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CREDIT DEBT AND CONSUMER INSOLVENCY REGULATION: FUNDAMENTAL ISSUES



Context

- World financial crisis stimulates rethinking of regulation of credit and debt
- Changes in banking and consumer credit over the past 25 years: rise of consumer lending and associated fees as a substantial aspect of banking
- The consumer as profit centre. Ability of consumer to protect herself given complexity of financial issues?
- The rise of over-indebtedness.
- The contemporary “flight to quality” and the problem of access.

World Bank (2009): model of consumer credit protection

- Disclosures
- Financial literacy
- Positive credit reporting
- Ombudsmen
- Some form of public regulation of the supply side through regulation
- Little discussion of details of private law ground rules or regulation of over-indebtedness
- Regulation of default and bankruptcy are part of the ground rules of credit system

EU

- Focus on targeted harmonization of measures to stimulate competition—standardised info, adequate explanations. 2008 Consumer Credit Directive
- “Best practices” and Open Method of Coordination in the field of overindebtedness (EU 2008)
- The rise of the principle of responsible lending

Models of public regulation: A Consumer Credit Safety Commission?

- UK model of Financial Services Authority and new licensing approach by Office of Fair Trading
- Proposed US Consumer Product Safety Commission
- Regulation *ex ante* of business model of credit grantors
- FSA GMAC decision October 2009.
- Focus on supply side regulation rather than demand side: change organisational culture of lenders?

The rise of over-indebtedness

- “Twenty years ago an academic book about consumer bankruptcy systems around the world would not have been possible. Most countries did not have a consumer bankruptcy system...” J. Niemi, I. Ramsay, W. Whitford Consumer Bankruptcy in Global Perspective (2003) at 1.
- “Insolvency procedures for consumers have become more common in different parts of the world.” J. Niemi, I. Ramsay, W. Whitford, Consumer Credit, Debt & Bankruptcy (2009) at 6.

Reasons for o/d

- European studies reflect different balance of reasons: adverse change of circumstances + financial imprudence
- France dominated by adverse changes [Bank of France] Germany [Backert] unemployment 42%, “loss of financial overview 37%: UK studies mixed in findings.
- May reflect different debtor populations/interpretation of authors of studies

Policies

- Niemi and Henrikson (Council of Europe 2005) prevention, alleviation and rehabilitation
- Prevention is an important goal in Europe e.g. advice and counselling, financial literacy, responsible credit practices, use of credit data.
- Design of treatment institutions: problem of processing large numbers of individuals: matching individuals to process: assessing effects of institutional choices on other aspects of credit system.

Enforcement Institutions and credit

- Too strict an enforcement system may lead to overlending
- Too lenient may reduce credit.
- Issues of error costs in enforcement
- May want to structure institutions to encourage use of relief mechanisms given the social costs

Economic analyses

- Economists attempt to measure impact of institutions through regression analysis
- Problems with this approach—e.g. use of proxies, attempting to control for all variables
- Measures correlations
- US General Accounting Office (2000) at 15 ‘research has encountered considerable difficulty in identifying the incentives effects...nevertheless, there is some evidence that the probability of filing for bankruptcy...depend on the benefit of the filing”

US studies

- Studies on state property exemptions: effects on bankruptcy filing, and price and availability of credit
- Impact of mortgage foreclosure protection on credit granting
- Studies on stigma—related to concern that if make easier to access insolvency then will this affect social norms re e.g pacta sunt servanda
- Rational actor model of consumer?

Treatment and rehabilitation

- Increasingly large numbers of individuals to be processed: 2008 England: approx. 100,000 Bankruptcies/IVAs + approx. 160,000 debt management plans: France, 180,000 applications to Overindebtedness Commission: Germany 95,000 bankrupts.
- Significant number of NINAs and LILAs
- Administrative/judicial model?
- Routinisation v. Individualisation: discretion within system
- The role of intermediaries: rational sorting of different debtors
- Who finances?

The NINA

- Open low cost access. UK Debt Relief Order as example
- Cf. France--- debtor must be “irredeemably compromised”: varying interpretations by Commissions.
- Are NINA’s debt problems a consequence of other problems/issues?

Characteristics of EU repayment plans

- Normally 5 years with writedown at end
- Nordic countries: significant barriers to entry
- May require demonstration of failure of voluntary agreement
- Often financed by state
- Counselling may be a part of the plan.

The role of repayment plans

- How to evaluate? [see Braucher, 2009]
- Creditor repayment net of admin costs
- Rates of discharge at end of plan
- Effectiveness of plan in rehabilitation
- Rational sorting

Assessment of European plans

- “The payment plans that seem to be at the heart of the European regulation usually yield little if anything to the creditors and their economic value is questionable” Niemi 2009
- Problem of rational sorting
- Treatment and rehabilitation. Is it a debt problem or a wider problem?
- Role and effects of debt counselling. Resource constraints on counselling
- Need for more longitudinal study of plans

UK model: Large number of options

- Debt Relief Order
- Bankruptcy
- Administration Order
- Individual Voluntary Arrangement
- Enforcement Restriction Order
- Statutory recognition for approved voluntary repayment order

Strengths/weaknesses

- Different tracks for different levels of o/d and type of debtor
- Can be relatively swift
- Complexity: need for intermediaries
- Need to regulate intermediaries
- Costs borne primarily by private parties