New Finance Support

Receivables finance for MSME resilience and economic growth

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Glossary

TERM / CONCEPT	DEFINITION
Anchor Buyer	Typically a large, creditworthy company that facilitates a supply chain finance programme for its network of suppliers and whose credit risk is the economic basis of the finance provided.
Central bank discount window	A programme operated by a central bank to allow eligible institutions to borrow money from the central bank, usually on a short-term basis, to meet temporary shortages of liquidity caused by internal or external disruptions.
Contractual subordination	Modification of the priority of a claim by agreement.
Digital trade	The exchange of goods, services, and information using digital technologies and platforms and digitalisation.
Factoring	A receivables product whereby the finance provider (factor) acquires receivables, typically by purchase, owed to a company (often referred to as the supplier) at a discounted rate with or without recourse.
Factoring company	A non-bank financial institution (including in some cases a bank subsidiary) that offers receivables products, such as factoring.
Hybrid procedures	Reorganisation procedures where most of the negotiations take place out-of-court. Then, once the required majority of creditors have agreed a reorganisation plan, it is submitted to the court or administrative authority for approval and typically becomes binding on dissenting creditors. Such procedures facilitate reorganisation and restore solvency with minimal court intervention.
Insolvency	The inability for a business to pay its debts, usually demonstrated either through the cash flow test (failure to pay obligations as they fall due) or the balance sheet test (i.e. liabilities exceed the value of assets). Some jurisdictions only allow businesses to use one (or some) of the available reorganisation procedures if they are either insolvent or not yet insolvent or at risk of insolvency.

TERM / CONCEPT	DEFINITION
Insolvency procedures	Formal legislative processes for insolvent liquidation or reorganisation that vary by jurisdiction but are usually commenced upon the court's approval of a petition for entry into insolvency proceedings. Insolvency procedures often impose restrictions on the activities of the debtor and its management and on the ability of creditors to recover debts, and are generally characterised as either reorganisation procedures or liquidation procedures.
Inventory	Goods held by a business for sale or lease.
Invoice	An accounting document itemising the amount owed for goods sold or services provided.
Insolvent liquidation	A formal insolvency procedure pursuant to which an insolvency practitioner (the liquidator) is appointed to manage the affairs and assets of a debtor in order to realise the assets and distribute the proceeds among creditors, in a set order of priority.
Negotiable instrument	A document representing an unconditional promise to pay a sum of money (for example, a cheque, promissory note, or bill of exchange) that may be transferred to third parties by endorsement and/or delivery.
New finance/ financing	New credit provided to a company, either in the form of a new credit line or the refinancing of an existing indebtedness.
Non-bank financial institution (NBFI)	A financial institution that can offer credit products but is not licensed as a bank and is not authorised to take deposits.

TERM / CONCEPT	DEFINITION
Non-performing exposure (NPE) or non-performing loans (NPL)	Debt obligations – originating from loans or debt securities – that are in delinquent status or where repayment is unlikely.
Prudential regulation	A form of financial regulation requiring financial institutions – typically, banks and NBFIs – to implement internal risk-control systems, hold loan-loss provisioning to absorb expected losses and maintain adequate capital to absorb unexpected losses. Additional prudential requirements comprise liquidity requirements and limits on large exposures (or concentration).
Receivables	Contractual obligations to pay money owed to businesses by their customers.
Recourse	The right of a purchaser or factor to transfer the receivable(s) back to the seller or assignor and reclaim any advance if the receivable(s) cannot be collected.
Reverse factoring	A receivables product involving a buyer-led supply chain financing programme that optimises working capital by providing early payment to suppliers.
Reorganisation in insolvency	The implementation of a plan to restore a company debtor's solvency through the reorganisation of its financial liabilities, usually agreed by majority creditors and/or approved by the courts. It may potentially involve changes in ownership structure and/or company control.
Statutory subordination	Subordination of debt according to the applicable insolvency law's order of priorities.
Supply chain financing	Includes factoring, reverse factoring and other receivables finance products. In some contexts, it may also include pre-shipment financing and inventory financing.
Trade Facilitation Programme	EBRD programme described at Appendix A aimed at promoting foreign trade to, from and within the EBRD regions and offering a range of products, including guarantees, trade-related cash advances, factoring and supply chain finance.

EBRD relevant legal research

Business Reorganisation Assessment (2022) covering the insolvency regimes for business reorganisation in 38 EBRD economies, www.ebrd-restructuring.com.

Blueprint Paper on Digital Trade and the UNCITRAL Model Law on Transferable Records with the Centre for Applied Sustainable Transition Law (CASTL) (2023), www.ebrd.com/what-we-do/sectors/legal-reform/access-to-finance.html.

Covid-19 Emergency Measures in the EBRD Regions report (2023) containing an analysis of emergency measures across 38 EBRD economies, www.ebrd-restructuring.com/emergency-measures-report.

Enforcement Study (2019) covering the frameworks and processes for enforcing debt claims and security interests across Albania, Croatia, Cyprus, Greece and Ukraine, www.ebrd-restructuring.com/enforcement-study.

Factoring Survey (2018) covering the regulatory and contractual frameworks for factoring across 37 EBRD economies, www.ebrd.com/what-we-do/legal-reform/access-to-finance/factoring.html.

Survey of Insolvency and Secured Transaction Regimes (2023) containing an overview of laws relevant to new financing to distressed businesses across the EBRD regions, www.ebrd-restructuring.com/survey-of-insolvency-and-secured-transactions.

ABBREVIATION	TERM/ENTITY
ADB	Asian Development Bank
BIS	Bank for International Settlements
BCBS	Basel Committee for Banking Supervision
BBB	Build Back Better
DLT	Distributed Ledger Technologies
ECB	European Central Bank
EBRD	European Bank for Reconstruction and Development
EU	European Union
GDPR	General Data Protection Regulation
GDP	Gross Domestic Product
IFC	International Financial Corporation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund

ABBREVIATION	TERM/ENTITY
IVSC	International Valuation Standards Council
IVS	International Valuation Standards
MSME	Micro, Small and Medium-Sized Enterprises
NBFI	Non-banking financial institution
NPE	Non-performing exposure
NPL	Non-performing loan
OECD	Organisation for Economic Co-operation and Development
SDG	Sustainable Development Goal
SME	Small and Medium-Sized Enterprises
TFP	Trade Facilitation Programme
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNIDROIT	International Institute for the Unification of Private Law

Executive summary

Micro, small and medium-sized enterprises (MSMEs) are the most common type of business and the greatest contributor to employment and economic activity, not only in the EBRD regions, but globally. Yet MSMEs in many countries struggle to access the financing they need to prosper. This undermines economic resilience and growth. Furthermore, given the disruptions to global supply chains caused by Russia's invasion of Ukraine, extreme weather and the discontinuation of pandemic-related support programmes, MSMEs are in need of better access to finance now more than ever.

In many economies where the EBRD operates, the predominant source of financing is bank loans. This is problematic for MSMEs because most banks only provide credit on favourable terms against fixed assets, such as land and equipment. MSMEs often either do not have fixed assets, or do not have fixed assets of sufficient value. These factors constrain MSME access to finance and limit economic growth.

Nevertheless, MSMEs do have valuable assets in the form of receivables. These are the amounts owed to businesses by their customers, frequently arising in supply chains. Receivables financing by banks or non-bank financial institutions can generate important working capital for businesses. According to figures from the FCI, the global representative body for factoring and financing of receivables, receivables financing is growing rapidly, with factoring globally generating more than an estimated €3 trillion in 2021, notwithstanding the Covid-19 crisis.[1]

There is increasing recognition by policymakers – and the private sector – of the potential for receivables finance solutions and the role that they can play in helping to link MSMEs to so-called "anchor buyers", such as retailers, processing companies and exporters, in their supply chains. Benefits for buyers include alleviating working capital shortages of their trading partners and building stronger supply networks. Simultaneously, benefits for MSMEs include the strategic ability to plan and procure the necessary inputs to their business, while making (and financing) the necessary investments. For international financial institutions like the EBRD, there is also the opportunity to advance the green agenda by offering financial incentives for suppliers in supply chain finance programmes that meet sustainability-linked targets. Nevertheless, historically, receivables financing has been relatively undeveloped in many economies where the EBRD invests.

As highlighted by the EBRD Factoring Survey, the primary reasons for the lack of receivables financing lie in: imperfect legislation, which makes assigning receivables difficult or time consuming; uncertain or unfavourable regulatory treatment; and a relative lack of receivables-related experience and expertise in local markets. During the Covid-19 pandemic, many national authorities provided short-term relief programmes targeting MSMEs. These consisted of measures such as interest payment subsidies for bank loans or a temporary moratorium on repayment obligations.[2] However, many of these measures have now expired and MSMEs need access to new finance in a difficult credit environment. The Survey of Insolvency and Secured Transaction Regimes conducted by the EBRD's Legal Transition Team across the Bank's regions, as part of the background research for this report, reveals weaknesses in secured transactions and insolvency laws for businesses seeking new finance or working capital. These legal impediments and market disincentives need to be removed to stimulate more lending to MSMEs.

Government support and public programmes can provide important incentives and conditions for banks and non-bank financial institutions to provide receivables financing, and can stimulate a supportive credit ecosystem for MSMEs. First, national authorities can undertake targeted legal and regulatory reforms to promote factoring and supply chain finance specifically, or broader reforms to secured transactions and insolvency law to promote all kinds of receivables-finance products. Second, national authorities can deploy existing state credit guarantee schemes or central bank programmes to incentivise the private sector to provide receivables financing.

Credit guarantees from the state encourage financial institutions to develop receivables financing programmes by mitigating risk and decreasing costs due to the more favourable prudential treatment of these programmes. This increases financing to the MSME sector. Furthermore, these programmes help to build industry awareness and expertise, thus enabling banks and non-bank financial institutions to continue offering receivables financing without relying on public assistance.

[1] Industry statistics FCI. Available at: https://fci.nl/en/industry-statistics (Accessed: 31 March 2023). Global factoring volumes in 2021 increased 13.5 per cent compared with 2020 figures.

[2] EBRD (2023), Strengthening the SME framework in Türkiye: Strategic guidance to Turkish SME agency KOSGEB, https://www.ebrd.com/sites/Satellite?c=Content&cid=1395310836703&d=&pagename=EBRD%2FContent%2FContentLayout.

International financial institutions like the EBRD also have a role to play in helping the private sector by delivering programmes that support receivables financing and greener business activities. These programmes include the EBRD's Trade Facilitation Programme, which promotes trade finance and, together with the EBRD's Supply Chain Solutions Framework, supply chain financing. However, the EBRD and partner organisations also provide useful technical assistance to financial institutions interested in developing skills and knowledge in the area of receivables financing and can raise companies' awareness of supply chain solutions. In the case of the EBRD, the Legal Transition Programme can also assist authorities that want to develop their secured transactions and insolvency laws.

Publication of this report coincides with a time of growing interest in receivables finance by private sector participants, represented by organisations, such as the FCI, as well as international financial institutions, such as the EBRD, the International Finance Corporation and the Asian Development Bank. Digitalisation is providing opportunities for the growth of digital trade and receivables financing. There is increasing recognition of the benefits of digitalisation of trade documents, such as bills of exchange and warehouse receipts, and the need for governments to support paperless trade by adopting the UNCITRAL Model Law on Electronic Transferable Records (MLETR) or similar legislation. Electronic invoicing and the development of digital factoring, invoice discounting and supply chain platforms are further helping to develop the market for receivables.

The development of receivables finance is also supported by the recent adoption of new international legal and regulatory standards and guidance. The 2023 Model Law on Factoring by the International Institute for the Unification of Private Law (UNIDROIT) builds on existing secured transactions instruments[3] and provides guidance to national legislators seeking to develop domestic legal frameworks for factoring. The Model Law also supports modern receivables finance products, such as supply chain financing. It will be complemented by a Guide to Enactment for policymakers and legislators, which also touches on regulatory aspects.

This report addresses the two main types of receivables financing: purchase financing – that is, supplier-led factoring and purchaser-led reverse factoring; and loan-based financing, such as loans secured by multiple supply-chain receivables. Both types of financing help to reduce credit risk and improve liquidity for MSMEs and should be available in any economy. Nevertheless, unlike purchase-based receivables products, such as factoring and reverse factoring, loan-based receivables financing requires a more developed legal and regulatory framework that is aligned with international standards such as the 2016 UNCITRAL Model Law on Secured Transactions and the Basel Framework.

The report covers the following topics:

- **Role of new finance** (section 1). This section addresses the role of new finance in building the resilience of businesses and fostering economic recovery, especially in circumstances of financial distress where businesses may need to navigate an insolvency procedure.
- **Receivables-based financing structures** (section 2). This section outlines the role of structures that enable a business to convert its receivables to cash, illustrated with practical examples.
- **Implementation strategy** (section 3). This section proposes a strategy to bolster receivables financing and access to credit based on the identification of "core elements" – represented by key aspects of secured transactions, insolvency and regulatory frameworks – and "critical enablers", consisting of technological infrastructure, such as collateral registries, electronic invoicing systems and valuation standards.
- **Roadmap** (section 4). This section offers a plan to improve the availability of receivables financing in EBRD regions through diagnostic assessments, implementation and policy adjustment.

[3] The UNIDROIT Model Law on Factoring provides a streamlined instrument designed to facilitate both domestic and cross-border factoring, while remaining broadly consistent with the 2001 United Nations Convention on the Assignment of Receivables in International Trade and the 2016 UNCITRAL Model Law on Secured Transactions.

Introduction

This report proposes a strategy to address liquidity and working capital issues affecting businesses in the EBRD regions in the aftermath of the Covid-19 crisis and the ongoing war on Ukraine. While the report refers to some countries by way of example, it is non-country specific.

The report is intended to provide guidance to law and policymakers – including ministries, regulatory agencies and central banks – on certain legal and regulatory actions needed to unlock new financing for businesses. Specifically, the report identifies the essential features for a recovery strategy to unlock liquidity in support of distressed businesses and promote overall business and economic resilience. Furthermore, it highlights the potential of receivables financing to support economic growth and private sector activity, which are at the heart of the EBRD's transition mandate.

In the EBRD regions, much like in other parts of the world, there is a need to enter an economic recovery phase focused on longer-term sustainable development objectives and an improved investment climate. The EBRD Survey of Insolvency and Secured Transaction Regimes indicated that 34 out of the 38 economies where the EBRD invests introduced various public assistance programmes to provide emergency liquidity to local businesses.[4] Twenty-two of these economies introduced or revamped state guarantee schemes. However, only a handful of economies required participating financial institutions to take any assets, including receivables, as collateral. This was understandable at a time when many MSMEs practically ceased their operations, but recovery requires adjustments that foster market-based secured lending.

Central banks, including the European Central Bank (ECB), enlarged the spectrum of eligible collateral that banks could use to access liquidity. The ECB already accepted loans extended to SMEs as eligible collateral, but during the Covid-19 pandemic it expanded the eligibility criteria to include loans to self-employed individuals and households backed by public sector guarantees. The central banks of Cyprus, Greece, Latvia and others took similar steps. Although helpful in dealing with emergency conditions, these programmes were costly. Moreover, the indiscriminate disbursement of emergency funds during the pandemic benefited not only viable businesses, but also non-viable (or "zombie") companies.[5] Such emergency programmes are not sustainable in the long term because they do not provide sufficient liquidity for economic recovery.

In a context where many emergency public measures have been phased out, institutional and economic weaknesses – that often pre-date the Covid-19 crisis – limit the ability of many national authorities to take cohesive policy actions to foster economic growth. Furthermore, businesses face new financial difficulties. The cost of both production and borrowing is increasing at the same time as the global economy is entering recession, with inflationary prices, contraction in capital markets and a spike in interest rates. To address these issues, a business recovery and resilience strategy is needed. The strategy should address both the immediate liquidity needs of distressed businesses and longer-term development goals for the real economy. This report (in Section 2) identifies, as part of such strategy, alternative measures to financial subsidies and other costly public programmes introduced in response to the pandemic. Specifically, the report focuses on how national authorities can foster receivables financing and partner with the private sector, using state guarantees, to help businesses access finance and receivables credit products.

[4] The EBRD Survey of Insolvency and Secured Transaction Regimes (2023) includes Russia and Belarus. However in April 2022, as a result of the Russian invasion of Ukraine, the EBRD Board of Governors voted overwhelmingly to suspend Russia and Belarus from accessing the Bank's resources, under Article 8.3 of the Agreement Establishing the Bank. The EBRD currently invests in 36 economies.

[5] EBRD Transition Report 2022-23 (2023), Chapter 4, Corporate debt and business dynamism. Available at: 2022.tr-ebrd.com (Accessed: 31 March 2023).

This report pays specific attention to MSMEs, which are strategic for overall economic performance and recovery, but which have been severely affected in recent years by geopolitical events and the Covid-19 pandemic.[6] To ensure continuity in business operations that support domestic economies, distressed MSMEs need access to finance, not only to survive, but also to thrive. However, in many economies where the EBRD operates, MSMEs face obstacles to traditional sources of finance, such as bank lending, which remains the predominant form of financing in the EBRD regions. Often this is because the most valuable form of assets that MSMEs have are their receivables or the amounts owed to MSMEs from their suppliers, and banks do not offer financing products based on MSME receivables.

Receivables financing structures that transfer or use receivables as underlying security for a loan can generate important working capital for businesses. These structures can unlock finance for a business while reducing the risk for the financier – be it a bank or a non-bank financial institution (NBFI) authorised to provide such products. Sustaining domestic, regional and international trade, receivables can also promote economic recovery. Jurisdictions in the EBRD regions should thus consider reforms and initiatives aimed at exploiting the full potential of receivables financing.

Strategies that encourage the availability of credit products for distressed businesses in the EBRD regions must be tailored to the domestic needs of each country. Various domestic agencies (for example, MSMEDA in Egypt and KOSGEB in Türkiye) may support the activities of MSMEs, including, but not limited to, enhancing access to credit. The deployment of receivables products as part of any government strategy for business recovery and resilience would benefit from the support provided by these agencies and from coordination with their other assistance programmes.

Receivables finance comprises two main categories of products: purchase products and loan products. This report emphasises the role of reverse factoring, which, like factoring, is purchaser led, as well as loan products secured by multiple supply-chain receivables in establishing new financing channels for MSMEs. Receivables finance products, particularly factoring and reverse factoring, do not require substantial legal reform. Most economies where the EBRD invests already provide a sufficient legal framework for reverse factoring, which is based on an agreement between the anchor buyer and its supplier network and is therefore not subject to the same risks as for factoring, where issues can arise with respect to anti-assignment clauses, priorities and non-notification to the client. The 2018 EBRD Factoring Survey found that 35 out of the 37 EBRD jurisdictions covered permitted the transfers of future receivables under factoring agreements, an essential element for the development of any receivables product. However, initial analysis by the EBRD indicates that average factoring volumes are considerably lower in the EBRD regions than in the more developed European countries (see Appendix A).

Nevertheless, in some countries, fundamental legal issues and uncertainties in secured transactions and insolvency laws impede finance and the development of receivables financing. The 2019 EBRD Enforcement Study identified the following three main impediments to secured credit with respect to movable assets, in order of importance: (i) uncertainty around the enforcement regime, (ii) uncertainty around the legal treatment of certain security rights, particularly in receivables, and (iii) high costs, including notarisation fees, taxes and duties.

In addition, existing regulatory frameworks for NBFIs and banks might further limit the development of receivables finance. In some jurisdictions, for instance, it is unclear whether purchased products (for example, factoring) and loan products (for example, loans secured with receivables) can be offered under the same licence. In most jurisdictions, banking regulations do not recognise receivables and other movable assets as collateral that is eligible for reducing prudential requirements. This results in transactions secured by receivables sharing the same prudential treatment as unsecured loans. Addressing these persistent regulatory challenges would aid the deployment of credit products designed to support distressed MSMEs, especially where supported by steps to improve legal frameworks for security rights and effective enforcement.

This report puts receivables financing at the centre of a proposed strategy for MSME support and economic recovery in the EBRD regions. It proposes a methodology for policymakers to assess which legal and regulatory elements are needed for the further development of receivables financing and the credit system generally in their jurisdictions. It draws attention to the potential of technology that makes various aspects of receivables financing more efficient and less costly, such as trading on electronic platforms. The report, therefore, guides domestic policymakers on how to promote the greater use of receivables in the credit system and to enact targeted reforms, with widespread future benefits for MSMEs.

[6] However, this report also refers to SMEs and MSEs, particularly where these terms are preferred by governments and organisations. At present there is a lack of consistency in the use of the definition of MSME or SME, which depends on national legislation and context. User Guide to the SME Definition (European Commission User Guide to the SME Definition (European Commission www.ec.europa.eu/docsroom/documents/42921 (Accessed: 31 March 2023) “The close financial, operational and governance relationships with other enterprises make it “difficult to precisely draw the line between an SME and a larger enterprise””.

Section 1: From emergency to recovery

The recent global health crisis has economically affected countries and businesses unevenly. In EBRD regions, MSMEs have been hit more severely. The Organisation for Economic Co-operation and Development (OECD) has identified SMEs and lower-rated companies as facing tougher financing conditions and being vulnerable to fluctuating cash flows.[7] SMEs operate in sectors, such as retail, agriculture, hospitality and related industries that suffered from the closure and health measures.[8]

Moreover, the disruptions to both the supply and demand of goods and services have been felt more strongly by MSMEs as larger businesses have been in a better position to manage temporary supply shortages and price increases.[9] The pandemic exacerbated the MSME shortage of working capital in both developed and developing economies.[10] For many MSMEs, the continued reliance on extraordinary assistance programmes became a necessary source of liquidity.[11] In this context, liquidity problems are poised to increase, owing to the excessive reliance to emergency measures that are being phased out.[12] Furthermore, in the unfolding global recession, MSMEs face new challenges as the costs of production and new finance are increasing, owing to inflationary dynamics and geopolitical tensions.[13]

To support broader economic recovery and sustainable development, businesses and, in particular, MSMEs need access to new finance. While the global pandemic started out as an external shock resulting in temporary liquidity shortages, the prolonged health emergency translated into long-term general solvency issues. The sectors hit particularly hard by the pandemic have been most likely to rely on public interventions to avoid permanent closure. Even businesses that were less affected early on found themselves dependent on public interventions after months of continued liquidity shortage. The IMF has predicted that SMEs will face significant difficulties in raising capital, especially when they lack collateral.[14] Although the pandemic has been brought under control, the ability of these businesses to recover may have already been compromised and their insolvency risk is high. The war in Ukraine and rising inflation and energy costs have heightened the insolvency risk for many businesses.

This Section comprises three parts. Part A maps the liquidity problems faced by MSMEs in different financially distressed scenarios. Part B highlights the key insolvency issues that emerged during the pandemic and which remain relevant in a distressed economic and business environment. Lastly, Part C surveys the primary emergency measures that have been implemented in the EBRD regions. The Section concludes by highlighting the core challenges that must be addressed to stimulate economic recovery and sustainable development going forward.

[7] OECD (2021), Covid-19 Government Financing Support Programmes for Businesses, p. 9, 22, www.oecd.org/finance/Covid-19-Government-Financing-Support-Programmes-for-Businesses-2021-Update.pdf (Accessed: 31 March, 2023).

[8] OECD, Covid-19 Government Financing Support Programmes for Businesses, p. 9, 22.

[9] WTO (2020), Helping MSMEs Navigate the Covid-19 Crisis, p. 4, www.wto.org/english/tratop_e/covid19_e/msmes_report_e.pdf (Accessed: 31 March, 2023).

[10] OECD (2021), One Year of SME and Entrepreneurship Policy Responses to Covid-19: Lessons Learned to “Build Back Better”, www.oecd.org/coronavirus/policy-responses/one-year-of-sme-and-entrepreneurship-policy-responses-to-covid-19-lessons-learned-to-build-back-better-9a230220/ (Accessed: 31 March, 2023). For instance, SMEs operate with low cash reserves, which in the United States average 27 days.

[11] OECD (2020), The impact of COVID-19 on SME financing, OECD iLibrary, p. 24-27, https://www.oecd-ilibrary.org/economics/financing-smes-and-entrepreneurship-an-oecd-scoreboard_ecd81a65-en (Accessed: 31 March, 2023).

[12] Financing conditions are expected to become worse for SMEs throughout 2022 and beyond; See OECD (2020), The impact of COVID-19 on SME financing, OECD iLibrary, p. 31.

[13] OECD (2022), Financing SMEs and Entrepreneurs 2022: An OECD Scorecard, Lending to SMEs, OECD iLibrary. http://www.oecd-ilibrary.org/sites/e9073a0f-en/1/3/1/index.html?itemId=%2Fcontent%2Fpublication%2Fe9073a0f-en&_csp_=f3c512744374df0f64f9df449eb7e26c&itemIGO=oecd&itemContentType=book. (Accessed: 31 March, 2023).

[14] Kalemli-Ozcan, S. (2020), Covid-19 and SME Failures, (IMF) http://www.imf.org/en/Publications/WP/Issues/2020/09/25/Covid-19-and-SME-Failures-49753 (Accessed: 31 March, 2023).

A. THE ECONOMIC IMPACT OF COVID-19 PANDEMIC

The availability of capital and liquidity for MSMEs is both a short-term and a long-term policy priority. MSMEs are a primary source of employment, economic growth, innovation, and development. Recognising the critical importance of access to finance for MSMEs, prior to the Covid-19 pandemic, most countries in the EBRD regions benefited from dedicated programmes aimed at supporting such financing.[15] Access to new finance for MSMEs is pivotal to restarting economic activity and supporting employment. Failure to offer MSMEs sufficient financing opportunities presents not only financial stability risks, but the potential for widespread default on loans. Debt moratoria introduced as temporary measures by many governments affected the frequency of repayments and extension of maturities caused loans to remain on lenders' balance sheets longer than usual.[16]

As economic recovery lags in the EBRD regions, the solvency of lenders may be impaired, rippling into banking problems – particularly in economies where banks' balance sheets are already distressed by problem loans – and dragging on banking operations and future lending.[17] Thus, the extension of new finance to MSMEs in distress promotes recovery, resilience and financial stability, as well as wider social stability given their central role in any economy.

The lack of access to credit for MSMEs and factors such as the high cost of credit and its limited availability without security over immovable assets, such as land or buildings, is a global phenomenon. The situation is no different in the EBRD regions. In EBRD jurisdictions that are also members of the European Union (EU), the percentage of rejected loan applications for SMEs is higher than the EU average.[18] The issue is often related to the lack of collateral. For instance, Lithuanian firms' dissatisfaction with collateral requirements is twice the EU average.[19] While the collateral requirements generally decreased during the pandemic, being substituted with credit guarantee schemes, their gradual withdrawal is expected to increase the demand for collateral.[20]

Policymakers and relevant stakeholders should encourage the development of market-based recovery mechanisms to provide credit to MSMEs, especially those in distress. Notwithstanding the idiosyncrasies of every business, the financing needs of MSMEs fall under two broad categories. One is the need for general financing support to provide liquidity as emergency measures are mostly phased out. The other is the need for market mechanisms to aid insolvent or soon-to-be insolvent MSMEs which have a prospect of successful financial restructuring and future viability.

[15] See Appendices C and D.

[16] OECD (2022), Financing SMEs and Entrepreneurs 2022: An OECD Scorecard, Lending to SMEs, OECD iLibrary. http://www.oecd-ilibrary.org/sites/e9073a0f-en/1/3/1/index.html?itemId=%2Fcontent%2Fpublication%2Fe9073a0f-en&_csp_=f3c512744374df0f64f9df449eb7e26c&itemIGO=oecd&itemContentType=book. (Accessed: 31 March, 2023).

[17] Arner, D.W., Avgouleas, E. and Gibson, E. (2020) Financial Stability, resolution of systemic banking crises and covid-19: Toward an appropriate role for public support and bailouts, University of Hong Kong Faculty of Law Research Paper No. 2020/044), p. 47 and 49, SSRN. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3664523 (Accessed: 31 March, 2023).

[18] EBRD (2020), Country Diagnostic Estonia, Latvia and Lithuania, www.ebrd.com/publications/country-diagnostics/estonia-latvia-lithuania (Accessed: 31 March, 2023), SMEs report access to finance as one of the key barriers, expressed through the share of SMEs that have been rejected loan applications – in Estonia, 11 per cent, in Latvia, 17 per cent, and in Lithuania, 24 per cent of SMEs, compared with the EU average of 6.5 per cent in 2018.

[19] EBRD (2020), Country Diagnostic Estonia, Latvia and Lithuania, p. 31.

[20] OECD (2022), Financing SMEs and Entrepreneurs 2022: An OECD Scorecard, Lending to SMEs, OECD iLibrary. http://www.oecd-ilibrary.org/sites/e9073a0f-en/1/3/1/index.html?itemId=%2Fcontent%2Fpublication%2Fe9073a0f-en&_csp_=f3c512744374df0f64f9df449eb7e26c&itemIGO=oecd&itemContentType=book. (Accessed: 31 March, 2023).

i. Generalised Economic Distress

A generalised economic distress currently affects most of the countries in the EBRD regions, due to the lingering effects of the pandemic and the disruption to supply chains, as well as the rise in energy prices since 2022 caused by the war in Ukraine.[21] In developing economies, the MSME recovery rate is expected to be slower.[22] This "economic long Covid" exacerbates the already growing ratio of public debt to gross domestic product (GDP).[23]

During the Covid-19 pandemic, many MSMEs relied on exceptional economic measures to meet their liquidity needs.[24] Given that most measures focused on stimulating borrowing through the banking system while easing fiscal pressure and curbing various costs for companies that suffered most, the result was a surge in bank loans in most EBRD countries.[25] Exposure of banks to troubled economic sectors increased correspondingly to the higher levels of corporate indebtedness,[26] especially prevalent among MSMEs.[27] Some of the companies benefiting from this emergency liquidity need to modify business models and structures because, in many cases, consumer preferences have changed irreversibly. Since emergency measures have been phased out, economic recovery is expected to be uneven, with "winners" and "losers" across different sectors.

In this environment, market-based recovery mechanisms should be introduced that help MSMEs transition into a new economic landscape without straining public resources. New policies, laws and infrastructures may need to be designed and adopted in the EBRD regions. The risks of inaction are insolvencies of otherwise viable MSMEs, which would have ripple effects for bank balance sheets and, ultimately, the economy as a whole.[28] Market-based mechanisms should be developed and offered as part of a broader strategy aimed to assist businesses, and MSMEs in particular, to gain access to new finance both pre- and during insolvency.

Digitalisation can play a key role in designing a strategy, particularly in reducing the cost of financing to MSMEs and supporting sustainable economic development. Digital finance has taken on an even more prominent role during the Covid-19 pandemic. Efforts to digitise property and collateral registries, credit registries, securities exchanges and platforms supporting secondary markets, as well as the availability of electronic invoicing, reduce the cost of new finance to distressed SMEs.

As described at Appendix A, the EBRD supports factoring and supply chain finance and is actively engaged in working on digital platforms and technologies to digitise and improve the receivables finance business. Several technological developments have already had a positive impact. For example, financiers can remotely consult electronic credit and collateral registries to assess the creditworthiness of potential borrowers, verify electronic invoices to ensure the goods have been delivered or services supplied and access platforms to transfer receivables in the secondary market.

Regulatory regimes should be designed to fully leverage these main digitalisation trends. An ideal regime would address risks while encouraging digital innovation, competition and sustainable development.[29] To this end, data protection standards, regulation and technology (RegTech) initiatives that facilitate compliance, as well as innovation hubs and sandboxes, are critical to support new financing for MSMEs in distress and stimulate long-term sustainable development.

As described further below, providing access to new finance to MSMEs fits within the broader strategies of many international organisations to "build back better".[30] Specifically, the EBRD's Strategic and Capital Framework for 2021-2025, seeks to accelerate transition through the crisis and recovery from the Covid-19 pandemic and sets out accelerating digital transition as one of its three cross-cutting themes.[31] The EBRD's new Digital Approach encourages policy dialogue for legal and regulatory reforms to promote innovation and competition in digital markets and support the digitalisation of financial institutions, SMEs and supply chains.[32]

[21] The EBRD Regional Economic Prospects report indicates that the GDP contractions of many economies have been larger than those registered in 2009, during the aftermath of the globalfinancial crisis; see EBRD (2020) Regional Economic Prospects, Covid-19 Early estimates of the damage, uncertain prospects, www.ebrd.com/what-we-do/economic-research-and-data/rep.html (Accessed: 31 March, 2023). See also EBRD (2022) War in Ukraine and inflation slow growth in EBRD regions, www.ebrd.com/news/2022/war-in-ukraine-and-inflation-slow-growth-in-ebrd-regions.html (Accessed: 31 March, 2023), 'Oil prices are elevated and gas prices in Europe are above historical highs and around four times the level in the United States, putting European producers at a disadvantage'.

[22] The World Bank indicates that in emerging and developing economies, the recession is deeper, and recovery will be slower, especially in jurisdictions that experienced large Covid-19 outbreaks and in low-income countries; see OECD (2022), Financing SMEs and Entrepreneurs 2022: An OECD Scorecard, Lending to SMEs, OECD iLibrary. http://www.oecd-ilibrary.org/sites/e9073a0f-en/1/3/1/index.html?itemId=%2Fcontent%2Fpublication%2Fe9073a0f-en&_csp_=f3c512744374df0f64f9df449eb7e26c&itemIGO=oecd&itemContentType=book. (Accessed: 31 March, 2023) and Kalemli-Ozcan, S. (2020), Covid-19 and SME Failures, (IMF) http://www.imf.org/en/Publications/WP/Issues/2020/09/25/Covid-19-and-SME-Failures-49753 (Accessed: 31 March, 2023).

[23] Wolf, M. (2022), The looming threat of long financial covid, Subscribe to read | Financial Times. Financial Times, http://www.ft.com/content/7ddd7ae4-f310-4c8e-a3f3-054ed6e51250 (Accessed: 31 March, 2023).

[24] For a survey of the measures adopted in 197 jurisdictions, see International Monetary Fund, Policy Responses to Covid-19, www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-Covid-19.

[25] In the EU, bank loans have increased significantly, in particular for companies operating in sectors that have been badly hit by the pandemic; see Andrea Resti, When and how to Unwind Covid Support Measures to the Banking System?, Economic Governance Support Unit (EGOV) Directorate-General for Internal Policies PE659.650 (March 2021), p. 11. In Serbia, despite the introduction of a new credit guarantee scheme business lending decelerated and the number of rejected loan applications increased. OECD (2022), Financing SMEs and Entrepreneurs 2022: An OECD Scorecard, Lending to SMEs, OECD iLibrary. http://www.oecd-ilibrary.org/sites/e9073a0f-en/1/3/1/index.html?itemId=%2Fcontent%2Fpublication%2Fe9073a0f-en&_csp_=f3c512744374df0f64f9df449eb7e26c&itemIGO=oecd&itemContentType=book. (Accessed: 31 March, 2023).

[26] Data from the BIS indicate that the core debt of banks – for example, credit to private non-financial sector – rose significantly across economies. In particular, for emerging market economies the aggregate share of core debt to GDP changed from 138.6% in 2018 to 165.8% in Q3 of 2020; for advanced economies, in the same time period, the share of core debt to GDP rose from 164.7% to 179.3%; see Total credit to the private non-financial sector (core debt) as a percentage of GDP, www.stats.bis.org/statx/srs/table/f2.1?p=20203&c=.

[27] OECD (2021), One Year of SME and Entrepreneurship Policy Responses to Covid-19: Lessons Learned to "Build Back Better", p. 20, www.oecd.org/coronavirus/policy-responses/one-year-of-sme-and-entrepreneurship-policy-responses-to-covid-19-lessons-learned-to-build-back-better-9a230220/ (Accessed: 31 March, 2023).

[28] OECD (2021), One Year of SME and Entrepreneurship Policy Responses to Covid-19: Lessons Learned to "Build Back Better", p. 29-20, www.oecd.org/coronavirus/policy-responses/one-year-of-sme-and-entrepreneurship-policy-responses-to-covid-19-lessons-learned-to-build-back-better-9a230220/ (Accessed: 31 March, 2023).

[29] Zetzsche, D.A. et al. (2020), Fintech toolkit: Smart Regulatory and market approaches to financial technology innovation, University of Hong Kong Faculty of Law Research Paper No. 2020/027, SSRN, http://www.papers.ssrn.com/sol3/papers.cfm?abstract_id=3598142 (Accessed: 31 March, 2023).

[30] Arner, D.W. et al. (2020), Digital Finance & the COVID-19 crisis, University of Hong Kong Faculty of Law Research Paper No. 2020/017, SSRN, http://www.papers.ssrn.com/sol3/papers.cfm?abstract_id=3558889 (Accessed: 31 March, 2023).

[31] See EBRD's Strategic and Capital Framework, www.ebrd.com/what-we-do/strategy-capital-framework.

[32] See EBRD adopts first Digital Approach (EBRD, November 2021), www.ebrd.com/news/2021/ebrd-adopts-first-digital-approach.html.

ii. Waves of Insolvency

Economic downturns have historically been linked to an increase in the number of Non-performing Loans (NPLs) and insolvencies. A 2022 EBRD paper commented that "the NPL exposure focuses [a] bank's internal resources on loan recovery work, including repossession of collateral and its disposal", adding that such diversion of resources is costly and comes "at the expense of expanding business".[33] Such findings have been corroborated by the World Bank that indicated, more generally, that an increase in NPLs accompanied by company vulnerability and inadequate insolvency systems sets up businesses for a perfect storm of failure.[34]

Despite a current lull in insolvency filings, a wave of business insolvencies may arrive soon, given that business losses accumulate over time.[35] In some countries, for example the United Kingdom, the number of insolvency proceedings rose in 2022.[36] The Bank for International Settlements (BIS), which promotes financial stability through international cooperation,[37] found that up to 50 per cent of companies, in developing and developed economies, have likely experienced liquidity shortages during the first year of the pandemic that hinder the ability to service their debts.[38] Furthermore, surveys focused on small businesses across the world have indicated that the rate of closures reached 25 per cent in the first five months of 2020 and levelled at 15 per cent for the following months.[39] Yet, the number of business insolvency filings remained low in the first year of the pandemic.[40]

There are several explanations for such a counterintuitive drop. As the pandemic evolved and emergency liquidity measures were implemented, many companies have adapted by cutting non-essential expenditures, such as certain non-essential personnel.[41] Furthermore, temporary insolvency-related measures, adopted in many jurisdictions, have limited the number of insolvency filings. As these insolvency-prevention measures are being phased out, it is important to provide financial support to viable MSMEs.

Curbing this impending wave of insolvencies should be a priority for policymakers because it will put significant strain on the economy. While the economy benefits from the timely and orderly liquidation of non-viable businesses, viable MSMEs experiencing difficulties should be given the opportunity to adjust their operations to new economic and business conditions. In this context, assets can be re-directed to stimulate economic recovery. In addition, this crisis can be transformed into an opportunity to steer activities towards sustainability, with the right support mechanisms and incentives.

Depending on the specific business and the applicable legal and regulatory frameworks in any given jurisdiction, mechanisms supporting business rescue should be available before the commencement of formal insolvency proceedings, as well as during such proceedings. These mechanisms include out-of-court work-outs, the facilitation of business reorganisation during insolvency, expeditious 'pre-packaged' insolvency restructuring arrangements and the sale of a business as a going concern. These procedural mechanisms should be supported by new finance that may be necessary not only to finance the ongoing liquidity needs of the business but also to facilitate longer-term business reorganisation.

[33] EBRD (2022), WP, Cross-border spillovers from reducing non-performing loans, www.ebrd.com/publications/working-papers/cross-border-spillovers-from-reducing-non-performing-loans (Accessed: 31 March, 2023).

[34] World Bank (2022), NPL Resolution, Insolvency and SMEs in Post-Covid-19 Times, www.worldbank.org/en/events/2022/05/12/npl-resolution-insolvency-and-smes-in-post-covid-19-times (Accessed: 31 March, 2023).

[35] Muro S. & Uttamchandani M. (2021), The Calm Before the Storm: Early Evidence on Business Insolvency Filings After the Onset of Covid-19, Covid-19 Notes Finance Series, p. 5, http://documents1.worldbank.org/curated/en/962221615273849133/pdf/The-Calm-Before-the-Storm-Early-Evidence-on-Business-Insolvency-Filings-After-the-Onset-of-Covid-19.pdf.

[36] UK National Statistics, Commentary - Company Insolvency Statistics April to June 2022, www.gov.uk/government/statistics/company-insolvency-statistics-april-to-june-2022/commentary-company-insolvency-statistics-april-to-june-2022.

[37] See more on the Bank for International Settlements (BIS), www.bis.org/about/index.htm?m=1%7C1.

[38] The analysis was based on a sample of 40,000 listed and large unlisted non-financial firms over 26 economies; see BIS, Covid-19 and corporate sector liquidity (BIS Bulletin No. 10, 28 April 2020), www.bis.org/publ/bisbull10.pdf.

[39] See Facebook, World Bank, OECD, 2021 Global State of Small Business Report (April 2021), p. 5, www.dataforgood.fb.com/wp-content/uploads/2021/04/Global-State-of-Small-Business-Report-April-2021.pdf.

[40] Muro S. & Uttamchandani M. (2021), The Calm Before the Storm: Early Evidence on Business Insolvency Filings After the Onset of Covid-19, Covid-19 Notes Finance Series, p. 13-15, http://documents1.worldbank.org/curated/en/962221615273849133/pdf/The-Calm-Before-the-Storm-Early-Evidence-on-Business-Insolvency-Filings-After-the-Onset-of-Covid-19.pdf. This trend has been noted in general in a number of jurisdictions, see OECD (2021), One Year of SME and Entrepreneurship Policy Responses to Covid-19: Lessons Learned to "Build Back Better", p. 21, www.oecd.org/coronavirus/policy-responses/one-year-of-sme-and-entrepreneurship-policy-responses-to-covid-19-lessons-learned-to-build-back-better-9a230220/ (Accessed: 31 March, 2023).

[41] Apedo-Amah M. et al. (2020), Unmasking the Impact of Covid-19 on Businesses Firm Level Evidence from Across the World (Policy Research Working Paper 9434, FCI, World Bank, 2020).

Build Back Better

Build Back Better (BBB) policies have been adopted by the EBRD, OECD, and the UN. As the Covid-19 emergency measures to provide liquidity and protect livelihoods and businesses are phased out, a key question is how to ensure a fairer, more sustainable and resilient economic future. BBB policies have generally focused on investments and economic reforms that will reduce the likelihood of future economic shocks and improve the ability of the economy to limit future economic downturns. Investing in trade finance, supporting innovation, and facilitating inclusive access to credit are the cornerstones of BBB policies.

EBRD Strategy for a Resilient and Sustainable Future 2021-2025

The EBRD Strategic and Capital Framework sets out the EBRD's strategic aspirations for a Resilient and Sustainable Future over a five-year period. This Strategy highlights six transition qualities to help countries transition to a sustainable market economy: competitive, well-governed, green, inclusive, resilient, and integrated. The Strategy also sets out three cross-cutting themes, including promoting access to finance as a tool to achieve equality of opportunity.

B. KEY INSOLVENCY ISSUES

On a global scale, the pandemic caused the adoption of several stark measures by national authorities to contain the risk of contagion, which entailed a direct and severe interference with existing contractual relationships. In some sectors, business activity was reduced while in others it temporarily stopped. This situation placed many businesses in default, especially on mid- to long-term contracts as well as general financing contractual arrangements. More importantly, lockdowns, limitations to imports/exports and similar measures had an immediate negative effect on cash flows, quickly generating severe liquidity tensions across economies. Those more intensely affected were MSMEs and in particular, MSMEs whose business model was altered for a longer period. MSMEs have suffered most acutely from liquidity shortages during the pandemic.

Under normal circumstances, shortage of liquidity and widespread default on financing contracts entail almost certain insolvency, which is often defined as the debtor's inability to pay debts as they fall due. In the best-case scenario, MSMEs found themselves in a situation of "likelihood" of insolvency, which is also a condition for entry into hybrid insolvency proceedings in many states.[42] From the lenders' perspective, the exceptional situation described generated an immediate risk of exponential growth of NPLs and asset deterioration, which, if materialised, could have generated solvency crises in national financial sectors, particularly among banks with higher exposure to MSME loans. On the institutional side, most (if not all) court systems were unable to efficiently adjudicate the rise in contractual litigation and initiation of formal insolvency proceedings, causing serious damage to the implementation of the rule of law.

Contract law, insolvency law and banking regulations are conceived for situations of normality. The ordinary functioning of rules was inadequate for the exceptional situation caused by the Covid-19 measures. Governments reacted by adopting emergency legislation. In the case of insolvency, rules seeking timely filing for insolvency proceedings by debtors were suspended, particularly rules related to the "duty to file". Such rules are normally triggered against inactive debtors (for example, its directors) when a period of time has passed (ranging, normally, from weeks to two to three months) from the time that they knew - or ought to have objectively known - that the business would become insolvent, in the sense given to the term insolvency in the relevant legislation (cash flow test being the relevant one in this case).[43]

Similar temporary measures were implemented in countries where a wrongful trading system was in place. Imposed measures also prevented creditors from successfully filing for formal insolvency proceedings, either because filing was not allowed, or a petition would not be given procedural effect. The suspension of the right to file for insolvency concerned in-court, "fully-fledged" proceedings. Out-of-court or hybrid proceedings were not affected. This is consistent with the nature of this type of solution, which requires voluntary cooperation by the debtor and its objective is, precisely, to prevent the opening of formal proceedings.

Further, the pressing need for liquidity moved jurisdictions to implement temporary rules to enhance access to finance, lifting certain insolvency restrictions. On the one hand, jurisdictions safeguarded the provision of credit during and in the immediate aftermath of emergency measures. The most widely adopted measure concerned the recognition of a safe harbour from avoidance provisions for credit provided during this period. Thus, if the borrower became insolvent at a later stage, a financing transaction could not be set aside. The measure would cover: i) financing provided at a higher interest rate, reflecting the borrower's limited access to funds and its higher risk (provided there was no abuse or fraud), and ii) the repayment of such loans, which may otherwise have been challenged based on an alleged undue preference.

Protection against avoidance actions based on preference was particularly relevant for several reasons. Because of cash shortages, often entrepreneurs during this complicated period had to choose which due and liquid debts to pay. Uncertainty with respect to payment terms, especially those required to ensure the continuation of business activity, could have caused great damage. The renewal of lines of credit, commercial credit instruments and loans aimed at financing working capital thus depended on there being a safe harbour from any avoidance actions.

In times of uncertainty and credit shortage, often the likely candidate - sometimes the only one willing to provide financing - are companies belonging to the same group, equity holders and/or company directors. These finance providers are already invested in the business and hence stand to lose more than the rest. To facilitate the flow of such financing, several jurisdictions suspended the rules that subordinate loans from "specially-related parties", so they would rank, in insolvency, according to the general rules determining the hierarchy of claims (for example, loans from shareholders would be unsecured, privileged or secured depending on the type of loan).

[42] Hybrid procedures are reorganisation in nature and most of the negotiations take place out-of-court. Such procedures facilitate reorganisation and restore solvency with minimal court intervention.

[43] The alternative to duty to file provisions is "wrongful trading". Debtors/company directors must take action to minimise damage to creditors in the "twilight period" around insolvency. The type of action required is not defined, and hence debtors/directors may pursue courses of action that do not necessarily involve filing for formal proceedings. This model is used in common law jurisdictions, although its use is now more frequent in civil law jurisdictions, especially since it has been adopted as best practice (see UNCITRAL Legislative Guide on Insolvency Law, Part IV, www.uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/19-11273_part_4_ebook.pdf). During the pandemic, wrongful trading provisions in many countries were also suspended.

The statutory subordination of loans from "specially-related parties" assumes that equity holders (and group companies) benefit from insider information that is not available to the other creditors. Furthermore, it is justified with the argument that the ownership of the business entails certain benefits that are beyond the reach of creditors, and hence higher risk must be accepted by equity-holders. These arguments become less convincing when financing is only available from related parties. The softening of statutory subordination rules during the Covid-19 pandemic seems to have worked adequately.[44]

The foregoing insolvency-related emergency measures were coupled, in most jurisdictions, with subsidies, guarantees and other public support mechanisms aimed at keeping the economy moving during the pandemic. As lockdowns and other restrictions were lifted, emergency legislation, including relating to insolvency, was also phased out.[45] The combination of economic stimulus and exceptional measures put a lid on the number of insolvency cases in many jurisdictions.[46] However, this may be just a temporary state with substantial damage to businesses lurking under the surface. To minimise the damage, and to avoid overburdening court systems, EBRD economies need to have adequate insolvency systems in place that do not make it necessary for businesses in financial difficulties to undergo full judicial proceedings.

In line with international standards, and consistent with the recent EU Restructuring Directive,[47] jurisdictions should provide for adequate out-of-court or hybrid procedures to deal with business distress from an early stage, as well as an efficient and expedient liquidation system. In accordance with the 2022 EBRD Business Reorganisation Assessment, about half of the 38 participating jurisdictions in the EBRD regions offer hybrid reorganisation procedures alongside court reorganisation and liquidation proceedings, with different degrees of compliance with international standards.[48] Given the likely financial stress experienced by many businesses in the aftermath of the pandemic and consistently with the strategy proposed in this report to "build back better", insolvency systems ought to include the following features:

- Access to proceedings aimed to deal with financial distress should be easy, especially for the debtor. While both cash flow and balance sheet insolvency tests are sufficient to access formal proceedings, jurisdictions ought to put in place efficient proceedings, which minimise court involvement (so-called 'hybrid' proceedings) or offer an alternative forum to the court. Actual insolvency should not be a requirement in these proceedings to facilitate early action by the debtor.
- Debtors should be encouraged to use hybrid reorganisation proceedings to prevent a subsequent insolvent liquidation. In this regard, especially with MSMEs, allowing the debtor to continue operating its business through the proceedings is paramount.
- Hybrid reorganisation-type proceedings should provide for a stay in enforcement against the debtor for a limited period. The stay should generally include secured claims, so long as the collateral is necessary for the continuation of the business. Creditors ought to be allowed to force a liquidation when the business has no objective viability.
- Pre-insolvency entitlements need to be respected, both in out-of-court and formal insolvency proceedings. Secured creditors, both in case of rights *in rem* and of others, including fiduciary transfers of the collateral, ought to enjoy absolute priority over the proceeds of the collateral, after deducting, where applicable, the fee of the insolvency administrator or enforcement officer. It is particularly important for lenders that this priority covers common as well less frequently used transactions in the relevant jurisdictions, including outright transfers and the perfection of security rights over receivables.

[44] The exceptional insolvency measures included in the text are those which we consider most relevant, but there were other measures, depending on the special context in each jurisdiction.

[44] For an analysis of the prudential measures taken, see Borio C., The Prudential Response to the Covid-19 Crisis (Basel, 30 June 2020), www.bis.org/speeches/sp200630a.pdf.

[45] For the specific situation in the relevant economies of operations of the EBRD, see Part C below.

[46] See www.blogs.worldbank.org/psd/calm-storm-early-evidence-business-insolvency-amid-covid-19.

[47] Directive (EU) 2019/1023 of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32019L1023.

[48] EBRD (2022), Business Reorganisation Assessment Main Report, p. 86, www.ebrd-restructuring.com/main-report (Accessed: 31 March, 2023).

- To ensure the continuation of the activity of viable businesses, the insolvency framework should render unenforceable *ipso facto* clauses and covenants directly linking termination rights with the commencement of reorganisation proceedings. Similarly, an adequate treatment of executory contracts during negotiations of a reorganisation agreement, including the disclaimer of onerous contracts ought to be put in place.
- Reorganisation agreements (and any prior consensual restructuring agreements negotiated out-of-court as part of a workout) concluded in good faith and on commercial terms need to be protected against avoidance actions to support a rescue culture and no automatic subordination should ensue only because the lender is a party related to the debtor.
- New finance provided during the negotiation of a reorganisation agreement (interim financing) or for the implementation of the agreement needs to be protected and, where possible, be given priority in recognition of the lender risk and context. Without this protection, especially in a period of uncertainty and economic volatility, new finance will not be available and viable business projects will fail. Protection can be achieved, in addition to the elimination of any subsequent avoidance risk, by recognising the validity and full effect of security rights over collateral of the debtor as well as by granting a sufficient level of priority for unsecured finance over the general estate of the debtor in case the reorganisation fails and liquidation-type insolvency proceedings are opened. In the EBRD regions, new financing (whether in the form of interim financing or as part of a reorganisation plan) is expressly permitted in at least one reorganisation-type insolvency procedure in 26 EBRD economies, however the legislative provisions recognising the role of new financing are underdeveloped. Statutory protections from avoidance actions for new finance provided during a reorganisation procedure are, however, present in the legislation of only 21 of these economies.[49]
- Jurisdictions ought to provide the framework enabling the sale of the business as a going concern in insolvency proceedings since sale of the business as a whole may permit the liabilities of the business to be left behind, thereby ensuring its survival and maximising returns to creditors. This entails the inclusion of several special rules concerning the continuation and assignment of contracts (which would not need the counterparty's agreement), transparency in the identification of the purchaser and the formation of the agreement concerning the sale of a business, etc.

Furthermore, policymakers should consider the development of more MSME-centric insolvency regimes. MSMEs often cannot afford the significant advisory costs associated with business reorganisation and are not able to access the necessary business and legal guidance. Simplification and expediency of insolvency proceedings for MSMEs is at the heart of the EBRD Core Insolvency Principles and the World Bank's Principles for Effective Insolvency and Creditor/Debtor Regimes, which highlight in some detail the need to streamline procedures for micro and small enterprises (MSEs). MSEs are also part of a much larger initiative by the United Nations Committee for International Trade Law (UNCITRAL), which has issued recommendations on MSE insolvency and has added a new chapter 5 on MSEs to its UNCITRAL Legislative Guide on Insolvency Law.[50] UNCITRAL Recommendation B.4. proposes that: "States should ensure that a simplified insolvency regime provides for simplified liquidation and simplified reorganization".[51]

The EU Restructuring Directive also supports the need for a simplified regime for SMEs.[52] For example, Article 8 of the Directive provides that "Member States shall make available online a comprehensive checklist for restructuring plans, adapted to the needs of SMEs. The checklist shall include practical guidelines on how the restructuring plan has to be drafted under national law". This provision aims to reduce advisory costs for debtors and provide guidance to SMEs on restructuring plans without necessarily engaging specialised advisors.

[49] EBRD Business Reorganisation Assessment (2022), Annex 6, Protection of New Financing, www.ebrd-restructuring.com/storage/uploads/documents/6.pdf.

[50] See www.uncitral.un.org/en/texts/insolvency/legislativeguides/insolvency_law.

[51] See www.uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/part_5_en.pdf.

[52] Directive (EU) 2019/1023 of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32019L1023.

Some EU Member States have introduced special regimes for SME insolvency, including Ireland[53] and Spain.[54] The United States has added Sub-Chapter 5 to Chapter 11 to allow small businesses with aggregated debt that does not exceed $2.75 million to reorganise their claims under a streamlined procedure. With the Covid-19 emergency legislation, this limit was increased to $7.5 million for an initial period of one year until March 2021.[55] The higher emergency limit was subsequently extended for one year by the enactment of the Covid-19 Bankruptcy Relief Extension Act of 2021 (Congress of the United States, 2021). In June 2022, the Correction Act extended this higher threshold for two more years, until June 2024.

C. EMERGENCY MEASURES AND THEIR PHASING OUT

A variety of emergency measures were adopted in EBRD regions to manage the pandemic-caused economic crisis. Most, have been phased out, especially those related to insolvency. This sub-Section provides an overview of those measures that include the following: monetary policies to reduce the cost of lending;[56] budgetary and fiscal policies, including the suspension of tax collection, subsidies, and state credit guarantee schemes;[57] and legal and regulatory policies, including measures to curb corporate insolvencies, facilitate debt restructuring, provide regulatory forbearances and incentivise bank lending.[58] See Table 1 (Emergency Measures) below and Appendices C and D. More permanent policy measures now need to be adopted to promote a sustained economic recovery and greater resilience, as well as to reduce the risks associated with the removal of these emergency measures. Consideration can be given to the repurposing of any existing support measures (see Appendix H). In this context, more is needed to address the long-term liquidity crisis facing MSMEs.[59]

[53] In Ireland, a rescue process for small and medium enterprises, known as the Small Company Administrative Rescue Process (SCARP), was introduced in December 2021, by the Companies (Rescue Process for Small and Micro Companies) Act 2021. See https://www.scarp.ie/.

[54] In Spain, the Law 16/2022, of 5 September, amending the revised text of the Insolvency Law, as approved by Royal Legislative Decree 1/2020, of 5 May, implements Directive (EU) 2019/1023 and introduces a number of amendments, including a new streamlined insolvency procedure for micro-sized companies.

[55] See A Guide to the Small Business Reorganization Act of 2019, www.flsb.uscourts.gov/sites/flsb/files/documents/Guide_to_the_Small_Business_Act_of_2019_%28Hon._Paul_Bonapfel_rev._06-2022%29.pdf.

[56] On monetary policies during the pandemic, see Thomas Harjes et al. (2020), Monetary and Financial Policy Responses for Emerging Market and Developing Economies, (IMF Special Series on Covid-19, June 2020), www.imf.org/en/Publications/SPROLLs/covid19-special-notes#mfp.

[57] Alberola-Ila E. et al, (2020), The Fiscal Response to the Covid-19 Crisis in Advanced and Emerging Market Economies, BIS Bulletin No 23, www.bis.org/publ/bisbull23.htm (Accessed: 31 March, 2023).

[58] For an analysis of the prudential measures taken, see Borio C., The Prudential Response to the Covid-19 Crisis (Basel, June 2020), www.bis.org/speeches/sp200630a.pdf.

[59] For an overview of the emergency measures adopted in EBRD jurisdictions, see Peter Sanfey et al, Covid-19 Repository of Policies: EBRD Policy Comparator, www.ebrd.com/what-we-do/economic-research-and-data/cse-economists/covid19-repository-of-policies-ebrd-policy-comparator.html.

TABLE 1: EMERGENCY MEASURES (2020-2021) IN SELECTED EBRD ECONOMIES [60]

	MONETARY POLICIES		BUDGETARY AND FISCAL POLICIES				LEGAL AND REGULATORY POLICIES			
							Insolvency	Regulation		
	Exchange Rate Adjustments	Cut of Policy Rate	Tax Deferrals/ Reliefs	Subsidised Loans	Public Guarantees	Sector Specific Measures	Suspension of Insolvency Proceedings	Loan Payment deferral	Release of prudential buffers	Adjustments of prudential policies
Armenia	✘	✔	✔	✔	✔	✔	✘	✔	–	✘
Egypt	✘ ***	✔	✔	✔	✔	✔	✘	✔	–	✘
Georgia	✘	✔	✔	✔	✔	✔	✘	✔	–	✔
Greece	✘	✔	✔	✔	✔	✔	✘	✔	✔	✔
Kazakhstan	✔	✔	✔	✔	✔	✔	✔	✔	✔	✔
Moldova	✘	✔	✔	N/A	✔	✔	✘	✔	–	✔
Montenegro	✘	✘	✔	✔	✔	✔	✘	✔	–	✔
Serbia	✔	✔	✔	✔	✔	?	✘	✔	–	✘
Türkiye	✔	✔	✔	✔	✘ *	✔	✔	✔	–	✔
Ukraine	✔	✔	✔	✔ **	✔	✔	✔	✔	–	✔

* However, any loans guaranteed by the Turkish Ministry of Finance-supported Credit Guarantee Fund may have been perceived as loans backed by public guarantees.

** A credit holiday was introduced by the state-owned PrivatBank for SMEs up until the end of May 2020.

*** No exchange rate adjustments were implemented, but foreign currency reserves were used to control exchange-rate volatility.

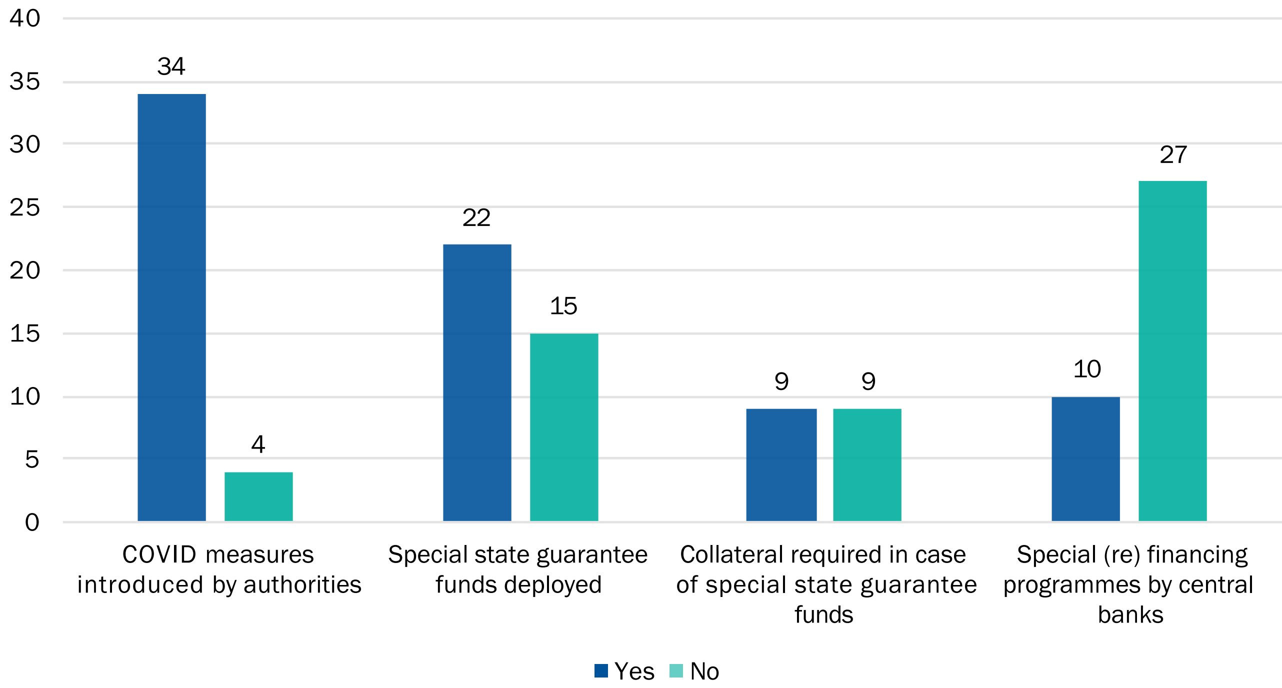
N/A lack of available information.

– the criterion does not apply.

[60] As of publication of this report, most of these emergency measures may no longer be in place.

The EBRD Survey of Insolvency and Secured Transaction Regimes of 38 economies revealed that 34 economies introduced some measures specific to credit to assist businesses in navigating the crisis. Notably, 17 economies deployed state guarantee schemes and nine provided special refinancing assistance, particularly to SMEs. Such assistance targeted the financing of working capital, payment of salaries, the temporary suspension of principal and other charges associated with repayment of loans, the suspension of measures that negatively impact credit rating of companies and the easing of a duty to file for insolvency. Interestingly, as revealed by a further analysis of emergency measures contained in the publication 'Covid-19 Emergency Measures in the EBRD Regions' fewer than half of the economies where the EBRD invests (18 in total) introduced emergency insolvency legislation. Covid-19 banking regulations and tax relief for businesses in the EBRD regions were more popular and widespread than emergency insolvency legislation. Thirty-three economies introduced emergency banking regulations and another 33 economies introduced tax relief aimed at supporting businesses.[61]

Figure 1: State support during the Covid-19 crisis in EBRD regions



Note: *This chart shows respondents' feedback to the EBRD Survey of Insolvency and Secured Transaction Regimes on specific measures employed by governments to combat the financial crisis caused by Covid-19 in the EBRD regions. The vertical axis reflects the number of EBRD economies.*

[61] In April 2022, the EBRD completed a short survey on Covid-19 emergency legislation enacted in the area of insolvency across all EBRD economies.The results of the survey are published in the EBRD Covid-19 Emergency Measures in the EBRD Regions report (2023) www.ebrd-restructuring.com/emergency-measures-report, and in the EBRD Transition Report 2022-2023 (Box 4.1.) 2022.tr-ebrd.com.

EBRD COVID-19 PANDEMIC MEASURES

The EBRD provided support through different existing and new programmes to inject liquidity into the economies of where the EBRD invests, as illustrated below.

SOLIDARITY PACKAGE

The EBRD was the first international financial institution to approve a comprehensive series of response and recovery measures through the Solidarity Package, unveiled on 13 March 2020. The package included a rapid roll-out of investments and disbursements to countries suffering from the economic shock of the crisis. It used existing instruments as well as new initiatives to provide finance and rapid advisory and policy support to help businesses and governments combat the economic and societal implications of the virus.

TRADE FACILITATION PROGRAMME (TFP)

The TFP has been running since 1999 and played a critical role in promoting international trade during the pandemic. Specifically, the support provided by the TFP strengthened the ability of local banks to provide trade finance. Recently, the TFP has been supporting food security and agricultural trade following the war in Ukraine.

RESILIENCE FRAMEWORK

An EBRD programme was approved on 13 March 2020 to streamline finance to meet the short-term liquidity and working capital needs of existing clients. The main goal was to provide access to liquidity for financial institutions and entrepreneurs.

ENHANCEMENT OF ESTABLISHED PROGRAMMES SUPPORTING SME LENDING

Current programmes include the Small Business Impact Fund and the Direct Finance Framework for SMEs. The Small Business Impact Fund directs donor funds to financing, advisory, and policy activities to support SMEs. The Direct Finance Framework for SMEs offers a range of financing instruments with advisory support. Since 2015, EBRD has offered finance directly to qualifying SMEs for projects up to €25 million.

VITAL INFRASTRUCTURE SUPPORT PROGRAMME (VISP)

An emergency EBRD support programme, launched 23 April 2020, aimed at infrastructure providers across emerging economies and included a focus on green sustainable infrastructure. The EBRD VISP was executed through three financing tools: providing capital to municipalities and utilities to deploy credit lines through local banks, stabilising key infrastructure providers through direct loans, and investment financing for public sector clients.

The end of emergency measures often requires a trade-off between different policy goals.[62] Some measures to limit structural dependencies were only in place for a few months, such as tax deferrals (like in Serbia), postponed loan repayments (like in Georgia) and tax exemptions (like in Kazakhstan). Other measures are gradually expiring, or their benefits are being reduced. For instance, in Armenia, the 3-year Stand-By Arrangement, approved in May 2019, expired on 16 May 2022.[63] Central bank liquidity programmes and capital requirement relief are gradually being phased out, replenishing central bank reserves and ensuring sufficient capitalisation of the banking system. For instance, the ECB has been phasing out different measures adopted to expand access to central bank liquidity to support the economy.[64] In respect to programmes designed to support SMEs, including public guarantee programmes, their phasing out tends to be even more gradual with exit strategies designed to incentivise borrowers to resort to market-based financing solutions.[65]

The evolving state of public assistance programmes together with adverse economic conditions pose new challenges for MSMEs. First, while support to MSMEs was central in the emergency phase, recovery packages tend to be focused on general economic conditions, favouring horizontal policies, such as digitalisation and green finance that may also (but not exclusively) benefit MSMEs.[66] Second, inflationary pressures combined with an increase in food and energy prices, exacerbated by the war in Ukraine,[67] are slowing down the recovery process for MSMEs while making the repayment of debts (supported by public programmes) more expensive. Consequently, while insolvency risks have not materialised during the pandemic, the combined effects of refocused policies, market uncertainties and higher costs, accelerate the need for market solutions to provide new finance to MSMEs.

Market-based risk mitigants, such as collateral and ordinary personal guarantees have played a limited role. Credit insurance may not be available and other forms of payment guarantees remain too costly. State credit guarantee schemes, especially those already implemented before the pandemic, are likely to stay and should play a role in facilitating new finance. As will be explored more in Section 3, they can be adjusted to incentivise a participating lender to take collateral or to develop receivables finance products identified in Section 2. Parameters can be set to promote the soundness and the integrity of credit markets,[68] rather than guaranteeing the repayment of any loan.

Transitioning from public support mechanisms to market-based solutions may be incentivised through different tools, including: (i) pricing that is higher than would be the case for market-based products; (ii) financial terms that encourage borrowers to pre-pay their loans; and (iii) other conditions that incentivise the exit from support mechanisms early. The ability of businesses to access new finance is critical to forestalling losses.[69]

A market-based solution has three main advantages. First, market participants, regulators and other stakeholders can develop pilot programmes, gather data and test credit products. Once public measures are phased out, markets will have gained sufficient experience and data to develop new products. Second, existing public assistance programmes will insulate financial institutions from risks affecting the MSMEs and regulatory compliance can be ensured while new finance products are developed. Third, the risk borne by the guarantee operator would be reduced by the liquid nature of collateral, especially in the form of receivables. Credit products to extend new finance can facilitate a progressive phase-out of the emergency measures. These products must be equally suitable to provide support pre- and during insolvency.

[62] FSB Covid-19 Support Measures: Extending, Amending and Ending (2021).

[63] IMF (2022), Executive Board Completes the Sixth and Final Review Under the Stand-By Arrangement with Armenia.

[64] See, e.g., the phasing-out of pandemic collateral easing measures, started on July 8, 2022, and scheduled for completion in March 2024; see ECB (2022),Gradual Phasing-out of Pandemic Collateral Easing Measures, ECB Economic Bulletin, Issue 3/2022, https://www.ecb.europa.eu/pub/economic-bulletin/focus/2022/html/ecb.ebbox202203_07~441fce9f64.en.html (Accessed: 31 March, 2023).

[65] OECD (2021), Covid-19 Government Financing Support Programmes for Businesses, p. 9, 22, www.oecd.org/finance/Covid-19-Government-Financing-Support-Programmes-for-Businesses-2021-Update.pdf (Accessed: 31 March, 2023).

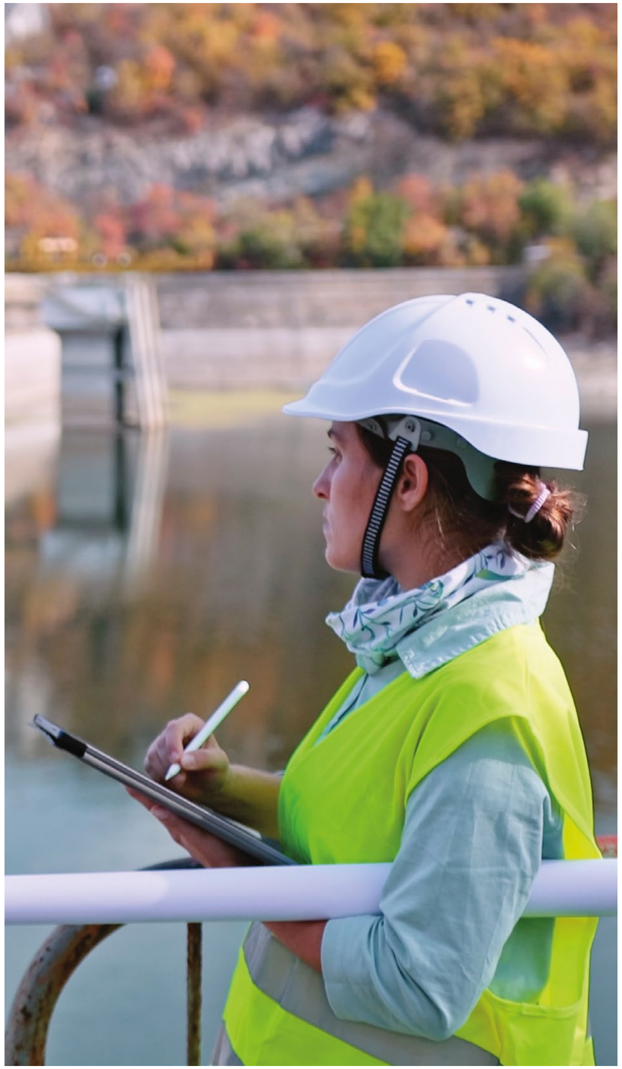
[66] OECD (2020), The impact of COVID-19 on SME financing, OECD iLibrary, p. 24-27, https://www.oecd-ilibrary.org/economics/financing-smes-and-entrepreneurship-an-oecd-scoreboard_ecd81a65-en (Accessed: 31 March, 2023).

[67] EBRD (2020) Regional Economic Prospects, Covid-19 Early estimates of the damage, uncertain Prospects, www.ebrd.com/what-we-do/economic-research-and-data/rep.html (Accessed: 31 March, 2023).

[68] For instance, lenders might be required to comply with conduct of business standards, maintain a sufficiently diverse portfolio of receivables, and accept receivables that are not owed by affiliates of the MSME.

[69] OECD (2021), Covid-19 Government Financing Support Programmes for Businesses, www.oecd.org/finance/Covid-19-Government-Financing-Support-Programmes-for-Businesses-2021-Update.pdf (Accessed: 31 March, 2023).

Section 2: Developing products for economic recovery



Ongoing MSME financial distress and the end of emergency measures signal the need for mechanisms to stimulate economic recovery. Maximising the availability and range of credit products suitable for MSMEs in the EBRD regions require modern secured credit and insolvency frameworks. This Section first explains and outlines the main criteria for selecting and designing new credit products, which may be supported by various public measures, to promote economic recovery, the role of credit and receivables finance and the kind of structures that can be deployed in such recovery.

As a central component of a comprehensive recovery strategy, products should align with broader policy objectives aiming at supporting an inclusive access to credit for MSMEs. This Section also highlights common issues and impediments within legal frameworks in many EBRD economies, drawing on the results of the EBRD Survey of Insolvency and Secured Transaction Regimes and the 2022 EBRD Business Reorganisation Assessment which assessed the legal regimes for business reorganisation in insolvency across 38 economies.[70] The identification of these features and impediments highlights the aspects of private law and regulatory frameworks that States' authorities may wish to modernise, as further elaborated in Section 3.

This Section identifies the types of support measures, especially state credit guarantees that have a minimal distortive effect on credit markets. If designed properly, they incentivise financial institutions to finance receivables, build their capacity in assessing the eligibility of receivables, take proper and prompt enforcement actions and enable a reduction in capital reserve requirements.

The strategy outlined in the following section leads to a transition to market-based lending once financial institutions have built up adequate expertise in managing receivables products. The EBRD and other partner institutions may play a facilitative role, including by advising on the implementation of a design for public guarantee schemes or even investing in programmes that meet the requirements set out in this report.

A. NEW FINANCE TO SUPPORT THE REAL ECONOMY

Section 1 described the liquidity needs of distressed MSMEs and highlighted the role of financing mechanisms capable of supporting economic recovery. Such a recovery can be achieved only by supporting the real economy, thus stimulating the production of goods and services, the creation of jobs and the distribution of welfare across society. While emergency measures have limited the economic impact of the pandemic, sustainable recovery efforts should be implemented with the goal of "building back better". These efforts should ensure that any recovery strategy does not undermine market functioning and financial stability.[71] Economic, legal and practice variables should be considered in order to identify credit products that can be deployed across the EBRD regions. As explained later, every country will need to develop its own product diagnostic, including a market analysis and credit product mapping exercise.

[70] EBRD (2022), Business Reorganisation Assessment, www.ebrd-restructuring.com.

[71] OECD (2021), Covid-19 Government Financing Support Programmes for Businesses, www.oecd.org/finance/Covid-19-Government-Financing-Support-Programmes-for-Businesses-2021-Update.pdf (Accessed: 31 March, 2023).

i. Selecting Suitable Credit Products: Main Criteria

Credit products developed to support new finance within a general recovery strategy promoted by domestic authorities and international financial institutions should meet five criteria.

1. MSME-centric

Credit products should serve the financing needs of viable MSMEs facing difficulties. In particular, credit products deployed to spur a sustainable recovery should address the financing needs of businesses in distress, including those facing insolvency or already in insolvency proceedings.

2. Flexible

Credit products should be flexible and adaptable to the different economic landscapes and legal conditions in the EBRD regions. While general issues and trends can be elicited, there is not a 'one-size-fits-all' solution. Hence, products designed to promote an effective recovery should be adapted to the domestic legal and economic frameworks. For instance, while some EBRD jurisdictions already enable a variety of credit products, others have a limited offering that relies primarily on the security of fixed assets. Credit products that are intended to promote economic recovery should be adaptable to such different situations.

3. Recognised internationally

Credit products should be relatively common in the global context and recognised by international standard setters. This feature yields several advantages. First, products that are common can be developed with a reference to international legal and regulatory standards. Second, international experiences and expertise can provide meaningful guidance on the development of such products locally. Third, products that are globally recognised provide for a solid foundation to link domestic economies to international supply chains and are more likely to attract foreign investment.

4. Easy to implement

Credit products should be implemented without requiring lengthy legal reforms. Given the urgency for businesses in distress, priority should be given to the development of products that do not require profound legal and regulatory changes. As the legal, regulatory and business environments mature, more articulated structures can be implemented progressively and the scope of reforms can expand accordingly.

5. Fostering inclusion

The implementation and development of credit products should promote the emergence of a sound and inclusive credit ecosystem. Any legal and regulatory adaptations to support the credit products should be in line with a broader trajectory of policy reforms and sustainable development, as expressed in the UN's Sustainable Development Goals (SDGs).

ii. Meeting the Criteria: Receivables-Based Finance for Supply and Value Chains

Credit products that are based on receivables meet all the above criteria. In general terms, receivables are generated by viable businesses, including and especially MSMEs that have contractual arrangements to sell goods or services to their clients against future payments (MSME-centric). Receivables finance can be a tool for transmitting much needed working capital to businesses that would otherwise face insolvency. As receivables are highly liquid and commonly available, they offer the greatest potential for credit product expansion.

Receivables finance products are versatile and designed to sustain a diverse range of domestic, regional and international trade activities in a multitude of industries and sectors (Flexible). International standard setters have issued several instruments fostering receivables finance. Products based on receivables are common and are often deployed to support domestic and international supply and value chains. Therefore, they benefit from an international network of professionals and industry-led organisations representing a reservoir of knowledge to guide domestic implementation and adaptation (Recognised internationally).

Domestic legal frameworks in the EBRD regions already provide for the rules that enable the deployment of some products, especially reverse factoring (easy to implement). Since many MSMEs operate in the trading sectors where transactions generate receivables, financing of such receivables would broaden inclusion and sustain development (fostering inclusion).

Financing Viable Businesses

International organisations, including the EBRD, have recognised the importance of global supply chains and have implemented measures to avert shortages of essential goods during the pandemic.[72] In EBRD countries, businesses are generally well-integrated into global supply chains. However, businesses dealing with the production and distribution of goods are more integrated than the businesses providing services.[73] While MSMEs sell goods to domestic and foreign customers, generating receivables, they also owe receivables to their suppliers and incur obligations to pay for inputs. A significant majority of customers in Western Europe have lengthened the maturity of their receivables, which negatively impacted the cash flow of MSMEs in the EBRD regions.[74]

Generally, financial institutions tend to finance receivables with maturities up to 90 days, so the economic value of receivables whose maturity was extended could have been eroded. Furthermore, whenever buyers were required to procure payment guarantees for the payment of the purchase price, the cost of doing business increased.[75] Sixty-nine per cent of MSMEs in Europe accepted unfavourable payment terms to preserve customer relationships.[76]

Receivables finance addresses various needs of businesses. For instance, traditional factoring of receivables can offer immediate liquidity to MSMEs. As further explained below, receivables finance products can be used to provide finance to small suppliers or distributors that deal with one or a limited number of large companies. Digital platforms can offer invoice-trading services that can be accessed by a variety of investors seeking to diversify their risk by acquiring receivables. In each case, consideration paid to the business will involve a discount, primarily based on the length of time before the receivables become payable and the likelihood of the account debtors fulfilling their obligations.[77]

Receivables products are less costly and more streamlined than similar financing products, such as forfaiting. In forfaiting, the financial institution would need to take delivery of individual negotiable instruments for protection against third parties, including in insolvency, rather than register a single notice against all existing and future receivables. Receivables products are a precursor to more articulated and complex structures, such as asset-backed securitisation where portfolios of receivables secure the issuance of bonds. The EBRD supports several receivables securitisations.[78]

[72] Riera O. & Philipp Paetzold P., Global Value Chains and Trade in the EBRD Regions (EBRD 2020), www.ebrd.com/what-we-do/economic-research-and-data/cse-economists/global-value-chains-and-trade-in-ebrd-regions.html.

[73] Riera O. & Philipp Paetzold P., Global Value Chains and Trade in the EBRD Regions (EBRD 2020), www.ebrd.com/what-we-do/economic-research-and-data/cse-economists/global-value-chains-and-trade-in-ebrd-regions.html.

[74] Recent studies indicated that 94% of businesses reported a lengthening of payment terms, which, on average, increased by 12 days; see Atradius Payment Practices Barometer (November 2020).

[75] OECD (2020), The impact of COVID-19 on SME financing, OECD iLibrary, p. 24-27, https://www.oecd-ilibrary.org/economics/financing-smes-and-entrepreneurship-an-oecd-scoreboard_ecd81a65-en (Accessed: 31 March, 2023).

[76] OECD (2022), Financing SMEs and Entrepreneurs 2022: An OECD Scorecard, Lending to SMEs, OECD iLibrary. http://www.oecd-ilibrary.org/sites/e9073a0f-en/1/3/1/index.html?itemId=%2Fcontent%2Fpublication%2Fe9073a0f-en&_csp_=f3c512744374df0f64f9df449eb7e26c&itemIGO=oecd&itemContentType=book. (Accessed: 31 March, 2023).

[77] Beale, H. Bridge, M., Gullifer, L. and Lomnicka, E., (2018) The Law of Security and Title-Based Financing, Third Edition (Oxford University Press, 2018), p. 305.

[78] For securitisation of receivables from car leases in Greece, see White & Case (2020), White & Case Advises EIF and EBRD on Securitisation of Auto Lease Receivables Originated by Avis Hellas www.whitecase.com/news/press-release/white-case-advises-eif-and-ebrd-securitisation-auto-lease-receivables-originated (Accessed: 31 March, 2023).

Adaptability and Flexibility

Whether an MSME is facing some temporary liquidity issues, is on the verge of insolvency, or insolvent already and navigating a reorganisation procedure, receivables financing can be used to sustain ongoing business operations. A variety of transactions and business operations can be supported through receivables finance, including sales of finished products, manufacturing processes, harvesting and delivery of crops, production and trade of commodities, as well as provision of services. Though receivables arise from transactions that typically occur within supply and value chains, such as the sale of inventory or crops, these underlying transactions may also involve credit extensions that would give rise to conflicting claims to the same receivable. For instance, a distributor sold inventory of goods to an MSME on a 90-day credit. The MSME resold the goods to its customers generating receivables that it has financed with a factor. The distributor has not been paid and claims that it has a right to the receivables that arose from the sale of goods it had supplied.

Receivables can be used to generate a variety of products to unlock new finance. Some products may be relatively simple, entailing the use of receivables as collateral to secure a loan between a financier and a borrower. Other products can be more articulated, involving larger corporations and platforms. As further illustrated in this Section, different product structures can be developed depending on the legal, regulatory and economic conditions of domestic markets.

Global Diffusion

Receivables have played a fundamental role in the current economic landscape and are primed to become even more relevant. Trade credit took on a much bigger role during the pandemic, including as a trade facilitator.[79] One study by the BIS indicated that the global volume of trade receivables is comparable to that of outstanding corporate bonds.[80] Due to the uneven economic impact of the pandemic, some sectors – such as those producing non-durable consumer goods and pharmaceuticals – have experienced an increased demand for trade credit. Other sectors, because of a shift in consumer preferences, have been generating fewer receivables.

Receivables finance benefits from several global developments. From a legal standpoint, international organisations, including the International Chamber of Commerce (ICC), UNCITRAL and the International Institute for the Unification of Private Law (UNIDROIT) have adopted or are drafting standards supporting the financing of payment rights, including receivables, as well as negotiable instruments, letters of credit and other trade finance instruments.

If EBRD jurisdictions deployed receivables finance more widely, they could benefit from those legal harmonisation and modernisation efforts. Moreover, global and regional private associations, such as FCI, support the development of sound business practices and promote cross-border financing of trade. With these developments, receivables finance systems can outlive current economic circumstances.

Receivables finance has the potential to support local production levels and this may in turn facilitate the connection to global supply chains. International attention to these credit products marks a larger trajectory for a sustainable and resilient development. Foreign lenders are familiar with these financing mechanisms and their availability. Attracting these lenders while also creating new opportunities for domestic lenders would pave the way to more foreign investment.

[79] White & Case (2020), White & Case Advises EIF and EBRD on Securitisation of Auto Lease Receivables Originated by Avis Hellas.

[80] Boyssai F. et al, (2020), Trade Credit, Trade Finance, and the Covid-19 Crisis (BIS Bulletin No. 24, June 2020).

Reforms: Short-term Needs and Long-term Perspectives

Some receivables finance products based on the purchasing of receivables, namely factoring and reverse factoring, may not require comprehensive reform for their deployment.[81] Factoring and reverse factoring require simple rules on assignment or transfer of claims. No collateral registry is required because the likelihood of conflicting claims to the same receivable is low. Nevertheless, in an unreformed legal regime governing the assignments of receivables, there may be fewer obstacles to reverse factoring than to factoring (for example, the requirement to identify the receivables specifically is more easily met for receivables owed by an Anchor Buyer).

However, all receivables products would benefit from a modern regime aligned with international standards that provides a certain and predictable environment. Hence, while little to no-reform might be needed in the short-term to unlock liquidity, a broader process of legal and regulatory modernisation should be considered to provide an enabling environment for other receivables finance products.

Law reforms, regulatory measures and implementation of technologies spurred factoring activity in several EBRD countries. For instance, a favourable regulatory environment in Türkiye has been in place since 2013 leading to an increase in receivables finance. In Ukraine, the creation of a 'Factoring Hub', an online platform for factoring of MSME receivables, increased factoring activity by 37 per cent in 2020.[82] More broadly, the EBRD supported directly many reforms that resulted in the enactment of special factoring laws in Croatia (2014), Montenegro (2017), Serbia (2017), Tunisia (2017), among others and continues to support reform initiatives in various jurisdictions, such as Georgia and Ukraine.

The development of receivables financing can support long-term efforts aimed at modernising domestic legal and regulatory frameworks. This modernisation process should not be limited to the legal rules governing transfers of receivables but should examine the related framework governing transactions that affect the claims to receivables. Through this process, domestic policymakers can address important elements that are generally overlooked in broader reforms.

Targeted legal reforms allow policymakers to ensure that the rights of finance providers in receivables, whether purchased or taken as collateral, are adequately protected. For instance, as unknown priorities in receivables are one of the issues plaguing the factoring industry,[83] a modern legal framework should ensure coordination with the rules governing security rights in the underlying transactions. The priority of a lender in receivables should be clearly defined as against the priority of a competing finance provider to the inventory or to the growing crops from which receivables arise.

Stimulating the Emergence of a Sound and Inclusive Credit Ecosystem

Incentivising receivables financing is expected to lead to the emergence of a sound and inclusive credit ecosystem. This ecosystem is composed of the applicable legal and regulatory framework, as well as other elements, such as valuation of assets. While the EBRD Survey of Insolvency and Secured Transaction Regimes indicates that it is fairly easy to obtain a reliable third-party valuation for immovable assets, valuation of movable assets is more problematic.[84]

This is a particularly salient issue in jurisdictions where: (i) appraisers are not subject to licensing requirements, (ii) domestic valuation standards are adopted instead of European Valuation Standards, and (iii) specific valuation methods are not prescribed by regulation.[85] The absence of clear valuation parameters may lead to a conservative approach in valuing the collateral, but also the company as a whole, particularly in insolvency proceedings. Targeted reforms to promote various type of receivables finance products, with an attention to the underlying transactions, can address these issues and, thus, promote a broader development agenda fostering a sound and inclusive credit ecosystem.

81 See Section 3 (Implementation Strategy) of this report.

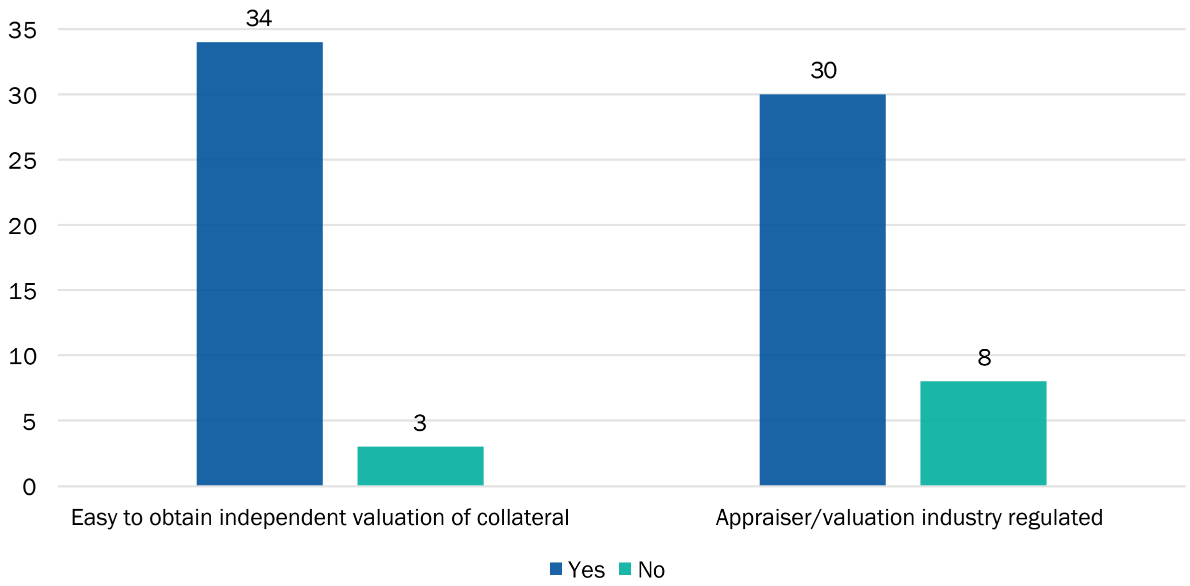
82 OECD (2022), Financing SMEs and Entrepreneurs 2022: An OECD Scorecard, Lending to SMEs, OECD iLibrary. http://www.oecd-ilibrary.org/sites/e9073a0f-en/1/3/1/index.html?itemId=%2Fcontent%2Fpublication%2Fe9073a0f-en&_csp_=f3c512744374df0f64f9df449eb7e26c&itemIGO=oecd&itemContentType=book. (Accessed: 31 March, 2023).

83 Factoring Model Law Working Group (First Session, 1-3 July 2020), www.unidroit.org/english/documents/2020/study58a/wg01/s-58a-wg-01-04-rev01-e.pdf.

84 EBRD Survey of Insolvency and Secured Transaction Regimes (2023).

85 On the valuation standards see Section 3(ii) of this report.

Figure 2. Frameworks for valuation of collateral are generally well-developed in EBRD regions



Note: *This chart shows respondents' level of agreement with certain questions (as displayed in the chart) covered by the EBRD Survey of Insolvency and Secured Transaction Regimes in relation to the independent valuation of collateral in the EBRD regions.*

Critically, receivables financing is in alignment with the UN's Sustainable Development Goals (SDGs). In particular, such financing directly addresses SDG 8 (to "[p]romote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all") and indirectly promotes SDG 10 (to "Reduce inequality within and among countries").[86] Receivables products promote sustainable economic growth and contribute to reducing socio-economic inequalities by offering direct financing mechanisms that both support and rely on the production of goods and services. While benefiting businesses of all sizes, receivables products are particularly suitable for MSMEs normally excluded from more traditional credit channels.

In fact, by tapping into the value of receivables generated during their ongoing business operations, businesses that are experiencing difficulties in obtaining credit, for example due to their limited credit history, can get financial support. Similarly, viable businesses facing distress can deploy receivables and obtain additional new finance and revamp their economic activities. When deployed as a strategy for the overall economy, this may help to reduce inequality between emerging and more developed economies.

For all the reasons mentioned above, the EBRD supports receivables finance in the context of supply and value chains both directly, through guarantee programmes and other liquidity mechanisms and, indirectly, through legal and regulatory reforms.

[86] United Nations Sustainable Development Goals, available at www.sdgs.un.org/goals.

B. RECEIVABLES FINANCE

Receivables finance addresses some of the key issues faced by main actors in the supply chains:

Helping SME Suppliers (Factoring):

Upon delivery of the contracted goods/services pursuant to a purchase order issued by the buyer, suppliers usually issue a corresponding invoice indicating the amount that is owed to them by the buyer as well as the payment terms (for example, the number of days by which the invoice needs to be paid – typically 30, 60 or 90 days). Depending on the sector/industry, many suppliers will need to promptly finance the next production cycle and will therefore need the invoices paid either promptly or at least as per the payment terms indicated in the invoice. The relationship between buyers and suppliers can be a lopsided one, where the buyer dictates (or ignores) the payment terms to the detriment of the supplier. Despite the existence of laws and regulations punishing late payments in commercial transactions, suppliers often find themselves in a peculiar situation where they must choose not to enforce their rights to the timely payment of invoices against their buyers due to their fear of losing them as a client. In this scenario, the supplier is often better-off using or factoring its invoices (for example, receivables) to obtain finance against them, albeit at a discount. Further, it may be efficient for the supplier to outsource the management and collection of the receivables to a factor, especially in business environments where there is a 'late payment' culture.

Helping Buyers and Suppliers (Reverse Factoring):

When bigger buyers (like retailers) are interested in retaining good relationships with their suppliers they may set-up a reverse factoring facility with a financier, allowing the financier to pay the invoices of their suppliers promptly upon submission, while they pay back the financier at some point later in the future. This allows buyers (commonly referred to as "anchor buyers" in these arrangements) to keep good and strong relationships with their supplier base but also to more comfortably extend their payment terms by agreeing a later payment date with the financier. Benefits for MSME suppliers include the strategic ability to plan and procure the necessary inputs to their business, while making (and financing) the necessary investments.

The existence of receivables is a strong signal of the viability of an MSME seeking new finance. In a context where finance providers may struggle to assess the ability of an MSME to service its debts, receivables provide advantages over security rights in other types of movable assets in terms of curbing credit risk. Compared to inventory or equipment collateral, for which there may not be a secondary market, receivables are liquid assets that can be converted into cash to weather temporary liquidity shortages and financial restructuring.

Furthermore, electronic invoicing or e-invoicing facilitates the emergence of electronic platforms and exchanges for receivables, which makes them more attractive to finance providers. If MSMEs remain viable and retain their customers, receivables allow finance providers to better mitigate credit risk. Lastly, receivables loans supporting business operations generate more receivables, and thus activate a virtuous economic circle supporting the production of goods and services in the long-term. The development of products to extend new finance is premised, however, on the existence of supportive legal and regulatory frameworks.

Receivables products are, at their core, designed to provide new finance to MSMEs that promotes a sustainable recovery in the EBRD regions. The FCI, a global representative body for factoring and financing of open account domestic and international trade receivables, estimated global volume of receivables finance in 2021 exceeding €3 trillion in its 2022 Annual Report.[87] While the volume declined in 2020 by 6.5 per cent, it increased in 2021 by 13.5 per cent.[88]

The use of receivables in secured lending and factoring is important for many MSMEs, which may not have immovable assets or fixed assets of sufficient value. Rights to payment may take different forms, including negotiable instruments and invoices, but modern receivables finance relies on intangible rights in the form of receivables, typically documented in electronic invoices. Credit products can be developed to transform such receivables into liquid assets, unlocking vital capital to support the operations of various businesses and, in particular, MSMEs.

In normal times, private law rules ensuring certainty and enforceability of rights, as well as regulatory regimes ensuring stability and market integrity, are crucial to promote access to finance.[89] In times of distress, these frameworks are essential to spur economic recovery and sustainable growth. Yet, the EBRD Enforcement Study and the EBRD Survey of Insolvency and Secured Transaction Regimes reveal that a number of countries in the EBRD regions lack several of the legal and regulatory elements supporting a sound and inclusive credit ecosystem for secured credit and insolvency.[90] For instance, a common type of problem that emerged from the five high NPL jurisdictions covered by the EBRD Enforcement Study is the difficulty of enforcing security rights upon default.[91]

Although general reforms to modernise the legal and regulatory frameworks are necessary, these will take time. A post-Covid-19 recovery requires new finance to be unlocked quickly. In this context, receivables credit products, such as factoring, are ideal since they do not rely on remedies that require formal, court-supervised repossession of the collateral from a delinquent borrower. Collection of a receivable is not affected by any limitations in the enforcement framework with respect to security rights because the finance provider owns the receivable. Moreover, in whole turnover arrangements, the finance provider is usually protected from potential defaults by a discount at which the receivables are purchased and, in some transactions, a recourse against the transferor/seller of the receivables.[92]

Nonetheless, specific attention should be paid to the legal and regulatory framework surrounding receivables products as receivables emerge from other commercial transactions that may generate risks for finance providers. For instance, secured transactions law should facilitate transfers of receivables despite the presence of an anti-assignment clause and insolvency law should render any *ipso facto* clauses that allow the counterparty to terminate contracts solely on the grounds of the other party upon filing for insolvency unenforceable, subject to any necessary safeguards or exceptions.[93]

Research conducted recently by the EBRD reveals that relatively few economies offer comprehensive protection against third party contractual termination on insolvency, but this is expected to improve as economies align with international standards in the field, such as the UNCITRAL Legislative Guide on Insolvency Law and within the European Union, the Directive 2019/1023 on preventive restructuring frameworks.[94] These secured transactions and insolvency features will provide comfort to the finance provider that the business relationships generating receivables will be preserved, provided that the business continues as a going concern.

Business Environment

Since the Covid-19 pandemic and recent geopolitical events, including the war on Ukraine, many MSMEs are struggling to raise new capital while keeping their business operations going. For financial institutions, it has become difficult to identify viable businesses to finance, given that the various public interventions – necessary to cope with the economic emergency – have made it more difficult to distinguish which business is viable. Receivables products, such as factoring and supply chain finance, can address these issues, while supporting the transition from an emergency to a sustainable economic recovery.

i. Receivables Finance in Practice

While a variety of finance products can be developed from receivables, they all rely on continued business operations that generate receivables. To clarify this point, consider the example of a traditional factoring structure.

FACTORING EXAMPLE

An MSME, engaging in trading activities, sells and delivers products to its customers who agree to pay 90 days after delivery. The payment obligation is evidenced in sale contracts and invoices. A factoring company – a financial institution authorised to undertake factoring activities[95] – offers an 80 per cent advance rate on the face value of the receivables (for example, €8,000 on a €10,000 invoice). The MSME assigns its rights to payment under its invoices to a factoring company (the Factor). The Factor notifies the MSME customers of the assignment.[96] It will collect the receivables when due and remit the remaining €2,000, minus its charges, to the MSME. All collections of receivables will be deposited into a bank account maintained by a bank subject to control by the Factor.

The process may be repeated with respect to all receivables of the MSME, existing and future. The Factor reserves the right of recourse for receivables that are not collectible. Thus, if a customer of the MSME fails to pay the receivable when due, the Factor will transfer it back to the MSME and reclaim the advance payment.[97] The factoring agreement prohibits the MSME from transferring any receivables to another financial institution or granting a security right in any asset that may generate receivables or proceeds.

KEY FEATURES

Parties

Factor: a financial institution licensed to undertake factoring activities. In this example, the factor is not a bank; it does not take deposits or maintain bank accounts.

SME: a business with an operating bank account that regularly issues invoices for the services provided or the goods sold.

Collection of Receivables

The SME transfers to the Factor the right to collect existing and future receivables.

Discharge of Customers

Customers of the SME receive a notification of assignment from the Factor. They pay in accordance with the notification into the designated bank account.

Right of Recourse (if applicable)

The Factor mitigates the risk of extending new finance to the SME by reserving a right of recourse. This allows the Factor to transfer back to the SME those receivables that are uncollectible and recover any advance payment.

KEY OUTCOMES

Collection or Right of Recourse

A) If the SME is viable and its customers pay on time, the Factor collects the full amount owed, making a profit.

B) If the customers of the SME default, the Factor may exercise a right of recourse and transfer the unpaid receivables back to the SME, while recovering any related payment.

C) If the customers of the SME file for insolvency, the Factor will be able to exercise the right of recourse against the SME.

[87] FCI (2022), Annual Review 2022, https://fci.nl/en/media/29926/download, (Accessed: 31 March, 2023).

[88] FCI (2022), Annual Review 2022, https://fci.nl/en/media/29926/download, (Accessed: 31 March, 2023).

[89] A greater level of coordination between private law rules and prudential regulation is needed to promote secured lending, see Castellano G. & Dubovec M. (2018), Credit Creation: Reconciling Legal and Regulatory Incentives (81-1 Law and Contemporary Problems 63,).

[90] Albania, Croatia, Cyprus, Greece and Ukraine. EBRD Enforcement Study (2019), www.ebrd-restructuring.com/enforcement-study (Accessed: 31 March, 2023).

[91] EBRD Enforcement Study (2019).

[92] In single invoice finance arrangements, the risk for the finance provider is higher.

[93] UNCITRAL Legislative Guide on Insolvency Law, Part Two, pp. 130-131, www.uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/05-80722_ebook.pdf.

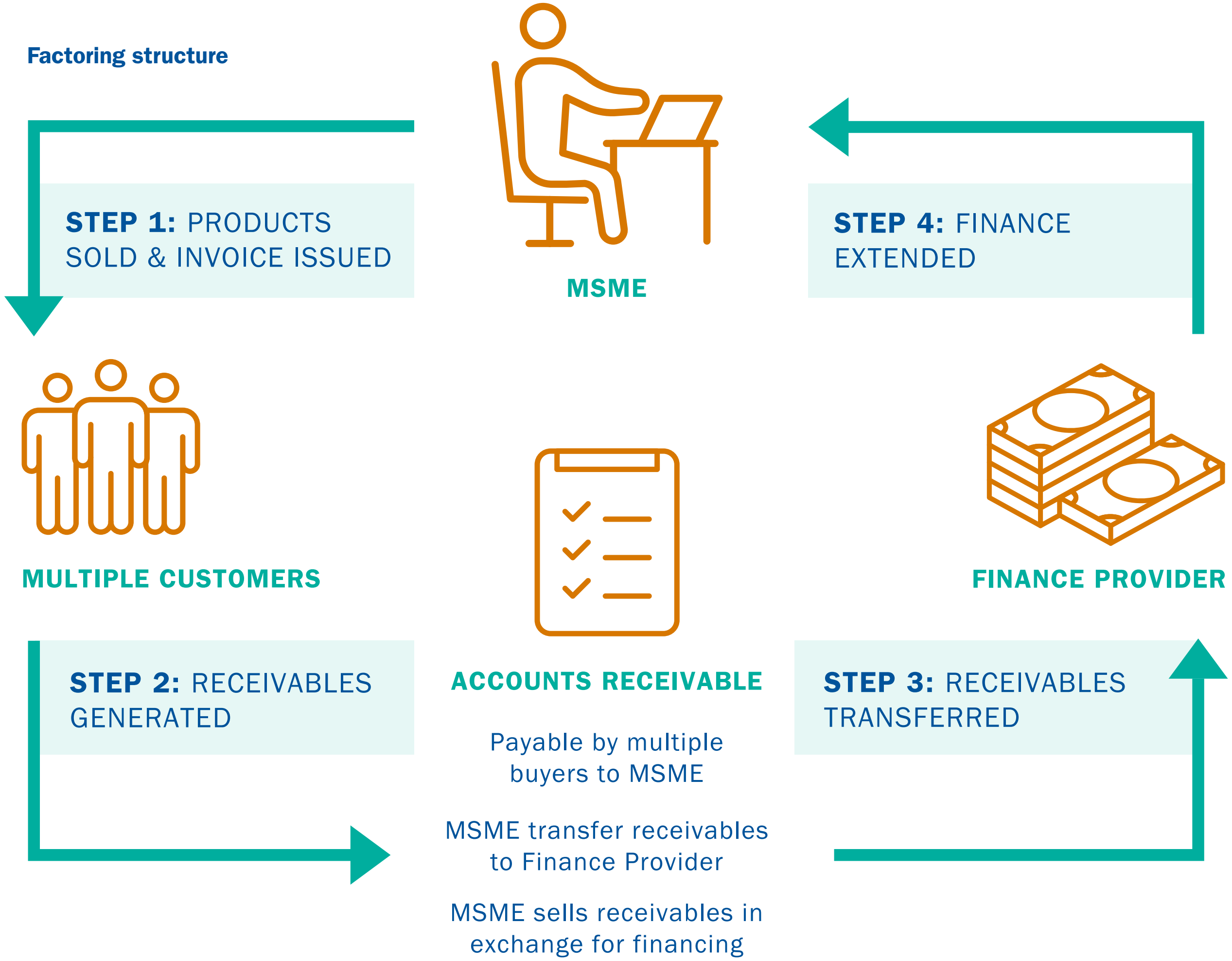
[94] EBRD Business Reorganisation Assessment (2022) Annex 7, Impact of Business Reorganisation Procedures on Third Party Contracts, www.ebrd-restructuring.com/storage/uploads/documents/7.pdf and EBRD Enforcement Study (2019).

[95] In the EBRD regions, factoring is often carried out by banks, which usually have the automatic right to factor. A licence to factor is not always required.

[96] The factor decides whether and when to notify account debtors, and much of factoring is done on a non-notification basis.

[97] Factoring may be structured without any recourse to the SME transferor.

Factoring structure



In this traditional factoring structure, the MSME sells products to its customers and issues invoices (Step 1). These transactions generate receivables payable 60-90 days after delivery of goods (Step 2). The Finance Provider purchases receivables (Step 3) and provides the MSME with immediate payment at a discounted rate, typically 80 per cent of the face value of the invoice (Step 4). The Finance Provider may choose to notify the MSME's customers and instruct them to pay into a designated bank account under control of the Finance Provider. The Finance Provider may also reserve recourse since the receivables owed to the MSME are payable by less creditworthy customers.

ii. Other Receivables-Based Products for Recovery

A traditional factoring structure (as visualised above) is suitable for providing liquidity in various economic contexts. However, as indicated in the EBRD Factoring Survey, the legal and regulatory frameworks of many jurisdictions in the region are not fully developed and further reforms are often needed to support the development of factoring.[98]

Conversely, where jurisdictions have a sufficiently viable legal and regulatory framework, traditional factoring is already present, to different extents, in local markets. In many emerging markets, the most suitable receivables products are those that can either be deployed without extensive reforms (where the local legal system is not fully developed) or be expanded beyond traditional factoring (where the product is already being offered).[99]

To address the financing needs of businesses in distress, this report focuses on two structures: (i) Reverse Factoring/ Supply Chain Financing (Structure 1), which can be used, alongside factoring due to its focus on less risky receivables owed by a creditworthy company to MSMEs and (ii) Loan Secured by Multiple Receivables (Structure 2): a loan to an MSME secured by multiple receivables and related assets, often including inventory, the sale of which generates those receivables, and which requires a more developed secured transactions and insolvency eco-system. Both structures allow for the development of different products that, depending on the circumstances, can include different parties (such as multiple finance providers as well as international financial institutions, including the EBRD), transactional elements (such as subrogation agreements) and public assistance programmes (such as public guarantees). Like traditional factoring, products based on these structures leverage the continued operations of the business that generates receivables.[100]

The first structure (Reverse Factoring/ Supply Chain Financing) is designed so that the financial institution is exposed solely to the risk of the creditworthy company, thus enabling financing through the supply chain. Products based on this structure are ideal for jurisdictions where legal and regulatory frameworks for factoring are not fully developed. They are also ideal for jurisdictions where factoring is already offered, as new financing channels can be offered to MSMEs that are owed receivables from a large, creditworthy account debtor (Anchor Buyer), such as a government entity, a retailer that owes payments to suppliers for goods, transportation companies for delivery services, or other highly rated corporations supporting a local supply chain.

While the credit profile of the MSME may not make it a suitable customer of a financial institution, the exposure to the highly creditworthy Anchor Buyer makes this arrangement attractive as the lender predominantly relies on the credit rating of the Anchor Buyer, rather than the MSME. The second structure (Loan Secured by Multiple Receivables) enables the development of products that reduce credit risk through both diversification, as receivables owed by multiple account debtors are pooled and reliance on other movable assets (related to receivables) as security such as inventory.

Unlike reverse factoring, a loan secured by multiple receivables and related assets, especially inventory and cash proceeds is typically provided in jurisdictions where the legal and regulatory frameworks are more mature. In fact, given the risk of ineffective security instruments (such as pledges over accounts into which any receivables secured by a loan are paid) and conflicting priorities for security rights in receivables, secured transactions and insolvency laws should be sufficiently developed to address such conflicts.

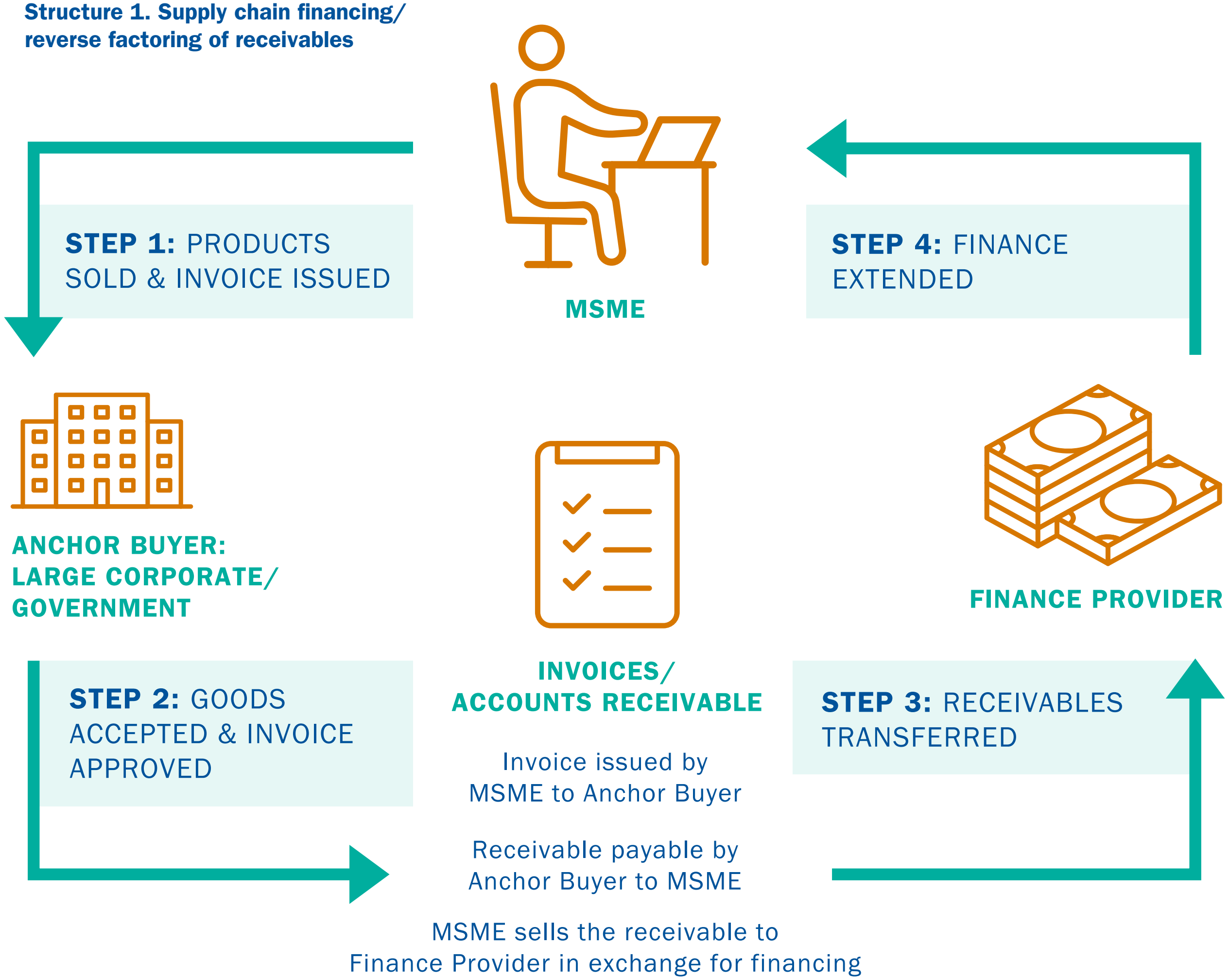
Drawing from these considerations, the following are graphical illustrations of the structures that also outline the sequences of actions. Each structure is followed by an example of a product that identifies the relevant parties and their relationships as well as possible additional elements. The structures and the examples offer a blueprint to isolate core legal and regulatory elements necessary to support the development of credit products, as further detailed in Section 3. This approach enables policymakers to identify, select and prioritise one or more structures to unlock new finance in a cohesive recovery strategy that implements targeted legal and regulatory reforms (if any) incrementally.

[98] EBRD (2018), Factoring Survey in EBRD Countries of Operations, Third Edition.

[99] See criteria 2 and 4 in Section 2(A)(i) of this report.

[100] For a criticism of the use of state credit guarantees that stifle a secured transactions reform and building of the lenders' capacity to administer asset-based loans, see Dubovec M. & Owada S., Secured Lending Stimulants: The Role and Effect of Public Guarantee Schemes in Japan, available at www.scholarship.law.upenn.edu/alr/vol16/iss3/1/ (Accessed: 31 March, 2023).

Structure 1. Supply chain financing/ reverse factoring of receivables



In the reverse factoring structure, also known as "payables finance",[101] a larger corporate, known as the Anchor Buyer, approaches a financial institution (the Finance Provider) to provide finance to its counterparties, typically sellers of goods (the MSME). The MSME provides goods or services to the Anchor Buyer and issues an invoice for such goods/ services (Step 1) with a deferred payment term, typically 60-90 days after the invoice is issued, thereby generating receivables (Step 2). The Anchor Buyer agrees to pay the Finance Provider when the invoice balances become due and the Finance Provider acquires the receivable (Step 3). The MSME obtains immediate payment on the invoice from Finance Provider (Step 4). Finance is typically provided without recourse to the MSME and the MSME receives 100 per cent of the face value of the invoice minus financing charges. The Anchor Buyer may be a large corporation, government, or other entity with a high credit rating. The Finance Provider is likely to be a bank, but it could also be a non-bank financial institution.

Public support might be still needed for different reasons, including the reluctance of the Finance Provider to develop new products in uncertain economic conditions or the need to extend credit to businesses to ensure that receivables are generated. Existing credit guarantee programmes can be used to provide protection to the Finance Provider, particularly in distress scenarios and unlock the liquidity needed to produce and sell the goods generating receivables. These public assistance programmes are not providing an indiscriminate support. Guarantees should be issued on the condition that the lender acquires a security right in the goods, immediately and acquires the receivables as soon as they are generated.

[101] See Standard Definition for Techniques in Supply Chain Finance (Global Supply Chain Finance Forum, 2016), p. 45, http://supplychainfinanceforum.org/ICC-Standard-Definitions-for-Techniques-of-Supply-Chain-Finance-Global-SCF-Forum-2016.pdf.

EXAMPLE

A product based on this structure could be developed in the context of agricultural finance. For instance, an MSME (a Farmer) is owed a receivable payable by a large creditworthy wholesaler (an Anchor Buyer) from the sale of a crop. In normal circumstances, the Anchor Buyer pays the Farmer at 90 days after delivery. The Farmer has a viable business, but the pandemic has disrupted the supply of inputs and sale of products to customers such as restaurants and hotels. Furthermore, consumption decreased, depressing the price of the crop. The MSME benefited from various emergency measures, including a loan and temporary fiscal relief. Emergency measures have been phased out and disruptions in the supply chain have been addressed. As the demand for crops is expected to return to normal levels, the Farmer seeks new financing to scale up operations. A local deposit-taking institution (a Bank) and a factoring company (a Factor) can offer different credit facilities. The Farmer seeks financing from both its Bank and from the Factor, through two distinct, yet coordinated, financing arrangements.

KEY FEATURES

Parties

Factor: a financial institution authorised to undertake factoring activities. In this example, the factor is not a bank.

Bank: a financial institution that is authorised to take deposits and extend loans. The Farmer has an account with the Bank that is willing to extend credit to the Farmer, alone or in addition to the Factor, if certain requirements are met.

Farmer: an MSME with an operating bank account that issues invoices to the Anchor Buyer for the sale of a crop.

Anchor Buyer: a large creditworthy wholesaler that buys crops from the Farmer to sell them to the retail market.

MECHANICS

Parties Relationships

Additional Elements

Crop Production Loan (secured)

The Farmer enters into a supply contract to deliver X quantity of crop to the Anchor Buyer.

The Farmer needs a crop production loan secured with its growing crop from the Bank.

The Bank is unwilling to extend a loan unless it obtains priority for its security right (a registered charge) in the growing crop and any proceeds.

Valuation and Secondary Market

For the Bank to determine the amount of the loan, it needs to obtain a valuation of the crop. Valuation is based on the market price quoted on a commodity exchange, a platform that trades either crop or right to future delivery thereof. Alternatively, valuation can be provided by a licensed valuer.

Receivable Purchasing

The Farmer harvests the crop and delivers it to the Anchor Buyer. As payment is due 90 days after delivery, the Farmer uploads invoice to a reverse factoring platform, the Anchor Buyer confirms the invoice and factor purchases it.

The financing terms are more attractive than the Bank may provide to the Farmer.

Subordination

The Bank is willing to facilitate the sale of a receivable to the Factor only if its crop production loan is re-payed.

The Factor is willing to purchase the receivable only if it has priority over the Bank.

The Factor and the Bank enter into a subordination agreement (or the Bank waives its right) with respect to the present and future receivables owed by the Anchor Buyer.

Public Assistance

Public Guarantee as Emergency Measure

The risk of default by the Farmer on its Crop Production Loan is too high, and the Bank requests a public guarantee. The Farmer can benefit from public assistance.

Public Guarantee Schemes Requiring Banks to Take Receivables as Collateral

The requirements to guarantee new finance under any Covid-19 guarantee programmes (whether general or sector-specific) are adjusted for instance, the access requirements modified to cover new financing arrangements aimed at financing viable businesses. To this end, the guarantee is extended only if the Crop Production Loan is secured with collateral and the guarantee's protection is triggered only after enforcement against collateral has failed.

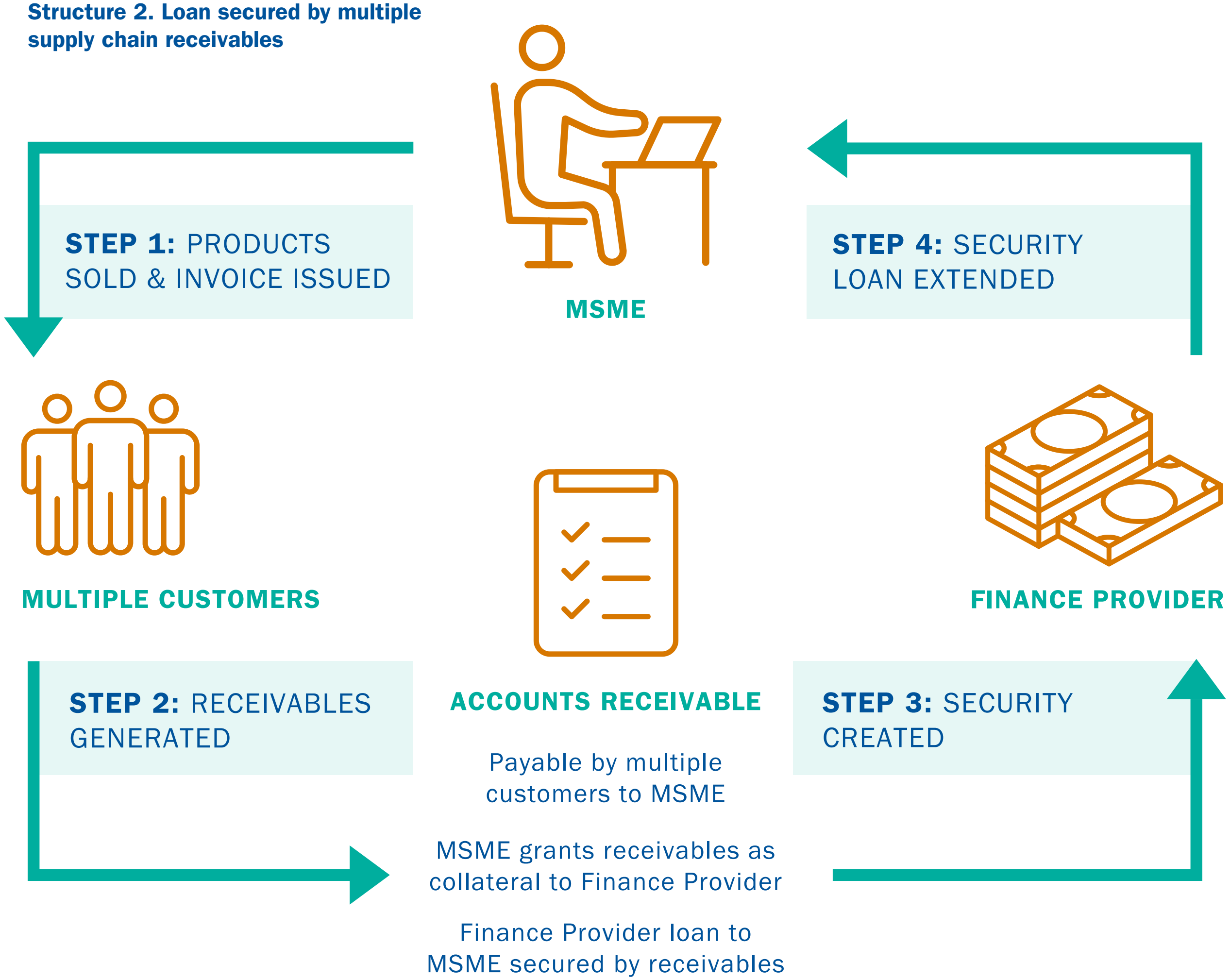
Agreements:

1. **Farmer-Factor:** factoring contract
2. **Farmer-Bank:** loan and security agreement
3. **Bank-Factor:** subordination agreement
4. **Public Guarantee-Bank-Farmer:** guarantee

In this example, two finance companies provide credit to a single borrower. The legal framework must have mechanisms to predictably allocate priorities, especially through a subordination agreement. In this regard, the EBRD Survey of Insolvency and Secured Transaction Regimes confirms the use of subordination agreements in most EBRD countries of operations as a tool for creditors to ensure their priority over other competing claims, with some reservations regarding the enforceability of such agreements in an insolvency scenario.[102] This would indicate the conduciveness of the legal frameworks to financing provided by multiple lenders, including in the reverse factoring situation. The perfection of the rights of both the Bank and the Factor should be achievable by registration and electronically at a low cost. Both finance providers should exercise due diligence to ensure their respective obligations are properly and timely satisfied.

[102] The EBRD Survey of Insolvency and Secured Transaction Regimes (2023) indicates that in 28 out of 38 economies where the EBRD operates, subordination arrangements are used for this purpose.

Structure 2. Loan secured by multiple supply chain receivables



The second structure involves an MSME that is owed multiple receivables, payable by less creditworthy customers than the Anchor Buyer described in the first structure above. The structure may involve receivables owed by other MSMEs, such as family-owned restaurants that owe payments to a supplier of food or produce.

In this structure, the MSME sells products or provides services to its customers and issues invoices, typically through an e-invoicing system (Step 1). These transactions generate receivables payable 60-90 days after delivery of goods (Step 2). The Finance Provider acquires rights in all existing and future receivables (Step 3) as security for a loan (Step 4).

The Finance Provider may require the MSME to grant security over its deposit accounts and to ensure that any proceeds from the receivables are paid into a designated account under the control of the Finance Provider (and/or choose to notify the MSME's customers to do the same). The advance rate is typically 80 per cent of the face value of the receivable. The Finance Provider will also reserve a right of recourse since the receivables owed to MSME are payable by less creditworthy customers.

In case of default in payment of the receivable, the Finance Provider transfers it back to the MSME. The Finance Provider may take a security right in other assets of the MSME, such as inventory. One of the differences from the preceding Structure is that the MSME obtains finance before the receivables are generated enabling it to acquire and market the inventory generating receivables. The advance rate on the receivables is lower as compared to the first Structure because the MSME already obtain finance in an earlier stage.

EXAMPLE

A product based on this structure can provide new finance to a retail store (the Store). The Store acquires inventory of goods with the purpose of reselling them to multiple buyers who either pay in cash on delivery or pay monthly for all purchases. The Store used to conduct most of its business in person. However, the disruption of supply chains and change in purchasing habits has required fundamental changes in the way retail business is conducted. As the Store struggles to adapt, the seller of inventory has not been paid and asserts a claim against receivables of the Store. Public assistance programmes,[103] such as a central bank discount window and insolvency moratoria have ensured the survival of the Store during the Covid-19 pandemic. With an emergency public loan falling due and costs increasing due to inflation, the Store must face difficult choices that include the possibility of commencing a formal insolvency process.

KEY FEATURES

Parties

NBFI: a financial institution licensed to undertake credit activities.

Bank: a financial institution that is authorised to take deposits and extend loans. Store has an account with Bank.

Store: an SME with an operating bank account that has acquired inventory from a seller and issues invoices to multiple buyers. It pays the seller for the inventory 90 days after delivery.

MECHANICS OF DISTRESSED FINANCING

Parties Relationships

Acquisition of Inventory

The Store acquires inventory for re-sale subject to a property right of the seller.

The applicable law may recognise that right as retention of title, vendor's charge or acquisition security right. Regardless of the form of recognition, seller has the right to the inventory and any proceeds from its sale.

Distressed Finance

The Store approaches the NBFI and the Bank to provide financing against inventory, receivables, and proceeds as it is running out of cash. Both the Bank and the NBFI are willing to provide financing if they can obtain first priority with respect to the collateral.

The loan is disbursed while the Store is still solvent; part of it is used to pay for the inventory.

Public Assistance

Central Bank Discount Window Using MSME Loans

The Bank is incentivised to offer such a loan because the Central Bank accepts MSME loans, meeting the specified criteria, as collateral to obtain the Central Bank's assistance. However, this option is only available if the Store has not filed for insolvency. New and existing MSME loans are eligible provided they meet the criteria.

[103] See Appendices C and D which reference EBRD economies where Covid-19 public assistance programmes were established.

[104] European Central Bank (2021), What are Additional Credit Claims (ACC) frameworks? www.ecb.europa.eu/ecb/educational/explainers/tell-me-more/html/acc_frameworks.en.html (Accessed: 31 March, 2023).

[105] This may be subject to further approval of the relevant insolvency court and/or majority creditors.

[106] EBRD Business Reorganisation Assessment (2022), Annex 6, Protection of New Financing, www.ebrd-restructuring.com/storage/uploads/documents/6.pdf.

Agreements:

1. **Store-NBFI:** loan and security agreement
2. **Store-Bank:** loan and security agreement
3. **Bank-NBFI:** subordination agreement
4. **Public Guarantee-Bank-Store:** guarantee

A variation of this structure entails the Store filing for insolvency to benefit from a temporary stay and achieve a reorganisation of its financial liabilities with its creditors, including trade creditors, subject to majority creditor consent. The Store needs additional working capital to continue trading. A central bank discount window may accept non-marketable collateral, such as credit claims in the form of MSME loans. For instance, the European Central Bank publishes a list of assets eligible as collateral for borrowing that include loans issued by banks to companies.

The general Eurosystem collateral framework also includes loans extended to SMEs.[104] However, banks might face regulatory constraints when lending to businesses subject to insolvency proceedings and existing public assistance programmes for banks may not be applicable in such situations. In particular, the EBRD Survey of Insolvency and Secured Transaction Regimes found that in 15 of the surveyed economies there are regulatory restrictions and in nine economies banks may further incur a liability when extending credit to a distressed borrower. Such restrictions may not necessarily apply to non-bank lenders.

In the example considered, reflecting the EBRD findings, the Bank is unable to offer new financing as the Store is financially distressed, but the NBFI believes that the Store can be successfully restructured within an insolvency reorganisation procedure. The NBFI offers new financing to the Store to enable it to continue its operations during the reorganisation procedure because the insolvency law gives any creditor supplying new financing priority over existing unsecured creditors and allows the NBFI to receive new security in consideration for its loan.[105] The Store is continuing to grow sales and new financing is provided on the basis of security over any unencumbered assets, including new and future receivables.[106]

MECHANICS IN INSOLVENCY (BUSINESS REORGANISATION) CONTEXT

Parties Relationships

Insolvency

The seller asserts a claim against receivables of the Store, but the Store does not have sufficient capital to continue its operations.

The Store files for business reorganisation within an insolvency procedure and seeks new finance to resume business operations.

New Finance

The Store is offered new financing that the NBFI is able to provide because the applicable insolvency law recognises the priority of such new financing over unsecured assets and the validity of any new security granted by the Store to the NBFI.

Public Assistance

Public Guarantee

Public guarantee schemes can be extended to facilitate the financing of borrowers in various states of distress. Specifically, guarantees should: (i) be available to NBFIs, as well as banks, and cover NBFI/ bank financing of MSMEs in insolvency reorganisation procedures (subject to adequate legal frameworks); and (ii) ensure that this new, riskier financing benefits from collateral.

Agreements:

1. **Store-NBFI:** loan and security agreement relating to the new finance
2. **Public Guarantee-Bank-Store:** guarantee

This structure facilitates deployment of different products. Depending on the domestic circumstances, the basic product structure can include additional layers to accommodate different distress situations and leverage on the existing public guarantee or other assistance programmes for MSMEs. A central bank discount window for MSME loans can offer a support mechanism that provides liquidity and promotes lending. In this context, banks can be encouraged to develop and deploy receivables products and, more generally, the financing of MSMEs through secured lending.

iii. Comparing Structures and Inherent Risks

Preference for Structure 1 (Reverse Factoring/ Supply Chain Financing) over Structure 2 (Loan Secured by Multiple Receivables) or vice-versa cannot be determined in the abstract. While this report offers the tools to make such a determination based on existing legal, regulatory and market circumstances (see Section 4 Roadmap, Checklists), key considerations are advanced in respect to how these two structures address the risks that are inherent to any receivables financing.

These inherent risks primarily relate to the non-performance or the default in the underlying commercial transaction that generates the receivables. Any receivables products will be viable in the jurisdictions that have implemented international standards. In contrast, different types of weaknesses exemplified in a legal and regulatory framework not fully compliant with the international standards will determine the degree of viability, costs and risks of the relevant transaction.

Structure 1 (Reverse Factoring/ Supply Chain Financing) addresses these inherent default risks at their core since the primary risk for the finance provider is towards the anchor buyer, generally a creditworthy entity. The Anchor Buyer approaches a financial institution to provide liquidity to its sellers and subsequently confirms the performance of the underlying commercial transaction, typically entailing delivery of goods or the provision of services. The risk of non-payment or multiple transfers of the same receivable is, thus, higher in both traditional factoring (where more underlying transactions generating receivables need to be monitored and conflicting priorities can compromise the value of receivables or their collection) and in loans secured by multiple receivables (Structure 2).

As illustrated in the above example (Structure 2), a receivable might have been generated from the resale of inventory that an MSME-distributor acquired subject to the right of the seller. Usually, the seller does not reserve any rights in the inventory but, during the pandemic, the MSME-distributor might have needed more time to pay the purchase price. As a result, the seller would potentially be able to assert a claim to the receivable that the MSME-distributor transferred to a finance provider. In this context, if other mitigants are not available, finance providers would need to conduct costly due diligence to ascertain possible risk exposure and even negotiate subordination agreements with sellers.

The risks inherent to receivables financing are normally addressed differently in the legal and regulatory framework governing the relevant structure. For instance, loans secured by multiple receivables can be a viable product especially in jurisdictions where traditional factoring is not developed if the legal framework provides for: (a) effective infrastructure for registration of security over movable assets, including intangibles such as receivables; (b) clear priority rules that resolve potential conflicts between competing claims in the underlying transaction; and (c) clear and efficient rules on taking security over receivables (present and future) as well as security over any deposit accounts into which the receivables are paid.

Furthermore, domestic insolvency law should have in place mechanisms to ensure the priority of a finance provider with respect to any receivables, or other collateral, financed following any entry into an insolvency or pre-insolvency procedure. In a similar vein, regulatory standards and supervisory frameworks add an additional level of protection. In fact, licensed financial institutions are required to implement different mechanisms to minimise risks, including a minimum level of capital, limits on exposures and concentration in the receivables portfolio as well as reporting requirements to facilitate controls.

Lastly, the risks associated with receivables finance can be mitigated through public programmes designed to provide liquidity to MSMEs. These measures were activated during the pandemic, as highlighted in the EBRD Survey of Insolvency and Secured Transaction Regimes.[107] While some measures, such as special central bank refinancing programmes are progressively phased out, others, like public guarantee programmes are likely to be scaled back to their pre-pandemic model.

[107] The EBRD Survey of Insolvency and Secured Transaction Regimes (2023) found that nine out of 38 economies implemented special central bank refinancing programmes during the pandemic.

Section 3: Implementation strategy

The development of strategies to support availability of credit products for distressed MSMEs in the EBRD regions must be tailored to domestic needs and idiosyncrasies. As illustrated in Section 2, new financing to MSMEs in distress can be provided through specific credit products. Specifically, two structures have been identified based on a set of criteria that ensure their alignment with short-term needs and long-term development goals. Their effective implementation requires efforts that consider specific variables, such as (i) the impact of the Covid-19 pandemic; (ii) the type of emergency measures adopted throughout the pandemic; (iii) the maturity of domestic credit markets; (iv) the existence of conducive secured transactions, insolvency and regulatory frameworks; and (v) the extent of digitalisation.

This Section provides a blueprint to consider domestic idiosyncrasies and develop a product-focused implementation strategy for EBRD jurisdictions. At the heart of this strategy is the identification of core elements – consisting of key aspects of secured transactions, insolvency and regulatory frameworks that are necessary for the development of the products – and critical enablers – consisting of technological infrastructure and capabilities and valuation standards that also underpin secondary markets all supporting receivables lending.

Identification of core elements and critical enablers for each product within a specific jurisdiction aids the determination of: (i) which products best dovetail with the existing legal and regulatory environment, (ii) what reforms might be needed and (iii) how to coordinate different elements of the credit ecosystem, including public assistance programmes, legal and regulatory elements, technology and secondary markets. In providing a blueprint for this assessment, this report distils actionable recommendations, so that policymakers can take measures enabling development of selected products, promote market-based solutions and support a sustainable recovery that is geared towards long-term policy goals.

This Section is structured in two parts. The first part offers an overview of the main impediments that may limit the development of receivable finance in the EBRD regions. The second part introduces the main international standards affecting the core elements of the selected credit products pertaining to secured transactions, insolvency and regulation. These standards have been elaborated by the EBRD and UNCITRAL, for secured transactions; and the EBRD, UNCITRAL and the World Bank, for insolvency. In respect to the regulatory elements, the focus is on prudential requirements for banks, with reference to the Basel Framework elaborated by the BCBS and domestic loan-loss provisioning. The critical enablers bolster the implementation of selected credit products at the domestic level.

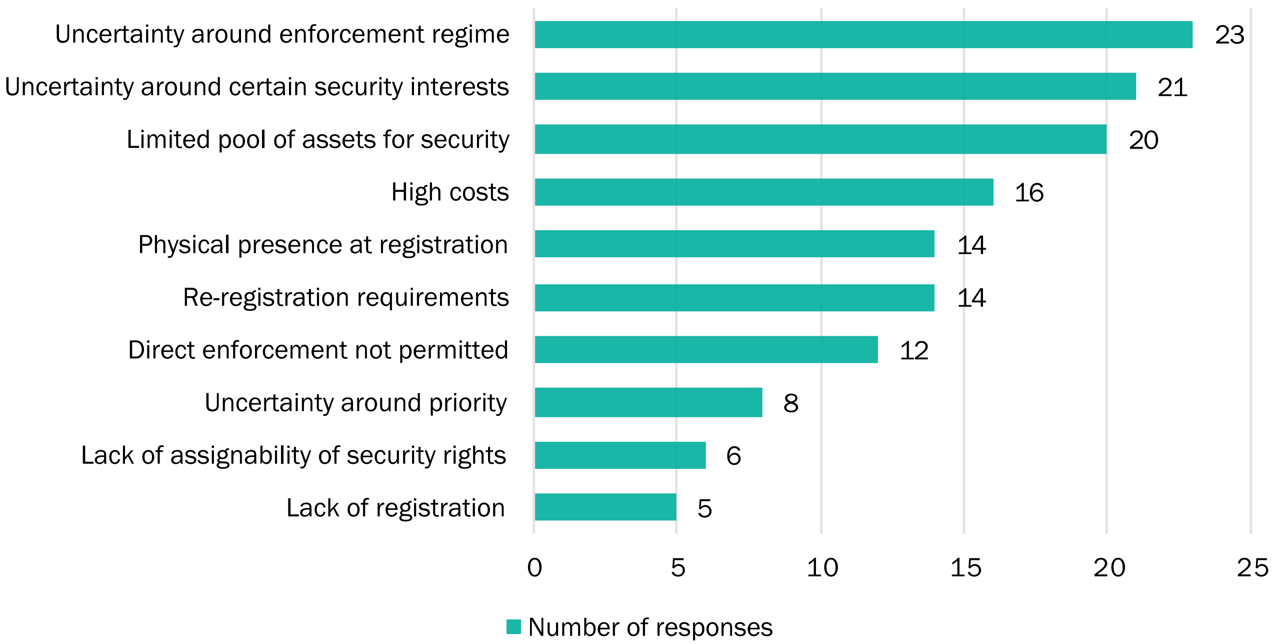
A. OVERVIEW

The identification of prototypical structures for credit products allows to distil the specific components of the credit ecosystem that are either essential or conducive to their development. Essential legal and regulatory components are labelled as "core elements", indicating that their absence is an impediment to the development of the credit products and, more generally, to secured credit. Technological solutions and valuation standards are labelled as "critical enablers", as they facilitate the implementation of the credit products.

In EBRD countries, such core elements and critical enablers might already be present or require minimal adaptations. For instance, the 2018 EBRD Factoring Survey indicated that 35 out of 37 covered jurisdictions permitted factoring agreements to provide for transfers of future receivables, which is essential for any receivables credit product.[108] However, more profound reforms might be needed to implement certain credit products and stimulate the emergence of a supportive credit ecosystem.

In particular, the Survey of Insolvency and Secured Transaction Regimes of the EBRD regions revealed the following four impediments to secured credit with respect to movable assets in the order of their significance: (i) uncertainty around the enforcement regime, (ii) uncertainty around the legal treatment of certain security rights, particularly in relation to receivables, (iii) a limited pool of assets for security and (iv) high costs, including notarisation fees, taxes and duties.[109] Although these challenges have been persistent in the EBRD regions,[110] addressing them would aid the deployment of credit products designed to support distressed MSMEs. In fact, effective enforcement, legal certainty for security rights and low transactional costs are vital to supporting new finance pre- and post-insolvency.

Figure 3: Main obstacles to taking security over movables in EBRD regions



Note: *This chart summarises responses from the EBRD Survey of Insolvency and Secured Transaction Regimes on the legal, regulatory and practical impediments to taking security over movable property in the EBRD regions.*

In this context, a product-focused approach to stimulate the extension of new finance yields several benefits and spurs broader reform. This Section devises a strategy to ensure that MSME-friendly credit products can be effectively and rapidly implemented in any given jurisdiction. This strategy first identifies the core elements and critical enablers of these credit products. Then, it determines which reforms should be undertaken, while promoting coordination with the phase-out of emergency measures. Hence, the development of credit products is tailored to the immediate need for new finance in any given jurisdiction and long-term modernisation trajectories.

[108] EBRD (2018), Factoring Survey in EBRD Countries of Operations, Third Edition.

[109] EBRD (2018), Factoring Survey in EBRD Countries of Operations, Third Edition, p.11

[110] Improving the enforcement framework has been a priority; see Regional: Study on the legal framework for the enforcement of creditors' claims in selected EBRD countries of operations (EBRD and DLA Piper, March 2019), www.ebrd-restructuring.com/enforcement-study (Accessed: 31 March, 2023).

B. CORE ELEMENTS AND CRITICAL ENABLERS

i. Core Elements

The core elements are secured transactions law, insolvency law and regulation. They contain rules designed to protect the rights of creditors, reduce financial instability and curb conduct risk. They are all essential to supporting a sound and inclusive credit ecosystem.[111] The role and importance of each of these core elements in any national strategy will depend on the country specific context.

CORE ELEMENTS

Secured Transactions Law

Secured transactions frameworks facilitate access to credit secured with rights in movable assets, including receivables, reducing the costs of lending.[112]

Secured transaction laws provide for the effective transfer of rights to movable assets, such as under a pledge, an absolute assignment or a security assignment of receivables, known as "security rights".

Absence of predictable secured transaction rules render movables-based finance too costly or prohibitive. As a result lending may predominantly rely on security over immovable assets.

Insolvency Law

Insolvency frameworks facilitate orderly resolution of debts and distribution of property in liquidation and the reallocation of assets and resources in reorganisation. They preserve value and promote the restructuring of viable businesses, including through hybrid proceedings.

An efficient insolvency framework protects the security right established under the secured transactions law, separates receivables transferred outright from the insolvency estate and enables new financing within insolvency proceedings, subject to adequate secured creditor protections.

The absence of effective and efficient insolvency frameworks results in piecemeal liquidations, with deterioration in the value of the debtor business.

Regulation

Regulatory governance plays a pivotal role in the establishment of a sound and inclusive credit ecosystem. The regulatory framework ensures both the viability of credit markets and the balance between the benefits and risks of credit, in the context of financial stability, market integrity and customer protection.

Regulatory regimes are typically classified into two broad categories:

- conduct of business: encompasses rules designed to protect the integrity of financial markets – that is, the ability of markets to operate fairly, efficiently and support legitimate activities;
- prudential regulation: aims at maintaining the soundness of individual financial institutions (micro-prudential) and the stability of the financial system in its entirety (macro-prudential).

[111] World Bank (2020), Coordinating Prudential Regulation and Secured Transactions Frameworks: A Primer, http://documents.worldbank.org/curated/en/739451604998793072/Coordinating-Prudential-Regulation-and-Secured-Transactions-Frameworks-A-Primer, p. 9, (Accessed: 31 March, 2023) and Arner, D.W., (2007), Financial Stability, Economic Growth and the Role of Law, Cambridge.

[112] Castellano G. (2015), Reforming Non-Possessory Secured Transactions Laws: A New Strategy?, 78-4 The Modern Law Review 611, 2015.

Secured Transactions Law

Several international standards outline how an efficient framework for security rights in movable assets may be designed. While they may differ in some respects, the underlying policies and approaches are similar. The EBRD Core Principles for a Secured Transactions Law express those common policies and approaches and provide the building blocks for an effective secured transactions regime that enables the development and deployment of secured credit products.[113] The 2021 Principles for Effective Insolvency and Creditor/Debtor Regimes are the most recent articulation of those principles, also ensuring coordination of secured transactions and insolvency regimes.[114]

The 2016 UNCITRAL Model Law on Secured Transactions[115] and the 1994 EBRD Model Law on Secured Transactions[116] provide concrete guidance to States on the implementation of those principles in domestic statutory frameworks. The implementation of these principles would reduce risks for lenders and lead to the increased availability of credit at reasonable rates. Earlier surveys showed an advanced status of legislative frameworks for secured transactions in the EBRD region. However, regardless of its advanced status, the support of credit products is still lacking in many areas, as revealed in the EBRD Survey of Insolvency and Secured Transaction Regimes. Furthermore, only a few states in the EBRD regions have implemented the UNCITRAL Model Law on Secured Transactions.

The secured transactions framework should: (i) enable the creation of a security right in fluctuating and future movable assets, particularly inventory and receivables, as well as security over any deposit accounts into which the receivables are paid, (ii) recognise the power to transfer receivables regardless of any restriction in the underlying contract (anti-assignment clause), (iii) prescribe a clear set of priorities among creditors with a right in the collateral, including those arising from the underlying transaction, (iv) provide for the right to collect or otherwise dispose of the receivables extra-judicially and (v) set out predictable conflict of law's provisions for cross-border transactions.

Insolvency Law

Insolvency frameworks also serve to guide the extension of credit as costs depend on the level of creditor protection. An adequate insolvency system enhances the extension of credit that might be otherwise unavailable or expensive.[117] The protection of secured creditors is necessary, not only in case of formal insolvency proceedings, but also in out-of-court or hybrid restructuring. As recent developments in some of the EBRD countries show,[118] there must be coordination between secured transactions and pre-insolvency arrangements.[119]

Several international standards exist for insolvency.[120] In 2004, UNCITRAL published Parts I and II of its Legislative Guide on Insolvency, which covered substantive and procedural aspects of insolvency proceedings as well as an analysis of its institutional framework. The Legislative Guide included a detailed set of recommendations by topic, which served as the basis for a comprehensive international standard.[121] The recommendations of the Legislative Guide were incorporated by the World Bank into its own set of broad principles, the Principles for Effective Insolvency and Creditor/Debtor Regimes.[122] At a regional level, the EBRD has produced some of the most influential standards on the subject matter, including the EBRD's Principles on Insolvency Office Holders as well as the EBRD's Core Principles of an Effective Insolvency System.[123]

Generally speaking, these standards feature a similar way of treating secured creditors in insolvency: (i) perfected security rights must be respected in insolvency proceedings; (ii) to preserve the going concern value of a business, the enforcement of security rights may be temporarily suspended if the collateral is necessary for the continuation of business activity; and (iii) the secured creditor must be provided adequate protection against potential damage suffered by the suspension of its rights. These rules ensure that security rights are only affected when necessary, to prevent damage to the secured creditor.

Over the past few years, the distinction between formal and informal proceedings has been substantially blurred. In the wake of the economic crisis caused by the Covid pandemic, the inclusion – or bolstering – of extrajudicial procedures to tackle business financial distress will be paramount. Some insolvency systems in the EBRD regions (like Albania, Poland, Greece) include mechanisms to foster the use of formal insolvency proceedings, either in the form of a duty to file or through wrongful trading provisions. These mechanisms are often tied with cash flow insolvency tests, so debtors and company directors might be pushed to open formal proceedings to avoid personal liability or disqualification.

The potential shortage of business liquidity increases the risk of clogging the courts, delaying proceedings and consequently destroying business value. To minimise this risk, jurisdictions have started to provide for informal systems (hybrid proceedings) whereby viable debtors and their creditors may reach solutions out of court, or with minimal court intervention (like in Greece, Poland and Romania). This trend is reinforced by recent legislative developments in the EU, which has traditionally had influence in other countries, including in the EBRD regions.[124]

These developments also address the effect of *ipso facto* clauses. The function of these clauses is to enable termination of a contract, including acceleration of a loan owed by a financially distressed debtor. Such clauses are made generally ineffective in insolvency proceedings as they destroy the going concern value of the business. There are some exceptions to the ineffectiveness of these clauses, such as provisions relating to financial collateral, but those are inapplicable to the receivables credit products. Recently, the ineffectiveness of *ipso facto* clauses has been extended to include the opening or request for opening of preventive restructuring proceedings (early measures for restoring a debtor's solvency) in the EU, which should be incorporated in the frameworks of EBRD jurisdictions.

Some insolvency frameworks include rules that grant protection to security rights created in the context of consensual financial restructuring or reorganisation procedures when certain legal requirements have been met. The protection is given against ex post avoidance actions, in case the restructuring fails and liquidation is commenced, in the absence of fraud. Similarly, systems with out-of-court hybrid procedures provide priority to creditors granting interim financing (that is, funds provided in the process leading to a restructuring agreement) and any new financing of the business with a view to implementing the restructuring agreement,[125] even when the restructuring ultimately fails and formal liquidation proceedings are commenced.

Insolvency law should ensure that the supply chain is not disrupted and value lost. The validity of the assignment of receivables under a contract executed before the opening of insolvency proceedings should be recognised, as well as the absolute priority of the secured creditor over, at least, those receivables which originate from a contractual relationship already existing when the insolvency proceedings commence. Moreover, a jurisdiction should provide for the protection in insolvency proceedings of secured creditors with rights over receivables arising from contracts that have been disclaimed by the insolvency administrator. This can be done through the requirement to provide adequate compensation to the secured creditor.

[113] EBRD Core principles for a secured transactions law, www.ebrd.com/what-we-do/legal-reform/access-to-finance/transactions.html.

[114] World Bank (2021), Principles for Effective Insolvency and Creditor/Debtor Regimes, www.openknowledge.worldbank.org/handle/10986/35506.

[115] UNCITRAL Model Law on Secured Transactions (2016), www.uncitral.un.org/en/texts/securityinterests/modellaw/secured_transactions.

[116] EBRD Model Law on Secured Transactions (2010 edition) www.ebrd.com/news/publications/guides/model-law-on-secured-transactions.html.

[117] Mooney Jr. C., Insolvency Law as Credit Enhancement and Enforcement Mechanism: A Closer Look at Modernization of Secured Transactions Law (2018), www.scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3180&context=faculty_scholarship (Accessed: 31 March, 2023).

[118] See Section 1 of this report.

[119] Bartos T. et al., Special Study: Legal Transition Programme Review, University of Hong Kong Faculty of Law Research Paper No. 2012/040, 2016 revision, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2181251 (Accessed: 31 March, 2023)

[120] IMF (1999), Orderly and Effective Insolvency Procedures: Key Issues, www.imf.org/external/pubs/ft/orderly/ (Accessed: 31 March, 2023).

[121] UNCITRAL Legislative Guide on Insolvency Law, www.uncitral.un.org/en/texts/insolvency/legislativeguides/insolvency_law. The Legislative Guide has further developed over the years: in 2010, Part III, on enterprise groups and insolvency, was adopted; and, in 2013, Part IV regarding the treatment of the liability of directors in insolvency was first approved (with a second edition in 2018).

[122] World Bank (2021), Principles for Effective Insolvency and Creditor/Debtor Regimes, www.openknowledge.worldbank.org/handle/10986/35506. The WB ICR Principles were first approved in 2001 and have been updated since then on several occasions. The Principles relevant to secured transactions and insolvency, as modelled in this report, would be the following: B2, B4, B5, C5, C8, C9, C10, C11, C12, C14, D1 and D8. The World Bank has issued a number of additional, best practice documents concerning particular aspects of the insolvency regime: The World Bank Guide on Out of Court Debt Restructuring (Dec. 2011), www.elibrary.worldbank.org/doi/abs/10.1596/978-0-8213-8983-6; or Report on the Treatment of the Insolvency of Natural Persons (World Bank, 2014), www.openknowledge.worldbank.org/handle/10986/17606; or Report on the Treatment of MSME Insolvency (World Bank, 2014), www.openknowledge.worldbank.org/handle/10986/26709.

[123] EBRD (2021), Core Principles of an Effective Insolvency System, and EBRD (2021), Principles for an Effective Professional and Regulatory Framework for Insolvency Office Holders, both at https://www.ebrd.com/what-we-do/sectors/legal-reform/debt-restructuring-and-bankruptcy/international-standards.html. The document on insolvency office holders followed an in-depth analysis finalised in 2014, and, since that date, the EBRD has worked in several jurisdictions, with the standard, to improve the insolvency profession. The EBRD's Core Principles were first published in 2007 and have been updated several times since.

[124] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks. For a thorough analysis of hybrid proceedings, which directly influenced the drafting of the Directive, see Contractualised Distress Resolution in the Shadow of the Law (July 2018), www.codire.eu, and L. Stanghellini et al, Best Practices in European Restructuring: Contractualised Distress Resolution in the Shadow of the Law (Walters Kluwer, 2018), www.codire.eu/wp-content/uploads/2018/11/Stanghellini-Mokal-Paulus-Tirado-Best-practices-in-European-restructuring.-Contractualised-distress-resolution-in-the-shadow-of-the-law-2018-1.pdf.

[125] These rules are expressly envisaged in the Directive (EU) 2019/1023 on preventive restructuring frameworks, whose transposition is mandatory in the following countries of the EBRD regions: Bulgaria, Croatia, Cyprus, the Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia.

Regulation

Of particular relevance for the development of credit products are the prudential standards pertaining to: (i) loan-loss provisioning, established at the domestic level in coordination with accounting standards, and (ii) bank capital requirements, or capital adequacy standards, enshrined in the Basel Framework elaborated by the BCBS.[126]

Conduct of business and prudential regulation interact with the selected credit products in different ways. In some instances, regulatory elements are essential for the development of credit products. While ensuring market integrity and the soundness of credit markets, they clearly set compliance standards, providing a validation mechanism that instils confidence in market participants as well as protecting from systemic risks. In other instances, regulatory elements may stifle the development of the credit products if they are not properly coordinated with private laws.

Receivables products – offered either by a bank or by a non-bank financial institution – ought to be subject to adequate conduct of business and prudential requirements. Clear licensing and supervisory frameworks for non-banking financial institutions (NBFIs) are essential to create diversified and liquid markets for receivables credit products. This is even more urgent for new finance in distress scenarios. In general, where regulatory standards are opaque, secured lending and receivables financing suffer because there is less confidence in credit products. During the Covid-19 pandemic, the problem is even more acute. The relaxation of prudential standards and the new liquidity measures have increased risks related to over-indebtedness and the accumulation of NPLs.

In a similar vein, the heavy reliance on online platforms, the sudden demand for immediate liquidity, the volatility of capital markets and conversion rates increase the risk of fraud. Hence, ensuring regulatory compliance is even more relevant to preserve the integrity of financial markets.[127] Overall, proportionate regulatory and supervisory regimes are necessary to address these issues and instil confidence in the market.[128]

In this context, a set of core regulatory elements, premised on the licensing and supervisory functions, would set unambiguous expectations for the industry and stimulate the emergence of a transparent market. Moreover, international best practices would inform the implementation of proportional graduated activity-based approaches – focusing on level of risk and allowing differential treatment of varying classes of lender. This would facilitate both market entry and competition, supporting innovation and access to finance while promoting financial stability and market integrity.[129]

The following regulatory requirements should be present: (i) a minimum level of capital consisting of shareholders' equity and, for banks, other liquid instruments and retained earnings; (ii) fitness and propriety standards for senior managers to ensure both professionalism and accountability; (iii) application of international accounting standards to maintain adequate levels of reserve allowance, with particular attention to problem assets; (iv) auditing obligations to instil transparency; and (v) application of an internationally compliant anti-money laundering regime to promote market integrity. Local authorities should be entrusted with regulatory and supervisory powers. In particular, they should be able to grant, suspend or withdraw license, perform on- and off-site inspections and adjudicate customer-related disputes in a fast and effective manner. As digitalisation evolves, it is also important to build an appropriate framework to address technological risks, including cybersecurity and to implement infrastructure safeguards.

[126] See Basel Framework, www.bis.org/basel_framework/.

[127] World Bank (2020), Coordinating Prudential Regulation and Secured Transactions Frameworks: A Primer, http://documents.worldbank.org/curated/en/739451604998793072/Coordinating-Prudential-Regulation-and-Secured-Transactions-Frameworks-A-Primer, p. 9, (Accessed: 31 March, 2023)

[128] World Bank (2020), Coordinating Prudential Regulation and Secured Transactions Frameworks: A Primer, http://documents.worldbank.org/curated/en/739451604998793072/Coordinating-Prudential-Regulation-and-Secured-Transactions-Frameworks-A-Primer, p. 10, (Accessed: 31 March, 2023) The Financial Action Task Force (FATF) indicates an "increase in Covid-19-related crimes, such as fraud, cybercrime, misdirection or exploitation of government funds or international financial assistance", that creates new sources of proceeds for illicit actors. Therefore, new, policies to address these compliance challenges need to be implemented; see Covid-19-related Money Laundering and Terrorist Financing Risks and Policy Responses (FATF, May 2020), https://www.fatf-gafi.org/en/publications/Fatfgeneral/Covid-19-ml-tf.html.

[129] Zetzsche, D.A. et al. (2020), Fintech toolkit: Smart Regulatory and market approaches to financial technology innovation, University of Hong Kong Faculty of Law Research Paper No. 2020/027, SSRN, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3598142 (Accessed: 31 March, 2023).

Coordinating Core Elements

Coordination between private law and regulatory elements, particularly between secured transactions law and prudential regulation, is essential for both the development and deployment of the selected credit products.[130] The UNCITRAL Practice Guide to the Model Law on Secured Transactions[131] and the World Bank's Knowledge Guide on Secured Transactions, Collateral Registries and Movable Asset-Based Financing[132] have highlighted the importance of coordinating these two areas in domestic law reforms. In addition, the International Financial Corporation (IFC) issued a Primer on Coordinating Prudential Regulation and Secured Transactions Frameworks, setting out the main components of a coordination strategy at the domestic level.[133]

Credit products that are based on receivables fall simultaneously within the purview of multiple branches of law in a "commercial law intersection",[134] including secured transactions law, insolvency law, conduct of business and prudential regulation.[135] A harmonious and synergetic interaction is required to support credit products, but certain coordination failures may arise.

While a jurisdiction may have a functioning private law framework, licensing requirements to offer selected credit products might be unclear. Although some special licensing requirements have been implemented for factoring companies (see Table 2 (Licensing for Factoring Companies) below), it might be unclear in some jurisdictions whether banks can engage in factoring activities under a general banking licence or if a new factoring licence is required. More broadly, the lack of a clear licensing regime for NBFIs might stifle the emergence of a liquid and diverse market for receivables products. Factoring companies may finance their operations by reselling or pledging portfolios of receivables. However, banks might find it too risky to purchase such portfolios or to extend finance to a factoring company, if clear licensing and regulatory standards are not established.[136]

Coordination must be sought also to avoid the implementation of excessively stringent regulatory standards. For instance, in some EBRD jurisdictions, prudential requirements penalise lenders – and, in particular, banks – that provide new credit to distressed businesses, even to those businesses that are potentially viable. Moreover, limits might be imposed on the regulatory treatment of collateral. Most movable assets, such as inventory and receivables might not qualify as eligible collateral under domestic prudential requirements, requiring banks to treat transactions secured with movable assets or receivable-based lending as unsecured credit.[137]

[130] Castellano G. & Dubovec M., Global Regulatory Standards and Secured Transactions Law Reforms: At the Crossroad between Access to Credit and Financial Stability (41 Fordham International Law Journal 2018).

[131] See Chapter 3 of UNCITRAL Practice Guide to the Model Law on Secured Transactions (2020), www.uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/19-10910_e.pdf.

[132] World Bank (2019), Secured Transactions, Collateral Registries and Movable Asset-Based Financing: Knowledge Guide, http://hdl.handle.net/10986/32551.

[133] World Bank (2020), Coordinating Prudential Regulation and Secured Transactions Frameworks: A Primer, http://documents.worldbank.org/curated/en/739451604998793072/Coordinating-Prudential-Regulation-and-Secured-Transactions-Frameworks-A-Primer, (Accessed: 31 March, 2023)

[134] The notion has been advanced in Castellano G. & Tosato A., Commercial Law Intersections, (72 Hastings Law Journal 999, 2021).

[135] Other branches of law include property, contract law, and civil procedure; see Castellano G. & Tosato A., Commercial Law Intersections, (72 Hastings Law Journal 999, 2021) p. 1017.

[136] Banks often have limits on dealing with unregulated financial institutions. Moreover, exposures towards unregulated financial entities might be treated as unrated corporate exposures.

[137] This the problem has been first noted in Castellano G. & Dubovec M. (2018), Credit Creation: Reconciling Legal and Regulatory Incentives (81-1 Law and Contemporary Problems). A set of guidelines to address this issue have been distilled in World Bank (2020), Coordinating Prudential Regulation and Secured Transactions Frameworks: A Primer, http://documents.worldbank.org/curated/en/739451604998793072/Coordinating-Prudential-Regulation-and-Secured-Transactions-Frameworks-A-Primer, p. 19-20, (Accessed: 31 March, 2023).

TABLE 2: LICENSING FOR FACTORING COMPANIES

COUNTRY	FACTORING LICENCE	AUTHORITY
Armenia	✔	Central Bank of Armenia
Egypt	✔	Financial Regulatory Authority
Georgia	✔	Central Bank of Georgia
Greece	✔	Central Bank of Greece
Kazakhstan	✔	National Bank of Kazakhstan
Moldova	✘	N/A
Montenegro	✔	Central Bank of Montenegro
Serbia	✔	National Bank of Serbia
Türkiye	✔	Banking Regulation and Supervision Agency
Ukraine	✔	National Bank of Ukraine

Addressing those challenges requires an assessment of domestic conditions to design a reform strategy that does not pursue a de-regulatory agenda.[138] In particular, legal and regulatory requirements should be implemented coherently to limit the risks associated with credit products and, specifically, with receivables products.[139] An example of this approach is reflected in the efforts of the EBRD Legal Transition Team to enact factoring laws that comprise private law rules and regulatory regimes (like Georgia) as well as in the strategies developed by other international organisations to promote coordination between secured transactions law and prudential regulation.[140] As further illustrated below, the strategy advanced in this report adopts and expands on such international standards to facilitate the development of receivables products.

ii. Critical Enablers

In addition to the core elements, technology and clear valuation standards and procedures are identified as critical enablers for the extension of new finance in distress scenarios.[141]

The remainder of this Section offers an overview of the chief aspects concerning technology and valuation in the context of receivables products and secured lending.

CRITICAL ENABLERS

Technology

Technology offers several solutions, especially collateral registries and digital invoicing systems that support secondary markets.

Valuation

Valuation of collateral determines the amount of the secured claim and the corresponding rights of the secured creditor in insolvency.

Both technology and valuation are instrumental for the establishment of secondary markets for collateral and the development of receivables products by policymakers.

In the context of receivables financing, secondary markets are chiefly represented by platforms. Several EBRD countries are in the process of establishing secondary markets (like Egypt and Serbia)[142] and some have already established commodity exchanges (like Türkiye).[143] Financial institutions and traders regularly use foreign exchanges (for example, the Chicago Mercantile Exchange) as a reference point to establish prices, especially for commodities.

Technology

Technological infrastructures and solutions can simplify the process of assessing creditworthiness and the suitability of MSME applicants[144], determine the existence and value of receivables, simplify payment processes, provide the infrastructure for collateral registries and underpin secondary markets, such as platforms to trade receivables. These infrastructures build on and complement the existing technologies and legal frameworks that, for instance, enable electronic signing and authentication of persons. Technology enables lenders to manage their risks more efficiently, reduce customer acquisition and monitoring costs as well as streamlining the onboarding of clients and facilitate regulatory compliance. Other aspects of credit products (like enforcement) are also affected by technology. For instance, the 2019 EBRD Enforcement Study highlighted the low level of digitalisation in judicial proceedings that may concern enforcement of security rights, as well in extra-judicial public auctions of the collateral.[145] Several EBRD economies are undertaking efforts to build infrastructures that facilitate commercial activities, more broadly (for example, an electronic auction system in Serbia).

In this context, several aspects of the digital financial infrastructure are particularly relevant to support MSME lending in the EBRD regions (see Table 3 (Digitalisation) below). First, to offer the credit products through FinTech solutions, such as platforms for receivables, the level of digital inclusion of a given economy must be assessed. If digitalisation is limited, credit products might first need to be developed in traditional form and then scaled up. Second, the existence of sovereign digital identification frameworks for individuals and businesses can facilitate the generation of receivables, as well as identification of debtors in collateral and credit registries, by providing certainty of identity and simplifying customer acquisition and credit analysis. Initiatives in this regard can be used to facilitate regulatory compliance. Third, the existence of specific solutions for receivables financing and secured lending should be assessed. This is most notably represented by the existence of electronic registries.

An electronic collateral registry is a key plank of a modern secured transactions regime that enables non-possessory security rights and protects the rights of secured creditors in insolvency. In the context of this report, it would be particularly helpful to facilitate Structure 2 type of transactions where a loan is secured by multiple receivables and related assets. Though the EBRD countries have implemented electronic registration systems for secured transactions (like Ukraine) or property (see Table 3 (Digitalisation) below), at times their processes have not been digitalised (like Greece) or electronic access is available only through a third party, such as a notary (like Slovakia).

International organisations and other entities have provided detailed guidance on the establishment of electronic collateral registries, including legal but also technical aspects. The UNCITRAL Guide on the Implementation of a Security Rights Registry provides the legal parameters to establish and operate electronic registries,[146] and the Best Practice in the Field of Electronic Registry Design and Operation combines legal with technical recommendations.[147] The benefits of establishing electronic collateral registries with distributed ledger technologies (DLT) have not been demonstrated. The tamper-proof nature of DLT has already been successfully implemented through other technologies in electronic collateral registries and the proposed applications and new features are not commercially attractive.[148]

[138] Blind de-regulation, in fact, would risk undermining confidence in the credit market while the application of international regulatory standards must be ensured; see World Bank (2020), Coordinating Prudential Regulation and Secured Transactions Frameworks: A Primer, http://documents.worldbank.org/curated/en/739451604998793072/Coordinating-Prudential-Regulation-and-Secured-Transactions-Frameworks-A-Primer,

[139] This is to say that law reforms should aim at preserving “legal coherence” by coordinating legal and regulatory elements; Castellano G. & Tosato A., Commercial Law Intersections, (72 Hastings Law Journal 999, 2021) at p. 1028.

[140] See generally World Bank (2020), Coordinating Prudential Regulation and Secured Transactions Frameworks: A Primer, http://documents.worldbank.org/curated/en/739451604998793072/Coordinating-Prudential-Regulation-and-Secured-Transactions-Frameworks-A-Primer,.

[141] Arner, D.W., et al., Digital Finance, Covid-19 and Existential Sustainability Crises: Setting the Agenda for the 2020s, University of Hong Kong Faculty of Law, Research Paper No. 2021/001, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3783605 (Accessed: 31 March, 2023).

[142] Egyptian Commodity Exchange, http://www.egycomex.com/; and Serbian Law on Commodity Exchange, https://www.sec.gov.rs/index.php/en/regulations/legislation/forms/300-law-on-commodity-exchanges (Accessed: 31 March, 2023).

[143] The Union of Chamber and Commodity Exchanges of Türkiye, http://www.tobb.org.tr/Sayfalar/Eng/AnaSayfa.php (Accessed: 31 March, 2023).

[144] For example, the Central Bank of Egypt is leading a reform to introduce electronic customer identification, which it expects will further develop the Egyptian banking and financial sector, by enabling the safe and efficient onboarding of new clients.

[145] EBRD Enforcement Study (2019), https://ebrd-restructuring.com/enforcement-study, p. 23.

[146] UNCITRAL Guide on the Implementation of a Security Rights Registry (2013), www.uncitral.un.org/en/texts/securityinterests/legislativeguides/security_rights_registry.

[147] UNIDROIT Guide on Best Practices for Electronic Collateral Registries (Aug. 2021), www.unidroitfoundation.org/e-registry-best-practice/.

[148] World Bank (2021), Distributed Ledger Technology and Secured Transactions: Note 1. Collateral Registry, Secured Transactions Law and Practice, www.openknowledge.worldbank.org/handle/10986/34007.

Electronic invoicing systems generally streamline receivables financing. Invoicing is related to receivables financing in that it enables the finance provider to assess whether goods have been sold or services provided. The invoice itself is generally not an asset that functions as collateral, but it may be requested by the finance provider. Invoices play a role in notification factoring, enabling the factor to affix its stamp physically on an invoice to inform the account debtor to submit payment to a different deposit account. The E-Invoicing Directive of the European Union 2014/55/EU made electronic invoicing mandatory for certain types of transactions and it is applicable in the EBRD countries that are EU Member States. Some EBRD countries mandate electronic invoicing for a large swath of commercial transactions.

For instance, in Türkiye all companies with a gross annual turnover of TRY 5 million (previously TRY 10 million) were required to digitise their invoices by 1 July 2020.[149] Electronic invoicing has been mandated by other EBRD countries for particular types of transactions that may not directly affect receivables finance, such as for value added tax, as in Ukraine. In other countries, electronic invoicing is permitted, but not mandated (like in Greece and Montenegro). Efficient electronic invoicing systems would also facilitate the emergence of invoice registries which would – among other things - curb the risk of double invoicing and thus increase confidence among factors in this respect. However, it is crucial for states to distinguish registries that ensure the authenticity of invoices from collateral registries that perfect and establish priorities for rights of finance providers.

TABLE 3: DIGITALISATION

COUNTRY	DIGITALISATION INDEX[150]	DIGITAL IDENTITY	ELECTRONIC COLLATERAL REGISTRY	E-INVOICING
Armenia	0.40	✔	✔	✔
Egypt	0.34	✔	✔	Planned
Georgia	0.40	✔	✔	No information
Greece	0.40	Planned	✘	✔
Kazakhstan	0.47	✔	✔	✔
Moldova	0.33	✔	✔	✔
Montenegro	0.42	✔	✔	✔
Serbia	0.31	✔	✔	✔
Türkiye	0.50	✔	✔	✔
Ukraine	0.22	✔	✔	✔

An assessment of these aspects also requires consideration of the broader context, where interoperable electronic payment systems and the regulatory framework for digital innovation can promote the development of new financing products based on receivables. For instance, interoperable electronic payment systems – allowing payments to be made electronically, safely, efficiently and securely across an economy – can be leveraged to support MSMEs cash-flow management of receivables. Applications are being roled out in the EBRD regions that enable MSMEs to receive payments instantly and securely, such as to digital wallets.

In respect to the regulatory environment, a country-specific assessment should examine two key aspects. First, the implementation of credit products may benefit from coordination with ongoing efforts to deploy technology for supervision and monitoring purposes (regulatory technology and supervisory technology, or "RegTech" and "SupTech"). In particular, products can be developed to implement digital reporting systems combined with data analytics. Second, the introduction of technology-based solutions supporting secondary markets may trigger different and additional regulatory requirements. Typically, the credit products under

[149] All intermediaries and merchants in the fruit and vegetable industry were required to do so by January 1, 2020, while companies in the energy market, car manufacturers, online sellers and web advertisers were allowed to take until July 1, 2020. See further list of countries for e-invoicing requirements, www.avalara.com/eu/en/products/e-invoicing.html.

[150] DiGiX: The Digitization Index (BBVA, March 2017), www.bbvaresearch.com/en/publicaciones/digix-the-digitization-index/.

consideration fall within the regulatory perimeter set up for factoring and banking activities, depending on the legal system and the financial institution. However, technology-focused regulatory regimes, like those regulating data collection or DLT and blockchain, may apply to asset-based lending.[151] The existence of these regulatory elements can further enhance the development and deployment of the selected credit products digitally.

The digitalisation of credit products is likely to intersect with the emerging regulatory regimes for data governance. For instance, following the impetus of the EU's General Data Protection Regulation (GDPR), a number of jurisdictions are implementing not only data protection and privacy frameworks but also requirements for the sharing of information in the context of financial services, generating unique "data governance styles".[152] As a general trend, countries are considering the implementation of regulatory approaches to gain analytics of aggregated data while minimising the risk of monopolistic behaviour of large firms and incumbent market players.

Currently, domestic policymakers have been implementing "open banking" and "open finance" regimes, requiring financial institutions to share collected information with other market players,[153] data ownership and control requirements, to give the right to the consumer to transfer their data,[154] and more direct requirements to control the circulation of data and limit its commercial use.[155] The existence of such regulatory elements may aid the development of credit products. For instance, data already acquired through open banking initiatives can be shared with alternative lenders or used to assess risk of an MSME.

Valuation

Transparent secondary markets enable lenders to determine the value of an asset that may serve as collateral and facilitate its sale upon default of the borrower. The absence of clear valuation standards and secondary markets may increase the cost of credit by inducing lenders to over-collateralise loans. As a result, the loan extended to an MSME may correspond to a fraction of the value of the collateral. However, the valuation of receivables poses fewer challenges than other types of movable assets, including during the pandemic.

Valuation standards provide guidance to lenders when they lack comparable data and when markets face uncertainty. Such guidance is especially critical during the pandemic that affects the operation of many markets that may not provide transparent or objective price discovery. The EBRD Survey of Insolvency and Secured Transaction Regimes found that in 30 of the surveyed 38 economies it is easy to obtain an independent valuation and that in 26 of the economies the industry is regulated.[156]

Valuation plays a critical role in insolvency, in formal proceedings, out of court and hybrid arrangements. The valuation of the collateral will determine the amount of the secured claim affecting the priority of the creditor. The part of the claim exceeding the value of the collateral will be ranked alongside other similarly situated unsecured creditors. In case there is a system of voting by classes, the voting rights of the creditor will be determined by the valuation of the collateral. In those systems where the receivables are considered part of the insolvency estate, even if the highest priority over the proceeds of the collateral is recognised, the insolvency administrator will be required to either value the receivables or arrange for professional valuation.

[151] World Bank (2021), Distributed Ledger Technology and Secured Transactions: Note 1. Collateral Registry, Secured Transactions Law and Practice, www.openknowledge.worldbank.org/handle/10986/34007.

[152] On emergence of "data governance styles" and their impact on cross-border transactions see Arner, D.W., Castellano G., and Selga E., The Transnational Data Governance Problem (Berkeley Technology Law Journal, forthcoming 2023) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3912487.

[153] This is, for instance, contained in the EU Payment Services Directive II; see Arner, D.W., Castellano G., and Selga E., Financial Data Governance (Hastings Law Journal, forthcoming 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4040604 and Dirk A. Zetzsche et al, Future of Data-Driven Finance and RegTech: Lessons from EU Big Bang II (European Banking Institute Working Paper Series 2019/35), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3359399.

[154] Most notably, this is the approach put forward by the EU GDPR (General Data Protection Regulation); see Arner, D.W., Castellano G., and Selga E., Financial Data Governance (Hastings Law Journal, Volume 74, Issue 2, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4040604

[155] Arner, D.W., Castellano G., and Selga E., Financial Data Governance (Hastings Law Journal, Volume 74, Issue 2, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4040604

[156] EBRD Survey of Insolvency and Secured Transaction Regimes (2023).

In the case of the "debtor in possession", either an independent appraiser is retained or the value is determined by another objective way. The latter would require the existence, in the jurisdiction, of a sufficiently developed secondary market for receivables, or a well-functioning electronic platform that allows for a transparent price discovery. In the more complex cases, the valuation of the collateral will need to be coordinated with the valuation of the business itself. This relationship will determine the minimum level of protection of the secured creditor who should not receive in a reorganisation plan (in or out of court) less than it would receive in a piecemeal liquidation.

Globally recognised standards for valuation are published by the International Valuation Standards Council (IVSC). In 20 EBRD economies, a national professional valuation standards body is a member of the IVSC. The EBRD Survey of Insolvency and Secured Transaction Regimes revealed diverging opinions on whether national valuation standards exist. For several EBRD countries, proper valuation of collateral poses particular issues in a crisis situation.[157]

The International Valuation Standards (IVS), effective as of January 2020, are divided into three parts: (i) The IVS Framework, (ii) IVS General Standards and (iii) IVS Asset Standards.[158] The IVS Framework consists of general professional principles for valuation such as objectivity, judgement, competence and acceptable departures from the IVS. The IVS General Standards set requirements for the conduct of all valuations for all types of assets and for any valuation purpose, including the terms, bases value, valuation approaches, methods and reporting. The IVS Asset Standards apply to the valuation of specific types of assets and include guidance on how the characteristics of asset types and asset specific requirements affect the common valuation approaches and methods.

Receivables valuation for financial reporting in countries that use IVS and IFRS requires following both standards. The IVS and IFRS reporting standards differ, but a valuation can be consistent with both standards with some consideration made to differences in terminology and underlying assumptions. The IVS General Standards apply to valuation of receivables, but the IVS Asset Standards do not lay out specific valuation considerations for receivables. IVS Standards have broader applications than IFRS.

IFRS 13 defines fair market valuation methods but "is not intended to establish valuation standards or affect valuation practices outside of financial reporting".[159] IVS 300 is a general valuation standard that must be included or considered in a valuation for financial reporting, including non-mandatory guidance that normally meets IFRS guidelines. There are also differences in valuation terminology – IFRS uses the term Fair Value and IVS uses the term Market Value, both meant to estimate a price obtainable in a hypothetical market transaction between willing parties. IVS and IFRS value terms rely on different assumptions.

For biological assets such as agricultural products, IVS General Standard and the more specific IFRS guidance for biological assets apply. IVS has discussed adding additional guidance for biological assets, beyond the General IVS Standard Market Value assumptions, because biological asset valuations are frequently inconsistent and typically require auditing under different guidelines such as IFRS. IVS has stated that any additional guidance will be consistent with IFRS valuation reporting standards for biological assets.

Under IFRS/IAS 41 the contract price does not typically determine the valuation of biological assets but is instead used to determine the recognition of gains and losses. The valuation of the biological asset is based on its price in an active market. If there is no active market, then recent comparable transactions and sector benchmarks can be used. Only when none of these options are available can the expected cashflow from the contract be used in the valuation of the biological asset. This last option may be used when a biological asset has no market in its current condition, such as partially grown plants. The fair value of a partially grown biological asset is measured by projecting the cash inflows from the sale of the full grown harvested biological asset minus the cost to grow the asset to marketable conditions discounted to the present value.

[157] EBRD Survey of Insolvency and Secured Transaction Regimes (2023).

[158] International Valuation Standards (IVSC, 2021), www.rics.org/globalassets/rics-website/media/upholding-professional-standards/sector-standards/valuation/international-valuation-standards-rics2.pdf.

[159] IFRS 13.IN4, https://www.ifrs.org/issued-standards/list-of-standards/ifrs-13-fair-value-measurement/

Section 4: Roadmap

The strategy to implement the credit products to provide new finance to distressed MSMEs follows a general roadmap that can be deployed in the EBRD regions. This roadmap includes three phases.

Consequently, this roadmap sets out a holistic strategy that unlocks credit products to offer new finance solutions to distressed MSMEs, while promoting a sustainable and enduring economic recovery in the EBRD regions.

Phase 1: Diagnostic

A diagnostic assessing local market conditions, keeping in mind the needs of MSMEs in different scenarios of distress.

The diagnostic will primarily identify the existence of core elements and critical enablers to support the credit product(s).

The goal is to determine which products are most suitable for providing new finance to local MSMEs.

Phase 2: Implementation

Implementation of the findings from phase 1 by developing and offering to the market the selected product(s) through a pilot.

Coordination between local stakeholders, training and capacity building, product development and the implementation of any legal or regulatory reforms that are necessary to support the development of credit products are the key elements of this phase.

Phase 3: Reforms and Data

Monitoring and gathering data (risk exposures, losses and profitability) on the deployment of products identified in phase 2 and offered in the market.

The data and reliable information collected can:

- isolate any challenges;
- identify which receivables products can be used more widely in the EBRD regions; and
- indicate which regulatory adjustments and reforms are required.

A. DIAGNOSTIC PHASE

The diagnostic phase aims at assessing market conditions and determining the existence of core elements and critical enablers supporting the development of credit products. This process will determine: (i) the impact of the Covid-19 pandemic on MSMEs, (ii) the state of emergency measures and their effect on domestic credit markets, (iii) the conduciveness of legal and regulatory frameworks, (iv) the level of digitalisation and existence of technological infrastructure supporting credit products and (v) the effectiveness of valuation standards and secondary markets.

i. Market Analysis

The first step is to determine whether the products are being implemented primarily to help MSMEs avoid insolvency, deal with a surge of MSME insolvencies, or a combination of both.[160] An analysis should identify the sectors that have been substantially affected by the pandemic, as well as those most likely to benefit from the "reopening of the economy". The primary objectives of this analysis are to identify which type of MSME generates receivables, what product structure can better serve the needs of MSMEs and the fragilities of the local economy.

ii. Checklists

Once the market analysis has been completed, the diagnostic should focus on the core elements and critical enablers for each credit product. Section 2 identified two primary scenarios.[161] The first envisages a large creditworthy account debtor that owes a receivable payable to an MSME. One example of this would be a wholesaler who owes a payment to a farmer, based on the sale of crops. The second scenario involves an MSME – such as a retail store – that is owed receivables payable by multiple customers. Both structures can be adapted to extend new finance to MSMEs in different conditions of distress.

Performing an assessment will enable the development of products that can be effectively deployed to meet specific needs. As product structures have been identified, law reformers can conduct a targeted assessment of the conduciveness of domestic legal frameworks for each product. This, in turn, allows for the determination of pressure points, weaknesses and strengths that will ultimately influence the decision as to which credit product is most suitable and what reforms must be prioritised. To facilitate this assessment, the presence of core elements can be assessed through a checklist. Such checklists, in turn, will provide for a diagnostic tool to conduct a targeted legal and regulatory analysis (see Appendices E and F). The presence of critical enablers at the domestic level is also determined through a checklist (see Appendix G).

iii. Product Determination

A market analysis and the completion of the checklists will give a strong indication of the most suitable credit products for a particular jurisdiction. For example, if the secured transactions law recognises anti-assignment clauses as effective and provides for judicial enforcement only, the first structure (Reverse Factoring/ Supply Chain Financing) would allow for a more rapid implementation. In fact, the Anchor Buyer is not expected to include an anti-assignment clause in its agreement with the MSME and the general prohibition against extra-judicial enforcement should not apply to the collection of receivables absolutely assigned to a financial institution.

In a similar vein, the assessment of the regulatory framework can help determining the most suitable product. For instance, the existence of a clear licensing and supervisory framework for factoring offers a solid basis to develop products that are grounded in the first structure (Reverse Factoring/ Supply Chain Financing) to meet the financing needs of MSMEs in distress. Moreover, the existence of a prudential framework that does not penalise MSME lending and receivables financing signals the possibility to develop products based on the second structure (Loan Secured by Multiple Receivables).

Lastly, the existence of critical enablers can offer powerful indications on how to develop and implement credit products in the EBRD regions. Efforts aimed at reinforcing digitalisation and FinTech solutions may offer a platform for developing credit products in a technologically evolving environment. For instance, systems for electronic invoicing and registries can be leveraged to facilitate the deployment of credit products based on receivables, as financial institutions can more easily establish the origin of an invoice and its priority. In some countries, the introduction of mandatory electronic invoicing has facilitated the development of digital trade and the assignment of trade receivables, providing greater transparency and operational security for all parties.[162]

[160] See Section 2(B) of this report for scenarios.

[161] See Section 2(B) of this report for prototypical structures.

[162] For example in Latin America. See https://bcrpub.com/publications/world-factoring-yearbook-2022

B. IMPLEMENTATION PHASE

The implementation phase aims at making credit products available in the market and initiating a process of broader reform. This would require coordination with relevant stakeholders, including governmental bodies, regulators and business associations. In this phase, products are developed and a pilot is launched. At the same time, legal and regulatory reforms to support the development of the products should be advanced (see Appendices E and F).

C. CAPACITY BUILDING

Capacity building will necessarily differ depending on the constituency of stakeholders, as they need to understand different aspects of the credit products. Training programmes need to be tailored to lenders, borrowers, judiciary, regulators, insolvency practitioners, valuation industry and operators of secondary markets. A different form of engagement can be tailored to address the needs of civil servants, such as those administering public assistance programmes, particularly state credit guarantee schemes. These programmes can also identify what additional challenges ought to be addressed in any necessary. Capacity building for judges is one of the core focus areas of the EBRD Legal Transition Team.[163] The EBRD also collaborates with industry associations to deliver targeted capacity building to enhance the uptake of specific credit products, such as factoring.[164]

D. LEGAL AND REGULATORY REFORMS

The country specific assessment performed through the checklists will also determine which reforms are the most urgent. For instance, a domestic secured transaction law may recognise a right to transfer a receivable, by way of assignment and without burdensome restrictions. However, domestic banking regulations might adopt a conservative approach either towards the use of receivables as collateral or towards the extension of credit to distressed MSMEs. For example, receivables might not be recognised as eligible collateral or banks might have some limits in extending credit to businesses in distress.[165] In these circumstances, while products can still be developed, a dialogue with domestic regulators should be initiated to determine what regulatory reforms can be implemented to foster long-term modernisation objectives.

Secured transactions and insolvency regimes should be primed to facilitate secured lending by providing adequate protections to secured creditors. This is done through predictable priority rules, typically implemented through electronic registries and insolvency law provisions. Even where these frameworks allow a receivables product, the requirements may make the transaction cost-prohibitive. For example, when a specific description of the collateral is required, it would have to be regularly updated as new receivables arise.

In general, domestic regulatory efforts should be primarily focused on establishing the conditions for movable assets to qualify as eligible collateral. As noted, prudential regulation tends to favour financial collateral and allow for receivables and physical collateral to reduce regulatory requirements only under the most sophisticated approaches.[166] However, some prospective borrowers, particularly MSMEs, do not have financial collateral, such as government securities, marketable financial instruments, or gold. Instead, their borrowing base consists primarily of receivables and, occasionally, also inventory, equipment and products.

Moreover, as an emergency response, domestic regulators have eased capital and provisioning standards to facilitate MSME lending. This approach does not favour the use of collateral. As emergency measures are progressively rolled back and market-based solutions implemented, prudential standards will have to return to normal levels. In this process, targeted reforms can be implemented to expand the list of collateral that are considered eligible for prudential purposes.

[163] EBRD, Legal Transition Team: FAQs, www.ebrd.com/legal-reform-overview/legal-transition-team/faqs.html.

[164] For example, the EBRD invited the FCI to cooperate on a workshop to promote factoring in Kosovo (FCI, 2019), www.fci.nl/en/news/EBRD%20invited%20FCI%20to%20cooperate%20on%20a%20workshop%20to%20promote%20factoring%20in%20Kosovo?language_content_entity=en.

[165] See Section 3 (Implementation Strategy) of this report on Core Elements and Regulation.

[166] See Castellano G. & Dubovec M., Bridging the Gap: The Regulatory Dimension of Secured Transactions Law Reforms (22 Uniform Law Review 663, 2017).

E. DATA GATHERING AND POLICY ADJUSTMENTS

The final phase aims at collecting data to support receivables financing in domestic credit ecosystems. This data gathering can identify strengths and possible weaknesses to improve product design. Data collected can also be shared as best practices for the industry and regulators.

Coordination between different elements of the credit ecosystem can be facilitated through the collection of data about the credit products offered to distressed MSMEs. Credit product pilots can generate data on the viability of credit markets, spurring more general policy changes aimed at establishing liquid secondary markets and a diversified credit ecosystem.[167] The absence of a transparent pricing mechanism and the lack of sufficient data on the types of collateral commonly used by MSMEs might limit the ability of financial institutions to consider movable assets as an alternative repayment mechanism. Moreover, when prudential regulatory requirements establish fixed risk weightings to calculate capital charges or provisioning allowances, financial institutions might not be incentivised to gather more data on the realisation of movable collateral. Therefore, the extent to which movable collateral curbs the credit risk remains unknown.

To reverse this trend, more data on collateral and credit products would need to be gathered. Financial institutions could be requested to collect information on the credit products they pilot, such as the expected losses and loss given default when credit exposures are collateralised by movable assets. They should also gather information about the time needed to enforce, valuation and other parameters. The results can provide an indication of the liquidity of secondary markets and the effective risk reduction provided by different products and collateral. Furthermore, analyses from pilot programmes can be used to adjust domestic prudential policies, while ensuring alignment with international standards. Public guarantee schemes should incentivise financial institutions to request collateral as a condition of issuing a guarantee. The EBRD Survey of Insolvency and Secured Transaction Regimes identified 17 economies that deployed public guarantee schemes during the pandemic, but only six of them required collateral.

Prudential policies should follow a risk-based and data-driven approach. Information should be collected and analysed on the functioning of the domestic credit market to identify and target any necessary policy changes. Data may be generated by the financial institutions and as part of public guarantee schemes and pilot programmes.

[167] This point has been emphasised in the World Bank (2020), Coordinating Prudential Regulation and Secured Transactions Frameworks: A Primer, http://documents.worldbank.org/curated/en/739451604998793072/Coordinating-Prudential-Regulation-and-Secured-Transactions-Frameworks-A-Primer, and noted in the literature, see for example Castellano G. & Dubovec M., Bridging the Gap, Id. at p. 67.

Appendix A: Overview of EBRD support for trade finance

EBRD Financial Sector Strategy: Trade Finance

Trade finance is a key part of the EBRD Financial Sector Strategy 2021-25 approved by the Board of Directors on 15 December 2021. An important source of trade finance is trade receivables. These can be sold and converted into cash or provided as security for a loan.

The availability of trade finance (including receivables finance) has a significant impact on both domestic and global trade. An insufficient supply of trade finance may compromise otherwise viable trade transactions and restrict global economic growth. A recent study by the Asian Development Bank estimated the global trade finance gap at US$ 1.5 trillion, which impedes delivery of growth and jobs.[168]

The Covid-19 pandemic severely disrupted global trade and external investment. The trade finance gap has strongly affected the EBRD regions, with banks experiencing significant operational continuity challenges and completing fewer letters of credit and invoice discounting transactions than usual. The war on Ukraine has further strained trade and regional supply chains, with food security emerging as one of the biggest global challenges.

The process of reopening supply chains and the resumption of trade has been uneven across regions, individual economies and sectors. In the EBRD regions, it is expected that most countries will continue experiencing a significant to severe shortage of commercial trade finance in the first half of the decade. Thus, support from international financial institutions and national authorities will be needed to help close the trade finance gap and support national and global growth.

[168] ADB Brief No 11 (2019), www.adb.org/sites/default/files/publication/521096/adb-brief-113-2019-trade-finance-survey.pdf.

A preliminary analysis of selected EBRD and European countries reveals that the average volume of one type of receivables finance – factoring – is considerably lower in the EBRD European countries than in more developed European countries.

Chart 1: Factoring turnover and penetration in EBRD and European countries

Total factoring turnover - € billion

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012-2021
Europe	1,299	1,354	1,463	1,557	1,593	1,702	1,829	1,976	1,845	2,118	819
Average	33	35	40	40	41	44	48	49	44	50	17
EBRD Europe average	4	4	5	5	5	5	6	6	6	7	3
High income average	44	45	50	53	54	58	62	68	63	72	28
Non-HI average	5	6	5	5	5	6	6	6	5	7	2

Overview of factoring penetration in European countries - turnover/GDP

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012-2021
Europe	7.6%	7.8%	8.3%	8.6%	8.8%	9.0%	9.4%	9.8%	9.6%	10.1%	2.6 pp
Average penetration rate	5.6%	5.7%	6.1%	5.6%	5.8%	5.9%	6.6%	6.4%	6.1%	6.4%	0.7 pp
EBRD Europe average	3.4%	3.5%	3.8%	3.5%	3.7%	3.6%	4.0%	4.0%	3.9%	4.1%	0.7 pp
High income average	6.9%	7.0%	7.5%	7.2%	7.5%	7.6%	8.2%	8.5%	8.4%	8.7%	1.8 pp
Non-HI average	1.2%	1.2%	1.2%	1.2%	1.2%	1.3%	1.4%	1.4%	1.5%	1.7%	0.5 pp

List of countries: Armenia, Austria, Azerbaijan, Belarus, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Georgia, Germany, Greece, Hungary, Ireland, Italy, Kosovo, Latvia, Lithuania, Luxembourg, Malta, Moldova, Netherlands, North Macedonia, Norway, Poland, Portugal, Romania, Russia, Serbia, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Türkiye, Ukraine, United Kingdom

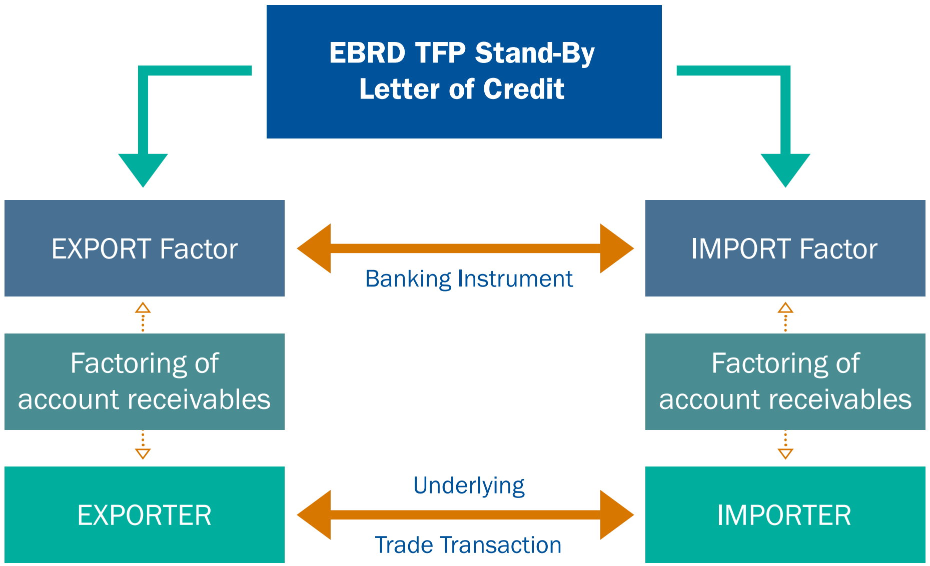
Statistics for 2021 show that factoring rebounded sharply, with the highest year-on-year growth in two decades of 12.6 per cent worldwide. Poland, Bulgaria, Romania and the Czech Republic display the largest increases, while factoring volumes in Türkiye decreased in hard currency for the second consecutive year.[169] Given that MSMEs constitute the backbone of all EBRD economies[170] and receivables are such valuable assets for MSMEs, national authorities should consider ways of further supporting receivables financing and encouraging the private sector to develop its supply chain products. Nevertheless, support from governments and international financial institutions is needed to promote trade finance and receivables financing in economies with less developed financial markets and legal frameworks due to the higher risk for factors. This may involve, on a transaction level, the issuance of guarantees and risk participation and, in the longer term, more tailored legal reforms to promote all available forms of receivables financing.

Trade finance - factoring

Over the years, the EBRD has built up considerable expertise in developing trade and receivables finance in the economies where it invests through financial and non-financial instruments.

The Bank operates a successful **Trade Facilitation Programme** (TFP) across selected countries. Set up in 1999 to promote and facilitate international trade, the EBRD's TFP has also been supporting the financing of domestic and international factoring transactions since 2006 by providing third party guarantees and cash advances, as well as through the transfer of skills and expertise to factoring companies and continuing professional education programmes.

Chart 2: TFP factoring guarantee structure



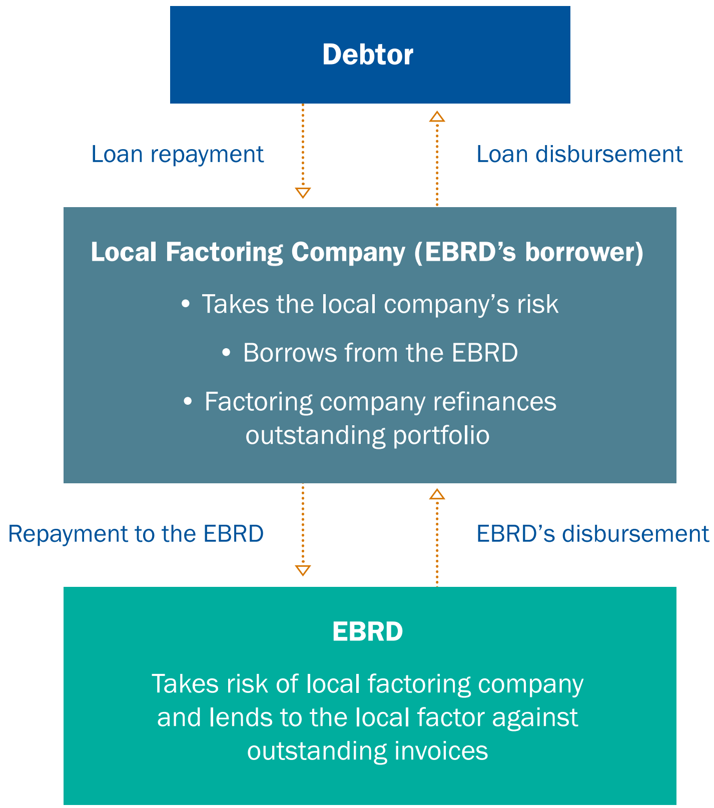
Charts 2 and 3 illustrate respectively the guarantee and cash advance structures used to support factoring transactions. The EBRD promotes the development of factoring by providing financing to its partner banks for their factoring activities, as well as by taking the political and commercial payment risk of international factoring transactions. As of February 2023, the EBRD TFP supported the financing of domestic and international factoring transactions with a total of €1.3 billion. The TFP currently has 16 factoring facilities in eight economies (Armenia, Bulgaria, Greece, Georgia, Romania, Türkiye, Serbia and Ukraine).

Given the importance of trade finance and its role during the present economic turmoil, the TFP is set to expand the trade finance toolkit of partner financial institutions through factoring products. Furthermore, the TFP is committed to supporting green trade finance and, through its **Green Trade Facilitation Programme** (Green TFP), stimulates trade involving the supply of high performance technologies and services.

[169] FCI (2021), World Factoring Statistics reports the largest double digit increase in volume in over two decades, https://fci.nl/en/news/press-release-fci-world-factoring-statistics-reports-largest-double-digit-increase-volume-over?language_content_entity=en.

[170] EBRD, Our approach to small businesses, www.ebrd.com/small-business-support/our-approach.html.

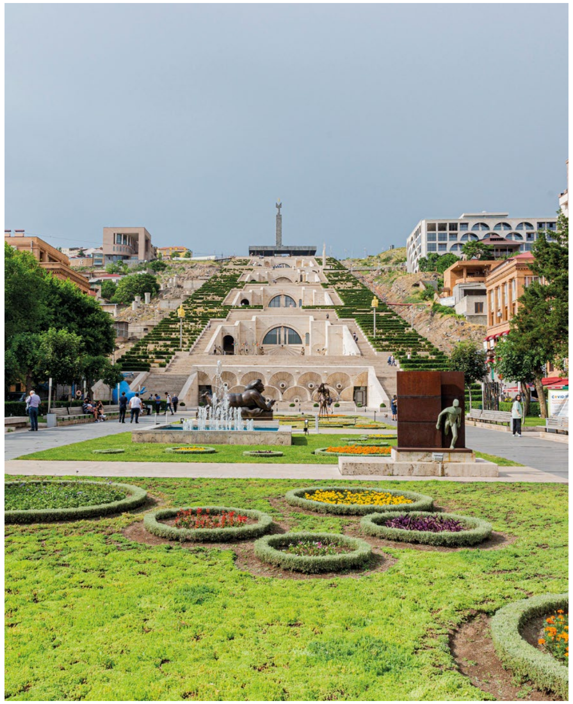
Chart 3: TFP structure for factoring cash advances



Case study: Importing confectionary products using international factoring

An Armenian chocolate factory has a contract with a Georgian confectionary distributor. The Georgian exporter required prepayment in order to deliver the products. The Armenian factory wanted to defer payment while allowing the exporter to settle at sight, and looked for solutions other than letters of credit to avoid the associated costs and process time. International factoring was the best solution.

The international factoring arrangement between the two banks was made possible via the cross-border factoring platform of FCI (the global representative body for the factoring industry) and was, for the first time, supported by EBRD guarantees, which covered stand-by letters of credit issued by the import factor in Armenia in favour of the export factor in Georgia.

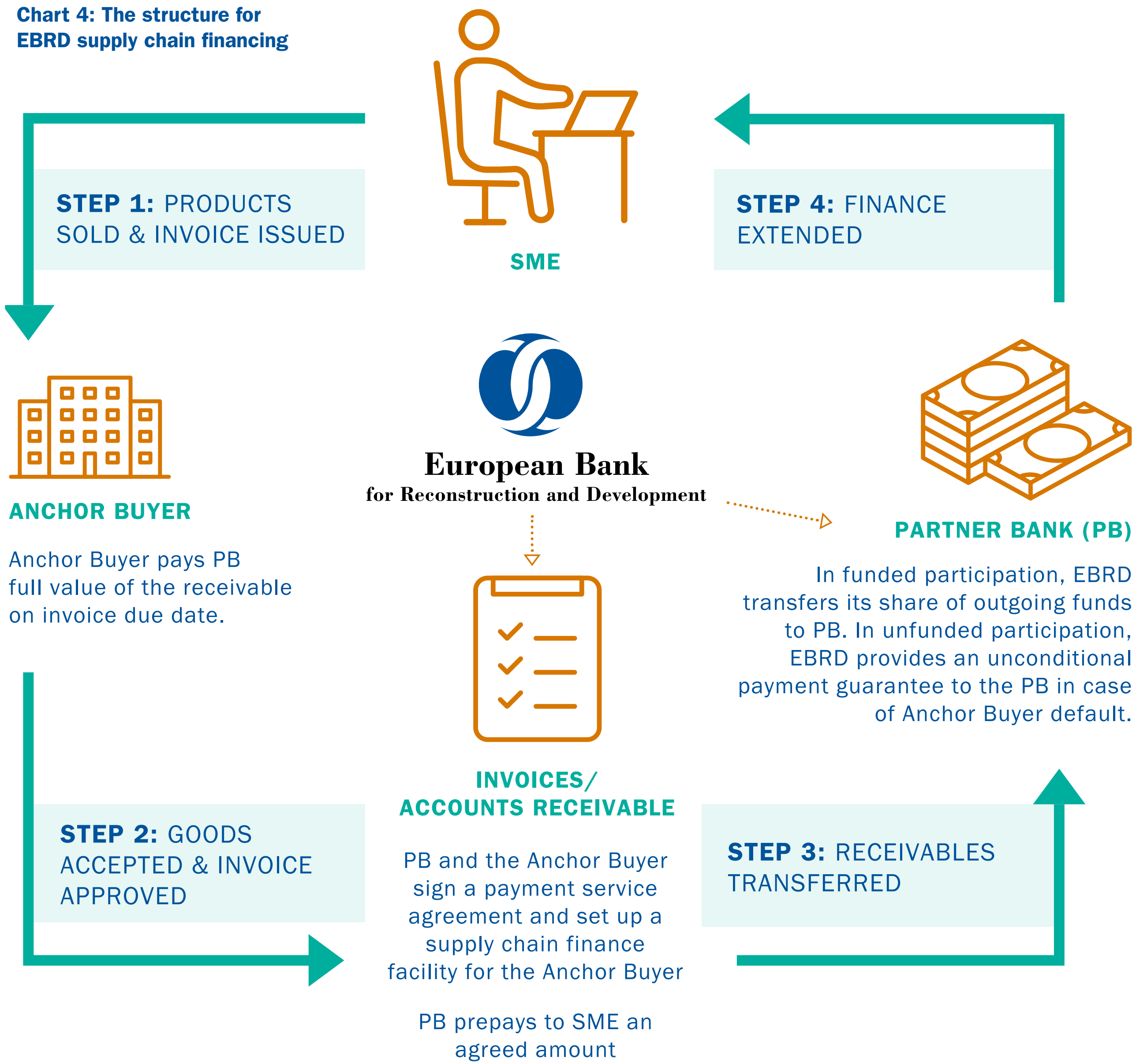


Supply chain solutions - reverse factoring

In 2022 the EBRD approved a new Supply Chain Solutions Framework under which it is risk sharing in supply chain finance (SCF) transactions, through both funded and unfunded participations. Managed by the EBRD SME Finance and Development team, transactions focus on reverse factoring, a buyer-led SCF product that leverages the strength of "Anchor Buyers" (for example, big retailers) that typically tend to have a higher credit rating and healthier balance sheets than their smaller suppliers, thus potentially lowering the cost of funding for such suppliers.

As illustrated by Chart 4, under such a framework, the EBRD will participate in individual sub-deals involving selected Anchor Buyers and their suppliers in EBRD economies by either (i) transferring a pre-agreed share of funds to the partner banks (for funded participations) or (ii) providing an AAA-rated irrevocable guarantee to Anchor Buyers (for non-funded participations). By leveraging the creditworthiness of Anchor Buyers, the framework will provide suppliers, particularly SMEs, with access to finance (which, in the case of SCF solutions, constitutes upfront cash to suppliers with no recourse) that is cheaper and easier to access compared with traditional channels.

Chart 4: The structure for EBRD supply chain financing



As an international financial institution, the EBRD can also leverage support from donors to roll out buyer-led SCF programmes that incorporate and address the sustainability priorities of Anchor Buyers and/or their partner banks. Referred to as “sustainable supply chain finance”, these types of programmes involve providing financial incentives to suppliers, usually in the form of a decrease in the headline discount rate, if suppliers meet defined performance targets on selected corporate sustainability indicators. Through its Advice for Small Businesses programme, the EBRD further complements sustainable supply chain finance programmes with bespoke advisory support to suppliers. Advisory services are tailored to help SME suppliers meet sustainability-linked targets and to foster the development of cohorts of suppliers that have the capacity to act as effective, longstanding and sustainable suppliers to Anchor Buyers.

Case study: Leveraging supply chain finance to reduce scope 3 emissions

The EBRD and Citibank Europe (Citi) are jointly rolling out a sustainable supply chain finance programme for Finnish technology and services company Metso Outotec (Metso) and its suppliers in Türkiye, the majority of which are SMEs. Under this arrangement, the EBRD is undertaking a €25 million funded risk participation in Metso's supply chain finance programme in Türkiye, which is administered by Citi, and further mobilising grant funding from the Türkiye-EBRD Cooperation Fund to be used as outcome-based incentives for Metso's Turkish suppliers. Such incentives involve reducing the discount rate which suppliers face when assigning their receivables to Citi where suppliers meet emission reduction targets under the Science-Based Targets Initiative.

The programme builds on Metso's strategic priorities, which include reducing the impact of its core business on the climate. The company has set science-based targets for reducing its scope 1 and 2 emissions and has committed to addressing its scope 3 emissions which are attributable to its suppliers.[171] Eligible Turkish suppliers participating in this programme receive advisory support facilitated by the EBRD, helping them to align with best practice environmental, social and governance standards and improve their ability to meet the emission reduction plans.

Direct and indirect financing to SMEs

Another leading EBRD programme, the **Small Business Initiative** (SBI), includes a framework to finance SMEs directly and through local banks and microfinance lenders, including dedicated credit lines for women in business and youth in business[172] as well as risk-sharing facilities in which the EBRD assumes funded or unfunded risk participations in individual loans extended by these banks to SMEs. For its direct and indirect engagements via risk-sharing facilities with PB, the range of available instruments is broad and features senior and junior loans, loans with performance-related remuneration, project finance loans, as well as quasi-equity and minority equity investments. The investment amount ranges from €1 million to €25 million, with an average of about €3.5 million.

Furthermore, the SBI's Advice for Small Businesses programme provides professional advisory services to help SMEs improve and expand their business operations. More than 4,000 SMEs and local consultants received training to build capacity in 2022, including in the areas of crisis management and digital transformation, and more than 50,000 participated in events (including online events or webinars).[173] The EBRD offers a number of targeted advisory support programmes. These include the EBRD Blue Ribbon programme that combines finance with business advice to help SMEs with strong growth potential by changing the way they are managed, and the Star Venture programme that supports innovative, high-potential start-ups with world-class business advice and access to finance to strengthen their performance and accelerate their business development life cycle.

To enhance the digital capacities of entrepreneurs and MSMEs, the EBRD has launched an e-learning platform, the Know How Academy. It offers a free online learning and advice programme for these businesses.

EBRD policy and advisory

As trade assets become increasingly digitised, there is great potential to inject additional liquidity into the trade finance market. Reliable technological infrastructure is critical for widespread distribution of trade assets in high volumes, particularly for short-term assets. By aligning policy and technological developments for trade finance assets to become a liquid, investable asset class, a large number of institutional investors could enter the trade finance market and extend liquidity to originators of various sizes and in various locations.

In order to leverage different forms of receivables financing and help SMEs access short-term funds to grow sustainable trade and mitigate trade risk, the EBRD's **Capital and Financial Markets Development** (CFMD) team is working to create a conducive funding environment with links to capital markets, and to keep the EBRD and its partners updated on emerging trends.[174] The CFMD's activities include analytical and advisory work, organising capacity-building and knowledge-sharing activities, as well as technical support for investments and capital market transactions that could act as a catalyst in the development of capital markets.

[171] Targets are currently considered "science-based" if they are aligned with the goals of the Paris Agreement, which include limiting global warming to 1.5 °C.

[172] See https://www.ebrd.com/small-business-support/our-approach.html for further details.

[173] For EBRD financial products, see www.ebrd.com/small-business-support/financial-products.html.

[174] See https://www.ebrd.com/what-we-do/ebrd-economics/policy-strategy-delivery.html for further details.

First, the CFMD seeks to activate new funding channels for receivables. It investigates how to address funding issues through commercial papers and securitised structures, as well as what tools can facilitate investors' access to the asset class, such as dedicated credit rating methodologies.

Second, the team ensures that the EBRD is in a position to take part in emerging opportunities in the field and collaborates with other teams within the EBRD to assess the feasibility of innovative products, such as digitised bills of exchange and enhanced supply chain finance solutions, such as deep-tier SCF. In addition, the CFMD supports market players in increasing their expertise and capacity. The team is part of the industry working group on Global Trade Finance Distribution and is developing technical assistance projects to help clients assess their "IT readiness" for SCF technologically heavy solutions.

Legal barriers to trade finance persist across the EBRD regions. These include an unclear regulatory regime, unfavourable tax incentives and a weak enforcement system. The EBRD's **Legal Transition Programme** (LTP) has been working to improve the legal and regulatory environments for secured transactions.[175] LTP efforts have focused on enabling the quick, cheap and simple creation of a proprietary security right; providing an effective means of publicising the existence of security rights and clear rules governing competing claims to the collateral; and enabling prompt realisation at market value of the collateral.

The LTP led the development of the New Finance Support Report which proposes a course of action for national policymakers to address liquidity and working capital issues affecting businesses in the EBRD regions, arising from the challenges of the COVID-19 crisis and the war on Ukraine. The report proposes a methodology and a roadmap for policymakers in the EBRD regions to assess the readiness of their existing legal and regulatory frameworks to support receivables-based finance and SME finance.

Furthermore, the LTP has supported the development of factoring services in economies such as Croatia, Georgia, Jordan, Kosovo, Montenegro, North Macedonia, Serbia, Tajikistan, Tunisia, Uzbekistan and the West Bank and Gaza. The LTP also advises national authorities on establishing an ecosystem of laws, regulations and infrastructure that supports the establishment of reverse factoring platforms (either private or public). Depending on the business model, such platforms can bring together the buyers and suppliers looking for finance and the financiers, thus creating a more competitive, transparent and efficient environment for receivables finance.

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[175] See https://www.ebrd.com/what-we-do/sectors/legal-reform.html for further details.

Appendix B: International and regional standards and policy guidance

The following sources are the relevant standards and guidance published by various international and regional organisations including the EBRD, the Bank for International Settlements (BIS), the Organisation for Economic Co-operation and Development (OECD), the United Nations Commission of International Trade Law (UNCITRAL), International Institute for the Unification of Private Law (UNIDROIT) and the World Bank Group.

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Appendix C: Emergency measures - budgetary and fiscal policies

State Credit Guarantee and Loan Schemes

Most used in Central and South-Eastern Europe, guarantee and loan schemes facilitated low-cost loans to cover essential operating expenses for businesses, such as wages, rent and income tax.[176] The following are some examples:

- The Turkish government implemented a 21-point stimulus package that provided funding to The Banks Association of Türkiye to offer loans with a 36-month maturity at a 7.5 per cent interest rate. Additionally, the loan principal or interest was not payable for three months. This two-tier system of funding was also implemented in Armenia where funding was provided to public banks to finance SMEs to pay employee salaries, purchase equipment and raw materials, as well as cover taxes and utility costs. Further, the Turkish government through its Economic Stability Shield Stimulus package for public banks provided new working capital loans to preserve current employment levels.
- In Egypt, a stimulus package of EGP50 billion was allocated to mortgage finance for middle-income groups and an additional EGP50 billion to support the tourism sector.[177] New loan schemes targeting SMEs operating in certain sectors were also launched.
- Greece implemented targeted loan schemes for agriculture, livestock, tourism, culture and even vegetable produce.
- In Armenia, the government provided one-time grant assistance to the IT sector to cover every fifth employee's salary for SMEs with between two and fifty employees and grants to cover up to 10 per cent of the turnover of goods for SMEs with less than AMD 25 million revenue. Likewise, Greece provided one-time grants to certain affected sectors.
- Some countries, such as Moldova, specifically supported SMEs owned by women.
- Schemes, like those in Ukraine, also supported the payment of wages, utilities, rent and taxes. For example, SMEs with a turnover of less than €10 million could qualify for a "new money loan" to cover wages, utilities, rent and taxes.
- Credit guarantees covering loans to SMEs accounted for about 0.5 per cent of GDP in Latvia and Lithuania or €180 million and €235 million, respectively, while Estonia stood at the lower end of the EU ranking, with €101 million worth of guarantees outstanding at the end of 2019. The Covid-19 pandemic has increased the role of the state credit guarantee schemes.[178]

Tax Benefits and Subsidies

Public resources were deployed to subsidise the costs of services, such as utilities, tax and unemployment benefits. Tax payments were deferred across the regions. Approaches differed in each country:

- In Ukraine, tax relief and deferrals were granted to every business, across industries, regardless of their size.[179]
- Moldova took a more targeted approach, granting tax relief only to those businesses impacted by health-related measures.[180]
- In Kazakhstan, SMEs were exempted from income and social security tax, pension and medical insurance contributions from April 2020 until October 2020. Similarly, Serbia also deferred labour taxes for SMEs for three months.
- In Montenegro, tax deferrals for SMEs were included in all four stimulus packages that have been implemented to date.

[176] EBRD (2020), Coronavirus Policy Response, State Credit Guarantee Schemes: Supporting SME Access to Finance Amid the Covid-19 Crisis, www.ebrd.com/what-we-do/economic-research-and-data/cse-economists/state-credit-guarantee-schemes.html.

[177] President El-Sisi's Decisions, Messages, to fight Coronavirus, its economic impacts (State Information Service, 2020), www.sis.gov.eg/Story/144181/President-El-Sisi%E2%80%99s-Decisions%2c-Messages%2c–to-fight-Coronavirus%2c-its-economic-impacts?lang=en-us.

[178] EBRD (2022), Country Diagnostic Estonia, Latvia and Lithuania, p. 31.

[179] Exceptions were not applicable to excisable goods; see State Tax Service of Ukraine, Amendments prescribed by the Law № 466-IX, which improves tax legislation, 2020, www.tax.gov.ua/en/new-about-taxes–news-/419743.html.

[180] Decision No. 3 of the Commission for Emergency Situations of the Republic of Moldova dated 23 March 2020.

Appendix D: Emergency responses - legal and regulatory measures

Insolvency Law

Businesses that would have otherwise been viable under ordinary circumstances were pushed to the brink of insolvency during the pandemic. The following emergency responses were the most common examples in the EBRD regions:[181]

- Suspension of the duty to file for insolvency by debtors, either generally (like in Bulgaria, Croatia, the Czech Republic and Slovenia) or upon certain conditions being met (like in Latvia, Lithuania and Ukraine);
- The suspension of the right of creditors to file for insolvency either generally (like in Latvia, Lithuania, Türkiye and Ukraine) or upon certain conditions being met (like in Romania);
- Suspension of foreclosure/enforcement of security rights, including within insolvency proceedings (like n Bulgaria, the Czech Republic, Croatia, Hungary and Slovenia);
- Suspension of the requirement to continue making payments or of the ordinary legal consequences of payment default under a reorganisation plan (like in Hungary, Latvia, Lithuania and Ukraine);
- The adoption of extraordinary procedural measures, such as the suspension of hearings or its substitution by videoconference (like in Latvia), the submission of claims and other filings electronically (like in Latvia and Greece, although the latter case was part of a more general reform), or the substitution of physical meetings of creditors with virtual ones (like in Latvia and Ukraine);
- The increase in threshold requirements to file for insolvency (like in Armenia and Romania); or
- The adoption of measures to protect access to credit during the state of emergency and for a period thereafter (such as, for example, the protection against *ex-post* avoidance of financing provided in the said period), or the disapplication of subordination for financing provided by related parties.

[181] European Commission's E-Justice Portal on Covid 19, www.e-justice.europa.eu/content_covid19_impact_on_civil_and_insolvency_matters-37843-en.do?clang=en; and the Financial Sector Response Guidance Notes on the Covid-19 Outbreak (2022), www.worldbank.org/en/topic/financialsector/coronavirus.

Loan Repayment Deferral and Restructuring

Regulators in the EBRD regions enacted several measures to ease the pressure on SMEs and incentivise lending, particularly loan repayment deferral and restructuring.

- In Türkiye, the payment of principal and interest owed to state-owned banks was postponed for three months.[182] Moreover, the maturity of SME loans was extended until January 2021.
- In Egypt, banks were instructed to review delinquent payments on a case-by-case basis and to waive accrued interest on debts when payments made represented a certain percentage of the principal loan amount.[183]
- Commercial banks in several EBRD countries (like in Georgia) postponed scheduled repayments and offered to restructure loans even without formal regulations or public programmes. Georgia's three banks – TBC Bank, Bank of Georgia and Liberty Bank – deferred loan payments for up to three months and launched restructuring initiatives for their clients.
- In Türkiye, public banks participated in joint programmes with the Union of Chambers of Commodity Exchanges of Türkiye (TOBB), a local banking group (DenizBank) and the Credit Guarantee Fund (KGF). The programme was created to facilitate the restructuring of loans, including a deferral of payments for six months for the hard-hit sectors such as tourism.
- Regulators have also locked or reduced interest rates on loans to SMEs, like the Central Bank of Egypt that lowered the preferential interest rate on housing loans well as on loans for the private, agricultural, construction and tourism sectors.[184]
- Similar measures were taken in Kazakhstan where interest on loans was fixed at 7 per cent.[185]

Prudential Regulation

In general, central banks and regulators enacted a variety of prudential policies to expand the banking system's loss-absorption capacity and support the extension of credit to the economy. Liquidity buffers can support banks' short-term obligations, limiting a disorderly sale of assets.[186] Capital buffers, together with minimum capital requirements, strengthen the loss-absorption capacity of banks beyond loan-loss provisions requirements, without impairing the viability of banks.[187] More broadly, prudential measures are only effective when banks are able and willing to expand their balance sheets, through the extension of new loans.[188]

- In Greece, as monetary policy and most banking supervisory functions are allocated to the European Central Bank, the relaxation of buffers was part of a broader set of measures enacted to respond to the pandemic.[189] In particular, the ECB introduced a series of capital reliefs for banks it directly supervises, including the release of liquidity and capital buffers, as well as other capital instruments.[190]
- Outside the EU, the National Bank of Georgia reduced capital requirements by more than three percentage points in March 2020[191].
- The National Bank of Kazakhstan also enacted a series of policies since March 2020.
    - First, it lowered risk weights for SME loans (from 75 per cent to 50 per cent), foreign currency loans (from 200 per cent to 100 per cent) and syndicated loans (from 100 per cent to 50 per cent).
    - Second, it expanded the list of eligible collateral, allowing a variety of movable assets to reduce credit risk.
    - Third, it lowered capital and liquidity buffers.[192]
- Prudential policies also focused on the classification of loans.[193] In the EBRD regions, the classification of loans in some countries benefited from tailored, domestic interventions.[194] Regulators enacted a wide array of measures to facilitate the restructuring of loans while controlling the surge of non-performing exposures. For example, the National Bank of Ukraine encouraged banks to restructure the loans of borrowers facing difficulties due to the implementation of public health measures. In this context, banks could omit performance indicators and refrain from downgrading borrowers until 2024 when assessing the quality of a borrower.[195]
- To disburse stimulus funding to viable businesses only, domestic regulators also coordinated access to credit policies with prudential requirements. In particular, the National Bank of Georgia required domestic banks to assess the quality of their loan portfolios based on standardised scenarios and methodologies to determine losses expected from the delayed pandemic recovery.[196]
- The Central Bank of Montenegro required banks to grant a moratorium until mid-2021 to borrowers from tourism, agriculture, forestry and fishing. However, borrowers must not be past due for more than 90 days and their loans must not have been classified as non-performing as of 31 December 2019. Approved or restructured loans that meet such criteria can be categorised as "A" (for a specified period), resulting in a significant reduction of capital requirements.[197]

[182] Turkey Policy Responses (2021), www.unescap.org/sites/default/d8files/2021-03/Turkey_Covid%20Country%20profile%20230321.pdf.

[183] This measure is part of a broader set of timely responses implemented by the Central Bank of Egypt to limit the impact of Covid-19 on the domestic economy and, in particular, to SMEs and individuals; Central Bank of Egypt Measures to Offset the Impact of Covid-19 (2022), https://www.cbe.org.eg/-/media/project/cbe/file/long-context/central-bank-of-egypts-measures-to-offset-the-impact-of-covid19.pdf.

[184] See above.

[185] Bloomberg (2020), Kazakhstan Cuts Rates as Second Lockdown Batters Economy, www.bloomberg.com/news/articles/2020-07-20/kazakhstan-cuts-rates-as-second-lockdown-batters-economy.

[186] Arner, D.W. (2011), Adaptation and Resilience in Global Financial Regulation, North Carolina Law Review, Vol. 89, 2011, p. 109.

[187] Borio C. et al. (2020) Post-crisis International Financial Regulatory Reforms: A Primer (BIS Working Papers, No 859, 23 April 2020), www.bis.org/publ/work859.htm; See also Castellano G. & Dubovec M. (2018), Credit Creation: Reconciling Legal and Regulatory Incentives (81-1 Law and Contemporary Problems 69).

[188] Drehmann M. et al. (2020), Buffering Covid-19 Losses – The Role of Prudential Policy (BIS Bulletin No 9 24 April 2020), www.bis.org/publ/bisbull09.pdf.

[189] The ECB considered Greece eligible for the Pandemic Emergency Purchase Programme, consisting in the temporary asset purchase programme of private and public sector securities to ensure financial and monetary stability. See ECB announces €750 billion Pandemic Emergency Purchase Programme (18 March 2020), www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200318_1~3949d6f266.en.html.

[190] Banking Supervision Provides Temporary Capital and Operational Relief in Reaction to Coronavirus (ECB, 12 March 2020), www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200312~45417d8643.en.html.

[191] IMF (2021), Policy Responses to Covid-19: Georgia, https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19.

[192] IMF (2021), Policy Responses to Covid-19: Kazakhstan, www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-Covid-19#K.

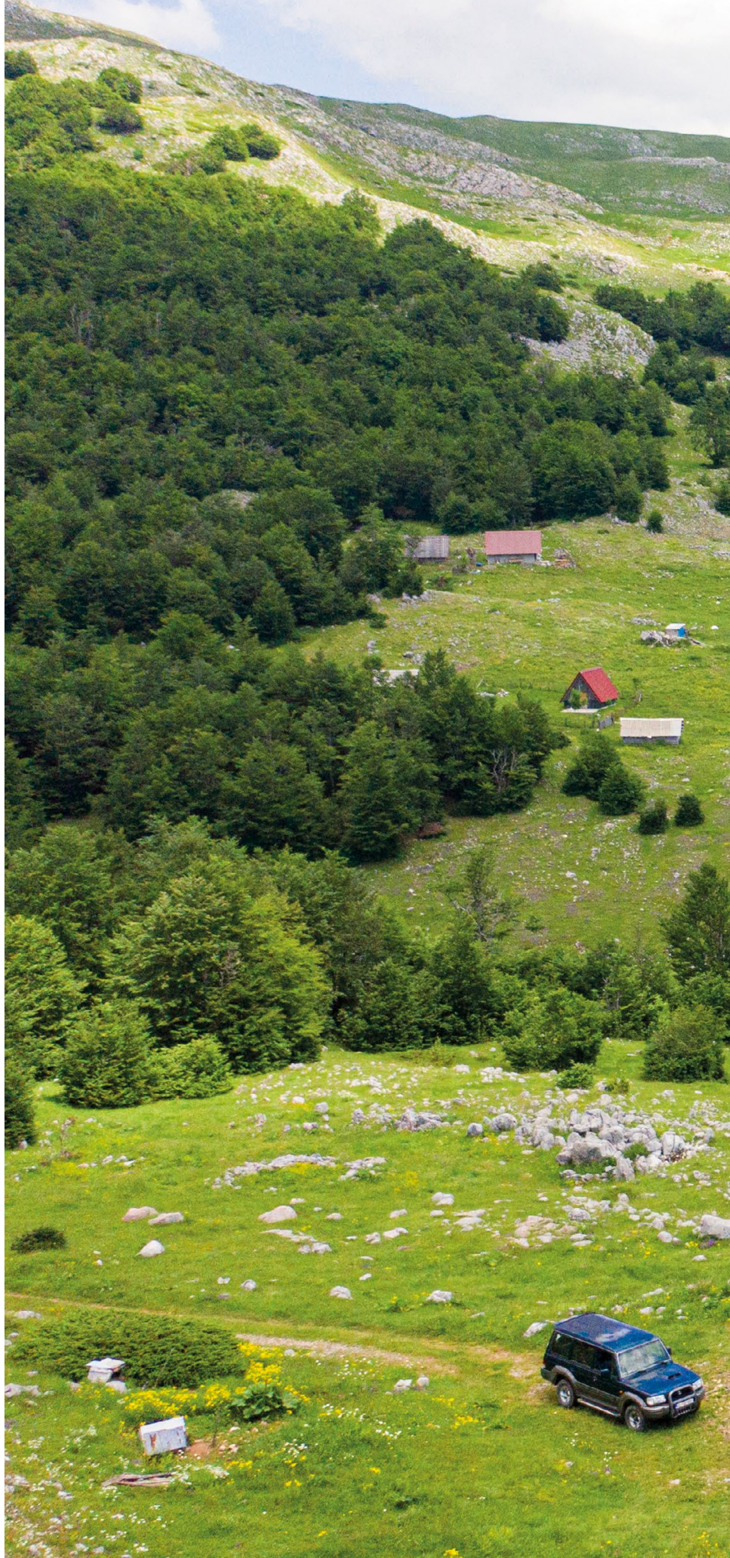
[193] International guidelines define exposure as non-performing (or NPE) when it is past-due for more than 90 days or the borrower is unlikely to repay. In addition, exposures that are defined as defaulted under the Basel Framework or considered impaired under applicable accounting standards are also considered NPE; see BCBS Guidelines Prudential treatment of problem assets – definitions of non-performing exposures and forbearance (2017), www.bis.org/bcbs/publ/d403.pdf. An exposure is defined "forborne" when the bank agrees to modify the terms for a borrower in financial difficulty, even though loan is still performing.

[194] Central Bank of Egypt Circular dated 5 May 2020 regarding the application of IFRS9 during Covid-19 crisis, https://www.cbe.org.eg/-/media/project/cbe/file/long-context/central-bank-of-egypts-measures-to-offset-the-impact-of-covid19.pdf.

[195] IMF (2021), Policy Responses to Covid-19: Ukraine, www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-Covid-19#U.

[196] IMF (2021), Policy Responses to Covid-19: Georgia, www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-Covid-19#G.

[197] IMF (2021), Policy Responses to Covid-19: Montenegro, www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-Covid-19#M.



Appendix E: Checklist 1: Factoring and post-Covid context

Core Elements for the Development of Factoring Products

Country Assessment

SECURED TRANSACTIONS	✗/✓
The law provides for the right of an SME to create a security right over the growing crop without having to mortgage the land. In addition, the applicable law provides a clear priority rule for that security right as against an interest in the land that may capture the crop, such as a mortgage.	
The law facilitates the creation of a security right by execution of an agreement that does not require excessive formalities. Collateral may be described generically and the law recognises the effectiveness of an agreement providing for the creation of a security right in future assets.	
The law recognises the right of an SME to transfer a receivable, whether by way of assignment in security or absolutely, regardless of any restrictions in the underlying agreement from which it arises.	

	✗/✓
The law enables the finance provider to take an effective security over a deposit account to which receivables are deposited.	
An electronic registration system for notices relating to collateral, including receivables accessible at a low cost has been established.	
The law provides a clear priority rule for Factor with respect to the right to collect the receivable as against any competing claims, especially that of Bank.	
The law recognises the power of Bank and Factor to allocate priorities as between each other through a subordination agreement that will be recognised and effective in insolvency of the SME.	

INSOLVENCY	✗/✓
The law recognises the effectiveness and priority of a security right established prior to commencement of insolvency proceedings of the SME.	
The law specifies which assets belong to the estate of the insolvent SME and defines which are excluded, particularly the receivable assigned absolutely.	
The law protects the perfection of the security right from ex post avoidance, even if the transaction took place in the vicinity of insolvency, as long as the creditor provided new value.	
The law provides for adequate compensation of the secured creditor for interference with its rights.	

REGULATION	✘/✔
Receivables products are regulated activities that can be offered by banks and non-banks financial institutions, such as factoring companies.	
Prudential requirements regulating loan-loss provisioning for banks and non-bank financial institutions allow for receivables to be used as eligible collateral.	
The regulatory framework allows banks to enter into a subordination agreement with non-bank financial institutions.	

Domestic requirements for non-bank financial institutions	✘/✔
The regulatory framework establishes clear rules in respect to the licensing of non-bank financial institutions offering receivables products.	
Licensed non-bank financial institutions offering receivables products are subject to conduct of business regimes ensuring the fitness and propriety of senior management, the auditing and compliance with international anti-money laundering standards.	
Licensed non-bank financial institutions offering receivables products are subject to a simplified set of prudential standards, entailing minimum capital requirements, provisioning and systems for risk monitoring and control.	

Domestic capital requirements for banks	✘/✔
Are implemented in coordination with international accounting standards.	
Contain a set of specific rules to calculate regulatory capital for exposures generated by the purchase of receivables.	
Recognise exposures to SMEs as a class of exposure that is distinct from unrated corporate exposures.	
Recognise the higher creditworthiness of Anchor Buyer.	
Recognise a lower risk-weight for claims protected by public guarantees.	

Appendix F: Checklist 2: Inventory and receivables finance

Core Elements for the Development of Inventory and Receivables Finance Products

Country Assessment

SECURED TRANSACTIONS	✗/✓
The law facilitates the creation of a security right by execution of an agreement that does not require excessive formalities. Collateral may be described generically and the law recognises the effectiveness of an agreement providing for the creation of a security right in future assets.	
The law recognises a right of an SME to transfer a receivable, whether by way of assignment in security or absolutely, irrespective of any restrictions in the underlying agreement with its customers.	
The law enables the finance provider to take an effective security over a deposit account to which receivables are deposited.	
An electronic registration system for notices relating to collateral, including receivables, accessible at a low cost, has been established.	
The law provides for priority rules to determine a conflict in the receivables between Seller and Bank.	
The law recognises an extra-judicial remedy as against inventory and business as a whole.	

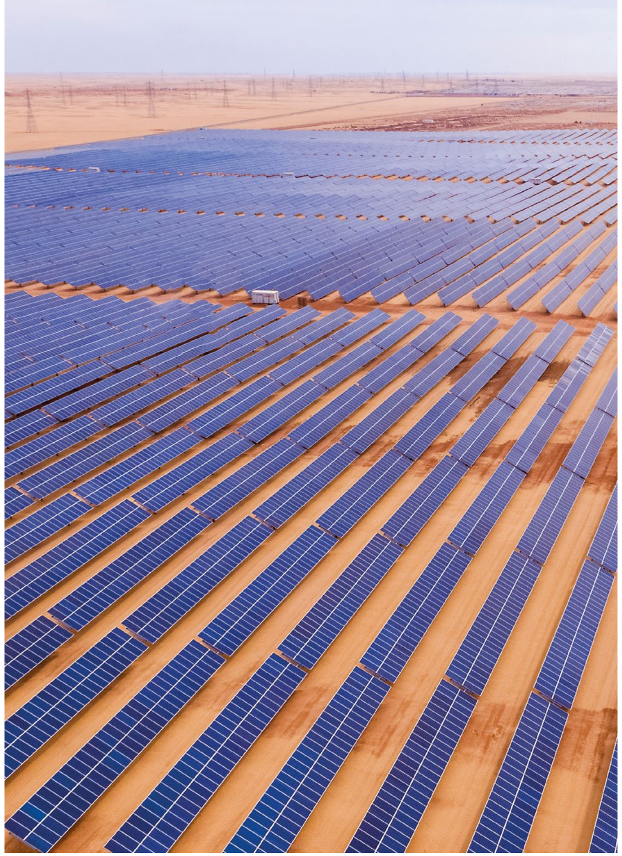
INSOLVENCY	✗/✓
Insolvency law recognises the effectiveness and priority of a security right established prior to the commencement of insolvency.	
Insolvency law enables new financing, taking into account the pre-insolvency priorities.	
Insolvency law permits a grant of a new security right over property belonging to the estate.	
The law provides for adequate compensation of the secured creditor for interference with its rights.	

REGULATION	✗/✓
Receivables products are regulated activities that can be offered by banks and non-banks financial institutions, such as factoring companies.	
Inventory and commodities qualify as credit risk mitigation for the purpose of calculating prudential allowances.	
Banks and other non-bank financial institutions are not subject to any regulatory requirements that limit their ability to extend new credit to distressed businesses.	
The regulatory framework establishes clear rules in respect to the licensing of non-bank financial institutions offering receivables products.	
Licensed non-bank financial institutions offering receivables products are subject to conduct of business regimes ensuring the fitness and propriety of senior management, the auditing and compliance with international anti-money laundering standards.	
Licensed non-bank financial institutions offering receivables products are subject to a simplified set of prudential standards, entailing minimum capital requirements, provisioning and systems for risk monitoring and control.	

Domestic capital requirements for banks:	✗/✓
Contain a set of specific rules to calculate regulatory capital for exposures generated by the purchase of receivables.	
Recognise exposures to SMEs as a class of exposure that is distinct from unrated corporate exposures.	

Appendix G: Checklist 3: Critical enablers

Critical Enablers for the Development of Receivables Credit Products



Country Assessment

SECONDARY MARKETS	✗/✓
Existence of an exchange/platform for receivables or commodities that facilitates price discovery.	

ACCESS TO A FOREIGN EXCHANGE/PLATFORM	✗/✓
Access to a foreign exchange or platform.	

VALUATION STANDARDS	✗/✓
Clear valuation standards relating to receivables exist.	
Clear valuation standards relating to inventory of tangible goods and specifically crops exist.	

TECHNOLOGY	✗/✓
Existence of digital invoicing systems and interoperable payment systems.	
Existence of regulatory regimes favouring technological innovation to promote financial inclusion.	
Existence of a sovereign digital identity frameworks for individuals and entities.	
Existence of a legal and regulatory framework for data protection and ownership.	

Appendix H: Coordination with existing support measures

Country Assessment

GENERAL OBJECTIVE

Adjust existing public assistance programmes, such as credit guarantees schemes, to promote recovery and sustainable development, by incentivising the use of collateral and especially the development of receivables finance products.

KEY ACTIONS TO ADJUST EXISTING EMERGENCY MEASURES

Allow the use of an existing state credit guarantee scheme to protect financial institutions in case the SME defaults.

Require collateral or the deployment of receivables financing products as a condition for participating in the public assistance programme.

Permit NBFIs to benefit from a guarantee for the finance provided to viable SMEs in financial difficulties to facilitate their reorganisation.

Promote the development of pilot programmes where financial institutions provide new finance to distressed SMEs through receivables products and ensure that risks are, at least in part, mitigated by public assistance.

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