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Consumer Protection in French and British Credit Markets

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I. Introduction

Driven by falling interest rates, appreciating real estate values, and financial market liberalization, consumers across Europe have dramatically increased their levels of borrowing. Both mortgage and non-mortgage lending has grown sharply. For many countries, this shift has occurred during a period of stagnant or even falling real wages. The consequence has been a rapid growth in the number of over-indebted consumers – typically defined as debt service above 35% of disposable income. In response, national governments have set about revising their policies for protecting consumers who borrow money. These protections have included measures to ensure transparency in consumer credit contracts, to limit excessive or extortionate lending, and, increasingly, to provide a fresh start to household borrowers who become overly indebted. Beginning in the mid-1980s, for example, nearly every advanced industrialized country has dramatically revised how it deals with personal insolvency.

In this paper, I review the trajectory of consumer credit reforms in France and the United Kingdom. Through a period of significant regulatory reform intended to help protect consumers, policymakers have had to conceive what policies *would* protect the consumer, and how. What is the consumer interest in the realm of consumer lending? In both France and the UK, consumer lending is closely tied to issues of social and economic exclusion. Yet each sees the connection differently. For British policymakers, consumer credit is a tool for fighting exclusion. Exclusion for them is quite directly exclusion from modern credit markets, and, by extension, from the goods and services that access to credit makes possible. For France, consumer credit is perceived as a useful tool of household finance, but one that risks to aggravate rather than to reduce social and economic exclusion. High interest rates charged to highly risky consumers are perceived as a transfer out of the lower classes. Consumer protection is understood at least in part as protection from credit itself.

Despite these different approaches to consumer credit, we observe broad convergence in strategies for dealing with its consequences. In both the UK and France, the governments have tried to promote extra-legal remediation procedures that offer the promise of lower administration costs and a higher repayment rate. For cases in which creditors and debtors are unable to arrive at a solution, both countries have moved to embrace the US principle of the 'fresh start.' Both have put in place procedures to provide a quick automatic discharge after liquidation of assets. But the underlying logic again differs. In the UK, providing a fresh start is

intended to encourage risk-taking and entrepreneurialism. In France, the fresh start emerged out of a concern for the inhumanity of leaving families to suffer without end under the extreme financial burden of excessive debt.

For both countries, consumer protection in credit markets implicates a number of competing interests. The collection and distribution of consumer credit histories, for example, has the potential to increase competition in lending and thereby lower interest rates. But it also threatens the privacy of personal data, a principle that the EU has designated as a basic human right. Consumer protection requires balancing these competing goals. Similarly, the interest in providing a rapid discharge for bankrupts faced strong and real opposition from observers worried about undermining respect for contracts. It is perhaps surprising in a statist society like France, but the sovereignty of contract has a central place in the French constitution, and moves to legally signed contracts are seen to risk undermining a fundamental public value. How these tensions are resolved depends to an important degree on how the role of consumer credit is understood in society.

In the sections that follow, I trace the broad outlines of consumer credit markets in France and Germany, then explore three areas of consumer protection. The first looks at efforts to protect consumers as they enter credit contracts. It focuses on measures to promote transparency and limit exploitation. The second case looks at the regulation of national credit rating agencies (although we will see that that term is not entirely accurate). The third area of comparison is in bankruptcy reform, where tremendous changes have been introduced in both countries.

II. A Tale of Two Debtors

Both France and Germany have experienced dramatic growth in consumer borrowing in the past 15 years. By 2007, UK households held debt, in the form of mortgages, installment credit, and revolving card-based credit, equal to 166% of their disposable income. In France, household indebtedness had also been growing rapidly, but given a far lower starting level, it had by 2007 reached only 68% of household disposable income. Whereas the UK has begun to look more like the United States, French households remain among the least indebted among the advanced industrialized economies. This difference in the burden of debt is reflected in difficulties in repayment. In 2005, French consumer credit defaults—payments more than 90 days late—accounted for two percent of consumer loans, compared to 5% in the United

Kingdom and 6% in the United States.[1] In both France and the UK, just less than half of all households held debt, suggesting that households that did carry debt in the UK had significantly higher levels of debt.

The structure of consumer lending in the two countries is quite similar. In France, non-mortgage lending is divided nearly evenly between conventional personal loans offered by banks and consumer loans offered by specialized consumer finance firms. The latter emerged in the early part of the 20th century, spawned mainly from large retailers who needed to offer their consumers a credit facility. These include Cetelem, Cofidis, and Cofinoga, plus two large lenders specializing in automobile finance: Crðipar (PSA Peugeot-Citroen) and DIAC (Renault).[2] With financial liberalization, France's large banks attempted to move further into the profitable consumer lending sectors. But efforts to create their own consumer finance operations typically failed. Credit Agricole opened the consumer finance group 'Unibanque,' then had to close it. Citicorp France opened and then sold its 'Citifinanement' group.[3] More recently, the big financial institutions have begun buying up the existing consumer finance groups. BNP Paribas bought Cetelem; Credit Agricole bought Sofinco; GE Capital bought Sovac. Of the big lenders, only Cofinoga remains majority owned by its founding retailer, Galleries Lafayette. Revolving credit, offered by both kinds of institutions either via the *carte bancaire* payment card or as overdraft protection, accounts for approximately one quarter of all consumer lending.

In the UK, banks and building societies account for two-thirds of all consumer credit. The remainder comes from specialized lending institutions, including home credit providers. Half of all non-mortgage credit takes the form of personal loans; one third is installment sales credit; roughly 20 percent is revolving credit card credit, making the UK one of the most highly developed credit card markets in Europe. Traditional credit cards like Barclaycard and Visa, and newer card companies like Egg and Capital One, were displacing traditional store credit. By 2000, UK credit card transactions accounted for 30 percent of all such transactions in all of Europe. Traditional bank and building societies have been losing market share to them, although

[1] Cédric Houdré, L'endettement des ménages début 2004," *Insee Première* 1131, April 2007.
[2] Cécile Desjardins, "La guerre ouverte des professionnels," *Les Echos*, 29 March 2000, p 63.
[3] Renaud de la Baume, "Les banques peinent sur le marché du crédit à la consummation," *La Tribune de L'Expansion*, 26 march 1992.

they still dominated the market. High-interest rate ‘sub-prime’ lending accounts for about 10% of UK household debt (compared to 25% in the US).[4]

Figure 1: Household debt as a share of disposable income, 1991 and 2005.

	non-mortgage debt		mortgage debt		total debt	
	1991	2005	1991	2005	1991	2005
US	22%	26%	76%	109%	98%	135%
UK	13%	26%	78%	131%	91%	159%
France	8%	18%	32%	46%	40%	64%

Why are household debt levels so different in the two countries? In a sense, France represents a perfect storm in restrictive access to consumer credit. A tradition of postal savings accounts that provided consumers with easy and inexpensive access to savings combined with strict postwar restrictions on the volume and terms of consumer lending that lasted into the mid-1980s. France moved early to eliminate tax breaks for mortgage interest payments, on the grounds that they disproportionately benefited the well off. France is also one of the few European countries (along with Finland and Italy) to collect and distribute only ‘black’ data for purposes of centralized consumer credit rating. Creditors are informed of any negative payment experiences of a potential borrower, but this does not include data on the total volume of credit, on income or tax levels, or other assets and liabilities. In the United Kingdom, by contrast, consumer lending was deregulated earlier (1979), and had in any case never been as tightly controlled. Tax-deductible mortgage interest and a recent move to mortgage securitization have driven the home lending sector. This higher level of mortgage lending is reflected in relatively higher home ownership rate: 65% in the UK compared to 54% in France. Private credit rating agencies in the UK distribute negative as well as positive consumer credit data, creating greater competition in the consumer lending market. Finally, the UK has no formal usury limits, although courts may revise loans that are found to be ‘extortionate.’

[4] Kerry Capell, “Britain’s coming credit crisis,” *Business Week*, 17 September 2007, p 68.

III. Transparency and Usury

Both France and the UK moved to help protect consumer debtors in the 1970s. The UK provisions are laid out primarily in the 1974 Consumer Credit Act; the French protections were in the 1978 law on consumer lending. In general, France's protections appear to provide a higher level of protection than do those adopted in the UK. In a survey of European markets by the French lender Cofidis, France ranked uniformly high in consumer protections across four indicators: restrictions credit advertising, rights of borrowers in contracting (including a cooling off period and usury caps) and repayment, recourse in case of over-indebtedness, and protection of private financial data. On the same scales, the UK ranked low in all but one category: recourse for the over-indebted.5 These scorings reflect different priorities of consumer protection in the two countries. In the trade off between consumer access and consumer protection, the UK favors access while France favors protection. In the UK, access to credit is perceived as a tool for bringing more of the population into the modern economy. It is a tool of social and economic inclusion. In France, the perception is nearly the opposite. While they have worked to liberalize consumer credit markets, French policymakers have tended to see consumer credit as a threat to social and economic cohesiveness.

Consumer protection in credit markets had its roots in the early move in France to protect consumers more generally against product-related loss. Early legislation focused on transparency of consumer credit transactions. The basic consumer protection provisions for consumer lending in France were legislated in the Scrivener law of 1978 (law 78-22, transcribed as articles 311-313 of the Consumer Code). The law applies to all forms of loans, including lease-sale agreements. It sets the terms for advertising credit, including direct mail campaigns. All offers must include both the total repayment costs and the effective interest rate (TEG) taking into account all related fees. A variety of other stipulations apply, including a minimum font (8 point) in which the terms of credit may be printed, and a set of nine credit offer models to which any offers of credit must conform. The law also provides a seven-day grace period for consumers to reconsider a credit contract.[6] The goal was to ensure that consumers were not pressured into accepting credit without sufficient time to read the terms and consider the implications.

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[5] One might question Cofidis' objectivity. Their conclusion from the survey was that the European Union should step in to impose uniform consumer protection standards across European credit markets. Cécile Desjardins, "Cofidis appelle à une réglementation européenne du credit à la consummation," *Les Echos*, 29 May 2001.

[6] Balaguy, Hubert, *Le crédit a la consummation en France* (Paris: Presses Universitaires de Paris, 1996), p 88-9.

Apart from these policies to promote transparency, the French government has a deep tradition of intervening in credit markets that still shades their approach to consumer lending today. In the immediate postwar period, concern that consumer credit would crowd out industrial investment led the government to restrict access to consumer credit in a variety of ways. They limited the growth of consumer credit extension (to 3% to 5% per year), restricted the kinds of products to which it applied (primarily automobiles and white goods), set a maximum duration (three years), a minimum required down payment (20%), and a maximum interest rate. The consumer credit law of 1966 set the maximum interest rate on consumer lending at twice the average industrial borrowing rate, although the economics ministry also commonly negotiated 'voluntary' interest rate targets with the main consumer lending institutions that were somewhat below the statutory limit. From 1984 to 1987, French financial markets were progressively liberalized, and many of the restrictions on consumer credit were relaxed.

Despite liberalization, French politicians have continued to view consumer credit as a tool of macroeconomic policy. In 1984, as the Socialist government of François Mitterrand sought to reign in inflation, it passed a 'law on the activity and control of credit institutions' that targeted offers of "free credit" by retailers. Retailers could no longer advertise free credit terms outside of the point of sale. More importantly, when free credit terms were offered, retailers were required to provide a *lower* price for goods when they were purchased without free credit. This lower price was set by a formula, based on the average interest rate plus 50%, that for average periods of credit gave prices that were roughly 20% below the 'free credit' price.[7] Most consumer groups supported the new law, as did small retailers, who did not have the financial means to compete with 'free credit.'[8] French politicians quickly discovered that consumer credit could also be used to provide a macroeconomic stimulus. In 1996, Jacques Chirac, faced with a potential recession, proposed a one-year tax incentive for consumer borrowing equal to one quarter of all consumer interest payments. Facing a similar economic slowdown in the summer of 2004, Nicola Sarkozy replicated Mitterrand's policy, applicable through the end of 2005.[9]

French politicians have been especially sensitive to the social consequences of high interest rates. The 1989 Neiertz law redefined usury to accommodate different risk classes while

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[7] François Renard, "Le credit gratuity va pratiquement disparaître," *Le Monde*, 25 July 1984, p 19.
[8] Laurent Chavane, "L'enterrement discret du 'crédit gratuity'", *Le Figaro*, 23 July 1984.
[9] Marie-Emilie Morel, L'Evolution du credit renouvelable: la consolidation du regime de protection de l'emprunteur, Mémoire, Université de Monpellier I, 2006, pp 34-5.

still limiting lending outside of a legally defined range. Each quarter, the Banque de France sets interest rate caps for six classes of consumer credit and five classes of industrial credit, calculated at one-third above the average rate for each class in the previous quarter. This scheme allows average rates to move without restriction while limiting outliers. Since the mid-1990s, interest rate caps on riskier classes of consumer credit have averaged 20%. One further protection added with the 1989 'Neiertz law' on consumer credit was a requirement that consumers be allowed to repay loans at any moment without additional fees.[10]

Public sensitivity about the social costs of high lending rates came to a head in 1996 when the UK based Thorne group launched its first rent-to-sell store in Bobigny, France, followed quickly by a second site in Havre. Called "Crazy George's," the store was based on the company's highly successful Rent-a-Centre format launched in 1992 in the United State (and followed by an equally successful 'Crazy George' chain in the UK). The store offered goods under a rental contract that would eventually lead to consumer ownership. Targeting communities with high concentrations of poor and elderly, where credit was not readily available, the stores sold only to customers within a 5km radius, and insisted that customers drop off their payments in person on a weekly basis. Because the rent-to-sell format was not formally a credit arrangement, it was not subject to France's usury restrictions. Indeed, the effective interest rate on rent-to-own products from the new stores rose to 56%. And a public poll found that 70% of French opposed the rent-to-sell format.[11] As one observer noted: "consumer lending...is to be condemned, and the old Christian tradition of usury, meaning a total prohibition on the charging of interest, not only abusive interest rates, should be retained."[12] Yet for Crazy George's customers, many of them retired, on a pension, and without access to traditional consumer credit, Crazy George's provided their only possibility to purchase large household goods. And while Crazy George's eventually closed its French stores, other French retailers had already stepped in to meet these needs. (Interestingly, Crazy George's 40 outlets in the UK operated on far lower effective interest rates – ranging between 20 and 25%.)

In Britain, as in France, protections for consumers in credit contracts were put in place as part of a broad wave of consumer protection measures instituted in the 1970s. Most of these basic protections were legislated in the 1974 Consumer Credit Act. Transparency was a primary

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[10] Gaudin, Michel, *Le Crédit au pariculier: Aspects économiques, techniques, juridiques et fiscaux*, Paris: SÉFI, 1996.
[11] *Le Monde*, 25 November 1996.
[12] Hugues Puel, "Crazy George's met l'éthique au défi," *La Croix*, 11 December 1996.

focus of the legislation. In general, a consumer credit contract must specify the equivalent annual percentage rate (the legislation specifies how to calculate this), the total cost of credit, and the cost of the product being purchased on credit. Not all financial institutions are required to disclose this information: building societies and insurance companies, for example, are exempt from these transparency requirements. All consumer credit providers, however, had to be formally licensed by the newly created Consumer Credit Licensing Bureau within the Office of Fair Trading. As in France, borrowers who contract for a loan at their door or through the mail enjoy a cooling off period during which they may cancel a consumer loan contract. For installment credit, creditors also received special protections against repossessions. Creditors were allowed to repossess without a court order only when the consumer had not yet paid for more than one third of the product. In any case a 7-day notice was required.

Unlike in France, the 1974 legislation fully abolished usury limits. Conventional consumer loans may now reach an annual percentage rate of 45%, while small short-term doorstep loans can range up to 1000% APR, although more typically they range from 75% to 175%.[13] Growth in lending in the sub-prime sector has stimulated considerable legislative interest in imposing interest rate caps. In 2003, a parliamentary commission considered the possibility of imposing interest rate restrictions on credit card companies operating in the UK. This in turn stimulated a debate about how financing to risky segments of the population should be funded. Credit card companies that focus on the sub-prime market emphasized that by charging especially high fees and interest rates to customers who do not pay regularly, they are able to extend relatively inexpensive credit to reliable borrowers, even if they do not have strong creditworthiness. This approach is very different from the traditional doorstep lending sector, in which it is expected that borrowers will occasionally miss a payment, and the cost of those missed payments is spread across all borrowers in the form of higher interest rates.

In 2006, the Consumer Credit Act underwent its first major rewriting since its introduction in 1974. The legislation was a response to a government investigation into consumer lending published in 2003, entitled "Free, Clear and Competitive."[14] Some of the provisions in the new Act are intended to increase transparency. Lenders must not provide detailed printed annual statements, as well as printed notices of accounts in arrears. This set of provisions pose a

[13] Jan Evers and Udo Reifner, *The Social Responsibility of Credit Institutions in the EU*, Baden-Baden: Nomos Verlagsgesellschaft, 1998, p 133.
[14] 2003 White Paper: "Fair, Clear and Competitive: the Consumer Credit Market in the 21st Century."

specific challenge to doorstep lenders, who have not traditionally operated with high levels of disclosure. Consumers now also have more time to respond to notices of default (14 days rather than seven). Potentially more important are the new forms and standards of recourse the act creates. First, consumers may take their grievances directly to the Financial Ombudman Service, which could in turn order licensed lenders to provide aggrieved consumers compensation.[15] Second, the Act has replaced the legal standard of 'extortionate' lending with a broader test for 'unfair relationship' between creditor and debtor. If courts interpret this standard broadly, it could have the effect of creating a new set of norms for responsible lending among UK creditors. Creditors have been quick to embrace the new legislation, with some relief that early proposals to impose hard interest rate caps were not included.

IV. Credit Rating and Data Privacy

Money lenders have long found ways to share data on borrowers, both to assess the overall creditworthiness of new applicants and to avoid 'over-borrowing' by a single borrower using credit lines from several sources. Because this sort of data could have a decisive impact on a consumer's access to credit, governments have stepped in to regulate the credit rating sector to protect consumers. In Europe, this intervention has been shaped by deep concerns about consumers' rights to control the use of personal data. How countries balance these two goals – data privacy and credit access – can shape dramatically the credit environment consumers face.

France's centralized credit rating system, managed by the country's central bank, records only negative credit episodes. Late payments are recorded once they reach 90 days, as well as any credit-related legal or administrative procedures (see below). The database, called the *Fichier national des incidents de remboursement des credits aux particuliers* (FICP), is accessible only to credit companies and to individual debtors who wish to view their own record.[16] Established in 1989, the FICP replaced a fully private list of negative payment incidents being maintained by France's association of financial institutions for its member companies. In practice, the FICP database has become a no-credit black list for borrowers. In 2003, there were 2.3 million people registered in the FICP. Data are kept for a maximum of 10 years.

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[15] John Willman, "Shake-up of credit rights to protect borrower," *Financial Times*, 7 April 2007.
[16] Chatain, Pierre-Laurent and Frédéric Ferrière, *Surendettement des particuliers*, Paris: Editions dalloz, 2000, p 188.

Since its creation, a debate has periodically surfaced concerning the potential advantages of collecting and distributing more extensive 'positive' credit data, including information on outstanding loans, taxes, income, and assets. In the most recent proposal, which came before the National Assembly in 2005, the center-right UDF party argued that a positive registry would give financial institutions a better sense of total lending and help them to better assess a consumer's ability to repay. France's financial institutions were divided on the proposal. Some, including the consumer lending institution Cofinoga, argued that positive data on potential borrowers would help them to avoid adverse selection in selecting customers, thereby reducing both defaults and credit rationing. But many other financial institutions, supported by France's industry association for financial firms (ASF, or Association des sociétés financiers), argued that a positive rating system would help foreign financial firms—like UK-based lender Egg—to identify new clients in France.[17] France's consumer groups generally agreed with this view, worrying that a positive list would become a tool for more aggressive commercialization of credit, leading to higher levels of consumer indebtedness.[18]

In the UK, consumer data is gathered and stored by private credit reference agencies. Through historical consolidation, three credit reference agencies now operate in the UK: Experian, Equifax, and Callcredit.[19] Under the terms of the Consumer Credit Act of 1974, which governs the treatment of credit data, the credit reference agencies do not themselves make assessments about the creditworthiness of individuals. And, unlike France's FICP, they are explicitly banned from creating a lending 'black list.' They provide lenders with raw information, leaving the lenders to employ their own private data and scoring systems to determine the terms on which credit should be offered. Credit reference data are retained for a maximum of six years, and cover all jurisdictions in the UK.[20] The data compiled by credit reference agencies to create credit histories include: electoral rolls (for proof of residency), county court judgments, payment of past debts, and bankruptcies and IVAs (both of which remain on a credit history for six years from the date the bankruptcy or IVAs are undertaken). Each time a new form of credit is opened, data about the loan is recorded by the credit reference agencies. If an individual in the UK is refused credit, under the Data Protection Act, the

[17] Catherine Maussion, "Credit: tout le monde dans le même fichier?" *Libération*, 5 October 2002.
[18] Bertrand Bissuel and Anne Michel, "Les établissements de credit accusés de favoriser le surendettement, *Le Monde*, 28 April 2005; Sylvie Ramadier, "La bataille du credit à la consummation," *Les Echos*, 21-22 January 2005, p 8.
[19] CreditCall was established 2001 in close collaboration with its US counterpart TransUnion.
[20] Hence the term 'credit reference agency' rather than 'credit rating agency.'

individual has the right to know the reasons for refusal. Reference agencies in the UK also allow individuals to explain a period of poor credit on their record: consumers may attach a 'notice of correction' to their credit report that explains missed payments.

Credit data activities in both France and Germany take place within the broader framework of the 1995 EU Data Protection Directive (EU Directive 95/46) governing the processing and movement of personal data. The directive came into force in 1998, and was transcribed into national law in the UK in 1998 and in France in 2004.[21] The goal of the EU directive was to harmonize national data protection policies so that member states with strong data protection regimes – especially Germany and France – would not block data flows with other EU members. The basic obligations imposed by the directive include consumer consent in the processing and transmission of personal data, consumer access to private data held by companies, and the creation of a national data protection authority to monitor the collection and use of private data and to enforce the data protection laws. Personal data are construed broadly in the directive to include such things as bank statements, credit card numbers, and criminal records. The term 'processing' is also construed broadly as "any operation or set of operations which is performed upon personal data, whether or not by automatic means, such as collection, recording, organization, storage, adaptation or alteration, retrieval, consultation, use, disclosure by transmission, dissemination or otherwise making available, alignment or combination, blocking, erasure or destruction."[22] Finally, in a provision that continues to dominate trans-Atlantic economic negotiations, the Directive bans companies from transmitting personal data to third countries that do not ensure "an adequate level of protection."

In practice, the requirement of consumer consent for data 'processing' and 'transfer' has placed limits on the use of credit data for the use of consumer credit data in more sophisticated efforts to avoid adverse selection in credit direct marketing. Only once consumers make a request for a loan are they considered to have given consent, allowing the credit reference agencies to distribute private credit data. In the UK, credit card companies that rely on direct mailing report that the data privacy protections double the cost of acquiring new customers compared to similar direct marketing campaigns in the United States. In France, the impact is even more dramatic.

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[21] The European Commission brought a case against France before the European Court of Justice for delaying implementation of the directive. France responded slowly in part due to the challenges of modifying its own strong data protection policies established in its own data privacy regime dating to 1978 legislation.

[22] EU Directive 95/46/EC Article 2.d.

France's financial institutions have long proposed to enhance that country's publicly managed black list with a privately managed database with positive credit information. But France's powerful data privacy association, CNIL, acting under the terms of the EU directive, has ruled out this approach, arguing that it infringes too heavily on consumer privacy. Moreover, while specific economic sectors are permitted to maintain private customer black lists, CNIL found that these data must not be shared across sectors, a practice they argued risked creating a permanent group of social and economic outsiders. Hence credit institutions are not allowed to consult data collected on rental fraud, even if these data are held *within* the same company.

V. Consumer Insolvency

The household debt crisis which plagued Europe throughout the late 1980s and early 1990s, served as the catalyst for change in consumer insolvency law. The deregulation of credit in the 1980s resulted in working-class and middle-class families with significant amounts of debt.[23] Alternative solutions to bankruptcy were needed. European politicians and policy makers looked to the US model of bankruptcy which, since the 19th century, had included the discharge of debts. Europe took note of such debtor-friendly practices and European countries increasingly adopted new laws that enabled consumers to submit a formal petition for adjustment of debt and partial discharge. In 1984, Denmark had adopted a bankruptcy law that allowed for consumer debt adjustment and debt discharge. Denmark's bankruptcy legislation set a precedent for European bankruptcy law though it was never widely adopted outside of Scandinavia.[24] The UK's Debt Administration Order was hardly ever utilized, as its requirements for indebted consumers were severe.[25] In 1989, France adopted its Law on prevention and regulation of Individual and Household Overindebtedness. In 1990, the UK government significantly reformed its Debt Administration Order. In 1993, Finland and Norway adopted laws for consumer debt adjustment and Sweden followed suit in 1994. Austria also passed consumer bankruptcy legislation in 1994. In Germany, consumer insolvency was added to the German Insolvency Reform Act which had been previously debated and drafted without any recognition of

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[23] Niemi-Kiesilainen, "Changing Directions" *Journal of Consumer Policy* 20: 133-142, 1997.

[24] Niemi-Kiesilainen, "Changing Directions in Consumer Bankruptcy Law and Practice in Europe and the USA" *Journal of Consumer Policy* 20: 133-142, 1997.

[25] Civil Justice Review, *Report of the Review Body on Civil Justice,* Cmnd 394 (London: Her Majesty's Stationery Office, 1988); Davies, J.E. "Delegalisation of debt recovery proceedings: A socio-legal study of money advice centres and administration orders, 1986, pp.191-192 in Ramsay, I. (Ed.) *Debtors and creditors: A socio-legal perspective* pp.182-207.

overindebted consumers. The German Act was amended in Parliament. Enacted in 1994, the new insolvency law came into force in 1999[26]. The French and German reforms were in this sense part of a broader trend toward bankruptcy reform.

The French Case

Until 1989, France provided no useful recourse to over-indebted consumers. Creditors with defaulting borrowers brought their cases to the courts, which summoned the defaulting consumers, who often simply did not appear. Courts would then grant creditors the right to repossess property and attach salaries, typically leading to eviction.[27] For creditors, this ad hoc response created coordination problems, as creditors rushed to secure insufficient assets. With liberalization of consumer credit in 1987, a rising incidence of over-indebtedness led France's consumer and finance associations to negotiate a novel solution. The law of 31 December 1989, called "loi Neiertz" for France's minister of consumption Véronique Neiertz, created a new administrative instrument that would work beside the legal system to help resolve cases of consumer over-indebtedness. The law has since been reformed several times, as the French government has moved slowly toward a system of consumer debt discharge.

The core of the new system is a set of Departmental Commissions for Over-indebted Individuals' (henceforth 'Commissions') managed by France's central bank and to which any consumer may apply for debt restructuring or relief. The commissions can suspend payments for up to two years, restructure the payment period for loans, and modify interest rates. The new repayment schedule is based on the Commission's assessment of the "minimum vital income" to meet the claimant's most basic needs. Repayment plans may last up to but not longer than ten years. Formally, Commissions may only propose a repayment solution. If both parties do not voluntarily accept it, the case goes before a judge, who, since 1995, has had the right to enforce the recommendation of the Commission on both parties, or, in rare cases, to design a new repayment scheme. A series of studies conducted in the 1990s showed that most cases went to the full 10 years, that interest rates were reduced on average from 13% to 9%, and that average monthly payments were reduced from 6,000 francs to 3,800 francs.[28] Within certain limits—business-related debt is excluded, and consumers must show 'good faith' in presenting their case

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[26] Niemi-Kiesilainen, "Changing Directions" *Journal of Consumer Policy* 20: 133-142, 1997.
[27] "Un peu d'oxygène pour les familles surndettées," *Nous* 103, March-April 1990, p 9.
[28] Balaguy, Hubert, *Le crédit a la consummation en France* (Paris: Presses Universitaires de Paris, 1996), p 106-7.

to the commission—nearly all cases are accepted. The number of cases filed with the commissions has grown dramatically since their founding. From 90,000 cases in their first year, 1990, the number of cases had risen to 190,000 in 2004.

Each commission has four members, representing the Banque de France, the treasury department of the department, a consumer association, a lender association. In 2003, two non-voting members were added: a social worker, and a lawyer.[29] Two features of the 1989 law were distinctive. First, the commissions included no formal requirement for credit counseling, although in practice consumer and family associations often helped indebted households to navigate the administrative procedures. Second, private credit intermediaries have been banned in France, although credit consolidation remains legal.[30]

Figure 2: Total and 'active' applications to France's departmental commissions

	Active	Total cases	active cases
1990	.48	64000	31000
2000	.36	125000	45000
2004	.27	153000	41000

In assessing cases, the commissions distinguish first between 'active' cases of over-indebtedness, in which consumers have simply taken on too much debt, and 'passive' cases, in which external causes have made it impossible for the borrower to continue paying. In 2001, active cases accounted for 36% of all cases. By 2004, active cases accounted for 27% of all cases. Because the total number of cases has grown substantially, the number of active cases has stayed nearly the same – approximately 50,000 cases per year. In 2004, the most important sources of passive cases were unemployment (30.8%), divorce or separation (14.7%), and sickness or accident (10.8%).[31] As the number of cases seen by the commissions each year has risen, the share of 'active' cases has consistently fallen.

Consumer creditors were initially highly skeptical of the Neiertz procedure. Initially, in 1990, only 45% of solutions proposed by the commissions were accepted by creditors.
Paul Defourny, head of one of France's largest consumer lending groups, Cetelem, estimated in 1992 that 50,000 of the 160,000 cases heard up until that point represented instances of clear

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[29] INC, Le Dispositif Juridique (internal documents)
[30] *Familles de France magazine* 664, September 2000.
[31] INC, *Le surendettement en chiffres* (internal publication)

cheating by borrowers—borrowers who had gone from lender to lender in order to borrow as much as they could without intention of repaying. He estimated that the loi Neiertz had cost the lending industry 1bn francs in its first two years. As he describes it, "the [Neiertz] law…moralized our profession by creating a sort of deontological code."[32] Yet as cases of over-indebtedness rose, and as the commissions showed that they were able to produce workable solutions, industry acceptance of commission proposals rose, to 75% by the end of the 1990s.

Yet, despite this success, a growing number of cases were coming back to the commissions. The Neiertz legislation had been intended for debtors who had simply fallen behind. Increasingly, however, the commissions were seeing cases in which the debtor did not have the means to repay at all, even at no interest over ten years. For these cases, debt restructuring was not enough. Increasingly, financial firms came to accept that, at least for the direst cases, a full discharge of debts might be necessary.

There was a precedent for this in France, in the departments of Alsace and Moselle. These departments, while under German occupation between 1971 and 1945, had adopted the German law of 1877 providing for discharge in bankruptcy. With the region's reintegration in to France, the German bankruptcy provisions were retained as a provision of local customary law.[33] Under this provision, courts in Alsace-Moselle could force creditors to accept partial repayment tied to a discharge of all remaining debt. In 2003, France introduced a version of this court-administered discharge at the national level. It would apply only to debtors in good faith who had presented their cases before the commissions and were found to be "irremediably compromised" in their ability pay. In such cases, which amounted to only 5 percent of all cases heard by the commissions in 2004, the judge could call for a liquidation of assets and a full discharge of remaining creditor claims.[34] Consumer group reactions to the civil bankruptcy procedure were mixed. While most family groups saw it as a positive step, trade union and other groups felt that it was overly harsh in its requirements to liquidate all property.[35]

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[32] Renaud de la Baume, "Surendettement: un banquier dénonce les 'tricheurs'," *La Tribune a l'Expansion*, 19 March 1992.

[33] Dagorne, Dominique, "La faillite civile en Alsace et en Moselle," in Michel Gardaz, ed. *Le surendettement des particuliers*, Paris: Economica, 1997.

[34] INC, Le Dispositif Juridique (internal documents)

[35] INC, "Les débats sur le surendettement continuent," *INC Hebdo*, 28 March 2003, p 2.

The British Case

In Britain, bankruptcy has also moved toward a greater emphasis on negotiated settlements, but with very significant differences. In the context of Victorian ideals about morality and bankruptcy, and a tradition of debtor prisons that extended into the interwar period, Britain entered the postwar era with a legal system that continued to deal harshly with consumer debt default. Already by the mid-1960s, consumers who had purchased new household goods on credit in the postwar period were beginning to face payment problems. Over the course of the 1960s and 1970s, a series of government commissions, including the Payne Committee (1965-1970), the Crowther Committee (1968-1971) and the Cork Committee (1977-1982), proposed changes to the consumer bankruptcy regime that would make it less putative for over-indebted households. The 1976 Insolvency Act brought some relief, for example, allowing bankrupts to apply for discharge after five years. The major reforms for non-commercial debtors were introduced in the 1986 Insolvency Act.

Two reforms were most significant. The first was an automatic discharge in bankruptcy after three years. The second was an extra-judicial debt remediation procedure called the Individual Voluntary Agreement (IVA). The IVA had originally been intended for individual business proprietors, and was based loosely on the Company Voluntary Procedure designed to help larger companies restructure their debts outside of legal insolvency procedures. By the early 1990s, however, IVAs had become a popular alternative for over-indebted household consumers who hoped to avoid a formal bankruptcy. The effect was to create a second, private alternative to legal bankruptcy procedures.

Part of the problem was the relatively harsh terms of Britain's bankruptcy provisions. While the 1986 law provided for discharge after 3 years, undischarged bankrupts were banned from public office, were forced to sell their homes and any luxury goods to pay creditors, and had their names published in the local newspaper. They were also legally required to tell any new creditors of their status as bankrupts. With the new IVA, the debtor was never formally bankrupt, could continue to gain access to credit, and, perhaps most important, could escape the social stigma still associated with bankruptcy.

In the IVA procedure, a private insolvency practitioner negotiates a new repayment schedule and contract between the debtor and creditors. The service has no up-front fee—instead, the agent takes on some amount of the consumer's debt, up to 27%, as payment. The

IVA requires support by 75% of creditors, while the resulting agreement is binding on all creditors. This provision helped to avoid the problem of holdouts. In extreme cases, IVAs include the forgiving of up to 75% of the consumers' debt. For creditors, the IVA ensures that some debt will be repaid, and studies have found that repayment rates for IVAs are higher than for traditional bankruptcy procedures. One study of IVAs and bankruptcy proceedings in 1997-8 found IVAs repaid 46% of the outstanding debt, compared to 30% for bankruptcies.[36] For debtors, the IVA is a private procedure that avoids public embarrassment. Average repayment periods were 5 years, compared to a 3 year repayment under conventional bankruptcy proceedings. The details of the IVA remain on the debtor's credit record for 6 years. If a debtor defaults on an IVA, he/she must pursue a legal bankruptcy proceeding.

Over the course of the 1990s, the number of IVAs for personal insolvencies rose at a slow rate. In 1990, the number of consumers with IVAs was 1,927. In the mid-1990s, IVAs accounted for 17% of all personal insolvencies in the United Kingdom. By 1997, the number climbed to 18% and to 20% in 1998. Studies have shown that IVAs appeal increasingly to young, married consumers and younger married families who are eager to avoid bankruptcy and its emotional and financial consequences. By 2000, it had surged to 7,978 and, by 2002, more than 5,000 UK consumers had IVAs. In the third quarter of 2006, the number of IVAs jumped to 12,228 an increase of more than 115% from the third quarter of 2005. In 2006, IVAs continued their exponential climb as approximately 40,000 consumers chose IVAs to resolve their indebtedness. Individual Voluntary Agreements reached an all-time high in 2006, with 107,288, an almost 60% increase from 2005.[37]

UK consumer debt management companies, which arrange IVAs for a percentage-based fee, experienced huge profits in recent years. UK companies like Debt Free Direct promote themselves with fairly aggressive marketing campaigns including television and newspaper ads, and have huge call centers. Operators take thousands of calls and type in information on the type of debt and information on household income and monthly outgoings (including rent, food, clothes, and utility bills). Specialized computer software then calculates which option (IVAs, bankruptcy or credit counseling) offers the least drastic solution for the caller. So successful and profitable have been the credit counseling services providing IVA services that banks and other

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[36] "Reinventing the wheel: The government is looking at the US model in its plans to reform UK insolvency law" *Financial Times* London: July 15, 1999, p.26.
[37] Jane Croft, "Personal Insolvency hits record 107,288" *Financial Times* London: February 3, 2007, p.13.

lenders have begun raising their expectations of payout for distressed consumer loans, up from 20p on the pound to 30p-40p. Consumer advocates have noted that the number of failed IVAs may also be growing as collections expectations become more aggressive.

The Personal Insolvency Provisions of the 2002 Enterprise Act introduced a consideration of debtor intent into legal bankruptcy proceedings. Motivated by the US experience, New Labor's goal was to encourage individuals to take risks without fear of overly burdensome bankruptcy costs. For debtors found to have been 'honest but unlucky,' discharge was accelerated, from a maximum of three years to a maximum of one year from the time of filing. Under certain conditions, discharge could be even faster. The new legislation met strong opposition from creditor groups. These pushed for special punitive conditions for debtors who were considered to have entered into excessive debt in bad faith, either without intent to repay or with no reasonable expectation of repayment. These 'corrupt' debtors would face a so-called bankruptcy restriction order (BRO), lasting up to fifteen years after bankruptcy and discharge, that would help to protect potential future creditors. BRO restrictions included requirements that subjects disclose their status in order to apply for additional credit (and, in case they had changed their name, indicate the name under which they had filed for bankruptcy), and banned them from positions of financial responsibility, including company directorships and employment in credit consulting firms.

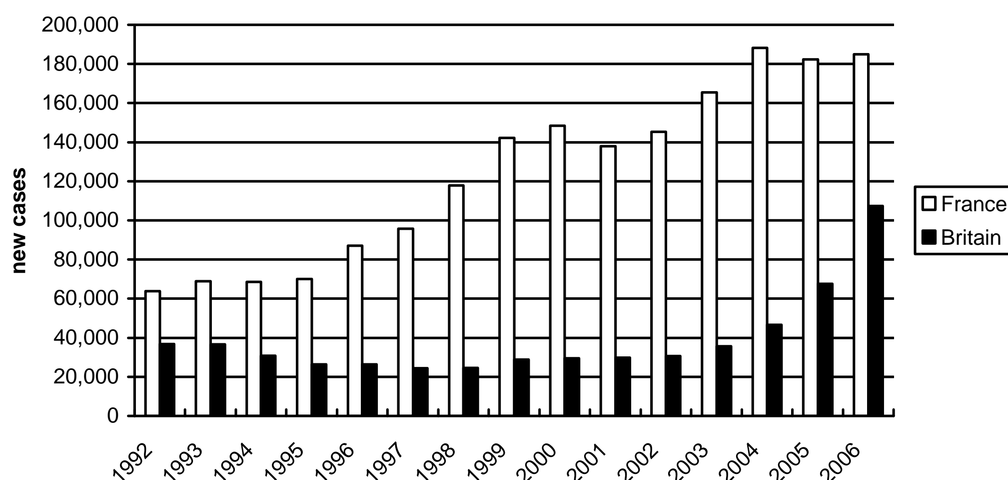
The new legislation also opened up the possibility for something akin to an IVA that could be filed within the bankruptcy procedure. Under the new fast track voluntary agreement (FTVA), an un-discharged debtor could make a written proposal to his/her creditors for a private settlement. The court-appointed receiver acts as the facilitator, no personal meeting was required, and, as with the IVA, the creditors may freely accept or decline subject to a three-quarters majority. For creditors, the absence of a private IVA practitioner meant that their returns could be higher. Fees for the receiver were fixed at 15% of funds collected.[38] From the government's perspective, it was hoped that the FTVA procedure would further lessen the burden on the court system, while also putting pressure on the margins of consumer debt counseling firms, for whom the IVA business was proving extremely profitable. A debtor may request an FTVA immediately

[38] "The Enterprise Act 2002" *Credit Management* (Stamford: March 2004): 30.

following a bankruptcy order; once an agreement is accepted by creditors and the debtor, the bankruptcy proceeding is annulled.[39]

Given the significantly greater household debt burden in the UK than in France, one of the surprises is that far more French borrowers end up in insolvency proceedings. As consumer indebtedness rose with financial liberalization in the 1980s, governments in both countries stepped in to spare local courts from a growing caseload of consumer defaults. Both created alternative, negotiated approaches to household over-indebtedness remediation that were designed to give consumers enough breathing room so that they might eventually repay at least part of their outstanding debt. But, despite a greater debt burden in the UK, French citizens were far more likely to initiate insolvency proceedings. French insolvency proceedings saw a dramatic growth in the mid-1990s; British insolvencies grew rapidly starting only in the early 2000s.

Figure 3: Initiated Insolvency Proceedings in France and United Kingdom[40]



Why, given the far higher rate of household indebtedness in the UK, are French consumers more likely to file for insolvency? There are several possible reasons. The availability of positive credit data in the UK may have made it possible to extend far more consumer credit with far fewer 'mistakes'. Alternatively, the French procedure may either set a lower bar for access to remediation than either of the British procedures, or carry less stigma for the insolvent consumer. Whatever the reason, the French experience suggests that the UK could face a

[39] Vernon Dennis and Alexander Fox, *The New Law of Insolvency: Insolvency Act1986 to Enterprise Act 2002* (London: Law Society, 2003): 215
[40] UK data are for Britain and Whales, combining bankruptcies and individual voluntary agreements (IVAs). French data are for new applications to departmental commissions.

sustained upsurge in bankruptcies, given the high level of debt of British consumer and their relatively low level of insolvency filings.

Figure 4. Self-reported cause of over-indebtedness in France and the UK
(percentage of all cases)

	France (2001)[41]	UK (2004-5)[42]
Unemployment/Business Failure	27	28.3
Accident/Illness	9	8.2
Divorce/separation	16	4.2
Reduction in resources	7	5
Living beyond means	32	48
Other	9	10

Despite the different scale of borrowing in France and the UK and the differing levels of insolvency, the underlying experience of over-indebtedness appears to be quite similar. In surveys of insolvent consumer households in the two countries, debtors gave very similar reasons for their insolvency. Over a quarter of all proceedings in both countries were triggered by unemployment or, especially in the UK, the failure of a family business. Accidents and illness were similarly important. But other differences were striking. Among British insolvency filers, nearly half attributed their problems to excessive borrowing, compared to only one third of French files. Conversely, divorce and separation were nearly four times as likely to lead to repayment problems in France as in Germany.

VI. Conclusions

Some common trends mark the French and British consumer credit reforms. First, both have made a double move both towards easier access to discharge, and towards an embraced of 'voluntary' contract renegotiation. Both reforms were precipitated by a growth in consumer debt and defaults, with the goal of making over-indebtedness less punitive for consumers. The move toward a system of automatic discharge represents a direct copying from the American bankruptcy regime—ironically, at the very moment when the American system was moving

[41] Bertrand Bissuel and Anne Michel, "Les établissements de credit accusés de favoriser le surendettement, *Le Monde*, 28 April 2005, p 9.
[42] The Bankruptcy Service, *Causes of Failure in Bankrupcty and Compulsory Liquidation*, Government of the UK, 2006.

away from universal automatic discharge. Perhaps surprisingly, both France and Germany (and France more than Germany) evince a deep concern about abridging credit contracts, both because of foundational importance of contractual sovereignty, and out of concern over its impact on ‘payment morale’. The move to government-sponsored schemes for voluntary debt restructuring represented in both countries an attractive alternative to frequent state intervention in contracts. If private parties could be convinced to find a separate peace, then the sovereignty of contract could remain intact. In cases where discharge was warranted, concerns over debtor abuse have led both countries to make a distinction between ‘honest but unlucky’ bankrupts and those that have taken out more debt than they either reasonably could or intended to repay. This distinction is a matter of judgment, but introducing it has allowed both states to accept the principle of automatic discharge without appearing to condone consumer opportunism.

Behind these common trends and concerns, however, lie very different conceptions of the very purpose both of consumer credit and of consumer protection in credit markets. In the UK, consumer access to credit markets as seen as a tool for greater economic and ultimately social inclusion. With access to credit comes an equality of opportunity, giving even the poor a chance to be entrepreneurial. This view of credit as economically enabling for the poor has deep roots in liberal economic tradition, roots that it shares with the recent emphasis on bringing microfinance facilities and property titling to the poor in developing countries. From this perspective, the goal of consumer protections in credit markets is to enable entrepreneurship. In consumer insolvency, for example, this implies making bankruptcy proceedings less punitive so as to encourage risky innovation. This view also provides little rationale for imposing specific interest rate caps, since highly risky ventures necessarily imply higher interest rates. So long as consumers are not misled into exorbitant loans—and British law works hard to avoid this—consumers should be able to contract for credit at any level of risk.

Perhaps inevitably, the conception of consumer credit in French public discourse is quite different. Rather than emphasizing the possibilities of credit to encourage economic inclusion, French policy has tended to emphasize the risk of persistent exclusion for consumers who become victims of excessive and persistent debt obligations. The motivation for a procedure leading to discharge is the patent unfairness of allowing families to live under persistent and degrading conditions of debt collection. The point is not to encourage risk-taking, but to ensure, for those consumers that have become over-indebted, that they will not be permanently excluded from the

benefits of citizenship. This orientation helps to explain the broad support that usury limits still enjoy in France. For a country that retains an active commitment to a broad public interest in equality, redistributive goals related to opportunity and inclusion are expressed through political channels that emphasize government fiscal and labor policy, rather than access to credit. This approach rests in turn on France's underlying republican social ideal, which has precluded a politics that emphasizes the access or exclusion of particular groups from credit markets.

These two different views are embodied in the very different implementation of consumer credit rating practices, even under the common frame of the European Union Directive on data privacy. For France, data privacy has been used as a rationale for blocking the collection of positive credit data on consumers. The fear is that such data, once assembled, will permanently exclude certain groups in society from access to credit through the logic of credit scoring technology. A public black list, by contrast, is limited in its scope to consumers who are clearly facing payments problems. French creditors have, in turn, embraced this logic out of concern that a public positive credit database would open their sector to excessive competition from foreign firms accustomed to integrating credit rating data into credit risk management. In the United Kingdom, the principles of data privacy are followed, but with less constraints on data collection and use. Credit providers may still not use the full suite of data available from Britain's private credit reference agencies to design credit offers, since the consumer has in no way indicated consent. Once consumers apply for credit, however, credit reference data are seen to allow lenders to extend credit to individuals who might otherwise have been excluded under simple geographical or demographic data. The public availability of such data also promotes competition (although no careful studies have yet to document lower interest rates in similar credit categories in the UK). Even in Britain, however, credit rating remains a matter of competitive strategy as well as principle. New sub-prime credit card providers are working to force Britain's traditional doorstep lenders into including their privately recorded transactions in the publicly-accessible credit registries.

Fascinating from a public policy perspective is the dual trend in these countries, both toward the US model of automatic discharge, but also in very different directions one from another. This leaves open questions about the future direction of consumer credit regulation both within the EU and globally. As greater securitization of consumer credit opens the possibility for sustained credit extension in Europe, and the likely accompanying growth in payments distress

and insolvency, will we see the emergence of a common regulatory regime in Europe? For the European project, the stakes are high. Because of the size and importance of consumer credit markets, failure to converge could lead to a permanently fragmented internal capital market. If divergence persists, might we see the consolidation of two worlds of consumer credit: the liberal market economies with high debt levels and low net household savings; and coordinated (continental European and Japanese) economies with relatively low consumer debt and high net household savings? Such effects, were they to persist, would in turn have implications for macroeconomic and trade policy.