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## Financial Inclusion, Access to Credit, and Sustainable Finance

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# FINANCIAL INCLUSION, ACCESS TO CREDIT, AND SUSTAINABLE FINANCE

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This Issue arose out of an in-person colloquium held at the Durham Law School at Durham University in England in 2019. That colloquium included a celebration of the appointment of one of this Issue's contributors to Durham University's Distinguished Honorary Professorship.<sup>1</sup> This Issue recognizes that achievement but, much more importantly, expands the discussion sparked by the colloquium.

The topic of that discussion, and of this symposium issue, is financial inclusion, access to credit, and sustainable finance. Not being well defined, these terms sometimes are used inconsistently. The initial focus of this symposium issue is to provide some definition.

The first article, *Scoping and Defining Financial Inclusion, Access to Credit, and Sustainable Finance*,<sup>2</sup> suggests that “financial inclusion” should encompass widespread deposit-account ownership and access to payments services; that “access to credit” should require adequate loan funding on reasonable terms, especially for aspiring entrepreneurs from underserved groups; and that “sustainable finance” should mean continuously providing financial inclusion and access to credit.

These are normative views about how these terms should be defined. To help assure internal consistency, the contributors to this symposium issue have attempted to follow these normative definitions. However, actual usage is sometimes broader. For example, “sustainable finance” sometimes includes

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1. Schwarcz *Conferred Distinguished Honorary Professorship at U.K.'s Durham University, Delivers Keynote Lecture*, DUKE UNIV. SCH. OF L. (May 22, 2019), <https://law.duke.edu/news/schwarcz-conferred-distinguished-honorary-professorship-uks-durham-university-delivers-keynote/> [<https://perma.cc/M957-MNGH>].

2. Steven L. Schwarcz & Theodore L. Leonhardt, *Scoping and Defining Financial Inclusion, Access to Credit, and Sustainable Finance*, 84 LAW & CONTEMP. PROBS., no. 1, 2021, at 1.

using finance to try to achieve the goals of the environmental, social, and governance (ESG) movement.

Some may regard financial inclusion, access to credit, and sustainable finance as more aspirational than practical goals. That must be true to some extent; after all, socially inclusive financial goals inherently involve a degree of wealth redistribution, and human nature is to resist giving up money without a satisfactory quid pro quo. Nonetheless, achieving these goals can provide important reciprocal exchanges, both tangible and intangible.

Tangibly, achieving these goals can reduce the risk of violence and revolution. It can also reduce the need for taxation to provide the poor with welfare and other social safety nets. Intangibly, achieving these goals can provide immense psychic benefits, increasing the common good and satisfying moral, philosophical, and religious aspirations of how we ought to act.

Additionally, as this symposium issue's articles show, achieving the goals of financial inclusion, access to credit, and sustainable finance does not always involve wealth redistribution. For example, rapid advances in technology, such as distributed ledger-based technologies and other financial technology (fintech), can facilitate these goals by increasing efficiency.<sup>3</sup> Also, in his Distinguished Honorary Professorship Lecture, one of us separately argued that access to credit might be achieved by recognizing concepts in finance that are already well accepted in the law.<sup>4</sup> That Lecture observes that a major impediment to upward mobility is the inability of the poor to use their property, in which they sometimes hold only de facto, not de jure, rights, as collateral to obtain credit. The World Bank estimates that, largely due to poverty, seventy percent of the world's population do not have registered title to their land.<sup>5</sup>

Although modern commercial law has many examples of policy goals and commercial realities overriding traditional property law limitations, the leading precedent is the Uniform Commercial Code (UCC). The UCC, a model commercial law that is uniformly enacted by states within the United States, is perhaps the world's most respected codification of commercial law. To facilitate transferability the UCC gives good faith purchasers—including holders-in-due-course of instruments and buyers-in-ordinary-course of goods—greater rights in transferred property than the seller had.<sup>6</sup> This recognizes and responds to commercial reality. For example, buying goods from a store would be

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3. See Emiliós Avgouleas, *Resolving the Sustainable Finance Conundrum: Activist Policies and Financial Technology*, 84 LAW & CONTEMP. PROBS., no. 1, 2021, at 55; Orkun Akseli, *Financial Inclusion, Access to Credit, and Sustainable Finance: What Role for the UNCITRAL Model Law on Secured Transactions?*, 84 LAW & CONTEMP. PROBS., no. 1, 2021, at 181; Heather Hughes, *The Complex Implications of Fintech for Financial Inclusion*, 84 LAW & CONTEMP. PROBS., no. 1, 2021, at 115.

4. That Lecture was subsequently published as Steven L. Schwarcz, *Empowering the Poor: Turning De Facto Rights into Collateralized Credit*, 95 NOTRE DAME L. REV. 1 (2019).

5. *Why Secure Land Rights Matter*, WORLD BANK (Mar. 24, 2017), <https://www.worldbank.org/en/news/feature/2017/03/24/why-secure-land-rights-matter> [<https://perma.cc/5T6D-49WE>].

6. Compare U.C.C. § 3-305 (explaining the rights of sellers) with U.C.C. § 9-320 (explaining the rights of buyers).

prohibitively expensive if, to protect the purchase, the purchaser had to perform due diligence on whether the store actually owned the goods and whether the goods might be encumbered by any third-party rights.

Enabling the poor to pledge *de facto* rights in their homes and other assets as collateral in order to obtain credit represents an important commercial reality. The *de jure* owner is not using the property commercially, while the *de facto* right holder is motivated to use it. In order to turn these *de facto* rights into collateralized credit for loans, the poor would need to be able to transfer legally recognized security interests in their property to lenders. This poses a puzzle: how could holders of *de facto* rights transfer greater rights than they hold?

The solution is to give good faith lenders, just like holders-in-due-course of instruments and buyers-in-ordinary-course of goods,<sup>7</sup> those greater rights when foreclosing on the collateral. Although that would cut off the holders of *de jure* rights in the collateral, commercial law constantly grapples with conflicting rights and the need for fairness. In a holder-in-due-course and buyer-in-ordinary-course context, commercial law resolves the conflict by, effectively, enabling the party with *de jure* rights to provide notice that it wishes to preserve those rights.

Precedent also exists outside of commercial law for preserving *de jure* rights through notice. For example, *de jure* rights are preserved by giving clear notice in the somewhat parallel tension between the rights of landowners and the *de facto* rights of squatters. In most jurisdictions, squatters can ultimately obtain superior rights over the land they occupy under the law of adverse possession. The original owner, however, can preserve its rights by providing explicit notification, such as posting a no trespassing sign or blocking entry to the land.

This same type of approach—recognizing the *de jure* rights of persons who provide clear notice to preserve those rights—should allow the poor to transfer legally recognized security interests in their *de facto* property to lenders, as collateral for loans. Although *de jure* right holders could always give notice, thereby preventing the poor from using the property as collateral, relatively few *de jure* right holders are likely to know their rights. In most jurisdictions, the government owns much of the property in which the poor hold *de facto* rights. The question of fairness then devolves into a political issue.

The need to access business credit is also critical in developing and middle-income countries. The World Bank Group (IFC) estimates that sixty-five million firms, representing forty percent of micro, small, and medium-sized enterprises in developing countries, have an unmet financing need of \$5.2 trillion every year.<sup>8</sup> This is equivalent to 1.4 times the current level of financing available to those firms.<sup>9</sup> The numbers worsen substantially if informal businesses are factored in. This dire situation shows that a majority of smaller businesses do not have access

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7. See *supra* text accompanying note 6. See also Schwarcz, *supra* note 4 (for further exploration of this argument).

8. *Small and Medium Enterprises Finance*, WORLD BANK, <https://www.worldbank.org/en/topic/smfinance> [<https://perma.cc/C88E-75MC>].

9. *Id.*

to the financial needs necessary to develop their business activity at adequate levels, a systemic failure that condemns many otherwise viable businesses to failure and severely hampers economic growth. Naturally, this problem most severely affects the smallest and more vulnerable businesses, which often do not have land to use as collateral.

Gaining an even more complete understanding of the global efforts concerning financial inclusion, access to credit, and sustainable finance requires the reader to pay close attention to transnational institutions. In contrast to the prior examples, which focus on using land as collateral, these institutions are also focusing on expanding the range of usable collateral. Thus, the International Institute for the Unification of Private Law (UNIDROIT) has been very active in trying to help facilitate access to credit by drafting a model law on factoring, reverse factoring, and supply-chain financing. Their work contemplates innovative technological solutions to allow more efficient use of accounts receivable—all too often, the only asset available to use as collateral by smaller entrepreneurs—to access credit. In a similar fashion, UNIDROIT and the United Nations Commission on International Trade Law (UNCITRAL) are working together to create a best-practice standard for warehouse-receipt financing, a tool for facilitating credit in the agricultural business sector.<sup>10</sup>

These transnational institutions also have been working to facilitate access to credit for entrepreneurs in developing and middle-income countries. The key to this effort is the new Protocol to the Cape Town Convention on International Interests in Mobile Equipment, approved in Pretoria in November 2019.<sup>11</sup> The Protocol focuses on equipment used in the mining, agriculture, and construction sectors. It notably helps to correct deficiencies in the legal infrastructure for using that equipment as collateral. The Protocol holds special promise for agricultural finance. It enables farmers and small producers previously limited to subsistence farming to achieve economies of scale by acting together through cooperatives and other joint-venture structures. An independently commissioned economic assessment concluded that the Protocol has the potential to increase economic growth in developing countries by over \$23 billion per year.<sup>12</sup>

Beyond access to credit, transnational institutions also are deploying substantial resources to ensure the growth of sustainable and ethical economic development and investment. This is exemplified by the joint projects of UNIDROIT with the Food and Agriculture Organization (FAO) of the United Nations and the International Fund for Agricultural Development (IFAD). One

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10. UNCITRAL also has promulgated a Model Law on Secured Transactions. *See* G.A. Res. 71/136, ¶ 1 (Dec. 13, 2016).

11. INT'L INST. FOR THE UNIFICATION OF PRIVATE LAW [UNIDROIT], PROTOCOL TO THE CONVENTION ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT ON MATTERS SPECIFIC TO MINING, AGRICULTURAL AND CONSTRUCTION EQUIPMENT (Nov. 22, 2019), <https://www.unidroit.org/english/conventions/mobile-equipment/mac-protocol-e.pdf> [<https://perma.cc/X9L8-KF9A>].

12. UNIDROIT, MAC PROTOCOL ECONOMIC ASSESSMENT 1 (2018), <https://www.unidroit.org/english/documents/2018/study72k/1808-final-mac-protocol-ea.pdf> [<https://perma.cc/A8AF-DZU2>].

such project, *The Legal Guide on Contract Farming*,<sup>13</sup> offers guidance to achieve balanced agreements between producers and their buyers, and supports the production of a wide range of agricultural commodities. In doing so, it helps increase agricultural productivity, improves the livelihoods of the rural poor, and discourages rural exodus. More recently, the *Legal Guide on Agricultural Land Investment Contracts*<sup>14</sup>—newly approved by the UNIDROIT Governing Council and by IFAD<sup>15</sup>—seeks to ensure that agricultural investment, especially international investment, happens in a context that is respectful to local communities and tenure-right holders, an approach which has been often ignored in large investments for the use of agricultural land. These and other potential economic and social benefits explain the interest of many domestic policymakers and international organizations in promoting sustainable contract farming models as part of their efforts to achieve food security.

In the end, what governments and international organizations increasingly have come to understand is that financial inclusion, access to credit, and sustainable finance are ultimately social goods for many societies.<sup>16</sup> They relate in fundamental ways to buying a home, achieving success in higher education, starting a new business, and more generally, having the means by which to live a decent life. The law and institutions of credit and finance thus have major social as well as economic significance. Getting the institutional design right for a system of credit and finance can be one of the most important objectives a government can undertake.

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13. UNIDROIT, U.N. FOOD & AGRIC. ORG. & INT’L FUND FOR AGRIC. DEV., *LEGAL GUIDE ON CONTRACT FARMING*, at xv (2015), <https://www.unidroit.org/english/guides/2015contractfarming/cf-guide-2015-e.pdf> [<https://perma.cc/BC68-T9AL>].

14. See *Study LXXX B - Preparation of An International Guidance Document on Agricultural Land Investment Contracts*, UNIDROIT, (May 28, 2020), <https://www.unidroit.org/work-in-progress/agricultural-land-investment> [<https://perma.cc/KE5C-BYUU>] (describing the background of the Legal Guide on Agricultural Land Investment Contracts).

15. The Guide is currently undergoing the formal clearance process by FAO.

16. John Linarelli, *Inequality and Access to Credit: A Social Contract Framework*, 84 LAW & CONTEMP. PROBS. No. 1, 2021, at 165.