"Responsible Credit and the European Coalition for Responsible Credit"

Udo Reifner has been an inspiration in promoting the ideal of a finance for citizens and productive credit system. He has made a great contribution to international thinking and policy making in the EU on financial services. His many collaborative research projects at the IFF since 1987 have maintained an important critical perspective on developments in personal finance. Udo's work is imaginative and rich in ideas, which have often stimulated others. In this blog, I focus primarily on his work on responsible credit, and overindebtedness, and the principles established by the European Coalition on Responsible Credit founded in 2006.

Since the Great Recession of 2008, triggered by problems in sub-prime mortgage markets in the US, an international paradigm change has taken place in the approach to the regulation of consumer credit. Concepts such as responsible credit, applicable throughout the life of a credit contract, have become embedded in international soft law documents. Many ideas in this paradigm were foreshadowed by Udo who before the recession outlined fundamental principles of responsible credit.[1] These were underpinned by the idea that credit was essential for full participation in society, and must be affordable for all. Credit should be productive for the borrower: credit relations should be transparent and understandable; lending should be cautious, responsible and fair: credit contracts should adapt to changes in circumstances; protective legislation has to be effective; overindebtedness should be a matter of public concern and bankruptcy should lead to rehabilitation; borrowers must have adequate means to defend their rights and be free to voice their concerns.

At the time of formulation of these principles the EU was about to finalise its Directive on consumer credit which, under the pressure of financial institutions operating through their respective governments, had watered down the responsible lending principle and envisaged a Directive driven primarily by an interest in market expansion rather than regulatory protection. Neoliberal ideas seemed dominant. Policies such as interest rate ceilings were regarded as old-fashioned, blunt, and ineffective methods of market regulation. Ironically the Directive came into effect a few weeks before the demise of Lehman brothers, initiating the largest downturn in the world economy since the Depression of the 1930s.

Commentators on credit often divide narratives of credit regulation into those which emphasise access and those which emphasise protection. The dominant international narrative pre-2008 was that of access to credit, albeit subject to consumer protection measures which promoted confidence in the market. Early work by the World Bank in central Europe focused on promoting credit bureaux, truth in lending, financial literacy and financial ombudsmen, institutions intended to construct a neo-liberal credit subject for the newly developing credit markets in those countries.[2]

Udo critiqued the increasingly neoliberal approaches to consumer credit protection where 'the debtor must learn to adapt to the market', arguing that consumer credit regulation must recognise the relational nature of credit contract, the structural causes of overindebtedness and the inevitably redistributive nature of consumer credit regulation.

The European Coalition for Responsible Credit principles promote both access and protection throughout the life of the credit contract. They recognise that credit is 'essential for full

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[1] Discussed in 'A Call to Arms'—For Regulation of Consumer Lending' in J Niemi, I Ramsay & W Whitford, *Consumer Credit, Debt and Bankruptcy* (Oxford, Hart, 2009) chapter 6

[2] See e.g. early draft of World Bank Good Practices, 'Good Practices for Consumer Protection and Financial Literacy in Europe and Central Asia (2008).

participation in society' but that credit relations should be 'productive'. Udo argues that this requires responsible credit, but it might also raise broader macroeconomic questions about the optimal level of consumer credit in a society, a theme taken up by Adair Turner in 2015, arguing that many contemporary economies produce both too much and also the wrong types of credit[3].

The Great Recession had a major effect on international thinking about household credit. The Financial Stability Board in 2010 reported on consumer credit, emphasising the importance of responsible lending, strengthened oversight agencies, and established the international organisation FINCONET to steer national initiatives. The OECD developed international principles for financial consumer protection including responsible business conduct and fair treatment of consumers. The World Bank indicates in a 2017 survey that 90 percent of jurisdictions have controls on excessive borrowing, intended to give effect to the OECD principle of fair treatment of consumers.[4] The EU Mortgage Credit Directive (2014), which before 2008 had been wending its way through the EU legislative process with a market expansion mission, was substantially changed to include tougher rules on irresponsible lending and greater controls on the supply side of the market. The European Court of Justice intervened in several credit cases to nudge member states towards higher ground rules on mortgage foreclosure procedures.

Interest rate ceilings remain a controversial method of regulation. Udo and others in a comprehensive report for the EU tested several hypotheses concerning the effects of ceilings with results which indicated the complexity of issues surrounding their role. Thus, while ceilings might limit access to high risk consumers little evidence existed that individuals would turn to illegal money lenders. [5] The UK traditionally eschewed ceilings but in a significant *volte-face*, the Financial Conduct Authority introduced ceilings for short term high cost loans in 2015, based on careful cost-benefit analysis which indicated that the costs of payday loans to certain high risk consumers outweighed their benefits. The FCA later found in a review of the effects of ceilings almost no evidence that individuals were substituting for lack of access by using illegal money lenders.

An important aspect of Udo's research has addressed the treatment of overindebtedness in the EU and his 2003 report with Nik Huls, Johanna Niemi and Helga Springeneeer, provides a template for the European regulation of over-indebtedness, focusing on the importance of the fresh start, public debt counselling and advice, and rehabilitation of the debtor.[6]

Udo gradually moved towards the position that the long-term nature of credit relations, where individuals are borrowing for many basic needs against future income, required methods of adapting to interruptions in income which draw on extended ideas of *force majeure*. Overindebtedness is an 'integral part of the credit society'[7] requiring forms of adaptation over time which responds to the needs of consumers. These ideas remain to be fully developed but they provide a direction for future research and also pose difficult questions

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[3] See A. Turner, *Between Debt and the Devil: Money, Credit and Global Finance* (Princeton, Princeton UP, 2015).

[4] World Bank, *Global Financial Inclusion and Consumer Protection Survey* (2017) https://openknowledge.worldbank.org/bitstream/handle/10986/28998/122058.pdf?sequence=2&isAllowed=y26. at 43.

[5] 'Study on interest rate restrictions in the EU Final Report', U Reifner, S Clerc-Renaud, RA Michael Knobloch (2010) http://ec.europa.eu/internal_market/finservices-retail/docs/credit/irr_report_en.pdf

[6] 'Consumer Overindebtedness and Consumer Law in the European Union' Udo Reifner, Johanna Kiesilainen, Nik Huls, Helga Springeneer (2003) at http://www.knl.lv/raksti_data/1147/parskats_ES_2003.pdf

[7] Reifner, n1,107.

about credit in contemporary societies where credit may be supplementing income in a model of ‘loans for wages’ with some consumers paying a high price for credit.

Ten years after the Great Recession many may be forgetting the pre-crisis scandals of payment protection insurance in the UK, the Dexia scandal in the Netherlands, or the details of the sub-prime mortgage scandal in the US. Indeed, in the US, the Trump administration seems set on dismantling the Consumer Financial Protection Bureau, established in the wake of the crisis to ensure greater safety for financial products. The political battle for meaningful responsible credit norms continues.

Iain Ramsay, Professor of Law, Kent Law School, University of Kent, Canterbury, UK
http://creditdebtandinsolvency.wordpress.com