2013

Regulation of Microfinance in the United States: Following a Peruvian Model

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Available at: http://scholarship.law.unc.edu/ncbi/vol17/iss1/9
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I. INTRODUCTION

In the aftermath of Hurricane Katrina Bernard McGraw was left without a job and home.1 The circumstances forced him to relocate his wife and six sons from New Orleans to San Antonio with nothing more than a suitcase of belongings.2 In his effort to rebuild his life, Bernard started a creole restaurant in a dilapidated shack on San Antonio’s Southside.3

While studying at The Baptist University of the Americas, the university asked him to move his already thriving restaurant into the campus’s dining area.4 In order to make the move, however, Bernard needed a small loan to stock the new location with supplies and hire employees.5 Without credit, Bernard could not turn to traditional commercial banks for a loan;6 instead, he secured financing from Accion Texas-Louisiana, a non-profit microfinance institution devoted to providing financial tools to people to improve their lives.7 With the loan, Bernard relocated his restaurant and currently serves the university and the surrounding community.8 Unfortunately, there are many others like Bernard who are never given the opportunity to fulfill their dream as the United States lacks the specific regulatory framework necessary to aid in the growth of microfinance.

As exemplified above, microfinance is an important sector in the financial market that focuses on good business practices and aiding

2. Id.
3. Id.
4. Id.
5. Id.
6. Id.
others.\(^9\) However, in the United States microfinance operates in a mostly unregulated “gray” area, which inhibits its ability to help people such as Bernard.\(^10\) As microfinance approaches its forty-year anniversary in the United States,\(^11\) the time has come for a regulatory framework that will enable microfinance institutions to grow and thrive.\(^12\)

This Note will discuss the importance of building a regulatory system for microfinance in the United States and how Peru provides an example for this system. Part II will provide an introduction to the United States microfinance industry.\(^13\) Part III will discuss the need for regulation in this industry.\(^14\) Finally, Part IV will conclude with an examination of Peru’s regulatory framework for microfinance and explain why this is an appropriate model for the United States.\(^15\)

II. THE BACKGROUND OF MICROFINANCE

A. What is Microfinance?

Microfinance is an emerging market in the financial services industry, aiming to provide small loans to low-income clients or small entrepreneurs who are traditionally overlooked by the mainstream credit markets.\(^16\) The Basel Committee on Banking Supervision defines microfinance as “the provision of financial services in limited amounts to low-income persons and small, informal businesses.”\(^17\) The term encompasses a variety of services, including microcredit, microsavings,
and microinsurance. The term can also be used more narrowly, referring to only microcredit given out to small entrepreneurs. This Note will use the term more narrowly.

Most microfinance is practiced by business entities called "microfinance institutions" (MFIs). MFIs, using practices developed within the last thirty years, provide sustainable lending to the sector of society overlooked by traditional banks. Over this time, MFIs have evolved significantly. Initially, they began as not-for-profit organizations, such as NGOs, credit unions, or cooperatives, focused on making small loans to local low-income persons and informal businesses. Now, commercial banks and for-profit non-bank entities have joined the industry and expanded the range of services to offer loans for consumption, housing, healthcare, and education.

Regardless of their organizational structure, MFIs have always sought to do more than merely issue loans. Microfinance began with the goal of providing sustainable lending to the unbanked in order to improve their lives. Access to microfinance can broaden the economic opportunities available to individuals in the developing world. MFIs often improve income, reduce vulnerability, empower women, and lead to a positive social impact. In Microfinance Revolution,
Marguerite Robinson\textsuperscript{28} tells of a local MFI in India that, in conjunction with a local landowner, gave poor households of the community an acre of land and a $25 cultivation loan.\textsuperscript{29} Within ten years from the initial loan, not only had each loan been repaid, but each plot owner more than tripled her yearly income, improved her nutritional well-being, began sending her children to school, and boosted her self-confidence.\textsuperscript{30}

B. Who does Microfinance serve?

It is estimated that almost 2.7 billion people lack access to even the most basic financial services.\textsuperscript{31} Most of these people live in developing areas on less than $2 a day with relatively small microfinance needs.\textsuperscript{32} However, microfinance is not confined to poverty-stricken countries in the third world; the need for microfinance exists in the United States as well.\textsuperscript{33}

In the United States, approximately eighty-five percent of businesses employ five or fewer employees.\textsuperscript{34} Of these businesses, about 10 million report insufficient access to credit to grow and expand,\textsuperscript{35} since most of them cannot qualify for a traditional loan from a commercial bank.\textsuperscript{36} During the 1990s and early 2000s, when the American economy was peaking, personal home equity lines and

\textsuperscript{28} Marguerite Robinson is a social anthropologist and internationally recognized expert on microfinance. She worked as a professor at Harvard University in the Institute for International Development. Additionally, in Indonesia she served as the Advisor to the Ministry of Finance and to Bank Rakyat Indonesia.


\textsuperscript{30} Id.


\textsuperscript{33} \textit{See} Tanya Mannes, \textit{Federal Microloans Big With Small Businesses}, SAN DIEGO UNION-TRIB., Sept. 20, 2010, at C1 (discussing how microfinance helped small businesses who could not receive loans from a traditional bank).


\textsuperscript{35} Id.

business credit cards met those small business owners’ needs.\footnote{Luz GOMEZ & ELAINE L. EDGCOMB, FIELD AT THE ASPEN INST., A NEWLY CROWDED MARKETPLACE: HOW FOR-PROFIT LENDERS ARE SERVING MICROENTREPRENEURS 2 (2011).} With the implementation of stricter lending requirements in the wake of the financial crisis\footnote{Banks Seem to Have a Lot of Money, So Why Aren’t They Making More Loans?, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, http://www.federalreserve.gov/faqs/banking_12847.htm (last visited Jan. 3, 2013).} and the bursting of the housing bubble,\footnote{With the declining home prices small businesses find it much more difficult to use home equity borrowing as a source for capital. Mark E. Schweitzer & Scott Shane, The Effect of Falling Home Prices on Small Business Borrowing, FEDERAL RESERVE BANK OF CLEVELAND, http://www.clevelandfed.org/research/commentary/2010/2010-18.cfm (last visited Jan. 3, 2013).} the use of these two forms of credit for small businesses has declined by nineteen percent since 2007.\footnote{Scott Shane, Why Aren’t Banks Lending to Small Business? Ask Bernanke., THE AMERICAN (May 2, 2012), http://www.american.com/archive/2012/may/why-arent-banks-lending-to-small-business-ask-bernanke.} Now, as the economy is rebuilding, MFIs have stepped in to provide small business loans, along with business development assistance, giving small businesses the support needed for growth.\footnote{GOMEZ & EDGCOMB, supra note 37, at 2.}

\section{Development of Microfinance in the United States}

The roots of microfinance in the United States can be traced to the 1970s, when it became widely apparent that the country needed an inclusive financial system for individuals who lacked access to critical financial products and services.\footnote{Founded in 1973, Shorebank represented the beginning of microfinance in the United States. The bank set out to prove you could lend money to poor communities profitably. See Shorebank Small Enough to Fail, THE ECONOMIST, Aug. 26, 2010, available at http://www.economist.com/node/16891993; see also Microlending in the United States: A Timeline History, 1973-2010, supra note 12.} The formal development of microfinance correlates directly with the recognition and development of the microenterprise.\footnote{See generally Microlending in the United States: A Timeline History, 1973-2010, supra note 12 (showing the correlation between the rise of microfinance and the recognition and resurgence of the microenterprise).} Originally, the Small Business Administration (SBA), a federal government agency tasked with advocating for the position of the small business and the small business owner, defined small businesses as having up to 500 employees.\footnote{A small business is defined, depending on industry, either by the average number of employees or by the average annual sales. See generally Microlending in the United States: A Timeline History, 1973-2010, supra note 12.} Throughout the
1970s and 1980s, corporate downsizing, disparity of income distribution, and outsourcing made policy makers more aware of the importance of small businesses and self-employment as a strategy for creating income and employment.\textsuperscript{45} In 1991, the SBA created a new category of business by defining microenterprises\textsuperscript{46} as having five or fewer employees, including the owners.\textsuperscript{47}

As the importance of the microenterprise grew, microfinance became increasingly more important to the United States and saw parallel growth.\textsuperscript{48} In 1973, ShoreBank Corporation was founded to help small businesses on Chicago’s South Side whom larger financial institutions had denied credit.\textsuperscript{49} The ShoreBank Corporation became one of the first microfinance institutions in the United States and initiated the trend towards improving financial inclusiveness.\textsuperscript{50} In 1977, microfinance was aided by the passage of the Community Reinvestment Act (CRA).\textsuperscript{51} The CRA requires federally regulated depository institutions\textsuperscript{52} to respond to the credit needs of the communities where they operate.\textsuperscript{53} The CRA encouraged commercial banks to invest in MFIs and to provide safe and sound banking operations in low-income neighborhoods.\textsuperscript{54} The CRA empowers regulators to rate banks based on their participation in channeling resources directly or indirectly (through non-profit organizations) into low-income communities.\textsuperscript{55}

\begin{thebibliography}{99}
\bibitem{46} Program For Reinvestment in Microentrepreneurs, 13 C.F.R. § 119.2 (2001) [hereinafter PRIME].
\bibitem{48} \textit{See Microlending in the United States: A Timeline History, 1973-2010, supra note 12.}
\bibitem{49} \textit{See id.}
\bibitem{50} \textit{See id.}
\bibitem{52} A federally regulated depository institution is any organization that is regulated by the Federal Deposit Insurance Corporation that accepts deposits from their clients and places it in any sort of investment vehicle for the benefit of the client and the organization. \textit{See} 12 U.S.C. § 1813(c) (2013).
\bibitem{53} \textit{See generally} 12 U.S.C. § 2901.
\bibitem{55} \textit{See id.}
\end{thebibliography}
In 1980, Self-Help Credit Union (Self-Help), widely considered to be the model for Community Development Financial Institutions (CDFIs), was created in Durham, North Carolina. CDFIs are mission-based financial institutions serving undercapitalized markets by offering a wide variety of microfinance products to low-income communities. Since its emergence in 1980, Self-Help has expanded to the national level and believes MFIs should not only offer loans, but should also strive to advocate for homeownership and community development.

As the industry began to surge in 1990s, series of regulations were established to encourage the growth and success of MFIs. In 1994, Congress passed the Community Development Banking and Financial Institutions Act, which aimed to provide government investment directly to CDFIs working in underserved communities. Subsequently, in 1995, the Clinton Administration reformed the CRA, with the goal of transforming banking at the community level. The administration changed the focus of the CRA enforcement from processes to results; ensuring money went towards financial inclusion efforts. In 1999, federal funding for microfinance programs increased with the passage of the Program for Investment in Microentrepreneurs (PRIME) Act. By 2002 there were more than 650 separate MFIs operating in the United States.

57. Id.
62. Id.
64. Burrus, supra note 44 at 4.
D. The Current Status of Microfinance in the United States

Microfinance is no longer just a cottage industry with small pockets of activity in the United States. In 2010 alone, it was estimated that MFIs helped over 347,000 individuals obtain loans totaling more than $164 million. Microfinance has evolved to offer microcredit and microsavings products. 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.

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. The SBA distributes most of the federal money to the non-profit lenders. The SBA’s role is not to lend the money directly to the small business owners; rather the SBA sets the guidelines for the loans and allows designated MFIs to make the loans. Essentially, the MFI becomes a third-party provider for the government’s money through one of the many SBA programs.

The largest MFI in the United States is Accion USA. Accion serves as a distributor of the SBA funds, and has facilitated loans worth greater than $305 million since its founding. The average loan made

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68. Walker, supra note 10, at 387.
69. See GOMEZ & EDGCOMB, supra note 37, at 5 (outlining for-profit commercial microlenders as one of the “new players” in American microfinance).
72. Id.
74. Where We Work: United States, supra note 34.
by Accion is $7,000$ with interest rates ranging from 8.99% to 15.99%. Although Accion’s interest rates and dollar amounts may resemble a traditional bank’s small business loan portfolio, Accion differentiates itself by providing aid in business planning and community development. In addition to the major non-profit MFIs, for-profit organizations such as Citibank are also beginning to see microfinance as a growing business opportunity. Accion, also recognizing the opportunity for commercial banks to expand access to credit because of their extensive resources, developed an initiative to aid banks in starting microfinance programs. Although, the microfinance market slowed in recent years due to the economic downturn, MFIs remain committed to their mission. And as the sector grows, the future of microfinance is evident in new organizational structures like peer-to-peer lending. Peer-to-peer lenders focus on collaborative lending in which people engage directly with each other. Collaborative lending allows borrowers to choose a loan amount, establish a purpose for the loan, and then make a loan listing. The loan listing is then reviewed and a single investor issues funds. That single investor receives payments from the borrower with interest. While the Consumer Financial Protection Bureau (CFPB)

75. Id.
82. GOMEZ & EDGCOMB, supra note 34, at 6.
84. Id.
85. Normally, commercial banks will not lend money to a borrower with a low-credit score. Therefore, peer-to-peer loans offer an alternative. The loans offer a good investment for the investor and a good rate for the borrower. Most of these peer-to-peer platforms focus on small businesses and personal loans of less than $25,000. See Peer-to-Peer
identified the peer-to-peer platform for new regulations, apart from these regulations, there is still no working framework in place that is specific to microfinance.86

III. REGULATION

A. Regulation of Microfinance in the United States

Aside from required compliance with state usury laws and general IRS requirements for nonprofits, MFIs are historically unregulated—especially in comparison to traditional U.S. financial institutions.87 Until the 1970s, MFIs did not need any sort of accreditation or license to provide loans and technical advice;88 recently however, microfinance-specific regulations have begun to arise.89 The Economic Intelligence Unit conducted a study of fifty-four nations and their microfinance regulatory scheme.90 It concluded that "microfinance is rapidly shifting from a niche product to a globally recognised[sic] form of finance [yet] ... regulatory and market gaps keep the industry from operating as well as it should."91 This need for

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86. Burrus, supra note 44, at 14; see also Valerie L. Hletko & John P. Kromer, Minifinance: CFPB Supervision of Short-Term, Small-Dollar Products and Services, 2012 EMERGING ISSUES 6301 (Apr. 19, 2012) (stating that the CFPB intends to promulgate regulations for peer-to-peer lending platforms).

87. Id.

88. Id.

89. Burrus, supra note 44, at 14; see, e.g., 12 C.F.R. § 25 (2006) (to receive federal money from the CRA, an organization must go through a certification process and become a recognized CDFI).


91. Id. at 4.
regulation exists in the United States just as it does in the rest of the world; structure is needed for the industry to continue to prosper.

B. Why Does Microfinance Need Regulation in the United States?

A regulatory framework for MFIs will protect the consumers, protect MFI investors, and help the microfinance industry to grow. The problem caused by India’s microfinance giant, SKS Microfinance Ltd. (SKS), provides an example of the need for suitable regulation. In mid-2010, SKS issued stock to the public with great success. This initial success of the public offering was praised for showing the maturity of the Indian microfinance market. However, later that year, more than 200 poor residents of Andhra Pradesh committed suicide, reportedly due to the pressure from SKS debt collectors. According to the reports, the SKS employees “verbally harassed over-indebted borrowers, forced them to pawn valuable items, incited other borrowers to humiliate them, and orchestrated sit-ins outside their homes to publicly shame them.” The lenders share price dropped rapidly at the reports of SKS’s involvement surfaced and only recently has the price begun to stabilize. However, the breakdown of SKS’s share price was not solely due to the reports of the suicides; overzealous regulations...
passed in reaction to the suicides also played a role. In particular, the Andhra Pradesh province instituted the Andhra Pradesh Microfinance Institutions Act (AP Act), which forced SKS to write off, or reduce the value of its loan portfolio by nearly eighty-five percent in the province. The AP Act also required MFIs to "register with the state government; it [said] that total interest payments charged by the MFIs can’t exceed the amount of the loan; it [banned] taking security for loans; and imposes penalties of up to three years in jail and a monetary penalty for using strong handed techniques. The cost of compliance was a heavy burden on SKS that amplified its losses in revenue.

The SKS catastrophe exemplified two of the main considerations for a microfinance regulator: to protect borrowers from abusive collection practices and usurious interest rates. In the United States, laws such as the Federal Trade Commission Act and the Consumer Credit Protection Act already exist to protect consumers from abusive practices. However, these acts do not specify microfinance as a specific financial institution. A simple provision in the acts would suffice to provide consumer protection against abusive collection practices. Usury laws protecting the consumer against exorbitant interest rates are also in place in many jurisdictions in the

101. See id.
103. Sowkar, supra note 99.
105. SKS share price dropped 22% over one month. See id.
109. A usurious interest rate is an exorbitant interest rate charged on a loan deemed to be unfair by state statute. Usurious interest rates vary from state to state. Usury Definition, BALLENTINE'S LAW DICTIONARY (3d 2010). To determine what is usurious in a specific state you must look at the specific state statute. For a list of usury laws by state, see Usury Laws by State, LOANBACK (Mar. 3, 2011) http://www.loanback.com/category/usury-laws-by-state.
United States. For example, in North Carolina a personal loan of $25,000 or less may only charge up to eight percent per year. But in order for MFIs to earn an adequate return on their loans to riskier customers, MFIs need to charge a higher interest rate than usury laws will allow. Therefore, usury laws require special attention in a microfinance regulatory system in order to account for the nature of the industry’s loans.

Second, regulation is needed to protect microfinance investors from unscrupulous “fly-by-night” MFIs. “Fly-by-night” MFIs are established quickly and liquidated quickly to take advantage of indigent consumers. Such underhanded practices could lead to the defamation of MFIs as a whole and a distrust of microfinance services.

Increased regulation of MFI corporate governance can protect investors by providing more transparency. Disclosure regulations will increase the flow of information to investors, thereby allowing them to use their resources more efficiently and effectively. Ideally the increased transparency will draw more investors into microfinance, thereby fostering industry growth. Additionally, transparency regarding the social and financial impact of an institution builds trust among consumers and is another important benefit of regulation.


111. See N.C. GEN. STAT. § 24-1 (2012).


115. See id.


117. Id.

118. See id.

119. See A GUIDE TO REGULATION AND SUPERVISION OF MICROFINANCE, supra note 92, at 51 (describing how non-prudential regulation can lead to more transparency).
Lastly, regulation would help legitimize the microfinance industry in the eyes of investors, allowing it to become sustainable without relying on federal funding. In countries such as Brazil, Peru, and Bolivia, where regulation of the industry is more structured, MFIs have become sustainable financial institutions by attracting private investors.\textsuperscript{120} The sustainability of our domestic microfinance industry requires regulation that considers the MFI’s specific goals and objectives. For guidance we need look no further than our South American neighbor, Peru.

IV. THE REGULATION OF MICROFINANCE IN PERU PROVIDES A REGULATORY FRAMEWORK SUITABLE FOR MICROFINANCE IN THE UNITED STATES

A. Why Peru?

Peru provides the appropriate regulatory framework for the United States to follow because it is unmatched in its sophistication and oversight of the industry.\textsuperscript{121} Microfinance began in Peru in the 1980s during a time of economic turmoil,\textsuperscript{122} prompting many Peruvians to relocate to major cities.\textsuperscript{123} The migration prompted an economic shift

\begin{itemize}
  \item \textsuperscript{120} In the study, Brazil, Peru, and Bolivia had some of the highest overall rankings due to an investor-friendly microfinance climate. \textit{See generally} Economist Intelligence Unit, \textit{Global Microscope on the Microfinance Business Environment 2011}, supra note 96.
  \item \textsuperscript{121} For the last five years, the Economist Intelligence Unit concluded Peru had the best overall environment for microfinance. The study evaluates “across two distinct categories: \textit{Regulatory Framework and Practices}, including legal recognition for microfinance institutions [,], national regulatory and supervisory capacity, policies towards deposits and market distortions; and \textit{Supporting Institutional Framework}, especially financial reporting standards and transparency, credit bureaus, pricing, dispute resolution, and policies for offering microfinance through new agents and channels.” Economist Intelligence Unit, \textit{Global Microscope on the Microfinance Business Environment 2012}, ECONOMIST 6-9 (2012), http://www1.ifc.org/wps/wcm/connect/467a47804ce326f793afdf7f81ee631cc/2012MicroscopeReport-EngWEB.pdf?MOD=AJPERES.
  \item \textsuperscript{122} During the 1980s in Peru, internal violence displaced many rural people to metropolitan areas. This disrupted the agricultural communities and urban commercial centers where refugees and displaced people flocked. \textit{See} SARA PAIT, \textit{The Microfinance Sector in Peru: Opportunities, Challenges and Empowerment with Gender Mainstreaming} 2 (WEMAN Programme Mar. 2009), http://www.microfinancegateway.org/gm/document-1.9.38550/THESOMICROFINANCE%20SECTOR%20IN%20PERU%20OPPORTUNITIES,%20CHALLENGES%20AND%20EMPOWERMENT%20WITH%20GENDER%20MAINSTREAMING.pdf.
  \item \textsuperscript{123} Seven out of ten Peruvians now live in a major city. \textit{See} Janina León, \textit{Partnership}
toward microenterprises, increasing demand on MFIs for loans.\textsuperscript{124} Since that time, Peru has sustained steady economic growth,\textsuperscript{125} with the microfinance industry growing every year.\textsuperscript{126} Today, microenterprises employ seventy-four percent of the economically active population.\textsuperscript{127}

\textbf{B. The Regulatory Framework of Peru}

The microfinance regulatory framework in Peru combines strong supervisory regulations with a balance of prudential and non-prudential regulations to efficiently increase transparency, and protect the consumer, investor, and industry.\textsuperscript{128} Three types of MFIs exist in Peru: (1) Municipal Savings and Loan Institutions (MSLIs), (2) Rural Savings and Loan Institutions (RSLI), and (3) Entities for the Development of the Small and Microenterprise (EDPYME).\textsuperscript{129} MSLIs were started in the early 1980s and are owned by local governments.\textsuperscript{130} They help small businesses expand their services by collecting and distributing funds to small communities.\textsuperscript{131} RSLIs were created to fill a gap in the agricultural community when the Agrarian Bank closed in 1992.\textsuperscript{132} The Agrarian Bank was a state owned development bank focused on channeling government funds to small farmers at subsidized interest rates and special loan conditions.\textsuperscript{133} Finally, EDPYMEs were created specifically for microfinance as legal financial entities that can make loans but cannot accept deposits (MSLIs and RSLIs accept

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\textsuperscript{124} See Alfredo Ebentreich, \textit{Microfinance Regulation in Peru: Current State, Lessons Learned and Prospects for the Future}, \textit{4 Essays on Regulation and Supervision} 1, 1 (IRIS Center, University of Maryland, Apr. 2005).


\textsuperscript{126} See Ebentreich, supra note 124, at 8.

\textsuperscript{127} \textit{PaT}, supra note 122, at 3.

\textsuperscript{128} For example, Peru uses industry supervisors, capital adequacy, and disclosure requirements to regulate the microfinance industry. See generally Ebentreich, supra note 124.

\textsuperscript{129} Ebentreich, supra note 124, at 1.

\textsuperscript{130} \textit{Id}.

\textsuperscript{131} \textit{Id}.

\textsuperscript{132} \textit{Id}.

\textsuperscript{133} \textit{Id}.
Each entity is supervised by the Superintendencia de Banca y Seguros (SBS). The SBS is key to the success of Peru’s financial sector. It has the duty of ensuring the stability and solvency of each of these institutions. It does so through on-site inspections of each MFI, issuing prudential requirements, and managing the risk of each institution’s client-base. The SBS requires each regulated MFI to submit an internal audit report in order to publish all information about interest rates, loan portfolios, and overall costs of each loan. Peru also requires each MFI to go through a licensing process similar to that for a regular bank, although the MFIs are held to different capital requirements than other financial institutions.

MFIs in Peru are allowed significant freedom to set interest rates, fees, and other charges. As a check on this freedom, the Association of Peruvian Banks created the Financial Client Defender (FCD) in 2003 to address grievances and abusive practices effectively. The office works to defend the rights of the financial clients in the network of member banks, acts as an independent mediator between financial providers and clients, and is free of charge to member banks. The FCD and other Peruvian regulations have created an MFI-friendly environment, resulting in increased competition and downward pressure on interest rates for loans.

Peru’s regulatory framework also facilitates data transparency

134. PAIT, supra note 122, at 3.
136. BASIX GRP., supra note 112, at 4.
137. Ebentreich, supra note 124, at 7.
138. Id. at 9.
139. BASIX GRP., supra note 112, at 4.
140. Ebentreich, supra note 124, at 3.
142. Id.
143. Id.
144. See Economist Intelligence Unit, Global Microscope on the Microfinance Business Environment 2012, supra note 121, at 49.
by requiring each MFI to be rated by an independent rating agency.\textsuperscript{145} Rating agencies consist of analysts who examine financial performance ratios, providing information for investors to judge investments.\textsuperscript{146} This independent assessment of Peruvian MFIs promotes short-term sustainability by attracting foreign investors\textsuperscript{147} and also positions the microfinance industry for long-term growth.\textsuperscript{148}

Despite Peru's robust regulatory regime, MFIs have maintained their original goal of efficiently providing funds to the unbanked.\textsuperscript{149} Over the last decade, Peruvian MFIs have continued to build their loan portfolios and have moved away from only giving loans in Lima.\textsuperscript{150} Additionally, the legitimizing effect of regulations allows most MFIs go unsubsidized as self-sustaining financial institutions with a socially accountable mission.\textsuperscript{151}

\textbf{C. How does Peru's Regulatory Framework Aid the Problems Facing the United States?}

The regulatory framework in Peru will aid the problems facing MFIs in the United States by providing a tested and refined example of a successful system.\textsuperscript{152} First, Peru enabled MFIs to work more efficiently by establishing them as separate legal entities apart from traditional banks.\textsuperscript{153} Reserving microfinance for a limited set of institutions, with certain barriers to entry, allows regulations to account

\begin{itemize}
  \item \textsuperscript{145} Basix Grp., \textit{supra} note 112, at 4
  \item \textsuperscript{146} Id.
  \item \textsuperscript{147} Id.
  \item \textsuperscript{148} Id.
  \item \textsuperscript{149} See Ebentreich, \textit{supra} note 124, at 8 (unbanked refers to people who normally could not receive a loan from a commercial bank).
  \item \textsuperscript{150} See Giovanna Priale Reyes et al., \textit{Financial Inclusion Indicators for Developing Countries: The Peruvian Case} 6 (Superintendencia de Banca y Seguros Nov. 15, 2011), available at http://www.microfinancegateway.org/p/site/m/template.rc/1.9.55712/ (describing how the amount of loans originating from Lima decreased steadily over the past decade, but the total number of loans increased, implying more loans were coming from smaller cities).
  \item \textsuperscript{151} See Basix Grp., \textit{supra} note 112, at 4.
  \item \textsuperscript{152} See Economist Intelligence Unit, \textit{Global Microscope on the Microfinance Business Environment} 2012, \textit{supra} note 121, at 49 (according to the Economist Intelligence Unit, Peru is the best example for microfinance regulation from the countries studied).
  \item \textsuperscript{153} See Economist Intelligence Unit, \textit{Global Microscope on the Microfinance Business Environment} 2010, \textit{supra} note 90, at 45.
\end{itemize}
more precisely for the specific purposes and objectives of MFIs. Microfinance specific regulation can allow tailored usury laws to account for the high-risk and unsecured loans typical of the microfinance market. Additionally, MFIs as a group might also be subject to different capital requirements than commercial banks.

Second, the financial oversight provided by SBS is key in establishing transparency in the Peruvian microfinance market, an entity with analogous powers is critical to the success of the microfinance industry in the United States. The SBS conducts inspections of each MFI, reviewing the entire database of microenterprise and consumer loans. If the SBS is not satisfied with an institution’s risk profile, it takes over the institution. Then, if there is no improvement after three months, the institution is liquidated. This leads to outstanding transparency in the industry as the SBS publishes its reports on the loan portfolios post-review.

Peru’s regulations and government incentives created a transparent, protective microfinance market, allowing microfinance providers to thrive. These providers entered at the exact time Peru was exiting from economic turmoil and turning towards microenterprise for revival. This perfect storm led to market competition, driving interest rates to sustainable levels (without usury laws), forced companies to focus more on consumer protection, and encouraged institutions to reach for foreign investment to provide for the growing

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154. With industry specific standards Peru can account for the altruistic purpose of the MFIs without hindering another industry with overly burdensome regulations. See Dissertation, supra note 135, at 9-10; see also Economist Intelligence Unit, Global Microscope on the Microfinance Business Environment 2010, supra note 90, at 45.

155. See BASIX GRP, supra note 112, at 4.

156. Ebentreich, supra note 124, at 4.

157. See Summary of Client Protection in Peru, supra note 141.

158. Ebentreich, supra note 124, at 7.

159. Risk profile refers to what the SBS uses to determine when to intervene with a MFI. The SBS examines the MFI’s capital ratios, prior sanctions, and reduction of regulatory capital. See id. at 5.

160. Id.

161. See Economist Intelligence Unit, Global Microscope on the Microfinance Business Environment 2012, supra note 121, at 49.

162. See PAIT, supra note 122, at 2 (referring to the 1990s, after the economic turmoil in Peru).

163. Even without usury regulations, the availability of many different lenders and many consumers created competition in the market, which kept the interest rates low. See Dissertation, supra note 132, at 43.
V. CONCLUSION

For the United States' microfinance to provide the unbanked with access to credit, it cannot ignore the need for a strong regulatory framework. The microfinance industry serves an important need in the financial industry by fighting poverty and rebuilding the economy of the United States through microenterprises. While the Peruvian regulatory framework may not be a perfect fit for the United States economy, we can use their experience to better inform the creation of our own regulation. Microfinance provides a valuable financial tool kit to help small business grow and prosper, but if regulation is not implemented, microfinance may never reach its true potential to aid the small business and the American economy.

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164. See León, supra note 123 (under the heading "contracting mechanics").