Microlending: State Regulatory Reforms to Promote Economic and Employment Growth in California

Deanna Chea
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Microlending has earned a great deal of acclaim for alleviating poverty and facilitating self-sufficiency among entrepreneur recipients of microloans, particularly in developing countries. The microlending structure has been repeatedly replicated and tailored to successfully meet each community’s unique needs. As one of the most socio-economically, geographically, and culturally diverse states in the United States, California can reap the benefits of microlending with careful development of proper infrastructure. This note examines the history of microlending, provides an overview of the current economic state of California, and proposes a number of state legislative and regulatory reforms to create a sustainable and robust microlending framework. In arguing that microlending is an effective potential tool to facilitate optimal economic recovery and growth, post-housing bubble recession, this paper seeks to promote further research and exploration of microlending in the California context.

I. INTRODUCTION

Microlending is a single financial product under the larger umbrella of microfinance—the provision of formal financial services to those in poverty and others who are systematically excluded from the traditional financial system. Microfinance embraces a broad array of credit products, as well as savings, money transfers, and insurance.

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2. Id.
“Microcredit,” synonymous with “microloans,” are generally much smaller than conventional bank loans, require no collateral or unconventional collateral (usually insufficient to cover a lender's loss in case of default), and borrowers are typically self-employed or informally employed.³

While the microfinance and microcredit phenomena are more frequently associated with efforts to end poverty abroad, microlending has great potential in California. As one of the most robust and socio economically, geographically, and culturally diverse states in the country, microcredit is particularly well-suited to promote self-sufficiency among low-income Californians, stimulate the state's economy, and provide a sustainable, profitable, socially conscious local investment tool. This note provides a history of microlending, an analysis of California's economic and employment conditions, and proposes legislative and regulatory reforms that will aid in achieving these outcomes in the California context.

II. BACKGROUND

A. MICRO CREDIT IN DEVELOPING COUNTRIES

1. History

Microlending has existed for hundreds of years.⁴ Accion International ("Accion"), a premier microfinance organization, and Muhammad Yunus, the founder of the Grameen Bank, however, both claim to have independently pioneered the concept of microcredit.⁵

In 1973, an organization under Accion began issuing small loans to micro-entrepreneurs in Brazil after observing that the major cause of poverty in Latin America was a lack of economic opportunity.⁶ The experiment was a success with a repayment rate of 99.5 percent.⁷ Within four years, 885 loans were issued, creating or stabilizing over 1,300 new jobs.⁸ Over the following decade, Accion successfully

³. CGAP, supra note 1, at 6.
⁴. Sana Khan, Poverty Reduction Efforts: Does Microcredit Help?, 29 SAIS REV. no. 2, 147 (Summer–Fall 2009).
⁷. Id.
⁸. Id.
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extended its microfinance programs to thirteen other countries in Latin America, with a repayment rate of ninety-seven percent.\(^9\) As of February 2013, Accion operates an expansive network with presence in Latin American and the Caribbean, Africa, Asia, and the United States.\(^10\)

In the 1970s, Yunus began a pilot program in his native country of Bangladesh.\(^11\) The program issued small loans to poor, rural women to fund their entrepreneurial endeavors in order to create self-sustaining sources of income.\(^12\) To participate, the women were required to join a small group, attend regular meetings, and adhere to the program’s guidelines.\(^13\) Unlike conventional lending models that require borrowers to meet a standard set of criteria establishing creditworthiness in addition to traditional collateral, the program employed a peer lending approach.\(^14\) All members were held jointly accountable to one another in the event that a single member defaulted.\(^15\) The pilot project was a success: It turned out that the women were highly reliable borrowers, resourceful entrepreneurs, and invested in the health and well-being of their families.\(^16\)

2. Success

With commercial banks in developing countries serving less than twenty percent of the population,\(^17\) microcredit programs are critical in providing access to basic financial services, otherwise unavailable through conventional banking institutions, to the poor.\(^18\) The primary purposes behind microlending are to allow recipients to create an asset base, enhance their income, and protect themselves against risk of income flow interruption.\(^19\) Loans are typically used for income generating activities, including small-scale enterprise development and agriculture.\(^20\)

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9. Id.
12. Id.
13. Id.
14. Id.
15. Id.
16. Id.
17. Richardson, supra note 5, at 924.
18. Khan, supra note 4, at 148.
19. Id.
20. Id.
Since Yunus' pilot project and the development of Accion, microfinancing has evolved to cover a menu of banking and financial services, including savings accounts, consumption/emergency loans, insurance, and business education. These products, in addition to Yunus's peer-lending microcredit model, have since been replicated around the world. Millions of microentrepreneurs have received billions of dollars in microloans to start and expand their businesses. With repayment rates of over ninety percent, these microlenders have enjoyed great success and have become self-sufficient.

Celebrated as a tool to eliminate poverty, microcredit has gained high esteem and recognition abroad. The U.N. declared the year 2005 to be the International Year of Microcredit; Muhammad Yunus and the Grameen Bank were co-recipients of the Nobel Peace Prize in 2006 for economic and social development; and Yunus was awarded the Presidential Medal of Freedom in 2009 for his work in poverty alleviation. Worldwide, Accion has served 5.1 million clients in thirty-one countries through sixty-three MFIs and has issued over $9.9 billion in microloans. The Grameen Foundation has helped 9.4 million microentrepreneurs internationally and enjoys a repayment rate between ninety-five percent and ninety-eight percent.

3. Current State

Today, nongovernmental organizations ("NGOs") and donor groups comprise the majority of microlenders in developing countries. An increasing number of commercial microcredit providers, including commercial banks that alter their traditional lending practices, credit unions, and commercialized NGOs licensed as financial institutions, are extending microloans. Microfinance institutions ("MFIs") are formal institutions primarily in the business of providing financial services to

23. Richardson, supra note 5, at 925.
24. Id. at 924.
26. Id.
29. Richardson, supra note 5, at 927.
30. Id.
the poor. Most seek funding from international development banks, the government, and to a smaller degree, private investors, in order to secure self-sufficiency.

B. MICROCREDIT IN THE UNITED STATES

1. History

Similarly modeled after Accion and the Grameen Bank, microlending in the United States began in the 1980s. By the early 1990s, MFIs spread throughout the country, leading a presence of at least 108 nonprofit leaders, in addition to state and national trade associations. In 1991, the Small Business Administration recognized microenterprise as its own category of business and established the Microloan Demonstration Project. By 1995, however, no microlender broke even in their microlending efforts, essentially operating as a charity. In 1999, the Program for Investment in Microentrepreneurs ("PRIME") Act was passed, increasing federal funding for microlending programs, but funding was drastically cut during the Bush administration from 2001 to 2005.

The presence of microbusinesses in the United States, defined as businesses with zero to four employees, has grown significantly. Between 2002 and 2009, the number of microbusinesses increased 16.96 percent, growing from 21.5 million to 25.1 million. Additionally, the country experienced a steady growth in the presence of microbusinesses from 86.7 percent to 88.19 percent over this time period.

31. CCAP, supra note 1, at 6.
32. Richardson, supra note 5, at 927.
33. Richardson, supra note 5, at 929.
35. Id. at 383.
36. Id. at 385–86.
37. Id. at 386.
39. Id.
40. Id.
2. **Current State**

In 2009, the American Recovery and Reinvestment Act ("ARRA") expanded the SBA’s Microloan program, designating an additional $50 million for loans and $24 million for technical assistance. The fiscal year 2009 appropriated $20 million for loans and $20 million for technical assistance. Microlenders may receive up to $3.5 million in low-cost loans from the SBA to finance their lending to small businesses. Funds under this Act have averaged $3.1 million over 2010 and 2011.

The overwhelming majority of microcreditors in the U.S. are non-profit organizations that serve as local intermediaries for federal funds. Some of these microlending organizations include MFI-focused groups, community based organizations, credit unions, and centers at universities. The Accion U.S. Network is the largest U.S. microlending network, having issued over 43,000 loans and $350 million since its inception in 1994. The average loan size from Accion U.S. is $10,049. The organization has enjoyed a loan repayment rate of ninety percent. Accion East and West Online, part of the Accion U.S. Network, issues loans with interest rates between eight percent and fifteen percent, which are more costly than prime-rate commercial loans, but far more affordable than financing with credit cards, invoice factoring companies, or payday loans. Grameen America is one of the fastest growing MFIs in the U.S. Since its inception in 2008, Grameen America has invested $66.2 million in 13,565 loan recipients. Its interest rate is fifteen percent on a declining balance.

42. Small Business Association, supra note 41.
43. Id.
44. Walker, supra note 34, at 386.
45. Id. See also Richardson, supra note 5, at 929.
46. Richardson, supra note 5, at 930; Walker, supra note 34, at 386.
48. Id.
49. Id.
53. FAQ, supra note 51.
thereby improving borrowers’ credit scores.\(^5^4\)

A smaller number of nonprofit organizations operate independently from the government.\(^5^5\) Generally, U.S. microlenders do not adopt the peer lending approaches that are used by lenders abroad.\(^5^6\)

Alternative microlending structures have emerged in recent years.\(^5^7\) Kiva and MicroPlace are two leading, exclusively online, platforms that make microloans available to individual lenders and to microentrepreneurs.\(^5^8\) Kiva adopts a “person-to-person” lending model, whereby lenders select a cause of their choice and lend as little as $25.\(^5^9\) Lenders can monitor the progress of their loan recipient via email updates.\(^6^0\) As the principal funds are returned to the lender, the money becomes available to relend or withdraw as the lender wishes.\(^6^1\) Lenders do not receive an additional return or interest for money loaned.\(^6^2\) Thus, Kiva essentially operates as a nonprofit intermediary in an informal lending setting.

MicroPlace, on the other hand, offers investment opportunities for individual lenders for as low as $20.\(^6^3\) Under MicroPlace, an additional intermediary is added to the lending process. MicroPlace connects individual lenders to organizations, or “issuers,” who offer short-term notes for purchase.\(^6^4\) The issuers then forward the proceeds to microborrowers for use in their enterprises.\(^6^5\) Borrowers’ loans generate interest between 0.5 percent to 4.5 percent after the notes mature; loans mature between three months and to five years.\(^6^6\) Issuers include privately operated, nonprofit, and cooperative organizations.\(^6^7\)

As of April 2011, there are approximately 25.5 million microbusinesses in the United States.\(^6^8\) Despite this growing presence, a
significant portion of microentrepreneurs remain underserved, particularly women, Black, Latino, and Native American owned businesses.69 Furthermore, nearly three-fourths of microentrepreneurs rely on their businesses as their primary sources of income.70 As of 2009, less than one percent of microentrepreneurs have received microloans to date.71 Loan repayment rates are lower in U.S. markets and microlenders have failed to reach the level of self-sufficiency and sustainability that many international MFIs have attained.72

Surveys of microentrepreneurs, however, show that strong employment is generated by microenterprises.73 In 2008, forty-five percent of microentrepreneurs reported paying employees or contractors to work in their business.74 Excluding owners, these businesses provided, on average, 2.2 jobs per business.75 Five-year group data shows even more promising data: Fifty-two percent of owners provided an average of 2.5 jobs per business.76 Thirty-nine percent of those who reported full or part time status of the positions created in 2008 reported that the jobs were full-time positions.77 Furthermore, about half of those who provided employment reported data on payments.78 For that group, the median hourly wage was $10.00—fifty-three percent higher than the federal minimum wage of $6.55.79 The mean wage was $13.00. While thirty-six percent below the median hourly wage of $15.57, the median is substantially higher than the federal minimum.80


69. Id. (Seventy percent of all businesses produce revenues under $100 thousand. Eighty-seven percent of women-, Black-, and Native American-owned businesses, and 81 of Hispanic-owned businesses generate less than $100 thousand. These groups are systematically underserved).


72. Richardson, supra note 5, at 929.


74. Id.

75. Id.

76. Id.

77. Id.

78. Id.

79. Id. at 3.

80. Id.
C. MICROCREDIT IN CALIFORNIA

Microloans funded by the U.S. Small Business Administration ("SBA") are issued through fourteen local intermediaries scattered throughout California.81 These intermediaries are nonprofit, community-based organizations experienced in lending and business management assistance.82 Loans through the SBA are available up to $50,000 for the purpose of assisting small businesses and certain not-for-profit childcare centers start up and expand.83 The average microloan is $13,000.84 Loan recipients may use the proceeds for working capital, inventory or supplies, furniture or fixtures, or machinery or equipment, but may not use it to pay existing debts or purchase real estate.85 Eligibility for the microloans depend on the criteria set by microlenders, which generally require some form of collateral in addition to a personal guarantee from the business owner.86 These intermediaries also determine repayment terms, interest rates, and fees, however the maximum repayment term is limited to six years. Interest rates are typically between eight percent and thirteen percent.87 Some lenders require applicants to meet training or planning requirements in order for applications to be considered.88

Some online microfinance platforms are headquartered in California, but many provide microloans virtually.89 Certain private microlenders in California operate as licensed lenders, who are permitted to make commercial loans without being subject to California’s usury provision in the state Constitution.90 These lenders can charge interest rates as high as one hundred and forty-nine percent for a $6,000 loan in addition to a $1,500 loan fee.91

82. Participating Intermediary Microlenders Report, supra note 81
84. Id.
85. Id.
86. Id.
87. Id.
88. Id.
California saw a recent expansion of the microenterprise sector. The number of microbusinesses increased from 2.7 million to 3.2 million or 16.85 percent, from 2002 to 2009, with the total number of microbusinesses hovering closely around eighty-nine percent of the number of total firms. Other measures of microenterprise growth support these findings, including tax-return data indicating a 25.8-percent growth, and Employment Development Department ("EDD") provided population survey data showing a 16.53 percent increase between 2000 and 2007.

Microenterprises in California make significant impacts on the state’s employment rates. In 2009, 23.3 percent of total employment in California was in microenterprises, slightly higher than the national rate of twenty-two percent. Between 2000 and 2007, the number of employees in microenterprises increased by twenty-six percent. Approximately seventy-nine percent of this increase was attributed to growth in self-employed. Additionally, microenterprises in rural counties employ a larger share of the workforce at 23.5 percent than microenterprises in urban counties at 18.7 percent. These data indicate that microenterprises and small businesses contribute to employment growth at a greater degree than larger businesses.

D. Projected Job Needs

As of 2011, employees in microbusinesses had strong presence in the following industries as compared to larger businesses:

- Real Estate and Rental and Leasing: 19.19 percent
- Professional and Technical Services: 11.26 percent
- Other Services (Repair and Maintenance; Personal and Laundry

93. Id.
96. Memo to Senator Leland Yee, Microenterprises in the Economy, supra note 52, at 10.
97. Id.
Services; Religious, Civic, Professional & Similar; Private Households): 48.21 percent

- Non-classifiable Establishments: 91.02 percent

The total number of employees in microbusinesses comprise 10.56 percent of the overall service industry. The highest long-term job growth in California between 2010 and 2020 is projected to be in the Professional and Business Services industry, with Other Services as the 10th highest projected job growth area. Similarly, the highest short-term job growth area in California between 2011 and 2013 is projected to be Professional and Business Services, with Other Services as the 11th highest projected job growth.

With high rates of current and projected employment presence of microenterprises, particularly in the service industries, California provides fertile ground for increased economic growth through greater development of the microenterprise sector. Furthermore, recent economic analyses suggest that start-ups impact job growth more significantly than mature small businesses, contrary to common belief that small businesses are the largest engines of job growth.

Of particular note is that California possesses very region specific industries, unique from other states. A recent report found that, "[w]ith agriculture in the Central Valley and high tech in the Bay Area, entertainment and foreign trade in Southern California and tourism in coastal and mountain locales, the state’s regions are known for their distinct economies. These regions possess different strengths, demographic profiles, housing prices, climates, and unemployment challenges."
III. ANALYSIS

A. CURRENT REGULATION

1. Federal

Microlenders in the U.S. are largely unregulated. Currently, there is no governmental body dedicated to the regulation of microlenders. The bulk of microlenders in the U.S. operate as nonprofits. As such, they are primarily subject to IRS regulations governing for nonprofits and state level small business and consumer protection regulations. Nonprofits that participate in the SBA’s Microloan program are subject to its rules under the PRIME Act. The Act authorizes the SBA to make grants to qualified intermediaries, and details the parameters of participating organizations, amounts of award allocations, and length of funding, etc. The Act, however, only affects microlenders that participate in the SBA’s Microloan program. Microlenders must also meet accreditation standards, such as undergoing a certification process to become a Community Development Financial Institution. Furthermore, the Association for Enterprise Opportunity (“AEO”), a national trade association for microbusinesses, has established a guide of minimal standards for which lenders should adhere, relating to lending, training, performance, governance, management issues, and financial soundness.

The Community Reinvestment Act (“CRA”) of 1977 was passed to encourage private banks to serve low-income communities and their credit needs by partnering with MFI’s and though other means. The CRA required that banking industry regulators consider whether banks offered such services in low-income communities as part of their duties to rank banks. Congress also passed the CRA because the government was unable to maintain certain community programs without support.
from the private sector. While the CRA has assisted in serving communities that have been traditionally unable to access common banking services, it is still significantly limited in lending to low-income borrowers. Banks set their own compliance goals for the CRA, there are no specific pass or no-pass thresholds, and regulators have wide latitude in determining a bank’s compliance. For these and other reasons, the CRA is regarded as highly ineffective in achieving its goals of assisting low-income communities.

Private banks partnered with MFIs, and in compliance with the CRA, are subject to the same regulations as any traditional bank. Under these regulations, interest rate ceilings and the possibility of excessive interest rates serve as two primary impediments to MFIs attaining self-sufficiency or profitability. Interest rate ceilings hinder the ability of MFIs to become profitable by limiting the greatest opportunity for revenue generation. Usury laws prohibit excessive interest rates; however, states enact these regulations. Most state usury laws cap interest rates at 10 percent.

Capital holding requirements also present impairments to achieving success with microlending in the private sector. Capital holding requirements necessitate that banks hold a certain amount of capital against each loan they distribute according to the level of risk that loans carry—the greater the risk, the greater the required holding. The Basel Committee on Banking Supervision is a group comprised of central banks and supervisory authorities from different countries that promulgate the Basel Capital Accord (“Basel III”). Basel III requires banks to hold a total of 8 percent of their “risk-weighted assets” (such as loans) and “asset-equivalent off-balance sheet exposures” (such as loan commitments). This total is slated to increase to 10.5 percent between

117. Id. at 932.
118. Id.
120. Walker, *supra* note 34, at 344.
121. Richardson, *supra* note 5, at 931.
122. Id.
123. Id.
124. Id.
125. Id.
126. Id. at 932.
127. Id.
2013 and 2019 by 2.5 percent, designated as a capital conservation buffer, which is established above the regulatory minimum capital requirement.\textsuperscript{129} These capital requirements impede loan origination by discouraging banks from issuing high risk loans.\textsuperscript{130} The Basel Committee recognized the inherent complexities of compliance with Basel III against the overall framework of microfinance.\textsuperscript{131} The Committee issued a consultation report clarifying the general application of Basel Core Principles of Basel III and a range of practices on regulating and supervising microfinance activities, however, it does not alter any provision in Basel III.\textsuperscript{132}

2. California

Currently, California provides several regulatory incentives and rewards for microentrepreneurs by way of small business funding appropriations, tax credits, loan guarantees, inclusion of qualified microlenders to the California Capital Access Program ("CalCAP"), and increases to loan reporting requirements, but provides few microenterprise-specific regulations.

The California Small Business Financial Development Corporation Law ("Law") authorizes the formation of small business financial developments corporations to grant loans or loan guarantees to stimulate small business development.\textsuperscript{133} The Law also created the California Small Business Board ("Board") and the California Small Business Expansion Fund ("Expansion Fund").\textsuperscript{134} The Board consists of the Secretary of Business, Transportation and Housing, six members actively involved in the California small business community, two members actively involved in the business or agricultural communities, and two members of the California Legislature.\textsuperscript{135} The Board is tasked with advising the Executive Director, approving new corporations recommended by the director, holding public hearings, and advising the state Governor and small business advocates regarding issues affecting

\begin{itemize}
  \item \textsuperscript{129} Id. at 54.
  \item \textsuperscript{130} Richardson, \textit{supra} note 3, at 932.
  \item \textsuperscript{131} \textit{BASEL COMMITTEE ON BANKING SUPERVISION, MICROFINANCE ACTIVITIES AND THE CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION} (June 2011), \textit{available at} http://www.bis.org/publ/bcbs175.pdf.
  \item \textsuperscript{132} \textit{BASEL COMMITTEE ON BANKING SUPERVISION, supra} note 131.
  \item \textsuperscript{133} \textit{CAL. CODE REGS.} Title 1, \textsection 14030-14031 (2001).
  \item \textsuperscript{134} Id.
  \item \textsuperscript{135} Id. at \textsection 14021.
\end{itemize}
California’s small business community. The Expansion Fund, operative in 2018, authorizes the State Treasury to pay out all or a portion of the funds to a lending institution or financial company that acts as trustee of the funds. The Expansion Fund is appropriated to pay for defaulted loan guarantees, administrative costs of corporations, and costs necessary to protect a real property interest in a defaulted loan or guarantee.

In February of 2013, Assembly Bill 780 was introduced to appropriate $2 million from the General Fund to financial development corporations for use in ongoing administrative operations. The amendment would also make specified declarations of legislative intent regarding the oversight and duties of the Governor’s Office of Business and Economic Development. Assembly Bill 201 was passed in October of 2013, which requires the Office to post on its website information regarding its direct lending, loan guarantee, and other programs, providing greater access to lending information.

Effective January 1, 2009, a new California tax credit is available for additional full-time employees hired by small businesses of twenty or fewer employees; a credit of up to $3,000 is available. On March 4, 2013, California allocated $400 million for this particular tax credit. To date, small business employers have filed 8,668 Personal Income Tax (“PIT”) returns and 15,677 Business Entity (“BE”) tax returns. Steady growth of both PIT and BE tax returns since the introduction of the New Jobs Tax Credits have generated tax credits totaling nearly $145 million. With a 60.32 percent growth rate in the number of its first new tax credit claims in 2010, and a 94.62 percent growth rate in the aggregate of tax credits, California should anticipate a rise in not only tax credits and PIT and BE tax return claims, but new employment.

Administered by the California Business, Transportation & Housing Agency, the California Small Business Loan Guarantee

136. Id. at § 14022.
137. Id. at § 14021.
138. Id.
141. Id.
143. Id.
144. Id.
145. STATE OF CAL. FRANCHISE TAX BOARD, NEW JOBS CREDIT (2009), supra note 142.
146. Id.
147. Id.
Program ("SBLGP") was reinstated following former-Governor Arnold Schwarzenegger’s elimination of the funds from the state budget.\textsuperscript{148} The SLCGBP allows small businesses to obtain a loan if they do not otherwise qualify for traditional loans.\textsuperscript{149} Loan proceeds must be used primarily in California, but are permitted for use in standard business practices.\textsuperscript{150} Guarantees may cover up to ninety percent of the loan amount, but must not exceed $500,000.\textsuperscript{151} Interest rates are set by the intermediary.\textsuperscript{152} In order to obtain a loan, potential borrowers must apply through a Financial Development Corporation ("FDC"), an intermediary, and must employ fewer than five hundred employees.\textsuperscript{153}

The California Capital Access Program ("CalCAP") was introduced in 1994 as an effort to encourage banks and other financial institutions to make loans to small businesses that have difficulty obtaining traditional financing.\textsuperscript{154} Qualified borrowers must have fewer than five hundred employees.\textsuperscript{155} Lenders under the Program have loaned a total of about $2.07 billion since inception.\textsuperscript{156} In addition, an influx of $84.3 million from the State Small Business Credit Initiative ("SSBCI") allows California lenders the opportunity to gain support for years ahead.\textsuperscript{157} There are four general programs within CalCAP.\textsuperscript{158} First, the loan insurance portfolio provides up to one hundred percent coverage of certain loan defaults, such that lenders can securely issue loans to what they traditionally consider riskier or high risk borrowers.\textsuperscript{159} Secondly, CalCAP offers up to fifty percent cash for collateral support to cover collateral shortfalls of loans of $100,000 or more.\textsuperscript{160} Third, the Program has partnered with the California Air Resources Board to provide up to


\textsuperscript{150} Id.

\textsuperscript{151} Id.


\textsuperscript{153} Id.


\textsuperscript{155} Cal. Code Regs. tit. 4, § 8070(f).

\textsuperscript{156} Id. at §§ 8070-8072.

\textsuperscript{157} Id.

\textsuperscript{158} Id.

\textsuperscript{159} Id.

\textsuperscript{160} Id.
one hundred percent coverage on repayment defaults for loans used to finance heavy-duty trucks, busses, and aerodynamic technologies.  

Lastly, certain qualified business owners may receive grant money to purchase newer, energy compliant vehicles under CalCAP’s Proposition 1B Loan Assistance Program.  

The recent passage of AB 901 expanded the definition of financial institutions within CalCAP to include small business financial development corporations and microbusiness lenders.  

AB 981 was also recently passed to provide extra incentives within CalCAP for lenders to lend to small businesses, including expanding the financial institution definition to include insured depository institutions, insured credit unions, and Community Development Financial Institutions (“CDFIs”).  

As previously stated, the federal government defers regulations on usury to the states. California’s complex usury laws provide a number of exemptions under several code sections. Of particular relevance is its exemption of licensed lending institutions, which include banks, savings and loans, credit unions, finance companies, and pawnbrokers. These institutions engage in the business of making consumer or commercial loans and are registered with the California Department of Corporations. This exemption permits some private lenders to charge higher interest on microloans. While excessively high interest rates are ostensibly an undesirable feature of microloans from these private lenders, the exemption brings attention to the need for more microlending. Furthermore, market forces responding to microlending needs may result in greater competition and thereby, lowered interest rates. 

IV. RECOMMENDATIONS  

California appears to recognize the socioeconomic significance of growing the microcredit industry within the state, as the wealth of recent legislative and trade-association attention has been drawn to

161. Id.  
162. Id.  
166. Id.  
167. Id.  
168. See Current Rates, CASICALL. MICR BUSINESS LOANS, supra note 91.
expanding small businesses. Despite these advances, California has yet to concentrate on better developing its MFIs to sustainable, profitable, and accessible levels. The following recommendations advocate for regulatory reforms closely tailored to the needs of microentrepreneurs who seek funding and the business of providing those funds.

A. INCREASED STUDIES ON THE IMPACT OF SMALL BUSINESS LEGISLATION ON MICROCREDIT

While there is an abundance of recent activity and legislative attention paid toward small businesses in California, there is minimal mention of microenterprise-specific legislation. It appears that studies have yet to be published on the impact of broader small business laws on microlending in California. Furthermore, there is a greater lack of information on the economy in the Central Valley, an integral portion of the state with a flourishing agricultural industry. The Central Valley region has been particularly hard hit in the post-recession recovery phase. Thus, thorough research of the Central Valley is necessary to optimize the potential for economic improvement in that segment and throughout the state. Research regarding job growth and training potential through microenterprise development may be especially helpful in moving California toward full recovery.

B. SHIFT TO PRIVATIZATION OF MICROLENDING THROUGH STATE USURY LAWS

There is no shortage of philosophies as to the appropriate levels of government involvement in microlending. Muhammad Yunus strongly believes that government regulation of microfinance and lending should be tempered and MFIs should be regulated more loosely, similarly to credit unions. As the bulk of microcredit services in California are primarily provided through charitable organizations, backed with

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172. Coghlan, supra note 171.

173. Walker, supra note 34, at 389.
federal funds, sustainability and long-term growth are serious questions worthy of at least partial privatization. California usury and lending laws should encourage microlending-specific activities in order to attain sustainability. 174

California should provide commercial entities with microlending-specific usury regulations that would allow them to be profitable. Appropriate interest rate caps that exceed the typical interest rates established for consumer loans (as microentrepreneurs are operating with limited, consumer-level resources), but are not onerously high ensure that long-term implosion of the microenterprise industry is kept at bay. In an effort to transition away from reliance on federal funds, California must recognize through specific legislation that a greater portion of privatization of microlending is necessary.

C. GRADUATED STATE TAX INCENTIVES FOR MICROLENDERS AND MICROENTREPRENEURS

California provides state tax incentives only for microborrowers who expand the number of their full-time employment positions. 175 Depending on the lending model, California must incentivize not only microentrepreneurs, but individual and institutional direct lenders. Either a declining model, whereby the initial periods of investment produce the greatest tax benefits that decline over a period of several years, or a sunset provision, can safeguard against abuse or shrinking tax revenue.

Under the person-to-person investing model, such as MicroPlace’s approach, whether managed by a nonprofit organization or commercial institution, the state should provide exemptions to investors who enjoy capital gains from lending to microentrepreneurs. Consistent with the notion of amended state usury laws, commercial MFIs will be able to enjoy CRA compliance, as well as profitability from the origination of microloans.

D. HEAVIER EMPHASIS ON REGION BASED MICROLENDING SUPPORT

While federal funds for microloans are primarily funneled through intermediaries scattered throughout California regions, there must be particular emphasis on providing infrastructure, training, and education that is unique to the needs of all serviced areas. Because every region

174. Id. at 393.
possesses unique socioeconomic and geographic characteristics, the needs of each distinctive region will differ tremendously. While there is funding and support available in training and assistance, California must ensure that it is accessible to microentrepreneurs, both in practical terms as well as in terms of cultural competency.

V. CONCLUSION

The concept of microfinance has seen great success abroad over its nearly fifty years of established development. As it has more recently transitioned to the United States, we have yet to determine precisely how far microlending can or will drive the American economy. Further, in light of the 2007 to 2009 housing bubble and the fact that the United States, and California in particular, operates on very different socioeconomic, regulatory, and legislative climates than the countries that have been successful with microlending, it is difficult to predict California's rate of success. However, with regulatory reform, microcredit in California is more likely to reach its true potential. California must start with several changes. First, greater studies on the issue of microlending in California is the first step in permitting the state to best fine tune its regulations to meet the needs of Californians, thereby driving economic recovery. Second, at least partial transition into privatization of the industry is necessary in order to build a self-sustaining microlending model. In addition, a carefully tailored set of tax incentives to microlenders, intermediaries, and micro borrowers will increase the likelihood of sustainability of the microcredit industry in California. Finally, a stronger emphasis on regional-based microlending support must be made available to microborrowers. Without recognizing the unique economy of California, the microcredit industry will be inhibited from achieving more optimum levels of sustainability and profitability.