

### **Imprint**

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### **Foreword**

Alarmed by the disruptions caused by the COVID-19 pandemic and its impact on our societies and economies, we launched, among other projects, a workstream to look into how regulations and regulatory authorities could help to expedite a sustainable economic recovery from the current pandemic.

The first topic we dealt with in this workstream was SME Finance regulation. As the COVID-19 pandemic took hold across the world in 2020, we quickly saw the impact it would have on small and medium-sized enterprises (SMEs). SMEs are the backbone of our economies. The pandemic has deeply impacted many sectors, but SMEs have suffered more as their activity is usually more focused than large companies. It is crucial to support them in surviving the pandemic and then smoothly entering a sustainable economic recovery phase.

This report analyzes regulatory and supervisory interventions in our members' countries and how critical those interventions have been for business continuity during the crisis so far. It also lists recommendations that regulators can implement to help SMEs contribute to a fast recovery from the crisis.

In parallel, our SME Finance workstream reviewed the financial centers' responses globally in supporting SMEs in the pandemic and how this support was developed, directed, and delivered. We published our final report, "Supporting SMEs with Sustained Post-Pandemic Economic Recovery," a few weeks ago. It summarizes the activities and programs developed by national governments, central banks, regulators, and supranational organizations to support SMEs in response to the pandemic. I would urge you to read this report, too.

The World Alliance for International Financial Centers (WAIFC) is pleased to share this report on SME Finance Regulation as part of our contribution to our broader work on financial centers' role in supporting the global economic recovery. We are very much looking forward to discussing our findings and recommendations with and across the international financial community.

Dr. Jochen Biedermann Managing Director WAIFC



### Introduction

"Small and Medium Enterprises – SMEs - don't just significantly contribute to the economy, they are the economy!" (Arnold, 2019). Christopher Arnold's bold claim is backed by considerable evidence: SMEs form 90% of the world's business population according to the World Trade Organization (WTO) (Arnold, 2019), contribute more than 70% of global employment (ILO, 2020), and have shares of 50% (WTO, 2016) and 40% (World Bank, 2020) in GDPs of developed and emerging economies, respectively.

The World Alliance of International Financial Centers (WAIFC) is a non-profit association that encourages cooperation and promotes good practice among its members and other organizations. Alarmed by the disruptions caused by the COVID-19 pandemic, the WAIFC launched, among other projects, a workstream to look into how regulations and regulators could help expedite economic recovery from the crisis created by the pandemic. The WAIFC developed and distributed a questionnaire to its members to reveal the following:

- Regulatory interventions implemented in their countries
- Critical regulatory topics that should be dealt with in each country
- Relevant issues to maintain the right balance between prudential regulations and economic priorities
- Crisis effects on communication between regulatory authorities and market participants

Members' responses to the questionnaire addressed issues affecting the capital market, banking, and insurance sectors. These sectors are playing vital roles in mitigating the economic and financial disruptions caused by the Well-designed policy interventions of the regulating and supervising authorities to maintain critical services offered by the three sectors have been essential - and will remain indispensable for some time to maintain economic strength in the short, medium, and long terms. Initiatives such as the postponement of loan installments, tax relief measures, the extending of AGMs dates, efforts supporting SMEs, and steps to help listed entities and insurance companies to continue to service their customers and clients have been at the heart of the policy responses pioneered by many WAIFC member countries. That demonstrates how critical regulatory and supervisory interventions have been to ensure business continuity during the covid crisis and to support a rapid and sustainable recovery after it.

The purpose of this report is to offer a list of recommendations that regulators can implement to help SMEs contribute to a fast recovery from the economic crisis that has struck the world as a result of the COVID-19 pandemic. The paper also reveals a set of perspectives from WAIFC members on measures that authorities have taken in their markets to mitigate the shocks imposed by the pandemic and promote a recovery.



# How the pandemic has affected SMEs



SMEs around the world have been hit very hard by the COVID-19 pandemic. Demand for and consumption of goods and services plummeted due to lockdowns imposed by many countries worldwide. Consequentially, the production of goods and services also slumped. Many companies were forced into temporary shutdowns (often of uncertain durations) of their offices and production sites and feared they might have to close operations permanently. The pandemic led countries to shut down their borders, hindering global trade and destroying value chains.

According to the International Labor Organization, seven hundred out of 1,000 companies from eight countries in four continents surveyed in May 2020 were compelled to shut down. 50% of those had to close in compliance with authorities' measures to narrow the virus's spread, and the other 50% had to shut down due to infections of staff or reduction in demand (ILO, 2020). The survey also showed that 90% of these companies were experiencing a shortage in cash flow. The demand for products of 75% of those businesses plummeted. 33% experienced a demand reduction of more than 50%.

# Members' Survey Responses

The Economic Development Board (EDB) of Mauritius is prioritizing tackling issues and challenges related to credit loss provisioning due to the COVID-19 pandemic crisis. They are currently exploring how capital markets can alleviate the risks and challenges arising from COVID worldwide to formulate further measures to support growth in Mauritius. The EDB also creates flexible regulations to allow SMEs to tap from emergency funding through the cashless payment system or market-based financing platforms such as crowdfunding platforms.





Measures they have implemented include:

- Boosting SMEs' access to capital markets by simplifying listing requirements and reducing regulatory burden to lower the costs related to exchange-listed financial instruments;
- Easing capital requirements without lowering standards of regulation;
- Promoting positive environmental impacts including through reimbursement of expenses related to a mandatory external verification for the issuance of green bonds; and
- Continuing efforts in developing regulations, appropriate supervision and monitoring of new instruments to promote sustainable and green finance (e.g., taxonomy and use of proceeds verifications).



The Korean Financial Services Commission announced that more than KRW 4.7 trillion (USD 4.3 billion) in fiscal resources has become available to facilitate smooth implementation of various pandemic-related financial support programs after the National Assembly passed the 3rd supplementary budget on July 3, 2020. In Korea, SMEs' liquidity of capital has been a critical concern for policymakers throughout the pandemic.

Busan Finance Center



The Government of Oman has introduced some economic and financial measures to curb the COVID-19 pandemic outbreak's effects. Royal orders were given to form a High Committee to deal with the consequences of the epidemic. The Central Bank of Oman (CBO) has developed a stimulus package to inject OMR 8 billion (USD 20.87 billion) into the economy. That is in addition to other precautionary procedures issued to banks and FLCs. As the regulator of the capital markets and insurance industries, the Capital Market Authority (CMA) instructed all SAOGs to postpone their Annual General Meetings (AGMs) as a measure to help narrow the spread of the pandemic. Later, it requested them to hold virtual AGMs (vAGMs) on a portal provided for that purpose. It also instructed all insurance companies to close their main customer service halls, move from physical customer service to virtual customer service, and provide 24/7 customer service centers. Moreover, the CMA requested all SAOGs to distribute dividends for the year ended 31/12/2019, requiring ex-dates to be the same as disclosed earlier in AGMs invitations sent to shareholders. This move aims to have as much as OMR 409 million (USD 1.1 billion) re-injected in the market.

of International Financial Centers

In France, €120 Billion (USD 145.5 Billion) in guaranteed loans have been granted by the banks to support 550 000 SMEs, while the French recovery plan dedicates €40 Billion (USD 48.5 Billion) to SMEs' solvability. Simultaneously, new kinds of investment funds were launched: the first to facilitate insurance companies' investments into SMEs and the second one driven by BPI France (the French development bank) to encourage the households' investments in private equity funds. In addition to these Government initiatives, Paris EUROPLACE set up "a crisis unit" initially. The objective was to gather all the French financial market professionals' ecosystem, including market authorities, to define a strategy to serve businesses and, more significantly, to accompany SMEs to overcome the crisis.





FinCity.Tokyo has proposed the addition of small and medium financial services firms (independent asset managers and fintech firms are assumed to be involved) into the scope of eligible applicants for low interest and unsecured loans (guaranteed by the Credit Guarantee Corporation).

In Germany, suffering companies in different industries can benefit from a comprehensive "Protective Shield against Coronavirus."

Borrowers apply for a loan from their local bank, which checks eligibility and creditworthiness, while KfW, the German development bank, provides the funds. Depending on the program, the local bank can be exempt from liability up to 100%, while the development bank can refinance itself on the market quickly. That comes with varying rates, falling with the bank's risk uptake. Hence all credit takers will have an incentive to make their bank take some of the risk burden. That was made possible only by a change of the bankruptcy law that allowed lenders to stay afloat much longer despite being technically insolvent.



In Luxembourg, a series of national measures have been implemented to support SMEs during the crisis:

- Startup vs. COVID19
- Bank guarantee for SMEs with liquidity issues
- Measures to ensure business continuity (e.g., conduct of general meetings)
- Tax relief measures
- Extraordinary leave for family reasons
- Short time working in the event of force majeure
- Social security measures for companies and the self-employed
- Various direct and indirect taxes measures
- Certificates for cross-border workers

Improving access to funding via private investors/channels for SMEs in the aftermath of COVID-19 is critical for achieving economic growth.





Canada's national prudential regulator, The Office of the Superintendent of Financial Institutions (OSFI), announced the lowering of the Domestic Stability Buffer (DSB) by 1.25% of risk-weighted assets. This action will allow Canada's large banks to inject \$300 billion of additional lending into the economy.





The scale and complexity of COVID-19 has brought about some of the most challenging economic conditions the UK has encountered. The pandemic has placed stress on UK businesses of all sizes and across all sectors.

The UK Government responded quickly in the early stages of the pandemic to ensure that Small and Medium-Sized Enterprises (SMEs) were able to manage the initial economic shock, safeguarding millions of jobs and putting the UK in the best position to recover.

However, due to the pandemic, many SMEs have taken on higher levels of debts than they would have planned for. To address this challenge, TheCityUK, supported by EY, convened a Recapitalisation Group of senior practitioners from across the financial and related professional services industry to think about how industry and Government could work together to address this challenge and support the recapitalization of businesses. In July 2020, TheCityUK published the final report of the Recapitalisation Group, Supporting UK economic recovery: recapitalizing businesses post COVID-19 Report, which sets out a range of options for converting, restructuring, and repaying this debt to help hundreds of thousands of SMEs recover, save jobs, protect billions of pounds of taxpayer money, and help power the UK's future growth. TheCityUK engaged with the Bank of England and HM Treasury throughout the process, and both are considering its recommendations at the highest level.

In Qatar, SMEs are recipients of a great support as the government moves forward with diversifying its economy away from hydrocarbons. In its strategy, Qatar Central Bank (QCB) specifies SMEs as a "key focus area". Qatar Development Bank (QDB) has accelerated financing of SMEs with a myriad of targeted programs to lift their potential. The Qatar Financial Centre (QFC), along with its independent regulatory arm, the Qatar Financial Centre Regulatory Authority (QFCRA), continues to actively support the various initiatives in the State of Qatar, including exploring the expansion of alternative financing methods (invoice discounting, factoring, supplier finance and P2P) that will enrich the current SME financing programs and allow for further success in the space.





## Recommendations

Since the vast majority of businesses in the world are SMEs and since these businesses create most jobs, it is natural and logical to think or believe that any recovery of the world's economy after the pandemic will be centered around them. Regulatory interventions tailored for SMEs could help ensure that economic recovery is both speedy and sustainable.

Based on members' responses and to support rapid recovery from the crisis, we recommend that governments consider the following principles as they devise regulatory interventions related to SMEs. Naturally, different conditions apply in different markets, and some of these recommendations will be more applicable in some markets than others.

### Ensure gradual return to normal

Once the pandemic has come to an end, it is essential that regulators do not rush to stop working with measures made during the pandemic. Measures such as tax reliefs, postponement of loan installments, lower interest rates on loans, and bank liquidity guarantees for SMEs should be kept in place during the immediate recovery phase until sustainable growth is back in sight.

### Reduce tariffs as far as possible to help SMEs grow by trading internationally

Exports of goods and services is one way by which SMEs can grow their revenues and profits. Although SMEs make up 90% of world businesses, their exports in developing economies account for only 7.6% of manufacturing sales and 34% in developed countries (WTO, 2016). Tariff restrictions are among the most significant barriers hindering SMEs' ability to participate in trade and are a more substantial hindrance for SMEs than for large firms (WTO, 2016).

Cutting tariffs could help SMEs participate more effectively in a rapid and sustainable recovery of the global economy in the post-COVID era.

# Facilitate gathering operational and financial information for commercial and development banks to support SMEs' credit applications

SMEs need to have much information to hand when applying for credit. Nevertheless, SMEs often struggle to produce lenders' relevant information due to a lack of internal procedures and capabilities. Reporting on access to finance for SMEs in the MENAP and CCA regions, the International Monetary Fund (IMF) states that "SMEs face several nonfinancial barriers related to their capacities, including lack of financial accounts and unavailability of reliable credit histories." Regulators could intervene by inviting SMEs to attend development programs aiming to develop their capabilities in developing and recording their financial transactions. That procedure could improve SMEs' capacities, expedite SMEs' credit application process by banks and other credit offering institutions, and speed up access to funds.

### Request credit institutions to design special products tailored for SMEs

SMEs require appropriate access to finance to survive and grow. Even during normal economic circumstances in pre-COVID-19 times, SMEs found it challenging to apply for credit, and now following covid the situation has become harder still. Designing special products to help SMEs access finance could save all of the parties involved many hassle. Regulators could request crediting institutions to create such products taking into account all risks associated with them. Before approving those products, both crediting institutions and regulators can then work to find ways to address those risks and find ways to mitigate them.

### Consider expanding adoption of World Bank's Credit Guarantee Scheme (CGS) for SMEs

A credit guarantee scheme can be viewed as a risk mitigation mechanism or method used to transfer a portion of the risk associated with lending SMEs to a third party. The latter can be a government that would absorb a part of a lender's loss should the SME defaults to repay its loan. According to the Organization for Economic Cooperation and Development (OECD), as cited in (Green 2003), almost 100 countries worldwide were implementing more than 2,250 CGSs. According to the World Bank, however, there was no common set of standards or principles to govern those schemes. This lead to a cooperation in 2015 between the World Bank and First Initiative to develop a tool of 16 principles intended to become "the standard for effectively and efficiently establishing and running public CGSs for SMEs around the world." This 16-principles standard addresses four areas: legal and regulatory framework, corporate governance and risk management, operational framework, and monitoring & evaluation.

In response to the COVID-19 pandemic, only 41 countries launched 57 CGSs for SMEs in 2020 (Dreyer & Nygaard, 2020). That leaves the door wide open for more SME CGSs to be started in the post-pandemic period to help establish sustainable economic recovery.

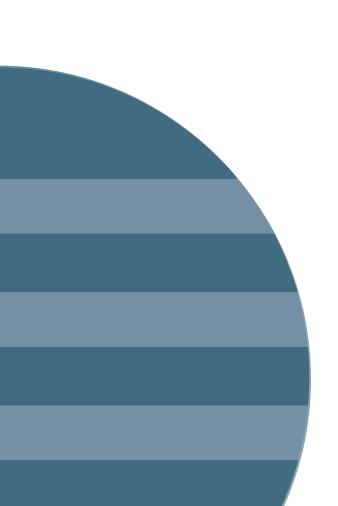
### Remove barriers that hinder SMEs' expansion into new markets

The removal of barriers that complicate SMEs' entry into the international markets could help SMEs trade across borders and grow. Obstacles can come in several forms, including financial, logistical, procedural, and operational. The WTO estimates that 50% of SMEs' credit applications are rejected compared to only 7% for multinational companies. They face "more credit rationing, higher screening, and higher interest rates" than large corporations. Logistics are also more expensive for SMEs than for larger companies. For example, SMEs in Latin America endure 24-27% more domestic logistics costs than large firms.

### Facilitate SMEs' access to funding through capital markets and other sectors

Funds sourced through capital markets could be much cheaper for SMEs. However, the regulatory framework has not been as friendly as it is for larger firms when raising capital on public markets (Zachariadis, 2019). As a result, SMEs have always had to turn to more expensive financing sources, including bank loans and their cash savings.

Because SMEs make up the vast majority of world businesses and create most jobs, regulators should make every effort to smooth their access to as many sources of finance as possible, including capital markets. The development of entry markets with reduced requirements for young and small companies should be favored, as well as new opportunities such as crowdfunding.



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### **WAIFC WORLDWIDE**

WAIFC facilitates cooperation between financial centers, exchange of best practices and communication with the general public. WAIFC members are city governments, associations, and similar institutions developing and promoting their financial centers.



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