



Peering Forward, 10 Years After: International Policy and Consumer Credit Regulation

I. Ramsay¹  · T. Williams¹

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Abstract

A key change since the financial crisis of 2008 is the internationalization of interest in consumer finance. International institutions monitor household credit because of its impact on financial stability and market expansion. Macroprudential concerns drove this interest, resulting in a sea change in approaches to consumer credit regulation in many jurisdictions. This article critically analyses the emerging international policy paradigm, contrasting pre- and post-crisis regulatory approaches and highlighting continuing tensions about key policy choices. It then uses two recent sites of contestation, debt adjustment and the regulation of high-cost credit to demonstrate the persistence of conflict over the positioning of consumers within an emergent stability focused paradigm of financial consumer protection.

Keywords Financial stability · Financial crash · Debt crisis · Consumer credit

More than 10 years have elapsed since the financial crash of 2008 when problems in the US household mortgage credit market triggered the World financial crisis, which subsequently mutated into a public debt crisis in Europe (Tooze 2018). A key change since then is the internationalization of policy interest in consumer finance. Household debt was traditionally situated at the bottom of the hierarchy of finance, and consequently not considered of major concern as a potential source of systemic risk (Pistor 2013; Williams 2013). International institutions now monitor household credit levels because of their impact on financial stability and safe, orderly market expansion. Macroprudential concerns rather than an interest in consumer protection per se drive this development, the novelty of which should be emphasized. In the United States of America (USA), the dominant pre-crash economy, macro-economic policy concern focused on the risk of a US dollar crisis caused by large deficits, reducing foreign investor confidence in US Treasury bonds and causing a dramatic

“The crisis has been a transformative moment in global economic history whose ultimate resolution will likely reshape politics and economics for at least a generation” Reinhart & Rogoff, *This Time is Different*, 208

✉ I. Ramsay
I.D.C.Ramsay@kent.ac.uk

¹ University of Kent, Canterbury, UK

freeze in financing. Few foresaw a world economic crisis triggered by “toxic securitized debt” in sub-prime mortgages that would bring down the US and Eurozone economies. The International Monetary Fund (IMF) and Central Banks in pre-crisis documents paid modest attention to the international ramifications of high levels of household credit (European Central Bank 2004) and tended to see it as a bulwark against risk. For example, a 2005 IMF report noted a dispersion of financial risk away from the banking sector, and characterized the household sector as a “shock absorber of last resort” (IMF 2005, p. 5). Other international finance institutions (IFIs) such as the World Bank, by contrast, had begun to focus on the development of retail financial services in emerging and transitional economies, driven by ideas of financial inclusion and facilitating financial market expansion as a modality of economic growth: the crisis intensified this focus on retail financial services, although there have been key shifts in priorities.

A sea-change has occurred since the crisis in approaches to consumer credit regulation in many jurisdictions. Peter Hall’s influential concept of a policy paradigm helps to illuminate key aspects of this change. Hall defines the policy paradigm as “a framework of ideas and standards that specifies not only the goals of the policy and kinds of instruments that can be used to attain them, but also the very nature of the problems they are meant to address” (Hall 1993, p. 279). Although continuity exists between pre- and post-crisis regulation with regulators drawing on pre-crisis terminology and policy tools, such as responsible lending (Wilson 2013), household credit regulation is positioned within the post-crisis paradigm internationally and domestically as a significant aspect of macro-prudential regulation to respond to systemic risk and maintain financial stability. This change is illustrated by international financial regulators’s insistence on more rigorous, market stabilizing, approaches to assessing affordability in the underwriting of mortgages (EU 2014; FSB 2012) and their identification of the proliferation of microlending as raising potential systemic concerns. International regulators today justify responsible lending norms not only in terms of neoclassical microeconomic concerns about efficiency, market failure, and equity but also in terms of global financial stability (Finconet 2017). This policy paradigm differs from established consumer law scholarship which views financial consumer protection debates primarily in terms of microeconomic concepts of individual consumer choice and paternalism (Fairweather et al. 2017).

As an international field of consumer finance norms develops, consumer lawyers should understand and engage with the emerging policy paradigm that underpins it. Hans Micklitz and Mateja Durovic have referred to the “game-changing” nature of the internationalization of consumer law (Durovic and Micklitz 2017) and this article poses key questions about the future development of this international field of consumer law.

Part 2 compares and contrasts the pre- and post-crisis regulatory approach and highlights continuing tensions about key policy choices. Part 3 illustrates the national and international policy shifts and continuing tensions by discussing three recent examples of financial consumer policy contestation, debt adjustment, the role of digital technology in expanding access to financial products, including credit granting and the regulation of high cost credit. Innovations in technology were associated with the increased “democratisation of credit” in the late twentieth and early twenty-first century and its potential for both increasing access for, and exploitation of, consumers (Bruckner 2018; Jablonowska et al. 2018) continues with the growth of algorithmic lending.

Regulatory Approaches Before and After the Crisis: The Emergence of an International “Stability” Inflected Paradigm of Financial Consumer Protection

Evolution of Consumer Credit Regulation to 2007

Most developed economies in Western Europe adopted a paradigm of state managed demand of consumer credit in the period from 1945 until the mid 1970s. Both prudential and regulatory controls existed to limit the expansion of consumer credit. Terms controls existed on downpayments and the length of loans, with central bank controls on the balance between consumer and production credit. The objectives of these controls were primarily macro-economic, intended to dampen demand, prevent inflation, and ensure that credit was channeled into production for export and reconstruction rather than consumption. A secondary objective was paternalistic, to protect both the domestic financial industry and consumers from imprudent lending. Thus the finance industry in the United Kingdom (UK) viewed such measures as methods of collective hands tying, preventing ruinous competition for high-risk clients. Terms controls on particular forms of credit were often criticized as distributionally regressive since more affluent consumers were able to avoid them through unregulated means such as bank overdrafts. In the UK, the Labour leader Clement Attlee referred to terms control as a “vicious piece of class legislation” (House of Commons Debates vol 495, col378, 1952)

The USA was something of an exception here, having abolished Regulation W in 1952. The post war US political compromise between labour and business promoted home mortgages and embraced consumer credit as ways to maintain consumer demand and keys to prosperity of the individual and the state. In 1969, consumer credit outstanding in the USA was four times that in the UK, and even higher compared to other European states (Hyman 2011; Prasad 2012).

Household credit regulation was primarily a private and parochial matter at the level of the nation state during this period (Williams 2013). From the early 1980s, however, credit was unleashed in many European countries; and in the 1990s and early 2000s, levels of household credit seeped into international discourse on development following the changes in the 1980s and 90s from a development model based on state-led growth behind tariff barriers, to a market based model with privatization of industry and finance (Trubek et al. 2013). Microfinance and microcredit became “silver bullet” ideas (Peck and Theodore 2015) within the development movement during this period with Muhammad Yunus claiming that microfinance could eradicate poverty in a generation.

The IMF in a generally upbeat assessment of the significant growth in household credit in emerging economies concluded in 2006 that “greater access to a varied range of household credit products improves the consumption and investment opportunities for households and enables better diversification of household wealth.”¹ It endorsed the lifecycle theory of household credit as income smoothing and counteracting liquidity constraints. It supported greater financial liberalization and new lending technologies

¹ Global Financial Stability Report, September 2006: Chapter II. Household Credit Growth in Emerging Market Countries, 46.

which, coupled with securitization, were said to reduce lending risk.² Several factors were considered conducive to market development in addition to prudential regulation, namely (1) securitization, (2) effective enforcement of collateral, (3) provision and sharing of credit information, (4) promotion of rating agencies and credit bureaus, and (5) transparency in lending, consumer protection and consumer education.³ These ideas derived from the work on information asymmetry pioneered by Stiglitz and Weiss (1981), and the neo-classical law and economics scholarship that promoted microeconomic-based approaches to policy. In 2005, the Organisation for Economic Co-operation and Development (OECD) promoted principles and practices for financial education and literacy and the United Nations (UN) collaborated with major international financial firms to co-sponsor the International Year of Microcredit.⁴

The overall goals of this pre-crash policy paradigm were the promotion of access to credit and the creation of confidence in an expanding and competitive consumer credit market. Consumer choice and individual management and responsibility for one's finances were the key assumptions guiding regulation. "Modern" consumer credit regulation rejected price controls as a crude and pre-modern form of regulation that would limit access and result in poor individuals paying more through more costly substitutes or being excluded from the market and having to borrow from illegal lenders. These international documents had little to say about what should happen when a credit relationship broke down – and an individual was unable to repay. Bankruptcy was for business, but not discussed as a significant ground rule for consumer credit markets.

Even as international and domestic policies promoted the expansion and democratization of credit, concerns about the marketing and promotion of credit emerged in both developed and emerging economies. In the UK, Australia, the USA, and the Netherlands, systemic fraud was associated with the sale of PPI, mortgages, pensions, and investments, microfinance came under increasing scrutiny and criticism, and in South Africa reckless lending was seen as a consequence of the sharp rise in credit liberalization (James 2015). Before the crash, however, scandals such as these were responded to as discrete national financial consumer protection problems that had no bearing on the international financial system and did nothing to diminish confidence in its safety. The extent of belief in the soundness of this system is exemplified by Lawrence Summers' comment on a 2005 paper examining whether "financial development" had made the world riskier, that its "basic, slightly Luddite premise ... (is) largely misguided" (Tooze 2018, p. 67).

The Crisis and Its Consequences

A large and growing literature now exists on the causes of the crash (Tooze 2018). In addition to provoking reflection on the role of household credit in the economy, the ensuing financial crisis has stimulated debate about the appropriate role of regulation.

² It did warn presciently that "unhedged" borrowers in Eastern Europe were at risk with mortgages in foreign currencies and noted the dangers of reduction in lending standards to achieve growth, as occurred in South Korea in the early 2000s when 10% of the adult population were delinquent on credit cards

³ Ibid 70.

⁴ The core sponsors of 2005 as the International Year of Microcredit were: Citigroup, ING, UNCDF, the United Nations Foundation and VISA. Retrieved from: https://www.yearofmicrocredit.org/pages/whosinvolved/whosinvolved_meetsponsors.asp (accessed 3 February 2019).

Table 1 Pre- and post-crash assumptions concerning consumer credit

Pre-crash	Post-crash
Consumer credit is welfare enhancing	<ul style="list-style-type: none"> • Consumer credit may be a form of secondary exploitation (Soederberg) • Consumer credit is potentially dangerous product (Warren) • Some types of consumer credit products (e.g., high cost short term credit) create consumer detriment
Lenders do not lend to those who cannot repay	<ul style="list-style-type: none"> • “Sweatbox model.”^a (Mann) • Rejection of idea that OK to lend on credit provided you expect to get your money back. • Responsible lending (e.g., creditworthiness, unsuitability, reckless lending)^b
Consumers act rationally in credit decisions	Consumers decisions are subject to behavioural biases
Point of Sale Regulation is sufficient to protect consumers.	To protect financial consumers effectively it is necessary to use ex ante monitoring to “open the box” of financial firms’s business models, practices, and incentive structures
Household credit is not of systemic financial importance	<ul style="list-style-type: none"> • Household credit is part of international financial architecture • Central Banks report on consumer credit in financial stability reports
Aggressive competition in credit market always benefits consumers	Aggressive competition in credit markets sometimes harms financial consumers (e.g., Payment Protection Insurance scandal in UK)
Policy issues about protecting financial consumers turn on questions of free choice versus paternalism	Recognition of the silent compulsion of credit “It is impossible to live without credit” (Soederberg)
Financial system is generally stable	<ul style="list-style-type: none"> • Financial system is inherently prone to periodic breakdown...crises hard to predict or define (Reinhardt, Rogoff; Kindleberger)
Price ceilings are counterproductive and a crude form of regulation	<ul style="list-style-type: none"> • The retention and extension of price ceilings on credit products

^a See R Mann, (2007) “Bankruptcy Reform and the ‘Sweatbox’ of Credit Card Debt” *University of Illinois L Rev* 375

^b Responsible lending is a protean concept and not always used consistently by international agencies. The Finconet report in 2014 provides a useful international survey at 58-85. The World Bank Overview of Responsible Lending Regulatory Tools includes a wide range of policies within it, namely ‘information disclosure and advertising, publishing price comparisons, income credit history and creditworthiness verification, suitability testing, explicit debt limits, ceilings on the cost of credit, ceilings for sanctions and penalties. (WB, 2013)’

Table 1 outlines the salience of pre- and post-crash ideas and policy approaches. Of course the post-crash ideas were in circulation before the 2007: Responsible lending had been promoted in Europe since the 1980s (Howells et al. 1992), as had arguments about consumers behavioural biases (Ramsay 2005) and ex ante controls on credit lending existed in many jurisdictions. However, the dominant idea that access to credit is welfare enhancing (Trumbull 2013) and therefore any restrictions on access presumptively suspect, remained powerful until the crisis, as were the assumptions that lenders would not lend to those unlikely to repay and that the financial system is stable and not inherently prone to crashes.

The proliferation of national changes since the crash indicates a significant movement in policies suggestive of a new policy paradigm. The World Bank in 2014 surveyed these changes noting that “financial consumer protection is an area of much reform” (World Bank Global Survey 2014, p. 2). The Bank documented an increase from 20 to 49 countries which

had introduced purportedly stability oriented regulation such as explicit limits on loan-to-value ratios in household credit lending (World Bank 2014, p. 24).⁵ They describe this as a “sea change in the outlook to financial consumer protection.”

This transformation in regulatory perspective has been accompanied by a mushrooming scholarship on the macro-dimensions of household debt. Rapid rises in levels of household debt are now viewed as significant factors in leading to financial crises and prolonging the depth of recessions (Lombardi et al. 2017; Mian and Sufi 2014). The IMF recently concluded that household credit might boost growth in the short term but give rise to financial stability risks in the long term; these consequences are more pronounced for advanced than emerging economies, and lower income groups tend to be more vulnerable (IMF 2017, pp. 53, 55). Other literature links credit growth to broader changes in labour markets and the economy (Lattanzi-Silveus 2019). Literature on the loans for wages model (Barba and Pivetti 2009) or “let them eat credit” (Rajan 2010), suggested that during the era of rapid household debt expansion credit was a method of maintaining consumption in the face of stagnant wages and growing inequality. The availability of credit contributed to depoliticizing conflicts which might erupt otherwise (Prasad 2012, p. 196), permitting capitalism to “buy time” (Streeck 2014). Colin Crouch posited “privatised Keynesianism” (Crouch 2009) as a framework for reinterpreting the pre-crisis policy of consumer finance expansion arguing that house price inflation driven by easy mortgage credit was the driver of the UK economy. Adair Turner, the influential chair of the Financial Services Authority (FSA) in the UK at the height of the crisis,⁶ argued that the financial system may be prone to produce too much of the wrong type of credit (Turner 2016, p. 13⁷), i.e., credit for consumption rather than investment, which would ultimately be unsustainable. The idea of credit as a form of welfare, admittedly a topic discussed before the crash (Ramsay 2003), highlighted the relationship between credit and the social welfare system, the extent to which risks which had traditionally been borne by employers and the state, were now being borne by individuals financing their needs through credit (Domurath 2017; Hacker 2006). The austerity which followed the crash in many European countries has exposed and heightened the extent to which private credit has become an adjunct to social welfare.

Finally, the financial crisis underlined the fact that the international financial system is fragile and prone to unpredictable recessions and crashes⁸. Financial crises are a relatively frequent occurrence (Kindleberger & Aliber 2005; Reinhart and Rogoff 2009). The 2008 crisis contradicted the assumption of the “Great Moderation,” namely that boom and bust cycles had been overcome.

As Table 1 shows, key ideas about the nature of the problems that financial consumer protection is intended to address and the standards and instruments that can be used to attain them have changed. International initiatives, focused on the stability of the international financial system, drove these changes. Between 2008 and 2011, the G20 held six summits. Much of the focus was on concerns about capital adequacy and systemic risk but all of the

⁵ And in 77% of economies, lenders are required to assess borrower ability to repay *ibid.*, 2.

⁶ Turner chaired the Financial Services Authority from 2008–13.

⁷ “Free markets left to themselves will keep on creating private credit and money beyond the optimal level and will allocate it in ways that generate unstable asset price cycles, crises, debt overhang, and post-crisis recession”.

⁸ Pistor (2013) cites to the “inherent instability”.

summits linked financial consumer protection to the strengthening of financial stability. In 2010, consumer protection was identified as needing more work. This was delegated to the FSB⁹ and the OECD and in 2011 Christine Lagarde, then president of the IMF, requested the development of common principles on financial consumer protection by the OECD by October 2011. The FSB report in 2011 identified three key aspects: The need for an international organization with a clear mandate and adequate capacity to maintain momentum on global financial consumer protection efforts; the development of best practices to guide institutional reform; and strengthening supervisory tools by identifying gaps and weaknesses (FSB 2011, p. 2). The formal creation in 2013 of Finconet, an international organization of supervisory authorities with responsibility for financial consumer protection directly achieved the first objective and indirectly contributes to the others.¹⁰ The OECD high level principles on Financial Consumer Protection (OECD 2011) represented a significant development towards best practices since members of the G20 agreed to assess their systems against the principles and where necessary implement reforms. The central principles were those of (1) a dedicated and expert regulator for consumer finance, (2) fair treatment of consumers, (3) financial literacy and education (the responsible consumer), and (4) accessible dispute resolution¹¹.

The G20 at Seoul in 2010 created also a Global Partnership for Financial Inclusion (the GPFI), “committed to improving access to financial services for poor people, through supporting the safe and sound spread of new modes of financial service delivery capable of reaching the poor.”¹² The World Bank in 2011 set a target for universal financial inclusion by 2020, and regularly publishes an index of financial inclusion¹³ (The Findex report). Although the Universal Financial Access 2020 project focuses on access to a transactional account, increasing the use of microfinance and other financial services remains an important goal. The GPFI in 2010 reasserted the welfare-enhancing nature of access to the formal financial system in terms of income smoothing, and life cycle planning,¹⁴ although the World Bank had raised questions about the value of microcredit in 2008 (World Bank 2008). Poor households in

⁹ The FSB “promotes international financial stability by coordinating national authorities and international standard setting bodies as they work towards developing strong regulatory supervisory and other financial sector policies. It fosters a level playing field by encouraging coherent implementation of these policies across sectors and jurisdictions...” See generally <http://www.fsb.org/about/>.

¹⁰ “Established in 2013, FinCoNet is an international organisation of supervisory authorities which have responsibility for financial consumer protection. It is a member based organisation and has been set up as a not-for-profit association under French law.”

FinCoNet promotes sound market conduct and strong consumer protection through efficient and effective financial market conduct supervision.

The US does not seem to be a member but China is a member. The EU, World Bank etc. are observers.

¹¹ The OECD in 2013 adopted a follow up identifying approaches among members to these principles, identifying common, innovative and effective emerging approaches.

¹² Retrieved from <http://www.g20.utoronto.ca/analysis/commitments-10-seoul.html#inclusion>.

¹³ The Council on Financial Inclusion defines it as CFI defines financial inclusion as a state in which everyone who can use them has access to a full suite of quality services at affordable prices, delivered by a range of providers in a competitive market, with convenience, dignity and consumer protections to financially capable clients. Account-holding is only a beginning. To validate progress, we need to see not only more active accounts, but also greater use of all four major types of financial services: payments, savings, credit, and insurance. With the exception of payments, the picture of financial inclusion is not as encouraging as we had hoped” see CFI Glass Half Full or Empty? (2018) https://www.centerforfinancialinclusion.org/storage/documents/FI_Hype_vs_Reality_Deconstructing_2017_Findex_Results-08032018.pdf.

¹⁴ Innovative Financial Inclusion, Principles and Report on Innovative Financial Inclusion from the Access through Innovation Sub-Group of the G20 Financial Inclusion Experts Group 25 May, 2010. Retrieved from https://www.gpfi.org/sites/default/files/documents/Principles%20and%20Report%20on%20Innovative%20Financial%20Inclusion_0.pdf.

particular could benefit from financial inclusion¹⁵. These comments reflected the continuing faith in microfinance as a “silver bullet” policy. The financial inclusion strand of the international agenda remains dominant both in terms of funding and activity. Financial education, literacy, and consumer protection would form the foundation of a regulatory framework for stable financial inclusion.

The financial consumer policy work of the World Bank, driven by its technical advice to emerging economies in Eastern Europe and Central Asia in the mid 2000s, represents the final strand in the international picture. In the absence of existing policy templates, the Bank developed a diagnostic guide for its employees, first published as “Good Practices” in 2008 (World Bank, 2008) which has gone through various versions, the most recent being the 2017 Good Practices. Early versions emphasized the importance of information, protection against unfair practices, and individual consumer rights also suggesting the importance of international benchmarks for building a robust global financial architecture. In July 2009, the World Bank asserted that “Consumer protection and financial literacy lies at the heart of any financial sector that is efficient, competitive and fair.” In September 2009, it stated:

Together, consumer protection and financial literacy set clear rules of engagement between financial firms and their retail customers—and help narrow the knowledge gap between consumers and their financial institutions. (World Bank 2009, p. iii)

By 2010 in its policy research working paper, the Bank notes the “importance of consumer protection and financial literacy for stability of the financial sector” in the context of arguing that in the US complex financial products had been sold to “poorly informed parties.” The report argued that the policy challenge was to strike the right balance between government regulation and market competition¹⁶ (World Bank 2010).

By 2013, the Bank was arguing that there was an increasing consensus on financial consumer protection with 77% of jurisdictions requiring lenders to ensure the affordability of credit products. It concluded:

There is some degree of consensus reflected in the laws across the world on a broad set of consumer rights, such as rights to be informed about the products offered, to obtain advice about the suitability of products on offer for the consumer’s needs and objectives and for financial institutions to engage in responsible lending practices, to seek recourse in case of wrong doing by the provider of financial services, and restrictions on unfair and misleading practices by providers of financial services.¹⁷

The introduction to the most recent (2017) iteration of the World Bank’s “Good Practices” states that “Financial stability, financial integrity, financial inclusion, and financial consumer protection should complement each other and a strong consumer protection regime is key to ensuring that expanded access to financial services benefits consumers.” The ultimate goal of the principles “is to maintain consumer confidence and trust in the financial system.” The 2017 principles also add that “the vast majority of consumers are at a significant disadvantage in business relations with any financial service provider and require appropriate and

¹⁵ “Financial inclusion also has many direct benefits to poor households that are using loans or savings to accelerate consumption, absorb shocks such as health issues, or make household investments in durable goods, home improvements or school fees”. Retrieved from <https://www.gpfi.org/why-financial-inclusion>.

¹⁶ Retrieved from http://responsiblefinance.worldbank.org/~media/GIAWB/FL/Documents/Knowledge%20paper/Consumer_Protection_and_Fin_LiteracyWPS5326.pdf

¹⁷ World Bank, Global Survey of Consumer Protection and Financial Literacy.

comprehensive protection.” The Good Practices track other international documents in promoting fair treatment of customers (World Bank 2017a, p. 35) – “at all stages of the relationship with consumers, financial service providers should be required to treat consumers fairly” and ensuring product suitability. For the first time, it includes recommendations for the introduction of individual bankruptcy for consumers. The 2017 World Bank Good Practices draws on a wider range of countries as sources from both high-income and middle-income jurisdictions, compared with earlier versions which drew primarily on the EU and USA.

The ideas from the OECD and the World Bank are referred to and repeated in the United Nations Guidelines on Consumer Protection of 2016 which for the first time has a section on financial services including addressing conflict of interests in sales on commission (UNCTAD 2016). The 2016 guidelines also create an intergovernmental group which will monitor the development of the guidelines. These international documents provide a set of indicators and benchmarks, a form of international soft law. Although less developed than the World Bank’s highly influential *Doing Business*, they undoubtedly have influence (Ahmed and Ibrahim 2018). International institutions and regulators can often form influential epistemic communities – promoting a diffusion of ideas and standards, and also providing opportunities for the promotion of national viewpoints through the international regulatory association.

Summary

The entry of international institutions changes the configuration of actors interested in consumer credit regulation, signaling the growth of consumer finance as a distinct field of intersecting and overlapping international, regional, and national regulation. The addition of central banks, and their regulatory networks to groups with an existing interest in financial consumer protection at a minimum generates more information and analysis on household debt, and the possible development of an international community of experts. Policies begun in a concern for financial stability may take on a life of their own, as they are incorporated in international bureaucracies and trigger further initiatives.

It is too early to assess the long-term significance of these international developments. Given the significance of mortgage market practices to the crisis, much international, regional, and national activity focused initially on reform of mortgage markets. This was a focus for the newly created FSB which also reported on sound underwriting practices (2012). The sea-change here is illustrated by the transformation of the EU mortgage directive from its pre-crash policy direction, in which there is no mention of lender responsibility to the final version where irresponsible lending is identified as a problem¹⁸ that the Directive seeks to eliminate. The directive thus requires there to be a thorough assessment of the creditworthiness of the borrower, includes specific references to the FSB, and in recital 3 to the importance of the EU being in line with “international principles.”

Do the changes represent a new paradigm in regulation of consumer credit markets? Responsible lending, fair treatment, greater ex ante controls, more effective institutional frameworks, and behavioural approaches have been layered on to existing protections and approaches which focused often on disclosure as a central technique. Tensions and conflicts remain between these approaches. The Trump administration in the USA, for example, has

¹⁸ Recital 4 refers to “irresponsible lending and borrowing caused by market and regulatory failure, the general economic climate and low levels of financial literacy”.

attacked the ability of the Consumer Financial Protection Bureau to regulate consumer credit markets (Confessore 2019) and the USA is not a member of Finconet. The World Bank in 2017 continues to promote expanding well-functioning markets with increased access as a central objective (World Bank 2017b). The Bank warns that “excessive regulation can harm financial inclusion” and in discussing responsible lending (product suitability) cautions against the danger of techniques such as debt-to-income ratios “unduly limiting access.” (World Bank 2017a, pp. 3, 39). At this stage, therefore, there may not be a new coherent paradigm but one with a remaining tension between inclusion and protection. The role of interest rate ceilings are an example of this tension. The World Bank does not discuss them as part of good practices, but disapproved of them in 2014 (World Bank 2014). However, Finconet notes in the same year the retention or reintroduction of these controls in several jurisdictions (Finconet 2014, p. 86).

Contemporary Challenges

Debt Adjustment and Write Down

The instability of the financial system raises the issue of stabilizers in the event of downturns and the need for adjustment of debt claims (Ramsay 2017). Macro-economic stabilizers (devaluation, interest rate reductions, inflation, etc.) can address some of the shocks from these crises but in a high-credit economy, consumers often act as shock absorbers. The experience of austerity in Europe over the past decade illustrates the hardships often experienced by lower income individuals. The financial system tends to be more elastic (i.e., subject to adjustment) at its apex and least flexible in the periphery (Pistor 2013, p. 320), i.e., household debt. The social security system is rarely sufficient to ensure that all individuals can weather a significant downturn. The concentration of losses on leveraged households in an asset price downturn amplifies a recession and lower income households are particularly vulnerable to economic shocks (ECB 2013).

As the aftershocks of the financial crisis increased, governments in the USA and Europe adopted a variety of individualized measures to protect homeowners and borrowers with mixed success (IMF 2012). Rescue programmes tended to be targeted and individualized, which hampered take up (Ramsay 2015). States and international institutions were wary of across the board moratoria, fearing opportunism. Political polarization prevented bankruptcy reform in the USA to permit the writing down of principal on mortgage debt. The IMF judged the US programme to alleviate consumer hardship to be relatively ineffective, compared with the more aggressive deleveraging of the 1930s (IMF 2012). The World Bank in its 2017 good practices recognizes the role of individual bankruptcy as a method of writing down debt, recommending that individual jurisdictions should adopt such a measure. This is of international significance because large numbers of individuals with debt overhang, generally those from lower income groups with the greatest propensity to consume, will hold back growth. However, many individuals who qualify for bankruptcy will not use it (White 1998) for fear of stigma and access is often cabined by restrictions.

Decision making in sharp recessions is often highly politicized and polarized (Mian et al. 2012). Technocrats worry that populists will “overreact” (Romano 2014). The European evidence from the Eurozone crisis is in fact of a general reluctance to introduce broad scale relief, notwithstanding the fact that the risks suffered by homeowners were out of

their control. The policy challenge may require more analysis during periods of “good weather” about policy measures for “bad weather”¹⁹ recessions.

Debt jubilees are one solution to reduce the burdens on highly indebted populations and have a long history. Hudson and Goodhart (2018) argue that debt jubilees historically were intended to prevent economic and social polarization, applied to “consumer” rather than business debts, and ensured the continuance of a productive class of individuals. In modern times, personal debts in Germany were effaced in 1948 and most recently jubilees have taken place in Croatia, and India. Debt jubilees have been promoted for sovereign debt and a campaign has been initiated for a form of debt jubilee in the UK (Jubilee Debt 2019). Johnna Montgomerie has recently proposed the creation in the UK of a household debt abolition fund, related to the amount used to bail out the banks after the world financial crisis of 2008. This policy would reduce both the debt hangover and reliance on debt-driven growth, as well as writing down high-cost credit to more manageable levels (Montgomerie 2019).

These across-the-board strategies have advantages over individualized approaches such as bankruptcy, but would also meet with strong political resistance.

A second strategy is therefore *ex ante* approaches to reduce the damaging effects of the combination of asset price collapses combined with high debt levels, characteristic of the great recession of 2008. One proposal would substitute greater levels of equity rather than debt financing. This could be applied to mortgage financing and student loans. Mian and Sufi note that even Milton Friedman supported greater equity finance for student loans (Friedman quoted in Mian and Sufi 2014, p. 169). Financial institutions would share more of the risk of down turns. Mian and Sufi recommend a model of the shared responsibility mortgage which would offer downside protection to a borrower through reduced mortgage payments, in the event of substantial declines in property prices in a relevant local house price index, with the possibility of a clawback of any subsequent gains. This would not only protect individual homeowners but also prevent the contagion in house price collapse from widespread foreclosure, and the collapse of household spending. This policy would have the knock on effect of reducing unemployment. It would also make lenders more hesitant to lend if a housing bubble seemed imminent (Mian and Sufi 2014, pp. 171–187). Modest examples of this approach already exist. The UK government provided equity loans in 2013 and Norway introduced a form of equity participation in response to the severe recession of the early 1990s where borrowers could write down the principal of a mortgage but the lender would share in any significant capital appreciation. The model of a shared responsibility mortgage is not novel. Islamic finance follows such a model.

High Cost Credit, and Microlending

The regulation of high-cost credit represents a continuing policy challenge. David Caplovitz highlighted in the early 1960s the extent to which lower income individuals might be exploited in the USA not only as workers but as consumers. Although the poor were now included in the consumer society, it was at considerable cost (Caplovitz 1963, p. 16; Silber 2017). Poor consumers were often subject to predatory credit practices and paid much higher charges than middle income consumers. Caplovitz did not have any easy solutions to these problems. He suggested greater responsibility on lenders, price controls, and better policing of credit regulation. He was not sanguine about price controls since they might drive individuals to

¹⁹ We are indebted to Christoph Paulus for the concepts of good and bad weather bankruptcy.

informal moneylenders. He concluded that “the consumer problems of low-income families cannot be divorced from the other problems facing them,” lack of education, occupational opportunities, income and discrimination. (Caplovitz 1963, pp. 191–192). Caplovitz was an early proponent therefore of what later became known as “joined up policy making”. In countries of the North, high cost credit is often an adjunct to the social welfare system (FCA 2019; Fleming 2018; Marston and Shevellar 2014; Rowlingson et al. 2016) and the appropriate balance of consumer and social policies in this area remains contested.

Emerging middle- and low-income economies are dominated by informal lending structures and a major international policy goal is to promote financial inclusion within the formal system of credit as well as payments, savings and insurance. Given limited social supports, high cost credit may have a role in meeting short-term needs (Karlan and Zinman 2010). The regulatory challenge is to ensure that it meets only this need and does not result in creating greater consumer fragility. The assumption in development literature is that access to the formal system is an improvement on informal lending or “loan sharks,” but microcredit within the formal system may also be exploitative and certainly not a solution to poverty (European Bank for Reconstruction and Development 2015; UNCTAD 2016, p. 121). The concurrent increase in high-cost-short-term lending in developed economies and in emerging economies provides an opportunity for international learning where high cost credit in both economies serves as an adjunct or substitute for limited welfare and job security.

The provision of small loans to lower income individuals at reasonable prices also illustrates continuing international controversy over the use of price controls in credit markets. Neo-classical economists argue that consumer policy should be restricted to ensuring that the market functions efficiently, but reject price ceilings which may backfire through the use by consumers of more costly substitutes or more limited access. This is the conventional wisdom of the World Bank and some regulators (World Bank 2014, 2010; Ramsay 2010). Redistribution should be through the tax and welfare system along with well-functioning employment policies which minimize the need for credit as a wage supplement.

More nuanced analysis suggests that information processing failures and externalities from overindebtedness make suppliers the superior internalizer of risks which justifies responsible lending provisions and price controls to reduce the social costs from extension to high risk individuals. The UK FCA justified its regulation of the payday lending market including the introduction of price controls on a careful cost-benefit analysis which indicated that those excluded at the margin through the regulation would be better off without a loan (FCA 2014). The FCA approach in the UK is of interest because pre-crisis the government was intellectually opposed to ceilings, a position supported by mainstream consumer and business groups. It only introduced them after being ordered to by the government. The most recent review indicates that those granted loans are paying lower rates while those declined are not turning to illegal moneylenders.

The FCA volte-face represents a paradigm change in the UK where previously access and choice had predominated over protection. The new policy may reduce access for a minority of individuals and individuals borrowing from these lenders still pay a high price. Thus regulation needs to be accompanied by policies which provide alternatives which may involve the state or civil society actors. This leads to a mixed approach for example, harnessing social housing providers to offer lower cost alternatives for financing household purchases, and attempting to facilitate institutional forms of financing which reduce the costs of credit. This approach recognizes the mixed economy of welfare, the fact that credit has a social function, and that states have often shaped the ground rules of credit markets for social objectives.

Digital Finance

Digital finance is a fast developing terrain of international policy discourse that is closely linked with the growth of financial inclusion as a global project intended to foster economic growth, increase the deposit base of the formal financial system, and contribute to the increased resilience of firms and individuals. The World Bank's target for Universal Financial Access by 2020 emphasises the welfare enhancing nature of access to the formal financial system in terms of income smoothing, and life cycle planning,²⁰ particularly for poor households²¹ and promotes the role of digital technology in achieving this goal.²² This aspect of the project reflects policy optimism about the capacity of information technology capacity to transform the living conditions of those in the global margins (Graham 2019). Digital finance that does not depend on bricks and mortar infrastructure is said to have significantly improved access in several countries, notably Kenya where institutions such as M-Pesa and M-Shawri are seen as successful initiatives to expand access to the unbanked (CGAP 2017a, b). Its further development and expansion is strongly endorsed by the G-20, which, under China's 2016 presidency, tasked the Global Partnership for Financial Inclusion with the work of creating, in collaboration with the World Bank, High-Level Principles for Digital Financial Inclusion²³ to promote inclusive digital finance. This G-20 commitment was then further affirmed in its 2017 Baden-Baden communiqué, which calls on "G20 and non-G20 countries to take steps to implement the G20 High-Level Principles for Digital Financial Inclusion." Illustrating the new stability inflected policy paradigm, it is interesting to note that even as it encourages countries to support the development of innovative digital financial products, the G20 warns about the need for vigilance and regulation to maintain financial stability.²⁴

Novel forms of creditworthiness assessment have developed with digital finance, such as borrowers' use of social media and phone activity (Björkegren and Grissen 2018; Finconet 2017) as a substitute for traditional forms of credit information. Some financiers in countries of

²⁰ "We know how greater access to even small amounts of credit can dramatically improve welfare—such as women being able to buy a sewing machine and establish a small business. Awareness is growing that access to a wider set of financial services provides poor people with capacity to increase or stabilize their income, build assets and have much greater resilience to economic shocks. Appropriate and affordable savings and credit products, payment and money transfer services (both domestic and international) as well as insurance, are all important". Innovative Financial Inclusion, Principles and Report on Innovative Financial Inclusion from the Access through Innovation Sub-Group of the G20 Financial Inclusion Experts Group 25 May, 2010. Retrieved from https://www.gpfi.org/sites/default/files/documents/Principles%20and%20Report%20on%20Innovative%20Financial%20Inclusion_0.pdf.

²¹ "Financial inclusion also has many direct benefits to poor households that are using loans or savings to accelerate consumption, absorb shocks such as health issues, or make household investments in durable goods, home improvements or school fees". Retrieved from <https://www.gpfi.org/why-financial-inclusion>

²² Retrieved from <http://www.worldbank.org/en/topic/financialinclusion/brief/achieving-universal-financial-access-by-2020>

²³ Retrieved from <https://www.gpfi.org/sites/default/files/G20%20High%20Level%20Principles%20for%20Digital%20Financial%20Inclusion.pdf>.

²⁴ See for example, para 6 of the Communiqué which states. "To ensure that we will reap the benefits and opportunities that digital innovation offers, while potential risks are appropriately managed, we encourage all countries to closely monitor developments in digital finance, including consideration of cross-border issues, both in their own jurisdictions and in cooperation with the FSB and other international organisations and standard setting bodies. We welcome the FSB work on the identification, from a financial stability perspective, of key regulatory issues associated with technologically enabled financial innovation (FinTech).", G20 Finance Ministers and Central Bank Governors Meeting Baden-Baden, Germany, 17-18 March 2017., retrieved from <https://www.gpfi.org/sites/default/files/G20%20Communiqué%20Baden-Baden%2C%2018%20March%202017.pdf>.

the North are now exploiting a wide range of social media data for digital sub-prime lending (Deville 2018). This approach to credit assessment where “all data is credit data”²⁵ raises many regulatory challenges. For example, the use of machine learning in developing creditworthiness assessments may provide decisional rules in a manner which a human cannot explain (Kroll et al. 2017, p. 638). The algorithm rather than the programmer decides what features are relevant to the credit decision. Privacy rights, and non-discriminatory and fair access to consumer financial products are clearly implicated by these developments (Zuboff 2019) and are likely to be significant battlegrounds for future international consumer law and policy. For example, the USA has traditionally been more permissive than the EU in permitting individuals to trade off privacy rights for access to credit (Quirk and Rothchild 2018).

These novel approaches to credit assessment illustrate the two-edged nature of digital technology and finance, performing a potentially useful function in emerging economies but also raising questions of potential exploitation through value extraction of lower income consumers.²⁶ International institutions have raised concerns that these new forms of digital finance may reduce lending standards (FSB 2017a, b) and these loans remain expensive for consumers.²⁷ Research in Kenya notes that many loans are used for working capital or day to day expenses, with significant numbers struggling to repay (CGAP 2018).²⁸ The key question is whether they increase individual capability. The mixed evidence on the policy of microfinance in transforming the lives of the poor in developing countries may have drawn attention away from more significant forms of development policy – better schools, sanitation, housing, and medical services which might increase individual capabilities (Natile 2016; Sen 1999).

Conclusion

Household debt remains high throughout the world (BIS 2017) which suggests that financial consumers continue to be cast as “shock absorbers” in the event of economic downturns even as austerity may have weakened the capacity to play that role. As the aftershocks of the financial crisis have continued in the USA and in Europe and the turn to austerity has caused significant suffering and provoked civil unrest, the question arises of the implications of the new priority of financial stability in the emergent policy paradigm. Does it serve to reinforce or normalize idea of strengthening consumer engagement with financial products on the assumption that such products better equip financial consumers to absorb shocks or does the paradigm in effect help to expose the limits of positioning consumers in this way and thus help refocus attention on social insurance and collective safety nets as institutions with the capacity to absorb the effects of financial crisis? The changes in many welfare states over recent decades have resulted in greater emphasis on individual responsibility and the transformation of benefits into loans (UK Social Fund). Coupled with stagnating wages, it has led to increased

²⁵ See Bruckner (2018) at 15.

²⁶ A leading US fintech technology platform claims to “identify millions of new creditworthy borrowers” (retrieved from <https://www.zestfinance.com/>).

²⁷ See CGAP comment on high cost credit in Kenya... Retrieved from <http://www.cgap.org/blog/digital-credit-kenya-time-celebration-or-concern>.

²⁸ Kenya’s Digital Credit Revolution, Five Years On, retrieved from <http://www.cgap.org/blog/kenya%E2%80%99s-digital-credit-revolution-five-years>.

reliance on credit, described by Susanne Soederberg as the “silent compulsion” of credit (Soederberg 2014).

The market stability orientation of the emergent policy paradigm perspective draws attention to broad issues of economic structure. Policy initiatives, however, often focus on how individuals should adjust to these changes: issues are individualized with the policy problem conceptualized as one of limitations in individual capacities. The vulnerable consumer for example lacks “financial resilience.” Structural pressures rather than individual failings may in fact often cause lower income individual to make less than optimal decisions (Mullinaithan and Shafir 2014). History seems to support this position. Low-income consumers are able to make rational decisions (Fleming 2018; O’Connell 2009).

An international field of household credit and finance law is emerging. This paper provides a map of this field which indicates the direction of future research on the relationship between the international, regional and national aspects of this field. Several questions exist for researchers to pursue:

- (a) Is it possible to develop coherent international policies on consumer credit for jurisdictions at different levels of financial development? The danger exists of imposing inappropriate or “one size fits all” models from high income jurisdictions on middle- and low-income jurisdictions. The mixed success of the law and development movement suggests caution here (Trubek et al. 2013).
- (b) Given differences in policies on consumer credit regulation, the *process* of development of international norms becomes an important site for research. Scholars have documented the growth of “transnational legal orders” in commercial law and the role of expertise and politics in the promotion of such orders (Halliday and Shaffer 2014). Similar studies of the diffusion of consumer finance norms should be undertaken. This includes both further interdisciplinary study of the relationship between international, regional, and national developments as well as detailed case studies of specific areas of consumer finance.

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