

1. Introduction

The provision of credit gives rise to one of the most important consumer/commercial interactions in our everyday lives: the consumer credit relationship. This relationship is placed within a web of associations and interconnections, and how the borrower is situated within these relationships gives context to borrowing behaviour. The borrower's relationship with the state, as a citizen, concerns education and welfare, for example – the more educated borrower (arguably) makes better decisions in maximisation of her/his resources – yet the borrower on state welfare, as an individual with low income, may only have access to certain types of (expensive) credit. Lack of support from the state may lead to borrowing to 'make ends meet'. Familial relationships may also be relevant. They may inform borrowing, such as in providing for one's family where borrowing is the only way of obtaining such provision.¹ This speaks particularly to our condition as human individuals, our 'place' and connections within the social framework and others, and is innate in our 'vulnerability' as human beings.² Overindebtedness of individual borrowers and subprime lending can have substantial impacts not only on the individual but on the economy. The role of the law and regulation in controlling such circumstances is therefore a crucial issue. Furthermore, the form and extent of regulation in consumer credit markets has unquestionable significance for other social questions, such as quality of life, social mobility and financial inclusion.

The financial crisis of 2007–8 had serious consequences for consumers, perhaps none more so than the credit consumer.³ The recession may have affected borrowers' ability to repay debt, due to unexpected unemployment or increased costs. Overcommitment to, or the unaffordability of, debt can lead, and no doubt has led, to insolvency and hardship for individuals and families.⁴ The 'credit crunch' engendered reduced availability of credit, exacerbating

¹ Sarah Brown 'Un-boxing Vulnerability in Protection of the Credit Consumer' (2019) 7 JBL 511, 522, 524.

² Ibid.

³ Department for Business, Innovation and Skills 'A Better Deal for Consumers: Economic Narrative' (July 2009 URN 09/1033) 2, <https://webarchive.nationalarchives.gov.uk/20121205050928/http://www.bis.gov.uk/files/file52074.pdf> accessed 29 March 2019.

⁴ Ibid 21.

financial exclusion.⁵ Globally, levels of household debt, and overcommitment to and unaffordability of debt, continue to raise concerns.⁶ In the aftermath of this crisis, regulatory efforts have been concentrated on prevention as much as cure, as the investigation that followed exposed undesirable banking practices at all levels of financial services. The consumer's share in the detriment that resulted from the crisis has contributed to the drive for reform and control. It is at least in part as a result of this event that the regulation of financial services in two of the most established consumer credit markets – those of the United States of America (US) and the United Kingdom (UK) – have gone through major reform, with consumer protection being an essential part of new regulatory frameworks.

While there may be cynicism regarding the extent to which banks and credit institutions have 'learned their lesson', there is no doubt that the crisis prompted a fundamental change to the regulation of consumer credit. Both the UK and the US have engaged in extensive reform in relation to consumer protection in financial services more widely, and consumer credit regulatory reform is still ongoing. In the UK, responsibility for consumer credit regulation transferred from the Office of Fair Trading (OFT) to the Financial Conduct Authority (FCA) on 1 April 2014, bringing the conduct of all financial services under one regulator. There was also a complete reappraisal of the legislation, replacing much of the incumbent legislation under the Consumer Credit Act 1974 (CCA), and the array of secondary legislation, with the rulebook regulatory regime which applied to other financial services. This has represented, at least superficially, a sea change in the approach to credit in UK regulation, from a 'rules-based' to a 'principles-based' approach. At around the same time in the US, regulation of financial services was subject to substantial reform. In 2010 the United States Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank), which created the Consumer Financial Protection Bureau (CFPB) and brought far reaching and controversial changes which are still being fiercely debated today.⁷

⁵ As predicted by the BIS in *ibid* at 11.

⁶ OECD *How's Life? 2017: Measuring Well-being* (OECD Publishing, 2017) Executive Summary, https://doi.org/10.1787/how_life-2017-en accessed 30 March 2019; Anna Zabai 'Household Debt: Recent Developments and Challenges' Bank for International Settlements Quarterly Review (2017) 39, www.bis.org/publ/qtrpdf/r_qt1712f.pdf accessed 30 March 2019.

⁷ The idea of the CFPB was conceived before the crash but it was the crisis that brought the reform forward: Adam J Levitin 'The Consumer Financial Protection Bureau: An Introduction' (2012–13) 32 *Review of Banking and Financial Law* 321, 335.

The purpose of this book is to examine recent and current policy and regulatory approaches and reform in protecting the credit consumer. It provides an insight into the development and current state of consumer credit control and supervision, drawing some conclusions as to what can be learned in terms of future direction of travel. This is done by conducting a comparative analysis of the systems in the UK and the US. The choice of comparison here is appropriate for a number of reasons. The connection between consumer protection and impacts on markets is well illustrated by the reform of financial services regulation in the UK and the drive for reform seen in the US. Issues within the UK and US markets are connected – examples include concerns over payday lending, forms of regulation and protection against unfairness. The US has one of the largest, if not the largest, consumer credit economies in the world. According to figures released by the Center for Microeconomic Data, total US household debt was \$13.54 trillion in the last quarter of 2018, with mortgage balances at \$9.1 trillion.⁸ The UK has one of the largest consumer credit markets in the European Union. In the UK, total household debt was £1,785 billion in the third quarter, 2018.⁹ The accepted taxonomy sees the US and UK as part of the ‘common law family’, within a capitalist society informed by the neoliberal agenda and a strong consumer culture. Influence from the US lies in the market itself and the developing culture of credit. In the past few decades the proliferation of credit, and its position in the psyche of the UK population as no longer a morally suspect activity, has turned credit into an accepted convenience or necessity of everyday life, and has brought the UK market closer to the US model. Indeed, it has been noted that the structural similarities between the two markets have allowed a convergence of regulatory approaches.¹⁰

The approach in the book is to conduct the analysis through the central theme of ‘management’ of the consumer credit relationship. Management of business–customer relationships by businesses is, in certain contexts, understood as ‘CRM’ – the customer relationship management approach of sales analysis, using data to aid customer retention and boost growth. There are other aspects to managing a commercial relationship; it is also, more generally, about how the parties handle the dynamics of the relationship between

⁸ Center for Microeconomic Data ‘Quarterly Report on Household Debt and Credit Q4’ Federal Reserve Bank of New York Research and Statistics Group (February 2019) www.newyorkfed.org/microeconomics/hhdc.html accessed 30 March 2019.

⁹ Daniel Harari ‘Household Debt: Statistics and Impact on Economy’ (HC Briefing Paper 7584 (21 December 2018) 9 <https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7584#fullreport> accessed 30 March 2019.

¹⁰ Michael Moran ‘Theories of Regulation and Changes in Regulation: The Case of Financial Markets’ (1986) 34(2) *Political Studies* 185, 201.

themselves (internal management) and the extent and propriety of outside influence (external management). Balance is an incredibly important aspect to this, not only in the context of the relationship itself but also in relation to how regulation responds to the complicated question of how best to protect both the individual credit consumer and the wider consumer community. It is of course recognised that the latter, in particular, raises difficult and important questions of the responsibility of the state, distribution of limited resources and the wider issue of state welfare. However, for the purposes of the scope of this book, the discussion – while holistic in terms of the overview of regulation – concentrates on the more specific legal and regulatory response, and the underpinning rationale, to credit consumer protection.

What can a comparative analysis bring in terms of contribution? The primary aim of comparative law is to enhance knowledge.¹¹ It extends and enriches the ‘supply of solutions’¹² and can be of particular benefit in understanding the development of law; it can support those who frame the law’s future direction, and can aid the study of the effect of rules.¹³ There are a number of accepted methods, although these are not without controversy.¹⁴ A ‘functional’ comparison is in part ‘evaluative’¹⁵ and allows us to consider the ‘purpose and utility’ of the legal system – how and with what effect does the legal system protect a consumer borrower¹⁶ – while a ‘formal’ comparison allows us to consider the concepts and doctrinal basis and context of the legal framework.¹⁷ However, while both the form and value of comparative legal analysis have been called into question, both the US and UK value comparative analysis: the UK’s Law Commission Act 1965 states that one of the functions of the Law Commission is to obtain such information as to the legal systems of other countries as appears likely to facilitate the performance of any of their functions. The FCA, in its consideration of whether to introduce a price cap on payday lending,

¹¹ K Zweigert and H Kotz *An Introduction to Comparative Law* (3rd edition Oxford University Press 1998) 15.

¹² *Ibid.*

¹³ Gerhard Dannemann ‘Comparative Law: Study of Similarities or Differences?’ in Mathias Reimann and Reinhard Zimmermann (eds) *The Oxford Handbook of Comparative Law* (Oxford University Press 2006) 396.

¹⁴ Ralf Michaels ‘The Functional Method of Comparative Law’ in Reimann and Zimmerman (n 13) 340.

¹⁵ *Ibid.* 342.

¹⁶ See for example the comparative study conducted by Marshall on financial inclusion in the US and UK: J Neil Marshall ‘Financial Institutions in Disadvantaged Areas: A Comparative Analysis of Policies Encouraging Financial Inclusion in Britain and the United States’ (2004) 36(2) *Environment and Planning A* 241.

¹⁷ Roy Goode, Herbert Kronke and Ewan McKendrick *Transnational Commercial Law: Texts, Cases and Materials* (2nd edn Oxford University Press 2015) para 4.51.

looked to international comparisons to help inform its thinking.¹⁸ In the US, the American Law Institute makes use of comparative law in drafting the restatements of law (albeit that much more is made of interstate comparison than of comparison with foreign law).¹⁹

The comparative investigation is designed to address key questions and issues pertaining to regulation of the consumer credit market and consumer protection. It therefore provides a basis of analysis for current progress and approaches. It also allows a reexamination and development of various issues and arguments, bringing a fresh perspective to views on how policy and regulation should develop going forward. The UK and US consumer protection structures seem to have much in common. At first glance, in many respects these two systems and the rationale that underpins them bear similarity, yet on closer inspection differences emerge. The discussion and analysis in this book explores the extent to which they are driven by the same goals, and to what extent success of regulatory and supervisory goals are hampered by potentially competing objectives of market preservation and optimal consumer protection. Particular focus includes modes of regulation and supervision, including the control of high cost credit and interest rates; the nature of the consumer, including small business, vulnerability, overindebtedness and the role of creditor responsibility; and interaction with other consumer protections. In terms of the US, the concentration will be on federal law, although where appropriate both federal and state level law will be covered. In the UK, for most intents and purposes the regulation pertaining to consumer credit extends across the whole of the UK.

The book begins with a brief overview of the development of consumer credit markets and regulation across the Atlantic, drawing on scholarship in this area. It provides some historical context to the research, touching on the development of the market and products and the responding regulations, including usury laws, money lending, and pawnbroking legislation, hire purchase regulation, the CCA, the change of regulator and influences from Europe. It then discusses the corresponding issues from the US perspective, including the development of credit protection in the US, looking at federal consumer laws, political tensions and the role played by the American Dream.

While Chapter 2 introduces context and the basis of current policy agendas, wider policy questions around how the consumer credit relationship should be managed are discussed at length in Chapter 3. This covers drivers of

¹⁸ FCA 'Consultation Paper Proposals for a Price Cap on High-Cost Short-Term Credit' CP 14/10, July 2014 www.fca.org.uk/publication/consultation/cp14-10.pdf accessed 29 March 2019.

¹⁹ Jan Smits 'Comparative Law and Its Influence on National Legal Systems' in Reimann and Zimmermann (n 13) 517, referenced in Roy Goode et al (n 17) para 4.32.

policy, including societal aspects such as overindebtedness and consumer empowerment in financial capability and financial inclusion. Definitions of overindebtedness are explored together with an examination of UK policy and the approach of the FCA. US policy and influences are considered. There is an examination of rationales underlying consumer credit policy and how these inform the reform agenda. The impact of the contentious nature of political manifestos is also touched upon here, together with potential conflicts that arise from the goals of competitive free markets and optimal consumer protection, and the wider concerns that engage culture and trust.

Borrowing may take place for any number of reasons and in diverse forms. It may be through unsecured credit, whether unconnected or 'connected' (connected credit being credit offered by a supplier or advanced exclusively for a particular supply of goods or services), for essentials or luxuries. Alternatively it may be secured, on real property (usually for the purpose of buying a home) or on personal property – for example, the auto title loan in the US, where lending is advanced on the basis of a charge on the borrower's vehicle. It may be for a fixed sum or for 'running account' credit allowing borrowing up to a limit, such as the credit card or the overdraft. It may even be a form of 'quasi-security', such as hire purchase, where the borrower has the option, having paid all instalments, to purchase the item at the end of the agreement. Some form of regulation covers all these methods of lending. Chapter 4 explores the development, purpose and aims of this regulation, and interaction with supervision by the relevant regulator, in both jurisdictions. The regulatory tools and framework utilised in the management of the consumer credit relationship are reviewed. The discussion also engages with arguments over principles-based versus rules-based regulation, the perceived role of the regulator and how regulation interacts with the supervisory framework.

The management of the consumer credit relationship of course goes beyond the mechanics of the regulatory and supervisory structure. One very important aspect is the nature of the parties themselves and how this impacts on their responsibilities towards each other. Chapter 5 provides a detailed analysis of the persona of the consumer borrower, reexamining previous work from a new perspective, asking who the credit consumer is and who should receive protection. There is consideration of how this concept is interpreted by the law and the regulator, and the impact on wider questions of responsibility and its desired extent in relation to creditors. Two particular personae that pose problems are of interest here, namely the small business borrower and the 'vulnerable' consumer. The question of vulnerability is both topical and important, and there is an exploration of definitions of vulnerability in relation to both jurisdictions, as well as the extent to which there is a misunderstanding of this concept which in turn hampers the achievement of policy goals.

Vulnerability is traditionally seen as connected to low income. Some credit products attract greater opprobrium than others, particularly those designed for the lower income consumer, these products sometimes being termed as ‘dangerous’ credit.²⁰ One particular danger is perceived to be in the price and charges that are attached to the loan. A strong response to this is in banning products or controlling the price at which they can be offered, but these approaches are problematic. Chapter 6, which examines protection in the creation of the credit relationship, considers this particular aspect to credit control in detail, looking at the proscriptive and prescriptive nature of regulation in its response to developing forms of credit, in particular high cost credit and subprime credit. It considers the pros and cons of interest rate controls, and experiences where such controls exist.

However, in some respects, the danger in reality lies not so much in the product itself but in the circumstances in which it is offered. Here the control of unfair treatment of the borrower, both in terms and in procedure, is important. Chapter 7 therefore analyses the extent to which policy responds to this issue, how it attempts to ensure borrowers are treated fairly and how regulation responds to undesirable creditor behaviour. Unfairness is a difficult concept to pin down and can occur at any point of the relationship. A comparison of US and UK approaches, whether through supervision or through legislative vehicles – for example, via codification of unfairness and its connection with unconscionability in the US, and the unfair credit relationship test in the UK – are analysed and compared. It considers what it means to be treated fairly and the consequences where this does not occur. One way in which the law responds is to ‘rescue’ the borrower from the consumer credit relationship and its terms. The chapter looks at these rescue mechanisms in detail, including enforcement of terms and methods of setting terms or agreements aside, and, more broadly, considers how the US and the UK approach management of this aspect of the relationship, from inception through to demise. Finally, Chapter 8 brings together the various analyses and discussions and draws some final conclusions around the regulation of consumer credit and the protection of the credit consumer, and puts forward suggestions for the future emphasis of policy and reform.

²⁰ See in particular Oren Bar-Gill and Elizabeth Warren ‘Making Credit Safer’ (2008) 157 *University of Pennsylvania Law Review* 1.