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Microfinance Regulation: Interest Rate Caps and Concept of Usury

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IR Rates Regulation and Microfinance

Final Draft

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I. Between Scylla and Charybdis: The balancing act of lending to the poor (Abstract)

Over the past two decades, microfinance has grown rapidly, reaching markets around the world and garnering the attention of policy makers and the media. Microfinance is the practice of offering small-scale banking services to communities in developing nations to improve the client's productivity and quality of life. The microfinance industry has attracted investors and practitioners who wish to unlock the profit potential of new markets while also achieving a philanthropic goal. As microfinance has grown, however, so has the need for legal regulation. Experts and practitioners agree that developing prudential and non-prudential legal frameworks for microfinance institutions is essential for continued growth; however, they are also well aware that hasty or heavy-handed government regulation in a particular country will put microfinance institutions out of business.

In this paper, we examine a regulatory dilemma that has been especially challenging for microfinance institutions. Microfinance practitioners in developing markets make tiny loans to their clients and recoup the cost of administering those loans by sometimes charging above-market interest rates. While it is far safer for an impoverished client to borrow from a carefully operated microfinance bank than a local moneylender, policy makers in developing nations are concerned about the issue of usury and have sought to enforce mandatory caps on microfinance interest rates as a safeguard. We start out by examining the concept of usury as it affects public perceptions and legal responses. We then examine the possible effects of interest caps on the growth of microfinance by comparing the regulatory dilemmas in Uganda and Ecuador, two nations where microfinance has flourished.

The comparison of Uganda and Ecuador yields interesting results about the realities of developing practical lending regulations and the role that lawyers will play in the future of microfinance regulation. In general, while we believe inflexible interest rate ceilings are inappropriate for the microfinance industry, microfinance institutions need to be proactive to

assure local governments that their citizens are protected, and no one-size-fits-all framework is the answer. Microfinance lawyers and practitioners must 1.) work with a nation's policy makers and banking institutions to draft nuanced legislation; 2.) develop umbrella associations to organize microfinance banks and enforce non-prudential regulations; and, 3.) recognize the role of cultural norms and recent history in determining the goals of both microfinance clients and government regulators.

a. MFIs is the media

Ever since the 1980s, when Dr. Muhammad Yunus pioneered the community-based lending scheme that was to become the Grameen Bank in Bangladesh,[1] microfinance institutions ("MFIs")[2] and the concepts that surround them have starred in the mainstream media, reflecting two remarkably divergent poles of public sentiment.[3]

Take, for example, *The New York Times's* black and white portrayal of microfinance lending in the week of August 23, 2009, as a snapshot of the established bi-polar trend. In an article by Nicholas Kristof and Sheryl WuDunn, "The Women's Crusade,"[4] an impoverished mother in Pakistan who is trapped in an abusive marriage takes out a $65 loan as part of a group lending program administered by an MFI.[5] The woman[6] uses the loan to buy beads and fabric, which she can then use to create elaborate embroidery to sell to merchants in the

[1] Ledgerwood, Joanna, *Microfinance Handbook: An Institutional and Financial Perspective* 2 (The World Bank 1999).
[2] MFIs can be nongovernmental organizations ("NGOs"), savings and loan cooperatives, credit unions, government banks, commercial banks or nonbank financial institutions. Ledgerwood, *supra*, n. 1, 1-2.
[3] *See* Rashmir Dyal-Chand, "Reflection in a Distant Mirror: Why the West Has Misperceived the Grameen Bank's Vision of Micro-Credit," 41 Stan. J. Int'l L. 217, 218 (Summer 2005) (Western media is fascinated with the Grameen Bank model but fundamentally misunderstands it because its practices are not similar to Western lending goals).
[4]Nicholas Kristoff and Sheryl WuDunn, "The Women's Crusade," *The New York Times Magazine - http://www.nytimes.com/2009/08/23/magazine/23Women-t.html?scp=3&sq=microfinance&st=cse#*
[5] *Supra,* n. 4.
[6] The Grameen Bank and many other MFIs attract and target women as borrowers, almost exclusively, because women have often been left out of economic activities in developing nations and may be more likely to spend profits on the household. Microfinance in some respects is all about banking for poor women. Tazul Islam, *Microcredit and Poverty Alleviation* 11-12 (Ashgate Publishing Co. 2007).

city.[7] With the money she earns, the woman is able to pay off her husband's debts, educate her daughters, renovate her house, employ her neighbors, pull herself out poverty, and continue borrowing.[8] It is no wonder that this simple story, with its dark beginning, courageous turning point, and free market dénouement, has been sewn up and oft repeated by a media that is desperate to roll out an algorithm for ending world poverty that may appeal to both liberals and conservatives.[9] Since Dr. Yunus won the Novel Peace prize in 2006,[10] *The New York Times* and *Wall Street Journal* alone have published a combined number of approximately 60 articles lauding microfinance and characterizing its individual and institutional participants as if they are pursuing something almost holy.[11]

The Times's other portrayal of microfinance from the week of August 28, 2009, typifies the opposite pole of public opinion that has evolved alongside the view of microfinance as a cure-all. In "Some Fear Profit Motive to Trump Poverty Efforts in Microfinance," French entrepreneur Jacque Attali's PlaNet Finance project, which is an umbrella organization for MFIs with Dr. Yunus on its board, is described as an illustration of "just how microfinance has become big business."[12] The article explains that an industry that has become highly liquid from selling investors a "double bottom line" of social responsibility and profitable returns may be creating a dangerous bubble, and "[t]here are also persistent questions about debt

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[7] *Supra,* n. 4.
[8] *Supra,* n. 4.
[9] Proponents of the idea that free markets make free people can embrace the idea that big-government entitlements are unnecessary when investors can spawn cottage industry entrepreneurship in developing nations, while library shelves full of liberal academics have been wooed by community-based, grass roots models of collective borrowing that heal communities and encourage investors to consider philanthropy as a profitable enterprise.
[10] Muhammad Yunus, *How Legal Steps Can Help Pave the Way to Ending Poverty,* 35-WTR Hum Rts. 22 fn. 1 (Winter 2008)
[11] http://query.nytimes.com/search/query?query=microfinance;
[12] Matthew Saltmarsh and Cat Contiguglia, "Some Fear Profit Motives to Trump Poverty Effort in Microfinance," The New York Times (August 28, 2009) (The article also points out that while Mr. Attalia favors an international treaty to regulate microfinance, others feel the industry is best left to regulate itself).

burdens and regulations."[13] The article also quotes Yale economist Dan Karlan, alleging that microfinance has not, thus far, lived up to the hype.[14] Indeed, questions about regulating microfinance to protect consumers and the veracity of claims made by microfinance proponents have persisted for decades, and since 2006 both *The New York Times* and *Wall Street Journal* have published approximately 30 articles aiming in some form or fashion to sound the alarm on the for-profit motives and potential abuses associated with the microfinance boom.[15]

b. interest rates and vulnerable lenders

This darker view of microfinance is most likely attributable to the public's intuitive realization of moral hazard, cross-cultural dislike of the concept of usury, and also a number of real cases of MFI misfeasance. First, as Beatriz Armendariz de Aghion and Jonathan Murdoch explain in *The Economics of Microfinance,* when there is little or no information available about prospective borrowers, the risk of moral hazard arising from offering money to those borrowers is high when the extra money may change behavior for the worse or simply motivate borrowers to abscond.[16] In addition, throughout the world, luring in the poor with high interest loans is well known and frowned upon as usury, and, in the media, it is hard to distinguish the simplified, fairytale version of the microfinance process from the concept of usury, especially when some MFIs have indeed garnered negative attention with poor practices. For example, in 2008, Mexican microfinance bank Compartamos went public, selling off $468 million in shares, but it kept its interest rates high, some as high 100-percent, even though its costs were falling.[17] In 2007, the reputation of MFIs in Uganda "took a turn for the worse" when savings and co-operative credit organizations ("SACCOs") where accused of

[13] *Supra,* note 12.
[14] *Supra,* note 12.
[15] http://query.nytimes.com/search/query?query=microfinance; *See, e.g.*, Elizabeth Malkin, "Lenders to the Poor Adopt Guidelines," The New York Times (September 25, 2008).
[16] Beatriz Armendariz and Jonathan Morduch, *The Economics of Microfinance* 7 (MIT Press 2005).
[17] *Supra,* note 15.

widespread fraud, prompting a government crackdown and new regulation.[18] In Nigeria, the Central Bank reported in August of 2009 that continued theft of deposits and donations by unlicensed MFIs is posing a threat to the nation's entire banking system,[19] but, by contrast, in Ecuador, a country where microfinancing seems to have flourished, the prospect of increased government regulation to address consumer protection issues may threaten the entire industry. [20]

How can potential investors, microfinance entrepreneurs, and the public reconcile the extreme polarity of the way microfinance is portrayed? For many, this question presents an academic wonderland. In a post-recession America, questions of dangerous investment bubbles, consumer protection, debt burdens, and whether to increase regulation on lending may sound rather familiar and daunting. However, while Western leaders have confronted the complexity of the credit crisis with a politically cautious "wait and see" approach,[21] microfinance experts and economists have, for years, been churning out answers for developing nations. The answer is this: the very same fledgling governments who are failing to provide their citizens with basic services and human rights need to deploy comprehensive and carefully nuanced arrays of micro-banking regulations that will interact with "credit technologies"[22] adopted by MFIs to fit the cultural, social and economic needs of indigenous populations. Once this happens, it would seem Western investment and local reform can

[18] Amy Rennison, "NEWS WIRE: Uganda: Microfinance Minister Cites Savings as Poverty Solution," http://www.microcapital.org/microcapital-story-the-probity-of-microfinance-firms-in-uganda-takes-another-downward-turn-with-a-savings-and-co-operative-credit-organisation-sacco-suspended-and-shut-down/ (Oct. 25, 2007).
[19] "CBN Discovers Five Fake MFBs in Lagos, Osun," (Sept. 15, 2009) http://allafrica.com/stories/200909150311.html
[20] Pedro Arriola Bonjour, "Make or Break Scenario: the Regulatory Pespective Ecuadorian Scenario" (July 1 2008) https://www.microfinanceinsights.com/articles_new.asp?member=&id=125
[21] Alex Berenson, "A Year Later, Little Change on Wall Street," New York Times (Sept. 11, 2009) http://www.nytimes.com/2009/09/12/business/12change.html?scp=7&sq=credit%20crisis%20regulation&st=cse
[22] Craig F. Churchill, *Client-Focused Lending: the Art of Individual Lending* 3 (Calmeadow 1999) (an in-depth description of financial products for low-income borrowers).

continue unabated. However, while academics may very well have mapped out the future of microfinance and contributed beneficially to lending methodology, U.S and European microfinance investors, scholars and practitioners need to unite over the question of taking personal, institutional, and international responsibility for lending to poor of other nations. The idea of a loan officer maintaining prolonged interaction with a debtor may sound absurd to a U.S. citizen with an easily portable credit history, but in order to avoid the imputation of paternalism, or worse, profit-motivated colonialism, this is what is necessary for a lending regime that calls itself charitable.

In this article, we argue that before microfinance can be considered an option for a community in a developing nation, the international and local MFI community must confront moral, and then legal, issues regarding how much interest to charge needy individuals. When a group or individual has little or no credit history, determining the appropriate amount of "rent"[23] to charge for money encompasses many risk-assessment factors – the nature of collateral, the availability of client information, the stability of the region – and the enduring legal issue of usury must be resolved in the context of real human need and the rights of individuals and communities to maintain a level of autonomy. Microfinance was created, in part, to shield poor households from the high interest rates charged by informal moneylenders; however, insuring that interest rates can be reduced is a complex issue "given the micro nature of the service and loans transacted."[24] The issue of controlling interest rates cannot be resolved by simply taking a survey of local MFIs and their potential lending markets and setting government-enforced interest rate ceilings[25] because if that type of information

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[23] Dickman v. Commissioner, 465 U.S. 330, 337 (1984) (Court characterizes interest on a loan as similar to rent paid for the use of a piece of property).
[24] *Rennison*, supra, note 18.
[25] Megan Whittaker, *South Africa's National Credit Act: A Possible Model for the Proper Role of Interest Rate Ceilings for Microfinance,* 28 Nw. J. Int'l L. & Bus. 561, 580-81 (Spring 2008) (South Africa's National Credit Act of 2005 would try to strike a balance between predatory lending and harsh usury laws by allowing a trade minister to set interest ceilings based on market data).

was already available and reliable, traditional domestic lending institutions would be reaching customers. Interest rate caps are almost certainly not the answer because microfinance loan portfolios are costly to manage and the loan cycles are often shorter. [26]However, the idea that is often argued in articles appearing from the Consultative Group to Assist the Poorest ("CGAP") that mircofinancing for the very neediest customers ought to be micro *savings* rather than micro *credit* ignores the acute time value of money for people who may live at or near a subsistence level of income.[27] How do you solve the problem of interest rates without falling into the trap of a one-size-fits-all interest rate cap scheme that may eliminate entire markets or, alternatively, letting unregulated lending methodology give MFIs a bad names? Even more presciently, how do you balance the cost of money and the need for sustainability against the duty that arises when debtor-creditor relationship has, as its basis, a charitable purpose?

In order to offer a possible resolution for the moral and practical impasse of regulating interest rates for MFIs, we have chosen to look at the regulatory developments in Ecuador and Uganda, two countries where MFIs have been widely successful and where lawmakers and MFIs are actively engaged in a regulatory debate.[28] Before understanding the recent developments in these nations, it is necessary to have some background on the development of the MFI and the increasing demand for legal practitioners.

c. Microfinance and the possible role of lawyers

[26] Ian Davis, *Rural Banking: Designing an Effective Legal Framework in Microfinance*, 2 J. Bus. Entrepreneurship & L. 394, 417 (Spring 2009) (Article proposes that interest rate caps are not feasible for MFIs, which is why Bangladesh's 2006 regulatory act left them out.)

[27] *Supra,* note 16, p. 291, fn. 21.

[28] *See* Joanna Ledgerwood and Victoria White, *Transforming Microfinance Institutions: Providing Full Financial Services to the Poor* 443-57 (World Bank 2006) (providing an overview of microfinance development and public policy in Uganda); John H. Magill and Richard L. Meyer, *Microenterprises and Microfinance in Ecuador* XXII-XXV (United States Agency for International Development 2005) (detailed summary of 2004 survey) http://www.microfinancegateway.org/p/site/m//template.rc/1.9.27059.

"Conventional banking serves clients with assets, business records and plans, and credit histories, who can provide sufficient information that they are low-risk."[29] When conventional banks are lending to either corporations or small businesses, the loan is guaranteed by the company's assets, which allows the bank to further reduce risk and use the legal system to enforce contracts, and because clients who can offer collateral are desirable for banks, interest rates are determined in part by competition among financial institutions.[30] Why is conventional banking not appropriate for small or *micro* entrepreneurs who lack assets, credit histories, legal documentation and who do not need large loans?[31]

It would seem, as a matter of common sense, that conventional banks could offer smaller loans to borrowers with fewer assets and receive *increasing* marginal returns because an entrepreneur with little capital might be able to make larger percentage gains with a loan than a well-capitalized entrepreneur who has already fully occupied a niche in the market; however, due to the effects of poverty and the mindset of conventional banks, this is not so.[32] It is unreasonable for micro entrepreneurs to collateralize the assets they have, and while conventional banks may be able to factor risk into setting interest rates, the process of "adverse selection," or *determining* the level of risk associated with a low-income borrowers, is costly to banking institutions that do not specialize in gathering information or even communicating at all with borrowers.[33]

In addition, the proceeds of microfinance loans are sometimes used by borrowers in a non-traditional manner because in the context of low-income households the money is considered necessarily fungible.[34] For example, while Dr. Yunus describes the effectiveness of

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[29] *Supra,* note 22, p. 6.
[30] *Supra,* note 22, p. 7.
[31] *Supra*, note 22, p. 8.
[32]*Supra*, note 16, p. 4
[33] *Supra,* note 16, p. 7.
[34] Interview with Reuben Summerlin, Microfinance Advisor, in Chattanooga, Tenn. (Mr. Summerlin has worked in microfinance for 12 years and is a co-founder of Alternative Credit Technologies, LLC, a

lending a small amount of money to a woman who builds stools out of bamboo at her house so that she can purchase more bamboo without getting exploited by the local money lender, it may be equally effective for this entrepreneur's business to use the money for basic home repairs, medical expenses or food in order to keep a home based business productive.[35] Churchill concurs with this observation, describing the "fungibility of money" problem as the tendency of borrowers to use the loan for varied business opportunities or "for more pressing non-business financial needs."[36] Rather than verifying loan usage, microfinance loan officers might address this problem by relying solely on a borrower's character to determine whether the debt will be repaid.[37] This methodology is normally not employed in a traditional banking scenario. Dr. Yunus likes the idea of using microfinance loans to promote many varieties individual and home-based businesses,[38] and commercial banks may not have a heuristic to assess these types of clients.

The next question is: why don't governments, who already have some assumed level of fiscal duty to the poor, provide capital for banks who lend to the poor? "Subsidized credit" has been a disaster for developing nations because not only does the problem of adverse selection increase moral hazard and cause repayment rates to drop below sustainable levels, there is also a political tendency to direct subsidized credit at favored industries that may not be reasonable for some borrowers.[39] In addition, many impoverished borrowers would prefer not to darken the door of a state bank, choosing instead to borrow from a local moneylender who has more information and ties to the community, albeit fewer resources.[40]

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consulting firm specializing in providing management consulting services to the field of microfinance and microenterprise development.) (Nov. 6, 2009).

[35] Muhammad Yunus, *Creating a World without Poverty 46-47 (*The Nobel Foundation 2007).

[36] Craig F. Churchill, *Client-Focused Lending 54* (Calmeadow 1994).

[37] *Churchill*, supra, note 22, p. 55.

[38] *Yunus,* supra, note 35, p. 54-55.

[39] *Supra,* note 16, p. 9.

[40] *Supra,* note 16, p.8.

The goal of microfinance, originally termed microcredit, was to combine the local moneylender's ability to gather information with an outside institution's resources. Dr. Yunus's Grameen Bank ("GB") addresses the goal by "issu[ing] loans using very simple trust-based financial arrangements"; no legal documents are involved because many of GB's borrowers have no collateral. [41] Or, as Craig Churchill puts it, collateral is used only as a "symbol" of the client's commitment to make clients feel ashamed if they do not repay their debts.[42] According to Dr. Yunus, GB has about 7.5 million borrowers in Bangladesh, and has loaned approximately $7 billion since its inception, with an average loan size of about $150.[43] Thanks to the innovations of the GB, microfinance has become a highly regarded anti-poverty mechanism around the world to the point where the United Nations has declared that implementing microfinancing strategies would cut world poverty in half by 2015.[44]

Dr. Yunus proudly declares that the GB does not rely on courts or lawyers to manage its operation;[45] however, as noted above, as the world has embraced microfinance, the need for legal regulation has been increasingly apparent. For one thing, as law professor Rashmir Dyal-Chand points out, though the West has praised the GB model, it has not necessarily understood it. The GB cannot truly claim success along the purely capitalist lines of proliferating micro entrepreneurs, and its trust-based lending system does not work in the absence of highly disciplined loan officers.[46] This latter point is perhaps the most important for understanding the need for legal regulation. Unlike conventional loans, the transactional costs – the cost of funds, risk and administration - associated with micro loans are high when MFI employees must court donors, harvest information, and work with borrowers.[47] These

[41] *Supra,* note 10, p. 22.
[42] *Supra,* note 22, p. 29.
[43] *Supra,* note 10, p. 22
[44] *Whittaker, supra,* note 26, p. 563.
[45] *Supra,* note 10, p. 22
[46] Dyal-Chand, *Supra,* note 3, p. 241.
[47] *Supra,* note 26, p. 564.

transactional costs can cause interest rates to skyrocket, which, in turn, may draw the ire of lawmakers or motivate MFIs to fly under the radar to avoid banking laws. This is where lawyers enter the picture.

Dr. Yunus admits that the future of microfinance may depend on the legal profession: "The needs are universal, but laws differ among countries, so perhaps lawyers can form groups in each country to develop or revise laws that ultimately help the poor to help themselves."[48] Dr. Yunus takes a broad view of what lawyers can do, suggesting that the needs of borrowers are best met when lawyers focus on broadening welfare and healthcare programs for the poor and simplifying lending laws for low-income borrowers.[49] By slight contrast, Prof. Dyal-Chiand argues that the rule of law itself presents a strategy for development for lawyers and practitioners who are "responsible both for crafting and teaching the rules of participation to low-income individuals in microcredit programs and for enforcing the rights and responsibilities of the participants."[50] Prof. Dyal-Chiand wants to see the rule of law play a pedagogical role but also guarantee that lending institutions structure their practices to inculcate indigenous values and not simply reflect Western goals.[51] Prof. Deborah Burand describes a broad array of roles that lawyers need to fill in a microfinance context, suggesting that MFIs ought to consider hiring more than one lawyer to meets the needs of their clients and investors.[52] Lawyers must survey the regulatory landscape in each market, manage corporate bylaws and contracts, address labor issues, determine minimal capital requirements, and maintain an institution's reputation as law abiding and accountable to the property authority.[53]

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[48] *Supra,* note 10, p. 23
[49] *Supra*, note 10, p. 23
[50] *Supra*, note 3, p. 223.
[51] *Supra,* note, p. 300.
[52] Deborah Burand, "Legal Transformation," *supra,* note 28, p. 245.
[53] *Supra*, note 28, p. 261-64.

We argue that a microfinance lawyer should take into account all three of these legal profession goals and add to that directive the idea that lawyers should also shoulder individual responsibility for advising lenders about the safeguards necessary for making sustainable underwriting decisions. Ultimately, the question of how to regulate interest rates in a way that both protects consumers while preserving opportunities to promote the productivity of prospective entrepreneurs is one that we have not answered in the West. Specifically, the enduring legal issue of usury, while ever-present in the context of microfinance, has been left largely unaddressed by microfinance practitioners, scholars, and reformers, but in order for MFIs to maintain autonomy and avoid negative press, the microfinance community to needs to wrestle with usury head on.

This remainder of the introduction will briefly discuss the concept of usury and its origins, examine the factors contributing to interest rates, and finally introduce the question of whether governments in developing countries should regulate the maximum amount of interest allowed in loan contracts.

d. The concept of usury

In the United States, the term "usury" typically evokes thoughts of unscrupulous lenders charging criminally high rates of interest. This attitude towards usury is influenced by the fact that most states have several "usury laws" which specify the maximum rate of interest that can be charged on different types of loans. In the United States, loan contracts containing interest rates higher than those allowed by statute can be invalidated by courts.[54] The specific rate caps provided by usury laws in the United States tend to create an association between the concept of usury and a certain interest rate.[55] When thinking about usury in the microfinance context, it is important to consider the development of the usury

[54] 44B Am. Jur. 2d Interest and Usury § 13 (Courts can invalidate loan contracts that contain rates of interest higher than those allowed by statute.)
[55] Example of a state usury law

concept in a historical context before exporting from American state laws the notion that usury is an interest rate in excess of X %.

1. Definition and Origin

The modern word "usury" comes from the Medieval Latin word "usuria," an alteration of the past participle (usus) of the verb "uti", meaning to use.[56] For centuries the term "usury" simply meant "interest," thus any money collected in excess of an original loan amount was considered "usury." The meaning of "usury" has evolved from its archaic definition into the more familiar modern definition, "an unconscionable or exorbitant rate or amount of interest; *specifically***:** interest in excess of a legal rate charged to a borrower for the use of money."[57]

2. Usury in Jewish Law

The practice of usury has been universally condemned by most world religions for thousands of years. Some of the earliest prohibitions on "usury" are found in Jewish Law, where the practice of charging interest is forbidden by the Torah. In the book of Exodus, "If thou lend money to any of My people, even to the poor with thee, thou shalt not be to him as a creditor; neither shall ye lay upon him interest."[58] Similarly, the prophet Ezekiel includes usury[59] along with rape, murder, robbery and idolatry in a list of behaviors that are unlawful.[60] Similarly in the book of Deuteronomy, "Thou shalt not lend upon interest to thy brother: interest of money…interest of any thing that is lent upon interest. Unto a foreigner thou mayest lend upon interest; but unto thy brother thou shalt not lend upon interest; that the LORD thy God may bless thee in all that thou puttest thy hand unto…"[61] While these

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[56] Merriam Webster Online http://www.merriam-webster.com/dictionary/usury
[57] *Id.*
[58] Exodus, 22:25 –*The Holy Scriptures* http://books.google.com/books?id=lVUHn44KXBkC
[59] Ezekiel 18:8
[60] Ezekiel 18:5-9
[61] Deuteronomy, 23:20-21

passages reveal that the charging of interest was generally disfavored in Jewish custom, they also suggest some tolerance for the practice when conducted outside of the community.

3. Usury in Early Christian and Islamic Law

Early Christian and Islamic law also reflect the early Jewish condemnation of the practice of charging interest or usury. The Council of Nicea in 325 A.D. forbade clergy from charging interest. This prohibition was later extended to the laity by future ecumenical councils.[62] While usury was considered a mortal sin and officially prohibited by the Catholic Church, there remained methods of profiting through the extension of credit although these transactions had to be constructed carefully as to respect the basic prohibition on usury.[63] Interest charged on a loan was generally prohibited in the Western Christian world until the 18th century, yet earning interest on the investment of capital (profits) was permitted.[64]

Islamic law echoes this distinction between commerce and lending at interest in the Qur'an, "Those who charge usury are in the same position as those controlled by the devil's influence. This is because they claim that usury is the same as commerce. However, God permits commerce, and prohibits usury. Thus, whoever heeds this commandment from his Lord, and refrains from usury, he may keep his past earnings, and his judgment rests with God. As for those who persist in usury, they incur Hell, wherein they abide forever."[65] Additionally, the Qur'an describes the modern conception of usury ("riba" in Shari'ah or Islamic law) as *excessive interest,* in contrast with its more ancient meaning of simply *any* form of interest,[66] "O you who believe, you shall not take riba, compounded over and over.

[62] Conrad Henry Moehlman, The Christianization of Interest *Church History*, Vol. 3, No. 1 (Mar., 1934), pp. 3-15 Published by: Cambridge University Press on behalf of the American Society of Church History Stable URL: http://www.jstor.org/stable/3161033 - p. 6
[63] Noonan, John T., Jr. 1993."Development of Moral Doctrine." 54 Theological Stud. 662– p. 662
[64] Moehlman, 6
[65] *Al-Baqarah 2:275*
[66] Supra, note 1.

Observe God, that you may succeed.[67] The description of *riba* as interest being compounded "over and over" represents a departure from the original definition of usury in early Jewish law[68] and a shift toward the modern conception of usury as excessive interest. While some of the most conservative clerics still interpret the Qur'an as prohibiting any type of interest, other believe that *riba* refers only to compound interest.[69]

4. The Modern Conception of Usury

The evolution of the word "usury" into its modern conception roughly paralleled an explosion in trade and commerce throughout the Western in the 15th century. The advent of the modern banking system and relaxed moral attitudes towards the practice of charging interest precipitated moral acceptance of interest in the business context. At the same time, the notion that charging excessive interest was antithetical to the laws of God persisted. This was reflected in the enactment of the statute entitled "An Act Against Usury" by the British Parliament in 1545, which capped the rate of allowable interest at ten percent.[70] The statute's use of the word "usury" in reference to interest above the rate of ten percent reflects not only the definitional change of the word "usury", but also a change in attitudes towards the practice of charging interest in the Western world.[71]

Although it became lawful to charge interest up to ten percent in England during the reign of Henry VIII, the moral debate over the practice of charging interest continued.[72] The law permitting interest was repealed in 1555 as part of the conservative religious backlash during the reign of Catholic Queen Mary,[73] but was later reinstated in 1570 under the reign of

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[67] *Al-'Imran 3:130*
[68] *Supra*. note 2.
[69] Dr. Theodore Karasik, & Steven Strom, *Islamic Finance in a Global Context: Opportunities and Challenges* 7 Chi. J. Int'l L. 379 (2007). link
[70] 37 Hen. 8, c. 9 (1545).
[71] Clarkson, The pre-industrial economy in England 1500-1570 p. 167 (1971)
[72] *Id.* at 168.
[73] *Id.* at 168.

Queen Elizabeth.[74] During the 17th century, with the morality of charging interest at a limited rate generally accepted, the debate shifted to what limit was most beneficial.[75] Limits on interest rates persisted until 1854, when England passed the "Usury Laws Repeal Act", effectively removing prohibitions on usury.[76]

5. Usury in American Law

Usury regulation has been a part of United States law from the very beginning. Most usury laws in the American colonies were pattered after the 1713 English Statute of Anne, a statute that set the maximum allowable rate of interest at 5%.[77] In 1866, all States had laws limiting the amount of interest that could be charged, with most capping the rate at 6%.[78] The introduction of usury laws in the United States was intended protect small farmers and businessmen against the onerous burden of high interest rates.[79] However, the capping of rates as low as 6% tended to have an opposite effect in many cases since lenders could not cover their risk and other lending costs at such a low rate of return. This trend forced many out of the legitimate lending business and in effect shrank the amount of available capital. Borrowers were forced to pay much higher rates and deal with the less reputable lenders and in the underground lending markets.[80] While most states have relaxed their usury laws as the economy of the United States has continued to thrive and credit markets have expanded, most states still maintain caps on legal rates of interest and general usury prohibitions.

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[74] 13 Eliz., c. 8 (1570).
[75] See James A. Ackerman, *Monetary Control Law*, 27 Ariz. St. L.J. 61, 82 (1981). link
[76] Usury Laws Repeal Act, 1854, 17 & 18 Vict. c. 90.
[77] Murray, History of Usury p. 50 (1866) http://books.google.com/books?id=hUcuAAAAYAAJ&dq=murray+history+of+usury&client=firefox-a&source=gbs_navlinks_s
[78] Marion Benfield, *Money, Mortgages, and Migrane- The Usury Headache*, 19 Case Western 819, 824 n.28 (1968). Link
[79] *Id*. at 825.
[80] *Id*. at 825.

Notably, Nevada,[81] New Hampshire[82] and South Dakota[83] do not restrict the amount of interest that parties may agree to in written contracts. Interest rate regulation in the United States is an incredibly complex combination of state and federal statutes, riddled with exceptions and special circumstances.[84] With a very brief background in the history of usury and interest rate regulation, we now examine the factors that contribute to the rate of interest charged in developed economies.

e. Interest Rates

1. Factors contributing to interest rates in the developed economies

To better understand the unique factors contributing to the interest rates charged by microfinance institutions, it is helpful to first review the factors involved in the interest rate calculus of highly developed economies. Typically, the rate of interest charged on a loan takes into account several factors, including the cost of funds, risk associated with the loan, administrative costs, competition in the lending market[85] and the rate of inflation. In the United States, banks can borrow from the central bank at a very low interest rate, thus

[81] NRS 99.050 Agreed interest rates; compounding; charges or fees. Except as otherwise provided in section 670 of the John Warner National Defense Authorization Act for Fiscal Year 2007, Public Law 109-364, or any regulation adopted pursuant thereto, parties may agree for the payment of any rate of interest on money due or to become due on any contract, for the compounding of interest if they choose, and for any other charges or fees. The parties shall specify in writing the rate upon which they agree, that interest is to be compounded if so agreed, and any other charges or fees to which they have agreed. [5:34:1861; A 1913, 31; 1919 RL § 2500; NCL § 4323]—(NRS A 1975, 1794; 1979, 583, 963; 1981, 1593; 1983, 976; 1984, 6; 2007, 944, 2850)

[82] N.H. Rev. Stat. Ann. § 399-A:1-19. N.H. Rev. Stat. Ann. Chapter 399-A of : "Regulation of Small Loans, Title Loans, and Payday Loans" does not directly limit the amount of interest that can be charged on a loan but does provide for several consumer protections and disclosure requirements. http://gencourt.state.nh.us/rsa/html/NHTOC/NHTOC-XXXVI-399-A.htm

[83] SD § 54-3-1.1. Rate of interest set by written agreement--No maximum or usury restriction. Unless a maximum interest rate or charge is specifically established elsewhere in the code, there is no maximum interest rate or charge, or usury rate restriction between or among persons, corporations, limited liability companies, estates, fiduciaries, associations, or any other entities if they establish the interest rate or charge by written agreement. A written agreement includes the contract created by § 54-11-9. Source: SL 1982, ch 341, § 1; SL 1987, ch 360, § 4; SL 1994, ch 351, § 147."

[84] Brian M. McCall, *UNPROFITABLE LENDING: MODERN CREDIT REGULATION AND THE LOST THEORY OF USURY*, 30 Cardozo L. Rev. 549, 614 (2008-2009).

[85] Marion Benfield, *Money, Mortgages, and Migrane- The Usury Headache*, 19 Case Western 819, 826 (1968). link

keeping the cost of funds low for the banks.[86] The Fed Funds Target Rate is set every six weeks by the Federal Reserve's Federal Open Market Committee and is published daily. This allows for increased efficiency and competition among banks since customers can easily compare the rates of loans offered by several different banks.[87]

We now turn to an examination of the factors influencing the rate of interest charged in the microfinance context.

2. Factors contributing to interest rates in the microfinance context

While cost of funds, risk, competition, administrative costs, and inflation[88] are all important factors in the determination of interest rates in developed economies, it is important to note some additional factors contributing to the clearing rate of interest in the microfinance context. MFIs typically determine interest rates based factors such as local market rates, type of business, frequency of repayment and the size of the loan.[89] Two of the biggest differences in microfinance lending are the increased risk and the higher administration costs associated with each loan.

a. Higher administration costs

The scale of micro-loans, education requirements for borrowers, and the group lending model all contribute to the increased administrative cost of originating and servicing loans in microfinance. To illustrate the differences between market-clearing interest rates in the United States and those in the microfinance world, it is useful to look at the following example: An entrepreneur in the United States needs a loan of $100,000. If she has a good credit score and a viable business plan, she will likely be able to obtain a loan for a period of six months to one year rather easily. Such a borrower could also compare rates and terms from a number of local banks and choose the most favorable. Apart from some origination

[86] http://www.wsjprimerate.us/
[87] Id.
[88] *Supra*, note 31.
[89] Craig F. Churchill, *Client-Focused Lending: The Art of Individual Lending* (Calmeadow 1999) at 38.

fees, a credit check and some paperwork, entrepreneur could get a loan at a very reasonable interest rate of 6-12%, depending on economic conditions. Such a deal would yield the bank a potential return of nearly $10,000 with minimal administrative costs involved.

On the other hand, micro-loans typically involve very small amounts of capital. Compare the previous situation to a potential scenario in the microfinance context. If a bank were to lend the same $100,000 in $100 increments to 1000 borrowers, many of whom are first-time borrowers with no experience with credit, one can see how the administration costs would increase exponentially. Banks would need an incredible amount of human capital to originate, evaluate risk, monitor, and collect on the 1000 loan portfolio. The risk within the loan portfolio would likely vary wildly and the bank would not be able to rely on traditional methods of risk assessment such as credit checks. Often, MFIs rely on personal contact in place of formal collateral or computerized credit scoring,[90] thus further increasing the human resources requirement for each loan. Furthermore, the evaluation of 1000 business plans would be a burdensome task. As a consequence, MFIs often charge higher rates of interest on smaller loans because of the significantly higher administrative costs and often the absence of competition in the lending market.[91] Rates of interest in the range of 20 – 80% are typical in the microfinance context.[92]

i. Education

In the previous example, an established entrepreneur in the United States would likely not require any education from the bank about her loan. In contrast, some form of credit education would likely be necessary for first time borrowers in the microfinance context. Behind the proliferation of microfinance institutions in the developing world has been a push to educate potential borrowers about the benefits and responsibilities of credit. In his well-

[90] *Summerlin,* supra, note 34.
[91] Churchill at 40.
[92] http://microcapitalmonitor.com/cblog/index.php?/archives/129-Microfinance-Interest-Rates-as-a-Function-of-Transaction-Costs.html

known book, *Banker to the Poor* (2003), Nobel Laureate Muhammad Yunus describes how the Grameen Bank began in Bangladesh developed in the one of the world's largest microfinance institutions.[93] Yunus describes the extensive and time consuming process of educating preparing borrowers who had previously had very little contact with a formal financial system.[94] The ultimate value for banks in providing borrower education is that it cultivates a new group of customers and prepares them to participate in the credit system. Borrowers with a better understanding of the credit process are generally more likely to have a lower rate of default.

ii. Group lending model

In addition to borrower education, microfinance institutions have also employed a group or community lending model as a means of increasing accountability amongst borrowers and ultimately reducing the risk of default. In the group lending model, clients guarantee each other's loans and build a credit history in a stepped process where the loan size is linked to the number of loans that repaid.[95] While some form of group lending has likely been going on for centuries, the often emulated model was developed by the Grameen Bank.[96] In this model, groups of four or five borrowers undergo several weeks of "indoctrination" and education about the loan process and group lending. If one borrower in the group defaults, all the borrowers in the group become ineligible for further loans.[97] In addition to the group lending model, MFIs have often used solidarity groups consisting of eight to ten borrowers who guarantee each others loans. A major advantage of group lending over commercial bank lending or individual microlending is that it removes the need for physical collateral, relying

[93] Muhammad Yunus, *Banker to the Poor: Micro-Lending and the Battle Against World Poverty* (Public Affairs 2003).
[94] *See generally*, Muhammad Yunus, *Banker to the Poor: Micro-Lending and the Battle Against World Poverty* (Public Affairs 2003).
[95] Churchill at 4.
[96] *See generally*, Muhammad Yunus, *Banker to the Poor: Micro-Lending and the Battle Against World Poverty* (Public Affairs 2003). p. needed? ??
[97] Churchill at 4-5.

on collateral substitutes such as cross guarantors and solidarity guarantees instead.[98] While such group lending models have proved effective in a number of countries throughout the world, such lending practices are often human-resource intensive for MFIs, thus further increasing the cost of each loan.

b. Higher degree of risk involved

In addition to the higher administrative costs of micro-loans, there is often a higher degree of risk and uncertainty involved with lending in developing economies.

i. Inflation

The rate of inflation is an important consideration to lenders in both developed and developing economies. In the world's most developed economies, the rate of inflation is studied extensively and tightly controlled by central banks. Lenders and borrowers alike in developing economies often do not have the luxury of depending on a government or central bank to control monetary policy, thus are subject to more uncertainty regarding inflation. Lenders must factor this uncertainty into their risk equations even when lending money in small amounts, since a sudden spike in inflation could quickly erase the profit margin on outstanding loans.

ii. Risk of default

Another important factor in setting interest rates in developing economies is the lender's recourse in the case of default. In developed economies, the legal system and collateral serve to mitigate bank risk associated with lending. Banks concerned with an increased risk of default can require collateral from borrowers as a condition to making a loan. In the case of default, banks can repossess or foreclose upon such collateral as a means of mitigating their losses. In the microfinance context, MFIs targeting the poorest populations do not typically have the luxury of requiring deposits of valuable collateral. Borrowers in

[98] *Summerlin*, supra, note 34.

these communities often are unable to provide monetary collateral when receiving loans. MFIs often accept non-traditional, symbolic or "token collateral" instead of requiring some form of monetary capital.[99] Forms of "token collateral" might include a family heirloom, livestock, tools, land[100] or collateral substitutes such as credit denial or social sanctions.[101] Accepting token collateral naturally increases the downside risk for the lender and this increase must also be factored into the overall interest rate. Despite this increased risk, the ability to lend to clients without collateral can be a significant advantage to MFIs dealing with populations without collateral-grade assets,[102] because it greatly expands the pool of potential borrowers.

f. A Note on Profit

As noted in Section, "MFIs in the Media," in April 2007, the Mexican MFI, Compartamos, generated controversy by running up high profits for investors.[103] One of the reasons the bank was able generate such profits was that it charged very high interest rates between 85 and 100 percent. In general, MFIs can increase profits by raising interest rates, and the assumption that increased competition will lower interest rates has often proven incorrect perhaps because of the difficulty borrowers have switching lending institutions.[104] Compartamos, however, is an outlier. A CGAP report, relying on data from 1,400 MFIs in 98

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[99] Churchill at 7.

[100] Beatriz Armendáriz de Aghion and Jonathan Morduch, *Microfinance: Where do we Stand?* Hampshire, UK: Palgrave Macmillan (2004) at 142. Available at http://www.nyu.edu/projects/morduch/documents/microfinance/Microfinance_Where_Do_We.pdf (Last Accessed 11/15/09).

[101] Philip Bond and Ashok Rai, *Collateral Substitutes in Microfinance* (2002) at 24. http://www.econ.yale.edu/seminars/develop/tdw02/rai-021118.pdf (Last Accessed 11/15/09).

[102] *Summerlin*, supra, note 34.

[103] *Malkin*, supra, note 15. *See* CGAP, *The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates? http://www.cgap.org/gm/document-1.9.9534/OP15_rev.pdf* (February 2009).

[104] *CGAP, Moneylender,* supra, note 99, p. 18. (For instance, credit card rates in the oversaturated U.S. market have proved stickier than other credit rates, probably due in considerable part to the substantial time investment required for a customer to search for and switch to a new card with better terms.)

countries, found that *sustainable* MFIs charge lower rates by minimizing profits, and while rates may be higher in fledgling markets, rates can drop below mainstream market levels as MFIs become more experienced.[105] The average interest yield, weighted by loan portfolio, for sustainable MFIs in 2006 was 28.1 percent.[106] There are many different ways to assess profitability, but the average return on MFI owners' equity in 2006 was 12.3 percent compared to the 17.7 percent for mainstream banks.[107] It is important to understand that while profit is clearly a component of interest rates, the relationship between profit and interest rates is a complex one, and research is ongoing. CGAP estimates that if MFI profits were eliminated worldwide, interest rates would only drop by about one-sixth, remaining at levels that would still look usurious to politicians and reporters.[108]

g. The Regulatory Dilemma

As the benefits of microfinance in developing economies continue to be realized and lending methodologies refined, the important question of regulation arises. Microfinance is distinct from traditional forms of banking, and while it has the potential to be profitable, motivations for entry into the microfinance market are often not entirely based on the potential profits. Considerations of social justice, long term economic development and poverty alleviation are often motivate governments, NGOs, and private companies to enter the microfinance market.[109] As governments have begun to deal with microfinance regulation in the last several decades, the dialectic of consumer protection versus sustainability has emerged. A government must be conscious of the impact their regulatory regimes will have on the microfinance sector of its economy. If MFIs are regulated in the same manner as

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[105] *CGAP,* supra, note 99, p. 3.
[106] *CGAP*, supra, note 99, p. 3.
[107] *CGAP*, supra, note 99, p. 21.
[108] *CGAP*, supra, note 99, p. 21.
[109] CGAP Microfinance Gateway: Organizations, available at http://www.microfinancegateway.org/p/site/m/organizations/ (last visited November 15, 2009). This site contains links to several NGOs representing the diverse motivations of NGOs and other groups have for entering the microfinance market.

traditional banks, the government runs the risk of limiting their growth. As discussed previously, the cost of making micro-loans is still high when compared with larger scale commercial lending. When regulating MFIs, governments should be careful not to ignore the potential of microfinance to produce long term economic value and development, benefits that often far outweigh the interest payments generated by loans.

A successful microfinance sector can create economic as well social ripple effects throughout an economy and a community,[110] as economic activity increases and individuals and families rise out of subsistence-level poverty.[111] A family with a successful micro-enterprise will likely have more expendable income than before, thus resulting in an increase in consumption. In a community or village, an increase in consumer spending has the potential to become a significant economic force when aggregated. When creating regulations, governments must also consider other, non-financial benefits of microfinance. For example, creating access to savings accounts for populations who have never been a part of the formal financial sector provides them with a secure and reliable means of storing excess resources until needed.[112] Furthermore, credit allows borrowers to leverage what they already own to purchase essential assets for income generation. Credit can also serve to smooth income flows, allowing families and individuals more flexibility when dealing with difficult times. Microfinanceer Reuben Summerlin of Alternative Credit Technologies, LLC notes, “despite the utility of financial services, millions of people are excluded from accessing them because they are too poor to manage transactions large enough to be considered profitable by most commercial banks.”[113] Such social benefits and long term

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[110] Pascal Marino, *Beyond Economic Benefits: The contribution of microfinance to postconflict recovery in Asia and the Pacific* (2005) at 1. http://www.gdrc.org/icm/country/fdc-afgan.pdf
[111] See International Fund for Agricultural Development, *Rural Finance: Small amounts making a big difference* (2009) at 1. Last accessed November 15, 2009. http://www.ifad.org/events/microcredit/eng.pdf
[112] *Summerlin,* supra, note 34.
[113] *Summerlin,* supra, note 34.

economic benefits have made entry into the microfinance market an attractive option for non-profits and NGOs all over the world. Such organizations often create MFIs with outside resources or grants and don't expect them to be profitable immediately or even at all. The problem arises when such institutions run up against financial regulations designed to govern the traditional banking sector. Because of the higher administrative costs of micro-loans, regulations such as interest rate caps or ceilings can prove highly restrictive and limit the effectiveness of MFIs in a country. When deciding how best to regulate MFIs, governments must consider the often un- or under-accounted for social value of microfinance, needs of consumer protection, as well as the continued growth and sustainability of the microfinance sector.

The Truth in Lending Act of 1968 ("TILA")[114] provides an example of how the United States government has enacted legislation aimed at consumer protection. Through Regulation Z, the TILA regulates what disclosures lenders must make to borrowers.[115] The stated purpose of the legislation is "to promote the informed use of consumer credit by requiring disclosures about its terms and cost."[116] Such a regulatory system serves both an informational purpose for consumers as well as creating rights and causes of action for debtors. In a developed economy, in which most borrowers have some access to the legal system, and the transactions or amounts in question are substantial enough to justify litigation, such consumer protection legislation can be effective in promoting and safeguarding the rights of borrowers. However, in the context of microfinance, where many borrowers lack the requisite financial literacy or access to the legal system,[117] complex disclosure regulations like the TILA do little to further the interests of micro-borrowers. While the benefits of such disclosure regulation

[114] 15 U.S.C. §§ 1601-1667f. (2000 & Supp. 2004); 12 C.F.R. § 226.1-226.36 (2008). (Truth in Lending Act)
[115] 15 U.S.C. §§ 1601-1667f. (2000 & Supp. 2004); 12 C.F.R. § 226.1-226.36 (2008). (Truth in Lending Act)
[116] 12 C.F.R. § 226.1(b).
[117] *Supra* n. 93.

might seem to carry over into the microfinance context, regulations giving poor borrowers the right to hire a lawyer to challenge to collateralization of their assets are not the solution.

In the context of MFIs in developing nations, where there is evidently a confluence of investor interest and human need, we would like to see lawyers playing the role of referees who can use the rule of law to create a lending environment that is socially and politically sustainable rather than simply profitable for a short term.[118] If this is possible in the largely unregulated and untested market for microfinance, maybe it could it also be possible in the West.

We have chosen to compare and contrast the nations of Uganda and Ecuador because microfinance has flourished in both countries in a variety of forms. These countries have also instituted major regulatory overhauls pertaining to microfinance and nationwide banking systems. However, the governments of both nations are facing legislative challenges in regards to interest rates and the many corollary issues - such as collateral requirements, ownership guidelines, and capitalization minimums - that affect interest rates. While larger, international MFIs and government-funded lenders are easier to supervise, both countries are in the process of understanding the role of smaller credit unions and credit-only lenders that reach the neediest rural clients. Does the popularity of these lenders and their potential social value outweigh the risk that they pose to a modern banking regime? The decisions made in Ecuador and Uganda in regards to interest rate regulation will determine the fate of lending to the poor in those countries and perhaps provide a heuristic for other nations undergoing economic reform.

We believe it is essential for microfinance practitioners and advisers to be aware of the fact that a nation's governmental and popular stance on banking reforms and regulations

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[118] *Supra*, n. 48.

derives largely from its political and economic history. We have tried to present each nation's relationship with MFIs in the context of recent history.

II. Microfinance Regulation in Uganda

A. Brief Political History: Idi Amin –Present

Uganda appears to be a rare, sub-saharan Africa success story. Less than twenty years ago, the country emerged from what seemed to be a hopeless political and economic situation to achieve a state of comparative tranquility.[119] Most notably, President Yoweri Museveni's ("Museveni") cooperation with the International Monetary Fund ("IMF") and the World Bank has allowed Uganda to implement radical economic reforms.[120] However, any discussion of present-day African development needs to be attuned to the contradictions initially created by European colonialism.[121] Like many African nations, Uganda was cobbled together out of different, fragmented societies by external forces.[122] The interests of missionaries and colonial entrepreneurs distorted indigenous power structures.[123] This conflict between external pressure and the need for domestic independence has created contradictions that are central to understanding both the recent history of Uganda and the development of microfinance regulation.

Uganda was granted independence from British rule in 1962;[124] however, post-colonial leaders were not able to rely on the spirit of independence and nationalism to hold the country together. Almost immediately, religious and ethnic conflicts began to weaken the new nation and occlude the process of forming a stable, democratic government.[125] From 1966 to 1971, President Milton Obote ("Obote") tried to deal with dissident forces by

[119] Holger Bernt Hansen and Michael Twaddle, *From Chaos to Order: The Politics of Constitution-Making in Uganda* 1 (Fountain Press 1994).
[120] Supra, note 83, p. 1.
[121] Joshua B. Rubongoya, *Regime Hegemony in Museveni's Uganda* 17 (Palgrave 2007).
[122] Supra, note 85, p. 19.
[123] Supra, note 85, p.19.
[124] Uganda History, *Encyclopedia of Nations* (Advameg, Inc. 2009) http://www.nationsencyclopedia.com/Africa/Uganda-HISTORY.html
[125] Supra, note 85, p. 22

consolidating power and revising the constitution, but he never achieved consensus.[126] In 1971, General Idi Amin ("Amin") staged a successful military coup, and Obote went into exile in Tanzania.[127] Amin held power for eight years through fear and intimidation, killing as many as 300,000 people until Obote returned with the help of the Tanzanian military and drove him out. From 1980 to 1986, Obote struggled to defend his government against guerilla factions. As many as 100,000 more Ugandans were killed as a result of massacres and starvation. Finally, in 1986, Museveni's National Resistance Movement ("NRM") achieved control of the country and began to implement reforms.[128]

While it took Museveni's NRM approximately five years to achieve enough stability to start improving government effectiveness,[129] since the mid-1990s Uganda has "enjoyed unprecedented economic and political stability."[130] According to the U.S. State Department, the 1995 constitution put into place by the NRM established Uganda as a republic with an executive, legislative, and judicial branch. [131] Under this constitution, Museveni was elected in 1996 and reelected in 2001 and 2006. Legislative responsibility is vested in the parliament; legislative elections were last held February 2006. There are currently 102 women representatives in the 332-member parliament. The Ugandan judiciary operates as an independent branch of government and consists of magistrate's courts, high courts, courts of appeals, and the Supreme Court. Parliament and the judiciary have significant amounts of independence and wield significant power.[132]

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[126] Supra, note 88.
[127] Supra, note 88.
[128] Supra, note 88.
[129] Supra, note 85, p. 22
[130] Ruth Goodwin-Groen, Till Bruett, and Alexia LaTortue, *Uganda Microfinance Sector Effectiveness Review* 3, CGAP (October 2004).
[131] U.S. Dept. of State, "Background Note: Uganda," 2009. http://www.state.gov/r/pa/ei/bgn/2963.htm#history.
[132] Supra, note 95.

The question of how Museveni succeeded in bringing democracy and relatively high levels of peace[133] and prosperity to Uganda is difficult to answer. The State House of the Republic of Uganda identifies free and fair elections, economic liberalization, civic education, the creation of an independent judiciary, and focus on "the principal of individual merit" as the reasons for the nation's success.[134] However, Museveni operated for nearly ten years without a "mandate from the people," gaining popularity by scaling back the military and simply using his personal charisma.[135] In addition, Museveni has always opposed the notion of a multi-party system of government, which raises the question of whether he is more concerned with democracy or personal succession.[136] Also, investment by external actors – the U.S., Britain, Sweden, the World Bank and the IMG – tied to strict stipulations about governance have played a major role in the NRM's forward progress.[137]

There are two major contradictions at work in present day, post-colonial Uganda that affect the development of microfinance regulation. The first is the political contradiction between Museveni's often unilateral control and the goal of democratic government by the people. The second contradiction is the economic and political contradiction of Uganda's post-colonial independence and its continued reliance on foreign investment. Both of these contradictions are central to the decisions involved in regulating microfinance institutions. On the one hand, "Museveni believes that financial services are key to his nation's future and keenly follows MFIs, from the outreach they achieve to the interest rates they charge."[138] On the other hand, members of Uganda's democratically elected Parliament ("MPs") have often been skeptical about addressing the problems of poverty by asking the poor to pay high

[133] The Lord's Resistance Army is still active in Northern Uganda. *See* Lord's Resistance Army (LRA), GlobalSecutiry.org (2009) http://www.globalsecurity.org/military/world/para/lra.htm
[134] The Official Website: State House, the Republic of Uganda. (http://www.statehouse.go.ug/achievement.php?category=Achievements)
[135] Supra, note 85, p. 24.
[136] Supra, note 83, pp. 8-9.
[137] Supra, note 85, p. 24.
[138] Supra, note 94, p. 3.

interest rates.[139] In addition, while private sector stake holders and foreign advisors have zeroed in on methodologies for regulating different types of MFIs,[140] the MPs are sometimes behind on the debates and wish to emphasize different issues.[141]

In Uganda, one of the central paradoxes of regulating MFIs in a developing nation is highlighted: while democratic reform may not be possible without a growing economy, fledgling democratic bodies may have trouble rapidly producing economic policy that is conducive to safe and competitive investment. In order to better examine this issue, it necessary to understand the recent history of Uganda's economy and central bank.

B. Banking & Economic Overview: 1980s –Present

"Uganda's economy is one of the most liberalized in Africa."[142] After decades of political and economic crises, the government has focused on creating an enabling environment for private-sector driven, sustainable economic growth.[143] Over the past decade, the size of Uganda's economy has more than doubled with average growth rates of about 6-percent per annum.[144] According to a recent survey, Uganda ranked second in 11 Sub-Saharan African countries in terms of Gross Domestic Product growth since 1990.[145] Economists, microfinance analysts, and historians seem to generally agree that "[t]hese achievements can largely be attributed the government's commitment to macroeconomic stability and the liberalization of the economy including the financial system."[146]

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139 Gabriela Braun and Alfred Hannig, "Creating a Separate Tier: The Micro Finance Deposit-Taking Institutions Act, 2003," in Ledgerwood, *supra*, note 28, p. 450.

140 AMFIU Microfinance e-Bulletin, Issue No. 1, June 2009, "AMFIU lobbies members of parliament on the microfinance bill" p. 3.

141 *See* Supra, note 103, p. 450.

142 Supra, note 103, p. 441.

143 Supra, note 103. P. 441.

144 Andy Carlton, Hannes Manndorff, Andrew Obara, Walter Reiter, Elisabeth Rhyne, *Microfinance in Uganda* 10-11, L &R Social Research (December 2001).

145 Supra, note 108, pp. 10-11.

146 Supra, note 108, pp. 10-11.

This "liberalization" of the economy, however, raises some interesting questions about the flow of capital in a free-market environment and underscores the need for a "micro" approach to reaching the impoverished. The NRM, partnering with the IMF and World Bank, accomplished its "liberalization" of the economy using the central Bank of Uganda ("BoU"). Starting in 1987, the BoU, which was the largest government-owned bank in Uganda, started to focus on a structural adjustment program that would enhance effectiveness and efficiency in the economy.[147] Initially, the liberalization was somewhat limited by the bank's unwieldy administrative processes, like its controls on interest rates;[148] however, in 1993, the Bank of Uganda Act deregulated interest and exchange rates to provide a more market-oriented environment.[149]

While the 1993 act may have laid the foundation for the centralized economic growth in Uganda mentioned above, lack of economic development in rural areas coupled with profoundly low incomes made much of Uganda immune to market-driven forces.[150] The immediate impact of financial reform on the BoU was that it had to contract "its branch network significantly across the country, leaving many rural districts without any financial services."[151] Rural citizens in Uganda already had limited access to banking resource and were considered by banks to be high risk, due in part to lack of conventional collateral. [152] Banking reform and economic "liberalization" in Uganda undoubtedly strengthened the economy when measured on a national scale, but Uganda is still one of the poorest countries in the world

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[147] David Kalyango, "Uganda's experience with the Regulatory and Supervisory Framework for MicroFinance institutions," Bank of Uganda 3 (May 2005) http://www.microfinanceregulationcenter.org/files/25977_file_ Uganda.pdf.
[148] Martin Brownbridge and Charles Harvey, *Banking in Africa: The Impact of Financial Sector Reform Since Independence* 138 (Africa World Press, Inc. 1998).
[149] *See Carlton,* supra, note 108, p. 26; *See also Braun* in *Ledgerwood*, supra note 103, p. 442.
[150] Supra, note 112, p. 142.
[151] Supra, note 111, p. 3.
[152] Supra, note 115, p.3.

with a per capita annual income of less than $300 U.S. dollars.[153] Depending on which methodologies are used to measure poverty, in some respects, Uganda has made very little headway. At least 50-percent of Uganda's citizens live far below the poverty line,[154] and poor trade terms coupled with the continuing conflict in Northern Uganda threatens the future of the country's economy.[155]

C. The Rise of Microfinance Regulation in Uganda

While the contraction of the centralized commercial banking system in Uganda made it harder for many citizens of Uganda to share in the economic growth, it did create more opportunities for NGOs, especially MFIs, in many different forms. Uganda has a population of nearly 24 million, and 86 percent of its working population is self-employed.[156] Close to 1.5 million people, which is about 90 percent of the economically active, non-farming population are employed in "micro" enterprises, creating a significant opportunity for MFIs.[157] In 1990, it was estimated that MFIs were providing loans to approximately 50,000 clients, and 2003, there were an estimated 1,500 MFIs serving 400,000 borrower and 900,000 savers.[158] Because MFI clients in Uganda tend to be very poor women with no collateral, many Ugandan MFIs use a lending technology based on joint-liability groups[159] and compulsory savings.[160] In 1996, the BoU first started to become aware of the growing popularity of MFIs and opened discussions of regulation with stakeholders.[161]

In sub-saharan Africa, there were sixteen countries, as of 2008, that have existing or draft legislation that provides for the categorization of MFIs and applies varying levels of

[153] Supra, note 103, p. 441.
[154] Supra, note 108, p. 10-11.
[155] *See* supra, note 103, p. 441.
[156] Supra, note 108, p. 3.
[157] Supra, note 108, p.3
[158] Supra, note 103, p. 443.
[159] *See* supra, § e, 2(a).
[160] Supra, note 103, p. 443.
[161] Supra, note 103, p. 445.

regulation depending on the size and scope of the institution's activities.[162] Throughout Africa, sixteen countries have no interest rate ceilings, including countries such as Liberia and Lesotho that have lifted interest rate ceilings in recent years, and in other countries, "interest rate restrictions are tied to certain types of loans (agricultural loans in Nigeria), to type of lending (10 percent maximum profit margin for Islamic
lending in Sudan), to a targeted government lending program (Uganda, Benin) or to a particular institutional type (cooperatives in Ghana)."[163] Uganda is unique in that it has the largest number of financial access programs in Africa, [164] which meant that stakeholder and government had to take special care to craft legislation that would fit many different types of organizations.

If there is one thing that microfinance lawyers, financial advisors and entrepreneurs should take way from the regulation process in Uganda, it is that lobbying and communicating with the government is vital. MFIs were also fortunate that Museveni and his government were willing to give stakeholders, private institutions, and foreign advisory groups the opportunity to draft proposals before legislation was implemented.[165] However, the downside of the prevalence of MFIs in Uganda and the government's eagerness to regulate them is that the process can be used as a political pivot, mainly because of the concept of usury. When newspapers have published articles focusing on the issue of usury and Uganda's savings and credit cooperatives ("SACCOs"), some MPs have used the public's concern as an excuse for MFI

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[162] *Africa Microfinance and Benchmarking Report*, CGAP 4 (Dec. 2008). In 2008, MFI funders had total commitments of $1.76 billion, covering 716 projects in all 48 countries in sub-Saharan Africa. Despite a 12 percent decrease in external funding in 2007, funders continued to be strongly interested in supporting access to finance as the total number of projects increased by 61 percent. *CGAP Benchmarking* 7.
[163] Supra, note 126, p. 6.
[164] Supra, note 126, p. 7.
[165] *See generally Ledgerwood*, supra note 103, p. 445; AMFIU Microfinance e-Bulletin, Issue No. 1, June 2009 "AMFIU lobbies members of parliament on the microfinance bill" p. 3. http://www.amfiu.org.ug/new/images/docs/ebulletin/issue%201%202009pdf.pdf

"bashing"[166] and have not stayed abreast of other important issues raised by the BoU, such as ownership guidelines and minimum capital requirements.[167]

Nevertheless, in 2001, the Association of Microfinance Institutions of Uganda ("AMFIU") presented a draft bill to Uganda's newly elected Parliament, which became The Micro Finance Deposit-Taking Institutions Act of 2003 ("MDI").[168] The MDI was the product of cooperation among AMFIU members, the BoU, the German government's GTZ program, the United Nations Development Program, the French Government, and the government of Uganda.[169] To regulate microfinance, the BoU came up with a tiered approach that divided Uganda's financial institutions into four categories: commercial banks, credit-only institutions, microfinance deposit-taking institutions, and cooperatives, and it imposes different regulation for each 'tier.'[170] The MDI regulates Tier 3 institutions, deposit-taking MFIs, which represent only a fraction – somewhere between six and nine institutions – of Uganda's microfinance industry.[171]

The MDI Act of 2003 is extraordinary in that it represents extensive private and public cooperation and shows that the BoU is able to be sensitive to many of Uganda's historical banking issues and the need for good corporate governance.[172] However, the MDI's licensing process is specifically designed to draw a circle of inclusion around a few, large MFIs[173] whose practices and procedures cannot meet the needs of impoverished lenders. First, the BoU is

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166 *Carlton*, supra note____, p. 27.
167 Supra note 103, p. 449.
168 Supra, note 103, p. 449.
169 Supra , note 103, p. 444.
170 *CGAP Benchmarking,* supra note___, p. 4.
171 Stefan Staschen, "Possible Mechanisms to regulate Tier 4 MFIs in Uganda," Financial Systems Development Programme, Kampala, Uganda, FSD series No. 11 (May 2003). http://www.microfinanceregulationcenter.org/files/3783_file_Tier_4_Report.pdf
172 Supra, note 103, p. 448.
173 As of 2006, the four licensed MFIs were FINCA Uganda Ltd., PRIDE Microfinance Ltd., Uganda Microfinance Ltd., and Uganda Finance Trust Ltd with portfolios ranging from $10.2 billion USD to $6.7 million USD. *Ledgerwood,* supra note 103, p. 452 (quoting Lloyd Stevens, DFID Financial Sector Deepening Programme, Uganda, January 2006).

entirely responsible for the licensing of deposit-taking MFIs, issuing regulations, and enforcing the MDI.[174] It seems unlikely that the BoU's oversight jurisdiction could be extended to the 1,300 SACCOs and smaller MFIs that are not covered by the act.[175] In addition, the MDI stipulates that institutions applying for licensure must meet a capital requirement of 25,000 currency points, 500,000 Uganda shillings, which would be about $276,000 U.S. dollars.[176] This requirement may rule out most Tier 4 lenders. The regulations issued by the BoU in 2004 are also focused on lender protection to an extent that would most likely make the sort of trust-based, group lending described above by Dr. Yunus nearly impossible.[177] The BoU's regulations require that a restructured credit facility must improve collateral to secure its loan, cannot restructure its loan more than twice, and must have sufficient capital to service its debt at the time that it is restructured.[178] This requirement would abrogate charitable, trust-based lending, which we will discuss more below.

It important to note, however, that although the MDI requires that interest rates be transparently reported and based on market norms, there is no ceiling on rates.[179] As we shall, AMFIU and the many organization with which it has cooperated are strongly opposed to placing a cap on interest rates.

D. Regulating Tier 4 MFIs

The contradictions facing Uganda's regulatory schema are teetering on the questions of centralization versus individual autonomy and unilateral control versus democratic decision-making. At present, the Parliament of Uganda has accepted proposals but not made any final

[174] *See generally* The Micro Finance Deposit-Taking Institution (Licensing) Regulations, 2004 Statutory Instruments Supplement to *The Uganda Gazette No. 53Volume XCVII dated Oct. 15, 2004.*
[175] *See Ledgerwood*, supra note 103, p. 255 ("A way needs to be found to increase transparency and oversight for [SACCOs] without overstretching the BoU's capacity.")
[176] The Microfinance Deposit-taking Institutions Act, 2003, *The Uganda Gazette No. 20 Volume XCVI,* § 15(2) (May 2, 2003).
[177] *See Supra* note 10, p. 22.
[178] The Microfinance Deposit-taking (Licensing) Regulations § 11(a)-(c), 2004, Statutory Instruments Supplement to *The Uganda Gazette No. 53 Volume XCVII dated Oct. 15, 2004.*
[179] MDI 2003 § 51(d).

decisions concerning the regulation of smaller, Tier 4 MFIs because these questions are historically difficult to resolve. In 2002, the parliament devised the following resolution:

> It is hereby resolved that the Cabinet undertakes to bring to the August House within 6 months a Bill regulating the activities of Community-Based Financial Institutions referred to as Tier IV in the Report of the Committee on Finance, Planning and Economic Development guaranteeing affordable interest rates and reasonable period of repayment to the borrowers.[180]

This resolution represents an admirable goal, but, at the same time, it reflects the attitude of Uganda's politicians that microfinance is a cure-all for poverty and interest rates are somehow disconnected from the actual cost of lending money.[181] The Ugandan government's Medium Term Competitive Strategy (MTCS) is much more detailed when it comes to government policy towards MFIs. With regard to small community-based organizations and the future of Tier 4 regulation, the MTCS opines: *"The policy of no restrictions on maximum interest rates shall continue in the case of MFIs that want to charge high interest rates for their operations because this is absolutely an essential precondition to the success of credit delivery systems for micro enterprises."*[182] Here, the interest rate ceiling contradiction is explicit.

Uganda's MPs would like to see Tier 4 MFIs regulated by an autonomous institution like AMFIU, but at the same time, they recognize the cost of regulating tiny institutions and have suggested that SACCOs should have at least 300 members before seeking licensure.[183] Once again, this requirement would eliminate some SACCOs from licensure, but it the government is understandably hesitant to license lenders that are reaching out to a small client base because the cost of regulation might exceed the benefit. Volitional membership in AMFIU and non-prudential regulation are an attractive option, but MPs cannot claim to be addressing the

180 *Staschen,* supra note 135, p. 11.
181 *See supra* note 103, p. 455.
182 *See Medium Term Competitive Strategy for the Private Sector – Matrix* § (b), p. 11 http://www.foodnet.cgiar.org/scrip/docs&databases/ifpriStudies_UG_nonScrip/pdfs/Government_of_Uganda/MTCS_for_the_private_sector_matrix.pdf; *See also Staschen,* supra note 135, p. 11.
183 *See AMFIU,* supra note 129, p. 3.

public's fears about usury without implementing enforceable, prudential guidelines.[184] The way in which Parliament resolves these issues will decide the future of MFIs in Uganda.

According to Saliya Kanathigoda of the GTZ in Uganda, there is a draft Bill of regulations for Tier 4 institutions being prepared, and the Government of Uganda is most likely not planning to institute interest rate caps across the board.[185] However, the Bill has been held up by disagreements in regards to which Ugandan Ministry will implement it and how to coordinate the various MFI umbrella institutions like AMFIU.[186] Hopefully, the upcoming 2011 election will provide an incentive to Parliament and its advisory committees to pass a Bill in 2010.[187]

It is also important to note that there are some ancillary and implied forms of credit union interest rate regulation in Uganda. First, in his 2006 election campaign, Museveni introduced a program known in Uganda as Bonna Baggaggawale, or "Prosperity for All," that uses the SACCOs as a means for getting government capital into the nation's more rural areas by choosing one SACCO in each sub county to receive government assistance.[188] Loans from the SACCOs would then be used to help citizens buy land, and the government would cap interest on such loans at 10-percent.[189] "However, the government’s strategy of providing credit at a subsidized interest rate is not likely to be sustainable in the long run and may undermine the private microfinance institutions that have been growing in Uganda."[190]

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[184] Supra, note 129, p.3.
[185] Saliya Kanathigoda, GTZ, email message, 10/6/2009.
[186] Kanathigoda, Supra, note 149.
[187] Kanathigoda, Supra, note 149.
[188] Dr. Pascal Odoch, "Rethink the Cash Strategy for Fighting Poverty," Uganda Daily Monitor (October 3, 2008).
[189] Government of Uganda, "The Plan to Achieve Prosperity for All Ugandans." (2007) http://www.finance.go.ug/docs/BONNA_BAGGAGGAWALE.pdf
[190] Ephraim Nkonya, John Pender, Kayuki C. Kaizzi, Edward Kato, Samuel Mugarura, Henry Ssali, and James Muwonge, *Linkages between Land Management, Land Degradation, and Poverty in Sub-Saharan Africa: the Case of Uganda* 87, International Food Policy Research Institute (2008). http://ageconsearch.umn.edu/bitstream/47224/2/rr159.pdf.

In addition, Uganda's credit unions are ostensibly regulated by the Cooperative Societies Act of 1970, which would require the board of each credit union to set an interest rate on loans based on statutory limits or mainstream commercial banking standards.[191] The GOU may also be considering World Council of Credit Unions' ("WACCO") Model Regulations as part of the Tier 4 regulation process.[192] These guidelines discuss a number of best practices for setting and disclosing interest rates; however, it remains to be seen what aspects of the Model Regulations will be of interest to Parliament. In many respects, these guidelines are valuable for protecting lenders while still allowing credit unions to set rates that realistically recoup the costs of lending, and we will discuss them further in Section IV.

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[191] The World Council of Credit Unions, Inc., *Guide to International Credit Union Regulation* 93, (2005) (As of 2001, it was not clear how these regulation might have been enforced by the government, if at all.)

[192] *Kanathigoda*, supra, note 149. *See* World Council of Credit Unions, Inc., *Model Regulations for Credit Unions* 17 (2008).

III. Case Study: Ecuador

E. Brief Political History

1. Early History

While little is known about the earliest inhabitants of the northwestern part of South America, there is evidence that people had been living in the area long before the Incan Empire began to take control around 1463.[193] Historically considered part of the Incan Empire, the land of modern-day Ecuador came under Spanish rule during the 16th century, after the Inca populations were ravaged by malaria and smallpox epidemics imported by the conquistadors. [194] In 1526 the Spanish arrived in northern Ecuador, and six years later, Francisco Pizarro marched inland from the coast. Within a few years Pizarro and his well-equipped, but relatively small force had toppled the massive Incan armies with the assistance of guns, disease, horses, and artillery.[195] As the Spanish exploited the cheap labor provided by colonial domination and the Pacific coast thrived while highland region of the country's interior lacked the development of the coastal regions.[196] These regional disparities still exist as most of the remaining indigenous populations (25% of Ecuador's total population) live in the highlands of Ecuador where they continue to lack economic opportunities and political representation.[197] After three centuries of Spanish rule, Ecuador gained independence from the Spanish crown on May 24, 1822.[198] The Republic of Ecuador was established on May 13, 1830.[199] While the struggle for indigenous communities to gain equal political representation

[193] Eakin, Marshall C. The History of Latin America: Collision of Cultures. P. ???
[194] Gerlach, Allen, Indians, oil, and politics: a recent history of Ecuador, 2003. p. 15
[195] *Id.* 17.
[196] *Id.* 22.
[197] Ecuador: A Development Overview - http://fsdinternational.org/intlopps/country/ecuador1
[198] https://www.cia.gov/library/publications/the-world-factbook/geos/ec.html - Until 1830, Ecuador was part of the Gran Colombia, a tripartite union that included modern day Colombia and Venezuela. *See* Gerlach p.24.
[199] Gerlach, 25.

and economic opportunities has persisted throughout the 19th and 20th centuries, the indigenous movement has been noted as one of the strongest in South America.[200]

2. Modern Political Developments

Ecuadorian history in the last century has been characterized by a number of regime changes and economic booms and busts. The current president, Rafael Correa Delgado took office on January 15, 2007.[201] The leftist Correa ran on a platform of broad economic and social reforms, promising to give Ecuador's poorest more representation and power.[202] Since becoming president in 2007, Correa has managed to gain support for the creation of a new constitution.[203] Voters recently adopted the new constitution by referendum in September of 2008, marking the country's twentieth constitution since gaining independence from Spain in 1822.[204] The new constitution also included a provision that allowed Correa to run for re-election in 2009. Running again on a platform of nationalistic economic policies and broad social reforms, Correa was re-elected in April 2009 with 51% of the popular vote.[205] Many in Ecuador hope that President Correa's re-election can lend a degree of political stability to a country that has ousted three presidents since 1997.[206] Correa is the country's tenth head of state since 1996 and will be eligible for re-election again in 2013.[207] A degree of political stability is essential if Ecuador is to continue with the broad social reforms instituted by Correa are to continue to take root and improve the quality of life for the most economically disadvantaged of Ecuadorians.

[200] Ecuador: A Development Overview - http://fsdinternational.org/intlopps/country/ecuador1
[201] http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/LACEXT/ECUADOREXTN/0,,menuPK:325122~pagePK:141159~piPK:141110~theSitePK:325116,00.html
[202] *Id.*
[203] *Id.*
[204] https://www.cia.gov/library/publications/the-world-factbook/geos/ec.html
[205] http://www.nytimes.com/2009/04/27/world/americas/27ecuador.html
[206] Worldbank.org
[207] http://www.nytimes.com/2009/04/27/world/americas/27ecuador.html

F. Modern Economic Climate

Just as the political climate in Ecuador as been marked by instability in recent decades,[208] so has the country's economic climate. Ecuador is a country with an area of 105,000 square miles[209] and a population around fourteen million people.[210] Nearly two-thirds of Ecuadorians live in cites,[211] with Quito, the country's capital, Guayaquil, Cuenca, and Manta among the country's largest cities.[212] The majority of the population is Roman Catholic and the official language of Ecuador is Spanish, while several indigenous languages are still spoken throughout the country.[213]

1. Exports and the Financial Crisis of 1999

Ecuador's major exports include petroleum, bananas, shrimp, and coffee. [214] Other industries include textiles, food processing, chemicals, and wood processing.[215] Ecuador currently ranks 31st in world oil production.[216] Oil production has significantly impacted both Ecuador's economy and political situation, and has accounted for over half of the country's export earnings in recent years.[217] Oil discoveries over the last several decades in Ecuador have given the country an important source of income and contributed to greater government spending in the public sector as well as lower taxes and governmental subsidies for oil.[218] While oil profits allowed for a period of increased government spending and investment in social programs, falling oil prices during the 1990s forced reductions in government largesse and an end to the unsustainable spending. By the end of the decade, Ecuador was facing an

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208 Supra, n. 166.
209 Worldbank.org
210 https://www.cia.gov/library/publications/the-world-factbook/geos/ec.html. July 2009 estimate of around 14.5 million, other sources list population as less than 14 million, worldbank.org.
211 *Id.*
212 Worldbank.org
213 *Id.*
214 Ecuador: A Development Overview - http://fsdinternational.org/intlopps/country/ecuador1
215 https://www.cia.gov/library/publications/the-world-factbook/geos/ec.html
216 https://www.cia.gov/library/publications/the-world-factbook/geos/ec.html
217 *Id.*
218 Ecuador: A Development Overview - http://fsdinternational.org/intlopps/country/ecuador1

economic crisis prompted by a drop in oil prices, the effects of El-Nino and a series of earthquakes, inflation, and mounting foreign debt.[219] Financial crises in Russian and Brazil contributed to the tightening of international credit conditions and Ecuador's foreign debt exceeded 100% of GDP in 1999.[220] As the government was no longer to fulfill its foreign debt obligations with its oil revenues, social spending was cut with the areas outside of the urban centers bearing much of the impact of the spending cuts.[221] Ecuador's currency, the sucre, depreciated by two-thirds during the year 1999.[222]

2. Dollarization in Ecuador

In 2001, facing a severe economic and banking crisis, Ecuador began the process of dollarization in an attempt to stabilize the economy and reign in inflation. Ecuador gave up its traditional currency, and made the U.S. dollar the country's legal tender.[223] By adopting the currency of the United States, a country with "a much better reputation for prudent monetary and exchange rate policy," Ecuador hoped to facilitate a more stable environment for investment and eliminate currency risk.[224] Other potential benefits of dollarization are reduced transaction costs as well as lower interest rates, both important to increasing private investment in Ecuador.[225] In the short term, efforts aimed at reducing inflation had the opposite effect and sparked a period of hyperinflation.[226] More than seven years after dollarization, inflation has stabilized around eight percent per annum, while thirty-eight percent of people still live below the poverty line.[227]

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[219] *Id.*
[220] March 2006 IMF Country Report http://www.imf.org/external/pubs/ft/scr/2006/cr06103.pdf p. 4.
[221] *Id.*
[222] March 2006 IMF Country Report http://www.imf.org/external/pubs/ft/scr/2006/cr06103.pdf p. 4.
[223] March 2006 IMF Country Report http://www.imf.org/external/pubs/ft/scr/2006/cr06103.pdf - p. 4
[224] *Id.* at 5.
[225] *Id.* at 5.
[226] Ecuador: A Development Overview - http://fsdinternational.org/intlopps/country/ecuador1
[227] https://www.cia.gov/library/publications/the-world-factbook/geos/ec.html

3. Wages

While Ecuador's economy has struggled in recent years, minimum wages in Ecuador have remained relatively high in comparison with other Latin American countries.[228] When measured as a percentage of per capita income, Ecuador in 2004 had the second highest minimum wage rate behind Colombia.[229] Additionally, since dollarization at the beginning of the decade, the unemployment rate in Ecuador has subsided from a high of 16.9% in 1999, to 11% in 2004,[230] to an estimated 8.7% in 2008.[231] Wage growth has exceed that of inflation in recent years, an indication that dollarization has had a stabilizing effect on Ecuador's economy.[232]

4. Interest Rates

Since the financial crisis of 1999, interest rates in Ecuador have become less volatile. According to a recent World Bank report on Ecuador's response to dollarization, "interest rates appear to have become less sensitive to negative political developments in the country, which in the past also tended to be reflected quickly in fluctuations in the exchange rate. These factors should have been a positive influence on the economy at large, including on private investment and efficiency."[233] A decoupling of interest rates from internal political events suggests that Ecuador's economic climate is stabilizing. Clearly investor confidence is an integral component to continued growth and development in Ecuador. The current commercial bank prime lending rate in Ecuador is 12.5% (October 2008), while the central bank discount rate is 9.14% (December 2008).[234]

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[228] http://www.imf.org/external/pubs/ft/scr/2006/cr06103.pdf at 23.
[229] *Id.* at 23.
[230] *Id.* at 23.
[231] https://www.cia.gov/library/publications/the-world-factbook/geos/ec.html
[232] http://www.imf.org/external/pubs/ft/scr/2006/cr06103.pdf at 23,24.
[233] *Id.* at 9.
[234] https://www.cia.gov/library/publications/the-world-factbook/geos/ec.html - current stat???

In the wake of Ecuador's recent financial crisis, the need for grassroots economic development is apparent as bottom-up growth is an important way to ensure that the country's future development extends to Ecuador's poorest and most underserved populations. Providing credit access to regions of Ecuador that have historically been overlooked and marginalized in an economic sense is an important tool in both encouraging economic growth and improving the standard of living for the country's most economically disadvantaged. The rapid growth in recent years of microfinance institutions in Latin America underscores how access to micro-credit can encourage entrepreneurial activity in areas that previously had no contact with the formal banking system.[235] Micro-credit also has the potential to provide a steady and consistent source of development, relatively insulated from outside shocks to Ecuador's financial system as a whole. Such shocks to the economy of Ecuador have derailed the government's development efforts in the past.[236] We now proceed to examine the current landscape of microfinance in Ecuador.

G. Microfinance in Ecuador

1. Brief Overview of Microfinance in Latin America

The concept of microfinance is not new in Latin America. Entrepreneurs have for years been able to borrow small amounts of capital from banks in Latin American countries. However, around the year 1990, many banks began instituting more formal micro-credit programs.[237] Today in Latin America, microfinance is a multi-billon dollar a year enterprise, serving over 4 million people.[238] Commercial banks, finance companies, state-owned banks, and Non-Governmental Organizations (NGOs) have all entered the microfinance business in

[235] Berger, Marguerite, *An inside view of Latin American microfinance* (Inter-American Development Bank 2006) at ix.
[236] Supra, note **Error! Bookmark not defined.** .
[237] Berger, at 118.
[238] Berger, at 1.

the last twenty years.[239] In her book, *An Inside View of Latin American Microfinance*, Berger asserts that while in the past, microfinance development was centered around institutions, "today it is moving from being about specialized institutions toward being about specialized products that can be offer by many types of financial institutions."[240]

2. Micro-Enterprise Landscape in Ecuador

The diverse microfinance landscape in Ecuador has been growing for the last several years since the banking crisis of 1999. Microfinance services currently reach 700,000 people, an estimated 50 percent of the potential demand, with a total portfolio of over 1.3 billion USD. The chief beneficiary of micro-finance services are Ecuador's micro-entrepreneurs who use these services to create micro-enterprises. Estimates differ as to how much micro-enterprises contribute to Ecuador's GDP, a USAID report from 2004 states that sales from micro-enterprises amount to 25.7% of Ecuador's GDP,[241] while another estimates states that micro-enterprises contributed 10%-15% to Ecuador's GDP.[242] The term 'micro-enterprise' in Ecuador typically refers to urban micro-enterprises.[243][244] There were approximately 500,000 micro-enterprises in Ecuador in 2002, employing over 1 million people. In 2007, it was estimated that there were 1.5 million micro-enterprises, with micro-enterprises employing nearly 1 million people in urban-areas.[245] Most urban micro-enterprises are family centered,

[239] Berger, at 118.
[240] Berger, at 13.
[241] http://www.centerforfinancialinclusion.org/Page.aspx?pid=1562, USAID report available at http://www.ruralfinance.org/servlet/BinaryDownloaderServlet?filename=1129121833621_Microenterprises_and_microfinance_in_Ecuador.pdf
[242] La Microempresa en Ecuador: perspectivas, desafíos y lineamientos de apoyo, Inter-American Development Bank at 11. (September 2006). http://www.sipromicro.org/fileadmin/pdfs_biblioteca_SIPROMICRO/001427.pdf
[243] Microempresas or Micro-enterprises are officially considered business of ten employees or fewer.
[244] Bicciato, Francesco et al. *Microfinanzas en países pequeños de América Latina: Bolivia, Ecuador y El Salvador*. (United Nations Pub., 2002) at 31. Availible at http://www.eclac.org/publicaciones/xml/1/9981/LCL1710e.pdf (Last accessed 10/8/09)
[245] La Microempresa en Ecuador: perspectivas, desafíos y lineamientos de apoyo, Inter-American Development Bank at 8. (September 2006).

and employ between one and three persons.[246] These informal businesses often operate illegally and lack access to financial services and modern technology. Examples of urban micro-enterprises include bakeries, repair shops, street or stall vendors of all types, and servicemen such as plumbers, electricians, and carpenters, operating primarily to serve the demands of the local population.[247] Much of the rural production is Ecuador is family centered consumed on the internal market, with few products such as bananas, coffee, and cacao being sold for export.[248]

3. Access to the Banking System in Ecuador

One of the primary aims of creating microfinance programs in developing countries is to provide more individuals with access to the formal banking system. Access to the formal banking system can supply individuals and families with a secure means of saving money and the opportunity to incorporate a greater degree of financial planning and organization into their lives. Traditionally, access to banking services has depending largely on physical proximity to banks and their branches, thus limiting access to those living in more developed urban areas. Those living outside the urban centers have been a long neglected market for financial services. As research on the impacts of micro-finance programs has proliferated over the last twenty years, governments have begun to take action to broaden access to financial services. For example, the United States Agency of International Development (U.S.A.I.D.) has developed a program in the Philippines called Microenterprise Access to Banking Services, (hereafter "MABS") aimed at encouraging Philippine banks to provide better access to financial services in rural areas.[249] The idea behind the program is that access to financial services will accelerate the growth of micro-enterprise activity and economic development in rural areas. The MABS program has created 650 rural banks in the Philippines

[246] Bicciato, at 31.
[247] Bicciato, at 32.
[248] Bicciato, at 32.
[249] http://www.rbapmabs.org/home/index.php/about-mabs (Last accessed 10/12/09).

over the last ten years.[250] According to MABS, "limited access to financial services constrains economic growth in the Philippines" and entrepreneurs in areas with limited access to capital are often forced to rely on investors, moneylenders, and other informal and inequitable channels.[251]

This paradigm observed by MABS in the Philippines is observable throughout the developing world, including in Latin America. An important constraint to financial services access is the lack of banking infrastructure in rural areas. According to CGAP, "to achieve universal access, banks will need to adapt their systems to a low-value, high-volume transactional environment and to build more flexible, scalable retail networks of points at which people can conveniently pay into or cash out from their transactional accounts."[252] Banks can use technology to develop "banking agents" or points of access to the financial system in existing retail or postal establishments in rural communities. Such a strategy allows existing financial institutions to expand into the low-value, high-volume transaction market with minimal infrastructure costs. A CGAP study looks at access to "banking agents" in several developing countries. For example, in Brazil, there are over 95,000 banking agents throughout the country. While in Ecuador, the landscape is far less developed with only sixty-three banking agents.[253] Better technology is consistently lowering the entry cost of established financial institutions into developing credit markets. The expansion formal banking into rural areas in Ecuador has the potential to provide a sustainable market based approach to broadening credit access. Such a development would serve as an important complement to existing micro-finance programs of NGOs and governments.

An example of a financial institution providing micro-finance services to the poor in Ecuador is Banco Solidario. Founded in 1995, Banco Solidario was intended to serve the

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[250] *Id.*
[251] *Id.*
[252] http://www.cgap.org/p/site/c/template.rc/1.11.1029/1.26.1525/ (Last accessed 10/12/09).
[253] http://www.cgap.org/p/site/c/template.rc/1.11.1029/1.26.1529/ (Last accessed 10/12/09).

microenterprise sector of the economy by providing a variety of different products, and has gradually developed its microenterprise portfolio from 18 percent in 1999, to 62 percent in 2005.[254] Banco Solidario was the first private banking institution in Ecuador intended to serve the microenterprise sector of the economy.[255] The bank has been successful in attracting support from both foreign investors and from international organizations, totaling 104 millions and 14 million respectively in 2008. Serving almost 150,000 customers in 2008, the bank's portfolios in 2008 was 236 million USD, with the average loan being 1606 USD.[256] Banco Solidario provides an example of how large private banks can be viable serving the micro-enterprise sector in Ecuador. Next we turn to an examination of the regulatory approaches the Ecuadorian government has undertaken, intended to both promote the development of microfinance and protect micro-entrepreneurs.

4. Approaches to Regulation of Microfinance Institutions

Central to advancing the continued growth and effectiveness of micro-finance institutions is the regulatory framework put in place by the government. It is important to note that many micro-enterprises in Ecuador operate in the informal sector of the economy and do not comply with city licensing requirements or register their workers with the social security system.[257] These businesses often receive loans and benefit from formal micro-finance institutions which are regulated more closely by the government. It is estimated that only twenty-five percent of the micro-enterprises in Ecuador are registered with tax identification numbers or licenses.[258] The regulatory framework discussed in this section affects primarily the formal financial institutions that are in the business of making loans to the diverse population of micro-enterprises in Ecuador.

[254] Berger, at 92.
[255] Berger, at 93.
[256] http://www.banco-solidario.com/en/achievements2008.php (Last accessed 10/12/09).
[257] La Microempresa en Ecuador: perspectivas, desafíos y lineamientos de apoyo, Inter-American Development Bank at 45. (September 2006).
[258] http://www.centerforfinancialinclusion.org/Page.aspx?pid=1562

a. Development of Micro-finance in Ecuador

In his article appearing in *Microfinance Insights,* Bonjour observes, "One the most important elements for the sustainable development of microfinance is the legal and regulatory framework. Entities should be able to work freely in order to offer adequate and accessible services to these segments, allowing MFIs to retain their economic viability and deepen their service offerings."[259] As the concept of micro-finance has grown in the last twenty years, financial regulations in many countries throughout the world have also been modified to accommodate the unique requirements of micro-loans. In several Latin American countries, the governments have created regulations specific to microfinance institutions. Colombia, Ecuador, and Nicaragua all regulate microfinance as an independent lending activity.[260] Responding to political pressures and pressures from micro-entrepreneurs, Latin American governments have enacted interest rate caps on microfinance institutions in recent years not only in Ecuador, but also in Colombia, Honduras, and Nicaragua.[261]

b. Ecuador's Regulatory Structure

The *Banco Central del Ecuador* (Ecuador's Central Bank) is responsible for setting the country's monetary policy,[262] while the *Ministerio de Finanzas del Ecuador* (Ministry of Finance) is charged with administering Ecuador's finances, transparent management, and promoting sustainable development.[263] In addition to the Central Bank and Ministry of Finance, Ecuador's *Superintendencia de Bancos y Seguros* (Banking Superintendent) is

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259 Pedro Arriola Bonjour, Make or Break Scenario: The Regulatory Atmosphere Ecuadorian Perspective, *Microfinance Insights* Vol. 7 July/Aug 2008.
https://www.microfinanceinsights.com/articles_new.asp?member=&id=125 (Last accessed 10/14/09).
260 Berger, at 118. (Chapter 4, author Ramon Rosales.)
261 Berger, at 120.
262 http://www.bce.fin.ec/
263 http://mef.gov.ec/portal/page?_pageid=37,1&_dad=portal&_schema=PORTAL
http://mef.gov.ec/portal/page?_pageid=37,29036&_dad=portal&_schema=PORTAL (Mission Statement)

responsible for safeguards in the financial system, providing information to the public, and ensuring that financial institutions are governed in accordance with the law.[264]

In 1994, Ecuador enacted the *Reglamento a la Ley General de Instituciones del Sistema Financiero* (General Law on Institutions in the Financial System).[265] This law contains the general provisions governing Ecuador's banking system and covers financial institutions, banks, homeowner societies, and credit cooperatives.

c. Regulation Specific to Microfinance

In the last decade, the government of Ecuador has begun to take notice of the potential of microfinance and pass legislation that enables the continued growth of the industry in Ecuador. While a microfinance division has existed in the office of the Banking Superintendent, until recently, microfinance activities in Ecuador were largely unregulated.[266]

In recent years, the government has promoted project such as the SALTO project, aimed at developing a more workable regulatory framework for microfinance institutions.[267] The SALTO project (Strengthening Access to Microfinance and Liberalization Task Order) was developed by USAID/Ecuador in conjunction with the office of the Banking Superintendent to draft norms that would apply to microfinance, aimed at spurring growth in the industry.[268] The goals of the project were, "to support for expansion of microfinance services that directly benefit micro enterprises and the poorer segments of the population" and to "support for macroeconomic reforms that will contribute to sustained economic growth."[269] The major norms that were approved by the *Junta Bancaria (Banking Board)* in December 2002 included, 1) defining a micro-loan as one that finances "a micro-enterprise whose source

[264] http://www.superban.gov.ec/practg/p_index
[265] http://www.idlo.int/Microfinance/Documents/Regulations/ECUADOR3.pdf
[266] Supervision and Regulation of Microfinance Industry in Ecuador - USAID/SALTO Project http://www.basis.wisc.edu/live/rfc/cs_01b.pdf (Last Accessed 10/19/09).
[267] *Id.* at 1.
[268] *Id.* at 3.
[269] *Id.* at 1.

of repayments are sales from production, commerce or service activities;" 2) setting the maximum size of a micro-loan at $20,000; 3) loans that are 90 days past due must be provisioned at 100% and written off within 180 day of being past due.[270] According the Center for Financial Inclusion, projects like SALTO "demonstrate[s] the importance of the microenterprise sector in Ecuador and shows commitment by the Banking Superintendent to address the current regulatory setbacks facing the industry."[271] Steps taken by the government and other outside groups have helped to establish a functional framework of regulations that have enabled continued growth and development in the micro-finance sector of Ecuador's economy.

5. Consumer Protection Laws

Consumer protection has become an important priority in the Ecuadorian banking system in recent years. The Banking Superintendent in Ecuador[272] is responsible for overseeing the banking system and ensuring banking customers receive the same measure of transparency provided for in the *Ley Orgánica de Transparencia y Acceso a la Información Pública* (National Law on Transparency and Access to Public Information). This 2004 law requires all public institutions to make their procedures public and requires transparency for private organizations as well as NGOs.[273] To make sure consumers are well informed, banks in Ecuador are required to inform their customers of the costs associated with financial services including the fees and commissions that are charged as well as to post interest rates issued by the central bank.[274] By establishing strong consumer protection standards, Ecuador is making it easier for the banking sector to expand into the historically underserved regions of the

[270] *Id*. at 3.
[271] Ecuador Client Protection | Microfinance in Ecuador - http://www.centerforfinancialinclusion.org/Page.aspx?pid=1562
[272] *Supra*, n. 264.
[273] http://www.freedominfo.org/documents/ecuador-spanish.pdf at 2.
[274] http://www.frbatlanta.org/filelegacydocs/ac_Consumer_Lending.pdf at 12.

country and serve new consumers that have never been part of a formal banking system. For such a system to be sustainable and mutually benefit both bank and consumer, measures to protect new banking consumers at an informational disadvantage are important. Such measures protect consumers and provide clear regulations that can be enforced by government and banking regulators. Continued governmental support of strong consumer protection laws is important for further expansion of credit to historically underserved parts of Ecuador.

6. Challenges to the growth of micro-finance in Ecuador

While sustained growth of both micro-finance institutions and micro-enterprises in Ecuador are important components of continued economic development in Ecuador,[275] their continued growth faces some important challenges. According the Center for Financial Inclusion, growth in the micro-enterprise sector is often limited by the growth ceiling that many micro-enterprises typically experience after their creation.[276] With few micro-enterprises developing into large-scale operations, growth in the micro-enterprise sector requires the continued funding and development of new businesses. The informal nature of many of Ecuador's micro-enterprises also makes it more difficult for them to acquire official loans from the bigger micro-finance institutions.[277] Another crucial challenge to the future development of micro-finance in Ecuador is interest rate ceilings or caps. The impact of interest rate caps on microfinance will be discussed in the following section.

H. Impact of Interest Rate Caps on Microfinance in Ecuador

Interest rate caps present one of the most daunting obstacles to the continued proliferation of microfinance institutions throughout Latin America. Such caps establish an upper limit on how much interest can be charged on a loan and potentially restrict the

[275] *See* n. 245.
[276] http://www.centerforfinancialinclusion.org/Page.aspx?pid=1562
[277] http://www.centerforfinancialinclusion.org/Page.aspx?pid=1562

flexibility of lenders who are often dealing with a diverse population of borrowers, many of whom are first-time participants in the credit market. In his article entitled, *Financial Regulation and its Significance for Microfinance in Latin America and the Caribbean*, Tor Jansson asserts that while some micro-finance institutions "may sometimes be able to get around this type of restrictions by charging higher commissions and fees than they otherwise would, interest ceilings are, if enforced, one of the most important obstacles facing microfinance."[278] While interest rate caps can be an important form of consumer protection in certain economies, the great diversity and often unique circumstances of each micro-loan create difficulties in imposing across the board limit on the amount of interest a lender can charge a borrower. Such interest rate ceilings and usury laws affect both the financial practicability of microfinance institutions and the credit supply in the microenterprise sector.[279] Jansson further notes that rate caps can "prevent microfinance institutions from charging market clearing interest rates that are high enough to cover the relatively high per unit costs of microfinance, but they also induce financial institutions in general to screen out clients with the highest credit risk."[280] While microfinance has and continues to thrive in Ecuador and throughout the world with the support of NGOs and other not for profit aid groups, interest rate caps have the potential to make microfinance less commercially viable for financial institutions and other investors. The continued growth and expansion of microfinance in the developing world will require more than just foreign aid programs and contributions of time and money from NGOs. If the business of lending small amounts of money to borrowers traditionally considered "at risk" for non-repayment can be made

[278] Jansson at 37. *Financial Regulation and its Significance for Microfinance in Latin America and the Caribbean* (1997).
[279] Jansson at 36.
[280] Jansson at 36.

profitable, private investment from banks should make the microfinance market more competitive and capable of reaching a larger percentage of the population.

1. Usury Laws

Currently in Ecuador, there are usury laws in place that prohibit lenders from charging interest in excess of 150% of the prime rate, set by the Central Bank of Ecuador.[281] Usurious rate are monitored by the Office of the Bank Superintendent.[282] Violation of usury laws is considered a criminal offense, [283] and is covered by chapter eight of Ecuador's Penal Code.[284] This provision of the Penal Code describes a usurious loan as one that charges more interest than is allowable by law either directly or indirectly. The law provides for a prision term of six months to two years as well as a fine for violation of this statute.[285] These usury laws apply generally to all forms of lenders in Ecuador including financial institutions, NGOs, credit cooperatives, credit unions, and non-profits.[286]

2. Fee Shifting

Some lenders in Ecuador attempt to end-run the interest rate caps by charging an assortment of fees in addition to the stated rate of interest. For example, on a loan of $500, a bank might charge an interest rate of 15%, while at the same time charging a $50 origination fee. Such an arrangement would effectively raise the interest rate of the loan from 15% to 25%, since the borrower would be responsible for paying back the $500 in principal + $75 in interest + $50 in fees at the end of the loan term, or $625, rather simply 15% of $500 or $575. Known as "fee shifting," this practice allows lenders to technically comply with the state imposed interest rate caps, while at the same time, effectively receive

[281] http://www.microfinanceregulationcenter.org/resource_centers/reg_sup/micro_reg/country/12/
[282] http://ww1.elcomercio.com/noticiaEC.asp?id_noticia=124760&id_seccion=6
[283] http://www.superban.gov.ec/medios/PORTALDOCS/downloads/normativa/Ley_gral_inst_sist_financiero_ene_2009.pdf at 72.
[284] http://www.miliarium.com/Paginas/Leyes/Internacional/Ecuador/General/cp.pdf at 93.
[285] http://www.miliarium.com/Paginas/Leyes/Internacional/Ecuador/General/cp.pdf at 93.
[286] http://www.microfinanceregulationcenter.org/resource_centers/reg_sup/micro_reg/country/12/

a much higher rate of interest from the loan.[287] In order to fully compensate lenders for the risk associated with lending to the least attractive borrowers, "financial institutions find other ways to compensate for their inability to charge market clearing interest rates; closing fees, servicing fees, and discounts from face value of the debt instruments are all common methods to circumvent a restrictive interest rate ceiling."[288] According to a recent report by the International Monetary Fund (IMF), bank revenue from fees has increased from 13% of total revenue in 2003 to 18.75% in 2005. Similarly, income from service fees nearly tripled during the same period. The IMF report credits these developments to "(i) the sharp decline in the legal ceiling on interest rates from about 17½ percent at end-2003 to 13½ percent in 2005, and (ii) the increased share of consumption and micro-credit loans."[289]

While interest rate caps have the potential to offer a degree of consumer protection and provide some regulatory guidance to lending institutions, the effect of interest rate caps in Ecuador has increased fees associated with borrowing and made banks more selective of their borrowers. In a microfinance context, the maximum interest rate imposed by a cap often does not allow lenders to cover their true cost of the loan, namely because of the low value of micro-loans and their increased costs of administration.

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[287] March 2006 IMF Country Report http://www.imf.org/external/pubs/ft/scr/2006/cr06103.pdf at 18.
[288] Jansson at 36. (citing Van Horne 1990)
[289] March 2006 IMF Country Report http://www.imf.org/external/pubs/ft/scr/2006/cr06103.pdf at 48.

IV. Comparison

A. General Comparisons between in the current microfinance landscape in Africa and Latin America

While the idea and concept of extending small amounts of credit to populations historically excluded from the banking sector is deceptively simple and universally recognized as a means of poverty alleviation throughout the world, the development of microfinance has take divergent paths in different parts of the world over the past several decades. Political structures, governmental stability, level of economic development, and cultural history are all factors that influence how microfinance develops in a country or region. The success or failure of microfinance efforts in a country often depends on the interplay of these factors. Given the unique political and social histories of Latin American and Africa, one would expect each region's experience with microfinance to be distinct. While the economies and microfinance markets within Latin American and Africa are highly diverse, some general comparisons can be made between the two regions in order to better understand how microfinance develops against a particular political, social, and economic backdrop.

One of the most significant factors in the how microfinance develops in a country is that country or region's level of economic development. Increasing access to credit in an area that already has moderate degree of economic development will have different implications than in an area with little infrastructure and a much larger percentage of the population living in poverty.[290] Berger remarks in a chapter of *An Inside View of Latin American Microfinance* that Latin American microfinance has been criticized because of its lack of outreach to the poor.[291] Comparing the relative levels of economic development in

[290] "The new threshold for extreme poverty has been revised upwards to $1.25 a day in 2005 prices, increasing the estimated number of people living in extreme poverty to 1.4 billion." – USAID http://pdf.usaid.gov/pdf_docs/PNADN074.pdf at 1.
[291] Berger, at 14.

Latin America with Africa offers one potential explanation to this observation. In a region that on the whole is more economically developed like Latin America,[292] there are more economic opportunities and individuals with some previous exposure to credit markets ready to take advantage when government organizations or NGOs begin offering micro-loans. For example, the Superintendent of Banking in Ecuador recognizes 'micro-loans' as those less than $20,000.[293] Such large loans might not be considered 'micro' in certain places in Africa. Commercial banks have naturally gravitated towards making the large, but still technically considered 'micro' loans for regulation purposes in Ecuador. NGOs and other non-profit organizations specialize more in what many consider 'mirco-credit,' lending amounts typically less than $500.[294]

In a similar vein, Christen and Miller assert in *An Inside View of Latin American Microfinance* that micro-credit has moved into the regulated banking sector in Latin American more so that in other parts of the world.[295] Microfinance in Latin America began in urban markets with credit as its primary focus rather than overall access to financial services such as savings accounts. Berger observes, "Although most of the [microfinance] pioneers did target the poor, and low income people still form the majority of microfinance customers, an exclusive focus on the poor is *not* the defining characteristic of Latin American microfinance, as it is for many Asian and African institutions."[296] When comparing and contrasting microfinance in Ecuador and Uganda, it is important to keep in mind that there exist broader differences on the regional level between the two markets. The economic and political realities of Latin America and Africa have uniquely influenced the development of microfinance in the respective regions. The regulations that have developed in each country

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[292] GDP of Latin America is 5x that of Africa
[293] Supra n. 241, USAID Report (2004) at 126.
[294] *Id*. at 98.
[295] Robert Peck Christen and Jared Miller *An Inside View of Latin American Microfinance* (2003) at 238.
[296] Berger, at 2.

are a response to the unique challenges microfinance faces in each country, as well as a reflection on the level of economic development, historical background, and general political attitudes of Ecuador and Uganda. The following section will discuss the similarities between the two countries.

B. Uganda and Ecuador

1. Similarities

A general comparison of the similarities in microfinance in Ecuador and Uganda is straight forward enough. However, when the question of interest rate regulation arises, the glaring differences between the microfinance environments in each country and countries themselves become more apparent. First, in examining the similarities, we think there are few key ideas that prospective legal advisors and practitioners should take note of.

a. Economic Growth

In both Ecuador and Uganda, the governments took steps to liberalize the economy to provide a better environment for domestic and foreign investment. Both Presidents Musevini in Uganda and Correa in Ecuador brought a level of relative political stability to their nations that eliminated some currency risk and allowed the countries' central banks to deregulate interest rates. The increasing popularity and success of MFIs in both countries correlates directly with economic growth and increased openness to foreign investment. In Uganda, between 1990 and 2003, the number of MFI clients increased by approximately 800-percent, and in Latin America, the microfinance also began to take root in 1990, becoming a multi-billion dollar industry. Growth in Latin American microfinance sector has been robust in recent years, estimated at 30-40%, indicating that the microfinance industry is doubling every few years.[297]

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[297] Thomas Miller-Sanabria, *The Future of Microfinance in Latin America,* at 277.

Rapid economic growth in Uganda and Ecuador allowed MFIs to provide a conduit between the economic activities of poorer citizens and the expanding mainstream economy. We believe that it is essential to understand this aspect of microfinance. Microfinance is a lending strategy that attempts to move capital in small, carefully supervised packages to the margins of a developing society in order to give citizens increased access to investment and formal banking structures. Microfinance is unlikely to work in a region or nation with an unstable political environment or an economic environment where the mainstream economy is deteriorating because of extrinsic forces.

As we noted in the Section I, microfinance is often mischaracterized by the media as a "cure-all" for poverty in developing nations or a panacea that insulates the poor from geo-political strife. While this is worthy goal, in Uganda and Ecuador, the "cure" began with improved leadership, more successfully managed democratic institutions, and increased participation in the global economy. It is essential that microfinance practitioners and legal advisors evaluate these necessary *pre*conditions in any potential market and avoid the notion that nations in crisis could be turned around by foreign investment in MFIs or that conflicts can be circumvented by MFIs. Under the auspices of General Idi Amin, microfinance most likely would not have been feasible in Uganda. In Ecuador, and other Latin American countries, increased governmental manipulation of industries and economic liberalization could make the operation of MFIs difficult and legally hazardous.

In part, the purpose of examining microfinance regulation in conjunction with the issue of usury is to forestall the notion that microfinance is inherently "good." Micro-lending only benefits a society when the loans are administered carefully throughout the life of the loan so that there is a reasonable likelihood that many customers will be able to repay the loans and have access to more capital. Delivering loans in an unstable environmental may do more harm than good.

b. Governmental Involvement

In both Uganda and Ecuador, the current governments have, for the past ten years, simultaneously embraced microfinance and recognized the need to regulate it. In Uganda, President Musevini and the Parliament have been eager to work with the GZT and AMFIU to encourage the efficacy of MFIs. In Ecuador, President Correa, an economist educated in the United States, has issued sweeping reforms and even pushed through a new Constitution since taking office in 2007. While the recent drop in oil prices has curtailed Ecuador's ability to continue expanding social programs (including microfinance programs), under Correa, Ecuador continues to show interest in promoting the interests of disadvantaged Ecuadorians. Although the government has not yet enacted substantial legislation significantly promoting the microfinance sector, projects in recent years like the SALTO project,[298] demonstrate that the government has an interest in developing microfinance in Ecuador.

While in some respects this governmental enthusiasm should be encouraging to microfinance practitioners, it is important to recognize that both these nations' governments are interested in giving their own low-income citizens broader access to their *own* financial system. For example, Uganda's MDI Act of 2003 is designed to insure that deposit-taking microfinance institutions behave more like *macro* finance institutions with an eye towards the continued growth of those institutions. In addition, President Musevini's Bonna Baggaggawale initiative aims to use SACCOs as a way to funnel government money to poorer regions where citizens might wish to buy land. The regulations and policies are not necessarily designed to give foreign microfinance practitioners broader access to those nations' poorer entrepreneurs by outlining portable safeguards. The move to embrace the popularity of MFIs by governments can be seen as move to lend legitimacy to government banking system and not necessarily an effort to lend legitimacy to MFIs.

[298] Supra, n. 268.

Potential microfinance investors and practitioners in the U.S. and other developed nations may see microfinance as an internationally fungible activity geared towards the same type of client around the globe. However, in Uganda and Ecuador, the governments' support of microfinance is inextricably bound to their own commercial goals. As Prof. Dyal-Chiand point out,[299] Westerners have continually misunderstood the Grameen Bank's success, which had more to do with the loan officer's in-depth knowledge of their clients' commercial prospects and less to do with the generalized application of the group lending model. We believe microfinance should be portrayed and viewed by investors as a nation-specific activity with goals and practices that are part and parcel of the economic policies of the host nation. In this sense, investing in microfinance, whether for profit or charity, is as much about investing in a specific nation's commercial future as it is investing in the world's poor.

In sum, Ecuador's and Uganda's embrace of microfinance is good news for MFIs to the extent those MFIs have an in-depth knowledge of government practice and policy in regards to economic development.

c. Consumer Protection and the Profit Motive

Finally, the governments of Ecuador and Uganda have explicitly addressed the issue of consumer protection, especially in regards to interest rate regulation. In Uganda, the Parliament is most concerned with protecting its poor citizens from high interest rates despite many other pressing legal issues that were raised by AMFIU. In Ecuador, high interest rates are already criminalized in the name of protecting the poor. Advocating for strong ‘consumer protection’ rules is a safe political mantra in Ecuador and a convenient way to increase governmental involvement in the financial sector. Before getting into differences between the two countries' goals, we need to highlight two important points.

[299] *Dyal-Chiand*, supra, note 3.

First, based on our comparison, it seems reasonable to say that MFIs operating in any nation should be aware that consumer protection is likely to be a popular *political* issue.[300] Governmental bodies must cast themselves in the role of guardians of the poor. Any MFI, or MFI umbrella organization, that wishes to avoid a negative regulatory impact should be explicit in regards to its consumer protection policies, especially in regards to the concept of usury.

Secondly, neither the governments of Uganda nor Ecuador, as they weigh the merits of regulatory models, have expressed concern with whether foreign investors are able to make a profit from MFIs. One reason for this may be that determining the profitability of MFIs, their lending products, and their customers is difficult when MFIs do not seek the most profitable borrowers or seek to maximize profits through loan pricing.[301] In addition, governments that are codifying the practices of MFIs to provide banking services to needy customers cannot be seen as lining the pockets of foreign investors. While it is completely plausible that well-run institution could generate a profit, we think MFIs should avoid describing the general practice of microfinance as a profit-driven endeavor. Sustainability is the key aspect of microfinance investment. As microfinance advisor Reuben Summerlin points out, MFIs that are continually dependent on the government and donors will be driven by their goals rather the goals of clients; however, MFIs need to be aware of the importance marketing their services in way that clearly distinguishes them from loan sharks or "pay day" lenders.

2. Differences

a. Population and Economy

Although both Uganda and Ecuador have recently experienced periods of economic growth and stability, the two countries face vastly different economic pictures. As noted in

[300] Give example in United States. http://www.politicsdaily.com/2009/10/22/house-committee-approves-new-consumer-protection-agency/

[301] *See Ledgerwood,* supra, note _____, pp. 314-317 (profitability analysis). *See also* Micro Finance Deposit-Taking Institutions Act (Regulations), § 5, Objectives.

Section III, Uganda is still one of the poorest countries in the world with fifty-percent of its population living below the poverty line, earning an average income of $300 annually.[302] In addition, the economy in Uganda is largely agrarian. By contrast, Ecuador's economy can rely on many major world exports, including oil, and its wages are the second highest in Latin America. Dollarization has stabilized the currency in Ecuador, unemployment is low, and citizens do not need to be as wary of sudden currency devaluation.

While both Ecuador and Uganda have many citizens who need more access to traditional banking services, the governments of these countries are going to have different goals. In Uganda, as evidence by Musevini's Bonna Baggaggawalle program, the government's primary goal is *outreach*.[303] When the BoU was forced to contract its network of services, MFIs stepped in to fill in the gaps, and Museveni embraced microfinance as the part his governments continuing relationship with the World Bank and IMF. Musevini most likely recognized that in order to maintain stability in his country, he needed foreign support. For a leader trying to establish legitimacy, microfinance activity appears to be an innocuous form of foreign investment. While MFIs bring new capital to Uganda's rural counties, the loans that fund them are not tied to the stipulations that might come with larger loans from foreign powers.

In Ecuador, however, Correa does not need to prove the nation's economic viability in order to legitimize his presidency. Instead, the legitimacy of his presidency depends more on his government's ability to independently provide services and opportunities to the nation's poorer citizens in order to include micro-enterprises in Ecuador's already considerable economic growth. Therefore, as pointed out in Section III, stronger oversight by the central bank of Ecuador seeks to *consolidate* the banking sector, rather than simply reach an isolated

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citizenry. The challenge facing Ecuador is the continued funding and development of new businesses in order to move capital from the center of the mainstream economy and incorporate the productivity of the nation's micro-enterprises. As in other leftist Latin American countries where oil is also a major export, this task has proved increasingly difficult as government revenues have fallen sharply with the decline in price of oil. Lower oil revenues make it more difficult for governments to demonstrate their largesse to the people, often an important factor in a government's continued enjoyment of political favor.

For a lawyer or micro-finance advisers, understanding the differences among the level of development in these nations is essential for approaching the issue of regulation. In a country like Uganda where the economy is under-developed and rural regions have no access to banking, the government may have a greater incentive to work with MFIs to insure that they remain autonomous. In Ecuador, where the concern is that micro-enterprises, which comprise anywhere from 10-25%[304] of the country's GDP, exist as a shadow economy alongside the nation's central industries, the government is concerned with insuring that micro-banking services conform to centralized transparency rules in order to promote increased economic uniformity.

MFIs that are transforming their practices or setting up new lending institutions in Ecuador or Uganda would to focus on designing different lending products and focus on different areas of the nations' laws.

b. Communication and Legislation

Both the governments of Ecuador, through its SALTO project,[305] and Uganda, through the MDI Act of 2003,[306] have expressed a strong desire to promote microfinance; however, the two countries have gone about it differently.

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[304] Supra, n. 241, 242.
[305] *Supra*, n. 266.

It is extremely important to the note that the willingness of Uganda's government to work with AMFIU and foreign advisory groups to study the effects of microfinance regulation before passing any laws is unprecedented in most developing nations. The process of cooperation between microfinance advisory groups and Uganda's MPs produced a new variety of MFI, the deposit-taking institution, and for the time being, kept constrictive usury laws off the books despite the potential political appeal of such laws. This experience underscores the role that lobbying and educating policy makers plays in promoting microfinance. We think that one of the crucial roles of legal practitioners in microfinance will be to learn the commercial banking standards of developing nations and then communicate with policy makers about the possible effects of regulations on the MFI sector. For the most part, Uganda provides a good example of that process can work.

Although MFIs have also thrived in Ecuador, the government's push for consumer protection laws has not involved bilateral communication with the MFI sector. (verifiable?). While politically popular, general consumer protection laws do not necessarily contribute to the growth and sustainability of MFIs. Many MFI sector practitioners are unsure of what Correa intends in terms of further regulation of MFIs, and it is also not clear the extent to which interest rate caps and usury laws apply to credit unions and smaller MFIs. When microfinance practitioners and prospective investors are unsure of the continued viability of the industry, they may be less likely to view Ecuador as good market for continued MFI development. Understanding how consumer protection laws specifically impact the microfinance sector can be useful in setting legislative priorities and ensure efficient allocation of economic and political resources. This problem emphasizes the need for well-informed legal advisors to communicate with the government of Ecuador, review the

[306] Supra, n. 168.

commercial banking laws, and propose proactive solutions that address the issue of consumer protection without chasing away microfinance.

c. Interest Rate Caps, Usury Laws, And Fee Shifting

In the usury section of this article, we pointed out that charging high interest for loans has been frowned upon and criminalized for centuries. On the other hand, even the Bible recognizes the need for commerce, and countries traditionally stream-line their lending laws to allow banks to recoup the cost of transferring funds to customers at rates that reflect the realities of the market. We also noted that microfinance loans involve higher administration costs. Perhaps the single most identifiable aspect of microfinance that differentiates it from predatory lending is the ability of MFIs to focus on the context-specific needs of borrowers and amend loan products and repayment rates accordingly. This may often mean that in some situations MFI lenders may need to charge above-market interest. At the same time, however, the goal of MFIs is to provision below-market interest rates by improving the financial well-being of consumers.

In Section I of this article, we cited a law review commentator[307] who argued that South Africa's National Credit Act of 2005 may have solved the problem of regulating interest rates by authorizing the nations trade minister to manipulate rate caps based on market data. However, we also cited commentators, like Reuben Summerlin, who are concerned that interest rate caps can jeopardize the feasibility of microfinance and encourage lenders to charge hidden fees.

In Uganda, as noted in Stephan Staschen's article,[308] the Medium Term Competitive Strategy specifically states the government's commitment to avoiding interest rate regulation. In addition, the MDI Act of 2003 did not set interest rate caps for MFIs. This aspect of Ugandan

[307] *Whittaker*, supra, note 25, pp. 580-81.
[308]

microfinance has captivated the attention of the microfinance community around the world, which bodes well for future investment in Uganda's economy. However, the MDI Act of 2003 left 1,300 SACCOs largely unregulated, and we noted in Section I, the news media shared the government's concern that SACCOs may not always do business fairly.

The government of Ecuador seems to offer a higher level of consumer protection to prospective borrowers. In theory, at least, The National Law on Transparency and Access to Public Information makes it easier for Ecuador's banking sector to reach needier clients for whom the problem of information asymmetry can be acute. However, just as the microfinance community has been intrigued by the Ugandan Government's willingness to forego interest rate caps, that same global community is increasingly wary of what interest rate caps and usury laws will mean for MFIs in Ecuador. MFIs in Ecuador may employ the practice of fee shifting that we described in Section II if they cannot recover the cost of administering small loans to their clients. Fee-shifting has been on the rise in recent years in Ecuador[309] and fees, unlike interest rates, represent more of a moving target and can more easily be manipulated to avoid regulation. In many respects, fee shifting looks more like usury than simply charging higher interest rates because end-run fees may be hidden and unresponsive to the context of the customer's loan. In addition, smaller MFIs and credit unions may be deterred from offering an expanding range of services to customers because they wish to avoid oversight by the central bank and fly beneath the radar like the SACCOs in Uganda.

We do not believe that microfinance practitioners' concern about interest rate caps amounts to an idle gripe about profit margins. Over-regulation of interest rates in microfinance can severely limit its efficacy at the national level. In Vietnam, for example, the Microfinance Decree of 2004, which was supposed to enable MFIs, succeeded in chasing

[309] Supra, n. 289.

smaller institutions, catering to the nation's neediest lenders, out of business because the regulatory burden was too high.[310] Specifically, the Vietnamese government's insistence on low interest rates was impracticable:

> MFIs operating in Vietnam contend that in order to compete with government programs, they are forced to offer comparable interest rates [8-9%]. At these interest rates, MFIs are unable to break even, much less expand their offerings. Research in other countries has demonstrated that the poor are willing to pay high interest rates to have access to financial services. MFI operators insist that eliminating interest rate subsidies would encourage efficiency and allow MFIs to establish sustainable business models.[311]

The problem of regulating microfinance to protect consumers and also promote the entry of new MFIs in to the market is not, as it turns, a simple question of whether to cap interest rates or how rates should be. In addition, we believe that the cases of Uganda and Ecuador prove that the simply drafting complex legislation to regulations to address the issue of usury may be insufficient.

d. Prudential v. Non-Prudential Regulation

One issue which has not been widely addressed by microfinance experts is the question of oversight because there is still a lot of research to be done in the area.[312] However, as Stephan Staschen points out, one answer to the problem of reconciling consumer protection laws with the need for MFI autonomy may lie in finding the correct combination of non-prudential and prudential regulation.

Both Uganda and Ecuador have relied on their central banks as the source of regulatory promulgation and oversight. However, in Uganda, the Parliament has noted that cost of regulating the country's 1,300 SACCOs may be too much for the BoU. It appears that the same problem is surfacing in Ecuador, where the central bank is unable to tweak its regulatory framework to contemplate smaller lenders. In addition, as illustrated by the

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310 Elin M. King, *Vietnam's Decree on Microfinance: A Flawed Attempt to Create an Enabling Legal Environment for Microfinance*, 17 Pac. Rim L. & Poly J. 187 (2008).
311 *King*, supra note 296, p. 198.
312 There is a footnote for this in Ledgerwood. I have to find it again.

problem with Vietnam's regulation framework, while sheaves of consumer-friendly regulations may seem to guard against the problem of usury, for a smaller institution, regulatory compliance could represent a significant percentage of its operating costs.

An organization like AMFIU in Uganda may be able to provide non-governmental certification and oversight services that allow the government to better protect consumers. A private sector umbrella organization would need to be backstopped by enforceable government requirements, and the government would need to rely on such on organization to report information on its membership accurately. The organization would also need to serve as an advocate for its members. U.S. lawyers could play an active role setting up non-prudential regulation networks that would operate in conjunction with mandatory prudential regulations of a developing nation.

V. Conclusion

In this article we have examined the concepts of usury and interest rate caps as they relate to microfinance. Focusing on the legal issue of usury and the economic issue of interest rate caps, the article attempts to reconcile the popular potential of microfinance with the problem of providing consumer protection and regulating interest rates. Looking at the impacts of usury laws and rate caps in two different countries provides examples of how governments have begun to develop regulations aimed at increasing the benefits of microfinance.

Microfinance has the proven potential to drastically improve the quality of life of a population by providing them entrée to the mainstream economy. Even though some citizens of developing nations are highly productive and resourceful, they often cannot offer sufficient credit history and collateral to be eligible for loans or savings accounts from traditional commercial banks. Microfinance institutions offer loan products to individuals or groups of clients by gathering information and assessing the specific circumstances surrounding each loan in order to make banking work for poorer citizens.

While microfinance has garnered a lot of positive media coverage in some contexts, many governments are concerned that the practice could be abused and the poor exploited. Microfinance loans are costly to administer, which means microfinance institutions sometimes need to charge high interest rates; however, legislative bodies in developing nations need to protect needier citizens from usurious, or predatory, lending in order to maintain credibility. We have attempted to put the concept of usury in its historical context as a way of divorcing the idea of usury from a specific percentage of interest. The goals of microfinance institutions are clearly distinguishable from those of unscrupulous moneylenders, although both might charge a similar nominal interest rate. A reputable MFI might charge a 30% interest on a loan to a poor villager because education costs, administration costs, and degree of risk are all considerably higher than with a typical loan. While 30% might evoke thought of payday lenders in a highly developed economy like the United States, such a rate is often entirely just and reasonable in the microfinance context. Putting the concept of usury into context serves as a useful means of examining the value of interest rate caps in microfinance regulation.

A tempting solution to the challenge of balancing consumer protection with financial viability might be to propose a set of bright-line regulations that would simultaneously allow practitioners to set their own interest rates while also providing debtors recourse to legal safeguards. However, after comparing the regulatory frameworks in Ecuador and Uganda – two nations that have struggled with this issue – it becomes more apparent that a one-size-fits-all solution would probably not be feasible.

In Uganda, where the government has been more receptive to the advice of foreign microfinance advisers, the average citizen earns approximately $300 USD per year. Despite recent economic progress, Uganda is one of the poorest nations in the world, and the government's goal in embracing microfinance is reaching out to citizens in its rural counties. The government of Uganda has been willing to forego the regulation of interest rates as long as the microfinance community continues to negotiate with its Parliament. In Uganda, the Parliament has passed some regulations that may help the growth of the industry, but practitioners may also need to take steps to regulate themselves. Uganda has an umbrella organization of microfinance institutions that may be able to achieve this goal.

By contrast, Ecuador has some of the highest wages in Latin America. Ecuador recently converted its currency to the U.S. dollar, and it exports oil, coffee, and bananas among other popular products. While Ecuador relies on microfinance to move capital from its mainstream economy to its many micro-entrepreneurs, the government has a vested interest in establishing itself as a guardian of the interests of the poor. The central bank of Ecuador has issued a number of interest rate caps, and the nation's penal system also outlines harsh penalties for the practice of usury. Microfinance practitioners in Ecuador may need to be more proactive about communicating with the government. In addition, microfinance institutions need to work harder to prove to the government that they will not allow predatory lenders in their midst.

Examining the difference in attitude towards microfinance in these two nations, it becomes clear that an understanding of recent history needs to play a major role in the development of microfinance regulation. Uganda's national identity has frequently been undermined by factionalism, so the government is looking for outside investment to strengthen its national outlook. Ecuador, however, may wish to prove to its citizenry that it can operate independently from the West, so the government's concerns about the rule of law in commercial banking may trump the interests of microfinance institutions.

Ultimately, legal practitioners need to gain an in-depth understanding of a nation's political and economic goals in order to assist in the development of both prudential and non-prudential regulations. While it might seem appealing to recommend that a developing nation should adopt guidelines similar to the U.S. Truth in Lending Act, that solution might not be realistic. Many U.S. citizens are not aware of their rights under federal lending laws and are unable to access our legal system because of the time and money required. Citizens of developing nations might be even less likely to benefit from extensive banking regulations that require a high level of education and involvement. National governments also have widely divergent goals when they set out to promulgate regulatory frameworks. In order to achieve higher levels of penetration and sustainability, the practice of microfinance needs to be tied to consumer education and a high level of lender involvement in the local community.

It is our hope that this article might prove informative for prospective microfinance practitioners and encourage people to look beyond the most immediately accessible sources to understand the particularized needs of nations and microfinance clients. The role of regulation will continue to be critical as microfinance programs continue to grow in countries around the world. Much of the potential success of microfinance efforts depends on how countries decide to regulate MFIs. While it is easy politically and often important for governments to enact popular measures aimed at consumer protection such as interest rate caps, practitioners and advisors to governments must be cognizant of the impacts that interest rate caps can have in the microfinance context. Understanding the unique nature of micro-loans and the array of factors involved in determining a sustainable rate of return for both the lender and borrow are crucial for developing sound regulation that not only takes into account the broader social and economic impacts of a thriving microfinance sector, but also acknowledges the relativity involved in the concept of usury.