A Thematic Evaluation of the Law's Response to Access to Credit and Debtor Financial Relief

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Abstract

This Introduction to the Special Issues uses the materials presented in the articles contained therein to demonstrate some of more philosophical challenges for legal change. Importantly too, this essay asserts that whilst finding principle is difficult, there is much, though within socio-cultural limits, to be gained in a pragmatic solution. At the heart of the issue of financial inclusion which might be said also to allow for second chances in personal insolvency is a socio-cultural issue. The issue of balancing access to credit and finance with the need perceived by some cultures as the ill of over-indebtedness. Comparative law thus sheds light on how different jurisdictions attempt that delicate tight rope.

Keywords: Financial inclusion; Personal Insolvency; small and micro-enterprises; insolvency reorganisation and restructuring; abusive lending; legal pragmatism

The context

At the core of the research undertaken in this Special Issue is the question as to how the law should view indebtedness. Even the terminologies employed are loaded. Terms like access to credit or financial inclusion are intended to evoke something warm, good and positive in borrowing. The other side of the [in]equation though are terms like "indebtedness", "responsible borrowing", "abusive lending" and "bankruptcy" which are intended to convey a less than salubrious notion of borrowing. Getting the balance right is perhaps an ever-frustrating pursuit conceptually but trying to get the balance right or close to right is necessary in the light of the cost-of-living crisis and the plight of many mired in poverty. It is a global human condition; financial impoverishment impacts people from developed or developing countries alike. Only the magnitude is different.

Small and micro enterprises, including sole traders, need financing for their enterprises. It is also important to observe that in many developing countries, there is little distinction between the micro-trader and the consumer debtor. Many impoverished consumers, whether they are employed or not in the traditional sense, would either be selling services or goods as a side

line economic activity[1] or be working in the gig economy[2] where their status is not always treated as that of an employee.

Traditional financing or creditworthiness testing has made it difficult for such traders successfully to gain access to much needed creditso. Indeed, there is a huge amount of research[3] attesting to this proposition. Influential international recognition of such a proposition has too resulted in highly ambitious development projects supporting microfinancing and similar schemes.[4] That initial phase beginning from the early 2000s was largely about enabling access and challenging banks and financial institutions to re-think their creditworthiness testing. Easy access of course does not mean responsible lending. Angus Young & Meihui Zhang show in their article on the largely *laissez-faire* system of moneylending in Hong Kong could be abused by unscrupulous lender to exploit the unwary into over-indebtedness or unfair credit terms.[5]

This Special Issue of the Journal of International and Comparative Law turns also to a more recent legal challenge: How the insolvency related laws of a country might frustrate the good intentions of microfinancing. After all, many micro or small enterprises do fail. The majority of the research articles in this Special Issue turn their attention thus to how insolvency and restructuring laws might be re-evaluated to ensure that micro or small enterprises live to fight another day, so to say. That is the other aspect of financial inclusion. It might be noted too that that would include the general insolvency law applicable to the "consumer", including the so-called "no income no asset" consumer detailed in Shammah G. Boterere and André Boraine's article[6].

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[1] See too Angus Young and Meihui Zhang, "Regulating Subprime Lending in Hong Kong and the Need for Law Reforms to Better Protect Vulnerable Consumers" (2023) 10:2 Journal of International and Comparative Law XXX.

[2] See generally Geremias Prassl, *Humans as a service: The promise and perils of work in the gig economy* (Oxford University Press, 2018); also Andy Hira and Katherine Reilly, "The emergence of the sharing economy: Implications for development" (2017) 33:2 *Journal of Developing Societies* 175-190; Tawanna R Dillahunt Amelia R Malone, "The promise of the sharing economy among disadvantaged communities" in *CHI 2015: Proceedings of the 33rd annual ACM conference on human factors in computing systems* 2285–2294.

[3] There is no space to reproduce the full references supporting such research. A good review of the early literature might be had in James C Brau and Gary M Woller, "Microfinance: A Comprehensive Review of the Existing Literature" (2004) 9:1 *Journal of Entrepreneurial Finance and Business Ventures* 1-28.

[4] International development agencies and organisations are clearly committed to microfinancing – see for example the Asian Development Bank (https://www.adb.org/what-we-do/topics/finance), OECD (

[5] Angus Young and Meihui Zhan, "Regulating Subprime Lending in Hong Kong" (n 1).

[6] See Shammah G. Boterere and André Boraine "'Much Ado about Nothing'? The Historical Journey Towards Financial Inclusion for Zimbabwe's Low Earning Consumers" (2023) 10:2 Journal of International and Comparative Law XXX

The shaping of the law, as has been demonstrated in the articles produced for this Special Issue, is *thus* about the law enabling individuals and small or micro enterprises obtain much needed financing for their livelihoods but also empowering them to survive insolvencies. Surviving insolvencies however as pointed out by Shammah G. Boterere and André Boraine should also be properly regulated to ensure that impoverished consumers do not become over-indebted. Financial inclusion, in more developed economies, will entail the provision of a safety net for those who have fallen into financing arrears because of hardship. For example, the law would require financial institutions to vary the terms of the credit agreement where the consumer finds themselves in hardship or utility companies to provide a minimum level of service even when the consumer's account is in arrears. In that context it is important for there to be clarity as to what the law means by "hardship" for the triggering of the safety net. Gail Pearson's[7] article points out how difficult it is for the courts to apply general principles of hardship (even where these are to said to exist in the frame of the common law) to ensure a base level of service for the indebted consumer or micro-small enterprise[8] whilst ensuring that they do not fall into the trap of over-indebtedness.

Ensuring a fair balance between the avoidance of over-indebtedness and access to continued financing or credit (as in the context of Gail Pearson's article), restructure or reorganise one's micro enterprise is a hard question. There are several potential approaches to striking the balance between credit access and responsible debt, it is suggested.

A Matter of Principles

This essay seeks to set the debate against the backdrop of several key principles.

A first principle is that all these different legal and regulatory provisions are interrelated and must thus be considered holistically. That essentially means that an evaluation of commercial insolvency rules *should not* be made without reference to rules on credit offerings, safety nets for defaulting debtors, unfair credit agreements, shadow lending, guarantees, security or collateral, and information transparency. The list is not exhaustive and is not intended to be so.

The articles published in this Special Issue demonstrate to a powerful extent that financial inclusion as a social or societal good cannot be dealt in discrete pockets of legislative (or judicial) activity. Although this might appear trite, Michelle Kelly-Louw's article clearly demonstrates that where there is legally a liberty to offer reckless lending, that in turn could well encourage less than circumspect suretyship by smaller participants, such as one family member guaranteeing for another. The network effect of one default would cause a troubling impact on the entire small and micro enterprise ecosystem. In countries which depend heavily on the small and micro enterprise sector, such as South Africa, the jurisdiction under study by

[7] Gail Pearson, "The Principle of Hardship: A Private-Public Partnership to Obtaining Credit and Managing Debt" (2023) 10:2 Journal of International and Comparative Law XXX

[8] In *Permanent Custodians Limited v Carolyn Joy Upston* [2007] NSWSC 223 cited by Gail Pearson (n 7), the hardship ground was used by a micro enterprise to vary the terms of the credit agreement.

Michelle Kelly-Louw, that effectively could devastate large communities socially and economically.[9]

A second principle is that modernisation of insolvency and restructuring laws is vital where emerging economies seek to enable better financial inclusion. Often insolvency law is designed or reformed with a view to ensuring that failed or failing entities and persons can exit the market in an orderly manner.[10] Less frequently, at least broadly speaking, does financial inclusion feature in the design apparatus. It is this aspect, which I venture to suggest is partly why Jason Kilborn found Kazakhstan's new personal insolvency wanting. Kilborn writes that "… individual entrepreneurs in Kazakhstan have no pathway to discharge of their unserviceable debts. … Excluding individual entrepreneurs from discharge relief undermines one of the principal purposes of personal insolvency—encouraging entrepreneurship and risk-taking for the benefit of society."[11]

No pathway to discharging their debts is clearly an extreme but there are other provisions which promote financial exclusion which should also be reviewed in any system of insolvency law. For example, if the law prohibits the individual from re-establishing their business over the course of an unduly long period of time or places high-cost barriers in the way of the individual from re-entering the market, the individual is essentially excluded from rejoining the market.

The insolvency regime in the United Kingdom generally entails *relatively* low personal costs to failed entrepreneurs and barriers to restructuring, and it contains a number of provisions to aid prevention and streamlining[12]. In other less forgiving countries, a considerable period of time to discharge is set by law – such that failed entrepreneurs have to wait five or more years before starting another business, compared to just one year in the United Kingdom[13]. In the EU, under the EU Preventive Restructuring Directive[14], debtors can now obtain a full

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[9] Michelle Kelly-Louw, "South African Micro-, Small- and Medium-Sized Enterprises (MSMEs): Challenges in Accessing Microcredit and the Need for Microcredit Legislation" (2023) 10:2 Journal of International and Comparative Law XXX

[10] M McGowan and D. Andrews, "Design of Insolvency Regimes across Countries" (OECD Economics Working Papers No 1504, ECO/WKP (2018) 52), Para 5.

[11] Jason J. Kilborn, "Not) Following the Leader in the Newest Personal Insolvency Laws in Uzbekistan and Kazakhstan" (2023) 10:2 Journal of International and Comparative Law XXX, xxxx.

[12] M McGowan and D. Andrews, "Design of Insolvency Regimes across Countries" (n 10), Para 3.

[13] S 279(1) Insolvency Act 1986 (UK)

[14] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132. This is discussed in Francesca Burigo, David C Ehmke and Eugenio Vaccari, "MSMEs in Distress: Regulatory Costs and Efficiency Considerations in the Implementation of Preventive Restructuring Mechanisms: An Anglo-German-Italian Perspective" (2023) 10:2 Journal of International and Comparative Law XXX.

discharge of their debts within three years of the end of the bankruptcy procedure. Whilst perhaps not quite as stark as post-Brexit UK, it radically changes many of the then rather conservative and restrictive systems in a good number of EU Member States.

Post discharge borrowing should therefore be permitted and at a reasonable cost. There are, even worse, countries which impose an indefinite stay on assets on the failed entrepreneur such that they are unable to acquire and own assets freely. This is an unmitigated restriction on re-starting their business.

The financial inclusion dimension of insolvency law must therefore also take into account the ease of restructuring. Barriers to restructuring include the prohibition on creditors to initiate restructuring, denial of any priority to be given to new financing over unsecured creditors, a lack of early warning mechanisms, pre-insolvency regimes and special insolvency procedures for small and micro enterprises. Francesco Burigo, David Ehmke and Eugenio Vacarri[15] point out that some countries have clearly gone the way to ensuring that micro, small and medium-sized enterprises are afforded special insolvency procedures – such as the UK, Ireland and Australia. In many of these jurisdictions the availability of special procedures for small and micro-enterprises is justified in the main by pragmatism. The principal argument is that insolvency is expensive and cumbersome and small and micro-enterprises, put simply, are unable to afford the luxury of initiating insolvency proceedings[16], so necessary if reorganisation is needed.

There is however a flip side. It has also been pointed out that small and micro-enterprises too have a preponderance for high risk taking[17]. The question for policy makers is how to ensure that entrepreneurism does not spiral into irresponsible risk taking, with the attendant negative impact on creditors and investors. In the long run, too, investors will stay away if excessive risk taking is not properly bridled. It might be observed that international recommendations for financial inclusion and second chances at entrepreneurship such as the UNCITRAL Legislative Recommendations on Insolvency of Micro- and Small Enterprises 2021 do recognise the need to place certain constraints on the debtor.[18]

A third principle, as Burigo, Ehmke and Vaccari are astute to acknowledge, is that no "one-size-fits-all" solution is necessary or preferable. Insolvency laws are the creature of a country's social and legal culture and any reform must necessarily work in a manner consistent with that cultural legacy. On this, Dan WEI and Zhe Ma[19], in commenting on the relatively recent introduction of personal insolvency law in Shenzhen in the People's

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[15] Francesca Burigo, David C Ehmke and Eugenio Vaccari, "MSMEs in Distress: Regulatory Costs and Efficiency Considerations in the Implementation of Preventive Restructuring Mechanisms: An Anglo-German-Italian Perspective" (2023) 10:2 Journal of International and Comparative Law XXX.

[16] A Gurrea-Martínez, Implementing an insolvency framework for micro and small firms (2021) 30:S1 *International Insolvency Review* S46–S66

[17] *Ibid*.

[18] Available at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/part_5_en.pdf

[19] Dan WEI and Zhe MA, "Towards a Chinese Approach of Personal Bankruptcy Discharge: From Shenzhen Experience to National Legislation" (2023) 10:2 Journal of International and Comparative Law XXX.

Republic of China (PRC), remind us that in the PRC a personal insolvency law was not deemed necessary when the country was predominantly an agrarian economy. When the country subscribed to Mao's communism as a form of political economy, there too was not felt to be the societal need for personal insolvency. After all, the state was the main provider. Even following the advent of "Deng Xiaoping Theory" and the PRC market was opened up, insolvency law[20] was introduced in the main to provide for corporations. Consequently, Regulations of Shenzhen Special Economic Zone on Personal Bankruptcy [21] examined by Dan WEI and Zhe MA is so important. It paved the way for the introduction, for the very first time, of personal insolvency law into one part of the PRC, where previously it had been left mainly to the creativity of courts and government officials to provide for the protection of creditor and debtor when the debtor defaults. As the two authors argue the personal bankruptcy law of the Shenzhen administrative region provides a useful model for national legislation as China has modernised laws on its social credit system and personal property.

Although not specifically addressed by the two authors, it is reasoned that any personal insolvency system which relies on the courts and government officials is not only laborious and potentially costly (since it involves resorting to different agencies) the outcomes cannot be said to be rule based. A rule-based system is crucial to ensuring consistency in decision making thus ensuring an orderly exit by the insolvent.

At the other side of the globe, we see some deference paid in the new Brazilian reforms to using informal resolution mechanisms. Unlike the Australian system as analysed by Gail Pearson,[22] the Brazilian system whilst recognising the notion of hardship to make special allowance for the indebted consumer like their Australian counterpart, adopts a more informal conciliation scheme to facilitate an agreement between creditor and debtor as to the most appropriate variations to be made to the credit terms. Claudia Lima Marques and Káren Rick Danilevicz Bertoncello show how the compulsory procedure places great emphasis on good faith and the need to reach a solution.[23] Moreover, to this commentator, the dispensing of lawyers at this conciliation phase is especially apposite. Clearly the Brazilian legislators saw this compulsory but informal and non-formalist resolution when the debtor has fallen into arrears and has encountered financial hardship is desirable.

A fourth principle, often highlighted, is that the converse of credit access is the debt trap. Options discussed in the range of articles in this Special Issue include (a) setting caps on interest rates (b) active discouraging of debt, such as in Singapore[24] (c) compulsory financial literacy education funded by lenders (d) rigorous credit scoring (e) better transparent credit terms (f) proscription on extortionate contracts (g) lenders licensing system based on criteria related to responsible lending. There is naturally some divide in cultural conviction about the role of debt – some countries are more ready to deem debt negatively, and to associate it with

[20] Enterprise Bankruptcy Law of 2006.
[21] Regulations of Shenzhen Special Economic Zone on Personal Bankruptcy. http://sf.sz.gov.cn/xxgk/xxgkml/zcfg/content/post_8586018.html
[22] Gail Pearson, "The Principle of Hardship" (n 7).
[23] Claudia Lima Marques and Káren Rick Danilevicz Bertoncello, "Consumer Credit and Over-indebtedness in Brazil: The Response of the 2021 Reform of the 1990 Brazilian Consumer Code" (2023) 10:2 Journal of International and Comparative Law XXX.
[24] Angus Young and Meihui Zhang, "Regulating Subprime Lending in Hong Kong" (n 1).

moral decrepitude whilst others see debt as a necessity for economic growth. There are of course two other moral questions – the moral obligation to repay one's debts and the moral obligation to forgive a debt. These are certainly highly problematic questions to be considered by policymakers. However, it might be pointed out that these propositions are not always binary. The upholding of one does not necessitate the derogation of the other. There is of course also the fact that finance, whether offered to small and micro enterprises, is globalised. One state's disinclination to encourage indebtedness of its people cannot ultimately be a matter for its own lawmakers. Finance providers are investors and will head where the credit market is more liberal. Closed markets will of course have to pay the price necessarily to insulate themselves from liberal credit.

Finally, although not quite a principle to guide legal change, it is important for lawmakers and policymakers to acknowledge the personal psychological attributes. Although in this article we have often used micro and small enterprises as shorthand, there are human beings behind them. Personal insolvency and credit access laws deal with natural persons, not merely legal or juristic persons. On that front, it rather begs the question as to what extent does the law need to recognise human psychological foibles and inclinations. The article on Hong Kong by Angus Young and Meihui Zhang is especially noteworthy.[25] Young and Zhang raise the problem of abusive practices in moneylending. Whilst it is reasonably clear that failure to meet creditworthiness criteria is one reason for consumers to rely on "loan sharks", it is also worth exploring empirically whether there are other socio-cultural factors for consumers to turn to such forms of borrowing despite a high level of financial awareness in Hong Kong. Such consumers cannot be said to suffer from any informational asymmetry – there is enough in the Hong Kong general and popular media for most to be aware of the harsh credit terms imposed by loan sharks. On this matter, the question as to whether a term is unfair or extortionate must surely come into the equation. As Young and Zhang demonstrate the English courts are slow to use consumer vulnerability as a test as to whether a credit agreement or term is extortionate or not, preferring a more objective approach. It is thus open whether credit terms, especially those offered to consumers and, small and micro enterprises, should be assessed more subjectively in the context of the specific cultural nuances in Hong Kong.

The way forward

The matter of access to credit or financial inclusion is not merely to be evaluated from a front end – whereby the legal or regulatory system merely seeks to create better access. The back end as to the extent the debtor is allowed to exit the market through personal or corporate[26]

[25] Angus Young and Meihui Zhan, "Regulating Subprime Lending in Hong Kong" (n 1).
[26] In the case of small and micro enterprises which have been incorporated. As to whether such enterprises should be incorporated in the first place must necessarily have to be the subject for examination elsewhere. A brief note, see Graham Beaver and Peter Jennings. "Editorial overview: Small business, entrepreneurship and enterprise development" (2000) 9:7 *Strategic Change* 397. For more detailed analysis, see Eden S Blair and Tanya M Marcum "Heed Our Advice: Exploring How Professionals Guide Small Business Owners in Start-Up Entity Choice" (2015) 53:1 *Journal of Small Business Management* 249; Indu Khurana e al., "Institutions, entrepreneurial adaptation, and the legal form of the organization"(2020) 10:2 *Journal of Entrepreneurship and Public Policy* 261; Sandra

insolvency is equally relevant. The articles appearing in this Special Issue clearly establish that the legal and regulatory system must tackle the issues at both ends of the spectrum. However, as is also amply demonstrated in this Issue, there is a policy or perhaps, more controversially, socio-cultural dimension: That is the matter of whether policy seeks to amplify creditor's duty or debtor's responsibility. On the issue of access, the articles in this Special issue are clearly in favour of imposing on the creditor a greater degree responsibility for ensuring that the debtor is not abused. What is less clear is how the country or jurisdiction in question should also hold the debtor to account. There are obviously systems which continue to see not getting into debt as a virtue – as Benjamin Franklin said "he that goes a borrowing goes a sorrowing". In this context, such a "virtue" could be preserved or enforced by law on the basis of a natural law theory of morality. Naturally, there is a view especially in the Westthat law should be removed from *the* or *a* moral justification. At the end, one might venture to suggest that systems of law such as Sharia have sometimes been characterised not merely as "law" but something wider[27].

The law in regulating financial access is asked to weigh up the balance between borrowing for necessities and borrowing for entrepreneurial risk taking. More modern thinking and research do bend towards the growing belief that entrepreneurial risk taking by small and micro enterprises is a means out of the poverty trap for many. The works in this Special Issue must thus deal with this tussle in their own special way – at the heart of comparative law analyses is always the legal culture.[28]

Similar and comparable value-driven considerations apply at the back end too. As to the issue of insolvency or default, as early as the 1970's that was an issue identified in the US by the Commission on the Bankruptcy Laws set up to analyse, evaluate, and redraft the US

Malach, Peter Robinson & Tannis Radcliffe, "Differentiating Legal Issues by Business Type", (2006) 44:4 Journal of Small Business Management 563.

[27] As Morison J commented in *Beximco Pharmaceuticals Ltd & Ors v Shamil Bank of Bahrain EC* [2003] EWHC 2118: "the principles of the Sharia are not simply principles of law but principles which apply to other aspects of life and behaviour" (at para 53). It should of course be observed that comment is not uncontroversial. See Jason C T Chuah, "Islamic Principles Governing International Trade Financing Instruments: A Study of the *Morabaha* in English Law" (2006) 27:1 Northwestern Journal of International Law and Business 137.

[28] See generally Roger Cotterrell, "Comparative Law and Legal Culture" in Mathias Reimann and Reinhard Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2nd edn, Oxford Handbooks, 2019). Roger Cotterrell's chapter is aptly summarised in its abstract: "The idea of legal culture has had an important place in major recent debates about the nature and aims of comparative law. The idea of legal culture entails that law should be treated as embedded in a broader culture of some kind. This culture may, but need not necessarily, be seen as wider than the lawyer's or lawmaker's professional realm of law. Often, however, conceptions of legal culture encompass much more than this professional juristic realm. They refer to a more general consciousness or experience of law that is widely shared by those who inhabit a particular legal environment, for example, a particular region, nation, or group of nations. Culture appears fundamental—a kind of lens through which all aspects of law must be perceived, or a gateway of understanding through which every comparatist must pass so as to have any genuine access to the meaning of foreign law."

Bankruptcy Act[29]. The commission was to include in its study a report on the *philosophy* of bankruptcy. That report found unequivocally that there was a lack "of either an articulated or widely accepted policy that explains and justifies the bankruptcy process".[30] Fast forward to the 21st century and several reforms to insolvency law globally, the matter of the tension prevails. Like alluded earlier, most states do not engage with the philosophical or jurisprudential considerations preferring instead a pragmatic approach. The same might be said of the approach taken in international instruments such as the World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* applicable to the insolvency of micro and small enterprises[31]. However, as this reviewer observes from the works published in this Special Issue, legal pragmatism might not necessarily mean that there is no integrity in the legal culture or philosophy.[32] It also does not mean that there are articulated principles guiding the reform or development of the law, as I attempted to show above.

In sum, therefore, one might conclude that in this frustrating pursuit of the right balance between over-indebtedness and access to credit and between debt forgiveness or second chance and borrower's responsibility, *pragmatic* solutions and the sharing of good *practice* might perhaps be the best we can hope for in this world of diverse and multifaceted socio-cultural values. Uniformity of precept is probably unachievable and undesirable.

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[29] S.J. REs. 88, 84 Stat. 468 (1970). The Commission on the Bankruptcy Laws of the United States was established by Public Law 91-354, 84 Stat. 468, effective July 24. For a useful summary of the report, see (1973) 29:1 The Business Lawyer 75-116.

[30] Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 137, 93rd Cong., 1st Sess. pt. I, 62 (1973)

[31] https://openknowledge.worldbank.org/entities/publication/de2cc5c4-c1ec-55eb-ad20-d27e916d000f

[32] On this see there is much literature. See Ronald Dworkin, *Law's Empire* (London, Fontana Press,1986) generally, and specifically at 148-52; For contrary views see the articles in "Symposium: The Renaissance of Pragmatism in American Legal Thought" (1990) 63 S. CAL. L. REV.. For an analysis of the prevailing literature at the time, see Steven D Smith, "The Pursuit of Pragmatism." (1990) 100:2 *The Yale Law Journal* 409