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## Introduction

This book is about personal debt and the over-indebtedness of consumers in the European Union (EU) from the different multidisciplinary perspectives of economics, policy and law.

Personal indebtedness is a topical theme for researchers, regulators, the financial services industry and civil and consumer organisations. This is particularly the case under the current economic model encouraging consumers to use debt to finance consumption and the contemporary policy discussions regarding personal debt's place in the economy. Equally, this is a topic in continuous development for the renovated thrust in the integration of the EU financial market and the ensuing development of new policies and regulatory changes. The latest EU initiatives on the Capital Markets Union (CMU)<sup>1</sup> to improve choice, transparency and competition in retail financial services in a truly integrated EU market are illustrations of this process.<sup>2</sup>

<sup>1</sup> European Commission, Green Paper – Building a Capital Market Union, COM(2015) 63 final. The CMU is a plan of the European Commission to mobilise capital in Europe and the creation of a true single market for capital in the EU. The initiative was followed by the adoption of an action plan setting out a list of key measures to achieve a true single market for capital in Europe. See European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Action Plan on Building a Capital Markets Union, COM(2015) 468 final. The European Commission has further updated and complemented the CMU action plan by strengthening existing actions and introducing new measures in response to evolving priorities and challenges. See European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Mid-Term Review of the Capital Markets Union Action Plan, COM(2017) 292 final.

<sup>2</sup> European Commission, Green Paper on Retail Financial Services. Better Products, More Choice, and Greater Opportunities for Consumers and Businesses, COM(2015) 630 final. The objective of this action is to improve choice, transparency and competition in retail financial services to the benefit of European consumers and how to facilitate true cross-border supply of these services, so that financial firms can make the most of the economies of scale in a truly integrated EU market. The Green Paper is followed by an action plan setting out a strategy to strengthen the EU single market for retail financial services. See European Commission, *Communication from the Commission – Consumer Financial Services Action Plan: Better Products, More Choice*, COM(2017) 139 final.

The focus of the book lies firmly on the social and economic phenomena of the ‘dark side’ of personal debt, i.e. over-indebtedness. The law and its analysis are treated as policy responses to this problem. The backdrop of the analysis is the recent financial and economic crisis that has transformed and shaped the latest EU policies and law in the financial sector. Over-indebtedness is empirically investigated and quantified using cross-country consumer-level data, and conceptualised through the lenses of the latest findings over its nature and causes.

The topic of this book is a traditionally difficult one to analyse, especially if taken in its European context. Consumer over-indebtedness has been often associated with financial credits, whose cultural approach, use and extension has varied significantly from one Member State to the other. Yet, the integration of EU consumer and mortgage credit markets is crucial for an efficient functioning of the EU financial system, the economy and the internal market. The market for loans available to consumers has grown rapidly across the EU and the industry of personal debt has become increasingly sophisticated. The economics of personal debt, the liberalisation and expansion of credit markets alongside the increased availability of credit and innovative solutions from financial institutions have explained the relatively recent mounting levels of consumer debt across societies. Although, from an economic perspective, it is known that personal debt may guarantee heightened economic welfare by smoothing out consumption over time, the risk exists that if more credit is available and offered to a broader base of consumers, more consumers become indebted and exposed to the risk of becoming unable to meet the contracted obligations.

On the other hand, credit availability and open access to credit markets have meant widening participation and financial inclusion to allow as many consumers as possible without discrimination to participate in the credit society and the consumption model of the market economy. These bases may also suggest why for a long period of time excessive lending or borrowing have been the focus of consumers becoming over-committed and unable to repay their debts, pushing the debate over behavioural issues of creditors or debtors. Irresponsible lending and predatory practices on one side, and irresponsible borrowing decisions, consumption choices and cognitive biases on the other side have so far dominated the attention of scholars and policymakers alike.<sup>3</sup> The emphasis on behavioural causes has often resulted in the attribution of defaults to a responsibility of the creditor or a personal failure of the debtor.

Thus, against the above background, this study examines the state and adequacy of EU policies and law in dealing with the large scale of over-indebted consumers and their insolvency, as well as the legal responses taken within the context of the overall goal of the integration of the EU retail financial market. It ultimately questions their effectiveness and suitability to address a complex multidimensional

<sup>3</sup> e.g. see Micklitz (2013a); Ramsay (2012a).

problem that impacts dearly on the lives of those who are affected and carries great social and economic costs for the EU. In analysing all the aspects of the problem, the potential for EU personal insolvency law to stem in the future this ‘dark side’ of the market will be ultimately evaluated.

An ambition of the research is to take a holistic perspective to ‘problem debt’. It discusses the extent to which an integrated but reformed EU personal insolvency regime is necessary. The law has limits in tackling the problems at their roots, but it can play a role in mitigating the effects of the problem. The EU dimension and the fundamental freedoms that it entails need to be taken into account too. This latter aspect is also particularly relevant as the European Commission has currently put forward a legislative proposal on the harmonisation of substantive insolvency law for businesses. It is not limited to legal persons but it extends to natural persons who are entrepreneurs. However, more evidence is needed to weigh up whether an adapted extension of harmonised EU rules of insolvency legislation to consumers is necessary or appropriate.

The warning, in the case of the regulation of over-indebted consumers, is that it is not only a market-related issue but the lives of people are at stake too.

Traditionally, financial services are a key and sensitive sector of the economy. The large majority of consumers and small businesses have dealings with providers of financial services. Access to financial services is increasingly considered as a necessary condition for participation in the economy and society generally. Failures of the financial system, or the way in which financial institutions conduct their businesses, may clearly have devastating effects on the economy and society as a whole, but ultimately on the lives of individuals. As an illustration, the global credit and financial crisis has raised important issues regarding the protection of consumers in financial markets, the scope, intensity and effectiveness of regulation in financial markets, and the need for additional safeguards to stem the social and individual problems that the crisis has caused or exacerbated. With the austerity measures imposed by a large number of Member States as a core strategy to overcome the crisis resulting from the failures of the financial system, non-performing personal and mortgage loans and job losses have increased and have remained at high levels. Ensuing individual and social problems have intensified and they seem to be persisting long after the onset of the crisis.

Therefore, important questions arise as to the rationales and the objectives of financial regulation. Why do consumer financial markets need regulation? Why would personal debt problems need regulation? What should financial regulation aim for?

So far, traditional consumer law theory mostly has followed market economic theory which identifies the main rationale for regulation in market failure. Markets are optimal when they operate in a situation of perfect competition and maximise the welfare of their economic agents because of their efficient allocation of resources. This assumption reflects the view that there is a relative or close

equivalence between the pursuit of suppliers' self-interest in the maximisation of profits and the promotion of the general interest, resulting in lower prices for consumers where marginal private benefits equal marginal social benefits, and marginal private costs equal marginal social costs. The traditional assumption of perfect competition is that all market actors act rationally, in their own self-interest, with good and full information, all goods and resources are freely transferable, all markets permit free and easy entry and exit, and prior distribution of wealth and resources does not unfairly impact on competition. In these terms, self-interest always promotes the interest of the community even though this is not part of the original intention.<sup>4</sup>

Here, the relationship between suppliers and consumers assumes a transfer of wealth, not its redistribution.

Market theory recognises that its assumptions practically never hold true in the real world and market failure occurs when there is a failure of one of the conditions for the optimal operation of a competitive market. Thus, the potential failures associated with one of these conditions provide a justification for regulation to correct it. Typical market failures are the obstacles to competition, soundness and safety of products or services, and the imbalance of power between suppliers and consumers.<sup>5</sup>

Thus, in the financial services arena, most of the objectives of consumer regulation are to tackle inefficiencies and externalities to make financial markets more competitive, promote confidence in the use of financial products, and empower consumers as economic agents. Examples are regulations intervening on the competitive behaviour of suppliers, contract terms, mandatory information disclosure, financial education initiatives and product safety.

Clearly, this free market approach is premised on utilitarianism and permeated by neo-liberal ideology that is not universally accepted and open to debate.

At the same time, there are also other more interventionist rationales for regulation which are not primarily justified on economic grounds. These are the non-economic, social rationales for regulation. The promotion of gender equality in financial markets, the mitigation of cultural exclusion, the widening and inclusion of access to products, and the redistribution of wealth are examples of non-economic objectives.

Thus, if the aim is to readjust the position of individuals in society rather than treating them solely as consumers – i.e. the demand side of the market – then wealth maximisation needs to be subordinated to wealth distribution and regulation becomes the tool to achieve it. This may not involve lower prices but policies of consumer protection to spread and shift risks from the consumer to the supplier.

<sup>4</sup> Smith (1776); see also e.g. Malloy (2004), esp. ch. 2.

<sup>5</sup> e.g. see Cartwright (2004), esp. ch. 2; Howells and Weatherill (2005), esp. ch. 1; Ramsay (2007), esp. chs. 1–2.

Distributive justice is a social rationale concerned with the distribution of resources and rights on the basis of what is fair rather than what is economically efficient.

Another rationale for regulation is paternalism, which is about state intervention on behalf and in the perceived interest of a person regardless of individual choice and wishes. The preservation or enhancement of community values such as trust, honesty, loss-sharing and fair dealing are other rationales for regulation that aim to address concerns over the type of society that people would like to live in.<sup>6</sup>

Also in this case, these non-economic rationales can be justified on ideological grounds for the achievement of a social market, or the defence or improvement of the welfare state.

To some extent, both the economic and social rationales for regulation of financial markets may coexist and apply at once, and some objectives may also overlap. For example, product safety is an aim of both economic and non-economic rationales. Both rationales, however, do not escape a rigorous cost–benefit analysis and trade-offs premised on a utilitarian calculus.

An underdeveloped and neglected approach to regulation can find its rationale in the respect of the fundamental rights or dignity of individuals as internationally recognised. Ultimately, it draws on the Kantian idea of the centrality of the individual, where the economy is at the service of humankind and not vice versa, and the individual may not be used as a means to social or economic ends.<sup>7</sup> The rights of the individual are treated seriously and trump any conflicting interest or competing consideration. The respect for the individual is at the centre of the attention of the regulator which will intervene to protect or preserve the individual rights at stake, or the means to achieve them. In this perspective, the emphasis is placed on the individual more than the collective. In this light, consumer rights may become rights of the individual instead of rights of a heterogeneous group. Consumers are not a separate group of people, they are human beings, and every consumer is a citizen.<sup>8</sup> The consumer evolves into a market or economic citizen. This vision is likely to attribute a constitutional dimension to consumers and consumer protection, where the rationale of financial regulation becomes the respect for fundamental rights and its objective is the respect for the dignity and freedom of the individual consumer and his/her full participation in society.

There are practical implications in a fundamental rights-led approach to regulation. Participation in the economic and social life of the community where individuals live is already a right recognised in international conventions.<sup>9</sup> The achievement or respect of human dignity already inform and are the objective of human rights legislation. Intervening in the financial marketplace, a right-led approach to regulation may provide

<sup>6</sup> *Ibid.*

<sup>7</sup> Kant (1785).

<sup>8</sup> e.g. see Deutch (1994), esp. p. 537.

<sup>9</sup> e.g. see the 1966 International Covenant on Economic, Social and Cultural Rights (ICESCR) which is binding on all EU Member States.

the necessary preconditions for individuals to participate in the economic and social life of their community. Inclusion and access to financial services become such preconditions. Consumer protection becomes part of the democratisation process where the consumer becomes a market or economic citizen rather than solely an economic or social agent. Financial services develop into services enabling the access of all citizens to affordable high-quality services throughout the community, including cross-border financial services. These include, for example, ad hoc schemes for persons with low income, safety, security and reliability of high-quality products and services, continuity of services, choice, transparency and access to information from providers and regulators. The implementation of these principles generally requires the existence of independent regulators with clearly defined powers and duties, such as powers of supervision and sanction. Other requirements are the provisions for the representation and active participation of consumers/users in the definition and the evaluation of services, the availability of appropriate redress and compensation mechanisms, and the existence of evolutionary clauses allowing terms and conditions to be adapted in accordance with changing objective user and consumer needs or circumstances, including changes in the economic and technological environment.<sup>10</sup> For example, access to a basic bank account or personal data protection become fundamental rights in financial markets necessary to the inclusion of the individual in economic and social life and respect for his/her dignity as a human being.

If the rationale for financial regulation is taken away from the exclusive cost–benefit analysis discourse embedded in market failure and the social rationales for regulation alike, consumer protection may become a right in itself when fundamental rights or constitutional values are at stake and claims need to be rendered justiciable. The consumer grows to be equipped with the tools necessary to take his/her role in the market.

Thus far EU consumer law and policy has served the purpose for the realisation of the internal market and seems to be inclined towards an economic approach to regulation. It has departed from a conception of consumer protection as the object of the law and is directed towards a notion of the consumer as an actor for the completion of the single market.<sup>11</sup>

The financial crisis and the social imbalances that it has caused may have finally offered the opportunity to the EU to intervene with non-economic rationales for regulating the financial market. Interest rate ceilings, measures to tackle the over-indebtedness of European consumers, controls on termination and default penalties and on debt recovery from consumers could be welcome policy initiatives of the EU in this direction.

However, what certainly the sophistication of financial markets and their close link with the lives of individuals have shown is that protection of the individual

<sup>10</sup> Szyszczak et al. (2011); see also Morgan (2006), esp. p. 465, taking the example of water.

<sup>11</sup> e.g. see Micklitz (2012b); Weatherill (2013).

consumer is a fundamental part of maintaining human dignity and a necessary precondition for his/her full participation in the economic, social and democratic life of society.

A holistic approach to policies and regulation of personal over-indebtedness may need to take all these rationales into account, especially the consideration that this is not only about market law or national social legislation, but that the dignity and lives of individuals are affected in their roots.

The book is divided into nine chapters.

This Chapter 1 introduces the topic of the book, the conceptual framework and the structure.

Chapter 2 provides an account of the role of personal debt in the modern economy and focuses on the size and the growth of the personal debt market in Europe. To this end, data from the ECRI Statistical Package are analysed over the period 1995–2016, both at aggregate level and by country. The focus is not only on the total amount of debt, but also on relative measures, such as the debt to gross domestic product (GDP) ratio, the debt to income ratio and the per capital amount of debt, in order to draw a picture of the personal debt market in Europe and its evolution over time. The chapter also provides an empirical analysis of the characteristics of indebted consumers using data from the Eurosystem's Household Finance and Consumption Survey. The analysis is framed within the life-cycle theory, which is the traditional economic setting where the characteristics of individuals and households holding debt are analysed. The socio-demographic and economic features of consumers who participate in the debt market are separately investigated for mortgage debt and consumer credit too, in order to shed light on the existing differences between the two groups of borrowers.

Chapter 3 analyses the economics of the personal debt industry in order to shed light on the mechanisms behind the development and growth of the business. In particular, the chapter highlights the variety of personal debt solutions and the innovations in the contractual terms of mortgages and consumer credit products that have contributed over years to diversify the portfolio of personal debt products and reach previously under-served customers, and presents the different types of players on the market, both mainstream, such as banks, specialised personal debt intermediaries and captive companies, and non-mainstream, such as pawnbrokers, doorstep lenders and high-cost short-term credit brokers. Credit providers making use of technologically enabled financial innovation in consumer services (fintech) are also newcomers in the landscape of the industry. The chapter also discusses the economics of personal debt and presents time-series data, from the European Central Bank, on interest rates, annual percentage rate of charges, card payments and non-performing loans, with the aim of focusing on the opportunities and risks of this dynamic industry. An empirical analysis of the performance of a representative sample of consumer credit companies concludes the chapter; data are from Orbis Bank Focus (Bureau Van Dijk) and covers the period 2005–16.

Chapter 4 introduces the topic of over-indebtedness and analyses the phenomenon from an economic perspective to quantify the size and the characteristics of consumers that are over-indebted or at risk of over-indebtedness. The chapter attempts to define over-indebtedness, focuses on the complexity of measuring the phenomenon and illustrates existing indicators aimed at capturing profiles of financial distress. It also discusses and analyses the causes of over-indebtedness, proposes a review of extant empirical literature which highlights the characteristics of over-indebted consumers, and provides an empirical investigation of the dimension of over-indebtedness in Europe and the characteristics of over-indebted households using data from Eurosystem's Household Finance and Consumption Survey. Besides, the chapter specifically focuses on the role played by psychological and personal traits – like impulsivity, myopia or overconfidence – on debt decision-making and risks of over-indebtedness. It investigates the under-studied impact of behavioural traits on the effectiveness of measures to prevent over-indebtedness. An empirical analysis concludes the chapter, with the aim of highlighting the role impulsivity plays in weakening the positive impact of financial literacy on debt decisions.

Chapter 5 further develops the issues raised in the previous chapter, i.e. the move from personal indebtedness to over-indebtedness and its consequences. It introduces the concept of financial fragility or vulnerability, distinguishing between the economic, policy and legal readings of vulnerability. The ensuing feeble dividing line between social and economic matters is addressed, as well as considerations regarding the intertwining of social and economic policies. In this context, a main aim of the chapter is to provide readers with an insight of the extent to which 'problem debt' is – or should be – a matter of national or EU competence in policy and lawmaking. This discussion includes debates about the competence of the EU to deliver social justice, and the policy and legal consequences of this answer. Questions over the private nature of debt relationships and the role attributed to contract and consumer law (including their national and EU dimensions) will also become part of and feed into the discussion over the economic and social attribution of competences. Next, the chapter examines the EU policy measures designed to address the phenomenon of consumer over-indebtedness. The resulting focus is mainly on ex-ante preventive measures – such as financial education, debt counselling, transparent information, arrears management. A substantial part of the chapter concerns responsible lending and borrowing measures, and the assessment of consumer creditworthiness. The emphasis given to policies on the responsible creditor and interferences with private autonomy and private law relationships are scrutinised. Finally, it investigates how EU policies to tackle over-indebtedness are translated into EU law. The key distinction between prevention and cure of over-indebtedness reflects the analysis of the relevant legislation. Within this context, preventive measures addressed in the Consumer Credit Directive and the Mortgage Credit Directive are analysed, alongside the guidelines provided by other relevant institutions (e.g. the European Banking Authority).



Chapter 6 explores the role and function of solvency data and financial technologies (fintech). The assessment of consumer creditworthiness features strongly under the law. Based on the previous chapter, this chapter focuses on the use of credit data, emerging technologies and big data as the tool mostly used by the credit industry for credit-risk analysis, to assess the creditworthiness of consumers and engage with responsible lending, as well as problems of over-indebtedness. However, this is an area which raises controversies and problems hardly addressed by the policies and the law. Unlike for the harmonisation of EU rules on credit to consumers for the creation of the internal market, the underlying consumer data infrastructure remains fragmented at national level, failing to achieve univocal, common or defined policy objectives under a harmonised legal framework. The multiple uses, incoherencies, fragmentation across the EU, and new risks for consumers are analysed to show the policy and legal gaps, which in turn feed into the policies and legal framework of over-indebtedness. Ultimately, the aim of the chapter is to analyse and demonstrate the extent to which the current practices alongside the relevant EU policies and law suffer from poor coordination to the detriment of both European consumers and the completion of the internal market. It is put forward that new solutions are needed. Equally, there is much hype about the potential for fintech and big data to transform and deliver financial services to consumers, which may present new opportunities but also new or incremental risks for consumers and their financial inclusion. Finally, an emerging aspect that the concluding part of the chapter addresses is the extent to which a standardisation of the data necessary to measure creditworthiness and over-indebtedness are starting to develop at EU level and the many obstacles that remain. The establishment of the Banking Union (BU) and the prudential supervision of the Euro-area suggest standardisation and convergence of the data used to measure debt levels, arrears and delinquencies.

Chapter 7, in turn, studies the credit risk analysis and creditworthiness in their legal context, with specific reference to solvency data and big data vis-à-vis the new EU data protection legislation set by the General Data Protection Regulation (GDPR). Fundamental rights and consumer protection concerns arise from the dissemination and sharing of traditional and non-traditional data, as well as from their expanding uses. This is an area of the EU internal market that demands the attention of the EU legislator without further delays. An aim of the Chapter is to analyse, from the perspective of financial inclusion and consumer protection, the extent to which the current EU legal framework set by the GDPR is prepared to respond to the challenges posed by the use of data and innovation in the context of the prospective opportunities and detriment for consumers. Particular emphasis is given to the issues of economic efficiency vis-à-vis consumer exploitation and inclusion – financial, economic and social. It assesses the extent to which the risks are likely to contrast or outweigh the benefits and the degree of protection offered by the GDPR to stem potential consumer detriment. Ultimately, it questions whether

the law is fit for purpose or not in consideration of the enactment of brand new legislation in this area.

Chapter 8 studies the treatment of over-indebtedness once this has materialised. Particular regard is given to personal insolvency law and its national dimension. Within a fragmented legal framework in the EU, the chapter analyses how the EU has pursued the route of mutual recognition to ensure engagement between the Member States (Council Regulation 1346/2000 and The Recast Regulation 2015/848) and the extent of their applicability to the insolvency of natural persons. In light of the many problems and risks facing European consumers faced with weak, uncoordinated or under-resourced insolvency laws, this chapter also provides an analysis of the role that the European Courts play in stemming the financial problems of consumers brought by the financial and economic crisis of recent years. By analysing the flourishing case law of recent years, the goal is to show how so far the Courts have supplemented for the deficiencies of policy and law makers. At the same time, the Chapter emphasises the limits of what the Courts can do under the current legal framework. Thus, the chapter brings together the identified policy and legislative weaknesses in ex-post curative measures or debt solutions for the treatment of the problem to analyse the major gaps and inconsistencies that the EU faces and the role of personal insolvency law. It offers a critique of the current EU framework of responsible lending and debt solutions to address a problem that the book identifies as a European one. At the same time, the chapter analyses the extent to which the legal framework and the case law are providing the surfacing of EU principles in the area of debt solutions. The latest legislative initiatives on business insolvency and the extent to which some provisions may apply to natural persons are analysed (e.g. the EU proposal on preventive restructuring frameworks and minimum standards for a second chance for entrepreneurs). The rationale and case for EU harmonisation of personal insolvency law against the latest policy initiatives (Green Paper on Retail Financial Services and Capital Market Union) is finally put forward.

Chapter 9 concludes by bringing together the findings of the previous chapters. It attempts to put forward the main argument that the EU should take the competence to harmonise and legislate in the area of debt solutions for consumers maintaining high levels of consumer protection and respect of fundamental rights enshrined in EU law. At the same time, it advances the ideas that it recognises as the way forward, suggesting the scope for further research and the new frontiers that it believes should constitute the future study of 'problem debt'.