growing migrant populations.

All of these are opening many new opportunities that can help MSME and microfinance realize its potential as a tool for financial inclusion and economic development. However, they also create new threats, as policies and regulations that have been put in place to keep institutions strong, maintain financial stability and protect consumers become ineffective in dealing with new developments – as seen in the recent Indian microfinance crisis. Consequently, the challenge facing economies today is the design and effective implementation of new laws, policies and regulations that will provide an enabling environment for expanded financial access and satisfy important macro- and micro-prudential and consumer protection objectives in the face of a rapidly changing economic and technological landscape.

Forum participants discussed this issue in the context of the markets for credit, savings and remittances and two key policy areas, credit information and legal frameworks for secured lending, as well as the broader policy environment for entrepreneurship. These discussions yielded the following conclusions:

- There is ample room to expand sources of funding for micro-credit, which can be accomplished by harnessing regional public-private collaboration. Multilateral institutions have been active in mobilizing private capital for microfinance. Commercial banks have been partnering with MFIs to raise capital and reduce risks. Public agencies from developed economies are enabling consumer lenders and manufacturers to provide affordable loans to low-income consumers and MSMEs in developing economies.
- As recent microfinance crises have illustrated, however, expanding micro-credit needs to be supported by a strong credit underwriting culture that can protect the interests of borrowers, lenders and investors. Key measures include the establishment of a robust credit information system, providing adequate consumer protection and promoting financial education. To be effective, these measures should form part of a cohesive financial ecosystem based on a comprehensive strategy, effective enforcement and close cooperation among relevant public and private institutions.
- Grassroots savings mobilization fulfills an important need of low-income households and strengthens the microfinance sector. However, it faces a number of challenges in many economies related to adequacy of regulatory frameworks, sustainability of the business model, and low-income households' lack of trust in and familiarity with formal banking institutions and services.
- Addressing these issues and promoting micro-savings require proportionate regulatory and supervisory frameworks, well-coordinated implementation of effective strategies, measures to promote financial literacy, enabling environments for participation of related service providers such as mobile phone companies, and capacity-building for MFIs in becoming licensed financial institutions.
- Remittances, which are expected to grow rapidly among Asia-Pacific economies, have great potential for promoting financial inclusion.

Harnessing remittances for financial inclusion will require addressing three major challenges – reducing costs, channeling remittances to savings and investments, and maximizing their benefits to recipients.

- These challenges can be addressed through policies and measures that harness technology and collaboration among MFIs. Policy makers and regulators can provide an enabling environment for branchless banking infrastructure using mobile wallets and prepaid cards by addressing barriers to transactions using these technologies, such as measures to enable open loop accounts. Cross-border collaboration among MFIs can help link remittances to other financial products for migrants' families in their home economies. Financial education is needed to enable migrants' families to maximize the benefits or remittances.
- The adoption of full-file and comprehensive credit information systems can promote financial inclusion and strengthen financial systems. Private credit bureaus, which complement public credit registries, can contribute significantly to this goal. Establishing viable and effective credit bureaus faces various challenges in emerging markets. Among these are pricing in the context of high-volume, low-value and small markets; availability, quality and timeliness of data; finding and retaining skilled personnel; promoting demand and securing stakeholder support and collaboration. Lenders will also need better skills and technology to effectively use information from credit bureaus.
- Policy makers and regulators face challenges in designing and implementing a robust credit information sharing system, including lack of technical capacity, insufficient data quality and data bases. A key issue is finding a balance between promoting access to broader sources of information and protecting individual privacy. Given that there is no one-size-fits-all model in this area, it is important to enhance the capacity of policy makers and regulators to understand how to adapt policies, regulations and measures to fit their respective domestic environments.
- In developing credit reporting systems, policy makers and regulators can benefit from the wealth of existing best practices and experiences, particularly in balancing consumer protection with the requirements for effective and efficient credit reporting; identifying legal prerequisites for effective systems; and alternative regulatory and enforcement models. A deep understanding of the role of credit bureaus in the context of the credit market cycle is key to designing effective systems. Effective credit reporting systems are based on robust, balanced and properly implemented legal and regulatory frameworks supported by grievance mechanisms and financial education.
- Rapidly growing regional integration will necessitate the development of a regional credit reporting framework for cross-border collection, use, storage and protection of credit information. Difficult challenges are involved, at the center of which is the protection of data used across jurisdictions. One option for moving forward is to incorporate data protection in regional free trade

negotiations. Unless there is prior general consensus among negotiating parties, however, this is likely to slow down the whole negotiation process.

- An alternative to seriously consider is the regional adoption of an open architecture based on a regional trust mark that allows portability of cross-border data, more easily accommodates the evolution of technology, including the emergence of networked online (cloud) storage solutions, and enables governments to provide a backstop without additional regulatory burdens. Eventually, policy makers will also need to explore whether and how a regional credit reporting regime could be made compatible with Europe's legal framework, particularly the EU Data Protection Directive.
- The use of alternative data, such as utilities, insurance and rental payments, have tremendous potential for expanding financial inclusion, by allowing an estimated 3.9 billion people worldwide who have no prior credit records and have no collateral, to access financial services using their reputations. While technological and economic barriers are surmountable, policy and regulatory barriers and uncertainties need to be addressed to enable use of such data for credit reporting. Active government and regulatory support to enlist and facilitate the cooperation of data furnishers is also important.
- Establishing financial identity is a key issue in promoting access to finance, enabling financial institutions to serve low-income population segments while fulfilling important regulatory requirements. Useful tools for establishing financial identity include government-issued IDs and authentication engines. IDs with a robust validation process can provide a unique identifier for each individual, but have limitations, including vulnerability to fraudulent use in non-face-to-face transactions and physical deterioration, among others.
- Authentication engines, which involve running consumer data from credit bureaus and other external sources through proven fraud prevention models and databases using customized questions and proprietary algorithms, have proven useful in verifying identity and know-your-customer (KYC) and anti-money laundering (AML) compliance, among others. Such a system would require meeting a number of challenges previously discussed in relation to the establishment of a credit reporting system, most importantly the challenge of collecting data on larger portions of the population.
- Improving the legal architecture for secured lending can greatly expand MSMEs' access to finance. Greater protection of creditor rights will attract more lenders into the market, expanding the amount of available credit and lowering financing costs. While a number of markets in the region have relatively high standards of creditor rights protection or have made improvements in recent years, many gaps in the legal and regulatory architecture remain. These include the lack of exclusive registry systems for security interests, voidable conversion or preferences, unclear perfection rules, lack of coverage for certain types of collateral such as movables, receivables or intellectual property, absence of blocked or pledged account security, untested or non-transparent legal systems, treatment of floating

charges and lack of broad licensing authority for commercial lending to facilitate entry of non-bank lenders.

- There is much scope for APEC to provide a platform for regional cooperation in addressing these issues. Among possible initiatives to consider are a survey of global best practices on secured lending regimes; development of model elements of a code of security interest creation, perfection and enforcement; creating an international standard for recognizing a broader range of assets; development of model treatment of floating charges and accounts receivable financing; public-private dialogues to validate improvements to legal and regulatory frameworks; and promoting broad licensing authority for commercial finance.
- Well-defined legal systems with effective enforcement mechanisms provide a predictable environment for lenders and investors that reduces risks and borrowing costs. However, it is important that laws and their enforcement do not discourage entrepreneurship and risk-taking. An effective legal and regulatory architecture for finance is one that strikes a good balance between offering predictability and allowing room for risk-taking. This would include comprehensive, practical, efficient, inexpensive and reliable bankruptcy and foreclosure laws, public registry systems and provisions in secured lending laws that facilitate the extension of rehabilitation and turnaround financing. Clear and reliable commercial laws, in particular, clear rules about rights of lenders and borrowers in bankruptcy, are necessary for efficient and orderly liquidation and redeployment of assets in the context of insolvency to avoid rash actions by stakeholders and consequent value destruction.
- Improving access to finance can only succeed in helping MSMEs if undertaken together with other necessary policies to promote entrepreneurship. While a number of less developed economies in the region still have a long way to go in providing an enabling environment for MSMEs, others have had varying degrees of success in addressing issues facing these enterprises. Comprehensive reviews of MSME and entrepreneurship issues and policies, such as the recent OECD review of Thailand, are helpful in identifying reforms to improve the environment for MSME development. There is much potential for regional cooperation, particularly through APEC, to share such experiences and lessons to help governments in designing and developing effective strategies.

In view of today's global economic situation, expanded access to finance is an issue that needs to be given more importance in APEC, which has traditionally focused on liberalizing and facilitating trade and investment. Expanded financial access for the vast mass of middle and lower income consumers and small enterprises is needed to unlock the potential of emerging markets, particularly in Asia, as a new engine of the global economy and rebalance trade and growth across the region. It also promises to address a key impediment that prevents MSMEs from effectively fulfilling their traditional role as generators of employment.

Expanded access to finance must also be pursued within a region-wide context, if finance is to effectively support APEC's vision of open trade and investment across borders. This would involve the coordinated development of laws, regulations, market infrastructure and industry practices, as well as open architectures that can facilitate the movement of capital and management of risks across the region, while maintaining financial stability and protecting consumers as member economies move toward greater integration. This would also involve the development of mechanisms through which remittances of the region's growing migrant population can be more efficiently channeled to local financial systems, savings and investment.

APEC has significant potential to become a platform for regional cooperation to promote expanded access to finance, given its membership (it includes most of the largest and most dynamic economies), its well-developed regional collaboration infrastructure involving a wide range of ministries and agencies, and well-established mechanisms for sustained involvement of the private sector, the academic community and multilateral institutions. Through focused policy dialogues and capacity building activities coordinated under the APEC Financial Inclusion Initiative, APEC can further advance the goal of stronger, more balanced and more inclusive growth throughout the region.

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Addressing the needs of many people living in poverty in the Asia-Pacific region through improved access to finance remains a major challenge. With growing constraints on public resources in the wake of the Global Financial Crisis, mobilizing private resources to serve financial needs of low-income households and small enterprises has become ever more important. Stronger, more balanced and more inclusive growth also requires efforts to further expand financial access through new channels, while addressing the key obstacles small enterprises face in accessing traditional sources of finance.

The first APEC Financial Inclusion Forum held in 2010[1] focused on how to provide enabling environments to extend the reach of microfinance, improve its commercial viability, and increase private investment in MFIs. In their *Kyoto Report on Growth Strategy and Finance*, APEC Finance Ministers welcomed the outcomes of this Forum and initiative of the APEC Business Advisory Council (ABAC) to set up subsequent discussions.

This year's Forum, which ABAC co-organized with the Asian Development Bank Institute (ADBI), in collaboration with the Asia-Pacific Credit Coalition (APCC), the Policy and Economic Research Council (PERC), the Asia-Pacific Finance and Development Center (AFDC), the Banking with the Poor Network (BWTP), the Foundation for Development Cooperation (FDC), the Institute for International Monetary Affairs (IIMA) and the Organisation for Economic Co-operation and Development (OECD), and sponsored by Citi, was held with three purposes in mind.

- First, it aimed to provide a venue for policy dialogue on expanding new channels to serve the financial needs of the unbanked, and how APEC can harness regional public-private cooperation to promote the sustainability and expansion of undertakings using these new channels. Participants were invited to discuss and develop recommendations for measures to provide an enabling environment in three areas - consumer and micro/small enterprise lending, grassroots savings mobilization, and remittances.
- Second, it aimed to provide a platform for capacity building to help relevant policy makers and regulators in the region address two key issues for expanding credit to micro-, small and medium enterprises (MSMEs): credit information and legal frameworks for secured lending. Key government and regulatory stakeholders, private sector financial services firms, and thought leaders were invited to survey challenges in these two areas and develop

[1] This was convened on 31 May 2010 in Sapporo, Japan, by the APEC Business Advisory Council (ABAC), jointly with the Advisory Group on APEC Financial System Capacity Building and in cooperation with the Ministry of Finance of Japan.

strategies for addressing them.

- Third, it aimed to provide a forum for discussion of broader institutional and economic framework conditions and policies affecting MSMEs, recognizing that expanding financial access can only be achieved with parallel efforts to improve design and implementation of SME and entrepreneurship policies, build a resilient and adaptable foundation of entrepreneurs, and develop policies to promote entrepreneurship. The last part of the forum was devoted to a discussion of the OECD's reviews of SME and entrepreneurship issues and policies in Thailand, and the prospects for utilizing this process more broadly as a tool for improving the design and delivery of policy and for information sharing in the region.

This Forum drew on the combined expertise and experiences of the public and private sectors, international institutions and academe from throughout the region. This report is intended to serve as basis for useful recommendations that will be conveyed to key officials and institutions, particularly those involved in developing regional frameworks to promote expanded financial access for households and enterprises.

EXPANDING NEW CHANNELS OF FINANCIAL INCLUSION

Currently, an estimated 2.7 billion people in emerging markets do not have access to financial services. However, progress in meeting these needs through microfinance has been slow. The 2010 CGAP Funding Surveys reveal that total commitments to microfinance amounted to US$21.3 billion at the end of 2009, with public donors and investors accounting for 68% of the total and private donors and investors contributing 32%.[2] Most public sector funds are channeled directly, while private sector funds are largely channeled through Microfinance Investment Intermediaries. Obviously, the needs are much greater than what governments and multilateral institutions with increasingly limited resources can meet. More adequately meeting these needs will therefore require more private sector resources.

Microfinance involves the delivery of various types of financial services – credit, savings, insurance, payments and remittances. Credit enables low-income clients to invest in businesses and to smooth consumption. Savings enable households to weather local economic downturns while providing a stable source of funding for microfinance institutions (MFIs). Insurance provides a safety net and enables greater investment in business activities. Payment and remittance systems enable greater market access for low-income households. Participants discussed how more private sector resources can be made available for greater financial inclusion in the areas of credit, savings and

[2] Data submitted by 61 funders and 90 microfinance investment intermediaries (MIIs) indicate 41 public donors and investors such as multilateral institutions, official development assistance agencies, export credit agencies and development financing institutions providing a total of US$14.6 billion in 2009, of which US$11 billion flowed directly to microfinance, US$1.2 billion to apexes and other intermediaries and US2.4 billion to MIIs. Similar data indicate private donors and investors such as foundations, institutional and retail investors providing a total of US$6.7 billion, of which US$5.7 billion flowed to MIIs, US$0.9 billion directly to microfinance and US$0.1 billion to apexes and other intermediaries.

migrants' remittances.

Credit for Low-Income Consumers and MSMEs[3]

There is ample room to further expand sources of funding for credit to low-income households and MSMEs through public-private partnerships. Multilateral institutions have been active in mobilizing private capital for microfinance. Aside from directly financing MFIs, the International Finance Corporation (IFC), for example, structures funds, holding companies and investment vehicles that offer opportunities for investors and commercial banks to be engaged in the microfinance sector. Microfinance Investment Vehicles (MIVs), which provide structures through which a wide range of investors[4] can have exposure to MFIs with a variety of capital, including debt, equity and guarantees among others, have been supplying an increasing portion of MFIs' funding needs. Public-private partnerships have proven highly successful in achieving financial success and social impact, with public agencies taking on catalytic roles in providing both funding and technical assistance to MFIs.

While they may not be directly engaged in microfinance, commercial banks can play important roles in enabling MFIs to become commercially viable, as "bankers to the bankers to the poor." One key area is reducing foreign exchange risks faced by non-deposit taking MFIs, which are typically dependent on donations and their own earnings and have limited access to local currency funding. Commercial banks can help raise funding from the local market such as through securitization of receivables that can be issued to investors[5] and international bond issuances.[6] There is great potential for partnerships between public financial institutions and commercial banks that can raise capital to help MFIs hedge foreign exchange exposures and mitigate risks, enabling them to lower costs for borrowers.

Public institutions can also play an important role in enabling businesses to provide expanded access to affordable loans for low-income consumers and

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[3] This section summarizes the presentations and discussions in Session One (Consumer and Micro-/Small Enterprise Lending), chaired by Dr. Julius Caesar Parrenas (Advisor on International Affairs, Bank of Tokyo-Mitsubishi UFJ, Ltd). Presentors in this session were Dr. Matthew Gamser (Principal, Advisory Service, East Asia and Pacific, International Finance Corporation), Mr. Tatsuhiko Takesada (Head, Global Manufacturing Finance Department, Japan Bank for International Cooperation), Mr. Robert A. Annibale (Global Director, Citi Microfinance and Community Development), Dr. Robin Varghese (Vice President, Policy and Economic Research Council) and Datin Shahariah Hashim (Deputy Director, Development and Enterprise Department, Central Bank of Malaysia).

[4] These include institutions such as pension funds, banks, foundations, funds of funds, NGOs, development finance institutions and government agencies.

[5] An example is the world's first microcredit securitization deal, wherein the Bangladesh Rural Advancement Committee (BRAC) received financing through a securitization structured by Citigroup, RSA Capital, the Netherlands Development Finance Company (FMO), and KfW Entwicklungsbank (KfW). A special purpose trust was created to purchase BRAC's receivables from its microcredit portfolio and issue certificates to commercial investors, part of which was backed by an FMO guarantee and a KfW counter-guarantee. The high quality of the notes made them attractive to investors in the domestic market.

[6] This can be illustrated by the experience of Grupo ACP, whose inaugural international bond offering, co-arranged and underwritten by Citibank del Perú S.A., with a size of US$85 million and a 10-year tenor was sold to local and international investors. Proceeds from this offering were used to finance the growth of the group's subsidiaries in Latin America, including a US$40 million syndicated loan executed by Citi and IFC and disbursed in local currency to Mibanco, a Peruvian MFI, to enable it to expand its credit portfolio.

small enterprises, even if financial inclusion is not directly a part of their mission. One example is the Japan Bank for International Cooperation (JBIC), whose mission is to promote Japan's access to important resources overseas, help Japanese industry maintain its international competitiveness, respond to international financial disruptions and promoting Japanese overseas projects that promote a clean environment. Among its various facilities to fulfill this mission,[7] JBIC has a loan and guarantee scheme for sales finance in emerging markets that has successfully expanded low-income customers' access to loans for the purchase of motorcycles in Indonesia and Thailand.[8] The Overseas Private Investment Corporation (OPIC)[9] provides another example. OPIC participates in local currency loans originated and funded by the private sector to MFIs in several emerging markets.[10]

The recent microfinance crisis in Andhra Pradesh caught media attention due to the large number of suicides that resulted from predatory practices and coercive loan recovery methods employed by micro-lenders. This was just the latest of a series of crises affecting microfinance, starting with Bolivia in 1999, a previous crisis in Andhra Pradesh in 2005, Pakistan and Morocco in 2008 and Nicaragua in 2009, among others. A common thread running through all these episodes of financial distress is the inadequacy of regulatory frameworks, the financial infrastructure and levels of financial literacy in ensuring sound lending practices.

The recent Andhra Pradesh crisis illustrated both supply- and demand-side factors that were at play. On the supply side, a combination of large injections of state funds into self-help groups and an unprecedented concentration of MFIs operating in the region resulted in an unhealthy overabundance of credit and competition for lending business. This was evident in the two South Indian states of Andhra Pradesh and Karnataka, which accounted for only 14% of low income households in India, but had a 52% share of MFIs' clientele nationwide. On the demand side was the high level of multiple loans taken out by poor people in rural areas leading to over-indebtedness.

Capping interest rates, which is often seen as a popular response to such a crisis, is in reality counterproductive to the goal of financial inclusion. Whenever lenders see the risk as higher than what the capped interest rate implies, the

[7] These facilities include export credit (to finance Japanese companies' exports), import loans (to finance Japan's imports of strategically important materials), investment loans (to help finance Japanese companies' overseas investment and natural resource development operations), untied loans (to finance projects related to improving the business environment for the operations of Japanese companies and to address the impact of disruptive overseas financial developments), guarantees and equity participation.

[8] JBIC's guarantee agreement with the local branch of the Bank of Tokyo-Mitsubishi UFJ for the latter's local currency denominated loan to an Indonesian auto finance company has provided stable local currency funding that enabled the sales finance company to meet the growing demand for motorcycles. Under this scheme, the bank extended a local currency loan to an auto finance company that provides sales finance for individual purchases; JBIC guaranteed the repayment of the loan in local currency.

[9] OPIC is a US government agency established to fund overseas investments in new and emerging markets, complement the private sector in managing risks associated with foreign direct investment, and support U.S. foreign policy.

[10] The OPIC-Citi microfinancing is a funding facility launched in December 2006 with US$100 million to provide financing to 23 MFIs in 13 markets. OPIC provided an additional US$250 million to expand the program in 2009.

result is reduced availability of funds. A more effective response would be to address the factors underlying lenders' and borrowers' decisions that ultimately lead to over-indebtedness and crisis through key measures.

- The first key measure is ensuring lenders' access to sufficient credit information. A robust credit information system is key to reducing asymmetric information and providing a disciplinary mechanism that incentivizes borrowers to pay on time. In addition, it reduces operational costs for lenders and leads to greater competition, reducing the cost to borrowers of searching for lenders. Full-file and comprehensive credit information systems provide the best environment to achieve these aims. However, such systems require the appropriate regulations on data quality, data content and consumer protection, as well as adequate understanding on the part of consumers and technical capacity on the part of lenders. Another issue that also needs to be addressed is the overlap between commercial and consumer lending, where the risk profile of the proprietor is used by lenders. Pricing for commercial lending to MSMEs usually differ from consumer lending due to the more stringent regulatory protection accorded to consumers vis-à-vis commercial enterprises. Regulatory frameworks also need to be flexible to enable the use of new technology and capture other data such as trade credit. In addition, credit information systems need to be complemented by policies to promote their use, as demonstrated by the sub-prime lending crisis in the USA, where there is no lack of sufficient credit information. Regional platforms for sharing of experiences and best practices and for capacity building can greatly contribute to enabling governments and regulatory agencies to develop robust credit information systems.
- The second key measure is providing adequate consumer protection, in particular to prevent over-indebtedness and promote transparency, which can lead to lower interest rates through greater competition. There are a number of ongoing initiatives.
    - ✧ A key global initiative is the Smart Campaign,[11] an umbrella for microfinance industry-wide efforts on client protection, which has put forward seven Client Protection Principles: (a) appropriate product design and delivery, (b) prevention of over-indebtedness, (c) transparency, (d) responsible pricing, (e) fair and respectful treatment of clients, (f) privacy of client data, and (g) mechanisms for complaint resolution.[12]

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[11] The Smart Campaign is a coalition initiated by the Center for Financial Inclusion at ACCION International and the Consultative Group to Assist the Poor (CGAP), following a meeting of microfinance leaders convened in Pocantico, New York in 2008. Further details are available at http://www.smartcampaign.org.

[12] These are defined as follows:

Appropriate product design and delivery: Providers will take adequate care to design products and delivery channels in such a way that they do not cause clients harm. Products and delivery channels will be designed with client characteristics taken into account.

Prevention of over-indebtedness: Providers will take adequate care in all phases of their credit process to determine that clients have the capacity to repay without becoming over-indebted. In addition, providers will implement and

- ✧ Another is MicroFinance Transparency, an industry-backed international non-governmental organization that promotes pricing disclosure, gathering and making available information on credit products and their prices in a clear and consistent fashion, as well as offers policy advisory services and develops training and education materials for market stakeholders.[13]
- ✧ The Inter-American Development Bank (IDB) provides a model for international cooperation in promoting consumer protection. The IDB collaborated with the Association of Supervisors of Banks in the Americas (ASBA) in developing the Guidelines of Principles for Effective Regulation and Supervision of Microfinance Operations in 2010,[14] which include a number of principles promoting consumer protection. Among these are the creation of full-file credit bureaus, rapid and effective resolution mechanisms for disputes, client protection for all clients, clear guidelines on product and price transparency and the range of processes to monitor and help prevent over-indebtedness. The IDB also works with other organizations to provide an index tracking conditions in 21 Latin American and Caribbean economies, including legal and regulatory frameworks, regulatory and supervisory capacity and institutional frameworks, especially financial reporting standards and transparency, pricing transparency, dispute resolution procedures, and policies and practices for offering microfinance through new agents and channels.[15]

The experiences of these and other similar initiatives illustrate the complexity of consumer protection and the need for a local approach and

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monitor internal systems that support prevention of over-indebtedness and will foster efforts to improve market level credit risk management (such as credit information sharing).

Transparency: Providers will communicate clear, sufficient and timely information in a manner and language clients can understand so that clients can make informed decisions. The need for transparent information on pricing, terms and conditions of products is highlighted.

Responsible pricing: Pricing, terms and conditions will be set in a way that is affordable to clients while allowing for financial institutions to be sustainable. Providers will strive to provide positive real returns on deposits.

Fair and respectful treatment of clients: Financial service providers and their agents will treat their clients fairly and respectfully. They will not discriminate. Providers will ensure adequate safeguards to detect and correct corruption as well as aggressive or abusive treatment by their staff and agents, particularly during the loan sales and debt collection processes.

Privacy of client data: The privacy of individual client data will be respected in accordance with the laws and regulations of individual jurisdictions. Such data will only be used for the purposes specified at the time the information is collected or as permitted by law, unless otherwise agreed with the client.

Mechanisms for complaint resolution: Providers will have in place timely and responsive mechanisms for complaints and problem resolution for their clients and will use these mechanisms both to resolve individual problems and to improve their products and services.

[13] For further information, refer to http://www.mftransparency.org.

[14] See http://www.iadb.org/document.cfm?id=35735061.

[15] The *Global Microscope Index* forms part of the *Global Microscope on the Microfinance Business Environment*, which was commissioned and funded by IDB's Multilateral Investment Fund, the Development Bank of Latin America (CAF) and IFC, and undertaken by the Economist Intelligence Unit, with the aim of benchmarking and evaluating business and operating conditions for microfinance in developing economies around the world.

close collaboration between industry and banking supervisors. There are limits on voluntary approaches by industry posed by existing regulations, such as those that continue to treat micro-credit as consumer loans. Promoting proportionate and differentiated regulations not just with respect to consumer protection, but to all other aspects of regulation in general, is necessary for micro-lenders to operate effectively and to access more diverse funding. It is nevertheless important for authorities to work within the mandate of banking supervision in promoting consumer protection.

- The third key measure is financial education, which is a necessary complement to client protection and regulation. The Andhra Pradesh crisis highlights the perils of inadequate financial literacy, which rendered low-income borrowers vulnerable to unsound financial decisions and predatory practices.

These experiences demonstrate the need for a cohesive financial ecosystem, where sound policies and regulations are effectively enforced. The Malaysian experience provides valuable lessons for policy makers in designing financial ecosystems that promote financial inclusion. The government developed a comprehensive strategy based on five pillars of an inclusive financial sector – financial service providers, distribution channels, banking products and services, financial literacy and financial infrastructure. Concrete measures were undertaken to address key issues in each of these areas. Various important public institutions[16] have been assigned clear and specific roles to play under this strategy. Combined with strong public-private sector collaboration, these measures enabled Malaysia to achieve significant progress, as reflected in its top global ranking in the "Getting Credit" category of the World Bank's Doing Business reports over the past three years.

Policy makers and regulators can benefit from sharing of similar experiences through international platforms provided by a number of global and regional initiatives. Technical assistance is also available from various institutions. An example is IFC's advisory services, which draw upon in-house and technical partners' expertise in supporting systemic interventions, including financial infrastructure, capacity building to help financial institutions extend services to un-banked and under-banked firms and individuals, as well as advice on risk management, governance and sustainable energy and finance.

The foregoing discussions indicate that there is much room for expanding sources of credit for low-income consumers and MSMEs. However, sound and sustainable micro-credit requires a strong credit underwriting culture that can protect the interests of borrowers, lenders and investors. Such a culture can be achieved through the development of robust and proportionate frameworks for consumer protection, credit information and financial literacy within a cohesive system. Together with diversified funding structures based on the development

[16] These include the Bank Negara Malaysia, the National SME Development Council, the Credit Guarantee Corporation, development financial institutions, the Financial Mediation Bureau, the Credit Counseling and Debt Management Agency, the Malaysian Deposit Insurance Corporation, the Micro Enterprise Fund, the Central Credit Reference Information System, Credit Bureau Malaysia and the SME Corporation Malaysia.

of other microfinance services such as savings, insurance, payments and remittances, and good governance and management of MFIs, these elements make up solid foundations for sustained growth of micro-credit through expanded funding from local and international markets.

Government financial institutions, multilateral agencies and the private sector can play important roles in expanding sources of funding and promoting capacity-building to foster micro-credit in the region's emerging markets. While there is much that is already being done through ongoing efforts, however, much more can be achieved in effectively and efficiently bringing financial and technical resources to bear. For this purpose, public and private sectors should work together to further explore how regional cooperation, such as through APEC, can be harnessed.

Grassroots Savings Mobilization[17]

As mentioned earlier, mobilizing small savings is of prime importance not only for both low-income households but also MFIs. Compared to credit, convenient and reliable savings accounts are needed by more such households. Deposits also provide an inexpensive, stable and foreign exchange risk-free source of finance for regulated MFIs. Throughout the recent global financial crisis, as well as the various microfinance crises in emerging markets over the past two decades, deposit-taking MFIs have proven more resilient to shocks than other types of MFIs. These factors highlight the need for greater efforts to promote micro-savings.

Grassroots savings mobilization involves a number of difficult challenges. On the supply side, these include the lack of adaptation of regulatory frameworks to local contexts, sustainability of business models for serving low-density areas and low-income populations, limited number of types of financial service providers in rural areas, and the design of savings products that are appropriate for low-income clients and the informal economy. The higher costs of dealing with many small accounts compared to a few large ones discourage financial institutions from catering to low-income clients. On the demand side, challenges include the prevalence of competing informal savings vehicles among low-income households (such as keeping cash, entrusting money to neighbors, group savings and investment in kind), lack of trust in the formal banking system, and lack of information on formal banking institutions and the services they offer.

Given these wide-ranging challenges, efforts need to address key issues affecting policies and regulations, clients, MFIs and related services providers. These include proportionate regulation and supervision, effective strategies, financial literacy, enabling environments for providers of related services and capacity building for MFIs.

[17] This section summarizes the presentations and discussions in Session Two (Grassroots Savings Mobilization), chaired by Mr. Kazuto Tsuji (Executive Technical Advisor, Public Policy, Industrial Development and Economic Infrastructure, Japan International Cooperation Agency). Presentors in this session were Mr. Robert Annibale (Global Director, Citi Microfinance and Community Development), Mr. Chris de Noose (Managing Director, World Savings Bank Institute), Mr. Kenneth Waller (Director, Australian APEC Study Centre at RMIT University) and Mr. Yohanes Santoso Wibowo (Deputy Director, Directorate of Credit, Rural Bank and SMEs, Bank Indonesia).

Proportionate regulatory and supervisory frameworks. Promoting financial inclusion entails a balance between the objective of maintaining sound financial systems with the objective of enhancing access to finance, which can be achieved through proportionate regulation. The G20 Principles for Innovative Financial Inclusion include the principle of proportionality, which enjoins regulators and supervisors to "build a policy and regulatory framework that is proportionate with the risks and benefits involved in innovative products and services and is based on an understanding of the gaps and barriers in existing regulation."[18] Proportionate regulation can be achieved if regulatory intervention is only undertaken after careful consideration of the costs and benefits and specific considerations of likely effects on low-income households and micro-enterprises.

Following are ways through which such a balance between soundness and inclusion can be achieved:

- Regulations must be based on an understanding of the fundamental causes of lack of financial access. One of these is information asymmetry, which results in adverse selection risks where lenders have less information than borrowers on riskiness of loans. A second cause is limited capacity of lenders to monitor performance of borrowers, which causes moral hazard risks, as well as limited capacity to enforce contracts within reasonable time frames.
- Small savings are not easy for traditional banks to deliver in a sustainable way, given the cost disincentives in dealing with small deposits vis-a-vis large ones, especially in complying with know-your-customer and other regulations. Regulators need to address various challenges related to identifying customers, especially in areas where many individuals do not have the identification normally required for financial transactions.
- Regulations should be developed to allow financial institutions to find a business case for offering small savings services, such as through cross-selling.
- To minimize regulatory arbitrage, financial services providers should be regulated in a uniform and consistent manner, with regulation based on the relevant activity rather than the type of institution.
- Policies and regulations should be developed to ensure the availability of a wide variety of financial services to unbanked and under-banked households and enterprises, including lending and deposit-taking by appropriately regulated financial institutions, as well as insurance, payments and remittances services. Furthermore, they should facilitate the raising of capital through such means as promoting greater access to markets by domestic and foreign banks and encouraging the development and provision of venture capital and private equity and the listing of mutual funds.

[18] Innovative Financial Inclusion: Principles and Report on Innovative Financial Inclusion from the Access through Innovation Sub-Group of the G20 Financial Inclusion Experts Group (25 May 2010), p. 5.

- The use of third party intermediaries by financial institutions can be a critically important way of promoting financial inclusion, particularly in emerging markets where there is physical or informational distance between users and providers of financial services and where new technologies offer new ways of providing financial services. Regulatory agencies should encourage and support the appropriate provision of services by such intermediaries and the delegated monitoring of borrowers by third parties, while putting relevant safeguards in place. Regulation should clearly define the role of non-bank credit institutions and the scope of their permitted activities.
- A light regulatory approach is needed to allow innovations that can promote greater financial access. Innovative products and delivery mechanisms are needed to make savings products for low-income individuals commercially sustainable. Collaboration and constant dialogue among relevant agencies and between regulators and industry are important for the adoption of approaches that can allow regulation to follow, rather than stifle, innovation and the use of new technologies. Regulators should keep abreast of innovation, particularly in payments systems and new forms of delivery of financial services. Regulators should also keep the door open for licensing robust deposit-taking MFIs in the future to allow the industry to grow and develop appropriate regulatory approaches that take into account differences in levels of risk between MFIs and other financial institutions.
- Coordination among government agencies and between the public and private sectors is a key element in developing sound policies and regulations. One way of achieving such coordination would be through the establishment of public-private councils that can develop, monitor, coordinate and evaluate policies, programs and regulatory practices and approaches affecting access to finance.
- Sound regulation can only be effective if supported by adequate capacity to supervise and implement. Authorities should be provided with knowledge and skills related to relevant financial products specifically targeted to unbanked and under-banked individuals and firms and the capacity to supervise and enforce relevant laws and regulations.

Effective strategies. Promoting grassroots savings mobilization is a complex task that involves various policy areas and institutions. The undertaking of complementary initiatives and effective coordination among institutions can greatly contribute to the success of this effort. The experience of Indonesia provides valuable lessons for governments on how they can collaborate with various institutions and support efforts to promote micro-savings.

Indonesia's financial sector is dominated by commercial banks, which hold 80% of the economy's total financial sector assets. In addition, Indonesia has over 1,800 rural banks and around 80,000 MFIs. MFIs include banks and formal non-banks, which fall under different regulatory regimes. Rural banks and micro-units of commercial banks are licensed and supervised by the central bank (indirectly through respective bank branches in the case of the micro-units).

Village credit agencies are licensed by the Ministry of Finance and supervised by Bank Rakyat Indonesia on behalf of the central bank. Non-banks are supervised either by the State Ministry of Cooperatives and SMEs (in the case of cooperatives), the Ministry of Finance (in the case of pawnshops) or local governments or regional development banks (in the case of village funds and credit institutions). In addition, there are non-formal non-banks that are unsupervised, including NGOs, self-help groups (SHGs) and Islamic financial cooperatives (BMTs).

Out of Indonesia's total population of 238 million (2010), only 52% have access to formal finance, according to World Bank estimates. About 31% are using informal service providers. The remaining 17% are living without savings or credit. About 13% of Indonesians live below the poverty line, almost two-thirds of which are in rural areas. Of these poor households, only 19% have access to formal finance, with 40% able to depend on informal finance and 39% having no access to savings or credit. With regard to savings, 32% of Indonesians do not have savings. Of those who have savings at formal financial institutions (47% of the population), more than half do not have accounts of their own, but are using other people's accounts. To address this situation, Indonesia has launched a number of initiatives – TabunganKu (My Savings), Tabprindo (Tabungan Bank Perkreditan Rakyat Indonesia, a rural banks' savings mobilization scheme) and PHBK (a program to link banks and SHGs).

- TabunganKu. This is a scheme launched in 2010 by Bank Indonesia and the banking industry to provide savings services to the unbanked, particularly low-income communities and children. This effort is intended to help increase domestic funding to support economic development, promote financial inclusion and build a savings culture. Previously, low-income individuals had little incentive to keep money in banks, because such savings tended to be eroded given that administrative fees charged by financial institutions (which are typically the same for all accounts regardless of the existing balance) exceed interest earnings. TabunganKu was launched by 70 commercial banks and 900 rural banks to provide a savings product that addresses this issue. The main features of the scheme are the waiver of the monthly administration fee, low initial deposits (only USD1.80 for commercial banks and USD0.90 for rural banks) and low interest rates. The scheme also provides vehicles that go to populated areas such as schools, markets, office and residential areas to let people open bank accounts. It is publicized through a public awareness campaign that includes mass media promotion using television, radio, print media and various types of promotional materials. Within its first year, TabunganKu has resulted in the opening of 1.4 million new savings accounts and new deposits worth US$1.67 million.
- Tabprindo. Among the features of this savings product are door-to-door collection of funds, open market area services, face-to-face approach, the use of electronic data capture technology and a lottery for savers jointly undertaken by rural banks. The number of accounts has exceeded 8 million by May 2011.

- PHBK. This is the product of a joint collaboration between Bank Indonesia and Germany's GTZ, which utilizes a group approach to minimize costs and credit risk for banks in providing financial services to micro-enterprises and incorporates savings mobilization as an integral part of all financial linkages. Micro-enterprises are organized into SHGs, thereby reducing transaction costs. The whole group guarantees conformance by members to group rules and regulations, which is formalized upon joining. Banks carefully select SHGs in accordance with a set of eligibility criteria. All financial services to SHGs are offered at market rates, and loan size is determined by the saving capacity of the SHG. Group members are only allowed to take out loans after they deposit savings. Through this scheme, the required physical collateral is replaced by the group members' joint liability and blocked savings accounts.

Financial literacy. Financial education is a key requirement for grassroots savings mobilization. An important first step is to educate people about the benefits of saving through the formal financial system, i.e., greater security provided by deposit insurance systems, cost and affordability vis-à-vis informal savings vehicles, and potential access to a wide range of financial services such as lending, payment and remittances. Financial education also needs to focus on inculcating the habit of savings, helping low-income clients understand basic financial concepts, opportunities and options to more efficiently use savings, and how to successfully and safely use new delivery channels such as branchless banking.

Policy makers in the region can learn from various experiences in promoting financial education. The World Savings Bank Institute, for example, has compiled successful experiences of its member banks, among which are the following:

- The National Savings Institute (India) helps widely dispersed rural populations develop the habit of savings by promoting small savings products tailored to their needs through various media including television, radios and newspapers.
- The Government Savings Bank of Thailand integrates financial education into product design. Its People's Bank program takes into account not just the amount saved but also the frequency of deposits in giving customers access to micro-loans.
- The National Saving Bank (Sri Lanka) helps expose schoolchildren to the savings culture by building dedicated banking units in school premises to provide access to savings projects and teach children to manage their own money.
- The Asociacion Popular de Ahorros y Prestamos (Dominican Republic) helps customers define their savings goals through a guidance outlining steps needed to achieve a successful savings plan and highlighting the importance of setting goals for savings, defining the savings term, financial planning and planning for emergencies, among others.

- The Banco Caja Social (Colombia) offers Progress Savings Accounts, which incorporate coaching of clients to set goals and developing tailored savings strategies.

Effective financial education can be achieved through the adoption of a multi-stakeholder approach and development of life-long learning programs. Key stakeholders that should be involved in financial education include, from the government sector, ministries of finance, education, social welfare, central banks and financial supervisory authorities, and from the private sector, relevant civil society organizations and the financial industry. The latter's involvement should be arranged in a way that is fair, transparent and unbiased.

Financial education should specifically be targeted to children and young people. Specific programs have been developed in a number of economies, which can provide lessons for interested governments. Basic financial education programs should be strengthened in schools and where appropriate introduced in school curricula.

Access to banking products is important for people to develop financial capability, as this gives them the opportunity to apply the lessons learned from financial education and develop the skills necessary to use financial services in a productive and responsible manner, while protecting themselves from abusive financial practices and over-indebtedness.

Enabling environments for providers of related services. How to encourage people to open accounts that will be useful and relevant to the individual and will not remain dormant is a challenge. Government to person payments can be considered as a way to address this issue. Bringing down costs and making it easier for people to use their accounts through technology is another solution. M-PESA provides an example of how the use of mobile banking can be expanded to go beyond transactions to managing savings accounts and enable people to find value. These require progressive regulations and partnerships between financial institutions and relevant service providers such as mobile phone companies.

Capacity building for MFIs. Encouraging more MFIs to become deposit-taking institutions will involve substantial capacity building in order for them to qualify for a license and to ensure the protection of depositors and the safety of the financial system. Many MFIs will also need transitional sources of funding as they transform themselves. As wholesale financial mechanisms that can channel financial resources to retail MFIs, apex institutions can play a significant role in this process. As experiences have shown, however, provision of funding from apexes need to go hand-in-hand with the development of a critical mass of competent retail MFIs. Technical assistance to ensure that apex institutions and MFIs are managed by people with the necessary technical and personal qualifications can substantially help expand the number of deposit-taking MFIs. Other measures that can be introduced to promote savings mobilization include incentives for MFIs to become regulated institutions and partnerships between licensed financial institutions and unlicensed institutions such as SHGs, NGOs and cooperatives.

Harnessing Remittances for Microfinance[19]

Remittances, which have great potential for promoting financial inclusion, are expected to grow in importance in coming years. An estimated US$450 billion are remitted by migrants to developing economies every year. To the East Asia and Pacific region, about 21 million migrants remitted from all over the world over US$90 billion in 2010. The region itself is host to around 7 million migrants, which are expected to increase considerably with the region's growing economic integration, against a backdrop of large income differentials among economies and aging populations in the more developed economies. Labor-sending economies are benefiting from migration in terms of poverty alleviation, macroeconomic management and financial development and stability, although long-run impact on human capital, growth and investment will depend on individual economies' policies.

There are three major issues in the management of remittances: (a) reducing remittance transfer costs; (b) channeling remittances to the financial system, savings and investment; and (c) maximizing the benefits of remittances to migrant families.

Reducing remittance transfer costs. Reducing costs of remittances is important because remittance flows tend to be highly sensitive to remittance costs. There are wide variations in costs, which can range from 2.5% to 26% of the total amount. Costs are relatively high for the East Asia and Pacific region, compared to South Asia, Latin America and Europe/Central Asia. Among major factors that account for high costs are exclusivity arrangements between banks and money transfer operators (MTOs) and various regulations on remittances service providers (RSPs) including AML regulations. Costs can decrease with greater competition among RSPs and larger numbers of migrants.

Channeling remittances to the financial system, savings and investment. Linking remittances more closely to banks and financial institutions such as MFIs or savings cooperatives can promote the mobilization of savings. In the Americas, banks with cross-border branch networks have developed efficient intra-Bank electronic transfer arrangements. However, branch networks are relatively less developed in the East Asia and Pacific region. Connectivity between transfer and deposit points is a key issue. Various means can be considered to harness migrant savings more efficiently:

- Branchless banking infrastructure based on information technology and telephony using mobile wallets and pre-paid cards can help reduce costs. Such infrastructure is already being deployed in a number of economies, with more being developed.
- MFIs can play greater roles in money transfer services, cash and

[19] This section summarizes the presentations and discussions in Session Three (Remittances and Cross-Border Microfinance), chaired by Ms. Erlijn Sie (Manager, Banking with the Poor Network). Presentors in this session were Dr. Ahmad Ahsan (Lead Economist, East Asia and Pacific Region, The World Bank), Mr. Atsumasa Tochisako (President and CEO, Microfinance International Corporation), Mr. Philip Yen (Group Head, Emerging Payments, Asia-Pacific, Middle East & Africa, MasterCard Worldwide), and Mr. Tung Tithanou (Deputy Head of Microfinance and Financing for SMEs, Ministry of Economy and Finance, Cambodia).

management products and lending products that use remittances as guarantees. These are especially useful for middle-income respondents who need loans amounting to between US$5,000 and US$10,000.

- Securitization of remittances can help avoid exchange rate and currency risks and facilitate the use of clean balance sheets. Over 400 transactions worth US$80 billion of future financial receipts have been securitized through diversified portfolio rights.
- Diaspora bonds, which have been successfully issued by Israel and India and are attracting the attention of a number of governments, can be marketed to overseas migrants.

A good macroeconomic environment that ensures stability and a good investment climate to facilitate high returns are also fundamental requirements for attracting remittances and making them more productive.

Collaboration among MFIs can play an important role in linking remittances to other financial products such as savings accounts, micro-loans and mortgage and business loans. Microfinance International Corporation (MFIC), which has been able to offer lower remittance fees and faster delivery of remittance to beneficiaries and help migrants in the USA develop remittance history used for credibility analysis in approving loans, provides an example. MFIC works with MFIs in migrant clients' home economies to promote the local microfinance industry and offer cross-border credit services. To promote the microfinance industry, MFIC lends to partner MFIs using the float settlement fund generated by remittance flows. It works with partner MFIs in home economies, which provide loans for housing and tuition to families of MFIC's migrant clients, using credit analysis based on migrants' remittance and credit records collected by MFIC.

MFIC also collaborated with the Federal Reserve Bank in developing the FedGlobal Project, which seeks to significantly reduce the costs of international money transfer and improve its efficiency. The core element of this project is the Fed's automated clearing house (ACH) system, which is connected with over 8,000 banks in the USA. With the Fed providing centralized fund settlement, remittance processing costs for participating US banks have been reduced to as low as US$4 per transaction, compared to as high as US$15 for transactions through traditional channels. MFIC's role consists in providing the Fed use of its remittance system, real-time transaction monitoring using a fully automated compliance checking function against money laundering and other prohibited transactions, foreign exchange management, and instant delivery of funds to recipients.

A key challenge that remains to be addressed is enabling more MFIs in far-flung rural areas to serve as conduits of remittances. Promoting closer international collaboration among MFIs and related financial institutions is one way of meeting this need. This is also an area where the use of technologies, discussed in greater detail below, could play an important role.

Maximizing the benefits of remittances to migrant families. Remittances enable

migrants' families to achieve financial independence. While typically, about 60 to 80 percent of remittances are used to cover basic necessities, some 20 to 40 percent end up being invested in education, health care, housing, small business ventures or saved for emergencies and retirement.

Financial education is important to help migrants and their families formulate long-term goals and prudent financial plans to mitigate the risks they face and understand the broad array of services and instruments such as savings, credit, and loans linked to remittances. Studies indicate that the majority of migrants and their families that have access to these services often do not take advantage of these opportunities due to lack of knowledge.

The potential of new technologies. The use of new technologies in the payments sector offers new possibilities for reducing costs of domestic and cross-border financial transactions and expanding financial inclusion. Mobile payment solutions and prepaid cards are two areas where such potential exists. The needs of many underserved consumers are increasingly being addressed by fast-growing mobile money services, being driven in large part by improving capabilities and sinking costs of smart phones.

How effectively these technologies can be harnessed to further promote financial inclusion will depend on how governments and regulators can provide an enabling environment by addressing the key "pain points." Cash-in/cash-out and intra-network person-to-person (P2P) transactions are two areas where consumer needs have already been largely met, with extensive networks of cash-in/cash-out merchants and agents in place and increasingly faster, cheaper and easier P2P transactions. Further improvements can be made in these areas, for example, in terms of promoting bank and cross-network interoperability and the use of prepaid cards in P2P transactions.

Areas where major improvements are still needed to harness these technologies to meet consumer needs include cross-network P2P transactions, salary and benefits transfers, merchant payments, bill payments and international remittance. Cross-network P2P transactions are hindered by the lack of inter-operability. Salary and benefits transfers are not currently linked to banking networks and accounts are tied to mobile service providers. Applications for merchant payments are hampered by limited acceptance of mobile payments among merchants and cumbersome transaction processes. There is yet no universal system for bill payments, which involve a multiplicity of banks and mobile service providers. Mobile-to-mobile international remittances are limited to a few select corridors.

Addressing these issues will require focusing on the key gaps: bank and cross-network inter-operability, P2P payments to prepaid cards, cross-network P2P payments, inter-operable systems across mobile network operators and banks, broader acceptance of mobile payments by merchants, a standard network for bill payments and cross-border remittances from banked consumers. Many of these gaps can be addressed by opening up closed loop solutions – replacing closed-loop stored value accounts (where the use of stored value devices is limited to items provided by the issuer of the stored value or related

entities) with full open loop accounts (where stored value devices can be used at multiple, unaffiliated merchants, service providers, or ATMs).

There is tremendous potential for the further evolution of mobile money services that can facilitate greater financial inclusion. Examples are the use of virtual card numbers for electronic commerce, mobile-to-mobile payments for goods and services, cards that can be used for worldwide remittances, and prepaid cards linked to mobile money. The Philippines is an example of an economy that has enabled many people to access finance using easy money transfer through prepaid cards linked to the largest mobile network, a large network of about 9,000 ATMs and 16 mobile banking partners, and using existing card networks to link to online merchants, establishments and ATMs worldwide.

Governments, companies and consumers can benefit from open loop prepaid cards in a number of ways. For governments and public agencies, they can be used for social security and benefits payments and financial assistance to beneficiaries through local governments. For companies, they can provide more efficient alternatives to the use of cash and checks, for example, through payroll programs, voucher replacement programs or healthcare reimbursement products designed to access deposits in tax-advantaged accounts.

For consumers, they can provide secure, convenient and reliable ways to receive, spend and manage money (Money In, Money Out and Money Management). Money In involves deposit payroll and benefits, inward remittances, account transfers and loading money at merchants, banks and ATMs. Money Out can involve buying airtime for oneself or others, outward remittances, paying merchants and bills, withdrawing cash at ATMs, account transfers, local purchases and card or point-of-sale purchases. Money Management functions include balance and activity queries, account management, activity, point of sale and ATM alerts. Foreign workers in the United Arab Emirates, for example, are able to securely and safely receive wages through prepaid cards that can be used domestically and internationally through ATMs and point-of-sale (POS) technology.

Enabling the use of open loop accounts to promote financial inclusion requires regulatory leadership. Regulatory reforms will be needed to clarify the lines between mobile money services and bank accounts, to enable non-financial institutions to distribute open loop prepaid instruments in non-bank locations and to allow the issuance of open loop prepaid cards targeting specific consumer needs such as remittances and payrolls or consumer segments such as young people. Banking laws will need to be re-examined to see whether know-your-customer (KYC) and minimum age requirements should be revised and payments of salaries and benefits to prepaid accounts, for example, could be mandated.

Successful adoption of these technologies requires government leadership, which is needed to create the business case for widespread use by businesses, merchants and consumers and sufficient transaction value. Government can drive this process by providing incentives for businesses as well as by leading the way in using open loop prepaid cards for its own transactions, including

payments to public employees, service providers and recipients of benefits. Governments can work with private companies that can help bridge the distance between banked entities and unbanked consumers using electronic payments to promote the development of a common technology infrastructure and standard user interface and move toward openness and inter-operability and equitable value distribution.

There are difficult challenges to the application of these new technologies for cross-border transactions, especially within the Asia-Pacific, where there is a great diversity of economic and regulatory environments and levels of development. The most important of these is the lack of a universal interpretation of regulatory requirements such as those for AML, KYC and those imposed in the wake of the September 11 terrorist attacks. This poses legal and regulatory uncertainties for financial institutions with respect to whether compliance of cross-border counterparties with such regulations is adequate.

IMPROVING INFORMATION SHARING AND PRUDENTIAL LENDING FOR GREATER FINANCIAL INCLUSION

Throughout the region, regulators are concerned with balancing two important policy goals – ensuring an adequate supply of credit to foster financial inclusion while preventing excesses that could endanger the longer term strength of financial institutions. Modern full-file credit information systems are key to achieving this balance. Credit bureaus play a role in making information available to help lenders properly underwrite new credit extensions while avoiding loans that are likely to default, and in encouraging credit extension to borrowers who have demonstrated habits of dependable repayment, thus incentivizing the proper handling of credit and the building of a good credit record.

Full-file bureaus can also serve the goal of creating level informational playing fields among potential creditors, bringing the benefits of competitive pricing to borrowers, and breaking down barriers to new credit entry. Still, important policy issues remain concerning the adequate protection of consumer and MSME financial information, the ownership and structure of credit bureaus, and how the use of information can best be turned toward encouraging the responsible extension and use of credit.

Key Elements of Information Sharing[20]

To fully understand the issues related to information sharing, it is important to make the following distinctions among variations in the structure of credit reporting:

- *Full file vs. negative-only reporting*. Full-file reporting is the reporting of both

[20] This section summarizes the presentations and discussions in Session Four (Key Elements of Information Sharing), chaired by Mr. Robert Annibale (Global Director, Citi Microfinance and Community Development). Presentors in this session were Dr. Robin Varghese (Vice President, Policy and Economic Research Council), Mr. Peter Sheerin (Principal Operations Officer, Financial Markets and Access to Finance, Advisory Services, East Asia and the Pacific, International Finance Corporation), and Ms. Norma Qurusu (Policy Analyst, Ministry of Finance and Treasury, Solomon Islands).

positive payment information and negative information such as delinquencies, collection, bankruptcies and liens, as well as both late and on-time payments. Negative-only reporting is the reporting of only negative information.

- *Segmented vs. comprehensive reporting*. Segmented reporting is a system of reporting information, whether full-file or negative-only, in which only data from one sector, e.g., retail or banking, are contained in reports. Comprehensive reporting is a system in which payment and account information, whether full-file or negative-only, are not restricted by sector, but contains information from multiple sectors.

The history and experience of information sharing shows that full-file and comprehensive credit information sharing tends to increase lending to consumers and small enterprises at the low-income end of society.[21] This also results in better loan performance in financial institutions, where default rates decrease as information moves from negative-only to full-file.[22] This is because with negative-only reporting, good risks are confused with bad ones and vice versa, and because greater data sharing improves the quality of information for risk provisioning that is allowed under Basel rules, which is associated with lower defaults, smaller capital requirements and lower credit constraints. Similar results were achieved when comparing the effects of using comprehensive and segmented data in US and Canada.

Full-file reporting also has positive distributional consequences. Using real credit files, it has been demonstrated that disadvantaged social segments such as racial and ethnic minorities, young people and low-income individuals gain greater access.[23] Simulations using Colombian data also show a higher level of acceptance for women under full-file compared to negative-only reporting (47 percent versus 33 percent of acceptances). It is clear from these studies that lending is broader and safer when lenders are able to use information on behavior of clients to assess risk. This has been especially true in markets where privately owned credit bureaus operate.

Private bureaus differ from public registries in that they normally collect

[21] This is borne out by studies comparing acceptance rates at targeted default rates using full-file and negative-only data for the USA, Argentina, Brazil and Colombia. See John M. Barron and Michael Staten, "The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience," in Margaret M. Miller ed., Credit Reporting Systems and the International Economy¸ 273-310 (Cambridge, MA: MIT Press. 2003); Michael Turner et al., The Fair Credit Reporting Act: Access, Efficiency, and Opportunity (Washington, DC: The National Chamber Foundation, June 2003); Giovanni Majnoni, Margaret Miller, Nataliya Mylenko and Andrew Powell, "Improving Credit Information, Bank Regulation and Supervision." World Bank Policy Research Working Paper Series, No. 3443 (Washington, DC: World Bank, November 2004); and Michael Turner and Robin Varghese, The Economic Impacts of Payment Reporting in Latin America (Chapel Hill, NC: Political and Economic Research Council, May 2007), Table 5.

[22] This conclusion is based on data on percentage point changes in the default rate at certain acceptance rates with a switch from the use of full-file to negative-only data. See Barron and Staten; Turner et al.; Majnoni, Miller, Mylenko and Powell; and Turner and Varghese.

[23] This is the conclusion of a comparison of effects on acceptance rates for a 3% targeted default rate between full-file and negative-only reporting for Non-Hispanic Caucasians, African-Americans, Latin Americans and other minorities in the US. See Turner et al.

information from non-bank lenders and public sources, provide a broader range of data, and offer more services to lenders, primarily to reduce information asymmetries and improve risk assessment in lending. Public registries are set up largely for supervisory purposes, to monitor the safety and soundness of the financial sector and determine whether reserves are sufficient. In Cambodia, for example, the central bank preferred to have a private credit bureau so that it can continue focusing on its core monetary and regulatory functions, where its expertise lies. In Turkey, the central bank transferred the ownership of the credit bureau to the bankers' association once the market has matured, for similar reasons. While data from private credit bureaus can be mined for purposes of improving decision, data from public registries, which are typically limited to those supplied by regulated entities, cannot be used in the same way. By this account, private bureaus are complements rather than substitutes to public registries.

A robust credit reporting system plays a key role in financial inclusion through its role in establishing financial identity. Credit bureau data provide an effective means of aggregating the inventory of unique identifiers that help establish financial identity and are used throughout the customer lifecycle, such as in identification of new customers, initial applicant screening, KYC compliance, account opening, account monitoring and collections.[24] The role of credit bureaus in identity proofing is becoming more important as complexities emerge with increasing personal and social mobility and population growth, which result, for example, in consumers sharing common surnames (over 13 million in the US share one of ten) or first names (57 million share one of ten in the US), changing family names, nicknames or initials and moving places of residence (over 40 million do so in the US). In emerging Asia, where there is growing mobility of persons, identity proofing is becoming more important not only in efforts to prevent fraud and identity theft, but to effectively and efficiently serve consumers' financial needs.

Key to effective identity proofing is shared information, where data from multiple third-party sources enable financial service providers to identify positive attributes and high-risk or negative conditions and to make historical assessments of consistent identity use and access. A robust system would include, for example, social security numbers; birth, death, voting, drivers and court records; public directories; change of postal address records; internet protocol addresses; bankruptcies; credit variables; shared application data; shared financial information; and postal known fraud drops.

The IFC's Credit Information Index indicates that among emerging market regions, credit information sharing systems have been most developed in Eastern Europe/Central Asia, followed by Latin America/Caribbean, and Middle East/North Africa. The East Asia/Pacific region ranks relatively low, being only

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[24] These include names, addresses, telephone and wireless numbers, social security numbers, dates of birth, drivers' license numbers, account numbers, financial transaction, proprietary personal identification numbers, emerging biometrics and out-of-wallet information. Source: Experian Information Solutions, Inc.

slightly ahead of South Asia and Sub-Saharan Africa.[25] In terms of coverage by private credit bureaus, Latin America/Caribbean and Eastern Europe/Central Asia lead all emerging market regions, with East Asia/Pacific coming next. In terms of growth of private credit bureau coverage, Eastern Europe/Central Asia, East Asia/Pacific and Middle East/North Africa have been the leading reformers. The fact that South Asia, which recently experienced a major microfinance crisis, also has the lowest coverage of private credit bureaus indicates the important role of credit information in promoting sustainable financial inclusion.

There are significant distinctions between commercial and consumer credit bureaus. Commercial credit bureaus report on companies that are smaller in size and earnings compared to corporations covered by rating agencies. Consumer credit bureaus, on the other hand, collect data on individuals and small business enterprises, although in some cases they also collect data on larger companies. Commercial credit bureaus cover trade credit transactions between business entities and larger sizes of commercial transactions and their attendant risks and have deeper payment performance and financial data. Consumer credit bureaus, on the other hand, have access to more sensitive information about individuals and greater concerns about protecting the privacy of information. Recently, there has been a trend toward convergence, as consumer credit bureaus make progress in developing commercial reporting capabilities.

Consumer credit bureaus obtain data from a wide variety of sources, although most of these are within the financial sector, particularly banks, credit card issuers and other financial institutions.[26] A significant but still limited number of credit bureaus now receive information from non-financial sources such as retailers, utilities, courts, statistical agencies and bankruptcy agencies. More than half of consumer credit bureaus surveyed obtain data from MFIs, but as most of these are from large regulated MFIs, data quality and coverage of the microfinance market remains an issue. These data include information on businesses, payment histories, lawsuits, tax liens, legal actions and judgments, business bankruptcies, and other businesses in respect of trade credit transactions, among others.

There are challenges in establishing viable and effective credit bureaus in emerging markets. One important issue is pricing of services, given that many MFIs in less developed economies have limited resources. In this regard, prices of credit reports vary widely across economies. A second issue is ensuring the

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[25] International Finance Corporation (IFC). The Credit Information Index is based on the following components: (a) both firms and individuals are listed; (b) both positive and negative information are included; (c) retailers and/or utilities submit data; (d) historical data cover 2 or more years; (e) all loans included are above 1% GNI per capita; and (f) the consumer's right to inspect is guaranteed by law.

[26] World Bank, *Doing Business 2011: Making a Difference for Entrepreneurs* (2011). Information supplied by 91 private credit bureaus indicate the following sources of consumer data (figures in parentheses correspond to the percentage of bureaus receiving data from each source): private commercial banks (91%), finance corporations and leasing companies (78%), credit card issuers (70%), public commercial banks (66%), credit unions and cooperatives (59%), development banks (52%), microfinance institutions (51%), retailers (48%), firms providing loans and trade providers (47%), utility providers (38%), other credit bureaus (26%), courts (24%), employers (9%), statistical agencies (9%) and other sources (19%).

flow of timely information to credit bureaus and promoting innovative use of information, which takes time to be fully understood and appreciated. A third is how to promote demand, which involves raising awareness of the role of credit reporting. A fourth is how to secure support for a broad consensus on credit information sharing systems from stakeholders, including policy makers, the banking industry and MFIs. In particular, effective strategies are needed to convince domestic lenders concerned about increased competition from global lenders as well as other stakeholders concerned about the impact of greater transparency.

For more developed markets, a key challenge is the inertia that makes it difficult to move from older models to more effective full-file and comprehensive systems. In Japan, for example, separate systems for non-bank and for banking institutions, which emerged at a time when these sectors served different clienteles, hinder the exchange of information. Australia and New Zealand continue to maintain negative-only reporting systems. In developing economies, on the other hand, where credit reporting systems are still being established or are in early stage, it has proven much easier to develop full-file and comprehensive systems.

Credit information sharing systems can bring great benefits to the financial system through enhanced capacity of lenders to manage risks through scoring using data provided by credit bureaus. However, this also requires better skills to understand the raw data and develop methodologies to use them effectively, as well as the use of information technology.

The experiences of Cambodia, Malaysia and India and the IFC's project in the Pacific Islands illustrate the challenges facing emerging markets in developing credit information sharing systems.

> *Cambodia*. In 2006, the central bank established a voluntary and negative-only consumer credit bureau on a pilot project basis, which it fully owned and operated. In the beginning, it did not attract much participation due to flaws in the design of regulatory and software solutions (regulations prescribed separate written consent from debtors prior to the default being reported, and the software failed to successfully match and merge records), which negatively affected the bureau's credibility. The central bank subsequently adopted a revised approach that focused on mandatory participation and consultation by covered entities. Covered entities were given the majority equity stake, while the central bank retained a director role in addition to a separate licensing and oversight role.
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> The lending market is currently dominated by MFIs, which issued 77% of loans in 2010. These loans are characterized by low values and high recurrence. However, banks also provide a large number of such loans, which all in all comprise 96% of the total lending market, leaving only 4% classified as conventional bank lending. The dominance of high-volume, low-value loans pose challenges to the development of the credit sharing information system, in addition to other factors, including the small size of the market, issues related to data quality and the matching and merging of data, and insufficient

capacity of the lending community.

Given the high-volume and low value characteristic of the market, pricing is a major challenge. Another challenge is preventing over-indebtedness, owing to low data quality, lack of unique identification data (particularly those related to matching records in Khmer and English), and inadequacy of various MFIs' lending practices and systems. Currently, management of lending systems has been in many cases outsourced to overseas-based software providers. Addressing these challenges will require overcoming various obstacles, including the reluctance of the market to move without clear signals from the central bank, differing positions of various stakeholder communities and inertia in changing the lending community's business practices.

The central bank is keen to develop the credit reporting system, which it believes will expand access to loans to those without collateral, shorten loan approval processes, increase loans to the private sector, reduce the level of non-performing loans, encourage borrowers to pay debts on time and lower interest rates for loans.

Malaysia. Following census findings in 2005 that identified constraints faced by SMEs in obtaining finance, the central bank initiated the establishment of Credit Bureau Malaysia (CBM), with the objective of promoting greater transparency, professionalism and sound credit culture in the SME sector and enhancing MSMEs' and individuals' access to finance. Since then, demand for CBM products has grown among various types of clients. These include reports and ratings for member financial institutions, corporate members and SMEs, the latter using these to self-check and improve their credit standing, as well as reports for the public. CBM also intends to provide reports on indebtedness levels of SMEs, consumers and households and macro-level industry and market reports to the central bank, as well as reports and reports to the Companies Commission of Malaysia and other public bodies, such as those responsible for issues related to insolvencies and electronic courts.

CBM faces a number of challenges. One is finding trained bureau personnel. CBM has been so far relying on secondment of personnel from more mature credit bureaus, but it needs a lower cost alternative to this arrangement. Another challenge is how to enhance the value of its products to lenders, given that the scores it provides are mainly used by lenders to supplement internal scores. A third challenge is how to meet expectations by banks that the bureau will provide training for their staff.

India. IFC started a Microfinance Credit Reporting Project in India. After securing donor support and local consultants and assessing stakeholder interests, IFC held a kick-off workshop in July 2009, which resulted in an informal consensus and support from India's Microfinance Institutions Network (MFIN). The project proceeded through an assessment stage using surveys, interviews and data analysis, followed by the implementation stage. By May 2011, two credit bureaus servicing the needs of MFIs have been established under the project, with which 27 MFIs have established arrangements to share data and which has uploaded almost 29 million client records and close to 27

million active loan accounts.

The project is now focused on overcoming several challenges. One is how to bring the stakeholders – particularly the credit bureaus and MFIs – together to collaborate (so far, only 27 out of more than a thousand MFIs, mostly larger ones, have joined the project to date). Another is data quality, including how to aggregate and pull data from various sources, including smaller MFIs. The lack of electronic records presents a third challenge. Lack of a unique identification data is another issue, particularly given India's federal structure with states having different systems. Finally, an overall regulatory environment to facilitate an effective credit reporting system is only beginning to take shape.

The IFC's credit bureau project in the Pacific Islands. Because of the small size of individual markets, IFC and the Pacific Islands governments decided to develop a hub-and-spoke credit information system with New Zealand as the hub. The system is still based on negative-only reporting, since this is the system operating in New Zealand and the costs of moving to a full-file system are too high. The project was set up after consultations between IFC, the central banks and bankers' associations, which led to the development of a voluntary code of conduct supported by central banks, which are unable to play a more active regulatory role due to lack of capacity. There are no regulations governing privacy, but dispute resolution mechanisms have been put in place.

These experiences illustrate the challenges of developing effective credit information sharing systems in emerging markets. Among the major challenges faced by regulators and policy makers are inadequate capacity to draft appropriately worded legislation, limited ability to operationalize the regulatory environment, insufficient data quality and limited ability of lenders to cleanse data in a timely fashion, absence of national identification cards or lack of access to national identification data bases or other data basis with identification information, and the lack of oversight capacity or the required detailed understanding for licensing or overseeing private sector credit bureas.

There is currently no consensus on what constitutes an adequate legal and regulatory framework for credit reporting. This stems from the natural tension that exists between the objectives of access to broader sources of information, which is important for effective credit reporting, on one hand, and the need to protect individual privacy. A survey of 85 economies with private credit bureaus show that banking and data protection laws are the most frequently used means to address privacy concerns in relation to credit reporting (each used by 56% of the responding jurisdictions), while others resort to central bank regulation (44%), special credit bureau laws (42%), codes of conduct (32%) and other laws (20%).[27]

The experiences also underscore the fact that, across the region's very diverse economies, there is no one-size-fits-all model that jurisdictions can simply adopt.

[27] World Bank, *Doing Business 2011: Making a Difference for Entrepreneurs* (2011).

In this context, it is important to enhance the capacity of policy makers and regulators to examine the broader environment surrounding the credit reporting system and accordingly design the policies, regulations and measures that fit the requirements of each economy.

Nevertheless, given its importance, this subject has gained the attention of key international institutions and efforts are under way to help policy makers and regulators develop robust frameworks for credit reporting. An important step is the publication by the World Bank of the *General Principles for Credit Reporting* in 2011 to guide these efforts. These principles, formulated by the Credit Reporting Standards Setting Task Force launched by the World Bank in collaboration with the Bank for International Settlements, aim to define minimum requirements for robust credit reporting systems.[28] The principles also include several recommendations for effective oversight of credit reporting systems.[29]

Legal Concepts and Regulatory Considerations for Credit Reporting[30]

In establishing credit reporting systems, it is useful to consider legal and regulatory concepts in key areas: consumer protection, expanding economic opportunity and effective credit reporting, as well as alternative regulatory and enforcement models.

Best practices for consumer protection. Various bodies, including APEC, the European Union and the OECD, have been or are presently involved in the process of developing guidelines, which continue to evolve. However, the fundamentals of consumer protection are universally known to and agreed by

[28] World Bank, *General Principles for Credit Reporting. Consultative Report* (March 2011). Following are the five general principles: (1) ***Data***: Credit reporting systems should have accurate, timely and sufficient data - including positive - collected on a systematic basis from all relevant and available sources, and should retain this information for a sufficient amount of time. (2) ***Data Processing***: Security and Efficiency: Credit reporting systems should have rigorous standards of security and reliability, and be efficient. (3) ***Governance and Risk Management***: The governance arrangements of credit reporting service providers and data providers should ensure accountability, transparency and effectiveness in managing the risks associated with the business and fair access to the information by users. (4) ***Legal and Regulatory Environment***: The overall legal and regulatory framework for credit reporting should be clear, predictable, non-discriminatory, proportionate and supportive of data subject and consumer rights. The legal and regulatory framework should include effective judicial or extrajudicial dispute resolution mechanisms. (5) ***Cross-Border Data Flows***: Cross-border credit data transfers should be facilitated where appropriate, provided that adequate requirements are in place.

[29] These are as follows: (1) Credit reporting systems should be subject to appropriate and effective regulation and oversight by a central bank, a financial supervisor, or other relevant authorities. It is important that one or more authorities exercise the function as primary overseer. (2) Central banks, financial supervisors, and other relevant authorities should have the powers and resources to carry out effectively their responsibilities in regulating and overseeing credit reporting systems. (3) Central banks, financial supervisors, and other relevant authorities should clearly define and disclose their regulatory and oversight objectives, roles, and major regulations and policies with respect to credit reporting systems. (4) Central banks, financial supervisors, and other relevant authorities should adopt, where relevant, the General Principles for credit reporting systems and related roles, and apply them consistently. (5) Central banks, financial supervisors, and other relevant authorities, both domestic and international, should cooperate with each other, as appropriate, in promoting the safety and efficiency of credit reporting systems. See World Bank, *General Principles for Credit Reporting. Consultative Report* (March 2011).

[30] This section summarizes the presentations and discussions in Session Five (Legal Concepts and Regulatory Considerations for Credit Reporting), chaired by Dr. Robin Varghese (Vice President, Policy and Economic Research Council). Presentors in this session were Mr. Anthony Hadley (Vice President, Government Affairs, Experian), Mr. Gabriel Davel (Private Consultant, PERC and former Chief Executive Officer, National Credit Regulator, South Africa), and Mr. Vereimi Levula (Acting Chief Manager, Financial Systems Development and Compliance Group, Reserve Bank of Fiji).

regulators, practitioners and experts. Key principles for the protection of private information include notice, choice, data integrity, access and correction, data security and accountability.[31]

Best practices for expanding economic opportunity. Effective credit reporting systems require a healthy balance between consumer protection and expanding economic opportunity. The Asia-Pacific Credit Coalition has compiled a number of best practices in this area. First, positive and negative payment data should be reported to private credit bureaus. Second, bank, non-bank and non-financial payment data should be integrated and reported to private credit bureaus in a comprehensive, non-segmented manner. Third, private credit bureaus and public credit registries play key distinct and complementary roles within the financial services sector. Fourth, a system where reporting of payment data is voluntary rather than mandated produces better results; nevertheless, the necessity of mandating such reporting must sometimes be acknowledged. Finally, data use should be limited to well-defined permissible purposes (although how this is applied is currently evolving due to globalization, for example, in the use of credit data multiple permissible purposes such as for establishing financial identity and electronic commerce, provided there is transparency). Enhanced and responsible sharing of personal information across industries, in itself, forms part of consumer protection against fraud and identity theft.

Legal prerequisites for effective credit reporting. The delicate and continuously evolving balance between promoting prudential risk and providing consumer protection requires a robust legal framework, which includes a number of key elements. First, there needs to be effective enforcement of claims to collateral, without which there will be no vibrant lending market that in turn provides demand for credit reports. Second, there need to be laws and regulations that recognize third-party information sharing. Third, there should be a clear set of operational rules that provide clear directions for businesses. Fourth, there must be a predictable enforcement regime. Fifth, the legal and regulatory framework for credit reporting must be compatible with existing bank secrecy laws.[32]

Alternative regulatory models. In developing regulations for credit reporting systems, authorities need to determine which system best fits domestic conditions. Existing models vary widely, and demonstrate that both government and the private sector are capable of establishing standards. For regulating consumer credit reporting, three major types of regulatory models exist. One is the model of a prescriptive law backed by interpretive rules and regulations, such as those which exist in the US, Japan, Singapore and Thailand. A second model is one with a data protection directive backed by detailed industry rules and reciprocity agreements, such as one in force in the

[31] These are enshrined, for example, in the Safe Harbor Privacy Principles issued by the US Department of Commerce on 21 July 2000 (http://ita.doc.gov/td/ecom/SHPRINCIPLESFINAL.htm).

[32] These elements have been adapted from Experian's list of criteria for investment in particular markets. Source: Experian Information Solutions, Inc.

UK. A third is a model of a broad constitutional law backed by detailed industry-established reciprocity agreements among banks and credit bureaus, supplemented by further legislation to fill gaps, such as the Brazilian model. At present, few regulatory structures exist for commercial credit bureaus.

Alternative enforcement models. Similarly, regulators can look at various existing enforcement models. Consumer agencies, courts and banking regulatory agencies can all play enforcement roles. In the US, supervision is under a consumer protection agency and civil penalties for violations are imposed by federal and state agencies; consumers have right of action against violations. In the UK, civil penalties are imposed by the Information Commissioner's Office. In Brazil, civil penalties are imposed by federal and state consumer protection agencies and individuals can initiate actions through the civil court. In Japan, Singapore and Thailand, supervision and enforcement are undertaken by banking regulatory agencies.

In designing effective legal requirements and monitoring and enforcement regimes, it is important for policy makers to fully understand the role of credit bureaus in the credit market. This is best considered in the context of the credit market cycle, which goes through a rise in asset prices as assets are commoditized, then commercialized, access to loan capital is expanded, intermediaries are incentivized to lend through commissions and distribution networks and debt builds up in the system. As lenders push money to borrowers, the latter starts borrowing to roll over loans, which allow asset prices to continue rising for a time amidst continued high liquidity and low default levels. However, there comes a point when lenders begin to perceive heightened risks and initiate the process of credit contraction. This leads to increasing debt collection and defaults, which escalates as asset prices tumble. In cases where a bubble has built up to a significant extent, bank failures typically occur toward the end of the cycle.

Credit information plays a critical role in the management of the cycle. In this context, the importance of full-file credit reporting as the best protection against failure becomes apparent. A system based on negative-only reporting only indicates trouble once borrowers start defaulting in significant numbers, by which time it is too late for lenders to react. Full-file systems enable lenders to see problems at an earlier stage, when borrowers begin to rely on further borrowing to roll over loans, and to react accordingly. Comprehensive credit information contributes to a clearer picture of borrowers' financial conditions. Availability and use of full-file and comprehensive credit information enables financial institutions to help moderate the credit cycle and avoid excessive asset price inflation and its equally excessive painful consequences.

Failure to address such problems in a timely way risks doing harm to the financial system, as unwise policy responses that undermine its efficiency are more likely to occur under severe bouts of financial stress. In such circumstances, decision makers typically come under intense political pressure that often leads to increased intervention and control to provide relief to debt-stressed individuals, firms and constituencies. Debt also tends to build up

outside the banking sector, but eventually leads to further bank failures. Debt stress causes damage to vulnerable households and leads to worsening stigmatization of the low-income market as a high-risk market segment in the eyes of lenders. Such episodes of excess also typically produce inequities, as a small sub-segment of society becomes mired in debt excess, while large population segments remain starved of finance.

This important role that credit information plays in the financial system has certain policy and regulatory implications. First, the credit information infrastructure and regulatory framework need to be developed at the early stage of market development. Second, market participants should be provided with sufficient information to assess credit risk and debt stress. Third, the framework needs to be inclusive of the full range of institutions that are sharing positive and negative information.

Policy makers aiming to develop legal requirements for credit reporting can look to a number of existing models, such as the EU's Data Protection Directive (Directive 95/46/EC), the US Fair Credit Reporting Act, the earlier mentioned General Principles for Credit Reporting prepared by the World Bank and the BIS, and legislation in various jurisdictions, While the General Principles are generic in nature, the EU Directive and the Fair Credit Reporting Act both offer specific examples, The EU Directive is of interest on two counts – it is a result of negotiations among 27 individual member jurisdictions, and its requirements need to be met by any other jurisdiction intending to share credit information with any EU member state.

Regarding legal requirements for credit providers and information providers, one key component that is often overlooked is the need to differentiate between rules on internal data management and rules on trade in data. Laws need to be clear on various aspects of data sharing and confidentiality, including the general obligation to protect client confidentiality, when client consent is required, the potential for obligatory sharing without client consent and potential prohibition against sharing of data. Obligation of providers to submit accurate data, address bureau and consumer enquiries and correct errors need to be specified in the law, ideally with penalties for violations.

Legal requirements for credit bureaus need to be robust in order to gain consumers' trust, while posing reasonable requirements for credit bureaus. Key areas include registration (requirements to register, forms of ownership to ensure neutrality and credibility, capacity and processes to deal with complaints, pre-registration audit and technical, human and financial capacity), data accuracy and security (formal policies and procedures to ensure data security standards and external review, use of data from permissible sources only, reasonable parameters for data received, maintenance of accurate records and technical, human and financial capacity), and limits on data retention and release.

The legal framework must also adequately address consumer complaints, which are critical for the credibility of bureaus and accuracy of records. Requirements to provide compulsory reports to consumers should specify frequency of free

reports (ideally distributed annually) and availability of paid reports, indicate to whom reports are provided and disclose sources of third party information. Requirements related to consumer complaints need to include formal policies on obligations to receive and record, process, and respond to such complaints, confirmation with supporting information within a defined period and not to report if the information is not confirmed within that period. Regulatory reporting requirements need to cover management compliance certificates, audit review and compliance certificates, statistical report and response to queries.

Proper monitoring and enforcement by regulators involve a number of key issues. Sound governance structures in credit bureaus are important, in particular the responsibilities of the bureau's board for policies and oversight, including responsibility for accuracy and quality of data. There should be annual compliance certification by the bureau management, as well as annual auditor compliance certificates. Error rates and statistics should be adequately monitored. Regulators should have the capacity to investigate (together with external specialists), particularly as auditing firms that are relied on to fulfill such roles are generally not familiar with credit bureaus. Compliance notices and penalties are also important tools. Regulatory oversight can be further strengthened if supported by codes of conduct and an independent ombudsman for consumer complaints.

An important issue is the tension between consumers' right to privacy and the effectiveness of the credit reporting system, which revolves around the issue of consent, the main privacy right associated with the creation and use of personal information. There is a view that consent tied to a transaction should be offered on a take-it-or-leave-it basis and the consumer must have the ability to withdraw it.[33] Such an interpretation poses difficult challenges for a full-file credit reporting system and for the operational efficiency of credit bureaus. The need for consent could limit data sharing and access as well as the scope of data that can be collected and used. The right to withdraw consent or withhold it entirely would affect the completeness and integrity of information in credit reports.

Policy makers will need to find appropriate ways to balance the need to protect consumers with the need for an effective and efficient credit reporting system. The approach adopted by Canada, South Africa and India provides a good example. This approach requires in place of consent a robust notice to the consumer describing the permissible uses of the ensuing account information and the reporting to the credit bureau. It also requires affirmative consent of the individual for any other use of his or her information that is not defined in law.

Another issue that needs a balanced approach is the tension between consumers' rights to free access to individual credit report data and efficiency of credit bureau operations. Consumers' right to free annual access, which was introduced in the US in 1970 and expanded in 2003, has been adopted by many jurisdictions. However, where many individuals may not yet have a record and

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[33] This opinion, for example, has been adopted by the EU Data Protection Working Party. See Article 29 Data Protection Working Party, *Opinion 15/2011 on the definition of consent* (13 July 2011).

where databases are still under development, such as in many emerging markets, frequent and widespread exercise of this right to which credit bureaus must respond becomes unproductive and wasteful. A balanced approach that policy makers could consider is to link free access to an adverse action or triggering event, such as when a consumer is denied credit, employment or insurance. It is important, that in designing such approaches, policy makers should ensure that they are appropriate to local conditions.

Legal and regulatory frameworks for credit reporting need to be appropriately adapted to the local conditions of the market. The case of Fiji illustrates the challenges of developing such frameworks in less sophisticated markets. Fiji has one credit bureau (Data Bureau Ltd), which is currently not regulated by the Reserve Bank of Fiji, which is the main regulator of the financial system. The credit bureau is privately owned and established under the Companies Act, which does not provide any oversight. The bureau is self-regulating, with members subscribing to an “Agreement for the Supply of Services,” a code of conduct and a complaints redress mechanism. The bureau mainly processes negative information. A number of consumer complaints have been raised with the Consumer Council of Fiji. Upon the suggestion of the Consumer Council, authorities are now studying a phased transition from a self-regulated bureau to a properly regulated environment. Lack of understanding among the public is an important issue that needs to be addressed through an educational program.

The Philippines’ experience underscores the importance of supporting legal and regulatory frameworks with implementation and grievance mechanisms and financial education. Over the past three decades, credit bureaus faced the problem of obtaining data mainly from banks, as the latter did not see incentives to share their data. Also, given that banks only have limited operations in rural areas, a large part of the population were not covered by the data. In 2008, the Philippine enacted the Credit Information System Act which mandates banks, credit card companies, to provide basic data on the credit history of borrowers to a newly created Credit Information Corporation (CIC).

The operations of CIC are circumscribed by various laws and regulations, including the Consumer Act, the Truth in Lending Act, the Law on Secrecy of Deposits, the Foreign Currency Deposit Act and the General Banking Act. For example, information on bank deposits and client funds, which are treated as confidential under several of these laws, are excluded from reporting requirements. Implementation and grievance mechanisms were established within regulatory agencies and alternative dispute resolution bodies within financial institutions. The government promotes public awareness through public information desks in government entities, financial literacy campaigns undertaken by agencies and MFIs, and financial education segments of business development services being offered by MFIs. Moving forward, the government aims to expand the coverage of financial literacy efforts beyond clients to all stakeholders, promote widespread adoption of alternative dispute resolution mechanisms and improve basic financial education at the primary levels.

With rapidly growing regional integration, interest in exploring the concept of a regional credit reporting system is increasing. At present, even between economies with traditionally close economic ties, such as the US and the UK, there is no convention to allow access to credit information across jurisdictions. Even with the EU, the storing of data across member economies remains prohibited and easy flow of data remains hampered by laws. The Pacific Islands' internet-based hub-and-spoke system with the data stored in the hub (New Zealand), while established with different considerations in mind, can serve as a starting point for discussion.

Developing a regional framework for cross-border collection, use, storage and protection of credit information will entail many difficult challenges. A key issue that policy makers will need to address is privacy law, particularly in relation to protecting data when used across jurisdictions. Negotiation of regional trade agreements can provide opportunities to address data security issues, although this might might slow down the process if data protection agreements are included without prior general consensus. An alternative approach is the regional adoption of an open architecture that allows portability of cross-border data. Regional agreements can incorporate new developments, such as the emergence of networked online storage (cloud storage), where data may be stored in a number of servers in different locations across the globe.

A related issue that needs to be further explored is the implication of cross-border data systems on transactions between the Asia-Pacific and Europe. The EU's Data Protection Directive provides a set of minimum legal requirements that is enforced throughout Europe. Laws and regulations that are compatible with these standards will facilitate transactions between these two major regions. However, the stringent EU standards also serve to encumber the introduction of innovations in the market, including the fuller use of internet-based information, search engines and social networks. As the Asia-Pacific region is not currently burdened by such constructs, an alternative view proposes instead the development of regulatory systems based on an open architecture, for example through reliance on a regional trust mark, that would keep government as a backstop while relieving it of additional regulatory burdens.

Customer Identification and Reaching Beyond the Mainstream[34]

The promise of alternative data. Credit reporting has considerable potential to help overcome basic obstacles to financial access and to promote financial inclusion. It works on the premise that reputation, based on information about a consumer's behavior, can be as good as collateral in securing access to loans and financial services. Currently, credit reporting systems have not yet been able

[34] This section summarizes the presentations and discussions in Session Six (Consumer Identification and Reaching Beyond the Mainstream), chaired by Mr. John West (Senior Consultant, Capacity Building and Training, Asian Development Bank Institute). Presentors in this session were Ms. Celina Leung (General Counsel, Asia-Pacific, TransUnion), Dr. Robin Varghese (Vice President, Policy and Economic Research Council) and Mr. Joselito Almario (Director III, Domestic Finance Group, Department of Finance, Philippines). Also included in this section is a summary of the presentation by Prof. Naoyuki Yoshino (Professor of Economics, Keio University and Director, Financial Research and Training Center, Financial Services Agency of Japan) in Session Seven.

to fulfill this potential due to the limitations of an approach that relies heavily on traditional data, namely bank loans (mortgage loans, automobile loans, revolving credit, installment loans and personal loans) and retail credit. This approach works for borrowers who are already in the system and have credit records. Consequently, a large part of the population who do not have collateral and credit histories remain in the informal sector, which is about 30 percent of the US population and a higher percentage in most emerging markets.

This can be addressed through the use of alternative data to help assess reputation. These include many forms of post payment, such as energy and water utility payments, land line and wireless phone bills, auto liability insurance payments and rental payments (especially for apartments). They also include remittance payments and stored value cards and prepayment for cell phones and education expenses. Such data could be used to predict probability of serious delinquency on a loan as well as creditworthiness, credit capacity and credit risk.

There are various obstacles to the reporting of these data. First, there are technological barriers, such as complex billing cycles and legacy information technology systems. Second, there are economic barriers such as compliance costs and customer service costs. Third, there are regulatory barriers, including statutory prohibitions and regulatory uncertainties. However, studies undertaken by the Policy and Economic Research Council in the US confirm that reporting of utilities and telecommunications payments hold much promise in assessing borrower reputation and increasing access to finance of underserved communities, while technological and economic barriers are surmountable. Nevertheless, legislative barriers and regulatory uncertainties need to be addressed.

The use of alternative data has the potential to help solve problems related to lending to lower income segments and those in the informal economy, where lenders face the problem of identifying risk and are concerned that incomes in these segments are too volatile for structured lending products. It provides a data based solution to the problem of loan monitoring, and enables automated scoring systems that can help reduce origination costs and costs of micro- and other small-value loans. It can enable large lenders to enter underserved markets while working mostly within their existing business models.

Accordingly, alternative data can help expand financial access to an estimated 3.9 billion people worldwide who comprise the “missing middle” population (people in every economy who are forced to rely on high-priced credit) in between the 1.3 billion who are “banked” (with access to affordable mainstream credit) and the 1.4 billion who are impoverished (the traditional market for microfinance). Given the costs involved, however, initiatives to promote the use of alternative data can only succeed if there is adequate regulatory support, in particular to move data furnishers to act. In many emerging economies, non-banks face cost hurdles, which need to be addressed. Government institutions can also play a role, as in Mexico, where the National Savings and Financial Services Bank (Banco del Ahorro Nacional y Servicios Financieros -

BANSEFI) serves as a hub collecting data from cooperatives.

Establishing financial identity through the use of government-issued IDs and alternatives. Establishing financial identity faces various challenges stemming from a number of factors. One is the difficulty of uniquely identifying and verifying individuals. A second relates to inconsistencies in matching individuals against differing data bases without unique identifiers. A third is the problem of duplication and inefficiency of record management systems, which are not centralized and difficult to update. The issuance of IDs by governments to citizens and residents seeks to provide a unique identifier for each individual, with a validation process that can be fully automated to reduce false positives that occur in manual processes.

However, government-issued IDs have a number of weaknesses. They can be used fraudulently on transactions that do not occur face-to-face. They are effective mostly for physical verification. An ID number still needs to be checked as to its validity, whether it belongs to a deceased person or whether it has not yet been issued by the government. A physical ID document may be vulnerable to deterioration, may include information that is not updated or may not be unique.

Authentication engines provide an alternative to government-issued IDs. Such a solution involves running consumer data through proved fraud prevention models and databases, which may include consumer records of credit bureaus and external data sources, using customized questions and proprietary algorithms. It can be used at any point in the account acquisition process, for example in account activation, and can be done online, through a call center or integrated voice recognition applications.[35] Authentication engines have proven very useful for such purposes as verifying identity, KYC and AML compliance, mitigating fraud losses, reducing call center costs (through shorter time required for authentication) and increasing consumer confidence.

Challenges for developing economies. For economies at very early stages of development, various challenges need to be met in providing a conducive environment for establishing financial identity and inclusive ways for assessing reputation of consumers. The case of Solomon Islands illustrates some of these challenges, In the absence of a credit bureau, banks use basic requirements for lending to individuals and businesses, such as pay slips to assess level of income and financial statements to provide information on financial performance. Banks and credit unions maintain information on defaults and loan payments, which consumers can access and which can be shared among lenders when a customer wishes to access loans.

Realizing the beneficial impact of credit bureaus, particularly on financial

[35] Authentication engines ask a series of questions whose answers are known only to the individual in order to verify identity. “Out of wallet” questions, such as credit limits on credit cards, as well as “out of bureau” questions, such as car license number, are often used. It relies also on randomization, in asking a different set of questions during subsequent attempts and asking different questions to different applicants. There is a timing mechanism for online processes that does not allow time to conduct research. It also uses other data bases for additional risk indicators, including high-risk fraud alerts and third party directory services. Source: TransUnion of Canada, Inc. (2008).

inclusion, the government is considering the establishment of a credit reporting system. However, it needs to address a number of challenges in order for credit bureaus to function properly. One challenge relates to the sustainability and viability of a credit bureau, whether it be private-owned or government-owned, given the small size of individual markets and the costs of establishing and operating a credit bureau. There are discussions among several Pacific Island economies to establish a credit bureau for the region. Another challenge is posed by low literacy rates, which have led to variations in name spellings, limited number of formal ID documents issued so far, and difficulty in locating individual consumers.

In many economies, data collection, particularly from smaller institutions that account for a large portion of customers, is an important challenge. In the Philippines, for example, customers of banks are covered by the data, but not those having accounts with non-banks, cooperatives and NGOs. Banks account for only one out of seven of these customers; with the data for most customers not captured, the quality of credit bureau data will remain low.

Developing a credit information database through credit guarantee corporations. Japan provides an example of an innovative approach in collecting credit information from SMEs, using credit guarantee corporations. In Japan, while large corporations can count on both banks and capital markets for funding, SMEs rely mainly on banks and microcredit. Domestically licensed banks are the main source of lending to SMEs, with credit associations coming in a far second and government-affiliated financial institutions supplying a small portion of total lending to SMEs.

However, according to surveys, government-affiliated financial institutions are considered by SMEs as crucial sources of funding during times of emergencies, during the start-up and early stages of operations and for revitalizing stagnant business. Credit guarantees play an important role in bank lending to SMEs. Among SMEs, smaller companies tend to be more dependent on borrowing for fundraising, while the share of capital in the fundraising structure increases with size of the enterprise. Credit guarantee corporations play an important role in the credit information sharing mechanism, as they collect SME data nationwide.

A credit information system for the SME sector is important to help address the challenge of information asymmetry and access to finance. It addresses a major issue, which is lack of data for SMEs. Japan provides a good example of how such a system can be put in place. As of October 2010, participation in Japan's credit risk database (CRD) included 200 institutions encompassing 135 private financial institutions, 52 credit guarantee corporations, 5 credit rating agencies, 3 government financial institutions and 5 other institutions. CRD data have been collected since 1995 and covers 1,887 corporations and 887 individually-owned companies (as of March 2010), including default data for 239 corporations and 369 individually-owned companies.

Participants in the CRD provide financial and non-financial data as well as default information to the CRD Data Center in accordance with the Basic Law on Small and Medium Enterprises. The CRD Data Center stores the data from

members in anonymous form and consolidates the data for use by members in credit risk scoring, data sampling and statistical information.

IMPROVING THE LEGAL ARCHITECTURE FOR SECURED LENDING TO PROMOTE SMALL BUSINESS FINANCE

The importance of securing access to financing for small businesses and of undertaking reform in lending systems to achieve that goal is widely recognized in both the public and private sectors. One of the most significant areas requiring reform is the legal rules around secured lending. There is a great need to further explore regional best practices and opportunities in reforming the legal architecture around secured lending, most particularly the rules for filing and perfecting security interests in collateral, ease of diligence and completeness of lien registries, and why these issues are important for expanding credit availability to small businesses on reasonable terms. The role of licensing and market access in facilitating credit is another area that was explored in the Forum.

Current gaps in the legal and regulatory architecture for Micro-, Small and Medium Enterprise Finance: Secured Lending[36]

Micro-, Small and Medium Enterprises (MSMEs) comprise the dominant percentage of firms in all APEC member economies and play a leading role in employment generation. However, as an IFC and McKinsey study illustrates, MSMEs in emerging markets face particularly difficult challenges in accessing finance. As many 315 million MSMEs (72 percent of the total in emerging markets) lack access to credit.[37] Secured lending has been an important means for companies to access affordable capital, and governments typically support MSMEs to access such lending through government guarantee or incentive schemes and improvements in regulatory and legal systems and in financial infrastructure, including measures to improve property registry systems, reduce enforcement costs for lenders and improve financial transparency and credit rating systems.

Within the region's emerging markets, there are gaps in the legal and regulatory architecture that impede access of MSMEs to a diverse range of financing opportunities. These include the following:

- Lack of a security interest registry system, which allows liens to be registered and searched by lenders.
- Absence of an exclusive security interest registry, such as in economies where there is a "hidden lien" issue where competing claims can be

[36] This section summarizes the presentations and discussions in Session Seven (Current gaps in the Legal and Regulatory Architecture for Micro-, Small and Medium Enterprise Finance: Secured Lending), chaired by Mr. Thomas Clark (Vice President, Government Relations, GE Capital Asia-Pacific). Presentors in this session were Mr. Clark Griffith (Senior Vice President, Structured Finance, GE Capital Japan), Dr. Naoyuki Yoshino (Professor of Economics, Keio University and Director, Financial Research and Training Center, Financial Services Agency of Japan), Mr. Ye Aung (Assistant Director, Foreign Exchange Management, Central Bank of Myanmar) and Ms. Khin Cho Oo (Assistant General Manager, Myanma Economic Bank, Myanmar).

[37] G-20 Financial Inclusion Experts Group/SME Finance Sub-Group, Scaling-Up SME Access to Financial Services in the Developing World (October 2010), Executive Summary.

registered under different laws and regulations.

- Voidable conversion or preferences.
- Unclear perfection rules or lack of coverage for certain types of collateral such as movables, receivables or intellectual property.
- Absence of blocked or pledged account security, which is a fundamental mandatory aspect of senior secured lending, especially where historical data on bankruptcy proceedings are lacking/
- Untested or non-transparent legal systems.
- Treatment of floating charges.
- Lack of broad licensing authority for commercial lending to allow greater participation of non-bank lenders in the market.

Attracting more lenders into the market results in greater competition, which expands the amount of available credit and benefits borrowers. To attract lenders, however, the legal and regulatory environment needs to provide them with the comfort and knowledge that their legal rights to a security against which any loan is made are assured, and gives them a clear idea of the seniority of their claims should a bankruptcy occur.

The current situation in various markets in the region can be characterized as follows:

- Within the region, Singapore and Hong Kong are arguably the markets where creditors' rights are best protected, particularly in reorganization contexts. Other markets such as Japan and Korea generally recognize the first lien priority interest of senior secured lenders.
- A number of APEC economies have made improvements in recent years on their property registration and collateral laws and bankruptcy codes, such as in Japan (which has improved its perfection law and is moving to register digital promissory notes), China (which has undertaken reforms of its property and bankruptcy laws) and Korea (which introduced a new property registration law).
- Nevertheless, important structural impediments remain to be addressed in various degrees in different economies across the region.

There is much scope for regional cooperation using APEC as a platform to improve the legal and regulatory environment for secured lending. Among possible initiatives that may be considered are the following:

- A survey of global best practices on secured lending regimes and their impact on financing availability and pricing.
- Development of model elements for a code of security interest creation, perfection and enforcement in pursuit of APEC's goal of promoting regulatory coherence, which can include clear perfection rules, broad coverage of collateral types, exclusivity (elimination of "hidden liens") and facilitating lien searches.

- Collaborating with multilateral institutions global organizations already undertaking initiatives in this area in creating a global standard for recognizing a broader range of assets.
- Development of model treatment of floating charges and accounts receivable financing.
- Continued public-private dialogues to validate improvements to legal and regulatory frameworks.
- Promoting broad licensing authority for commercial finance.

Special Aspects in the Legal and Regulatory Architecture for SME Finance: Turnaround and Rehabilitation, the Role of Public-Private Partnerships and Entrepreneurship Policies[38]

An important issue related to the legal environment is what happens when a borrower defaults and the collateral is insufficient. This section also focuses on how regulations and regulators can facilitate turnaround of SMEs facing temporary liquidity constraints, how special provisions in secured lending laws can incentivize the extension of rehabilitation and turnaround financing, and how entrepreneurship policies and public-private partnerships can assist SMEs in accessing finance.

Although many Asian economies may not appear to place as much value on the rule of law as part of the development agenda as in the West, it is widely acknowledged that well-defined legal systems with effective enforcement mechanisms provide a predictable, and hence attractive environment for finance. The major factor in this relationship between legal systems and finance is risk, including its identification, management and transfer, which underlies investment decisions. Lower risks correspond to lower costs of borrowing and investing, and systems that are more predictable present lower risks to lenders and investors.

In designing the legal and regulatory architecture for finance, however, it is important to consider its impact on entrepreneurship. Pursuing the rule of law to the extreme, such as the past practice of maintaining debtors' prisons, would have the effect of discouraging entrepreneurship and risk-taking. Between this and the other extreme of failure to pay debts having no consequences lies a field where policy makers need to strike a healthy balance that will offer predictability while promoting entrepreneurship.

Financial systems have evolved to accommodate varying risk preferences based on the concept of risk-adjusted returns. Thus, various sources of finance offering opportunities for investors and lenders over a wide range of risk tolerance have become available – from venture capital and private equity at the higher end of the risk spectrum to infrastructure funds and pension funds in the middle and

[38] This section summarizes the presentations and discussions in Session Eight (Special Aspects in the Legal and Regulatory Architecture for SME Finance: Turnaround and Rehabilitation, the Role of Public-Private Partnerships and Entrepreneurship Policies), chaired by Mr. Gary Judd (Queen's Counsel and Co-Chair, Advisory Group on APEC Financial System Capacity Building). Presentors in this session were Mr. Norman Page (Partner and Chair, China Practice Group, Davis Wright Tremaine LLP), Mr. Arthur Mitchell (Senior Counselor, White & Case Law Offices) and Ms Zhang Shaohua (Director, Research Bureau, The People's Bank of China).

secured lending from banks at the lower end.[39] Increased availability of capital seeking higher returns with higher risks have fostered entrepreneurship and society as a whole, with many of today's leading companies, particularly in the technology sector, having grown from small beginnings with the help of angel and venture capital investors.

In deciding whether a particular project is bankable, lenders and investors typically consider the overlapping categories of risk involved. These include country and financial risks (relating to political stability, maturity of legal system, enforcement, currency risks, and legal and tax policy changes, among others), policy and regulatory risks (such as ease of obtaining licenses and approvals and stability and clarity of policies and tariffs, among others), technical and project-specific risks (for example, suitability of technology for a category of investment, construction risks and delays and environmental issues) and market risks (for example, impact of changes in competition on project viability and changes in the price and supply of energy).

Regulators can encourage lenders and investors to provide financing through measures that reduce such risks. Government intervention in promoting renewable energy, which is not currently a market-driven sector, provides an example of how this works. Although it is practically impossible for SMEs to enter the power plant business due to the very high transaction costs, government can enable SMEs to participate in the storage and generation of energy through smart grids. Promoting clean energy may also involve policy mechanisms such as feed-in tariffs, green certificates and other subsidies. These measures are being undertaken in the hope that costs will eventually come down to the point where subsidies become unnecessary.

An important area where reforms can have a major impact on the environment for financing SMEs is commercial law. Secured lending and bankruptcy law form a single integrated body of law that forms the backbone of modern commercial law systems in developed and developing economies. As many SMEs worldwide rely heavily on inventory and receivables to finance their operation and growth, the development of comprehensive, practical, efficient, inexpensive and reliable bankruptcy, foreclosure and secured lending laws and public registry systems could benefit SMEs by reducing the risk faced by lenders and consequently the costs of finance.

Commercial law sets the rules governing various stages of a lender's business relationship with a borrower. In the beginning of a relationship, it provides the rules for structuring a business transaction or relationship in a way that reduces the risk of a party's insolvency or default. When a borrower experiences financial stress, it provides the rules for restructuring the business relationship to reduce risk or minimize damage. In this situation, commercial law must be complemented by the existence of a good early warning system in the form of access to timely and accurate financial information.

[39] In addition, there is concessional financing from international financial institutions, which is limited in quantity, focused on projects with developmental impact and not particularly geared toward returns.

When a borrower becomes insolvent, it is possible to resort to various options, the effectiveness of which depends on particular factors. In case of reorganization with creditor cooperation, key to successful pre-negotiated reorganization is the existence of clear rules about the rights of lenders and borrowers in bankruptcy, which will facilitate informal workouts. In case of reorganization without creditor cooperation, insolvent companies can restructure and survive if they have a right to use cash collateral, obtain a priming lien for post-bankruptcy finance and to use cram-downs against unsecured or under-secured creditors. Promoting efficient and orderly liquidation and redeployment of assets is important to avoid rash actions by stakeholders that may destroy potential value. Clarity and reliability of commercial laws are the key issues.

In the US, bankruptcy courts play major roles, as borrowers generally file bankruptcy rather than allow lenders to repossess collateral. While the prospect of the borrower becoming a debtor-in-possession after the filing of a bankruptcy provides incentives for informal workouts, the prospect of the matter being brought to bankruptcy court creates unpredictability. In jurisdictions where laws are not seen as comprehensive and reliable and where there is a deficit in transparency, such uncertainties on the part of lenders are further increased.

Negative experiences with implicit guarantees have also underscored the importance to lenders and investors of legal certainty governing credit support. In certain cases, lenders and investors incurred large losses, having extended credit relying on informal assurances, including comfort letters and legal opinions issued by law firms, mistakenly assuming that these were guaranteed by the host government.

Reforming secured lending laws to promote SME finance: the experience of China[40]

In 2003, the central bank undertook a survey on access to credit of SMEs, which showed that a significant number (27 percent) were denied access due to the lack of proper collateral. There was a major mismatch between what domestic banks were willing to accept (mostly real estate) and what assets SMEs had (mostly movable assets, particularly accounts receivables and inventories). The main conclusion drawn from the survey was that the legal framework governing secured transactions needs to be reformed in order to allow SMEs to use movable assets, which is estimated to amount to RMB 70 trillion and which SMEs are unable to use under the 1995 Securities Law.

To address this issue, China passed a new law in 2007 that covers movable assets in addition to real estate. Part 4 of the law contains the key provisions. These include expanding the scope of collateral, implication of the concept of floating charges, centralization of the real estate registry system and creating a registry agency for accounts receivables, specifying the way of dealing with conflicting multiple security interests, simplifying enforcement procedures and

[40] This section summarizes the presentation of Ms Zhang Shaohua (Director, Research Bureau, The People's Bank of China) in Session Eight.

clarifying the relation between registry and priorities.

Subsequent to the enactment of the law, the central bank issued its rules on registration of accounts receivables and the first internet-based registry system in China became operational, covering factoring and accounts receivables-backed corporate bonds, In 2009, lease registration was also incorporated in the accounts receivable registry. The establishment of the registry was followed by robust registration and search volume, particularly on the part of SMEs. As of June 2011, total registration numbered over 384,000 and searches totaled over 489,000, of which 81 percent were conducted by SMEs. The lease interest registry recorded over 32,000 registrations and over 8,000 searches.

Remaining challenges include the need to update definitions, such as those for mortgages, pledges and liens, to make floating charges explicit and to consolidate existing multiple registry systems. The definition of MSMEs has been updated, although different standard definitions remain for different economic sectors. In addition, SMEs currently face severe difficulties due to tightening monetary policies, which have led to greater difficulties in accessing bank loans and a rise in financing costs.

Another area where progress has been made is the area of debtor-in-possession (DIP) financing, The chapter on reorganization (Chapter 8) of the August 2006 Enterprise Bankruptcy Law contains provisions similar to DIP financing. Article 73 allows the debtor to manage his property and business operations under his own supervision, while Article 75 provides for the suspension of the exercise of security rights except in cases of possible damage or marked depreciation of value that may impair the interests of the secured creditor. The debtor or administrator who borrows funds to carry on with the business is also allowed to create a security on the loan. Nevertheless, the law has no explicit provision for DIP financing and priming liens.

STRENGTHENING MSMEs AND PROMOTING ENTREPRENEURSHIP IN THE ASIA-PACIFIC REGION

Improving their access to finance can only succeed in helping MSMEs if undertaken together with the other necessary policies to promote entrepreneurship that will address the broader issues facing these enterprises in developing economies. Drawing on the OECD's review of SME and entrepreneurship issues and policies in Thailand[41] – the first such review of an Asian economy – this section[42] discusses how to strengthen MSMEs and

[41] OECD, OECD Studies on SMEs and Entrepreneurship: Thailand: Key Issues and Policies (2011).

[42] This section summarizes the presentations and discussions in Session Nine (Strengthening MSMEs and Promoting Entrepreneurship in the Asia-Pacific Region), chaired by Dr. Yuqing Xing (Director, Capacity Building and Training, Asian Development Bank Institute). Presentors in this session were Dr. Yuthasak Supasorn (Director General, Thai Office of Small and Medium Enterprise Promotion), Dr. Jonathan Potter (Senior Economist, Centre for Entrepreneurship, SMEs and Local Development, Organisation for Economic Co-operation and Development), Ms. Nguyen Thanh Le (International Cooperation Division, Agency for Enterprise Development, Vietnam), Ms. Dorothy Chen (Assistant Director General, Department of Banking, CBC) and Mr. Bountheung Douangsavanh (Deputy Director General, SME Promotion and Development Office, Ministry of Industry and Commerce, Lao PDR). It also summarizes the Special Presentation in Session Three of Mr. Ken Sasaji (Director, APEC Office, Trade Policy Bureau,

promote entrepreneurship in the region, and the potential of such reviews as a tool for improving the design and delivery of policy and for information sharing within the region.

Following are the main findings of the OECD's study on Thailand.

- Thailand has benefited from sound macroeconomic policies, export growth, growing competitiveness and dynamic enterprises, which have contributed to economic growth. Thailand's SME sector is comparable with most other economies in terms of structure and contributions to the economy, and enjoys steady growth. The proportion of female entrepreneurs is higher than the global average.
- Weaknesses of the sector include significant segments with low productivity, limited growth potential and poor income and employment conditions; unequal regional distribution; and a limited number of medium-sized and growth-oriented enterprises.
- Obstacles to further development include gaps in technological readiness, lack of finance, underdeveloped infrastructure and institutional weaknesses.
- Thailand has introduced measures to strengthen efforts to develop the SME sector, including the establishment of the Office of SME Promotion (OSMEP), which has played an important role in this regard, and the development of SME Promotion Master Plans.
- Steps that could further strengthen the government's ability to promote the development of SMEs include promoting greater policy coherence across government ministries and agencies that affect SMEs and, in the context of budget constraints, a more focused approach that favors policies with the greatest impact.

The OECD report makes the following recommendations to help Thailand enhance its innovative capacity.

- Improve the framework for formulation and implementation of SME and entrepreneurship policies through: (a) reinforcing central coordination of policies and programs with OSMEP as the focal point; (b) switching to flexible, rolling program budgeting and strategic planning and from sector and industry focused to results-based planning; (c) adopting a portfolio approach in supporting SME and entrepreneurship projects and programs; (d) increasing accountability through improved evaluation of strategy, program and project results; and (e) improving the quality, timeliness, reliability, accessibility and cost-effectiveness of program management information.
- Promote the growth of innovative, growth-oriented and internationally active SMEs through: (a) developing cost-effective and accessible policies programs to enhance capacity of SMEs and entrepreneur to innovate and compete internationally; (b) taking SME issues into account in trade

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Ministry of Economy, Trade and Industry, Japan).

negotiations, including FTA negotiations; and (c) improving SMEs' and entrepreneurs' access to finance, such as by strengthening credit rating, credit management, information sharing systems, financial education and advisory services; identifying ways to effectively harness venture capital and closer public-private collaboration.

- Develop policies to promote productive entrepreneurship for regional and social development through (a) supporting a shift from "necessity" entrepreneurship to productive and opportunity-driven entrepreneurship with cost-effective advisory, mentoring and training programs and support; and (b) focusing on SME development in underdeveloped regions to address regional inequalities in SME and entrepreneurship activity.

The Third SME Promotion Master Plan for 2012-2016 seems to be heading in the right direction. The Master Plan defines the mission, goals and indicators, overall strategies and their interconnections, and the structure for implementation. The implementation structure reserves a central role for OSMEP in the development and coordination of the SME Promotion Plan, action plans and monitoring and evaluation of related policies and programs at the central, regional and local levels. OSMEP will also be in charge of the SME Promotion Fund, which will be based on annual SME promotion action plans involving the government, public agencies, state enterprises and related private organizations at all levels.

The experience of Chinese Taipei provides important insights into the role of credit assistance policies and measures in promoting the growth of SMEs. This sector is especially important for the economy, accounting for almost 98 percent of all business enterprises, 78 percent of all employed workers and 31 percent of total sales of business enterprises. The major reasons for SMEs' difficulties in accessing formal finance include operational weaknesses, the lack of assets for collateral and the lack of financial transparency. Chinese Taipei's credit assistance policies and measures to address these issues have four core elements.

- *The Act for the Development of SMEs*. This legislation was passed with the aim of helping SMEs improve their operational environments, promote mutual cooperation and assist in growth through their own efforts. Two key articles of the Act related to financing are Articles 13 and 14. Article 13 mandates the Small and Medium Enterprise Administration (SMEA) to coordinate with financial institutions and credit guarantee institutions to ensure that SMEs' capital requirements are met; to allocate part of its budget to the Small and Medium Enterprise Credit Guarantee Fund (SMEG); and to actively assist SMEs to obtain loans from banks, reporting annually to the legislature. Article 14 requires all banks within the scope of their businesses to maintain an adequate ratio of financing facilities for SMEs and the setting up of SME assistance center to enhance the provision of relevant services.
- *Small and Medium Enterprise Administration (SMEA).* The SMEA was established as the central competent authority for the development of SMEs, with a mission to create a favorable environment for their growth. Its

responsibilities include formulating plans and legislation, providing guidance to and inspecting SMEs, undertaking relevant surveys and research, assisting SMEs in improving production technology and training, and providing guidance to improvement of SMEs' operation, management and financing, among others. The deputy governor of the central bank is involved in planning and review of SME development policy as a member of the SME Policy Deliberation Committee.

- *Small and Medium Enterprise Credit Guarantee Fund (SMEG)*. SMEG was established in 1974 to provide financial assistance to SMEs and is the sole organization providing credit guarantees to SMEs. Since 2003, SMEG operates under the regulation of the Ministry of Economic Affairs. Most of its funds (81 percent of the total) are sourced from government and the rest is provided by financial institutions. It provides two types of credit guarantees. The first is indirect guarantee (applying to 99 percent of the total), where the bank refers application for loans from SMEs to SMEG for credit guarantees. The second is direct guarantee, where SMEG grants guarantees to enterprises with significant development potential but faces higher risks. Such enterprises can apply directly to SMEG for credit guarantees and subsequently use them to secure loans from banks. The central bank's deputy governor is also a member of SMEG's board of directors.
- *Financial Supervisory Commission (FSC).* The FSC, which was established in 2004, regulates the banking, securities and insurance industries. In 2005, the FSC launched the Plan for Increasing Loans to SMEs by Domestic Banks, to help local SMEs secure loans. The FSC sets annual goals relying on inputs from rating agencies, and provides incentives to encourage domestic banks to lend to SMEs, such as by allowing them to open new branches in metropolitan areas.

Actions and measures undertaken by Chinese Taipei have been effective in increasing the amount of loans extended to SMEs by domestic banks. Between June 2005 and June 2011, such loans grew from NT$2.37 trillion to NT$3.96 trillion. By June 2011, these loans represented 47 percent of loans to all enterprises and 51 percent of loans to all private enterprises.

During the recent global financial crisis, SMEG played a key role in Chinese Taipei's strategy to restore financial stability, assist businesses in coping with the crisis and prevent the rise of unemployment. SMEG launched the Golden Lever Project, through which it raised the guarantee coverage ratio to share in the lending risks faced by banks from an average of 64.8 percent to 76.9 percent, lowered guarantee fees to help reduce costs for SMEs from 0.83 percent to 0.57 percent, and increased the maximum amount of guaranteed loans for a single enterprise from NT$100 million to NT$120 million. Other measures included exempting SMEs involved in public investment projects from the maximum limit for guaranteed loans, relaxing restrictions on eligibility for credit guarantees and improving payment processes to encourage banks to extend more loans to SMEs.

The Golden Lever Project succeeded in promoting the recovery of outstanding

loans to SMEs, reducing the likelihood of a credit crunch and mitigating the impact of the global financial crisis on SMEs. It also helped improve banks' asset quality, as the NPL ratio of SME loans, which rose to 2.81 percent in April 2009, was gradually reduced to 0.73 percent by June 2011. The default rate also decreased from 4.61 percent in February 2009 to 0.78 percent in June 2011. SMEG was able to assist 130,000 enterprises obtain operating capital and save an estimated 1.5 million jobs. Between July 2010 and June 2011, over 14,000 SMEs joined the Pledge to Promote Employment (through which they enjoyed a preferential guarantee rate) and provided over 79,000 new jobs.

In Vietnam, SMEs face various challenges. As in many other economies, many SMEs lack capital and access to production facilities, have old technology, weak enterprise management skills, a limited market and lack of linkages to large and foreign enterprises. Other challenges include overlapping legal frameworks, lack of transparency and frequent policy changes. Authorities have limited experience in SME development and promotion. The government has recently developed a support policy for SME development, with the goal of increasing the number of SMEs and strengthening their competitiveness.

Formulated by the Enterprise Development Agency under the Ministry of Planning and Investment, this policy has three objectives. The first is to create a favorable and transparent business and legal environment through reforms of laws governing enterprises, land, taxes and trade, among others. The second is to promote SMEs' access to finance through credit guarantee, SME finance and venture investment funds and through better access to bank loans and lease finance. This will involve collaboration among various agencies, including the Ministry of Finance, the State Bank of Vietnam and provincial and city governments. The third is to promote SMEs' competitiveness through technology innovation, application and transfer, intellectual property protection, human resources training and better domestic and overseas market information.

Following the First SME Development Plan, a second 5-year plan has been drawn up for the years 2011-2015. It includes measures to strengthen financial support to SMEs, through the establishment of credit guarantee funds (under the responsibility of the Ministry of Finance, the development bank and other relevant agencies), strengthening of capacity of financial institutions and SMEs (under the responsibility of the central bank and the Ministry of Planning and Investment, among others) and the SME Development Fund (under the responsibility of the Ministry of Planning and Investment, the Ministry of Finance and others). The SME Development Fund draws resources from the government budget and local, foreign and multilateral sources.

In Laos, several measures have been initiated to improve SMEs' access to finance, which was one of the six policy directions outlined in the Prime Minister's April 2004 decree on SME promotion and development. These measures, outlined in the SME Development Strategy for 2006-2010 and the SME Development Plan for 2011-2015, included the following:

- The Lao Development Bank, a government-owned commercial bank, was transformed into a bank focusing on SME lending in 2008, with operations

on full commercial basis. A project to develop human resources and improve credit operations was launched with assistance from the Japan Finance Corporation, Micro Business and Individual Unit (JFC-Micro).

- An online credit information system was established in November 2010 at the Credit Information Bureau of the central bank.
- Licenses were issued to four leasing companies to start operations.
- Implementation of the Secured Transaction Law was decreed in June 2011, which allows SMEs to obtain financing by using movable assets as collateral.
- A government bank (Nayoby Bank) was established that focuses on supporting poverty reduction.

With these measures, the government hopes to improve the economy's low ranking in the World Bank Ease of Doing Business index. MSMEs will nevertheless continue facing significant challenges, and it is expected that more time will be needed before they develop the capacity to fully benefit from these initial measures.

There is much potential for regional collaboration to share such experiences and lessons to assist governments design and develop effective strategies for strengthening MSMEs and promoting entrepreneurship. There is much potential for APEC to develop into an effective platform for such regional collaboration. Current work of senior officials in APEC that relates to this involve three strategic areas – strengthening SMEs as a source of driving force for prosperity and employment, advancing open innovation and entrepreneurship and strengthening the capacity of women entrepreneurs.

- *Strengthening SMEs.* The first joint meeting of trade and SME ministers in 2011 identified a number of major barriers to trade that small business owners and exporters face in the region. Foremost among these is lack of access to finance, which is critical for exporters as buyers prefer vendors that are able to extend credit. In addition, SMEs' ability to access finance is often hindered by particular borrowing requirements such as the need for longer repayment periods. In the joint meeting, the ministers identified credit guarantee and trade insurance as key measures that could address some of these important financing needs. APEC also identified a number of core elements in future trade agreements that will be important to SMEs, which include assistance to support industries, promoting the dissemination of technology innovation and developing human resources. Sharing of experiences and best practices will be needed to help member economies identify and implement effective measures to meet these objectives. Finally, structural reform is another area where APEC is promoting measures that would strengthen SMEs and promote entrepreneurship. To assist SMEs in getting credit, APEC has already undertaken capacity building activities to disseminate knowledge on how to strengthen legal frameworks and improve credit information to facilitate credit to SMEs. Building on these activities, APEC is now creating detailed plans through consultation among member

economies on capacity building, information sharing and the dispatch of technical experts.

- *Advancing open innovation and entrepreneurship.* APEC is considering the development of an APEC Open Innovation Platform that will bring together research institutes, NGOs, firms, banks, venture capital funds, government funds, policy makers, universities and other supporting organizations. This work is based on the concept of three pillars of cooperation for open innovation. The first is advancing the trade and investment system, particularly the establishment of the best trade agreement models on innovation, trade and investment. The second is promoting absorptive capacity building for the benefit of developing economies. The third is enhancing global networking among innovation actors through an international networking conference. Simultaneously addressing issues affecting innovation, trade and investment is crucial given the mutually reinforcing interplay between innovation on one hand, and trade and investment on the other. APEC is also developing a global innovation conference and an e-gateway for global open innovation, to expand opportunities for enterprises to access funding from venture capital, financial institutions, investment funds and government funds globally.
- *Strengthening the capacity of women entrepreneurs*. Under Japan's chairmanship in 2010, APEC convened the first Women's Entrepreneurship Summit, which was followed by a similar summit (Women and the Economy Summit) the following year. The discussions identified four priority areas for future action – access to capital, access to markets, capacity and skills building and promoting leadership.

SUMMARY AND CONCLUSIONS

Expanding access to finance for low-income households and MSMEs, which is a key issue in addressing poverty and development, is a complex task that requires comprehensive approaches and close coordination and collaboration among various stakeholders in the public and private sectors. Microfinance, originally developed as a survival strategy for the poor and attracting the attention mainly of institutions and individuals supporting charitable and social causes, has undergone a tremendous transformation into one of the most important tools for achieving sustained, balanced and inclusive economic growth and development, involving a wide range of financial markets and institutions.

Two elements that play key roles in the ongoing evolution of MSME and microfinance are innovation and globalization. Innovation, particularly the introduction of mobile and agent banking using new technologies, has enabled microfinance to overcome the barriers to commercial viability. Technology continues to provide solutions addressing various impediments to its further development, including in such key areas as financial identity and payments systems. Globalization has impacted MSME and microfinance on many fronts, from attracting global investors using microfinance investment vehicles to the cross-border linkages that are starting to develop among MFIs and related institutions on the back of the region's growing migrant populations.

All of these are opening many new opportunities that can help MSME and microfinance realize its potential as a tool for financial inclusion and economic development. However, they also create new threats, as policies and regulations that have been put in place to keep institutions strong, maintain financial stability and protect consumers become ineffective in dealing with new developments – as seen in the recent Indian microfinance crisis. Consequently, the challenge facing economies today is the design and effective implementation of new laws, policies and regulations that will provide an enabling environment for expanded financial access and satisfy important macro- and micro-prudential and consumer protection objectives in the face of a rapidly changing economic and technical landscape.

Forum participants discussed this issue in the context of the markets for credit, savings and remittances and two key policy areas, credit information and legal frameworks for secured lending, as well as the broader policy environment for entrepreneurship. These discussions yielded the following conclusions:

- There is ample room to expand sources of funding for micro-credit, which can be accomplished by harnessing regional public-private collaboration. However, expanding micro-credit needs to be supported by a strong credit underwriting culture that can protect the interests of borrowers, lenders and investors. Key measures include the establishment of a robust credit information system, providing adequate consumer protection and promoting financial education. To be effective, these measures should form part of a cohesive financial ecosystem based on a comprehensive strategy, effective enforcement and close cooperation among relevant public and private institutions.
- Grassroots savings mobilization faces a number of challenges in many economies related to adequacy of regulatory frameworks, sustainability of the business model, and low-income households' lack of trust in and familiarity with formal banking institutions and services. Addressing these issues and promoting micro-savings require proportionate regulatory and supervisory frameworks, well-coordinated implementation of effective strategies, measures to promote financial literacy, enabling environments for participation of related service providers such as mobile phone companies, and capacity-building for MFIs in becoming licensed financial institutions.
- Harnessing remittances for financial inclusion will require addressing three major challenges – reducing costs, channeling remittances to savings and investments, and maximizing their benefits to recipients. These challenges can be addressed through policies and measures that harness technology and collaboration among MFIs. Policy makers and regulators can provide an enabling environment for branchless banking infrastructure using mobile wallets and prepaid cards by addressing barriers to transactions using these technologies, such as measures to enable open loop accounts. Cross-border collaboration among MFIs can help link remittances to other financial products for migrants' families in their home economies. Financial education is needed to enable migrants' families to maximize the benefits or

remittances.

- The adoption of full-file and comprehensive credit information systems can promote financial inclusion and strengthen financial systems. Private credit bureaus, which complement public credit registries, can contribute significantly to this goal. Establishing viable and effective credit bureaus faces various challenges in emerging markets. Among these are pricing in the context of high-volume, low-value and small markets; availability, quality and timeliness of data; finding and retaining skilled personnel; promoting demand and securing stakeholder support and collaboration. Lenders will also need better skills and technology to effectively use information from credit bureaus.
- Policy makers and regulators face challenges in designing and implementing a robust credit information sharing system, including lack of technical capacity, insufficient data quality and data bases. A key issue is finding a balance between promoting access to broader sources of information and protecting individual privacy. Given that there is no one-size-fits-all model in this area, it is important to enhance the capacity of policy makers and regulators to understand how to adapt policies, regulations and measures to fit their respective domestic environments.
- In developing credit reporting systems, policy makers and regulators can benefit from the wealth of existing best practices and experiences, particularly in balancing consumer protection with the requirements for effective and efficient credit reporting; identifying legal prerequisites for effective systems; and alternative regulatory and enforcement models. A deep understanding of the role of credit bureaus in the context of the credit market cycle is key to designing effective systems. Effective credit reporting systems are based on robust, balanced and properly implemented legal and regulatory frameworks supported by grievance mechanisms and financial education.
- Rapidly growing regional integration will necessitate the development of a regional credit reporting framework for cross-border collection, use, storage and protection of credit information. Difficult challenges are involved, at the center of which is the protection of data used across jurisdictions. One option for moving forward is to incorporate data protection in regional free trade negotiations. Unless there is prior general consensus among negotiating parties, however, this is likely to slow down the whole negotiation process.
- An alternative to seriously consider is the regional adoption of an open architecture based on a regional trust mark that allows portability of cross-border data, more easily accommodates the evolution of technology, including the emergence of networked online (cloud) storage solutions, and enables governments to provide a backstop without additional regulatory burdens. Eventually, policy makers will also need to explore whether and how a regional credit reporting regime could be made compatible with Europe's legal framework, particularly the EU Data Protection Directive.
- The use of alternative data, such as utilities, insurance and rental payments,

have tremendous potential for expanding financial inclusion. While technological and economic barriers are surmountable, policy and regulatory barriers and uncertainties need to be addressed to enable use of such data for credit reporting. Active government and regulatory support to enlist and facilitate the cooperation of data furnishers is also important.

- Useful tools for establishing financial identity include government-issued IDs and authentication engines. IDs with a robust validation process can provide a unique identifier for each individual, but have limitations. Authentication engines have proven useful in verifying identity and KYC and AML compliance, among others. Such a system would require meeting a number of challenges previously discussed in relation to the establishment of a credit reporting system, most importantly the challenge of collecting data on larger portions of the population.
- Improving the legal architecture for secured lending can greatly expand MSMEs' access to finance. Greater protection of creditor rights will attract more lenders into the market, expanding the amount of available credit and lowering financing costs. While a number of markets in the region have relatively high standards of creditor rights protection or have made improvements in recent years, many gaps in the legal and regulatory architecture remain. These include the lack of exclusive registry systems for security interests, voidable conversion or preferences, unclear perfection rules, lack of coverage for certain types of collateral such as movables, receivables or intellectual property, absence of blocked or pledged account security, untested or non-transparent legal systems, treatment of floating charges and lack of broad licensing authority for commercial lending to facilitate entry of non-bank lenders.
- There is much scope for APEC to provide a platform for regional cooperation in addressing these issues. Among possible initiatives to consider are a survey of global best practices on secured lending regimes; development of model elements of a code of security interest creation, perfection and enforcement; creating an international standard for recognizing a broader range of assets; development of model treatment of floating charges and accounts receivable financing; public-private dialogues to validate improvements to legal and regulatory frameworks; and promoting broad licensing authority for commercial finance.
- An effective legal and regulatory architecture for finance is one that strikes a good balance between offering predictability and allowing room for risk-taking. This would include comprehensive, practical, efficient, inexpensive and reliable bankruptcy and foreclosure laws, public registry systems and provisions in secured lending laws that facilitate the extension of rehabilitation and turnaround financing. Clear and reliable commercial laws, in particular, clear rules about rights of lenders and borrowers in bankruptcy, are necessary for efficient and orderly liquidation and redeployment of assets in the context of insolvency to avoid rash actions by stakeholders and consequent value destruction.

- Improving access to finance can only succeed in helping MSMEs if undertaken together with other necessary policies to promote entrepreneurship. Comprehensive reviews of MSME and entrepreneurship issues and policies, such as the recent OECD review of Thailand, are helpful in identifying reforms to improve the environment for MSME development. There is much potential for regional cooperation, particularly through APEC, to share such experiences and lessons to help governments in designing and developing effective strategies.

In view of today's global economic situation, expanded access to finance is an issue that needs to be given more importance in APEC, which has traditionally focused on liberalizing and facilitating trade and investment. Expanded financial access for the vast mass of middle and lower income consumers and small enterprises is needed to unlock the potential of emerging markets, particularly in Asia, as a new engine of the global economy and rebalance trade and growth across the region. It also promises to address a key impediment that prevents MSMEs from effectively fulfilling their traditional role as generators of employment.

Expanded access to finance must also be pursued within a region-wide context, if finance is to effectively support APEC's vision of open trade and investment across borders. This would involve the coordinated development of laws, regulations, market infrastructure and industry practices, as well as open architectures that can facilitate the movement of capital and management of risks across the region, while maintaining financial stability and protecting consumers as member economies move toward greater integration. This would also involve the development of mechanisms through which remittances of the region's growing migrant population can be more efficiently channeled to local financial systems, savings and investment.

APEC has significant potential to become a platform for regional cooperation to promote expanded access to finance, given its membership (it includes most of the largest and most dynamic economies), its well-developed regional collaboration infrastructure involving a wide range of ministries and agencies, and well-established mechanisms for sustained involvement of the private sector, the academic community and multilateral institutions. Through focused policy dialogues and capacity building activities coordinated under the APEC Financial Inclusion Initiative, APEC can further advance the goal of stronger, more balanced and more inclusive growth throughout the region.

APPENDIX: Forum Program

(Insert final Forum Program here)