On: 'Responsible Credit in the EU: National Law, the New EU-Directive and Beyond'[1]

In November 2008, at the peak of the financial crisis, and only a month after the British Government had bailed out three of the UK's largest banks, HM Queen Elizabeth II visited the London School of Economics. Whilst there she famously asked[2] the academics present why no-one had seen the crisis coming? After pondering this question for a period of eight months, a formal response was eventually delivered by some of the nation's most respectable economists to the Royal Household. Its analysis concluded[3]:

> *"In summary, your Majesty, the failure to forsee the timing, extent and severity, and to head it off, while it had many causes, was principally a failure of the collective imagination of many bright people…"*

Perhaps then, one of the lessons from the crisis is that the British intelligentsia, as well as the very bright people in charge of global financial institutions, the central banks, and the regulators should, in future, make more of an effort to listen to those providing critiques of neo-liberalism rather than its cheerleaders?

It was certainly not the case that no-one understood the dangers of credit market liberalisation. From 2005 onwards, Udo devoted his considerable energies to providing a comprehensive critique of these. Bringing together critical voices ranging across numerous academic disciplines, consumer groups, and, in some cases, from within the financial sector itself, Udo was the driving force behind the creation of the European Coalition for Responsible Credit ('ECRC'). He also made an immense intellectual contribution to the positions that the ECRC adopted. Distilling his vast knowledge of the history, ethics, and the legal foundations of credit use in society, Udo drafted and promoted the seven Principles of Responsible Credit, which some thirteen years later remain a lodestone for those of us who can imagine and seek to ensure a more productive, ethical, and effective financial services system.

For me, one of the finest expositions of Udo's thought - revealing the detailed socio-legal analysis which underpin the Principles – is his Chapter 'Responsible Credit in the EU: National Law, the New EU-Directive and Beyond', which was published in a collection of papers seeking to understand the impact of consumer credit regulation on economic activity[4] in 2007.

The chapter begins by recognising that the neo-liberal approach to credit regulation was being exported from the US (and inevitably therefore the UK) into European markets with a resulting deterioration in the types of financial services products being offered to consumers. Usurious prices 'disguised as risk based pricing'; the cross-selling of useless insurances, and the constant flipping of credit agreements into long term revolving debt obligations were the

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[1] Comment on: Udo Reifner, Responsible Credit in the EU – National Law, the new EU-Directive and Beyond, in: Delia, E.P. (ed) Evolving Legislation on Consumer Credit and Trade Practices : Stimulus or Drag on Economic Activity? APS Bank Publication Malta 2007 pp 53-98.

[2] 'The Queen asks why no one saw the credit crunch coming', Daily Telegraph, 5th November 2008

[3] Cited in Gordon, J. (). 'On the role of the actuary in a changing world'. Dolman Scott Ltd.

[4] In Delia, E.P, ed (2007) 'Evolving Legislation on Consumer Credit and Trade Practices: Stimulus or Drag on Economic Activity?'

main results. But it is Udo's summary of the policy narrative behind the process of market liberalisation which particularly catches the attention in his introduction (p.54):

> *"Claiming that everybody should have access to credit, the quality of credit products is increasingly freed from all cultural rules that historically defined consumer debts as a dangerous product. More access will lead to more competition and cut prices so that 'the consumer' will profit. This is the neo-liberal message from DG Market in Brussels."*

The proposition of universal access to credit is rightly to be considered preposterous if one simultaneously removes controls over pricing and relies only on consumers being properly informed about the content of agreements for their protection. Udo was clear: providing credit at extortionate prices to the poorest was driving them further into poverty and creating 'social losses' – or, for me, what could be termed economic externalities: for example in the form of mental and physical health problems or increased homelessness.

Udo's chapter therefore rightly focused on defending the historical protections that had been put in place in Europe and which were being threatened by the European Commission's acquiescence to neo-liberal ideology (p.56):

> *…continental Europe has still a rich and active history of protection against usurious credit practices which are not limited to interest rates. It is mostly not part of the consumer credit legislation which followed the first EU Consumer Credit Directive but is part of the tradition of civil law with its rules on bona fide and good morals, on anatocism, default interest, early repayment, improvident credit extension and limits to usurious refinancing practices. This legislation still in force starts from the assumption that for ordinary people less debt is better than much debt and that debt which does not represent actual investments is dangerous for people and families."*

At the time of writing, Udo, and the ECRC he founded, sought to defend these types of protections across continental Europe by calling for a 'Responsible Lending' principle within what was to become the Consumer Credit Directive of 2008. However, the Commission could not be persuaded on this point. In the end the Directive would contain nothing more than a requirement for Member States to ensure lenders assessed the 'creditworthiness' of applicants - for example by calculating credit scores based on the information held by credit reference agencies. Quite rightly, Udo identified that this process achieved the precise opposite of what was actually needed because it enabled lenders to segment for their perceived risk, and to price accordingly (p.58):

> *"The scores derived from those data bases for each household increasingly are not the basis for credit denial but more for the higher prices for poorer clients in risk based credit pricing systems. It thus achieves the opposite: the debt burden of the overindebted is higher with than without 'responsible lending' which leads to a self-fulfilling prophecy: higher risk equal higher cost, equal an increased debt burden which again increases overindebtedness."*

We now know, of course, that the expansion of credit data, ever increasing market segmentation, and risk based pricing are the key ingredients in the development of sub-prime markets and create considerable instability in the financial system – especially when portfolios of sub-prime loans are bundled up as investment opportunities through the process of securitisation. But even in 2007 and 2008, with the causes of the financial crisis coming

into view, policy makers held to the ridiculous notion that lenders would use information positively to make responsible lending decisions of their own accord, and that formal requirements in this respect were not necessary.

Importantly the concept of Responsible Lending, as articulated by Udo, covers not only the decision to lend, but also the subsequent adaptation of credit agreements in the face of changes in the circumstances experienced by borrower. This is critical as a means of protecting people from exploitation and preventing overindebtedness (p.60):

> *"[Responsible Lending] is not only a principle which intends to prevent unconscious borrowing (and lending) but it wants to adapt credit to the needs and social circumstances of consumers to make render it productive for them. Thus national regulations incorporate the wisdom of several thousand years in handling personal debts when they for example limit anatocism fix interest rate ceilings and regulate duties to care for the families and their living conditions if credit turns from a promising investment into mere debt."*

The chapter goes on to detail the many different laws and regulations in place in countries across Europe which could, if drawn together into a cohesive package, form the basis of a pan-European Responsible Lending Directive. The level of detail in the chapter, which includes not only the specific laws and regulations, but in many cases also discusses their historical development and the legal and ethical principles contained within them, is considerable. This was a typical feature of Udo's work and is of great and lasting value. There is not space here to comment on the many individual 'best practices' which the chapter highlights. However, the natural end point of the chapter is set out in the Principles for Responsible Credit, and specifically in Principle 3: 'Lending has at all times to be cautious, responsible and fair', which includes (p.91) the following:

> *"There needs to be a social guarantee that lenders will not abuse their position when the borrowers circumstances worsen through no fault of their own. In these circumstances lenders should not be able to seek higher charges on default or to worsen the position of the borrower further. There also needs to be a more sophisticated understanding of risk and a proper consideration of risk across the credit portfolio rather than an attempt to identify an individual risk based price for each and every social group."*

For me, writing this review in 2018, it is clear that the distribution of risk amongst society lies at the heart of our continuing problems in the 'post-financial crisis' period. Our economies are held back by considerable debt overhangs. The burden of repayments are concentrated in low to middle income groups, who, particularly here in the UK, have also been faced with a cost of living crisis. Individual risk based pricing penalises these groups – they become higher risk as their financial circumstances worsen. Social, or 'solidarity', pricing as Udo once called it, urgently needs to be adopted as a fairer, more responsible, and more stable, alternative.

Achieving this, and in the process reimagining a credit society which is productive, responsible, and socially just, is an immensely difficult task. We will need to use our collective imaginations and engage in discussion with those eminent economists and the very bright people in global finance, central banks and regulatory institutions, who have not been particularly open to criticism in the past. The door is even now only half open. When we do talk to them, it will serve us well to have Udo's words in our minds.

Damon Gibbons, Director, Centre for Responsible Credit, UK