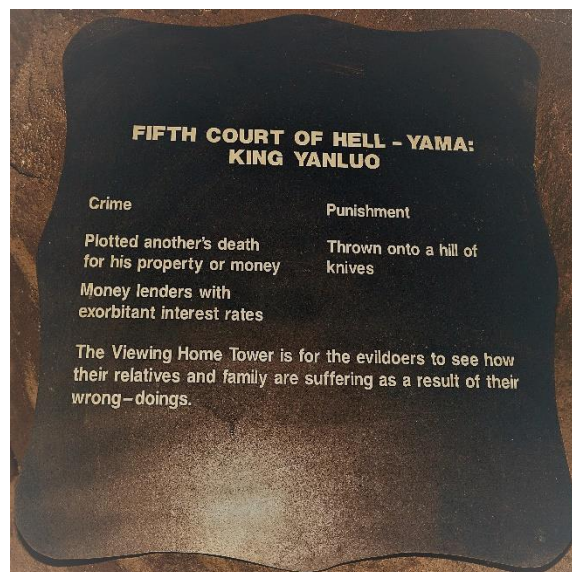


# How to Approach High-Cost Credit: Beyond Freedom and Protection



**Jodi Gardner  
Corpus Christi College**

**D.Phil in Law  
Trinity Term, 2018**

## Abstract

The regulation of consumer credit poses several challenges for governments; they need to ensure a fair balance between the enforcement of parties' mutually agreed promises on one hand, and protection of consumers with lesser bargaining power on the other. This is a particularly important and difficult balance in relation to high-cost credit, commonly referred to as 'payday lending'. These financial products have received considerable media attention recently, specifically concerning the challenges of regulating this type of lending. The public interest has not been replicated in the academic arena, and the subject remains relatively under-researched. There are two particular gaps of note. First, inadequate analysis of the relevant philosophical concepts which has resulted in an oversimplistic approach to regulation. Second, a lack of engagement in, and awareness of, the high-cost credit market and who are using these financial products. This thesis takes steps to fill both these gaps. The first section considers the concepts of freedom, protection and social minimums to gain a deeper understanding of high-cost credit. This involves an analysis of the three concepts, including their meaning, limitations, history and rationale, and examples of the concepts in our legal system. The thesis then utilises qualitative empirical research to develop an accurate and representative debtor profile. The research was conducted through a series of in-depth interviews with a wide range of people in the high-cost credit industry. The taxonomy developed from this research is used to evaluate the needs of each class of borrower, assess the role of the three relevant concepts, and analyse the appropriateness of current and past legal responses. The result of these steps is to raise a number of further relevant questions. The final section of the thesis therefore addresses these questions, recommending some initial practical steps and identifying what is necessary to take each forward.

**WORD COUNT: 95,807 WORDS**

## Acknowledgements

Foremost, I would like to express my sincere gratitude to the General Sir John Monash Foundation. Without their confidence in my project and subsequent financial assistance, I would not have been able to undertake such enlightening and meaningful research. When the length of this project was extended, my financial support was generously reinforced by the Association of Banking and Finance Lawyers.

I would like to recognise the useful participant feedback I received from my presentations at the International Association of Consumer Law Conference, the Oxford Regulation Discussion Group, the Obligations Conference and the UCL Early Career Obligations Workshop. A number of sections of this thesis have also been published in journals, and I would like to extend my appreciation to the anonymous referees of these publications. I have had the benefit of several mentors, who kindly read and commented on my work, including Lindsey Appleyard, Liz Fisher, Catharine MacMillan, Charles Mitchell, Karen Rowlingson and Sandy Steel. The insight provided by these people and forums has undoubtedly improved the quality of the overall product. All errors obviously remain my own (but, in my defence, are likely to be linked to my three small children and the lack of a full nights' sleep in five years).

I am fortunate enough to be surrounded by incredible friends. These amazing people have made the D.Phil journey manageable and – at times – even fun. There are too many to mention, but specific recognition must go to Joanna Bell, Hayley J Hooper and Josh McGeechan. Finally, I need to recognize the patience and support of Ben Spagnolo, who has gone above and beyond to provide me with academic, professional and personal assistance; I fear I will be forever in his debt.

My deepest gratitude goes to my indefatigable supervisor, Professor Mindy Chen-Wishart. Her patience, encouragement and faith in my project has been constant. Mindy has however been so much more than a supervisor. She taken every opportunity to help me grow and mature as a student, a professional and, most importantly, as a mother; I am honoured to call her my friend.

The most important thing in the world is family. I am forever indebted to my wonderful family who for many years have pretended, mostly convincingly, to be interested in the nuances of consumer credit law. I would particularly like to thank my eternally patient parents, Ian and Joy, who always encouraged me to follow my own path. I could not ask for more loving or supportive people in my life, and I am thankful for everything they have given me over the years. Huge levels of appreciation must go to my ever suffering, but never complaining, husband Sebastian. He has sacrificed so much of his own career to help me reach my goals and ambitions, and is the most wonderful partner in all aspects of life. My final thanks go to my daughters – all of whom were born during the D.Phil progress – Eleanor Catherine, Margaret Joy and Beatrice Vera. You three light up my life in so many ways.

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## Table of Abbreviations

ABCUL	Association of British Credit Unions Ltd
ACCA	Association of Chartered Certified Accountants
AHRC	Arts and Humanities Research Council
APR	Annualised Percentage Rate
ASA	Advertising Standards Authority
ASIC	Australian Securities and Investment Commission
Beveridge Report	Social Insurance and Allied Services Report
BIS	Department of Business Innovation and Skills
CA	Court of Appeal
CAB	Citizens Advice Bureau
CAP	Christians Against Poverty
CCLAEA	Consumer Credit Legislation Amendment (Enhancements) Act 2012 (Cth)
CDFI	Community Development Financial Institution
CFA	Consumer Finance Association
CMA	Competition & Markets Authority
CONC	Consumer Credit Sourcebook
COP	Court of Protection
CPAG	Child Poverty Action Group

CPAs	Continuous Payment Authorities
CRA	Consumer Rights Act 2015 (UK)
Crowther Report	Consumer Credit: Report of the Committee of Sir Geoffrey Crowther
DMP	Debt Management Plans
DTI	Department of Trade and Industry
DWP	Department of Work and Pensions
ExCh	Court of Exchequer Chamber
Fam	Family Court
FCA	Financial Conduct Authority
FOS	Financial Ombudsman Service
FSA	Financial Services Authority
GCPH	Glasgow Centre for Population Health
HCA	High Court of Australia
HCSTC	High-Cost, Short-Term Credit
HL	House of Lords
ILG	Irresponsible Lending – OFT Guidance for Creditors
ISA	Individual Savings Account
IVA	Individual Voluntary Arrangements
MALG	Money Advice Liaison Group

MCA	Mental Capacity Act 2005
MLA 1900	Money-lenders Act 1900 (UK)
NCCPA	National Consumer Credit Protection Act 2009 (Cth)
NAO	National Audit Office
NHS	National Health Service
OFT	Office of Fair Trading
PAC	Public Accounts Committee
PC	Privy Council
PFRC	Personal Finance Research Centre, University of Bristol
PPI	Personal Protection Insurance
QB	Queen's Bench
RGSB	Responsible Gambling Strategy Board
SACC	Small Amount Credit Contracts
SC	Supreme Court
StepChange	StepChange Debt Charity
The Act	Consumer Credit Act 1974 (current version)
The 1974 Act	Consumer Credit Act 1974 (as passed)
The 2006 Act	Consumer Credit Act 2006
UK	United Kingdom

UNDHR	Universal Declaration of Human Rights
UTCCR	Unfair Terms in Consumer Contracts Regulations 1999
WWI	World War I
WWII	World War II

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*"But I don't want comfort. I want God, I want poetry, I want real danger, I want freedom, I want goodness. I want sin."*

*"In fact," said Mustapha Mond, "you're claiming the right to be unhappy."*

*"All right then," said the Savage defiantly, "I'm claiming the right to be unhappy."*

*"Not to mention the right to grow old and ugly and impotent; the right to have syphilis and cancer; the right to have too little to eat; the right to be lousy; the right to live in constant apprehension of what may happen to-morrow; the right to catch typhoid; the right to be tortured by unspeakable pains of every kind."*

*There was a long silence.*

*"I claim them all," said the Savage at last.*

**Aldous Huxley, *Brave New World***

## Introduction

The collapse of Wonga, previously the country's largest high-cost credit provider, has brought the regulation of these financial products back into the spotlight. Wonga was potentially worth over \$US 1 billion at the height of its popularity.<sup>1</sup> However, due to a run of illegal actions and irresponsible lending, it is now in administration and unlikely to survive. Many people have argued that the removal of Wonga from the market is a good thing, as the company made its money from exploiting financially vulnerable people. Unfortunately, it is not that simple. Negative consequences can and do arise when legal (but potentially harmful) products are no longer on the market. Many questions therefore remain. Where will these customers go? Will they be better off without access to Wonga's loans (with annualised percentage rates 1,509% APR<sup>2</sup>)? Does the government have any obligation to assist these borrowers? If so, what? These questions are the focus of this thesis. I explore the regulation of high-cost credit, and the impact of interest rate

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<sup>1</sup> Kevin Peachey, 'Wonga: Where have all the borrowers gone?' (*BBC News*, 30 August 2018) <<https://www.bbc.co.uk/news/business-45343042>> accessed 30 August 2018.

<sup>2</sup> Wonga Group Limited, 'Short Term Loan' (*Wonga Group Limited*, August 2018) <<https://www.wonga.com/>> accessed 30 August 2018.

restrictions and consumer protection mechanisms which impact these financial products or possibly even remove them from the market. These findings are then used to make a range of recommendations for how to go forward and address the ongoing challenges of high-cost credit.

Complementing the analysis of high-cost credit, this thesis also addresses the boundaries between private law and social welfare. It looks at how these interact with one another, and their limitations. The thesis explores three concepts – freedom, protection and social minimums – and how they relate to our legal regime. The issue of high-cost credit, particularly to people in or on the fringes of poverty, highlights the complex and sometimes conflicting nature of ‘freedom’. Freedom has been the cornerstone of English law and of those systems developed from it. Contract law is premised on the freedom to enter into contracts, with a range of legal doctrines designed to ensure that once a contract has been formed between the parties, it is generally enforceable. The freedom to enter into high-cost credit contracts may, however, cause more harm than good, particularly for borrowers struggling with pre-existing financial difficulties.

An alternative to a freedom-based approach is contractual protection, meaning State intervention in the market. This can involve the government restricting or removing products from the market on the basis that they are dangerous, harmful or in some way detrimental to consumers. Whilst the motivations of the government are generally altruistic in nature, negative consequences can arise. In the context of high-cost credit, this issue is not merely hypothetical in nature but has real consequences for large numbers of already vulnerable individuals. When oversight of consumer credit in the UK was transferred from the *Office of Fair Trading* (OFT) to the *Financial Conduct Authority* (FCA),<sup>3</sup> the landscape changed dramatically. The 2014 High-Cost Short-Term Credit

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<sup>3</sup> This will be discussed in more depth at 1.1.2 and 1.1.3 below.

(HCSTC)<sup>4</sup> reforms and the 2015 cap on the cost of credit resulted in ‘pricing’ certain borrowers out of the market, primarily those on low incomes or with an impaired credit history. The FCA estimated that approximately 11% of the market, or around 160,000 people could no longer access HCSTC.<sup>5</sup>

It is assumed that these borrowers are better off because they can no longer use high-cost credit. Questions however arise – where do they go for their credit needs, and are they better off without access to this expensive and potentially harmful product? If not, how should the State best respond to the challenges associated with high-cost credit? A freedom-based approach does not work adequately, but a protection-based focus also raises a number of limitations and concerns. Whilst there can be no pretense that these are simple questions to answer, this thesis provides a taxonomy of high-cost credit borrowers and a framework for developing appropriate legal and social solutions. It presents a third approach to high-cost credit, the provision of a social minimum, and argues that freedom, protection and a social minimum are all necessary to address the complexities of the current market.

## Why High-Cost Credit?

Freedom, protection and social minimums are relevant to a wide variety of legal products. This thesis focuses on the issues on high-cost credit, as such products provide an excellent case study for the theoretical debates raised – showing how philosophical challenges can

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<sup>4</sup> Defined by the FCA as credit with an interest rate of over 100% APR for a period of less than 12 months, excluding Community Development Finance Institutions and Home-Collected Credit – see The Financial Conduct Authority, *Detailed rules for the price cap on high-cost short-term credit; Including feedback on CP14/10 and final rules* (2014). This definition is contentious and has been subject to significant and (in the author’s opinion) valid criticism.

<sup>5</sup> The Financial Conduct Authority, *Proposals for a Price Cap on High-Cost Short-Term Credit: Consultation Paper* (2014) para 5.15. The impact of the price cap alone was later estimated to be approximately 7% of the market: The Financial Conduct Authority (n 4) 69.

be applied to (and indeed, benefit from) specific case studies.<sup>6</sup> High-cost credit is often referred to by the colloquial term 'payday loan'.<sup>7</sup> Payday loans are a specific, and well-known, subset of high-cost credit; they are loans that are paid back in a lump sum when the borrower next receives regular income (wages or assistance from the State). High-cost credit encompasses a range of products and is not limited only to payday loans, it includes products such as loans repaid on installment and doorstep credit. Wherever possible the term 'high-cost credit' will be used in this thesis, however at times it will be necessary to use 'payday loan' or a similar term.<sup>8</sup>

During and after the recent period of international financial turbulence, growing numbers of UK consumers accessed short-term finance to close the increasing gap between their income and living expenses.<sup>9</sup> There was a consequent upsurge in the use of high-cost credit to 'make ends meet'. High-cost credit is, by definition, credit that carries a high interest rate. Whilst the interest rates for these short-term loans vary dramatically,<sup>10</sup> rates as high as 16,000% APR have been reported.<sup>11</sup> It was widely recognised that there were a range of problems with this type of financial product, including exploitative lender

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<sup>6</sup> It is recognised that there are a number of other parties that impact the experiences of consumers in this area, including debt collectors and finance brokers, however an analysis of the legal regimes associated with these parties is beyond this thesis; see further Gail Pearson, 'Finance Brokers – A Regulatory Anomaly' (2003) 14 *Journal of Banking and Finance Law & Practice* 200; Gail Pearson, 'The ambit of unconscionable conduct in relation to financial services' (2005) 23 *Companies and Securities Law Journal* 105.

<sup>7</sup> As outlined by the FCA, 'the common term for high-cost short-term products is "payday loans"': The Financial Conduct Authority, *Detailed proposals for the FCA regime for consumer credit* (Consultation Paper CP13/10, 2013) 54-55.

<sup>8</sup> In line with the terminology and approach used by a variety of other bodies, unless explicitly stated otherwise, the term 'payday loan' will refer to broader high-cost credit products and not merely loans repaid when income is received.

<sup>9</sup> For further discussion, see Iain Ramsay, 'Consumer Credit Regulation After the Fall: International Dimensions' (2011) 1 *Zeitschrift für Europäisches Unternehmens- und Verbraucherrecht* 24.

<sup>10</sup> This is discussed in The Office of Fair Trading, *Payday Lending Compliance Review - Interim Report* (The Office of Fair Trading, 2012).

<sup>11</sup> David Barclay, The Contextual Theology Centre (28 March 2013). Telephone Interview.

behaviour and harmful business models.<sup>12</sup> Ninety-three per cent of the general population believed that further regulation was needed, with 68% supporting stricter regulation of the advertising of loans, and 65% supporting a cap on the total cost of credit. In contrast, only 7% of people believe there is no problem with high-cost credit.<sup>13</sup>

After the 2008 global financial crisis, demand for high-cost credit increased dramatically over a short period of time. In 2009 the high-cost credit industry was estimated to be worth approximately £900 million annually.<sup>14</sup> The *Competition and Markets Authority* (CMA) determined in 2014 that the payday lending industry<sup>15</sup> was issuing around 10.2 million loans each year in a market worth £2.8 billion annually.<sup>16</sup> This equates to a threefold increase in five years. The FCA has provided slightly different figures based on their definition of HCSTC<sup>17</sup> – in 2013 1.6 million people took out 10 million loans worth £2.5 billion.<sup>18</sup> Independent academic research paints an even more dramatic picture; Beddows and McAteer estimate that 'traditional payday loans and short-term cash advances' have increased ten-fold, from £0.33 billion in 2006 to £3.709 billion in

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<sup>12</sup> The Office of Fair Trading, *Payday Lending Compliance Review – Interim Report* (n 10); The Office of Fair Trading, *Payday Lending: Final Compliance Review* (The Office of Fair Trading, 2013); The Right Honourable Ian McCartney and Damon Gibbons, *Protecting Low Income Borrowers in the Credit Crisis* (2008); Veronika Thiel, *Doorstop Robbery: Why the UK needs a fair lending law* (New Economics Foundation, 2009).

<sup>13</sup> R3: The Association of Business Recovery Professionals, 'Rein in 'payday lenders', say 93% of GB population' <<http://www.r3.org.uk/index.cfm?page=1114&element=16322>> accessed 9 May 2013.

<sup>14</sup> The Office of Fair Trading, *Payday Lending Compliance Review – Interim Report* (n 10) 9.

<sup>15</sup> These figures relate solely to the payday lending industry and not the high-cost credit sector in general. A number of the reports and research referred to in this thesis are focused solely on payday lending, however many of them mistake all forms of short-term, high-cost credit as 'payday loan'. Regardless, when a source is specifically referred to payday loans, this term will be used in the thesis.

<sup>16</sup> Competition & Markets Authority, *Payday Lending Market Investigation: Provisional Findings Report* (2014) para 2.76.

<sup>17</sup> See discussion of the FCA definition in fns 4 above.

<sup>18</sup> The Financial Conduct Authority, *Proposals for a Price Cap on High-Cost Short-Term Credit: Consultation Paper* (n 5) para 3.8.

2012.<sup>19</sup> The use of these financial products has stabilised since that period of time, and at times even reduced slightly, but it remains at much higher rates than a decade ago.<sup>20</sup> Despite the significant increase in the high-cost credit sector, it is still only a small percentage of the entire consumer credit market.<sup>21</sup> Notwithstanding this small market share, focus on the high-cost credit sector is warranted in view of the personal characteristics of borrowers, the impact that inappropriate lending can have on their financial wellbeing, and the exploitative actions of many of the lenders.<sup>22</sup>

The global financial crisis increased not only the number of loans, but also the severity of the problem with high-cost credit. In 2012 the OFT undertook a detailed review of the industry to determine the extent of irresponsible and exploitative behaviour. This process included a detailed review of advertisements, mystery/secret shopping<sup>23</sup>, and compliance inspections. The interim and final OFT reports highlighted the disturbing and widespread lack of compliance with the current regulatory regime.<sup>24</sup> There was significant evidence of irresponsible lending; too many people were given loans that they could not

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<sup>19</sup> Sarah Beddows and Mick McAteer, *Payday lending: fixing a broken market* (Association of Chartered Certified Accountants 2014) 7. It is argued that this is the most accurate figure as it is not limited to payday loans and encompasses other forms of high-cost credit.

<sup>20</sup> See discussion of the market in The Financial Conduct Authority, *High-cost Credit Review - update* (2018) and specifically for HCSTC, The Financial Conduct Authority, *FCA regulation of high-cost short-term credit (HCSTC)* (2017).

<sup>21</sup> In 2010, it was the consumer credit market was estimated at £200 billion, making high-cost credit less than 2% of the sector: The Office of Fair Trading, *Review of High-Cost Credit* (2010) para 2.1-2.4.

<sup>22</sup> This was discussed in Jeannie Paterson and Gerald Brodie, 'Targeting business models that prey on vulnerable consumers: the role of prohibition on unfair and unconscionable conduct' (International Association of Consumer Law Conference, Sydney, 4 July 2013). Mindy Chen-Wishart, *Contract Law* (6th edn, Oxford University Press 2018).

<sup>23</sup> 'A research technique allowing businesses to evaluate the quality of the service they and their competitors provide to customers. It involves trained professional researchers posing as real customers, assessing the nature and quality of the service they receive and reporting this in aggregate form to the client': The Association for Qualitative Research, 'Mystery Shopping Definition' (2017) <<https://www.aqr.org.uk/glossary/mystery-shopping>> accessed 20 January 2017. The 'trained professional researchers' in this case were employees of the OFT.

<sup>24</sup> The Office of Fair Trading, *Payday Lending Compliance Review - Interim Report* (n 10), the results of which were confirmed in The Office of Fair Trading, *Payday Lending: Final Compliance Review* (n 12).

afford and, when they were unable to repay, were encouraged to extend them, further exacerbating their financial difficulties.<sup>25</sup>

One of the most alarming findings of the review was that lenders were making approximately 50% of their revenue from loans that were rolled over or refinanced.<sup>26</sup> Firms were therefore ‘incentivised’ to lend to people who could not afford to repay on time. The perverse effect was that lenders who undertook proper affordability assessments and lent responsibly lost out to less scrupulous businesses.<sup>27</sup> In light of these findings, the OFT expressed specific concerns about:

- the adequacy of affordability checks;
- the proportion of loans not repaid on time;
- the frequency and circumstances of rollovers;
- the lack of forbearance when borrowers get into financial difficulty; and
- debt collection practices.<sup>28</sup>

The OFT findings were strongly supported by other research. The *Citizens Advice Bureau* (CAB) reported that three out of four high-cost credit borrowers have some ground for an official complaint to the *Financial Ombudsman Service* (FOS) about their treatment. The CAB undertook an in-depth analysis of 665 high-cost loan cases between 1 January and 30 June 2013. Of these cases, 76% of borrowers had at least one ground for complaint, including fraud (20%), problems with *Continuous Payment Authorities*<sup>29</sup> (CPAs) (more than

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<sup>25</sup> The Office of Fair Trading, *Payday Lending: Final Compliance Review* (n 12) 2.

<sup>26</sup> *ibid* 2.

<sup>27</sup> *ibid* 3.

<sup>28</sup> The Office of Fair Trading, *Payday Lending Compliance Review - Interim Report* (n 10) 4.

<sup>29</sup> This is where the borrower gives the lender the right to take money on a regular basis from their debit or credit card without requiring further permission or authority. They give the lender more control than direct debits or standing orders and often resulted in ‘drip feeding’ of funds from borrowers’ accounts.

33%), harassment of borrowers (12%), and unfair treatment of people in financial difficulties (10%).<sup>30</sup> In a second study, *Europe Economics* conducted detailed research on compliance costs and firm behaviour in the high-cost credit market. Its October 2013 report outlined a number of ingrained problems, including lenders not carrying out affordability assessments, overuse of loan rollovers, exploitative and inappropriate use of CPAs, provision of unsuitable advice, unfair dealings with borrowers experiencing financial difficulties, and aggressive debt collection practices.<sup>31</sup> A third study conducted by the *Department of Business Innovation and Skills* (BIS) used in-depth consumer and business surveys that confirmed that lenders were not complying with the Good Practice Charter or the relevant Codes of Practice.<sup>32</sup> Whilst the report highlighted a number of disturbing practices, it was particularly concerned with the unfair treatment of borrowers in financial difficulty.<sup>33</sup>

This extensive research has been coupled with other evidence of widespread exploitative and irresponsible behavior of lenders. For example, the credit provider *Wonga* was involved in two separate regulatory actions. In late 2014 the lender was found to have breached responsible lending guidelines by providing loans to people who could not afford to repay without suffering financial hardship. The company subsequently entered into an agreement with the FCA to provide remedial redress to over 350,000 customers, at a cost in excess of £220 million, as well as making significant changes to

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<sup>30</sup> Citizens Advice Bureau, 'Citizens Advice urges payday loan customers to fight back against unscrupulous lenders' Citizens Advice Bureau <[http://www.citizensadvice.org.uk/index/pressoffice/press\\_index/press\\_office-20130805.htm](http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_office-20130805.htm)> accessed 23 September 2013.

<sup>31</sup> Europe Economics, *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour* (2013).

<sup>32</sup> Department of Business Innovation and Skills, *Making Consumer Credit Fairer: BIS report on surveys of the payday lending good practice charter and codes of practice* (2013).

<sup>33</sup> *ibid* 13-14.

their lending guidelines and criteria.<sup>34</sup> Earlier that same year, *Wonga* entered into an agreement with the FCA in 2014 to pay compensation over £2.6 million for unfair debt collection activities. The lender sent letters from non-existent law firms threatening legal action to customers in arrears, and some customers were even charged ‘administrative’ fees associated with the fraudulent correspondence.<sup>35</sup> In 2015 the FCA entered into an agreement with *Dollar Financial (UK)*, another large high-cost credit provider<sup>36</sup>, to provide £15.4 million of redress to almost 150,000 customers. The regulator found that the firm was lending to people who were not in a position to repay the money without suffering financial hardship, and were not carrying out adequate checks on borrowers’ financial positions before approving loans.<sup>37</sup> These are not isolated events, with the regulator reporting similar behaviour across the industry. Many lenders in the high-cost credit industry act irresponsibly, and the business models used are often exploitative in nature.<sup>38</sup> These products are designed to keep borrowers ‘trapped’ in an expensive cycle of credit. People using high-cost credit are frequently financially vulnerable<sup>39</sup> and in desperate need of funds, making them easy targets for businesses who offer quick cash with minimal checks and balances.

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<sup>34</sup> The Financial Conduct Authority, *Media Release: Wonga to make major changes to affordability criteria following discussions with the FCA* (2014).

<sup>35</sup> The Financial Conduct Authority, *Media Release: Wonga to pay redress for unfair debt collection practices* (2014).

<sup>36</sup> Trading under the names The Money Shop, Payday UK, Payday Express and Ladder Loans.

<sup>37</sup> The Financial Conduct Authority, *Press Release: Payday lender Dollar to provide £15.4 million redress to over 147,000 customers* (2015).

<sup>38</sup> The Office of Fair Trading, *Payday Lending Compliance Review - Interim Report* (n 10), the results of which were confirmed in The Office of Fair Trading, *Payday Lending: Final Compliance Review* (n 12). For details further details see The Financial Conduct Authority, *Press Release: Payday lenders failing customers in arrears, says FCA* (Financial Conduct Authority 2015).

<sup>39</sup> See analysis of high-cost credit borrowers in Competition & Markets Authority, *Research into the Payday Lending Market* (2014) and further discussion at Part 1.2.1 below.

Borrowers of high-cost credit will usually be on low incomes and have limited access to alternative financial products. This means that they can be desperate for money and can be easily taken advantage of by lenders.<sup>40</sup> A snapshot from the 2014 CMA empirical research highlights the extent of the problem:

- Fifty-one per cent of customers had not used any other form of credit during the previous 12 months (excluding other high-cost loans and overdrafts).<sup>41</sup>
- In the previous 12 months, 56% of borrowers had gone into overdraft on their banking or building society account, 27% had gone into unauthorised overdraft, 52% had a debt problem in the last five years, and 38% had a bad credit rating.<sup>42</sup>
- Over half the borrowers used the funds from the loan in question for ‘living expenses’, although this was not further defined by the CMA. In addition, 7% of borrowers used it on ‘general shopping’ and 10% on their car/vehicle, meaning these three categories of ‘general expenses’ relate to 70% of the market.<sup>43</sup>
- Fifty-six per cent of people surveyed stated that they ‘definitely’ could not have gone without the credit.<sup>44</sup>
- Seventy-nine per cent of high-cost credit borrowers had taken out multiple loans, and 34% had taken out 10 or more loans.<sup>45</sup>

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<sup>40</sup> The Office of Fair Trading, *Payday Lending Compliance Review - Interim Report* (n 10) 2.

<sup>41</sup> Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 29.

<sup>42</sup> *ibid* 30.

<sup>43</sup> *ibid* 68.

<sup>44</sup> *ibid*.

<sup>45</sup> *ibid* 32.

- Finally, four out of ten borrowers had no access to alternative financial products, and most of these people took the loan as a ‘last resort’.<sup>46</sup>

Research from *StepChange Debt Charity* (StepChange) supports these findings, highlighting that, when people are struggling financially, they take out ‘distress’ credit – which is higher in cost, more damaging, and more likely to tip them into problem debt.<sup>47</sup>

Even though high-cost credit is generally concerned with small amounts of money borrowed for short periods of time,<sup>48</sup> people often cannot repay without suffering hardship and therefore take out further loans to bridge the gap.<sup>49</sup> Whilst each loan is usually relatively small, the total numbers can be overwhelming to borrowers on low incomes. Consumers of high-cost credit often suffer enormously if and when their credit agreements go astray, and they cannot afford repayments. Amendments that improve the legal system are likely to make a real difference to the lives of many people who are already struggling to maintain an adequate standard of living. The current regulatory approaches are clearly not working adequately. The factual matrix of these transactions calls into question the nature of the market, the role of contract law, and the limitations of our legal system. This vulnerability justifies both additional consumer protection and research on the specific challenges experienced by these borrowers.

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<sup>46</sup> *ibid* 80-81.

<sup>47</sup> Stepchange Debt Charity, *Life on the Edge: our major new report on the state of the nation's family finances* (2014).

<sup>48</sup> For example, the average payday loan is valued between £265 and £270 and borrowed over 30 days; The Office of Fair Trading, *Payday Lending: Final Compliance Review* (n 12).

<sup>49</sup> For example, a quarter of high-cost loans are for £100 or less, an indication that many borrowers have a financial safety net of less than £100 and are exceptionally financially vulnerable: Department of Business Innovation and Skills, *Making Consumer Credit Fairer* (n 32) para 4(a).

## Method, Scope and Outline

There has been a distinct and unfortunate lack of research into the characteristics, financial needs and motivations of high-cost credit borrowers. In light of the requirement for further empirical research on high-cost borrowing in the UK, there are three methodologies used in this thesis. The first is a legal analysis of the UK high-cost credit regulatory regime. The second is a theoretical and philosophical perspective, analysing the concepts of freedom, protection and social minimums – including the history, justifications and limitations of these concepts. The final aspect is a socio-legal one, which involves empirical research through in-depth interviews with key stakeholders to identify the most common situations where people access high-cost credit. The taxonomy developed from this process will be combined with the earlier analysis to create a new paradigm for thinking about the interplay between individual private law rights and government obligations.

This thesis critically examines the legal approach to high-cost credit from the perspective of addressing consumer problems. It does not focus on regulatory theory, in the sense of controlling the behaviour of credit providers.<sup>50</sup> The thesis develops a taxonomy of high-cost credit borrowers, and offers a framework for considering the relevant issues. It does not, however, provide specific policy advice, as further research into individual issues will be necessary before making such recommendations.

The analysis in this thesis is limited to high-cost credit and does not consider mainstream financial services or other forms of consumer credit. This has been done on purpose and for a variety of reasons. First, until relatively recently there has been a lack of academic attention paid to this important area in comparison to the richness of research

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<sup>50</sup> For a very informative discussion of the latter, including engagement with empirical research on the topic, see Christopher Hodges, *Law and Corporate Behaviour: Integrating Theories of Regulation, Enforcement, Compliance and Ethics* (Hart Publishing 2015).

on mainstream banking regulation. Second – as discussed above – due to the specific vulnerability of high-cost credit borrowers, it is crucial that this area is subject to rigorous academic research and scrutiny. An ineffective regulatory framework can exacerbate pre-existing hardships, while a strong, effective one can counter some of the disadvantages that exist in our society.

The thesis has six chapters. Chapter 1 details the history of high-cost credit, the important political issues it raises, and the consequent ongoing regulatory responses. The chapter also outlines the background of the high-cost credit market and the two regulatory approaches to high-cost credit evident in recent English law, the OFT's freedom-based focus and the FCA's more protective approach. While both have their advantages and disadvantages, neither approach is sufficient. This chapter concludes by deconstructing the problems associated with high-cost credit and providing the framework for the remainder of the thesis.

Chapters 2, 3, and 4 all follow the same basic structure, focusing in turn on each of the three key concepts of the thesis – freedom, protection and social minimums. The meaning of each of these concepts is complicated and subject to significant debate. For the purposes of this thesis, freedom is defined as State intervention limited to ensuring consent and avoiding lender exploitation or misinformation. Protection is defined as intervention to avoid substantively unfair agreements and/or coercion arising from a borrower's lack of choice. Finally, social minimum is the provision of resources sufficient to ensure all people have a 'decent and meaningful life'.<sup>51</sup> Each of these key concepts will be further defined and developed in their relevant Chapter. The chapters analyse the concepts in question, including their meaning, history and rationale, discuss examples of

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<sup>51</sup> More detailed definitions of the concepts will be provided in Parts 2.1, 3.1 and 4.1 respectively.

the concepts in our legal system, and finally explore their limitations. The current legal system has an 'all or nothing' approach which prioritises one concept over the others, instead of using the concepts in different ways for the benefit of different borrowers. These chapters conclude by arguing that freedom, protection and social minimums are all valuable approaches to the high-cost credit market, but are necessary at different times and for different borrowers.

Chapter 5 utilises the theoretical analyses of the preceding three chapters and applies them to the practical issues associated with high-cost credit. It develops a profile of borrowers, providing general guidance and an agenda for future research. The first part of this chapter undertakes qualitative empirical research in the form of in-depth interviews with various stakeholders, to develop a profile of high-cost credit borrowers in the UK. It identifies three distinct categories of borrowers, each with varying financial circumstances and credit needs. The chapter then applies the borrower taxonomy developed to the concepts of freedom, protection and social minimum, and to the current legal approach to high-cost credit.

The first five chapters of the thesis identify the borrower taxonomy, assess the need of each class, and outline the current legal responses. The final chapter develops these findings by proposing a range of reforms, and raises further questions for the future. It highlights a number of questions for further analysis and discusses what is necessary to take each forward. The chapter looks at law reform proposals, social welfare responses and further research necessary. It also highlights the limitations of our legal system. The solution for high-cost credit cannot be addressed merely through legislative amendments, as it is deeply rooted in issues of poverty, access to justice and financial exclusion. This chapter argues that for the law to make a positive contribution to the high-cost credit market, these societal issues need to be recognised and – where possible – addressed.

# Chapter 1: High-Cost Credit in the UK

*Debt is the slavery of the free*  
- Publilius Syrus

## Introduction

The chapter provides an outline of the high-cost credit environment in the UK. There are two sections; the first summarises the regulation of high-cost credit, looking at the history, the approaches of the OFT and FCA, and the direct enforcement mechanisms available to consumers. The regulatory approaches represent a complex array of considerations, and it is recognised that this discussion does not provide a detailed outline of the different approaches. The laws and political actions in question can however be read against the background of prevailing political philosophy to provide a useful insight. The second section analyses the challenges associated with regulating this industry – namely the tendency to blame borrowers for their own financial difficulties, and inadequate engagement with the market. The chapter concludes by discussing what needs to be done to address these challenges.

## 1.1: How is High-Cost Credit Regulated?

Moneylending – and credit provision to the poor – has been an ongoing challenge. It is therefore important to understand the different historic and legislative approaches taken towards high-cost credit. Whilst the history will be briefly discussed, the current section is focused on the two most recent approaches to high-cost credit, and how they represent very different underlying approaches and philosophies. It will conclude by summarising the non-regulatory enforcement mechanisms and analysing what we can learn from the different approaches to high-cost credit.

### 1.1.1: The History of Moneylending Regulation

There is a rich and detailed history of moneylending and government-instituted caps on the cost of credit, which is far beyond the scope of the current thesis.<sup>52</sup> The discussion will commence from 1818, when a Select Committee of the House of Commons considered the effects of religiously motivated usury.<sup>53</sup> It held that the laws in place were ineffective, and the techniques used by lenders to avoid the regulations actually increased the cost of loans. They noted that, at the time of writing, the market rate was lower than the legal rate, thus providing an opportunity to repeal the laws without fearing that borrowers would be charged extortionate levels of interest. Whilst this report had no immediate impact, it is likely to have assisted the passing of subsequent legislation reducing the limitations on usury, and for the creation of 1854 17 & 18 Vict, c 90 which repealed 'all existing laws against usury'.<sup>54</sup> This passage was also likely to have been assisted by the 1841 Select Committee of the House of Lords, which made no concrete recommendations

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<sup>52</sup> Different historical aspects of high-cost credit will be discussed in the next three chapters; however, for a detailed analysis see Rosa-Maria Gelpi and Francois Julien-Labruyere, *The History of Consumer Credit: Doctrines and Practice* (Palgrave MacMillan 2000).

<sup>53</sup> This term is often used in an emotional or moralistic fashion, and so the definition has itself become controversial. Some texts refer to usury as the charging of any interest on money, whilst others limit it to only unconscionable or excessive rates of interest, and usury can alternatively be considered interest charged at an illegal rate. This definitional issue was discussed as early as 1754 by John Erskine (see John Erskine, *The principles of the law of Scotland: in the order of Sir George Mackenzie's Institutions of that law* (Bell & Bradfute 1754) 532; see also discussion in Wayne AM Visser and Alistair Macintosh, 'A short review of the historical critique of usury' (1998) 8 *Accounting, Business & Financial History* 175, 175-176). The uncertainty between these three definitions has continued, and is highlighted by the definition of usury in the Oxford English Dictionary as 'The fact or practice of lending money at interest; esp. in later use, the practice of charging, taking, or contracting to receive, excessive or illegal rates of interest for money on loan' (Oxford English Dictionary, "Usury, n" Oxford University Press accessed 4 March 2015). In the modern financial world, the charging of interest is generally considered a given (Karl Polanyi, 'The Idea of Usury: From Tribal Brotherhood to Universal Otherhood, by Benjamin N. Nelson' Commentary <<https://www.commentarymagazine.com/article/the-idea-of-usury-from-tribal-brotherhood-to-universal-otherhood-by-benjamin-n-nelson/fhy>> accessed 3 March 2015). 'Excessive' does not indicate above market rate; it refers to setting a level of interest higher than can be reasonably justified given the lending risk posed by the specific borrower. Therefore, when 'usury' is used in this thesis outside of a quotation or direct reference of another source, it refers to the charging of excessive, but not illegal, rates of interest.

<sup>54</sup> Hugh Bellot, *The law relating to unconscionable bargains with money-lenders : including the history of usury to the repeal of the usury laws* (Stevens & Haynes 1898) 30-31.

on this topic but included evidence of the harmful impact that the usury laws were having on the 'bona fide' creditors of borrowers in pecuniary distress.<sup>55</sup> The focus on non-intervention and freedom of contract was therefore continued.

Moneylending received further public attention at the turn of the nineteenth century, when a Select Committee was formed in 1897 to look into these issues. Significant evidence was given to this Committee about various unscrupulous activities in the market, and the harm caused by the light-touch regulation of debt agreements.<sup>56</sup> The full title of this group was 'The Select Committee appointed to inquire into the alleged evils attending Money Lending Transactions at high rates of interest, or under oppressive conditions as to Repayment, between the poorer classes and professional Money Lenders', and this provides a useful insight into how Parliament at that time viewed the moneylending profession.<sup>57</sup> In its report, the Committee noted that 'the nature of the evils alleged to be attendant upon the system of money lending are well known'<sup>58</sup>, further concluding that

After carefully considering the evidence which has been given in regard to particular transactions and the general expressions of opinion of persons so well qualified to form a judgment .... [the] Committee have unhesitatingly come to the conclusion that the system of money lending by professional money-lenders at high rates of interest is productive of crime, bankruptcy, unfair advantage of over

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<sup>55</sup> *ibid* 30. This passage of legislation is also discussed in William Selwyn, *An Abridgment of the Law of Nisi Prius* (W Clarke and Sons 1812) 309-311.

<sup>56</sup> *The Select Committee on Money Lending, 1897 Report from the Select Committee on money lending; together with the proceedings of the committee, minutes of evidence, appendix, and index* (19th Century House of Commons Sessional Papers, No 364, 1897).

<sup>57</sup> *ibid* iii (emphasis added).

<sup>58</sup> *The Select Committee on Money Lending, 1898 Report from the Select Committee on money lending; together with the proceedings of the committee, minutes of evidence, appendix and index* (House of Commons Papers; Report of Committees, No 260, 1898) iii.

creditors of the borrower, extortionate from the borrower's family and friends, and other serious injuries to the community.<sup>59</sup>

The Committee highlighted that moneylending advertisements were often misleading in a number of ways, including stating interest rates on a monthly basis when consumers generally believed this was the annual figure.<sup>60</sup> High levels of interest were also charged, with one moneylender admitting his rates were sometimes as high as 3,000%.<sup>61</sup> One of the biggest apprehensions of the Committee was the fact that many borrowers obtained loans when 'default is inevitable ... such as to force him to obtain renewal after renewal at increasingly extortionate rates until he is utterly ruined'.<sup>62</sup> In situations such as these, moneylenders 'frequently display great cruelty and harshness'.<sup>63</sup>

This resulted in the *Report from the Select Committee on Money Lending*, and subsequently the Money-Lenders Act 1900 (UK) (MLA 1900). The Act introduced a variety of new duties for lenders, with severe penalties for breach – including up to two years imprisonment with hard labour.<sup>64</sup> It also resulted in enhanced government and contractual intervention, including the registration of lenders, and the power of courts to re-open 'harsh and unconscionable' credit transactions. This represented an improvement in consumer protection but nonetheless resulted in a number of difficulties, since it required borrowers to personally bring actions against lenders in civil court, and focused

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<sup>59</sup> *ibid* iv.

<sup>60</sup> *ibid* iii.

<sup>61</sup> *ibid* iv.

<sup>62</sup> *ibid* iv.

<sup>63</sup> *ibid* iv.

<sup>64</sup> Moneylenders Act 1900 (UK), s 4.

on the status of the lender rather than the type of transaction in question.<sup>65</sup> It also continued the emphasis on disclosure and consumer empowerment, as opposed to product prohibition and further market intervention. The MLA 1900 was eventually replaced by the Moneylenders Act 1927 (UK), which introduced annual licensing of lenders and restricted the way in which creditors could seek business. This Act continued to concentrate on the status of the lender, and did not provide general protection for borrowers. Such a focus became problematic, as creditors developed ways to circumvent the legislation such as installment selling, hire purchase, and the sale of goods on credit.<sup>66</sup>

Despite the MLA 1900, a freedom-based approach remained the predominant way of thinking until the onset of the Great Depression in the 1930's. The devastating consequences of the Depression and its potential links with the freedom-based approach to financial regulation challenged this focus, initiating a very brief return to protectionism (including interest rate restrictions) from both a practical and moral perspective.<sup>67</sup> This hiatus was interrupted by the libertarian discourse of the mid-twentieth century. During this period, there was a return to individual freedom, with the attendant emphasis on respect for individual choice, negative liberty, and limited government intervention into private affairs. Many academics and policymakers rejected the previous protection-based approach to usury and interest rate controls. Society embraced and promoted notions such as personal freedom, individual rights and acquisitiveness, and these encouraged liberal spending, consumption, and the satisfaction of immediate individual desires. At the same time, other cultural practices that tempered market activity and promoted

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<sup>65</sup> The disparity between the public enforcement regime and private redress was discussed in The Law Commission and The Scottish Law Commission, *Consumer Redress for Misleading and Aggressive Practices* (Law Com No 332 & Scot Law Com No 226, 2013).

<sup>66</sup> Karen Rowlingson, *Moneylenders and their Customers* (Policy Studies Institute 1994) 13-14.

<sup>67</sup> See further discussion in the texts from footnote 526 to 531.

important community values – such as charity towards those in positions of weakness, and disdain for greed and the concentration of wealth – received significantly less attention.<sup>68</sup>

Prior to 1974 the legal regime for consumer credit was highly unsatisfactory. Some parts of the market were regulated by a complex arrangement of different legislative and common law provisions, whilst other parts appeared to have little or no legal regulation.<sup>69</sup> It became clear in the 1960's that there was inadequate protection for the increasing number of people accessing consumer credit products. In 1968 Sir Geoffrey Crowther was appointed Head of a Committee to analyse the consumer credit industry, and to make recommendations for future reform. The resulting *Consumer Credit: Report of the Committee* ('Crowther Report') was published in 1971.<sup>70</sup> It noted that there had been no previous attempts made by an official committee to look into consumer credit as a whole,<sup>71</sup> and recommended a 'sweeping review' of the existing laws.<sup>72</sup> The review suggested a range of reforms, including limits on advertising of consumer credit products,<sup>73</sup> provision of pre-contractual information,<sup>74</sup> mandated disclosure of the cost of

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<sup>68</sup> Vincent D Rougeau, 'Rediscovering Usury: An Argument for Legal Controls on Credit Card Interest Rates' (1996) 67 *University of Colorado Law Review* 1, 38.

<sup>69</sup> For more discussion see Sir Geoffrey Crowther, *Consumer Credit: Report of the Committee* (Department of Trade and Industry, 1971) 52-60.

<sup>70</sup> Department of Trade and Industry, *Reform of the Law on Consumer Credit* (1973) 6.

<sup>71</sup> Crowther (n 69) 9.

<sup>72</sup> *ibid* 183.

<sup>73</sup> *ibid* 257.

<sup>74</sup> *ibid* 266.

credit,<sup>75</sup> rights of cancellation,<sup>76</sup> and a uniform licensing system for consumer credit.<sup>77</sup> It did not recommend an interest rate cap or the prohibition of certain types of lending models.<sup>78</sup> The *Department of Trade and Industry* (DTI) considered the Crowther Report and its recommendations, and enacted the ‘general approach’ of the Report.<sup>79</sup>

### 1.1.2: The Office of Fair Trading

The difficulties and government processes discussed in 1.1.1 above resulted in the Consumer Credit Act 1974 (‘the 1974 Act’), which came into force on 31 July 1974. The stated rationale for the legislation was ‘the failure of private law to protect individual rights or deter unscrupulous practices and the limited scope of existing licensing regimes’.<sup>80</sup> The government was, however, reluctant to interfere with what it perceived as private agreements between individuals, and so the legislation was focused more on consumer education and ‘light touch’ intervention.<sup>81</sup> The review also resulted in the creation of the OFT, which commenced operating in 1973. The OFT had the duty to administer the licensing system, monitor persons carrying on consumer credit businesses, and take steps to enforce the Act and related regulations where necessary and expedient.<sup>82</sup> The Secretary of State had the power to regulate the carrying out of functions

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<sup>75</sup> *ibid* 271.

<sup>76</sup> *ibid* 289.

<sup>77</sup> *ibid* 329-334.

<sup>78</sup> *ibid* 79.

<sup>79</sup> Department of Trade and Industry (n 70) 6.

<sup>80</sup> Iain Ramsay, *Consumer Law and Policy* (3rd edn, Hart Publishing 2012) 386.

<sup>81</sup> Rowlingson (n 66) 13.

<sup>82</sup> Consumer Credit Act 1974 (UK), s 1(1)(a) and (d).

under the Act, including the drafting of specific regulations and directions.<sup>83</sup> As a result of the Crowther Report's recommendation for the creation of a Commission with responsibility for the consumer credit regime, the OFT was given jurisdiction over consumer credit licensing, including the administration of the licensing system, making appropriate regulations, and educating parties on their rights and obligations.<sup>84</sup> It was considered preferable for this to be performed by an independent regulator, rather than as part of the government.<sup>85</sup>

The 1974 Act was implemented at a time when credit cards were beginning to appear on the consumer market, and interest rates, even for short-term loans, were generally not exorbitant. For example, the Crowther Report highlighted that the interest rates for standard 'money-lender' loans were between 30% and 50%, with the average loan being around 40% per annum.<sup>86</sup> As the use of consumer credit in the UK became more widespread, different types of lending emerged and the interest rates charged for short-term loans skyrocketed. It became clear in the early twenty-first century that significant amendments to the 1974 Act were required to ensure that it was appropriate and adequate to regulate the consumer credit market at the time.<sup>87</sup> The situation was exacerbated by the global financial crisis, as mainstream creditors generally became more risk-averse, which in turn forced more people to look to alternative lending streams.<sup>88</sup>

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<sup>83</sup> Consumer Credit Act 1974 (UK), s 2.

<sup>84</sup> Crowther (n 69) 326.

<sup>85</sup> *ibid* 326-327.

<sup>86</sup> *ibid* 79.

<sup>87</sup> This was considered in a number of government publications. See, for example, Department of Trade and Industry, *Fair, Clear and Competitive: The Consumer Credit Market in the 21st Century - White Paper* (2003); HM Treasury, *Promoting Financial Inclusion* (2004).

<sup>88</sup> McCartney and Gibbons (n 12) 10.

These problems prompted an in-depth examination of the consumer credit market, which resulted in the recommendation for substantial legislative amendments, particularly in relation to the enforcement of consumer rights. The Consumer Credit Act 2006 (UK) ('the 2006 Act') came into force on 6 April 2007, and was the 'culmination of a three-year review of consumer credit law'.<sup>89</sup> The 2006 Act made significant amendments to the 1974 Act,<sup>90</sup> including provisions on unfair relationships between creditors and borrowers,<sup>91</sup> enhancing the powers of the OFT,<sup>92</sup> the creation of the Consumer Credit Appeals Tribunal,<sup>93</sup> and the increased jurisdiction of the FOS as a redress body for users of consumer credit.<sup>94</sup> These changes continued the previous focus on consumer empowerment and assisting borrowers to make informed decisions, thus the freedom approach continued.<sup>95</sup>

The legislative and regulatory protection provided to high-cost credit borrowers under the Act is largely modelled on recommendations from the Crowther Report, but has been updated in an attempt to ensure its relevance to the current lending market. All providers of consumer credit must be licensed, and loans are subject to regulation. It is notable that the Act continued a freedom-based approach. An OFT review commented that 'the greatest strength of the Act is that it ... explicitly endorses freedom of contract

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<sup>89</sup> Julia Smith and Sandra McCalla, *Consumer Credit Act 2006: A Guide to the New Law* (Law Society (Great Britain) 2006) Introduction.

<sup>90</sup> See *ibid*, especially 1-91 for a full discussion of the amendments.

<sup>91</sup> Consumer Credit Act 2006 (UK), ss 19-23; Consumer Credit Act 1974 (UK), ss 140A-140D.

<sup>92</sup> Consumer Credit Act 2006 (UK), ss 38-43; Consumer Credit Act 1974 (UK), ss 1-7.

<sup>93</sup> Consumer Credit Act 2006 (UK), ss 55-58; Consumer Credit Act 1974 (UK), Sch A1 and Transfer of Functions of the Consumer Credit Appeals Tribunal Order 2009 (UK).

<sup>94</sup> Consumer Credit Act 2006 (UK), ss 59-61; Financial Services and Markets Act 2000 (UK), ss 226 and 234.

<sup>95</sup> See discussion in Smith and McCalla (n 89).

within a framework of rules designed to ensure openness'.<sup>96</sup> Thus, the emphasis on freedom was continued. During this period, a combination of economic, legal and social factors resulted in an increased demand for – and supply of – high-cost credit, generally to people who were already financially disadvantaged.<sup>97</sup>

This section has outlined how the UK's consumer credit legislative regime underwent significant transformation in 1974, and has been amended numerous times since. Despite the reforms, the OFT's free-based regime remained inadequate to deal with the challenges of high-cost credit. The specific details of these issues will be discussed in more depth in the next three chapters; it is clear that the regulatory approach under the OFT focused largely on the procedural fairness of the transaction, such as disclosure and pre-contractual protection. It had a number of ongoing problems, which will be discussed in more detail below, including:

- a lax licensing process that did not actively exclude inappropriate lenders from the market;
- the limited utility of a disclosure, particularly those desperate to access credit;
- vague and generally unenforced responsible lending guidelines;
- a lack of engagement with the unfair terms regime and the uncertainty of the 'unfair relationship' test<sup>98</sup>;
- a regulator with limited resources and enforcement powers, and the inability to respond proactively to borrower detriment; and

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<sup>96</sup> The Office of Fair Trading, *Consumer Credit Deregulation: A Review by the Director General Of Fair Trading of the scope and operation of the Consumer Credit Act 1974* (1994) (emphasis added).

<sup>97</sup> The impact of this is further discussed in Part 2.2 below.

<sup>98</sup> This is a mechanism which permits the court to intervene in the credit contract if the agreement is held to be 'unfair' based on a term of the contract, the way the creditor has exercised or enforced rights or 'any other thing done (or not done). This will be discussed more in 2.4.4.

- borrowers who were not adequately exercising their rights to obtain remedies against lenders before the FOS.

Freedom of contract remained paramount, and the regime attempted to create optimal conditions for the creation of high-cost credit contracts.<sup>99</sup> This approach continued until the financial crisis of 2008, when the devastating consequences of a freedom-based approach to high-cost credit started to be felt, largely by those who could afford it the least.

### 1.1.3: The Financial Conduct Authority

As the demand for consumer credit increased, it became clear that the existing regime posed significant difficulties and was in dire need of reform. Furthermore, the OFT compared unfavourably to the *Financial Services Authority* (FSA), the regulator of mainstream credit services, in terms of its resources and power to impose sanctions.<sup>100</sup> In addition to the limitations discussed above, the OFT did not have an adequate understanding of the high-cost credit market and assumed a false level of borrower homogeneity; the *Public Accounts Committee* (PAC) commented that the regulator needed 'a much better understanding of how different consumers use credit'.<sup>101</sup> These challenges contributed to a culture of lender non-compliance and led to significant reforms, including a transfer of jurisdiction from the OFT to the FCA, a move away from a focus on contractual freedom, and the creation of a more protective approach to regulation.

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<sup>99</sup> This type of regulatory approach is discussed in Richard Thaler and Cass Sunstein, *Nudge: Improving Decisions about Health, Wealth, and Happiness* (Yale University Press 2008).

<sup>100</sup> Report by the Report by the Comptroller and Auditor-General, *The Office of Fair Trading: Protecting the Consumer from Unfair Trading Practices* (HC57 Session 1999-20, 2000) para 2.17.

<sup>101</sup> Public Accounts Committee, *8th Report - Regulating Consumer Credit* (2013) Recommendation 2.

Even with the additional powers under the 2006 reforms,<sup>102</sup> the OFT still did not have the same authority as the FSA to monitor the behaviour of credit providers.<sup>103</sup> In addition, the OFT was disturbingly under-resourced, which adversely affected its ability to prevent consumer detriment. The regulator's turnover-to-expense ratio was £15,000, meaning that for every £1 spent on regulation in 2011/12, over £15,000 was lent to consumers.<sup>104</sup> This figure contrasted starkly with the ratios of other regulators, including those that regulate the communications, energy, post, water and rail markets, which ranged from £306 to £853.<sup>105</sup> Unaddressed complaints cost consumers £450 million in 2011/2012 alone.<sup>106</sup> In 2012 it became clear that additional resources were urgently required, and consumers were suffering because of the limitations of the current regulatory regime.<sup>107</sup>

The PAC review of the OFT also highlighted numerous failings of the regulator. These included a lack of information about the market which was needed to regulate it effectively,<sup>108</sup> a lack of understanding of the customer base,<sup>109</sup> and that the OFT acted in a 'passive' manner regarding breaches of regulation and exploitative business practices.<sup>110</sup> It

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<sup>102</sup> See discussion at text to fns 89 to 95 above.

<sup>103</sup> The Financial Stability Board, *Consumer Finance Protection with Particular Focus on Credit* (2011); National Audit Office, *Office of Fair Trading: Regulating Consumer Credit* (2012); HM Treasury and Department of Business Innovation and Skills, *A New Approach to Financial Regulation: Transferring Consumer Credit Regulation to the Financial Conduct Authority* (2013).

<sup>104</sup> National Audit Office (n 103) 32.

<sup>105</sup> The turnover-to-expense ratio spread sheet was provided during an anonymous interview and is based on information mostly obtained from the Annual Reports of the regulators. A simple turnover-to-expense ratio was discussed in the Public Accounts Committee (n 101) Recommendation 4.

<sup>106</sup> Europe Economics (n 31) para 121.

<sup>107</sup> National Audit Office (n 103) 32.

<sup>108</sup> Public Accounts Committee (n 101) Recommendation 1.

<sup>109</sup> *ibid* Recommendation 2.

<sup>110</sup> *ibid* Recommendation 3.

was clear that further reforms were needed to strengthen consumer protection, and to ensure a proactive approach to addressing high-cost credit and the root causes of financial harm to vulnerable consumers.<sup>111</sup> As outlined by HM Treasury,

[t]he Government believes that fundamental change is necessary to ensure that regulation is able to keep up with a rapidly changing market and to tackle detrimental practices more swiftly. The Government also believes that this change can best be achieved by bringing consumer credit into the same regulatory regime as other financial services, while retaining the existing consumer rights and protections in the [Consumer Credit Act].<sup>112</sup>

This ‘fundamental change’ came in the form of a new regulator – the FCA, established by the Financial Services Act 2012 (UK) with jurisdiction over credit licences and providers of consumer credit, including high-cost credit. The FCA took over responsibility on 1 April 2014, and had significantly increased resources. The jurisdiction transfer aimed to ensure that the regulator:

- was able to flex to keep pace with a fast-growing, innovative market;
- had the powers and resources to protect consumers from actual – and potential – detriment;
- put a proportionate and manageable regulatory burden on business; and
- delivered a well-functioning consumer credit market, which ensures that consumers have access to the credit they need, and which supports the sustainable growth of the UK economy.<sup>113</sup>

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<sup>111</sup> The Financial Stability Board (n 103) 5-7.

<sup>112</sup> HM Treasury and Department of Business Innovation and Skills (n 103) para 4.18.

<sup>113</sup> *ibid* para 1.5.

The FCA declared its aim to ‘step in earlier, and act faster, when we identify problems that risk harming consumers or the integrity of the market’.<sup>114</sup> The regulator had additional powers beyond those held by the OFT, including product governance, early intervention,<sup>115</sup> and the ability to completely ban misleading product promotions.<sup>116</sup> These all highlight a changing regulatory emphasis and an approach focused more strongly on protection, moving away from the previous approach of contractual freedom and consumer disclosure.

The transition was, in many ways, successful. The FCA was significantly more active in the financial market than its predecessor, with a specific focus on the high-cost credit industry.<sup>117</sup> Nevertheless there were some causes for concern. Despite the alarming results of the OFT review,<sup>118</sup> the FCA highlighted its intention to adopt a ‘proportionate’ approach to consumer credit regulation, stating:

the Government has worked with the [the regulator] to design a regime where the regulatory burdens on firms are proportionate. Broadly, fees for consumer credit activities will be lower than for other FCA regulated firms. Regulatory burdens will be also comparatively lower.<sup>119</sup>

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<sup>114</sup> The Financial Conduct Authority, *Journey to the FCA* (2012) 8.

<sup>115</sup> *ibid* 13.

<sup>116</sup> *ibid* 14. See also ‘Annex D – A concordat between the Office of Fair Trading and the Financial Conduct Authority’ in The Financial Conduct Authority and The Office of Fair Trading, ‘Memorandum of Understanding between the Office of Fair Trading and Financial Conduct Authority’ <<http://www.fca.org.uk/static/fca/documents/mou/mou-oft.pdf>> accessed 4 April 2013, 28.

<sup>117</sup> See discussion in Martin Wheatley, *Consumer Credit and the FCA: one year on: A speech delivered by Martin Wheatley on 11 March 2015* (Financial Conduct Authority 2015).

<sup>118</sup> See discussion in text to fns 23 to 28 above.

<sup>119</sup> HM Treasury and Department of Business Innovation and Skills (n 103) 12 (emphasis in original).

Such comments are troubling. Providers of high-cost credit are obviously in a different risk category from mainstream banking institutions in that they are not classified as ‘deposit taking institutions’,<sup>120</sup> but this is not the only factor that should be considered when determining appropriate regulatory approaches.

Despite these initial comments, the FCA has been active in its approach to the high-cost credit challenges. Since taking over the jurisdiction, the FCA has been relatively proactive – instituting a new authorisation scheme, amending responsible lending requirements, creating a number of prohibited and limited lending activities, and implementing a cap on the total cost of credit.<sup>121</sup> The new regulator supplemented the OFT’s freedom-based disclosure approach with a regime offering a more protective focus, one that intervened in the market and actively prohibited certain conduct and products. Whilst this approach took steps to tackle the exploitation that was occurring in the industry, it raised a range of other issues. In 2014 the FCA estimated that the combination of the lending limitations and cap would result in 160,000 – or 11% of the existing borrowers – being unable to access high-cost credit. The financial exclusion of such a high number of people did not seem to concern the regulator, with it reporting ‘these customers will be better off not having taken out a loan’.<sup>122</sup>

Disturbingly no data was given by the FCA to support these assertions, and it has not followed-up these consumers to determine whether they are indeed ‘better off’ for not having used high-cost credit. Further research, including interviews with borrowers of

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<sup>120</sup> See discussion in The Financial Conduct Authority’s Practitioner Panel, ‘High-Level Proposals for an FCA Regime for Consumer Credit’ <[http://www.fspp.org.uk/docs/inquiry\\_responses/PP%20Consumer%20Credit%20FCA%20consultation%20response%2020130501%20.pdf](http://www.fspp.org.uk/docs/inquiry_responses/PP%20Consumer%20Credit%20FCA%20consultation%20response%2020130501%20.pdf)> accessed 20 August 2013.

<sup>121</sup> See discussion of the cap on the total cost of credit at 3.4.2.

<sup>122</sup> The Financial Conduct Authority, *Proposals for a Price Cap on High-Cost Short-Term Credit: Consultation Paper* (n 5) para 1.27.

high-cost credit, reveals that financial exclusion of this type can actually exacerbate pre-existing disadvantages.<sup>123</sup> In fact, the FCA's comments go directly against the recommendations of the PAC, which highlighted the impact of financial exclusion and the importance of supporting those who are 'credit poor' instead of merely eliminating them from the market.<sup>124</sup> Despite recommendations from the PAC, the FCA has not adequately engaged with the details of the high-cost credit market and its borrowers. The regulator has continued to assume a level of homogeneity, particularly in relation to borrowers who use these types of financial products. Thus, while the movement to the FCA may have improved the situation for a number of people, it is still not adequate and a more nuanced and targeted approach is necessary.

#### 1.1.4: Non-Regulatory Legal Enforcement

Whilst the regulators have power to commence actions against lenders, consumers themselves can also start proceedings against businesses. The main way this occurs is through the FOS, which commenced in 2000 and investigates complaints made by users of a range of financial services. In 2007 the jurisdiction of the FOS was expanded to cover consumer credit, including high-cost credit. Consumers can therefore make complaints about these products to the Ombudsman, and the disputes are dealt with 'fairly, reasonably, quickly and informally'.<sup>125</sup> The FOS service is impressively consumer-friendly; it is provided at no cost to the individual, who can choose whether or not to accept the Ombudsman's determination of the matter. If they reject the decision, the traditional

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<sup>123</sup> Karen Rowlingson, Lindsey Appleyard and Jodi Gardner, 'Payday lending in the UK: the regul(ar)isation of a necessary evil?' (2016) 45 *Journal of Social Policy* 527. Financial exclusion will be discussed in depth in 3.5.3.

<sup>124</sup> Public Accounts Committee (n 101) Recommendation 7.

<sup>125</sup> The Financial Ombudsman Service, *2012 Annual Review of Consumer Complaints* (2012) Key Facts About the Financial Ombudsman Service.

court processes are still available. If the consumer accepts the Ombudsman's decision, it becomes binding on the consumer and the business involved, which has no choice but to accept the FOS determination.<sup>126</sup> The *Personal Finance Research Centre* (PFRC) conducted an in-depth review of the service provided by the FOS, and judged it 'a thoughtful, well-managed organisation that is doing a good job under difficult circumstances'.<sup>127</sup>

Since its inception, consumer use of the FOS has been significant. It reached a peak in 2013/14, with in excess of 2,350,000 enquiries and complaints. This was largely associated with Personal Payments Insurance, and has reduced slightly to just over 1,631,000 enquiries and complaints in 2015/16<sup>128</sup> and 1,456,396 in 2017/18.<sup>129</sup> Initially, high-cost credit borrowers were not making adequate use of the services provided by the FOS when compared with users of other financial services. For example, in 2011/12 there were 296 complaints to the FOS about payday loans<sup>130</sup> compared with 19,183 complaints about credit cards,<sup>131</sup> and in 2012/13 there were 542 payday lending complaints compared with 19,634 credit card complaints.<sup>132</sup> These numbers were grossly unbalanced, even when the complaints levels were related to the size of the market.<sup>133</sup>

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<sup>126</sup> Financial Services Market Act 2000 (UK), Part XVI especially ss 228-230.

<sup>127</sup> Elaine Kempson, Sharon Collard and Nick Moore, *Fair and reasonable: An assessment of the Financial Ombudsman Service* (Personal Finance Research Centre, 2004) 39.

<sup>128</sup> The Financial Ombudsman Service, *Financial Ombudsman Service Annual Review 2015/2016* (2016) 19.

<sup>129</sup> The Financial Ombudsman Service, *Financial Ombudsman service Annual Review 2017/2018* (2018) 2.

<sup>130</sup> The Financial Ombudsman Service, *2012 Annual Review of Consumer Complaints* (n 125) 24.

<sup>131</sup> *ibid* 53.

<sup>132</sup> The Financial Ombudsman Service, *2013 Annual Review of Consumer Complaints* (2013) 33.

<sup>133</sup> There were approximately 63 million credit and charge cards in the United Kingdom at the end of 2013, compared with approximately 8.2 million payday loans (The UK Cards Association, *Summary of Key Payments Statistics: September 2013* (2013)). Extrapolating these figures, it would be expected that there would be approximately 1,540 complaints about high-cost credit loans (being 7.7% of the 19,634 credit card complaints received by the FOS). This is not factoring into account the extreme divergence in the outcomes of complaints about these two financial products (discussed in the text to fns 140 to 143 below), which should be reflected in a greater proportion of high-cost credit complaints.

The small number of FOS complaints about high-cost lending might be interpreted as evidence of general compliance with laws and regulation in this area, as well as consumer satisfaction with the services provided. Unfortunately, as previously outlined, this is far from the truth. The low number high-cost credit complaints to FOS is quite surprising as it is clear that there is a substantial and ongoing problem with exploitative and irresponsible lending to vulnerable consumers.<sup>134</sup> The under-utilisation of FOS may be more related to the extreme vulnerability of high-cost credit borrowers, indicating that they have difficulties accessing even the most consumer-friendly services. It also reaffirms Lord Hunt's comments in his 2008 review, that 'the FOS still looks too much like a middle-class service, for middle-class people'.<sup>135</sup>

The number of FOS complaints about high-cost credit remained disproportionately small until 2015/16 (after the transfer of jurisdiction to FCA), when there was a significant increase in the use of FOS for high-cost credit, particularly payday lending. The reasons for the previous low number of complaints were unclear; however, the low numbers did not accurately reflect the reality of the short-term loan market and the extent of the problems being experienced. In an attempt to increase consumer awareness, FOS published a 2013 special issue of its update specifically focused on high-cost credit lending decisions.<sup>136</sup> The number of complaints about high-cost credit has increased dramatically since then, with FOS receiving 3,216 complaints in 2015/16 – more

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<sup>134</sup> See, for example, Sharon Collard, Andrea Finney and Kate Crosswaite, *Facing the Squeeze: A Qualitative Study of Household Finances and Access to Credit in a 21st-Century Recession* (Personal Finance Research Centre, 2009); Sharon Collard, Andrea Finney and Sara Davies, *Working Households' Experiences of Debt Problems* (A Research Report Prepared for StepChange Debt Charity 2012).

<sup>135</sup> Rt Hon Lord Hunt of Wirral MBE, *Opening Up, Reaching Out and Aiming High: An Agenda for Accessibility and Excellence in the Financial Ombudsman Service* (2008) 2.

<sup>136</sup> The Financial Ombudsman Service, 'Ombudsman News: Issue 109, April/May 2013 - Payday Lending' <<http://www.financial-ombudsman.org.uk/publications/ombudsman-news/109/109-payday-lending.html>> accessed 16 September 2013. It also undertook specific staff training on these issues; The Financial Ombudsman Service, *Financial Ombudsman Service Annual Review 2015/2016* (n 128) 114.

than double the number received in the previous year.<sup>137</sup> This pattern continued, with 10,529 complaints being received in 2016/17 and 17,256 complaints received in 2017/18.<sup>138</sup> FOS believes that these increases are likely to be related to the high level of publicity around high-cost credit, particularly in light of the FCA's actions to tackle unfair practices in the industry.<sup>139</sup>

There is also a dramatic divergence in the outcomes of disputes for different financial products. In 2012/13, 81% of disputes for payday loans were resolved in favour of the consumer compared with 44% for credit cards and 37% for personal loans.<sup>140</sup> This is a highly concerning statistic, as eight out of every ten loans were found to be in breach of law or professional business practices. The trend has continued, and the success rate for complaints about high-cost credit has remained significantly above the average FOS rates, with consumer success rates of 66% in 2015/16,<sup>141</sup> 59% in 2016/17,<sup>142</sup> and 60% in 2017/18.<sup>143</sup>

In addition to the protection provided by the regulator and the FOS, consumers can make direct claims against lenders in court. In theory, consumers continue to have access to remedies under the common law, and in relation to certain statutory<sup>144</sup>

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<sup>137</sup> The Financial Ombudsman Service, *Financial Ombudsman Service Annual Review 2015/2016* (n 128) 48.

<sup>138</sup> The Financial Ombudsman Service, *Financial Ombudsman service Annual Review 2017/2018* (n 129) 3.

<sup>139</sup> The Financial Ombudsman Service, *Financial Ombudsman Service Annual Review 2015/2016* (n 128) 59.

<sup>140</sup> The Office of Fair Trading, *Payday Lending Compliance Review - Interim Report* (n 10) 10.

<sup>141</sup> The Financial Ombudsman Service, *Financial Ombudsman Service Annual Review 2015/2016* (n 129) 48.

<sup>142</sup> Ben Salisbury, 'Payday loan complaints to Ombudsman triple in a year' (*Money Saving Expert*, 13 June 2017) <<http://www.moneysavingexpert.com/news/loans/2017/06/payday-loan-complaints-to-ombudsman-triple-in-a-year>> accessed 14 June 2017.

<sup>143</sup> The Financial Ombudsman Service, *Financial Ombudsman service Annual Review 2017/2018* (n 129).

<sup>144</sup> For example, the unfair relationship test: The Office of Fair Trading, *Unfair relationships: Enforcement action under Part 8 of the Enterprise Act 2002* (2011). For more details on enforcement, see Financial

obligations on lenders. There are, however, significant limitations on the ability of consumers to access their rights in these traditional court settings, particularly in disputes against businesses.<sup>145</sup> These include their inability to understand the relevant laws and the legalistic nature of the financial documents in question, the rules of evidence, the cost of litigation, as well as the complexity of the legal system and the intimidating nature of the courtroom and adversarial system in general.<sup>146</sup>

#### 1.1.5: What Can We Learn?

This section has discussed the history of moneylending, focusing on the regulatory approach of both the OFT and FCA, highlighting the dramatic changes to the regulation of high-cost credit in a relatively short period of time. Before moving forward, two key points must be highlighted. First, neither approach has worked adequately. The OFT's freedom-based focus left many borrowers vulnerable to lender actions, and allowed predatory lending practices to develop and prosper. Its limited resources fostered a regulatory environment that accepted disturbingly low levels of compliance in the industry. The FCA's interventionist approach, whilst providing increased protection to a large number of people, created two unfortunate side-effects; it reduced the financial choices of borrowers, and left a number of people without any access to the (legal) credit market. Neither regulator adequately engaged with the borrower base and market. Second, the

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Conduct Authority, *Enforcement Guide, Chapter 20: Enforcement of the Consumer Credit Act 1974* (2018).

<sup>145</sup> See discussion in Adrian Zuckerman, *Zuckerman on Civil Procedure: Principles of Practice* (3rd edn, Sweet & Maxwell 2013) 454-455.

<sup>146</sup> Charles L. Owen, Ronald W. Staudt and Edward B. Pedwell, *Access to Justice: Meeting the Needs of Self-Represented Litigants* (Institute of Design and Chicago-Kent College of Law, Illinois Institute of Technology 2002) 15-17. For alternative consumer redress, see Christopher Hodges, 'Consumer Redress: Implementing the Vision' in P Cortés (ed), *The New Regulatory Framework for Consumer Dispute Resolution* (Oxford University Press 2017); Christopher Hodges, 'Unlocking Justice and Markets: The Promise of Consumer ADR' in J Zekoll, M Bälz and I Amelung (eds), *Dispute Resolution: Alternatives to Formalization Formalization of Alternatives?* (Brill 2014).

regulation of high-cost credit is a highly political issue. There have been a high number of legislative amendments and regulatory changes over a relatively short period of time.<sup>147</sup> There is also competing and conflicting evidence about the impact of reforms, particularly that of a cap on the cost of credit.<sup>148</sup> The current dominant approach to the regulation of high-cost credit, namely enhancing freedom versus protection, overlooks a number of complex issues. The problems being experienced in this area – whilst often characterised as issues of modernity<sup>149</sup> – are by no means new phenomena. The regulation of high-cost credit has been an ongoing problem for the State. As will be discussed in Chapters 2 and 3, there have been a variety of approaches used to tackle the problem and none have worked effectively, resulting in frequent legal changes and a swinging pendulum of regulation between freedom and protection-based approaches.<sup>150</sup> This thesis argues that we need to better understand the nature of the high-cost credit market on practical and theoretical levels, which requires a deeper engagement with the philosophical and practical challenges. This engagement will also highlight the importance of social minimums to the high-cost credit debate.

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<sup>147</sup> As this section has highlighted, there has been regulatory amendments to high-cost credit in 2006, 2010, 2014 and 2015.

<sup>148</sup> See discussion in 3.4.2.

<sup>149</sup> High-cost credit has often been referred to as ‘modern day usury’: see The Center for Responsible Lending, *Modern Day Usury: The Payday Loan Trap* (2010). This is strongly related to the increase in the use of technology in the lending process, including online lending or even apps developed by companies.

<sup>150</sup> For a detailed analysis of this pendulum approach to freedom of contract, see Patrick Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford University Press 1985) and Patrick Atiyah, *Essays on Contract Law* (Oxford University Press 1990), particular Essay 12 ‘Freedom of Contract and the New Right’ for discussion of a slightly later period.

## 1.2: What are the Challenges to Regulation?

The previous section outlined the regulatory approach to high-cost credit in the UK. The system is still not working adequately, and reform is necessary. This section develops the earlier discussion, deconstructing the challenges to effective regulation in the high-cost credit market. Two key issues will be discussed. First, throughout history there has been a tendency to blame users of high-cost credit for their financial difficulties, and this has significantly influenced the regulatory approach and prevented borrowers from receiving adequate support. Second, the regulators have not adequately engaged with the high-cost credit market. This has resulted in a false assumption of market homogeneity for both borrowers and lenders, and over-simplistic guiding principles based on a cursory and inadequate understanding of the market. This section will analyse these two challenges and highlight how further research into the market, borrower motivations, and underlying philosophical challenges are necessary to understand and address the current challenges.

### 1.2.1: Victim Blaming

There has long been a tendency to blame people who use high-cost credit for their own financial misfortune. Financial regulation and intervention is often premised on the individual borrower's 'own weakness, their lack of self-discipline, or their inability to manage their finances'.<sup>151</sup> The majority of people who access these credit products are financially vulnerable in that they are likely to have one or more of the following characteristics – low income, limited or no savings, no access to alternative financial products, previous financial difficulties, or bad credit ratings.<sup>152</sup> On this basis, those who

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<sup>151</sup> Rougeau (n 68) 34.

<sup>152</sup> Rowlingson, Appleyard and Gardner (n 123); Competition & Markets Authority, *Research into the Payday Lending Market* (n 39).

use high-cost credit can be 'blamed' for their reliance on these potentially harmful financial products. Blaming the poor is not new; it has been around since at least the Victorian period, when Mayhew discussed the 'dishonest poor' who were 'distinguished from the civilised man by his repugnance to regular and continuous employment'.<sup>153</sup> It is hard to imagine a more accurate portrayal of victim-blaming than debtors' prisons. Until the passing of the Debtors Act 1869, tens of thousands of people were incarcerated for not being able to repay their loans. These cruel institutions resulted in horror stories of 'shackled debtors covered with filth and vermin, and suffered to die, without pity, of hunger and jail fever', merely because they became over-indebted.<sup>154</sup>

Victim-blaming continued for 500 years, coming to a high-water mark with the writings of Murray, who utilised Charles Darwin's 'survival of the fittest' theory to explain why Britain had developed such a distinct 'underclass'. Murray argued that people in this underclass were the 'undeserving' poor.<sup>155</sup> He contended that this group of people generally had no desire to be in gainful employment, were involved in crime, and had high levels of illegitimate births. The English social services system had allowed these circumstances to develop into welfare dependence, creating a strong disincentive for people to become employed and independent.<sup>156</sup> The appropriate response was, according to Murray, to provide these people with less state assistance in order to encourage them to become self-sufficient. This blame-the-victim mentality is frequently reflected in political approaches to poverty and welfare. Government policy often

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<sup>153</sup> Charles Murray, 'The Emerging British Underclass' in Ruth Lister (ed), *Charles Murray and the Underclass: The Developing Debate* (IEA Health and Welfare Unit in association with The Sunday Times 1996) 24.

<sup>154</sup> David Graeber, *Debt: The First 5,000 Years* (Melville House Publishing 2012) 334-335.

<sup>155</sup> *ibid* 25.

<sup>156</sup> *ibid* 49.

promotes self-regulation, of both borrowers and lenders, in order to produce financially responsible neoliberal subjects. The State can therefore blame individuals for their ‘feckless irresponsible financial behaviours’, rather than ensure sustainable employment and adequate welfare.<sup>157</sup>

Bentham’s economic analysis also can be seen to blame victims of high-cost credit for their own struggles. In his *A Defence of Usury* manuscript, Bentham asserted that poor people were not better off, and in fact were in many ways disadvantaged, by the implementation of credit restrictions. When confronted with the protection interest rate caps provided to vulnerable borrowers, he declared they did not need any additional protection. Bentham stated that, provided there was no ‘defect’ in a poor man’s judgment or temper, he should be able to look after his own interests as well as someone who is better off. If he suffered from his financial decisions, it was due to his own irrationality.<sup>158</sup> This is the starting point of the (now largely discredited<sup>159</sup>) ‘rational man’ principle in economic theory.

This blame-the-victim view is still prevalent today. Fifty-nine per cent of the UK population believes that poor people are bad at managing money, and that they could cope financially if they organised their finances more efficiently.<sup>160</sup> This belief contrasts

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<sup>157</sup> Carl Walker, ‘Responsibilizing’ a healthy Britain: personal debt, employment and welfare’ (2011) 41 *Neoliberalism and Health* 525, 531-533.

<sup>158</sup> Jeremy Bentham, *Defence of Usury; shewing the impolicy of the present legal restraints on the terms of pecuniary bargains. In a series of letters to a friend. To which is added, a letter to Adam Smith, Esq; LL.D. on the discouragements opposed by the above restraints to the progress of inventive industry* (Messrs. D. Williams, Colles, White, Byrne, Lewis, Jones, and Moore 1788) Letter IV.

<sup>159</sup> Richard Posner, ‘Rational Choice, Behavioral Economics, and the Law’ (1997) 50 *Stanford Law Review* 1551; Werner Hirsch, *Law and Economics: An Introductory Analysis* (3rd edn, Academic Press 1999) starting from 11. James Boyd White, ‘Economics and Law: Two Cultures in Tension’ (1987) 54 *Tennessee Law Review* 161; Alan D. Miller and Ronen Perry, ‘The Reasonable Man’ (2012) 87 *New York University Law Review* 323. For application to high-cost credit, see Karen Francis, ‘Rollover, Rollover: A Behavioral Law and Economics Analysis of the Payday-Loan Industry’ (2010) 88 *Texas Law Review* 611.

<sup>160</sup> The Baptist Union of Great Britain and others, *The lies we tell ourselves: ending comfortable myths about poverty* (2013) 19.

sharply with the empirical research on the financial choices of low-income borrowers, which highlight how they often make the best possible decisions in light of their limited means and choices.<sup>161</sup> Recent political debates have used terms such as ‘welfare scroungers’, welfare as a ‘lifestyle choice’, ‘the curse of intergenerational worklessness’<sup>162</sup>, and ‘strivers and shirkers’.<sup>163</sup> When the extent of the lending crisis became evident, some commentators stated that ‘British households that borrowed too much money must “accept responsibility” for their role in the current economic troubles’.<sup>164</sup>

An extreme example of victim-blaming is seen in the comments of the Conservative Peer Lady Jenkin in December 2014. During the launch of the Church of England-funded report *Feeding Britain*, examining the increasing reliance on food banks, Lady Jenkin stated ‘we have lost a lot of our cookery skills. Poor people do not know how to cook. I had a large bowl of porridge today, which cost 4p. A large bowl of sugary cereals will cost you 25p’.<sup>165</sup> The combination of low-income households and porridge was actually the subject of a 1913 book, in which Reeves and Wilson highlighted that families with financial limitations have additional restraints preventing them from taking advantage of low-cost food options. When discussing the challenges associated with

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<sup>161</sup> ibid. See also discussion in Rowlingson, Appleyard and Gardner (n 123) and Maia Szalavitz, ‘Why do we think poor people are poor because of their own bad choices?’ (*The Guardian*, 5 July 2017) <<https://www.theguardian.com/us-news/2017/jul/05/us-inequality-poor-people-bad-choices-wealthy-bias>> accessed 5 July 2017.

<sup>162</sup> Lindsey Macmillan, ‘While there is evidence that workless spells are associated across generations, the ‘culture of welfare dependency’ argument does not hold’ (*LSE British Politics and Policy*, 2 April 2014) <<http://blogs.lse.ac.uk/politicsandpolicy/intergenerational-worklessness-the-unexplored-curse/>> accessed 4 June 2018.

<sup>163</sup> Juliette Jowit, ‘Strivers v shirkers: the language of the welfare debate’ *The Guardian* (8 January 2013).

<sup>164</sup> James Kirkup, ‘Families must accept share of blame for Britain's woes’ *The Telegraph* <<http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9244414/Families-must-accept-share-of-blame-for-Britains-woes.html>> accessed 4 June 2018.

<sup>165</sup> Cited in Patrick Butler, Patrick Wintour and Amelia Gentleman, ‘Tory peer forced to eat her words after claiming poor people can’t cook’ *The Guardian* <<http://www.theguardian.com/society/2014/dec/08/poor-cannot-cook-peer-eats-words>> accessed 8 December 2014 (emphasis added).

cooking on a low-income (cleverly named ‘The Gospel of Porridge’), the authors recalled how health visitors came to deprived areas of Lambeth to teach the women how to cook porridge for their families.<sup>166</sup> What the visitors had not taken into account was that porridge was a time-intensive dish (the working poor often have more constraints in this regard) that required the maker to have access to fresh milk, a cook top, electricity and a decent pot or pan<sup>167</sup> – all things to which poorer families may not have access, either in 1913 or today.<sup>168</sup> Lady Jenkin’s comments shows that many of the societal perceptions of poor families and their financial capabilities have remained largely unchanged over the last 100 years.

In the *Shriver Report*, Ehrenreich observes that

pundits and politicians have bemoaned the character failings and bad habits of the poor for at least the past 50 years. In their view, the poor are shiftless, irresponsible, and prone to addiction. They have too many children and fail to get married. So if they suffer from grievous material deprivation, if they run out of money between paychecks, if they do not always have food on their tables—then they have no one to blame but themselves ... sadly, this has become the means by which [countries] manage to remain complacent in the face of alarmingly high

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<sup>166</sup> Maud Pember Reeves and Charlotte Wilson, *Round About A Pound A Week* (G Bell & Sons 1913 (reprinted in 1994 by Virargo Books)) 57.

<sup>167</sup> *ibid* 57-58.

<sup>168</sup> The most recent report from the Department of Energy and Climate Change highlighted that approximately 2.28 million households experienced fuel poverty in 2014, representing approximately 10.4% of all English households. Fuel poverty is measured by the Low Income High Costs definition. A household is considered to be fuel poor if they have required fuel costs that are above average and, if they were to spend that amount, would be left with a residual income below the official poverty line: Department of Energy and Climate Change, *Annual Fuel Poverty Statistics Report, 2014* (2014) 5.

levels of poverty: by continuing to blame poverty not on the economy or inadequate social supports, but on the poor themselves.<sup>169</sup>

This victim-blaming provides an excuse for governments to avoid looking deeply into the issues of high-cost credit. By focusing on the individual borrowers' weaknesses, instead of the complex structural and societal pressures of the high-cost credit market, governments can avoid engaging with substantive fairness and welfare issues. They do not need to actively address the fairness of the agreement, create meaningful choices, or address the reasons why so many people become dependent on these financial products.

### 1.2.2: Inadequate Engagement with the Market

The second issue to consider is inadequate engagement with the market, especially a lack of understanding of the people using high-cost credit. It is too often assumed that lenders and borrowers in the market are largely homogeneous. In reality, the industry encompasses a wide variety of both consumers and lending models. Discussions about the need to intervene in the high-cost credit market are frequently premised on the view that users of these financial products are economically irrational and price-insensitive.<sup>170</sup> This is an inaccurate portrayal of the financial position of many high-cost credit borrowers.

O'Connell undertook a detailed analysis of working-class debt in the UK, and 'rejects the notion that low-income consumers were feckless. Such statements emanated from a model of the rational middle-class consumer and frequently made little sense in the

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<sup>169</sup> Barbara Ehrenreich, 'Time to Wake Up: Stop Blaming Poverty on the Poor' in Maria Shriver (ed), *The Shriver Report: A Woman's Nation Pushes Back from the Brink* (Center for American Progress 2014).

<sup>170</sup> Rowlingson, Appleyard and Gardner (n 123); Lindsey Appleyard, Karen Rowlingson and Jodi Gardner, 'The variegated financialization of sub-prime credit markets' (2016) 20 *Competition & Change* 297; Ronald Mann, 'Nudging from Debt: The Role of Behavioral Economics in Regulation' [2011] *The Lydian Payments Journal* <<http://pymnts.com/journal-bak/201/nudging-from-debt-the-role-of-behavioral-economics-in-regulation/>> accessed 7 July 2012.

context of the choices available to the working-classes'.<sup>171</sup> It is often assumed that all people using high-cost credit products are under significant external pressures, have limited education or understanding of the financial product, cannot control their spending desires, or are so desperate for credit that they are not acting 'rationally' in their choices.<sup>172</sup> This view is not completely wrong – there is evidence that a significant number of borrowers do exhibit these characteristics.<sup>173</sup> Many borrowers are, however, not vulnerable, act rationally, and choose to use high-cost credit because of its speed and convenience.

There is also an underlying assumption that high-cost credit products are used in a similar way by individuals with comparable needs and backgrounds, reflecting a lack of understanding about the nature of the market and its borrowers. This deficiency was most accurately outlined by the PAC in its 2013 review of the OFT. Three of the eight recommendations by the PAC focused on a lack of information and engagement with the high-cost credit market.<sup>174</sup> Despite this Report, the FCA has continued this lack of engagement.<sup>175</sup> There is a frequent assumption that high-cost credit is always harmful, and that consumers are better off without access to the financial product. This is not necessarily the case, as high-cost credit can actually be cheaper than many alternatives,

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<sup>171</sup> Sean O'Connell, *Credit and Community: Working-Class Debt in the UK since 1880* (Oxford University Press 2009) 286.

<sup>172</sup> This can be seen in, for example, Stella Creasy MP's comments (Stella Creasy, 'Consumers need protection against high-cost moneylenders online' *The Guardian* accessed 29 July 2016) and in numerous publications from the FCA (The Financial Conduct Authority, *Consumer credit firms must raise advertising standards, says FCA* (2014); The Financial Conduct Authority, *FCA confirms price cap rule for payday lenders* (2014)).

<sup>173</sup> See discussion in Competition & Markets Authority, *Research into the Payday Lending Market* (n 39), particularly the discussion at 70-87. This is also discussed in McCartney and Gibbons (n 12).

<sup>174</sup> Public Accounts Committee (n 101) Recommendations 1, 2, and 5.

<sup>175</sup> See discussion in Part 1.2.3 above.

such as going into unauthorised overdraft.<sup>176</sup> The high-cost credit market, like most others, has significant diversity; borrowers use credit in a wide variety of ways.<sup>177</sup> There is much controversy and ambiguity about who is actually borrowing, and what impact high-cost credit has on their wellbeing.<sup>178</sup>

There is also an assumption that high-cost lenders are uniformly exploitative, and a belief that all consumers would be better off if these products were removed from the market.<sup>179</sup> This is of particular concern to the media and certain political figures. An example of this approach is the 'End Legal Loan Sharking' Campaign and Petition, which was directed at high-cost credit providers in the UK.<sup>180</sup> Unfortunately, the approach taken by the regulators often reflects similar beliefs and assumptions. For example, after the OFT's Compliance Review, the regulator sent letters to the 50 largest high-cost credit providers demanding that they improve their lending practices, and giving them 12 weeks to respond and explain what measures they were going to take.<sup>181</sup> The regulator therefore gave the appearance that it believed all large firms were acting in the same manner. Whilst on the whole the level of compliance in the industry was inadequate, some lenders were behaving considerably better than others. This is clear from research conducted by the regulator itself. The Compliance Review Report showed that firms take very different approaches to lending, and indicated that some businesses in the area were operating

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<sup>176</sup> See discussion in Part 3.5.3 below.

<sup>177</sup> Rowlingson, Appleyard and Gardner (n 123); Appleyard, Rowlingson and Gardner (n 170).

<sup>178</sup> As discussed below, this topic is subject to significant disagreement between the lenders and trade associations on one hand, and the consumer advocates, politicians and charitable organisations on the other. For more discussion on this, see text of fns 191 to 199.

<sup>179</sup> The clearest indicator of this is the FCA's belief that the 160,000 people excluded from the high-cost credit market are better off; see discussion in Part 3.5.3 above.

<sup>180</sup> UK Government and Parliament: Petitions, *End Legal Loan Sharking: Cap the Total Cost of Credit Petition* (2012).

<sup>181</sup> The Office of Fair Trading, *Payday Lending Compliance Review - Interim Report* (n 10).

appropriately and in compliance with their legal obligations.<sup>182</sup> Further, since the release of the OFT Compliance Report and the transfer of the consumer credit jurisdiction to the FCA, many firms have either left the market or improved their practices.<sup>183</sup> A report commissioned by the *Association of Chartered Certified Accountants* (ACCA) further shows that the three biggest players in the industry (which account for 70% of market share) 'are among the most responsible lenders operating in the UK'.<sup>184</sup>

Even the wide use of the term 'payday loan' highlights the ongoing assumptions made about this industry. As discussed above, payday loans are a specific subset of high-cost credit.<sup>185</sup> Many firms operating in the industry offer a variety of financial products, including payday loans; nonetheless they are more often than not referred to only as 'payday lenders', making it seem as if this is the only financial product creating difficulties. This is not the case, and all types of high-cost credit have the potential to cause consumer detriment.<sup>186</sup> The incorrect perception of the nature of these financial products is not just

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<sup>182</sup> The Office of Fair Trading, *Payday Lending: Final Compliance Review* (n 12) see esp 10 and 23.

<sup>183</sup> For example, after the OFT issued notices to the 50 biggest payday lenders 19 decided to leave the market instead of responding: Rachel Rickard Straus, 'Almost half of payday lenders quit the market rather than face OFT probe' This is Money <<http://www.thisismoney.co.uk/money/cardsloans/article-2393291/19-payday-lenders-quit-market-face-OFT-probe.html>> accessed 15 August 2013. This has also been shown empirically by the rate of lending in the industry. For example, the FCA originally predicted that a price cap would result in 11% of consumers being unable to obtain access to credit (The Financial Conduct Authority, *Proposals for a Price Cap on High-Cost Short-Term Credit: Consultation Paper* (n 5) para 5.15). This figure was, however, updated to reflect the impact of the enforcement regime and the tighter regulation of the market has resulted in less irresponsible lending, so that it is now believed that only 7% of the market will be unable to obtain credit (The Financial Conduct Authority, *Detailed rules for the price cap on high-cost short-term credit; Including feedback on CP14/10 and final rules* (n 4) 69).

<sup>184</sup> Beddows and McAteer (n 19) 11. The regulatory actions against Wonga and the company's demise have however raised questions about this claim.

<sup>185</sup> For a discussion on the definitional issues associated with high-cost credit, see text of fns 6 to 8.

<sup>186</sup> See, for example, the harm of doorstep credit; Andrew Falconer and Joe Lane, *Debt on Your Doorstep: Problem Debt in the Home Credit Market* (Citizen Advice 2017); Yvonne Roberts, 'As even the higher paid fall into debt trap, charities target money lenders' *The Observer* (6 October 2013) <<http://www.theguardian.com/society/2013/oct/06/broke-britain-doorstep-lending>> accessed 6 October 2013.

a problem in the media,<sup>187</sup> but also for government bodies<sup>188</sup> and even for the regulators themselves.<sup>189</sup> Despite the fact that the FCA officially uses the definition HCSTC for regulatory purposes,<sup>190</sup> most of the communications to the public refer only to 'payday loans', creating a misleading impression of the scope of the industry. This lack of engagement suggests that the regulator may not have an accurate comprehension of who they are regulating, and thus of the consequences of its actions.

There has been minimal research into the motivations and circumstances of people using high-cost credit.<sup>191</sup> Significant disagreement exists between lenders and trade associations on the one hand, and consumer advocates, debtor advisors and consumer lawyers on the other. The lenders and trade associations assert that the 'typical' high-cost borrower is employed, earns a reasonable income, and uses the loans in an educated and responsible manner for one-off expenses or discretionary purchases.<sup>192</sup> They also stress the favourable experiences of borrowers. At its peak, Wonga claimed that 97% of customers feel 'well informed' and that 92% would refer the business to a

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<sup>187</sup> Amelia Gentleman, 'Wonga: the real cost of a payday loan' *The Guardian* <<http://www.theguardian.com/business/2012/mar/01/wonga-real-cost-payday-loan>> accessed 12 February 2013; Becky Barrow, 'Britain has become 'wild west' for payday loan lenders with millions at risk of losing their homes, MPs warn' *MailOnline* (7 November 2012) <<http://www.dailymail.co.uk/news/article-2111332/Britain-wild-west-payday-loan-lenders-millions-risk-losing-homes-MPs-warn.html>> accessed 10 May 2013.

<sup>188</sup> Competition & Markets Authority, *Research into the Payday Lending Market* (n 39).

<sup>189</sup> The Financial Conduct Authority, *FCA confirms price cap rule for payday lenders* (n 172).

<sup>190</sup> The Financial Conduct Authority, *Detailed proposals for the FCA regime for consumer credit* (n 7) 54-55.

<sup>191</sup> One notable exception is Personal Finance Research Centre, *The Impact on Business and Consumers of a Cap on the Total Cost of Credit* (Department of Business and Innovation Skills 2013). This research was focused specifically on the impact of a cap on the total cost of credit and not at developing a general borrower profile. There was some quantitative research completed by the CMA, but it was more concerned with the nature of the market and high-cost products than the motivations of the borrowers; Competition & Markets Authority, *Research into the Payday Lending Market* (n 39).

<sup>192</sup> YouGov, *Consumer Finance Association: Attitudes Towards Payday Loans Amongst Payday Customers & Policymakers* (Sponsored by Consumer Finance Association, 2012).

friend.<sup>193</sup> Further, the *Consumer Finance Association* (CFA) (the leading high-cost credit trade association) stated that 93% of borrowers felt that they were treated with dignity and respect, and 89% believed that the fees and charges were explained clearly.<sup>194</sup> There is also some academic support for high-cost credit. In the report 'Moneylenders and their Customers', Rowlingson identified a number of advantages to high interest, short-term credit; it supplemented the uncertainty of borrower income and stopped people from getting into long-term debt.<sup>195</sup> She asserted that borrowers could 'indeed act rationally since they chose between available and suitable alternatives to achieve particular goals'.<sup>196</sup> The PFRC also concluded that 'borrowing is not the problem *per se*: it undoubtedly helps smooth out the ebbs and flows of income and consumption'.<sup>197</sup>

Consumer advocates, debt advisors, and consumer lawyers in the industry paint a very different picture. Research from *Which?* found that 69% of borrowers regretted taking out a loan or other credit product in the previous year, and that 56% of all borrowers had missed a payment and incurred default charges. The organisation also highlighted that creditors were regularly lending irresponsibly. As examples, 48% of people who have taken out a loan could not afford the repayments, 29% of people have obtained credit that they knew they could not afford to repay in full and on time, and 43% of borrowers believed that it is too easy to obtain credit.<sup>198</sup> This information is supported

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<sup>193</sup> Wonga, 'Wonga.com: Straight Talking Money' (2013) <<http://www.wonga.com/money/about/>> accessed 23 April 2013.

<sup>194</sup> YouGov (n 192).

<sup>195</sup> Rowlingson (n 66) 92-95.

<sup>196</sup> *ibid* 78.

<sup>197</sup> Andrea Finney, Sharon Collard and Elaine Kempson, *Easy Come, Easy Go: Borrowing Over the Life-Cycle* (Personal Finance Research Centre, 2007) 23.

<sup>198</sup> Which?, 'Half of people with payday loans cannot afford to pay back their debts' <<http://press.which.co.uk/whichstatements/half-of-people-taking-out-payday-loans-cannot-afford-to-pay-them-back/#.UYyyvMrsxn4>> accessed 9 November 2012.

by media horror stories – such as that of a 23-year-old man who borrowed £400, ended up with loans from multiple lenders totaling thousands of pounds, and committed suicide over the stress of his precarious financial position.<sup>199</sup>

What is still needed is an in-depth understanding of the borrowers – *who* is using these types of products and *why*, and *what* we should do to address the situation. Research already conducted by regulators, the industry, and non-governmental research bodies tells us that a variety of people access high-cost credit for different reasons. Some borrowers use these types of financial products because they value the speed and convenience that comes with the transaction, and hence are happy to pay a premium for this service.<sup>200</sup> These people are exercising a legitimate and valuable choice. On the other hand, many others are forced to rely on high-cost credit because they are effectively excluded from the mainstream market. They need money and do not have a meaningful choice as to how they obtain it.<sup>201</sup> Until this heterogeneity is recognised and responded to, it will be difficult for the government to regulate high-cost credit in a fair and effective manner.

### 1.2.3: What Can We Do?

We currently have a high-cost credit market where vulnerable consumers are inappropriately blamed for their financial problems, and at the same time as there is a lack of understanding of borrowers, lenders and products. The best way to respond to these

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<sup>199</sup> Ann Edwards, 'Rugby league player, 23, hanged himself 'after getting into huge debt with payday loan companies' *The Daily Mail* (16 April 2013) <<http://www.dailymail.co.uk/news/article-2309797/Kenny-Davies-Rugby-league-player-23-hanged-getting-debt-payday-loan-companies.html>> accessed 19 April 2013.

<sup>200</sup> Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 11; see also discussion in Rowlingson, Appleyard and Gardner (n 123): Appleyard, Rowlingson and Gardner (n 170).

<sup>201</sup> Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 80-81.

two challenges is through detailed, empirical research on the problem. This thesis aims to take the first steps in this regard. The problems associated with the regulation of high-cost credit evolve largely from the simplistic nature of the regulatory debate generally.<sup>202</sup> We have created a dichotomy in our approach to the regulation of high-cost credit, framed as a battle between State intervention (protection) and non-intervention (freedom).<sup>203</sup> This is an unrealistic and ineffective way to look at a particularly complex situation, which involves access to credit for some of the most financially disadvantaged people on our society. A valuable concept of freedom must therefore mean something more than non-intervention into the high-cost credit market. In a similar vein, if we really want to protect financially vulnerable individuals we must do more than merely limit people's access to certain products or prohibit the most harmful aspects of the market. If we truly want to protect borrowers, we need to understand why they are reliant on such expensive and potentially harmful credit. Taking a freedom-based approach is not bad *per se* as disclosure and consumer empowerment are both important. Taking a protection approach is also not wrong – prohibiting harmful products, limiting interest and restricting business models may be necessary to protect vulnerable borrowers. Both concepts are important and can be useful in the right situation; individually they are an inadequate response. Something more is needed. Chapters 2 and 3 provide a detailed analysis of both freedom and protection, including the history, meaning, justifications and limitations of the two concepts. Chapter 4 introduces a third concept that is very important but too often overlooked – the provision of welfare and a social minimum. Having a better

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<sup>202</sup> The Office of Fair Trading, *Consumer Credit Deregulation: A Review by the Director General Of Fair Trading of the scope and operation of the Consumer Credit Act 1974* (n 96); Don Pittis, 'Payday loan crackdown vs. the freedom to get dangerously into debt' CBC News, 6 June 2016 <<http://www.cbc.ca/news/business/payday-lending-freedom-exploitation-1.3614559>> .

<sup>203</sup> This is discussed in Joseph Raz, *The Morality of Freedom* (Oxford University Press 1988) 5-15. See also comments by P. S. Atiyah, 'The Liberal Theory of Contract' in P. S. Atiyah (ed), *Essays on Contract* (Oxford University Press 1990) 46-147.

understanding of the key concepts and philosophical approaches to high-cost credit will provide a solid practical and theoretical basis for empirical research on the topic.

Both the current and previous regulators have recognised high-cost credit as one of the key areas needing further attention. Whilst the government is aware of *a* problem, it currently lacks sufficient information or research identifying the exact *nature of the* problem.<sup>204</sup> It therefore remains unclear exactly who is resorting to these high interest loans, why they are doing so, and the impact that this type of lending has on their general and financial wellbeing. Gibbons from *The Centre for Responsible Credit* notes that unlike other countries, the UK has yet to conduct a ‘rigorous study of the long-term effects of a payday loan on living standards and essential budgets’.<sup>205</sup> Thus, during a period of immense regulatory scrutiny and legislative change, there is no accurate profile of borrowers that can pinpoint the nature and extent of the problems that need to be addressed. This thesis fills the gap by creating a profile of high-cost credit borrowers in the UK. Information of this type is crucial to understanding the nature of the problem, and to tailoring regulatory responses in line with the findings. It will also assist in recognising the limitations of the law and identifying what other political processes are needed to address the problems identified.

The victim-blaming approach discussed above is strongly discredited by researchers looking at the systematic disadvantage of more vulnerable groups in our society.<sup>206</sup> It is not supported by academic research or empirical data, which highlights

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<sup>204</sup> In 2010 the OFT highlighted the importance of collecting further information on the high-cost credit market to ensure accurate and useful regulation of the area: The Office of Fair Trading, *Review of High-Cost Credit* (n 21) 52.

<sup>205</sup> Cited in Carl Packman, *Loan Sharks: The Rise and Rise of Payday Lending* (Searching Finance 2012) 59.

<sup>206</sup> See for example Alan Walker, ‘Blaming the Victims’ in Ruth Lister (ed), *Charles Murray and the Underclass: The Developing Debate* (IEA Health and Welfare Unit in association with The Sunday Times 1996) and Ehrenreich (n 169).

how poverty and financial disadvantage is a complex phenomenon and largely the result of systemic and structural disadvantage.<sup>207</sup> As one simple but clear example, there are more people living in poverty and working (6.1 million) than there are living in poverty whilst unemployed (5.1 million).<sup>208</sup> Even so the victim-blaming approach is still ‘favoured by the political Right because it panders to their underlying belief in individual responsibility and minimum intervention by the state in welfare’.<sup>209</sup> The victim-blaming of those who are less fortunate is a strong political and rhetorical tool. Society cannot just blame people who are dependent on high-cost credit for their own misfortune – it is cruel, unjustified and inappropriate in a democratic welfare state. Further research on the causes of high-cost credit dependency will help to dispel the myth that people who utilise this type of financial product are to be blamed for their own debt problems. This is the aim of Chapter 5, where qualitative empirical research will be used to develop a profile for users of high-cost credit. Empirical research in the form of in-depth qualitative interviews with a wide range of stakeholders in the industry is used to create a profile of the key reasons why people are accessing these expensive and potentially harmful financial products. The identification of a profile of borrowers will further discredit the victim-blaming approach, as well as allow the tailoring of regulatory approaches towards the specific circumstances and needs of consumers.

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<sup>207</sup> For a summary of this research see Walker (n 206). See also Rowlingson, Appleyard and Gardner (n 123) and Appleyard, Rowlingson and Gardner (n 170) of which discuss the reality of high-cost credit borrowers and their financial situations.

<sup>208</sup> The Baptist Union of Great Britain and others (n 160) 13.

<sup>209</sup> Walker (n 206) 67.

## Conclusion

This chapter has provided a summary of the high-cost credit environment in the UK, which will serve as background for the analyses in the next three chapters. The first section in this chapter outlined of how high-cost credit is regulated, looking at the historical background, as well as the differing approaches from the OFT and FCA and the direct enforcement mechanisms for consumers. It is clear that neither regulatory approach has worked adequately, and the regulators are struggling to address the vulnerabilities of many consumers. The second section built on the work in the first by discussing the main challenges of high-cost credit, namely the ongoing victim-blaming of debtors and the lack of adequate engagement in the market. It highlights how further research, both empirical and theoretical in nature, is necessary to tackle the current situation and create an effective legal regime.

## Chapter 2 – Freedom

*Individual freedom is not everyone's primary need*  
- Isiah Berlin

### Introduction

This chapter analyses the first of the three key concepts, namely freedom. Freedom is the cornerstone of the common law, including for contracts of high-cost credit. The freedom approach has not completely resulted in non-intervention, but has instead limited interference so as to be based on the process of contracting and not on the content. In the context of high-cost credit, this has meant an approach that ensures consent and avoids coercion or misinformation by lenders. The chapter has five sections. The first analyses the concept of freedom and the English law on negative freedom. The second highlights the history of freedom in high-cost credit, and the third further develops this discussion by looking at the explanations for a negative freedom-based approach. The fourth section outlines a variety of examples of negative freedom for high-cost credit, including restrictions on who can lend, disclosure and advertising restrictions, cooling off rights, the unfair relationship test, and vitiating factors. The chapter concludes by discussing the limitations of the negative freedom approach, including the failure of disclosure, lack of meaningful choice and impact of poverty.

## 2.1: What is Freedom?

Before we can delve into an analysis of freedom, it is important to define what the term means, particularly in the context of high-cost credit. This is no easy task as the definition of freedom is a highly contested (but extremely important) concept that means different things in different contexts. Freedom is a central part of our legal and political system, receiving unparalleled support and respect.<sup>210</sup> So many of the rights that liberal societies hold dear are founded on this concept: freedom of thought, freedom of movement, freedom of speech, and freedom of contract. Two things are however often overlooked when discussing what it means to be free. First, freedoms often come at a price, namely the favouring of an individual's choice over other factors such as the good of the community, prevention of harm, equality, protection of the vulnerable, and welfare of the individual chooser. Second, the meaning of 'freedom' is by no means self-evident. It is therefore important to define and discuss the concept before going any further.

Freedom is the starting point of the English common law on contracts. The oft-cited judgement of Sir George Jessel MR in *Printing and Numerical Registering Co v Sampson*<sup>211</sup> is one of the many examples<sup>212</sup> where freedom of contract is assumed to be the predominant factor when determining the enforceability of potentially unfair contractual arrangements. In holding that an agreement to assign all future patent rights was enforceable, His Lordship commented

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<sup>210</sup> See E.K. Bramstead and K.J. Melhuish (eds), *Western Liberalism: A History in Documents from Locke to Croce* (Prentice Hall Press 1978) ch 1, esp 1-2.

<sup>211</sup> *Printing and Numerical Registering Co v Sampson* (1875) LR 19 Eq 462 (CA).

<sup>212</sup> See also *Fender v St John-Mildmay* [1938] AC 1 (HL), 12 as per Lord Aiken and *Lancashire County Council v Municipal Mutual Insurance Ltd* [1996] 3 All ER 545 (CA), 555-556 as per Simon Brown LJ; Hugh Collins, *The Law of Contract* (4th edn, LexisNexis 2003) esp ch 6.

you are not to extend arbitrarily those rules which say that a given contract is void as being against public policy, because if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of Justice. Therefore, you have this paramount public policy to consider - that you are not lightly to interfere with this freedom of contract.<sup>213</sup>

The primacy of freedom of contract has been the dominant value in the philosophy of contract law, the common law<sup>214</sup> and, until relatively recently, statute law.<sup>215</sup> The courts are therefore hesitant to intervene in an agreement between parties, or to impose substantive requirements of fairness of exchange. A contract will generally not be invalidated merely because of vague notions of 'justice', such as the fact that the terms were harsh, unreasonable or grossly unfair.<sup>216</sup> Traditionally this focus on freedom of contract also covers consumer contracts, including those for the provision of credit.<sup>217</sup> In the context of usury and interest rates, regulation of the relationship between lenders and borrowers arises solely from any government regulation and contractual obligations; there are very limited specific common law duties of care.<sup>218</sup> Even in a high-cost credit setting,

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<sup>213</sup> *Printing and Numerical Registering Co v Sampson* (n 211) 465 (emphasis added).

<sup>214</sup> As stated by Benson, 'the common law conception of contract gives individuals an unfettered liberty to do as they please'; Peter Benson, 'The Unity of Contract Law' in Peter Benson (ed), *The Theory of Contract Law* (Cambridge University Press 2001) 200. This is clearly an exaggeration but makes an interesting point.

<sup>215</sup> Atiyah, 'Contracts, Promises and the Law of Obligations' in Atiyah (ed) *Essays on Contract* (Oxford University Press 1990) 11.

<sup>216</sup> Jack Beatson and Daniel Friedman, 'Introduction: From 'Classical' to Modern Contract Law' in Jack Beatson and Daniel Friedman (eds), *Good Faith and Fault in Contract Law* (Oxford University Press 1997) 8-9.

<sup>217</sup> *ibid* 7.

<sup>218</sup> Beyond those applicable to general contract law protections; Therese Wilson, 'The bank and customer relationship, and *Australian Competition and Consumer Commission v Oceana Commercial Pty Ltd*' (2004) 25 *Queensland Lawyer* 2; *Foley v Hill* (1848) 2 HL Case 28, 9 ER 1002; Lee Aitken, 'A "duty to

freedom of contract reigns supreme in the common law – regardless of the adequacy of consideration, the appropriateness of the loan, or the capacity to repay.<sup>219</sup>

There are many – sometimes conflicting – notions of ‘freedom’. As Berlin observed, ‘almost every moralist in human history has praised freedom. Like happiness and goodness, like nature and reality, it is a term whose meaning is so porous that there is little interpretation that it seems able to resist’.<sup>220</sup> The concept of freedom used in this thesis is ‘negative freedom’, meaning the lack of interference, obstacles or coercion – enabling a person to act unobstructed by others.<sup>221</sup> This can be contrasted with a positive concept of freedom, which advocates that true freedom means something more than non-intervention. Freedom and autonomy, in any valuable or meaningful sense, should equate to more than merely the right to make certain choices or enter into specific contracts.<sup>222</sup> A positive notion of freedom provides people with the *capability* to act upon their own free will.<sup>223</sup> It goes beyond a mere absence of intervention or obstacles, and requires the control of destiny and self-determination.<sup>224</sup>

Negative freedom allows people to enter into contracts of their choosing, on their own terms, and with whom they choose. The emphasis is on individual choice and limited

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lend responsibly" - a new terror for lenders in a consumer's world?' (2007) 18 *Journal of Banking and Finance Law and Practice* 18; Jodi Gardner, *The Challenges of Regulating High-Cost Short-Term Credit: A Comparison of UK and Australian Approaches* (Centre on Household Assets and Savings Management 2014).

<sup>219</sup> Atiyah, ‘The Liberal Theory of Contract’ (n 203); John Cartwright, *Unequal Bargaining: A Study of Vitiating Factors in the Formation of Contracts* (Oxford University Press 1991).

<sup>220</sup> Isaiah Berlin, ‘Two Concepts of Liberty’ in Isaiah Berlin (ed), *Four Essays on Liberty* (Oxford University Press 1958) 168.

<sup>221</sup> Based on the definition in *ibid* 169.

<sup>222</sup> Raz, *The Morality of Freedom* (n 203) 154-155.

<sup>223</sup> See also discussion in Martha Nussbaum, ‘Women and Cultural Universals’ in Martha Nussbaum (ed), *Sex and Social Justice* (Oxford University Press 1999).

<sup>224</sup> Ian Carter, ‘Positive and Negative Liberty’ (*Stanford Encyclopedia of Philosophy*, 2003) accessed 11 November 2016.

government intervention into private affairs – supported by prominent libertarians including Fried,<sup>225</sup> Hayek,<sup>226</sup> Nozick<sup>227</sup> and Friedman.<sup>228</sup> This approach regards the enforcement of an individual's promise as being of the highest importance, generally outweighing other societal values such as fairness and good faith. An example of this is Mill's 'harm principle'. This principle dictates that the only legitimate reason the state can interfere with an individual's freedom is to prevent harm to others; protection of individuals from themselves, physically or morally, is not a sufficient premise.<sup>229</sup> In the context of contracts 'all the law can do is to police the bargaining process, to try and ensure that contracts are indeed the result of free and voluntary ... processes; but once we have done that, the result must be accepted'.<sup>230</sup>

A focus on negative freedom does not mean a complete lack of government intervention, as that would result in the 'law of the jungle', which is clearly unsuited and unjustified for any modern society. Some restrictions and limitations are required, although negative freedom means these are limited. In the context of high-cost credit, the alignment with negative freedom has resulted in a focus on procedural fairness between consumers and lenders.<sup>231</sup> The legal restrictions are aimed at addressing the process by which parties enter into the contract, and not the fairness of the resulting transaction.<sup>232</sup>

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<sup>225</sup> Charles Fried, *Contract as Promise: A Theory of Contractual Obligation* (Harvard University Press 1981).

<sup>226</sup> Friedrich Hayek, *The Constitution of Liberty* (University of Chicago Press 1960).

<sup>227</sup> Robert Nozick, *Anarchy, State and Utopia* (Basic Books 1974).

<sup>228</sup> Milton Friedman, *Capitalism and Freedom* (University of Chicago Press 1963).

<sup>229</sup> John Stuart Mill, *On Liberty* (Longman, Roberts & Green 1859).

<sup>230</sup> Atiyah, *Essays on Contract Law* (n 150) Essay 11, p 347.

<sup>231</sup> Spencer Thal, 'The Inequality of Bargaining Power Doctrine: The Problem of Defining Contractual Unfairness' (1988) 8 *Oxford Journal of Legal Studies* 17, 26. See discussion by Atiyah about the difficulties of separating the two concepts; P. S. Atiyah, 'Contract and Fair Exchange' (1985) 35 *University of Toronto LJ* 1, 5-6.

<sup>232</sup> Steven Smith, 'In Defence of Substantive Unfairness' (1996) *Law Quarterly Review* 138; Mindy Chen-Wishart, 'The O'Brien Principle and Substantive Unfairness' (1997) 56 *Cambridge Law Journal* 60. This

There are two main aspects to procedural fairness; the first ensuring borrowers freely consent to the transaction, and the second preventing coercion by lenders.<sup>233</sup> The common law and legislation relevant to high-cost credit have several provisions designed to ensure procedural fairness, including restrictions on who can lend money, disclosure obligations and advertising restrictions, cooling off rights, the unfair relationship test, and vitiating factors.

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debate then moves on to whether protection can be justified by reference only to procedural fairness, or whether substantive fairness can also be a valid aim: see discussion from an English perspective in Séverine Saintier, 'Defects of Consent in English Law' in Larry DiMatteo and Martin Hogg (eds), *Comparative Contract Law: British and American Perspectives* (Oxford University Press 2016). For an American perspective on the debate, see Jeffrey L Harrison, 'Quality of Consent and Distributive Fairness: A Comparative Perspective' in Larry DiMatteo and Martin Hogg (eds), *Comparative Contract Law: British and American Perspectives* (Oxford University Press 2016). It is also discussed in the context of vitiating factors in Mindy Chen-Wishart, 'The Nature of Vitiating Factors in Contract' in Prince Saprai, George Letsas and Greg Klass (eds), *Philosophical Foundations of Contract Law* (Oxford University Press 2014) and Thal (n 231).

<sup>233</sup> Randy E. Barnett, 'A Consent Theory of Contract' (1986) 86 *Columbia Law Review* 269, esp opening comments; Raz, *The Morality of Freedom* (n 203) 88; Gillian Hadfield, 'An Expressive Theory of Contract: From Feminist Dilemmas to a Reconceptualisation of Rational Choice in Contract Law' (1998) 146 *University of Pennsylvania Law Review* 1235; Peter H. Schnuk, 'Rethinking Informed Consent' (1994) 103 *Yale Law Journal* 899, 900.

## 2.2: The History of (Negative) Freedom

This section outlines the important historical role of freedom in the development and regulation of high-cost credit. An awareness of the history of freedom of contract is essential to understanding the challenges we are currently tackling. The historical aspects of freedom of contract are not merely legal and are closely linked with economic, social and political movements. As outlined in Atiyah's historical analysis, 'freedom of Contract is, at that time, by no means exclusively a legal concept or a concept of interest only to lawyers ... [it] began as an economic and even political ideal, which probably had roots in the personal, religious, and intellectual freedoms'.<sup>234</sup> Whilst a detailed discussion of these issues is clearly beyond the scope of the current project,<sup>235</sup> a brief outline of the key historical points is necessary to illuminate the later analysis.

The early laws relating to usury and moneylending rejected notions of freedom of contract, and were strongly focused on the religious prohibition of usury. Whilst the prohibitions were the result of canon law, they clearly applied to the Christian laity and the clergy,<sup>236</sup> and punishment continued to be imposed by the ecclesiastical courts.<sup>237</sup> Although there was some notable variation and uncertainty, the protective approach was largely dominant until 1545 when the first Act to remove the cap on interest was passed.<sup>238</sup> Religious arguments were side-lined with the rise of commerce, and an

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<sup>234</sup> Atiyah, *Essays on Contract Law* (n 150) Essay 12, p 355.

<sup>235</sup> See Atiyah, *The Rise and Fall of Freedom of Contract* (n 150) for this discussion.

<sup>236</sup> R. H. Helmholz, *The Oxford History of the Laws of England. Volume I: The canon law and ecclesiastical jurisdiction from 597 to the 1640s* (Oxford University Press 2004) 378.

<sup>237</sup> John Baker, *The Oxford History of the Laws of England. Volume VI: 1483-1558* (Oxford University Press 2003).

<sup>238</sup> This will be discussed in more detail in Chapter 3.2.1.

approach favouring economic freedom was pursued.<sup>239</sup> The ‘relaxation’ of usury restrictions created a commercial market for credit and allowed increased access to funds for individuals, businesses and the government. This change occurred within the Enlightenment period and the corresponding increase in movement and trade, industrial progression and the creation of a more international world.<sup>240</sup> Money was needed to fund developments, both from commerce and from the State, and this was difficult to achieve with a religious-based prohibition on usury. New ways of thinking about these issues quickly developed to reflect the practicality of the government’s financial needs.<sup>241</sup>

The Enlightenment period is also strongly associated with individual and market-based freedom, with many scholars advocating against government intervention into either economic or individual affairs. This commonly resulted in a move against the historical prohibition of usury and towards freedom. It was however far from universal, and many scholars continued to endorse the religious-based moral condemnation of usury. The initial approach to usury during the Enlightenment period was to morally denounce the charging of interest, but approve the practice on some other ground.<sup>242</sup> For example, Luther compromised by stating that, due to the economic benefits obtained from access to credit and the Crown’s need for additional funds, usury should be tolerated to a limited extent. At the same time, he believed that Christianity should continue its

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<sup>239</sup> Glyn Davies, *A history of money : from ancient times to the present day* (University of Wales Press 1994) 221.

<sup>240</sup> Yaron Brook, ‘The Morality of Moneylending: A Short History’ *The Objective Standard* <<https://www.theobjectivestandard.com/issues/2007-fall/morality-of-moneylending/>> accessed 3 June 2015.

<sup>241</sup> For more discussion on this, see Graeber (n 154) esp ch 11.

<sup>242</sup> See, for example, Martin Luther, *Von Kauffshandlung vnd Wucher (On Trading and Usury)* (Durch Hans Lufft 1524) Usury; written without page numbers ‘There are some who not only deal in little sums, but also take too much return – seven, eight, nine, ten percent. The rulers ought to look into this. Here the poor common people are secretly imposed upon and severely oppressed. For this reason these robbers and usurers often die an unnatural and sudden death, or come to a terrible end ... for God is a judge for the poor and needy, as He often says in the Old Law’.

prohibition on all forms of interest charging, and that usury should be morally condemned in the strongest manner possible. In addition, the charging of interest should never be permitted in small sums and/or to the poor, as it was 'God's will that the needy shall be helped by loans or gifts'; thus the moral stance against moneylending was retained, although there was a begrudging acceptance of usury in commercial settings.<sup>243</sup> Luther justified the differences in practice and theory on the grounds of the value of freedom and the need for a strong separation between Church and State, acknowledging that different borrowers should be treated differently.<sup>244</sup>

Whilst the early Enlightenment approach to charging interest was based largely on religion, 'towards the end of the eighteenth century, principles of political economy were gaining ground in public estimation, and common experience showed that the usury laws were injurious to legitimate trade and commerce'.<sup>245</sup> Classic free-market economic arguments prevented the imposition of interest rate caps.<sup>246</sup> By the end of the eighteenth century almost all commentators in Britain (and the Continent) had accepted the legitimacy of interest-bearing loans, and the benefits that an open credit market had on commerce and finance.<sup>247</sup> The economic benefits of interest charging were advocated by Salmasius and Turgot, with the latter also emphasising the property rights of the moneylender as a reason to permit usury.<sup>248</sup>

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<sup>243</sup> *ibid* The Two Kingdoms.

<sup>244</sup> *ibid* God's Laws and Secular Laws.

<sup>245</sup> Bellot (n 54) 28-29. See also William Hawkins, *A treatise of the pleas of the crown, or, A system of the principal matters relating to that subject, digested under proper heads*, vol 1 (Printed by Eliz. Nutt, (executrix of J. Nutt, assignee of E. Sayer) for J. Walthoe 1721), 613, ss 3-4 (vol 1).

<sup>246</sup> Rougeau (n 68) 2.

<sup>247</sup> Joseph Persky, 'From Usury to Interest' (2007) 21 *Journal of Economic Perspectives* 227, 230.

<sup>248</sup> See discussion in Brook (n 240).

This approach to usury was not, however, universal. Smith, widely referred to as the ‘Father’ of free-market capitalism, was a strong advocate of *laissez-faire* economics. It is often considered surprising that, in his seminal 1776 work *The Wealth of Nations*, Smith came out strongly in favour of an interest rate ceiling.<sup>249</sup> While he did not believe in a strict prohibition on usury,<sup>250</sup> Smith did advocate for restrictions on the amount of interest that could be charged. He believed that the interest rate should be set only slightly higher than the market rate. Smith wanted to protect low-*risk* borrowers (as opposed to low-*income* borrowers) and allow them to continue to invest in socially useful activities. This was again recognising that there are different types of borrowers, who should to be treated differently. He was concerned that an unregulated market would mean ‘the greater part of the money [would] be lent ... to prodigals and projectors, who alone would be willing to give [a] high interest rate’.<sup>251</sup> Accordingly the focus was not at all on protection of those less fortunate, but instead on ensuring that there was sufficient credit available to provide funds to people who would use the money in a wealth-maximising manner.

Smith also warned that an interest rate must not be set lower than the market rate or people would merely find multiple ways to evade the law, and so it would be useless to society.<sup>252</sup> His strongest concern about the capping of interest was the fact that it had the potential to increase the cost of credit generally. The debtor would be required to pay not just for the interest, but for the ‘risk’ the creditor was taking in illegally lending

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<sup>249</sup> Giuseppe Coco and David De Meza, ‘In Defense of Usury Laws’ (2009) 41 *Journal of Money, Credit & Banking* 1691, 1691.

<sup>250</sup> Adam Smith, *An inquiry into the nature and causes of the wealth of nations* (The Modern Library 1937), Book II, 4.13.

<sup>251</sup> *ibid* Book II, 4.15. ‘Prodigals and projectors’ have been described as ‘various financial promoters of highly dubious projects aimed at fleecing the public of their savings’: Persky (n 247) 235.

<sup>252</sup> Smith (n 250) 4.15.

the money (ie any penalty they may incur from the unauthorised lending). Smith feared that the borrower 'is obliged, if one may say so, to insure his creditor from the penalties of usury'.<sup>253</sup> It would be the debtor who suffered the consequences of the cap, not the lender. This concern is repeated throughout history, and has even been used relatively recently by the current regulator as a warning on the potential externalities of interest rate caps.<sup>254</sup>

Smith's view on interest was further illuminated in his *Lectures on Justice, Police, Revenue and Arms*. He highlighted that the level of interest, just like any other commodity, is determined by supply and demand.<sup>255</sup> Smith did, however, comment that the transaction of lending money raised another factor that must be considered in the determination of the level of interest charges, which is the risk that the money may not be repaid to the lender.<sup>256</sup> Smith was a utilitarian, and his approach to capitalism was based on the social benefits from a laissez-faire approach to economics. He therefore did not address issues of vulnerability, exploitation or lending to the poor, preferring to see interest (and the regulation of it) as just another commodity. Unfortunately this limited focus and failure to understand the relationship between high-cost credit and social policy is an ongoing theme in the approach taken to these financial products.

Bentham strongly argued against Smith's views on usury in his book *A Defence of Usury* – and was clearly shocked by his mentor's stance on this issue. He believed that people were best placed to make their own decisions regarding credit and interest. Taking

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<sup>253</sup> ibid 339.

<sup>254</sup> See discussion in Tim Wallace, 'Cap on payday loan rates may hurt vulnerable' *City AM* (11 April 2013) <<http://www.cityam.com/article/cap-payday-loan-rates-may-hurt-vulnerable>> accessed 12 April 2013.

<sup>255</sup> Adam Smith, *Lectures on justice, police, revenue and arms* (Edwin Cannan ed, Clarendon Press 1896) 220.

<sup>256</sup> ibid 221.

a laissez-faire approach to public regulation,<sup>257</sup> Bentham argued against government limitations on usury. The book was universally and internationally acclaimed, but was unsuccessful in changing Smith's mind on the topic.<sup>258</sup> Whilst *A Defence of Usury* is often cited as a purely economics-based argument against government limitations on interest – and indeed the focus is largely on highlighting the negative impact that restrictions would have on economic growth – there is a fleeting discussion of the concept of individual rights and freedoms.<sup>259</sup> Bentham contended a range of alternative arguments (in addition to the philosophical justifications) permitting interest to be charged. He advocated that it would be better for the borrower, lender and State to have a more open credit market.<sup>260</sup> This included the belief that ongoing prohibition of usury may allow illegal lenders to grow and prosper.<sup>261</sup> He also believed that usury could not accurately be described as a 'crime', considering that the 'victim' in the scenario (ie the borrower) had consented to the transaction. If consent for the usurious transaction was obtained improperly or

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<sup>257</sup> Bentham was a strong advocate of utilitarianism, and focused on maximizing social utility and nowhere is this more obvious than Bentham's production of Jeremy Bentham, *A Manual of Political Economy* (McMaster University Archive for the History of Economic Thought 1843) which is a 'direct utilitarian calculation of the likely consequences could be employed to determine the appropriateness of government action': J Crimmins, 'Political Economy and Projectors: Bentham's Defence of Usury' in T Artemieva and M Mikeshin (eds), *The Philosophical Age, The Science of Morality: J Bentham and Russia* (St Petersburg Center for the History of Ideas 1999) 67.

<sup>258</sup> Smith openly approved of Bentham's work in the area but it did not change his mind on the matter. When Bentham was working on the second edition of the manuscript, he wrote to Smith asking for an open admission that Smith now favoured a more open approach to lending laws, Smith reportedly responded with a dedicated copy of *The Wealth of Nations* as a response: Crimmins (n 257) 61. This is also discussed in Persky (n 247) 234.

<sup>259</sup> 'My neighbours, being at liberty, have happened to concur among themselves in dealing at a certain rate of interest. I, who have money to lend, and Titus, who wants to borrow it of me, would be glad, the one of us to accept, the other to give, an interest somewhat higher than theirs: Why is the liberty they exercise to be made a pretence for depriving me and Titus of ours?': Bentham, *Defence of Usury; shewing the impolicy of the present legal restraints on the terms of pecuniary bargains. In a series of letters to a friend. To which is added, a letter to Adam Smith, Esq; LL.D. on the discouragements opposed by the above restraints to the progress of inventive industry* (n 158). All Bentham quotes have cited with minor translation amendments so that they are in modern English.

<sup>260</sup> *ibid* Letter VI, commencing at 56, see particularly 67-71.

<sup>261</sup> *ibid* at, for example, 75-76.

exploitatively, this was an issue of fraud or duress and not the 'crime' of usury.<sup>262</sup> Bentham also argued that credit is the same as any other good or service, and therefore failed to see why it was appropriate to fix the cost of credit when there were no other similar restrictions in the market.<sup>263</sup>

One of the most famous early legal works on usury, *A treatise upon the law of usury and annuities*,<sup>264</sup> was written in 1797 by Plowden, then a Barrister-at-Law. This book addressed (and rejected) the religious prohibition on charging interest, explicitly declaring it to be a matter for civil law to address. The book opens by highlighting how usury had been morally condemned throughout history, largely on the basis of religious prohibition of the concept.<sup>265</sup> Plowden argued that the regulation of usury is a legal issue, and that debate on the topic should not be overshadowed by moralist and religious stances. Whilst citing Biblical passages condemning usury,<sup>266</sup> he departed from the earlier work of Aristotle and Aquinas by stating that 'a mere loan at interest or upon Usury appears not from its nature criminal or sinful before God'.<sup>267</sup> He reasoned that due to the impact the

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<sup>262</sup> See further discussion in Crimmins (n 257) 62.

<sup>263</sup> Bentham, *Defence of Usury; shewing the impolicy of the present legal restraints on the terms of pecuniary bargains. In a series of letters to a friend. To which is added, a letter to Adam Smith, Esq; LL.D. on the discouragements opposed by the above restraints to the progress of inventive industry* (n 158) Letter IX.

<sup>264</sup> Frances Plowden, *A treatise upon the law of usury and annuities by Francis Plowden of the Middle Temple, Barrister at Law* (Printed for J. Butterworth, Fleet-Street 1797). All Plowden quotes have cited with minor translation amendments so that they are in modern English.

<sup>265</sup> 'Such have at all times been the general prepossessions against Usury and Usurers, that it is scary possible to speak temperately upon the subject without given scan or offence to a large portion of mankind. If we form our opinion of Usury upon the general doctrine of divines, or the rigorous feverity with which legislators have generally punished the Usurer, we shall necessarily place it at the head of the ... table of offenses against God and man. Usury has almost at every age and every civilized country been the invariable theme of censure to the moralist': *ibid* 10.

<sup>266</sup> *ibid* 11-12.

<sup>267</sup> *ibid* 13.

law has on the actions of individuals, the position of usury had moved beyond a religious matter and could only be held unlawful through a legal process.<sup>268</sup>

Plowden also noted that under English laws the charging of interest at certain levels was acceptable. He was therefore critical of the religious approach, stating that the ‘whole Christian world was kept for centuries in embarrassment and perplexity [by] condemning in theory what [was] continued to practice’.<sup>269</sup> Here we start to see movement away from religion and towards individual and economic freedom. Plowden did condemn lending to the poor, and commented that there were justifications to prevent these sorts of activities. He declared ‘every species of oppression and extortion upon the poor and distressed directly militates against this law of nature; and therefore the acts are prohibited’.<sup>270</sup> This did not mean that all acts of usury should be illegal, or that wealthy parties have an obligation assist those in need. Plowden advocated instead for a prohibition on loans of money only where the agreement was obtained through corruption.<sup>271</sup> He argued for a system of moneylending based on legislative restrictions of interest and not a prohibition on charging interest completely, and limited restrictions on loans that were unconscionable. This indicated an ongoing movement towards a freedom-based focus, but kept some minimal protection of those who were financially struggling and could be easily exploited.

Mill’s ‘harm principle’ continued the progression towards a focus on individual liberty and economic freedom.<sup>272</sup> The government’s role is merely to enforce contractual

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<sup>268</sup>     ibid 13.

<sup>269</sup>     ibid 26.

<sup>270</sup>     ibid 25.

<sup>271</sup>     ibid 220-221.

<sup>272</sup>     Mill (n 229).

agreements between parties – even if they are usurious in nature. Mill was morally against usury, stating that it was absolutely appalling and the outcome of wasteful and immoral trading arrangements.<sup>273</sup> He proclaimed that usury allowed situations where the lender ‘draws from capital which he does not possess, usurious interest, out of proportion with the capital he actually owns’.<sup>274</sup> Whilst this may appear to place the blame on the lender, Mill was critical of the overall system that permitted these transactions. He theorised that usury allowed people to make money solely from the ownership of money, and not from their own labour or goods.<sup>275</sup> Despite this, Mill did not believe that the state should regulate the cost of credit. In *Principles of Political Economy*, Book V, ‘The Influence of the Government’, he included usury laws under the heading ‘Of An Interference of Government Grounded on Erroneous Theories’.<sup>276</sup> Mill believed that restrictions on usury were based on irrational religious beliefs and not on economically sound justifications.<sup>277</sup> He therefore saw no adequate reason for the State to intervene and undermine the individual’s contractual freedoms.

The history of the freedom-based approach to high-cost credit provides a very useful insight into the current challenges associated with these financial products. The Enlightenment Period resulted in a movement away from the traditional religious prohibition of usury, and towards a focus on freedom. The early Enlightenment scholars continued to condemn usury on moral or religious grounds, but allowed it to continue for practical reasons associated with the freedom of economic markets and the moral

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<sup>273</sup> John Stuart Mill, *On Socialism* (Lewis S Feuer ed, Prometheus Books 1987) 37.

<sup>274</sup> *ibid* 39-40.

<sup>275</sup> *ibid* 9.

<sup>276</sup> John Stuart Mill, *Principles of Political Economy* (Longmans, Green & Co 1891) Book X, Chapter VI, 605.

<sup>277</sup> John Stuart Mill, *Principles of political economy, and, Chapters on socialism* (Jonathan Riley ed, Oxford University Press 1994) 306.

importance of freedom in individual affairs. This resulted in a movement away from State intervention and, on the cusp of the twentieth century, the desire to protect people from moneylending transactions had largely disappeared. It was replaced with a belief in the rational man principle and/or overridden by the importance of individual freedom and liberty. This approach continued to be the dominant mode of regulation until the FCA's takeover and the subsequent high-cost credit reforms discussed above.

### 2.3: Explanations for (Negative) Freedom

The negative freedom focus has been the dominant regulatory approach for high-cost credit contracts, but why has this occurred? This section builds on previous discussion by looking at the historical explanations for a freedom-based approach. Four are put forward, namely:

- 1) the important role of consent;
- 2) the lack of protection for social and economic rights (when compared with protections of civil and political rights) under human rights conventions;
- 3) the role of Thatcherism and the 'financialisation' of society after 1979; and
- 4) the distinction between defective financial products and defective physical products.

Each of these explanations (and their limitations) will be discussed. The first two explanations are general to contract law, and the second two are more specifically focused on high-cost credit.

#### 2.3.1: Consent

Liberal tradition has placed great importance on people's ability to voluntarily undertake obligations to one another and to rely on them once undertaken, and thus valued (and in turn shaped) the legal practice of recognising and enforcing these obligations.<sup>278</sup> The freedom-based approach decrees that the government's role in contract law is merely to provide a sufficient framework for the creation and enforcement of agreements between parties. This allows autonomous individuals to impose obligations on themselves as an

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<sup>278</sup> Dori Kimel, 'Neutrality, Autonomy, and Freedom of Contract' (2001) 21 *Oxford Journal of Legal Studies* 473, 473. See also Dori Kimel, *From Promise to Contract: Towards a Liberal Theory of Contract* (Hart Publishing 2003)

exercise of their free will.<sup>279</sup> Schnuk outlines how consent is the cornerstone of English contract law, commenting that it ‘expresses the primacy of individualistic values in our culture. To say that one cannot be bound by a promise that one did not voluntarily and knowingly make is to say that the individual should be the author of her own undertakings’.<sup>280</sup> Consent and freedom are intrinsically linked; we support a freedom-based approach because we care about the parties’ consent.<sup>281</sup>

The current approach to contract law is strongly focused on determining the presence (or absence) of consent to legal transactions. Contracts are enforced when the parties have consented; conversely contracts are not enforced when parties do not consent, or when their consent is defective. Consent has powerful consequences as it acts as an indication of the parties’ intentions, and attributes legal responsibilities to them. For a contract to be binding, the parties must voluntarily consent to that contract. This is not a controversial statement – it is widely accepted that valid consent is necessary for a contract to be enforceable.<sup>282</sup> The question is therefore not whether defective consent will prevent a contract from being enforceable, but rather *what is* defective (or valid) consent in the context of high-cost credit?

Consent is a complex phenomenon and subject to external influences. Hadfield contends that behaviour is driven by various influences beyond an individual’s control, including biological, psychological and sociological factors.<sup>283</sup> If an individual’s voluntary

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<sup>279</sup> Fried (n 225). See also Brian Bix, ‘Contracts’ in Franklin Miller and Alan Wertheimer (eds), *The Ethics of Consent: Theory and Practice* (Oxford University Press 2009) 251.

<sup>280</sup> Schnuk (n 233) 900.

<sup>281</sup> For a further discussion on the limitations on this link, see Alain Marciano, ‘Freedom, Choice and Consent. A Note on a Libertarian Paternalist Dilemma’ (2015) 32 *Homo Oeconomicus* 287.

<sup>282</sup> Barnett (n 233) esp opening comments; Raz, *The Morality of Freedom* (n 203) 88.

<sup>283</sup> Hadfield (n 233).

and informed consent is unacceptably limited, the mere notion of 'choice' is not sufficient to ground contractual obligations.<sup>284</sup> It is therefore important to recognise that choice and consent are not as clear-cut as they are often presented. Consent and capacity are 'constitutive of who we are and how we develop as individuals and as communities'.<sup>285</sup> The limited approach often taken to the definition of consent under the common law is not sufficient for high-cost credit borrowers. As outlined by Atiyah

consent alone, without inquiry into the reasons for which the consent was given, seems a barren thing. It is, indeed, an example of formal reasoning, which can easily become formalistic if not fetishistic, to insist that consent must bind, no matter what the reasons for which consent was given.<sup>286</sup>

We need to go beyond narrow questions of negating contracts on the basis of 'defective' consent, and focus on a more meaningful definition of consent. True consent requires more than mere acquiescence to the promise or agreement in question; the promisee must be able to make an informed judgment on their own situation and best interests.<sup>287</sup> A meaningful concept of consent requires people to have a range of worthwhile choices from which to pick.<sup>288</sup> As previously discussed,<sup>289</sup> a number of common factors in high-cost credit scenarios undermine borrowers' ability to validly consent, including the use of legalistic and complex standard form contracts, provision of easy credit to vulnerable consumers, and the inequality of bargaining power.

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<sup>284</sup> *ibid* 1251.

<sup>285</sup> *ibid* 1260.

<sup>286</sup> Atiyah, *Essays on Contract Law* (n 150) Essay 11, p 353. See also discussion in Chen-Wishart, 'The Nature of Vitiating Factors in Contract' (n 232) 295-296.

<sup>287</sup> Raz (n 203) 155.

<sup>288</sup> *ibid* 151-155; Schnuk (n 233) 900.

<sup>289</sup> See discussion in the Introduction in the texts of fns 24 to 49.

### 2.3.2: Human Rights Approaches

The second explanation for a negative freedom approach is based on society's approach to human rights. The majority of human rights protections are focused on civil and political rights, and not on basic economic rights. This comes from a largely Western perception regarding which rights are of paramount importance.<sup>290</sup> The predominant human rights instrument, the Universal Declaration of Human Rights (UNDHR), includes the right to:

- equal protection and freedom from discrimination (Article 7)
- effective court or tribunal remedies (Articles 8, 10 and 11)
- freedom of movement (Article 13)
- a nationality (Article 16)
- own property (Article 17)
- freedom of thought, opinion and assembly (Articles 18, 19 and 20)
- take part in democratic processes (Article 21)
- work (Article 23)
- rest and leisure (Article 24)

Only one article in the UNDHR provides protection for economic rights.<sup>291</sup> Article 26(1) states that all people should have 'the right to a standard of living adequate for the health and well-being of himself and of his family'. This was, however, followed by Article 26(2), which focuses on the civil right of equality between children born in and out of wedlock.

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<sup>290</sup> Emily Badger, 'Are Economic Rights Fundamental Human Rights?' (2009) <<https://psmag.com/are-economic-rights-fundamental-human-rights-524ede71ed88#.3wmf7jymh>> accessed 21 November 2016.

<sup>291</sup> Fredman has however questioned whether there is any difference between social and economic rights when compared with civil and political rights; Sandra Fredman, *Human Rights Transformed: Positive Rights and Positive Duties* (Oxford University Press 2007) esp chs 7 & 8.

The one human right that protects economic rights was not considered important enough to be a free-standing right on its own, and was instead linked with political issues of family and prevention of child-marriage. This puts the right to an adequate standard of living in context, highlighting that it is implicitly limited to issues of family living standards and not a right in and of itself.

Whilst political and civil rights are valid and worthy of protection, the UNDHR reflects a predominately Western approach to what is considered important. Posner argues that one of the reasons why there was such hesitation to enshrine economic rights was the disagreement between the United States and the Soviet Union on what rights should be protected. The United States favoured civil and political rights, whereas the Soviet Union focused more on social and economic rights. Hence the former was associated with libertarian democracies and the latter with socialist states. Many Asian countries have chosen to restrict political and civil rights in favour of economic progression. For example, China and India – two countries responsible for lifting almost one billion people out of extreme poverty<sup>292</sup> – have come under significant criticism for their approaches to human rights and for preferring economic development to political liberalism.<sup>293</sup> It took another 18 years after the UNDHR to develop a treaty that provided anything close adequate recognition of social and economic rights, namely the 1976 International Covenant on Economic, Social and Cultural Rights.<sup>294</sup>

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<sup>292</sup> The Economist Newspaper Limited, 'Towards the end of poverty' (2013) <<http://www.economist.com/news/leaders/21578665-nearly-1-billion-people-have-been-taken-out-extreme-poverty-20-years-world-should-aim>> accessed 21 November 2016.

<sup>293</sup> Badger (n 290). See also, discussion in Eric Posner, 'Human Rights - the long read: The Case Against Human Rights' (*The Guardian*, 4 December 2014) <<https://www.theguardian.com/news/2014/dec/04/-sp-case-against-human-rights>> accessed 15 November 2016.

<sup>294</sup> Posner (n 293).

This Westernised approach to human rights is reflected in the libertarian focus of the English legal system, which is much more comfortable protecting people's negative liberty than actively promoting positive concepts of freedom.<sup>295</sup> A connection can be drawn between civil/political rights and the negative freedom approach.<sup>296</sup> This provides a degree of justification for the lack of regulation of financial products, including high-cost credit. It is, however, ultimately unconvincing. Research has increasingly highlighted the importance of providing people with both social/economic rights and civil/political rights – as Satz and Green show, the two are inherently linked.<sup>297</sup> The recent global financial crisis has confirmed the importance of social and economic rights, with increasing numbers of people in some of the most privileged and economically developed countries struggling to provide themselves with basic food and shelter.

The positive and negative notions of freedom do not conflict or compete with each other. There needs to be some scope for negative freedom and protections for civil and political rights, but this must be bounded to some extent by protection of economic and social rights. Intervening and limiting vulnerable people's right to access potentially harmful financial products does undermine people's negative liberty, but it also enhances their ability to contribute actively to our society and to live meaningful lives. The benefits can therefore outweigh the detriments.

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<sup>295</sup> See discussion in Part 2.3.2 of this thesis.

<sup>296</sup> There is also a connection between substantive fairness and protection of social and economic rights.

<sup>297</sup> Debra Satz, *Why some things should not be for sale: the moral limits of markets* (Oxford University Press 2010) 100-105; T. H. Green, 'Liberal Legislation and Freedom of Contract' in Paul Harris and John Morrow (eds), *Lectures on the Principles of Political Obligation and Other Writings* (Cambridge University Press 1986); See also quote from Messer and Cohen: 'Country case studies across the developing world demonstrate that those denied civil liberties suffer disproportionately from social injustices and material deprivations, including food insecurity, hunger-related disease, malnutrition, and preventable child mortality. The significance of freedom of speech, a free press, and freedom of assembly for the protection of economic rights, including the right not to starve, connects food security to democracy and good governance': Ellen Messer and Marc J. Cohen, *Approaches to Food and Nutrient Rights, 1976-2008* (2009). This will be further discussed in Part 4.3.1.

### 2.3.3: Responsibilisation and Financialisation

Since 1979 the UK has undergone a process of ‘responsibilisation’, where individuals are expected to become increasingly responsible for their own financial wellbeing, as opposed to relying on the State for assistance. This is closely linked to the victim-blaming discussed in Chapter 1,<sup>298</sup> as it places accountability for financial decisions on individuals, consequently allowing them to be blamed if and when things go wrong. Governments from the 1980’s onwards have increasingly promoted the idea of an active welfare state to replace the supposedly passive welfare system. Such ideas were accepted by New Labour’s Third Way approach, which supported the idea of a modern, active welfare state based on welfare-to-work, and the development of skills and flexibility to support those in work or those actively seeking work.<sup>299</sup> The 1997 New Labour (and more recent Coalition and Conservative) governments extended this notion of obligations alongside rights through the personalisation of welfare and the strengthening of responsibility agendas, identifying the root causes of poverty with the individual problems rather than any structural issues. For example, Tony Blair suggested in 2002 that welfare reform is essential to ‘restor[e]...civic responsibility’ by making ‘new contract between citizen and state, a contract that says with rights come responsibilities and obligations’.<sup>300</sup>

Under New Labour, the Gregg Review and the *Department for Work and Pensions* (DWP) proposals for welfare reform aimed to reward responsibility. The welfare system adopted an active, personalised role to widen the obligations on people to both work and

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<sup>298</sup> See discussion at Part 1.2.1.

<sup>299</sup> Fran Bennett and Jane Millar, ‘Social Security: reforms and challenges’ in Jane Millar (ed), *Understanding Social Security: Issue for Policy and Practice* (Policy Press 2003) 20.

<sup>300</sup> Tony Blair, ‘My vision for Britain: by Tony Blair’ *The Observer* (10 November 2002) <<http://www.guardian.co.uk/politics/2002/nov/10/queensspeech2002.tonyblair?CMP=email>> .

save. Labour continued the reforms begun by the Thatcher and Major Conservative governments by further implementing pension reforms, which were marketed as providing the public with greater information and choice, and to encourage individual responsibility for savings and borrowing behaviour.<sup>301</sup> This focus was also evident in Tony Blair's modernising agenda, which aimed to create a market-oriented 'third way' of delivering welfare by removing the responsibility from the government and transferring it to other agencies.<sup>302</sup> These changes have reconfigured the relationship between individuals and the state so that citizens actively participate in their own social and economic wellbeing. The responsibility of providing credit to low-income people was transferred from government bodies (through the social fund) to commercial entities by deregulation and the opening of the lending market.<sup>303</sup>

The responsibility discourse emerged alongside the 'financialisation' of everyday life, with increased access to the private financial market.<sup>304</sup> Successive British governments encouraged and expanded the financial services sector from the mid-1980s onwards through de-regulation and the introduction of 'light-touch' regulation. This approach to regulation facilitated an expansion of personal lending from the 1970s onwards. Whilst mortgage lending has declined since 2008, there has been a corresponding increase in other types of borrowing, particularly high-cost credit.<sup>305</sup> This

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<sup>301</sup> Neil Gilbert, *Transformation of the welfare state: The silent surrender of public responsibility* (Oxford University Press 2002).

<sup>302</sup> John Clarke, Mary Langan and Fiona Williams, 'Remaking welfare: the British welfare regime in the 1980s and 1990s' in Allan Cochrane, John Clarke and Sharon Gewirtz (eds), *Comparing Welfare States* (2nd edn, Sage 2001) 101.

<sup>303</sup> *ibid* 40.

<sup>304</sup> Alan Finlayson, 'Financialisation, Financial Literacy and Asset-Based Welfare' (2009) 11 *The British Journal of Politics and International Relations* 400, 403.

<sup>305</sup> See discussion in Jodi Gardner, 'Responsible Lending and Borrowing' (2018) 2 *Journal of International Consumer Law and Practice* Forthcoming.

financialisation of personal lending facilitated the changed regulatory approaches towards disclosure, consent and competition – further emphasising the State’s focus on negative freedom. As will be discussed in 3.4 below, regulation in the UK is largely focused on the registration of lenders and on disclosure obligations, continuing to put responsibility on borrowers to ensure they read and understand the agreement.<sup>306</sup>

The State’s response towards lending has been to decrease government assistance while increasing access to financial markets, in order to create more individually responsible citizens. These two concepts – responsabilisation and financialisation – are the constant impetus behind the regulation most affecting vulnerable groups in our society. These political movements help to explain the ongoing hesitation to engage with the market and take a more active approach to addressing the problems associated with high-cost credit. They do not, however, provide anything close to a justification. The opening of the financial markets for high-cost credit allowed lenders to develop unfair business practices, and consumers in desperate need of funds have become dependent on these products.

#### 2.3.4: Differing Approaches to Financial and Physical Products

The different approaches taken to defective financial products compared with those for defective physical products further facilitated the negative freedom approach to high-cost credit. There are strong justifications for holding the manufacturers of dangerous products strictly liable for any harm caused, or for going a step further and completely preventing

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<sup>306</sup> Karen Fairweather, ‘Apples and Oranges? Responsible Mortgage Lending in the UK and Australia’ in Paul O’Shea, Karen Fairweather and Ross Grantham (eds), *Credit, Consumers and the Law: After the global storm* (Routledge (Markets and the Law Series) 2016).

the product from entering the market.<sup>307</sup> Financial products have been treated differently from physical items throughout history, although it is not at all clear if the distinction is defensible. States have generally actively intervened to ensure the safety of tangible products, and it is arguable that this approach should be replicated with credit products. In the words of (2020 Presidential Candidate) Warren,

Consumers can enter the market to buy physical products confident that they won't be tricked into buying exploding toasters and other unreasonably dangerous products ... Consumers entering the market to buy financial products should enjoy the same protection.<sup>308</sup>

Unfortunately this is not the case, and governments are often hesitant to intervene in the financial market to the same extent as for physical products. Consumers frequently use high-cost credit in a dangerous manner, resulting in financial hardship or a debt spiral.<sup>309</sup> Grossly unfair contracts are often considered unfair precisely because of their potential for adverse long-term impacts on the autonomy of the individual in question.<sup>310</sup> The government can (and arguably should) restrict a person's short-term freedom of choice in order to ultimately provide them with greater autonomy, or prevent harm to their future autonomy. This includes removing dangerous products from the market if and when necessary.<sup>311</sup> Whilst high-cost credit may deliver temporary relief to individuals, the significant repayment burden is likely to limit future autonomy and choices, and can result

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<sup>307</sup> Roger Traynor, 'The Ways and Meanings of Defective Products and Strict Liability' (1965) 32 *Tennessee Law Review* 363.

<sup>308</sup> Elizabeth Warren, 'Unsafe at Any Rate' [2007] *Democracy: A Journal of Ideas* 8.

<sup>309</sup> See the case studies in Beddows and McAteer (n 19)

<sup>310</sup> Chen-Wishart, 'The Nature of Vitiating Factors in Contract' (n 232) 12.

<sup>311</sup> Raz, *The Morality of Freedom* (n 203) 419. See also Chen-Wishart, 'The Nature of Vitiating Factors in Contract' (n 232).

in extreme financial hardship. The negative impact that these products can have on borrowers and their future autonomy therefore justifies a movement away from the traditional focus of negative freedom. It is important to recognise that harmful financial products can cause just as much damage as dangerous tangible products.<sup>312</sup>

This distinction between physical products and financial products may be defended on the ground that defective credit products cause financial/economic losses, compared with dangerous physical products which have the potential to cause physical harm. The tort laws in numerous countries<sup>313</sup> have limited the ability of people to claim damages for pure economic loss compared with damages for physical injury and mental distress. There are varying reasons for this, but they largely revolve around economic loss being seen as a less important interest to protect,<sup>314</sup> concerns of indeterminate liability, and the focus on compensating physical and psychiatric damage over financial loss. None of these explanations are adequate in the context of high-cost credit. Despite the widespread problems associated with these financial products, they focus on a specific group in society and are limited in both the size of loan and number of loans given.<sup>315</sup> There are few, if any, concerns of indeterminate liability for products that can cause physical damage such as contaminated food, defective household appliances, and flammable clothing, even though all these products are significantly more common in our society than high-cost credit loans. Also, whilst the immediate harm caused by defective

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<sup>312</sup> Luke Nottage, 'Innovating for 'Safe Consumer Credit': Drawing on Product Safety Regulation to Protect Consumers of Credit' in Therese Wilson (ed), *International Responses to Issues of Credit and Over-indebtedness in the Wake of Crisis* (Ashgate Publishing Limited 2013).

<sup>313</sup> *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465, [1963] UKHL 4; *Perre v Apand* (1999) 198 CLR 180; [1999] HCA 36; Mauro Bussani and Vernon Valentine Palmer (eds), *Pure Economic Loss in Europe* (Cambridge University Press 2003); Herbert Bernstein, 'Civil Liability for Pure Economic Loss under American Tort Law' (1998) 46 *American Journal of Comparative Law* 111.

<sup>314</sup> See discussion in *Canadian National Railway v Norsk Pacific Steamship Co* [1992] 1 SCR 1021, (1992) 91 DLR (4th) 289, 383.

<sup>315</sup> See Beddows and McAteer (n 19) for statistics on both.

high-cost credit products is financial in nature, the consequences of these types of credit products can go significantly further than mere economic loss. *StepChange* highlights the harmful nature of high-cost credit products on children's development and family structure,<sup>316</sup> *Shelter* comments that it can contribute to homelessness and rough housing,<sup>317</sup> and research from the *Glasgow Centre for Population Health* states that these products are contributing to physical and mental health problems for the most vulnerable groups in our society.<sup>318</sup>

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<sup>316</sup> StepChange Debt Charity, *Life on the Edge: Towards more resilient family finances* (2014).

<sup>317</sup> Shelter, 'Know the real cost of payday loans' <[http://england.shelter.org.uk/get\\_advice/help\\_with\\_money/loans\\_debt\\_and\\_bankruptcy/payday\\_loans/cost\\_of\\_payday\\_loans](http://england.shelter.org.uk/get_advice/help_with_money/loans_debt_and_bankruptcy/payday_loans/cost_of_payday_loans)> accessed 11 September 2013.

<sup>318</sup> Glasgow Centre for Population Health, *Public Health Implications of Payday Lending* (Briefing Paper 48, 2016). For example, 'public health has a responsibility to recognise payday lending as a contemporary socioeconomic determinant of health and wellbeing': 16-17.

## 2.4: Examples of (Negative) Freedom

This section sets out some examples of how negative freedom has been incorporated into the legal system. In the context of high-cost credit, the alignment of regulation with negative freedom has resulted in a focus on procedural fairness between consumers and lenders.<sup>319</sup> The legal restrictions are aimed at addressing the process by which parties enter into the contract, and not on the underlying fairness of the resulting transaction.<sup>320</sup>

There are two main aspects of procedural fairness; first, ensuring borrowers consent to the transaction<sup>321</sup> and second, preventing active coercion by lenders. The common law and the legislation relevant to high-cost credit have several provisions designed to ensure procedural fairness, including restrictions on who can lend money, disclosure obligations and advertising restrictions, cooling-off rights, the unfair relationship test, and vitiating factors. Each will be discussed in turn.<sup>322</sup>

### 2.4.1: Restrictions on Who Can Lend

In an attempt to prevent exploitation or coercion, the Consumer Credit Act 1974 ('the Act') makes it is an offence for a lender to enter into a consumer credit agreement<sup>323</sup>

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<sup>319</sup> Thal (n 231) 26. See discussion by Atiyah about the difficulties of separating the two concepts; Atiyah, 'Contract and Fair Exchange' (n 231) 5-6.

<sup>320</sup> See discussion in fn 232.

<sup>321</sup> Barnett (n 233) esp opening comments; Raz, *The Morality of Freedom* (n 203) 88; Hadfield (n 233); Schnuk (n 233) 900.

<sup>322</sup> For an interesting perspective on these rights under the Consumer Credit Act 1974 (UK), see Atiyah, *Essays on Contract Law* (n 150) Essay 12, pp 361-263. Atiyah discusses how these provisions are in line with freedom of contract and 'the New Right'.

<sup>323</sup> Defined as 'an agreement between an individual ('the debtor') and any other person ('the creditor') by which the creditor provides the debtor with credit in any amount': Consumer Credit Act 1974 (UK), s 8(1).

without a licence.<sup>324</sup> To obtain a licence, the creditor must make an application and satisfy the regulator that they are a 'fit person' to carry on a consumer credit business.<sup>325</sup> If the OFT wanted to refuse a licence, it needed to provide reasons for the refusal and give the applicant an opportunity to provide supporting information for the application.<sup>326</sup> The requirement that all parties involved in consumer credit lending be licensed was recommended by the Crowther Report<sup>327</sup>, and is arguably its most significant contribution<sup>328</sup> (at least, in principle). The OFT published guidance on how it determined whether a person is 'fit' to obtain a licence.<sup>329</sup> The guidelines were disturbingly vague; they focused on the creditor's 'personal integrity'<sup>330</sup> and 'credit confidence' without providing adequate clarification of these requirements.<sup>331</sup> The guidelines also provided 'examples of the kind of evidence that may involve integrity issues' as opposed to a list of

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<sup>324</sup> Consumer Credit Act 1974 (UK), s 21(1) and definition of 'consumer credit business' in s 189. The only exceptions to this are public authorities (s 21(2)) and 'A body corporate empowered by a public general Act naming it to carry on a business' (s 21(3)).

<sup>325</sup> Consumer Credit Act 1974 (UK), s 25(1); this is now regulated by s 25(1B). To determine whether this criterion is satisfied, the regulator shall have regard to the skills, knowledge and experience of the applicant and other persons participating in the business, and any practices or procedures that the applicant proposes to implement in connection with the business; Consumer Credit Act 1974 (UK), s 25(2).

<sup>326</sup> Consumer Credit Act 1974 (UK), s 27.

<sup>327</sup> Crowther (n 69) 52-60. Named after Sir Geoffrey Crowther who, in 1968, was appointed Head of a Committee to analyse the consumer credit industry and to make recommendations for future reform.

<sup>328</sup> This includes the provision of financial advice and debt management services, Crowther (n 69) Part 7.2.

<sup>329</sup> Consumer Credit Act 1974 (UK), s 25A. This obligation has now been passed to the Financial Conduct Authority.

<sup>330</sup> The Office of Fair Trading, *Consumer Credit Licensing: General guidance for licensees and applicants on fitness and requirements* (2008) 3-4.

<sup>331</sup> *ibid* 6. The OFT has denied licences to three debt management companies on the basis that the organisations 'lacked the necessary skills, knowledge and experience to operate a compliant consumer credit businesses' (The Office of Fair Trading, 'OFT refuses to licence three debt management companies in ongoing drive to push up standards' <<http://www.offt.gov.uk/news-and-updates/press/2013/13-13#.URj3H2fz6So>> accessed 11 February 2013).

prohibited activities.<sup>332</sup> This can be contrasted with the stricter, more prescriptive requirements for determining whether a private landlord is a fit and proper person to be a licence-holder under the Housing Act 2004 (UK).<sup>333</sup>

There were significant concerns with the licensing system under the OFT, and evidence that it did not provide a sufficient safety net for borrowers. As an example of a potential oversight, Olivier Larholt was given a consumer credit licence despite the fact he had served 20 days in jail for possessing a flare pistol with intent to cause fear of violence.<sup>334</sup> Larholt went on to establish Toothfairy Finance, which continued to lend for a number of years despite numerous allegations of harassment,<sup>335</sup> being the subject of a dedicated *Consumer Action Group* fraud warning webpage,<sup>336</sup> and official action from the OFT to address its unsatisfactory business practices.<sup>337</sup> The PAC reviewed the OFT in May 2013 and was scathing of its regulation of the industry, particularly the regulator's lax licensing regime. It reported that

The OFT told us that it ran a "licensing regime" rather than a "supervisory regime" meaning that it didn't look at the firms' activities regularly. Instead the OFT relied

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<sup>332</sup> The Office of Fair Trading, *Consumer Credit Licensing: General guidance for licensees and applicants on fitness and requirements* (n 330) 4.

<sup>333</sup> Helen Carr and others, *The Housing Act 2004: A Practical Guide* (Jordan Publishing Limited 2005) 88-89; see also Housing Act 2004 (UK), ss 88-89.

<sup>334</sup> Packman (n 205) 69.

<sup>335</sup> Carl Packman, 'OFT writes to 240 payday lenders to warn them over poor practices: The legal loan sharks have been cautioned.' *NewStatesman* (21 November 2012) <<http://www.newstatesman.com/economics/2012/11/oft-writes-240-payday-lenders-warn-them-over-poor-practices>> accessed 17 September 2013; Nick Sommerlad, 'This won't hurt a bit, says payday lender Toothfairy Finance' *Mirror.co.uk* <<http://blogs.mirror.co.uk/investigations/2011/09/this-wont-hurt-a-bit-says-payd.html>> accessed 17 September 2013.

<sup>336</sup> Consumer Action Law Group, 'Consumer Action Group Fraud Warning: Toothfairy Finance Limited' (2013) <<http://www.consumeractiongroup.co.uk/forum/forumdisplay.php?334-Toothfairy-Finance-Limited>> accessed 17 September 2013.

<sup>337</sup> The Office of Fair Trading, 'Press Release: 9 November 2010 - OFT acts to improve lending practices' <<http://www.oft.gov.uk/news-and-updates/press/2010/116-10#.Ujsluj8ygmY>> accessed 15 September 2013.

on information received from customer complaints and other third parties such as Citizen's Advice, the FSA and the Financial Ombudsman Service. Although it relied on others to supply it with intelligence the OFT claimed that it was also able to be proactive by picking up emerging themes from this information. However the OFT acknowledged that this approach was not picking up all the problems in the market. The OFT recognised that many people who had problems did not come forward to complain, and we were also concerned that many local Citizens Advice Bureaux did not have the resources to pick up all debt issues and look into debt problems so information they supplied would be incomplete.<sup>338</sup>

Between its inception in 1973 and transfer of the jurisdiction to the FCA in 2015, the OFT only revoked 25 licences, representing approximately 0.03% of the 72,000 licences awarded.<sup>339</sup> In addition, firms were able to continue trading whilst being investigated and also if they had appealed the OFT decision against them.<sup>340</sup> The revocation process took up to two years, during which the firm continued to lend.<sup>341</sup> The licensing regime therefore provided limited assistance in avoiding exploitation, and allowed numerous unscrupulous lenders to continue operating.

The OFT had power to take action against lenders who breached their obligations under the 1974 Act. Lenders, however, had various rights to appeal against decisions made by the OFT regarding licences and the imposition of civil penalties. The 2006 Act included the creation of the Consumer Credit Appeals Tribunal,<sup>342</sup> which has jurisdiction

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<sup>338</sup> Public Accounts Committee (n 101) para 2.8.

<sup>339</sup> *ibid* para 2.9.

<sup>340</sup> *ibid* para 2.10.

<sup>341</sup> *ibid* Recommendation 3.

<sup>342</sup> Consumer Credit Act 2006 (UK), ss 55-58, Consumer Credit Act 1974 (UK), Sch A1.

over appeals from these OFT decisions. The system underwent significant changes when the Consumer Credit Appeals Tribunal was replaced with a First Tier Tribunal (Consumer Credit), which can be appealed to the Upper Tribunal.<sup>343</sup> The Crowther Report recognised the difficulties of enforcement through the court system. It did not, however, make any specific recommendations for the creation of a dedicated tribunal or any alternative dispute-resolution process.<sup>344</sup> The Tribunals are exceptionally under-utilised; between 2008 and 2013 a total of 59 cases were heard by the First Tier Tribunal (Consumer Credit), of which only four have been allowed in full or in part, the vast majority being dismissed, struck out or withdrawn by the licence-holder.<sup>345</sup> This is likely to be related to the OFT's resource difficulties discussed above, as there were so few decisions from which to appeal. The regulator's enforcement actions were limited to only the most heinous breaches, meaning that those businesses were unlikely to appeal the decision and even less likely to be successful on appeal. The underutilisation of the Tribunal was likely a factor in its closure in 2013.

The authorisation regime under the FCA is significantly more proactive than the OFT's approach. The basic conditions of authorisation are found in The Financial Services and Markets Act 2000 (Threshold Conditions) Order 2013 (UK).<sup>346</sup> This sets out a range of 'threshold conditions' that firms must meet. These conditions involve a wide range of requirements, including locating an office in the UK,<sup>347</sup> undertaking activities and providing

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<sup>343</sup> The Transfer of Functions of the Consumer Credit Appeals Tribunal Order 2009 (UK).

<sup>344</sup> Crowther (n 69) see especially 303-307.

<sup>345</sup> HM Courts & Tribunals Service, 'First-tier Tribunal (Consumer Credit): Case Register as at 3rd June 2013' (2013) <<http://www.justice.gov.uk/tribunals/general-regulatory-chamber>> . The HM Courts & Tribunals Service does not appear to have released a Case Register since this time.

<sup>346</sup> This Order amends the Financial Services and Markets Act 2000 (UK) and came into effect on 1 April 2013.

<sup>347</sup> Financial Services and Markets Act 2000 (UK) Sch 6, Part 1B, r 2B.

products that can be effectively supervised by the FCA,<sup>348</sup> ensuring that the business has adequate financial and non-financial resources,<sup>349</sup> and ensuring that the individual is a fit and proper person with adequate skills and experience.<sup>350</sup> These reflect the OFT's licensing regime, but provide more detail on what is required by the firm and the individuals involved in lending. The FCA also states that the firms' 'business model (that is ... strategy for doing business) must be suitable for a person carrying on the regulated activities'.<sup>351</sup> Factors that the FCA will consider in determining whether the business model is suitable include whether the model is being conducted in a sound and prudent manner, the interests of consumers, and the integrity of the financial system.<sup>352</sup> The threshold conditions have also been incorporated into the FCA's Handbook.<sup>353</sup>

All firms licensed under the OFT were required to apply for authorisation under the FCA. Out of the 72,000 licences given by the OFT, only 19,533 applied to be authorised under the new regime by June 2015.<sup>354</sup> Out of these, 93.3% were approved, 6.5% were withdrawn (usually after requests for further information by the FCA), and 0.2% were refused.<sup>355</sup> Since the authorisation process was completed, the FCA has continued to be strongly proactive. In the first two years, the regulator revoked the authorisations of 40

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<sup>348</sup> For further discussion, see The Financial Conduct Authority, *FCA Handbook, COND Threshold Conditions*, COND 2.3 'Effective Supervision'.

<sup>349</sup> Financial Services and Markets Act 2000 (UK) Sch 6, Part 1B, r 2D.

<sup>350</sup> *ibid* Sch 6, Part 1B, r 2E.

<sup>351</sup> *ibid* Sch 6, Part 1B, r 2F.

<sup>352</sup> *ibid* Sch 6, Part 1B, r 2F(2)(a)-(e).

<sup>353</sup> See The Financial Conduct Authority, *FCA Handbook, COND Threshold Conditions* (n 348) COND 2.1.

<sup>354</sup> These statistics are the latest available as at 9 August 2016. It is likely that a small number of firms have sought authorisation since June 2015. If firms do not seek authorisation under the FCA, they are excluded from lending; thus the authorisation process has resulted in a significant reduction in the number of licensed firms.

<sup>355</sup> The Financial Conduct Authority, *Consumer Credit: Authorisations Data Bulletin published June 2015* (2015) 7.

consumer credit firms – compared with just 25 revoked by the OFT in approximately 40 years. In addition, over 1,400 firms have had their authorisation refused or have decided to withdraw their application.<sup>356</sup> The FCA is therefore taking a more rigorous approach to preventing active exploitation and ensuring procedural fairness.

#### 2.4.2: Disclosure Obligations and Advertising Restrictions

Disclosure obligations and advertising restrictions aim to ensure the borrowers' informed consent to the transaction, and to prevent lenders targeting vulnerable consumers.

Disclosure requirements are a keystone of the Act, and creditors have several obligations in this regard.<sup>357</sup> These include the provision of adequate pre-contractual explanations of important terms<sup>358</sup> and a copy of the consumer credit agreement.<sup>359</sup> This area is further regulated by the Consumer Credit (Disclosure of Information) Regulations 2010 (UK).<sup>360</sup>

When oversight of consumer credit was transferred to FCA, the regulator increased disclosure obligations, including requiring a financial warning to be included in advertisements<sup>361</sup> and requiring lenders to provide borrowers who rollover a loan with an

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<sup>356</sup> Tracey McDermott, *Consumer credit regulation: the journey so far: Speech delivered at the Credit Summit 2016 on 7 April 2016* (2016).

<sup>357</sup> The disclosure requirements again largely follow the Crowther Report recommendations. The Report outlined a number of basic principles that should be observed when prescribing the formalities of a consumer credit contract, including that: (a) any requirements should be easy to understand and comply with, (b) relevant information should be made prominent, and (c) the sanctions when lenders breach these formalities should be tailored to the gravity of the offence. The Report also provided specific details about what should be included in different types of loan agreements; it explicitly made reference to the disclosure of the interest rate and recommended that the 'debtor should be told the cost of borrowing in terms of a rate per cent per annum'; *ibid* 271. It was however despondently noted that this may not have much influence on consumer actions, particularly on borrowers in lower income brackets, *ibid* 272.

<sup>358</sup> Consumer Credit Act 1974 (UK), s 55A.

<sup>359</sup> Consumer Credit Act 1974 (UK), s 55C.

<sup>360</sup> See specifically, Consumer Credit (Disclosure of Information) Regulations 2010 (UK), Sch 1, created under Consumer Credit Act 1974 (UK), s 55.

<sup>361</sup> The Financial Conduct Authority, *FCA Handbook, Consumer Credit Sourcebook (CONC)*, para 3.4.

information sheet including how to access free debt advice.<sup>362</sup> This sheet is, however, provided to the borrower after the rollover has occurred, thereby limiting the opportunity for it to inform the borrower's decisions. Despite this, the FCA has continued to focus on increasing borrowers' awareness<sup>363</sup> as a way of preventing exploitative lending. In the light of economic and psychological evidence on the impact of bounded rationality and cognitive bias, the protective potential of consumer disclosure and the impact it has on the decision-making abilities of consumers, without further regulatory action, is subject to significant and valid criticism.<sup>364</sup>

Procedural fairness requires all communications and advertisements to be fair, clear and not misleading. The Act gives power to the Secretary of State to make regulations on the form and content of advertisements for consumer credit products.<sup>365</sup> The resulting Regulations, produced in 1989, 2004 and 2010, provide detailed rules on the general form of advertisements,<sup>366</sup> as well as specific information about the disclosure of the total cost of credit.<sup>367</sup> The *Advertising Standards Authority* (ASA) has been active in preventing the publication of potentially misleading high-cost credit advertisements. It upheld a number of complaints about advertising, including text messages sent to

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<sup>362</sup> *ibid* 6.7.20. See also HM Treasury and Department of Business Innovation and Skills (n 103) 54.

<sup>363</sup> The Financial Conduct Authority, *Detailed proposals for the FCA regime for consumer credit* (n 7) 175.

<sup>364</sup> Bix (n 279) 265-266.

<sup>365</sup> Consumer Credit Act 1974 (UK), s 44. The protection given to borrowers prior to entering into contracts is strongly in line with the suggestions of the Crowther Report. The report recognised the importance of providing borrowers with protection against unfair practices before they enter into contracts with potential creditors; Crowther (n 69) Part 6.4. This includes making it an offence to issue advertisements of consumer credit products that are false or misleading (*ibid* 259) and requiring that relevant financial information (including, but not limited to, the overall cost and effective interest rate of the credit) be published in advertisements (*ibid* 260).

<sup>366</sup> Consumer Credit (Advertisements) Regulations 1989 (UK), reg 2; Consumer Credit (Advertisements) Regulations 2004 (UK), reg 3; Consumer Credit (Advertisements) Regulations 2010 (UK), reg 3.

<sup>367</sup> Consumer Credit (Advertisements) Regulations 1989 (UK), Sch 3; Consumer Credit (Advertisements) Regulations 2004 (UK), Sch 2; Consumer Credit (Advertisements) Regulations 2010 (UK), Sch 1.

customers encouraging borrowing to fund social activities,<sup>368</sup> on-screen advertisements that did not display APRs and other required information<sup>369</sup> or did not display it prominently enough,<sup>370</sup> and on-screen text that was not legible.<sup>371</sup> The ASA upheld a number of complaints made against Cash Lady for its ‘fast cash for fast lives’ advertisements using Kerry Katona, a celebrity famous partly because of her widely-publicised financial difficulties and subsequent bankruptcy.<sup>372</sup> The advertisement was found to be irresponsible as it encouraged people in similar situations to Ms Katona to borrow money from high-cost credit lenders,<sup>373</sup> and the lender advertised itself as a legitimate alternative to banks, despite charging interest of over 2,000% APR.<sup>374</sup> It also held that the phrase ‘fast cash for fast lives’ may give the impression that high-cost loans are not a financial commitment that required consideration and planning.<sup>375</sup> Under the FCA, the ASA continued to ban high-cost credit advertisements in breach of the relevant guidelines.<sup>376</sup> This included an action against Pounds to Pocket for an advertisement

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<sup>368</sup> Advertising Standards Authority, *ASA Adjudication on First Financial (UK) Ltd* (19 June 2013).

<sup>369</sup> Advertising Standards Authority, *ASA Adjudication on CashEuroNet UK LLC* (7 October 2009).

<sup>370</sup> Advertising Standards Authority, *ASA Adjudication on CashEuroNet UK LLC* (31 July 2013).

<sup>371</sup> Advertising Standards Authority, *ASA Adjudication on SRC Transatlantic Ltd* (11 September 2013).

<sup>372</sup> Jessica Winch, ‘Kerry Katona payday loan advert banned’ *The Telegraph* (14 September 2013) <[www.telegraph.co.uk/finance/personalfinance/borrowing/10041767/Kerry-Katona-payday-loan-advert-banned.html](http://www.telegraph.co.uk/finance/personalfinance/borrowing/10041767/Kerry-Katona-payday-loan-advert-banned.html)> accessed 14 September 2013.

<sup>373</sup> Advertising Standards Authority, *ASA Adjudication on PDB UK Ltd* (31 July 2013).

<sup>374</sup> Advertising Standards Authority, *ASA Adjudication on PDB UK Ltd* (8 May 2013).

<sup>375</sup> Advertising Standards Authority, *ASA Adjudication on PDB UK Ltd* (n 373). On the other hand, the ASA has also upheld a complaint from Provident (the largest doorstep lender in the UK) against a credit union for sending out printed flyers labelling doorstep lenders as ‘loan sharks who charge extortionate levels of interest’: Advertising Standards Authority, *ASA Adjudication on Stevenage Homes* (13 April 2011)).

<sup>376</sup> It continued to consider complaints received prior to 1 April 2014.

encouraging people to borrow high-cost credit to fund birthday celebrations, and giving a discount for people who applied for loans over £2,000.<sup>377</sup>

The Consumer Credit (Advertisements) Regulations 2010 were repealed when the oversight of consumer credit was transferred to the FCA. This area is now regulated by the Consumer Credit Sourcebook (CONC). Under these rules, all lenders must ensure that communications are clear, fair and not misleading.<sup>378</sup> The FCA expects firms to comply with the Consumer Protection from Unfair Trading Regulations 2008 (UK), which make it an offence to engage in unfair practices, including misleading actions.<sup>379</sup> In addition, all communications must:

- be balanced and, in particular, not emphasise any potential benefits of a product or service without also giving a fair and prominent indication of any relevant risks;
- be sufficient for, and presented in a way that is likely to be understood by, the average member of the group to which it is directed, or by which it is likely to be received; and
- not disguise, omit, diminish or obscure important information, statements or warnings.<sup>380</sup>

The FCA has been proactive regarding the advertising of high-cost credit, reviewing 500 different advertisements and commencing 108 cases against lenders within seven weeks

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<sup>377</sup> Advertising Standards Authority, 'ASA Ruling on CashEuroNet UK LLC' (n 369).

<sup>378</sup> The Financial Conduct Authority, *FCA Handbook, Consumer Credit Sourcebook (CONC)* (n 361), *Financial promotions and communications with customers*, 3.3.1(1).

<sup>379</sup> Consumer Protection from Unfair Trading Regulations 2008 (UK), see especially reg 3-5. The Act also makes it an offence to 'canvass debtor-creditor agreements off trade premises' (Consumer Credit Act 1974, s 49(1)) unless in response to a written request from the borrower (Consumer Credit Act 1974, s 49(2)).

<sup>380</sup> The Financial Conduct Authority, *FCA Handbook, Consumer Credit Sourcebook (CONC)* (n 361) 3.3.1A(c)-(e).

of becoming the regulator.<sup>381</sup> Of the cases commenced, 75 firms agreed to withdraw or amend the offending advertising.<sup>382</sup> These actions highlight the ongoing attempts to ensure procedural fairness in high-cost credit transactions by limiting exploitative and potentially misleading advertisements.

Despite the ASA and FCA activity, advertising by high-cost lenders is still a significant concern, particularly when aimed at vulnerable low-income borrowers.<sup>383</sup> What was particularly concerning was that C2DE ('working class') adults were being exposed to nearly double the number of advertisements for high-cost credit as ABC1 ('middle class') adults.<sup>384</sup> A study by OfCom on the advertising of high-cost credit reported that almost 400,000 high-cost credit advertisements are shown annually.<sup>385</sup> Adults are watching on average 152 advertisements a year, and children between 70 and 84 (depending on the age group),<sup>386</sup> including some advertisements being shown during programs specifically designed for children.<sup>387</sup>

#### 2.4.3: Cooling-Off Rights

The cooling off rights under the Consumer Credit Act allow consumers an opportunity to change their mind. They aim to ensure borrowers have properly consented to the credit

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<sup>381</sup> This included 38 cases against payday lenders, 19 cases against other unsecured lenders, 5 against home-collected credit and 4 against pawnbrokers: The Financial Conduct Authority, *Consumer credit firms must raise advertising standards, says FCA* (n 172).

<sup>382</sup> The remaining cases are currently going through this process; see details in *ibid*.

<sup>383</sup> Department of Business Innovation and Skills, *Making Consumer Credit Fairer* (n 32) 9-10, 42-46.

<sup>384</sup> OfCom, *Trends in Advertising Activity - Payday Loans* (2013) 16. These classes are developed from Office of National Statistics data; C2DE adults are generally categorised as 'working class' and ABC are 'middle class': see discussion in James Dobson, *Measuring Social Class* (Bright Blue 2016).

<sup>385</sup> OfCom (n 384) 4.

<sup>386</sup> *ibid* 4.

<sup>387</sup> *ibid* 19.

contract. The Act gives consumers who change their minds after entering into certain consumer credit agreements the right to cancel the contract within 14 days,<sup>388</sup> and requires lenders to inform borrowers of this cancellation right. This was designed to curb abusive or aggressive sales tactics, and to ensure consumers actually consent to the transaction.<sup>389</sup> Whilst these provisions have the potential to provide an escape route for consumers who experience ‘borrowers’ remorse’, consumers must be aware of their rights and therefore have read and understood the information provided to them. More importantly, the speed and convenience of high-cost loans means that the funds are provided and most likely spent before the consumer has had the opportunity to consider exercising their cancellation rights, strongly undermining the effectiveness of this regulatory provision.

#### 2.4.4: Unfair Relationship Test

A further mechanism to ensure procedural fairness is the ‘unfair relationship test’.<sup>390</sup> This is a mechanism for consumers to take direct action against lenders, and allows the court to look at the general relationship between the lender and borrower, including ‘any other thing done (or not done) by, or on behalf of, the creditor’.<sup>391</sup> Whilst there is no specific

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<sup>388</sup> Consumer Credit Act 1974 (UK), ss 66A. This section was inserted by the Consumer Credit (EU Directive) Regulations 2010 (UK), which implemented the UK’s obligations under the European Union Directive on Consumer Rights (2011/83/EC). See also Consumer Credit Act 1974 (UK), ss 67 and 69-73.

<sup>389</sup> Consumer Credit Act 1974 (UK), s 64(1). In addition, there is a five-day cooling off period for contracts entered into off trade premises: Consumer Credit Act 1974 (UK), ss 63 and 68. The borrower obligations associated with the cancellation right and cooling off period are slightly different, see Consumer Credit Act 1974, ss 67-68. This post-contractual protection largely reflected the Crowther Report recommendation that if a consumer credit agreement is entered into other than at an appropriate trade premise, consumers should have the right to cancel the agreement even if there is a binding contract (Crowther (n 69) 289). The Committee also recognised that many consumers would have difficulties writing ‘even the simplest letter’, and therefore recommended that in these circumstances lenders be required to provide the debtor with a cancellation slip that could simply be signed and posted.

<sup>390</sup> Consumer Credit Act 1974 (UK), s 140A as implemented by the Consumer Credit Act 2006.

<sup>391</sup> Consumer Credit Act 1974 (UK), s 140A(1)(c).

reference to responsible lending in the legislation, it was explicitly stated that the duty to lend responsibly was included in the unfair relationship test.<sup>392</sup> Ramsay observed that 'given its broad scope, the unfair relationship test could be used as a private law method of attacking irresponsible lending practices'.<sup>393</sup> This could be an effective approach to regulation of the market, as it will allow the courts to set definite limits on what is acceptable and unacceptable lender behaviour.

There has been limited judicial consideration of the scope of the protection afforded by the unfair relationship test. It therefore remains unclear how the courts will approach the interpretation of the test and its connection with responsible lending obligations or substantive unfairness issues. The Court of Appeal analysed the unfair relationship test in *Harrison v Black Horse Limited*.<sup>394</sup> It applied the test narrowly, holding that a relationship will not be 'unfair' unless the lender has breached a legal duty. This case did not refer to responsible lending obligations, and in fact stated that the wording of the legislative provision 'offers no guidance in respect of the factors which either may or must be regarded as rendering the relationship unfair'.<sup>395</sup> The outcome of *Harrison* was effectively overruled in the Supreme Court case of *Pelvin v Paragon Personal Finance Ltd*,<sup>396</sup> which held that a relationship can be unfair without the creditor breaching a legal duty. *Pelvin* considered the application of the unfair relationship test in relation to a credit agreement where the lender obtained a large commission from the sale of Personal Protection Insurance (PPI), and therefore did not consider issues related to responsible

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<sup>392</sup> Parliamentary Under-Secretary of State for Trade and Industry Responding to suggested amendments in Grand Committee, (8 November 2005); HL Deb, 8 November 2005, vol 675, cols GC160-GC162.

<sup>393</sup> Ramsay, *Consumer Law and Policy* (n 80) 440.

<sup>394</sup> *Harrison v Black Horse Ltd* [2011] EWCA Civ 1128, [2012] Lloyd's Rep IR 521.

<sup>395</sup> Lord Justice Tomlinson in *ibid* [38].

<sup>396</sup> *Plevin v Paragon Finance Limited* [2017] UKSC 23, [2018] 1 All ER 292 ('Pelvin').

lending.<sup>397</sup> The case did, however, increase the scope and role of the unfair relationship test, which will be a positive outcome in the event that a high-cost credit or irresponsible lending case is brought before the courts.

The cases referring to the unfair relationship test have largely related to procedural issues, and therefore continued the focus on negative freedom.<sup>398</sup> The direction of the court in these matters has included the right to amend pleadings to introduce a claim of an unfair relationship,<sup>399</sup> and an application to appeal against forfeiture out of time on the grounds that the credit was obtained through an unfair relationship.<sup>400</sup> There has been a handful of cases considering the scope of the test. An unfair relationship was not found in *Shaw v Nine Regions*<sup>401</sup> in the context of a £3,000 loan at 119.16% APR for 36 months, which created total repayments of £13,724.88. This was on the basis that the borrower, despite having bad financial judgment, was considered a 'sophisticated, articulate and intelligent man'.<sup>402</sup> In contrast, an unfair relationship was held to exist in *Morrison v Betterplace Ltd (t/a Log Book Loans)*.<sup>403</sup> In this case two loans of £1,500 were entered into, one at 343.4% APR with Mr Morrison and the second one approximately 2 ½ years later at 485.25% APR, but this time with Mrs Morrison. Both were repayable over 58 weeks. The judge held that the second loan was out of the ordinary as

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<sup>397</sup> Lord Sumption did however mention responsible lending obligations when discussing voluntary codes of conduct; *ibid* para [36].

<sup>398</sup> The Queen's Bench has considered the unfair relationship test in the context of a credit card agreement and held that a breach of Consumer Credit Act 1974 (UK), s 78(1) (duty to give information to debtor under running-account credit agreement) does not on its own give rise to an unfair relationship: *Carey v HSBC Bank plc* [2009] EWHC 3417 (QB).

<sup>399</sup> *Barnes v Black Horse Ltd* [2011] EWHC 1416 (QB), [2011] 2 All ER (Comm) 1130.

<sup>400</sup> *Barons Finance Ltd v Makanju* [2013] EWHC 153 (QB), [2013] All ER (D) 87 (Feb).

<sup>401</sup> *Robert Shaw v Nine Regions* [2009] EWHC 3553 (QB).

<sup>402</sup> *ibid* [29].

<sup>403</sup> *Morrison v Betterplace Ltd (t/a Log Book Loans)* 1 September 2009, (County Court at Lowestoft).

Mrs Morrison was essentially taking over responsibilities of the first loan, but at a significantly higher rate. His Honour therefore varied the rate of the second loan to that of the first. He also held that sending multiple default letters each month at a cost of £12 per letter was unfair, and limited this to one letter per month. The judge did not directly consider whether 485.25% APR was unfair and did not make a finding on this point. An unfair relationship was also held to exist in *Patel v Patel*, where a number of loans totalling £56,450 between two friends had snowballed after 30 years into over £6 million owed, despite the borrower is making repayments totalling £72,336. The unfair relationship was found for a variety of reasons, including the parties' personal relationship, a lack of any written terms of the loans, the borrower not being provided with a copy of the agreements, repayment sums only being made on request of the creditor, and a lack of account information provided to the borrower.<sup>404</sup> Despite the disturbing practices in both cases, there was no consideration by the court of whether the lender's actions breached responsible lending obligations, or any substantive unfairness issues.

The exact meaning of 'unfair relationship' remains unclear, as does its relationship to responsible lending; further clarification from the courts is urgently required. It does show that the courts have largely focused on procedural aspects of contract, the law intervenes when there are issues with the how the contract was entered into and not when there was substantive unfairness. The test therefore continues the freedom-based approach to high-cost credit.

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<sup>404</sup> *Patel v Patel* [2009] EWHC 3264 (QB), [2010] 1 All ER (Comm) 864.

#### 2.4.5: Vitiating Factors

Several common law and equitable doctrines can potentially protect the procedural fairness of high-cost credit contracts. These include misrepresentation and non-disclosure, incapacity, mistake of fact, duress, unfairness, undue influence, and unconscionable bargains.<sup>405</sup> A detailed analysis of the nature of vitiating factors is clearly beyond the scope of this thesis;<sup>406</sup> it is clear that they ensure valid consent and avoid coercion and exploitation of the vulnerable. The specific circumstances of high-cost credit mean that vitiating factors provide limited assistance to borrowers.

The major advantages of high-cost credit are the speed and convenience of the transaction,<sup>407</sup> with some lenders advertising that the 'money will be in your bank within 15 minutes',<sup>408</sup> 'no credit checks',<sup>409</sup> and 'get a loan with just two simple texts'.<sup>410</sup> These types of limited processes open the door for potential issues of misrepresentation and non-disclosure, capacity, and mistakes of fact. In addition, many borrowers are vulnerable to exploitation due to their desperate situations, and so the common law vitiating factors of duress, unfair influence and unconscionable bargains may assist these consumers.<sup>411</sup> These vitiating factors require personal dealings between the parties, so would generally

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<sup>405</sup> For more information, see Edwin Peel and G.H. Treitel, *The Law of Contract* (13th edn, Sweet & Maxwell 2011) chs 8-10, 12; Chen-Wishart, *Contract Law* (n 22) chs 5, 7-9; H. G. Beale and Joseph Chitty, *Chitty on Contracts* (32nd edn, Sweet & Maxwell 2017) chs 5-8.

<sup>406</sup> For very insightful analysis of these issues see Chen-Wishart, 'The Nature of Vitiating Factors in Contract' (n 232).

<sup>407</sup> This was one of the major findings in Competition & Markets Authority, *Research into the Payday Lending Market* (n 39).

<sup>408</sup> Mobile Quid, 'Quick 'n Easy Cash' (2013) <<https://mobilequid.com/>> accessed 18 September 2013.

<sup>409</sup> Payday Swift, 'Payday Swift Homepage' (2013) <<http://cashadvanceoffer.com/>> accessed 18 September 2013.

<sup>410</sup> Toothfairy Finance, 'Fast Track: Instant Money' (2013) <<https://www.toothfairyfinance.com/>> accessed 18 September 2013.

<sup>411</sup> Jodi Gardner, *It's Supreme Time: Unfair Lending in Australia* (Griffith University Research Paper, 2009). For a discussion of the vulnerability of payday borrowers, see Paterson and Brodie (n 22).

only be of assistance to borrowers who have taken loans out in person, and provide limited use for the majority who use the online process.

One doctrine that could be particularly relevant is unconscionability. This, however, generally requires a specifically identifiable characteristic or ‘disadvantage’ such as a disability, having English as a second language, or literacy problems.<sup>412</sup> The protection provided by this doctrine was stretched to include lower income and less educated parties in *Cresswell v Potter*, which may benefit borrowers of high-cost credit.<sup>413</sup> Despite this extension to the notion of ‘disadvantage’, financial difficulties in and of themselves remain insufficient to warrant legal protection through the doctrine of unconscionability. In Lord Templeman’s words ‘unequal bargaining power [without further abuse] ... provide[s] no basis for equitable interference’.<sup>414</sup> Further, the use of any general law doctrine is dependent on the consumer’s obtaining access to expensive court processes and remedies, meaning the doctrines are under-utilised. Therefore, the ability of vitiating factors to provide meaningful assistance to high-cost credit borrowers is clearly limited.

To conclude this section, the English approach to credit regulation has largely focused on negative freedom – avoiding intervention where possible and, when it was required, emphasising procedural over substantive fairness.

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<sup>412</sup> *Boustany v Pigott* (1993) 69 P & CR 298 (PC); *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447 (HCA).

<sup>413</sup> *Cresswell v Potter* [1978] 1 WLR 255 (Ch D).

<sup>414</sup> *Boustany v Pigott* (n 412) 303. See also Mindy Chen-Wishart, ‘Undue Influence: *Beyond* Impaired Consent and Wrongdoing towards a Relational Analysis’ in Andrew Burrows and Alan Rodger (eds), *Mapping the Law: Essays in Memory of Peter Birks* (Oxford University Press 2006) 203.

## 2.5: Limitations of (Negative) Freedom

The range of potential explanations for the focus on negative freedom and limiting intervention in the high-cost credit market to matters of procedural fairness has been discussed. None of these have been adequate, they are necessary but not sufficient. There is an innate value in consumer choice and freedom of contractual affairs. We therefore need to go beyond a lack of justification and consider whether the negative freedom approach *creates* any problems. This section will discuss three concrete limitations of negative freedom – the failure of disclosure, lack of consumer choice, and impact of poverty.

### 2.5.1: Failure of Disclosure

As previously discussed, disclosure is one of the key aspects of procedural fairness.<sup>415</sup> It is easy to over-estimate the effectiveness of mandatory disclosure.<sup>416</sup> The Crowther Report recognised the limited impact of such disclosure on the decision-making of low-income borrowers,<sup>417</sup> and this is supported by a large body of academic literature.<sup>418</sup> For

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<sup>415</sup> *Baker v Canada* [1999] 2 SCR 817 (SCC); In the context of administrative decisions, see Kristina Stern, 'Procedural Fairness – Its Scope and Practical Obligation' (2008) 56 AIAL Forum 2.

<sup>416</sup> See the comprehensive critique of the impact of mandatory disclosure in Omri Ben-Shahar and Carl E. Scheider, 'The Failure of Mandated Disclosure' (2011) 159 University of Pennsylvania Law Review 647, especially 665-667.

<sup>417</sup> Crowther (n 69) 272.

<sup>418</sup> See further, Amartya Sen, 'Rational Fools: A Critique of the Behavioral Foundations of Economic Theory' (1977) 6 Philosophy & Public Affairs 317; Hillel Einhorn and Robin Hogarth, 'Behavioural Decision Theory: Processes of Judgment and Choice' (1981) 19 Journal of Accounting Research 1; Gordon Foxall, 'A Behaviouralist Perspective on Purchase and Consumption' (1993) 27 European Journal of Marketing 8; Justin Malbon, 'Shopping for Credit: An Empirical Study of Consumer Decision-Making' (2001) 29 Australian Business Law Review 44; Wim Dubbink, *Assisting the Invisible Hand: Contested Relations Between Market, State and Civil Society* (Kluwer Academic Publishers 2003); Larry DiMatteo and others, *Visions of Contract Theory: Rationality Bargaining and Interpretation* (Carolina Academic Press 2007); Richard Wiener and others, 'Consumer Credit Card Use: The Roles of Creditor Disclosure and Anticipated Emotion' (2007) 13 Journal of Experimental Psychology 32; Ren Essene and William Apgar, *Understanding Mortgage Market Behaviour: Creating Good Mortgage Options for All Americans* (Joint Centre for Housing Studies, Harvard University, 2007); Francis (n 159); Mann (n 170).

disclosure to be an effective form of consumer protection, borrowers have to: (a) read the material disclosed, (b) understand the information provided, and (c) respond to the information in a rational way.<sup>419</sup> Unfortunately ‘humans can be short-sighted, impulsive, inert and optimistic’,<sup>420</sup> and a large number of consumers do not undertake these steps, act in a rational manner, or have financial options.<sup>421</sup> In addition, many borrowers of high-cost credit often have limited financial choices but urgent financial needs, meaning that this approach will have a minimal impact on their lending decisions.<sup>422</sup>

Disclosure will only be effective if the consumer can adequately understand the contractual obligations into which they enter. Financial education and awareness is a significant concern for high-cost credit users, and can significantly undermine the effectiveness of disclosure. As outlined by Raz

Autonomy is opposed to a life of coerced choices. It contrasts with a life of no choices, or of drifting through life without ever exercising one’s capacity to choose. Evidently the autonomous life calls for a certain degree of self-awareness. To choose one must be aware of one’s options ... he must be capable of

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<sup>419</sup> Hadfield (n 233) 1247.

<sup>420</sup> David Evans, ‘The Behavioral Economics of Paying and Borrowing’ [2010] *The Lydian Payments Journal* <[http://pymnts.com/assets/Lydian\\_Journal/LydianJournalJanuaryEconomics.pdf](http://pymnts.com/assets/Lydian_Journal/LydianJournalJanuaryEconomics.pdf)> accessed 31 August 2012.

<sup>421</sup> Richard Thaler, ‘Toward a Positive Theory of Consumer Choice’ (1980) 1 *Journal of Economic Behaviour and Organisation* 39.

<sup>422</sup> Marianne Bertrand and Adair Morse, *Information Disclosure, Cognitive Biases and Payday Borrowing* (Chicago Booth Research Paper No 10-01, 2009). Because of this, Plymouth Council have gone a step further and banned lenders from advertising on billboards and bus stops, as well as blocking the 50 most popular high-cost credit websites on all council computer networks, including libraries and schools; Steven Morris, ‘Plymouth council becomes first to ban payday loan ads on billboards’ *The Guardian* (23 July 2013) <<http://www.theguardian.com/uk-news/2013/jul/23/plymouth-council-bans-payday-loans>> accessed 22 September 2013.

understanding how various choices will have a considerable and lasting impact on his life.<sup>423</sup>

Clearly, not all high-cost credit borrowers are impacted by a lack of financial awareness. Research shows that many borrowers make financially responsible decisions,<sup>424</sup> and use this type of financial product because it is the best option available to them.<sup>425</sup> To some extent this validates the imposition of disclosure requirements on lenders, although they are insufficient. There is still a significant group of people whose inability to fully understand the operation of high-cost credit leaves them open to exploitation,<sup>426</sup> and challenges the value of disclosure.<sup>427</sup> Even if they understand the agreement, unless they have financial options they are unable to utilise the information to make more appropriate choices. The high-cost credit industry was referred to the CMA for review in 2013.<sup>428</sup> A 20-month long investigation found that the industry was not working adequately, the key issue being that borrowers were focused more on the speed and ease

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<sup>423</sup> Raz, *The Morality of Freedom* (n 203) 15.

<sup>424</sup> See, for example, discussion in Reeves and Wilson (n 166) and again in Sendhil Mullainathan and Eldar Shafir, *Scarcity: Why Having Too Little Means So Much* (Allen Lane 2013). Amazingly, these books were originally published exactly 100 years apart – highlighting the importance of understanding the historical aspect to these challenges.

<sup>425</sup> Rowlingson, Appleyard and Gardner (n 123) 530.

<sup>426</sup> The Office of Fair Trading, *Payday Lending Compliance Review - Interim Report* (n 10); Citizens Advice Bureau (n 30); Europe Economics (n 31).

<sup>427</sup> See The Financial Conduct Authority, *Consumer credit and consumers in vulnerable circumstances* (2014). This lack of understanding is part of the wider phenomenon of information asymmetry that exists with consumer transactions and standard form contracts; Mindy Chen-Wishart, 'Regulating Unfair Terms' in Louise Gullifer and Stefan Vogenaur (eds), *English and European Perspectives on Contract and Commercial Law: Essays in Honour of Hugh Beale* (Hart Publishing 2015) and Margaret Radin, *Boilerplate: The Fine Print, Vanishing Rights, and the Rule of Law* (Princeton University Press 2012).

<sup>428</sup> The Financial Conduct Authority, *Detailed proposals for the FCA regime for consumer credit* (n 7) 53.

of getting credit and not on the interest, fees and charges that may be incurred.<sup>429</sup> The law must therefore go beyond disclosure when trying to respond to these challenges.

Individuals can be denied the opportunity to live an autonomous life through the working of social institutions, without any active overriding or violation of their rights.<sup>430</sup> This is particularly obvious in the way in which high-cost credit contracts are trivialised in advertisements (in that they are portrayed as minor or unimportant decisions), and are aimed at particularly vulnerable audiences.<sup>431</sup> Entering into a high-cost credit contract gives the borrower immediate gratification, pushing their financial problems to another day. This type of advertising takes advantage of the lack of understanding and financial awareness of many high-cost credit borrowers. Such advertising makes getting a high-cost credit loan seem like a very simple, straight-forward exercise as opposed to a serious financial commitment, and thus can prey on people in desperate times. The extent of advertising is also a serious concern. In 2011 Wonga spent £16 million on television advertising alone, approximately £1 million more than the entire annual budget of the OFT.<sup>432</sup> These challenges undermine the benefits of disclosure obligations, and highlight the need to focus beyond procedure to issues of substantive fairness.

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<sup>429</sup> See discussion in Competition & Markets Authority, *Payday Lending Market Investigation: Provisional Findings Report* (n 16) especially paras 12-20.

<sup>430</sup> Raz, *The Morality of Freedom* (n 203) 247.

<sup>431</sup> Committee of Advertising Practice, *Trivialisation in short-term, high-cost credit ads* (2015); OfCom (n 384); Broadcasting Committee of Advertising, *BCAP Payday Loans Consultation Regulatory Statement* (2015).

<sup>432</sup> Gentleman (n 187).

## 2.5.2: Lack of Meaningful Choice

The second limitation is the lack of meaningful choice available for consumers. To validly consent to a contractual arrangement, the promisee must have a genuine choice whether or not to enter into the agreement. As stated by Raz

If having an autonomous life is an ultimate value, then having a sufficient range of acceptable options is of intrinsic value, for it is constitutive of an autonomous life that is lived in circumstances where acceptable alternatives are present.<sup>433</sup>

A similar approach exists in the analysis of market intervention. There is a widely-held belief that strong competition can correct existing market failings, and therefore benefit consumers.<sup>434</sup> As a result, consumer protection regimes, particularly those related to the provision of consumer credit, have largely focused on increasing competition in the market place.<sup>435</sup> True competition creates a choice of *suppliers* and a choice of *products*. The current high-cost credit market is lacking in both of these aspects.<sup>436</sup> This lack of effective competition and adequate consumer options allows lenders to charge customers more than they would in an adequately competitive market, adding between £5 and £10 to the average cost of a loan.<sup>437</sup> Negative freedom implicitly assumes that people have a range of meaningful choices from which to pick. In the high-cost credit market, borrowers

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<sup>433</sup> Raz, *The Morality of Freedom* (n 203) 205, emphasis added.

<sup>434</sup> Joshua Gans, 'Protecting Consumers by Protecting Competition: Does behavioural economics support this contention?' (2005) 13 *Competition and Consumer Law Journal* 1; Department of Trade and Industry, *A Fair Deal for All - Extending Competitive Markets: Empowered Consumers, Successful Businesses* (2005).

<sup>435</sup> Ian Manning and Alice de Jonge, *Regulating the Cost of Credit* (Consumer Affairs Victoria, 2006) 13.

<sup>436</sup> See findings in Competition & Markets Authority, *Payday Lending Market Investigation: Final Report* (2015).

<sup>437</sup> *Ibid*, Overall Findings.

often have limited options,<sup>438</sup> and in these situations, procedural fairness is unlikely to produce a useful or indeed fair result.

Borrowers of high-cost credit products generally have little choice of financial products. The majority of consumers are using these products because they have an impaired credit history, and therefore limited access to mainstream products.<sup>439</sup> The CMA review found that four out of every ten high-cost credit borrowers had no access to alternative financial products.<sup>440</sup> Due in large part to government austerity measures, there is currently insufficient access to alternative financial products, including Community Development Financial Institutions (CDFIs) and Credit Union products, both of which provide affordable and safe credit to borrowers who are financially marginalised or on low incomes. The government-run Social Fund – widely considered the lender of last resort – has been dismantled and replaced with *ad hoc* council-based schemes.<sup>441</sup> Because of this lack of choice and competition, borrowers who use high-cost credit products are more likely to accept a (fully disclosed) loan that may be detrimental to them in the long run, such as one with extremely high interest rates, financial repayments that they will be unable to meet without substantial hardship, or high default fees and charges.<sup>442</sup>

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<sup>438</sup> Raz, *The Morality of Freedom* (n 203) 152.

<sup>439</sup> Department of Business Innovation and Skills, *Making Consumer Credit Fairer* (n 32); Keith Ernst, Debbie Bocian and Wei Li, *Steered Wrong: Brokers, Borrowers, and Subprime Loans* (Centre for Responsible Lending, 2008).

<sup>440</sup> Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 80-81.

<sup>441</sup> Damon Gibbons, *Where now for local welfare schemes?* (Centre for Responsible Credit 2015) 20 and 30-33.

<sup>442</sup> See discussion in Lynden Griggs, 'The [ir]rational consumer and why we need national legislation governing unfair contract terms' (2005) 13 *Competition and Consumer Law Journal* 1.

The current state of the high-cost credit market highlights that a narrow concept of freedom is not appropriate, and often results in extreme consumer detriment. As outlined by Atiyah

No modern contract scholar would deny that respect for individual free choice remains an important value of Western societies, but I suspect most of these scholars would argue that the law must also accommodate countervailing values deriving from the pursuit of collective goals and from the paternalistic belief that collective judgments about the best interests of individuals are sometimes more likely to be correct than the individual's own judgment ... Judges and lawyers, in all countries, and for many years, faced with practical problems arising from human relationships, have concluded that pure autonomy, extreme liberal freedom of contract, is often unjust and ought not to be pursued at the expense of all other values.<sup>443</sup>

A negative freedom approach is over-simplistic in light of these challenges. Whilst disclosure and consumer empowerment are important concepts, it is clear that many high-cost credit borrowers require more. Any truly valuable concept of freedom would engage with the context of the decision being made, something which the regulators have not done in any meaningful sense.

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<sup>443</sup> Atiyah, 'The Liberal Theory of Contract' (n 203) 146.

The UK is experiencing a difficult employment market,<sup>444</sup> and a movement away from State-provided assistance towards individual financial empowerment.<sup>445</sup> The multiple economic and social pressures on high-cost credit borrowers have a significant impact on the value of negative freedom.<sup>446</sup> The choice between expensive debt and hunger is not a worthwhile option. The dramatic consequences of the limited financial choices for many borrowers call into question the utility of focusing on procedural fairness. People in these situations will not benefit from a focus on the bargaining process. We need to move beyond limited questions of procedural fairness to tackle issues of fairness of outcome, and the causes of the increasing demand for high-cost credit.

### 2.5.3: Poverty

The third limitation to consider is the role of poverty, as the weight of hardship will undermine the utility of procedural fairness. If people are teetering on the brink financially, they will struggle to make free and informed decisions, particularly around accessing credit. Loans (especially high-cost ones) provide short-term benefits, but

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<sup>444</sup> Since 2008, there has been a significant increase in the number of people who are unemployed, rising from 1.5 million in 2007 to nearly 2.7 million by 2011. More recent figures show that unemployment levels have dropped, but as at the end of 2014, nearly 2 million people remained unemployed: Karen Rowlingson and Steve McKay, *Financial Inclusion Annual Monitoring Report 2015* (University of Birmingham 2015) 5. In 2014 there were 5.3 million working age benefit claimants, as well as 12.9 million people on the State pension: Department of Work and Pensions, *DWP Quarterly Statistical Summary, First Release* (2014) Department of Work and Pensions, *DWP Quarterly Statistical Summary, First Release* (2014). The benefits system is not only important for people who are unemployed; a large number of workers in employment rely on the government to supplement their wages. For example, almost three million people were 'underemployed', wanting to work on average 11.3 additional hours per week, and 1.8 million people were on 'zero hour' employment contracts. A large number of employed people also earn below the threshold which entitles them to working tax and/or child tax credits, with over 17% of all households in receipt of these benefits: The Poverty Site, 'In receipt of tax credits' The Poverty Site Release <<http://www.poverty.org.uk/15/index.shtml>> accessed 3 March 2016.

<sup>445</sup> As discussed in Rowlingson, Appleyard and Gardner (n 123), since 1979 the UK government has increasingly encouraged people to engage in the financial markets as opposed to seeking assistance from the State. This has occurred in conjunction with reduced regulation of many sectors; Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 80-81.

<sup>446</sup> Hadfield (n 233) 1251.

potentially create long-term problems for people struggling to make ends meet. As outlined by Raz ‘harsh ... conditions can reduce the degree of autonomy of a person to a bare minimum just as effectively as systematic coercive intervention’.<sup>447</sup> He provides the example of hunger, stating that a person who is forced to take a job they do not like out of necessity to eat has no ‘free choice’. Whilst the action of taking the job was free, the person was not really free to do anything else.<sup>448</sup> In the context of employment, the State moved beyond the mere bargaining process and has implemented a range of substantive protections to limit the opportunity for exploitation, including minimum wage, workplace safety laws, and working time regulations. The same type of approach can therefore be justified for high-cost credit.

The focus on negative freedom and procedural fairness does not engage with the challenges posed by poverty, nor give guidance on an appropriate way to improve the situation. This is not, however, a new challenge. As discussed in Part 2.2, historically, these issues have significantly impacted the State’s approach to high-cost credit. These concerns were raised in 1973 by Cayne and Treblicock, who stated ‘consumer problems of the poor are an inherent consequence of paucity of resources and can only be remedied by augmenting these resources, that is by making the poor not poor’.<sup>449</sup> Poverty is a central cause of the current challenges.<sup>450</sup> O’Connell’s investigation into working-class debt in the

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<sup>447</sup> Raz, *The Morality of Freedom* (n 203) 156.

<sup>448</sup> *ibid* 15.

<sup>449</sup> David Cayne and MJ Treblicock, ‘Market Considerations in the Formulation of Consumer Protection Policy’ (1973) 23 *University of Toronto Law Journal* 396, 430 (similar comments are also made at 407). This quotation finishes by saying that ‘we have too often in the past yielded to the temptation to look for scapegoats to whom to attribute the unpleasant consequences of poverty. The somewhat unromantic and visible figures of the ghetto merchant, slum land-lord, peddler, and loan shark, have proved easy, although irrelevant, targets.’ I clearly strongly disagree with the last few words, and believe that lenders are definitely *relevant* targets for government regulation.

<sup>450</sup> The authors, for example, discuss how, due to the lack of liquidity, the poor pay more for a variety of goods and services, which has a strong impact on their credit need; *ibid*, 397-398. See also David Caplovitz, *The Poor Pay More* (Free Press 1967).

UK further highlights the fact that high-cost credit<sup>451</sup> increased largely due to the rise in inequality, and in the growth of lone-parent families.<sup>452</sup> These challenges were reiterated by Landsley and Lack in *Breadline Britain: The Rise of Mass Poverty*, which discusses the links between poverty and the use of high-cost credit.<sup>453</sup>

The liberal economic approach assumes that people only enter into credit contracts above market rates if they are acting irrationally.<sup>454</sup> In truth, the increasing dependency on this type of financial product appears to have more to do with the underlying socio-economic status of borrowers. As Rowlingson states

poverty is the underlying reason why some people lack access to suitable, low-cost credit. The improved provision of social lending schemes will be a help. But, to some extent, these schemes will just be papering over the cracks of the much more fundamental problem of poverty.<sup>455</sup>

This is further supported by Ramsay who argues that, for a number of borrowers, ‘the central problem ... is poverty’.<sup>456</sup> Responding to the impact of poverty remains a challenge for policy makers and, in the context of high-cost credit, this is particularly concerned with creating affordable and safe credit products for people on low incomes.<sup>457</sup>

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<sup>451</sup> In the era O’Connell was analysing door-stop lending (also known as home-collected credit) was the most common form of high-cost credit.

<sup>452</sup> O’Connell (n 171) 186-187.

<sup>453</sup> Stewart Lansley and Joanna Mack, *Breadline Britain: The Rise of Mass Poverty* (OneWorld Publications 2015) 59-60.

<sup>454</sup> Anthony Ogus, *Regulation: Legal Form and Economic Theory* (Clarendon Law Series 1994); see also discussion of efficient market hypothesis in relation to the credit market; R. Ball, ‘The Global Financial Crisis and the Efficient Market Hypothesis: What Have We Learned?’ (2009) 21 *Journal of Applied Corporate Finance* 8 and analysis of rational choice theory and credit cards: Posner (n 159) esp 1574.

<sup>455</sup> Rowlingson (n 66) 166.

<sup>456</sup> Iain Ramsay, ‘To Heap Distress Upon Distress’: Comparative Reflections of Interest-Rate Ceilings’ (2010) 60 *University of Toronto Law Journal* 707, 708.

<sup>457</sup> Rowlingson (n 66) 166.

The question of regulation of high-cost credit is therefore exceptionally complex. As outlined by O'Connell, 'working-class consumer credit is a subject where it is difficult to separate the social from the economic, the commercial from the cultural'.<sup>458</sup> Mullainathan and Shafir further highlight the complexities of low-income borrowers' need for further credit in their ground-breaking book *Scarcity: Why Having too Little Means so Much*.<sup>459</sup> The majority of people who use these products are financially vulnerable, and a significant minority are living in poverty. Whilst a solution to increasing levels of poverty is clearly beyond the scope of this thesis, the importance of this issue must be recognised. Until these challenges are addressed, a mere focus on ensuring procedural fairness is unlikely to make any substantial impact on the lives of vulnerable borrowers.

## Conclusion

Freedom is and will continue to be a cornerstone of English legal system. It is an important philosophical concept and has a strong historical grounding in the English system. This approach is generally limited to negative freedom, focusing on the freedom to enter into contracts. There is inherent value in this approach, but in the context of high-cost credit, it is severely inadequate. A freedom-based approach is useful for people who have multiple options and are choosing to use high-cost credit for the convenience and speed of these products. In these circumstances, the current legal protections focused on procedural

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<sup>458</sup> O'Connell (n 171) 3.

<sup>459</sup> For example, they outline how one in every six families in the lowest income quintile pay at least one bill late per year; 18% of the poorest families have had their phones disconnected and 10% have had their utilities shut off. Nearly 5% of the annual income of the poor is spent on debt servicing, reconnection charges, and late fees: Mullainathan and Shafir (n 424) 107. These are statistics from the United States, however similar issues have been reported in the United Kingdom, see Collard, Finney and Davies (n 134) and Sarah Bridges and Richard Disney, 'Use of credit and arrears on debt among low-income families in the United Kingdom' (2004) 25 *Fiscal Studies* 1.

fairness will generally be sufficient. A large number of people who rely on high-cost credit are entering into these agreements from vulnerable situations and with limited options. This personal situation impacts their ability to utilise their contractual freedom in a meaningful way. The negative-freedom approach does not adequately address the needs of these borrowers, and allows them to enter into potentially harmful contracts including ones with CPAs that provide automatic access to bank accounts, high interest rates, and significant penalty fees. Sometimes the law has to go beyond negative freedom and procedural fairness, and instead protect people from substantively unfair contracts.

## Chapter 3 – Protection

*A necessitous man is not a free man*  
- Franklin Roosevelt

### Introduction

Chapter 2 outlined how freedom is a guiding principle in the law's approach to high-cost credit contracts. Freedom is not, however, absolute. Complete negative freedom and lack of government intervention is clearly not a suitable concept for a functioning society. We need to maintain a balance between different values. This chapter therefore moves away from freedom to discuss the role of protection in the challenges presented by high-cost credit. It has five sections, and follows the same structure as the previous chapter on freedom. The first section considers the role of protection in high-cost credit, explaining that the focus in this thesis is on protection from both substantively unfair agreements and coercion through lack of choice. The second outlines the history of protection in high-cost credit, specifically focusing on the role of religion in our approach to these issues. The third section develops this analysis by outlining the historical explanations and justification for protection, namely preventing harmful outcomes, stopping unconscionable behaviour, and defending the vulnerable. The fourth discusses the examples of protection that already exist in the UK legal system, including interest rate restrictions, responsible lending, unfair terms legislation, and various common law doctrines. The chapter finishes by highlighting the limitations of a protective approach, providing evidence for the need to look beyond the freedom and protection dichotomy.

### 3.1. What is Protection?

Freedom, particularly negative freedom, is associated with *non*-intervention into private arrangements and economic markets. Protection is, by contrast, linked with intervention into laws and markets, largely to ensure that these systems are not used in an unfair or unacceptable manner. Freedom and protection are inherently linked. Berlin highlights the relationship between the two concepts, stating ‘to avoid glaring inequality or widespread misery I am ready to sacrifice some, or all, of my freedom: I may do so willingly and freely; but it is freedom that I am giving up for the sake of justice or equality or love of my fellow men’.<sup>460</sup> So many aspects of life that we take for granted are impositions on our freedoms for the greater good – the development of government and democracy, health and safety requirements to ensure people are not injured unnecessarily, traffic and road rules to prevent avoidable accidents, employment laws to give workers rights against potentially exploitative employers, the list goes on.<sup>461</sup> These protections (and many more) are highly valued and ingrained in our society. It is clear that we are surrounded by limitations on our negative freedom that are designed to protect us and those around us. The question then becomes not whether society should impinge on some negative freedoms in a protective manner, but more ‘where should we draw the line’?

Protecting parties means, by definition, intervening with the market or legal system. This type of intervention can be criticised on the basis that the government is not acting fairly or ‘neutrally’; it is instead favouring one party over another. There are two types of neutrality discussed in this thesis – neutrality between competing notions of ‘the good’, and neutrality between individuals.<sup>462</sup> Both types of neutrality are relevant for

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<sup>460</sup> Berlin (n 220) 174.

<sup>461</sup> See discussion in Anthony Ogus, *Costs and Cautionary Tales: Economic Insights for the Law* (Hart Publishing 2006).

<sup>462</sup> ‘In invoking neutrality in the context of examining the liberal attitude to the freedom of contract, the basic thought is that most forms of intervention in the freedom of contract represent a deviation from

contract law issues in high-credit transactions. When the State limits or prohibits certain types of contracts on the ground of potential danger or harm, it appears to be choosing a particular concept of 'good' financial products and contracts.<sup>463</sup> When intervening in a contractual dispute to protect a vulnerable individual, the State can also appear to favour that party over the other, and consequently not remain neutral.<sup>464</sup>

This concern for neutrality assumes two things; first, the State should not intervene into contracts for the purpose of ensuring its version of 'good' or a 'good life', and second, that all parties come to the transaction on equal footing. Neither of these assumptions is entirely valid in the context of high-cost credit. Chapter 1 discussed the real concerns about how these products are working, and the harm that is being caused to borrowers. The State has strong justifications to intervene in the market to create its version of a 'good' credit and lending environment. Sandel stresses the need for society to have a richer and more morally engaged discourse about what is a 'good life,' and how this should impact the products that should be available on the market.<sup>465</sup> Government intervention should be allowed, even required, to prevent harm to a borrower's ability to live a 'good life'.<sup>466</sup> This discourse should also take into account the context in which the lending is occurring, and therefore be influenced by social values, conventions and

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a policy of neutral concern. When the law protects the relatively vulnerable party against the strong, for instance, it is not neutral; it helps the former and hinders the latter': Kimel, 'Neutrality, Autonomy, and Freedom of Contract' (n 278) 477.

<sup>463</sup> John Rawls, *A Theory of Justice* (Harvard University Press 1971); See also Samuel Freeman, *Rawls* (Routledge 2007).

<sup>464</sup> Kimel, *From Promise to Contract: Towards a Liberal Theory of Contract* (n 278) 121-122; Kimel, 'Neutrality, Autonomy, and Freedom of Contract' (n 278) particularly 477-479.

<sup>465</sup> Michael Sandel, *What Money Can't Buy: The Moral Limits of Markets* (Penguin 2013); Michael Sandel, 'What Shouldn't Be Sold' Philosophy Bites <[http://ec.libsyn.com/p/3/8/1/381482933460cb0c/Michael\\_Sandel\\_on\\_What\\_Shouldnt\\_Be\\_Sold.mp3?d13a76d516d9dec20c3d276ce028ed5089ab1ce3dae902ea1d01cf8e31d1cc5f696e&c\\_id=1779608](http://ec.libsyn.com/p/3/8/1/381482933460cb0c/Michael_Sandel_on_What_Shouldnt_Be_Sold.mp3?d13a76d516d9dec20c3d276ce028ed5089ab1ce3dae902ea1d01cf8e31d1cc5f696e&c_id=1779608)> accessed 12 August 2013. See also Margaret Radin, 'Market-Inalienability' (1987) 100 *Harvard Law Review* 1849.

<sup>466</sup> Raz, *The Morality of Freedom* (n 203) 417.

norms.<sup>467</sup> A 'good life' is multi-faceted, encompassing notions of success, happiness and most importantly, meaningfulness.<sup>468</sup> Having a situation where many low-income individuals regularly have to resort to loans with thousands of per cent interest<sup>469</sup> challenges society's norms about minimal living standards. These situations negatively impact many people's ability to live a good life, and raise serious questions about the appropriateness of these financial products specifically, and the emphasis on contractual freedom more generally. A protective approach is readily justified.

Second, there are inequalities in the high-cost credit market that have a significant impact on the way that 'freedom' operates in practice. If extreme inequalities already exist between contracting parties, a strong adherence to neutrality will support the status quo and therefore favour the stronger party.<sup>470</sup> Freedom and neutrality are supported on the ground that they allow for a 'fair contest' between parties. Providing high-cost credit to vulnerable individuals is far from a fair contest. These loans can be harmful and cause the borrower to go into financial hardship or a debt spiral. Borrowers are frequently unable to meet the repayments, and can therefore be subjected to default fees and/or 'roll-overs' of the original loan. Lenders are aware of this vulnerability, and can utilise it to their own advantage.<sup>471</sup> Lending to people who cannot afford to repay without suffering financial hardship is therefore beneficial for the lender.<sup>472</sup> Whilst many high-cost credit

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<sup>467</sup> Michael Sandel, *Liberalism and the Limits of Justice* (2nd edn, Cambridge University Press 1998).

<sup>468</sup> Susan Wolf, 'Happiness and Meaning: Two Aspects of the Good Life' (1997) 14 *Social Philosophy and Policy* 207.

<sup>469</sup> The current interest rate cap in the UK is 1,500% APR, see discussion in Part 3.4.2 below.

<sup>470</sup> Kimel, *From Promise to Contract: Towards a Liberal Theory of Contract* (n 278) 122. See also Raz, *The Morality of Freedom* (n 203) ch 9.

<sup>471</sup> As outlined in Part I, lenders make approximately 50% of their revenue from the loans that are rolled over or refinanced at least once: The Office of Fair Trading, *Payday Lending: Final Compliance Review* (n 12) 2.

<sup>472</sup> See economic analysis in Beddows and McAteer (n 19).

borrowers are higher risk and therefore there is justification for higher costs, it should not be used as tool for exploitation. These extreme inequalities and the lack of a 'fair contest' between lenders and borrowers show that, for the State to be acting in a truly neutral fashion, it must intervene on behalf of the weaker party – in this case the borrower.<sup>473</sup>

The State has a strong justification for intervention to 'level the playing field'. There are many accepted and uncontroversial examples of this happening. For example, sports such as boxing are often run with weight classifications to ensure that contestants are not placed in grossly unfair competitions. In criminal trials, prosecutors (the stronger party) are required to hand over relevant evidence to defendants, who are weaker, in order to level the playing field. The negative freedom approach discussed in the previous Chapter generally means limiting legal processes to creating a framework for the creation and enforcement of agreements. When there are power imbalances, the law needs to go further – 'by defining the framework in a way which enables a certain "strong" party to capitalise on the vulnerability of a certain "weak" party, the state – the law – does not merely fail to help the latter; it plays an active role in creating the conditions of its fall'.<sup>474</sup> If the State wishes to act in a truly neutral fashion it should not avoid intervention. Such situations will often require active intervention by the government to ensure that power imbalances are not manipulated.

A protection-focused approach can also be criticised on the grounds of consent. By intervening into a contract between two parties, the State can appear to be undermining the value of consent.<sup>475</sup> There are, however, many interventions which

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<sup>473</sup> Raz, *The Morality of Freedom* (n 203); Nozick (n 227); Rawls (n 463).

<sup>474</sup> Kimel, 'Neutrality, Autonomy, and Freedom of Contract' (n 278) 480.

<sup>475</sup> Examples of this can be seen in John Adams and Roger Brownsword, *Understanding Contract Law* (5th edn, Sweet & Maxwell 2007) and comments in *Zamet v Hyman* [1961] 1 WLR 1442 (UKCA), where the court focuses on whether there has been "full, free and informed" consent (at 1444). For a full list of

cannot be explained by a narrow concept of consent. Many limitations placed on people in our society are imposed in situations where full and informed consent can be and is given by the parties involved. There are multiple examples of these, including the limitations on the purchase and consumption of cigarettes and alcohol, the requirement for passengers of motor vehicles to wear seat belts, and the inability for people to limit potential liability for personal injury and death. These all reduce the choice and freedom of the parties involved. Our current approach limits or prohibits certain actions, even if people involved have consented to the transaction or risk.<sup>476</sup> Consent is therefore an insufficient rationale for stopping State-based protection.

Both protection and freedom can mean a wide variety of different things. For the purpose of this thesis, protection is associated with government intervention into the contractual affairs of individuals. This means restricting liberty in some cases to promote other important values including equality, social or moral norms, justice and protection of the weak.<sup>477</sup> In the context of high-cost credit, this thesis will focus on two main types of protection. The first, which is grounded on Kantian respect and concerns for distributive justice<sup>478</sup>, is protection against substantively unfair agreements – meaning preventing enforcement of grossly one-sided contracts.<sup>479</sup> The second type of protection is focused on preventing coercion that arises from a borrowers' lack of choice. This goes further than

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the Orthodox defective consent approach, see Chen-Wishart, 'The Nature of Vitiating Factors in Contract' (n 232) fns 3-22.

<sup>476</sup> The most well-known example of this is the infamous criminal law case, *R v Brown* [1993] UKHL 19, [1994] 1 AC 212.

<sup>477</sup> See Carter (n 224) discussing Berlin.

<sup>478</sup> Chen-Wishart, 'The Nature of Vitiating Factors in Contract' (n 232) 304; Anthony Townsend Kronman, 'Contract Law and Distributive Justice' (1980) 89 *Yale Law Journal* 472; Saintier (n 232); for an American perspective on the debate, see Harrison (n 232).

<sup>479</sup> See Atiyah, *Essays on Contract Law* (n 150) Essay 11; Smith (n 232); Chen-Wishart, 'The O'Brien Principle and Substantive Unfairness' (n 232).

avoidance of coercion by lenders discussed in Chapter 2, and aims to provide assistance when borrowers are coerced through social structures, the environment, or any other impairment that may impact the transaction in question. As outlined by Atiyah 'the victim of monopoly who consents to an arrangement because he has no effective choice is surely entitled to attack the result notwithstanding his consent. His position scarcely differs from the victim of fraud or duress who knowingly consents and then seeks to repudiate afterwards'.<sup>480</sup>

The negative freedom approach discussed in the previous chapter is based on concern for an individual's autonomy. The mere theoretical right to freedom is hollow if it cannot be utilised in a way that improves a person's life. If we value autonomy in a meaningful sense, the State is required 'to assume an active role in shaping the arena within which the freedom of contract can be exercised, so as to ensure that, by and large, this freedom would enhance the well-being of those who enjoy it, and make a positive contribution to their chances of leading, valuable, successful lives'.<sup>481</sup> Sometimes the only way we can do this is by moving away from a freedom focus to a more protective-based approach.

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<sup>480</sup> Atiyah, *Essays on Contract Law* (n 150) Essay 11, p 353.

<sup>481</sup> Kimel, 'Neutrality, Autonomy, and Freedom of Contract' (n 278) 493.

### 3.2. The History of Protection

This section will briefly outline the historical development of the protective approach in relation to high-cost credit. It will commence with a discussion of the link between usury, religion and high-cost credit, followed by an analysis of the religious basis of protection. The section will conclude with a summary of what the historical approach can teach us about current high-cost credit challenges.

#### 3.2.1: Usury, Religion and High-Cost Credit

The protective approach to moneylending has a strong religious grounding in the prohibition of usury. Every major religion has criticised usury, favouring a protective approach to lending practices.<sup>482</sup> This thesis will focus on Judeo-Christian beliefs, as they have had a significant impact on the current legal system. There are four references to moneylending and usury in the Old Testament.<sup>483</sup> Like so many passages in the Bible, the meaning is far from clear. These four passages have been subject to significant analysis and debate as to their exact meaning, given that they contain ambiguous and contested phrases such as ‘thy brother’, ‘waxen poor’, and ‘my people’.<sup>484</sup> The most direct prohibition of usury is in *Deuteronomy*, where lending of money to ‘thy brother’ is

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<sup>482</sup> This section focuses on protective approaches to usury in Judeo-Christian practices. It should however be noted that historically there has been hostility to usury in all major religions, including Hinduism and Buddhism; Rougeau (n 68) 25. In fact, some of the oldest references to usury are from the Vedic texts from Hinduism; Visser and Macintosh (n 53) 175.

<sup>483</sup> Exodus XXII, 25-27; Leviticus XXV, 35-37; Deuteronomy XXII, 19-20; Ezekiel XVIII, 8 & 13.

<sup>484</sup> Also known as the ‘Old Testament’ or ‘Torah’ and consists of the first part of the Christian Bible.

prohibited but is allowed 'unto a foreigner'.<sup>485</sup> Passages from *Exodus*<sup>486</sup> and *Leviticus*<sup>487</sup> clearly apply usury restrictions to the 'poor' without any other limitations. The *Leviticus* passage further extends the obligations outlined in *Exodus*, applying restrictions on both money and food stuff or grain.<sup>488</sup> Whilst all four references prohibit the charging of any interest, there is a significant variation when it comes to those to whom the protection applies.<sup>489</sup>

The exclusion of usury is continued in a dramatic fashion in *Ezekiel*,<sup>490</sup> which clearly prohibits the charging of interest in any form and includes vivid indications of the consequences of usury. Whilst usury and moneylending are clearly condemned in the Old Testament, the extent of the prohibitions (and thus protection) is a controversial topic.<sup>491</sup>

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<sup>485</sup> 'Thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of any thing that is lent upon usury: Unto a foreigner thou mayest lend upon usury; but unto thy brother thou shalt not lend upon usury: that the Lord thy God may bless thee in all that thou settest thine hand to in the land whither thou goest to possess it': King James Bible, *Authorised Version* (Cambridge Edition) Deuteronomy XXII, 19-20.

<sup>486</sup> 'If thou lend money to any of my people that is poor by thee, thou shalt not be to him as an usurer, neither shalt thou lay upon him usury. If thou at all take thy neighbour's raiment to pledge, thou shalt deliver it unto him by that the sun goeth down: For that is his covering only, it is his raiment for his skin: wherein shall he sleep? and it shall come to pass, when he crieth unto me, that I will hear; for I am gracious': King James Bible (n 485) Exodus XXII, 25-27.

<sup>487</sup> 'And if thy brother be waxen poor, and fallen in decay with thee; then thou shalt relieve him: yea, though he be a stranger, or a sojourner; that he may live with thee. Take thou no usury of him, or increase: but fear thy God; that thy brother may live with thee. Thou shalt not give him thy money upon usury, nor lend him thy victuals for increase': King James Bible (n 485) Leviticus XXV, 35-37.

<sup>488</sup> Bernard J. Meislin and Morris L. Cohen, 'Backgrounds of the Biblical Law against Usury' (1964) 6 *Comparative Studies in Society and History* 250, 262.

<sup>489</sup> Whether 'foreigner' in the *Deuteronomy* passage is the same as 'stranger' referred to in *Leviticus* is highly contentious; however Meislin and Cohen strongly argue that they have very different meanings as, during the period of *Deuteronomy*, a 'foreigner' was a non-resident alien who was only temporarily present in the land and therefore could be charged interest: *ibid* 264-265.

<sup>490</sup> 'He that hath not given forth upon usury, neither hath taken any increase, that hath withdrawn his hand from iniquity, hath executed true judgment between man and man' and later 'hath given forth upon usury, and hath taken increase: shall he then live? he shall not live: he hath done all these abominations; he shall surely die; his blood shall be upon him'; King James Bible (n 485) Ezekiel XVIII, 8 & 13.

<sup>491</sup> Despite common myths about historical limitations on usury and the stereotyped 'Jewish moneylender', restrictions on charging interest were generally only limited to obtaining a reward for loaning money to a kinsman or fellow clansman. This applied across many different groups, for

These prohibitions are often interpreted to only apply to members of the same religion or social group.<sup>492</sup> Putting this political debate aside, the Old Testament passages imply that there were strong concerns about the impact of moneylending on their communities, and on the exploitative actions of lenders.

The situation in the New Testament is not however as straightforward. There are passages that continue to criticise or forbid the charging of usury, but the message is significantly weaker and sometimes conflicted.<sup>493</sup> Despite this, there are a number of specific references to Jesus speaking out against usury, and encouraging Christians to lend to those who are less fortunate without the charging of interest. For example, in *Luke* Jesus told his disciples 'But love ye your enemies, and do good, and lend, hoping for nothing again; and your reward shall be great.'<sup>494</sup> Jesus also famously went into Temple where the moneychangers operated and cast them out, calling them 'thieves'.<sup>495</sup>

Despite the very clear condemnations in the Old Testament of the charging of interest, moneylending continued to be widely practiced by Jewish communities during Biblical times and beyond. There is evidence from the fifth century BC that Jewish moneylenders in Egypt charged interest on loans as a standard practice.<sup>496</sup> It also

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example, Jews could not charge interest to Jews (but could to 'Gentiles'), similarly for Roman citizens to Roman citizens, and for Christians to Christians (see discussion in Bellot (n 54) 1.

<sup>492</sup> Meislin and Cohen argue against this interpretation, and assert that the 'Bible's anti-usury laws are more easily reconcilable with practices and customs growing naturally out of the Hebrews' economic and historical development', and therefore the prohibition extends to all usury, not merely to the charging of interest to other Jewish people. See discussion in Meislin and Cohen (n 488) 266.

<sup>493</sup> The most famous of these is the Parable of the Talents, discussed in J. Duncan and M. Derrett, 'Law in the New Testament: The Parable of the Talents and Two Logia' (1965) 56 *Zeitschrift für die neutestamentliche Wissenschaft* 184.

<sup>494</sup> King James Bible (n 485) Luke VI, 35.

<sup>495</sup> *ibid* Matthew XXI, 12-18.

<sup>496</sup> This has led Visser and MacIntosh to consider that 'the prohibition on interest suggests that its violation was regarded not as a criminal offence with penal sanctions attached but as a moral transgression': Visser and MacIntosh (n 53) 178.

represents a widespread interpretation of the usury limitations only applying to people in the same religious or cultural group, leading to the creation of the 'Jewish moneylender' stereotype. Whilst the references to usury in the New Testament are not as clear as those in the Old Testament, the concept of usury was something that was 'most fervently taken up as a cause by the institutions of the Christian Church',<sup>497</sup> at least on a theoretical level. On a practical level, commercial credit and debt has become widely accepted, and almost unquestionably forms part of the commercial market. Hudson summarises that 'nowhere has this ideology moved further away from that of Biblical times than in its tolerance of ... interest-bearing debt regardless of their polarizing economic consequences'.<sup>498</sup>

### 3.2.2: The Development of Protection

Religion has a strong influence on the way we look at credit and usury. Judeo-Christian beliefs were the basis of the State's approach to usury and protection of borrowers throughout much of early history. By the fourth century AD, the Roman Catholic Church had prohibited the clergy from charging interest.<sup>499</sup> Usury was declared to be a criminal offence by the eighth century, and this approach continued until the 'high water' mark in 1311 when Pope Clement V made a bar on usury absolute, abolishing all secular law on the topic.<sup>500</sup> There was little analysis of the reasons why usury was no longer allowed,

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<sup>497</sup> ibid 178.

<sup>498</sup> Michael Hudson, *The Lost Tradition of Biblical Debt Cancellations* (Henry George School of Social Science 1992) 44.

<sup>499</sup> Visser and Macintosh (n 53) 178.

<sup>500</sup> ibid 178.

merely control by the Church and a belief that because the Bible opposed usury, it should be prohibited.<sup>501</sup>

One of the first philosophers to consider the role of usury in a secular manner was Aristotle. He argued that, whilst the creation and accumulation of wealth was something that should be encouraged, money should not be being loaned merely for the purpose of making money, as this was not good for society.<sup>502</sup> He fought against moneylenders, as their trade was merely focused on making money as an end to itself.<sup>503</sup> In his book *The Politics*, Aristotle argued that usury is unproductive and unnatural, and therefore unjust, declaring it 'most reasonably hated, because one's possessions derive from money itself and not from that which it was supplied... interest is money born of money. So of the sorts of business this is the most contrary to nature'.<sup>504</sup> Aristotle argued that there can be virtue in the good use of wealth, but people in this position should exercise both temperance and generosity.<sup>505</sup>

The impact of religion was particularly evident during the Middle Ages, where society reverted to earlier views on money and exchange, as well as there being a strong reliance on the Bible for guidance and teaching and thus the law.<sup>506</sup> This impacted the

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<sup>501</sup> Davies (n 239) 219. Unsurprisingly, various avoidance mechanisms were adopted by lenders to get around those provisions. To combat these issues, all previous usury laws were repealed in 1545 by 37 Hen VIII, c 9. This Act fixed the legal rate of interest at 10% for commercial and real estate transactions, and enacted a range of anti-avoidance provisions. Penalties also increased, so that if a person was found guilty of usury they forfeited treble the value of the loan and treble the value of profit obtained, half which went to the King and half to the plaintiff or informer. The usurer was also subject to imprisonment and a fine: Bellot (n 54) 20-21.

<sup>502</sup> Jean Roberts, *Routledge Philosophy Guidebook to Aristotle and the Politics* (Routledge 2009) 69-70.

<sup>503</sup> *ibid* 70.

<sup>504</sup> Book 1, Chapter 10 (Carnes Lord trans 1984) cited in Rougeau (n 68) fn 82.

<sup>505</sup> Roberts (n 502) 70.

<sup>506</sup> 'The Bible was the most studied book of the middle ages. Bible study represented the highest branch of learning': Beryl Smalley, *The study of the Bible in the Middle Ages* (3rd ed. edn, Blackwell 1983) 1.

stance on usury as well as the justifications being used for its prohibition. There was a movement away from the Aristotelian approach allowing interest to be charged, and towards Judeo-Christian based prohibition on usury in all forms. This was summarised by Brookes, who stated that during this period ‘the Bible was considered the basic source of knowledge and thus the final word on all matters of importance. For every substantive question and problem, the scripture was consulted for answers—and the Bible clearly opposed usury’.<sup>507</sup>

Nearly 1,500 years later, Thomas Aquinas further developed the concept of fairness in exchange raised by Aristotle.<sup>508</sup> He argued that money was developed for promoting exchanges; hence the proper and principled use of money was as an intermediary of exchange for goods and services as opposed to being a wealth-creating resource in and of itself. The use of money to create more money (ie the charging of interest) was an unnatural use. Aquinas also advocated strongly for the fairness of exchange, stating

a man with money is not in every case bound to lend it ... he who is not bound to lend may receive compensation for what he has done in lending, but ought not to exact more. But compensation is given him according to the equality of justice, if the exact amount is returned to him that he has lent. Hence if he exacts more for the use of a thing that has no other use than the consumption of the substance, he exacts a price for that which has no existence, and so the exaction is unjust.<sup>509</sup>

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<sup>507</sup> Brook (n 240).

<sup>508</sup> Saint Thomas Aquinas, *Aquinas ethicus, or, The moral teaching of St Thomas : a translation of the principal portions of the second part of the "Summa theologica"* (Joseph Rickaby ed, 2nd edn, London : Burns and Oates 1896) especially Question LXXVI.

<sup>509</sup> *ibid* Question LXXVII, § 5.

Despite drawing on the Bible to support of his position on usury,<sup>510</sup> Aquinas clearly felt that there was no duty on the wealthy to lend money.<sup>511</sup>

A similar approach to usury is evident in the writings of Enlightenment scholar Francis Bacon, who in 1601 wrote one of the earliest known detailed academic texts on usury. In his piece *De Usura sive Foenore*,<sup>512</sup> Bacon approached usury from a religious perspective, but justified the charging of limited and strictly enforced levels of interest on the basis of the potential benefits this could have for society. He outlined the many negative aspects of freedom of contract and the charging of interest – it was a ‘lazy trade’ that unfairly disadvantaged the poor, centralised wealth into the hands of a few, impacted the price of land, and dampened industry and development. Lastly and potentially most importantly, interest had the potential to create ‘the canker and ruin of many men's estates; which, in process of time, breeds a public poverty’.<sup>513</sup> Bacon argued that society needed to be protected from these practices. This highlights a very early understanding of the harmful impact that exploitative loans can have on society.

Bacon did recognise the limited benefits of usury, including the encouragement of new industry and trade, particularly for young merchants. It could provide people with access to funds to get through difficult periods, so that they would not have to sell their possessions, and finally it had a practical value, as people need to charge some level of interest for their lending services.<sup>514</sup> After weighing up the positive and negative aspects

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<sup>510</sup> See for example *ibid* Question LXXVII, § 2.

<sup>511</sup> These are discussed in more detail in Chapter 3.2 below.

<sup>512</sup> Francis Bacon, *The Essayes or Covnsels Civill and Morall of Francis Bacon: baron of Verulam, viscount St. Alban, and lord high chancellor of England* (Judy Boss in 1998 tr, Renascence Editions 1625), written in Latin and translated without page numbers.

<sup>513</sup> *ibid* ‘Of Usury’.

<sup>514</sup> Stating ‘whereas usury doth but gnaw upon them, bad markets would swallow them quite up’; *ibid* ‘Of Usury’.

of usury, Lord Bacon suggested a two-tiered approach to the law. First, anyone could lend money, but only at a maximum rate of 5% per annum. Second, a category of licensed moneylenders would be created. These people would be allowed to charge higher rates of interest (up to 10% per annum), but would then be subject to regulation and limitations.<sup>515</sup> When faced with criticism that his plan allowed or encouraged unconscionable behaviour, Bacon also adopted a practical approach and stated ‘that it is better to mitigate usury, by declaration, than to suffer it to rage’.<sup>516</sup>

As discussed in Chapter 2, the Enlightenment created a variety of practical needs and philosophical justifications for the charging of interest, and for a freedom-based approach to credit. At the end of the nineteenth and beginning of the twentieth centuries, the full extent of moneylending (and its damaging impact) was becoming apparent. In response the regulatory approach began to change, and there was a return to a more protective stance.<sup>517</sup> This resulted in a further Select Committee being designated in 1897 to look into the issues associated with moneylending, resulting in the Money-Lenders Act 1900.<sup>518</sup> This Act improved some consumer protections, but still focused largely on economic and contractual freedom of borrowers by advocating non-intervention into debt agreements where possible.<sup>519</sup>

Influenced by the work of Marx, twentieth century thinking on usury changed significantly with more of a focus on the harmful effects of an open credit market on

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<sup>515</sup> *ibid* ‘Of Usury’. This is highly reflective of the approach taken in the Crowther Report and the CCA 1974.

<sup>516</sup> *ibid* ‘Of Usury’.

<sup>517</sup> Chesterton’s book was written in 1933, but was only published in 1943 after his death.

<sup>518</sup> The Select Committee on Money Lending, *1897 Report from the Select Committee on money lending; together with the proceedings of the committee, minutes of evidence, appendix, and index* (n 56).

<sup>519</sup> See discussion in Part 2.1 above.

society. Rougeau comments that 'usury laws have been used throughout history to exercise social control over economic relationships that, unchecked, tend to degenerate into exploitation and other socially counterproductive behaviour'.<sup>520</sup> Marxist theory focused around the importance of labour, and the artificial impact usury had on the market.<sup>521</sup> Both of these benefitted the lenders, who obtained profits without undertaking any productive work; merely making money from the manipulation of capital and the desperation of others. Marx describes usury as 'like a parasite ... it sucks out its blood, enervates it and compels reproduction to proceed under ever more pitiable conditions'.<sup>522</sup>

Keynes' work on interest rates and monetary policies built on these foundations. Whilst disagreeing with a significant proportion of Marxist theory, Keynes had similar approaches to usury and moneylending, describing the acceptance of interest during the Enlightenment as one of the 'pseudo-moral principles which have hag-ridden us for two hundred years, by which we have exalted some of the most distasteful of human qualities into the position of the highest virtues'.<sup>523</sup> Keynes was against opening the credit market because it created 'distasteful and unjust' outcomes that were accepted because they were very useful in promoting the accumulation of wealth.<sup>524</sup> He commented that the 'Medieval' practices forbidding usury were one of the most ancient economic practices on record. In addition to their moralistic arguments, limitations on credit had a positive impact on economic growth. If the credit market was allowed to run without restriction, it

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<sup>520</sup> Rougeau (n 68) 3.

<sup>521</sup> Karl Marx, *Capital Volume III: The Process of Capitalist Production as a Whole* (Institute of Marxism-Leninism, translated by Marxists Internet Archive 1894) Chapter 36: Pre-Capitalist Relationships, Division of Profit into Interest and Profit of Enterprise. Interest-Bearing Capital.

<sup>522</sup> *ibid.*

<sup>523</sup> John Maynard Keynes, 'Economic Possibilities for our Grandchildren' in John Maynard Keynes (ed), *Essays in Persuasion* (W. W. Norton & Company 1963) 362.

<sup>524</sup> *ibid* 362-363.

would impede industrial growth and those with money would focus on exploitative moneylending instead of useful investments.<sup>525</sup>

The devastating consequences of the Great Depression saw a sharp return to protectionism, which included statutory controls on lending and interest rates. When writing shortly after the Depression, Chesterton advocated for a return to an Aquinas-based approach to usury.<sup>526</sup> He believed that the Bentham method of trade and finance<sup>527</sup> was not only morally bankrupt, but was also the cause of the largest ‘universal commercial collapse of our time’.<sup>528</sup> This argument has some justification, and indeed open monetary policies and laissez-faire economic approaches had a clear impact on the Great Depression<sup>529</sup> (although the specific causes are strongly contested and beyond the scope of this thesis). What is clear is that, after the Depression, society was more skeptical of the financial system and more willing to accept government intervention into the market, including the limitation of interest rates.<sup>530</sup> There was also an increasing concern about the need to assist the less fortunate – poverty, inequality and under-consumption all played a role in the creation and impact of the Great Depression.<sup>531</sup> This period saw a movement away from the traditional thoughts of protection to a more consumer-focused consideration of the issues.

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<sup>525</sup> John Maynard Keynes, *The General Theory of Employment, Interest and Money* (MacMillan Cambridge University Press 1936) Chapter 23: Notes on Mercantilism - The Usury Laws, Stamped Money and Theories of Under-Consumption, Section V.

<sup>526</sup> Persky (n 247) 235.

<sup>527</sup> Discussed in Part 2.2.

<sup>528</sup> Gilbert Keith Chesterton, *St. Thomas Aquinas* (Hodder & Stoughton 1943) 225.

<sup>529</sup> See discussion in Peter Temin, *Did monetary forces cause the Great Depression?* (Norton 1976).

<sup>530</sup> See discussion in Brook (n 240).

<sup>531</sup> Elisabeth Allgoewer, *Underconsumption theories and Keynesian economics: Interpretations of the Great Depression* (University of St. Gallen, Department of Economics: Research Paper 2002-14 2002) especially 24-26.

The Marx/Keynes approach to usury and interest rate restrictions clearly had a significant impact on both ongoing academic work and government policy. For example, Franklin D Roosevelt cited moneylending and usury as a cause of the Great Depression in his 1933 First Inaugural Address, stating

Because the rulers of the exchange of mankind's goods have failed, through their own stubbornness and their own incompetence, have admitted their failure, and abdicated. Practices of the unscrupulous money changers stand indicted in the court of public opinion, rejected by the hearts and minds of men. True they have tried, but their efforts have been cast in the pattern of an outworn tradition.

Faced by failure of credit they have proposed only the lending of more money. Stripped of the lure of profit by which to induce our people to follow their false leadership, they have resorted to exhortations, pleading tearfully for restored confidence. They know only the rules of a generation of self-seekers. They have no vision, and when there is no vision the people perish.

The money changers have fled from their high seats in the temple of our civilization. We may now restore that temple to the ancient truths. The measure of the restoration lies in the extent to which we apply social values more noble than mere monetary profit.<sup>532</sup>

The analogies that lenders have ‘fled from their high seats in the temple of our civilization’ and of the need to restore ‘ancient truths’ are particularly interesting, appearing to reference the Christian perspectives on moneylending (discussed in Part 3.2.1 above). Rousseau outlined that ‘most usury prohibitions are grounded in deep ethical and religious

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<sup>532</sup> Franklin D Roosevelt, ‘First Inaugural Address’ (*History Tools*, 4 March 1933) <<http://www.historytools.org/sources/froosevelt1st.html>> accessed 24 June 2015.

condemnations'.<sup>533</sup> The approach taken by Roosevelt signaled a strong movement away from the free market approach to monetary principles, and towards government intervention to ensure a system that reflected 'social values'. The religious prohibition on usury remained a strong underpinning of the protective approaches to high-cost credit.

### 3.2.3: What Can We Learn?

The historical discussion of high-cost credit very effectively highlights the dynamic nature of credit regulation. Throughout history many people have been unable to access mainstream credit, and so were reliant on sub-prime lenders – whether that be the moneychangers from the Bible, moneylenders of Shakespearean times, the doorstep lenders of the early 1900's, or the online payday lenders of today. Whilst the forms of lending have changed dramatically with the evolution of technology, the problems have largely stayed the same. There has been an ongoing pendulum approach to regulation, swinging between the freedom and protective stances on the topic.

Religious grounding resulted in the prohibition of usury throughout much of early history. At the end of the Middle Ages, moneylending was still considered morally reprehensible but was also becoming economically beneficial. Indeed, precept did follow practice – when the Enlightenment arrived, so did new justifications allowing for the charging of interest. The religious stance was swept away in favour of a more practical focus which emphasised personal and economic freedom. The Benthamite approach to usury<sup>534</sup> remained predominant for almost a century, and during this time most lawyers, economists and political commentators advocated against what they perceived as undue

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<sup>533</sup> Rougeau (n 68) 25.

<sup>534</sup> Discussed in Part 2.2.

restrictions on the access to credit.<sup>535</sup> The post Great Depression period saw a temporary return to the protective approach to moneylending and usury. This hiatus was, however, short-lived. The mid-twentieth century resulted in the rise of libertarianism and a focus on individual freedom, choice, and limited government intervention. The high-water mark was hit in the Thatcher era of ‘responsibilisation’, and the opening of the economic and credit markets. The financial crisis and explosion in harmful forms of consumer credit highlighted the failure of this disclosure-focused, freedom-based regime, and the FCA instituted the protective regime discussed in Chapter 1. Thus, the pendulum approach between freedom and protection continues.

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<sup>535</sup> See, for example, discussion in Persky (n 247) and Brook (n 240). Hume added to the jurisprudence on this topic by analysing the connection between high mercantile profits and high interest levels, ‘No man will accept of low profits where he can have high interest ; and no man will accept of low interest where he can have high profits’: David Hume, *The Philosophical Works of David Hume* (Edinb. 1826) Book III, 343; general discussion at 340-345.

### 3.3: Explanations for Protection

The discussions in Chapter 2 showed that negative freedom is almost uniformly considered the starting point of English law.<sup>536</sup> Actions by the government to ‘protect’ people from certain types of credit mean taking options away from borrowers. Justification is therefore needed to move away from this basis to a more protective approach.<sup>537</sup> In the context of high-cost credit, there are three potential justifications for protection that will be discussed – preventing harmful outcomes, stopping unconscionable behaviour, and defending the vulnerable.<sup>538</sup>

#### 3.3.1: Preventing Harmful Outcomes

The first explanation to consider is protection as a means of preventing harmful outcomes. There are two strands to this justification, the first focusing on the harm caused to society in general and the second based on harms to the individual borrower. Both of these are highly relevant to the protective approach taken to high-cost credit contracts.

We as a society have a general dislike of (and distrust towards) people engaging in usurious activities. These types of products are often seen as destructive to the community. Intervention can therefore be justified by the impact that these financial agreements have on our society. The ‘protection’ given is not only to specific individuals, but more importantly to notions of what are acceptable and palatable aspects of society. Intervention of this type in the context of high-cost credit is largely associated with the general disdain for usury. The charging of extortionate levels of interest is widely

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<sup>536</sup> See discussion in Part 2.2.

<sup>537</sup> Rougeau (n 68) 19.

<sup>538</sup> It is recognised that there are a number of other justifications for protection available, see for example discussion in Satz (n 297) and Chen-Wishart, ‘The Nature of Vitiating Factors in Contract’ (n 232). These three were chosen because of their particular relevance to high-cost credit challenges.

criticised, arising from the historical religious prohibitions. As has been discussed in Part 3.2 above, there is a long and complex history of multiple religions prohibiting usury.<sup>539</sup> This has had a strong impact on the way our society views high-cost credit. These products, in particular payday lending, have been widely referred to as ‘modern day usury’,<sup>540</sup> and there is frequent discussion on the evil nature of such products.<sup>541</sup> In these extreme cases, the contracts made are ‘offensive to decency’ and intervention is justified.<sup>542</sup>

Many commentators throughout history have justified protection on the grounds of harm to society, for example Aristotle, Aquinas and Bacon.<sup>543</sup> This approach is an example of moral-based paternalism,<sup>544</sup> where intervention is justified on the belief that society will be better without the activity in question. It is not concerned with the outcome for the individual impacted by the intervention action, only the state of the

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<sup>539</sup> See discussion in Part 3.1 above. It is also discussed in Charles R. Geisst, *Beggar Thy Neighbor: A History of Usury and Debt* (University of Pennsylvania Press 2013).

<sup>540</sup> See discussion in The Center for Responsible Lending (n 149).

<sup>541</sup> See, for example, Gentleman (n 187); Barrow, (n 187); Edwards, (n 199); Packman (n 205); Sommerlad (n 335).

<sup>542</sup> Fried (n 225) 11.

<sup>543</sup> These historical commentators are discussed in Part 3.2.2.

<sup>544</sup> Gerald Dworkin, ‘Moral Paternalism’ (2005) 24 *Law and Philosophy* 305, 307-310. The contrast between these moral and welfare-based paternalism can be seen in the regulation of prostitution. A strict moral-based paternalistic approach would outlaw the activity, enforcing punishments on both the prostitute and his or her clients. Hence the immoral act has been prevented and the regulatory goal has been fulfilled. In contrast, a welfare-based paternalistic approach would focus on the harm caused by prostitution, i.e. the damage that is suffered when people are in such potentially degrading and harmful situations. A regulatory response may therefore outlaw the activity but is unlikely to punish the ‘victims’ of prostitution – the prostitutes themselves – and instead focus on the clients. It would also organise rehabilitation programs designed to prevent people from falling into this profession. Alternatively, a welfare-based response may recognise that outlawing these activities often pushes the activities underground, making the situation more dangerous for the people involved. Thus it could legalise prostitution providing that certain requirements are met, ensuring that the activity occurs in a safe and secure manner: For more details on the different regulatory approaches to prostitution, see Jane Scoular and Maggie O’Neill, ‘Regulation Prostitution: Social Inculcation, Responsibilisation and the Politics of Prostitution Reform’ (2007) 47 *British Journal of Criminology* 764. It is beyond the scope of this thesis to consider the different forms of paternalism in any depth, however further reading can be found at Christian Coons and Michael Weber (eds), *Paternalism: Theory and Practice* (Cambridge University Press 2013).

community as a whole. This notion of ‘harm’ is linked with ideas of the moral limits of markets, and what types of contractual transactions can and should be enforced by our society.<sup>545</sup> A similar distinction is raised by Satz, who uses the extreme harm that noxious markets can have on society and/or individuals as a justification for government intervention.<sup>546</sup>

The second type of harm to consider is the damage that these products can cause to borrowers. In the context of high-cost credit, the focus is not on the state of the lender or the characteristics of the borrower, but on how the lending impacted the debtor.<sup>547</sup> There is strong evidence to support this justification, which has been discussed in-depth earlier in this thesis.<sup>548</sup> Inappropriate lending of high-cost credit clearly has the ability to cause significant and long-lasting harm to borrowers, including the creation of destructive debt spirals where it can sometimes take years to repay the loans in question.<sup>549</sup>

We have created an economic and social situation where many people enter into these potentially harmful contracts just to ‘get by’. This is unacceptable – as outlined by Chen-Wishart ‘voluntarily undertaking something repugnant is worse than undertaking it under coercion’.<sup>550</sup> As an example, having a society where people choose to be enslaved

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<sup>545</sup> See Satz (n 297) especially 98, Table 1: What Makes a Market Noxious.

<sup>546</sup> See Gerald Dworkin, ‘Paternalism’ (*Stanford Encyclopedia of Philosophy*, 2016) <<https://plato.stanford.edu/entries/paternalism/>> accessed 13 December 2016, Parts 2.1- 2.5. It is beyond the scope of this thesis to consider the different forms of paternalism in any depth, however further reading can be found at Coons and Weber (n 544).

<sup>547</sup> See Dworkin, ‘Paternalism’ (n 546), Parts 2.1- 2.5. It is beyond the scope of this thesis to consider the different forms of paternalism in any depth, however further reading can be found at Coons and Weber (n 544).

<sup>548</sup> See, in particular, the discussion on ‘Why High-Cost Credit’ in the Introduction.

<sup>549</sup> Carl Packman, Author & Consumer Advocate (28 February 2013). Telephone interview; David Barclay, The Contextual Theology Centre (28 March 2013). Telephone interview.

<sup>550</sup> Chen-Wishart, ‘The Nature of Vitiating Factors in Contract’ (n 232) 26. See also Raz, *The Morality of Freedom* (n 203).

(or sell their children into slavery) due to lack of viable alternatives is in many ways worse than forcing people into slavery.<sup>551</sup> The outcome is the same, but because a 'choice' was apparently made, responsibility is taken away from the State and blame placed on the individual. As discussed above in 1.2.1, victim-blaming is an ongoing problem in the high-cost credit market. Raz highlights that a more meaningful understanding of freedom can justify the restriction of a person's rights for the sake of providing them with greater autonomy, or preventing harm to their future autonomy.<sup>552</sup> Such contracts need not and should not be upheld; they are not worthwhile choices that the law should facilitate.

### 3.3.2: Stopping Unconscionable Behaviour

The second explanation to consider in the context of high-cost credit is the prevention of unconscionable lender behaviour and exploitative actions. This concept focuses on the actions of lenders, and states that, when a certain threshold of unconscionability is reached, the law is entitled, and possibly even obligated, to intervene in the market to protect borrowers. A freedom of contract approach is not concerned with advantage-taking by parties. Financial difficulties in and of themselves remain insufficient to warrant legal protection.<sup>553</sup> The liberal version of contract law is generally associated with a rigid concept of freedom of contract. It is a freedom to make contracts and have them enforced, even in circumstances where considerations of fairness and substantive equality

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<sup>551</sup> Satz (n 297) 100.

<sup>552</sup> Raz, *The Morality of Freedom* (n 203) 419.

<sup>553</sup> *Boustany v Pigott* (n 412) 303. See also Chen-Wishart, 'Undue Influence: *Beyond* Impaired Consent and Wrongdoing towards a Relational Analysis' (n 414) 203. This was also outlined in Lord Templeman's words 'unequal bargaining power ... provide[s] no basis for equitable interference', which is also discussed in 2.4.5 above.

may justify otherwise.<sup>554</sup> A protective approach has a different focus; exploitation and unconscionability are key reasons for active intervention.

Unconscionable lender conduct has been an ongoing theme of moneylending. The condemnation of usury and 'villainous' moneylenders is prevalent throughout most of history, and even appears in writings by Dante and Shakespeare.<sup>555</sup> In Dante's poem *The Inferno*, usurers were condemned to the seventh rung of Hell, where they were punished by having a heavy bag of money placed around their neck for eternity and so were forever weighed down by their own greed.<sup>556</sup> One of the most famous examples of the 'evil moneylender' is in the Shakespearean play *The Merchant of Venice*. The Jewish moneylender Shylock is described as acting with 'extreme cruelty'<sup>557</sup> when he lends money to the Merchant of Venice.<sup>558</sup> The condemnation of usury and moneylenders was also evident in the courts. In 1913 a judge in New York sent a moneylender to jail for six months, stating

Poor people must be protected from such sharks as you, and we trust that your conviction and sentence will be a notice to you and all your kind that the courts have found a way to put a stop to usury. Men of your type are a curse to the community, and the money they gain is blood money.<sup>559</sup>

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<sup>554</sup> Kimel, *From Promise to Contract: Towards a Liberal Theory of Contract* (n 278) 117. Iain Ramsay, 'Consumer Law, Regulatory Capitalism and the 'New Learning' in Regulation' (2006) 28 *Sydney Law Journal* 9; Ogus, *Costs and Cautionary Tales: Economic Insights for the Law* (n 461); Ogus, *Regulation: Legal Form and Economic Theory* (n 454).

<sup>555</sup> Brook (n 240).

<sup>556</sup> Dante Alighieri, *The Inferno*, Canto XVII, lines 51–54.

<sup>557</sup> William Shakespeare, *The Merchant of Venice* (Printed by IR for Thomas Heyes 1600) Title Page.

<sup>558</sup> See, for example, Barbara K. Lewalski, 'Biblical Allusion and Allegory in "The Merchant of Venice"' (1962) 13 *Shakespeare Quarterly* 327.

<sup>559</sup> James Grant, *Money of the Mind : borrowing and lending in America from the Civil War to Michael Milken* (Farrar Straus Giroux 1992) 83.

This distaste towards usury and high-cost credit was further reflected in literature, with many prominent authors such as Dickens and Dostoyevsky including villainous moneylenders as characters in their works.<sup>560</sup>

There is significant evidence of modern-day lender unconscionability. The Introductory discussion<sup>561</sup> and Chapter 1<sup>562</sup> of this thesis provided numerous further examples of lenders acting in an unconscionable manner that justifies State interference in any resulting contracts. There is clearly ample evidence of inappropriate lender actions, and it is happening to such an extent that a more protective approach is strongly justified, and indeed necessary.

### 3.3.3: Defending the Vulnerable

The final historical explanation to consider is the defence of vulnerable parties. Intervention on this basis is justified because the borrower in question is in such an impaired situation that they could not have provided sufficient consent to the contract in question. A 'defending the vulnerable' approach can be seen in *Earl of Aylesford v Morris*<sup>563</sup> and *Fry v Lane*,<sup>564</sup> where the courts set aside the transactions on the basis that one of the parties was 'poor, ignorant or illiterate'.<sup>565</sup> The approach was continued in *Cresswell v Potter*, where Megarry J applied the test in *Fry v Lane* to find that a telephone

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<sup>560</sup> Brook (n 240).

<sup>561</sup> See discussion in the text for fns 34 to 39.

<sup>562</sup> See discussion in the text for fns 96 to 99.

<sup>563</sup> *Earl of Aylesford v Morris* (1872-73) LR 8 Ch App 484 (CA).

<sup>564</sup> *Fry v Lane* (1888) 40 Ch D 312 (Ch D).

<sup>565</sup> *ibid* in particular the statement from Kay J that there 'are clear authorities that a purchase at an undervalue from a poor, ignorant, or illiterate person, having no independent advice, cannot be sustained' (at 319).

receptionist without any understanding of property transactions and conveyancing 'may fairly be described as falling within whatever is the modern equivalent of "poor and ignorant"'.<sup>566</sup> The interpretation placed on these words in the modern context has been expanded generously to provide assistance to a wide range of potentially vulnerable parties.<sup>567</sup>

This justification focuses on the context of the lending situation, and recognises that the multiple economic and social pressures experienced by borrowers can justify protection. The discussions in Chapter 1 identify that people should have a range of meaningful choices from which to pick. If these choices are not present, there is sufficient ground for intervention.<sup>568</sup> Protecting the vulnerable focuses on personal autonomy<sup>569</sup> and engages with the specific characteristics of borrowers. As discussed by Kimel,

Certain options can have the effect of reducing one's overall autonomy, of one's chances of leading an autonomous life, even if chosen freely. Discouraging, or even preventing a person from choosing such an option can quite straightforwardly be justified as a means of protecting her autonomy, of preventing her from compromising it through one rash or ill-calculated, albeit free, decision.<sup>570</sup>

In the context of high-cost credit, an analogy can be drawn between protecting borrowers and justifications for indirect discrimination protection. They are both concerned with

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<sup>566</sup> *Cresswell v Potter* (n 413) 257.

<sup>567</sup> In fact, Atiyah goes further and comments that 'the interpretation placed on these words ... is so generous that they seem to have virtually disappeared as independent requirements of the principle': Atiyah, *Essays on Contract Law* (n 150) Essay 11, pp 344-345.

<sup>568</sup> Raz, *The Morality of Freedom* (n 203) 152.

<sup>569</sup> Personal autonomy is discussed in Raz (n 203). See also discussion in Part 3.3.3.

<sup>570</sup> Kimel, 'Neutrality, Autonomy, and Freedom of Contract' (n 278) 485.

preventing 'compounding injustice'<sup>571</sup> to an already vulnerable group of individuals. As outlined by Hellman, 'the actor has a special reason to avoid harming a victim of injustice when her actions would constitute compounding injustice'.<sup>572</sup> It does, however, mean that legal intervention can be justified, not because the lender caused the borrower's vulnerability, but because their actions exacerbated or increased the harm suffered by that individual. There is also severely unequal bargaining power between the parties involved in the high-cost credit market.<sup>573</sup> Exchanges between parties with vast differences in wealth can often include some form of advantage-taking due to the superior bargaining position of the wealthier party. They are less likely to be in a position that forces them to make an agreement on unfavourable terms.<sup>574</sup> They can be compared to impecunious parties who are conversely almost always at some sort of disadvantage.<sup>575</sup>

The emphasis on freedom, particularly relating to the economic market, is often based on unrealistic assumptions about individuals. One of these is the fiction that all parties are rational beings who can look out for their own interests without State assistance.<sup>576</sup> A number of characteristics of high-cost credit borrowers challenge this libertarian perspective of contractual relations. Many borrowers have attributes that place them in a vulnerable position where they can be easily exploited by lenders, although

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<sup>571</sup> Defined as 'an action that exacerbates the harm caused by the prior injustice because it entrenches the harm or carries it into another domain'; Deborah Hellman, 'Indirect Discrimination and the Duty to Avoid Compounding Injustice' in Hugh Collins and Tarunabh Khaitan (eds), *Foundations of Indirect Discrimination Law* (Hart Publishing 2018) 107. I am very grateful to Sandy Steel for bringing this material to my attention.

<sup>572</sup> *ibid* 108.

<sup>573</sup> Justin Malbon, 'Predatory Lending' (2005) 33 *Australian Business Law Review* 224, 235.

<sup>574</sup> Kronman (n 478) 496.

<sup>575</sup> See comments by Justice Posner in *Selmer Co v Blakeslee-Midwest Co* 704 F 2d 924 (7th Cir 1983), 928.

<sup>576</sup> Daniel Farber, 'Contract Law and Modern Economic Theory' (1983) 78 *Northwestern University Law Review* 303.

determining when a consumer is sufficiently 'vulnerable' can be difficult.<sup>577</sup> High-cost credit products are not an active choice for some people, and may be the only option for many desperate consumers to 'get by' each month. These borrowers will usually be unable to purchase mainstream products due to their previous interactions with the credit system.<sup>578</sup> This financial vulnerability means that high-cost credit borrowers will continue to need these potentially dangerous products, justifying additional government protection and intervention into the market.

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<sup>577</sup> Fred Morgan, Schuler Drue and Jeffrey Stoltman, 'A Framework for Examining the Legal Status of Vulnerable Consumers' (1995) 14 *Journal of Public Policy & Marketing* 267; Craig Smith and Elizabeth Cooper-Martin, 'Ethics and Target Marketing: The Role of Product Harm and Consumer Vulnerability' (1997) 61 *Journal of Marketing* 1.

<sup>578</sup> Department of Business Innovation and Skills, *Making Consumer Credit Fairer* (n 32).

### 3.4: Examples of Protection

The law has used a number of tools to protect borrowers from substantively unfair agreements and lenders' coercive tactics. In the context of high-cost credit, five key examples of protective-based intervention will be discussed; (1) amending or restricting contract terms, (2) interest rate restrictions, (3) responsible lending requirements, (4) unfair terms legislation and (5) common law protections. The first three are specifically related to high-cost credit, and whilst the final two are general provisions they are highly relevant to the current issues.

#### 3.4.1: Amending or Prohibiting Contract Terms

The first legal mechanism that can be used to protect borrowers is amending or prohibiting terms in the loan contract that are considered harmful. Prohibitions are amongst the strongest types of protection as they directly restrict the choices that can be made by consumers. The regulation of credit contract terms in this manner was loosely supported in the Crowther Report. Its recommendations included making a number of 'objectionable terms' void, such as terms seeking to exclude or limit borrowers' rights or to accelerate borrowers' obligations, and the imposition of interest on default at a rate higher than the contract interest rate.<sup>579</sup> These were largely implemented in the CCA 1974,<sup>580</sup> creating a range of contractual restrictions and prohibitions that apply specifically to high-cost credit contracts.

Prior to the transfer of oversight, the FCA announced a further range of limitations and prohibitions that would apply to these financial products. These proposals expanded

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<sup>579</sup> Crowther (n 69) 286.

<sup>580</sup> See, for example, Consumer Credit Act 1974 (UK), ss 86F, 87 and 93.

the existing OFT protections, complementing them with increased supervision and enforcement powers.<sup>581</sup> The regulations took a more interventionist approach, recognising the considerable problems being experienced and removing the most harmful aspects of these credit products.<sup>582</sup> The contractual limitations included:

- permitting a maximum of two rollovers<sup>583</sup> of the loan amount;<sup>584</sup>
- allowing for a maximum of two unsuccessful attempts at Continuous Payment Authorities (CPAs) to pay off the loan in full;<sup>585</sup> and
- a prohibition on the use of CPAs for part payments.<sup>586</sup>

The purpose of these reforms was to protect borrowers by removing some of the most harmful aspects of high-cost credit, and prohibiting businesses from lending to consumers who could not afford the loan.<sup>587</sup> These legal provisions attempt to stop relatively small and short-term loans of money from snowballing into largely unmanageable debts, and to prevent lenders from being able to 'drip-feed' money from borrowers' accounts without their awareness or approval (and before priority debts are paid). It highlights a movement away from the OFT's freedom-based approach, and towards a more interventionist focus where specific business practices or lending models are prohibited.

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<sup>581</sup> HM Treasury and Department of Business Innovation and Skills (n 103) Parts A4, 11, 12.

<sup>582</sup> *ibid* 53-54.

<sup>583</sup> Defined as the automatic extension the loan after its initial due date, thus incurring further interest.

<sup>584</sup> The Financial Conduct Authority, *FCA Handbook, Consumer Credit Sourcebook (CONC)* (n 361) 6.7.23.

<sup>585</sup> *ibid* 4.6.2(2)(j).

<sup>586</sup> *ibid* 7.6.12(1).

<sup>587</sup> HM Treasury and Department of Business Innovation and Skills (n 103) 54.

### 3.4.2: Prohibiting or Limiting Interest

Another key way that the law can protect borrowers of high-cost credit is through the prohibition or restriction on the interest that can be charged. After significant consideration, the Crowther Report decided not to recommend an interest rate cap. It agreed instead with the approach already in place, where an interest rate in excess of 48% would be considered by the court to be *prima facie* excessive, and the transaction harsh and unconscionable.<sup>588</sup> As the use of consumer credit in the UK became more widespread, different types of lending emerged and the interest rates charged for short-term loans skyrocketed. It became clear in the early 2000s that significant amendments to the 1974 Act were required to ensure that it was appropriate and adequate to regulate consumer credit in the twenty-first century.<sup>589</sup> The situation was exacerbated by the global financial crisis, as mainstream creditors generally became more risk-averse in lending, which in turn forced more people to look to alternative lending streams.<sup>590</sup>

The explosion of high-cost credit from 2011 created a new focus towards restricting the total cost of credit,<sup>591</sup> and the interest rate cap debate received increasing levels of media and academic interest.<sup>592</sup> Interest rate caps are not unusual; England had

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<sup>588</sup> Crowther (n 69) 274.

<sup>589</sup> This was considered in a number of government publications. See, for example, Department of Trade and Industry, *Fair, Clear and Competitive: The Consumer Credit Market in the 21st Century - White Paper* (n 87); HM Treasury (n 87).

<sup>590</sup> McCartney and Gibbons (n 12) 10.

<sup>591</sup> See Ramsay, 'To Heap Distress Upon Distress': Comparative Reflections of Interest-Rate Ceilings' (n 456), which comments 'All groups believe that they are acting in the best interests of lower-income consumers. They agree that the poor pay more for credit but differ on the effective means of responding to this problem ... These differences may reflect deeper ideologies about the market and consumers, with more concern in France than in the United Kingdom to protect consumers from the market rather than the presumption in favour of consumer choice or access' (at 714).

<sup>592</sup> See, for example, Chris Deeming, Sharon Collard and David Hayes, *Affordable Credit: Lessons from Overseas* (Personal Finance Research Centre, 2011); Damon Gibbons, *Taking on the money lenders: Lessons from Japan* (Centre for Responsible Credit, 2012); Wallace (n 254).

interest caps at a number of points during history.<sup>593</sup> A number of jurisdictions have caps, including Japan,<sup>594</sup> Germany, Greece, France, Ireland, Malta<sup>595</sup> and more recently Australia.<sup>596</sup> There is strong evidence that interest rate caps have had a positive impact in other jurisdictions, as they ensure loans can be provided only at a socially agreed maximum rate, and consequently force unscrupulous lenders out of the market.<sup>597</sup> Limitations on the cost of credit can be justified on the grounds of substantive fairness<sup>598</sup> or distributive justice.<sup>599</sup> The ‘horror stories’ from Chapter 1<sup>600</sup> citing interest repayments that quickly spiral out of control also make these reforms seem an appropriate response. Implementing interest rate caps is not, however, the straight-forward fix many people believe it to be, and banning high-cost credit will not stop people on low incomes experiencing financial difficulties.<sup>601</sup>

Under the OFT, there was a debate about the merits of enforcing some sort of cap on the total cost of credit, particularly as reports came to light of interest rates of up to

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<sup>593</sup> See discussion in 3.2.1.

<sup>594</sup> See discussion in Gibbons (n 592).

<sup>595</sup> Udo Reifner, Sebastien Clerc-Renaud and RA Michael Knobloch, *Study on interest rate restrictions in the EU, Final Report for the EU Commission DG Internal Market and Services* (Institute for Financial Services, Hamburg, 2010).

<sup>596</sup> On 1 July 2013, the Consumer Credit Legislation Amendment (Enhancements) Act 2012 (Cth) came into force. This Act made significant amendments to the National Consumer Credit Protection Act 2009 (Cth) and the National Credit Code 2009 (Cth) limiting interest to 48% per annum and providing strict restrictions on fees and charges for loans: National Credit Code 2009 (Cth), ss 31A, 32A. Note that this is subject to some exemptions for Authorised Deposit Taking Institutions. Discussed in detail in Nicola Howell, ‘New regime for regulating small loans in Australia’ (Consumers, Credit and the Law Symposium, Brisbane, 8 July 2013).

<sup>597</sup> See analysis of Japan in Gibbons (n 592), and Australia in Marcus Banks and others, *Caught Short: Exploring the Role of Small, Short-Term Loans in the Lives of Australians* (Social Policy Unit, The University of Queensland, Brisbane, 2012).

<sup>598</sup> See discussion of substantive unfairness in Chapter 4.

<sup>599</sup> See Harrison (n 232); Kronman (n 478); Iain Ramsay, ‘Consumer Credit law, Distributive Justice and the Welfare State’ (1995) 15 *Oxford Journal of Legal Studies* 177.

<sup>600</sup> See specifically text attached to fn 199.

<sup>601</sup> Marie Burton, *Keeping the plates spinning: perceptions of payday loans in Great Britain* (Consumer Focus 2010).

8,000%<sup>602</sup> and 16,000%<sup>603</sup> APR. The OFT did not implement any sort of restriction on the cost of credit. The PFRC at Bristol University released a report in 2013 highlighting the lack of empirical evidence on the potential impact of a cap in the UK.<sup>604</sup> The FCA itself also commented that owing to the lack of credit alternatives for low income consumers, a restriction on the total cost of credit could exacerbate the financial difficulties of some borrowers.<sup>605</sup> Consumer organisations themselves are divided about whether restricting access to credit, particularly in the form of interest rate caps, is the best way to protect borrowers.<sup>606</sup> Whilst the exact outcome of a cap on credit is difficult to determine, it is clear that due to the high upfront costs and the short-term nature of the loans, any substantial cap on the cost of credit will price the vast majority of high-cost credit

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<sup>602</sup> McCartney and Gibbons (n 12) 8.

<sup>603</sup> David Barclay, The Contextual Theology Centre (28 March 2013). Telephone Interview.

<sup>604</sup> Personal Finance Research Centre, *The Impact on Business and Consumers of a Cap on the Total Cost of Credit* (Department of Business and Innovation Skills 2013).

<sup>605</sup> The Regulator stated 'Many consumers use payday loans because, despite high APRs, that is the only source of credit available to high-risk borrowers in emergencies. They might be made worse off by caps on APRs or restrictions on how often they can borrow if they reduce availability to some consumers. Indeed, usury laws and similar provisions have been cited as an example of regulatory failure driven by regulators' own behavioural biases.' See further discussion in Tara Evans, 'No cap on payday loan interest rates hints new government watchdog' *This Is Money* <<http://www.thisismoney.co.uk/money/cardsloans/article-2308191/No-cap-payday-loan-rates-hints-new-government-watchdog.html>> accessed 14 April 2013. The comments about behavioural bias of regulators reflects the discussion in Part 3.3 below, which highlights the potential for regulators to overlook the negative impact caps can have on people who can no longer access credit. This is further discussed in by Porres in disturbingly similar wording – 'In this respect, usury laws have been denounced as a "regulatory failure" driven by the regulators' own behavioral biases': E. Porres, *Bubbles and Contagion in Financial Markets: An Integrative View* (Palgrave MacMillan 2016) 87.

<sup>606</sup> The complex nature of this question is elegantly outlined by the conflicting messages in an article by Rougeau analysing usury laws. The potential negative impact of increased restrictions on consumer lending is discussed by the author, who states consumer protection reforms can 'constrict the supply of credit in the economy and the ability of consumers of credit to make economic choices. Such laws hurt the poorer members of society because they are least likely to get credit ... If one assumes that the major purpose of usury laws are to protect lower income borrowers, then the economic analysis suggests that the laws harm exactly those people they are supposed to help' (Rougeau (n 68) 17). He does however comment later in the same article that a restriction in the supply of credit can have positive consequences for borrowers and society at large, stating that 'consumers might have less access to credit, but that is not necessarily a negative development. Less unsecured consumer credit in the economy may have socially beneficial effects, such as promoting savings, lowering indebtedness, discouraging impulse buying, and encouraging more community-based and mutual-aid type lending' (ibid 43).

providers out of the market. A report produced by the Joseph Rowntree Foundation estimated that, because of the significant costs involved in short-term lending, a not-for-profit home lending business would have to charge customers approximately 129% APR merely to cover costs.<sup>607</sup> Any significant limitation on the cost of credit will therefore result in less access to high-cost credit products, particularly for low-income individuals, as businesses may not to lend to higher risk borrowers at the statutory rate.

Despite these reservations, the government announced a cap on the total cost of credit in November 2012. An amendment to the Financial Services (Banking Reform) Act 2013 required the FCA to restrict the charges applicable to HCSTC by 2 January 2015. After the results of the research by Bristol University and the FCA, this move took a large number of stakeholders by surprise, and appeared to be a highly politicised reaction to the public backlash against high-cost credit.

The FCA published proposals for the cap on 15 July 2014,<sup>608</sup> and confirmed the details on 11 November 2014.<sup>609</sup> The cap consisted of the following:

- the initial cost of credit capped at 0.8% per day;<sup>610</sup>
- default fees limited to £15 and default interest to 0.8% per day;<sup>611</sup> and
- a 100% repayment cap, meaning that the borrowers will not repay more than double the amount they borrowed.<sup>612</sup>

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<sup>607</sup> Elaine Kempson and others, *Is a Not-For-Profit Home Credit Business Feasible?* (Joseph Rowntree Foundation, 2009).

<sup>608</sup> The Financial Conduct Authority, *Proposals for a Price Cap on High-Cost Short-Term Credit: Consultation Paper* (n 5).

<sup>609</sup> The Financial Conduct Authority, *Detailed rules for the price cap on high-cost short-term credit; Including feedback on CP14/10 and final rules* (n 4).

<sup>610</sup> The Financial Conduct Authority, *FCA Handbook, Consumer Credit Sourcebook (CONC)* (n 361) 5A.2.3.

<sup>611</sup> *ibid* 5A.2.14.

<sup>612</sup> *ibid* 5A3.2.

The impact of the cap means that the ‘average’ 30-day loan will cost consumers £24 per £100 lent. This is still expensive credit, equating to an annualised percentage rate of over 1,270%. Prior to the implementation of a cap, the OFT reported that the average loan was costing £25 per £100 lent.<sup>613</sup> This suggests that, for some loans, the impact of the cap will be relatively small. This is not uniform, and the cap will have more of an impact in certain parts of the industry and for certain lenders. As an example, prior to the cap *Wonga* charged £37.15 to borrow £100 over a month.<sup>614</sup>

The FCA cap has reduced the cost of credit for many borrowers in the market, but it will remove others from the high-cost credit market completely. The FCA estimated that the combination of the lending limitations (discussed in Part 3.4.1 above) and cap will result in 160,000 – or 11% of the existing borrowers<sup>615</sup> – being unable to access high-cost credit. The regulator commented that these borrowers would be ‘better off’, although no data was given by the FCA to support these assertions. Further research, including interviews with borrowers of high-cost credit, highlights financial exclusion of this type can actually exacerbate pre-existing disadvantages. This will be discussed further in Part 3.5.3 below.

### 3.4.3: Responsible Lending Obligations

The third protective mechanism to consider is the introduction of responsible lending obligations, arguably the most important aspect of the current legislative regime for high-

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<sup>613</sup> The Office of Fair Trading, *Payday Lending Compliance Review - Interim Report* (n 12) 4.

<sup>614</sup> Website checked 30 June 2014.

<sup>615</sup> The Financial Conduct Authority, *Proposals for a Price Cap on High-Cost Short-Term Credit: Consultation Paper* (n 5) para 5.15. The impact of just the price cap was later estimated to be approximately 7% of the market; The Financial Conduct Authority, *The Financial Conduct Authority, Detailed rules for the price cap on high-cost short-term credit; Including feedback on CP14/10 and final rules* (n 4) 69.

cost credit. Responsible lending protects borrowers by providing a legal imperative for lenders to act in an accountable and safe manner when contracting with borrowers. There were no explicit references to responsible lending obligations in the 1974 Act. Under the Act as passed, the requirement to lend responsibly was included in the fitness test for licensees; the OFT required creditors to engage in responsible lending in order to obtain and continue to hold a consumer credit licence.<sup>616</sup> There were also indications of responsible lending requirements in the duty to explain the nature and consequences of credit,<sup>617</sup> and the duty to make a creditworthiness assessment.<sup>618</sup> The Consumer Credit Act 2006 introduced section 25(2B), stating that the OFT required creditors to lend ‘responsibly’ as a licence condition – although again no definition of ‘responsible lending’ was provided under the Act.

Prior to the FCA amendments in this area, the duty on the lender was merely a requirement to explain the nature and consequences of the credit. The lender had an obligation to provide the borrower with a sufficient explanation of the credit contract so that the *borrower* could determine whether the agreement was suitable for their needs and financial situation.<sup>619</sup> Effectively, this put the obligation on the consumer to *borrow* responsibly. There was no obligation for the lender to enquire about the borrower’s intended use, requirements or objectives of the credit sought.<sup>620</sup> It was, however, a breach of the guidance to promote the sale of a credit product which was ‘clearly unsuitable’ for the specific borrower and their financial situation and/or intended use (but only if this

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<sup>616</sup> See references to the requirement to lend responsibly in The Office of Fair Trading, *Consumer Credit Licensing: General guidance for licensees and applicants on fitness and requirements* (n 330) 4, 6, 8, 9 and 30.

<sup>617</sup> Consumer Credit Act 1974 (UK), s 55A.

<sup>618</sup> Consumer Credit Act 1974 (UK), s 55B.

<sup>619</sup> Consumer Credit Act 1974 (UK), s 55A(1).

<sup>620</sup> This was discussed in Fairweather (n 306).

information was known by the lender).<sup>621</sup> As there was no obligation on the lender to enquire about this information, it was unclear if and how this provision could be enforced by the regulator. It effectively encouraged lenders to not enquire about the borrower's financial situation or intended use, thereby putting a premium on lender ignorance. In addition, the reference to 'clearly unsuitable' laid down a high threshold for a breach of the obligation.

It became evident that many lenders were not following these requirements, and in 2011 the OFT produced 'Irresponsible Lending – OFT Guidance for Creditors' (ILG). Lenders needed to comply with this guidance as part of determining fitness for their consumer credit licence, taking 'reasonable steps' to ensure that borrowers could meet their credit repayments in a sustainable manner (ie credit can be repaid without undue difficulty, over the life of the specific credit agreement, and without the borrower having to release any assets).<sup>622</sup> The specific requirements of 'reasonable steps' were proportionate to<sup>623</sup> and dependent upon a number of different factors, including the type of credit product, the amount of credit provided, the borrower's financial situation, existing and future financial commitments, and credit history.<sup>624</sup> Unfortunately, the OFT did not lay down any guidance on the steps that may be required in this regard, indicating that it was left to the discretion of the lender to determine what was reasonable in the specific circumstances of the loan. Huge discretion was given to the lender, despite there being clear evidence of exploitative activities and business models.

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<sup>621</sup> The Office of Fair Trading, *Irresponsible Lending - OFT Guidance for Creditors* (2010) 15.

<sup>622</sup> *ibid* 14, 36.

<sup>623</sup> Proportionality was clearly a key concept for the OFT guidelines on Irresponsible Lending, as it was referred to 17 times in the Guidance, including the aim of a 'fair, effective and proportionate enforcement' regime. However, what this phrase meant in the context of responsible lending and how the test would be applied was never specified by the regulator.

<sup>624</sup> The Office of Fair Trading, *Irresponsible Lending - OFT Guidance for Creditors* (n 621) 36, 40-42.

The legal enforceability of the ILG was also uncertain, as outlined in the Foreword of the Guidance:

The primary purpose in producing this guidance is to provide greater clarity for businesses and consumer representatives as to the business practices that the Office of Fair Trading (OFT) considers may constitute irresponsible lending practices for the purposes of section 25(2B) of the Consumer Credit Act 1974. It indicates types of deceitful or oppressive or otherwise unfair or improper business practices which, if engaged in by a consumer credit business, could call into consideration its fitness to hold a consumer credit licence. Whilst this guidance represents the OFT's view on irresponsible lending, it is not meant to represent an exhaustive list of behaviours and practices which might constitute irresponsible lending.<sup>625</sup>

The 'guidance' appears to have been treated as such, with a number of Trade Association Codes of Conduct stating that members merely need to 'have regard to'<sup>626</sup> the ILG; it was not considered to provide specific enforceable requirements. The guidance also appeared to have had little, if any, impact on the actions of lenders. This is despite the fact that it could be 'taken into account' by the FOS in its decision-making process.<sup>627</sup> The OFT Compliance Review in 2013 found that unacceptably high level of irresponsible lending continued in the industry.<sup>628</sup>

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<sup>625</sup> ibid Foreword.

<sup>626</sup> For example, Consumer Finance Association, 'Code of Conduct for FCA Members' <<http://www.cfa-uk.co.uk/assets/files/CFA%20Lending%20Code%202012.pdf>> accessed 28 May 2013.

<sup>627</sup> The Financial Ombudsman Service, *Terms of Reference* (2010), Term 8.1

<sup>628</sup> The Office of Fair Trading, *Payday Lending Compliance Review - Interim Report* (n 10); The Office of Fair Trading, *Payday Lending: Final Compliance Review* (n 12).

To further highlight the limitations of the UK responsible lending obligations, there were inadequate sanctions for irresponsible lending. The potential sanctions that were available to the OFT were fines for breaches of licence requirements,<sup>629</sup> revocation or suspension of a credit licence,<sup>630</sup> or the imposition of additional obligations on a licence holder.<sup>631</sup> The regulator did not have the power to remove the firm from the market instantaneously, meaning lenders were able to continue trading during investigations and appeals against OFT decisions.<sup>632</sup> All of these factors undermined the ability for responsible lending to provide useful protection for borrowers of high-cost credit.

With the movement of consumer credit oversight to the FCA, the ILG has been supplemented by the FCA's Consumer Credit Source Book (CONC 5) *Responsible Lending*. The underlying obligations remain very similar. Under CONC 5, lenders are expected to conform to general principles of fair business practice, and must make 'reasonable creditworthiness assessment' to ensure that borrowers can meet their credit repayments in a sustainable manner.<sup>633</sup> How this varies from the OFT's obligation to take 'reasonable steps' is unclear.<sup>634</sup> CONC 5 does, however, provide slightly more guidance for lenders, including suggestions for useful documentation to request from borrowers.<sup>635</sup>

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<sup>629</sup> Consumer Credit Act 1974 (UK), s 39A.

<sup>630</sup> Consumer Credit Act 1974 (UK), s 32.

<sup>631</sup> Consumer Credit Act 1974 (UK), s 33A. There is however the potential for enforcement action under Enterprise Act 2002 (UK), Part 8 but it has to be shown that the collective interests of consumers have been harmed.

<sup>632</sup> Public Accounts Committee (n 101) para 2.10.

<sup>633</sup> The Financial Conduct Authority, *FCA Handbook, Consumer Credit Sourcebook (CONC)* (n 361) *Responsible Lending*, 5.2.2.

<sup>634</sup> *ibid* 5.2.4.

<sup>635</sup> *ibid* 5.2.4(3).

Despite the 2006 amendments to the responsible lending regime and the transfer of oversight to the FCA, the process in the UK continues to focus on responsible *borrowing*. The UK regime puts the onus on consumers to ensure that the loan is suitable for their needs. This creates a situation where borrowers are not given adequate protection, and can be exploited by lenders who have limited regard for responsible lending requirements and are happy to exploit their vague and discretionary nature. Unfortunately, the 2014/2015 FCA largely transposed the pre-existing ILG into the new FCA regime. Parts of the guidance will become binding rules (including the requirement for firms to lend only where the loan is affordable, and to only refinance a loan at the consumer's request and where the firm reasonably believes it is in the consumer's best interests), but mostly it will remain as mere guidance.<sup>636</sup> Thus, while steps have been taken, the current approach is unlikely to completely avoid the pitfalls experienced by the OFT's generally inadequate approach to responsible lending.

#### 3.4.4: Unfair Terms Legislation

The next example of protection to consider is unfair terms legislation. This is a general protection mechanism but can be applied to high-cost credit contracts. When enforced effectively by the regulator, unfair terms limitations have the potential to 'advance the interests of consumer protection in an effective and controlled manner'.<sup>637</sup> Credit contract terms were previously subjected to a 'fairness' test under the Unfair Terms in Consumer Contracts Regulations 1999 (UK) (UTCCR). This is a controversial area, and the OFT has provided significant additional guidance and information on what it considered an 'unfair

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<sup>636</sup> The Financial Conduct Authority, *Detailed proposals for the FCA regime for consumer credit* (n 7) 56.

<sup>637</sup> Susan Bright, 'Winning the Battle Against Unfair Contract Terms' (2000) 20 *Legal Studies* 331, 352.

term'.<sup>638</sup> This has included the creation of the 'Unfair Terms Hub', a website providing assistance to business and consumers on the UTCCR, and specific guidance for a range of different industries including package holidays, tenancies and fitness clubs.

This area is currently regulated by the Consumer Rights Act 2015 (UK) (CRA) Part 2. The legislation has the potential to protect high-cost credit borrowers, as it strikes out unfair terms in contracts between traders<sup>639</sup> and consumers.<sup>640</sup> A term 'is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer'.<sup>641</sup> Whilst there are likely to be significant imbalances in high-cost credit contracts, the price and main subject matter of the contract is excluded from the fairness requirement, provided they are 'transparent and prominent'.<sup>642</sup>

The underlying assumption in the unfair terms regime is that individuals are aware of the price of goods, but tend to underestimate the importance of other terms. The key issues associated with high-cost credit contracts tend to be the interest rate payable, and default fees and charges.<sup>643</sup> This information is generally provided in a clear and

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<sup>638</sup> The Office of Fair Trading, *Unfair Contract Terms Guidance: Guidance for the Unfair Terms in Consumer Contracts Regulations 1999* (2008)

<sup>639</sup> Defined as a 'person acting for purposes relating to that person's trade, business, craft or profession': Consumer Rights Act, s 2(1). A high-cost credit lender will generally meet this definition.

<sup>640</sup> Defined as 'an individual acting for purposes that are wholly or mainly outside that individual's trade, business, craft or profession: Consumer Rights Act 2015 (UK), s 2(1). A person borrowing high-cost credit not for professional circumstances will generally meet this definition.

<sup>641</sup> Consumer Rights Act 2015 (UK), s 62(4).

<sup>642</sup> Transparent means 'expressed in plain and intelligible language' (Consumer Rights Act 2015 (UK), s 64(4)) and prominent means 'brought to the consumer's attention in such a way that an average consumer would be aware of the term' (Consumer Rights Act 2015 (UK), s 64(4)). It is however contended that the 'average' consumer is not, in fact, the 'average' consumer as defined by the Consumer Rights Act 2015 (UK), s 64(5) which requires them to be 'reasonably well-informed, observant and circumspect'. This juxtaposition between theory and practice will have seriously ramifications on how the test of prominence is defined.

<sup>643</sup> This is discussed in, for example, the The Office of Fair Trading, *Payday Lending: Final Compliance Review* (n 12).

transparent fashion, and therefore will be excluded from the fairness assessment.<sup>644</sup> For example, there are detailed rules on disclosure for consumer credit contracts in the FCA Handbook, including sections focused on 'Financial Promotions and Communications with Customers'<sup>645</sup> and 'Pre-Contractual Disclosure and Adequate Explanations'.<sup>646</sup> These requirements are highly likely to ensure that the information on costs fulfils the definition of 'transparent and prominent'. As the interest rates and fees are excluded from a fairness analysis, the CRA is of limited application to high-cost credit contracts.

No specific guidance has been created in relation to unfair terms in consumer credit or high-cost credit agreements. These types of contracts have continued to receive little attention in relation to unfair contract terms.<sup>647</sup> This may be because high-cost credit is thought to have its own legislation and consumer protection regime under the Consumer Credit Act 1974, which is more suited to respond to borrowers' needs than the general protection afforded by the unfair terms legislation.

### 3.4.5: Common Law Protections

The final example of protection are the provisions available under the common law. As discussed in Chapter 2, freedom is generally associated with procedural fairness. The

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<sup>644</sup> See *The Office of Fair Trading v Abbey National Plc & Ors* [2009] UKSC 6, [2009] 3 WLR 1215 where it was held that the unplanned overdraft of an account was a 'core term' and thus excluded from the fairness assessment. A similar finding was held in Immanuel Kant, *Anthropology from a Pragmatic Point of View* (Cambridge University Press 2006).

<sup>645</sup> The Financial Conduct Authority, *FCA Handbook, Consumer Credit Sourcebook (CONC)* (n 361) CONC 3.

<sup>646</sup> *ibid*, CONC 4.2.

<sup>647</sup> For example, there are only three references to consumer credit contracts in the Unfair Contract Terms Guidance: Guidance on the unfair terms provisions in the Consumer Rights Act 2015 (UK) (Competition & Markets Authority, *Unfair Contract Terms Guidance: Guidance on the unfair terms provisions in the Consumer Rights Act 2015* (2015)). The first one relates to cancellation of a credit contract (para 5.18.4). The second one is a general discussion on the unfair relationship test under the Consumer Credit Act 1974 (UK) (paras 6.31-6.32). The third are two footnotes discussing statutory provisions governing cancellation rights (fns 96 & 103). There was a similar lack of attention to consumer credit contracts under the previous guidance.

'standard view' of contract law is that the courts refuse to intervene solely on the grounds of substantive unfairness, as this would be too great a threat to contractual freedom. Whilst this is the prevailing perspective of the role of contract law, it is by no means universal. Atiyah in his essay *Contract and Fair Exchange* provides numerous examples of ways that the law looks beyond the procedural issues to the substantive outcome.<sup>648</sup> In light of Atiyah's analysis, it is unnecessary to go into detailed discussion of this point, although a number of brief points can be made.

Vitiating factors, whilst generally seen to be focused on ensuring procedural fairness,<sup>649</sup> often look behind these issues and analyse the fairness of the subsequent agreement. In this manner they can be concerned with protecting the fairness of outcome. The law does this in numerous ways, but the starting point is that 'there is a reasonable presumption of fact that a very unfair or imbalanced contract was the result of procedural improprieties'.<sup>650</sup> In this matter the unfairness is merely used as evidence of a procedural fault, and so the courts still appear to be concerned with procedure and not substance. There are however numerous other instances where the court clearly goes beyond this, and invalidates a contract because the unfairness of outcome is so severe that it 'shocks the conscience of the court'.<sup>651</sup>

A protective approach was seen in the third-party undue influence case of *Royal Bank of Scotland v Etridge (No 2)*.<sup>652</sup> In this case, legal intervention was warranted on the basis that, even though the bank had not done anything actively wrong, it should have

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<sup>648</sup> *ibid* 14-15.

<sup>649</sup> See discussion in Part 2.4.5 above.

<sup>650</sup> Atiyah, *Essays on Contract Law* (n 150) Essay 11, p 334. See also discussion at pp 343-344.

<sup>651</sup> Chen-Wishart, 'The Nature of Vitiating Factors in Contract' (n 232) 303-304; Atiyah, *Essays on Contract Law* (n 150) Essay 11. See discussion in Part 3.3.3 above.

<sup>652</sup> *Royal Bank of Scotland v Etridge (No 2)* [2001] UKHL 44, [2002] 2 AC 773.

been more aware of the guarantor's vulnerability and lack of meaningful choice. Despite this vulnerability, the bank protected its own interests and was a party to a grossly unequal bargain between the borrower and guarantor. The House of Lords held that these circumstances and the bank's knowledge justified intervention.<sup>653</sup> There is a parallel between this situation and high-cost credit transactions. Due to the obligation to undertake an affordability assessment, the lender will have actual knowledge of the borrower's precarious financial situation, the fact that they are unlikely to have viable credit alternatives, and the very realistic prospect of financial hardship. When providing a loan at thousands of per cent interest in these instances, the lender is making a grossly unequal bargain. Intervention in high-cost credit transactions can therefore be justified without actual lender wrongdoing; passive victimisation of the borrower is sufficient.

The common law can also be used to protect people from contracts that were entered into because of the coercion arising from lack of choice. This is clearly evident in salvage duress cases. The court will set aside or amend a salvage agreement if the ship in distress was so desperate that they had no alternative but to consent to a salvage agreement that was inequitable, disproportionate or exorbitant.<sup>654</sup> In *The Cargo Ex Woosung*, a ship was wrecked on a reef and the captain entered into an agreement with the salvage boat to give over half the value of any items saved. This was significantly more than standard salvage agreements, but it was unlikely that any other ship would reach the *The Woosung* in time to assist. After the salvage was completed, the Captain refused to

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<sup>653</sup> See further Chen-Wishart, *Contract Law* (n 22) ch 9; Malcolm Cope, *Duress, Undue Influence and Unconscientious Bargains* (The Law Book Company Limited 1985); Malcolm Cope, 'The Review of Unconscionable Conduct Bargains in Equity' (1983) 57 *The Australian Law Journal* 279. A similar approach was taken in Australia through the use of unconscionable bargains, where a stronger party takes advantage of a special disadvantaged of the weaker party for their own benefit: see *Commercial Bank of Australia v Amadio* (n 412) and Competition and Consumer Act 2010 (Cth), sch 2, pt 2.2 'Unconscionable Conduct'.

<sup>654</sup> See discussion in John Reeder (ed), *Brice on Maritime Law of Salvage* (5th edn, Sweet & Maxwell 2012) [5-121]-[5-127].

pay the agreed amount and offered an amount closer to standard salvage agreements. When this case was litigated, the Court of Appeal held the transaction to be unenforceable. Even though the Captain of the *The Woosung* was 'perfectly capable of understanding' the nature and consequences of the salvage agreement,<sup>655</sup> the agreement was not enforced as the Captain had no choice but to accept 'the lesser evil of losing a portion of the profit and property being submitted to rather than the greater evil of losing all'.<sup>656</sup> This type of reasoning can be applied to high-cost credit transactions, where borrowers (who are desperate for credit and limited alternatives) accept loans of over 1,000% APR. A number of common law provisions can therefore potentially be used to protect vulnerable high-cost credit borrowers.

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<sup>655</sup> *The Cargo Ex Woosung* (1876) 1 PD 260 (CA), 265 (Sir Phillimore, with whom the Court of Appeal agreed).

<sup>656</sup> *ibid* 265 (Sir Phillimore, with whom the Court of Appeal agreed).

### 3.5: Limitations of Protection

Analogous to the freedom-based approach, the protective focus also has limitations that undermine its ability to adequately respond to the challenges posed by high-cost credit. In addition to the limitations already discussed in Part 2.5, this section will also discuss the issues of illegal lending and financial exclusion.

#### 3.5.1: Overlap with Limitations of (Negative) Freedom

Chapter 2 discussed three limitations of the freedom-based approach to high-cost credit contracts, namely failure of disclosure, lack of meaningful choice, and poverty. These are also limitations to a protection-based approach. Protection-based legal reforms aim to exclude or limit potentially unfair or injurious contracts, or remove harmful terms from contracts. These actions have significant benefits for borrowers, but (similar to a freedom-based approach) do not address disclosure limitations, provide consumers with additional choices, or address ongoing poverty concerns.

#### 3.5.2: Illegal Lending

The next limitation to consider is the potential relationship between protective legal processes and illegal lending. The claim that decreased access to high-cost legal credit is likely to result in increased use of illegal credit is one of the main arguments against an interventionist approach to regulation.<sup>657</sup> A strongly protective approach to high-cost credit is likely to decrease access to legal products for certain high-risk borrowers, and this may in turn push people towards illegal lending. During his 2015 prosecution for illegal lending, Samuel Hayes defended his actions by arguing that he was merely providing a

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<sup>657</sup> Gibbons, *Taking on the money lenders: Lessons from Japan* (n 592); Russell Hamblin-Boone, *Industry response to FCA regulation* (Consumer Finance Association 2014).

valuable service to 'people payday lender Wonga wouldn't touch'.<sup>658</sup> Whilst clearly anecdotal evidence only, the case highlights the potential for strongly protective laws to make previous borrowers of high-cost credit dependent on illegal lenders.

The claim that decreased access to legal credit is likely to result in increased use of illegal credit is a highly contentious matter that assumes people desperate for credit will turn to unlawful activities. Research on illegal lending levels is notoriously difficult to conduct, as people are unlikely to volunteer that they have engaged in this unlawful industry. Whilst all figures are estimates, the *PFRC* and think-tank *Policis* conducted research into the market in 2006 ('the 2006 Report'), and stated that approximately 165,000 households in the UK used illegal moneylenders.<sup>659</sup> This figure was increased to 310,000 in a 2010 *Policis* Report prepared for the *Department of Business, Innovation & Skills* ('the 2010 Report'), representing 2% of all low-income households and 6% of households in the most deprived areas.<sup>660</sup> Both reports observed that the majority of borrowers were based in the most deprived communities, and were people who usually could not access credit from other forms of high-cost lending.<sup>661</sup> The 2010 Report focused particularly on the strong links between financial exclusion and illegal moneylending, stating that

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<sup>658</sup> See National Trading Standards, 'Manchester loan shark sentenced to twelve months in prison' (*National Trading Standards*, 30 September 2015) <<http://www.nationaltradingstandards.uk/news/manchester-loan-shark-sentenced-to-twelve-months-in-prison/>> accessed 16 February 2017, for accurate details on the case and prosecution and Paul Britton, 'Loan shark who claimed he was cheaper than Wonga ordered to pay back £43,000 - or go to jail' (*Manchester Evening News*, 29 February 2016) <<http://www.manchestereveningnews.co.uk/news/greater-manchester-news/loan-shark-samuel-hayes-manchester-10964426>> accessed 16 February 2017, for comments from Hayes.

<sup>659</sup> Personal Finance Research Centre and *Policis*, *Illegal Lending in the UK: Research Report* (2006) 5.

<sup>660</sup> Anna Ellison and others, *Interim Evaluation of the National Illegal Money Lending Projects* (Department of Business, Innovation & Skills and *Policis* 2010) 10.

<sup>661</sup> Personal Finance Research Centre and *Policis* (n 659) 7; Ellison and others (n 660) 10-11.

The high cost of certain types of sub prime and non standard lending products may not be a socially desirable feature of these models. However the modus operandi of legal, regulated lenders is surely less detrimental to the interests of disadvantaged consumers than that of unregulated illegal lenders. Resorting to illegal lenders will be not only to incur a much higher cost than any form of legal credit but is also deeply damaging in a number of other respects.

Clearly there are a range of consumer protection considerations in this context. However, against this background, perhaps the single most important element in containing illegal money lending and moderating the damage done to victims and communities arising from it, is the maintenance of a regulatory environment that maximises the availability of legal, regulated credit, albeit that this may come at a high cost for some.<sup>662</sup>

This concern appears to be reasonably widespread. In 2010 Ramsay noted that many mainstream UK consumer organisations (*Which?*, *Consumer Focus* and *Citizens Advice Bureau*) were opposed to interest rate caps because of the potential to push already struggling people into the hands of illegal loan sharks.<sup>663</sup>

There is some empirical support for this concern. *StepChange* surveyed clients who had taken out high-cost credit, and found that 5% of those who had been refused a loan would consider using an illegal lender and that 2% had actually used (or attempted to use) one.<sup>664</sup> A particularly concerning finding from this survey was the lack of government

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<sup>662</sup> Ellison and others (n 660) 105 (emphasis added).

<sup>663</sup> This can be compared to the equivalent French organisations, which focused on the importance of ceilings to limit over-indebtedness: Ramsay, 'To Heap Distress Upon Distress': Comparative Reflections of Interest-Rate Ceilings' (n 456).

<sup>664</sup> This can be compared with 60% of people who stated that if their application was refused, they would not borrow money at all: Stepchange Debt Charity, *StepChange Debt Charity response to the Financial Conduct Authority consultation: CP10/14: Proposals for a price cap on high-cost short-term credit* (2014) 4.

support; if unable to use high-cost credit products, over twice as many people would access credit from an illegal lender than from the Social Fund or government services.<sup>665</sup> These figures are obviously conservative, as many people would not want to admit either considering or using an illegal activity. Even though these do sound like small numbers, data from the FCA<sup>666</sup> estimates that 8,000 people would consider using illegal lenders, and 3,200 would use or attempt to use an illegal lender as a result of the new restrictions on high-cost credit. The relationship between the high-cost credit and illegal lending is therefore worthy of further research, and is something that the regulator must be aware of before taking further protective steps.

### 3.5.3: Financial Exclusion

The final limitation to consider is the impact of financial exclusion<sup>667</sup> on high-cost credit borrowers. Financial exclusion and vulnerability remain significant – and in many ways growing – problems in the UK.<sup>668</sup> There is legitimate concern that increased protection (and subsequent decreased access to high-cost credit) could push increasing numbers of people desperate for credit into the hands of illegal moneylenders. As previously discussed, the FCA estimated that its legal reforms will result in approximately 11% of the

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<sup>665</sup> Based on figures from Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 71.

<sup>666</sup> The 160,000 borrowers are no longer using legal high-cost credit: The Financial Conduct Authority, *Proposals for a Price Cap on High-Cost Short-Term Credit: Consultation Paper* (n 5) para 5.15.

<sup>667</sup> There is no agreed definition of financial exclusion, although the European Commission defines it as ‘a process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong’: Social Affairs and Equal Opportunities Inclusion Directorate-General for Employment, Social Policy Aspects of Migration, Streamlining of Social Policies,, *Financial Services Provision and the Prevention of Financial Exclusion* (European Commission, 2008) 9; See also Social Affairs and Equal Opportunities Directorate-General for Employment, *Towards a Common Operational European Definition of Over-Indebtedness* (European Communities, 2008).

<sup>668</sup> Charlie Cadywould, *Banking for All* (Demos, 2016) 15-17.

market, or around 160,000 people, no longer being able to access high-cost credit.<sup>669</sup> The financial exclusion of such a high number of people did not seem to concern the regulator, with it reporting

we believe that for most of these people [high-cost credit] is not the best outcome for them due to the high cost, particularly if they are unable to pay back on time. The effect of our cap will prompt more people in financial difficulty to seek other ways of handling their situation, such as by seeking debt advice. Apart from a short initial period we believe these customers will be better off not having taken out a loan.<sup>670</sup>

Paradoxically, the FCA's comments in this regard go directly against the recommendations of the PAC, which highlighted the impact of financial exclusion and the importance to support those who are 'credit poor' instead of merely eliminating them from the market.<sup>671</sup>

Strongly protective approaches, including caps on the cost of credit, are likely to result in financial exclusion, which can exacerbate pre-existing financial problems, as opposed to solving them. As Rougeau states, protective-based reforms can

constrict the supply of credit in the economy and the ability of consumers of credit to make economic choices. Such laws hurt the poorer members of society because they are least likely to get credit ... If one assumes that the major purpose

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<sup>669</sup> The Financial Conduct Authority, *Proposals for a Price Cap on High-Cost Short-Term Credit: Consultation Paper* (n 5) para 5.15. The impact of just the price cap was later estimated to be approximately 7% of the market; The Financial Conduct Authority, *Detailed rules for the price cap on high-cost short-term credit; Including feedback on CP14/10 and final rules* (n 4) 69.

<sup>670</sup> The Financial Conduct Authority, *Proposals for a Price Cap on High-Cost Short-Term Credit: Consultation Paper* (n 5) para 1.27.

<sup>671</sup> Public Accounts Committee (n 101) Recommendation 7.

of usury laws are to protect lower income borrowers, then the economic analysis suggests that the laws harm exactly those people they are supposed to help.<sup>672</sup>

This thinking is by no means new. Bentham asserted in 1788 that poor people were not better off, and in fact were in many ways disadvantaged by the implementation of credit restrictions. When confronted with potential protective approaches to moneylending, he declared that borrowers did not need any additional protection. Bentham stated that provided there is no 'defect' in a poor man's judgment or temper, he should be able to look after his own interests as well as someone who is better off; 'he knows what is his interests as well as they do, and is well disposed and able to pursue it as they are'.<sup>673</sup> Bentham's assertions are largely supported by more recent empirical research.

Protective-based approaches will prevent many borrowers from accessing high-cost credit products. This may benefit people who are using the funds for discretionary expenses, although it will disadvantage those who urgently need money or who are reliant on the funds for everyday living expenses. A significant portion of borrowers have no access to alternative financial products, and are using the funds for everyday expenses that they 'definitely' could not have gone without.<sup>674</sup> If access to high-cost credit was reduced or severely limited for these people, their alternatives include pawnbroking, unauthorised overdrafts, borrowing from family or friends, and (as discussed above)

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<sup>672</sup> Rougeau (n 68) 17, emphasis added. He does however comment later in the same article that a restriction in the supply of credit can have positive consequences for borrowers and society at large, stating that 'consumers might have less access to credit, but that is not necessarily a negative development. Less unsecured consumer credit in the economy may have socially beneficial effects, such as promoting savings, lowering indebtedness, discouraging impulse buying, and encouraging more community-based and mutual-aid type lending': 43.

<sup>673</sup> Bentham, *Defence of Usury; shewing the impolicy of the present legal restraints on the terms of pecuniary bargains. In a series of letters to a friend. To which is added, a letter to Adam Smith, Esq; LL.D. on the discouragements opposed by the above restraints to the progress of inventive industry* (n 158) Letter IV.

<sup>674</sup> Fifty-nine per cent of payday borrowers used the money for purchases they 'definitely' could not have gone without; Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 68.

possibly illegal lending. These have the potential to further disadvantage an already marginalised and financially excluded group of people.<sup>675</sup> The unauthorised overdraft option may be even more expensive than high-cost credit, due to the crippling nature of current bank fees.<sup>676</sup> This analysis is supported by the borrowers themselves, with one in fifteen using high-cost credit because the alternatives were *more* expensive.<sup>677</sup> These concerns exist in other countries. Comments of a similar type were made by the United States Federal Reserve Board Governor Martha Seger, when contemplating imposing a federal cap on credit card charges. Seger stated that a cap ‘would likely reduce the amount of credit made available, forcing consumers to rely instead on less convenient and possibly more expensive substitutes, or to lose access to credit at any rate’. She further commented that this impact would be most severe on lower-income borrowers.<sup>678</sup> A strongly protective approach to high-cost credit will undoubtedly leave significant gaps, particularly for those who are unable to access other forms of credit.

Quantitative research undertaken by the CMA has been supported by empirical research commissioned as part of Arts and Humanities Research Council’s (AHRC) *FinCris* Research project, which analysed responsibility and ethics in the financial crisis. As part of

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<sup>675</sup> Rowlingson, Appleyard and Gardner (n 123) see especially 540-543.

<sup>676</sup> Money Mail compared the cost of borrowing £200 for a period of 10 days from different sources and found that unauthorised overdrafts of even small amounts from high street banks were by far the most expensive. For example, Lloyds TSB charges customers an £87 fee for an unauthorised overdraft. This can be compared with a ‘typical’ payday lending fee of £25: See discussion in Baines & Ernst, ‘Extortionate overdraft bank charges make payday loans the cheaper option’ <<http://www.bainesandernst.co.uk/news/extortionate-overdraft-bank-charges-payday-loans-cheaper-option/>> accessed 15 February 2013.

<sup>677</sup> Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 84. In light of this, the regulator has made it clear that further changes are needed to the fee structure for bank accounts, as well as proposals to increase competition and consumer confidence in the sector: The Office of Fair Trading, ‘Press Release: 25 January 2013 - OFT says major change still needed in personal current account market’ <<http://www.of.gov.uk/news-and-updates/press/2013/10-13#.UY4pCsrsxn4>> accessed 18 March 2013. This will benefit consumers who may otherwise turn to high-cost credit when in desperate need of funds, due to the astronomically high cost of certain bank fees.

<sup>678</sup> Martha Seger, ‘Fed Opposes Legal Cap on Credit Card Interest Rates’, *LA Times*, 22 April 1987, cited in Rougeau (n 68) 14.

this project, Rowlingson, Appleyard and Gardner<sup>679</sup> interviewed borrowers of a variety of short-term credit about their experiences and attitudes to credit use. It was clear that most people understood that they were using an expensive form of credit, but due to their financial position it was unavoidable.<sup>680</sup> The findings of this project were published in the *Journal of Social Policy*, with the authors' commenting that

We are not seeking to deny ... that payday lending is an extremely expensive form of credit which can lead people into highly problematic debt situations. We do, however, argue that a more critical analysis of the root causes of the growth of payday lending, along with a better understanding of the 'lived reality' of payday borrowing provides an important basis for a robust analysis of policy options. We have shown that the regula(risa)tion of payday lending will do nothing to tackle the root causes of demand for this form of credit.<sup>681</sup>

Many users of high-cost credit may benefit from a more protective approach to regulating high-cost credit, whilst others – usually those who are already the most vulnerable – could be worse off.<sup>682</sup> The financial exclusion experienced by users of high-cost credit can exacerbate their pre-existing disadvantages; high-cost credit and subsequent debt spirals can result in other types of exclusion, such as homelessness or rough housing,<sup>683</sup> children being kept from school as they cannot afford books, fees and uniforms, and adults being unable to hold down jobs as they cannot afford car repayments or public transportation costs. This type of situation severely limits people's long-term choices and their ability to

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<sup>679</sup> The author of this thesis.

<sup>680</sup> Rowlingson, Appleyard and Gardner (n 123) 536.

<sup>681</sup> *ibid* 540.

<sup>682</sup> *ibid* 540.

<sup>683</sup> See also Shelter (n 317).

pursue freely chosen goals and relationships. It is therefore critically important to address how and why such large numbers of people have become financially excluded from the mainstream credit system and need to use loans in such a dangerous way, and to try and stop the demand for this type of high-cost credit. Without engaging with the welfare system, any type of protective regulatory response is going to increase the financial exclusion of some borrowers, potentially exacerbating their already precarious financial situation.

## Conclusion

Protection is important, and there is a long history of the protective approach being associated with usury and high-cost credit. A protective focus is clearly already part of our common law and regulatory system in numerous ways, but this type of approach has significant limitations. The complexity of high-cost credit justifies a more nuanced approach than simply 'should we restrict high-cost credit lending?' or 'should we implement an interest rate cap?' Merely regulating credit does not deal with the underlying difficulties that many households face. The government needs to understand and recognise the reasons *why* people use such expensive and potentially harmful credit products, and the impact that financial exclusion can have on their wellbeing. The previous two chapters discussed the competing and often conflicting notions of freedom and protection. Neither of these approaches is adequate by itself. Freedom has not worked, as the vulnerable have continued to be exploited, and protection creates limited choices for people already struggling with financial exclusion. This tension is evident in the political, social and legal attitudes to the regulation of high-cost credit. The pendulum has continually swung between the two dominant theories, with neither providing a sustainable solution. When one fails, the other comes to the forefront and the cycle continues endlessly. All the while, vulnerable people are financially excluded or mistreated. The next chapter introduces a third concept, a social minimum, which can address some of the limitations posed by both freedom and protection.

## Chapter 4 – A Social Minimums

*A decent provision for the poor is the true test of civilization*  
- Samuel Johnson

### Introduction

This chapter introduces a third concept – the provision of a social minimum.<sup>684</sup> Unlike the two concepts already discussed, freedom and protection, the role of a social minimum has not previously been considered in relation to high-cost credit. The debate on how to regulate these financial products is usually characterised in terms of a tension between freedom and protection. This dichotomous approach has not yielded effective results for how to tackle the problems associated with high-cost credit. The current chapter moves away from this dichotomy to consider the role that the provision of a social minimum can play in the response to high-cost credit challenges. There are five sections, following the same structure as the previous two chapters. The first section examines the concept of a social minimum, including why it is an important consideration in the high-cost credit markets. This is followed by an analysis of the history of social minimums and the development of the Welfare State. The third section analyses three justifications for the State's responsibility to provide a social minimum. The fourth section summarises how this concept is already incorporated into the legal and regulatory system, including welfare support, bankruptcy processes, and vitiating factors. The final part considers the limitations of the social minimums approach; effective reforms will only be made if there is further research into the high-cost credit market.

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<sup>684</sup> The thesis will use 'social minimums' and 'a social minimum' interchangeably depending on the circumstances of the discussion.

#### 4.1: What is a Social Minimum?

The modern notion of social minimums has been around since Rawls' *A Theory of Justice* in 1979. This concept recognises the importance of providing a certain level of resources to all people to ensure a minimally acceptable standard of living.<sup>685</sup> This has been pivotal in how we approach issues of poverty and inequality, and is linked to the provision of welfare by the State.<sup>686</sup> Academics and philosophers have framed the social minimum in a variety of ways.<sup>687</sup> For the purpose of this thesis, the focus on a social minimum is identifying what is necessary for people to have a 'decent and meaningful life' in the society in which they live. This approach is supported by Nussbaum, who framed the concept of a social minimum by identifying central functional capabilities that people need to live a life which is truly 'human'.<sup>688</sup>

Precisely pinpointing the appropriate level of a social minimum is a difficult task, and a highly political one.<sup>689</sup> The Beveridge Report itself stated that 'any estimate of subsistence income' could not be scientifically determined, but had to be 'to some extent

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<sup>685</sup> For a sample of the literature on this topic, see Rawls (n 463); Amartya Sen, *Inequality Reexamined* (Harvard University Press 1992); Amartya Sen, *The Standard of Living* (Cambridge University Press 1987); Jeremy Waldron, 'John Rawls and the Social Minimum' (1986) 3 *Journal of Applied Philosophy* 21. An excellent introductory writing by Professor Stuart White can also be found at Stuart White, 'Social Minimum' (*Stanford Encyclopedia of Philosophy*, 2004) <<http://plato.stanford.edu/entries/social-minimum/>> accessed 13 July 2014.

<sup>686</sup> See discussion in Lansley and Mack (n 453) specifically chs 1 & 2.

<sup>687</sup> The definition of protection of a social minimum is also open for debate. For example, Waldron defines it as a 'level of material well-being beneath which no member of society should be allowed to fall' (Waldron (n 685) 21), Sen talks about the need for people to be 'happy and satisfied' (Sen, *The Standard of Living* (n 685)), and White states it is 'the bundle of resources that a person needs in order to lead a minimally decent life in their society' (White (n 685)).

<sup>688</sup> These are (1) the capability for physical survival; (2) the capability for bodily health; (3) the capability for bodily integrity; (4) the capability for the exercise of imagination; (5) the capability for emotional response and exploration; (6) the capability for practical reason; (7) the capability for love and friendship; (8) the capability for connection with nature and other species; (9) the capability for play; and (10) the capability for the exercise of control over environment, including political control; Nussbaum (n 223). Whilst the majority are reasonable uncontroversial, the last few capabilities are clearly up for debate, particularly their application to developing countries.

<sup>689</sup> See, for example, discussion in Lansley and Mack (n 453) 25-31.

a matter of judgment'.<sup>690</sup> Throughout modern history there have been many attempts to determine the poverty level and/or social minimum. This started with the ground-breaking work of Rowntree, whose surveys on the living standards in York shocked the nation when they highlighted the extent of 'in work' poverty. Rowntree was the first person to coin the term 'poverty line', which for a long period formed the basis of the social minimum in the UK.<sup>691</sup> This research was followed by the *Breadline Britain Surveys*, which identified what society believed to be basic necessities for all citizens. These surveys were first conducted in 1983, and have been repeated numerous times since.<sup>692</sup> More recent work on social minimums focused on identifying a 'Minimum Income Standard'.<sup>693</sup> The answer is far from clear. Whilst these challenges must be acknowledged, they do not in any way minimise the importance of social minimums for both the current high-cost credit debate and society in general.

The role of a State-provided social minimum has developed at great speed in the UK. Minimum wages were first set a little over 100 years ago with the protection of the 'sweated trades' in 1909.<sup>694</sup> The *National Health Service* (NHS) provides all people in England with access to a minimum level of health care, and was founded less than 70

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<sup>690</sup> Rodney Lowe, *The Welfare State in Britain since 1945* (2nd edn, MacMillan Press Ltd 1999) 136.

<sup>691</sup> B. Seebohm Rowntree, *Poverty: The Study of Town Life* (MacMillan and Co Ltd 1908); these surveys were repeated decades later and similar results obtained: B. Seebohm Rowntree, *Poverty and Progress: a Second Social Survey of York* (Longmans, Green and Co 1941); Lowe (n 690) 136.

<sup>692</sup> For details see Lansley and Mack (n 453) ch 1.

<sup>693</sup> Centre for Research in Social Policy, 'Minimum Income Standards' (*Department of Social Sciences, Loughborough University*) accessed 14 June 2016. Analysis of this Standard has been performed by Abigail Davis and others, *A Minimum Income Standard for the UK in 2016* (Joseph Rowntree Foundation 2016).

<sup>694</sup> Stephen Machin and Alan Manning, 'Employment and the Introduction of a Minimum Wage in Britain' (1996) 106 *The Economic Journal* 667, 668. These trades were known for their long hours and poor rates of pay, in particular clothing and boot making.

years ago.<sup>695</sup> It was a mere 20 years ago that the Labour Party and Liberal Democrats both promised – if elected – to institute a country-wide minimum wage, thus starting a political, economic and philosophical debate on the topic.<sup>696</sup> This was followed by the implementation of child and working tax credits in 2003,<sup>697</sup> which supplemented the minimum wage and were again designed to ensure that families in the UK did not fall below a certain designated level of income. The ongoing political focus on living wages versus minimum wages<sup>698</sup> has again reignited the discussion of social minimums, and what, if any, role they play in the UK’s political system – especially during times of austerity.

The chapter does not attempt to define what is an appropriate level for a social minimum (a quantitative issue that is constantly changing with political, social and economic movements, and is beyond the scope the current thesis). The task here is to establish its necessity. Before moving forward to analyse the concept, three key points must be made about high-cost credit and the social minimum: (1) to be effective it must be provided *and* maintained, (2) it is a relative and not an absolute concept, and (3) it fluctuates over time and societies.

First, for the concept to be effective and valuable, the State needs to focus on both the provision and maintenance of a social minimum. This is particularly relevant in

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<sup>695</sup> National Health Service Choices, ‘The history of the NHS in England’ (*National Health Service*, 2015) <<http://www.nhs.uk/NHSEngland/thenhs/nhshistory/Pages/NHShistory1948.aspx>> accessed 28 September 2016.

<sup>696</sup> David Greenway, ‘Economic Aspects of Minimum Wages’ (1996) 106 *Economic Journal* 637.

<sup>697</sup> Tax Credits Act 2002 (UK). See discussion of family poverty in A.B. Atkinson, *The Economics of Inequality* (Oxford University Press 1975) 216-218.

<sup>698</sup> Heather Stuart, ‘No 10 to proceed with ‘national living wage’ despite pressure’ *The Guardian* (8 August 2016); See also Community Investment Coalition, ‘Submission to the London Assembly’s Economic Committee investigation into low pay and the London Living Wage’ <[http://www.communityinvestment.org.uk/wp-content/uploads/2013/08/CIC\\_GLA-submission-on-low-pay-Aug-13.pdf](http://www.communityinvestment.org.uk/wp-content/uploads/2013/08/CIC_GLA-submission-on-low-pay-Aug-13.pdf)> accessed 27 August 2013.

the context of high-cost credit. The current concept of social minimums is usually focused on the *provision* of an adequate bundle of resources. It does not tackle the question of the *maintenance* of these resources.<sup>699</sup> Despite the significant impact social minimum has had on the way many people think about protecting the vulnerable, it has yet to be discussed in the context of debt and credit obligations. The social minimum thesis can therefore be used to develop new approaches for high-cost credit regulation, particularly the importance of maintaining the social minimum. These financial products work in a manner that requires individuals, many of whom are already on low incomes, to repay loans at exceptionally high interest rates. A social minimum will only achieve its aim of providing a decent and meaningful life if the individual in question does not have any unforeseen or emergency expenses that necessitate obtaining credit. This is often not the case. The majority of people using high-cost credit are doing so because of an unforeseen change in circumstances. According to the CMA, 52% of loans were linked to an unexpected increase in expenses or outgoings, and 19% due to an unexpected decrease in income.<sup>700</sup> This means that even if people are initially provided with a social minimum, unexpected outgoings and high-cost credit contracts have the potential to put borrowers below the level of resources needed to live a decent and meaningful life. This is not acceptable; people should not be required to agree to contracts that push them below the social minimum because they have no other options. To truly tackle the problems with high-cost credit, the government needs to develop a welfare system that not only provides but also *maintains* the social minimums of vulnerable borrowers.

The second point is the general acceptance that a social minimum and welfare provision are relative notions; they are not absolute 'lines in the sand'. Many people

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<sup>699</sup> See discussion in White (n 685) pt I.

<sup>700</sup> Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 70.

believe it is inappropriate to talk about 'poverty' in today's advanced countries, as even the most deprived individuals are significantly better off than the general population during most of history, and possibly better off than many people in developing countries.<sup>701</sup> However, as Galbraith explains,

People are poverty-stricken when their income, even if adequate for survival, falls markedly behind that of their community. Then they cannot have what the larger community regards as the necessary minimum for decency, and they cannot wholly escape therefore, the judgment of the larger community that they are indecent. They are degraded for, in a literal sense, they live outside the grades or categories which the community regards as acceptable.<sup>702</sup>

The exact level of a social minimum will therefore depend on the community in which the individual is based. Richer communities will have a higher standard of living, thus a higher social minimum.<sup>703</sup>

The relativity of social minimums is widely accepted across the political spectrum in the UK,<sup>704</sup> and by economists,<sup>705</sup> philosophers<sup>706</sup> and academics alike.<sup>707</sup> It was even

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<sup>701</sup> Atkinson (n 697) 186. See also discussion in Sen, *Inequality Reexamined* (n 685) 114-116.

<sup>702</sup> JK Galbraith, *The Affluent Society* (Penguin 1958) 261.

<sup>703</sup> Sen, *The Standard of Living* (n 685) specifically 38-40.

<sup>704</sup> Lansley and Mack (n 453) 4-8. Save for a short period under the Thatcher administration: see discussion in *ibid* 6.

<sup>705</sup> Smith, *An inquiry into the nature and causes of the wealth of nations* (n 250) book 5, ch 2, art IV.

<sup>706</sup> Sen, *Inequality Reexamined* (n 685) 39: the social minimum can vary 'from such elementary things as being adequately nourished, being in good health, avoiding escapable morbidity and premature mortality, etc., to more complex achievements such as being happy, having self-respect, taking part in the life of the community'; also discussed in Sen, *The Standard of Living* (n 685) and Nussbaum (n 685).

<sup>707</sup> Peter Townsend, 'The Meaning of Poverty' (1962) 13 *British Journal of Sociology* 225. Even Raz has highlighted the importance of relativism, stating that 'a person's well-being depends to a large extent on success in social defined and determined pursuits and activities': Raz, *The Morality of Freedom* (n 203) 309.

acknowledged by the Conservative government, which claimed that those who are in poverty should still 'share in [the] increasing national prosperity'.<sup>708</sup> Townsend concludes that 'poverty' should be relative to the standards and amenities 'customary' to the society in question.<sup>709</sup>

Whilst it is generally perceived that social minimums increase as society becomes more affluent, the relationship is not linear. The final point to note is that the social minimum can and does fluctuate. Given that this concept is itself a reflection of the values that exist in a specific community at that specific time, the minimum will increase or decrease depending on the values of that society. Items that may be considered a 'necessity' at one period of time may become less important later on. One of the best illustrations of this fluctuation is the Breadline Britain/Poverty and Social Exclusion Surveys.<sup>710</sup> These surveys provide a very useful and unique insight into a community-defined social minimum. During specific years (1983, 1990, 1999 and 2012), adults in Britain were given a list of items or experiences and asked whether these items were 'necessities', or were 'widespread and may be desirable but are not necessities'.<sup>711</sup> A selection of the responses has been included below in Table 1.

The surveys show that whilst the UK financial situation has improved significantly in the 30 years between the first and last survey, there has not been a universal increase in what is considered a 'necessity'. Many social activities have seen an increase, whereas other 'traditional' aspects of life have seen sharp decreases.<sup>712</sup> Even the gross average has

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<sup>708</sup> Lowe (n 690) 143.

<sup>709</sup> *ibid* 141.

<sup>710</sup> The surveys were called Breadline Britain in 1983 and 1990, but were renamed Poverty and Social Exclusion Surveys in 1999 and 2012: Lansley and Mack (n 453) 16-17.

<sup>711</sup> *ibid* 17.

<sup>712</sup> For example, having a roast joint or equivalent once a week was considered a necessity by 67% of people in 1983, but by 2012 this had decreased to 36%. There has also been a decrease in the number

not increased in a uniform manner. In 1983 the average determination of the items and experiences as necessities was 64%, this increased in 1990 (73%) and 1999 (74%), but then decreased sharply in 2012 (67%).<sup>713</sup> Technological developments also mean some items that were not envisioned at the commencement of the surveys, and were once thought of as luxuries, are now considered necessities.<sup>714</sup>

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of people who believe that a washing machine, keeping the home in a decent state of decoration, household contents insurance, a warm waterproof coat, and an annual holiday are necessities.

<sup>713</sup> Using figures from Table 1 to determine percentages, but removing items/experiences that had only been surveyed in two or less years.

<sup>714</sup> This was discussed by Lord Knight who said the government used to have 'a scheme where people on tax credits could apply for a pre-charged visa card which could be used in a number of high street stores to buy a laptop. As a result 500,000 low-income families buy a computer. It delivered for a lot of kids and the government is continuing to fund it for children with special educational needs but not for everyone. People may think it is a luxury and times are hard, but the times are changing and the next generation need to know how to use the latest technology': quoted in Daniel Boffey, 'Children with internet access at home gain exam advantage, charity says' (*The Guardian* 21 May 2011) <<https://www.theguardian.com/education/2011/may/21/children-internet-access-exam-advantage>> accessed 2 February 2017. One of the clearest examples of this is access to a computer-like device and the internet at home. Increasing research is highlighting that children who do not have access to these perform significantly worse at school (Jessica Shepherd, 'No web access at home for 2m poor pupils, warns charity' (*The Guardian* 2010) <<https://www.theguardian.com/technology/2010/dec/28/uk-children-home-computer-access>> accessed 2 February 2017). This is one of the key causes of inequality of educational outcomes: Boffey (n 714).

Table 1: Breadline Britain Surveys<sup>715</sup>

	<b>1983</b>	<b>1990</b>	<b>1999</b>	<b>2012</b>
Heating to keep home adequately warm	97%	97%	95%	96%
Damp free home	94%	98%	94%	94%
Two meals a day	64%	90%	91%	91%
Fresh fruit and vegetables every day			86%	86%
Washing machine		88%	87%	83%
Celebrations on special occasions	69%	73%	77%	82%
Warm waterproof coat	87%	91%	87%	83%
Telephone	43%	56%	72%	77%
Meat, fish or protein source every other day	63%	77%	81%	76%
Hobby or leisure activity	64%	67%	79%	70%
Enough money to keep home in decent state of decoration		88%	80%	69%
Household contents insurance		92%	83%	69%
Two pairs of all weather shoes	67%	74%	67%	54%
Regular savings (of at least £20 month <sup>716</sup> ) for rainy days		68%	67%	54%

<sup>715</sup> This information was obtained from consumer surveys conducted around Britain during the specified years. They were given a list of items and asked on the list was considered a 'necessity' for life in Britain. The table is excerpted from information in Lansley and Mack (n 453) 19.

<sup>716</sup> This was £10/month in 1990 and 1999.

Television	51%	58%	58%	51%
Friends or family around for meal or drink at least monthly	32%	37%	65%	45%
Holiday away from home (not staying with relatives)	63%	54%	56%	42%
Roast joint or equivalent once a week	67%	64%	58%	36%
Going out socially once a fortnight	36%	42%	41%	34%
Total average	64%	73%	74%	67%

## 4.2: The History of Social Minimums

The term ‘social minimum’ is relatively new, although the underlying concept of welfare provision has strong historical grounding. This section briefly summarises the history of social minimums and welfare, particularly in relation to high-cost credit. It will consider religious and charitable obligations, the Victorian Poor Laws, the Beveridge Report, and the post ‘Welfare State’ period.

### 4.2.1: Religious & Charitable Obligations

The provision of welfare was historically a voluntary or charitable obligation, rather than a State obligation.<sup>717</sup> There is a strong historical link between high-cost credit and religious-based provision of welfare. The prohibition on lending for profit in the Old Testament – discussed in Part 3.2.1 above – was coupled with an obligation to give charitably (or potentially lend at no cost) to the poor. This is explained in Bible passages addressing usury.<sup>718</sup> First *Exodus* states that ‘gracious’ people are to provide financial assistance to those who are suffering.<sup>719</sup> The religious obligation is reinforced in *Leviticus*, where Jewish

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<sup>717</sup> David Gladstone, ‘Welfare before the Welfare State’ in David Gladstone (ed), *Before Beveridge: Welfare before the Welfare State* (IEA Health and Welfare Unit 1999) 2-3. Gladstone also notes that self-help was also an important factor, with ‘friendly societies’ being the largest working-class organisation in Britain at the end of the nineteenth century: David G. Green, ‘The Friendly Societies and Adam-Smith Liberalism’ in David Gladstone (ed), *Before Beveridge: Welfare before the Welfare State* (IEA Health and Welfare Unit 1999) 18. See also William P. Quigley, ‘Five Hundred Years of English Poor Laws, 1349-1834: Regulating the Working and Nonworking Poor’ (1997) 30 *Akron Law Review* 73, 78-82.

<sup>718</sup> The other two bible passages discussed in 3.2.1 do not address the moral obligation to assist the poor that was evident in the *Exodus* and *Leviticus* passages. Despite this, it is widely accepted that Jewish (and later Christian) approaches to lending involved charitable responsibilities to those who were less fortunate.

<sup>719</sup> ‘If thou lend money to *any of my people that is poor* by thee, thou shalt not be to him as an usurer, neither shalt thou lay upon him usury. If thou at all take thy neighbour's raiment to pledge, thou shalt deliver it unto him by that the sun goeth down: For that *is his covering only, it is his raiment for his skin: wherein shall he sleep?* and it shall come to pass, when he crieth unto me, that I will hear; for I *am gracious*’: King James Bible (n 485) *Exodus XXII*, 25-27. All emphasis (ie italics and bolding) are from this version and not included by the author. See further discussion in Meislin and Cohen (n 488) 260.

people were forbidden by Moses to practice usury among themselves.<sup>720</sup> These Bible passages clearly apply to the 'poor' without any other limitations. Thus, in Biblical days,<sup>721</sup> moneylending to people already suffering from financial hardship went against religious dogma; instead, there were charitable obligations. The *Leviticus* passage further extends the obligations outlined in *Exodus*, applying restrictions on both money and food stuff or grain. The nature of these loans therefore appears to be related to providing assistance to the poor for short term agricultural needs, or generally to relieve hardship.<sup>722</sup>

There are also a number of references to debt forgiveness in the New Testament, and this forms a strong part of the teachings of Jesus:

Lending is put forth as the characteristic test for admission to heaven, for it is the most prevalent mode of exerting either coercive power or generosity with regard to one's fellow beings. Luke 6:35 cites Jesus' admonition to 'lend, without expecting to be repaid.' Centuries of commentary on this passage by medieval Churchmen elaborated how this exhortation meant that a creditor should not demand to be repaid if the debtor cannot do so without injuring himself.<sup>723</sup>

Furthermore, the Parable of the Unmerciful Servant encourages people to forgive the debts of the poor.<sup>724</sup> The historical tradition of forgiving debts and freeing debt-servants

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<sup>720</sup> And if thy brother be waxen poor, and fallen in decay with thee; then thou shalt relieve him: *yea, though he be a stranger, or a sojourner*; that he may live with thee. Take thou no usury of him, or increase: but fear thy God; that thy brother may live with thee. Thou shalt not give him thy money upon usury, nor lend him thy victuals for increase': King James Bible (n 485) Leviticus XXV, 35-37.

<sup>721</sup> For example, Deuteronomy was probably written approximately 1000 BC: Meislin and Cohen (n 488) 254.

<sup>722</sup> *ibid* 262.

<sup>723</sup> Hudson (n 498) 47.

<sup>724</sup> *ibid* 46.

every seventh year<sup>725</sup> further highlights the interesting juxtaposition between two related but strongly conflicting phenomena. The widespread practice of moneylending in Jewish communities, even during Old Testament times, and the fact that debt forgiveness was enforced, continued Jesus' teachings about assisting those who were less fortunate and the importance of welfare.<sup>726</sup>

#### 4.2.2: The Poor Laws

The provision of welfare was generally considered a voluntary or charitable obligation until the passing of the Elizabethan Poor Law Act of 1598,<sup>727</sup> where welfare duties to the poor were transferred from religious organisations to local parishes.<sup>728</sup> The Act developed 'the first comprehensive English system of poor relief'.<sup>729</sup> It created an obligation on local authorities to put able-bodied people to work, and to provide for those who were unable to work.<sup>730</sup> The Act<sup>731</sup> imposed obligations on the local authorities to give 'outdoor' relief to the poor, in the form of basic necessities or possibly money to make their own

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<sup>725</sup> This year has special importance in Jewish tradition. As outlined in King James Bible (n 485) Deuteronomy XXXI, 10 - Moses commanded that the laws be read out to all people 'at the end of every seven years, in the solemnity of the year of release, in the feast of tabernacles'. The 'year of release' refers to *shemitta* – the forgiving of debts; Hudson (n 498) 7.

<sup>726</sup> For a full discussion on debt forgiveness in Jewish tradition, see Hudson (n 498).

<sup>727</sup> There were some state-based attempts to alleviate the circumstances of the poor prior to this law, however they tended to be piecemeal and short-lived: see Quigley (n 717) 82-92. One important piece of legislation was the Statute of Artificers 1563, which created a legal obligation for every person to be employed (see *ibid* 94). People found begging who were deemed to be fit for work were subject to punishment, including arrest, imprisonment and whipping (first offence) and having an ear cut off (second and third offence). This was a statutory obligations for local parishes: *ibid* 94-95.

<sup>728</sup> *ibid* 82.

<sup>729</sup> *ibid* 92.

<sup>730</sup> J. F. Sleeman, *The Welfare State: Its Aims, Benefits and Costs* (George Allen & Unwin Ltd 1973) 9. The law was further developed by the Act of Settlement in 1662, which declared that people had a right to be assisted by their 'parish of settlement'. This created a system where local parishes would remove the poor and send them back to their original parish, as they were obliged to provide the support: Quigley (n 717) 104-106.

<sup>731</sup> In addition to the frequent amendments in 1723, 1756 and 1782.

purchases.<sup>732</sup> The amount given was very little (merely enough to ‘prevent death or utter destitution’), and was only provided to those who were deemed unfit to work.<sup>733</sup> Despite these rather extreme limitations, the provision of Poor Laws was an early form of social minimum provision and is often referred to as transitioning from individualism to collectivism – represented by AC Dicey’s famous analysis of this period.<sup>734</sup>

From the 1800’s, a wave of ‘New Liberalism’ stressed the importance of a *laissez-faire* approach. This resulted in an increased role of the State to ensure that vulnerable people were not overly disadvantaged, whilst also promoting individual responsibility.<sup>735</sup> An example of this thinking was the passing of the 1834 Poor Law Amendment Act, which was designed to address and reduce homelessness in Britain. It abolished ‘outdoor’ relief (ie the provision of basic necessities to the poor), and created a system of ‘indoor relief’ where the poor were required to live in workhouses. The standard of living in these houses was specifically designed to be less favourable than the lowest form of paid labour, to discourage people from unnecessarily utilising the system.<sup>736</sup>

Even with the passing of the Poor Laws, voluntary organisations and individual philanthropy still provided significant assistance to those who were vulnerable and/or

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<sup>732</sup> For example, this happened in the 1790’s when the cost of bread rose significantly and it was easier to provide poor relief in the form of money: Sleeman (n 730) 10.

<sup>733</sup> Quigley (n 717) 81, citing Backer.

<sup>734</sup> Jose Harris, ‘Political Thought and the Welfare State 1870-1940: An Intellectual Framework for British Social Policy’ in David Gladstone (ed), *Before Beveridge: Welfare Before the Welfare State* (IEA Health and Welfare Institute 1999) 45.

<sup>735</sup> John Stewart, ‘The Twentieth Century: an Overview’ in Robert M Page and Richard Silburn (eds), *British Social Welfare in the Twentieth Century* (Palgrave 1999) 23.

<sup>736</sup> Norman Barry, ‘Neoclassicism, the New Right and British Social Welfare’ in Robert M. Page (ed), *British Social Welfare in the Twentieth Century* (Palgrave 1999) 64. It therefore encompassed the concept of moralistic judgementalism: Robert M. Page, ‘The Prospects for Social Welfare’ in Robert M. Page and Richard Silburn (eds), *British Social Welfare in the Twentieth Century* (Palgrave 1999) 302.

financially struggling.<sup>737</sup> As government intervention increased in 1908 (with the provision of old-age pensions) and again in 1911 (with social insurance), the concepts of charity and the volunteer sector changed to ones that complemented or supplemented government support.<sup>738</sup>

#### 4.2.3: The Beveridge Report

Social minimum provision as we know it and the true 'Welfare State'<sup>739</sup> were developed post World War II (WWII). There were, however, significant steps taken in this direction decades earlier. Numerous government welfare schemes were enacted after World War I. These included statutory social insurance schemes for the unemployed, sick, elderly, widows and orphans. Local authorities started to run publicly funded health services, including maternal and infant welfare clinics, treatments for specific diseases (mainly venereal diseases, tuberculosis and infectious diseases and mental health conditions). These were limited to the poor and working classes, whilst middle-class consumers were expected to cover their own medical expenses and were excluded from the social insurance schemes.<sup>740</sup>

This all changed after WWII, as the impact of the War led to a 'profound rethinking and reorganisation' of Britain's social services.<sup>741</sup> Society had become used to

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<sup>737</sup> Janes Lewis, 'The Voluntary Sector in the Mixed Economy of Welfare' in David Gladstone (ed), *Before Beveridge: Welfare Before the Welfare State* (IEA Health and Welfare Unit 1999) 13; Harris (n 734) 43, 47.

<sup>738</sup> Lewis (n 737) 15-16.

<sup>739</sup> It is noted that there is considerable debate and disagreement on how 'welfare state' should be defined and whether, in fact, Britain was ever a pure welfare state: see, for example, Stewart (n 735) 26-31; Barry (n 736) 66-68; Sleeman (n 730) ch 1. This thesis does not intend to enter this debate.

<sup>740</sup> Noel Whiteside, 'Private Provision and Public Welfare: Health Insurance Between the Wars' in David Gladstone (ed), *Before Beveridge: Welfare Before the Welfare State* (IEA Health and Welfare Unit 1999) 27. Details on the health care provided can be found at 28-32. See also Sleeman (n 730) ch 3.

<sup>741</sup> Sleeman (n 730) 39.

two novel aspects; first, a significant increase in government provision of services, and second, a higher level of taxation – to cover the costs of the War. These two issues were key to the development of a social services network in Britain.<sup>742</sup> The Beveridge Report (formerly known as the *Social Insurance and Allied Services Report*)<sup>743</sup> used the post-War experience in Britain to recommend a complete reshaping of the welfare system into a single comprehensive scheme to cover the entire population.<sup>744</sup>

The Beveridge Report is considered the ‘founding document’ of the Welfare State.<sup>745</sup> It provided several key policies for post-war Britain to improve welfare in the country, and was aimed to address the ‘Five Giants’ in the community – Want, Disease, Ignorance, Squalor and Idleness.<sup>746</sup> Beveridge believed that the government had three key welfare duties:

- 1) the introduction of a family allowance to limit poverty in large families;
- 2) the introduction of a comprehensive, nation-wide health service; and
- 3) governmental responsibility for maintaining a high and stable level of employment in the country.<sup>747</sup>

This represented the development of a clear social minimum, a ‘defining moment’ in English history, and a transition to an institutional Welfare State.<sup>748</sup> The Report resulted in the passing of several key pieces of legislation, including the Education Act 1944, the

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<sup>742</sup> For specific details of the impact of WWII on social service provision, see *ibid* 39-41.

<sup>743</sup> Sir William Beveridge, *Social Insurance and Allied Services* (HMSO London 1942).

<sup>744</sup> Sleeman (n 730) 41.

<sup>745</sup> Stewart (n 735) 17.

<sup>746</sup> Sleeman (n 730) 41.

<sup>747</sup> *ibid* 43.

<sup>748</sup> Gladstone (n 717) 3.

Family Allowances Act 1945, The National Health Service Act 1946, and the National Insurance Act 1946.<sup>749</sup> The aim of these reforms was to expand the role of the State. The social minimum provided by the government was no longer limited to relieving the most extreme cases of poverty or inequality; it was now designed to positively promote the welfare of all citizens.<sup>750</sup>

#### 4.2.4: After the 'Welfare State'

In the 1970's the Welfare State in Britain was widely perceived to be in crisis, largely because the social minimum provided to citizens was considered (by some parties) to be excessively generous. This view was precipitated by a range of political and economic factors, including the election of a Conservative government, the quadrupling of oil prices creating an unprecedented level of annual inflation, the slowing down of economic growth, an actual fall in GDP, and an unprecedented increase in unemployment.<sup>751</sup> As a result the 'New Right' started a campaign to roll back the Welfare State and decrease the government social minimum, particularly through the promotion of the private sector for the delivery of social services, and requiring family provision of assistance previously delivered by the State. This was continued and enhanced when Margaret Thatcher came to power in 1979.<sup>752</sup> The gradual erosion of the social minimum continued for the next 15 or so years.<sup>753</sup> In May 1996 the Guardian published a now-infamous front-page article

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<sup>749</sup> Louise Warwick-Booth, *Social Inequality* (Sage Publishing 2013) 170-171.

<sup>750</sup> Sleeman (n 730) 1.

<sup>751</sup> Lowe (n 690) 305.

<sup>752</sup> Stewart (n 735) 24.

<sup>753</sup> For details of this see Lowe (n 690) ch 12, particularly 305-329; Lawrence M Mead, 'The Rise of Paternalism' in Lawrence M Mead (ed), *The New Paternalism: Supervisory Approaches to Poverty* (Brookings Institution Press 1997) 17-20.

titled 'The End of the Welfare State'. This article discussed the ways in which both Labour and the Conservatives had chipped away at the welfare safety net created decades earlier.<sup>754</sup> During this process, the State began to view charity and voluntary organisations as not just complementary services, but as an alternative to government welfare provision.<sup>755</sup>

When elected in 2010, the UK coalition government set about making significant changes to the welfare system, mainly in the form of large cuts to its funding.<sup>756</sup> This culminated in *the Spending Review 2010 Command Paper* (Spending Review 2010), which aimed to make 'net welfare savings of £7 billion a year'.<sup>757</sup> This was largely a response to the global financial crisis, and the savings were mainly made through a reduction of the social minimum. Many argued that this focus was quite unfair, as the poorest in society had seen very little, if any, of the benefit of the financial boom, but were the ones who suffered the most from the crash.<sup>758</sup> As well as reduced welfare spending, the financial crisis resulted in difficulties obtaining credit (particularly for borrowers classed as 'higher risk'), and job insecurity and instability for many people.<sup>759</sup> A similar program was announced in 2013, when the government proposed its 'big bang' package of benefits reforms, which aimed to further reduce spending by around £20 billion.<sup>760</sup> The 'Big

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<sup>754</sup> Stewart (n 735) 15.

<sup>755</sup> Lewis (n 737) 16.

<sup>756</sup> Lansley and Mack (n 453) 121-125.

<sup>757</sup> HM Treasury, *Spending Review 2010* (Cm Paper 7942, 2010) 8.

<sup>758</sup> Warwick-Booth (n 749) 177-178.

<sup>759</sup> *ibid* 177-178.

<sup>760</sup> Lansley and Mack (n 453) 130.

Society' and 'Shared Society' notions promoted by the Conservative Party<sup>761</sup> further indicated an erosion of the Welfare State in favour of individual responsibility.

Whilst there has been movement away from the classic Welfare State envisioned by the Beveridge Report, some level of political inheritance remains, despite changes in government.<sup>762</sup> The Beveridge reforms were so universally popular that subsequent Conservative governments have been reluctant to significantly curb these advances. Even the Spending Review 2010, which was aimed at making severe reductions in welfare spending, confirmed the importance of many pillars of the Beveridge Report, including the NHS,<sup>763</sup> adequate state pensions, and the provision of free education for all.<sup>764</sup> The key aspects of the Beveridge Report and provision of a social minimum have endured, albeit damaged, for numerous decades and across many political changes.<sup>765</sup> Politicians are careful to ensure that new reforms are not seen as taking away the social minimum, but rather as shifting the emphasis or limiting its application to those deemed 'not worthy' of State assistance. Commentators have therefore optimistically noted that 'the Welfare State is here to stay'.<sup>766</sup>

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<sup>761</sup> This is discussed further in Part 4.5.1 below.

<sup>762</sup> The 'path dependency' theory highlights that significant policy mechanisms shape political interests for many years: Page (n 736) 303.

<sup>763</sup> NHS England, 'New research – public NHS satisfaction levels rise with dissatisfaction levels at all time low' (*NHS England*, 29 January 2015) <<https://www.england.nhs.uk/2015/01/nhs-satisfaction-levels-rise/>> accessed 7 February 2017. The societal pride of this system was highlighted in the London Olympics opening ceremony in 2012, which had a large part specifically dedicated to the NHS and Great Ormond Street Hospital, and their impact on English history.

<sup>764</sup> HM Treasury, *Spending Review 2010* (n 757) 6-7. The education assistance has specific benefits to those most in need, including 15 hours a week for young children and the introduction of a £2.5 billion pupil premium to assist the most disadvantaged.

<sup>765</sup> Although the Beveridge Report findings were broadly subscribed into the principles of the Labour Party, the majority of the practical development of these principles actually occurred under the Conservative Party which has continued to 'cautiously praise' the communitarian aspects of the Welfare State: Stewart (n 735) 17; Barry (n 736) 55; Warwick-Booth (n 749) 171.

<sup>766</sup> Sleeman (n 730) 187.

### 4.3: Explanations for Social Minimums

The provision of a social minimum requires the redistribution of assets; the State must remove property from businesses and higher earning individuals and give it to those on a lower income.<sup>767</sup> This type of action requires justification. Three potential explanations for the provision of a social minimum will be discussed – equality and liberal democracy, general government obligations, and the happiness of society. These three justifications are inherently linked, but each focuses on a different aspect of a State’s obligations to its citizens.

#### 4.3.1: Equality and Liberal Democracy

The first explanation for a social minimum is the fact that a certain level of equality is needed for a functioning democratic system. The provision of a social minimum is intrinsically connected to the social and economic rights of individuals, and these rights are key elements of a working democratic system. Developing on T. H. Marshall’s influential work on citizenship, Satz outlines the importance of equal status in a functioning democracy, stating that

an equal right to vote has little effective meaning if some voters are too badly educated to read a ballot; citizenship means little for the destitute if society is so structured that they have no opportunity to share in society’s benefits ... Someone who is desperately poor might agree to an exchange that requires her to function as an around-the-clock domestic servant or to bond her labor to obtain a loan at

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<sup>767</sup> This is discussed in more detail at 4.5.1.

usurious rates that she can never hope to repay. The fate of such a person may be little different from that of a serf under feudalism.<sup>768</sup>

Satz advocates 'positive liberty'<sup>769</sup> as a fundamental tenant of democracy. If we believe in a democratic society, people need to be given a social minimum in order to exercise their democratic choice as 'co-deliberants and co-participants' in society.<sup>770</sup> This is further confirmed by Badger, who states 'what good is the right to vote, they ask, if you starve on the way to the ballot box? Or the right to an independent media if you can't read what it's printing?'.<sup>771</sup> The provision of a social minimum allows people to participate in society, thus in government and democratic processes.<sup>772</sup>

Correspondingly, inequality is 'divisive and socially corrosive', and undermines the democratic structures of our society.<sup>773</sup> It creates a range of negative outcomes, including health and social problems, political instability, delayed economic growth, negative impacts on subjective well-being, and exclusion of the most vulnerable.<sup>774</sup> The greater the level of inequality, the lower the trust in the government.<sup>775</sup> The achievement of complete equality is clearly impossible, although we can (and should) aim to reduce inequalities between citizens. People need to participate on an equal footing when deciding the laws

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<sup>768</sup> Satz (n 297) 100, emphasis added.

<sup>769</sup> Acting in a way to have more meaningful control over one's life; see discussion of positive freedom to text related to fns 222 to 224.

<sup>770</sup> Satz (n 297) 96, see also 100-105. This is not a new concept, see also Green (n 297).

<sup>771</sup> Badger (n 290).

<sup>772</sup> This can be applied more specifically to markets for goods and services. Markets are designed to allow a person to participate in society. Intervention into the market is therefore justified if it is harmful for the standing of parties as equal citizens in a democracy; Satz (n 297) 95.

<sup>773</sup> Warwick-Booth (n 749) 21.

<sup>774</sup> See discussion that statistic evidence outlined in *ibid* 18-21.

<sup>775</sup> Richard Wilkinson and Kate Pickett, *The Spirit Level: Why Equality is Better for Everyone* (Penguin 2010) 52-53. This may be linked to the impact of oxytocin on the body; see discussion in 213-214.

that will govern them.<sup>776</sup> A certain level of resources, in the form of a social minimum, is therefore necessary for individuals to participate in democracy.

#### 4.3.2: Government Duty

The second explanation is that providing a social minimum is a *duty* of government. Political institutions must be justified – by the will, choices or decisions of people over whom they have authority.<sup>777</sup> The State should act for the good of its citizens, thus promoting their interests and allowing for human flourishing.<sup>778</sup> In a modern democracy, this equates to a government obligation for the provision of social minimum to those in need. Communitarians<sup>779</sup> believe that the State has a duty to redistribute property in favour of the poor to create greater equality within society. Goodin argues that the government is responsible for the consequences that its actions and choices have on those affected. Since the State's job is to protect the public interest, it must attempt to do good, or at the very least to prevent harm.<sup>780</sup> There is a duty to assist those who are dependent on State resources and have nowhere else to turn.<sup>781</sup> These people are vulnerable and dependent on the government, which has a special obligation to protect the group – this is the primary purpose of welfare.<sup>782</sup>

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<sup>776</sup> Satz (n 297) 102.

<sup>777</sup> Jonathan Wolff, *An Introduction to Political Philosophy*, vol 3rd (Oxford University Press 2016) 35.

<sup>778</sup> See Joseph Raz, 'Liberalism, Autonomy, and the Politics of Neutral Concern' (1982) 7 *Midwest Studies in Philosophy* 89, 112-113.

<sup>779</sup> For discussion on definitional issues, see Stephen Mulhall and Adam Swift, *Liberals and Communitarians* (2nd edn, Blackwell Publishes 1996) xiii-xiv.

<sup>780</sup> Robert E. Goodin, *Protecting the Vulnerable: A Reanalysis of Our Social Responsibility* (The University of Chicago Press 1985) 142; see also Fried (n 225) 106 which is discussed further in 5.3.2 below.

<sup>781</sup> Goodin (n 719) 147.

<sup>782</sup> *ibid* 150-151.

Even between communitarians, there are clear differences in opinions on the level of support that should be provided. Dworkin argues for a strict notion of equality of resources, where inequality is only legitimate if it arises from the decisions or intentions of the individuals concerned.<sup>783</sup> In a slightly less extreme claim, Rawls believes that the State should play an active role in promoting equality of all people. He advocates in *A Theory of Justice*<sup>784</sup> that each person should have an equal right to basic liberties (The Liberty Principle),<sup>785</sup> and that social and economic inequalities should be arranged to give the greatest benefit to the least advantaged (The Difference Principle).<sup>786</sup> He argues for the presumption of equality, famously declaring that ‘all social values – liberty, opportunity, income and wealth and the bases of self-respect – are to be distributed equally unless an unequal distribution of any, or all, of these values is to everyone’s advantage’.<sup>787</sup> Rawls therefore sees an inherent link between justice and equality, considering injustice as simply inequalities that are not for the benefit of society.

There are two further potential reasons that the duty to provide a social minimum falls on the State. First, it is a responsibility of the moral community, and democratically elected governments are the embodiment of the moral community.<sup>788</sup> Second, albeit less convincingly in this age of austerity, is the ‘deep pockets’ theory; the government is in the

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<sup>783</sup> Ronald Dworkin, *Sovereign Virtue: The Theory and Practice of Equality* (Harvard University Press 2000) ch 2.

<sup>784</sup> Described as the ‘single most important stimulus to the renaissance of political theory’ for decades: Mulhall and Swift (n 779) 1.

<sup>785</sup> Rawls (n 463) 176-180. There is also a third principle ‘The Fair Opportunity Principle’, which will not be discussed here.

<sup>786</sup> *ibid* 65-68. There is also a third principle ‘The Fair Opportunity Principle’, which will not be discussed here.

<sup>787</sup> *ibid* 54.

<sup>788</sup> Goodin (n 719) 152.

best financial position to provide such assistance.<sup>789</sup> Others believe that the primary role of the State is to promote 'social justice'. This concept arose over 2,000 years ago from Plato's *Republic* and his enquiry into the 'true nature' of justice, including the role of the State.<sup>790</sup> It is generally accepted that social justice includes the provision of a social minimum (although the level is often subject to significant dispute).<sup>791</sup>

#### 4.3.3: Social Minimums and Happiness

The final explanation to consider is the relationship between social minimums and a happy, functioning society. A wide range of research highlights that the provision of a social minimum is beneficial not just for the recipients, but also for society as a whole. In contrast to the theoretical analyses of the earlier section, this proposition is grounded in utilitarianism. The best society maximises happiness, and government promotes happiness more effectively than does the state of nature.<sup>792</sup> A natural extension of this is that the State should redistribute property and provide welfare in a way that maximises happiness in society. Analysing social minimums from a basic economic perspective should indicate that people 'losing' resources would be strongly against the concept.<sup>793</sup> By extension, this would mean that the provision of a social minimum is unlikely to fulfil the

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<sup>789</sup> ibid 152-153.

<sup>790</sup> Norman P. Barry, *An Introduction to Modern Political Theory* (3rd edn, The MacMillan Press Ltd 1995) 148.

<sup>791</sup> ibid 149-150. See also discussion at 166 on the difficulty of distinguishing between welfare and justice in the framework of Western morality.

<sup>792</sup> Wolff (n 777) 52.

<sup>793</sup> The standard claim is that 'collective delivery of the familiar welfare services does not normally result in an increase in social well-being because particular individuals will be harmed, especially those compelled to pay for them, and because compulsion reduces freedom of choice': Barry (n 736) 59.

utilitarian test for State regulation. Surprisingly this does not play out in practice, and societies with strong welfare systems are generally the happiest.<sup>794</sup>

In their book *The Spirit Level: Why Equality is Better for Everyone*, Wilkinson and Pickett argue that, once a country reaches a certain level of economic achievement, further unequal financial gains do not improve happiness levels and, in fact, are likely to decrease the levels in that society.<sup>795</sup> The authors reviewed a wide range of indicators, including community life and social relations, trust, mental health and drug use, physical health (including life expectancy and obesity), educational performance, violence and imprisonment, and social mobility to determine what makes the happiest society. They concluded that the majority of the population benefited from increased equality, not just the recipient of the welfare.<sup>796</sup>

Table 2 below highlights further compelling links between welfare and happiness. It outlines the Top 10 countries in terms of highest levels of happiness, lowest poverty rates, and highest levels of equality. Whilst it is difficult to obtain an objective measure of a social minimum, two indicators have been used; the lowest poverty rate and the highest levels of equality. Both of these factors are indicative of a government system that is redistributing resources from those who have the most to those who have the least.<sup>797</sup> As

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<sup>794</sup> When determining what makes an individual 'happy', the following aspects were considered: GDP per capita, social support available, healthy life expectancy at birth, freedom to make choices, generosity and perceptions of corruption: John Helliwell, Richard Layard and Jeffrey Sachs, *World Happiness Report 2016, Update* (Sustainable Development Solutions Network 2016) 16 (with a detailed summary of each aspect at p 17).

<sup>795</sup> Wilkinson and Pickett (n 775) 8.

<sup>796</sup> *ibid* 275. This is particularly evident in health. In developed nations, inequality has a much bigger impact on health than the national average income. Health and social problems are closely related to inequality in more prosperous nations; they are however only weakly related to national average income in these countries: *ibid* 20-21. The authors note that this trend is repeated within US states: 22. These health problems are not linked to only those who are negatively impacted by the inequality, but spread across all spectrums of society, indicating that in the context of health, equality is better for everyone; *ibid* 175-177.

<sup>797</sup> For a critique of this connection, see Barry (n 736) 66-68.

discussed above, absolute equality is not achievable – but society can take steps to reduce pre-existing inequalities. There is a significant overlap between these factors. Six countries, Denmark, Iceland, Norway, Finland, Netherlands and Sweden (all underlined), appear in the Top 10 for all three indices, and a further two, the Czech Republic and Switzerland (both italicised), appear in two out of the three categories.

Table 2: Happiness, Poverty and Equality Rates

Rank	Highest Levels of Happiness <sup>798</sup>	Lowest Poverty Rates <sup>799</sup>	Highest Levels of Equality <sup>800</sup>
1.	<u>Denmark</u>	<u>Iceland</u>	<u>Iceland</u>
2.	<i>Switzerland</i>	<u>Denmark</u>	<u>Norway</u>
3.	<u>Iceland</u>	<i>Czech Republic</i>	<u>Denmark</u>
4.	<u>Norway</u>	<u>Finland</u>	Slovenia
5.	<u>Finland</u>	<u>Norway</u>	<i>Czech Republic</i>
6.	Canada	<u>Netherlands</u>	<u>Finland</u>
7.	<u>Netherlands</u>	France	Belgium
8.	New Zealand	Luxembourg	Austria
9.	Australia	<i>Switzerland</i>	<u>Netherlands</u>
10.	<u>Sweden</u>	<u>Sweden</u>	<u>Sweden</u>

<sup>798</sup> Helliwell, Layard and Sachs (n 794) 20. It is recognised that Australia and New Zealand are amongst the happiest countries, but do not have low poverty rates or highest levels of equality. The author's perspective of this is the benefits of the good weather and excellent people.

<sup>799</sup> Organisation for Economic Co-operation and Development Data, 'Poverty Rate: Chart' (*Organisation for Economic Co-operation and Development* 2016) <<https://data.oecd.org/inequality/poverty-rate.htm#indicator-chart>> accessed 31 January 2017.

<sup>800</sup> Organisation for Economic Co-operation and Development Data, 'Income Inequality: Chart' (*Organisation for Economic Co-operation and Development*, 2016) <<https://data.oecd.org/inequality/income-inequality.htm>> accessed 31 January 2017.

The link between equality and happiness also appears to be reflected in the UK. Inequality in this country generally increased from 2000 to 2015,<sup>801</sup> with the most significant changes occurring in the period 2012-2015.<sup>802</sup> Inequality is also predicted to further increase over the period 2015-2020, but at a much higher rate (largely due to austerity measures).<sup>803</sup> Over the same period, happiness levels in the UK have decreased. In 2012 the United Kingdom was ranked the 18th happiest country in the world.<sup>804</sup> This dropped significantly over the subsequent three years, where it has been ranked 21st<sup>805</sup>, 22nd<sup>806</sup> and 23rd<sup>807</sup> happiest country. In 2016 it received its worst relative happiness rating, behind Mexico, Singapore, Brazil and the United States.<sup>808</sup> Quantitative happiness levels in the UK have also dropped significantly.<sup>809</sup>

The relationship between equality and happiness has been endorsed by both mainstream UK political parties. David Cameron said in 2009 ‘that among the richest countries, it’s the more unequal ones that do the worst according to almost every life indicator ... We all know, in our hearts, that as long as there is deep poverty living

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<sup>801</sup> For discussion on austerity, see Adam Corlett and Stephen Clarke, *Living Standards 2017: The past, present and possible future of UK incomes* (Resolution Foundation 2017) 8-9.

<sup>802</sup> For statistics, see *ibid* 11. This is also discussed in Lansley and Mack (n 453) ch 2, particularly 51-55.

<sup>803</sup> For statistics, see Corlett and Clarke (n 801) 11.

<sup>804</sup> John Helliwell, Richard Layard and Jeffrey Sachs, *World Happiness Report 2012* (United Nations Sustainable Development Solutions Network 2012) 30.

<sup>805</sup> John Helliwell, Richard Layard and Jeffrey Sachs, *World Happiness Report 2015* (Sustainable Development Solutions Network 2015) 26.

<sup>806</sup> John Helliwell, Richard Layard and Jeffrey Sachs, *World Happiness Report 2013* (Sustainable Development Solutions Network 2013) 22.

<sup>807</sup> Helliwell, Layard and Sachs, *World Happiness Report 2016, Update* (n 794) 17.

<sup>808</sup> *ibid* 17. There has however been a slight increase since then and the UK is now ranked 19<sup>th</sup> Happiest Country; see John Helliwell, Richard Layard and Jeffrey Sachs, *World Happiness Report 2018* (Sustainable Development Solutions Network 2018). This is however an increase relative to other countries. There has still been a general decrease in absolute happiness in the country: *ibid* 26.

<sup>809</sup> Helliwell, Layard and Sachs, *World Happiness Report 2016, Update* (n 794) 26.

systematically with ... great riches, we all remain poorer'.<sup>810</sup> The following year, Ed Miliband stated in his first speech as the leader of the Labour Party, 'I do believe that this country is too unequal and the gap between rich and poor doesn't just harm the poor, it harms us all ... if you look around the world – at the countries that are healthier, happier and more secure – they are the more equal countries'.<sup>811</sup>

The connection between happiness and equality is so strong that the 2016 Happiness Report specifically addressed the relationship.<sup>812</sup> The Report stated that 'there are arguments both ethical and empirical suggesting that humans are or at least ought to be happier to live where there is more equality of opportunities and generally of outcomes as well'.<sup>813</sup> Initial research conducted by the United Nation's Sustainable Development Solutions Network highlights a number of connections between equality and happiness, including the fact that inequality reduces social trust,<sup>814</sup> and that there is a correlation between increased income equality and general well-being.<sup>815</sup> Similar comments were made in the 2018 Happiness Report, indicating that it is an ongoing theme.<sup>816</sup> Despite these comments, 'much further research is needed' to fully understand and utilise the initial findings.<sup>817</sup> It is, however, clear that social minimums are beneficial

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<sup>810</sup> Cited in Wilkinson and Pickett (n 775) 298.

<sup>811</sup> *ibid.*

<sup>812</sup> Helliwell, Layard and Sachs, *World Happiness Report 2016, Update* (n 794) 4-6, 9-10, 29-41.

<sup>813</sup> *ibid* 29-30. This report goes on to state 'Beyond such direct links between inequality and subjective well-being, income inequalities have been argued to be responsible for damage to other key supports for well-being, including social trust, safety, good governance, and both the average quality of and equal access to health and education, - important, in turn, as supports for future generations to have more equal opportunities': *ibid* 30.

<sup>814</sup> *ibid* 31.

<sup>815</sup> *ibid* 32.

<sup>816</sup> Helliwell, Layard and Sachs, *World Happiness Report 2018* (n 808) 14-15.

<sup>817</sup> Helliwell, Layard and Sachs, *World Happiness Report 2016, Update* (n 794) 41.

for those who technically 'lose' from the redistribution of assets, as well as for those who are recipients of the welfare.

#### 4.4: Examples of Social Minimums

A social minimum is incorporated into our current regulatory system in a number of ways.

This section will discuss three examples. First, government welfare aims to provide all people with a social minimum. Second, bankruptcy relief processes maintain the social minimum. Finally, in certain vitiating factors the courts have tacitly considered whether the contract in question will push the vulnerable party into poverty and thus below a social minimum.

##### 4.4.1: Welfare Provision

The main way in which a social minimum is delivered to individuals is through State-based social welfare. Ensuring a minimum level of resources to live a decent and meaningful life is an important obligation of the political system. A detailed discussion of the welfare system and its different benefits is not necessary, and is clearly beyond the scope of this thesis.<sup>818</sup> The provision of a social minimum is, however, evident in a number of areas such as benefits payments, including sickness and disability assistance,<sup>819</sup> access to education,<sup>820</sup> minimum wage,<sup>821</sup> social housing initiatives,<sup>822</sup> the NHS,<sup>823</sup> and tax credits.<sup>824</sup>

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<sup>818</sup> For more information, see Sleeman (n 730); Lowe (n 690); Walker. For a historical discussion, see Gladstone (n 717); Harris (n 734); Pat Lane, 'The Working Class and State 'Welfare' in Britain, 1880-1914' in David Gladstone (ed), *Before Beveridge: Welfare Before the Welfare State* (IEA Institute of Health and Welfare 1999); Clarke, Langan and Williams (n 302).

<sup>819</sup> Lawrence H. Summers, 'Some Simple Economics of Mandated Benefits' (1989) 79 *The American Economic Review* 177.

<sup>820</sup> See discussion in White (n 685) pt 3.3.

<sup>821</sup> Machin and Manning (n 694); Greenway (n 696).

<sup>822</sup> Summers (n 819).

<sup>823</sup> See discussion of health care provision in the USA in Richard B. Freeman, 'The Minimum Wage as a Redistributive Tool' (1996) 106 *The Economic Journal* 639.

<sup>824</sup> Summers (n 819).

The impact of social minimums on the political outlook in the UK should therefore not be underestimated.

Poverty is often measured solely in monetary terms, but this does not capture the full extent of deprivation.<sup>825</sup> As been discussed above,<sup>826</sup> the government first took responsibility for social minimum provision on the premise that it was merely basic resources (ie food and possibly shelter). Our understanding of welfare has developed further, and it is now recognised that it must move beyond the mere avoidance of starvation or destitution. It is widely believed that income inequality as a concept is too narrow, as it does not reflect the range of social disadvantages that may be experienced by people.<sup>827</sup> Social inequality encompasses a great range of disadvantages, including loneliness, vulnerability, disenfranchisement, and the denial of dignity.<sup>828</sup> Rawls outlined that equality is not just about money, emphasising both the importance of ‘fair equality of opportunity’ and the complicated nature of a social minimum.<sup>829</sup> It goes beyond merely preventing death or utter deprivation, and instead focuses on addressing multiple forms of social exclusion.<sup>830</sup> The social minimum level should identify what it means to be a human and to live a life of dignity within a given society. If we truly believe in addressing social exclusion and inequality, the social minimum must include other important aspects

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<sup>825</sup> Warwick-Booth (n 749) 7-8.

<sup>826</sup> See 4.2.2.

<sup>827</sup> Warwick-Booth (n 749) 2.

<sup>828</sup> See Amartya Sen, *Development as Freedom* (Oxford University Press 1999) and Warwick-Booth (n 749).

<sup>829</sup> Rawls (n 463) 73-77.

<sup>830</sup> Warwick-Booth discusses three potential dimensions of social exclusion: (1) Resources – material and economic, access to private and public services; (2) Participation – economic (by employment), social, education and political participation (voting); and (3) Quality of life – health and well-being, the environment and crime levels; Warwick-Booth (n 749) 6, drawing on research from Ruth Levitas and others, *The Multi-Dimensional Analysis of Social Exclusion* (University of Bristol 2007) 117.

of society including education, health, and opportunities to achieve. An example of this broader concept is the Scottish approach to welfare.<sup>831</sup>

The social minimum in the UK is clearly designed to go beyond the provision of basic resources. There are multiple examples of government services and assistance that highlight the State's desire for people, even those on the lowest incomes or in some way vulnerable, to live a meaningful and fulfilled life. The government provides various allowances so that people can afford to heat their homes adequately;<sup>832</sup> certain groups have access to free or significantly subsidised television licences;<sup>833</sup> others receive assistance with the cost of public transport;<sup>834</sup> free education is provided for all children; and early education is free for children whose parents earn below a certain level.<sup>835</sup> Government assistance has even been extended to provide free access to public swimming pools for all children under 16 years of age, and free swimming lessons to children whose parents receive certain benefits.<sup>836</sup> It is not, however, all positive. As discussed in Part 4.2.4 above, there has been a shift towards a more conservative

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<sup>831</sup> Six dimensions of social exclusion have been identified – low incomes, access to employment, house quality and availability, education, health and fertility, and citizenship and community participation; Scottish Parliament, *Measuring Social Exclusion Research Paper 99/11* (Scotland Information Centre 1999) 7. These categories are still – by large – applied when determining issues of social exclusion; see Peter Kenway and others, *Monitoring Poverty and Social Exclusion in Scotland 2015* (Joseph Rowntree Organisation 2015) especially ch 1;

<sup>832</sup> GOV.UK, 'Winter Fuel Payment' (*GOV.UK*, 8 February 2017) <<https://www.gov.uk/winter-fuel-payment>> accessed 15 February 2017; GOV.UK, 'Cold Weather Payment' (*GOV.UK*, 28 December 2016) <<https://www.gov.uk/cold-weather-payment>> accessed 15 February 2017; GOV.UK, 'Warm Home Discount Scheme' (28 December 2016) <<https://www.gov.uk/the-warm-home-discount-scheme>> accessed 15 February 2017.

<sup>833</sup> GOV.UK, 'Get a free or discounted TV licence' (*GOV.UK*, 23 September 2016) <<https://www.gov.uk/free-discount-tv-licence>> accessed 15 February 2017.

<sup>834</sup> Department of Transport and HM Treasury, *Support to help with the cost of transport: Policy paper* (GOV.UK 2013).

<sup>835</sup> GOV.UK, 'Help paying for childcare' (*GOV.UK*, 8 November 2016) <<https://www.gov.uk/help-with-childcare-costs/free-childcare-and-education-for-2-to-4-year-olds>> accessed 15 February 2017.

<sup>836</sup> Oxford City Council, 'Free swimming for young people aged 16 and under' (*Oxford City Council*, 2017) <[https://www.oxford.gov.uk/info/20029/leisure\\_centres\\_and\\_swimming\\_pools/811/free\\_swimming\\_for\\_young\\_people\\_aged\\_16\\_and\\_under](https://www.oxford.gov.uk/info/20029/leisure_centres_and_swimming_pools/811/free_swimming_for_young_people_aged_16_and_under)> accessed 15 February 2017.

approach to social security and a reduction in social welfare spending since the 2008 global financial crisis and economic downturn. This declining welfare provision and social minimum coincides with stagnating wages, increased unemployment and higher costs of living, occurring at a time when people most need the extra support.<sup>837</sup> Welfare provision has therefore decreased just at the time when people need it the most.

#### 4.4.2: Bankruptcy Relief

Bankruptcy can be considered the ultimate social minimum maintenance.<sup>838</sup> It gives borrowers an opportunity to 'wipe the slate clean' and have existing debts forgiven, whilst still providing them with a socially-agreed minimum standard of living. Bankruptcy is also an instrument of distributive justice. It aims to achieve a 'fair division of wealth among members of society',<sup>839</sup> and has the effect of shifting wealth from one group of people (the creditors) to another (the debtors).<sup>840</sup>

Whilst it is very important to have bankruptcy 'protection', its role in social minimums should not be overstated. Bankruptcy is not an appropriate response in the majority of cases where people are pushed below the social minimum. The poverty rate in the UK is currently 16.7%, meaning approximately one in six people live below the social minimum.<sup>841</sup> In addition, 7.3% of people<sup>842</sup> in the country are considered to be in

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<sup>837</sup> See Rowlingson, Appleyard and Gardner (n 123).

<sup>838</sup> Kronman (n 478) 473.

<sup>839</sup> *ibid* 472.

<sup>840</sup> *ibid* 473.

<sup>841</sup> Dominic Webber and Callum Clark, *Persistent poverty in the UK and EU* (Office of National Statistics 2017) 5.

<sup>842</sup> *ibid* 5.

‘persistent poverty’.<sup>843</sup> Income instability and financial insecurity are also significant problems. Between 2012 and 2015, over 30% of people in the UK were at risk of poverty at one point.<sup>844</sup> In light of the high numbers of people struggling to maintain a social minimum, bankruptcy cannot be considered the sole solution for dealing with these issues.

Bankruptcy is also not an appropriate solution to high-cost credit challenges. There is no evidence of a link between the two, as ironically those who are struggling with problem debt often cannot afford the £680 fee required for bankruptcy relief.<sup>845</sup> This means that a number of people who are repaying these loans are living significantly below the social minimum, but cannot afford the one thing that would provide them with a financial lifeline.<sup>846</sup> Bankruptcy therefore offers a certain level of protection for middle-income earners, but is of limited utility to low-income individuals struggling under the weight of high-cost credit.

There are other potential arrangements for people with problem debt that are not as drastic as bankruptcy, including *Debt Management Plans (DMPs)*, *Individual Voluntary Arrangements (IVAs)*, and *Debt Relief Order (DROs)*. None of these options is as costly as bankruptcy, but they are still inadequate responses to the current issues. Most providers of DMPs will charge the consumer fees to implement the agreement.<sup>847</sup> The DMP is also

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<sup>843</sup> Persistent poverty is defined as ‘being in relative income poverty in the current year and at least two of the three preceding years’: *ibid* 2. Relative poverty occurs if the individual lives ‘in a household with an equivalised disposable income that falls below 60% of the national median in the current year. This is a relative low income measure also referred to as the “at risk of poverty” rate, which measures income compared with other people’. For 2015, the poverty threshold in the UK was £12,567: *ibid* 2.

<sup>844</sup> *ibid* 7.

<sup>845</sup> Applications currently cost £680; GOV.UK, ‘Guide to Bankruptcy: Costs’ (*Crown Copyright*, 2018) <<https://www.gov.uk/bankruptcy/overview>> accessed 19 September 2018.

<sup>846</sup> Carl Packman, Author & Consumer Advocate (28 February 2013). Telephone interview.

<sup>847</sup> A notable exception to this is StepChange Debt Charity.

not binding on all creditors, so the borrower may continue to be contacted by parties demanding repayment of existing debts. Consumers under an IVA will repay their loan over five or six years, and at the end of the period the remaining debt is written off. IVAs are binding on all creditors,<sup>848</sup> and therefore provide a greater level of coverage, but involve both a nominee and ongoing supervisor fee. Similar to bankruptcy, the IVA and DRO will be recorded on the public register and the borrower's credit rating will be adversely impacted, as will their ability to access credit during the IVA period.

Each of these debt repayment options has its own advantages and disadvantages, although it is clear that none is an adequate solution for social minimum maintenance.<sup>849</sup> Bankruptcy and other debt relief processes are a drastic response to indebtedness, and are at the far end of the outcome spectrum. As well as impacting the individual involved, bankruptcy has a number of detrimental impacts on society. It undermines commercial stability and lowers consumer confidence in the enforceability of financial arrangements.<sup>850</sup> It is therefore not something that should be used regularly for maintaining a social minimum. High-cost credit borrowers need programs that will prevent them from getting into financial difficulties in the first place, as opposed to expensive 'escape routes' when they become overburdened with problem debt.

#### 4.4.3: Vitiating Factors

Social minimums are generally considered the responsibilities of government policies, as opposed to the results of legal rules and doctrines. The welfare system provides a social

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<sup>848</sup> Not including family court proceedings, student loans, court fines or debt relating to fraud, or any debts incurred after the IVA was in place.

<sup>849</sup> For further discussion of this see Joseph Spooner, 'Seeking shelter in personal insolvency law: recession, eviction and bankruptcy's social safety net' (2017) 44 *Journal of Law and Society* 374.

<sup>850</sup> Michelle White, 'Personal Bankruptcy under the 1978 Bankruptcy Code: An Economic Analysis' (1988) 63 *Indiana Law Journal* 1.

minimum and the bankruptcy regime maintains it. Whilst the law can consider and respond to the substantive unfairness of a transaction in question, it is much harder for it to address underlying issues of poverty and social minimums. There is, however, one area of law where the financial situation of the vulnerable party can be relevant. This section will discuss how vitiating factors are beginning to recognise and respond to the challenges associated with social minimums.<sup>851</sup>

Vitiating factors respond to a wide range of situations. Chapter 2 of this thesis highlighted how they can be used to ensure the procedural fairness of the agreement in question, and Chapter 3 discussed how vitiating factors can prevent grossly unfair transactions being enforced. There are also indications that the courts look beyond the agreement between the parties and consider the impact the contract would have on the social minimum of the vulnerable party. For example, this concern is evident in the test for whether a threat to breach a contract will be classified as economic duress. If the party threatens to breach a contract because performance would risk putting them into bankruptcy or financial difficulties (and thus below a social minimum), this is generally considered a 'warning' and not a threat sufficient for a finding of economic duress.<sup>852</sup> An example of this is *Williams v Roffey Brothers*, where the Court of Appeal held there was no economic duress when the claimant was unable to perform the contract at the originally agreed price.<sup>853</sup>

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<sup>851</sup> The starting point for this section was the illuminating discussion in Chen-Wishart, *Contract Law* (n 22) particularly chs 5-9.

<sup>852</sup> *ibid* 326-327 citing J Beatson, *The Use and Abuse of Unjust Enrichment* (Clarendon Press 1991).

<sup>853</sup> *Williams v Roffey Brothers & Nicholls (Contractors) Ltd* [1991] 1 QB 1 (CA) at 6 where it was held that the 'that the agreed price of £20,000 was too low to enable the plaintiff to operate satisfactorily and at a profit'.

One of the key examples of social minimum maintenance is the infamous undue influence case, *Allcard v Skinner*.<sup>854</sup> In this case the Court of Appeal set aside gifts given to the Catholic Church by Ms Allcard, a postulant<sup>855</sup> at the time. It is difficult to explain the outcome of this case on any other basis apart from the maintenance of a social minimum and avoidance of poverty. The decision cannot be justified because of the wrongful actions of the defendant; the judges were very careful not to make any allegations of misconduct by the Mother Superior in taking the gifts.<sup>856</sup> Neither can it be explained through protecting a vulnerable claimant. Ms Allcard was categorised by the Court as ‘a woman well-informed respecting the matter in hand, and capable of appreciating and forming a decision on matters of business’<sup>857</sup> and ‘a well-educated lady’.<sup>858</sup> As Ms Allcard handed over all her worldly positions to the Church, she would have suffered from severe poverty when leaving the sisterhood.<sup>859</sup> The Court returned her gifts to prevent this from happening. The decision can therefore be rationalised on the grounds that the judges were concerned with preventing the claimant from going into poverty, thus maintaining a social minimum.

Other undue influence cases demonstrate a similar concern for avoidance of poverty and maintenance of a social minimum. For example, in *Hammond v Osborn*<sup>860</sup> the defendant (Ms Osborn) was given a gift of £297,005 from Mr Pritler’s estate. He was a

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<sup>854</sup> *Allcard v Skinner* (1887) LR 36 Ch D 145 (CA).

<sup>855</sup> A novice nun who is asking for admission to the convent.

<sup>856</sup> *Allcard v Skinner* (n 854), for example in the original decision as per Kekewich J at 158; and appeal as per Cotton LJ at 170.

<sup>857</sup> *ibid*, Kekewich J at 166.

<sup>858</sup> *ibid*, Kekewich J at 167.

<sup>859</sup> This transfer was referred to as one that could not ‘be reasonably accounted for on the ground of friendship, relationship, charity, or other ordinary motives on which ordinary men act’; *ibid*, Lindley LJ at 185. It is expressed doctrinally as a transaction that ‘calls for an explanation’.

<sup>860</sup> *Hammond v Osborn* [2002] EWCA Civ 885, [2002] 2 P & CR D41 [61].

frail, elderly man who was living alone when the defendant had befriended him. The Court of Appeal required Ms Osborn to repay the money, despite the fact that she 'was not guilty of any reprehensible conduct',<sup>861</sup> and that Mr Pritler had 'sufficient ability to comprehend fully what he was going'.<sup>862</sup> The gift given by Mr Pritler constituted over 90% of his estate and left him without sufficient assets to pay his future care. Only £30,000 remained, which would not have been enough to pay for the capital gains tax bill. A similar situation arose in *Randall v Randall*, where the court set aside a number of gifts from an elderly woman to her nephew.<sup>863</sup> In this case, the court was concerned that the donor would not have been able to afford her additional nursing home care when she left the hospital.<sup>864</sup> *Royal Bank of Scotland v Etridge (No 2)*<sup>865</sup> also shows concerns about the maintenance of a social minimum, in this case the matrimonial or family home. When determining whether the surety was valid, the House of Lords emphasised that the applicants' 'home may be her only substantial asset, as well as the family's home ... she could be made bankrupt'.<sup>866</sup> If the property in question was one of numerous assets held by the applicants, it is likely that the Court would have been less concerned with protecting their financial interests from the bank.

The maintenance of a social minimum is also important in unconscionable conduct cases. The entire basis of unconscionable dealing is premised on protecting people who have a special disadvantage, which includes people who are (or who at risk of falling) below the social minimum. In the UK it is designed to protect those who are 'poor,

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<sup>861</sup> *ibid* [61].

<sup>862</sup> *ibid* [59].

<sup>863</sup> *Randall v Randall* [2004] EWHC 2258 (Ch), 7 ITELR 340.

<sup>864</sup> *ibid* [55].

<sup>865</sup> *Royal Bank of Scotland v Etridge (No 2)* (n 652).

<sup>866</sup> *ibid*, 808.

ignorant or illiterate'.<sup>867</sup> This type of approach was seen as early as 1787 in *Evans v Llewelin*.<sup>868</sup> In this case, the Court of Chancery protected a desperate man who sold his share of an estate, which was his only real asset, at a significant undervalue. In Australia, the beneficiaries of unconscionable conduct were defined by Fullagar J as individuals who had a range of 'weaknesses', including 'poverty or need of any kind'.<sup>869</sup> This does not only protect people who are below the social minimum, but those who are at risk of going into poverty because of the transaction in question. This approach can be seen in the Australian case of *Louth v Diprose*.<sup>870</sup> In this case Mr Diprose became infatuated with Ms Louth, giving her significant gifts and eventually buying her a house. When the relationship deteriorated, Mr Diprose requested Ms Louth return the property. The High Court ordered Ms Louth transfer the house back to Mr Diprose. The judges were concerned that the house was a 'substantial gift' and Mr Diprose had children to support. He 'had only limited assets, that the mortgage moneys were his principal asset'.<sup>871</sup> Similar to *Etridge*, it is likely that the courts would have been less interested in protection had Mr Diprose had other significant assets, and the social minimum was not a concern.

Whilst not explicitly taking the matter into account, a range of vitiating factor cases are concerned with preventing the vulnerable party from going into poverty. This is best seen as the maintenance of a social minimum. There are strong justifications for this type of approach. As stated by Chen-Wishart,

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<sup>867</sup> *Fry v Lane* (n 564), in particular the statement from Kay J that there 'are clear authorities that a purchase at an undervalue from a poor, ignorant, or illiterate person, having no independent advice, cannot be sustained' (at 319). This was discussed in more detail in Part 3.3.3 above.

<sup>868</sup> *Evans v Llewelin* (1787) 1 Cox 334 (Ct of Ch).

<sup>869</sup> *Blomley v Ryan* [1956] HCA 81; (1956) 99 CLR 362 at 405.

<sup>870</sup> *Louth v Diprose* [1992] HCA 61; (1992) 175 CLR 621.

<sup>871</sup> *ibid* [9]-[10].

The law should not facilitate undertakings that can have the effect of unduly reducing an individual's overall autonomy; hence it should be reluctant to enforce contracts that will push the complainant below some social minimum. Grossly unfair contracts are often objectionable precisely because they have an adverse long-term effect on the autonomy of the complainant. This is but an extension of the facility of bankruptcy, which renders contracts unenforceable in order to give the bankrupt a fresh start rather than require her to live the life of quasi-indentured servitude.<sup>872</sup>

Whether the maintenance of a social minimum is an appropriate factor for judges to consider, and whether the courts should be concerned with avoiding poverty, are very interesting questions that unfortunately need to be left for another day.

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<sup>872</sup> Chen-Wishart, 'The Nature of Vitiating Factors in Contract' (n 232) 304.

## 4.5: Limitations of the Social Minimums Approach

In spite of its many positives – equality, respect, protection of the vulnerable, happiness of society and adherence to a valuable notion of democracy – maintaining a social minimum is not entirely without controversy. This section will consider three limitations of the concept – the impact on property rights, difficulties with responsibility, and moral hazards.

### 4.5.1: Impact on Property Rights

Providing a social minimum means removing the property of some without their express permission, and giving it to others. The way money is taxed and spent inherently highlights the State's values. All people enjoy the benefits of the State, and therefore must contribute to the costs involved in running it.<sup>873</sup> Everyone who is earning a salary (over a certain level) is required to pay income tax. The government then uses these resources and the tax system in general to support the activities and programs that it believes worthy.<sup>874</sup> Taxes are, however, unequally distributed, with a larger share generally going to people who are recipients of the social minimum. The higher the provision of welfare, the more property must be taken from the wealthy and redistributed to those in need. Despite the strong justifications already discussed,<sup>875</sup> the impact on property rights has made the welfare system a highly contentious issue. Libertarians<sup>876</sup> argue that, because of

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<sup>873</sup> Wolff (n 777) 55-56. It is recognised that taxes can be collected in a variety of non-income related manners, including Value Added Tax on expenditure, excise duties, company tax and stamp duty.

<sup>874</sup> As an example of this value-system, people who spend their time gambling (which is subject to significant levies and duties) are subsidising the life of those who visit museums or art galleries, which are supported by government funds; Mulhall and Swift (n 779) 26. See also discussion in Raz, *The Morality of Freedom* (n 203) 161.

<sup>875</sup> See discussion in 4.3.

<sup>876</sup> It is acknowledged that terms such as 'liberals', 'libertarians' and 'communitarian' often have competing definitions: see Mulhall and Swift (n 779) xiii-xiv.

the importance of property rights, redistribution should be kept as minimal as possible.<sup>877</sup>

For example, Nozick believes that the State should only tax for the defence of citizens against each other, and for protection from foreign aggressors. It would therefore be an unjustified violation of property rights to provide tax-based welfare to the poor.<sup>878</sup>

Providing welfare to individuals in need is a restriction on the actions of others; it can be justified on many grounds, including equality, protection of the vulnerable, and compassion.<sup>879</sup> The impact on property rights is therefore not sufficient to prevent the government from providing a social minimum. Raz advocates that 'a government whose responsibility is to promote the autonomy of its citizens is entitled to redistribute resources, to provide public goods and to engage in the provision of services.'<sup>880</sup> The aim of a social minimum is to create a fairer and more egalitarian society, which can override concerns for the property rights of certain individuals.<sup>881</sup> Dworkin famously stated that 'no government is legitimate that does not show equal concern for the fate of those citizens over whom it claims dominion and from whom it claims allegiance'.<sup>882</sup>

Debates on property rights and social welfare are often categorised as one between 'libertarian versus communitarian'. Libertarians believe that individual property rights are of paramount importance, whereas communitarians focus on issues of social good and fairness. This thesis argues that it does not have to be an either/or proposition.

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<sup>877</sup> See discussion the individualist prerogative and the right to private property in Eric Mack, 'Individualism and Libertarian Rights' in Thomas Christiano and John Christman (eds), *Contemporary Debates in Political Philosophy* (Blackwell Publishing 2009) 130-134.

<sup>878</sup> Nozick (n 227).

<sup>879</sup> See discussion in 4.3 above. Mill famously stated 'all that makes existence valuable to anyone depends on the enforcement of restraints upon the actions of other people': Mill, *On Liberty* (n 229) 9.

<sup>880</sup> Raz, *The Morality of Freedom* (n 203) 417.

<sup>881</sup> Page (n 736) 301.

<sup>882</sup> Dworkin (n 783) 1.

As outlined in Part 4.3.3, all groups in society benefit from the provision of a social minimum. Property rights are valued, and in fact protected by the promotion of equality and fairness. People who own property generally do not want social unrest and destabilisation, as this would negatively impact their property rights. As Chamberlain notes, 'the foundations of property are made more secure when no real grievance is felt by the poor against the rich'.<sup>883</sup> Despite the fact that the property of some people is taken without their express permission, the government duty for the provision (and maintenance) of a social minimum is justified on the grounds of both property rights and fairness.

#### 4.5.2: Responsibility for Social Minimums

The second difficulty to consider is who should have the responsibility for social minimum provision. As discussed in Part 4.2, there is an ongoing historical debate on the obligations of welfare and protection of the vulnerable. There has been a gradual movement from welfare provision by religious or charitable organisations towards a stronger role for the State, but this has not been complete or linear.<sup>884</sup> Without a clear understanding of who is responsible for social minimums, those in need could easily slip through the cracks of the welfare system.

As discussed above, social welfare provision was initially the duty of religious institutions, and there is a strong historical link between moneylending and social welfare. The religious prohibition on lending for profit in the Old Testament was coupled with an

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<sup>883</sup> Lane (n 818) 91.

<sup>884</sup> It is however recognised that this movement has not been linear: see Lewis (n 737); Stewart (n 735) 31-32.

obligation to give charitably (or potentially lend at no cost) to the poor.<sup>885</sup> Providing financial assistance to the poor was generally considered a charitable obligation to be performed by the church, which has a proud history of assisting those to those in need.<sup>886</sup> Writing shortly after the Depression, Chesterton advocated for a return to religious and Aquinas-based beliefs on usury – namely that ‘loans were a manifestation of charity. Usury was a sin precisely because it took advantage of the needs of others’.<sup>887</sup>

Even with the development of the Welfare State, charities and religious organisations have continued to assist in providing a social minimum to the most vulnerable in our society. More recently, the church has started to take steps to minimise the harm caused by high-cost credit, highlighting the relevance of connections between Christianity, usury, and protection of the poor.<sup>888</sup> The charging of excessive interest, particularly to the poor, continues to be something that the church<sup>889</sup> is fighting against. This includes the creation of the organisation *Christians Against Poverty*, which aims to help people ‘crippled by debt’.<sup>890</sup> The condemnation of usury by Christianity also had important implications for the high-cost credit debate. In 2013, the Archbishop of

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<sup>885</sup> ‘If thou lend money to any of my people that is poor by thee, thou shalt not be to him as an usurer, neither shalt thou lay upon him usury. If thou at all take thy neighbour’s raiment to pledge, thou shalt deliver it unto him by that the sun goeth down: For that is his covering only, it is his raiment for his skin: wherein shall he sleep? and it shall come to pass, when he crieth unto me, that I will hear; for I am gracious’: King James Bible (n 485) Exodus XXII, 25-27. All emphasis (ie italics and bolding) are from this version and not included by the author.

<sup>886</sup> Meislin and Cohen (n 488) 260; Martin Charlesworth and Natalie Williams, *The myth of the undeserving poor : a Christian response to poverty in Britain today* (Grosvenor House Publishing Limited 2014); Mead (n 753) 10.

<sup>887</sup> Persky (n 247) 235.

<sup>888</sup> Charlesworth and Williams (n 886); Justin Welby The Archbishop of Canterbury, *Payday loans: Archbishop’s speech in the House of Lords on 20 June 2013* (2013).

<sup>889</sup> For example, Christians Against Poverty, the Salvation Army, Compassion International and Samaritan’s Purse.

<sup>890</sup> Christians Against Poverty, ‘The CAP Story: How it all Started’ (*Christians Against Poverty*) <<https://capuk.org/about-us/the-cap-story>> accessed 25 June 2015.

Canterbury stated in the House of Lords that the industry was preying on the ‘most disadvantaged’ in our society. He further stated that ‘my own group, the church, can play a part’ in solving these problems, and that ‘the church is in a unique position up and down the country’.<sup>891</sup> The Archbishop has also created a taskforce chaired by the previous Chair of the FSA, Sir Hector Sants, to ‘compete payday lenders out of business’.<sup>892</sup>

Whilst these are all excellent steps, and the Church should be commended for its work in this area, significant difficulties arise when social minimum provision is left to religious and/or charitable organisations. Beyond the theoretical questions about whether these institutions should be responsible for welfare, it raises concerns about whether all individuals would receive equal assistance. Leaving responsibility for social minimums in the hands of the Church may create a real fear that individuals of other faiths or non-religious individuals would not receive the help they may clearly need. There are much stronger practical and philosophical justifications for social minimum provision to be an obligation on the State.

Despite these justifications, the current Conservative Government is trying to limit its responsibility for social minimum provision. The Beveridge Report is largely considered the ‘high water mark’ of the Welfare State; since the 1970’s, there has been a marked decrease in the willingness of the State to address social minimum issues.<sup>893</sup> Unsurprisingly, poverty has continued to be a significant concern, and the need for assistance remains. The Conservative Government has attempted to address these issues by pushing responsibility for social minimum provision from the State to the general

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<sup>891</sup> The Archbishop of Canterbury (n 888).

<sup>892</sup> Michael Klimes, ‘CoE Bolsters Crusade Against Payday Loans with Hector Sants Hire’ International Business Times <<http://www.ibtimes.co.uk/coe-eyes-crusade-against-payday-loans-hector-sants-hire-1432514>> accessed 11 March 2015.

<sup>893</sup> For details of this Part 4.2.3-4.2.4.

public. This approach can be seen in David Cameron's (failed) creation of 'A Big Society'. Cameron's 2010 speech outlined this policy, stating 'whether it is in building affordable housing, tackling youth unemployment, inviting charities to deliver public services ... the people in Britain worked out the answer to the big social problems. A big part of that answer is the Big Society'.<sup>894</sup> The emphasised section is highly telling, indicating a desire for the government to move away from benevolent public services, and instead putting them in the hands of charities and other social organisations. This concept has been highly criticised; the Big Society discourse has been dismissed by many commentators as merely a cynical attempt to allow cuts in public spending by the government.<sup>895</sup> The concept is highly reminiscent of Thatcher's 'responsibilisation' of society,<sup>896</sup> although it also adds a further requirement that in addition to being responsible for their own individual welfare needs, people have a moral obligation to volunteer for the general betterment of their society.<sup>897</sup>

The problem with the Big Society concept goes deeper than government malaise – it is highly contradictory. As outlined by Kinsby,

given that the conservative critique of the state usually rests on a deeply negative and pessimistic view about human nature—with individuals viewed as selfish utility-maximisers in conflict with others, and that since they themselves know best what they want, their needs ought to be met through market rather than state mechanisms—it seems odd that Cameron is appealing to human altruism,

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<sup>894</sup> David Cameron, *Speech on the Big Society* (A Speech Delivered in Liverpool on 18 July 2010) (emphasis added).

<sup>895</sup> Ben Kinsby, 'The Big Society: Power to the People?' (2010) 81 *The Political Quarterly* 484, 485.

<sup>896</sup> Analysed in Part 2.3.3.

<sup>897</sup> Kinsby (n 895) 486.

albeit not an altruism expressed through state redistribution of resources, to prop up public services.<sup>898</sup>

Unsurprisingly, the Big Society concept was widely considered a disappointment that disproportionately impacted the most vulnerable.<sup>899</sup> An independent review completed by *The Civil Exchange* and *DHA Communications* concluded that the Big Society has 'largely failed'.<sup>900</sup> One of the most negative aspects of the movement was the transfer of government services to the voluntary sector, and the subsequent reduction of funding. As a result, the voluntary sector lost £1.3 billion of State funding in the 2011-12 financial year alone. Whilst this had negative outcomes across the board, smaller organisations and services to disadvantaged groups were impacted to the greatest extent.<sup>901</sup> These drastic cuts were not replaced by an increase in contribution from voluntary or charitable organisations. Prior to the Big Society, these organisations were already frequently struggling to meet the demands of the public<sup>902</sup> and, post Big Society, formal volunteering and community social action actually declined.<sup>903</sup>

Despite the current government's attempts to reduce its responsibility for delivering a social minimum, the obligation for this important task should remain with the

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<sup>898</sup> ibid 485.

<sup>899</sup> Caroline Slocock, Ruth Hayes and David Harker, *Whose Society? A Final Big Society Audit* (Civil Exchange and DHA, in conjunction with Joseph Rowntree Charitable Trust and the Barrow Cadbury Trust 2015) 57. Slocock et al comment that 'the poorest in society have paid disproportionately for efforts to reduce the government deficit ... cuts in public services have hit the poorest particularly hard'.

<sup>900</sup> ibid 8.

<sup>901</sup> ibid 32, with further discussion at 33; 'The loss of statutory income will be significantly greater each year until at least 2017-18 and there is no sign of income from other sources filling the gap. Moreover, nongovernmental funding is less likely to reach those causes which in the past have been funded by government and where needs may be greatest'.

<sup>902</sup> See statistics discussed in ibid 25.

<sup>903</sup> ibid 11. For interesting comparison, see discussion of reciprocity and undertakings in the communal domain in Mindy Chen-Wishart, 'In Defence of Consideration' (2013) 13 *Oxford University Commonwealth Law Journal* 209, 236-237.

State. The government is trying to get the best of both worlds; advocating the importance of a social minimum whilst also reducing its practical obligations in this regard. It also looks like this approach may largely be continued in Theresa May's vision of a 'shared society', despite the demonstrable lack of prior success.<sup>904</sup> The reliance on the Church to fill these gaps, despite having a strong historical grounding, raises significant theoretical and practical challenges. Using a concept of the Big Society is also an inadequate and inappropriate response, particularly when these organisations are already stretched to fulfil the current demands on their services. Until the State recognises its responsibility to ensure that a social minimum is provided and maintained, significant problems will continue to exist and the welfare system will not be able to adequately address to the challenges posed by high-cost credit.

#### 4.5.3: Moral Hazards

One of the most intractable concerns arising from the provision of a social minimum is the potential for a 'moral hazard' to develop.<sup>905</sup> This occurs 'when a measure designed to deal with the problem of a deprived group encourages the size of that group to grow'.<sup>906</sup> It is difficult to provide an appropriate level of assistance for those who need State help without creating a system that encourages 'opportunism' by others. This is not a new challenge. When the social security provisions in the Beveridge report were first enacted, there was a remarkable increase in the number of people claiming invalidity benefit

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<sup>904</sup> Theresa May, *The shared society: Prime Minister's speech at the Charity Commission annual meeting on 9 January 2017* (Gov.UK 2017), see specifically her comment 'The shared society is one that doesn't just value our individual rights but focuses rather more on the responsibilities we have to one another ... And it's a society that recognises the obligations we have as citizens – obligations that make our society work'.

<sup>905</sup> Jonathan Klick and Greg Mitchell, 'Infantilization by Regulation' (2016) 39 Regulation 36, 39.

<sup>906</sup> Barry (n 736) 63.

(which was higher than unemployment benefits), despite the fact that the general health of the population was improving significantly at that time.<sup>907</sup> As social minimum provision is a State obligation, taxpayers will ultimately bear the cost.<sup>908</sup> To avoid a floodgates situation, assistance should only be provided to those who are legitimately at risk of falling into poverty.<sup>909</sup>

The private market has developed several incentives to reduce the impact of moral hazards, for example the use of deductibles and increased premiums for claims under insurance policies. It is more difficult for the State, as it risks hurting or excluding people who need the assistance.<sup>910</sup> Attempts have been made, but these often fall under significant scrutiny. There is a certain level of acceptance of the consequences of moral hazards if an attempt to remove them would result in the victimisation of those in need. There are, however, limits to how much this will be tolerated.<sup>911</sup> If, for example, the State were to abolish all commercial high-cost credit and instead institute a government system of small-amount loans, many people who could afford to pay for these financial products would utilise the system, with the taxpayer covering the cost. Whilst universal coverage may be acceptable in some circumstances, and has been embodied in the approach to healthcare and education, it is unlikely to be considered appropriate in the context of the financial sector.<sup>912</sup>

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<sup>907</sup> *ibid.*

<sup>908</sup> See discussion in above 4.5.1.

<sup>909</sup> Sleeman (n 730) 2-4.

<sup>910</sup> *ibid.*

<sup>911</sup> *ibid.* 65.

<sup>912</sup> See, for example, discussion of language in Jowit, (n 163) and means-testing benefits in Barry (n 736) 69-72.

Moral hazards are a particular concern when dealing with users of high-cost credit. The British model of welfare is largely based on means-testing and the idea that welfare policies should not be widespread or all-embracing, but instead focused on the genuinely needy.<sup>913</sup> The standard form of means-testing assistance uses income levels and family size.<sup>914</sup> This approach cannot be applied to providing a social minimum for high-cost credit users. Whilst there is some link between income and dependence on these financial products, it is only one of a large number of relevant factors.<sup>915</sup> Not all borrowers of high-cost credit are financially vulnerable and in need of State support. To develop an appropriate solution for providing and maintaining the social minimum of high-cost credit users, we first need to identify the differing profile and needs of these borrowers. As outlined in Part 1.2.2, there has been limited engagement in the market and therefore it is difficult to understand accurately who is using these products and why. Before any recommendations on social minimum provision can be made, further research into the high-cost credit market must be undertaken.

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<sup>913</sup> Barry (n 736) 68.

<sup>914</sup> Atkinson (n 697) 219-227.

<sup>915</sup> Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 12, 25.

## Conclusion

Whilst freedom and protection are both important concepts, we must move beyond a focus on contract law and legal rights. The State should encourage self-authorship, with people pursuing valuable goals and relationships.<sup>916</sup> This is a richer conception of ‘a decent and meaningful life’,<sup>917</sup> going beyond both procedural and substantive fairness. In the context of high-cost credit, we need a legal and social welfare system that allows all people access to a robust and meaningful social minimum which is not imperiled by high-cost credit contracts. Providing and maintaining this social minimum can justify coercive government action, including overriding contractual obligations and the redistribution of assets via the tax and welfare system.<sup>918</sup> The legal and political systems have already instituted a number of processes to provide and maintain the social minimum, although in the context of high-cost credit these are not adequate, and further work is necessary. The provision of social minimums is not without its difficulties. Whilst questions about interference with property rights and the relative responsibilities of the state or non-state sectors for delivering the social minimum can be dealt with reasonably easily, the concern about how to respond appropriately to moral hazards is more complicated. The challenges related to social minimum provision and moral hazards make it imperative that further research into the high-cost credit market be undertaken. Until this occurs, it will be difficult to make any valid and helpful recommendations on how social minimum maintenance can deal with the challenges of high-cost credit.

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<sup>916</sup> Joseph Raz, ‘Promises in Morality and Law’ (1982) 95 *Harvard Law Review* 916; Chen-Wishart, ‘In Defence of Consideration’ (n 903).

<sup>917</sup> The definition of a social minimum in 4.1.

<sup>918</sup> Chen-Wishart, ‘In Defence of Consideration’ (n 903) 214; Raz, *The Morality of Freedom* (n 203) 157, 416.

## Chapter 5: Application to Borrowers

*Fairness does not mean everyone gets the same. Fairness means everyone gets what they need*  
- Rick Riordan

### Introduction

The preceding chapters have highlighted the need for further empirical research on the circumstances of high-cost credit borrowers in the UK. This chapter starts to fill the information and research void previously identified. Chapter 1 suggested that although lenders insist that there is no real problem and therefore no need for major reform, the overwhelming evidence (from borrowers themselves, consumer advocates, debt advisors, parliamentarians, and lawyers working in the industry) points to the contrary. Both the OFT and FCA have recognised high-cost credit as one of the key areas needing further attention, including the collection of additional information on the market to ensure accurate and useful regulation.<sup>919</sup> Whilst there is the perception of the existence *a* problem, the government lacks adequate information or research that identifies the exact nature of *the* problem.<sup>920</sup> The regulator has yet to undertake detailed qualitative empirical research in this area. As a result of this, there is no accurate profile of high-cost credit borrowers that can pinpoint the nature and extent of the problems, during a period of immense regulatory scrutiny and legislative change. The first part of this chapter fills the information gap by creating a profile of high-cost credit users. Information of this type is

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<sup>919</sup> The Office of Fair Trading, *Review of High-Cost Credit* (n 21) 52; The Financial Conduct Authority, *Detailed rules for the price cap on high-cost short-term credit; Including feedback on CP14/10 and final rules* (n 4) esp 69.

<sup>920</sup> Gibbons from the Centre for Responsible Credit summarises that unlike other countries, the UK has not conducted a 'rigorous study of the long-term effects of a payday loan on living standards and essential budgets': cited in Packman (n 205) 59.

crucial for the FCA to understand the nature of the lending problems, and to tailor its regulatory response in the light of the findings. There are two sections: the first outlines the research method used during the empirical research process; the second provides a summary of the research results, outlining three 'classes' of high-cost credit borrowers. The second part of the Chapter utilises the analysis from Chapters 2, 3 and 4 in light of the profile developed. It highlights the complexity of the high-cost credit market, and the need to address borrowers in a fair and appropriate manner.<sup>921</sup> The concepts of freedom, protection and social minimums are important for the three classes of borrowers identified, but in differing ways. The legal regime also has very different responses to the three borrower classes.

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<sup>921</sup> The basis of this chapter is 'personalised paternalism', which is where the government creates differentiated approaches for people in different circumstances, rather than having a single blanket approach that applies to everyone: see Cass R. Sunstein, 'The Storrs Lecture: Behavioral Economics and Paternalism' (2013) 122 *The Yale Law Journal* 1826, 1871.

## 5.1: Research Method and Results

Empirical qualitative research was collected through a series of in-depth interviews with people involved in the high-cost credit industry. Empirical research is ‘the systematic collection of information (“data”) and its analysis according to some generally accepted method.’<sup>922</sup> Bright and Whitehouse observe that empirical legal studies are generally associated with the scientific or positivist tradition, meaning that quantitative work tends to dominate.<sup>923</sup> The aim of this thesis is to develop a general profile of the motivations of users of high-cost credit, and to identify the circumstances in which they access these financial products. Whilst this type of research could be interpreted as quantitative, given that the results are placed into a table and counted, it is more aligned with qualitative research processes. As outlined by Kirk and Miller, ‘technically, a “qualitative observation” identifies the presence or absence of something, in contrast to a “quantitative observation” which involves measuring the degree to which some feature is present.’<sup>924</sup>

The research project was designed to comply with the requirements of a high-quality empirical research project, as suggested by Webley in her paper ‘Qualitative Approaches to Empirical Legal Research’.<sup>925</sup> First, the most appropriate method was identified to answer the research question within the relevant constraints.<sup>926</sup> In this case,

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<sup>922</sup> Peter Cane and Herbert Kritzer, ‘Introduction’ in Peter Cane and Herbert Kritzer (eds), *The Oxford Handbook of Empirical Legal Research* (Oxford University Press 2010) 4. For a discussion on the use of empirical research in the social sciences, see Christopher McCrudden, ‘Legal Research and the Social Sciences’ (2006) 122 *Law Quarterly Review* 632, 632-650.

<sup>923</sup> Susan Bright and Lisa Whitehouse, ‘The Opportunities and Challenges of Empirical Work: Housing Possession in Theory and in Practice’ in Bram Akkermans, Eveline Ramaekers and Ernst Marais (eds), *Property Law Perspective II* (Intersentia 2013).

<sup>924</sup> Kirk and Miller cited in Lisa Webley, ‘Qualitative Approaches to Empirical Legal Research’ in Peter Cane and Herbert Kritzer (eds), *The Oxford Handbook of Empirical Legal Research* (Oxford University Press 2010) 927.

<sup>925</sup> One aspect of research design suggested by Webley, taking into account whether the research should be conducted alone or in a team, was irrelevant to the process and therefore is not discussed: *ibid* 932.

<sup>926</sup> *ibid* 932.

the main constraints were limitations on access to high-cost credit borrowers, ethical difficulties of working with vulnerable consumers,<sup>927</sup> and financial restrictions. The required information was obtained from a series of interviews with different stakeholders instead of from the borrowers themselves. The interviewees included consumer advocates, debt advisors, consumer lawyers, lenders, parliamentarians, trade associations, credit unions and researchers. By interviewing a wide range of people, I obtained a broad portrayal of the lending situation, which could be cross checked against responses from different stakeholders. Second, the subjects needed to be appropriately selected. A number of interviewees were obtained through 'snowball sampling'; that is, participants were asked at the conclusion of their interview to suggest other people who would be appropriate for the research in question.<sup>928</sup> A small number of well-known people working in the relevant areas were contacted directly, my project explained to them, and their assistance requested to identify potential interviewees. Most people responded quickly and were extremely helpful with referrals, and offered to provide a range of additional assistance, including invitations to attend consumer events and providing access to research and resources that had not been published.

Third, the data collection method was 'interacting', that is using the interviews and surrounding communications to gain an in-depth understanding of the high-cost credit market and the motivations of people who use these products.<sup>929</sup> The interviewees

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<sup>927</sup> See discussion in S. Thompson, *Paying Respondents and Informants* (University of Surrey Social Research Update 1999) regarding paying non-professional respondents for their time and input. This is a particular concern when interviewing people in financial difficulties, such as people struggling with problem debt.

<sup>928</sup> Webley (n 924) 934.

<sup>929</sup> Kim Scheppele, 'Counting, Reading, Interacting: Focusing on the Activities of the Researcher in Thinking about Methods' paper presented at the Law and Society Association Early Career Workshop 2009, Denver, referred to in Laura Nielson, 'The Need for Multi-Method Approaches in Empirical Legal Research' in Peter Cane and Herbert Kritzer (eds), *The Oxford Handbook of Empirical Legal Research* (Oxford University Press 2010) 954.

were questioned both about their experiences with borrowers and the general characteristics of people who needed to access this type of lending. Finally, the relevant ethical issues were considered.<sup>930</sup> All empirical research undertaken was reviewed and approved by the University of Oxford Central University Research Ethics Committee, using the resources relevant for the Social Sciences and Humanities. The Committee was provided with copies of my interview questions, the information sheet given to interviewees, the process for interviewing, and the consent form.

A total of 26 interviews were completed. The interviewees were:

- 1) four researchers – two at University-based research centres, one based at a ‘Think Tank’, and one who worked with a number of research institutes;
- 2) four consumer advocates – all of whom worked for different not-for-profit organisations;
- 3) four debt advisors – all of whom worked for different not-for-profit organisations;
- 4) four lenders or trade associations – one short-term only lender, one short- and medium-term lender, and two trade associations;
- 5) four consumer lawyers – all of whom worked for not-for-profit organisations;
- 6) four government parties – one policy advisor, one person from a regulator, one Member of Parliament, and one Parliamentary Assistant; and
- 7) two miscellaneous – a credit reporting agency and a credit union.

The interview process did not attempt to produce results that would be statistically significant, nor to provide statistical quantification of the circumstances of high-cost credit borrowers – it was to ‘capture and categorise’ the social experiences.<sup>931</sup>

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<sup>930</sup> Webley (n 924) 932.

<sup>931</sup> *ibid* 928.

In light of the relatively limited number of consumer advocacy and debt advice organisations in the UK, the number of interviews conducted was considered sufficient to draw solid conclusions from the information obtained in the process.<sup>932</sup> In the words of Webley, the findings

... capture a broad range of experiences rather than those from only a few people or situations. The findings will be representative in the sense of capturing the range or variation in a phenomenon, but not in the sense of allowing for the estimation of the distribution of the phenomenon in the population as a whole.<sup>933</sup>

There were significant difficulties obtaining access to high-cost credit firms and trade associations, which is perhaps not surprising. This category of interviewee has a vested interest in denying or downplaying any problems associated with high-cost credit, and challenges any calls for increased consumer protection in this area. This also indicates that additional interviews in this category would be unlikely to provide any further assistance. Despite the ability to draw solid conclusions from the current data, the information obtained from the interview process would be strengthened by the findings being confirmed through quantitative research on the topic.<sup>934</sup> Further research in this area would therefore be of great benefit and utility.

The interview participants were asked a set number of open-ended questions.<sup>935</sup> The main question was *'what were, in the interviewee's experience, the five most common*

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<sup>932</sup> ibid 933.

<sup>933</sup> ibid 934.

<sup>934</sup> Sally Engle Merry, 'Getting Justice and Getting Even' in Simon Halliday and Patrick Schmidt (eds), *Conducting Law and Society Research: Reflection on Methods and Practices* (Cambridge University Press 2009).

<sup>935</sup> Webley (n 924) 937.

scenarios where people use high-cost credit loans?’ For each of the five scenarios

identified, the interviewee was asked about:

- the connection between the lending and bankruptcy;
- the legal protection available to the borrower;
- whether they believed the creditors were engaging in responsible lending; and
- how frequently borrowers accessed legal or financial advice.

Finally, the interviewee was asked a small number of general questions including ‘whether, in their experience, borrowers read and understand consumer credit contracts’ and ‘where they believe the balance should lie between freedom of contract and consumer protection?’.<sup>936</sup>

The questions generally stayed the same across all interviews, although there were slight variations within the different categories of interviewees. The main focus of the interviews was on the different scenarios where borrowers accessed short-term loans, and the reasons they needed the credit. Additional information came to light during the interview process that raised other potentially relevant questions, and these were pursued.<sup>937</sup> The questioning varied on occasions, depending on the answers and focus of the interviewees. The interview responses were reviewed and collated as they were completed. This provided the opportunity to reflect on the information received, and to amend the questioning process in the light of the knowledge already obtained. To

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<sup>936</sup> The complete interview questions can be found in Appendix 1. A list of interview questions with different wording for Question 1 was emailed to a number of categories of interviewees prior to the interviews occurring, however the version in Appendix 1 was used for all the actual interviews. There were some slight wording changes in the two versions, but they did not substantially change the questions that were asked.

<sup>937</sup> Hazel Genn, ‘Paths to Justice’ in Simon Halliday and Patrick Schmidt (eds), *Conducting Law and Society Research: Reflection on Methods and Practices* (Cambridge University Press 2009); Herbert Kritzer, ‘“Research is a messy business” – An archaeology of the craft of sociological research’ in Simon Halliday and Patrick Schmidt (eds), *Conducting Law and Society Research: Reflection on Methods and Practices* (Cambridge University Press 2009) 266-267.

encourage honesty and freedom of discussion, the interviews were not recorded and instead detailed short-hand notes were taken during the interview process. All interviewees were then sent the interview transcript shortly after it had been prepared and finalised. Provided that the interviewee had time to consider the transcript and gave consent, they are identified by name in the footnote. Some interviewees did not have time to consider the transcript or did not consent, and these responses have been kept anonymous. When discussing the results received by the research, the interviewees will be referred to by their 'category' as this provides guidance on the background and perspectives of the specific respondent.

Despite the differing opinions of the stakeholders about the utility of high-cost credit, it became clear quite quickly that there was a surprising level of agreement as to when and why people use these products. Three different classes of borrowers, encompassing six separate lending scenarios, clearly stood out as the most frequently referred to in the interviews. These classes have been further analysed for a greater understanding of the high-cost credit market, and to provide the basis for a more targeted regulatory response to the current challenges. The borrower classes and lending scenarios are as follows:

- 1) Financially Secure Borrowers, who use the funds obtained:
  - a. for discretionary expenses – including for travel or luxury items; and
  - b. for one-off or emergency expenses – for example, a larger than expected bill or an unexpected expense.
- 2) Financially Insecure Borrowers, who use the funds obtained:
  - a. for essential expenses – including rent, food and costs related to children; and
  - b. to meet existing financial obligations – mainly repaying interest on loans already incurred.

- 3) Significantly Impaired Borrowers, including:
- a. people with mental health conditions; and
  - b. people who are compulsive gamblers.

Whilst there was a general level of agreement, some responses combined two of the scenarios together or broke the above scenarios down into further detailed sub-categories. This has been reflected in the table of interview results.<sup>938</sup>

Despite the assumed homogeneous nature of the high-cost credit market,<sup>939</sup> each of these borrower classes has a very different relationship to the financial products and the lending market. The next three sections will focus on the three different classes, and apply the empirical research findings to the concepts of freedom, protection and social minimums and to the current legal approach to high-cost credit.

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<sup>938</sup> Included in Appendix 1.

<sup>939</sup> See discussion in 1.2.2.

## 5.2: Financially Secure Borrowers

Financially Secure Borrowers use funds from high-cost credit loans for discretionary expenses or for once-off purchases. These consumers are utilising the financial products in a responsible manner that does not create long-term financial hardship. They are not financially excluded or vulnerable, and could obtain credit from other mainstream (and probably less expensive) providers. These borrowers, however, value the speed and convenience of high-cost credit,<sup>940</sup> so choose to use these products over the less expensive options. This borrower class also corresponds very strongly with the types of borrowers touted by lenders as 'standard' consumers.<sup>941</sup>

### 5.2.1: Lending Scenarios

The first scenario of borrowing (use of loans for discretionary expenses) was discussed to the largest extent by the lenders and trade associations. These parties highlighted that young people are increasingly using high-cost credit because of the convenience and technology factors. One interviewee stated:

It is a cultural thing as much as anything else. Young people like new products; their social interactions are increasingly online, so it makes sense that their financial requirements would move this way. There is also the generational focus on 'instant gratification'.<sup>942</sup>

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<sup>940</sup> Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 84.

<sup>941</sup> See, for example, Consumer Finance Association, 'About the Industry' (2013) <<http://www.cfa-uk.co.uk/about/about-industry/loans-designed-for-life's-unexpected-expenses.html>> accessed 4 August 2013.

<sup>942</sup> Anonymous Interview, Trade Association (27 March 2013). Telephone interview.

Purchasing items on 'flash sales' was an example of a discretionary expense, where it could be cheaper for the consumer to obtain a high-interest loan and buy the item on sale than to wait until they had saved the funds themselves.<sup>943</sup> This type of activity is supported by the findings of the CMA quantitative research on the high-cost credit market, which states that 4% of borrowers used the funds for holidays, 2% for presents, and 2% for going out or socialising.<sup>944</sup> Furthermore, a total of 7% of borrowers stated that they could have 'easily' gone without the loan and 32% stated that they could 'possibly' have gone without it,<sup>945</sup> indicating that there is a reasonable amount of discretionary borrowing and spending associated with the high-cost credit market.

This category was also discussed by the researcher and debt advisor interviewees, and to a lesser extent by consumer lawyers and government parties. The emphases on convenience and young people with access to technology were reinforced by a number of interviewees, including the regulator.<sup>946</sup> The credit referencing agency highlighted that people may use high-cost credit because they see it as 'short-term', whereas other credit products are viewed as 'long-term' debt, which they wanted to avoid.<sup>947</sup> One consumer advocacy organisation that had undertaken client surveys of loan expenditure reported that approximately 10% of high-cost credit borrowers used all or part of the funds received from the loan for discretionary spending.<sup>948</sup> A researcher stated that while this was previously a significant category, it was now decreasing in contrast to other rationales

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<sup>943</sup> Anonymous Interview, Lender (16 April 2013). Telephone interview.

<sup>944</sup> Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 68.

<sup>945</sup> *ibid.*

<sup>946</sup> Anonymous Interview, Regulator (3 April 2013). Telephone interview.

<sup>947</sup> James Jones, Experian (8 March 2013). Telephone interview.

<sup>948</sup> Martyn Saville, Which? (20 March 2013). Telephone interview.

for borrowing.<sup>949</sup> Moreover, one of the debt advisor interviewees stated that, whilst some borrowers may use loan funds for these purposes, it would be uncommon owing to the exceptionally high interest rates of the loans. These borrowers are coping financially, and are likely to have incomes at or above the national average; people who are already experiencing financial difficulties would generally not be able to afford this type of discretionary expenditure.<sup>950</sup>

The second lending scenario for Financially Secure Borrowers was using funds on a one-off basis for unexpected expenses. This is the most commonly represented use for this type of financial product, and is also the most widespread representation in advertisements. The interview responses for this scenario were in line with the responses received for discretionary expenses. These borrowers could afford to repay the loans without financial hardship, and choose to use high-cost credit owing to the ease and convenience of obtaining the money when compared with more mainstream credit products. A number of interviewees across the categories combined these two scenarios together, labelling them as situations where borrowers used high-cost credit 'appropriately and responsibly'.<sup>951</sup> The most common examples of expenditure in this scenario were a temporary financial crisis or shock that could not be absorbed into the regular income stream, an unexpected bill, or something breaking and needing repair. The loan obtained could, however, easily be repaid without any long-term financial harm.

The lenders/trade association category emphasised that the expenditure for this category of borrower was generally quite practical, and one even noted that they had not

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<sup>949</sup> Sharon Collard, PFRC (28 March 2013). Telephone interview.

<sup>950</sup> Anonymous Interview, Debt Advisor (18 March 2013). Telephone interview.

<sup>951</sup> For example, Donald Hirst, Consumer Focus (7 March 2013). Telephone interview.

seen funds spent on anything ‘frivolous’.<sup>952</sup> A researcher highlighted that many people can use loans appropriately and have personal reasons for wanting to use such high-cost credit – generally irregularly and on a one-off basis.<sup>953</sup> The consumer lawyer and government party categories also referred to this scenario, agreeing that, in certain circumstances, high-cost credit can be used responsibly and appropriately. As discussed in Chapter 1,<sup>954</sup> these views are supported by academic research outlining the potential benefits of high-cost credit.

### 5.2.2: Application to High-Cost Credit Concepts

Negative freedom has inherent value for all classes of borrowers; it is, however, the most important concept for Financially Secure Borrowers. These consumers appreciate being able to exercise their financial freedom, and are choosing to use high-cost credit because of its speed and convenience. This is a valuable choice that the law should protect.

Interference with the credit choices of Financially Secure Borrowers creates the risk of unwarranted ‘infantilisation’ of consumers. Infantilisation removes or restricts the ability for people to make their own choices, an important aspect of psychological development.<sup>955</sup> As outlined by Sunstein,

It is true that people err and that their errors can impair their welfare. But mistakes are often productive. Life is a movie, not a snapshot, and people can learn from what goes wrong. We should not freeze people’s frames ... [the] government ought not to short-circuit the valuable process of learning-by-doing. The process greatly increases

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<sup>952</sup> Anonymous Interview, Trade Association (27 March 2013). Telephone interview.

<sup>953</sup> Donald Hirst, Consumer Focus (7 March 2013). Telephone interview.

<sup>954</sup> See discussion in 1.1 regarding research from Rowlingson (n 66) and the Finney, Collard and Kempson (n 197).

<sup>955</sup> Sunstein (n 921) 95.

human welfare. A paternalistic government infantilizes people; it treats them like children and makes it less likely that they will grow up.<sup>956</sup>

There is value in taking risks, making mistakes, and learning from the process. If the state is overly paternalistic in its approach to regulation, it ‘robs [people] of the opportunity to genuinely flourish’.<sup>957</sup>

The concern of infantilisation applies to all contracts, including high-cost credit agreements. There should therefore be strong justifications for undermining borrowers’ negative freedom. The State needs to balance the damage of interfering in high-cost credit contracts (ie the infantilisation of borrowers) against the damage of taking a negative freedom approach (eg potential harm to borrowers). Loans to Financially Secure Borrowers generally do not cause ongoing harm; they occur on a one-off or irregular basis, and borrowers have the capacity to repay without suffering undue financial hardship. The balance is therefore in favour of negative freedom and non-interference; the focus on consent and non-exploitation by lenders will generally be a sufficient and appropriate way to respond to needs of Financially Secure Borrowers.

The aim of protection, namely stopping substantially unfair agreements and coercion from lack of choice, is not relevant to most Financially Secure Borrowers. These consumers have access to financial alternatives, so lack of choice is not a concern. Considering the long historical and religious concern with usury and general dislike of usurious agreements in our society,<sup>958</sup> there is some justification that – regardless of the lack of borrower vulnerability – prevention of a substantially unfair agreement may still be

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<sup>956</sup> *ibid* 94.

<sup>957</sup> Jonathan Klick and Greg Mitchell, ‘Infantilization by Regulation’ (2016) 39 *Regulation* 32, 32. See also Thaler and Sunstein (n 99).

<sup>958</sup> Discussed in 3.2.1.

relevant to Financially Secure Borrowers. This is focused on preventing a harmful outcome to society as a whole, as opposed to protecting specific borrowers.<sup>959</sup> There is also one specific group of Financially Secure Borrowers that may benefit from further protection, particularly by stopping substantially unfair agreements. There are increasing numbers of younger Financially Secure Borrowers,<sup>960</sup> who are attracted to these products for the speed and engagement with technology. These individuals are likely to be more vulnerable due to their lack of financial experience, which may be a justification for taking a more protective approach.<sup>961</sup>

Financially Secure Borrowers, by definition, should not need social minimum provision or maintenance. They use the funds obtained for discretionary purposes or for one-off expenses, and are at or above the social minimum when they enter into the credit transaction. These borrowers have financial alternatives and use high-cost credit because they value the speed and ease of these products. There were some concerns from interviewees about overlap between Financially Secure and Financially Insecure Borrowers. In particular, it is possible that Financially Secure Borrowers could easily obtain a loan for a discretionary or one-off expense, be unable to afford the repayments, and 'slip off the edge' into the next class.<sup>962</sup> If this happens, the social minimum is more likely to be a concern. These types of borrowers are no longer classified as Financially Secure, as they cannot make ongoing repayments without suffering undue financial hardship and/or falling below the social minimum. They are therefore more appropriately classed as

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<sup>959</sup> Discussed in 3.3.1.

<sup>960</sup> See 3.3.3.

<sup>961</sup> Anonymous Interview, Lender (16 April 2013). Telephone interview.

<sup>962</sup> Yvonne Fovargue MP (24 April 2013). Personal interview.

Financially Insecure Borrowers, and the relevant social minimum concerns will be discussed below.

### 5.2.3: Application to Current Legal Approach

The legal approach currently taken to high-cost credit is generally appropriate for the needs of Financially Secure Borrowers. As outlined in Chapter 2, the high-cost credit market has a strong focus on negative freedom with consent, disclosure and procedural fairness all being important aspects of the legal regime.<sup>963</sup> These mechanisms are extremely well suited to Financially Secure Borrowers, as they ensure consent and non-exploitation whilst avoiding infantilisation. There are, however, two potential concerns. First, the effectiveness of the current disclosure regime has been subject to significant criticism.<sup>964</sup> Second, there is the potential for some Financially Secure Borrowers (particularly younger, less experienced consumers) to be exploited by unscrupulous lenders or unfair business models.<sup>965</sup> How these issues should be addressed will be discussed in the next chapter.

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<sup>963</sup> Rowlingson (n 66) 13.

<sup>964</sup> See discussion in 2.5.1. It is recognised that this would however negatively impact the law's interaction with all borrowers.

<sup>965</sup> See discussion of cognitive biases at 2.5.1.

### 5.3: Financially Insecure Borrowers

Financially Insecure Borrowers utilise high-cost credit in a manner that is likely to create long-term financial harm or hardship. These consumers use the funds from loans for everyday expenses or to repay existing financial obligations. They are often vulnerable, financially excluded, and cannot obtain credit from mainstream providers. There was significant apprehension about this class of borrowers amongst many interviewees; they were generally considered to be at significant financial risk. Lending to Financially Insecure Borrowers often results in an 'untenable financial situation',<sup>966</sup> and the creation of a debt spiral<sup>967</sup> where 'borrowers are in perpetual loans'.<sup>968</sup>

#### 5.3.1: Lending Scenarios

There are two lending scenarios relevant to Financially Insecure Borrowers. The first is loans for essential expenses (for example rent, food, council tax and utilities). This was discussed by each of the interviewee categories. This scenario has become an increasingly common category owing to the economic downturn, reduction of the Welfare State, and stagnating wages.<sup>969</sup> Many households are struggling financially, and high-cost credit has become part of these borrowers' routine; 'people are in a desperate situation – the ends just don't meet'.<sup>970</sup> Borrowers on low incomes generally have little or no savings, and are

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<sup>966</sup> Matt Bland, ABCUL (12 March 2013). Telephone interview.

<sup>967</sup> Carl Packman, Author & Consumer Advocate (28 February 2013). Telephone interview; Sharon Collard, PFRC (28 March 2013). Telephone interview.

<sup>968</sup> Anonymous Interview, Debt Advisor (4 April 2013). Telephone interview.

<sup>969</sup> Sharon Collard, PFRC (28 March 2013). Telephone interview; Matt Bland, ABCUL (12 March 2013). Telephone interview. This is also discussed in Packman (n 205) 38-39; Community Investment Coalition (n 698).

<sup>970</sup> David Barclay, The Contextual Theology Centre (28 March 2013). Telephone Interview.

highly vulnerable to financial shocks from even small additional expenses.<sup>971</sup> One interviewee highlighted high-cost credit 'loans can be the only choice of credit for everyday expenses for a large number of vulnerable people who are overstretched and need access to funds'.<sup>972</sup> This scenario was also recognised by all of the government parties, with the regulator stating that high-cost credit has 'become a way of life' for many people who need access to additional funds to get through the month's usual expenses.<sup>973</sup>

The use of funds in this way, and the resultant harm, is strongly supported by other research. As an example, one consumer advocacy organisation interviewed had undertaken client surveys of loan expenditure, and found that 38% of clients reported using funds from high-cost credit for household essentials (such as food and children's needs), 32% had used the funds for regular household bills, and 20% had used the funds for rent or mortgage repayments.<sup>974</sup> *Shelter* stated that in 2012/13 almost 1 million people took out high-cost credit in order to pay their rent or mortgage.<sup>975</sup> Quantitative data from the CMA highlights the significant role that this category plays in the provision of high-cost credit, with 53% of respondents stating that the money was used for everyday expenses (including groceries, utility or household bills or food). A further 10% said that the funds were used for general shopping, including clothes and household items, and 59% used the money for something they 'definitely' could not have gone without.<sup>976</sup>

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<sup>971</sup> Matt Bland, ABCUL (12 March 2013). Telephone interview.

<sup>972</sup> Anonymous Interview, Researcher (11 April 2013). Personal interview.

<sup>973</sup> Anonymous Interview, Regulator (3 April 2013). Telephone interview.

<sup>974</sup> Martyn Saville, Which? (20 March 2013). Telephone interview.

<sup>975</sup> Shelter, 'Almost one million people resorting to payday loans to help pay rent or mortgage' <[http://england.shelter.org.uk/news/january\\_2013/1.4\\_million\\_britons\\_falling\\_behind\\_with\\_the\\_rent\\_or\\_mortgage](http://england.shelter.org.uk/news/january_2013/1.4_million_britons_falling_behind_with_the_rent_or_mortgage)> accessed 11 September 2013.

<sup>976</sup> Competition & Markets Authority, *Research into the Payday Lending Market* (n 39).

There was general agreement between the interviewees that high-cost credit was used by borrowers in this class to just 'get by'. There was, however, disagreement as to whether these loans were beneficial or detrimental for borrowers. One lender acknowledged that there may be a few customers who needed money for everyday expenses, but argued that this was 'quite rare'.<sup>977</sup> A different lender commented that high-cost credit is an important source of lending to people who cannot access mainstream financial services, or have self-excluded from mainstream lending, such as people who do not have bank accounts or do not trust High Street banks.<sup>978</sup> A trade association interviewee also commented that, if high-cost credit were not available for people to cover these types of expenses, there would be a significant problem with financial exclusion, which could make consumers' situations worse.<sup>979</sup>

Other categories of interviewees argued that the use of such high-interest loans for everyday expenses was generally dangerous, with one researcher declaring it an initial sign of financial distress.<sup>980</sup> The credit reference agency interviewee declared that, if high-cost credit lenders were being responsible, borrowers in this situation would be turned away.<sup>981</sup> A consumer lawyer interviewee commented that these 'people do not have enough money to live on day to day and any sort of commercial credit is merely

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<sup>977</sup> Anonymous Interview, Lender (16 April 2013). Telephone interview.

<sup>978</sup> Anonymous Interview, Lender (16 April 2013). Telephone interview.

<sup>979</sup> Anonymous Interview, Trade Association (27 March 2013). Telephone interview.

<sup>980</sup> Sharon Collard, PFRC (28 March 2013). Telephone interview. Similar comments were made by Carl Packman, Author & Consumer Advocate (28 February 2013). Telephone interview.

<sup>981</sup> James Jones, Experian (8 March 2012). Telephone interview.

deepening their situation'.<sup>982</sup> There were also references to these borrowers being 'on the margins', with this type of loan 'push[ing] them over the edge'.<sup>983</sup>

Financially Insecure Borrowers also use funds to repay existing financial obligations. This is highly concerning, as approving loans for this purpose is *prima facie* irresponsible lending, and will often result in the creation of a debt spiral.<sup>984</sup> A number of interviewees provided case studies of consumers who had used high-cost credit for the repayment of existing financial obligations and become stuck in a harmful debt spiral, sometimes taking years to repay the loans in question.<sup>985</sup> They were often unable to improve the situation, and spent their lives 'ducking and diving' to make ends meet.<sup>986</sup> These types of borrowers are in an 'untenable financial situation', having exhausted existing credit options. The lender therefore becomes the last resort when existing debts become unmanageable.<sup>987</sup> This type of borrower is generally struggling on a very low income, often on benefits or tax credits, and uses high-cost credit loans because they 'are easy to obtain and people can get sucked in ... they might think it is bailing them out but it is actually escalating the problem'.<sup>988</sup>

Unsurprisingly, this is the lending scenario that has attracted the most divergent views. The lender/trade association interviewees strongly believed that lending of this

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<sup>982</sup> Joanna Kennedy, Consumer Lawyer (18 March 2013). Personal Interview.

<sup>983</sup> Helen McCarthy, CAB (12 April 2013). Telephone interview.

<sup>984</sup> Sharon Collard, PFRC (28 March 2013). Telephone interview.

<sup>985</sup> Carl Packman, Author & Consumer Advocate (28 February 2013). Telephone interview; David Barclay, The Contextual Theology Centre (28 March 2013). Telephone interview.

<sup>986</sup> Niall Cooper, CAP (12 March 2013). Telephone interview.

<sup>987</sup> Matt Bland, ABCUL (12 March 2013). Telephone interview. Supported by findings from Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) where 23% of borrowers stated that the high-cost loan was their 'last resort' (71) and one in four said that they had no other financial option (80-81).

<sup>988</sup> Anonymous Interview, Debt Advisor (18 March 2013). Telephone interview.

type did not occur. This, they argued, was because it was against the ILG and/or because the software that they used would prevent loans of this type being approved. This is a stark contrast with the other categories of interviewees, who believed that (a) lending of this sort occurs to a concerning extent, and (b) is generally on the rise.<sup>989</sup> One consumer advocacy organisation stated that 24% of clients reported using the loan funds to repay existing credit obligations.<sup>990</sup> The relative frequency of this scenario is confirmed by the CMA, where 36% of people needed to repay an existing high-cost credit loan in the month before taking out the loan in question. Two per cent of people also used the funds to directly repay an existing high-cost loan.<sup>991</sup> Unfortunately, no figures were obtained for the number of borrowers who used the funds to repay other types of existing financial obligations (such as credit card bills, pawnbroking costs or door-stop credit). The full extent of the problem therefore remains unknown.

### 5.3.2: Application to High-Cost Credit Concepts

Negative freedom has inherent value for all borrowers, including Financially Insecure ones. Infantilisation is therefore still a potential concern for these consumers, although the factors to balance are quite different from those for the previous class. Financially Insecure Borrowers are generally vulnerable and lack adequate financial alternatives – high-cost credit has ‘become a way of life’.<sup>992</sup> These borrowers are usually already in financial distress, and the loan can often push them into a debt spiral. Use of credit in this manner may provide temporary relief but exacerbates future financial difficulties; ‘people

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<sup>989</sup> For example, John Ludlow, Parliamentary Assistant (24 April 2013); Personal interview. Carl Packman, Author & Consumer Advocate (28 February 2013). Telephone interview; Yvonne Fovargue MP (24 April 2013). Personal interview.

<sup>990</sup> Martyn Saville, Which? (20 March 2013). Telephone interview.

<sup>991</sup> Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 69.

<sup>992</sup> Anonymous Interview, Regulator (3 April 2013). Telephone interview.

think that accessing [high-cost credit] loans will generally help the situation, but it almost inevitably makes it worse – it is like throwing petrol onto a fire to put it out’.<sup>993</sup> This situation provides significantly stronger justification for government intervention, limiting borrowers’ short-term choices to avoid long-term harm. An analogy can be drawn between Financially Insecure Borrowers and bankruptcy. In terms of individual financial control, being under a bankruptcy agreement is highly infantilising and takes away the bankrupt’s freedom to a significant extent, as their income and expenditure choices are extremely limited. This situation is widely accepted and justified on a range of bases, including protection of social minimums, ensuring future autonomy, and rehabilitation.<sup>994</sup> A higher level of infantilisation can therefore be accepted for Financially Insecure Borrowers, as it is important for their financial rehabilitation.

Financially Insecure Borrowers need protection, from both substantively unfair agreements and coercion that arises from a lack of choice. These consumers are at a significant disadvantage when contracting, and there is a real risk that they will agree to unconscionable terms and conditions because they have no other legal credit options. This effectively summarised by Satz, who comments that ‘when a person enters a contract from a position of extreme vulnerability he is likely to agree to almost any terms that are offered’.<sup>995</sup> It is, however, important to be aware of the potential consequences of protection.<sup>996</sup>

Protection – in the form of limitations on access to credit – can provide some assistance but, as outlined in Part 3.5, financial exclusion and the impact of poverty means

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<sup>993</sup> Niall Cooper, Consumer Advocate (12 March 2013). Telephone interview.

<sup>994</sup> Fried (n 225) 108.

<sup>995</sup> Satz (n 297) 97.

<sup>996</sup> See discussion in Parts 3.5.2 and 3.5.3.

that government intervention can leave these borrowers in a worse financial position. The provision and maintenance of a social minimum is therefore the most important factor for Financially Insecure Borrowers, as their reliance on high-cost credit often arises from pre-existing financial difficulties and ongoing poverty. The State must take some responsibility for this situation, as opposed to leaving it to private law mechanisms. Fried discussed these challenges in *Contract as Promise*, stating that courts can theoretically refuse to enforce contracts with highly disadvantaged people on this basis. He comments that the lack of real choice *and* substantially unfair terms may be considered sufficient to hold a contract unenforceable, especially if poverty or relatively powerlessness are pertinent factors.<sup>997</sup> However, he goes on to explain that lack of choice and substantive unfairness are not the fault of the contracting party. If the options are limited or inadequate, such as for Financially Insecure Borrowers, this is not the lender's fault.<sup>998</sup> Fried further comments that refusing to uphold these contracts may be tempting, as the law wants to protect vulnerable parties. He questions 'why should just this one representative of the more fortunate classes be made to bear the burden of our redistributive zeal?', arguing instead that the State should be responsible for the welfare of these parties.<sup>999</sup>

Fried's comments on substantive unfairness are no longer an accurate representation of our approach to high-cost credit. As discussed above, there are a variety of legal mechanisms in place, under both the common law and government regulation, to limit or prevent substantially unfair bargains.<sup>1000</sup> These are piecemeal and arguably inadequate, but there has been some movement to address issues of substantial

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<sup>997</sup> Fried (n 225) 104. Fried clearly disagreed with this reasoning and with the 'no real choice' theory: 104-106.

<sup>998</sup> *ibid* 105.

<sup>999</sup> *ibid* 105.

<sup>1000</sup> See discussion in 3.4.

unfairness. Fried's insight into the relationship between private law mechanisms and State duties does however have real value for the current high-cost credit situation, particularly for Financially Insecure Borrowers. This is about poverty and redistribution of resources. The key concern for these borrowers is the provision and maintenance of a social minimum, and this is far beyond the power of the private law.

### 5.3.3: Application to Current Legal Approach

High-cost credit is generally marketed as being for discretionary purchases or one-off expenses, and trade association websites use a range of statements to that effect, including '[l]oans are not designed for longer-term borrowing, but to improve short-term personal cash flow',<sup>1001</sup> 'designed for short-term borrowing, not long-term debt'<sup>1002</sup> and '[p]ayday lending ... helps consumers to avoid long-term debt'.<sup>1003</sup> High-cost credit is extremely expensive, and therefore not designed to be used on a regular or even semi-regular basis. If this type of lending is limited to a rare one-off occasion, there is some level of justification for the exceptionally high cost of the credit.<sup>1004</sup> Based on the above definition, the use of high-cost credit by Financially Insecure Borrowers is a strong indicator of financial exclusion. These borrowers are not accessing or using financial services in a mainstream market in a way that is appropriate to their needs.<sup>1005</sup>

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<sup>1001</sup> Consumer Finance Association, 'About the Industry' (n 941).

<sup>1002</sup> Consumer Finance Association, 'Home Web Page' (2013) <<http://www.cfa-uk.co.uk>> accessed 4 August 2013.

<sup>1003</sup> Consumer Finance Association, 'About the Industry' (n 941).

<sup>1004</sup> *ibid.*

<sup>1005</sup> Sharon Collard, Elaine Kempson and Claire Whyley, *Tackling Financial Exclusion: An area-based approach* (The Policy Press 2001); Nicola Howell and Therese Wilson, 'Access to Consumer Credit: The Problem of Financial Exclusion in Australia and the Current Regulatory Framework' (2005) 5 *Macquarie Law Journal* 127; Elaine Kempson and Sharon Collard, *Developing a Vision for Financial Inclusion* (Friends Provident Foundation, 2012).

The legal system is not responding to the needs of Financially Insecure Borrowers.

The procedural fairness approach of negative freedom allows these individuals to be exploited by lenders and business models designed to keep them trapped in expensive debt that they struggle to repay. The protective approach, which addresses the substantive fairness of the transaction, does improve the welfare of some borrowers by removing the most harmful aspects of these contracts. Many other consumers are, however, pushed out of the legal market, and risk financial exclusion or being pushed towards it. The law is unlikely to provide the answer; we need to move beyond the private legal system and consider the role of government services and social security in addressing the needs of Financially Insecure Borrowers.

## 5.4: Significantly Impaired Borrowers

Significantly Impaired Borrowers use high-cost credit as a result of being under the influence of either a mental health condition or compulsive gambling. Whilst some of these borrowers may be financially included and adequately resourced, research highlights that they – as a class – are more likely to suffer from financial exclusion and poverty than average consumers.<sup>1006</sup> The ability of these borrowers to understand the implications of high-cost credit contracts has been impaired to a concerning degree. This results in a lack of valid choices, as these borrowers can be coerced by the lending environment and their personal impairment.

### 5.4.1: Lending Scenarios

The first lending scenario is when people with mental health conditions access high-cost credit. A large number of interviewees stated that they had concerns about people without adequate understanding or capacity using high-cost credit products. One consumer advocate interviewed had spoken with an ex-lender who had been concerned about the company he worked for lending to people with capacity issues, and this was one of the reasons he left the position.<sup>1007</sup> Two debt advisor interviewees also reported potential issues with high-cost credit and mental health; they expressed concern that there was no ability to question the client about this issue specifically.<sup>1008</sup> Similar concerns were voiced by interviewees in the consumer lawyer and government categories. One

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<sup>1006</sup> See below for discussion in relation to mental health conditions. In relation to gambling, see Matt Barnard and others, 'Exploring the relationship between gambling, debt and financial management in Britain' (2014) 14 *International Gambling Studies* 82 and Heather Wardle and others, *Debt and problem gambling: Evidence from the Adult Psychiatric Morbidity Survey: Briefing Paper 1* (NatCen: Social Research That Works for Society July 2012).

<sup>1007</sup> David Barclay, The Contextual Theology Centre (28 March 2013). Telephone interview.

<sup>1008</sup> Anonymous Interview, Debt Advisor (4 April 2013). Telephone interview; Anonymous Interview, Debt Advisor (18 March 2013). Telephone interview.

lawyer commented that there was ‘very much’ a link between the two, especially as a large number of borrowers are vulnerable people with reduced capacity who do not adequately understand the contracts associated with high-cost credit loans.<sup>1009</sup> Lending to borrowers with mental health concerns was also raised by one of the lenders interviewed, who acknowledged that whilst it may be a problem, they were not sure how to deal with the situation.<sup>1010</sup>

Despite the widespread awareness of the potential problems, there appears to be little if any research on Significantly Impaired Borrowers. The *Money Advice Liaison Group* (MALG) has produced guidelines on providing credit to people with mental health conditions.<sup>1011</sup> One interviewee reported, however, that these are completely voluntary and generally not adhered to, so provide little additional protection to borrowers.<sup>1012</sup> The complexity of the situation has also been recognised by FOS, which published a case study on high-cost credit where a loan was given to someone with mental health condition shortly before he was sectioned. The Ombudsman specifically commented on the difficulties of the borrower (or another party acting on their behalf) providing proof of the situation to lenders, especially in light of the (very valid) confidentiality requirements associated with mental health. This makes it difficult for lenders to adequately and promptly respond to concerns, with FOS finding that the firm had not ‘acted very sensitively, and that there was more they could have done’, such as proactively stopping interest from accruing and not sending overdue payment messages when the borrower

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<sup>1009</sup> Helen McCarthy, CAB (12 April 2013). Telephone interview; Anonymous Interview, CAB (14 March 2013), Personal interview.

<sup>1010</sup> Anonymous Interview, Lender (16 April 2013). Telephone interview.

<sup>1011</sup> Money Advice Liaison Group, *Good Practice Awareness Guidelines For Consumers with Mental Health Problems and Debt* (2nd edn, Money Advice Liaison Group 2009).

<sup>1012</sup> Joanna Kennedy, Consumer Lawyer (18 March 2013). Personal Interview.

was hospitalised. The complaint was therefore upheld, and the lender was not entitled to the interest and charges associated with the loan in question.<sup>1013</sup>

The links between mental health and debt in general have been considered, with the *Royal College of Psychiatrists* undertaking an in-depth review of the complex way in which debt and mental health interact.<sup>1014</sup> *Focus on Mental Health* also completed a quantitative study of 556 people with mental health concerns, with 72% of respondents defining themselves as low income and 66% having difficulties making their income last through the week.<sup>1015</sup> There is limited literature specifically focused on the impact of high-cost credit.<sup>1016</sup> This is of significant concern, considering the high levels of mental health problems in our society (one in four people in the UK will experience mental illness at some point during their lifetime<sup>1017</sup>), and the interactions between mental health concerns and poverty.<sup>1018</sup> The *Glasgow Centre for Population Health* (GCPH) produced a 2016 Briefing Paper on the link between high-cost credit and mental health. It determined that these type of credit products:

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<sup>1013</sup> The Financial Ombudsman Service, *Ombudsman News Issue 119 (August 2014): Short-Term Credit* (2014) Case Study 119/9.

<sup>1014</sup> Chris Fitch and others, *Debt and Mental Health: What do we know? What should we do?* (Royal College of Psychiatrists, 2011). Ann Davis, 'Counting the Cost' <[http://www.mind.org.uk/campaigns\\_and\\_issues/report\\_and\\_resources/778\\_counting\\_the\\_cost](http://www.mind.org.uk/campaigns_and_issues/report_and_resources/778_counting_the_cost)> accessed 23 April 2013.

<sup>1015</sup> Focus on Mental Health, 'An Uphill Struggle: A survey of the experiences of people who use mental health services and are on a low income' <<http://www.ontheside.org/focus/fpovsur.htm>> accessed 23 April 2013. Further discussion in Chris Fitch and Ryan Davey, *Debt collection and mental health: ten steps to improve recovery* (The Royal College of Psychiatrists and The Money Advice Trust, 2010).

<sup>1016</sup> For further research on general debt and mental health see, Jane Sharpe and Janet Bostock, *Supporting People with Debt and Mental Health Problems* (Community Psychology 2002).

<sup>1017</sup> Money Advice Liaison Group (n 1011) 2.

<sup>1018</sup> This issue was also discussed with Damon Gibbons, Centre for Responsible Lending (15 February 2013). Telephone interview.

increased susceptibility to mental health disorders (and worsened physical health in the longer term) among borrower populations, through four cumulative mechanisms:

1. Low income and existing adverse socioeconomic conditions.
2. Existing personal debt and financial difficulties.
3. Exhausted or excluded access to low interest credit.
4. Worsened debt burden through unmanageable ... loans, high interest and fees.<sup>1019</sup>

The *GCPH* recommended that further work be undertaken into the complex relationship between high-cost credit and borrower vulnerability/disadvantage, particularly in relation to mental health concerns.<sup>1020</sup>

The connection between mental health and credit goes both ways. First, people with existing mental health concerns are more likely to fall into problem debt. Second, financial difficulties (especially those related to debt) can be a trigger or cause for the development of mental health concerns. The Director of *Rethink Mental Illness* comments: 'studies show that one in four people with a mental health problem also have problem debts and that one in two adults with debts also have a mental health problem'.<sup>1021</sup> Without further research it is impossible to determine the number of borrowers who fall into this category, although the initial figures indicate that a significant number of people are likely to be affected.

The second scenario to consider is people with compulsive gambling problems accessing high-cost credit. The potential link between debt and gambling has been

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<sup>1019</sup> Glasgow Centre for Population Health (n 318) 17.

<sup>1020</sup> *ibid* 19.

<sup>1021</sup> Rethink, 'Mental health and debt: knowing the facts and where to seek help' (*Rethink Mental Illness* 2015) <<https://www.rethink.org/news-views/2015/08/debt>> accessed 13 March 2017.

recognised to some degree, and there has been an increasing academic and charitable focus on this topic.<sup>1022</sup> One of the debt advisors interviewed discussed how, due to privacy issues, it can be difficult for people working with high-cost credit borrowers to determine if there are any addiction problems, including those around gambling.<sup>1023</sup> One of the consumer lawyers had seen several cases where compulsive gamblers accessed high-cost credit to fund their gambling.<sup>1024</sup> One interviewee had seen a large number of clients with gambling problems, and stated that if lenders conducted proper affordability assessments they should pick up on the issue (indicated for example by high income, minimal expenses, significant money unaccounted for) and refuse any further loans.<sup>1025</sup>

Existing research shows a strong link between compulsive gambling and debt issues,<sup>1026</sup> although there has been minimal consideration of the specific relationship with high-cost credit. The interviews highlighted two potential issues regarding gambling and high-cost credit. First, the increased use of both online gambling and online lending by consumers (and potential interaction between these two),<sup>1027</sup> and second, the close physical proximity of gambling venues and physical high-cost credit shops in disadvantaged communities.<sup>1028</sup> A consumer advocate interviewee stated that this

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<sup>1022</sup> For example, Gerda Reith, *Research on the Social Impacts of Gambling* (Scottish Executive Social Research, 2006); Carolyn Downs and Ryan Woolrych, *Gambling and Debt Pathfinder Study* (Research Institute for Health and Social Change, GamCare and the Money Advice Trust, 2009).

<sup>1023</sup> Daniel Tansey, CAP (12 April 2013). Telephone interview.

<sup>1024</sup> Helen McCarthy, CAB (12 April 2013). Telephone interview.

<sup>1025</sup> Yvonne Fovargue MP (24 April 2013). Personal interview.

<sup>1026</sup> Reith (n 1022); Downs and Woolrych (n 1022).

<sup>1027</sup> This was supported by comments from Sharon Collard, PFRC (28 March 2013). Telephone interview.

<sup>1028</sup> Martyn Saville, Which? (20 March 2013). Telephone interview. See also Dave Clements, 'Payday Loans and Gambling: Protecting the Poor from Themselves' *The Huffington Post* (23 March 2013) <[http://www.huffingtonpost.co.uk/dave-clements/payday-loans-gambling-protecting-the-poor\\_b\\_2949481.html](http://www.huffingtonpost.co.uk/dave-clements/payday-loans-gambling-protecting-the-poor_b_2949481.html)> accessed 12 May 2013 and Heather Wardle and others, 'Risky Places?': Mapping Gambling Machine Density and Socio-Economic Deprivation' (2014) 30 *Journal of Gambling Studies* 201.

proximity can result in 'a very profitable business when directed at desperate people with a high risk of being tempted into gambling'.<sup>1029</sup> There are obvious concerns about the potential for gambling to create a need for high-cost credit, as there have been increased calls for planning laws to prevent lenders from opening in close proximity to bookmakers.<sup>1030</sup> One researcher interviewee highlighted 'gambling has not been such a big piece of the picture, but that could be because we are lagging behind in our understanding'.<sup>1031</sup> This comment seems to align with the research that has been undertaken, which highlights the relationships between gambling and problem debt, but also states that 'we do not have the rich understanding needed to fully assess the relationships observed'.<sup>1032</sup> Considering that high-cost credit is generally marketed on the ease and speed with which the borrower can obtain money, there is significant potential for the product to detrimentally impact people desperate for funds to feed compulsive gambling, and it is an area ripe for further investigation.

Initial research supports the finding that there is a significant link between gambling and high-cost credit. The *Responsible Gambling Strategy Board (RGSB)* undertook a survey of people who had participated in online gambling in the previous 12 months, and reported that 25% of respondents had taken out high-cost credit and a further 27% had taken out a personal loan (which is likely to include some high-cost credit

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<sup>1029</sup> Niall Cooper, CAP (12 March 2013). Telephone interview.

<sup>1030</sup> Simon Read, 'Lenders shouldn't target gamblers' *The Independent* (14 April 2013) <<http://www.independent.co.uk/money/loans-credit/simon-read-lenders-shouldnt-target-gamblers-8570508.html>> accessed 10 September 2013; Simon Read, 'Payday lenders: are they targeting gamblers?' <<http://blogs.independent.co.uk/2013/04/08/payday-lenders-are-they-targeting-gamblers/>> accessed 8 April 2013.

<sup>1031</sup> Sharon Collard, PFRC (28 March 2013). Telephone interview.

<sup>1032</sup> Wardle and others (n 1028) 4.

loans).<sup>1033</sup> Evidence from the *Adult Psychiatric Morbidity Survey* highlights as many as 44% of problem gamblers have definite or severe money problems.<sup>1034</sup> The situation therefore seems analogous to that of mental health discussed above; whilst there is no empirical evidence specifically identifying the number of people impacted by connection between gambling and high-cost credit, it is likely to be affecting a large number of already vulnerable individuals.

#### 5.4.2: Application to High-Cost Credit Concepts

Addressing the requirements of this class of borrowers is exceptionally complex; the need for assistance can vary quite widely between different Significantly Impaired Borrowers, and for the same borrower at different points in time. As with all consumers, negative freedom is still an important concept for Significantly Impaired Borrowers. Intervention should only occur when the harm caused by the contract outweighs the risk of undue infantilisation. However, owing to the impact that the impairment in question has on the ability for these borrowers to validly consent to the contract, there will often be more than adequate justification for intervention beyond the procedural fairness approach of negative freedom.

The most important factor for Significantly Impaired Borrowers is protection. Both aspects of high-cost credit protection, avoidance of substantially unfair agreements and coercion from lack of choice, are relevant for these consumers. There needs to be mechanisms in place to stop these borrowers from accessing agreements at extortionate interest rates. The impairment in question can prevent the consumer from understanding

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<sup>1033</sup> Personal correspondence provided by Katherine Jackson of the RGSB based on figures provided to them by the Gambling Commission's online gambling behaviour surveys (December 2015 and March 2016).

<sup>1034</sup> Wardle and others (n 1028) 2.

or appreciating the nature of the transaction, and how it may impact them in the long-term. The challenges of mental health conditions and compulsive gambling raise real questions about the validity of existing legal mechanisms of disclosure, cooling-off periods, and advertising restrictions. This is a particular concern for contracts relating to the provision of credit. These challenges highlight the limited role that negative freedom and procedural fairness can and should play when addressing the needs of Significantly Impaired Borrowers, and the importance of moving beyond this approach to stopping substantively unfair agreements. In addition, Significantly Impaired Borrowers need protection from coercion arising from a lack of choice. As discussed in Chapter 3, this goes beyond coercion of lenders and looks at the social structures and environment in which the party is transacting. If people are entering into potentially harmful credit contracts because of a mental health condition or urges arising from compulsive gambling, there are real concerns of coercion through lack of choice.

Significantly Impaired Borrowers come from a range of financial backgrounds, and use the high-cost credit funds in a variety of ways. The law needs to intervene not because of the coercive effect of poverty, but because of the coercive impact of the impairment in question. Whilst evidence shows that people who suffer from gambling additions or mental health conditions are more likely to struggle financially, this is by no means uniform. Significantly Impaired Borrowers are, however, more likely to suffer from financial exclusion and poverty, and therefore be categorised as Financially Insecure Borrowers.<sup>1035</sup> Due to the potential links between these two classes, the social welfare responses identified for Financially Insecure Borrowers should also apply to Significantly

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<sup>1035</sup> In relation to mental health conditions, see Focus on Mental Health (n 1015) and Fitch and Davey (n 1015). In relation to gambling, see Barnard and others (n 1006) and Wardle and others (n 1006).

Impaired Borrowers when they use funds from high-cost credit for everyday expenses or to repay existing financial obligations.

#### 5.4.3: Application to Current Legal Approach

There is a strong connection between gambling, mental health issues and consent. This connection is particularly relevant in the context of high-cost credit, and highlights the important role of legal protection. When not impaired, these borrowers may not want or need to use this type of financial product. The impact of 'passions' on an individual's decision-making ability has long been recognised as an important factor. Kant in *Anthropology* defined these passions as an 'illness of the mind'.<sup>1036</sup> These borrowers could be in a situation where they are 'knowingly acting against one's better judgment'.<sup>1037</sup> Elster gives the example of a compulsive gambler who knows he is ruining his life and tries to quit, but relapses.<sup>1038</sup> Significantly Impaired Borrowers can know what they are doing when they enter into high-cost credit contracts, but their condition may be overwhelming. Mental health conditions and gambling can undermine an individual's ability to control their actions to such an extent that they are no longer able to provide valid consent. The existing legal mechanisms of procedural fairness are insufficient. There is a need to actively prevent Significantly Impaired Borrowers from entering into potentially harmful high-cost credit contracts.

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<sup>1036</sup> Kant (n 644) 7-251. Similar discussion also occurred in Immanuel Kant, *Metaphysical Elements of Justice* (Translated with Introduction and Notes by John Ladd ed, Hackett Publishing Company 1999). For further discussion on this topic see Paul Formosa, 'A Life Without Affects and Passions: Kant on the Duty of Apathy' (2011) 13 *Parrhesia* 96.

<sup>1037</sup> Jon Elster, 'Weakness of will and preference reversals' in Jon Elster and others (eds), *Understanding Choice, Explaining Behaviour* (UniPub ForLag Oslo Academic Press 2006) 58.

<sup>1038</sup> *ibid* 58. He uses the particularly vivid description of Euripides's *Medea*; when the protagonist attempts to kill her children declaring 'I know indeed what evil I intend to do. But stronger than all my after thoughts is my fury'.

There are three potential ways the law currently responds to Significantly Impaired Borrowers; the common law, the Mental Capacity Act 2005 (MCA), and inherent jurisdiction. The common law of contract provides limited protection for these borrowers through capacity requirements and vitiating factors.<sup>1039</sup> Contracting parties must have the capacity to enter into binding agreements.<sup>1040</sup> Unsoundness of mind, even to the extent of lunacy, historically did not constitute a valid defence, and these agreements were enforceable against parties and their estate.<sup>1041</sup> The law was however modified by Pollock CB in *Moulton v Camroux*.<sup>1042</sup> The result is that if a borrower does not have capacity when entering a high-cost credit contract, it cannot be enforced against them.<sup>1043</sup> The requirements for incapacity are, however, quite high. In *Irvani v Irvani*, the Court of Appeal held that a serious ongoing alcohol addiction was insufficient grounds to void an arbitration agreement.<sup>1044</sup> Only the most serious of mental health conditions will be sufficient to hold high-cost credit contracts unenforceable. It is unlikely that any sort of gambling addiction would be accepted by the courts as an adequate reason. Society's disapproval of compulsive gambling, and general refusal to recognise it as a legitimate

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<sup>1039</sup> Insanity may also be considered a contract law 'defence', but this is highly controversial: see Andrew Dyson, James Goudkamp and Fred Wilmot-Smith, 'Thinking in Terms of Contract Defences' in Andrew Dyson, James Goudkamp and Fred Wilmot-Smith (eds), *Defences in Contract* (Hart Publishing 2017) 8.

<sup>1040</sup> See *Hart v O'Connor* [1985] AC 1000, [1985] UKPC 1.

<sup>1041</sup> For a discussion of this background, see *Moulton v Camroux* (1847) 2 Ex 487 (CA), 500-501; Joseph Chitty, *A Treatise on the Law of Contracts* (Sweet and Maxwell 1912) 190.

<sup>1042</sup> His Honour stated that the rule had 'in modern times been relaxed, and unsoundness of mind (as also intoxication) would now be a good defence to an action upon a contract, if it could be shown that the defendant was not of the capacity to contract, and the plaintiff knew it': *Moulton v Camroux* (n 1041) 501.

<sup>1043</sup> There are, however, certain requirements that the other party be aware of the mental incapacity: *Hart v O'Connor* (n 1040) 1018-1019.

<sup>1044</sup> *Irvani v Irvani* [2000] 1 Lloyd's LR 412 (CA), see esp comments at 424.

medical condition, is likely to create a lack of sympathy for gamblers and in turn will impact the approach taken.<sup>1045</sup>

If the impairment is so great that the borrower did not understand the nature of the transaction *and* the lender was aware of the impairment, the contract is voidable by the borrower<sup>1046</sup> and there is a strong case of irresponsible lending.<sup>1047</sup> In the context of high-cost credit transactions, it is very unlikely that there would be a sufficient relationship between the parties to provide the lender with an awareness of the impairment. The nature of the loan will often prevent the lender from obtaining this information; the transactions are quick, there is minimal disclosure, and often no direct contact between the lender and borrower. In addition, lenders cannot enquire about the borrower's physical or mental health or condition<sup>1048</sup> as this is 'sensitive personal data'.<sup>1049</sup> Even if they obtained this information, the lender cannot treat the borrower less favourably on the basis of the condition.<sup>1050</sup> It is unclear how these competing legal obligations should be approached whilst also ensuring that lenders are fulfilling their duties under the ILG.

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<sup>1045</sup> Jeffrey J. Marotta, Judy A. Cornelius and William R. Eadington, *The Downside: Problem and Pathological Gambling* (University of Nevada Press 2002) 430.

<sup>1046</sup> *Moulton v Camroux* (n 1041) 501; *Irvani v Irvani* (n 1044) 424; *Pitt v Smith* (1811) 3 Camp 33, 170 ER 1296 (NP); *Matthews v Baxter* (1873) LR 8 Exch 132 (ExCh).

<sup>1047</sup> Subject to a potential claim for unjust enrichment of the original amount loaned. See *Blomley v Ryan* (n 869); Peter Hall, *Unconscionable Contracts and Economic Duress* (CCH Australia Limited 1985); David Harland, 'Unconscionable and Unfair Contracts: An Australian Perspective' in Roger Brownsword, Norma Hird and Geraint Howells (eds), *Good Faith in Contract: Concepts and Context* (Ashgate Dartmouth 1999); Cope (n 653).

<sup>1048</sup> Data Protection Act 1998 (UK), Equality Act 2010 (UK) and Mental Capacity Act 2005 (UK).

<sup>1049</sup> Data Protection Act 1998 (UK), s 2(e).

<sup>1050</sup> Equality Act 2010 (UK), s 4 which states that 'disability' is a protected characteristic. 'Disability' is defined in s 6 as a 'physical or mental impairment'. See also Mental Health (Discrimination) Act 2013 (UK).

The second common law protection for Significantly Impaired Borrowers is vitiating factors. These factors were initially quite restrictive, but have expanded to address issues of procedural unfairness, substantive unfairness, and (arguably) maintenance of a social minimum. There are a number of vitiating factors, such as undue influence, unconscionability and economic duress, which may be relevant to high-cost credit contracts.<sup>1051</sup> Significantly Impaired Borrowers still have to prove the elements of a vitiating factor; merely having a mental health condition or compulsive gambling problems will not be sufficient to find a high-cost credit contract voidable.<sup>1052</sup> Thus, while vitiating factors have the potential to provide some assistance to Significantly Impaired Borrowers, it is a piecemeal approach that is insufficient to respond to the current challenges.

The MCA also provides limited protection for Significantly Impaired Borrowers. The profile identified two key scenarios for these borrowers. First, mental health concerns cover a range of conditions including schizophrenia, bipolar disorder, depression and anxiety, and these are all clearly recognised health conditions or disorders.<sup>1053</sup> The second scenario is problem gambling, which, according to the World Health Organisation's *International Statistical Classification of Diseases and Related Health Problems*, is defined

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<sup>1051</sup> Beatson and Friedman (n 216) 12-14.

<sup>1052</sup> See, for example, the discussion of unconscionable bargains and mental incapacity in *Hart v O'Connor* (n 1040).

<sup>1053</sup> These are divided into two categories in World Health Organisation, *International Statistical Classification of Diseases and Related Health Problems* (10th ed, World Health Organisation 2016). The first is Schizophrenia, schizotypal and delusional disorders (F20-F29, described as 'This block brings together schizophrenia, as the most important member of the group, schizotypal disorder, persistent delusional disorders, and a larger group of acute and transient psychotic disorders'). The second is Mood [affective] disorders (F30-F39), described as 'This block contains disorders in which the fundamental disturbance is a change in affect or mood to depression (with or without associated anxiety) or to elation. The mood change is usually accompanied by a change in the overall level of activity; most of the other symptoms are either secondary to, or easily understood in the context of, the change in mood and activity. Most of these disorders tend to be recurrent and the onset of individual episodes can often be related to stressful events or situations').

as 'pathological gambling' and is also a recognised mental and behavioural disorder.<sup>1054</sup>

Both scenarios are therefore associated with recognised health conditions.

The MCA creates a distinction between people who have capacity (and therefore are deemed to be able to consent) and those who do not have capacity (and therefore cannot consent). The threshold test for capacity is whether the person is able, at the material time, to make a decision for him or herself.<sup>1055</sup> This is further explained in section 3, which states that a person is unable to make a decision if they are unable to:

- a) understand the information relevant to the decision;
- b) retain that information; and
- c) use or weigh that information as part of the process of making the decision; or
- d) communicate the decision (whether by talking, using sign language or any other means).<sup>1056</sup>

Significantly Impaired Borrowers may not have adequate capacity when entering into high-cost credit contracts. They are particularly likely to experience difficulties with adequately weighing the short-term benefits against the long-term implications. At other times, they have may the ability to make decisions, and therefore have full capacity. Most of these borrowers will, however, have fluctuating incapacity, meaning that they have periods of lucidity. This makes it difficult to create a regulatory response that adequately addresses the needs of these consumers. As outlined by Herring and Wall, the MCA

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<sup>1054</sup> ibid F63.0 defines pathological gambling as 'The disorder consists of frequent, repeated episodes of gambling that dominate the patient's life to the detriment of social, occupational, material, and family values and commitments'.

<sup>1055</sup> Mental Capacity Act 2005 (UK), s 2(1). For criticisms of the capacity test, see Jonathan Herring and Jesse Wall, 'Autonomy, capacity and vulnerable adults: filling the gaps in the Mental Capacity Act' (2015) 35 *Legal Studies* 698 and Nancy Knauer, 'Defining Capacity: Balancing the Competing Interests of Autonomy and Need' (2003) 12 *Temple Political & Civil Rights Law Review* 321.

<sup>1056</sup> Mental Capacity Act 2005 (UK), s 3(1).

‘typically seeks to determine the minimum necessary for autonomy and treats the person as autonomous once they cross that threshold’.<sup>1057</sup> It is therefore a blunt instrument, and cannot respond adequately to the needs of these borrowers. There will be situations where the consumer in question does not meet the threshold under the MCA, but still justifies some sort of protection.

There will also be instances where an individual will not meet the threshold of the common law or MCA, but their decision-making abilities remain substantially impacted. A third potential approach has been developed, namely the inherent jurisdiction of the court. This is a common law doctrine that could ‘plug’ this gap, and create a situation where the law can intervene on behalf of vulnerable people who are deemed to have capacity.<sup>1058</sup> The court has gradually increased the scope and application of inherent jurisdiction.<sup>1059</sup> As outlined by the Court of Appeal in *DL v Local Authority*, inherent jurisdiction applies when ‘other factors ... combine with his borderline capacity to remove his autonomy to make an important decision’.<sup>1060</sup> This definition highlights the potential relevance of inherent jurisdiction to Significantly Impaired Borrowers. Many of these individuals will have capacity under the MCA 2005, but other factors will ‘remove [their] autonomy to make an important decision’ (namely enter into a high-cost credit contract).

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<sup>1057</sup> Herring and Wall (n 1055) 702.

<sup>1058</sup> The most frequently arising example of this situation is in relation 16 and 17 year olds being pressured into marriage: see, for example, *Re SA (vulnerable adult with capacity: marriage)* [2006] 1 FLR 867, [2005] EWHC 2942 (Fam).

<sup>1059</sup> The key cases extending inherent jurisdiction are: *ibid*; *Re SK* [2005] 2 FLR 230, [2004] EWHC 3202 (Fam); *Re G (An Adult)* [2004] EWHC 2222 (Fam).

<sup>1060</sup> The quote in full states ‘where, on a strict mental health appraisal, such an individual does not lack capacity in the terms of the MCA 2005 and therefore falls outside the statutory scheme, but other factors, for example coercion and undue influence, may combine with his borderline capacity to remove his autonomy to make an important decision, why, one may ask, should that individual not be able to access the protection now afforded to adults whose mental capacity puts them on the other side of that borderline?’: *DL v A Local Authority* [2012] EWCA 253 [65].

The application of inherent jurisdiction was further discussed in *Re SA (vulnerable adult with capacity: marriage)*, where Munby J held it applicable to:

A vulnerable adult who, even if not incapacitated by mental disorder or mental illness, is, or is reasonably believed to be, either (i) under constraint or (ii) subject to coercion or undue influence or (iii) for some other reason deprived of the capacity to make the relevant decision, or disabled from making a free choice, or incapacitated or disabled from giving or expressing a real and genuine consent.<sup>1061</sup>

The final comments in (iii) on being disabled from making a free choice and exercising real and genuine consent can be applied to (at least some) Significantly Impaired Borrowers and high-cost credit contracts. Inherent jurisdiction clearly goes beyond mere issues of capacity, and looks for genuine consent, taking a long-term view on autonomy and freedom. While not providing a comprehensive list of the people covered by inherent jurisdiction, Munby J comments that

many ... circumstances that may so reduce a vulnerable adult's understanding and reasoning powers as to prevent him forming or expressing a real and genuine consent, for example, the effects of deception, misinformation, physical disability, illness, weakness (physical, mental or moral), tiredness, shock, fatigue, depression, pain or drugs. No doubt there are others.<sup>1062</sup>

This broad discussion highlights the wide spectrum of situations covered by inherent jurisdiction, indicating that mental health conditions and gambling addictions (falling short of what is required for the MCA) may be covered. The essential purpose of inherent jurisdiction is to respect and protect the autonomy of the individual,<sup>1063</sup> their negative

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<sup>1061</sup> *Re SA (vulnerable adult with capacity: marriage)* [79].

<sup>1062</sup> *ibid* [78]. Munby J does not attempt to provide an exhaustive list of situations, stating this would be 'unwise, and indeed inappropriate' [77].

<sup>1063</sup> See discussion in Herring and Wall (n 1055) 702.

freedom can be limited to provide them with greater positive freedom. Whilst the inherent jurisdiction powers of the court have potential to assist high-cost credit borrowers with impacted capacity, its ability to invalidate private law contracts is unclear. There have been cases where marriage has been held invalid through inherent jurisdiction,<sup>1064</sup> but the court has yet to consider its impact on commercial contracts. If, however, there were a process in place whereby people could be excluded from the market, such as the creation of a 'do-not-lend registry', it would be relatively uncontroversial for the court to exercise its powers under inherent jurisdiction, and utilise this process for the benefit of the Significantly Impaired Borrower.

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<sup>1064</sup> See, for example, *A Local Authority v SY* [2013] EWHC 3485 (COP) and *XCC v AA & Ors* [2012] EWHC 2183 (COP).

## Conclusion

This chapter has highlighted the importance of recognising and responding to the underlying circumstances of borrowers and their specific needs. It has developed three classes of consumers who use high-cost credit; Financially Secure Borrowers, Financially Insecure Borrowers and Significantly Impaired Borrowers. All three of the concepts previously considered – freedom, protection and social minimums – are important, but in varying ways for the different borrower classes. The law has responded to the situation in a number of ways, but it is clear that more work needs to be done to address the challenges of high-cost credit. The next chapter will therefore provide a range of recommendations in light of the profile and taxonomy of borrowers developed.

## Chapter 6: Recommendations

*True freedom requires the rule of law and justice, and a judicial system in which the rights of some are not secured by the denial of rights to others*

- Lord Jonathan Sacks

### Introduction

The previous chapters have identified the borrower taxonomy, assessed the needs of each class and analysed the current and past legal processes associated with the borrowers.

These steps have raised a number of further questions for the future. This final chapter therefore makes a range of recommendations for how to utilise the taxonomy, and what steps are necessary to take each recommendation forward. It is first and foremost a plea for further research and policy analysis. It is clear that the private law alone cannot solve the problems identified in Chapter 5 – we need to go beyond the existing legal structures and look at how they interact with the social welfare system. The recommendations in this chapter will therefore be divided into three separate headings; legal reform recommendations, social welfare responses, and further research necessary.

## 6.1: Law Reform Recommendations

This section puts forward law reform recommendations. They arise from the gaps in the legal approaches to the three borrower classes identified in the previous chapter. The recommendations relate to enhanced disclosure, responsible lending obligations, and opt out processes.

### 6.1.1: Enhanced Disclosure

Disclosure is a central aspect of high-cost credit regulation; it is crucial that all borrowers understand the financial transaction into which they have entered or are about to enter. Information provision is one of the key ways that the State can assist people to make better decisions without the need for active paternalistic involvement.<sup>1065</sup> Even a negative freedom approach supports disclosure obligations on lenders. Despite the limitations about disclosure, it is important to get it right. There needs to be an increased focus on transparent and effective disclosure. The current approach to disclosure has been subject to trenchant criticism on its failure to engage with the lending reality of borrowers.<sup>1066</sup> The former Consumer Minister Jo Swinson called for additional legal protection and enhanced disclosure.<sup>1067</sup> Providing all borrowers classes with clear, easy to understand information about high-cost credit is a necessity.

The FCA acknowledged the limitations with disclosure in high-cost credit transactions. As part of its reforms, the regulator included a requirement for a financial warning on all advertisements. Originally the warning was

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<sup>1065</sup> Sunstein (n 921) 1856.

<sup>1066</sup> It is important to identify the limits associated with disclosure, namely the minimum impact that information disclosure has on the decision-making process of many individuals: see discussion in 2.5.1.

<sup>1067</sup> Rupert Jones and Hilary Osborne, 'Crackdown on payday loans advertising' *The Guardian* (2 July 2013) <[www.theguardian.com/money/2013/jul/01/crackdown-payday-loans-advertising](http://www.theguardian.com/money/2013/jul/01/crackdown-payday-loans-advertising)> accessed 22 September 2013.

*Think! Is this loan right for you? Over 2 million short-term loans were not paid off on time in 2011/12. This can lead to serious money problems. If you're struggling, go to [www.moneyadviceservice.org.uk](http://www.moneyadviceservice.org.uk) for free and impartial help.*<sup>1068</sup>

This was 'downgraded' to 'Warning: Late repayment can cause you serious money problems. For help, go to [moneyadviceservice.org.uk](http://moneyadviceservice.org.uk)'.<sup>1069</sup>

The UK obligations can be contrasted with the equivalent warning in Australia, which is required to be included on both lender websites<sup>1070</sup> and business premises;<sup>1071</sup> it states

*Do you really need a loan today?*

*It can be expensive to borrow small amounts of money and borrowing may not solve your money problems.*

*Check your options before you borrow:*

- *For information about other options for managing bills and debts, ring 1800 007 007 from anywhere in Australia to talk to a free and independent financial counsellor*
- *Talk to your electricity, gas, phone or water provider to work out a payment plan*
- *If you are on government benefits, ask for an advance payment from Centrelink: 13 17 94*

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<sup>1068</sup> The Financial Conduct Authority, *Detailed proposals for the FCA regime for consumer credit* (n 7) 69.

<sup>1069</sup> The Financial Conduct Authority, *FCA Handbook, Consumer Credit Sourcebook (CONC)* (n 361) 3.4.1.

<sup>1070</sup> National Consumer Credit Protection Regulations 2010 (Cth), r 28XXA referring to Schedule 7 for the wording of the warning.

<sup>1071</sup> National Consumer Credit Protection Regulations 2010 (Cth), r 28XXB referring to Schedule 9 for the wording of the warning.

*Go to [www.moneysmart.gov.au](http://www.moneysmart.gov.au) -- MoneySmart shows you how small amount loans work and suggests other options that may help you.*

This Australian warning is obviously focused specifically on the assistance provided in that country, although that model is likely to be more effective as it provides readers with concrete alternatives to high-cost credit as opposed to merely a warning. A similar model could be implemented in the UK, especially as the downgrading of the originally proposed warning was not justified by the regulator.

#### 6.1.2: Responsible Lending Obligations

The approach to responsible lending was discussed in Part 3.4.3.<sup>1072</sup> Despite the 2006 amendments to the responsible lending regime and the transition to the FCA, the UK system continues to put the onus on consumers to ensure that the loan is suitable for their needs. This is not appropriate, as Financially Insecure Borrowers often have few financial options and can be easily exploited.<sup>1073</sup> There is also a lack of adequate detail about what amounts to responsible lending; in particular, what specific obligations lenders have regarding financial hardship, inappropriate lending models, and documentation required to prove repayment ability. This creates a situation where borrowers are not given adequate protection, and can be exploited by lenders who provide minimal protection and take advantage of the lack of proscriptive detail in the guidelines.

This relatively passive approach to responsible lending can be contrasted with the Australian regime. The responsible lending obligations in Australia comprise an entire

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<sup>1072</sup> Fairweather (n 306).

<sup>1073</sup> This is further discussed in Gardner, 'Responsible Lending and Borrowing' (n 305).

chapter of legislation<sup>1074</sup> with over 70 pages of text, as well as a Regulatory Guide<sup>1075</sup> produced by the national regulator.<sup>1076</sup> The core obligation on lenders in Australia is to ensure that the credit contract is 'not unsuitable' for the borrower. There are two aspects to this determination: whether the consumer can meet the financial obligations under the contract without substantial financial hardship,<sup>1077</sup> and whether the product meets the consumer's requirements and objectives.<sup>1078</sup> The lender has an obligation to take 'reasonable steps to verify information' provided by the consumer about their financial position to ensure that the credit is 'not unsuitable'. The lender is required to 'understand the purpose for which the credit is sought and determine if the type, length, rate, terms, special conditions, charges and other aspects of the proposed contract meet this purpose'.<sup>1079</sup> This is a very different approach to that adopted in the UK. It puts additional obligations on lenders to ensure that the loan is appropriate and suited to the borrower's needs. It also fulfills the requirement of ensuring that the borrower will be at or above the social minimum when the loan is taken out and during all scheduled repayments.

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<sup>1074</sup> National Consumer Credit Protection Act 2009 (Cth).

<sup>1075</sup> Australian Securities and Investment Commission, *Credit Licensing: Responsible Lending Conduct* (Regulatory Guide 209, 2013).

<sup>1076</sup> The Australian Securities and Investment Commission (ASIC). The *National Consumer Credit Protection Act 2009* (Cth) (NCCPA) and the National Credit Code (NCC) regulate the provision of consumer credit. In 2013, the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) (CCLAEA) was enacted, providing for a national interest rate cap and additional protections for borrowers of high-cost credit. For more details, see Gardner, *The Challenges of Regulating High-Cost Short-Term Credit: A Comparison of UK and Australian Approaches* (n 218).

<sup>1077</sup> A detailed list of what is potentially relevant for determining whether a consumer can repay their financial obligations without suffering substantial financial hardship is set out in Australian Securities and Investment Commission (n 1075) 32-37. There are also presumptions of substantial financial hardship for small-amount loans under the National Consumer Credit Protection Act 2009 (Cth), ss 118, 123, 131, 133.

<sup>1078</sup> A detailed list of what should be considered when determining whether the credit product meets the consumer's requirements and objectives is set out in *ibid* 40-42. The ASIC Guide however explicitly states that the contract is not unsuitable merely because another product would be more suitable for the consumer, highlighting that the product does not have to be the most suitable loan available.

<sup>1079</sup> Explanatory Memorandum, National Consumer Credit Protection Act 2009 (Cth) para 379.

Furthermore, for people who access 'small-amount credit' in Australia, the *Consumer Credit Legislation Amendment (Enhancements) Act 2012* (Cth) (CCLAEA) in combination with the *National Consumer Credit Protection Act 2009* (Cth) (NCCPA) imposes additional responsible lending requirements in relation to Small Amount Credit Contracts (SACCs). The borrower will be presumed to be unsuitable for additional loans if (a) they are currently in default under a SACC or (b) have had two or more SACCs in the past 90 days. If the borrower already has an account in an authorised deposit-taking institution, the lender must as part of the assessment of loan suitability, obtain *and consider* statements from their account over the previous 90 days before approving a loan. This ensures that the lender is aware of – and takes into account – the financial situation of the borrower before a loan is granted. The CCLAEA dictates that if 50% or more of the borrower's income is from government benefits or pension, the SACC repayments can only be a maximum of 20% of the borrower's income. If the loan is paid back under a CPA<sup>1080</sup>, the lender cannot attempt to debit the borrower's account until the borrower is advised that the debit has been unsuccessful. This is an attempt to stop the 'drip feeding' of money out of borrowers' accounts, and to ensure that there is sufficient money to pay priority debts.

The UK would benefit from taking a more detailed approach to lender obligations. This would be particularly relevant for the class of Financially Insecure Borrowers, as these types of lending restrictions are designed to ensure that borrowers can afford to repay their credit obligations without going below the social minimum or suffering financial hardship. They therefore assist with the maintenance of the borrower's social minimum. Whilst the specific details would need to be determined in the light of the unique legal

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<sup>1080</sup> A Continuous Payment Authority, see fn 29 for the definition.

culture in the UK,<sup>1081</sup> helpful guidance for responsible lending obligations can be drawn from the Australian approach.

### 6.1.2: Opt Out Processes

Proactive mechanisms could be put in place to prevent consumers, particularly the class of Significantly Impaired Borrowers, from accessing harmful high-cost credit by developing an 'opt out' process. An analogy can be drawn to Ulysses and the Sirens, where Ulysses asks to be tied up when passing the Sirens to avoid succumbing to the temptation. From a regulatory perspective, this is 'pre-commitment'; the notion of constraining the rights and actions of an individual when they are in a rational state, to protect them from choices they may make when acting in a less rational manner.<sup>1082</sup> Significantly Impaired Borrowers could voluntarily remove their access to high-cost credit during times of lucidity, and this would be binding on them when impacted by the impairment in question. If a loan were given in breach of the pre-commitment, the lender would not be able to recover the funds. When high-cost credit usage impact on people beyond the borrower (ie family members reliant on funds for living expenses), those impacted could also request that the borrower be excluded from the market. The opt out could then be imposed on the borrower. This would not, however, be an automatic process, and would require further regulatory hurdles (such as court or regulatory approval) to ensure that the borrower's freedom was not unduly undermined. This type of interventionist approach is already available in the gambling industry, but on an optional basis. Considering the strong links

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<sup>1081</sup> For an interesting analysis of applying doctrines from one country to another; see Mindy Chen-Wishart, 'Legal Transplant and Undue Influence: Lost in Translation or a Working Misunderstanding' (2013) 62 *International & Comparative Law Quarterly* 1.

<sup>1082</sup> See further discussion in Jon Elster, *Ulysses Unbound: Studies in rationality, precommitment, and constraints* (Cambridge University Press 2000); Elster, 'Weakness of will and preference reversals' (n 1037).

between gambling and problem debt, the extension of the process to high-cost credit should be relatively uncontroversial.

The regulatory approach to Significantly Impaired Borrowers may raise potential issues of discrimination, ie people with mental health conditions or compulsive gamblers are being treated unfavourably compared to the remaining population. Negative discrimination against vulnerable groups is prohibited,<sup>1083</sup> although positive discrimination (or more accurately 'protection') should be encouraged on the basis that these groups need additional assistance from the State. There are examples of positive discrimination for both borrower categories. Consumer credit contracts in Scotland are unenforceable if the borrower did not have adequate capacity, irrespective of whether the lender had constructive notice of the situation.<sup>1084</sup> Singapore recognised the need for specific protection of people with gambling problems, and has excluded from gambling institutions citizens who have a poor credit record or are financially vulnerable.<sup>1085</sup> Whilst Singapore is a more authoritarian society and there is less concern for freedom of contract, such limitations are also justifiable in the UK, as the 'freedom' to become indebted because of compulsive gambling is not a worthwhile freedom that the law should facilitate.<sup>1086</sup>

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<sup>1083</sup> Equality Act 2010 (UK), s 4 which states that 'disability' is a protected characteristic. 'Disability' is defined in s 6 as a 'physical or mental impairment'. See also Mental Health (Discrimination) Act 2013 (UK).

<sup>1084</sup> See discussion in The Office of Fair Trading, *Mental capacity - OFT guidance for creditors* (2011) 3.

<sup>1085</sup> Ministry of Social and Family Development, 'Press Release: 28 May 2013 - Casino Visit Limit on Financially Vulnerable Singaporeans and PRS Takes Effect from 1 June' Government of Singapore <[http://www.news.gov.sg/public/sgpc/en/media\\_releases/agencies/msf/press\\_release/P-20130528-1.print.html?AuthKey=>](http://www.news.gov.sg/public/sgpc/en/media_releases/agencies/msf/press_release/P-20130528-1.print.html?AuthKey=>) accessed 10 September 2013; Social standards implemented under Casino Control Act 2006 (Sg).

<sup>1086</sup> Raz, *The Morality of Freedom* (n 203) see especially 15, 156.

## 6.2: Social Welfare Responses

This section discusses the need for a welfare-based response in conjunction with the legal reforms discussed above. As discussed in the previous section, the challenges of lending – particularly to Financially Insecure Borrowers – cannot be solved merely by looking at the legal regime associated with high-cost credit. Chapter 4 described how the concept and application of a social minimum has developed quickly in the UK. There is, however, more work to be done in the area before the social minimum can be applied to meet the current challenges of high-cost credit challenges. These financial products require people, many of whom are already on low incomes, to repay loans at exceptionally high interest rates. Even if people are provided with an adequate social minimum, high-cost credit repayments have the potential to push them back below this level. This section will therefore discuss both the provision and maintenance of a social minimum in relation to high-cost credit.

### 6.2.1: Providing a Social Minimum

Providing a social minimum involves tackling the underlying issues of poverty by the redistribution of resources. This is particularly important for Financially Insecure Borrowers, as they often turn to high-cost credit to make ends meet. Protection will therefore not solve the problem, as (a) redistribution will only occur on an ad hoc basis between specific lenders and borrowers and (b) borrowers will still have limited financial means and choices. The problems go beyond the private law realm to resolve, and need a response from the State.<sup>1087</sup> The redistribution should come from the State in the form of

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<sup>1087</sup> We must however recognise the role of responsible borrowing and lender obligations. As has been discussed above, if loans are given when borrowers cannot afford to make repayments without suffering financial hardship, this is an issue with lender's exploitative actions and the contracts should not be upheld by the courts.

an effective and proactive social welfare system. The importance of this was highlighted by Fried:

Redistribution is not a burden to be borne in a random, ad hoc way by those who happen to cross paths with persons poorer than themselves. Such a conception, heartwarmingly spontaneous though it may be, would in the end undermine our ability to plan and live our lives as we choose. Liberal democracies have chosen to effect redistribution (to assure a social minimum) by welfare benefits on one hand and by general taxation based on overall ability to pay on the other. In this way government, as it seeks contributions to remove inequalities, remains neutral about the ways in which the better-off acquire their greater wealth, exacting (in principle, at least) the same contribution from everyone who enjoys the same level of wealth ... The provision of a social minimum should be society's general responsibility.<sup>1088</sup>

The UK is a developed Welfare State, and it is accepted that citizens have a right to a basic standard of living. There is an expectation that the government will provide a minimal level of support for vulnerable and low-income citizens.<sup>1089</sup> Since the 2008 global financial crisis and economic downturn, there has been a shift towards a more conservative approach to social security and away from the Welfare State. This decreasing government support coincides with stagnated wages, increased unemployment and

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<sup>1088</sup> Fried (n 225) 106. Similar comments were made by Atiyah; 'During the past decade or so the view has been gaining ground, certainly in England, that these contracts should still be left to the market, while we should try and control or handle the externalities by other government actions. If a tenant is too poor to pay an open market rent, then the tenant should receive some state financial benefit, but the market should be left to operate freely': Atiyah, *Essays on Contract Law* (n 150) Essay 12, 360.

<sup>1089</sup> For discussion of the causes of poverty and role of the government, see Tracy Shildrick and others, *Poverty and Insecurity: life in 'low-pay, no-pay' Britain* (Policy 2012); Jonathan Cribb and others, *Living standards, Poverty and Inequality in the UK 2013* (Institute for Fiscal Studies distributed by Central Books Ltd 2013); Dalia Ben-Galim and Tess Lanning, *Strength Against Shocks: Low-income Families and Debt* (Institute for Public Policy Research, 2010).

higher costs of living, occurring at a time when people most need the extra support.<sup>1090</sup> Increasing numbers of low-income consumers are using high-cost credit to pay for life's necessities, raising the question of whether 'mainstream society is failing these people'.<sup>1091</sup> Financially Insecure Borrowers are an increasing class of high-cost credit users. They have been forced to turn to high-cost credit for everyday expenses or existing financial obligations. These types of purchases are 'not something we should be relying on credit for,' and the State should ensure people have access to these basic essentials without resorting to high-cost credit.<sup>1092</sup>

It is beyond the purpose and scope of this thesis to enter a detailed debate about how adequate levels of State welfare should be calculated. What is important to note is that if the government wants to tackle high-cost credit, it must address the links with poverty and therefore the need to provide an adequate social minimum. The current government, however, is taking steps to reduce the welfare safety net for many vulnerable people at the same time as regulating the high-cost credit market. The positive impact of the latter is likely to be greatly overshadowed by the negative impact of the former. Individuals, whether employed or not, must be provided with their basic needs without resorting to credit. The State needs to take welfare provision seriously and raise the social minimum. Research from the Child Poverty Action Group highlights the failure of the current social minimum. Two parents working full-time on the current *national living wage* earn £49 less per week than they need to live what society defines as an

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<sup>1090</sup> See Rowlingson, Appleyard and Gardner (n 123).

<sup>1091</sup> Carl Packman, Author & Consumer Advocate (28 February 2013). Telephone interview. This was discussed numerous times in the interviews; Packman stated, 'I have to question the use of the term "civil society" ... [it is] a drastic and scary situation which is undermining people's financial security' (Carl Packman, Author & Consumer Advocate (28 February 2013). This is supported by James Jones from the credit reference agency Experian, who states that the widespread use of high-cost credit for everyday expenses 'suggests other things are not working well in society and welfare in general' (James Jones, Experian (8 March 2013). Telephone interview).

<sup>1092</sup> James Jones, Experian (8 March 2013). Telephone interview.

‘acceptable, no-frills living standard’. The situation is significantly worse for parents who are unemployed or part-time workers, in minimum wage jobs, on zero-hour contracts, or are lone parents.<sup>1093</sup> Until the importance of providing a decent social minimum is acknowledged and addressed, history will continue to repeat itself, and the high-cost credit market will remain an ongoing source of regulatory frustration and failure.

#### 6.2.2: Maintaining a Social Minimum

Whilst the *provision* of a social minimum is clearly important, the *maintenance* of this minimum is also critical. It is no use providing people with adequate resources if they then have such limited financial choices that, when unexpected expenses arise, they need to resort to high-cost credit contracts with repayments that push them below the social minimum. The majority of people using high-cost credit are doing so because of an unforeseen change in circumstances; over seven out of ten high-cost credit users access funds because of an unforeseen financial situation.<sup>1094</sup> Even if people are initially provided with a social minimum, exploitative high-cost credit contracts have the potential to push borrowers below the level of resources needed to live a meaningful life.<sup>1095</sup>

To truly tackle the problems of high-cost credit, the government needs to develop a financial system that not only provides but also maintains the social minimum of vulnerable borrowers. There are two aspects to this approach. The first is to ensure that lenders are prohibited from giving high-cost credit if the repayments are going to push

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<sup>1093</sup> See Donald Hirsch, *The Cost of a Child in 2018* (Child Poverty Action Group 2018) and analysis in Child Poverty Action Group, ‘The Cost of a Child in 2018’ (*Child Poverty Action Group*, 20 August 2018) <<http://cpag.org.uk/content/cost-child-2018>> accessed 2 September 2018.

<sup>1094</sup> Competition & Markets Authority, *Research into the Payday Lending Market* (n 39) 70.

<sup>1095</sup> This is discussed in The Rt Hon Frank Field MP and The Rt Revd Tim Thornton, *Feeding Britain: A strategy for zero hunger in England, Wales, Scotland and Northern Ireland* (All-Party Parliamentary Inquiry into Hunger in the United Kingdom 2014) particularly Recommendation 24 on page 26.

people into financial hardship (discussed above in relation to responsible lending requirements), and the second is to create a social security system where people do not need to turn to these loans in times of need. This second step requires a range of responses, including:

- increasing financial control when borrowers experience problem debt;
- providing affordable credit options for low income consumers;
- establishing financial hardship regulations that give people flexibility when they suffer temporary financial difficulties; and
- encouraging a savings culture.

Each of these responses will be briefly discussed. First, the government should be given more financial control over borrowers with unacceptable levels of problem debt. If Financially Insecure Borrowers are using high-cost credit for everyday expenses or to repay existing obligations, their credit position is highly precarious and it is likely they will need an intervention to get their finances under control. An analogy can be drawn between Financially Insecure Borrowers and people in bankruptcy. Their financial obligations have become overly detrimental, and they need external control from the State for the sake of their future autonomy. This control could for example consist of the government (or a not-for-profit organisation) receiving any income from the borrower, and making the necessary payments on their behalf.

There are currently a number of debt management companies providing this service.<sup>1096</sup> These are likely to do more harm than good as the services cost the borrower

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<sup>1096</sup> See, for example, CreditFix: Helping you deal with debt, 'About Us' (*CreditFix*, 2017) <<http://www.creditfix.co.uk/about-us/>> accessed 13 April 2017; Direct Debt Help, 'Who We Are' (*Direct Debt Help*, 2017) <<http://www.debthelpdirect.co.uk/who-we-are/>> accessed 13 April 2017; and Debt Advice Shop, 'Debt Solutions' (*Debt Advice Shop*, 2017) accessed 13 April 2017.

money – and at a time they can least afford further expenses.<sup>1097</sup> These companies often exploit the vulnerabilities of people who use them, and concerns about their services have been raised by *Which?*,<sup>1098</sup> *Citizens Advice Bureau*<sup>1099</sup> and the OFT.<sup>1100</sup> Providing borrowers in problem debt with private market solutions is not the answer; it merely creates opportunities for business further exploit the vulnerability of these consumers. We should instead institute a government-based solution. Some initial comments can be made here. *StepChange* is a not-for-profit organisation that is already providing advice and assistance to people struggling under the weight of problem debt. The scope of their services, or of other similar not-for-profit organisations, could be extended to include financial control services for people, similar to those offered in the private market. Once people have gone through financial education, akin to a rehabilitation program, they can gradually regain control of their own finances.

The second recommendation is to provide borrowers with increased financial options. The government is currently focusing on reforms to regulate the high-cost credit industry and to provide increased protection. Attention must also be paid to preventing the need for loans in the first place. Consumers should have valuable options, and the government should ensure that there are robust, efficient and widely available alternative credit products for low income consumers. Steps have already been taken in this

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<sup>1097</sup> See analysis (from an Australian perspective) in Greg Hoy, 'Financial counsellors urge caution over new industry offering help for budget difficulties' *ABC News* (Australia, 9 December 2013) <<http://www.abc.net.au/news/2013-12-09/financial-counsellors-urge-caution-over-new-industry-offering-h/5145550>>.

<sup>1098</sup> Which? News, 'Debt management companies exploit the vulnerable, says charity' (*Which?*, 16 September 2011) <<http://www.which.co.uk/news/2011/09/debt-management-companies-exploit-the-vulnerable-says-charity-265956/>> accessed 13 April 2017.

<sup>1099</sup> Citizens Advice Bureau, 'People in debt being 'exploited' by rogue advice companies' (*Citizens Advice Bureau*, 2011) <<http://www.cas.org.uk/news/people-debt-being-exploited-rogue-advice-companies>> accessed 13 April 2017.

<sup>1100</sup> See The Office of Fair Trading, *Debt management guidance compliance review* (Compliance Review: OFT1274, September 2010) and The Office of Fair Trading, 'OFT refuses to licence three debt management companies in ongoing drive to push up standards' (n 331).

direction; the UK has invested £35.6 million into the credit union sector to provide a viable alternative to high-cost loans. It is estimated that this will save consumers almost £1 billion in interest repayments.<sup>1101</sup> In the light of the size of the high-cost credit market and the (understandable) limits of credit unions, the amount of money provided by the government is disproportionate, and further reforms are required. This could include an increased role for *Community Development Finance Institutions*<sup>1102</sup> or reinvigoration of the dismantled *Social Fund*.<sup>1103</sup> Again, lessons can be learnt from the Australia. The country's No-Interest and Low-Interest Lending Schemes provide affordable loans for hundreds of thousands of low-income Australian consumers,<sup>1104</sup> thereby removing their reliance on high-cost credit during their time of need.

The third response is to give consumers more leeway when they suffer temporary financial difficulties. Financially Insecure Borrowers use the funds obtained for everyday expenses and existing financial obligations. A considerable portion of these loans could be resolved by the implementation of financial hardship requirements, which legally require businesses (or other creditors, such as government bodies) to enter into penalty-free repayment plans when consumers suffer temporary financial difficulties. Such programs could easily be instituted for the payment of utilities, council tax and existing financial

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<sup>1101</sup> Association of British Credit Unions, 'Credit union sector set to transform in two years' <<http://www.abcul.org/media-and-research/news/view/334>> accessed 8 March 2013.

<sup>1102</sup> An example of this is the funding that the Australian Government has given to CDFIs. See Department of Families Housing Community Services and Indigenous Affairs, 'Community Development Financial Institutions (CDFI) Pilot Project' <<http://www.fahcsia.gov.au/our-responsibilities/communities-and-vulnerable-people/programs-services/financial-management-program/community-development-financial-institutions-cdfi-pilot-project>> accessed 7 August 2013.

<sup>1103</sup> Information about the April 2013 changes to the Social Fund is available at Citizens Advice Bureau, 'Changes to the Social Fund in England' <[http://www.adviceguide.org.uk/england/benefits\\_e/benefits\\_welfare\\_benefits\\_reform\\_e/changes\\_to\\_the\\_social\\_fund\\_in\\_england.htm](http://www.adviceguide.org.uk/england/benefits_e/benefits_welfare_benefits_reform_e/changes_to_the_social_fund_in_england.htm)> accessed 8 August 2013.

<sup>1104</sup> Whilst no recent figures have been provided for the LILS, over 200,000 Australians have benefited from the NILS: see Good Shepherd Microfinancing, 'What is NILS?' (*NILS: Good Shepherd Microfinancing*, 2017) <<http://nils.com.au/>> accessed 20 April 2017.

obligations. Widespread financial hardship obligations of this nature are already implemented in Australia,<sup>1105</sup> and consumers there can deal directly with the issues causing the need for funds rather than entering into expensive and potentially harmful high-cost credit contracts.

The final suggestion is an increased focus on encouraging low-income consumers to save money, providing them with a financial 'safety net'. The credit needs of Financially Insecure Borrowers show how many consumers do not have sufficient savings to deal with these issues, and therefore turn to credit. This is strongly linked with the shortage of consumer savings and the lack of a 'savings culture' in the UK. As outlined by Packman, 'The UK has a very severe savings problem which becomes particularly problematic for low income households. The issue for many people is not that they aren't saving enough, but that they are not saving at all'.<sup>1106</sup> *Now: Pensions* reports that 28% of people have stopped saving since the recession, 32% of people have less than £500 in savings, and one in five has no savings at all.<sup>1107</sup> Some research has already been conducted on this topic, with *Toynbee Hall* and *J.P. Morgan* producing a 2017 joint report into low-income savings. This report outlined a wide range of recommendations for increasing the savings rates amongst those who have the greatest need.<sup>1108</sup> By encouraging and rewarding low-income consumers to save, we are providing them with a safety net and avoiding the need to access high-cost credit in the first place.

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<sup>1105</sup> See, for example, National Credit Code (Cth), s 72 and Energy Legislation (Hardship, Metering and Other Matters) Act 2006 (Vic).

<sup>1106</sup> Carl Packman, *Savings for the Future: Solving the Savings Puzzle for Low Income Households* (Toynbee Hall and J.P. Morgan 2017) 18.

<sup>1107</sup> Now: Pensions, 'Britain's Savings Culture in Crisis' <<http://www.nowpensions.com/wp-content/uploads/2013/07/Britains-savings-culture-now-pensions.pdf>> accessed 6 October 2013.

<sup>1108</sup> See Packman, *Savings for the Future: Solving the Savings Puzzle for Low Income Households* (n 1106) especially 64-82.

### 6.3: Further Research Necessary

The profile developed provided a new taxonomy of high-cost credit borrowers, and a means to approach the ongoing market issues for these financial products. Further research is, however, needed on a range of topics related to high-cost credit. First, the borrower profile and taxonomy developed was obtained through qualitative empirical research. This should be supported and complemented by further research, including (1) qualitative research with borrowers themselves, and (2) quantitative empirical research to confirm the profiles and provide an idea of the commonality of the different classes. Whilst there is considerable agreement from interviewees about the existence of the borrower classes, there is disagreement between various stakeholders as to the sizes of the different classes and scenarios. Some steps have been taken in this regard,<sup>1109</sup> but more research and consumer engagement are clearly necessary.

Second, we need to understand the impact of the FCA's 2014/2015 reforms on the 160,000 people who are no longer able to access high-cost credit. It has been assumed that these consumers are 'better off' because they are no longer accessing potentially harmful credit products, but there is no evidence either way. In 2013, the PFRC bemoaned the lack of empirical evidence on the overall impact of a cap in the UK.<sup>1110</sup> No research has been conducted since, so our awareness and understanding of the situation has not improved. Until we do, it will be difficult to make evidence-based recommendations on the best way to approach these difficult questions.

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<sup>1109</sup> See the research based on consumer interviews in Rowlingson, Appleyard and Gardner (n 123); Appleyard, Rowlingson and Gardner (n 170); Jodi Gardner, Karen Rowlingson and Lindsey Appleyard, 'Responsible Borrowing and Lending' (International Conference on Trade, Business, Economics and Law, Oxford, 2-4 March 2015). Research of this nature is being undertaken by Appleyard and Packman, Lindsey Appleyard and Carl Packman, *Payday Futures: Sub-Prime Credit Markets in Transition?* (Centre for Business in Society, Toynbee Hall and Barrow Cadbury Trust 2018).

<sup>1110</sup> Personal Finance Research Centre (n 191). This was also supported by Sharon Collard, PFRC (28 March 2013). Telephone interview.

Third, further work is needed to understand the connections between high-cost credit, gambling and mental health. We know there is a major problem with Significantly Impaired Borrowers accessing high-cost credit, but it is unclear how many people are impacted and how the legal and social welfare system could most effectively respond to these challenges. This is, at least partly, the result of a lack of organisational interaction. People on the financial side (lenders, regulators and debt advisors) are aware of the problems associated with mental health and gambling. Those working in the specialist organisations (not-for profit and government organisations, Gambling Commission etc) are aware of the problems associated with high-cost credit. There appears, however, to be limited discussion between the two groups. These bodies need to work together to undertake targeted research on this complicated relationship, further identifying the specifics of the problem as well as potential solutions. Some initial steps have been taken, particularly the excellent initiatives of the *Responsible Gambling Strategy Board*, but there is clearly scope for further work. If this does not happen, it is unlikely that any regulatory proposals will be utilised successfully. For example, if the 'opt out' process discussed above were implemented, support organisations for people with mental health conditions and compulsive gambling would need to be aware of the processes so they could assist their clients to access the service. Significantly Impaired Borrowers present a particularly complex range of challenges; a multi-faceted and multi-party response is therefore needed. In addition, as highlighted in 5.4.3 above, further research on the relationship between lending, privacy and non-discrimination law is required to clarify what information lenders are allowed to ask borrowers during the application process, and what they can do with this information once it is received.

## Conclusion

This chapter concludes the thesis by using the discussion in Chapters 2-4 and application in Chapter 5 to make a range of recommendations. These are not meant to be detailed policies, but are designed to act as guidance for where we should go next to tackle the ongoing problems of high-cost credit. There are three main types of recommendations – law reform, social welfare responses and further research necessary. The fact that law reform recommendations are only one aspect of a multi-pronged approach to these challenges highlights the complex nature of the high-cost credit situation. This thesis has provided a new taxonomy of borrowers, and highlighted the important role of social minimums to the debate. More work is, however, needed to understand the high-cost credit market, and to respond to the needs of the different classes of people using these financial products.

## Overall Conclusion

This thesis has used the challenges currently experienced in the high-cost credit market as a case study highlighting the limits of private law concepts. It has shown how existing contract law principles are insufficient to respond to vulnerable borrowers in desperate need of funds. There are several challenges in the current high-cost credit market. First, people who use these products are too often blamed for their own financial problems. This victim-blaming has occurred throughout history, starting with debtors' prisons and continuing until the present day, where people with financial difficulties are too often the subject of disparaging and offensive commentary in political and media debates on poverty and welfare. Second, there is inadequate engagement in the high-cost credit market. During a time of intense scrutiny, we do not have an accurate understanding of the concepts relevant to high-cost credit, or the needs and circumstances of borrowers. The way to respond to both these challenges is through quality, objective research into the high-cost credit market and the people using these products. The thesis has started to fill this information gap.

This thesis presented three concepts relevant to high-cost credit – freedom, protection and social minimums. The first concept, (negative) freedom, is associated with non-intervention and procedural fairness, including ensuring consent and avoiding exploitation by lenders. There are several explanations why the law takes a negative freedom approach – the importance of consent, human rights approaches, responsabilisation, and the different approaches to financial and physical products. The law related to high-cost credit has a number of examples of negative freedom, including licensing of lenders, disclosure obligations, advertising restrictions, cooling off rights, unfair relationship test, and vitiating factors. Despite the historical explanations for negative freedom, this approach has its limitations, such as the failure of disclosure, lack of meaningful choice and inability to address underlying borrower poverty. Negative freedom therefore does not address the ongoing concerns or underlying unfairness of the

agreement, and allows consumers to continue accessing potentially harmful credit products.

Owing to these failings, many people advocate a movement away from the freedom focus, and instead towards a more protective-based approach to high-cost credit. The second concept, protection, is associated with government intervention. It aims to protect consumers against substantively unfair agreements and coercion arising from lack of choice. Protection has a strong historical basis in the religious prohibition on usury; it aims to prevent harmful outcomes, stop unconscionable conduct, and defend the vulnerable. There are many ways the law on high-cost credit has embraced protection, including prohibition on contract terms, interest rate restrictions, unfair terms legislation, and various common law mechanisms. As high-cost credit borrowers often have restricted financial choices, a protective-based approach also has limitations. The procedural fairness approach of negative freedom can only work if disclosure is effective, and borrowers have meaningful choices. Protection and substantive fairness restrict access to legal credit, creating a risk of financial exclusion and potentially pushing already desperate people to illegal lending. Responding to the fairness of the agreement is not sufficient. The coercion often does not arise from a borrower impairment or the lending environment – the underlying issues are poverty and a lack of affordable credit options.

These concerns are strongly connected with the State's obligation to provide and maintain a social minimum, the third concept. There are many justifications for social minimums, including equality and liberal democracy, government obligations and societal happiness. At the present time, the social minimum is provided through welfare and maintained by bankruptcy relief. The law related to vitiating factors is also beginning to recognise and address social minimum maintenance. Despite the strong justifications, there are some limitations on the utility of social minimums and their ability to address ongoing challenges, including undermining property rights, uncertainty about who is

responsible for the provision of the social minimum, and the potential development of moral hazards.

It is crucial to have an accurate understanding of the high-cost credit market and who is utilising these types of products. The thesis therefore used qualitative empirical research to identify three classes of borrowers – Financially Secure Borrowers, Financially Insecure Borrowers, and Significantly Impaired Borrowers. Each of these classes have different needs, and values the concepts of freedom, protection and social minimums in varying ways. The three classes of borrowers also have different relationships with the current legal approach to high-cost credit. This recognises the heterogeneity of the borrowers, thus appreciating and responding to the lending reality. The final chapter provided a range of recommendations, including further research necessary, law reform suggestions and social welfare proposals. The borrower taxonomy created and overall analysis, whilst specific to the high-cost credit situation, can be applied more broadly. The general philosophical debate on freedom, protection, and social minimums is widely applicable – particularly during a period of austerity and political conservatism. The underlying framework and findings of the thesis therefore have a wider utility, and are relevant to a range of consumer products and financial challenges in our legal system.

If the State wishes to tackle high-cost credit, it must address the links with poverty. The current government is regulating the high-cost credit market but paradoxically at the same time that it is taking steps to reduce the safety net for many vulnerable people. The positive impact of the former is likely to be greatly overshadowed by the negative impact of the latter. We cannot address issues of vulnerable borrowers merely through the lens of private law obligations and contract law rules. This challenge goes much deeper, and raises issues of government obligations to its citizens. The primary obligation of the State should be to promote and protect the *real* autonomy of all people; it should encourage self-authorship, with all people pursuing meaningful goals and

relationships.<sup>1111</sup> This is a richer comprehension of freedom and autonomy. In the context of high-cost credit, the law should move away from the concepts of ‘freedom versus protection’ or ‘procedural versus substantive fairness’. Instead, we need to look for a richer, more meaningful concept of autonomy, yielding a social welfare system that allows people to pursue a good life.<sup>1112</sup>

The recent collapse of the notorious high cost credit loan company Wonga has been met with mixed responses. Before we celebrate the death of Wonga and dance on the company’s metaphorical grave, we – as a society – need to ask ourselves a few hard questions. That company, whilst flawed and based on an exploitative business model, was only allowed to thrive because of an inadequate legal regime, the desperate need of financially excluded borrowers, the lack of adequate social minimum maintenance, and austerity measures. The powerful combination of these factors sent millions of people into the arms of commercial high-cost credit providers, including Wonga. It is quite possible however that many of Wonga’s clients will be worse off without access to the company’s very expensive products. If we actually care about the welfare of these individuals, we must ensure that their basic needs are met without resorting to potentially harmful credit. Until this is acknowledged and addressed, history will repeat itself – the demand for high-cost credit will continue, a new company will rise, phoenix-like, from Wonga’s ashes, and the market will remain an ongoing source of regulatory frustration and failure.

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<sup>1111</sup> Raz, *The Morality of Freedom* (n 203) 416.

<sup>1112</sup> This concept is discussed in a range of sources; Chen-Wishart, ‘The Nature of Vitiating Factors in Contract’ (n 232); Raz, ‘Promises in Morality and Law’ (n 916); Chen-Wishart, ‘In Defence of Consideration’ (n 903).

## Appendix 1: Table of Interview Responses

Scenarios	Using payday loans for discretionary expenses	Using payday loans on a once-off basis	Using payday loans for essential purposes (rent, bills, food)	Using payday loans to repay existing financial obligations	People with mental health conditions accessing payday loans	People with gambling addictions accessing payday loans	Other scenarios where payday loans are used
<b>Researchers</b>							
<b>Researcher at a University-based Research Centre</b>	Young people usually using online lending for discretionary spending. Eight years ago a major group, but it is now decreasing.	Not discussed.	Increasing scenario due to the economic downturn and reduction in Welfare State. People in this scenario are usually showing signs of financial distress.	These borrowers are already in financial stress. Loans of this type result in a 'debt spiral'.	No specific research links, but strong links with general debt.	Research shows strong link between debt and gambling. Increasing concerns about online gambling and online lending.	General concerns about lead generators and lack of regulation.
<b>Researcher at various Centres</b>	People who use payday loans appropriately and responsibly and have personal reasons for wanting to use high-cost credit, usually only irregularly.		Borrowers are desperate, locked in and have a lack of information or understanding; payday lending ' <i>becomes a way of life for many people</i> '.		Not discussed.	Not discussed.	Nil.
<b>Researcher at Think Tank</b>	This has nothing to do with vulnerability, but is related to how	For example, appliance repairs.	Borrowers who urgently need money to pay	People who have 'maxed out' existing mainstream credit	Not discussed.	Not discussed.	People who have some decrease in income causing

	loans are marketed. Students and younger people use the service because it is a convenient way to get large sums of money quickly.		general bills, usually utility bills.	options, and therefore need payday loans to cover interest on previous loans.			financial difficulties to such an extent that they cannot access mainstream credit.
<b>Researcher at a University-based Research Centre</b>	Not discussed.	Usually related to an unexpected expense.	Payday loans can be the only choice of credit for everyday expenses for vulnerable people who are overstretched.	Not discussed.	The links go both ways and it is hard to see what the direct causal effect is.	Has not come across any links but there is significant research on the links between general debt and gambling problems.	Nil.
<b>Consumer Advocates</b>							
<b>Consumer Advocate</b>	Not discussed.	Using payday loans in a ' <i>quick and easy</i> ' manner.	Separated on the basis of (a) previous borrowing from mainstream credit and (b) previous borrowing from family and friends.	Discussion with ex-lender who expressed concerns about lending to people with capacity issues.	Heard stories of people with gambling addictions accessing payday loans for gambling.		Nil.

<p><b>Consumer Advocate &amp; Author</b></p>	<p>Not discussed.</p>	<p>Not discussed.</p>	<p>Two categories: (a) People needing large amounts of money for rent/mortgage/bills</p> <p>(b) People needing smaller amounts of money for immediate needs.</p>	<p>People get into 'debt spiral' – provided case examples.</p>	<p>General concerns about lending to people who may not have adequate capacity.</p>	<p>Not discussed.</p>	<p>Nil.</p>
<p><b>Consumer Advocate</b></p>	<p>Not discussed.</p>	<p>When borrower has a financial shock that cannot be absorbed into income stream, no savings and they urgently need to access funds.</p>	<p>Payday loans become part of the individual's routine, there are multiple loans with different lenders and life involves '<u>ducking and diving</u>' to make ends meet.</p>	<p>Not discussed.</p>	<p>Not discussed.</p>	<p>Concerned with increasing numbers of betting shops in small, poor communities often close to payday lending outlets. '<u>It is a very profitable business when directed at desperate people with a high risk of being tempted into gambling</u>'.</p>	<p>Borrowers self-excluded from mainstream lenders – for example, they do not have a bank account or trust banks.</p>

<b>Consumer Advocate</b>	Not discussed.	Obtaining loans for unexpected expenses – ie something breaks, unexpected bills.	Increasing use in this way. <i>'People are in a desperate situation – the ends just don't meet'</i> .	Provided two relevant case studies.	Provided a relevant case study.	Provided a relevant case study.	Increasing problem of borrowing money from family and friends.
<b>Debt Advisors</b>							
<b>Debt Advisor</b>	Not dealing with these categories of borrowers.	Generally these borrowers have a sudden drop in income – losing job, redundancy, sick, divorce, losing overtime etc.	Borrowers are struggling with very low incomes for long periods, often people on benefits or tax credits. Payday loans <i>'are easy to obtain and people can get sucked in ... they might think it is bailing them out but it is actually escalating the problem'</i> .	There is a large body of research on this connection. Debt advisors have witnessed this issue but do not have the ability to explicitly record it.	There is a body of research showing the connections between debt and mental health issue.	Nil.	
<b>Debt Advisor</b>	Not discussed.	People in a difficult financial place, have	People already in considerable trouble and using payday	These people <i>'are in perpetual loans</i>	There is significant qualitative evidence on the link and there	There is anecdotal evidence of a link.	Nil.

		significant debts and are ' <u>cash hungry</u> '. .	loans to make ends meet. ' <u>These people think that accessing payday loans will generally help the situation, but it almost inevitably makes it worse – it is like throwing petrol onto a fire to put it out</u> '.	<u>due to credit difficulties</u> '.	is evidence of payday borrowers with capacity issues.		
<b>Debt Advisor</b>	Increase in loans through 'apps'; tend to be younger people who have access to technology.	Not discussed.	Not discussed.	People get into a 'debt spiral' and may use payday loans for existing financial obligations.	It is hard to measure as most people do not disclose this information and all clients suffer from some level of stress.	Clients include people recovering from addictions, including gambling. They are getting back on their feet. Due to privacy, it is difficult to determine number of people affected.	People in a relationship breakdown or who have lost their job.

<b>Debt Advisor</b>	10-11% of clients use funds for discretionary purposes.	34% of clients use funds for household emergencies.	38% of clients use funds for household essentials; 32% of clients use funds for regular household bills; 20% of clients use funds for rent or mortgage payments.	24% of clients use funds for existing credit obligations. This group is 'low income in crisis' and have given up trying to service their existing debts, often borrowing from family and friends.	Not on survey and therefore no focus group information.	Not on survey, but there was a recent round-table on whether to ban payday lenders from operating close to gambling venues.	Broke up payday loan users into seven different categories based on income levels and coping abilities.
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<b>Lenders / Trade Associations</b>							
<b>Lender Trade Association</b>	Young people and technology, generally using funds for discretionary purposes to supplement inconsistent income.	The most important basis for loans - people need access to credit for unexpected, once-off financial needs.	Showed concerns about financial exclusion for these people if payday loans were not available.	ILG should prevent these people from accessing loans.	Covered by the Code of Practice.	Not discussed.	Nil.
<b>Lender</b>	For example, if there was a 'flash sale' and it is cheaper to get a loan and buy the item on sale.	In tough economic times there is increasing use of payday loans in this manner.	Not discussed.	Lending of this type is not allowed and should not be occurring.	This may be a problem but unsure of what the lender does in this regard, there is no specific question to borrowers.	Not discussed.	There is a wide variety of reasons and we should not assume borrowers are ignorant or misinformed, payday borrowing can be a completely reasonable course of action.

<b>Lender Trade Association</b>	<i>'It is a cultural thing. Young people like new products; their social interactions are increasingly online, so it makes sense that their financial requirements would move this way. There is also a generational focus on 'instant gratification'.</i>	People who have financial stress, no bank account but a good salary. They have adapted their standard of living to their income but need quick access to cash.	Not discussed.	Not discussed.	Not discussed.	Not discussed.	<i>'We must regulate for the lowest common denominator, but must also recognise that it is a broad, more varied market'.</i>
<b>Lender</b>	A very common situation, people want to make a large discretionary purchase but do not have the funds.	The primary use of funds ie car/appliance repair, health needs etc. - expenses <i>'which are quite practical'</i> . They have never come across anything 'frivolous'.	Very few customers access loans for everyday expenses, primarily for one-off unexpected expenses.	The software program used would not allow this type of lending.	Covered by the lender's Code of Conduct.	Not discussed.	Nil.

Consumer Lawyers							
<b>Consumer Lawyer</b>	Not discussed.	Not discussed.	Concerns about the crippling cost of mainstream banking fees.	Not discussed.	Had seen this connection in theory and practice.	Not discussed.	A large portion of clients were Muslim and borrowed from family/friends, not commercial lending.
<b>Consumer Lawyer</b>	Have noticed an increase in young single men aged 25-34 using payday loans, largely through increased use of technology. Lenders are marketing using the internet, smart phones, 'apps' etc.	Not standard circumstances of clients.	A large number of people take out payday loans for general living expenses.	People take out a loan for emergency expenses, including paying existing financial expenses.	Frequently hear stories of people with mental health conditions obtaining large inappropriate loans, therefore <i>'would not be surprised'</i> if this link also existed with payday loans.	Do not see a big link, however there are concerns about the number of gambling venues in close proximity to payday lenders.	People who take payday loans are generally on very low incomes or benefits.
<b>Consumer Lawyer</b>	Not discussed.	Some clients were just managing financially, but any unexpected	Payday loans are used for a range of things, including general household expenses.	Not discussed.	There is <i>'very much'</i> a link. A large number of people do not understand the credit contract	Has seen a couple of cases of gambling addicts using the funds for their addiction.	Nil.

		expenditure pushes them <i>'over the edge'</i> .			and are vulnerable with reduced capacity.		
<b>Consumer Lawyer</b>	People who want to buy a luxury item but do not have the funds.	People suffering a financial shock or unexpected expenses arising.	An unexpected financial burden associated with everyday expenditures.	Not discussed.	Not discussed.	Not discussed.	There is a general lack of research identifying the characteristics of payday borrowers.
<b>Government Parties</b>							
<b>Policy Advisor</b>	Young people use loans for discretionary purchases, they tend to be on lower wages and need money on a once-off basis.		People need loans on a regular basis and do not have access to alternative, mainstream credit.		Problems with payday loans also run into other areas, including mental health.	Not discussed.	Nil.
<b>Regulator</b>	Some people find it easy and convenient, particularly for online transactions	Used by people who experience unexpected financial shocks, for example,	Increasing numbers of people are not just using payday loans for temporary one-off issues, <i>'it has become a way of life'</i> and they need it to get through the month's usual expenses.		Not discussed.	Not discussed.	The regulator did not undertake consumer surveys - only

	and younger borrowers.	unplanned or larger than expected bills.					anecdotal evidence available.
<b>Member of Parliament</b>	Did not see any evidence of this – why would people pay high interest if they did not have to?	People are <i>'on the margins'</i> and any small event can tip them over the edge. These are small expenses, but the borrowers have no savings to cushion the blow.		This sees borrowers going into a 'debt spiral'.	Large numbers of borrowers are obviously suffering from low level depression due to financial difficulties.	Saw a number of people who had obtained loans for gambling addictions. If the lenders had conducted affordability assessments, they should have picked up the issue and not provided the loan.	The situation will become worse as access to the Social Fund decreases.
<b>Parliamentary Assistant</b>	Not discussed.	The use of payday loans used to be mainly associated with an unexpected income decrease or expenses increase, but this	Cost of living means that people have increasingly turned to payday loans to cover the gap.	Increasing use in this scenario.	Not discussed.	Did not see much evidence of this.	Nil.

		scenario is decreasing.					
<b>Other</b>							
<b>Credit Referencing Agency</b>	Some people use loans because they want quick, convenient credit without long-term implications. These people may have savings and overdraft facilities. They are making an educated decision as payday loans are 'short-term' debt, whereas other products are 'long-term'.		These people generally have no savings and are using loans as a last resort. They cannot get mainstream credit, are financially struggling and probably should not be given credit. If payday lenders were being responsible, these borrowers should be turned away.		Not discussed.	Not discussed.	Recognised that <i>'there is a kaleidoscope of people accessing payday lending products'</i> .
<b>Credit Union</b>	Not discussed.	Incomes have stagnated and the cost of living is consistently increasing, people are using loans for any reasonably large costs they incur, such as rent or unexpected bills.	Often relevant for people on low fixed incomes, including benefits. These people have little or no savings and are very vulnerable to small financial shocks.	Borrowers are in an untenable financial situation, payday loans are the 'last resort' when the debts become unmanageable.	Not discussed.	Not discussed.	Since the sub-prime crisis, lenders have become more risk adverse and more people need access to including payday loans.

## Appendix 2: Interview Questions

### Interview Questions for all Interviewees

*Main question (sent to interviewee for consideration prior to interview)*

- 1) In your experience what are the five most common scenarios where people use payday loans?

*Questions related to each lending scenario*

- 1) Do people in this particular situation frequently end up in bankruptcy or a formal debt agreement (as opposed to an informal payment arrangement or hardship variation)? If so, how frequently?
- 2) What legal protection is available for borrowers in these situations?
- 3) Do you believe that this legal protection is adequate? If not, what additional protection should be provided to the borrower?
- 4) Do you think, in circumstances such as these, that the lenders or their agents engage in appropriate lending and responsible lending practices? If not, what concerns do you have about the practices?
- 5) In your experience, how frequently do people in this particular situation engage a financial counsellor and/or legal advice to assist? Do you think that these professionals were able to help?

*General Questions*

- 1) In your experience, do debtors read the lending contract they enter into with the creditor? If so, what do they generally understand of these loans?
- 2) Where do you think the balance should lie between protecting consumers and allowing people the right to enter into contracts of their choosing?

### Interview Questions Specific to Interviewee

- 1) When you become aware that clients are in financial difficulties, what, if any, steps do you take to provide assistance? (Consumer Lawyer, Debt Advisor, Lender, Trade Association)
- 2) In your experience, what are the main reasons that people access their credit report and score? (Credit Reporting Agency)
- 3) What role do Credit Unions have in providing people who may have to resort to high cost credit with access to finance? (Credit Union)
- 4) How do you envision the new FCA regulatory regime? (Various)

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