

## The Future of Microfinance in the United States: Regulatory Reforms For Economic Prosperity

Laura Raheb

Follow this and additional works at: <https://scholarship.law.stjohns.edu/jcred>

---

This Notes and Comments is brought to you for free and open access by the Journals at St. John's Law Scholarship Repository. It has been accepted for inclusion in Journal of Civil Rights and Economic Development by an authorized editor of St. John's Law Scholarship Repository. For more information, please contact [selbyc@stjohns.edu](mailto:selbyc@stjohns.edu).

## THE FUTURE OF MICROFINANCE IN THE UNITED STATES: REGULATORY REFORMS FOR ECONOMIC PROSPERITY

LAURA RAHEB\*

“All human beings are very creative—full of potential, full of energy. . . So, money kind of allows them to express it . . . And if you’re successful, you can take more money. You can expand your capacity, reach next level of capacity, and so on.”<sup>1</sup>

### INTRODUCTION

Sherife is a 34-year-old single hardworking woman who lives with her mother in Kosovo. She works as a seamstress in a local factory. After Sherife’s shift, she returns home to sew products that she sells to individuals. Sherife hopes to be able to expand her solo sewing business as her sole source of income. Expanding her business would allow Sherife to escape the factory life where she is paid far below what is considered minimum wage in the United States. Owning her own seamstress business is the only viable way for Sherife to escape her impoverished life. With the help of a microfinance institution, a financial institution that offers small loans to low-income or underserved entrepreneurs, Sherife’s dream can become a reality. Around the world, microfinance institutions have been successful in helping men and woman start and grow their businesses with the offer of microloans.

Many individuals, like Sherife, who hope to start their own business, live here in the United States. In the U.S., many individuals are turning to self-employment as their source of

\*J.D. Candidate, St. John’s University, School of Law, Class of 2016.

<sup>1</sup> Q&A with Muhammad Yunus, PBS, <http://www.pbs.org/now/enterprisingideas/Muhammad-Yunus.html> (last visited Feb. 22, 2015).

income, with the hope that they can apply their skill set meaningfully and lucratively and break the cycle of poverty.<sup>2</sup> In order to start a business, one usually requires a loan from a bank. Unfortunately, many individuals are denied loans because they have either poor credit or lack credit entirely, and thus they are turned away from traditional forms of banking here in the United States. Without an alternative to the traditional banking sector; without adequate microfinance institutions to provide the financial backbone entrepreneurs need, the hope of materializing these dreams are extremely slim for U.S. citizens. Therefore, the impoverished, lower income families, or those who have not had the opportunity to build credit are rejected from the standard loan market.

This is a problem because without a start-up loan, the poor have limited ways in generating income in order to climb the financial ladder. In contrast to those that are denied loans, those that are in good financial standing and have a strong credit history are allotted all of the services banks provide, making it easy for them to finance their professional endeavors. This pattern of financial practice, in which the poor are systematically turned away from obtaining a loan has led to detrimental changes in the economy. Examples include the growing disparity of income distribution, the loss of blue-collar jobs, the shift from relatively well paying manufacturing jobs to minimum wage service sector jobs, and corporate downsizing, outsourcing, and unemployment.<sup>3</sup> And despite the difficulty in securing a loan, more individuals today are turning to self-employment as their source of income, with the hope that they can apply their skill set meaningfully and lucratively and break the cycle of poverty.<sup>4</sup>

This becomes the role of microfinance: To grant people who are normally excluded from the financial services of traditional banks access to credit and collateral free loans which make it possible for

<sup>2</sup> Bill Burrus, *Lessons and Trends of Microcredit in the United States*, ACCION USA, at 1-2, <http://www.microfinancegateway.org/sites/default/files/mfg-en-paper-lessons-and-trends-of-microcredit-in-the-united-states-2005.pdf>.

<sup>3</sup> *Id.* at 3.

<sup>4</sup> *Id.*

the poor to lift themselves out of poverty.<sup>5</sup> Microfinance<sup>6</sup> is defined as a type of banking service provided for those in poverty or others who are systematically excluded from the traditional financial system.<sup>7</sup> Microfinance institutions offer small loans, ranging from roughly \$10-\$1,000 to poor people attempting to start small businesses.<sup>8</sup> The borrowers are people that have been denied access to loans via traditional financial institutions due to the high transaction costs and high risks associated with lending to entrepreneurs lacking credit.<sup>9</sup> By securing a loan and generating income, individuals can invest in other areas, such as healthcare, education, and necessary nutrition for sustainable living.<sup>10</sup> Therefore, microfinance has become an essential tool for poverty alleviation.

Microfinance has earned a great deal of acclaim for alleviating poverty and facilitating self-sufficiency among entrepreneur recipients of microloans, particularly in developing countries.<sup>11</sup> Despite this international success, microfinance efforts in the United States are nowhere near self-sufficient, face high default rates and are not meeting the needs of low-income individuals and small businesses.<sup>12</sup> Failed attempts to mimic the international

<sup>5</sup> See Mohammad Arifujjaman Khan & Mohammed Anisur Rahaman, *Impact of Microfinance on Living Standards, Empowerment and Poverty Alleviation of Poor People: A Case Study on Microfinance in the Chittagong District of Bangladesh*, UMEA SCHOOL OF BUSINESS 1 (2007), <http://umu.diva-portal.org/smash/get/diva2:141240/FULLTEXT01.pdf>.

<sup>6</sup> The terms “microfinance” and “microcredit” are used interchangeably throughout scholarship and precise definitions remain unfounded. Microfinance refers to banking or financial services targeted at low-income individuals and small businesses. Microlending, or sometimes called microcredit, refers to a specific financial service: lending. For purposes of this note, microfinance will refer to the concept of creating an institution made for financial services for the poor and undeserved, while microlending is the act of giving a small amount of money to entrepreneurs and/or small businesses. See *About Microfinance and Microcredit*, [http://www.unep.org/training/programmes/Instructor%20Version/Part\\_2/Activities/External\\_Drivers/Finance/Core/About\\_Microfinance\\_and\\_Microcredit.pdf](http://www.unep.org/training/programmes/Instructor%20Version/Part_2/Activities/External_Drivers/Finance/Core/About_Microfinance_and_Microcredit.pdf) (last visited Feb. 28, 2015).

<sup>7</sup> *A Guide to Regulation and Supervision of Microfinance*, CGAP (Oct. 2012), available at [http://www.cgap.org/sites/default/files/Consensus-Guideline-A-Guide-to-Regulation-and-Supervision-of-Microfinance-Oct-2012\\_0.pdf](http://www.cgap.org/sites/default/files/Consensus-Guideline-A-Guide-to-Regulation-and-Supervision-of-Microfinance-Oct-2012_0.pdf) (last visited Feb. 28, 2015).

<sup>8</sup> Alexandra O'Rourke, *Public-Private Partnerships: The Key to Sustainable Microfinancing*, 12 L. & BUS. REV. AM. 179, 183 (2006).

<sup>9</sup> *Id.*

<sup>10</sup> See *Q&A with Muhammad Yunus*, *supra* note 1.

<sup>11</sup> Deanna Chea, *Microlending: State Regulatory Reforms to Promote Economic and Employment Growth in California*, 10 HASTINGS BUS L.J. 451, 451 (2014).

<sup>12</sup> Molly Richardson, *Increasing Microlending Potential in the United States Through a Strategic Approach to Regulatory Reform*, 34 IOWA J. CORP. L. 923, 925 (2009).

phenomenon have left shallow hope in those searching for the financial means to start their businesses. However, by creating federal legislation that will focus on regulatory reforms to support this unique system of banking, microfinance can become a stable system to provide for those in need here in the United States.

Part II of this note will provide a comprehensive explanation of the history, success and current state of microfinance abroad and the current state of microfinance in the United States. Part III will analyze why U.S. microfinance has not reached the same level of efficiency as its international counterparts. Finally, Part IV proposes the most promising solution: a proposal to Congress for regulatory reform to set the stage for the development and growth of microfinance in the United States. This unique system, when created abroad, will no longer be expected to fit in the regulatory system that the U.S. has long created for traditional banks. By creating a regulatory system solely dedicated to microfinance, microfinance has an opportunity to grow as a stable financial structure. As a result, this new system of banking will finally thrive in the United States, ultimately providing economic opportunities for those in need.

## I. BACKGROUND

### A. *Microcredit in Developing Countries*

Microfinance originated in a developing country and has expanded to many countries around the globe. The U.S. Accion International (“Accion”), a premier finance organization, and Muhammad Yunus, the founder of the Grameen Bank, both claim to have independently pioneered the concept of microcredit.<sup>13</sup> Since their inception in the 1970s, microfinance institutions (“MFIs”) have offered economic opportunities to poor people, in part by lending small amounts of capital to borrowers who use this money to fund their small businesses.<sup>14</sup>

<sup>13</sup> Chea, *supra* note 11, at 452.

<sup>14</sup> Jameel Jaffer, *Microfinance and the Mechanics of Solidarity Lending: Improving Access to Credit Through Innovations in Contract Structure*, 9 J. TRANSNAT’L L. & POL’Y 183, 184 (1999).

In 1976, Muhammad Yunus explored the potential for small loans to ease poverty in developing countries.<sup>15</sup> He was a professor and head of the Rural Economics Program at the University of Chittagong.<sup>16</sup> Yunus began a lending program in his native country of Bangladesh, which issued small loans to poor, rural women in order to fund their small businesses and create a self-sustaining source of income.<sup>17</sup>

As a part of this program, women were required to join a small group and attend regular meetings concerning the loan program.<sup>18</sup> All members were held jointly accountable in the event that a member defaulted.<sup>19</sup> This was used as an alternative to the “credit” approach used in traditional U.S. banking institutions and in many countries around the world because unlike lending programs in the US, a borrower’s credit history did not have to be reviewed and accepted before receiving a loan.<sup>20</sup> This made the transaction a bit riskier, since credit is used as a record of the consumer’s ability to repay debts and demonstrates responsibility in paying debts.<sup>21</sup> This pilot project was a success: the women were reliable borrowers, resourceful entrepreneurs, and invested in the health and well being of their families.<sup>22</sup>

Yunus argues credit is not a privilege, but a human right of all individuals, regardless of present income and loan credibility.<sup>23</sup> Through this philosophy, Yunus has provided many poor individuals, lacking a history of credit, to secure loans through microfinance institutions. Yunus’s program eventually evolved into the Grameen Bank, a nongovernmental organization (“NGO”)

<sup>15</sup> Chea, *supra* note 11, at 453.

<sup>16</sup> Richardson, *supra* note 12, at 928.

<sup>17</sup> Rebekah J. Salt, *Exploring Women’s Participation in a U.S. Microcredit Program*, 42 J. OF NURSING SCHOLARSHIP 270, 270-71 (2010).

<sup>18</sup> *Grameen Bank History*, FUNDING UNIVERSE, <http://www.fundinguniverse.com/company-histories/grameen-bank-history/> (last visited Feb. 22, 2015).

<sup>19</sup> *Id.*

<sup>20</sup> Chea, *supra* note 11, at 453.

<sup>21</sup> Kelly Gallagher, *Rethinking the Fair Credit Reporting Act: When Requesting Credit Reports for “Employment Purposes” Goes Too Far*, 91 IOWA L. REV. 1593, at 1597 (July 2006).

<sup>22</sup> Chea, *supra* note 11, at 453.

<sup>23</sup> See *supra* note 1.

dedicated to providing microloans.<sup>24</sup> Today, the Grameen Bank extends loans to nearly two million borrowers in Bangladesh.<sup>25</sup>

Similarly, in the 1970s, Accion began issuing small loans to microentrepreneurs in Brazil, after observing that the main cause of poverty in Latin America was a lack of economic opportunity.<sup>26</sup> Within four years, 885 loans were issued, creating over 1,300 new jobs.<sup>27</sup> The project was so successful that Accion was able to expand its efforts to fourteen more countries in South America.<sup>28</sup> Today, Accion has expanded to Africa, Asia, the Caribbean, and the United States.<sup>29</sup>

### *B. Success in the Developing World*

Although it has survived a short period of time, microfinance has reached a vast number of poor people in over 100 developing countries throughout the world.<sup>30</sup> From 1997 to 2006, Accion International had lent \$12.3 billion to 4.94 million people, with a repayment rate of 97%.<sup>31</sup> In only two years, the Grameen Bank has also shown success by loaning more than \$750 million with a 97% rate of repayment.<sup>32</sup> While commercial banks in developing countries serve less than 20% of the country, microcredit programs prove to be critical in providing access to basic financial services,

<sup>24</sup> *Grameen Bank History*, *supra* note 18.

<sup>25</sup> Jay Lee, *Equity and Innovation: Using Traditional Islamic Banking Models to Reinvent Microlending in Urban America*, 16 *IND. INT'L & COMP. L. REV.* 523, 527 (2006).

<sup>26</sup> *1970s: Microlending Begins*, ACCION, <https://www.accion.org/content/1970s-microlending-begins> (last visited Jan. 15, 2015).

<sup>27</sup> *Id.*

<sup>28</sup> *Accion History: 1980's-1990's*, ACCION, <https://www.accion.org/content/1980s-1990s-expanding-opportunity-2016> (last visited Sept. 27, 2016).

<sup>29</sup> *Our History*, ACCION, <https://www.accion.org/content/our-history> (last visited Sept. 27, 2016).

<sup>30</sup> Richardson, *supra* note 12, at 926.

<sup>31</sup> Mary Fu, *Microcapital Story: Accion Gateway Microfinance Investment Vehicles Fund (GMIV) Invests in Lok Capital, AfriCap*, MicroCapital (Nov. 19, 2007), <http://www.microcapital.org/microcapital-story-accion-gateway-microfinance-investment-vehicles-fund-gmiv-invests-in-lok-capital-afriCap/>; *Key Statistics*, ACCION, <https://www.accion.org/impact-and-key-statistics> (last visited Feb. 24, 2015).

<sup>32</sup> Jaffer, *supra* note 14, at 185.

otherwise unavailable through conventional financial institutions.<sup>33</sup>

Due to its success as a tool to eliminate poverty in many countries, microfinance has gained world recognition. The U.N. declared 2005 to be the International Year of Microcredit.<sup>34</sup> Additionally, Muhammad Yunus and the Grameen Bank won the Nobel Peace Prize in 2006 for economic and social development.<sup>35</sup> Yunus was also awarded the Presidential Medal of Freedom in 2009 for his work in poverty alleviation.<sup>36</sup>

### C. Current State in the Developing World

Microcredit has evolved to offer a variety of financial services including savings, insurance and banking education.<sup>37</sup> Many institutions have modeled their microfinance institutions after the Grameen and Accion models and today, NGOs and donor groups comprise the majority of the microlenders in developing countries.<sup>38</sup> Most MFIs receive grants from international development banks, and to a smaller degree, private investors.<sup>39</sup>

Some scholars argue that microfinance success has been exaggerated because it does not reach all of those who need microfinancing in order to escape poverty.<sup>40</sup> Studies have varied; some have questioned the statistics indicating high repayment rates and argue that lenders are justified in requiring traditional

<sup>33</sup> Aaron Jones, *Promotion of a Commercially-Viable Microfinance Sector in Emerging Markets*, 13 GEO. J. ON POVERTY L. & POL'Y 187, 193 (2006).

<sup>34</sup> *International Year of Microcredit*, YEAROFMICROCREDIT, [http://www.yearofmicrocredit.org/pages/whyayear/whyayear\\_learnaboutyear.asp#comeabout](http://www.yearofmicrocredit.org/pages/whyayear/whyayear_learnaboutyear.asp#comeabout) (last visited Sep. 27, 2016).

<sup>35</sup> *The Noble Peace Prize 2006*, NOBEL PRIZE, [http://www.nobelprize.org/nobel\\_prizes/peace/laureates/2006/](http://www.nobelprize.org/nobel_prizes/peace/laureates/2006/) (last visited Sept. 27, 2016).

<sup>36</sup> *Muhammad Yunus Awarded Presidential Medal of Freedom*, GRAMEEN FOUNDATION, <http://www.grameenfoundation.org/press-releases/muhammad-yunus-awarded-presidential-medal-freedom> (last visited Sept. 27, 2016).

<sup>37</sup> James C. Brau & Gary M. Woller, *Microfinance: A Comprehensive Review of the Existing Literature*, 9 J. ENTREPRENEURIAL FIN. & BUS. VENTURES 1, 2-3 (2004).

<sup>38</sup> Jones, *supra* note 33, at 193.

<sup>39</sup> Alexandra O'Rourke, *Public-Private Partnerships: The Key to Sustainable Microfinancing*, 12 L. & BUS. REV. AM. 179, 183.

<sup>40</sup> Kenneth Anderson, *Microcredit: Fulfilling or Belying the Universality Morality of Globalizing Markets?*, 5 YALE HUM. RTS. & DEV. L.J. 85, 86-87 (2002). Critics question whether MFIs function "within" or "outside" the market. This asks "whether [microfinance] has embraced market [standards and exists in another] disciplinary mechanism." See Richardson, *supra* note 12, at 927. This note examines microfinance within the market framework.



collateral because such loans are risky.<sup>41</sup> Despite these allegations, “a World Bank Study . . . found that five percent of Grameen Bank [borrowers] moved out of poverty each year.”<sup>42</sup> Although this number seems small, Yunus perfectly described this statistic to mean “every day, every week more and more families are getting out [of poverty].”<sup>43</sup> The most important step to ending poverty, Yunus claims, is the creation of employment and income opportunities for those in need.<sup>44</sup> He argues credit is not a privilege, but a human right of all individuals, regardless of present income and loan credibility.<sup>45</sup> Microfinance is “not a cure-all” to poverty alleviation, “but few critics can point to programs that have done more to alleviate poverty and generate capital in developing countries.”<sup>46</sup>

#### *D. Microfinance in the United States*

The United States has been a follower, rather than a leader in the microfinance world.<sup>47</sup> Due to international success, microfinance became popular among advocates for the poor in developed nations, all of which struggle to combat issues of poverty and economic development. However, despite efforts to establish microfinance programs, the United States has not been as successful when compared with its international counterparts.<sup>48</sup> Microfinance institutions have failed to reach the self-sufficiency that many international MFIs have attained.<sup>49</sup> Default rates are higher and the market reach is far below the need.<sup>50</sup> As more citizens in the United States have shifted towards small business, microfinance has been repeatedly attempted, but has yet to become a sustainable practice. Exploring the history of microfinance in the U.S. leaves scholars wondering if the U.S. is

<sup>41</sup> Anderson, *supra* note 40, at 98.

<sup>42</sup> Muhammad Yunus, *Credit for the Poor: Poverty as Distant History*, 29 HARV. INT'L L.J. 20, 22 (2007).

<sup>43</sup> *Interview with Muhammad Yunus*, *supra* note 1.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> Richardson, *supra* note 12, at 929.

<sup>47</sup> Burrus, *supra* note 2, at 2.

<sup>48</sup> *Id.* at 6.

<sup>49</sup> *Id.* at 13.

<sup>50</sup> Lee, *supra* note 25, at 530.

capable of reaching the success of international MFIs in a market where regulations, laws, and structure hinder microfinance sustainability.

1. The Movement Towards Small Business in the U.S.

Although the phrase “microfinance” was not used in the U.S. until the 1980s, efforts to encourage the growth of small businesses can be traced back to as early as the 1950s with the creation of the Small Business Administration (“SBA”).<sup>51</sup> Founded in 1953 as a federal government agency, the SBA was tasked with advocating for the position of the small business and the small business owner.<sup>52</sup> The SBA had defined a small business as having up to 500 employees, but it was not until 1991 that the SBA recognized microenterprise as a separate category of business.<sup>53</sup> Additionally, in 1991, the SBA established the Microloan Demonstration Project, a program that provides direct loans to qualified non-profit intermediaries who, in turn, provide “microloans” of up to \$50,000 to small business owners, entrepreneurs, and non-profit child care centers.<sup>54</sup>

By the late 1980s, microfinance began to gather steam.<sup>55</sup> Bill Burrus, President of Accion USA, claims three socioeconomic trends converged to give impetus in the field.<sup>56</sup> The first trend related to the debate over the effectiveness of government entitlement programs to help the disadvantaged escape poverty.<sup>57</sup> The need for welfare reform became evident, and peaked in the Clinton Administration with the passage of the Landmark Welfare Reform Bill in 1991.<sup>58</sup> Second, the income disparity continued to grow due to a loss of blue-collar jobs.<sup>59</sup> The shift of jobs from the relatively high-paying manufacturing sector to the minimum-

<sup>51</sup> About SBA – History, U.S. SMALL BUS. ADMIN., [https://www.sba.gov/about-sba/what\\_we\\_do/history](https://www.sba.gov/about-sba/what_we_do/history) (last visited Feb. 28, 2015).

<sup>52</sup> *Id.*

<sup>53</sup> Burrus, *supra* note 2, at 1.

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> *Id.* at 12.

<sup>57</sup> *Id.*

<sup>58</sup> *Clinton Administration Bill on Welfare Reform*, [https://www.csulb.edu/projects/ccwrl/CalWorks\\_Curriculum.update.pdf](https://www.csulb.edu/projects/ccwrl/CalWorks_Curriculum.update.pdf) (last visited Jan. 12, 2015).

<sup>59</sup> Burrus, *supra* note 2, at 1.

wage service sector made it more difficult for families to stay above the poverty line.<sup>60</sup> The third trend involved demographic changes that encouraged self-employment.<sup>61</sup> More women entered the workforce, many immigrants, who faced language barriers, turned to self-employment, and the growing aging population turned to self-employment as a way to generate income well into their sixties.<sup>62</sup> Additionally, Burrus points to the decline of rural economies, in which some families bound by their rural roots, chose self-employment as a way to remain in their communities.<sup>63</sup> These trends created an environment in the United States for self-employment and small businesses to thrive.

## 2. The History of Microfinance in the U.S.

One of the earliest microfinance institutions in the United States was the Shorebank Corporation, founded in Chicago in 1973.<sup>64</sup> Shorebank provided investment capital to business owners who were denied credit by the traditional financial sector.<sup>65</sup> The efforts made by Shorebank proved that disadvantaged communities and small businesses are credit worthy.

Congress became involved in microfinance in 1977 through the passage of the Community Reinvestment Act (“CRA”).<sup>66</sup> The CRA first invented the process of banks being ranked by regulators based in part on their participation of funneling resources directly or indirectly (through non-profit organizations) into low-income communities.<sup>67</sup> Congress passed the CRA in part because the government could not maintain certain community programs without help from the private sector.<sup>68</sup> The CRA encourages banks to serve the credit needs of the community and lend to

<sup>60</sup> *Id.*

<sup>61</sup> *Id.* at 2.

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> *Microlending in the United States: A Timeline History, 1973-2010*, ACCION SAN DIEGO,

[http://www.accionsandiego.org/documents/HistoryofMicrofinanceinUS2010\\_000.pdf](http://www.accionsandiego.org/documents/HistoryofMicrofinanceinUS2010_000.pdf) (last visited Dec. 22, 2014) (timeline for the growth of microfinance).

<sup>65</sup> *Id.*

<sup>66</sup> Burrus, *supra* note 2, at 9.

<sup>67</sup> *Id.* at 10.

<sup>68</sup> Emily Berkman, Note, *Microloans as a Community Reinvestment Act Compliance Strategy*, 3 N.Y.U. J.L. & BUS. 329, 342–43 (2006).

traditionally “unbanked” groups.<sup>69</sup> The CRA and microfinance share common goals of meeting financial needs of poor people, but it still faces significant limitations to low-income borrowers and does not reach nearly the amount of borrowers Congress was hoping it would.<sup>70</sup>

After Shorebank and the CRA, the 1980s brought an expansion of microfinance projects. Microenterprise development (“MED”) programs started to appear in the U.S., beginning with a small number of non-profit organizations testing developing-country models.<sup>71</sup> Initially, these MFIs focused on credit, assuming that access to capital was the primary need of microentrepreneurs.<sup>72</sup> As the industry matured, it began to diversify its approach to supporting microenterprise by offering intense business training and technical assistance.<sup>73</sup> In 1991, a trade organization for microlenders, the Association for Enterprise Organization (“AEO”), was founded.<sup>74</sup> Only a year later, MFIs spread throughout the country, leading a presence of at least 108 non-profit leaders.<sup>75</sup> By 1995, however, no microlender broke even, not even meeting operational costs, and were essentially operating as a charity.<sup>76</sup>

In the early 1990s, Congress passed the Community Development Banking and Financial Institutions Act, which aimed to provide government funds directly to lenders registered as “Community Development Financial Institutions” (“CDFI”) working in underserved communities.<sup>77</sup> CDFIs are mission-based financial institutions serving undercapitalized markets by offering

<sup>69</sup> Jones, *supra* note 33, at 189, 196–97 (“unbanked” groups are groups that traditional commercial banks do not serve, in this case, because the people do not have the financial resources to participate in traditional financial transactions); *see generally* 12 U.S.C. § 2901 (1977).

<sup>70</sup> *See* Jones, *supra* note 33, at 197–98; *See* Berkman, *supra* note 68, at 347.

<sup>71</sup> *Mircoenterprise Fact Sheet Series*, Issue 1, Spring 2005, ASS’N FOR ENTERPRISE OPPORTUNITY, [https://www.csbgta.org/index2.php?option=com\\_member&task=toolkit&act=download&id=169&no\\_html=1&Itemid=17](https://www.csbgta.org/index2.php?option=com_member&task=toolkit&act=download&id=169&no_html=1&Itemid=17) (last visited Feb. 12, 2015).

<sup>72</sup> *Id.*

<sup>73</sup> *Id.* at 3.

<sup>74</sup> Olivia Walker, *The Future of Microlending in the United States: A Shift from Charity to Profits?*, 6 OHIO ST. ENTREPRENEURIAL BUS. L.J. 383, 385 (2011).

<sup>75</sup> Burrus, *supra* note 2, at 4.

<sup>76</sup> Walker, *supra* note 74, at 385–86.

<sup>77</sup> *What Does the CDFI Fund Do?*, CDFI FUND, <https://www.cdfifund.gov/Pages/default.aspx> (last visited Sept. 28, 2016).

a wide variety of microfinance products to low-income communities.<sup>78</sup>

The most significant congressional action was in 1999, when the Program for Investment in Microentrepreneurs (“PRIME”) Act was passed. This increased federal funding for microlending programs to CDFIs.<sup>79</sup> However, funding was drastically cut during the Bush Administration from 2001 to 2005.<sup>80</sup>

Despite these challenges, by 2002, the number of organizations that identified as microfinance institutions grew to 650 organizations.<sup>81</sup> Of this, 554 are organizations that provide direct services and 96 are support organizations that offer funding, training and technical assistance to these practitioner organizations. Between 2002 and 2009, the number of microbusinesses increased 16.9%, growing from 21.5 million to 25.1 million.<sup>82</sup>

### 3. Current Status of Microfinance in the United States

Recently, the American Recovery and Reinvestment Act (“ACRA”) of 2009 expanded the SBA’s microloan program, and designated an additional \$50 million for loans and \$24 million for technical assistance.<sup>83</sup> Funds for this act have averaged \$3.1 million in 2010 and 2011.<sup>84</sup> In 2010 alone it was estimated that MFIs helped over 347,000 individuals obtain loans, totaling more than \$164 million. The formation of Microfinance USA, a conference that gathers practitioners, policymakers, and investors from across the United States to discuss the expansion of the market, represents the growing presence of microfinance.<sup>85</sup>

The field has evolved in a very organic, grassroots type of way, with a large number of diverse and often small organizations providing services to microentrepreneurs in their local

<sup>78</sup> *Id.*

<sup>79</sup> Walker, *supra* note 74, at 386.

<sup>80</sup> *Id.*

<sup>81</sup> Burrus, *supra* note 2, at 4.

<sup>82</sup> *Id.*

<sup>83</sup> Walker, *supra* note 80, at 386.

<sup>84</sup> April H. Lee, *Microloans Taking Hold for U.S. Firms*, CHI. TRIB. 2 (Sept. 6, 2010).

<sup>85</sup> MICROFINANCE USA CONFERENCE, *Microfinance USA Conference 2011*, <http://www.microfinanceusaconference.org/about-us/> (last visited Sept. 23, 2016).

communities.<sup>86</sup> These organizations range from those that focus on microenterprise only, to credit unions, to community development corporations.<sup>87</sup>

Currently, the major MFIs in the United States fall into one of three groups: (1) non-profit organizations that act as distributors of federal money, (2) non-profit organizations that operate independently from the government, and (3) for-profit organizations.<sup>88</sup> The majority of microcreditors in the U.S. are non-profit organizations that act as distributors of federal money.<sup>89</sup> The SBA's role, for example, is not to lend the money to the small business owners; rather the SBA sets the guidelines for the loans and allows designated MFIs to make the loans.<sup>90</sup> Essentially, the MFI becomes a third-party provider for the government's money through one of the many SBA programs.<sup>91</sup>

Accion USA is the largest U.S. microlending network, having issued over 43,000 loans and \$350 million since its inception in 1994.<sup>92</sup> The average loan size from Accion U.S. is \$10,049, and the organization has enjoyed a loan repayment rate at 90%.<sup>93</sup> Grameen America, founded by Yunus, is one of the fastest growing MFIs in the U.S. and has invested \$66.2 million in 13,565 loan recipients.<sup>94</sup> The organization also reports the repayment rate to the federal credit bureaus, which in turn, improve the borrower's credit scores.<sup>95</sup>

In addition to the three major categories, alternative microlending structures have emerged in recent years. Kiva is a non-profit organization that makes microloans available directly

<sup>86</sup> See Burrus, *supra* note 2, at 4.

<sup>87</sup> See *id.*

<sup>88</sup> Luz Gomez & Elaine L. Edgcomb, *A Newly Crowded Marketplace: How For-profit Lenders Are Serving Microentrepreneurs*, FIELD AT THE ASPEN INSTITUTE 1, 2 (2011), <http://fieldus.org/publications/ForProfitLenders.pdf>.

<sup>89</sup> Molly Richardson, *Increasing Microlending Potential in the United States Through a Strategic Approach to Regulatory Reform*, 34 J. CORP. L. 923, 927 (2009).

<sup>90</sup> U.S. SMALL BUS. ADMIN., *What SBA Offers to Help Small Businesses Grow*, <http://www.sba.gov/content/what-sba-offers-help-small-businesses-grow> (last updated Apr. 13, 2012).

<sup>91</sup> See *id.*

<sup>92</sup> *About the Accion U.S. Network*, ACCION, <http://us.accion.org/usnetwork> (last visited Sept. 23, 2016).

<sup>93</sup> *Id.*

<sup>94</sup> *FAQ*, GRAMEEN AMERICA, <http://grameenamerica.org/faq> (last visited Jan. 12, 2015).

<sup>95</sup> *FAQ*; see also Chea, *supra* note 11, at 457.

to individual lenders and microentrepreneurs.<sup>96</sup> It adopts a “person-to-person” lending model, whereby lenders select a cause of their choice and lend as little as \$25 dollars.<sup>97</sup> As the funds are returned to the lender, the money becomes available to withdraw or as the lender wishes.<sup>98</sup> These lenders do not receive an additional return or interest, thus making Kiva a non-profit intermediary within an informal lending setting.<sup>99</sup>

While the growth of the field in the United States has been impressive, it is relatively young. One study, conducted by the Aspen Institute and FIELD (Microenterprise Fund for Innovation, Effectiveness Learning and Dissemination) collected data on organizations since 1992.<sup>100</sup> They found that nearly half of the 554 organizations reporting were established between 1995 and 1999.

Defining and measuring the outcomes of MFIs is complicated by the fact that MFIs function in many different ways. FIELD estimates in the year 2000, microenterprise organizations reached between 150,000 and 170,000 individuals, and \$98.5 million in 13,758 loans were outstanding at the end of 2002.<sup>101</sup> That same year, the SBA spent well over \$340 million in small business subsidiaries in the fiscal year.<sup>102</sup> The 2004 Directory of U.S. Microfinance lists 517 programs in all 50 states.<sup>103</sup> Of these, 626,277 participants have been served since program establishment.<sup>104</sup> Regarding these organizations effectiveness and efficiency, FIELD estimated that in the year 2000, out of all clients served, 65 percent were woman and 55 percent were from minority groups.<sup>105</sup> Fifty nine percent have incomes at or below the level of “low-income” set by the U.S. government.<sup>106</sup>

<sup>96</sup> Kiva, KIVA WORKS, <http://www.kiva.org/about/how> (last visited Sept. 26, 2016).

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> Burrus, *supra* note 2, at 4.

<sup>101</sup> *Id.* at 5.

<sup>102</sup> See Signe-Mary McKernan & Henry Chen, *Small Business and Microenterprise as an Opportunity and Asset-Building Strategy*, 3, THE URBAN INSTITUTE, (June 2005), <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/311188-Small-Business-and-Microenterprise-as-an-Opportunity-and-Asset-Building-Strategy.PDF>.

<sup>103</sup> See *Microenterprise Fact Sheet Series*, *supra* note 71, at 2.

<sup>104</sup> *Id.*

<sup>105</sup> Burrus, *supra* note 2, at 5.

<sup>106</sup> *Id.* at 6.

Depending on their mission, capacity and strategy, MFIs offer different services to help potential and existing entrepreneurs.<sup>107</sup> For example, some emphasize increasing family income through business creation; their focus on poverty alleviation and economic self-sufficiency leads to helping the unemployed and welfare recipients.<sup>108</sup> Others give priority to businesses that show potential for growth, thus generating jobs and contributing to a community's economic development.<sup>109</sup> Regardless of their mission, the following set of core program elements have emerged during the past decade of practice: outreach services, training and assistance, access to market services, capital, asset development/financial literacy and education.<sup>110</sup>

#### 4. Challenges to Microfinance in the United States

The first problem in domestic microfinance is the failure of MFIs to reach the demand. As of April 2011, there are approximately 25.5 million microbusinesses in the United States.<sup>111</sup> At the start of the millennium, there were 13.1 million Americans who have a business with five or less employees.<sup>112</sup> The Association of Enterprise Opportunity ("AEO") defined them as microentrepreneurs.<sup>113</sup> Of the 13.1 million, 10.8 million did not receive a bank loan for their business.<sup>114</sup> Of these 10.8 million, many had applied for a bank loan but were rejected.<sup>115</sup> Nearly 50% had considered a bank loan but did not even apply because they assumed they would be rejected.<sup>116</sup> Because most traditional banks do not lend to people without sufficient credit history, the need for microloans are great.

<sup>107</sup> See *Microenterprise Fact Sheet Series*, *supra* note 71.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> *Underserved Entrepreneur Index*, ASSOCIATION FOR ENTERPRISE OPPORTUNITY (AEO), [http://www.aeworks.org/pdf/underserved\\_entrepreneur\\_indextm\\_april\\_28\\_2011.pdf](http://www.aeworks.org/pdf/underserved_entrepreneur_indextm_april_28_2011.pdf) (last visited Feb. 22, 2015).

<sup>112</sup> Burrus, *supra* note 2, at 3.

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*



Despite the need for microloans, a significant portion of microentrepreneurs in the U.S. remain undeserved, particularly women, Black, Latino and Native American owned businesses.<sup>117</sup> If one compares the potential need in the market of those microentrepreneurs who have not received bank loans (10.8 million), to the current number of outstanding loans (13,728), the percentage of the market reach is far below 1%.<sup>118</sup> In addition, recessions have resulted in job losses, which in turn result in more people becoming self-employed.<sup>119</sup> Although this presents an opportunity to microlenders,<sup>120</sup> the fact remains that most are serving a very small number of clients.<sup>121</sup>

A second issue with domestic microfinance, is the lack of a uniform system for measuring MFIs' outcome and impact. Data is needed to demonstrate the performance and results of MFIs' investments.<sup>122</sup> Without a uniform system of measuring MFIs' impact on small business owners, it is nearly impossible to gather data and aggregate this information. This has been complicated by the fact that the multiple goals of most microenterprise programs require measuring not only economic, but also personal and social outcomes as well.<sup>123</sup> Until recently, terms commonly used in microlending practices, such as "percentage of portfolio risk," "restructured loans," "financial self-sufficiency," and many other basic terms had no common definition, further complicating information purposes.<sup>124</sup> Additionally, a large number of microentrepreneurs patch together earnings from more than one source to make ends meet, and thus it is difficult to identify the financial success accrued from the microfinance.<sup>125</sup> Due to these complications, it has been difficult to compare performance across programs or to aggregate the information to draw conclusions.

A third issue faced domestically, and possibly the biggest problem, is MFIs continue to struggle to be self-sufficient. Accion

<sup>117</sup> *Id.*

<sup>118</sup> Burrus, *supra* note 2, at 6.

<sup>119</sup> Richardson, *supra* note 12, at 931.

<sup>120</sup> *Id.*

<sup>121</sup> Burrus, *supra* note 2, at 6.

<sup>122</sup> *Microenterprise Fact Sheet Series*, *supra* note 71, at 7.

<sup>123</sup> *Id.* at 6.

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*

defines self-sufficiency as the ability to generate enough revenue from lending to cover operational costs.<sup>126</sup> While some MFIs, like Accion, have been lending in the U.S. for over 10 years, its “goal of creating programs that are financially self-sufficient is still illusionary” because reaching self-sufficiency remains a challenge.<sup>127</sup> Currently, Accion is only 25% to 63% self-sustaining. One hundred percent represents fully self-sustaining lending.<sup>128</sup> Generally, many U.S. MFIs suffer from low loan repayment rates, and thus microlenders have failed to reach the level of self-sufficiency needed to reach the demand.<sup>129</sup>

Many factors have attributed to the problems in domestic microfinance. One of the biggest factors, and possibly most important is the current U.S. regulations. After an analysis of current market regulations, a major problem is revealed to show that regulations have hindered MFIs’ effectiveness. Because domestic microfinance has not been effective, it has yet to reach those in need.

## II. ANALYSIS

### A. *The Debate Concerning Microfinance Regulations in the United States*

Microlenders in the U.S currently operate as non-profits.<sup>130</sup> Due to their status as non-profits and the way in which microlending organically has grown in the United States; there is no regulatory body that specifically oversees microlending.<sup>131</sup> Unlike almost all other financial institutions in the U.S., such as credit unions and banks, non-profit microlenders operate in a gray area and are essentially unregulated.<sup>132</sup>

Many scholars are in agreement that regulation for MFIs is necessary, however there is disagreement as to the degree of regulation and what regulatory rules should apply to

<sup>126</sup> Burrus, *supra* note 2, at 11.

<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> See Richardson, *supra* note 12, at 931.

<sup>130</sup> Burrus, *supra* note 2, at 14.

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

microfinance.<sup>133</sup> Some scholars believe that the government should play a role in the microfinance industry, but that government cannot play a leading role.<sup>134</sup> Those who take this view believe the government's role should be to only subsidize the costs of development.<sup>135</sup> Yunus believes that completely new laws and regulations should be designed exclusively for establishing microfinance banks for low-income people and people on welfare.<sup>136</sup> Although he believes the current laws are inappropriate for microlending institutions, MFIs should be regulated more like credit unions than traditional banks.<sup>137</sup> Additionally, Yunus believes regulation for the poor should be as minimal as possible – waiver medallions should be explored and there should be simpler laws in general.<sup>138</sup> Sujeet Kumar of the Hauser Center for Nonprofit Organizations at Harvard University, supports structure and regulation for microlenders because it protects those who benefit from microloans, those who are often vulnerable to economic exploitation, as well as protect the legitimate microlenders in the event of a market meltdown.<sup>139</sup>

### *B. Current Regulations Affecting Microfinance.*

Although microfinance is largely unregulated in the United States, these financial institutions must abide by state usury laws, capital holding requirements and other banking laws. In addition to independent MFIs, private banks partnered with MFIs, and in compliance with the CRA, are subject to the same regulations as any traditional bank.<sup>140</sup>

<sup>133</sup> See Walker, *supra* note 74, at 389.

<sup>134</sup> *Id.*

<sup>135</sup> *Id.*

<sup>136</sup> Muhammad Yunus, *How Legal Steps Can Help Pave the Way to Ending Poverty*, 35 ABA HUM. RTS. 22, 23 (2008).

<sup>137</sup> *Id.*

<sup>138</sup> *Id.*

<sup>139</sup> Sujeet Kumar, *Should the Microfinance Industry Be Regulated?*, Hauser Center (Nov. 8, 2010), <http://hausercenter.org/iha/2010/11/08/should-the-microfinance-industry-be-regulated/>.

<sup>140</sup> *Id.*

### 1. The Community Reinvestment Act.

The CRA has been used to encourage more successful U.S. microlending. Both the CRA and microlending have common goals of meeting financial needs of poor people. The CRA encourages private banks to serve low-income communities and their credit needs by partnering with MFIs and through other means.<sup>141</sup> Thus, the CRA has resulted in lending to “traditionally un-banked groups,” but it has not lifted all the limitations on lending to low-income borrowers.<sup>142</sup> Banks set their own compliance goals for the CRA and there are no specific pass-thresholds so regulators have wide latitude in determining a bank’s compliance.<sup>143</sup> For these reasons, the CRA is regarded as highly ineffective in achieving its goals of assisting low-income borrowers.<sup>144</sup>

### 2. Interest Rate Regulations.

Under these regulations, current interest rate caps, known as usury laws, present significant obstacles to MFI sustainability.<sup>145</sup> Interest rate caps limit the amount of interest an institution can charge a borrower, originally designed for traditional commercial banks.<sup>146</sup> Interest rate ceilings hinder the ability of MFIs to become profitable by limiting the greatest opportunity for revenue generation.<sup>147</sup> Although states differ in these regulations, they usually cap interest rates at ten percent.<sup>148</sup>

### 3. Capital Holding Requirements.

Capital holding requirements also present impairments to achieving success with microlending in the private sector.<sup>149</sup> Capital holding requirements necessitate that banks hold a certain amount of capital against each loan they distribute according to the level of risk that loan carries – the greater the

<sup>141</sup> See Jones, *supra* note 33, at 196.

<sup>142</sup> *Id.* at 197

<sup>143</sup> Berkman, *supra* note 68, at 347.

<sup>144</sup> See Richardson, *supra* note 12, at 931.

<sup>145</sup> O’Rourke, *supra* note 8, at 185.

<sup>146</sup> *Id.*

<sup>147</sup> Berkman, *supra* note 68, at 341.

<sup>148</sup> Richardson, *supra* note 12, at 931.

<sup>149</sup> O’Rourke, *supra* note 8, at 184.

risk, the greater the required holding.<sup>150</sup> These laws help stabilize the market by ensuring that institutions can withstand financial hardship.<sup>151</sup> The Committee on Banking Supervision is a group comprised of central banks and supervisory authorities from different countries that promulgate the Basel Capital Accord (“Basel III”), which requires banks to hold a total of 8% of their “risk-weighted assets,” such as loans.<sup>152</sup> This total is slated to increase to 10.5% by the year 2019.<sup>153</sup> Because microfinancing is considered risky by traditional lending standards, capital requirements demand “disproportionately large investments for small-scale projects” like MFIs.<sup>154</sup> These requirements make it difficult for MFIs to raise money because investors often require microlending institutions to put up 10% of the capital required, an amount they cannot always produce.<sup>155</sup>

*C. Differences in the U.S. and Developing Nations’ Markets.*

Microlending’s success in developing countries and relative lack of success in the United States can, in many ways, be attributed to differences between the markets in developed and developing nations.<sup>156</sup> Rashmi Dyal-Chand, an assistant professor of law at Northeastern University School of Law, argues that microlenders in developing countries have been more successful because their markets have fewer regulations than U.S. markets.<sup>157</sup> This informality allows “quicker, easier, and deeper penetration of the market by new entrants.”<sup>158</sup> Microentrepreneurs need not be invested in formal transaction instruments (like written contracts)

<sup>150</sup> Richardson, *supra* note 12, at 932.

<sup>151</sup> O’Rourke, *supra* note 8, at 184.

<sup>152</sup> Basel Committee on Banking Supervision, *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems*, at 64 (June 2011), <http://www.bis.org/publ/bcbs189.pdf>.

<sup>153</sup> *Id.*

<sup>154</sup> O’Rourke, *supra* note 8, at 184.

<sup>155</sup> *Id.*

<sup>156</sup> Richardson, *supra* note 12, at 932.

<sup>157</sup> Rashmi Dyal-Chand, *Reflection in a Distant Mirror: Why the West Has Misperceived the Grameen Bank’s Vision of Microcredit*, 41 STAN. J. INT’L L. 217, 248 (2005).

<sup>158</sup> *Id.* at 248-49. Some argue microlending resembles venture capital lending, as opposed to traditional banking. Venture capital lending is when lenders make riskier loans and more closely monitor and manage the borrower’s use of the loan. MFIs require fixed interest rates, and do not take any portion of the borrower’s profits, but in practice, microlenders are making highly risky loans.

and microfinance institutions do not need to abide by such financial regulations, such as usury laws and interest rate caps. This would suggest that in the U.S., microentrepreneurs need more market-specific information before they obtain a microloan for a business venture.<sup>159</sup>

Regardless of the market differences, the ultimate question is whether U.S. MFIs can be sustainable, meaning, can domestic revenue exceed domestic costs. Although there is stark difference in the levels of success for domestic and international MFIs, there is a necessity to build microfinance in line with U.S. market standards.

#### *D. The Need for Microfinance in the U.S.*

Surveys of microentrepreneurs show that strong employment is generated through microenterprises.<sup>160</sup> In 2008 alone, 45% of microentrepreneurs reported paying employees or contractors to work in their business and on average, provided 2.2 jobs per business.<sup>161</sup> Five – year group data showed that 52% of owners provided an average of 2.5 jobs per business.<sup>162</sup> About half of these businesses reported the median hourly wage to be \$10.00, which is 53% higher than the federal minimum wage.<sup>163</sup> Business survival rates of microenterprise clients are between 57-90%.<sup>164</sup> This is in comparison to the SBA's estimate that only 47% of small businesses are still operating only after four years.<sup>165</sup> In addition to the economic effects, an interview conducted by Accion in 1998 found that many microentrepreneurs expressed an increased sense of self-esteem as a result of their involvement with a microfinance organization.<sup>166</sup> Women often reported a sense of independence that they gained by running their own business and receiving a business loan from a microlender.<sup>167</sup> Finally, these

<sup>159</sup> *Id.* at 249.

<sup>160</sup> Chea, *supra* note 11, at 458.

<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

<sup>164</sup> *Microenterprise Fact Sheet Series, Microenterprise Development Works!: Outcomes for Clients*, ASPEN INSTITUTE & ASS'N FOR ENTERPRISE OPPORTUNITY, Issue No. 6, Fall 2000, at 3, [http://fieldus.org/publications/fact\\_sheet6.PDF](http://fieldus.org/publications/fact_sheet6.PDF).

<sup>165</sup> *Id.*

<sup>166</sup> Burrus, *supra* note 2, at 8.

<sup>167</sup> *Id.*

entrepreneurs find that being self-employed is important to their sense of family, helping them balance their personal and professional lives.<sup>168</sup> This data proves the dramatic impact microenterprise development can have on the poor. Although the path out of poverty is not linear, income generating businesses and financial stability are sure steps to poverty alleviation.<sup>169</sup>

### III. RECOMMENDATIONS

The efforts taken so far in the United States to implement and utilize microfinance is proof that the country recognizes its socioeconomic significance for lifting those out of poverty. Congress and the AEO have taken steps in the right direction, but the biggest problem still lies with microfinance sustainability. Since U.S. microfinance institutions have hardly been sustainable, they have not been successful in reaching the potential need. Recall that with 10.8 million microentrepreneurs that have not received a bank loan, the percentage of the market reached is far below 1%.<sup>170</sup> For microlending to become sustainable in the United States, advocates need to enact reforms at the regulatory level.

Legal reforms are necessary in order to implement sustainable microfinance programs in the U.S. market. The first step is to move MFIs to the private sector to ensure sustainability. The second step is to establish a separate category of regulations for the unique structure of microfinance in order to create self-sufficient MFIs. These reforms will therefore allow MFIs to reach a bigger number of borrowers. Ultimately, these borrowers will be able to generate income and economic prosperity through their small businesses and entrepreneurships, those that have been denied small loans and financial services in the past. The most important reality is to recognize the difference of the domestic market economy to those in developing nations. The structure of microfinance must be different in the U.S. than it is abroad in

<sup>168</sup> *Id.*

<sup>169</sup> *Introduction to Starting and Sustaining a Microenterprise Development Program*, ASSOCIATION FOR ENTERPRISE OPPORTUNITY, <http://www.resnaprojects.org/AFTAP/telework/forum09/IntroMED.pdf> (last visited Feb. 21, 2015).

<sup>170</sup> *See id.* Section II (discussing the problems with microfinance particularly not reaching the demand).

order to become a viable service. However, the principles of microfinance, that is, allowing the poor to receive loans in order to generate income and financial stability, remains the goal of microfinance anywhere in the world. The following proposal presents a way to balance microfinance objectives while molding to market principles, ultimately reaching the microentrepreneurs in need.

*A. A Shift to Private MFIs and Regulatory Reform.*

Microfinance institutions should move towards privatization in order to become more sustainable. Yunus strongly believes that loans should be non-governmental.<sup>171</sup> This is because microloans dependent on government backing have more of the characteristics of charity or welfare, and the focus is not on the government programs themselves becoming self-sustaining.<sup>172</sup> When microloans are tied to the government, the funding is contingent on the whims of Congress and administration.<sup>173</sup> This is evident during the Bush Administration when microloan funding was cut.<sup>174</sup> Many scholars have proposed microenterprises shift towards the private sector in order to create more sustainable programs.<sup>175</sup> If micro-lenders were for-profit corporations, they could be regulated more easily under existing law. However, wholly private industry has posed a problem to microfinance institutions in the past: these institutions have not been able to have revenue exceed cost – a primary need in order to make profits. Additionally, Yunus told the *Wall Street Journal* in July 2010, “microcredit should not be presented as a money making opportunity.”<sup>176</sup> He claims that because credit is a human right, this right should not be subject to the whims of global investment trends or corrupted by greed.<sup>177</sup>

<sup>171</sup> Yunus, *supra* note 42, at 3.

<sup>172</sup> *Id.* at 4.

<sup>173</sup> Walker, *supra* note 74, at 396.

<sup>174</sup> *Id.*

<sup>175</sup> See Walker, *supra* note 74, at 396; see also Chea, *supra* note 11, at 468.

<sup>176</sup> Nin-Hai, *Can microfinance be both moral and profitable?* (Aug. 19, 2010, 11:51AM), [http://archive.fortune.com/2010/08/19/news/international/SKS\\_microfinance\\_IPO.fortune/index.htm](http://archive.fortune.com/2010/08/19/news/international/SKS_microfinance_IPO.fortune/index.htm).

<sup>177</sup> Muhammad Yunus, *Sacrificing Microcredit for Mega Profits*, N.Y. TIMES (Jan. 14, 2011), [www.nytimes.com/2011/01/15/yunus.html](http://www.nytimes.com/2011/01/15/yunus.html), cf. A study concluded that the two different types of microlenders in Brundi, non-profit and for profit “do not differ much in terms of



As a compromise between profit and non-profit, the most practical solution for the future of microenterprise is to partner with traditional banks and use these private institutions as the backbone to microfinance sustainability. However, these partnerships cannot be subject to the same banking regulations as the traditional for-profit corporations. Therefore, Congress should pass a new act, encouraging more MFIs to partner with traditional banking institutions with the promise that a new series of regulations, adhering to the microfinance structure, will be implemented in order to foster its success and ultimately, reach those in need of microfinance. In addition, this note will provide a strategy to enact the reforms, that is, appealing to lobbyists on both sides of the political spectrum.

### *B. The MICROS Act*

In order to ensure the success of these partnering institutions, it is necessary to create legislation aimed at implementing regulatory reforms in the microfinance industry – separate from laws and regulations aimed at traditional banks. The Movement In Community Regrowth Operating through Small Business Act (“MICROS”) is modeled after the attempted (and failed) approach of the 1977 CRA, to create community banking that is profitable. PRIME still remains important for the non-profit MFIs that are dependent on government funds through the SBA. However, due to uncertainty of public funding, legislation aimed at the private sector, or non-profits partnering with private banks, is imperative. This legislation will be enforced and carried out by an agency, such as the AEO. It will have five parts: one, to encourage MFIs to partner with existing banks through financial incentives; two, to create new interest rate and capital holding requirements for legitimate MFIs; three, to implement a screening process to ensure the legitimacy of these microlenders; four, to require statistical data on program performance; and, five, push to educate the poor about these alternative financial programs.

microloan allocation patterns, which is in line with the overall global trend of convergence types of MFIs.” See also Moise Sagamba et al., *Do Microloans Officers Want to Lend to the Less Advantaged? Evidence from a Choice Experiment*, UNIV. OF GOTHENBERG SCH. OF BUS. ECON. L. Working Paper No. 492 (2011), [www.csae.ox.ac.uk/conferences/2011-edia/papers/618-shchetinin.pdf](http://www.csae.ox.ac.uk/conferences/2011-edia/papers/618-shchetinin.pdf).

### 1. Partnering with For-Profit Financial Institutions

As past scholars have said, “Regulatory agencies hold the power.”<sup>178</sup> By encouraging banks to partner with MFIs or create microloan programs of their own, microfinance can be sustained through the bank’s raised revenue. Banks will be motivated to make these moves if they can receive “credit” for their performance which would be considered when the bank attempts to financially change its structure. One example would be a merger. However, the standards cannot be arbitrary, as the CRA has proven to be lacking objective guidance. Instead, MICROS will establish uniform measures used in the assessment of the banks. For example, the bank can set a goal as to the number of microloans that will be lent to microentrepreneurs within the fiscal year. If banks reached or exceed their goal, they can receive a certain amount of points towards approving the merger.

One can predict, that as these small businesses grow from the loans given and become more lucrative, microentrepreneurs will tend to utilize the bank’s other services. Traditional bank financial services may offer financial counseling or a mortgage for his/her private home.<sup>179</sup> MFIs will have a backbone of sustainability through partnering with traditional banks and banks will be able to gain credit needed for future financial endeavors. As a result, there will be a greater amount of lending to small businesses and individuals.

### 2. New Interest Rate and Capital Holding Requirements

Since usury laws are created at the state level, MICROS would authorize states to charge slightly higher interest rates in order to cover all costs associated with smaller loans and reach a sustainable program. Although state interest rates are normally capped at 5-12%, the federal act, which preempts state law, would authorize banks partners with certified MFIs to charge an interest rate closer to a custom MFI interest rate, around 20%. For the Grameen Bank, this number is around 20%.<sup>180</sup> In addition, regulators should accommodate U.S. microlenders by allowing

<sup>178</sup> Berkman, *supra* note 68, at 348.

<sup>179</sup> *See id.* at 349-50.

<sup>180</sup> Richardson, *supra* note 12, at 938.

flexibility in holding requirements. The Grameen Bank enjoys loan repayment rates as high as 90%,<sup>181</sup> which would suggest that these loans are not as risky as many people perceive them to be.<sup>182</sup> Capital holding requirements should be relaxed because microlenders cannot always assert the level of risk associated with a microloan.<sup>183</sup>

As discussed in Section III, the framework created by the Basel Committee has frustrated microfinance. As a result, the Committee issued a consultation report clarifying the general application of Basel Core Principles of Basel III and a range of practices on regulating and supervising microfinance activities, however, it does not alter any provision in Basel III.<sup>184</sup> MICROS would directly alter this provision by placing a different capital holding requirement in place for microlenders, sensitive to the fact that the risk cannot always be asserted. In order to allow MFIs to escape the Basel principles, a stringent certification process for MFIs must be put in place.

### 3. A Stringent Certification Process for Regulation Qualification

Because MFIs partnering with traditional banks will be subject to new laws, MICROS will require banks to undergo a rigorous screening process. This is to ensure they are legitimate MFIs and not in the business of predatory lending. Congress has established some accreditation standards for microlenders.<sup>185</sup> For example, non-profits that participate in the SBA's microloan program are subject to its rule under the PRIME Act.<sup>186</sup> In order for these non-profits to receive federal funding, an organization must be certified as a CDFI.<sup>187</sup> Additionally, the national trade association for microlenders, the AEO, has recently implemented a process that would "establish minimal standards relating to lending and/or

<sup>181</sup> Jaffer, *supra* note 14, at 185.

<sup>182</sup> *Id.*

<sup>183</sup> *Id.* at 184-85.

<sup>184</sup> Chea, *supra* note 11, at 463-64.

<sup>185</sup> *Id.* at 462-63.

<sup>186</sup> Walker, *supra* note 74, at 388.

<sup>187</sup> *See* Burrus, *supra* note 2, 14.

training performance, governance and management issues and financial soundness.<sup>188</sup>

In addition to the past efforts of Congress, banks will be required to present their microloan programs/institutions to the AEO with a business plan and mission statement. This process can be similar to the process of the CDFI, in which a non-profit organization submits an application for review by the agency before receiving government funding. These institutions must have a primary mission of promoting community development, primarily serve multiple markets and offer developmental services in conjunction with its financial program.<sup>189</sup> This is where data collection becomes important, as discussed further below, not only to assess impact on the community, but also to assess functionality of the institution itself.

#### 4. Data Collection on MFI Performance

MICROS will also require a uniform system of data, which is to be collected by the agency from the participating MFIs. The field has been slow to create uniformity and consistency across organizations in the collection of data. Therefore, it is difficult to compare performance across programs or to aggregate the information to draw conclusions. Although some progress has been made in order to establish standard definitions of key industry terms,<sup>190</sup> not all MFIs have been accounted for in the attempt to consolidate information. Under MICROS, any legitimate MFI partnered with a traditional bank and subject to the new usury and capital-holding requirements will be analyzed according to a uniform set of standards.

These standards will include the number of outstanding loans in a given year and job growth among members. However, there are very important non-economic effects of microcredit services. Some may argue they are just as important as the financial and economic factors and may be the primary reason for choosing self-employment in the first place.<sup>191</sup> These feelings include increased

<sup>188</sup> *Id.*

<sup>189</sup> *About Us, Cmty. DEV. FIN. INST. FUND,* <http://www.cdfifund.gov/about/pages/default.aspx> (last visited Sept. 25, 2016).

<sup>190</sup> *See Burrus, supra note 2, at 14.*

<sup>191</sup> *Id.* at 8.

self-esteem, financial independence from spouses, and importance in their families and communities.<sup>192</sup> Although these statistics are hard to measure and thus compare, by interviewing members and gathering information, these statistics can be collected and reported through an analysis of each MFI.<sup>193</sup>

#### 5. Educating the Poor about Alternative Financial Programs

Generally, poor people without credit histories have limited knowledge about how the credit market works and how to most effectively participate in the market. This is evident by the 50% of 10.8 million microentrepreneurs that did not even apply for any loan, at the fear of getting rejected.<sup>194</sup> This is generally an easy fix for MFIs that are partnered with for-profit banks: when a borrower is denied a loan through traditional methods of banking, these banks can encourage the borrower to seek their partnered MFI for additional information regarding their eligibility for a microloan. Again, the bank will encourage the borrower to seek out the MFI in the hope that, as these borrowers become financially stable, they will seek services with the traditional bank, since they have gained a relationship and trust with the MFI and its partner institution.

#### C. *How to Enact MICROS*

In order for MICROS to be enacted, advocates must convince Congress that this agenda is worthy of the time and money, and MICROS offers a viable solution to sustainable microfinance. There are two ways in which microlending can appeal to political activists. One is the promising effect to generate economic activity in low-income sectors. Democrats will be especially inclined to rally for a reform which directly causes poverty alleviation. While microfinance offers loans to low-income borrowers, these borrowers can generate income among a sector of society that is

<sup>192</sup> *Id.*

<sup>193</sup> MicroTest collected this information through variables that “report” the general feeling of microlenders through a question and answer. My proposal is that under MICROS, a committee can do the same and include this information in an encompassing report that is used to rank the banks for credit. As long as the system is uniform, data will be more easily collected and analyzed, for regulators and borrowers to see.

<sup>194</sup> See Burrus, *supra* note 2, at 3.

normally stagnant. In addition to democratic lobbyists, some corporations have also seen the economic benefits of microfinance work. IBM is partnering with the Grameen Foundation to help expand MFIs software programs.<sup>195</sup> Some scholars suggest that this is especially appealing to corporations because in a competitive market, banks are trying to differentiate themselves.<sup>196</sup> This “uncommon” innovation will attract shareholders and investors who are interested in the corporation’s economic opportunities as well as their social activism.

The second way in which microlending is appealing is because it offers the poor a way out of poverty as an alternative to government-assistance programs. As microlending improves people’s economic state, the need for welfare is lessened. This is especially appealing to Republicans, who largely favor reducing welfare reliance. This is evident in an interview conducted by Bill O’Reilly, a notable Republican figure, and President Obama, early this year.<sup>197</sup> He stated, “I am a more self-reliance guy.”<sup>198</sup> Microlending and Republican platforms have a common ground, which can be translated to reforming the microfinance system in order to reduce welfare and create economic opportunities for the poor.

#### D. *The Lingering Questions*

Though MICROS offers the most encompassing and optimistic solution to the struggling microfinance industry, many will not be convinced that such a program can work in an economy run by market regulations and corporate giants looking to maximize profits. The two biggest concerns remain: can a model that was created in the developing world thrive in a more formalized market? In addition, can microlending, as it moves to a partner with for-profit institutions, coexist with its underlying principles

<sup>195</sup> *IBM Partners with Grameen Foundation to Expand Its Open Source Microfinance Banking Platform And Help Eradicate Poverty*, GRAMEEN FOUNDATION (Oct. 15, 2007), [http://www.csrwire.com/press\\_releases/20281-IBM-Partners-with-Grameen-Foundation-to-Expand-Its-Open-Source-Microfinance-Banking-Platform-And-Help-Eradicate-Poverty](http://www.csrwire.com/press_releases/20281-IBM-Partners-with-Grameen-Foundation-to-Expand-Its-Open-Source-Microfinance-Banking-Platform-And-Help-Eradicate-Poverty).

<sup>196</sup> Richardson, *supra* note 12, at 941.

<sup>197</sup> Ian Schwartz, Obama: “*We Have Not Massively Expanded The Welfare State*”, REAL CLEAR POLITICS (Feb. 3, 2014), [http://www.realclearpolitics.com/video/2014/02/03/obama\\_we\\_have\\_not\\_massively\\_expanded\\_the\\_welfare\\_state.html](http://www.realclearpolitics.com/video/2014/02/03/obama_we_have_not_massively_expanded_the_welfare_state.html).

<sup>198</sup> *Id.*

of humanitarian principles?<sup>199</sup> While being conscious of these concerns, microfinance can still come to fruition in the United States.

### 1. Adopting Microlending Consistent with the U.S. Market

As noted earlier, it is important to maintain the theories and principles underlying Muhammad Yunus and Accion's microfinance, so intelligently implemented to aid a neglected portion of the economy. However, failed attempts at microfinance in the past have partially contributed to bringing a cookie-cutter model to the U.S. In a more formalized market, the informal approaches used in developing countries might not be what microlenders need to reach self-sufficiency and successfully collect loan repayments.<sup>200</sup> For example, the social pressure to repay loans in rural areas of developing countries does not have the same effect in large, more anonymous, urban centers.<sup>201</sup> Instead, one way to encourage loan repayment rates is for MFIs to offer savings accounts and utilize these savings accounts once borrowers can generate income.<sup>202</sup> Savings accounts are a standard norm for bankers in the U.S., and this practice, if implemented in the MFI structure, can encourage borrowers to save their income and accumulate money for expenses, business expansion, emergency, and especially, loan repayment. Another way to encourage repayment is through the threat of denying future loans to borrowers.<sup>203</sup> Rather than mimicking the international MFI structure, U.S. MFIs have to pick and choose practices that will work in the U.S., and reconfigure those that will not, even if those methods have proved successful in international microlending.<sup>204</sup>

### 2. Moving to Profits and Keeping the Humanitarian Effort Alive

It is clear that Yunus began the microcredit crusade as a result of resolving an injustice with the poor (as he believes credit is a

<sup>199</sup> See Walker, *supra* note 74, at 403.

<sup>200</sup> Richardson, *supra* note 12, at 938.

<sup>201</sup> *Id.* at 939.

<sup>202</sup> *Savings and the Poor: A Better Mattress*, THE ECONOMIST (May 11, 2010), <http://www.economist.com/node/15663834>.

<sup>203</sup> Richardson, *supra* note 12, at 939.

<sup>204</sup> *Id.*

right, not a privilege). Yet, some scholars are concerned that as microfinance organizations partner with for-profit entities or move to make profits themselves, they will lose their original purpose and mission. However, making this transition to partnerships will only benefit the principles underlying the original microfinance mission. As microfinance institutions become more sustainable in the U.S. economy, MFIs will be able to lend more loans. As they lend more loans and receive repayments, MFIs can make riskier loans by loaning to the “poorest” of the poor sectors of society, and reach the impoverished that have never dreamed of attaining a loan for a business start-up.<sup>205</sup>

### CONCLUSION

There are many American citizens who wish to turn to self-employment as a means to generate income. Microfinance can provide the financial services needed to start their business, expand their trade, and fund their careers. Although non-profit MFIs have struggled with sustainability, partnerships with traditional banks are the future for self-sufficient MFIs. And although microfinance seemed incompatible with a formalized market, regulatory reforms, which adhere to the unique system of microfinance, will bring stability to microfinance and service to more borrowers. And just as Sherife has hopes of using a microloan to improve her means of wealth, many American women, minorities and the impoverished, can do the same.

<sup>205</sup> Veronica Gonzalez Aguilar, *Is Micro-Finance Reaching the Poor? An Overview of Poverty Target Methods*, GLOBENET, <http://www.globenet.org/archives/web/2006/www.globenet.org/horizon-local/ada/c18.html> (stating “[t]he extent to which micro-finance programmes are able to reach the poorest of the poor with their services is still an open debate”).