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EXPLOITING LATIN AMERICAN MICROFINANCE DEREGULATION: ONE BORROWER AT A TIME

ABSTRACT

Microfinance seeks to eradicate poverty through the economic growth and development that results when seed capital is given to microenterprises. In 2015, Latin America's microfinance loan portfolio totaled \$40 billion USD and included more than twenty-two million borrowers. Due to the current state of microfinance in the region—abusive lending practices and betraying the original goal and purpose of eradicating poverty—this Note advocates for a regional regulatory body, such as the Latin American Microfinance Association, that would develop and assist Latin American countries to implement model legal frameworks that increase client protection, create licensing requirements, establish interest rate caps, and recognize microfinance institutions as part of the formal lending sector. This framework is based on the recommendations of Verónica Trujillo-Tejada, Victoria Muriel-Patino and Fernando Rodríguez-López (TMR Guidelines). The suggested model framework balances the interests of “financial stability, resilience, integrity, and consumer protection with the need to preserve financial inclusion, innovation, and healthy competition.” Additionally, this Note offers a comparative legal analysis and critique of the current regulatory frameworks in Latin America, particularly in Bolivia, Brazil, the Dominican Republic, and Nicaragua.

INTRODUCTION

Microfinance is regarded as the cure for global poverty, one that does not require “charity, redistribution, rethinking economic policy, or restructuring existing economic institutions.”¹ Pioneered by Dr. Muhammad Yunus, microfinance has been portrayed as a “vital way of legitimizing and promoting capitalism in developing countries and essentially ‘bringing capitalism to the poor.’”² However, microfinance operates under a largely deregulated model and has yet to show positive impacts or an alleviation of poverty.³ This lack of impact is due in part to abusive interest rates, loan shark methods of debt collection, and massive over-lending.⁴ In many countries microfinance has become a predatory loan system that further marginalizes the people it sets out to help.⁵ These people are left with

1. HUGH SINCLAIR, *CONFESSIONS OF A MICROFINANCE HERETIC: HOW MICROLENDING LOST ITS WAY AND BETRAYED THE POOR* ix (2012).

2. Milford Bateman, *The Age of Microfinance: Destroying Latin American Economies from the Bottom Up* 4 (Österreichische Forschungsstiftung Für Internationale Entwicklung, Working Paper No. 39, 2013), available at <http://www.networkideas.org/focus/sep2013/Microfinance.pdf>.

3. See SINCLAIR, *supra* note 1, at 2–3.

4. See generally *id.* at 5–7.

5. See *id.*

insurmountable debts and in a far worse position than the one they were in before they took out the loan.⁶ As a result, broad consensus has developed within the microfinance community calling for increased regulations and monitoring of institutional practices.⁷ However, within the microfinance community, there is still much disagreement regarding the creation and implementation of a proper legal framework.⁸

Part I of this Note defines microfinance and its development in Latin America. Part II identifies the legal and economic issues resulting from the deregulation of microfinance. Next, Part III discusses the current regulatory frameworks and constitutional guarantees of Brazil, the Dominican Republic, Nicaragua, and Bolivia, according to the “Criteria for the Assessment of Legal Frameworks for Microfinance” and the TMR Guidelines.⁹ Part IV then explores the areas of economic, legal, and academic debate around strengthening regulations in the microfinance world. Part V proposes a regional regulatory body that should be created by treaties and be empowered to set model rules such as the TMR Guidelines; this Part also discusses the legality and the implications of adopting such a proposed regional regulatory body. Lastly, this Note concludes by summarizing the key issues that affect the current unregulated microfinance market and suggests major reforms and regulatory undertakings.

Throughout this Note, there will be mention of a fictional character by the name of *Pedrito*, a hypothetical farmer who has been approved to receive a microfinance loan to start a business. These hypothetical examples will help to explain the complex concepts within microfinance.

I. WHAT IS MICROFINANCE?

Microfinance is a form of banking that is geared toward the marginalized¹⁰ and poor, uses extremely high interest rates, and provides small-scale financial services to clients without requiring collateral.¹¹ Conversely, “banks typically borrow money from clients (savings) and lend them to other clients (borrowers, with collateral).”¹² Furthermore,

6. *See id.*

7. *See* Anne Pouchous, *The Regulation and Supervision of Microfinance: Main Issues and Progress*, INT’L INST. FOR SUSTAINABLE DEV. 1 (Sept. 2012), http://www.iisd.org/pdf/2012/regulation_supervision_microfinance.pdf.

8. *See id.*

9. *See* STEFAN STASCHEN, REGULATORY REQUIREMENTS FOR MICROFINANCE: A COMPARISON OF LEGAL FRAMEWORKS IN 11 COUNTRIES WORLDWIDE 60–64 (2003), <http://www.bu.edu/bucflp/files/2012/08/Regulatory-Requirements-for-Microfinance.pdf>.

10. Throughout this Note, the term “marginalized” shall mean having little to no access to primary education, little to no access to social mobility, as well as exclusion from many opportunities as a result of geographic location and a lack of infrastructure.

11. *See* Miguel Jaramillo, *Guide to Microfinance in Latin America*, EVIDENCE AND LESSONS FROM LATIN AMERICA 1, http://ella.practicalaction.org/wp-content/uploads/files/130410_ECO_Mi_c_GUIDE.pdf.

12. *See* SINCLAIR, *supra* note 1, at 18.

microfinance institutions are not funded by borrowing from clients' savings accounts. Instead, they are funded by large loans from multilateral organizations.¹³ These loans from multilateral organizations allow microfinance institutions to lend money to clients like *Pedrito*. However, since the institution itself is lending out money it received from a loan, it is left without a reserve—generated from clients' savings—to lend to other clients.¹⁴

For example, suppose multilateral organization *A* lends \$1 million USD to microfinance institution *B* over a period of two years at a 4% interest rate. *B*'s mission is to lend to others with the understanding that they will use the money to start a business. Now consider *Pedrito*—a poor farmer who would like to start a business but is low on cash. *B* offers *Pedrito* \$100 USD, with the funds provided by *A*, at an interest rate of 200% to be paid over two months. *Pedrito* now has a balance of \$301 USD (\$100 loan + 200% interest rate) that he must repay within two months. On one hand, *Pedrito* is pleased that he receives the loan—one that he would have never had access to because of his financial circumstances. However, his excitement is short-lived because of the high interest rate, which often results in default, and can lead to depression and in some instances even violence.

A. SO WHAT! WHY SHOULD WE CARE ABOUT MICROFINANCE?

One example of the detrimental effects of unmonitored lending practices was the global economic crisis of 2008, which was in part a consequence of reckless banking.¹⁵ Highly “esoteric and complex financial products” were provided to individuals who should not have been targeted for these services.¹⁶ A similar trend occurs in microfinance—borrowers, like *Pedrito*, default on loans that should have never been serviced. However, *Pedrito* has access to these loans due to largely unmonitored microfinance practices.¹⁷ The detrimental effects of such practices were evidenced in the microfinance meltdowns and economic crises of Bolivia and Nicaragua.¹⁸

Theoretically, by way of microfinance, institutions issue loans that are intended to jumpstart small businesses. However, it seems that few lending institutions issue loans with such business expectations in mind. In fact, most of these loans are given with the sole expectation of profiting off the interest, rather than encouraging market and economic growth.¹⁹ For example, these loans are made available to the *Pedritos* of the world, who then use the money for other purposes, such as paying for weddings or *quinceañeras*, or spending

13. *See id.*

14. *See id.*

15. *See id.* at 8.

16. *See id.*

17. *See id.* at 3.

18. *See id.* at 8.

19. *See generally id.* at 10, 77.

the money on things that do not yield a return or enable them to pay back the loan.²⁰ In essence, institutions like *B* are giving *Pedrito* access to more lines of credit without a proper business plan or supervision, leading to higher rates of consumption and consumer debt.²¹ Spending on credit increases *Pedrito*'s poverty level because he is just as poor as he was before he took the loan, but now has thousands of additional dollars in consumer debt, all with high interest rates.²²

Microfinance is a “bottom pyramid business, focusing on the poor with questionable business practices, but get[s] away with it [by using] the title ‘microfinance.’”²³ A clear indication of this phenomenon is evidenced by the comparison of interest rates in Mexico and in the United States. In Mexico, microfinance interest rates have gone up as high as 195% per year.²⁴ Meanwhile, in the United States, the average commercial bank interest rate for a personal loan was 10% in 2017.²⁵ In some states, like New York, interest rates may not exceed 16% per year.²⁶ In other words, in a developed country like the United States, even in the absence of interest rate caps, commercial banks would not get away with charging an interest rate as high as 195%, especially if the borrower lives in extreme poverty. Yet, in a developing country like Mexico, deregulated microfinance institutions can get away with charging such abusive interest rates.

As family units feel the pressure of repaying the debt, they turn to their children for help. Consequently, microfinance has been linked to incidences of child labor.²⁷ As a result, children's educational goals are hindered, thus perpetuating the cycle of poverty. Consider again *Pedrito*, who only has two months to pay back \$301 USD (\$100 original loan plus \$201 interest). He is a marginalized poor farmer who does not generate any additional income from the loan and does not have access to the tools he needs to earn more money. Thus, he relies on his children to help make ends meet.

Just as traditional banks account for risk, microfinance institutions need to mitigate their risks when providing loans, even if their institutional structures are different. In microfinance, for example, loans can be given to

20. *See id.* at 5.

21. *See* PovertyCure, *Microfinance 101*, YOUTUBE (Feb. 11, 2013), https://www.youtube.com/watch?v=_LK4XMF2u8Y.

22. *See id.*; *see also* Madeleine Morris, ‘India’s Microfinance Meltdown’ for BBC Newsnight, YOUTUBE (June 26, 2012), <https://www.youtube.com/watch?v=JzF6thf5GqA>.

23. *See* Abhay N, *What Are the Realities of Microfinance?* Yale School of Management, YOUTUBE (Feb. 7, 2012), <https://www.youtube.com/watch?v=xhkuH30lxco> (discussion of the state of microfinance between Rodrigo Canales, Tony Sheldon, and Dean Karlan).

24. *See* SINCLAIR, *supra* note 1, at 6.

25. *See* Consumer Credit, BOARD OF GOVERNORS OF THE FED. RES. SYS., <https://www.federalreserve.gov/releases/g19/current/default.htm> (last visited Sept. 28, 2017).

26. *See* N.Y. Banking Law § 14-a(1) (McKinney 2012).

27. *See* SINCLAIR, *supra* note 1, at 5–6.; *see also* Talks at Google, *Hugh Sinclair: “Confessions of a Microfinance Heretic”*: Talks at Google, YOUTUBE (Apr. 8, 2013), <https://www.youtube.com/watch?v=rhdZ2RfmiXo>.

individuals or groups. Individual loans are given to one person, whereas a group can obtain a collective loan and must repay the loan each week with each member serving as a guarantor of one another.²⁸ Without mitigating the risk of issuing these types of loans, the likelihood of collecting the outstanding debt decreases, rather than increases. Institutions that carry out this practice believe that it mitigates against the lack of collateral and increases the likelihood of collecting the outstanding debt.²⁹ However, this can cause greater strain on the individuals in the group.³⁰

The increased commercialization of microfinance, in addition to the departure from its original purpose, calls for change.³¹ Making changes to the core practices of microfinance is the only way to ensure that each country's financial system has the tools to fight abusive interest rates.³² Additionally, a change in the way consumers are protected can help prevent fraud and financial crimes.³³ Such changes will help to prevent another financial crisis from occurring.

B. THE RISE OF MICROFINANCE IN LATIN AMERICA

In the 1940s and throughout most of the 1980s, Latin America depended heavily on the importation of goods.³⁴ During this period, some Latin American countries, particularly Argentina, Brazil, and Mexico, began domesticating their industries by following Argentinean economist Raul Prebisch's recommendation of Import-Substitution-Industrialization (ISI model).³⁵ The ISI model promoted policies that "gradually replace[d] imports of manufactured goods [with] locally-produced goods."³⁶ However, because these economic policies did not promote exports, the success of the ISI model was limited.³⁷ In fact, with the intensification of the Cold War, the ISI model was no longer serving the interests of the United States.³⁸

Thus, through the World Bank and the International Monetary Fund, the United States rejected the ISI model and any form of proactive state intervention, and instead pressured and forced Latin American governments to embrace neoliberal economic policies known as the "Washington

28. See SINCLAIR, *supra* note 1, at 19.

29. See Tor Jansson & Mark Wenner, Financial Regulation and its Significance for Microfinance in Latin America and the Caribbean 34 (Dec. 1997), available at <http://www.gdrc.org/icm/govern/iadb-jansson.pdf>.

30. See generally SINCLAIR, *supra* note 1, at 19–20.

31. See generally Pouchous, *supra* note 7, at 3.

32. See *id.*

33. See *id.*

34. See Bateman, *supra* note 2, at 9.

35. See *id.*

36. *Id.*

37. See *id.* at 10.

38. See *id.*

Consensus.”³⁹ Microfinance then became a popular model in Latin America because it aimed to promote capital growth and “the efficient allocation of resources, as well as the safety, stability, and soundness of financial providers,”⁴⁰ rather than proactive state intervention. However, these neoliberal economic policies “proved to be quite disastrous . . . [T]hey precipitated massive bankruptcies and financial crises. Private banks had to be nationalised . . . [and] a significant percentage of Latin America’s scarce financial resources had to be channeled into (or wasted on) repaying the debts accumulated by governments.”⁴¹ Moreover, the new economic policies increased the already high level of poverty, deprivation, and inequality that existed before 1980.⁴²

Around this time, Dr. Muhammad Yunus saw success in Grameen Bank. Grameen Bank is closely associated with the start of microfinance in the 1980s.⁴³ A general understanding of the period before “the microfinance era” in Latin America allows one to see why Latin American soil was ripe for promoting microfinance—it was during the height of the Cold War, when the United States failed to overthrow Fidel Castro in Cuba, that the ISI model was seen as a proactive state interventionist model that contradicted the capitalist way.⁴⁴ The success of Grameen Bank was viewed as a way of bringing capitalism to Latin America; thus, the United States committed to providing extensive funding and technical assistance programs to start microfinance in Latin America.⁴⁵

As a result, three types of microfinance classifications emerged in Latin America: (1) greenfields, (2) upgrades, and (3) downscapes.⁴⁶ Greenfields are “new, specialized institutions . . . started from scratch”⁴⁷ in order to provide financing to micro-entrepreneurs.⁴⁸ Upgrades are “regulated financial institutions that [were once] nongovernmental organizations that operated

39. *See id.* (citing John Williamson, *Latin American Adjustment: How much has happened?* (John Williamson ed., 1990)).

40. Veronica Trujillo-Tejada, Victoria Muriel-Patino & Fernando Rodríguez-López, *How is Microfinance Being Regulated in Latin America?* 26 *ENTERPRISE DEV. & MICROFINANCE* 343, 344 (Dec. 2015), https://www.researchgate.net/publication/287994101_How_is_microfinance_being_regulated_in_Latin_America.

41. Bateman, *supra* note 2, at 10.

42. *See id.*

43. *See id.* at 4.

44. *See id.* at 4, 9–11.

45. *See id.* at 4, 12.

46. *See* Miguel Jaramillo, *Latin America’s Institutional and Regulatory Innovations for Microfinance Growth*, EVIDENCE AND LESSONS FROM LATIN AMERICA 4, http://ella.practicalaction.org/wp-content/uploads/files/130225_ECO_Mic_BRIEF2.pdf.

47. *See id.*

48. *See* Beatriz Marulanda & Maria Otero, *The Profile of Microfinance in Latin America in 10 Years: Vision and Characteristics*, ACCION INTERNATIONAL 1, 5 (Apr. 2005), <http://www.microfinancegateway.org/sites/default/files/mfg-en-paper-the-profile-of-microfinance-in-latin-america-in-10-years-vision-characteristics-apr-2005.pdf>.

through banks.”⁴⁹ Downscales are commercial banks that aim to expand their services⁵⁰ by “incorporating low-income segments into their clientele.”⁵¹

II. PROBLEMS WITH MICROFINANCE IN LATIN AMERICA

A. LEGAL ISSUES

Generally, if one borrows money from an institution and a dispute arises, there are institutional, legal, or alternative dispute mechanisms in place to solve it. However, in the case of unregulated microfinance institutions, such legal mechanisms are nonexistent.⁵² Additionally, many borrowers are geographically marginalized, meaning they are too far from or do not have access to means of transportation to take advantage of dispute resolution mechanisms.⁵³ Lastly, institutional governance, together with the lack of staff training, is unable to handle the influx of complaints and costs of educating clients about their rights to resolve disputes.⁵⁴

B. ECONOMIC CRISES

In the 1980s, microfinance was on the rise as Bolivia underwent significant economic restructuring.⁵⁵ During the 1990s, the Bolivian microfinance market was still relatively small, with an estimation of 232,000 eligible borrowers of “microloans.”⁵⁶ However, later research showed that the microfinance sector had actually distributed at least 380,000 microloans during this period.⁵⁷ This mismatch in supply of microloans, which was much larger than the estimated size of the microfinance market, caused an economic meltdown.⁵⁸

On July 2, 2001, associations of micro-entrepreneurs—such as farmers and fruit vendors—“took Bolivia’s Superintendency of Banks hostage . . . with dynamite [and] demanded forgiveness or reduction of [the] debt they

49. See Jaramillo, *supra* note 46, at 4 (stating that upgrades “are characterized as moving up-market to increase profitability in countries where there are still challenges with the regulatory environment”).

50. See *id.*

51. See Marulanda & Otero, *supra* note 48, at 5.

52. See MARITZA RODRÍGUEZ SAAVEDRA & DAMIAN VON STAUFFENBERG, PUBLIC CREDIT REGISTRIES, CREDIT BUREAUS AND THE MICROFINANCE SECTION IN LATIN AMERICA 36, 82, 96, 108 (2013), <http://www.microrate.com/media/downloads/2013/06/MicroRate-Report-Public-credit-registries-credit-bureaus-and-the-microfinance-sector-in-Latin-America-v2.pdf>.

53. See *id.* at 82, 96, 108.

54. See *generally id.*

55. See Bateman, *supra* note 2, at 12.

56. See *id.* at 13.

57. See *id.*

58. See *id.*

incurred through microlenders.”⁵⁹ At the heart of the issue was the over-lending and deregulation that gave people like *Pedrito* access to quick and cheap loans, or gave an already indebted *Pedrito* access to additional loans, causing over-indebtedness.⁶⁰ As a result, Bolivia “experience[d] heightened social unrest, with mass protests,”⁶¹ leading to the events of July 2, 2001, when bank employees were held hostage⁶² and debtors threatened to blow up buildings.⁶³ It was not until the Bolivian government implemented strict regulations, interest rate caps, and compliance mechanisms that the Bolivian market came to be regarded as the second best for microfinance.⁶⁴

The events in Bolivia were not isolated incidents. In 2008, predatory lending led to the microfinance meltdown known as Nicaragua’s No Pago Movement. The Movement was a response by farmers to the high and unfair interest rates thrust upon them,⁶⁵ and was led by Omar Gonzalez Vilchez, whose speech encouraged protests that spread over ten miles and blocked the Pan-American Highway.⁶⁶ These protests grew increasingly violent and culminated in an attempt to burn down one of the microfinance institution buildings.⁶⁷

III. CURRENT REGULATORY FRAMEWORKS AND CONSTITUTIONAL GUARANTEES IN LATIN AMERICA

There are three main schools of thought regarding “best practices” for microfinance regulators: the Association of Supervisors of Banks of the Americas (ASBA); the Basel Committee for Banking Supervision (BCBS); and the Consultative Group to Assist the Poor (CGAP).⁶⁸ The TMR

59. ELISABETH RHYNE, CRISIS IN BOLIVIAN MICROFINANCE 1 (2001), *available at* <http://www.cgdev.org/doc/blog/Roodman%20open%20book/Rhyme,%20Crisis%20in%20Bolivian%20Microfinance.pdf>.

60. *See id.*

61. *Id.* at 2.

62. One hundred people were held hostage for ten hours; some had dynamite tied to their bodies. When police attempted to enter, the debtors threw dynamite off the roof to keep them away. Hostages were also taken at the Office of the Public Defender. Five hours later, a human rights group was able to create dialogue between the debtors and various financial entities. It was not until the financial institutions agreed to change their loan agreements that the debtors released ninety-four hostages. Six remained to guarantee that the changes would be made. *See Bolivia: Deudores Mantienen Ocupada Superintendencia de Bancos en La Paz*, COOPERATIVA (July 3, 2001), <http://www.cooperativa.cl/noticias/mundo/bolivia-deudores-mantienen-ocupada-superintendencia-de-bancos-en-la-paz/2001-07-03/163400.html> [hereinafter COOPERATIVA].

63. *See RHYNE, supra* note 59, at 2.

64. *See Bateman, supra* note 2, at 13.

65. *See* Elizabeth Minchew, *A Movement to Acknowledge: The Nicaraguan Movimiento No Pago*, MICROFINANCE FOCUS (Sept. 14, 2011), <http://www.microfinancetransparency.com/evidence/PDF/12.5%20MF%20Focus%20no%20pago%20article.pdf>.

66. *See id.*

67. *See id.*

68. *See* Trujillo-Tejada et al., *supra* note 40, at 346 (“CGAP [] focuses on the design of the regulatory and supervisory frameworks for microfinance and the performance of private players, including NGOs. ASBA . . . analyses the appropriateness of applying the recommendations issued

Guidelines, created by Verónica Trujillo-Tejada, Victoria Muriel-Patino and Fernando Rodríguez-López (TMR Guidelines), are the most comprehensive standard for best practices for microfinance regulations in Latin America. The TMR Guidelines put together the most appropriate recommendations from ASBA, BCBS, and CGAP, and set forth a regulatory framework specific to the Latin American region.⁶⁹ The guidelines are divided into seven major categories: (1) capital requirements in the legal framework, (2) risk management regulation, (3) institutional issues related to ownership and governance (NPRs), (4) consumer protection regulation, (5) licensing and property, (6) public law, and (7) microfinance supervision.⁷⁰

Financial systems that are part of legal frameworks, like traditional banks, are controlled and monitored by “prudential” and “non-prudential” regulations. Prudential regulations (PRs) are regulations that are “designed to protect the system[s] integrity by preventing systemic risk”⁷¹ and protecting depositors’ savings. On the other hand, non-prudential regulations (NPRs) focus on guiding business behavior.⁷² For example, NPRs seek to implement regulations that promote good behavior in the markets.⁷³ Both PRs and NPRs can be implemented in order to enhance protection of the financial institution and deposit holder or promote responsible practices.⁷⁴ However, PRs are designed to preserve the financial sustainability of microfinance institutions and financial systems,⁷⁵ whereas NPRs focus on the development of microfinance institutions.⁷⁶

It is important to note that the constitutions and regulatory frameworks of these countries adopt the concept of positive human rights, as opposed to negative human rights. Positive human rights, common in developing countries, create an affirmative duty for the government to act,⁷⁷ such as to

by the [BCBS] to the microfinance industry. . . . BCBS . . . analyses the specific features of microfinance activities and relates them to the Basel regulation principles.”)

69. *See id.*

70. *See id.* at 346–50.

71. Trujillo-Tejada et al., *supra* note 40, at 345.

72. *See id.*

73. *See id.*

74. *See id.*

75. *See id.*

76. *See id.*

77. *See generally* Hugh Breakey, *Positive Duties and Human Rights: Challenges, Opportunities and Conceptual Necessities*, 63 POL. STUD. 1198 (2015).

provide food security,⁷⁸ adequate housing,⁷⁹ or access to sports.⁸⁰ On the other hand, the concept of negative human rights, common in developed countries, focuses on prohibitions,⁸¹ such as the prohibition against unreasonable searches and seizures.⁸² The constitutional guarantees present in each country further emphasize the importance of addressing the problems of abuse and lack of transparency in lending. The sections that follow highlight the constitutional protections that *Pedrito* has in different countries and shed light on the different legal aspects of microfinance-related issues. Importantly, microfinance frameworks exist on a spectrum, with highly regulated markets like Bolivia on one end, moderately regulated markets like the Dominican Republic in the middle, and deregulated markets like Nicaragua on the other end.

A. DEREGULATED: NICARAGUA

The Nicaraguan Constitution sets up the *Banco Central de Nicaragua* as the country's financial regulator.⁸³ Article 99 gives the State the primary responsibility of guaranteeing economic and social democracy, and recognizes microenterprises as one of the vehicles of economic development.⁸⁴ Nicaragua has the second least-regulated⁸⁵ microfinance market system in the region and has only implemented twenty-nine PRs.⁸⁶ In 2011, the country passed *Ley de Fomento y Regulación de las Microfinanzas*⁸⁷ (FRM), which specifically regulated nongovernmental

78. See CONSTITUIÇÃO FEDERAL [C.F.] [CONSTITUTION] art. 6 (Braz.); see also CONSTITUCIÓN NACIONAL [CONST. NAC.] [CONSTITUTION] art. 16 (Bol.); see also CONSTITUCIÓN NACIONAL [CONST. NAC.] [CONSTITUTION] art. 54 (Dom. Rep.); see also CONSTITUCIÓN POLÍTICA DE LA REPÚBLICA DE NICARAGUA [CN.] tit. IV, ch. III, art. 63, LA GACETA, DIARIO OFICIAL [L.G.] 9 January 1987.

79. See CONSTITUIÇÃO FEDERAL [C.F.] [CONSTITUTION] art. 6 (Braz.); see also CONSTITUCIÓN NACIONAL [CONST. NAC.] [CONSTITUTION] art. 19 (Bol.); see also CONSTITUCIÓN NACIONAL [CONST. NAC.] [CONSTITUTION] art. 59 (Dom. Rep.); see also CONSTITUCIÓN POLÍTICA DE LA REPÚBLICA DE NICARAGUA [CN.] tit. IV, ch. III, art. 64, LA GACETA, DIARIO OFICIAL [L.G.] 9 January 1987.

80. See CONSTITUIÇÃO FEDERAL [C.F.] [CONSTITUTION] art. 217 (Braz.); see also CONSTITUCIÓN NACIONAL [CONST. NAC.] [CONSTITUTION] art. 104 (Bol.); see also CONSTITUCIÓN NACIONAL [CONST. NAC.] [CONSTITUTION] art. 65 (Dom. Rep.); see also CONSTITUCIÓN POLÍTICA DE LA REPÚBLICA DE NICARAGUA [CN.] tit. IV, ch. III, art. 65, LA GACETA, DIARIO OFICIAL [L.G.] 9 January 1987.

81. See Breakey, *supra* note 77, at 1198.

82. See U.S. CONST. amend. IV.

83. See CONSTITUCIÓN POLÍTICA DE LA REPÚBLICA DE NICARAGUA [CN.] tit. VI, art. 99, LA GACETA, DIARIO OFICIAL [L.G.] 9 January 1987.

84. See *id.*

85. Costa Rica has the least regulated microfinance market system in the region. See Trujillo-Tejada et al., *supra* note 40, at 355.

86. See *id.* at 355.

87. "Law of Encouragement and Regulation of Microfinance"

microfinance organizations.⁸⁸ This law was intended to promote good corporate governance and regulate microfinance institutions through the *Comisión Nacional de Microfinanzas*.⁸⁹

The country has incorporated fifteen PRs in the FRM.⁹⁰ Of the PRs that have been incorporated, it is concerning that there are no mechanisms for solvency⁹¹ and that half of the recommended measures against credit risk are missing, such as maximum loan size requirements and simplifying the required documentation for borrowers.⁹² Moreover, there are no measures for setting stricter requirements on the maximum loan size.⁹³ Furthermore, with the implementation of only nine NPRs in the FRM,⁹⁴ the country performs poorly in consumer protection.⁹⁵ The absence of simple and low-cost mechanisms to resolve consumer complaints is a major concern.⁹⁶ Additionally, the standards that are in place for consumer rights are not enforced, even though government agencies are intended to ensure compliance.⁹⁷ Furthermore, neither regulated nor deregulated financial systems utilize the infrastructure in place to handle consumer complaints.⁹⁸ Consumers can only lodge complaints in the country's capital, leaving the majority of consumers, who are located *en el interior*⁹⁹ and live far from the capital, without a place to bring and resolve their disputes.¹⁰⁰

B. MODERATELY REGULATED

1. Brazil

Brazil was the first Latin American country exposed to microfinance.¹⁰¹ Between 1995 and 2011, the Brazilian government “took an active role in

88. See Ley No. 769, 9 June 2011, Ley de Fomento y Regulación de las Microfinanzas, LA GACETA, DIARIO OFICIAL [L.G.], 11 July 2011 (Nicar.).

89. “National Commission of Microfinance;” *see id.*

90. See Trujillo-Tejada et al., *supra* note 40, at 355.

91. *See id.* at 352.

92. *See id.* at 351.

93. *See id.* at 353.

94. *See id.*

95. *See id.*

96. *See id.*

97. See SAAVEDRA & VON STAUFFENBERG, *supra* note 52, at 108.; *see also* Ley No. 769, 9 June 2011, Ley de Fomento y Regulación de las Microfinanzas, LA GACETA, DIARIO OFICIAL [L.G.], 11 July 2011 (Nicar.).

98. See SAAVEDRA & VON STAUFFENBERG, *supra* note 52, at 108.

99. “In the interior.” This term refers to individuals who have difficulty accessing the capital because of physical distance, lack of financial or vehicular resources, or lack of infrastructure such as bridges and unpaved roads, among other reasons.

100. See SAAVEDRA & VON STAUFFENBERG, *supra* note 52, at 108.

101. See Crystal Folmar, Microfinance Regulation and Promotion Policies in Latin America: An Analysis of Bolivia, Peru, Brazil, and Argentina, 5 (Dec. 14, 2015) (unpublished thesis, University of Pittsburgh, Graduate School of Public and International Affairs), http://www.academia.edu/21516144/MICROFINANCE_REGULATION_AND_PROMOTION_POLICIES_IN_LATIN_AME RICA.

formulating and introducing public policies to provide credit to low-income populations.”¹⁰² Among these public policies was *Lei 11.110*,¹⁰³ which allowed for specialized microfinance institutions and created the National Bank for Social Development.¹⁰⁴ Article 3 of the Brazilian Constitution sets out the eradication of poverty and social inequalities as a fundamental objective of the government.¹⁰⁵ Additionally, Article 170 states the proposition that the Constitution ensures everyone a life of dignity, with guiding principles of social justice.¹⁰⁶ These principles include preferential treatment for small enterprises.¹⁰⁷ Furthermore, Article 173 suggests an affirmative duty to disallow arbitrary increases of profits in public companies.¹⁰⁸ All in all, *Pedrito*'s microenterprise is given developmental rights and guarantees, but problems related to the commercialization of microfinance, such as arbitrary profits, are seemingly condoned through the lack of explicit restrictions.

In 1999, the Brazilian Congress passed *Lei 9.790*.¹⁰⁹ *Lei 9.790* was the first legislation designed to regulate microfinance operations that created two regulated microfinance entities.¹¹⁰ Since then, the Brazilian congress has passed a series of regulations in an attempt to promote development in the microfinance sector.¹¹¹ Overall, “[a]lthough [] there are some rules for the microfinance sector, they are very recent and insufficient to promote its development. The microcredit programs run by the central government have had limited success.”¹¹² To further understand this, an analysis of the current PRs and NPRs is required.

Brazil has only enacted eighteen PRs.¹¹³ It has adopted all but one of the minimum capital requirements, which recommends additional capital amounts for unexpected losses and fluctuations.¹¹⁴ Additionally, there are mechanisms in place for credit risks, such as differentiating microfinance

102. *Id.* at 12.

103. *See* Lei No. 11.110, de 25 de Abril de 2005, COL. LEIS REP. FED. BRASIL, Abril 2005 (Braz.).

104. *See* Folmar, *supra* note 101, at 12.

105. *See* CONSTITUIÇÃO FEDERAL [C.F.] [CONSTITUTION] art. 3 (Braz.).

106. *See id.* at art. 170.

107. *See id.*

108. *See id.* at art. 173.

109. *See* Lei No. 9.790, de 23 de Março de 1995, COL. LEIS REP. FED. BRASIL, Março 1995 (Braz.).

110. *See* Folmar, *supra* note 101, at 12; *see also* SAAVEDRA & VON STAUFFENBERG, *supra* note 52, at 41.

111. *See* Folmar, *supra* note 101 at 12–13 (discussing Lei No. 10.194, regulations covering deposit accounts, and Decreto No. 226, which created a national organization and a permanent source of financial resources for microfinance institutions); *see also* Lei No. 10.194, de 14 de Fevereiro de 2001, COL. LEIS REP. FED. BRASIL, Março 1995 (Braz.); *see also* Decreto No. 226, de 29 de Novembro de 2004, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 29.11.2004 (Braz.).

112. SAAVEDRA & VON STAUFFENBERG, *supra* note 52, at 41.

113. *See* Trujillo-Tejada et al., *supra* note 40, at 355.

114. *See id.* at 352.

from other financial services and implementing loan maximums.¹¹⁵ All recommendations regarding market risks, licenses, deposit insurance and internal control, and audits have been enacted.¹¹⁶ However, more needs to be done. For example, there should be solvency mechanisms in place, and the documentation requirements for borrowers need to be simplified. Moreover, there are no PRs to mitigate against liquidity risk, interest rate risk, and operational risks—making microfinance institutions weaker in the event of a financial crisis.¹¹⁷

Turning to NPRs, Brazil has implemented eleven recommendations.¹¹⁸ In addition to there being small claims courts, each financial institution handles debtor claims in-house.¹¹⁹ While there are guidelines in place to resolve debtor complaints,¹²⁰ Brazil can further strengthen consumer protection and institutional transformation regulations by incorporating special protection for microfinance borrowers rather than commercial bank borrowers in the Consumer Protection Code.¹²¹

On another note, Brazil has “excellent data collection . . . with a majority of microfinance institutions reporting to credit bureaus.”¹²² Not only is there legislation in place, but the regulations are also “clear and have predictable consequences for the participants in the credit reporting system.”¹²³

2. Dominican Republic

Overall, in the Dominican Republic, “[t]he legal framework is clear, though it is poorly disseminated . . . [H]owever, the challenge remains to adequately attend consumers within the unregulated financial system.”¹²⁴ Since the collapse of three large banks in 2003,¹²⁵ there has been stricter standardization of the financial sector.¹²⁶ Nevertheless, there are not enough PRs and NPRs in place to develop a more successful microfinance environment.

115. *See id.* at 352, 347.

116. *See id.*

117. *See id.*

118. *See id.* at 353.

119. *See* SAAVEDRA & VON STAUFFENBERG, *supra* note 52, at 47.

120. The Consumer Protection Code describes the complaint process and establishes the National Consumer Defense System to help local consumers throughout the complaint process. *See* Lei No. 8.078, de 11 de Setembro de 1990, COL. LEIS REP. FED. BRASIL, Setembro 1990 (Braz.).

121. *See* Trujillo-Tejada et al., *supra* note 42, at 353; *see also* *Client Protection in Brazil*, CTR. FOR FIN. INCLUSION, <http://www.centerforfinancialinclusion.org/publications-a-resources/client-protection-library/101-summary-of-client-protection-in-brazil> (last visited Sept. 28, 2017); Lei No. 8.078, de 11 de Setembro de 1990, COL. LEIS REP. FED. BRASIL, Setembro 1990 (Braz.).

122. *See* SAAVEDRA & VON STAUFFENBERG, *supra* note 52, at 48.

123. *Id.*

124. *Id.* at 122.

125. *See* Manuel Jiménez, *Citan Causas Quiebra Bancos 2003*, HOY DIGITAL (Apr. 1, 2005), <http://hoy.com.do/citan-causas-quiebra-bancos-2003-2/>.

126. *See* SAAVEDRA & VON STAUFFENBERG, *supra* note 52, at 123.

The Dominican Republic lies in the middle of the regulated microfinance spectrum. The principal legislation, *La Ley Monetaria y Financiera*¹²⁷ (LMF), applies to all financial institutions.¹²⁸ The LMF does not have any microfinance-specific sections or rules.¹²⁹ However, the Dominican Republic Constitution sets out several guarantees for micro-borrowers like *Pedrito*. For example, Article 222 of the Constitution guarantees the creation of environments that incentivize the development and protection of microenterprises by providing access to financing, technical assistance, and training.¹³⁰ Additionally, Article 217 strongly suggests an emphasis on economic development through the promotion of human development via “economic growth, redistribution of wealth, social justice . . . [and] equality of opportunities.”¹³¹

The Constitution sets out the *Junta Monetaria* as the regulatory agency.¹³² Through resolutions, the *Junta Monetaria* creates rules for the monetary and financial system.¹³³ The main characteristics of the financial system are as follows: (1) a supervisory entity,¹³⁴ (2) a public credit registry, (3) two private credit bureaus,¹³⁵ (4) a regulatory body to monitor compliance,¹³⁶ and (5) reporting mechanisms.¹³⁷ The most recent resolution is the *Resolución Proyecto de Reglamento de Microcreditos*¹³⁸ (RPM), which establishes norms and guidelines for the administration of microfinance and proposes a legal framework based on international best practices and PRs.¹³⁹

The country has implemented eighteen PRs in the RPM.¹⁴⁰ The regulatory framework needs to better address entry requirements for new microfinance institutions. The RPM does not set forth an absolute amount of minimum capital requirement and only considers the maximum amount of

127. “Monetary and Financial Law”

128. See Ley No. 183-02, 21 Noviembre 2002, Que Aprueba La Ley Monetaria y Financiera [Ley No. 183-02], 10187 G.O. (Dom. Rep.).

129. See *id.*

130. See CONSTITUCIÓN NACIONAL [CONST. NAC.] [CONSTITUTION] art. 222 (Dom. Rep.).

131. See *id.* at art. 217.

132. See Ley No. 183-02, 21 Noviembre 2002, Que Aprueba La Ley Monetaria y Financiera [Ley No. 183-02], 10187 G.O. (Dom. Rep.).

133. See *id.* at art. 4(f); “Resolution” (R) is the formal name of the rulemaking power of the *Junta Monetaria*. The term “rules” is utilized to refer to the outcome generated by the individual aspects of all Rs, as each R regulates the behavior and institutional requirements of all financial institutions, just as a “rule” would. See *id.*

134. The supervising entity is *el Banco Central de la República Dominicana* (the Central Bank). See *id.*

135. The private credit bureaus are Transunion and Datacrédito. See SAAVEDRA & VON STAUFFENBERG, *supra* note 52, at 123.

136. The *Junta Monetaria* is the regulatory body. See Ley No. 183-02, 21 Noviembre 2002, Que Aprueba La Ley Monetaria y Financiera [Ley No. 183-02] art. 1, 10187 G.O. (Dom. Rep.).

137. See SAAVEDRA & VON STAUFFENBERG, *supra* note 52, at 123.

138. “Draft Resolution of Microfinance Regulation”

139. See Administración Monetaria y Financiera Junta Monetaria, tit. 1, cap. 1, art. 1, de 27 de junio de 2013 (Dom. Rep.).

140. See Trujillo-Tejada et al., *supra* note 40, at 355.

loan possible as microcredit.¹⁴¹ Moreover, the RPM does not describe the type of documentation needed to be considered a microfinance institution, nor does it impose requirements on becoming a corporation.¹⁴² These documentation and licensing requirements are important when overseeing microfinance institutions and ensuring that these institutional structures are in compliance with the RPM.¹⁴³ However, the LMF does set out the institutional, legal, and evidentiary requirements for becoming an “*entidad de intermediación financiera*”¹⁴⁴—entities such as commercial banks, cooperatives, credit unions.¹⁴⁵ Nonetheless, this legal framework is ineffective because it does not address the lack of regulation in the microfinance sector.¹⁴⁶ The Dominican Republic needs to set forth regulations that address solvency and develop more measures to mitigate against liquidity risk, interest rate risk, operational risk, and credit risk.¹⁴⁷ That said, the Dominican Republic meets all requirements with regard to market risk, licensing, permitted activities, deposit insurance, and internal controls and audits.¹⁴⁸

With respect to NPRs, the Dominican Republic has only enacted ten recommendations.¹⁴⁹ The country performs poorly in the “third-parties-as-agents” category—they do not regulate the use of third parties, nor is there regulation of the payment systems between traditional and small financial institutions.¹⁵⁰ More can be done with licensing requirements.¹⁵¹ For example, periodic risk assessments of microfinance institutions can be implemented as well as periodic evaluations and trainings for credit officers.¹⁵²

The Dominican Republic has sufficient regulatory requirements and guidelines under the RPM to satisfy the “main sources of information for the supervisory authority” category.¹⁵³ Under Article 39 of the RPM, microfinance institutions are required to send monthly reports to the

141. See Administración Monetaria y Financiera Junta Monetaria, tit. 2, cap. 1, de 27 de junio de 2013 (Dom. Rep.).

142. See *id.*; LMF imposes requirements in order to become a commercial bank but does not address how to establish a microfinance institution. Since RPM intends to regulate microfinance institutions, it should impose requirements and lay out how to become one. If not, anyone could create a microfinance institution.

143. See STASCHEN, *supra* note 9, at 61.

144. Translated as “Financial Intermediary or Financial Institution.”

145. See Ley No. 183-02, 21 Noviembre 2002, Que Aprueba La Ley Monetaria y Financiera [Ley No. 183-02] sección 5, tit. 3, sección 1., art. 34, 10187 G.O. (Dom. Rep.).

146. See SAAVEDRA & VON STAUFFENBERG, *supra* note 52, at 122.

147. See Trujillo-Tejada et al., *supra* note 40, at 351–52.

148. See *id.* at 355.

149. See *id.*

150. *Id.* at 353.

151. See *id.*

152. See *id.* at 349.

153. See SAAVEDRA & VON STAUFFENBERG, *supra* note 52, at 123.

superintendencia de bancos.¹⁵⁴ Moreover, Article 41 outlines the minimum requirements for the monthly reports, which include information about the businesses, applications and approvals, loan agreements, disclosure statements, and outstanding balances, among other items.¹⁵⁵ These regulatory requirements are important because they have the power to increase or decrease the effectiveness of monitoring microfinance institutions. Without this information, the *superintendencia de bancos* cannot ensure that microfinance institutions are complying with all laws and regulations.

C. HIGHLY REGULATED: BOLIVIA

Bolivia's Constitution sets out an array of constitutional guarantees that can be applied in the context of microfinance for potential borrowers like *Pedrito*. For example, Article 8 of the Constitution grants fundamental rights such as equality, inclusion, transparency, equality of opportunity, social justice, and the distribution and redistribution of social wealth;¹⁵⁶ Article 14 prohibits discrimination based on economic or social condition;¹⁵⁷ and Articles 47 and 318 state that microenterprises will receive special protection from the state and preferential allocation of financial resources to promote their business.¹⁵⁸ Additionally, Article 306 assures economic development through the equitable redistribution of economic surplus,¹⁵⁹ and Article 313 sets out goals to eliminate poverty and economic exclusion.¹⁶⁰ These guiding principles have contributed to the legal structure and regulatory framework of Bolivia's microfinance industry. By taking a "larger role in shaping the financial system"¹⁶¹ and making microfinance a priority,¹⁶² Bolivia earned its right to be ranked in the top ten microfinance markets in the world in 2014 and 2015.¹⁶³

154. "Banking Supervisory Agency." The Banking Supervisory Agency is a completely autonomous institution that oversees all financial institutions and ensures that all laws, regulations and decrees are being carried out. See Ley No. 183-02, 21 Noviembre 2002, *Que Aprueba La Ley Monetaria y Financiera* [Ley No. 183-02], 10187 G.O. (Dom. Rep.); see also Administración Monetaria y Financiera Junta Monetaria, tit. 6, cap. 1, art. 39, de 27 de junio de 2013 (Dom. Rep.).

155. See Administración Monetaria y Financiera Junta Monetaria, tit. 6, cap. 3, art. 41, de 27 de junio de 2013 (Dom. Rep.).

156. See CONSTITUCIÓN NACIONAL [CONST. NAC.] [CONSTITUTION] art. 8 (Bol.).

157. See *id.* at art. 14 (Bol.).

158. See *id.* at arts. 47, 318.

159. See *id.* at art. 306.

160. See *id.* at art. 313.

161. THE ECONOMIST INTELLIGENCE UNIT, GLOBAL MICROSCOPE 2015: THE ENABLING ENVIRONMENT FOR FINANCIAL INCLUSION 62 (2015),

https://centerforfinancialinclusionblog.files.wordpress.com/2015/12/eiu_microscope_2015_web.pdf.

162. See CONSTITUCIÓN NACIONAL [CONST. NAC.] [CONSTITUTION] art. 318 (Bol.); see also THE ECONOMIST INTELLIGENCE UNIT, *supra* note 161, at 62.

163. THE ECONOMIST INTELLIGENCE UNIT, *supra* note 161, at 10 (Bolivia ranked as number 8); see also THE ECONOMIST INTELLIGENCE UNIT, GLOBAL MICROSCOPE 2014: THE ENABLING ENVIRONMENT FOR FINANCIAL INCLUSION 10, 12 (2014), <http://www.citi.com/latinamerica/en/co>

Bolivia has implemented more PRs than any other country in the region, with twenty-two PRs.¹⁶⁴ The country performs particularly well in minimum capital requirements, credit risk, market risks, licensing, deposit insurance, and internal control and audits.¹⁶⁵ However, Bolivia can enhance its PRs by implementing solvency requirements and instituting higher liquidity requirements for microfinance, softening reserve requirements, and setting limits to large funding from one source.¹⁶⁶ In doing so, microfinance institutions will be further strengthened and protected from financial crisis.

Bolivia has also implemented the most NPRs in the region, with sixteen regulations.¹⁶⁷ All of the recommendations regarding consumer protection, third-party-as-agents measures, property and governance, and institutional transitions have been implemented; however, Bolivia performs very poorly in the financial crimes regulations indicator, where it has not implemented any regulations.¹⁶⁸

IV. CONTENTIOUS AREAS IN STRENGTHENING REGULATIONS

The “main objective[s] of these international norms are to prevent a systemic failure of the financial system and protect depositor savings.”¹⁶⁹ But is there really a benefit to increased regulation in the microfinance market when doing so is costly and may interfere with the free market system?

At the heart of the debate is the question, “at what point does government interference in the microfinance industry become overly expansive, crippling and contrary to the free market system?”¹⁷⁰ At the same time, however, “free markets . . . need a legal framework that protects property, enforces contracts and allows free exchange to flourish.”¹⁷¹ Whether and how these conflicting

mmunity/data/2014_Global_Microscope-EN.pdf (Bolivia ranked as number 7); *but see* THE ECONOMIST INTELLIGENCE UNIT, GLOBAL MICROSCOPE 2016: THE ENABLING ENVIRONMENT FOR FINANCIAL INCLUSION 28, 29 (2016) http://www.eiu.com/Handlers/WhitepaperHandler.ashx?fi=EIU_Microscope_2016_English_web.pdf&mode=wp&campaignid=Microscope2016 (In 2016, Bolivia moved down in the ranks to tie for 13th place.).

164. *See* Trujillo-Tejada et al., *supra* note 40, at 351–52.

165. *See id.*

166. *See id.*

167. *See id.* at 353.

168. *See id.*

169. Pouchous, *supra* note 7, at 3.

170. *See* Stephen F. Copp, *The Legal Foundations of Free Markets*, in THE INST. OF ECON. AFF., THE LEGAL FOUNDATIONS OF FREE MARKETS, 19, 20 (Stephen F. Copp ed., 2008).

The essence of a free market is that it is one where parties can compete freely through voluntary exchange on terms settled by agreement, on their own or with others, free from interference with their person or their property. Because free markets are based on the economists’ model of perfect competition that can lead to a Pareto-optimal (i.e. first best) outcome, they offer a real hope of increased economic prosperity. The behavior consistent with free markets is not an accident but the product of laws, based on strong moral foundations.

Id.

171. *Id.* at 13.

theories apply to microfinance is a question that lingers as microfinance remains a largely deregulated sector. Here, each section poses questions surrounding the debate, highlights the issues and consequences of deregulation, adopts these guidelines,¹⁷² and classifies them into the following categories of concern: (1) protecting the country's financial system, (2) rapid growth and fast commercialization, (3) consumer protection, (4) new providers and credit delivery mechanisms, (5) recent financial crisis considerations, and (6) fraud and financial crimes prevention.¹⁷³

A. RAPID GROWTH, FAST COMMERCIALIZATION, AND MONOPOLIES

Should governments be allowed to interfere in the growth and commercialization of microfinance? The microfinance sector grew at a yearly rate of 40% from 2004 to 2008.¹⁷⁴ More than \$60 billion USD were accumulated in assets, with rates of return ranging between 15% and 30%.¹⁷⁵ These profits were due in large part to microfinance institutions shifting their focus paradigm from pro-poor outreach and poverty reduction missions funded by donors and government support, to increasing the profits of new corporate investors who provided another source of funding.¹⁷⁶ As a direct result of this switch, many microfinance institutions focused on increasing investor profit margin to secure future funding.¹⁷⁷ Consequently, there was a decrease in asset quality as “many low-income borrowers [took out] multiple loans, the size of which was not fit to their needs, nor their repayment capacity ... [and] contributed to major repayment crisis” and loan delinquency problems.¹⁷⁸

Should competition¹⁷⁹ and cooperative activities¹⁸⁰ be regulated? Cooperative activities are horizontal arrangements whereby firms in the same market limit competition among members by “creation of cartels” or through

172. This Note does not adopt the “PCTI” guideline, which advocates for not setting ceilings on interest rates. Rather, this Note advocates against this recommendation and sets forth the reasoning in Part V.

173. See Pouchous, *supra* note 7, at 3.

174. Pouchous, *supra* note 7, at 3 (citing Greg Chen, Stephen Rasmussen, & Xavier Reille, *Growth and Vulnerabilities in Microfinance*, CGAP FOCUS NOTE 61, 1 (2010)).

175. *Id.*

176. *See id.* at 3–4.

177. *See id.*

178. *See id.*

179. See Richard A. Epstein, *Unilateral Practices and the Dominant Firm: the European Community and the United States*, in THE INST. OF ECON. AFF., THE LEGAL FOUNDATIONS OF FREE MARKETS 191, 191–92 (Stephen F. Copp ed., 2008) (“[C]ompetition policy” refers to the linkage between the competitive ideal and social welfare, “independent of the choice of legal entity to house the basic business enterprise.”).

180. *See id.* at 192.

mergers and acquisitions.¹⁸¹ Controlling competition via cooperative activities is important in avoiding situations where low-income borrowers without a sustainable plan for repayment can take out multiple loans.¹⁸² How much control is too much? Do these horizontal arrangements lead to monopolies?¹⁸³ The problem with monopolizing the microfinance market is that consumers are then left with less of a choice between institutions. Moreover, institutions will not be incentivized to provide better services and tools. This is particularly concerning when considering the current abusive practices, such as extremely high interest rates.

B. CONSUMER PROTECTION

The microfinance industry excessively focused on growth and returns instead of asset quality, increasingly utilized contracts with misleading information, and imposed excessive interest rates.¹⁸⁴ Lending methods like “group lending”¹⁸⁵ have led to emotional harm due to the amount of peer pressure involved in repaying these debts.¹⁸⁶ Moreover, collection methods like daily harassment, public humiliation, and social exclusion have led to some serious concerns such as suicide and public unrest.¹⁸⁷

“Truth-in-lending” is one of the “most controversial regulatory debates in microfinance.”¹⁸⁸ Issues, such as interest rate caps, have caused a divide between regulators and microfinance professionals. On the one hand, regulators “believe that capping interest rates is an appropriate way to avoid abusive rates and promote transparency.”¹⁸⁹ On the other hand, most microfinance professionals are opposed to such practices because capping interest rates results in lower profits.¹⁹⁰ Moreover, where interest rate caps have been imposed they have “resulted in lower provision of tiny loans and more opaque pricing structures.”¹⁹¹

181. *See id.*

182. *See* Pouchous, *supra* note 7, at 4 (arguing that as a result, many borrowers were lured into credit contracts that were clearly not adapted to their needs, which in turn contributed to the major repayment crisis in Bolivia, Guatemala and Nicaragua from 1997–2000).

183. *Monopoly*, BLACK’S LAW DICTIONARY (9th ed. 2009) (“A privilege or peculiar advantage vested in one or more persons or companies, consisting in the exclusive right (or power) to carry on a particular business trade, manufacture a particular article, or control the sale of a whole supply of a particular commodity.”).

184. *See* Pouchous, *supra* note 7, at 4.

185. *See* SINCLAIR, *supra* note 1, at 19 (group lending is where a group (of mainly women) gets a collective loan and repays the loan together each week).

186. *See* Pouchous, *supra* note 7, at 4.

187. *See id.*; *see also* Madeleine Morris, ‘India’s Microfinance Meltdown’ for *BBC Newsnight*, YOUTUBE (June 26, 2012), <https://www.youtube.com/watch?v=JzF6thf5GqA>; *see also* COOPERATIVA, *supra* note 62.

188. *See* Pouchous, *supra* note 7, at 10.

189. *Id.* at 4.

190. *See id.* at 11.

191. *See id.* at 4, 11 (citing Brigit Helms & Xavier Reille, *Interest Rate Ceilings and Microfinance: The Story So Far*, CGAP OCCASIONAL PAPER 9, (Sept. 2004)) (suggesting that most

However, this argument is flawed. Excessive interest rates do not align with the social mission of microfinance, especially when considering their effects on extremely poor and marginalized communities, who are forced to pay rates of 100% or higher.¹⁹² Surprisingly, these excessive rates are “applied by highly profitable and stock exchange listed institutions.”¹⁹³ Additionally, arguing that these institutions have higher operational costs than conventional banks is unfounded. Even if that is the case, this is not a severe enough burden to justify the current extreme interest rates. Part of operating a business is finding innovative ways to lessen operational and overhead costs, all while promoting and improving efficiency. Likewise, the additional burdens faced by microfinance institutions, such as operating in remote areas, processing large numbers of small loans manually, and being located in regions with socioeconomic and political risks, are not enough to justify interest rates as high as 195%. Microfinance institutions should be required to disclose their lending terms and the costs associated with borrowing, as it promotes truth-in-lending. Furthermore, the main actors advocating against interest rate caps are the ones profiting from such abusive interest rates.¹⁹⁴ As such, it is not in the self-interest of the microfinance institution to promote economic policies that favor the consumer—here, poor, disenfranchised, and marginalized groups.

C. NEW PROVIDERS AND CREDIT DELIVERY MECHANISMS

The rise of electronic money institutions and mobile banking present special consumer-related concerns in microfinance. First and foremost, mobile banking affects borrowers like *Pedrito*, who often lack the basic technological skills and financial familiarity to understand how to use mobile banking.¹⁹⁵ Moreover, there have been issues with “addiction” to mobile banking.¹⁹⁶ These issues result when access leads to over-indebtedness, loss of social ties between the borrower and the creditor, loss of group cohesion in group lending programs, and data privacy issues.¹⁹⁷ That there are no regulations addressing electronic money and electronic money institutions in Latin America, much less regulations specific to microfinance, is not surprising when industrialized countries are just now beginning to regulate these new forms of banking.¹⁹⁸

regulators believe in interest rate caps and that the “biggest danger, in their view, is that policy-makers will not be able to set an interest rate cap high enough to permit the development of sustainable microcredit, which in turn would jeopardize financial inclusion services to the poor”).

192. See SINCLAIR, *supra* note 1, at 6.

193. Pouchous, *supra* note 7, at 11–12.

194. *See id.* at 4, 11.

195. *See id.* at 5.

196. *See id.*

197. *See id.*

198. *See generally id.*

D. RECENT FINANCIAL CRISIS CONSIDERATIONS

Legal frameworks have to take into consideration microfinance institutions' ties to international financial markets (particularly those that have now become publicly traded institutions) that are vulnerable to turbulence in the global financial market.¹⁹⁹ For example, a number of microfinance institutions were devastated by the 2008 financial crisis due to the increased dependency on international markets for funding.²⁰⁰ To mitigate the risks associated with microfinance institutions receiving large amounts of funding from international markets, there should be increased PRs and supervision. Such regulations should focus on institutional refinancing risk and foreign currency dislocations.²⁰¹

With respect to supervision in microfinance, the main concerns for these major institutions are the inadequacy of standard supervisory tools, the costs of supervision, and the non-financial costs linked to both regulation and supervision.²⁰² However, in some microfinance institutions, such as greenfields and upscales, these concerns about increased operational cost are inherently flawed. For example, consider salary costs: ACCIÓN²⁰³ director Maria Otero earned \$2 million USD; the average salary of a Chief Executive Officer in the industry is \$276,000 USD and the average bonus is \$255,400 USD.²⁰⁴ After taking into account the industry averages and bonuses, it would seem there is room to account for increased overhead costs without hurting the borrower, especially when the aim of microfinance is to benefit the poor.

E. FRAUD AND FINANCIAL CRIMES PREVENTION

Turning to anti-fraud and financial crime regulation, it is imperative to ask “who should be held financially or criminally liable, the institution or the individual?” Fraud “is a willful act by [a] person internal or external to the institution . . . [i]t can be distortion of financial statements or other records [or] stealing of cash or other property.”²⁰⁵ Fraud in microfinance stems from

199. *See id.* at 5.

200. *See id.* (stating that institutions in many Latin American countries, especially Nicaragua, Peru and Bolivia, were hard hit by the 2008 financial crisis).

201. *See id.*

202. *See id.* at 12.

203. ACCIÓN is a greenfield, large microfinance institution that operates heavily in Latin America.

204. *See Company Overview of Compartamos Financiera S.A.*, BLOOMBERG, <http://www.bloomberg.com/research/sTocks/private/people.asp?privcapId=117471046> (last visited Sept. 28, 2017); *see also* Hugh Sinclair, *Generous or Excessive Salaries at Accion?*, MICROFINANCE TRANSPARENCY BLOG (Oct. 10, 2014), <http://blog.microfinancetransparency.com>; *see also* Pouchous, *supra* note 7, at 3 (citing to Greg Chen, Stephen Rasmussen, & Xavier Reille, *Growth and Vulnerabilities in Microfinance*, CGAP FOCUS NOTE 61, 1 (2010)) (discussing the return on investment to range from 15–30%).

205. Alok Kumar & Alimamy Conteh, *Common Frauds in Micro Finance Institutions*, 1 INT'L J. OF ADVANCED RURAL MGMT. 11 (2015).

several problem areas: weak corporate governance; poor accounting practices, procedures, and policies; lack of client due diligence; weak internal control systems, policies, and procedures; slow and circuitous judicial processes; and fears of negative publicity.²⁰⁶ It is generally accepted that microfinance institutions should be subject to increased PRs as traditional financial institutions are,²⁰⁷ yet many PRs have not been implemented.²⁰⁸

V. SOLUTIONS TO THE DEREGULATED MICROFINANCE MARKET AND THEIR LEGALITY

A. THE LATIN AMERICAN MICROFINANCE ASSOCIATION

The region should create a Latin American Microfinance Association (LAMA) to implement and monitor the model rules suggested in the TMR Guidelines. The goals of LAMA would be to protect micro-borrowers and maintain a fair market through the transparency and facilitation of microenterprise. The current regional associations, like the Latin American Free Trade Association and the Mercado Común del Sur, are not efficient because they focus on trade and creating a common market.²⁰⁹ Regional oversight of microfinance institutions is especially important because a large amount of microfinance institutions are multinational organizations. Such oversight would allow for clearer and streamlined implementation of regulations.

With the 2008 financial crisis in mind, LAMA would require quarterly and yearly reporting of microfinance institutions to oversee profit margins and lending terms. The reporting requirements would mirror those of the United States Securities and Exchange Commission's 10-Q and 10-K forms for publicly held companies, except that LAMA would require reporting from all microfinance institutions. This is not to suggest that institutions should not profit from microfinance, but instead to place a check on the excessive compensation that microfinance executives receive. These high salaries are earned by charging predatory interest rates that hurt the very people these institutions aim to empower. Such high profit-yielding purposes are more appropriate for the for-profit corporation, rather than a business model geared toward social benefit. It is important to reiterate that the purpose of microfinance is to benefit micro-borrowers, not investors and executive officers.

The proposed model rules, through the TMR Guidelines, would call for increased PRs to develop a more transparent, credible, and successful

206. *See id.* at 12.

207. *See generally* Pouchous, *supra* note 7.

208. *See* Trujillo-Tejada et al., *supra* note 40, at 351–52.

209. *See* ASOCIACIÓN LATINOAMERICANA DE INTEGRACIÓN, <http://www.aladi.org/sitioAladi/quiienesSomos.html> (last visited Sept. 28, 2017).

microfinance system.²¹⁰ Minimum capital requirements²¹¹ would be set at rates that are low enough to promote competition and high enough to allow the funds necessary for incorporation. Capital adequacy requirements²¹² would be higher than those at conventional banks.²¹³ Additionally, shadow banks would be subject to PRs. Many argue that shadow banks²¹⁴ should not be subject to PRs.²¹⁵ However, it is important to recall that shadow banks played a role in the period leading to the financial crisis of 2008—the “conversion of opaque, risky, long-term assets into money-like, short-term liabilities” through shadow banks “masked the amount of risk taking in the system, and the accumulation of tail risk[.]”²¹⁶ which in turn led to a systemic crisis. Thus, model rules would regulate shadow banks. Additionally, the model rules would promote cooperative competition by allowing microfinance institutions in the region to come together and set agreements on prices, restrictions, and general industry norms. These agreements would then be submitted to LAMA and subsequently to regulatory institutions of each country for review.

There are different approaches to protect consumers—first, from a practical standpoint, second, a dispute resolution standpoint, third, an institutional reporting standpoint, fourth, interest rates, and finally, a digital divide standpoint. Regarding practices, the model rules would focus on solving abusive lending and collection practices through LAMA monitoring.²¹⁷ The proposed solution adopts both soft and hard measures to prevent abusive lending and collection practices. The soft measures include developing professional codes of conduct for lenders, creating self-regulatory

210. See generally SINCLAIR, *supra* note 1 (To date, there has been no proof of a direct correlation between poverty reduction and microfinance. In other words, in a period of almost forty years the promise, purpose, and objectives of microfinance have yet to be seen).

211. See Pouchous, *supra* note 7, at 7 (defined as “the lowest amount of currency that investors can bring to the equity base of a financial institution seeking a banking license”).

212. See *id.* (“This ratio refers to the minimum amount of capital a financial institution should hold to avoid solvency problems.”).

213. See *id.* at 8 (stating several reasons: (1) “MFIs’ portfolios tend to be more volatile than those of commercial banks, and, accordingly, can deteriorate with surprising speed.” Additionally, “MFIs’ portfolios are usually unsecured or secured by limited—and often illiquid—assets.” (2) “[N]on-repayment events in MFIs tend to be more contagious than in a commercial bank . . . [if] a micro-borrower sees that other clients are not paying back their loans, his/her own incentive continues to decline rapidly.” Consider, for example, Bolivia, Guatemala and Nicaragua during the 1997–2000 downturns. (3) “[O]perational risks in microfinance tend to be particularly high.”).

214. See FED. RES. BANK OF N.Y., STAFF REP. NO. 559, SHADOW BANKING REGULATION 1 (2012), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr559.pdf [hereinafter SHADOW BANKING REGULATION] (These institutions resemble banks as financial intermediaries but cannot legally accept deposits. “Shadow banks contributed to the credit boom in the early 2000s and collapsed during the financial crisis of 2007–09. . . . The shadow banking system is a web of specialized financial institutions that channel funding from savers to investors through a range of securitization and secured funding techniques.”).

215. See Pouchous, *supra* note 7, at 7.

216. See SHADOW BANKING REGULATION, *supra* note 214, at 1.

217. See Pouchous, *supra* note 7, at 9.

organizations that promote responsible lending, and creating a forum to lodge complaints against lenders.²¹⁸ Regarding dispute resolution, each country would need to create a mobile forum—to lodge complaints—that can move throughout the rural areas of each country. Regarding reporting, it is important to create credit bureaus that have access to common databases with information on borrowers and their paying habits.²¹⁹ Hard measures such as strict reporting requirements and increased frequency in reporting should also be implemented. Regarding rates, the model rules propose interest rate caps, and LAMA would oversee institutional adherence. Not only are excessive interest rates not in line with the inherent purpose of microfinance—to provide a way for the poor to escape poverty—they also hamper the ability of the extremely poor and marginalized from ever removing themselves from their existing socioeconomic positions. Regarding the digital divide, while keeping the growing role of technology in mind, the model rules would propose a regulatory mechanism for mobile banking that is modeled after the European Union’s E-Money Directive, which regulates electronic money institutions and their services through PRs.²²⁰

LAMA would also ensure that the model rules address two concerns associated with fraud and financial crimes: (1) securities and abusive investment arrangements, and (2) money laundering and insider lending.²²¹ The model rules deal with money laundering and insider lending²²² by restricting the amount of insider loans to a certain percentage of capital²²³ and putting in place supplemental precautionary measures like increased monitoring by third parties within the organization to increase the level of accountability.²²⁴ Additionally, both the employee and the institution, pursuant to a balancing test,²²⁵ will be subject to civil and possibly criminal

218. *See id.* at 10.

219. *See id.*

220. *See* Council Directive 2009/110, 2009 O.J. (L 267) 7, tit. 1, art. 2, para. 1–2. (“[E]lectronic money institution’ means a legal person that has been granted authori[z]ation . . . to issue electronic money ‘[E]lectronic money’ means electronically [and] magnetically . . . stored monetary value . . . which is issued on receipt of funds for the purpose of making payment transactions . . . and which is accepted by a natural or legal person other than the electronic money issuer.”).

221. *See* STASCHEN, *supra* note 9, at 29 (“Insider loans are ‘loans made to a person who is in a position of influence within the lending institution, or to someone else connected with such a person.’”).

222. *See id.* at 29 (suggesting that insider lending entails issues that go beyond conflicts of interest, the loan conditions “are much more favo[r]able than for external loans, in other cases it is simply much easier for borrowers to have their loans rescheduled or even forgiven”).

223. *See id.* at 30.

224. *See generally id.* at 34 (Author discusses how credit bureaus in Bolivia have experienced a high level of accountability in business management and consumer protection after reporting to third parties. This Note suggests that such a positive outcome can be possible in other behavioral aspects of microfinance institutions.).

225. The balancing test should include concepts and factors such as *respondeat superior*—who handled the loan, what position they held, the type of crime committed, and the senior management’s level of involvement, to name a few.

sanctions in an effort to ensure that institutions are protecting against fraud and financial crimes. The model rules would also incorporate other recommendations from CGAP, outside of the TMR Guidelines, such as banning insider lending in the form of loans to employees.²²⁶ Although not included in the TMR Guidelines, the model rules would also suggest regulations that require internal control mechanisms and independent audits.²²⁷

B. LEGALITY OF LAMA

The creation of a regional body such as LAMA is dependent upon its constitutionality in each member country. As noted above, the governments of Bolivia, Brazil, the Dominican Republic, Nicaragua, and most of Latin America believe in positive human rights. As such, considering the constitutional articles that promote economic and social welfare, and the above-listed principles promoting integration in the region, LAMA is not only legal, but its function and purpose are in line with the spirit of these constitutions. This section highlights the articles of the respective constitutions that support the creation of LAMA.

In Bolivia, Article 255 sets out the guiding principles behind becoming signatories to agreements such as LAMA. Among those principles is the imperative of providing access to basic services for wellbeing and development.²²⁸ Moreover, the government commits to promote economic integration with Latin American countries.²²⁹ Being that microfinance is a tool for socioeconomic development that provides the poor with access to the formal sector of the economy through microloans for business start-ups, LAMA would pose no legal concerns.

In Brazil, Article 4 sets forth the governing principles surrounding international agreements and states that Brazil should seek the economic integration of Latin America.²³⁰ While LAMA caters to microfinance rather than trade, it would still promote economic integration in the region through the coordination of monetary and fiscal policies. The operational aspects of LAMA are also feasible as Article 32 allows for providing technical and economic assistance, as well as facilitating cooperation and research in implementing international agreements like LAMA.²³¹

In the Dominican Republic, the aim behind the creation of LAMA falls squarely within Article 26 of the Constitution. Here, the Dominican

226. See CGAP, A GUIDE TO REGULATION AND SUPERVISION OF MICROFINANCE CONSENSUS GUIDELINES 32 (2012), https://www.cgap.org/sites/default/files/Consensus-Guideline-A-Guide-to-Regulation-and-Supervision-of-Microfinance-Oct-2012_0.pdf.

227. See Kumar & Conteh, *supra* note 205, at 15.

228. See CONSTITUCIÓN NACIONAL [CONST. NAC.] [CONSTITUTION] art. 255 (Bol.).

229. See *id.* at art. 265.

230. See CONSTITUIÇÃO FEDERAL [C.F.] [CONSTITUTION] art. 4 (Braz.).

231. See *id.* at art. 32.

Republic: (1) commits to acting on international, regional, and national levels for economic development; (2) promotes and favors integration with other nations of the Americas to defend the interest of the region; (3) enters into international treaties to promote development, and ensure welfare and collective security, as well as delegates necessary powers to supranational organizations to take part in the integration process; and (4) favors economic solidarity among the Americas.²³² LAMA would be a supranational organization that increases economic development in the region by fostering and encouraging both upward mobility from extreme poverty to the middle class and entry into the formal economic sector. Additionally, LAMA would ensure that multinational microfinance institutions are regulated in accordance with Latin America's best interest, rather than the interests of foreign shareholders.

In Nicaragua, Article 9 favors unity in the Latin American region and encourages the creation of bodies, like LAMA, necessary to achieve those goals.²³³ Moreover, the Constitution states that the creation of such organizations shall be put into effect by legislation and treaties.²³⁴

CONCLUSION

Since many of the large microfinance institutions operate in many countries of Latin America, a regional approach to address problems within the microfinance industry and enforce regulations should be created. Countries like Bolivia, Brazil, the Dominican Republic, and Nicaragua can become signatories; LAMA can develop regional benchmarks and model rules, and oversee their implementation in each country to create a more uniform and balanced system of microfinance. Most of the existing regulations are ambiguous and do not adequately address the issues specific to microfinance.

As demonstrated by *Pedrito*, microfinance has proved to be more of a problem than a solution. *Pedrito's* situation is a representation of many peoples' financial circumstances, wherein microfinance has failed to bridge the economic gap between the rich and poor. If microfinance institutions continue to function in their present form, they run the risk of causing more harm than good and betraying their original goals and purpose. However, through proper regulation and supervision, microfinance can be a positive critical component for economic growth in Latin America.

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232. See CONSTITUCIÓN NACIONAL [CONST. NAC.] [CONSTITUTION] art. 26 (Dom. Rep.).

233. See CONSTITUCIÓN POLÍTICA DE LA REPÚBLICA DE NICARAGUA [CN.] tit. II, art. 9, LA GACETA, DIARIO OFICIAL [L.G.] 9 January 1987.

234. See *id.*

* B.A., Florida International University, 2012; J.D., Brooklyn Law School, 2017. This work is dedicated to those who have always inspired me to work hard and follow my dreams: my parents, Bélgica Collado and Asdrúbal Cabral; my husband, Juan Domingo Moreno; my

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