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# Debt Expansion as “Relief and Rescue” at the Time of the Covid-19 Pandemic: Insights from the Legal Theory of Finance

Iris H-Y Chiu\*, Andreas Kokkinis\*\* and Andrea Miglionico\*\*\*

## I. Introduction

The outbreak of the Covid-19 pandemic has led to a public health crisis of widespread contagion. As such, lockdowns have been imposed in many countries to limit face-to-face social interaction, thereby severely impacting economic activity and workplaces.<sup>1</sup> The United Kingdom (UK) was “locked down” between March 23 and July, 4, 2020, which resulted in the freezing of business activity for many sectors, such as brick-and-mortar retail (except groceries and pharmacies), travel and leisure, restaurants, public services, and service-based industries affected by social distancing such as transport, work-sharing facilities, leisure, hospitality, etc. Although many sectors have reopened since early July, the risks to public health have not subsided and emergency local lockdowns are being reimposed.<sup>2</sup> It is estimated that economic output has been reduced in the UK by at least 20% compared to the same period last year.<sup>3</sup> Gross domestic product was reduced by 9.5% in the United States (US) in the second quarter of 2020.<sup>4</sup>

The financial implications of economic lockdown in so many sectors were immediate as the corporate sector is heavily financialized.<sup>5</sup> The freezing of business activity in hard-hit sectors has implications for their cash flow, servicing of debt, solvency, and market-valuation and credit-rating assessments. The economic woes for corporations inevitably affect households as

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<sup>1</sup> See Daniel Dunford et al., *Coronavirus: The World in Lockdown in Maps and Charts*, BBC NEWS (Apr. 6, 2020), <https://www.bbc.co.uk/news/world-52103747>.

<sup>2</sup> Dan Martin & Amy Orton, *Live Updates: Pressure on Government Over Lockdown Release, Door-to-Door Testing*, LEICESTERSHIRE LIVE (last updated 09:08, July 10, 2020), <https://www.leicesterm Mercury.co.uk/news/leicester-news/live-updates-leicester-lockdown-latest-4297621>.

<sup>3</sup> Richard Partington, *UK GDP Falls by Record 20.4% in April as Lockdown Paralyzes Economy*, THE GUARDIAN (June 12, 2020, 05.06 EDT), <https://www.theguardian.com/business/2020/jun/12/britains-gdp-falls-204-in-april-as-economy-is-paralysed-by-lockdown>.

<sup>4</sup> Ben Casselman, *A Collapse that Wiped Out 5 Years of Growth, With No Bounce in Sight*, N.Y. TIMES (July 30, 2020), <https://www.nytimes.com/2020/07/30/business/economy/q2-gdp-coronavirus-economy.html>.

<sup>5</sup> See KAREN HO, *Corporate Nostalgia? Managerial Capitalism from a Contemporary Perspective*, in CORPORATIONS AND CITIZENSHIP 267, 271 (Greg Urban ed., University of Pennsylvania Press 2014).

redundancies have been gradually announced<sup>6</sup> and wider macroeconomic uncertainties affect household income and welfare.<sup>7</sup>

Besides public finance packages for emergency help, such as furloughing<sup>8</sup> and paycheck protection,<sup>9</sup> policy makers have turned to private-sector finance to alleviate the financial stress and hardships caused to households and corporations during the pandemic. Private-sector finance is being relied on—to a significant extent, but not exclusively—to meet the policy goals of “relief” and “rescue.” “Relief” refers to the policy goal of giving corporations and households temporary release from the pressures of debt which would be exacerbated in the weak economic conditions during the pandemic. “Rescue” refers to the policy of facilitating the access of corporations to finance to keep them afloat in relation to expenses, losses, and shoring up capital for the future. *The upshot of relief and rescue policies is that debt expansion, or the carrying of increased debt burdens for corporations and households, has been adopted as a key policy response to the financial woes of corporations and households during the pandemic.* These policies are not dissimilar to those undertaken in many countries.<sup>10</sup>

The legal implementation of relief and rescue policies in the US, UK, and European Union (EU) involves legal and regulatory suspensions to facilitate a level of debt expansion that would normally have been limited by the operation of microprudential regulation for lenders and contractual constraints in debt arrangements. Further, the legalization of extraordinary fiscal and monetary policies has been carried out. This episode reflects how law and regulation have been made elastic in order to address crisis management and social needs.<sup>11</sup> Reis and Vasconcelos<sup>12</sup> argue that such elasticity is institutionally supported based on the expected macroeconomic behavior of agents in markets, and empirical evidence also offers support for the ex post efficiency and welfare effects of certain suspensions, particularly in private law agreements such as debt moratoria.<sup>13</sup> Carruthers characterizes contractual suspensions as

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<sup>6</sup> See Ben King, *Coronavirus: Redundancy 'Stressful and Upsetting,'* BBC NEWS (Aug. 9, 2020), <https://www.bbc.com/news/business-53680671>; Pascale Davies & Alice Tidey, *Coronavirus Job Cuts: Which Companies in Europe are Slashing Their Workforces Because of COVID-19?*, EURONEWS, (last updated Mar. 3, 2020) <https://www.euronews.com/2020/07/24/coronavirus-job-cuts-which-companies-in-europe-are-slashing-their-workforces-because-of-co>; Lauren Aratani, *US Job Losses Pass 40m as Coronavirus Crisis Sees Claims Rise 2.1m in a Week*, THE GUARDIAN (May 28, 2020, 08.35 EDT), <https://www.theguardian.com/business/2020/may/28/us-job-losses-unemployment-coronavirus>.

<sup>7</sup> See Stephanie Chok, *Covid-19: Impacts on Employment & Household Income*, BEYOND RESEARCH (Mar. 18, 2020), <http://beyondresearch.sg/covid-19-impacts-on-employment-household-income/>; *POVERTY AND DISTRIBUTIONAL IMPACTS OF COVID-19: POTENTIAL CHANNELS OF IMPACT AND MITIGATING POLICIES*, WORLD BANK 1 (Apr. 16, 2020), <http://pubdocs.worldbank.org/en/980491587133615932/Poverty-and-distributional-impacts-of-COVID-19-and-policy-options.pdf> (focusing on developing countries to provide insights for channels of welfare impact applicable to developed countries too).

<sup>8</sup> A scheme in the UK where the government sponsored the wages of employees who were temporarily unable to work or undeployable. HM Revenue & Customs, *Claim for Wages Through the Coronavirus Job Retention Scheme*, U.K. Gov't, <https://www.gov.uk/guidance/claim-for-wages-through-the-coronavirus-job-retention-scheme> (last updated 9 Oct. 2020).

<sup>9</sup> US Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, § 1102, 134 Stat. 281, 297 (2020).

<sup>10</sup> See *Policy Responses to Covid-19*, INT'L MONETARY FUND, <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19> (last visited).

<sup>11</sup> See Katharina Pistor, *A Legal Theory of Finance* 41 J. COMP. ECON. 315, 325 (2013).

<sup>12</sup> Marcos Reis & Daniel Vasconcelos, *The Legal Theory of Finance and the Financial Instability Hypothesis: Convergences and Possible Integration*, 39 J. POST KEYNESIAN ECON. 206, 214 (2016).

<sup>13</sup> See Patrick Bolton & Howard Rosenthal, *Political Intervention in Debt Contracts*, 110 J. POL. ECON. 1103, 1123 (2002); Carmen M. Reinhart & Christoph Trebesch, *A Distant Mirror of Debt, Default, and Relief*, 49 (Nat'l Bureau of Econ. Research, Working Paper No. 20577, 2014) (relating to sovereign debt).

“financial decommodification,” which is necessary when markets are temporarily dysfunctional.<sup>14</sup>

We situate the policies for relief and rescue within the theorization of legal elasticity in Pistor’s legal theory of finance.<sup>15</sup> This theorization, drawn largely from observations during the global financial crisis of 2007-09,<sup>16</sup> offers a path for structural reforms in law and regulation as part of post-crisis management.<sup>17</sup> In particular, such theorization allows us to critically query the alleged temporary nature of the legal and regulatory suspensions during the pandemic. The theoretical insight drawn is that legal elasticity is often more structural in nature and will have to continue to apply to mitigate the long-term adverse consequences of debt expansion.

In Section II, we discuss the relief and rescue policies in the US, UK, and EU and show how they have been advanced by legal elasticity in suspensions from normal private and regulatory law. Crucially, such legal elasticity is intended to facilitate an increased debt burden for corporations and households as a means of relief and rescue. We argue that this policy choice, which is startlingly similar in these developed jurisdictions, has been influenced by the contexts of financialization in these jurisdictions and the perception of temporary duration by policy makers. However, there is a need to critically interrogate the impact of debt expansion as a means of relief and rescue.

Section III explores the impact of debt expansion on corporations and households and argues that the legal and regulatory framing of debt has been substantially distorted by the measures discussed in Section II, contributing to increased corporate and household fragility in the long term. The likely temporary effect of debt expansion is overstated, and the consequences of the trade-off with micro- and macro-financial resilience and stability would be highly mixed but significant. This does not mean that substantive policy agendas such as relief and rescue are sub-optimal. However, there is a longer term need for the continuous adjustment of law and regulation to address adverse consequences for households, corporations, and the financial system as a whole.

We argue in Section IV that the theoretical insights from legal elasticity suggest that more lasting and continuing applications of elasticity could be needed to fully address adverse impacts from first-round applications. Our arguments also intend to enrich the theoretical understanding of legal elasticity and can thus contribute to future policy applications.

In Section V, we apply our theoretical insights to construct a methodological framework for mapping long-term policy and reform considerations, in order to address the adverse consequences of corporate and household fragility, as well as risks to the financial system as a whole. In so doing, we offer a blueprint for substantive policy choices, without being unduly prescriptive. The theoretical insights of legal elasticity provide us with a platform to consider more broadly and holistically the problems of overindebtedness in the corporate and household

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<sup>14</sup> Bruce G. Carruthers, *Financial Decommodification: Risk and the Politics of Valuation in US Banks*, in POLICY SHOCK: RECALIBRATING RISK AND REGULATION AFTER OIL SPILLS, NUCLEAR ACCIDENTS AND FINANCIAL CRISES 349, (Edward J. Balleisen et al. eds., 2017).

<sup>15</sup> Pistor, *supra* note 11, at 317.

<sup>16</sup> See, e.g., Dan Awrey, *Law, Financial Instability and the Institutional Structure of Financial Regulation*, in SYSTEMIC RISK, INSTITUTIONAL DESIGN, AND THE REGULATION OF FINANCIAL MARKETS 61, 95 (Anita Anand ed. 2016); Rosa Maria Lastra, *Emergency Liquidity Assistance and Systemic Risk*, in SYSTEMIC RISK, INSTITUTIONAL DESIGN, AND THE REGULATION OF FINANCIAL MARKETS 225, 225 (Anita Anand ed. 2016).

<sup>17</sup> See discussion *infra* Sections IV, V.

sectors in developed jurisdictions, heightened and sharpened during the Covid-19 pandemic. It is time for policy makers to reflect on the structural implications of addressing these problems. Section VI concludes.

## II. Advancing “Relief and Rescue” in the UK, US, and EU

The UK, US, and EU have responded to the needs of households and corporations for financial support by promoting a relief and rescue agenda. This agenda features a mixture of public and private sector provisions, the latter incentivized and supported by legal and regulatory adjustments.<sup>18</sup> This mixture is ultimately framed within the context of financialization in the UK, US, and EU<sup>19</sup> and is skewed towards increased indebtedness for households, corporations, and governments in combatting the financial consequences of this public health crisis.<sup>20</sup> We adopt a comparative approach in this section to discuss the major policies in the relief and rescue agenda, namely, loan repayment holidays for households and corporations, salary support schemes, and facilitating increased corporate borrowing.

### A. *Loan Repayment Holidays for Households*

In order to alleviate the financial stresses for households servicing existing debt in the midst of disruptions caused by the pandemic, loan repayment holidays could be a temporary measure of relief. We observe that this relief measure has been commonly rolled out in the UK, US, and EU.<sup>21</sup> The UK has been able to impose mandatory relief on regulated entities by virtue of its relatively centralized financial regulatory architecture.<sup>22</sup> In the EU, mandatory relief has been achieved in different member states by legislative intervention,<sup>23</sup> but this is not coordinated by EU legislative fiat. The US relies heavily on private sector leadership to provide temporary relief for households.<sup>24</sup> Nevertheless, the UK, US, and EU underpin temporary debt relief measures by similar regulatory interventions.

In the UK, temporary relief has been mandated in relation to all forms of regulated consumer credit.<sup>25</sup> The Financial Conduct Authority (FCA), which regulates all financial institutions in relation to the conduct of business, has introduced loan payment holidays for the consumer credit products it regulates.<sup>26</sup> In terms of mortgages, FCA guidance requires firms to grant a payment holiday, originally for three months from March 2020 (and subsequently extended for a further four months), to any customer who indicates that they may potentially experience difficulties.<sup>27</sup> This measure does not affect the accrual of interest on the loan and firms are not required to investigate the individual circumstances of each customer who requests such a payment holiday or extension. The balance achieved in this measure is that customers are not imposed with burdens to prove that they can afford a payment holiday, but banks are also not

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<sup>18</sup> Discussed below.

<sup>19</sup> See discussion *infra* Section II.E.

<sup>20</sup> See *infra* Section III.

<sup>21</sup> See discussion below, and in particular, *infra* n27, 29-31, 37-40.

<sup>22</sup> The UK’s financial regulatory architecture comprises the FCA and PRA, established under the Financial Services and Markets Act 2000 amended in 2012, and the two authorities are mandated to cooperate with each other, see s3D and 3E of the Act.

<sup>23</sup> see *infra* n37-39.

<sup>24</sup> See *infra* n43.

<sup>25</sup> See *infra* n27, 29-31.

<sup>26</sup> *Ibid.*

<sup>27</sup> FINANCIAL CONDUCT AUTHORITY, MORTGAGES AND CORONAVIRUS: INFORMATION FOR CONSUMERS (2020), <https://www.fca.org.uk/consumers/mortgages-coronavirus-consumers> (last updated June 19, 2020).

asked to forego their expected earnings on these assets in due course. In cases where a customer is already in default at the commencement of the guidance, the guidance prevents firms from commencing or continuing repossession proceedings, and any possession order already made must not be enforced.<sup>28</sup>

In parallel, the FCA also requires banks and other regulated lenders to offer a temporary payment holiday for personal loans and credit cards, for a period of up to three months from March 2020, to any consumers negatively impacted during the pandemic and, in the case of consumers with an arranged overdraft, to provide an additional interest-free overdraft facility of £500 for a three-month period.<sup>29</sup> These measures had, as of the end of June 2020, been extended until October 31.<sup>30</sup> However, in light of surge of public health concerns and the UK's second lock-down which began on 4 November 2020, the FCA has extended the period for all consumer credit and mortgage customers to make deferred payment requests until the end of January 2021.<sup>31</sup> Each customer is however permitted to defer payments for a total period of six months only, whether the deferral request has been made in March 2020 or during the extended periods.<sup>32</sup> The FCA has also taken temporary measures to freeze repayments within the context of high-cost, short-term credit loans, initially for a period of one month from April 2020, but now extended to deferral requests that may be made up to the end of January 2021.<sup>33</sup> Deferral requests also do not have to be based on the lenders' investigations of borrowers' individual circumstances.<sup>34</sup> The FCA also expects high-cost, short-term credit firms to deal with vulnerable customers sensitively in relation to working out how obligations are to be resumed or eventually repaid after the deferral period.<sup>35</sup> Other forms of consumer credit, such as motor-finance and "buy-now-pay-later" or "rent-to-own" credit in relation to consumer goods purchases, also benefit from the extension up to the end of January 2021, for deferred payments.<sup>36</sup> In sum, the FCA has taken a consistent approach to payment holidays in relation to all consumer credit arrangements it regulates.

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<sup>28</sup> *Ibid.*

<sup>29</sup> FINANCIAL CONDUCT AUTHORITY, CORONAVIRUS: INFORMATION FOR CONSUMERS ON PERSONAL LOANS, CREDIT CARDS, OVERDRAFTS, MOTOR FINANCE AND OTHER FORMS OF CREDIT (Apr. 3, 2020), <https://www.fca.org.uk/consumers/coronavirus-information-personal-loans-credit-cards-overdrafts>.

<sup>30</sup> FINANCIAL CONDUCT AUTHORITY, FCA CONFIRMS FURTHER SUPPORT FOR CONSUMER CREDIT CUSTOMERS (Jan. 7, 2020), <https://www.fca.org.uk/news/press-releases/fca-confirms-further-support-consumer-credit-customers>.

<sup>31</sup> 'FCA announces proposals for further support to consumer credit borrowers impacted by coronavirus' (4 November 2020), <https://www.fca.org.uk/news/press-releases/fca-announces-proposals-further-support-consumer-credit-borrowers-impacted-coronavirus>.

<sup>32</sup> *Ibid.*

<sup>33</sup> FINANCIAL CONDUCT AUTHORITY, HIGH-COST SHORT-TERM CREDIT AND CORONAVIRUS: TEMPORARY GUIDANCE FOR FIRMS (Apr. 24, 2020), <https://www.fca.org.uk/publications/finalised-guidance/high-cost-short-term-credit-and-coronavirus-temporary-guidance-firms>. FINANCIAL CONDUCT AUTHORITY, HIGH-COST SHORT-TERM CREDIT AND CORONAVIRUS: UPDATED TEMPORARY GUIDANCE FOR FIRMS (July 3, 2020), <https://www.fca.org.uk/publications/guidance-consultations/high-cost-short-term-credit-coronavirus-updated-temporary-guidance-firms>; FINANCIAL CONDUCT AUTHORITY, HIGH-COST SHORT-TERM CREDIT AND CORONAVIRUS: PAYMENT DEFERRAL GUIDANCE (Nov 19, 2020), <https://www.fca.org.uk/publication/finalised-guidance/high-cost-short-term-credit-coronavirus-payment-deferral-guidance.pdf>.

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> FINANCIAL CONDUCT AUTHORITY, FCA ANNOUNCES PROPOSALS TO FURTHER SUPPORT MOTOR FINANCE AND HIGH COST CREDIT CUSTOMERS (July 3, 2020), <https://www.fca.org.uk/news/press-releases/fca-announces-proposals-further-support-motor-finance-high-cost-credit-customers>; FINANCIAL CONDUCT AUTHORITY, RENT-TO-OWN, BUY-NOW PAY-LATER, PAWNBROKING AND CORONAVIRUS: PAYMENT DEFERRAL GUIDANCE (Nov 19, 2020), <https://www.fca.org.uk/publication/finalised-guidance/rent-to-own-buy-now-pay-later-pawnbroking-coronavirus-payment-deferral-guidance.pdf>.



In the EU, there is no single regulator for consumer credit. Consumer credit rules are not completely harmonized across the EU,<sup>37</sup> so national regulators administer and implement both national and harmonized regulations in their jurisdictions. However, pan-European agencies coordinate the continuing work of regulatory harmonization and supervisory convergence.<sup>38</sup> The European Banking Authority has taken the lead in providing direction to national regulators regarding consumer credit arrangements during the pandemic, and has welcomed national regulatory initiatives regarding legislative moratoria on loan repayments, payment holidays, default, and forbearance.<sup>39</sup>

In the US, relief measures for different forms of consumer credit have been more fragmented. Under the Coronavirus Aid, Relief, and Economic Securities Act (CARES Act), banks are required to provide homeowners—with mortgages insured by the federal government—up to six months in deferred payments upon request. Specifically, the act provides an initial forbearance period of 180 days for borrowers, extended to an additional 180 days upon request, and mortgage foreclosures are suspended for a 60-day period from March 18, 2020.<sup>40</sup> In terms of mortgage forbearance, Fannie Mae and Freddie Mac have also provided a four-month cap on servicers' obligations to deliver missed payments.<sup>41</sup> Fannie Mae has also guaranteed payments to investors in mortgage-backed securities insured or securitized by the Federal Housing Administration and the Department of Veterans Affairs, effectively extending a lending facility for homeowners during payment holidays.<sup>42</sup> However, temporary relief from other forms of consumer credit are provided at the initiative of the private sector, working in tandem with state regulators.<sup>43</sup> For example, mortgage forbearance and deferments on

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<sup>37</sup> The Consumer Credit Directive 2008/48/EC harmonized certain protections for consumers but excludes secured consumer credit such as mortgages. It also omits dealing with responsible lending, *see Opinion and Recommendations of the Financial Services User Group on the Review of the Consumer Credit Directive* (2019), [https://ec.europa.eu/info/sites/info/files/business\\_economy\\_euro/banking\\_and\\_finance/documents/fsug-opinions-190408-responsible-consumer-credit-lending\\_en.pdf](https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/fsug-opinions-190408-responsible-consumer-credit-lending_en.pdf). The lack of EU regulation of payday lending is criticized in Olha O. Cherednychenko & Jesse M. Meindertsma, *Irresponsible Lending in the Post-Crisis Era: Is the EU Consumer Credit Directive Fit for Its Purpose?*, 42 J. CONSUMER L. POL'Y 483, 484-85 (2019).

<sup>38</sup> The European Banking Authority, European Securities and Markets Authority and European Insurance and Occupational Pensions Authority.

<sup>39</sup> EUR. BANKING AUTHORITY, STATEMENT ON THE APPLICATION OF THE PRUDENTIAL FRAMEWORK REGARDING DEFAULT, FORBEARANCE AND IFRS9 IN LIGHT OF COVID19 MEASURES, 1, 3 (Mar. 25, 2020), <https://eba.europa.eu/eba-provides-clarity-banks-consumers-application-prudential-framework-light-covid-19-measures>. *See also* EBA Guidelines EBA/GL/2020/07, Reporting and Disclosure of Exposures Subject to Measures Applied in Response to the COVID-19 Crisis (June 2, 2020).

<sup>40</sup> CARES Act § 4022.

<sup>41</sup> FANNIE MAE, IMPACT OF COVID-19 ON SERVICING (Aug. 27, 2020), <https://singlefamily.fanniemae.com/media/22261/display>; BILL MAGUIRE, TEMPORARY SERVICING REQUIREMENTS RELATED TO COVID-19 (Mar. 18, 2020), <https://guide.freddiemac.com/app/guide/bulletin/2020-4>; BILL MAGUIRE, TEMPORARY SERVICING REQUIREMENTS RELATED TO COVID-19 (Apr. 8, 2020), <https://guide.freddiemac.com/app/guide/bulletin/2020-10>.

<sup>42</sup> FED. HOUSING AND FIN. AGENCY, FANNIE MAE AND FREDDIE MAC ASSISTANCE OPTIONS FOR FAMILIES IMPACTED BY COVID-19 (2020), <https://www.fhfa.gov/Homeownersbuyer/MortgageAssistance/Documents/FAQs-FannieMae-FreddieMac-Assistance-Options-for-Families-Impacted-by-COVID-19.pdf>.

<sup>43</sup> Press Release, Board of Governors of the Federal Reserve System, Agencies Issue Revised Interagency Statement on Loan Modifications by Financial Institutions Working With Customers Affected by the Coronavirus (Apr. 7, 2020), <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200407a.htm>.

consumer credit have been introduced under private sector coordination, although some observers have criticized the limited nature of available relief to homeowners and renters.<sup>44</sup>

Loan repayment holidays are, crucially, supported by suspensions of lenders' regulatory obligations, preventing lenders from becoming too risk averse vis a vis their borrowers on payment holidays.<sup>45</sup> Regulated lenders are subject to microprudential regulation to ensure that their lending profiles do not pose hazards to the stability of the financial system.<sup>46</sup> In particular, microprudential tools focus on calibrating lenders' lending behavior and appetite for risk by imposing capital, leverage, and liquidity requirements.<sup>47</sup> One of the *intended* effects of microprudential rules is to constrain excessive lending, a policy theme that has dominated since the regulatory reforms after the global financial crisis 2007-09,<sup>48</sup> as the crisis was characterized by excessive leverage and risk-taking.<sup>49</sup>

Loan forbearance creates concerns that deferred loans may be nonperforming in due course. Since the global financial crisis, lenders have been required to adopt a forward-looking approach<sup>50</sup> to calculate the regulatory cost of their loan assets to ensure adequate levels of loss-absorbing capital at early signs of distressed loans. The accounting standard—international financial reporting standard (IFRS)—IFRS 9, which applies to EU and UK banks, requires lenders to account for debt instruments at fair value<sup>51</sup> and ensure that they have sufficient capital to absorb potential losses.<sup>52</sup> Payment holidays exacerbate information asymmetry in relation to borrowers' creditworthiness and lenders may make increased loan-loss provisions against these.<sup>53</sup> In other words, anticipating sour loans incentivizes banks towards conservation of capital, and also refrain from lending.

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<sup>44</sup> Emily Wavering Corcoran & Nicholas Haltom, *Mortgage and Student Loan Forbearance During the COVID-19 Pandemic*, RICHMOND FED. RES. 2-3 (27 August 2020), [https://www.richmondfed.org/-/media/richmondfedorg/publications/research/coronavirus/corcoran\\_covid19\\_paper.pdf](https://www.richmondfed.org/-/media/richmondfedorg/publications/research/coronavirus/corcoran_covid19_paper.pdf).

<sup>45</sup> See discussion below and n55.

<sup>46</sup> See *infra* n47 and also extensively discussed in Chiu, n63.

<sup>47</sup> *Id.*

<sup>48</sup> Led by the international standards under the Basel III reforms between 2009-2017. See Bank for International Settlements, *Basel III: International Regulatory Framework for Banks* (Dec. 2017), <https://www.bis.org/bcbs/basel3.htm>.

<sup>49</sup> FINANCIAL SERVICES AUTHORITY, *THE TURNER REVIEW: A REGULATORY RESPONSE TO THE GLOBAL BANKING CRISIS*, 39-42 (Mar. 2009) [https://webarchive.nationalarchives.gov.uk/20090320232953/http://www.fsa.gov.uk/pubs/other/turner\\_review.pdf](https://webarchive.nationalarchives.gov.uk/20090320232953/http://www.fsa.gov.uk/pubs/other/turner_review.pdf); see also, HOWARD DAVIES, *THE FINANCIAL CRISIS: WHO IS TO BLAME?* (2010).

<sup>50</sup> Rosa M. Lastra, *Defining Forward Looking, Judgement-Based Supervision*, 14 J. BANKING REG. 221, 222–223 (2013).

<sup>51</sup> Unless they satisfy the contractual cash flow test and business model assessment requirement. THE INT'L FIN. REPORTING STANDARDS FOUND., *IFRS 9, IFRS* (last visited Dec. 22, 2020), <https://www.ifrs.org/issued-standards/list-of-standards/ifrs-9-financial-instruments/>.

<sup>52</sup> INTERNATIONAL ACCOUNTING STANDARDS BOARD, *IFRS 9 Financial Instruments* (July 2014), 7-8, <https://www.ifrs.org/-/media/project/financial-instruments/project-summaries/ifrs-9-project-summary-july-2014.pdf>.

<sup>53</sup> Stephen Morris, *BOE Warns Bank Loan Reserves Risk Choking Business Funding*, FIN. TIMES (April 26, 2020), <https://www.ft.com/content/75767049-edfb-4074-942c-f9ce4d07f861>; Stephen Morris, *European Bank Investors Brace for Loan-Loss Provisions*, FIN. TIMES (April 26, 2020), <https://www.ft.com/content/75767049-edfb-4074-942c-f9ce4d07f861>; Jon Rees, *UK Banks' Loan Loss Provisions Soar in Face of Pandemic*, S&P GLOBAL MKT. INTELLIGENCE (May 7, 2020), <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/uk-banks-loan-loss-provisions-soar-in-face-of-pandemic-58478176>.



The UK has explicitly introduced adjustment to the interpretation of nonperforming loans in order to mitigate lenders' risk aversion. The Prudential Regulation Authority<sup>54</sup> (PRA) clarifies that lenders should not treat deferred payments as being in default.<sup>55</sup> Even if deferred payments do not resume promptly, lenders should seek to understand borrowers' individual circumstances and not mechanistically treat such loans as nonperforming. Although the PRA is a separate regulator from the FCA,<sup>56</sup> the regulatory architecture that binds them<sup>57</sup> is relatively coordinated and ensures complementary regulatory actions. In the EU, although consumer credit regulation is not fully harmonized, the European Central Bank (ECB) acts as a microprudential supervisor for lenders in the euro area.<sup>58</sup> The ECB also steers banks to apply IFRS 9 in a similarly flexible manner, emphasizing case-by-case flexibility and banks refraining from too quickly treating loans as nonperforming.<sup>59</sup>

In the US, legislative centralization is the main tool for mitigating banks' risk aversion to borrowers on payment holidays. Under the CARES Act, banks are to delay their implementation of the initially imposed forward-looking approach to expected loan-loss provision,<sup>60</sup> which is more stringent than that under IFRS 9 discussed above. In the US, the Financial Accounting Standards Board introduced the CECL (current expected credit losses) so that banks would provision regulatory cost for the expected lifetime losses of a loan at the point of origination.<sup>61</sup> The implementation of the CECL is to be delayed for two years in the wake of the Covid-19 pandemic.<sup>62</sup>

Although loan forbearance measures seem decentralized in the EU and US, the UK, US, and EU have implemented regulatory support through relatively centralized measures that are binding. This is arguably also necessary due to the stringency of microprudential regulation which has attained a highly demanding and numerical character,<sup>63</sup> after the global financial crisis of 2007-09.

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<sup>54</sup> Financial Services and Markets Act 2000 § 2B (UK) (as amended by the Financial Services Act 2012) (establishing the UK regulatory authority for the microprudential supervision of banks and important financial institutions).

<sup>55</sup> Letter from Sam Woods, Deputy Governor & CEO of the Prudential Reg. Auth, BANK OF ENG. PRUDENTIAL REG. AUTH., to the Chief Executive Officers of UK Banks, Covid-19: IFRS 9, Capital Requirements and Loan Covenants (March 26, 2020), <https://www.bankofengland.co.uk/prudential-regulation/letter/2020/covid-19-ifrs-9-capital-requirements-and-loan-covenants>; Statement by the PRA on Regulatory Capital and IFRS 9 Requirements for Payment Holidays, BANK OF ENG. PRUDENTIAL REG. AUTH. (May 22, 2020), <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/statement-on-application-regulatory-capital-ifrs9>.

<sup>56</sup> Financial Services and Markets Act 2000 §§ 1B, 2B ) (UK) (as amended by the Financial Services Act 2012).

<sup>57</sup> *Id.* at §§ 3D, 3E.

<sup>58</sup> 2013 O.J. (L 287/63) 1024.

<sup>59</sup> *FAQs on ECB Supervisory Measures in Reaction to the Coronavirus*, EUROPEAN CENT. BANK (July 28, 2020), [https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320\\_FAQs~a4ac38e3ef.en.html](https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320_FAQs~a4ac38e3ef.en.html).

<sup>60</sup> Michael S. Gibson, *SR 20-9: Joint Statement on Interaction of the Regulatory Capital Rule: Revised Transition of the CECL Methodology for Allowances with Section 4014 of the Coronavirus Aid, Relief, and Economic Security Act*, BOARD OF GOVERNORS OF THE FED. RES. SYS. (March 31, 2020), <https://www.federalreserve.gov/supervisionreg/srletters/SR2009.htm>.

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> Iris H-Y Chiu, *Rethinking the Law and Economics of Post-Crisis Micro-prudential Regulation—The Need to Invert the Relationship of Law to Economics?* 38 REV. OF BANKING AND FIN. L. 639, 648 (2019).

## ***B. Loan Repayment Holidays for Corporations***

We turn to loan repayment holidays for corporations, which are viewed as important in preventing corporations from being drained by debt servicing expenses and forced into insolvency in the near term.

In the UK, as the FCA does not have a regulatory perimeter over business lending, an act of Parliament was passed to give temporary relief for business borrowers.<sup>64</sup> This fast-tracked piece of legislation allows companies with debt obligations to apply for a moratorium.<sup>65</sup> Directors can apply if they are of the view that the company is unable to pay its debts.<sup>66</sup> They, however, need to appoint an insolvency practitioner as “monitor” to verify that rescue for the company is possible.<sup>67</sup> A successful application for moratorium allows the company to enjoy relief from its debt obligations, except specified obligations such as rent and employees’ wages, for an initial 20 days with a possible extension for another 20 days.<sup>68</sup> During the period of the moratorium, no insolvency proceedings can commence against the company.<sup>69</sup> Furthermore, the Bank of England has provided a new Coronavirus Corporate Financing Facility,<sup>70</sup> which is designed to help tide businesses over liquidity squeezes through their bank. This could help prevent banks from being dragged into liquidity hazards by corporate customers.

In the EU, debt relief measures for corporations are not centrally coordinated, and are left to each member state to implement. What is observed is similarity in most EU jurisdictions<sup>71</sup> in the manner of legislative enactment to provide corporate debt relief, such as mandatory payment holidays as well as moratoria from insolvency proceedings.<sup>72</sup> There are slight differences in terms of whether only small businesses benefit from these measures<sup>73</sup> or whether they apply to all corporate entities.

In the US, debt moratoria for companies is arranged between lenders and borrowers, although lenders work with the Conference of State Bank Supervisors towards constructive treatment of borrowers.<sup>74</sup> There has been a significant level of corporate bankruptcies in the US since the onset of the pandemic, although some companies have been nearing bankruptcy for some

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<sup>64</sup> Corporate Insolvency and Governance Act 2020 c. 12 (June 25, 2020) (UK) (amending the Insolvency Act 1986).

<sup>65</sup> *Id.*, at s4.

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* at §§ 3, 6, 7.

<sup>68</sup> *Id.* at §§ 9-10, 18, 20, 21.

<sup>69</sup> *Id.* at s4.

<sup>70</sup> *Covid Corporate Financing Facility (CCFF): Information for Those Seeking to Participate in the Scheme*, BANK OF ENG. (March 20, 2020), <https://www.bankofengland.co.uk/news/2020/march/the-covid-corporate-financing-facility>.

<sup>71</sup> Wolfgang Münchau, *Europe Needs to Avoid a ‘Decade of Forebearance,’* FIN. TIMES (August 30, 2020), <https://www.ft.com/content/9a2532e5-0b1f-46b2-b7b5-d474b2a9dd08>.

<sup>72</sup> Eran Chvika, *Coronavirus: Impact of French Measures on Financing Agreements*, PINSENT MASONS (April 17, 2020), <https://www.pinsentmasons.com/out-law/analysis/coronavirus-finance-agreements-france>; *COVID-19 Overview on Moratoria*, SCHOENHERR ATTORNEYS AT LAW (October 15, 2020), <https://www.schoenherr.eu/publications/publication-detail/covid19-overview-on-moratoria/>; *German Government and Institution Measures in Response to COVID-19*, KMPG (October 28, 2020) <https://home.kpmg/xx/en/home/insights/2020/04/germany-government-and-institution-measures-in-response-to-covid.html>.

<sup>73</sup> E For an example of measures in Austria see *Covid-19 Overview on Moratoria*, *supra* note 72.

<sup>74</sup> See *United State of America Government and Institution Measures in Response to COVID-19*, KMPG, <https://home.kpmg/xx/en/home/insights/2020/04/united-states-of-america-government-and-institution-measures-in-response-to-covid.html> (last updated June 3, 2020).

time.<sup>75</sup> The lack of coordination in debt moratoria is, however, likely balanced by the expansion and facilitation of corporate borrowing in the US, perhaps the most pronounced package for financial boost amongst the jurisdictions surveyed here.

In sum, different extents of regulatory intervention have been introduced to effect temporary debt relief for households and corporations in order to override the normal application of contractual obligations which would have led to economic stress. Relief measures are underpinned by regulatory suspension in relation to expected loan-loss provision by lenders. However, regulatory adjustments are temporal in nature, providing little guidance on loan distress and the consequences for both borrowers and lenders. The near-term approach to relief and rescue is a common characteristic of the financial support policies in the UK, US, and EU, further discussed below.

Nevertheless, there are signs of EU policy makers becoming cognizant of long-term effects. The ECB is considering flexibility in the treatment of nonperforming loans by banks.<sup>76</sup> For example, such loans can, in theory, be restructured and transferred to a separate asset management company in order to perform workouts or liquidations of the stressed loan portfolios at a more opportune time to amortize losses.<sup>77</sup> Alternatively, the European Commission is looking to the private sector (i.e., capital markets) to absorb and spread the risk of lending by banks during the pandemic. To this end, the commission proposes amending the EU Securitisation Regulation to facilitate the synthetic securitization of nonperforming loans.<sup>78</sup> Under the EU Securitisation Regulation, securitized assets need to comply with certain rules in relation to design and marketing to institutional investors in the EU.<sup>79</sup> These standards have been introduced to correct poor securitization practices and disclosures prior to the global financial crisis of 2007-09,<sup>80</sup> so as to facilitate a credible and liquid refinancing market for bank loans. It is now proposed that banks' nonperforming loans can be synthetically securitized by obtaining credit protection arrangements for them, such as guarantees from investors.<sup>81</sup> In this manner, investors underwrite potential bank losses in the nonperforming loans but benefit from the premiums paid by banks for such protections. The recognition of such synthetic securitization in the regulation allows for marketability across the EU.

We will, however, argue in Section III that the perception of temporariness in financial relief and rescue measures during the pandemic is hazardously decoupled from the reality of harsh financial consequences for the economy and society in the long term. The implicit reliance on

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<sup>75</sup> Scigliuzzo et al., *The Covid Bankruptcies*, BLOOMBERG (Aug. 29, 2020), <https://www.bloomberg.com/graphics/2020-us-bankruptcies-coronavirus/>.

<sup>76</sup> See Press Release, European Central Bank, ECB Banking Supervision Provides Temporary Capital and Operational Relief in Reaction to Coronavirus (Mar. 12, 2020), <https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200312~43351ac3ac.en.html>.

<sup>77</sup> Douglas W. Arner, Emiliios Avgouleas & Evan C. Gibson, *Financial Stability, Resolution of Systemic Banking Crises and COVID-19: Toward an Appropriate Role for Public Support and Bailouts 1* (Univ. of H.K. Faculty of Law Research Paper Series, No. 2020/044, 2020), <https://ssrn.com/abstract=3664523>.

<sup>78</sup> European Commission Press Release IP/20/1382, Coronavirus response: Making Capital Markets Work for Europe's Recovery (July 24, 2020), [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_20\\_1382](https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1382).

<sup>79</sup> Commission Regulation 2017/2402, 2017 O.J. (L 347/35) (EU).

<sup>80</sup> Richard E. Mendales, *Collateralized Explosive Devices: Why Securities Regulation Failed to Prevent the CDO Meltdown, And How To Fix It*, 2009 U. OF ILL. L. REV. 1359, 1400-12 (2009).

<sup>81</sup> *Proposal for a Regulation of the European Parliament and of the Council Amending Regulation (EU) 2017/2402 Laying Down a General Framework for Securitisation and Creating a Specific Framework for Simple, Transparent and Standardised Securitisation to Help the Recovery from the COVID-19 Pandemic*, COM (2020) 282 final (July 24, 2020).

the eventual resumption to normal is a reflection of the dominant paradigm of financialization<sup>82</sup> in the UK, US, and EU. We doubt that increased financialization and reliance on the private financial sector's contractual and pricing mechanisms would serve the policy goals of combatting the adverse financial consequences of the pandemic for households and corporations. Before we turn to that, we explore two further pillars of relief and rescue implemented in the UK, US, and EU. Although these measures reflect a significant measure of public intervention, the private order of financialization is not fundamentally affected. This provides the crucial context for the long-term problems for households and corporations explored in Section III.

### *C. Salary Support Schemes*

The second pillar of relief measures introduced in common in the UK, US, and EU for households and corporations is the provision of fiscal support through grants or loans for employers to retain workers and continue to pay all or at least part of their salaries, even if workers cannot be deployed during lockdowns.

In March 2020, the UK government introduced a comprehensive salary support scheme.<sup>83</sup> The Coronavirus Job Retention Scheme is aimed at protecting jobs by alleviating wage expenses for businesses during the pandemic.<sup>84</sup> The scheme applies to employees and workers put on what is technically known as 'furlough leave' whereby an employee or worker agrees in writing with their employer to stop working temporarily while remaining employed.<sup>85</sup> Such employers may then claim from the government 80% of their workers' salaries up to an upper limit of £2,500 per month, as well as the employer's "national insurance" contributions (the equivalent of social security contributions).<sup>86</sup> The scheme was envisaged to terminate at the end of October 2020,<sup>87</sup> but has been extended to end of March 2021<sup>88</sup> due to the ongoing public health challenges of the pandemic and the UK's second lockdown from 4 November 2020. The extended Scheme undoubtedly increase fiscal indebtedness,<sup>89</sup> a problem that the UK is struggling to solve.<sup>90</sup>

In the EU, fiscal measures to support employment are within the exclusive jurisdiction of individual member states, and many have implemented schemes similar to the one adopted by

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<sup>82</sup> See *infra* Section II.E.

<sup>83</sup> See *infra* n86.

<sup>84</sup> See *Putting employees on "furlough" to protect jobs*, TAYLOR WESSING (March 23<sup>rd</sup>, 2020), <https://www.taylorwessing.com/en/insights-and-events/insights/2020/03/putting-employees-on-furlough-to-protect-jobs>.

<sup>85</sup> *Infra* n86.

<sup>86</sup> U.K. GOVERNMENT, *Claim for Wages Through the Coronavirus Job Retention Scheme*, (last visited Jan 11, 2021) <https://www.gov.uk/guidance/claim-for-wages-through-the-coronavirus-job-retention-scheme>.

<sup>87</sup> *Chancellor extends furlough scheme until October*, HM GOVERNMENT (May 12, 2020), <https://www.gov.uk/government/news/chancellor-extends-furlough-scheme-until-october>.

<sup>88</sup> *Government extends Furlough to March and increases self-employed support*, HM GOVERNMENT (Nov 5, 2020), <https://www.gov.uk/government/news/government-extends-furlough-to-march-and-increases-self-employed-support>.

<sup>89</sup> At the end of July 2020, UK public sector net debt exceeded £2 trillion. It was £227.6 billion more than at the same point in 2019 and stood at 100.5% of gross domestic product, compared to 80.1% of GDP at the end of July 2019. OFFICE FOR NATIONAL STATISTICS, *Public Sector Finances, UK: July 2020* (Aug. 21, 2020), [https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/july2020#:~:text=Debt%20\(public%20sector%20net%20debt,the%20same%20point%20last%20year](https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/july2020#:~:text=Debt%20(public%20sector%20net%20debt,the%20same%20point%20last%20year).

<sup>90</sup> Ethan Ilzetzki, *Covid-19 and UK Public Finances*, VOXEU (Jun. 11, 2020), <https://voxeu.org/article/covid-19-and-uk-public-finances>.

the UK.<sup>91</sup> These schemes are expected to increase European member states' fiscal deficits,<sup>92</sup> and may jeopardize the Stability and Growth Pact agreed amongst euro area countries to maintain fiscal discipline.<sup>93</sup> Member states are already justifying deviation from the pact by applying the "general escape clause" that allows them to adopt discretionary fiscal measures to address emergency situations.<sup>94</sup>

In contrast, in the US, salary support is legally framed as private debt, thus directly increasing the indebtedness of corporations seeking such support, albeit with a prospect of loan forgiveness. The CARES Act introduced the Paycheck Protection Program (PPP),<sup>95</sup> a loan program to support small to medium-sized businesses (less than 500 employees except for specific sectors [i.e., restaurants, hotels, and franchises where the eligibility is based on location]) in order to maintain workers on their payroll. The act provides that loans will be partly or fully forgiven insofar as the amount borrowed is used to cover payroll costs, mortgage repayments, renting, and other eligible costs, but full forgiveness is based on strict conditions regarding the retention of employees and salary levels for a period of time.<sup>96</sup> The PPP program is administered by the Small Business Administration that originates and services the loans from private lenders.<sup>97</sup> Despite its immediate success, the PPP program has been criticized for the unclear eligibility requirements and terms of the application,<sup>98</sup> and it is doubtful the intended effects of job protection are achieved.<sup>99</sup> The PPP, however, ended on August 8, 2020,<sup>100</sup> somewhat prematurely as the Covid-19 pandemic was far from over at that time. Small businesses will need to reckon with continuing needs by seeking avenues of private sector finance.<sup>101</sup> Nevertheless, in terms of social provision, the CARES Act has expanded unemployment benefits including unemployment insurance eligibility.<sup>102</sup>

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<sup>91</sup> Germany, France, Italy, and Spain have all adopted schemes comparable to the UK scheme. These schemes have been taken up by 20% of workers in the five economies. Martin Arnold, *Over 30m Workers in Europe Turn to State for Wage Support*, FIN. TIMES, (Apr. 28, 2020), <https://www.ft.com/content/3e68bb70-1b17-4fd3-82f5-dfa4ea7454a2>.

<sup>92</sup> ECB: *Coronavirus Downturn Could Put Strain on Eurozone*, DEUTSCHE WELLE, (May 26, 2020), <https://www.dw.com/en/ecb-coronavirus-downturn-could-put-strain-on-eurozone/a-53578028>.

<sup>93</sup> *EU Economic Governance: Monitoring, Prevention, Correction*, EUROPEAN COMM'N (last visited Jan 11, 2021), [https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction\\_en](https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction_en).

<sup>94</sup> See *Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact*, COM (2020) 123 final (Mar. 20, 2020); Angelos Delivorias, *The 'General Escape Clause' Within the Stability and Growth Pact: Fiscal Flexibility for Severe Economic Shocks*, EUR. PARLIAMENTARY RESEARCH SERV. (Mar. 2020), [https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/649351/EPRS\\_BRI\(2020\)649351\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/649351/EPRS_BRI(2020)649351_EN.pdf).

<sup>95</sup> CARES Act, *supra* note 9, § 1102.

<sup>96</sup> CARES Act, *supra* note 9, §§ 1102, 1106.

<sup>97</sup> See <https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program>.

<sup>98</sup> See Ilya Beylin, *The Ignominious Life of the Paycheck Protection Program* 16-17 (Aug. 24, 2020), <https://ssrn.com/abstract=3661005>.

<sup>99</sup> Michael Barr, Howell Jackson & Margaret Tahyar, *The Financial Response to the Covid-19 Pandemic* 8-9 (Aug. 1, 2020), <https://ssrn.com/abstract=3666461>.

<sup>100</sup> See *supra* n99.

<sup>101</sup> Greg Iacurci, *PPP Loans are Ending. Here's Where Small Businesses Can Turn Now*, CNBC (June 20, 2020, 8:00 AM), <https://www.cnbc.com/2020/06/30/ppp-loans-are-ending-heres-where-small-businesses-can-turn-now.html>.

<sup>102</sup> CARES Act, *supra* note 9, §§ 2102-2104.



#### ***D. Government-Backed Borrowing for Corporations***

Finally, and most importantly, a key rescue policy implemented in the UK, US, and EU is that of access to increased borrowing by corporations during the pandemic. All jurisdictions recognize the lack of incentives for private-sector lending and have implemented fiscal support for corporate borrowing. This is, however, not the same as public-sector provision.

The UK government provides fiscal support for two loan schemes. UK businesses with turnover of less than £45 million can benefit from the Coronavirus Business Interruption Loan Scheme, which is administered by the government-owned British Business Bank.<sup>103</sup> The loan scheme enables accredited lenders to provide loans and overdraft facilities of up to £5 million, guaranteed at 80% by the government, to be repaid over up to six years.<sup>104</sup> UK small- and medium-sized businesses will also benefit from the Bounce Back Loan Scheme that provides loan facilities of up to £50,000, guaranteed at 100% by the government to be repaid over up to six years with no payments in the first twelve months.<sup>105</sup> Lenders are expected to assess whether businesses should access such government-guaranteed finance, the principle being that loans should only be available to otherwise healthy businesses that need to trade through the short-to-medium-term revenue loss caused by the lockdown.

Fiscal support is also introduced in the US for corporate borrowing, trade credit, and commercial paper.<sup>106</sup> The Federal Reserve Board (the Fed) in the US introduced the Main Street Lending Program that provides support to small and mid-size nonfinancial firms hit by the pandemic.<sup>107</sup> The Main Street Lending Program allows the Fed to set up special-purpose vehicles to purchase participations in bank business loans, therefore supporting private financial sector lending to nonfinancial businesses, as long as they had been financially healthy prior to the pandemic.<sup>108</sup> The basis for the Fed's program is the CARES Act, which empowers the Fed and the Treasury to act as guarantors while private-sector banks underwrite and allocate credit.<sup>109</sup> Further, the CARES Act allows the Treasury to directly lend to significantly impacted

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<sup>103</sup> See <https://www.british-business-bank.co.uk/ourpartners/coronavirus-business-interruption-loan-scheme-cbils-2/for-businesses-and-advisors/>.

<sup>104</sup> *Apply for the Coronavirus Business Interruption Loan Scheme*, UK GOVERNMENT (23 March 2020), <https://www.gov.uk/guidance/apply-for-the-coronavirus-business-interruption-loan-scheme>.

<sup>105</sup> *Apply for a Coronavirus Bounce Back Loan*, UK GOVERNMENT (27 April 2020), <https://www.gov.uk/guidance/apply-for-a-coronavirus-bounce-back-loan>.

<sup>106</sup> CARES Act, *supra* note 9, §§ 1102, 1105 (for small businesses); *Id.* § 3102 (for sectors affected severely). There is a total cap of \$208 billion for loan assistance.

<sup>107</sup> *B Main Street Lending Program*, BOARD OF GOVERNORS FEDERAL RESERVE SYSTEM (September 8, 2020), <https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm>. The Program provides the following facilities: the Main Street New Loan Facility (MSNLF), the Main Street Priority Loan Facility (MSPLF), the Main Street Expanded Loan Facility (MSELF), the Nonprofit Organization New Loan Facility (NONLF) and the Nonprofit Organization Expanded Loan Facility (NOELF). Loans will be offered by banks, who retain 5 percent of the loan and sell the remaining 95 percent to one of three Main Street facilities (the New Loan Facility, the Priority Loan Facility, and the Expanded Loan Facility). These facilities vary by the type of loan such as loan size, borrower leverage, and whether the loan is new or expands an existing loan. All Main Street loans have a five-year maturity, deferring interest payments for one year and principal payments for two years, can be prepaid without penalty, and have a loan rate of LIBOR plus 3 percentage points. William B. English & J. Nellie Liang, *Designing the Main Street Lending Program: Challenges and Options* 1, 2, 19-20 (Hutchins Ctr. for Fiscal and Monetary Policy, Working Paper No. 64, 2020), <https://www.brookings.edu/research/designing-the-main-street-lending-program-challenges-and-options>.

<sup>108</sup> *Id.*

<sup>109</sup> See Steve Cecchetti & Kim Schoenholtz, *The Fed Goes to War: Part 3*, Money Banking (April 12, 2020), <https://www.moneyandbanking.com/commentary/2020/4/12/the-fed-goes-to-war-part-3> (arguing that the Fed should limit its involvement in the allocation of credit to the private nonfinancial sector).



sectors.<sup>110</sup> Economic Injury Disaster Loans are also available to small businesses and nonprofit organizations that have been experiencing a temporary loss of revenue due to the pandemic, which can be used to cover standard operational expenses.<sup>111</sup>

In the EU, fiscal support for corporate borrowing is administered at the national level.<sup>112</sup> However, EU-level agreements have been secured to support national-level actions. These schemes are not directly open to corporations. First, member states may borrow from the European Stability Mechanism (ESM), a pan-European funding facility established after the global financial crisis of 2007-09 to address the fiscal crises suffered by several European countries whose banking sectors had been impaired during the crisis.<sup>113</sup> The ESM now provides specific “Pandemic Crisis Support” based on the existing credit lines.<sup>114</sup> A new pan-European commitment has been secured to financially support member states’ economy recovery.<sup>115</sup> A recovery fund of over €1.8 trillion has been agreed to be disbursed to member states in the form of both grants and loans for rebuilding their economies after the pandemic.<sup>116</sup> The recovery fund is itself based on the European Commission borrowing €750 billion from the financial markets. Next, the ECB is also able to support European government debt by temporarily easing certain collateral requirements for borrowing countries.<sup>117</sup> Finally, the Emergency Support Instrument, funded at €2.7 billion, is available to member states or private-sector entities for financial support to undertake specific activities that meet the needs of the public health crisis, such as mask procurement.<sup>118</sup> These would be in the form of grants.<sup>119</sup> Outright grants, therefore, feature much less importantly than debt discipline for financial support, although fiscal support distorts market-based debt discipline anyway.

That said, contrary to the situation in the UK or US, significant support for some European companies has been in the form of public-sector equity investments, such as the German government’s €6 billion stake in Lufthansa.<sup>120</sup> The EU has also, in principle, mobilized €300

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<sup>110</sup> CARES Act, *supra* note 9, § 4003(c)(2).

<sup>111</sup> *Economic Injury Disaster Loans*, U.S. SMALL BUS. ADMIN., <https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/economic-injury-disaster-loans> (last visited Nov. 7, 2020).

<sup>112</sup> See *Covid-19 Summary of Government Financial Support in Europe and the Middle East*, SQUIRE PATTON BOGGS (August 28, 2020), <https://www.squirepattonboggs.com/-/media/files/insights/publications/2020/04/updated-covid19-summary-of-government-financial-support-across-europe-and-the-middle-east/covid19-summary-of-government-financial-support.pdf>.

<sup>113</sup> See generally *Programme Overview*, EUROPEAN STABILITY MECHANISM <https://www.esm.europa.eu/assistance/programme-database/programme-overview> (last visited Nov. 7, 2020) (displaying information about the financial assistance programmes).

<sup>114</sup> Subject to standardized terms agreed in advance by the ESM governing bodies. *ESM’s Role in the European Response*, EUROPEAN STABILITY MECHANISM, <https://www.esm.europa.eu/content/europe-response-corona-crisis> (last visited Nov. 7, 2020).

<sup>115</sup> *A Roadmap for Recovery: Towards a More Resilient, Sustainable and Fair Europe*, EUROPEAN COUNCIL (April 21, 2020), <https://www.consilium.europa.eu/media/43384/roadmap-for-recovery-final-21-04-2020.pdf>.

<sup>116</sup> Jim Brunsten et al., *EU Recovery Fund: How the Plan Will Work*, FIN. TIMES (July 21, 2020), <https://www.ft.com/content/2b69c9c4-2ea4-4635-9d8a-1b67852c0322>; Kajus Hagelstam et al., *An EU Recovery Fund: How to Square the Circle?*, SUERF (May 2020), [https://www.suerf.org/docx/f\\_f2d34fcd37e85f9867708bf71782cda6\\_12945\\_suerf.pdf](https://www.suerf.org/docx/f_f2d34fcd37e85f9867708bf71782cda6_12945_suerf.pdf).

<sup>117</sup> Council Decision 2020/506, 2020 (amending EU Guideline 2015/510 on the implementation of the Eurosystem monetary policy framework and EU Guideline 2016/65 on the valuation haircuts applied in the implementation of the Eurosystem monetary policy framework).

<sup>118</sup> *Questions and Answers on Emergency Support Instrument*, EUROPEAN COMM’N (June 23, 2020), [https://ec.europa.eu/commission/presscorner/detail/en/QANDA\\_20\\_1164](https://ec.europa.eu/commission/presscorner/detail/en/QANDA_20_1164).

<sup>119</sup> See [https://ec.europa.eu/echo/what/civil-protection/emergency-support-instrument\\_en](https://ec.europa.eu/echo/what/civil-protection/emergency-support-instrument_en).

<sup>120</sup> Ben Hall, *State Equity Supports Runs Risk of Moral Hazard*, FIN. TIMES (July 30, 2020), <https://www.ft.com/content/f90e4824-1d66-4454-bb36-c61e96e57fc3>.

billion in the form of the Solvency Support Instrument under the European Fund for Strategic Investments for equity support,<sup>121</sup> although it is observed that a policy push for equity instead of debt support is still lacking.<sup>122</sup> The UK has introduced regulatory relaxations for emergency corporate equity fundraising,<sup>123</sup> but companies' predominant turning to debt is observed by most commentators.<sup>124</sup> The preference for increased indebtedness for corporations is driven by pronounced regulatory adjustments made to incentivize lending and by central banks' liquidity operations to support corporate bond markets.

*i. Regulatory Suspensions to Facilitate Increased Lending*

Pronounced regulatory relaxations of microprudential regulatory rules applicable to lenders are key to incentivizing increased debt expansion for corporations needing financial support. First, an inherently flexible capital measure known as the countercyclical buffer (CCyb) is relaxed for banks. The CCyb was introduced in the wake of the global financial crisis to allow regulators to impose capital cost on banks to dampen procyclical creation of debt in periods prone to economic bubbles.<sup>125</sup> In times of excessive market confidence in leverage and asset prices, the introduction of the CCyb would make it more costly for banks to extend credit. This measure plays a part in moderating financial institutions' behavior and markets' tendencies towards a cycle of Minskian instability.<sup>126</sup> As Masur and Posner argue, such regulation is designed to address the need for financial regulators to shape the incentives of financial actors that are inherently biased towards procyclicality, in order to moderate potential market excesses that are not self-correcting.<sup>127</sup> In downturns, as has been caused by the onset of the Covid-19 pandemic, the relaxation of prudential regulation that is inherently adjustable is merely countercyclical regulation that counteracts suboptimal market behavior.

Prior to the onset of the Covid-19 pandemic, the CCyb was set at 1% for UK banks to be elevated to 2% by December 2020,<sup>128</sup> as economic activity looked strong and banks should be prevented from excessive risk-taking. This was abruptly adjusted to 0% during the pandemic,<sup>8</sup> freeing up an estimated capital cost of £190 billion for banks.<sup>129</sup> The reduction of the CCyb has

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<sup>121</sup> *Questions and Answers: Solvency Support Instrument*, EUROPEAN COMM'N (May 29, 2020), [https://ec.europa.eu/commission/presscorner/detail/en/qanda\\_20\\_946](https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_946).

<sup>122</sup> Martin Sandbu, *The Corporate Zombies Stalking Europe*, FIN. TIMES (September 9, 2020), <https://www.ft.com/content/cd90dfbe-3089-4cec-8436-39aed04cafc3>.

<sup>123</sup> Statement of Policy: listed companies and recapitalisation issuances during the coronavirus crisis, FIN. CONDUCT AUTH. (Apr. 8, 2020), <https://www.fca.org.uk/news/statements/listed-companies-recapitalisation-issuances-coronavirus>.

<sup>124</sup> Michael Halling et al., *How Did COVID-19 Affect Firms' Access to Public Capital Markets?* 1, 3 (Swedish House of Fin., Res. Paper No. 20-15, 2020), <https://ssrn.com/abstract=3596114> (focusing on the US).

<sup>125</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, 2013 O.J.(L 176) 346.

<sup>126</sup> See generally Hyman P. Minsky, *The Financial Instability Hypothesis* 1, 6 (The Jerome Levy Econ. Inst. of Bard Coll., Paper No. 74, 1992) (describing the financial instability hypothesis as a theory on the impact of debt on system behavior), <http://www.levyinstitute.org/pubs/wp74.pdf>.

<sup>127</sup> Jonathan S. Masur & Eric A. Posner, *Should Regulation be Countercyclical?*, 34 YALE J. ON REG. 857, 860 (2017).

<sup>128</sup> *Financial Stability Report*, FINANCIAL POLICY COMMITTEE OF THE BANK OF ENGLAND (Dec 16, 2019), <https://www.bankofengland.co.uk/financial-stability-report/2019/december-2019>.

<sup>129</sup> *Bank of England Measures to Respond to the Economic Shock from Covid-19*, BANK OF ENG. (11 March 2020), <https://www.bankofengland.co.uk/news/2020/march/boe-measures-to-respond-to-the-economic-shock-from-covid-19>; *Statement by the PRA Accompanying Measures Announced by the Financial Policy Committee*, BANK OF ENG. (11 March 2020), <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/statement-by-the-pra-accompanying-measures-announced-by-the-fpc>.

also been observed in a number of European countries,<sup>130</sup> as this is not centralized at the EU level. At the EU, the European Systemic Risk Board has the remit to recommend levels of CCyB to member states, but implementation is left to the member states.<sup>131</sup> In the US, the CCyB has been held at 0% even before the onset of the pandemic,<sup>132</sup> reflecting a long-held desire to prevent microprudential regulation from adversely affecting economic growth.<sup>133</sup>

Freeing up the cost of capital originally imposed by the CCyB does not, however, automatically result in more lending. A raft of suspensory measures in addition to the inherently flexible CCyB was introduced to more strongly incentivize banks to provide increased credit.<sup>134</sup>

Banks in the UK, US, and EU are permitted to draw down regulatory capital buffers. Regulatory capital buffers, such as the capital conservation, systemic risk, Pillar-2 buffer, and buffers applying to systemically important banks, are required to be maintained as risk-constraining measures, following the post-crisis reforms.<sup>135</sup> The UK PRA allows banks to draw down on all regulatory buffers, while maintaining the notional levels of mandatory regulatory buffers (such as firms' systemic risk buffer rates) so as to maintain market confidence regulation.<sup>136</sup> Similar regulatory action has been taken in the US to allow banks to use their regulatory buffers to respond to needs during the pandemic in an open-ended, "prudent" manner.<sup>137</sup> In the EU, the ECB, as the single supervisor for banks in the euro area, also allows banks to draw down their Pillar-2 and capital conservation buffers.<sup>138</sup>

Next, liquidity and leverage thresholds have been relaxed for banks, many of these not thought to be inherently flexible as they relate to moderating banks' risk-taking behavior. In the UK, US, and EU, banks are encouraged to allow businesses with credit lines and undrawn credit to draw upon such lines, even if this means banks' liquidity ratios may fall below the mandatory 100% they are supposed to maintain.<sup>139</sup> The liquidity-coverage ratio is intended to be

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<sup>130</sup> Council Regulation 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, 2010 O.J. (L 331) 1.

<sup>131</sup> *Countercyclical Capital Buffer*, EUROPEAN SYSTEMIC RISK BD., (last updated Oct. 26, 2020) (reporting notifications of CCyB changes made in Member States), [https://www.esrb.europa.eu/national\\_policy/ccb/html/index.en.html](https://www.esrb.europa.eu/national_policy/ccb/html/index.en.html).

<sup>132</sup> Press Release, Fed. Rsrv. Bd., Federal Reserve Board Votes to Affirm the Countercyclical Capital Buffer (CCyB) at the Current Level of 0 Percent (Mar. 6, 2019), <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306c.htm>.

<sup>133</sup> *generally What Does The Partial Rollback Of Dodd-Frank Mean For The Largest U.S. Banks?*, FORBES (May 29, 2018), <https://www.forbes.com/sites/greatspeculations/2018/05/29/what-does-the-partial-rollback-of-dodd-frank-mean-for-the-largest-u-s-banks/#76716e9b2f19> (discussing in 2019, the Economic Growth, Regulatory Relief and Consumer Protection Act was passed to "roll back" on the 2010 Dodd-Frank Act, which paved the way for implementing stringent microprudential regulation).

<sup>134</sup> *Q&A on the use of Liquidity and Capital Buffers*, BANK OF ENG. (Apr. 9, 2020),

<https://www.bankofengland.co.uk/prudential-regulation/publication/2020/buffer-usability-qanda>.

<sup>135</sup> Iris Chiu and Jo Wilson, *Banking Law and Regulation* (Oxford: OUP 2019), ch.8.

<sup>136</sup> *Q&A on the use of Liquidity and Capital Buffers*, BANK OF ENG. (Apr. 9, 2020), <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/buffer-usability-qanda>; *PRA Decision on Systemic Risk Buffer Rates*, BANK OF ENG. (Apr. 9, 2020), <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/pradecision-on-srb-rates>.

<sup>137</sup> Joint Release, Bd. Of Governors of the Fed. Rsrv. Sys., Fed. Deposit Ins. Corp. and Office of the Comptroller of Currency, Statement on the Use of Capital and Liquidity Buffers (Mar. 17, 2020), [tps://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200317a1.pdf](https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200317a1.pdf).

<sup>138</sup> EUROPEAN CENT. BANK, *Supra* note 59.

<sup>139</sup> Bank of Eng., *Supra* note 136.

maintained at all times at 100%, which effectively means that a firm can meet its cash outflows for a period of 30 days, so as to prevent a liquidity-driven systemic crisis.<sup>140</sup>

A post-global-financial-crisis initiative, the leverage ratio is also relaxed. The leverage ratio limits all leverage created by banks to be supported by at least 3% of CET1 (Common Equity Tier 1) capital.<sup>141</sup> This backstops bank lending and complements other microprudential regulation. During the Covid-19 pandemic, the US introduced measures to prevent the leverage ratio from hindering important lending activities. First, the ratio is reduced for community banks perceived to support real economy needs.<sup>142</sup> Additionally, holdings of Treasury bills and deposits are not counted towards the leverage ratio.<sup>143</sup> This allows banks to enjoy expanded capacity to lend, including sovereign lending. The loosening of the leverage ratio is more modest in the UK and EU as sovereign debt is still counted. A new EU Capital Requirements Regulation,<sup>144</sup> the “CRR Quick Fix” package, was introduced to provide temporary flexibility in implementing the leverage ratio.<sup>145</sup> It specifically facilitates increased borrowing<sup>146</sup> by allowing exposures such as guaranteed loans by national governments to be excluded from the ratio.<sup>147</sup> The PRA also clarifies that loans made under the Bounce Back Loan Scheme are not counted in the leverage ratio.<sup>148</sup> In sum, these regulatory suspensions roll back, albeit temporarily, all major enhancements to microprudential regulation since the global financial crisis. These raise concerns about the balancing of short-term crisis management objectives against prudential regulatory objectives.

In order to prevent regulatory suspensions from being taken advantage of for perverse incentives such as rewarding shareholders, the PRA, ECB, and Fed have provided strongly phrased guidance to banks to suspend capital distributions to shareholders, including the payment of dividends and share buybacks.<sup>149</sup> In the UK, this restraint also applies to the

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<sup>140</sup> BASEL COMM. ON BANKING SUPERVISION, *BASEL III: THE LIQUIDITY COVERAGE RATIO AND LIQUIDITY RISK MONITORING TOOLS*, 4 (Jan. 2013), <https://www.bis.org/publ/bcbs238.pdf> (enacted in EU and UK legislation).

<sup>141</sup> Regulation 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms and Amending Regulation 648/2012, 2013 O.J. (L 176) art. 429-30 (CET1 capital relates to shareholders’ equity, regarded as best quality loss absorbing capital, applicable to the UK).

<sup>142</sup> Joint Press Release, Bd. of Governors of the Fed. Rsrv. Sys. Fed. Deposit Ins. Corp. and Office of the Comptroller of Currency, Agencies Announce Changes to the Community Bank Leverage Ratio (Apr. 6, 2020), <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200406a.htm>.

<sup>143</sup> Joint Press Release, Bd. of Governors of the Fed. Rsrv. Sys. Fed. Deposit Ins. Corp. and Office of the Comptroller of Currency, Regulators Temporarily Change the Supplementary Leverage Ratio to Increase Banking Organizations’ Ability to Support Credit to Households and Businesses in Light of the Coronavirus Response (May 15, 2020) <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200515a.htm>.

<sup>144</sup> Regulation (EU) 2020/873, O.J. L 204/2020, (L 204/7) 17.

<sup>145</sup> European Banking Auth., at 4, “Guidelines on Reporting and Disclosure of Exposures Subject to Measures Applied in Response to the COVID-19 crisis” final (June 2, 2020) (“to facilitate reporting on the basis of these guidelines, the EBA will provide [a] technical package, covering validation rules, the data point model (DPM) and the XBRL taxonomy and will fully integrate the new reporting into the EBA reporting framework.”).

<sup>146</sup> *Id.*

<sup>147</sup> Regulation (EU) No. 873/2020, *supra* note 114, at ¶ 9.

<sup>148</sup> Press Release, Bank of Engl., Statement on Credit Risk Mitigation Eligibility and Leverage Ratio Treatment of Loans Under the Bounce Back Loan Scheme (May 4, 2020) (“The PRA is offering a modification by consent for banks subject to the UK Leverage Ratio Part of the PRA Rulebook to exclude loans under this scheme from the leverage ratio total exposure measure, if they choose to do so.”).

<sup>149</sup> Press Release, Bank of England, PRA Statement on Deposit Takers’ Approach to Dividend Payments, Share Buybacks and Cash Bonuses in Response to Covid-19 (Mar. 31, 2020); Press Release Federal Reserve Board, Federal Reserve Board Releases Results of Stress Tests for 2020 and Additional Sensitivity Analyses Conducted

payment of cash bonuses to certain material categories of staff.<sup>150</sup> Regulators' power over dividend restrictions is warranted under existing regulation<sup>151</sup> in order to promote the resilience of banks and financial stability. This use of discretionary power—outside of its original rationale—may, however, raise long-term problems relating to banks' cost of capital and ability to attract and retain talented staff.

Finally, the relaxation of microprudential requirements to incentivize lending is complemented by the suspension of supervisory activities that may put pressure on banks towards conservative microprudential compliance. In the UK, the Bank of England is suspending externally administered stress testing for banks.<sup>152</sup> Stress tests are a useful exercise for supervisors to understand whether banks have enough capital to continue to lend in disrupted scenarios.<sup>153</sup> The tests are forward-looking and facilitate supervisory judgments and cross-bank comparisons. The Bank of England has postponed its 2020 stress test<sup>154</sup> to keep credit flowing to households and businesses and reduce pressure on banks induced by the stress test.<sup>155</sup> The European Banking Authority has also decided to postpone its scheduled stress test.<sup>156</sup> The ECB has postponed the enforcement of major supervisory decisions, such as deadlines for remedial actions imposed on banks as a result of on-site inspections.<sup>157</sup> In the US, the Fed initially announced a reduction in its examination activities for banks, focusing on outreach and helping banks cope with meeting the needs from the pandemic.<sup>158</sup> Although the Fed has since

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in Light of the Coronavirus Event (June 15, 2020); European Central Bank, Recommendation of the European Central Bank of 27 July 2020 on dividend distributions during the COVID-19 pandemic and repealing Recommendation, 2020 O.J. (C 251/1) ¶ 1.

<sup>150</sup> Press Release, Bank of Engl., *supra* note 151 (“The PRA also expects banks not to pay any cash bonuses to senior staff, including all material risk takers, and is confident that bank boards are already considering and will take any appropriate further actions with regard to the accrual, payment and vesting of variable remuneration over coming months.”).

<sup>151</sup> 2013 O.J. (L 176/339) Art. 141.

<sup>152</sup> See *infra* n156.

<sup>153</sup> Donald Kohn, Stress Tests: A Policymaker's Perspective (Feb. 5, 2020), <https://www.bankofengland.co.uk/speech/2020/donald-kohn-speech-at-2020-ecb-conference-on-macroprudential-stress-testing> (“Stress tests inform supervisory judgments about whether banks have enough capital to continue to intermediate and lend even as GDP falls and losses mount.”).

<sup>154</sup> Press Release, Bank of Eng., Bank of England Announces Supervisory and Prudential Policy Measures to Address the Challenges of Covid-19 (Mar., 20 2020), <https://www.bankofengland.co.uk/news/2020/march/boe-announces-supervisory-and-prudential-policy-measures-to-address-the-challenges-of-covid-19> (“The decision to cancel the 2020 stress test for eight major UK banks and building societies is intended to help lenders focus on meeting the needs of UK households and businesses via the continuing provision of credit.”).

<sup>155</sup> ‘Delphine Strauss & Stephen Morris, *BoE Cancels Stress Tests to Ease Pressure on Lenders*, FIN. TIMES (Mar. 20, 2020), <https://www.ft.com/content/7433d55c-6a89-11ea-800d-da70cff6e4d3> (“The Bank of England has cancelled its annual stress tests of the banking sector . . . it aimed to lessen the operation burdens on the sector and focus on assuaging the fears that banks would not be able to keep credit flowing to households and businesses.”).

<sup>156</sup> European Banking Auth., EBA Statement on Actions to Mitigate the Impact of COVID-19 on the EU Banking Sector (Mar. 12, 2020) (“The EBA . . . is coordinating a joint effort to alleviate the immediate operational burden for banks at this challenging juncture . . . The EBA has decided to postpone the EU-wide stress test exercise to 2021.”).

<sup>157</sup> European Central Bank, FAQs on ECB Supervisory Measures in Reaction to the Coronavirus (July 28, 2020).

<sup>158</sup> Board Press Release, Fed. Reserve Bd., Federal Reserve Provides Additional Information to Financial Institutions on how its Supervisory Approach is Adjusting in Light of the Coronavirus (Mar. 24, 2020), <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200324a1.pdf> (“To minimize disruption and to focus on outreach and monitoring, the Federal Reserve will temporarily reduce its examination activities, with the greatest reduction in activities occurring at the smallest banks.”).



announced the resumption of examinations,<sup>159</sup> such examinations may be less intense and offsite in nature.

The extensive regulatory suspensions of microprudential rules introduced to incentivize lending are arguably shortsighted, and they sideline issues of moral hazard and adverse financial consequences for increased household and corporate indebtedness.<sup>160</sup> Next, we discuss central banks' actions to facilitate liquidity conditions in financial markets supporting corporate and public-sector bond issuance. These measures crucially underpin the use of debt expansion as the mainstay of financial rescue during the pandemic.

## *ii. Central Bank Policies Facilitating Increased Liquidity for Debt Markets*

Central banks in the UK, US, and EU have undertaken expansive monetary policy measures to support liquidity in the markets for sovereign and corporate bonds. Central bank asset purchases provide constant liquidity to investors in capital markets, such as in situations where there are intense selling pressures by exchange-traded funds.<sup>161</sup> The maintenance of liquidity conditions prevents bond prices from suffering systemic collapse, in particular by protecting large and listed corporations as well as investors.<sup>162</sup>

In the UK, the Monetary Policy Committee of the Bank of England decided unanimously in March 2020 to increase the bank's holdings of UK government bonds and of nonfinancial investment-grade corporate bonds by £200 billion, financed by central bank reserves.<sup>163</sup> Out of the £200 billion at least £10 billion would be used to purchase corporate bonds.<sup>164</sup> For a bond issuer to be eligible, it must be a company that makes a material contribution to economic activity in the UK either directly or via a subsidiary.<sup>165</sup> Eligible bonds must have the following characteristics: (a) conventional senior unsubordinated debt either secured or unsecured; (b) rated investment grade by at least one major rating agency; (c) cleared and settled through Euroclear and/or Clearstream; (d) a minimum amount in issue of £100 million; (e) a minimum residual maturity of twelve months (no perpetual debt is eligible); (f) at least one month to have lapsed since the bond was issued; and (g) admitted to official listing on an EU stock exchange.<sup>166</sup>

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<sup>159</sup> Press Release, Fed. Reserve Bd., Federal Reserve Board Announces it will Resume Examination Activities for all Banks, After Previously Announcing a Reduced Focus on Exam Activity in Light of Coronavirus Response (June 15, 2020),

<https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200615a.htm> (“The Federal Reserve Board on Monday announced that it will resume examination activities for all banks, after previously announcing a reduced focus on exam activity in light of the coronavirus response.”).

<sup>160</sup> See *supra* Section III.

<sup>161</sup> Agnès Bénassy-Quéré et al., *A Proposal for a Covid Credit Line*, VOXEU (Mar. 21, 2020), <https://voxeu.org/article/proposal-covid-credit-line>.

<sup>162</sup> Peter Chatwell, *The Liquidity ‘Doom Loop’ in Bond Funds is a Threat to the System*, FIN. TIMES (Mar. 24, 2020), <https://www.ft.com/content/b7c15426-6e1b-11ea-89df-41bea055720b> (“I call it a liquidity doom loop. And it occurs because bond markets have finite liquidity . . . while ETFs do not (there is no capital charge for ETF traders). Thus, when bonds are suffering illiquidity, as they are in the current crisis, ETF selling can make the bond market illiquidity worse. This is of systemic importance, and of enormous significance to the real economy, because it means that companies will have to pay higher funding costs than they would otherwise.”).

<sup>163</sup> See *infra* n168.

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

<sup>166</sup> Press Release, Bank of Eng., Asset Purchase Facility (APF): Additional Corporate Bond Purchases – Market Notice (Apr. 2, 2020), <https://www.bankofengland.co.uk/markets/market-notice/2020/asset-purchase-facility-additional-corporate-bond-purchases>.



In the EU, the ECB has been purchasing government bonds on the secondary market from commercial banks as well as purchasing public and private assets<sup>167</sup> under its Corporate Sector Purchase Programme.<sup>168</sup> However, as part of dedicated efforts to support debt markets during the pandemic, the Pandemic Emergency Purchase Programme<sup>169</sup> has been introduced to allow the ECB and national central banks collectively to purchase “private and public sector securities” up to €750 billion.<sup>170</sup> Moreover, the emergency nature of this measure allows waivers of eligibility criteria, potentially introducing moral hazard for bond issuers and investors alike.<sup>171</sup> The massive injection of liquidity into the banking sector and capital markets inevitably raises inflation and exacerbates indebtedness.<sup>172</sup>

In the US, quantitative easing tools, which rely on asset purchases, are extensively used by the Fed.<sup>173</sup> The Fed’s MSLP<sup>174</sup> is the largest liquidity stimulus package with over \$2 trillion supporting the trading of US Treasuries, mortgage-backed securities, and commercial paper, as well as municipal and corporate bonds.<sup>175</sup> Further, the Fed has set up facilities to provide dollar liquidity to foreign central banks and monetary authorities so that commercial transactions with the US corporate sector or dollar-settled transactions can continue without disruption.<sup>176</sup> Foreign central banks and international organizations with accounts at the Federal Reserve Bank of New York can temporarily exchange their US Treasury securities held with the Fed for dollars, which can then be made available to institutions in their jurisdictions for dollar-denominated transactions and commerce.<sup>177</sup> The extensive liquidity operations assumed by the

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<sup>167</sup> Sage Belz et al., *What’s the ECB Doing in Response to the COVID-19 Crisis?*, BROOKINGS INST. (June 4, 2020), <https://www.brookings.edu/research/whats-the-ecb-doing-in-response-to-the-covid-19-crisis/>.

<sup>168</sup> European Cent. Bank, Corporate Sector Purchase Programme (CSPP) – Questions & Answer (Apr. 8, 2020), <https://www.ecb.europa.eu/mopo/implement/omt/html/cspp-qa.en.html> for eligible corporate debt.

<sup>169</sup> See Decision 2020/440, of the European Central Bank of 24 March 2020 on a Temporary Pandemic Emergency Purchase Programme (ECB/2020/17); 2020 O.J. (L 91) 1.

<sup>170</sup> See *id.* at 2.

<sup>171</sup> See *Asset purchase programmes*, EUR. CENT. BANK (Oct. 18, 2020), <https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html>.

<sup>172</sup> See MORITZ SCHULARICK, SASCHA STEFFEN & TOBIAS TRÖGER, BANK CAPITAL AND THE EUROPEAN RECOVERY FROM THE COVID-19 CRISIS 6–8 (Leibniz Inst. for Fin. Research SAFE ed. 2020).

<sup>173</sup> See Jonathan Hartley & Alessandro Rebucci, *An Event Study of COVID-19 Central Bank Quantitative Easing in Advanced and Emerging Economies 2* (Nat’l Bureau of Econ. Rsch., Working Paper No. 27339, 2020).

<sup>174</sup> See generally Coronavirus Aid, Relief, and Economic Security Act, 15 U.S.C. §§ 9001–9080 (2020) (stating that the CARES Act was preceded by the other legislative interventions, namely the Coronavirus Preparedness and Response Supplemental Appropriations Act 2020 and the Families First Coronavirus Response Act both promulgated on March 2020).

<sup>175</sup> The Federal Reserve introduced the following facilities to support the flow of credit: (i) Commercial Paper Funding Facility; (ii) Primary Dealer Credit Facility; (iii) Money Market Mutual Fund Liquidity Facility; (iv) Primary Market Corporate Credit Facility; (v) Secondary Market Corporate Credit Facility; (vi) Term Asset-Backed Securities Loan Facility; (vii) Paycheck Protection Program Liquidity Facility.

<sup>176</sup> See Press Release, Fed. Reserve Bd,

Federal Reserve announces the extension of its temporary U.S. dollar liquidity swap lines and the temporary repurchase agreement facility for foreign and international monetary authorities (FIMA repo facility) through September 30, 2021

(Dec 16, 2020), <https://www.federalreserve.gov/newsevents/pressreleases/monetary20201216c.htm>; Kathryn Judge, *Congress Should Endorse the Federal Reserve’s Extraordinary Measures*, COLUM. L. SCH.’S BLOG ON CORPS.’ & THE CAPITAL MKTS.’ (Mar. 24, 2020), <https://clsbluesky.law.columbia.edu/2020/03/24/congress-should-endorse-the-federal-reserves-extraordinary-measures/>.

<sup>177</sup> Fed Reserve Bd, *Id.*

Fed, at a global level, has moved the Fed into uncharted territory,<sup>178</sup> giving rise to concerns regarding its mandate.<sup>179</sup>

### E. *Policy and Regulatory Measures in the Context of Financialization*

The financial relief and rescue measures in US, UK, and EU need to be understood against the backdrop of financialization, an established and long-term trend in these economies. The context of financialization crucially shapes the nature of financial relief and rescue. More crucially, this context shapes the legal and regulatory framing for private-sector finance, which Section III argues would ultimately pose hazards to households and corporations accessing debt expansion during the pandemic.

Financialization is defined as “the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies.”<sup>180</sup> In other words, private-sector finance is dominant in meeting financial needs, whether on the part of households, corporations, or sovereigns. The process of financialization dates back to the late 1970s and early 1980s, and it marks the transition from the postwar social consensus era to the current neoliberal era, and from industrial domination of the economy to financial domination of the economy.<sup>181</sup> With state retreat from social welfare, households needed to rely on the private sector to meet various saving and consumption needs such as education, housing, and health,<sup>182</sup> giving rise to a cultural shift towards debt-financed consumption.<sup>183</sup> Debt, however, is framed as a transactional paradigm, obscuring its social underpinnings.<sup>184</sup>

The rise in saving and investment needs has driven “money manager capitalism”<sup>185</sup> where the financial sector is entrusted to allocate financial resources. However, such financial intermediation has only led to a generation of yield and financial value, decoupled from long-term investment in real economy productivity.<sup>186</sup> In this manner, corporations, as engines of real economy wealth creation, have been affected in fundamental ways. Corporations’ focus has turned to their financial values (i.e., share price), often on a short-term basis.<sup>187</sup> Further,

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<sup>178</sup> The Editorial Bd., *The Fed’s radical policies are uncharted territory*, FIN. TIMES (April 9, 2020), <https://www.ft.com/content/70a0d2ca-7987-11ea-af44-daa3def9ae03>.

<sup>179</sup> See Christine Desan & Nadav Orian Peer, *The Constitution and the Fed after the COVID-19 Crisis* 5–6 (Univ. of Colo. L. Legal Studies Research Paper No. 20-38, 2020 and Harvard Pub. L. Working Paper No. 20-12, 2020); David Zaring, *The Government’s Economic Response to the COVID Crisis* 9 (Aug. 7, 2020) (unpublished article) (<https://ssrn.com/abstract=3662049>).

<sup>180</sup> Gerald A. Epstein, *Introduction: Financialization and the World Economy*, in FINANCIALIZATION AND THE WORLD ECONOMY 3 (Gerald A. Epstein ed., 2005).

<sup>181</sup> See THOMAS I. PALLEY, FINANCIALIZATION: THE ECONOMICS OF FINANCE CAPITAL DOMINATION 17 (1st ed. 2013).

<sup>182</sup> See JACOB S. HACKER, THE GREAT RISK SHIFT THE NEW ECONOMIC INSECURITY AND THE DECLINE OF THE AMERICAN DREAM 14 (rev. and expanded ed. 2006).

<sup>183</sup> See BRUCE G. CARRUTHERS & LAURA ARIOVICH, MONEY AND CREDIT: A SOCIOLOGICAL APPROACH 86–87 (2010); Neil Fligstein & Adam Goldstein, *The Emergence of a Finance Culture in American Households, 1989–2007*, 13 SOCIO-ECON. REV. (Special Issue) 575, 579 (2015).

<sup>184</sup> See generally Seth Frotman, *Broken Promises: How Debt-Financed Higher Education Rewrote America’s Social Contract and Fueled a Quiet Crisis*, 4 UTAH L. REV. 1, 1 (2018) (categorizing student debt as a threat to the American social contract).

<sup>185</sup> L. Randall Wray, *Money Manager Capitalism and the Global Financial Crisis* 2 (The Levy Econs.’ Inst., Working Paper No. 578, 2009).

<sup>186</sup> See DEP’T FOR BUS., INNOVATION & SKILLS, THE KAY REVIEW OF UK EQUITY MARKETS AND LONG-TERM DECISION MAKING 22 (2012).

<sup>187</sup> See Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265, 269–271 (2012).

the distribution of corporate wealth has become skewed in favor to those contributing to financial value rather than productive value.<sup>188</sup>

Against the financialization backdrop, there is heavy reliance on the private-sector provision for financial support during the Covid-19 pandemic, even if interlaced with public-sector support.<sup>189</sup> Indeed, even in government-backed borrowing, the transactional and underwriting expertise of private-sector lenders is relied upon, although the incentives for moral hazard cannot be underestimated. Private sector lenders are firmly in charge of the outworking of debt relations with borrowers. Further, central banks' liquidity support shows the inevitability of relying on market forces to sustain the corporate sector, whose funding needs and financialized valuations have become inextricably intertwined.

We critically question whether the financialized context in which relief and rescue policies are implemented can bring about the public interest outcomes needed in combatting the adverse impact of the Covid-19 pandemic. Ultimately, financial relief and rescue is intended to support the economic recovery of businesses<sup>190</sup> and the alleviation of households' economic suffering.<sup>191</sup> Both these objectives combine economic and social rationales and values. Supporting corporate recovery is not only about preserving financial value but about productive value and job-creation capacity. Similarly, providing financial relief for households is not only about maintaining levels of aggregate demand but about substantive well-being. However, economic rationales are often not juxtaposed well with the social consequences of excessive

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<sup>188</sup> See Anat R. Admati, *A Skeptical View of Financialized Corporate Governance*, 31 J. ECON. PERSPS.' 131, 131–132 (2017); Paddy Ireland, *Financialization and Corporate Governance*, 60 N. IR. LEGAL Q. 1, 2–3 (2009); William Lazonick, *The Financialization of the U.S. Corporation: What has Been Lost, and how it can be Regained*, 36 SEATTLE U. L. REV. 857, 858–859 (2013).

<sup>189</sup> Natascha van der Zwan, *Making Sense of Financialization*, 12 SOCIO-ECON. R. 99, 99 (2014).

<sup>190</sup> In the UK, Minister for Regional Growth and Local Government, Simon Clarke MP has stated that: “We have always said that we would stand behind our businesses and communities as we rebuild following the coronavirus pandemic. . . . Small and medium sized businesses are the beating heart of communities.” Press Release, See Simon Clark, member of parliament, & Ministry of Hous., Comty. & Loc. Gov't., *£20 million in new grants to boost recovery of small businesses*, GOV.UK (July 30, 2020), <https://www.gov.uk/government/news/20-million-in-new-grants-to-boost-recovery-of-small-businesses>. In the EU, Valdis Dombrovskis has emphasized that the importance of private funding for economic recovery: “Capital markets are vital to the recovery, because public financing alone will not be enough to get our economies back on track.” See *European Commission Press Release IP/20/1382*, Coronavirus response: Making capital markets work for Europe's recovery (July 24, 2020), [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_20\\_1382](https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1382). In the US, the Government has clearly indicated that providing economic support to families and businesses is a major priority, Press Release, The Whitehouse, *President Donald J. Trump Is Supporting American Businesses, Workers, and Families Impacted by the Coronavirus* (Mar. 18, 2020), <https://www.whitehouse.gov/briefings-statements/president-donald-j-trump-supporting-american-businesses-workers-families-impacted-coronavirus/>.

In the EU, Valdis Dombrovskis has emphasized that the importance of private funding for economic recovery—“...Capital markets are vital to the recovery, because public financing alone will not be enough to get our economies back on track.” See ‘Coronavirus response: Making capital markets work for Europe's recovery’ (24 July 2020), [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_20\\_1382](https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1382). In the US, the Government has clearly indicated that providing economic support to families and businesses is a major priority, ‘President Donald J. Trump Is Supporting American Businesses, Workers, and Families Impacted by the Coronavirus’ (18 March 2020), <https://www.whitehouse.gov/briefings-statements/president-donald-j-trump-supporting-american-businesses-workers-families-impacted-coronavirus/>.

<sup>191</sup> The UK government has stated that their first objective is to save lives and the second is “protecting and restoring people's livelihoods and improving people's living standards.” See HM GOVERNMENT, *OUR PLAN TO REBUILD: THE UK GOVERNMENT'S COVID-19 RECOVERY STRATEGY*, 2020, 16 (UK). The EU Commission also emphasizes the need to “protect citizens and mitigate the severely negative socio-economic consequences of the coronavirus pandemic.” See *European Commission Press Release IP/20/1496*, Coronavirus: Commission proposes to provide €81.4 billion in financial support for 15 Member States under SURE (Aug. 24, 2020), [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_20\\_1496](https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1496); *Id.* for the US position.

indebtedness, which we discuss in the next section as fundamentally important to meet the objectives of promoting business recovery and alleviating household suffering.

Further, shortsighted financial relief and rescue policies need to be balanced against a third important objective: the preservation of the stability of the financial system and mitigation of systemic risk, which can be caused both by failures or distress in large banks and by accumulation of risk in other firms or markets.<sup>192</sup> Financial stability remains essential, as a robust financial system is necessary for the other two regulatory objectives to be achievable. In this respect, there is insufficient regulatory consideration of how excessive indebtedness adversely affects financial institutions' capacities.<sup>193</sup> Further, to what extent can the extraordinary liquidity operations of central banks be sustainable? Asset prices in bond and equity markets are already viewed by many as artificially high<sup>194</sup> and divorced from economic fundamentals.<sup>195</sup>

We turn to discuss the adverse implications of financial relief and rescue policies dominated by debt expansion. Policy makers need to reckon with these adverse implications and engage with the long-term needs for further legal and regulatory adjustments.

### III. Adverse Implications of Debt Expansion

Although private debt expansion provides relief and rescue for the near term, high levels of indebtedness entail longer-term consequences that could exacerbate corporate fragility and household suffering. There is significant empirical literature that demonstrates how corporations become more financially fragile (i.e., edge closer to the risks of insolvency and distress) due to high levels of indebtedness.<sup>196</sup> Corporate insolvencies, reflecting micro-level financial fragility, are often related to macro-level financial fragility in the financial system.<sup>197</sup>

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<sup>192</sup> Press Release, Bank of Eng., *Bank of England announces supervisory and prudential policy measures to address the challenges of Covid-19* (Mar. 20, 2020), <https://www.bankofengland.co.uk/news/2020/march/boe-announces-supervisory-and-prudential-policy-measures-to-address-the-challenges-of-covid-19>. In the EU, the importance of financial stability during the pandemic is emphasized, Luis de Guindos, Vice President, Euro. Cent. Bank, *Financial stability and the pandemic crisis*, Speech at the Frankfurt Finance Summit, (June 22, 2020),

<https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200622~422531a969.en.html>. In the US, the Fed recently warned that the financial system is vulnerable, highlighting financial stability concerns, BD. OF GOVERNORS OF THE FED. RESERVE SYS., *FINANCIAL STABILITY REPORT: MAY 2020* (May 15, 2020), <https://www.federalreserve.gov/publications/financial-stability-report.htm>.

<sup>193</sup> Alissa Kleinnijenhuis et al., *Usable Bank Capital*, VOXEU (June 30, 2020), <https://voxeu.org/article/usable-bank-capital#.XwA9ibxoIRc.twitter>.

<sup>194</sup> Kevin Carmichael, *Stocks soar despite coronavirus and a recession. It's time for a reality check, and a crash.*, NBC UNIVERSAL (June 8, 2020), <https://www.nbcnews.com/think/opinion/stocks-soar-despite-coronavirus-recession-it-s-time-reality-check-ncna1227771>; *ESMA Sees High Risk Of Decoupling Of Financial Market Performance And Underlying Economic Activity*, EUR. SEC. & MKT. AUTH. (Sept. 2, 2020), <https://www.esma.europa.eu/press-news/esma-news/esma-sees-high-risk-decoupling-financial-market-performance-and-underlying>.

<sup>195</sup> Jeanna Smialek & Jack Ewing, *Central Bankers Have Crossed Bright Lines to Aid Economies*, N.Y. TIMES (June 9, 2020), <https://www.nytimes.com/2020/06/09/business/economy/central-banks-coronavirus-economies.html>.

<sup>196</sup> Sander van der Hoog, *The Limits to Credit Growth: Mitigation Policies and Macroprudential Regulations to Foster Macrofinancial Stability and Sustainable Debt*, 52 COMPUTATIONAL ECON. 873, 886-87 (2018).

<sup>197</sup> C. Bruneau et al., *Macroeconomic Fluctuations and Corporate Financial Fragility*, 8 J. FIN. STABILITY 219, 219 (2012); Laura Alfaro et al., *Corporate Debt, Firm Size and Financial Fragility in Emerging Markets*, 118 J. INT'L ECON. 1, 3 (2019); see generally E Philip Davis, *Debt, Financial Fragility and Systemic Risk*, OXFORD



This is because corporate insolvencies and defaults exacerbate stress for lenders, and large losses can cause lenders to become financially fragile themselves. At scale, the banking sector could be greatly reduced in its capacity to support the real economy.<sup>198</sup>

Household indebtedness can also lead to financial fragility.<sup>199</sup> Personal bankruptcy or financial distress is not merely a micro-level issue, but more broadly implicates household suffering. Indebted households may suffer from stress which affects individuals' states of mental well-being,<sup>200</sup> relational well-being at a social level,<sup>201</sup> and workplace productivity.<sup>202</sup> In the worst cases, financial fragility for individuals and households contributes to social cost, including issues of poverty<sup>203</sup> and homelessness.<sup>204</sup> The global financial crisis of 2007-09 crucially showed the tight relationship between dispossessed subprime homeowners—a sign of distress during the global financial crisis<sup>205</sup>—and systemic crisis for the banking sector.<sup>206</sup> Household financial fragility is also likely to affect aggregate demand,<sup>207</sup> thus limiting the corporate sector's economic output and contributing to its economic woes and financial fragility.

In this manner, household, corporate, and financial-sector fragility are intertwined. We critically query if increased indebtedness would really meet the three policy objectives of (a) corporate economic recovery, (b) alleviation of household economic suffering, and (c) preservation of the stability of the financial system.<sup>208</sup>

It may be argued that the picture of indebtedness and fragility depicted above is exaggerated, given the purely near-term needs of corporations and households that seek relief and rescue

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SCHOLARSHIP ONLINE, 1995, at DOI:10.1093/0198233310.003.0003 (on the causes and implications of recent trends of debt in OECD countries).

<sup>198</sup> Davis, *supra* footnote 200.

<sup>199</sup> Paola D'Orazio, *Income Inequality, Consumer Debt, and Prudential Regulation: An Agent-Based Approach to Study the Emergence of Crises and Financial Instability*, 82 *ECON. MODELLING* 308, 321 (2019).

<sup>200</sup> Chris Fitch et al., *The Relationship Between Personal Debt and Mental Health: A Systematic Review*, 16 *MENTAL HEALTH R. J.* 153, 157-158 (2011); *See also* Randy Hodson et al., *Credit card blues: the middle class and the hidden costs of easy credit*, 55 *SOC. Q.* 315, 317 (2014).

<sup>201</sup> Susan Johnson, *Debt, Over-indebtedness and wellbeing: an exploration*, in *MICROFINANCE, DEBT AND OVER-INDEBTEDNESS* 64, 64 (Isabelle Guérin, Solène Morvant-Roux & Magdalena Villarreal eds., 2014); Guérin et al., *The Social Meaning of Over-Indebtedness and Creditworthiness in the Context of Poor Rural South Indian Households (Tamil Nadu)*, in *MICROFINANCE, DEBT AND OVER-INDEBTEDNESS* 125, 125 (Isabelle Guérin, Solène Morvant-Roux & Magdalena Villarreal eds., 2014); Francesco Zanutelli, *Multiplying Debt and Dependence: Gender Strategies and the Social Risks of Financial Inclusion in Western Mexico*, in *MICROFINANCE, DEBT AND OVER-INDEBTEDNESS* 192, 192 (Isabelle Guérin, Solène Morvant-Roux & Magdalena Villarreal eds., 2014).

<sup>202</sup> Raminder Luther, Irene E. Leech & E. Thomas Garman, *The Employer's Cost for the Personal Financial Management Difficulties of Workers: Evidence from the U.S. Navy*, 2 *PERS. FIN. & WORKER PRODUCTIVITY* 175, 178 (1998).

<sup>203</sup> Lungile Ntsalaze & Sylvanus Ikhide, *The Threshold Effects of Household Indebtedness on Multidimensional Poverty*, 44 *INT'L J. SOC. ECON.* 1471 (2017).

<sup>204</sup> A. Mechele Dickerson, *Over-Indebtedness, the Subprime Mortgage Crisis, and the Effect on U.S. Cities*, 36 *FORDHAM URB. L.J.* 395, 418 (2009).

<sup>205</sup> Lauren M. Ross & Gregory D. Squires, *The Personal Costs of Subprime Lending and the Foreclosure Crisis: A Matter of Trust, Insecurity, and Institutional Deception*, 92 *SOC. SCI. Q.* 140, 140 (2011).

<sup>206</sup> HOWARD DAVIES, *THE FINANCIAL CRISIS: WHO IS TO BLAME?* 30, 71, 76 (2010); Francis A. Longstaff, *The Subprime Credit Crisis and Contagion in Financial Markets*, 97 *J. FIN. ECON.* 436, 436 (2010).

<sup>207</sup> Paulo L. dos Santos, *A Cause for Policy Concern: The Expansion of Household Credit in Middle-Income Economies*, 27 *INT'L REV. OF APPLIED ECON.* 316 (2013).

<sup>208</sup> *Supra* Section II.E.

during the pandemic.<sup>209</sup> However, increased indebtedness for corporations and households raises heightened concerns for financial fragility, as extant levels of indebtedness are already high in the corporate<sup>210</sup> and household sectors<sup>211</sup> in the jurisdictions surveyed. Financial fragility is a result of the rigidity of the demands of debt upon borrowers. The demands of debt are legally framed, and, as a result, legal framing contributes to financial fragility for corporations and households. In particular, we argue that the legal framing of debt underwritten during the pandemic exacerbates such financial fragility.

### ***A. How the Legal Framing of Corporate Debt Affects Financial Fragility***

The legal framing of corporate debt affects corporate financial fragility in two ways. The first relates to the way in which corporate capital structure decisions are affected by the legal or regulatory framing that supports access to debt. The second relates to legal framing for the terms of debt that place demands on borrowers, accelerating or culminating in financial fragility when they are enforced.

In relation to the first respect, although the Modigliani-Miller theorem<sup>212</sup> posits that firms' decisions on capital structure (i.e., the mix of debt financing and equity financing) do not matter for firm value under assumptions of perfect market conditions, the absence of perfect conditions in the real world means that firms do grapple with attaining an optimal capital structure.<sup>213</sup> In making decisions about whether to borrow more or raise funds from capital markets, commentators posit that corporations' decisions are influenced at the micro-level by their incentives<sup>214</sup> and preferences<sup>215</sup> as well as by broader industry factors, such as competition,<sup>216</sup> and institutional factors, such as legal and regulatory regimes.<sup>217</sup> Indeed, legal

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<sup>209</sup> Indeed, the Bank of England survey shows near-term benefits for households averting financial shock by resorting to payment holidays. *How Has Covid-19 Affected the Finances of UK Households?*, BANK OF ENGLAND (Aug. 25, 2020), <https://www.bankofengland.co.uk/bank-overground/2020/how-has-covid-19-affected-the-finances-of-uk-households>.

<sup>210</sup> DAVIS, *supra* note 200, at 32–74.

<sup>211</sup> Michael Kumhof, Romain Rancière & Pablo Winant, *Inequality, Leverage, and Crises*, 105 AM. ECON. REV. 1217 (2015); Charles Randell, Chair of the FCA and PSR, *A Financial System to Support the Recovery*, speech to a virtual roundtable of bank chairs hosted by UK finance, (Jun. 16, 2020), <https://www.fca.org.uk/news/speeches/financial-system-support-recovery> (on high levels of household indebtedness in the UK).

<sup>212</sup> Franco Modigliani & Merton Miller, *The Cost of Capital, Corporation Finance and the Theory of Investment*, 48 AM. ECON. REV. 261, 261 (1958).

<sup>213</sup> Peter H. Huang & Michael S. Knoll, *Corporate Finance, Corporate Law and Finance Theory*, 74 S. CAL. L. REV. 175, 191 (2000); See Michael S. Knoll, *The Modigliani-Miller Theorem at 60: The Long-Overlooked Legal Applications of Finance's Foundational Theorem*, 36 YALE J. REGUL. BULL. 1, 1 (2018).

<sup>214</sup> For the trade-off theory that posits that firms balance the cost and benefits of equity and debt in order to decide on the capital mix, see Franck Bancel & Usha R. Mittoo, *Cross-Country Determinants of Capital Structure Choice: A Survey of European Firms*, 33 FIN. MGMT. 103, 103, 104 (2004); Thiess Buettner et al., *Taxation and Capital Structure Choice—Evidence from a Panel of German Multinationals*, (Econstor, Working Paper No. 1841, 2005).

<sup>215</sup> see Wolfgang Bessler, Wolfgang Drobetz & Robin Kazemieh, *Factors Affecting Capital Structure Decisions*, in CAPITAL STRUCTURE AND CORPORATE FINANCING DECISIONS: THEORY, EVIDENCE, AND PRACTICE 17–40 (H. Kent Baker & Gerald S. Martin eds., 2011); Mark T. Leary & Michael R. Roberts, *Do Firms Rebalance their Capital Structures?*, 60 J. FIN. 2575, 2575 (2005).

<sup>216</sup> Maurizio La Rocca, *Capital Structure and Corporate Strategy*, in CAPITAL STRUCTURE AND CORPORATE FINANCING DECISIONS: THEORY, EVIDENCE, AND PRACTICE 41–58 (H. Kent Baker & Gerald S. Martin eds., 2011).

<sup>217</sup> Carmen Cotei & Joseph Farhat, *Worldwide Patterns in Capital Structure*, in CAPITAL STRUCTURE AND CORPORATE FINANCING DECISIONS: THEORY, EVIDENCE, AND PRACTICE 111, 114 (H. Kent Baker & Gerald S. Martin eds., 2011); Joseph P.H. Fan, Sheridan Titman & Garry Twite, *An International Comparison of Capital Structure and Debt Maturity Choices*, 47 J. FIN. QUANTITATIVE ANALYSIS 23, 23, 24–25 (2012).



and regulatory framing pervades the micro-level factors too, as legal and regulatory framing affects corporations' calculations on cost. Commentators have observed that tax regulatory treatment that favors debt reduces the cost of debt,<sup>218</sup> and strong creditor rights<sup>219</sup> and protections contribute to the ease of access to debt as supply-side confidence is fostered.

Equity fundraising is relatively more expensive due to regulatory framing (in relation to securities regulation)<sup>220</sup> and corporate law (in relation to shareholder rights and protections).<sup>221</sup> Such regulatory framing, however, boosts supply-side confidence and enhances ease of access to capital markets.<sup>222</sup> In countries with weaker legal and regulatory framing for capital markets protections, research finds that reliance on debt financing is even stronger.<sup>223</sup> Legal framing of private debt correspondingly enhances lender protection in relation to the terms of debt, such as duration and monitoring.<sup>224</sup>

Section II shows how developed jurisdictions have almost unanimously steered corporations towards increased indebtedness during the Covid-19 pandemic in order to tide over their difficulties. However, increased indebtedness is not necessarily beneficial for all firms, as the demands of the terms of loans may exert greater pressure on certain firms over others. For example, in the sectors that were hardest hit, such as tourism and travel, revenue predictions remain highly uncertain for the foreseeable future.<sup>225</sup> Firms in these sectors would likely suffer from cash flow volatility and constraints. Arguably, the cash flow discipline for managers that comes from the legal framing of debt, in relation to obligations for periodic payments contractually agreed, could be contrary to firms' needs.<sup>226</sup> We also doubt that strong debt covenant burdens in favor of creditor monitoring are compatible with effective corporate crisis management. This is because managers who can exercise significant discretion are usually needed to steer corporations out of a crisis.<sup>227</sup> Empirical research also suggests that where firms

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<sup>218</sup> Huang Huang & Knoll, *supra* note 178, at 191; Fan et al., *supra* note 182, n.22, at 38; Silke Runger, Rainer Niemann & Magdalena Haring, *Investor Taxation, Firm Heterogeneity and Capital Structure Choice*, 26 INT'L TAX & PUB. FIN. 719, 722 (2019).

<sup>219</sup> See Thomas W. Hall & Frederick Jorgensen, *Legal Variation and Capital Structure: Comparing Listed and Non-Listed Companies*, 40 EUR. J.L. & ECON. 511, 513 (2015).

<sup>220</sup> On the cost of complying with securities regulation, see Elizabeth Howell, *An Analysis of the Prospectus Regime: The EU Reforms and the "Brexit" Factor*, 15 EUR. CO. & FIN. L. REV. 69, 91 (2018).

<sup>221</sup> Nam H. Nguyen, Hieu V. Phan & Eunju Lee, *Shareholder Litigation Rights and Capital Structure Decisions*, 62 J. CORP. FIN. 10161, 10164 (2020); Zhe An, Donghui Li & Jin Yu, *Earnings Management, Capital Structure, and the Role of Institutional Environments*, 68 J. BANKING & FIN. 131, 132 n.8 (2016).

<sup>222</sup> Nguyen et al., *supra* note 224, at 10185.

<sup>223</sup> Cotei & Farhat, *supra* note 220, at 113.

<sup>224</sup> See generally Rima Turk Ariss, *Legal Systems, Capital Structure, and Debt Maturity in Developing Countries*, 24 CORP. GOVERNANCE: INT'L REV. 130 (2016).

<sup>225</sup> See Vicky Karantzavelou, *Over a third of UK's SMEs in the travel sector will need 2 years to recover from coronavirus*, TRAVEL DAILY NEWS INT'L (Apr. 28, 2020, 9:19 ), <https://www.traveldailynews.com/post/over-a-third-of-uks-smes-in-the-travel-sector-will-need-2-years-to-recover-from-coronavirus>.

<sup>226</sup> Cash flow constraints impede investment by firms. See Matei Tamasilaa et al., *Cash Flow and Investment Decision: An Application on the Romanian Agriculture Sector*, 238 PROCEDIA SOC. & BEHAV. SCI. 704, 706-07 (2018).

<sup>227</sup> Decisive and powerful managers who are able to make decisions quickly and with a large berth of discretion have been observed to be key to crisis-struck firms' recovery. See Marc van Essen, Peter-Jan Engelen & Michael Carney, *Does "Good" Corporate Governance Help in a Crisis? The Impact of Country- and Firm-Level Governance Mechanisms in the European Financial Crisis*, 21 CORP. GOVERNANCE: INT'L REV. 201, 203 (2013); Chris Nichols, Shoma Chatterjee Hayden & Chris Trendler, *4 Behaviors That Help Leaders Manage a Crisis*, HARV. BUS. REV., Apr. 2, 2020, <https://hbr.org/2020/04/4-behaviors-that-help-leaders-manage-a-crisis>.

are highly indebted and unable to be productive, financial fragility risks are enhanced.<sup>228</sup> Firms battling the economic woes caused by the pandemic may deploy debt to “fight fire” and pay expenses, or may deploy debt to switch to forms of productivity relevant to needs during the pandemic.<sup>229</sup> Debt finance would likely be suboptimal for a struggling firm that is unable to turn productivity around for revenue generation. For instance, a retailer suffering from consumer consumption aversion during the pandemic would probably not benefit from taking on more debt just to foot its rent and other fixed costs.

However, regulatory suspensions of microprudential regulation and government support for increased lending are two key aspects of regulatory framing that steer increased demand, as well as supply, for loans. Lenders may be incentivized towards quick and significant amounts of loan generation with minimal diligence standards, as they do not have much incentive to price conservatively. In this case, regulatory framing overcomes risk aversion on the part of lenders during a time of information asymmetry<sup>230</sup> as borrowers’ financial circumstances become volatile. However, moral hazard in lending and indiscriminate borrowing on the part of debtors entail long-term suboptimal effects.

Arguably, firms with certain long-term needs and longer-term horizons for economic recovery could benefit from turning to equity rather than debt during this crisis.<sup>231</sup> However, compared to regulatory suspensions for lenders, only the UK and EU have implemented limited measures to facilitate equity fundraising, while maintaining much of the securities regulatory investor protection regime.<sup>232</sup> Market sentiment in capital markets is unfortunately procyclical and investors are behaviorally risk averse, as reflected in their preference for cash (using Lo’s adaptive capital markets hypothesis).<sup>233</sup> Indeed, levels of private investment in the corporate sector have fallen,<sup>234</sup> while companies are turning more to debt than equity issuances.<sup>235</sup> The legal and regulatory framing adopted by policy makers during the pandemic has arguably not done enough to facilitate equity capitalization as a realistic alternative to increased debt.

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<sup>228</sup> Dirk Bezemer & Maria Grydaki, *Financial Fragility in the Great Moderation*, 49 J. BANKING & FIN. 169, 175 (2014).

<sup>229</sup> The appropriateness of increased debt finance is not the same for all firms. Some firms may strategically reinvent themselves but others may hoard cash and contribute little to economic recovery, or become hard-pressed. Jonathan Guthrie, Andrew Whiffin & Pan Kwan Yuk, *Lex In-depth: Why rescue finance will slow recovery for businesses*, FIN. TIMES (Aug. 26, 2020), <https://www.ft.com/content/3afb13c5-99d1-418f-ad51-33f3d6db81ca>.

<sup>230</sup> See Peter Lee, *CBILS Faulty: Sunak’s Flagship UK Lending Scheme Looks Unfit for Purpose*, EUROMONEY, Apr. 24, 2020, <https://www.euromoney.com/article/b1lbgfwrx72nn3/cbils-faulty-sunaks-flagship-uk-lending-scheme-looks-unfit-for-purpose>.

<sup>231</sup> Companies that are healthily capitalised and have cash buffers are seen as more resilient. Stefano Ramelli & Alexander F. Wagner, *Feverish Stock Price Reactions to COVID-19*, 9 REV. CORP. FIN. STUD. 622, 640 (2020).

<sup>232</sup> Statement, Fin. Conduct Auth., Statement of Policy: Listed Companies and Recapitalisation Issuances during the Coronavirus Crisis (Apr. 8, 2020), <https://www.fca.org.uk/news/statements/listed-companies-recapitalisation-issuances-coronavirus>. The EU Commission has recently proposed a Capital Markets Recovery Package to permit a short-form prospectus for established issuers, and lower compliance burdens for investment advisors when dealing with experienced investors respectively. European Commission Press Release IP/20/1382, Coronavirus Response: Making Capital Markets Work for Europe’s Recovery (July 24, 2020).

<sup>233</sup> See Andrew W. Lo, *The Adaptive Markets Hypothesis: Market Efficiency from an Evolutionary Perspective*, 30 J. PORTFOLIO MGMT. 15, 23 (2014).

<sup>234</sup> Attracta Mooney & Peter Smith, *Investors pull record €250bn from European funds*, FIN. TIMES (April 22, 2020), <https://www.ft.com/content/29d69ff6-749b-45dc-b53e-85a236186983>; David Ricketts, *UK investors flee equity funds on coronavirus fears*, FIN. NEWS, (February 27, 2020, 12:01 am), <https://www.fnlonon.com/articles/uk-investors-flee-equity-funds-on-coronavirus-fears-20200227>.

<sup>235</sup> HALLING ET AL., *THE DYNAMICS OF CORPORATE DEBT STRUCTURE*, 56 (2020).

Commentators already expect at least 40% of loans in the UK's Bounce Back Loan Scheme to default in due course.<sup>236</sup> In general, the level of loans made during the pandemic that can be expected to be nonperforming will increase.<sup>237</sup> This is likely to cause hardship for corporations, as banks have no incentive to work things out with corporations and support them in a more relational manner. This is because government guarantees introduce perverse incentives for banks to accelerate treating borrowers as in default so as to call upon the guarantee and remove these borrowers from banks' balance sheets. Although moratoria have been introduced to prevent lenders from initiating actions against debtor firms,<sup>238</sup> these are temporary in most countries, and would expire by the time borrowers reckoned with loan repayment. It is left to the private outworking between lenders and firms to determine how debt is to be restructured within the legal frameworks of insolvency law. One doubts whether corporate insolvency law is appropriate to deal with a macroeconomic scale of corporate distress.<sup>239</sup>

The legal and regulatory framing is arguably too focused on supply-side enhancement to promote ease of access to loans. Such legal and regulatory framing does not encompass demand-side considerations, such as loan terms, that should be tailor-made for pandemic-related needs, including relational restructuring possibilities and business conduct considerate of borrowers' extraordinary situations.<sup>240</sup> Legal and regulatory framing has also refrained from regulating business lending, leaving lenders and corporate borrowers full freedom to negotiate their terms. Such legal and regulatory framing, although supportive of the supply side of credit and promotive of ease of access, fails to subject lenders to social and ethical considerations for borrowers in such extraordinary times.

The resumption of full microprudential regulatory compliance for banks may also have the impact of constraining them in their future ability to support the real economy if bank resilience is weakened from increased lending during the pandemic.<sup>241</sup> The UK PRA seems to assume that the regulatory framework would simply resume after a likely 12-month period of suspension of the CCyb, and maintains that other unadjusted capital requirements remain the

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<sup>236</sup> Stephen Morris et al., *UK banks warn 40%-50% of 'bounce back' borrowers will default*, FIN. TIMES (May 31, 2020), <https://www.ft.com/content/8a551c37-2de8-446b-a8b8-d4a61d33ef73>.

<sup>237</sup> See Ivan Huljak et al., *Do Non-Performing Loans Matter for Bank Lending and the Business Cycle in Euro Area Countries?* 2 (Eur. Cent. Bank, Working Paper No. 2411, 2020); *COVID-19: The Regulatory and Supervisory Implications for the Banking Sector*, IMF AND WORLD BANK (May 21, 2020), <https://www.imf.org/en/Publications/Miscellaneous-Publication-Other/Issues/2020/05/20/COVID-19-The-Regulatory-and-Supervisory-Implications-for-the-Banking-Sector-49452>; Laura Noonan & Robert Armstrong, *Three US banks set aside record \$28bn for loan losses*, FIN. TIMES (July 14, 2020), <https://www.ft.com/content/f1bbaf65-7cb7-4855-ba7f-d9bda5f4b053>; Stephen Morris & Owen Walker, *European banks braced for €800bn of loan losses if pandemic worsens*, FIN. TIMES (July 21, 2020), <https://www.ft.com/content/1c4faf6c-975c-4566-8e0e-c9cbd613db42>.

<sup>238</sup> Corporate Insolvency and Governance Act 2020, c. 12, § 174A (Gr. Brit.).

<sup>239</sup> The limitations of corporate insolvency law in dealing with potential financial institution insolvencies during the global financial crisis 2007-09 paved the way for the development of 'lex specialis' for the resolution of financial institutions. See Rosa Lastra, *Northern Rock and Banking Law Reform in the UK*, in *THE FAILURE OF NORTHERN ROCK: A MULTI-DIMENSIONAL CASE STUDY* 139-141 (Franco Bruni & David T. Llewellyn eds., 2009) (stating that it is queried if a *lex specialis* can be extended to large-scale corporate distress in the non-financial sector, highlighted in Section V.).

<sup>240</sup> Thomas Huertas, *Here is How Banks Can Help Save the Economy*, FIN. TIMES (May 11, 2020), <https://www.ft.com/content/f02df444-8f78-11ea-bc44-dbf6756c871a>.

<sup>241</sup> See Anil Ari et al., *COVID-19 and Non-Performing Loans: Lessons from Past Crises*, EUR. CENT. BANK (May 27, 2020), <https://www.ecb.europa.eu/pub/economicresearch/resbull/2020/html/ecb.rb200527~3fe177d27d.en.pdf>; ELENA CARLETTI ET AL., *THE BANK BUSINESS MODEL IN THE POST-COVID-19 WORLD* 17 (2020).

same.<sup>242</sup> The ECB has opined that banks would not resume full microprudential compliance until the end of 2022.<sup>243</sup> However, with great uncertainty regarding when and how the public health crisis will recede, these timelines may add pressure to banks, in turn having adverse implications for the treatment of borrowers.

It may be argued that the fiscal backstop for government-guaranteed loans would mitigate the adverse aspects of bank-borrower relationships described above. This is precisely what the guarantees are for. At a macro level, however, would a fiscal backstop not create a vicious-circle problem for banks, as banks are also the principal funders for sovereigns? If banks suffer from impaired balance sheets from excessive credit creation during the pandemic, governments' own fiscal backstops may not be credible since governments rely on private sector funding themselves.

### ***B. How the Legal Framing of Household Debt Affects Financial Fragility***

The legal framing of household debt affects household financial fragility in two ways. First, the legal and regulatory framing of consumer credit affects consumers' choice of credit products. Distortion of choice is exacerbated, to consumers' potential detriment, by the legal and regulatory framing offered in financial regulators' measures to address the Covid-19 pandemic. Second, the legal and regulatory framing of the terms of consumer credit, although improved in terms of consumer protection in developed jurisdictions in recent years, still insufficiently protects consumers from being pushed into situations of fragility and financial suffering.

Consumer credit is regulated in the UK by the FCA<sup>244</sup> and in the US by the Consumer Financial Protection Bureau (CFPB).<sup>245</sup> In the EU, the European Banking Authority<sup>246</sup> and European Securities and Markets Authority<sup>247</sup> both have mandates to recommend pan-European financial consumer protection policies, but regulatory implementation is left to national regulators. In liberal market economies such as the UK and US, market choice is a prized policy objective, as choice mitigates the likelihood of consumer exploitation.<sup>248</sup> Indeed, the FCA has an explicit pro-competition regulatory objective<sup>249</sup> alongside its consumer protection objective,<sup>250</sup> seen as complementing the latter. In this light, highly risky consumer credit products, such as doorstep

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<sup>242</sup> See BANK OF NEW ENG. PRUDENTIAL REGUL. AUTH., PILLAR 2A: RECONCILING CAPITAL REQUIREMENTS AND ACROPRUDENTIAL BUFFERS 3 (2020), <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2020/ps1520.pdf>.

<sup>243</sup> *FAQs on ECB supervisory measures in reaction to the coronavirus*, EUR. CENT. BANK (July 28, 2020), [https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320\\_FAQs~a4ac38e3ef.en.html](https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320_FAQs~a4ac38e3ef.en.html).

<sup>244</sup> See *Consumer credit firms*, FIN. CONDUCT AUTH., <https://www.fca.org.uk/firms/consumer-credit> (last visited Jan 11, 2021).

<sup>245</sup> See *About us*, CFPB, <https://www.consumerfinance.gov> (last visited Jan 11, 2021).

<sup>246</sup> See *EBA at a Glance*, EUR. BANKING AUTH., <https://eba.europa.eu> (last visited Jan 11, 2021).

<sup>247</sup> *European Supervisory Framework*, EUR. SEC. & MKTS. AUTH., <https://www.esma.europa.eu/about-esma/governance/european-supervisory-framework>.

<sup>248</sup> Neelie Kroes, Member, European Commission, *European Competition Policy – Delivering Better Markets and Better Choices*, Speech at the European Commission (Sep. 1, 2005).

<sup>249</sup> Financial Services and Markets Act 2000, c. 1, § 1E (UK).

<sup>250</sup> *Id.* at § 1C.



lending,<sup>251</sup> high-cost, short-term credit<sup>252</sup> or payday lending,<sup>253</sup> and consumer goods-based purchase credit,<sup>254</sup> are often legally available to consumers. Regulators may, however, intervene ex post in response to empirically observed problems. For instance, in 2015 the FCA introduced a cap on interest charges levied by payday and rent-to-own lenders<sup>255</sup> when problems such as extortionate interest charges were discovered.<sup>256</sup> In the US, ex post interventions are also often the norm,<sup>257</sup> based on broadly framed powers conferred upon the CFPB under the Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>258</sup> The FCA also undertakes some proactive review of consumer credit sectors.<sup>259</sup> Access to consumer credit is often regarded as key to financial inclusion,<sup>260</sup> and regulatory policies have favored the supply side by erecting few barriers to consumer access. Regulatory intervention into the terms of consumer credit is selective,<sup>261</sup> and many such interventions rely on ex post actions, such as consumers' challenges over unfair terms,<sup>262</sup> or actions for limited sums brought before the UK's Financial Ombudsman Service, a regime for informal resolution of disputes on the basis of fairness rather than on strict application of the law.<sup>263</sup>

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<sup>251</sup> Caitlin Morrison, *FCA should go further in crackdown on doorstep lending, consumer groups say*, THE INDEPENDENT (May 31, 2018), <https://www.independent.co.uk/news/business/news/fca-doorstep-lending-crackdown-citizens-advice-credit-price-cap-debt-overdrafts-a8377316.html>.

<sup>252</sup> *PS14/16: Detailed rules for the price cap on high-cost short-term credit - Including feedback on CP14/10 and final rules*, FIN. CONDUCT AUTH. (Jan. 2, 2015), <https://www.fca.org.uk/publications/policy-statements/ps14-16-detailed-rules-price-cap-high-cost-short-term-credit>.

<sup>253</sup> Payday lending is allowed in a majority of states in the US but banned in 15 states. *State Payday Loan Regulation and Usage Rates*, THE PEW CHARITABLE TRUSTS (July 11, 2012), [https://www.pewtrusts.org/-/media/data-visualizations/interactives/2014/state-payday-loan-regulation-and-usage-rates/report/state\\_payday\\_loan\\_regulation\\_and\\_usage\\_rates.pdf](https://www.pewtrusts.org/-/media/data-visualizations/interactives/2014/state-payday-loan-regulation-and-usage-rates/report/state_payday_loan_regulation_and_usage_rates.pdf).

<sup>254</sup> An example would be rent-to-own, catalogue credit. See *PS19/6: Rent-to-own price cap – feedback on CP18/35 and final rules*, FIN. CONDUCT AUTH. (Mar. 5, 2019), <https://www.fca.org.uk/publications/policy-statements/ps19-6-rent-own-price-cap-feedback-cp18-35-and-final-rules>; see also *High-cost Credit Review: Feedback on CP18/12 with final rules and guidance and consultation on Buy Now Pay Later offers*, FIN. CONDUCT AUTH. (Dec. 2018), <https://www.fca.org.uk/publication/consultation/cp18-43.pdf#page=29>.

<sup>255</sup> See *PS19/6: Rent-to-own price cap*, *supra* note 258; see also *PS14/16: Detailed rules for the price cap on high-cost short-term credit*, *supra* note 258.

<sup>256</sup> Price caps were frowned upon as intervening in market price formation mechanisms, but this leaves consumers few avenues to challenge poor credit deals. The 2015 interventions signal a significant shift in regulatory policy. Consumer Credit Act 1974, c.39, § 140A-C (Eng.).

<sup>257</sup> See *Enforcement actions*, CONSUMER FINANCIAL PROTECTION BUREAU (last visited Oct. 23, 2020), <https://www.consumerfinance.gov/policy-compliance/enforcement/actions/>; see also Christopher L Peterson, *Consumer Financial Protection Bureau Law Enforcement: An Empirical Review* 90 TUL. L. REV. 1057, 1072-73 (2016); but see Todd Zywicki, *Consumer Financial Protection Bureau: Savior or Menace*, 81 GEO. WASH. L. REV. 856, 908-10 (2013), for a critique of the CFPB's enforcement as ultimately increasing cost for access to finance.

<sup>258</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 1031-36, 124 Stat. 1376 (2010).

<sup>259</sup> See *High-cost Credit Review*, *supra* note 220, for the most recent pro-active review of consumer credit sectors.

<sup>260</sup> Thorsten Beck *et al.*, *Finance, Inequality and the Poor*, 12 J. ECON. GROWTH 27, 28 (2007).

<sup>261</sup> *PS14/16: Detailed rules for the price cap on high-cost short-term credit*, *supra* note 218; *PS19/6: Rent-to-own price cap*, *supra* note 220; *High-cost Credit Review*, *supra* note 220.

<sup>262</sup> See Consumer Rights Act 2015, c. 15, § 62 (Eng.). But see Consumer Rights Act 2015, c. 15, § 64 (Eng.), for limitation on § 62; *Office of Fair Trading v. Abbey National Pic & Others* [2009] UKSC 6, 87-89 (for an example of an unsuccessful challenge).

<sup>263</sup> See Financial Services and Markets Act 2000, c. 8, §§ 225-230 (Eng.).



The protection of financial consumers is a relatively more recent development,<sup>264</sup> driven by post-crisis reforms that push back against the neoliberal political preferences that had prevailed before the global financial crisis of 2007-09.<sup>265</sup> In the UK and US, the FCA and CFPB, having dedicated mandates to secure consumer protection, started to introduce ex ante responsibilities for lenders in the context of consumer credit.<sup>266</sup> These responsibilities include creditworthiness assessments of borrowers ahead of lending, including customers' incomes and nondiscretionary expenditure in order to ascertain affordability of debt and the impact on consumers' basic living needs.<sup>267</sup> However, there is limited application in the US, as the "ability-to-repay" rule is only imposed on mortgage assessments and was scrapped from application to payday lending only a year after its introduction.<sup>268</sup> The change in policy is for the purposes of not unduly limiting access to such credit.<sup>269</sup> In the UK, there is a proportional application of responsible lending rules, depending on the nature of the transaction and the scale and size of the firm.<sup>270</sup> Small amounts of short-term credit or the purchase of a single item on catalogue credit would be unlikely to entail a detailed assessment by lenders. In this manner, consumers may incur small amounts of catalogue credit or payday lending with several lenders, creating disparate pictures of their credit profile that could fall into a gap of insufficient scrutiny. Questions continue to be asked whether more paternalistic and ex ante interventions are necessary, such as ex ante product governance and regulation of consumer credit.<sup>271</sup> The EU's recent product governance rules can provide a template for more ex ante responsibility on the part of product providers,<sup>272</sup> but they are highly procedural for product providers, and consumer enforcement may not be available.<sup>273</sup> Consumer protection, which is relatively more developed in the EU, may also be achieved by financial regulators' "product intervention"

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<sup>264</sup> Before the Global Financial Crisis of 2007-2009, neoliberal policies were advocated, see e.g., GREAT BRITAIN DEPARTMENT OF TRADE AND INDUSTRY, CONSUMER CREDIT REPORT OF THE COMMITTEE, 1971, Cm. 4596, at 151 ¶ 3.9.1 (Mar. 1971). See also Abdul Karim Aldohni, *The Accessibility of Credit and the Protection of Consumers in the High Cost Credit Sector: A Multifaceted Challenge*, LAW & CONTEMP. PROBS. (forthcoming 2020).

<sup>265</sup> See Niamh Moloney, *The Legacy Effects of the Financial Crisis on Regulatory Design in the EU*, in THE REGULATORY AFTERMATH OF THE GLOBAL FINANCIAL CRISIS 111-12 (Cambridge Univ. Press 2012).

<sup>266</sup> See *infra* ns271, 272.

<sup>267</sup> See generally Consumer Credit Sourcebook: Chapter 5 Responsible Lending, FIN. CONDUCT AUTH. (Oct. 2020) <https://www.handbook.fca.org.uk/handbook/CONC/5/?view=chapter> (United Kingdom's customer creditworthiness assessment handbook).

<sup>268</sup> See *Consumer Financial Protection Bureau Takes Steps to Address GSE Patch*, CONSUMER FIN. PROT. BUREAU (June 22, 2020), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-steps-address-gse-patch/> (ability-to-repay requirements were established as part of a broader regulatory attempt to remedy the problems of the sub-prime mortgage market leading to the Financial Crisis); see also Laura Noonan, *Rules Juggle Protection of Payday Loan Borrowers and Lending Market*, FIN. TIMES (Oct. 16, 2019), <https://www.ft.com/content/6c7eb0e2-cf26-11e9-b018-ca4456540ea6> (some politicians, consumer groups, and think-tanks have pushed for application of the "ability-to-pay" requirements to other sources of consumer credit such as payday loans). But see Claire Williams, *CFPB Scraps Ability-to-Repay Provision from Payday Rule: Instant Reaction*, MORNING CONSULT (July 7, 2020), <https://morningconsult.com/2020/07/07/cfpb-payday-lending-rule-instant-reaction/> (The Consumer Financial Protection Bureau finalized a rollback of requirements that payday lenders ensure that a borrower has the ability to repay a loan).

<sup>269</sup> For a discussion on policy dilemmas and the need to regulate this sector, see generally Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855 (2007).

<sup>270</sup> Consumer Credit Sourcebook: Chapter 5 Responsible Lending, *supra* note 271, at 25-26.

<sup>271</sup> See generally John Y. Campbell, *Restoring Rational Choice: The Challenge of Consumer Financial Regulation*, 106 AM. ECON. REV. 1 (2016) (arguing for intervening in the economy).

<sup>272</sup> Guidelines on MiFID II Product Governance Requirements, EUROPEAN SEC. AND MKTS. AUTH., (May 2, 2018), <https://www.esma.europa.eu>; Antonio Marcacci, *European Regulatory Private Law Going Global?, The Case of Product Governance*, 18 EUR. BUS. ORG. L. REV. 305, 313-14 (2017).

<sup>273</sup> Verrle Colaert, *Product Governance: Paternalism Outsourced to Financial Institutions?* (Jan Ronse Inst. for Co. & Fin. Law, Working Paper No. 2019/2, 2019), <https://ssrn.com/abstract=3455413>.

powers.<sup>274</sup> Regulators can impose ad hoc restrictions on the distribution and marketing of financial products that may be detrimental to consumers.<sup>275</sup> Still, the exercise of such powers has tended to concentrate upon risky and complex investment products,<sup>276</sup> not credit products.<sup>277</sup>

During the Covid-19 pandemic, regulatory framing has been aimed at debt forbearance and deferred payments, as well as at increasing access to debt.<sup>278</sup> The FCA's policies of loan forbearance for consumer credit, which can effectively allow consumers to defer consumer credit payments until the end of January 2021<sup>279</sup> and to enjoy £500 extra in bank overdrafts up to October 2020 interest-free,<sup>280</sup> incentivize consumers towards these sources of short-term debt and to defer payments as well.<sup>281</sup> In particular, the FCA, by relieving lenders from the excessive diligence of borrowers who request deferment of loan repayments,<sup>282</sup> shifts the burden onto borrowers to ensure that they can afford such requests. Borrowers focusing on their near-term troubles may take a short-sighted approach<sup>283</sup> and postpone any long-term thinking about affordability and their own financial fragility, accumulating arrears that may become even more unmanageable in the future.<sup>284</sup> With the imminent closure of furlough schemes<sup>285</sup> or the end of the PPP in the US,<sup>286</sup> would debtors be tempted to finance living costs and debt repayment with new debt by, for example, accessing bank overdrafts, credit card debt, and payday lending? These are easily accessible, especially if consumers are existing customers. Easily accessible forms of credit also have the tendency to exert more demands on borrowers as they are high cost and mostly structured as short term, thus exacerbating their financial fragility. Catalogue and other retailers that offer purchase credit may also tempt customers in their bid to boost sales and consumption during this period.

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<sup>274</sup> See *infra* ns279, 280.

<sup>275</sup> E.g., Council Regulation 1286/2014 art. 17, 2014 O.J. (L 352) 1; Council Regulation 600/2014 art. 39-43, 2014 O.J. (L 173).

<sup>276</sup> E.g., *Product Intervention*, EUR. SECS. & MKT. AUTH., <https://www.esma.europa.eu/policy-activities/mifid-ii-and-investor-protection/product-intervention> (last visited Nov. 2, 2020) (the European Securities and Markets authority has restricted the distribution and marketing of Contracts for Differences and Binary Options to retail clients).

<sup>277</sup> There is no record of the European Banking Authority having exercised such powers as of November 2020. See, *Product Intervention Powers Under MiFIR*, EUROPEAN BANKING AUTH., <https://eba.europa.eu/consumer-corner/product-intervention-powers> (last visited Nov. 2, 2020).

<sup>278</sup> For a further discussion of this issue, see *supra* Section II.

<sup>279</sup> See *supra* Section II.A.

<sup>280</sup> *FCA confirms further support for consumer credit customers*, *supra* note 29.

<sup>281</sup> See *How has Covid-19 Affected the Finances of UK Households?*, BANK OF ENG. (Aug. 25, 2020), <https://www.bankofengland.co.uk/bank-overground/2020/how-has-covid-19-affected-the-finances-of-uk-households> (approximately one in six UK mortgage-holders have taken advantage of a payment holiday as of June 2020).

<sup>282</sup> *Id.*

<sup>283</sup> See generally Campbell, *supra* note 275, for a discussion of consumers' bounded rationality; NIAMH MOLONEY, *HOW TO PROTECT INVESTORS 1-44* (Cambridge Univ. Press 2010) (discussing consumers' implicit trust in regulated financial products).

<sup>284</sup> "See Nicolas Megaw & Matthew Vincent, *Lenders sound warning on mortgage holidays*, FIN. TIMES (March 25, 2020), <https://www.ft.com/content/3a6b82b0-6e77-11ea-89df-41bea055720b>.

<sup>285</sup> Richard Partington, *UK business leaders warn over closure of furlough scheme*, THE GUARDIAN (8 July 2020), <https://www.theguardian.com/business/2020/jul/08/uk-business-leaders-warn-closure-furlough-scheme-chancellor>.

<sup>286</sup> MICHAEL BARR, HOWELL JACKSON & MARGARET TAHYAR, *THE FINANCIAL RESPONSE TO THE COVID-19 PANDEMIC*, 8 (Aug. 1, 2020), <https://ssrn.com/abstract=3666461>.

Legal and regulatory framing in relation to loan forbearance, although appealing to near-term needs, do not sufficiently provide for the protection of borrowers in terms of business conduct between them and lenders during such extraordinary times. In particular, would there be moderation of the usual strong creditor-protection rights in terms of demands for periodic payments, accrual of interest, default, and enforcement after mandated forbearance is over?<sup>287</sup> While in the UK, the regulator urges banks to enter into tailored forbearance agreements with their borrowers,<sup>288</sup> this is soft law at best. Delegating to borrowers to negotiate how creditors' rights would be exercised is arguably suboptimal in the absence of clearer and more legalized obligations to offer borrowers relational restructuring or outworking. The FCA's guidance for firms for how to treat their "vulnerable" customers may pave the way for more cautious approaches on the part of lenders at the point of sale or in relational outworking with borrowers.<sup>289</sup> However, the definition of "vulnerable" is open-ended<sup>290</sup> and consumer protection derived from such guidance, if any, is likely ex post in nature.

In a broader context, consumer credit would be a less hazardous issue for individual and social well-being if households had higher savings levels and were more resistant to macroeconomic shocks.<sup>291</sup> In this respect, legal and regulatory framing in financial regulation, as well as economic and corporate regulation more broadly, do not incentivize towards household saving. The FCA's regulatory intervention into poor savings products provided by banks only took place in 2020.<sup>292</sup> Although tax benefits encourage saving,<sup>293</sup> the unregulated nature of some "tax-free" financial products has given rise to scandals<sup>294</sup> and highlights regulatory gaps in the savings product market. Further, general pro-business policies that tolerate corporate "short-

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<sup>287</sup>See generally Imani Moise, *U.S. borrowers struggle to get coronavirus relief from big banks*, REUTERS (April 2, 2020) (discussing different creditor actions after forbearance ends), <https://www.reuters.com/article/us-health-coronavirus-banks-forbearance/u-s-borrowers-struggle-to-get-coronavirus-relief-from-big-banks-idUSKBN21K2YB>.

<sup>288</sup> *PRA statement on Covid-19: IFRS 9 and capital requirements – Guidance as Covid-19 specific payment deferrals come to an end*, PRUDENTIAL REG. AUTH. (26 August 2020), <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/statement-covid19-ifs9-capital-requirements-specific-payment-deferrals>.

<sup>289</sup> See *GC20/3: Guidance for firms on the fair treatment of vulnerable customers*, FIN. CONDUCT AUTH. (29 July 2020), <https://www.fca.org.uk/publications/guidance-consultations/gc20-3-guidance-firms-fair-treatment-vulnerable-customers>.

<sup>290</sup> Characteristics of vulnerability are left unspecified. *Id.*

<sup>291</sup> See Christoph Basten, Andreas Fagereng & Kjetil Telle, *Saving and Portfolio Allocation Before and After Job Loss*, 48 J. MONEY, CREDIT & BANKING 293, 294 (2016).

<sup>292</sup> See *FCA acts to help customers get better rates for cash savings*, FIN. CONDUCT AUTH. (9 January 2020), <https://www.fca.org.uk/news/press-releases/fca-acts-help-customers-get-better-rates-cash-savings>.

<sup>293</sup> E.g., the tax-free allowance implemented in the UK for a variety of retail savings and investment products, known as 'ISAs'.

<sup>294</sup> See generally *Investors face £230m loss in London Capital & Finance collapse* (9 January 2020), <https://www.theguardian.com/uk-news/2020/jan/09/investors-face-230m-loss-in-london-capital-finance-collapse> (discussing scandal involving sales of unregulated tax-free bond products to retail investors).

termism”<sup>295</sup> and consumption-fueled economies<sup>296</sup> in the surveyed jurisdictions underpin narratives that support access to consumption-led consumer credit,<sup>297</sup> which has been found to be systemically risky for the financial sector<sup>298</sup> and diminishes social well-being in the long term. This is because consumer credit is often used to bridge consumption needs not met due to long-term stagnation of workers’ incomes.<sup>299</sup> Without improvement in social mobility, individual and household welfare may not be improved.<sup>300</sup> Increased indebtedness during the pandemic can be counterproductive to household resilience and recovery, economically suboptimal, and detrimental to long-term human well-being.

#### **IV. Mitigating the Adverse Consequences of Debt Expansion: Drawing upon the Legal Theory of Finance**

We argue that corporate and household financial fragility has been exacerbated during the Covid-19 pandemic and attribute this to legal and regulatory framing that promotes distorted ease of access to private debt, which involves relatively inflexible obligations that secure creditors’ protection. In this section, we reach into the legal theory of finance, particularly its application in explaining the mammoth scale of debt forgiveness for systemically important banks during the global financial crisis of 2007-09,<sup>301</sup> to derive insights for addressing the adverse consequences of private debt expansion. This is because the legal theory of finance provides a conceptual basis for elasticity to be introduced in law, which leads to changes both temporary and permanent.

Legal elasticity is argued to be a function of the legal theory of finance posited by Pistor.<sup>302</sup> The legal theory of finance frames finance in legal terms, as financial transactions and obligations are constructed as legal structures in order to work as intended.<sup>303</sup> In particular, the legal theory of finance conceptualizes finance as being underpinned by the crucial qualities

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<sup>295</sup> See generally CORP. VALUES STRATEGY GRP., OVERCOMING SHORT-TERMISM: A CALL FOR A MORE RESPONSIBLE APPROACH TO INVESTMENT AND BUSINESS MANAGEMENT, 4 (Sep. 9, 2009) (discussing how current policies encourage pursuing short-term financial objectives), <http://www.aspeninstitute.org/publications/overcoming-short-termism-call-more-responsible-approach-investment-business-management>. See also BIS, *The Kay Review: terms of reference* (June 2011), [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/253465/bis-11-1015-kay-review-terms-of-reference.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/253465/bis-11-1015-kay-review-terms-of-reference.pdf).

<sup>296</sup> Halina Szejnwald Brown, *The US economy is reliant on consumer spending – can it survive a pandemic?*, THE CONVERSATION (13 August 2020), <https://theconversation.com/the-us-economy-is-reliant-on-consumer-spending-can-it-survive-a-pandemic-141244>. See also *It’ll take more than shopping to save our debt-addled economy* (Aug. 20, 2018), <https://www.theguardian.com/commentisfree/2018/aug/20/shopping-debt-economy-britain-growth-model-consumption-production-inequality>.

<sup>297</sup> See generally Alberto Russo, Luca Riccetti & Mauro Gallegati, *Increasing Inequality, Consumer Credit and Financial Fragility in an Agent Based Macroeconomic Model*, 26 J. Evolutionary Econ., 25 (2016). See also Paola D’Orazio, *Income inequality, consumer debt, and prudential regulation: An agent-based approach to study the emergence of crises and financial instability*, 82 ECON. MODELLING 308 (2019) (investigating the relationship between income inequality, higher credit demand, and financial crises).

<sup>298</sup> Paulo L. dos Santos, *A Cause for Policy Concern: The Expansion of Household Credit in Middle-Income Economies*, 27 INT’L REV. APPLIED ECON. 316, 333 (2013).

<sup>299</sup> See D’Orazio, *supra* note 301, at 309.

<sup>300</sup> See Melanie G. Long, *Pushed into the Red? Female-headed Households and the Pre-crisis Credit Expansion*, 47 F. SOC. ECON. 224, 224 (2018).

<sup>301</sup> See *infra* notes 311-313.

<sup>302</sup> Pistor, *supra* note 11.

<sup>303</sup> *Ibid.*

of certainty and enforceability that law supplies.<sup>304</sup> However, during the global financial crisis, it was observed that the very qualities of certainty and strict enforceability of financial obligations and transactions in various markets would collectively lead to damaging consequences—a manifestation of systemic risk.<sup>305</sup> As such, the solution was also found in law, i.e. to resort to legal elasticity in order to suspend and mitigate the adverse impacts driven by law, in order to meet the needs of crisis management.

In this theoretical framework, it can be argued that legal elasticity serves an unwinding purpose—to unwind the adverse effects caused by its very own legal nature, when regulatory objectives and policy goals so demand. Elasticity also redeems financial laws or regulations as such, when it appears that the application of an existing law or regulatory instrument has run its course, legal elasticity entails institutional change and paves the way for law reform.

The above conceptualization of legal elasticity in finance provides a framework for institutional change from the previous state of the law. Indeed, it can be argued that the post-crisis reforms to the banking and financial sector reflected this conceptualization of legal elasticity. Where banks had been unable to absorb their losses during the global financial crisis, legal elasticity was applied so that regulatory discipline was not meted out to them for being inadequately capitalized.<sup>306</sup> Instead, many jurisdictions bailed out their banks by injecting state capital<sup>307</sup> and then proceeded to reform capital rules to tie banks to higher and more robust levels of capitalization for loss absorption.<sup>308</sup> Banks that teetered upon the edge of insolvency were, in most cases, rescued<sup>309</sup> and spared the full force of private sector insolvency laws, leading to the subsequent development of a bespoke bank crisis management and resolution regime in many jurisdictions.<sup>310</sup>

Although the prevailing perception among US, UK, and EU policy makers is that financial regulatory measures during the Covid-19 pandemic are temporary in nature, it is questionable whether these measures can and should be conceived of in such limited terms. It has been argued that UK corporate and financial law would be unlikely to experience permanent change in response to the pandemic, as formal legal change has been resisted in favor of temporary

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<sup>304</sup> *Ibid.*

<sup>305</sup> Steven L. Schwarz, *Systemic Risk*, 97 GEO. L.J. 193 (2008) (discussing systemic risk and which systemic risks should be regulated).

<sup>306</sup> Referring to the state bailout of banks, see *infra* n311.

<sup>307</sup> See Mike Collins, *The Big Bank Bailout*, FORBES (July 14, 2015, 4:22 PM), <https://www.forbes.com/sites/mikecollins/2015/07/14/the-big-bank-bailout/>; *Rescue packages: what governments have offered*, THE TELEGRAPH (20 Oct. 2008 15:47 PM), <https://www.telegraph.co.uk/finance/3229434/Rescue-packages-what-governments-have-offered-financial-crisis.html>.

<sup>308</sup> See generally BASEL COMM. ON BANKING SUPERVISION, *BASEL III: A GLOBAL REGULATORY FRAMEWORK FOR MORE RESILIENT BANKS AND BANKING SYSTEMS*, (2011) (describing standards reforms made to strengthen global liquidity and capital rules), <http://www.bis.org/publ/bcbs189.pdf>; BASEL COMM. ON BANKING SUPERVISION, *BASEL III: FINALISING POST-CRISIS REFORMS*, BANK OF INTERNATIONAL SETTLEMENTS (2017) (finalizing changes to the Basel III framework), <https://www.bis.org/bcbs/publ/d424.pdf>. The European Union introduced additional prescriptive rules apart from adopting Basel III in Directive 2013/36/EU, art. 28-32, 2013 O.J. 338, 360-362; Regulation (EU) No. 575/2013, 2013 O.J. 1, both further amended in 2019 by Regulation 2019/876, 2019 O.J. 1 (EU).

<sup>309</sup> Except the failure of Lehman Brothers in the US.

<sup>310</sup> See *Key Attributes of Effective Resolution Regimes for Financial Institutions*, FIN. STABILITY BD., (15 Oct. 2014), <https://www.fsb.org/2014/10/key-attributes-of-effective-resolution-regimes-for-financial-institutions-2/>, implemented in the European Union in the Bank Recovery and Resolution Directive 2014/59/EU, 2014 O.J. 190.



and practical de facto adjustments.<sup>311</sup> However, we envisage that the structural nature of legal elasticity will be called upon to manage long-term consequences, such as the significant hazards of debt expansion in the post-Covid world.

It is fully understandable that financial regulators have no appetite for major institutional changes as the post-crisis financial regulatory reforms have only recently been completed, after just over a decade.<sup>312</sup> Further, the current financial stresses are caused by an exogenous public health crisis and are therefore not perceived as entailing existential consequences for the substance of financial laws or regulations. However, we caution against assumptions of temporariness and the lack of recognition of long-term financial consequences and urge policy makers as well as regulators to consider more structural adjustments based on legal elasticity.

Nevertheless, objections can be raised against our proposal to apply legal elasticity to address post-Covid hazards and consequences for the economy and society. There are three possible objections. One objection is that the legal theory of finance, which introduces legal elasticity, is crucially based on the interests of powerful structures in finance that would be unlikely to support the introduction of significant policy changes affecting creditors' rights. Second, it can be argued that our conception of legal elasticity is incorrect, as our expectations of its responsiveness to policy change are misplaced. The legal precepts in relation to debt are not merely responsive to social demands, but form a relatively autopoietic system.<sup>313</sup> Third, it can be argued that we overestimate what legal elasticity can do to alleviate the hazards of debt expansion, as many solutions lie outside of the law. We counter each of these in turn. The theorization of legal elasticity yields structural insights that support expressing policy goals through the qualities of legal and regulatory framing. We do not exclude the relevance of extralegal policy measures<sup>314</sup> but have chosen to focus on legally framed ones for the purposes of this article. We also argue that legal elasticity based on the legal theory of finance provides a robust methodological framework that is less susceptible to arbitrary discretion by policy makers.<sup>315</sup>

Pistor's legal theory of finance constructs a hierarchical structure with sovereigns at its heart, to the extent that they control their own currency, borrow mostly in that currency, and can therefore act as true lenders of last resort.<sup>316</sup> Private parties fit into this hierarchical structure depending on their size and economic power, from large systemic banks down to retail investors and borrowers. Pistor posits that elasticity tends to be more accentuated at the top of the system to the benefit of sovereigns and large banks, while those at the bottom are left to

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<sup>311</sup> See IAIN MACNEIL & IRENE-MARIE ESSER, THE PANDEMIC RESPONSE IN THE UK IN THE CONTEXT OF CORPORATE AND FINANCIAL LAW – WITHIN AND WITHOUT LAW, 14-15 (2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3636292](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3636292).

<sup>312</sup> The Basel Committee's reforms were issued between 2009-2017, see *Basel III: international regulatory framework for banks*, BANK OF INTERNATIONAL SETTLEMENTS, (last visited Nov. 5, 2020), <https://www.bis.org/bcbs/basel3.htm>; and the EU's regulatory regime firmed up only in 2013, followed by amendments in 2019. See *id.*

<sup>313</sup> See Gunther Teubner, *Introduction to Autopoietic Law*, in *AUTOPOIETIC LAW - A NEW APPROACH TO LAW AND SOCIETY 2* (Gunther Teubner ed., 1987).

<sup>314</sup> See generally, *supra* POLICY SHOCK: RECALIBRATING RISK AND REGULATION AFTER OIL SPILLS, NUCLEAR ACCIDENTS, AND FINANCIAL CRISES. (discussing regulatory frameworks and regulatory best practices for crisis prevention and mitigation).

<sup>315</sup> David Zaring, *The Government's Economic Response to the Covid Crisis* (2020), <https://ssrn.com/abstract=3662049> (criticizing discretion and uncertain regulatory mandates).

<sup>316</sup> Pistor, *supra* n11, at 321, 323-324.

face the full rigor of the law.<sup>317</sup> This conceptualization resonates very closely with the events of the global financial crisis, during which most distressed, large financial institutions were rescued with the use of public money, while individual investors and borrowers were left to face the financial consequences of the crisis.

As the Covid-19-induced economic crisis is exogenous to the financial system, in the sense that financial firms are not responsible for its occurrence and could have done nothing to prevent it, the key financial institutions and the sovereign at the heart of the financial system would not be incentivized to support any fundamental institutional change to financial law and regulation. Hence, the regulatory suspensions in financial regulation discussed in Section II are likely to be seen only as a set of temporary measures that are needed to circumvent the rigidities of institutional stability during an economic shock. In this manner, legal elasticity and its impact can be contained by the framing and decisions made by powerful structures in finance, allowing legal elasticity to exist as minimally disruptive. Further, as much of the elasticity employed during the pandemic has been used to the benefit of actors in the periphery of the financial system, such as indebted households or small businesses, it can be argued that such elasticity is of a different and less radical quality than that affecting the heart of the financial system during the global financial crisis.

In parallel, Pistor's key thesis is that the core of the financial system must always be protected.<sup>318</sup> In the current circumstances, despite the severity of the pandemic and the ensuing economic recession, financial institutions are not (yet) in distress.<sup>319</sup> This permits governments and regulators to take measures to alleviate the consequences of the crisis for households and businesses on the grounds of social welfare. These measures are also a means to implement a macroeconomic policy of supporting the economy during what is hoped to be a short recession. But if the core of the financial system becomes threatened, then it is likely that elasticity will again be used primarily to benefit core actors such as systemically important financial institutions. Based on the power structures perspective of legal elasticity, more fundamental policy change would likely be resisted after the Covid-19 pandemic. This narrower reading of the theory means that legal elasticity and institutional change are only connected if power structures and actors at the core of the financial system elect to make them so.

As the “temporary” measures of relief and rescue facilitate a significant level of debt expansion, the social consequences from such debt expansion are likely to affect financial regulators and their objectives in due course. The onset of corporate and household fragility, as well as financial-sector weaknesses, raises questions regarding long-term social and economic welfare and normative questions regarding what finance's role is and should be. As the COVID-19 pandemic tails off, is it right for banks simply to resume enforcing obligations on borrowers who have been on payment holidays? Does the issue implicate Conduct-of-Business obligations to treat customers fairly?<sup>320</sup> Would consumer protection policies require a more radical distributive treatment such as some extent of debt forgiveness? The winding

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<sup>317</sup> Pistor, *supra* n11, at 323-325.

<sup>318</sup> *Ibid.*

<sup>319</sup> *Banking system resilience in the time of COVID-19*, MCKINSEY (last visited on 11 January 2021), <https://www.mckinsey.com/industries/financial-services/our-insights/banking-system-resilience-in-the-time-of-covid-19#>.

<sup>320</sup> Such as treating consumers fairly under the *Principles for Business: The Principles*, Fin Conduct Auth., <https://www.handbook.fca.org.uk/handbook/PRIN/2/?view=chapter> (October 2020).

down of the public health crisis is likely to be followed by economic and social welfare effects that cannot be addressed by a resumption of regulatory regimes and contractual obligations.

We posit that power structures alone are not likely to sustain institutional stability, as bottom-up social appetite and demands can exert new pressures in the future. One of us has argued that social movements have contributed to a gradual institutional change in corporate regulation, for example.<sup>321</sup> Lothian<sup>322</sup> and Arup<sup>323</sup> have also, in the wake of the global financial crisis, called for greater socialization of the objectives of financial regulation. Such a radical re-orientation has not yet been seen, however, as financial regulation is generally dominated by an economic paradigm.<sup>324</sup> Post-crisis reforms have only edged closer to macro-level economic perspectives such as financial stability.<sup>325</sup> However, there is a consistent social cry for financial regulation reform, especially regarding protecting consumer welfare.<sup>326</sup> The undercurrents of dissatisfaction with the myopic paradigms of financial regulation may again be raised in the wake of the adverse consequences of debt expansion that would be significantly felt by economic actors and society. The powerful structures of financial systems are not immune to these forces even if they have not demonstrated a preference for institutional change.<sup>327</sup> Our conceptualization of legal elasticity potentially adds to the legal theory of finance by recognizing a wider range of actors that drive institutional change beyond the needs and preferences of powerful structures.

Second, it may be argued that even if legal elasticity does not merely respond to powerful financial actors' initiatives, it is too simplistic to think that bottom-up demands would result in radical shifts in the legal conception of private debt. This assumes that the legal regime for private debt is entirely responsive to social demands, an assumption that is inconsistent with the influential autopoietic conception of law.<sup>328</sup> The legal conception of private debt is arguably a relatively closed system of established contractual, governance, and property rights,<sup>329</sup> constituting a particular transactional regime of debt relations. This concept is even reinforced in regulatory treatment as microprudential regulations absorb established tenets of debt structuring in order to assign risk weightings and regulatory cost.<sup>330</sup> Even flexibility in the

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<sup>321</sup> Iris H-Y Chiu, *An Institutional Theory of Corporate Regulation*, 39 NW. J. INT'L L. & BUS. 85 (2019).

<sup>322</sup> See generally TAMARA LOTHIAN, *LAW AND THE WEALTH OF NATIONS: FINANCE, PROSPERITY, AND DEMOCRACY* (2017) (discussing re-orienting the service of finance to the real productive economy instead of leaving to a free-market approach).

<sup>323</sup> See generally Christopher Arup, *The Global Financial Crisis: Learning from Regulatory and Governance Studies*, 32 L. & POL'Y 363 (2010) (suggesting cultural influences just as important as economic policies).

<sup>324</sup> *Economics for Effective Regulation*, FIN. CONDUCT AUTH. (Mar. 2016), <https://www.fca.org.uk/publication/occasional-papers/occasional-paper-13.pdf>.

<sup>325</sup> MADS ANDENAS & IRIS H-Y CHIU, *THE FOUNDATIONS AND FUTURE OF FINANCIAL REGULATION* 16-72 (2014).

<sup>326</sup> See *Pillar 2A: Reconciling capital requirements and macroprudential buffers*, *supra* note 246; *FAQs on ECB supervisory measures in reaction to the coronavirus*, *supra* note 247.

<sup>327</sup> See *Pillar 2A: Reconciling capital requirements and macroprudential buffers*, *supra* note 246; *FAQs on ECB supervisory measures in reaction to the coronavirus*, *supra* note 247.

<sup>328</sup> The maintenance of law as an autonomous system of internal sense-making and ordering is however a matter of degree as it remains cognitively open to changing social facts. Teubner, *supra* note 317, at 1-11; Michael King, *The 'Truth' about Autopoiesis*, 20 J. of L. & Soc'y 218, 219 (1993).

<sup>329</sup> Debt is enforceable as a contractual right, but it is also characterized by proprietary notions, being assignable claims. Geoffrey Samuel, *Property Notions in the Law of Obligations* 53 CAMBRIDGE L.J. 524, 533 (1994).

<sup>330</sup> See generally Risk weightings for debt can depend on whether there are contractually agreed credit mitigation arrangements. Basel Committee on Banking Supervision, *CRE22 - Standardised approach: credit risk mitigation* (Dec. 15, 2019), [https://www.bis.org/basel\\_framework/chapter/CRE/22.htm?ldate=20220101&inforce=20220101](https://www.bis.org/basel_framework/chapter/CRE/22.htm?ldate=20220101&inforce=20220101).

enforcement of private debt obligations is legally structured within established processes such as company voluntary arrangements.<sup>331</sup>

Nevertheless, even in a theorized autopoietic conception of the legal nature of private debt, the proponents of legal autopoiesis accept that legal systems are normatively closed (i.e., the way law constructs meaning within its system is autonomous and independent of other social systems) but cognitively open (i.e., law's mediation of social evolution does take place when confronted with changes in social reality).<sup>332</sup> The relatively strong and inflexible nature of creditors' rights agreed ex ante and the certainty of contractual enforcement are legal tenets of private debt relations that have become almost universal in the US, UK, and EU.<sup>333</sup> Such legal framing is not merely an independent abstraction, but is underpinned by policies promoting financialized and liberalized societies.<sup>334</sup> The US, UK, and EU treat debt as part and parcel of financial welfare provisions,<sup>335</sup> in light of the retreat of the state from public welfare. Private debt can only play this role if the legal framing of its transactional relations facilitates the commoditization of debt<sup>336</sup> for market confidence. In other words, political and social acceptance of the role of private debt is not divorced from the legality of debt as an autopoietic regime.

If the social reality of excessive corporate and household indebtedness in the post-Covid world presents a picture of successive bankruptcies,<sup>337</sup> homelessness,<sup>338</sup> unemployment, and poverty,<sup>339</sup> social and even political forces of public interest and the needs of social welfare would be unleashed. These would challenge interpretive systems within the law in relation to its conception of private debt relations. To be clear, we are not positing legal elasticity as a thesis asserting socio-legal dominance of substantive law that disregards the conceptual value

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<sup>331</sup> See generally Insolvency Act 1986, c. 45, Part I (Eng.) (referring to an insolvent company's arrangements with creditors that are negotiated through the facilitation of an insolvency practitioner).

<sup>332</sup> Teubner, *supra* note 317, at 2; King, *supra* note 332, at 227. But see Hugh Baxter, *Autopoiesis and the "Relative Autonomy" of Law* 20 CARDOZO L. REV. 1987, 1993-94 (1998).

<sup>333</sup> See Irina Domurath, *Mortgage Debt and the Social Function of Contract*, 22 EUR. L.J. 758, 763 (2016) (on the EU). E.g. Lynn M. Fisher, *Renegotiation in the Common Law Mortgage and the Impact of Equitable Redemption*, 32 J. REAL EST. FIN. & ECON. 61, 70 (2006) (on the inflexibility of common law debt relations).

<sup>334</sup> Guido Comparato, *THE FINANCIALISATION OF THE CITIZEN: SOCIAL AND FINANCIAL INCLUSION THROUGH EUROPEAN PRIVATE LAW* 10-11 (2018) (insights arguably applicable to similarly financialised societies in the even more neoliberal economies of the US and UK).

<sup>335</sup> Abbye Atkinson, 'Rethinking Credit as Social Provision' 71 Stan. L. Rev. 1093 (2019). See generally Abbye Atkinson, *Rethinking Credit as Social Provision* 71 STAN. L. REV. 1093 (2019) (arguing against credit as financial welfare for low income people).

<sup>336</sup> Teemu Juutilainen, *Law-Based Commodification of Private Debt* 22 EUR. L.J. 743, 743 (2016).

<sup>337</sup> Lee Clifford and Phil Wahba, *A running list of companies that have filed for bankruptcy during the coronavirus pandemic*, FORBES (Aug. 4, 2020, 7:00 AM), <https://fortune.com/2020/08/04/companies-filing-bankruptcy-2020-due-to-covid-list-filed-chapter-11-coronavirus-pandemic/>. In the UK, insolvency moratoria periods are in progress for many companies, but STA Travel (whose parent company is in New Zealand) for example has announced insolvency. *Coronavirus forces STA Travel out of business*, BBC (Aug. 21, 2020), <https://www.bbc.com/news/business-53868447>.

<sup>338</sup> Tenant evictions and potential homelessness is due to be on the rise in the UK, temporarily stalled by government intervention. Kevin Peachey, *Coronavirus: Eviction ban to be extended by four weeks*, BBC (Aug. 21, 2020), <https://www.bbc.com/news/business-53851945>.

<sup>339</sup> See Andy Sumner, Chris Hoy & Eduardo Ortiz-Juarez, *Estimates of the Impact of COVID-19 on Global Poverty* 7-8 (U.N. Univ. World Inst. for Dev. Econ. Research, Working Paper No. 2020/43, 2020), <https://www.wider.unu.edu/sites/default/files/Publications/Working-paper/PDF/wp2020-43.pdf>. Increased poverty would also hit developed countries. Increased poverty would also hit developed countries. See Angela Giuffrida, 'They are the new poor': *Covid-19 fuels rising poverty in Italy*, THE GUARDIAN (June 29, 2020) <https://www.theguardian.com/world/2020/jun/29/they-are-new-poor-covid-19-fuels-rising-poverty-italy>.

of autopoiesis. Legal elasticity, drawn from the legal theory of finance, does not damage the autopoietic conception of law as an internal framing system. Rather, we argue that it is possible to enrich the conception of legal autopoiesis by providing a methodology that explains how its cognitive openness is able to mediate forces of change from sociological spheres.<sup>340</sup>

Indeed, in the legal framing of debt, public-interest level challenges have already been unleashed, consistent with notions of democratic accountability and social justice. Such discussions can, for example, be found in relation to sovereign debt restructuring,<sup>341</sup> which implicates the welfare of an indebted country's citizens, and where the limits of private debt as a financialized form of social provision<sup>342</sup> have proven to be counterproductive.<sup>343</sup> In addition, legal evolution in the framing of debt relations has gradually been observed in the regulatory intervention into consumer credit, such as the UK FCA's price cap intervention for certain types of short-term and predatory consumer credit that the agency oversees.<sup>344</sup> Regulatory intervention has also been observed in the UK pertaining to the manner of debt enforcement where lender conduct creates excessive unfairness to consumers, even if this unfairness is a result of the terms of the contract.<sup>345</sup> In this manner, we argue that legal elasticity provides a framework for charting legal and regulatory changes that address the adversities of post-Covid debt relations.

Finally, it can be argued that drawing solutions from within the law, (i.e., via legal and regulatory framing to address the hazards and adverse consequences of private debt expansion during the pandemic), is a limited exercise. This is because legal elasticity and its application cannot address the wider policy context that incentivizes economic actors towards debt expansion. For instance, nonlegal policies contribute significantly to marginalizing non-debt options in financial provisions, such as equity-based<sup>346</sup> or solidarity-based provisions.<sup>347</sup> There is a lack of imagination in policy options for corporate recapitalization such as by long-term government-led investment,<sup>348</sup> as a matter of industrial policy, or in the form of public-private partnerships.<sup>349</sup> Further, we do not observe significant policy mobilization of alternative

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<sup>340</sup> Debt or money relations are argued to be socially-framed or else the human aspect can be marginalised in transactional, utilitarian conceptualisation. Geoffrey Ingham, *Money is a Social Relation*, 54 REV. SOC. ECON. 507, 507 (1996). See also Carlo Trigilia, ECONOMIC SOCIOLOGY: STATE, MARKET AND SOCIETY IN MODERN CAPITALISM 37-40 (Wiley 2002) (1998) (ch.2 on Simmel's conception of money relations).

<sup>341</sup> Matthias Goldmann, *Public and Private Authority in a Global Setting: The Example of Sovereign Debt Restructuring*, 25 IND. J. GLOBAL LEGAL STUD. 331, 333 (2018); Matthias Goldmann & Silvia Steininger, *A Discourse Theoretical Approach to Sovereign Debt Restructuring: Towards a Democratic Financial Order*, 17 GERMAN L.J. 709, 712-13, 724 (2016).

<sup>342</sup> Atkinson, *supra* note 339, at 1121.

<sup>343</sup> *Id.* at 1147-57.

<sup>344</sup> FINANCIAL CONDUCT AUTHORITY, *supra* note 256 at 7; FINANCIAL CONDUCT AUTHORITY *supra* note 258 at 3-5; and FINANCIAL CONDUCT AUTHORITY, *supra* note 258, at 5.

<sup>345</sup> See Hilary Osborne, *FSA fines Kensington Mortgages £1.2m*, THE GUARDIAN (Apr. 12, 2010, 11:15 AM), <https://www.theguardian.com/money/2010/apr/12/fsa-kensington-mortgages-fine>.

<sup>346</sup> See *supra* Section III.

<sup>347</sup> See, e.g., *Co-op Loan Fund*, CO-OP LOAN FUND, <https://loanfund.coop> (last visited Nov. 9, 2020), for a discussion of how co-operative finance can be based on more long-termist and relational outworking.

<sup>348</sup> Daniel Thomas, *Investor Plans £15bn Support for UK Companies Toiling with Crisis Loans*, FIN. TIMES (Jun. 1, 2020), <https://www.ft.com/content/e38f23da-4147-4bd3-b613-c7e6f1096cc6>, (discussing how a private sector-led business growth fund is preparing to invest in the UK corporate economy to help its recovery as reliance cannot be placed on public debt financing alone).

<sup>349</sup> *UNECE Mobilizes Experts to Develop Guidance on Public-Private Partnerships to Help Build Back Stronger from the COVID-19 Pandemic*, UNECE, <https://www.unece.org/info/media/news/trade/2020/unece-mobilizes->



options in solidarity-based financial provisions, such as the growth of social and community-based institutions like cooperative financing,<sup>350</sup> social banking, and investment instruments.<sup>351</sup> It follows that what needs to be addressed is the wider policy context that encourages overreliance on conventional commercial debt, such as in the context of central bank monetary transactions in supporting liquidity in corporate debt markets.<sup>352</sup> However, we contend that maintaining a clear divide between legal and nonlegal approaches is conceptually limiting. The application of legal elasticity affects many policy measures that are expressed as law or regulation.<sup>353</sup>

We turn to the introduction of a methodological framework to apply the theoretical insights of legal elasticity to structural considerations for legal and regulatory reform. This article provides a high-level perspective of choices for reform to legal and regulatory framing instead of arguing more narrowly for specific legal and policy reforms, each of which require more detailed examination. On the one hand, it could be argued that depth is sacrificed in favor of breadth. On the other hand, the survey of breadth provides a useful starting point for more targeted research in the future. The non-prescriptive approach in this article is also consistent with recognizing that the jurisdictions we discuss face different contextual factors that will affect policy and regulatory choices.

## **V. A Methodological Framework for the Application of Legal Elasticity: A Blueprint for Policy Choices in Post-Covid Debt Regulation and Wider Measures**

In this section, we explore how legal elasticity can be applied, affecting a wide range of legal and regulatory regimes, in order to mitigate the long-term adverse consequences of increased indebtedness for households and corporations. Legal elasticity can be applied to aspects of legal and regulatory framing that have facilitated access to debt and inflexibility in private debt relations, in order to consider their adjustment in light of the three regulatory objectives of (a) facilitating corporate economic recovery, (b) alleviating household suffering, and (c) preventing systemic risk impact on the financial system. This approach also constrains arbitrary applications of legal elasticity thus promoting greater accountability for policy makers considering legal or regulatory changes.

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experts-to-develop-guidance-on-public-private-partnerships-to-help-build-back-stronger-from-the-covid-19-pandemic/doc.html (last visited Nov. 7, 2020).

<sup>350</sup> See CO-OP LOAN FUND, *supra* note 351.

<sup>351</sup> Olaf Weber, Mission and Profitability of Social Banks 3–5 (Nov. 10, 2011) (unpublished working paper) (on file with the author); Daniel Tischer & Sven Remer, *Growing Social Banking Through (Business) Associations*, in ROUTLEDGE HANDBOOK OF SOCIAL AND SUSTAINABLE FINANCE, 480, 481-82, 485 (Othmar M Lehner ed., 2017); see *COVID-19 Response and Resources*, SOCIAL FINANCE, <https://socialfinance.org/covid/> (last visited Nov. 7, 2020); MAXIMILIAN MARTIN, BUILDING THE IMPACT ECONOMY: OUR FUTURE, YEAR OR DAY 129-50, 167-78, 187-205 (2016); Lisa Brandstetter & Othmar M. Lehner, *Opening The Market For Impact Investments*, in ROUTLEDGE HANDBOOK OF SUSTAINABLE AND SOCIAL FINANCE (Othmar M Lehner ed., 2016).

<sup>352</sup> Paolo Cavallino & Fiorella De Fiore, *Central Banks' Response to Covid-19 in Advanced Economies*, BIS (2020), <https://www.bis.org/publ/bisbull21.pdf>. There is a concern that policymakers tend to over-rely on the central bank as 'the only game in town'. The Fed's role in the US is critically reviewed in, David Zaring, *Modernizing the Bank Charter*, 61 WM. & MARY L. REV., 1397, 1401, 1409, 1427 (2020).

<sup>353</sup> For general remarks on how law or regulation is the dominant instrument to effect policy, extensive discussion can be found in European commentary regarding the role of law and regulation to effect economic policies such as building an integrated European market, e.g., Iris H-Y Chiu, *Regulatory Convergence in EU Securities Regulation 43-109* (Mar. 2007) (published Ph.D. thesis, University of Leicester)(on file with UMI Dissertation Publishing).

We set out below a methodological framework to map the three regulatory objectives against the legal and regulatory aspects of debt framing argued in Section III as contributing to adversities for corporations and households during the pandemic. This mapping sheds light on a list of potential structural measures for regulators to consider.

**Table 1. Mapping the Policy Choices in Relation to Corporate Debt: Debt-Specific and Wider Complimentary Measures**

Regulatory Objectives / Aspects of Legal Framing: Corporate Debt	Legal / Regulatory Framing Affecting Corporate Capital Structure	Legal / Regulatory Framing for Debt Servicing Terms
Facilitating economic recovery	<ul style="list-style-type: none"> <li>(a) Balancing government-backed loans with government-engaged equity, such as by government investment vehicles, sovereign wealth investment,<sup>354</sup> and public-private partnerships,<sup>355</sup></li> <li>(b) More adjustments to securities and rights offering processes to facilitate quicker and cost-effective fundraising,<sup>356</sup></li> <li>(c) Address distortions in tax regulation that favors debt (i.e., the deduction of interest payments as expenses from corporate tax liability) to achieve tax neutrality in corporate capital structure;<sup>357</sup></li> <li>(d) Facilitating or mandating the issue of convertible debt instruments, drawing upon</li> </ul>	<ul style="list-style-type: none"> <li>(a) Regulatory scrutiny of any industry-developed Covid-specific loan terms<sup>359</sup> and consideration of the wider policy of regulating business lending,<sup>360</sup></li> <li>(b) Regulatory requirements (in principles/rules) to be incorporated into government-backed loans;</li> <li>(c) Loan terms requiring relational outworking with debtors;<sup>361</sup></li> <li>(d) Regulatory requirement or encourage private sector to introduce/standardize debt covenants in relation to debtor-companies’ “long-termism” and inclusion of relevant aspects of sustainability, social</li> </ul>

<sup>354</sup> *Covid-19 Hastens Sovereign Wealth Funds' Refocus to Home*, THE STRAITS TIMES (Jun. 26, 2020, 9:14 AM), <https://www.straitstimes.com/business/economy/covid-19-hastens-sovereign-wealth-funds-refocus-to-home>.

<sup>355</sup> See UNECE, *supra* note 353.

<sup>356</sup> Examples of possible adjustments include the shortening of offer periods or dispensation of offer disclosure documents altogether, Eilis Ferran, *Limits of Private Sector Solutions for Banks: Recent UK Rights Issues* 25–26 (Eur. Corp. Governance Inst., Working Paper No. 115/2008, 2008), <http://ssrn.com/abstract=1290717>, going further than the UK’s and EU’s temporary adjustments, *see, e.g.*, Regulation 1286/2014, *supra* note 279, at 17–18; Regulation 600/2014, *supra* note 279, at 133–39.

<sup>357</sup> Herwig J. Schlunk, *The Zen of Corporate Capital Structure Neutrality*, 99 MICH. L. REV. 410, 411, 449–51 (2000).

<sup>359</sup> [FNT TO DELETE] Such as the Loan Market Association’s guidance on loan terms for UK government-backed loans, <https://www.lma.eu.com/documents-guidelines/documents/category/issues-and-guidance#relevant-documents145>.

<sup>360</sup> Imogen Tew, *FCA Urged to Regulate Commercial Lending*, FTADVISER.COM (June 14, 2019), <https://www.ftadviser.com/regulation/2019/06/14/fca-urged-to-regulate-commercial-lending/>.

<sup>361</sup> *See generally* Ian R. Macneil, *Relational Contract: What We Do and Do Not Know*, 1985 WIS. L. REV. 483 (1985) (providing for reflections of the reality of human and social interactions for long-term post-contract adjustments).

	<p>lessons from mandatory ‘bail-in’ debt for banks;<sup>358</sup></p> <p>(e) Encouraging supply-side diversity for finance (e.g., cooperative-based or social finance).</p>	<p>responsibility, and good governance;<sup>362</sup></p> <p>(e) Consider a <i>lex specialis</i><sup>363</sup> for nonfinancial sector corporate resolutions where the scale of corporate distress may have macroeconomic or systemic risk impact.<sup>364</sup></p>
Alleviating household suffering	<p>(a) Policies to support redeployment of human capital, adequate redundancy support;</p> <p>(b) Considerate transition by government out of any fiscal support such as furlough or the PPP and clarification of the relationship between government support for wages/employment and employment law.<sup>365</sup></p>	<p>(a) Policy and regulatory choices regarding banks and relationships with zombie companies,<sup>366</sup> including <i>lex specialis</i> for nonfinancial corporate restructuring above;</p> <p>(b) Consider distributive effects in creditor priorities (e.g., wages in the enforcement of corporate debt or insolvencies).</p>
Prevention of systemic risk to finance sector	<p>(a) Public-backed “bad bank” for bailing out of nonperforming assets, such as distressed corporations’ debt,<sup>367</sup> which likely</p>	<p>(a) Regulatory forbearance towards lenders in relation to resumption of microprudential</p>

<sup>358</sup> International policy is developed for globally systemically important banks to issue mandatory convertible debt which “bails-in” debtors to become equity holders to absorb losses and prevent disorderly insolvency. See FIN. STABILITY BD., KEY ATTRIBUTES FOR EFFECTIVE RESOLUTION REGIMES FOR FINANCIAL INSTITUTIONS 9 (2011), [https://www.fsb.org/wp-content/uploads/r\\_111104cc.pdf](https://www.fsb.org/wp-content/uploads/r_111104cc.pdf) [hereinafter FIN. STABILITY BD., KEY ATTRIBUTES (2011)]; FIN. STABILITY BD., PRINCIPLES ON BAIL-IN EXECUTION 2–4 (2018), <https://www.fsb.org/2018/06/principles-on-bail-in-execution-2/>.

<sup>362</sup> Gillian Tett, *Business Faces Stern Test on ESG amid Calls to ‘Build Back Better’*, FIN. TIMES (May 17, 2020), <https://www.ft.com/content/e97803b6-8eb4-11ea-af59-5283fc4c0cb0>.

<sup>363</sup> Laws to regulate the specific subject matter of bank recovery and resolution have been enacted or proposed. See, e.g., Directive 2014/59/EU, art. 5, 2014 O.J. (L. 173) 223; FIN. STABILITY BD., KEY ATTRIBUTES FOR EFFECTIVE RESOLUTION REGIMES FOR FINANCIAL INSTITUTIONS (2014); FIN. STABILITY BD., KEY ATTRIBUTES (2011), *supra* note 362, at 13–14.

<sup>364</sup> See Kristin van Zwieten, Horst Eidenmueller & Oren Sussman, *Bail-outs and Bail-ins are Better than Bankruptcy: A Comparative Assessment of Public Policy Responses to COVID-19 Distress* 23–24 (Eur. Corp. Governance Inst., Working Paper No. 535/2020, 2020), <https://ssrn.com/abstract=3669541>.

<sup>365</sup> See Anna Tims, *Furloughed from Work? It Pays to Know Your Rights*, THE GUARDIAN (May 3, 2020, 4:00 AM), <https://www.theguardian.com/money/2020/may/03/furloughed-from-work-it-pays-to-know-your-rights>.

<sup>366</sup> Zombie companies refer to companies that do not generate sufficient revenue to pay interest payments on their debt obligations, yet are not dissolved. See *Why covid-19 will make killing zombie firms off harder*, THE ECONOMIST (September 26, 2020) (last visited 11 January 2021), <https://www.economist.com/finance-and-economics/2020/09/26/why-covid-19-will-make-killing-zombie-firms-off-harder>.

<sup>367</sup> Matt Scuffham & John O’Donnell, *Exclusive: ECB Prepares ‘Bad Bank’ Plan for Wave of Coronavirus Toxic Debt*, REUTERS (June 10, 2020, 1:38 AM), <https://www.reuters.com/article/us-health-coronavirus-ecb-badbank-exclus/exclusive-ecb-prepares-bad-bank-plan-for-wave-of-coronavirus-toxic-debt-sources-idUSKBN23H0MV>. Bailouts are also supported (under certain considerations) in van Zwieten et al., *supra* note 368, at 23–24.

	<p>preserves financial stability;<sup>368</sup></p> <p>(b) Macroprudential policies for corporate sector borrowing, such as debt-to-equity ratio.</p>	<p>compliance, reporting and stress testing;<sup>369</sup></p> <p>(b) Macroprudential oversight of levels of corporate debt and distress.<sup>370</sup></p>
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**Table 2. Mapping the Policy Choices in Relation to Consumer Credit: Debt-Specific and Wider Complimentary Measures**

Regulatory Objectives / Aspects of Legal Framing: Household Debt	Legal/Regulatory Framing Affecting Credit Product Design and Access	Legal/Regulatory Framing for Debt Servicing Terms
Alleviating household suffering/facilitating economic recovery if households are able to maintain aggregate demand	<p>(a) More paternalism in the regulation of the sales and marketing of credit and hybrid credit,<sup>371</sup> (e.g., presumptions in favor of consumers in relation to aggressive sales and marketing tactics); to consider banning the most predatory forms of lending such as doorstep credit;</p> <p>(b) Creating disincentives to excessive household leverage (e.g., imposing higher due</p>	<p>(a) Mandatory relational contractual terms in debt servicing, perhaps on a scale relevant to customer vulnerability;</p> <p>(b) Regulatory scrutiny in relation to the enforcement of foreclosure powers and possible impositions of debtor protections;<sup>375</sup></p> <p>(c) Loan forgiveness as a penalty for lenders engaged in egregious conduct of business;</p> <p>(d) Constant review of consumer credit</p>

<sup>368</sup> Douglas W. Arner, Emiliios Avgouleas & Evan C. Gibson, *Financial Stability, Resolution of Systemic Banking Crises and COVID-19: Toward an Appropriate Role for Public Support and Bailouts 5* (Univ. of H.K. Faculty of Law, Research Paper No. 2020/044, 2020), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3664523](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3664523).

<sup>369</sup> See discussion *supra* Section II.D.

<sup>370</sup> Macro-prudential regulation relates to oversight for financial systems' overall health and is a shift from incentive-based micro-prudential regulation. See Andrew Baker, *The Gradual Transformation? The Incremental Dynamics of Macroprudential Regulation*, 7 REG. & GOVERNANCE 417, 417–19, 430 (2012). In 2012, the United Kingdom amended the Bank of England Act 1998, the Financial Services and Markets Act 2000, and the Banking Act 2009 and conferred greater macro-prudential regulatory oversight powers on the Financial Policy Committee. See Financial Services Act 2012, c. 21, § 9A(2)–(3). Similarly, in 2010, the United States established the Office of Financial Research with the passage of the Dodd-Frank Act. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 152, 12 Stat. 1376, 1413–14 (2010).

<sup>371</sup> Even relatively sophisticated consumer protection emanating from the EU is based on disclosure to investors, which assumes consumers' ability to make informed choices and the lack of need for paternalism. See Regulation 1286/2014, arts. 5–14, 2014 O.J. (L 352) 10–16.

<sup>375</sup> Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Non-Judicial Foreclosure Act*, 53 DUKE L.J. 1399, 1401, 1447-48, 1456-64 (2004).

	<p>diligence for repeat lending; introducing penalties such as nullification of loan for egregious conduct of business);</p> <p>(c) Improving access to justice for mis-selling and unfair treatment;<sup>372</sup></p> <p>(d) Mandatory requirement to assess for creditworthiness/affordability in all consumer credit products and assess especially for vulnerability<sup>373</sup> before lending;</p> <p>(e) Regulatory scrutiny of algorithmic and automated systems of credit generation for bias<sup>374</sup> towards over-inclusion, over-exclusion and other distortions;</p> <p>(f) Encouraging supply-side diversity in terms of type of lender (e.g., cooperative-based or social finance).</p>	<p>terms; to consider extensive product regulation<sup>376</sup> for consumer credit;<sup>377</sup></p> <p>(e) Extension of out-of-court dispute resolution systems (such as the UK Financial Ombudsman) mandate<sup>378</sup> to deal with household debt restructuring.</p>
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<sup>372</sup> Particularly, such improved access might be achieved through out-of-court dispute resolution such as the UK Financial Ombudsman, *see* Financial Services and Markets Act 2000, c. 8, § 225, or specialized financial services dispute tribunals, *see* Richard Samuel, *The FCA Has Now Listened: Banks, It Is in Your Interests to Listen Too*, 13 CAP. MKTS. L.J. 3, 17–22 (2018); Richard Samuel, *Tools for Changing Banking Culture: FCA Are You Listening?*, 11 CAP. MKTS. L.J. 129, 140 (2016).

<sup>373</sup> FCA, *supra* note 293.

<sup>374</sup> Katja Langenbucher, *Responsible A.I.-based Credit Scoring – A Legal Framework*, 31 EUR. BUS. L. REV. 527, 532 (2020); Nikita Aggarwal, *The Norms of Algorithmic Credit Scoring*, CAMBRIDGE L.J. (forthcoming 2021) (manuscript at 2, 11-12), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3569083](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3569083).

<sup>376</sup> Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 6-7 (2008).

<sup>377</sup> Regulation could reduce ease of access to credit, but quantitative reduction may be accompanied by qualitative improvement in welfare (i.e., less defaults and distress for households). Anthony A. Defusco, Stephanie Johnson & John Mondragon, *Regulating Household Leverage*, 87 REV. ECON. STUD. 914, 919, 956 (2020). *But see* SUMIT AGARWAL ET AL., *REGULATING CONSUMER FINANCIAL PRODUCTS: EVIDENCE FROM CREDIT CARDS* 4 (2014), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2330942](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2330942) (providing contrary findings that customer access and welfare are unaffected by regulation of credit card fees).

<sup>378</sup> Financial Services and Markets Act 2000, c. 8, § 225(1) (UK).



Prevention of systemic risk to financial sector	<ul style="list-style-type: none"> <li>(a) Public-backed “bad bank” for bailing out of non-performing assets in distressed consumer debt;</li> <li>(b) Policy balance between state financial welfare provision and financialization such as public sector involvement in housing and regional development projects;</li> <li>(c) Fiscal policies such as “helicopter drops.”<sup>379</sup></li> </ul>	<ul style="list-style-type: none"> <li>(a) Mandatory relational contractual terms in debt servicing;</li> <li>(b) Considering how securitization channels may adversely affect relational outworking of distressed consumer debt.<sup>380</sup></li> </ul>
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It may be argued that the above frameworks are limited, as they only identify issues for consideration and provide a starting blueprint. To be sure, a proposal for terms of relational outworking does not necessarily indicate what a contractual term to this effect would look like. Regulators could impose a mandatory negotiation period with borrowers, or lenders could be prevented from formal enforcement action, such as foreclosures until a minimum number of workouts have been attempted. However, our aim is not to argue for or support specific regulatory designs, but rather to supply a methodological framework for mapping out the issues susceptible to legal elasticity and structural policy choices.

In parallel, we argue that regulatory design involves further considerations of (a) macro-level choices v. micro-level choices, such as whether the regulatory design should work on incentives<sup>381</sup> or mandatory norms in order to address a commons;<sup>382</sup> (b) soft v. hard legal framing and enforceability, such as whether private sector actors may play an effective part in standards generation and/or enforcement;<sup>383</sup> (c) underpinnings of legal traditions in relation to

<sup>379</sup> Martin Sandbu, *Coronavirus: The Moment for Helicopter Money*, FIN. TIMES (Mar. 20, 2020), <https://www.ft.com/content/abd6bbd0-6a9f-11ea-800d-da70cff6e4d3>.

<sup>380</sup> Tomasz Piskorski, Amit Seru & Vikrant Vig, *Securitization and Distressed Loan Renegotiation: Evidence from the Subprime Mortgage Crisis*, 97 J. FIN. ECON. 369, 371 (2010), <http://ewget.uek.krakow.pl/papers/Piskorski-paper.pdf>.

<sup>381</sup> See ZANNA ISCENKO ET AL., FIN. CONDUCT AUTH., ECONOMICS FOR EFFECTIVE REGULATION, OCCASIONAL PAPER NO. 13 at 4-5, 20 (2016), <https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-13-economics-effective-regulation>.

<sup>382</sup> See ELINOR OSTROM, GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION 1-2, 8-9 (1990).

<sup>383</sup> Such as “smart regulation” where private sector actors play a part in co-supervising regulatory compliance, Neil Gunningham & Darren Sinclair, *Economic Aspects of Environmental Compliance Assurance: Designing Smart Regulation*, OECD, 113-14, 123-24 (Dec. 2-3, 2004), <http://www.oecd.org/environment/environmentinemergingandtransitioneconomies/37719119.pdf>; NEIL GUNNINGHAM, PETER GRABOSKY & DARREN SINCLAIR, SMART REGULATION: DESIGNING ENVIRONMENTAL POLICY, 93 (1st ed. 1998 ) (arguing that regulation should not be exclusive to governments);

common-law, civil-law, and hybrid legal systems, in relation to the mixture of ex ante and ex post legal designs;<sup>384</sup> and (d) underpinnings of political economy, as social contract bargains forged in different political economies provide different distributive preferences.<sup>385</sup> In this manner, regulators in the UK, US, and EU can apply the methodological framework above to identify where legal elasticity should be applied for regulatory adjustments and new policy choices. We cannot be overly prescriptive.

We also urge regulators to engage in substantive regulatory decision-making in the holistic manner proposed by Sunstein<sup>386</sup> and honest discourse and narratives that do not conceal underlying assumptions and normative choices. Sunstein's approach to regulatory decision-making is grounded in cost-benefit analysis in the broadest terms.<sup>387</sup> This approach goes beyond merely looking to monetary values of benefits and drawbacks in the marketized sense and seeks to encompass "hard-to-value," controversial, and subjective evaluations in order to interrogate what each policy proposal may achieve.<sup>388</sup> The evaluative compass is anchored upon the human perspective, including difficulties in putting a monetary value on societal values and preferences.<sup>389</sup> This approach responds to extant criticism levelled against cost-benefit approaches. Criticisms of the cost-benefit approach in regulatory decision-making include: narrowly defined practices in order to avoid hard questions,<sup>390</sup> highly proceduralized practices in order to show that formalities are completed for advancing a particular legal reform,<sup>391</sup> and practices that are vague and weak when grappling with variables that are difficult to value.<sup>392</sup> However, as Wiener argues, evaluative approaches like cost-benefit analysis need not be implemented in narrow, formalistic, and meaningless terms.<sup>393</sup>

It may be argued that the regulatory/policy choices offered in the tables above include well-trodden issues such as improving companies' long-term outlook and sustainability profiles and ongoing consumer protection issues. These have already been discussed before the

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and meta-regulation where regulated entities are delegated the details of implementing regulatory frameworks and principles, CHRISTINE PARKER, *THE OPEN CORPORATION: EFFECTIVE SELF-REGULATION AND DEMOCRACY* 245-46 (2002); Christine Parker, *Meta-Regulation: Legal Accountability for Corporate Social Responsibility*, in *THE NEW CORPORATE ACCOUNTABILITY: CORPORATE SOCIAL RESPONSIBILITY AND THE LAW* 208-209 (Doreen McBarnet et al., 2007).

<sup>384</sup> See Susan Rose-Ackerman, *Regulation and the Law of Torts*, 81 AM. ECON. REV. 54, 54 (1991) (discussing the balance between regulatory and private law).

<sup>385</sup> PETER A. HALL & DAVID SOSKICE, *VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE* 1-68 (2001).

<sup>386</sup> CASS R. SUNSTEIN, *VALUING LIFE: HUMANIZING THE REGULATORY STATE* 1, 1 (University of Chicago Press 2014).

<sup>387</sup> Cass R. Sunstein & Robert W. Hahn, *A New Executive Order for Improving Federal Regulation? Deeper and Wider Cost-Benefit Analysis* 7 (John M. Olin Program in L. and Econ. Working Paper No. 150, 2002), [https://chicagounbound.uchicago.edu/law\\_and\\_economics/10/](https://chicagounbound.uchicago.edu/law_and_economics/10/).

<sup>388</sup> SUNSTEIN, *supra* n390, at 67-70.

<sup>389</sup> Cass R. Sunstein, *The Limits of Quantification*, 102 CAL. L. REV. 1369, 1372, 1374 (2014).

<sup>390</sup> Julie Froud & Anthony Ogus, *'Rational' Social Regulation and Compliance Cost Assessment*, 74 PUB. ADMIN. 221, 225, 228, 233 (1996).

<sup>391</sup> Christopher Carrigan & Stuart Shapiro, *What's Wrong with the Back of the Envelope? A Call for Simple (And Timely) Benefit-Cost Analysis* 11 REGUL. & GOVERNANCE 203, 203 (2017).

<sup>392</sup> See Mark Harrison, *Assessing the Impact of Regulatory Impact Assessments*, 16 AGENDA 41, 41-42 (2009), <http://ssrn.com/abstract=1906482>.

<sup>393</sup> Jonathan Wiener, *Better Regulation in Europe* 3-4 (Duke Law Sch., Working Paper No. 65, 2006), <http://www.osservatorioair.it/wp-content/uploads/2009/08/wiener2006.pdf>.

onset of the Covid-19 pandemic,<sup>394</sup> and reiteration of these issues under the cover of the pandemic appears to be furthering an existing agenda. However, the pandemic provides an opportunity for the acceleration of regulatory thinking and a sharper focus upon the achievement of the three regulatory objectives enumerated previously. Further, mapping regulatory/policy choices in this manner allows an integrated, not siloed, view of choices and policies.

Moreover, we argue that regulators and policy makers should adopt two procedural tenets in advancing their thinking on the legal and regulatory choices in the tables above. First, decision-making frameworks should be instituted in a manner inclusive of decision-makers and stakeholders. Second, as policy reforms are essentially pursuant to legal elasticity, they should be subject to an inbuilt provision for continuing review.

#### **A. Multi-Stakeholder Regulatory Decision-Making**

Regulatory decision-making should be subject to an inclusive framework to apprise regulators and policy makers fully of different stakeholders' views of potential regulatory reforms. This allows regulators to be fully informed and avoids regulatory decision-making dynamics that only involve powerful financial actors.

The following relational linkages should be fostered:

- (a) The relational dimension amongst financial regulators and all relevant policy makers should be strengthened. Crisis management by the public sector is often not taken for granted due to the delineations between government bodies, independent agencies, and the structure of government and bureaucracy.<sup>395</sup>
- (b) Relevant regulators should engage with their regulated entities. This relationship is often fraught with depictions of capture,<sup>396</sup> polarization, excessive delegation (resulting in self-regulation),<sup>397</sup> etc. Although the relationship between regulators and their regulated entities remains a work in progress in regulation theory studies, we suggest that constructive engagement is inevitable, although relational dynamics may not be perfect.
- (c) The relational dimension between regulators, policy makers, and stakeholders or society should be strengthened. Crisis management benefits from multi-stakeholder participation, the consolidation of resources,<sup>398</sup> social mobilization, and solidarity.

One of the lessons from the global financial crisis for regulators was the importance of coordination amongst each other and with relevant government agencies and treasury departments. After the global financial crisis, the UK and EU reorganized regulatory

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<sup>394</sup> See, e.g., CAMBRIDGE UNIV. PRESS, THE CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY 3-10 (Beate Sjøfjell & Christopher M. Bruner eds., 2019) (discussing reforms needed in corporate law for long-termism and sustainable purposes).

<sup>395</sup> See Charles Baubion, *OECD Risk Management: Strategic Crisis Management* 8, 22 (Org. Econ. Co-operation and Dev., Working Papers on Public Governance, Paper No. 23, 2013), <https://www.oecd-ilibrary.org/docserver/5k41rbd1l1zr7-en.pdf?expires=1605216690&id=id&accname=guest&checksum=FC5B961B638B58EEF61A37BD5D3B6AC4>.

<sup>396</sup> See Lawrence G. Baxter, *Capture in Financial Regulation: Can We Channel It Toward the Common Good?* 21 CORNELL J.L. & PUB. POL'Y 175, 178-80 (2011).

<sup>397</sup> See Cristie L. Ford, *New Governance, Compliance, and Principles-Based Securities Regulation* 45 AM. BUS. L.J. 1, 60 (2008).

<sup>398</sup> Julia Black, *Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a 'Post-Regulatory' World* 54 CURRENT LEGAL PROBS. 103, 103-04 (2001).

coordination, such as the formalization of the Treasury, Bank of England, PRA, and FCA relations,<sup>399</sup> and the establishment of EU financial regulatory agencies, a joint committee, and relations with the ECB in microprudential and macroprudential supervision.<sup>400</sup> The management of the Covid-19 crisis is now a joint effort by the PRA and FCA.<sup>401</sup> In the US, we also see joint releases by the Fed, FDIC, OCC, and the CFPB,<sup>402</sup> which demonstrates the necessity of coordination even if the regulatory architecture is dispersed.

Although the relationship between regulators and their regulated entities has been depicted as involving lobbying, informal “capture or sympathy,”<sup>403</sup> or excessive trust (especially before the global financial crisis),<sup>404</sup> it remains imperative that regulators maintain informational and supervisory proximity to those they regulate. Omarova argued in the wake of the global financial crisis, that a system of tripartite financial regulation should be introduced where “bankers” and “bureaucrats” would enroll “guardians” who are stakeholders representing public interest to co-govern in the realm of financial regulation.<sup>405</sup> This would allow public interest issues to be brought to bear in financial regulation and for weaknesses in the relational paradigm between the regulator and those regulated to be moderated. Such a multipartite form of networked governance is consistent with, and has always been envisaged in, regulatory theory.<sup>406</sup>

### ***B. Mandatory Review of Legal Elasticity Measures***

We propose that any policy reforms adopted to address the adverse consequences post-pandemic indebtedness should be subject to ongoing review. Policy makers may also adopt a stronger form of temporality by stipulating sunset clauses to compel review and legislative scrutiny.

Mandatory review for continuation of policy is a technique frequently employed in EU legislation, consistent with the theoretical paradigm of *experimentalist governance*.<sup>407</sup> Experimentalist governance is a theoretical conception for governance in the EU due to the multi-level nature of EU regulation, which requires national and EU level participation in decision-making and implementation.<sup>408</sup> Although experimentalist governance addresses a regulatory architecture problem of coordination between EU member states and EU-level institutions, it can offer broader insights for regulatory coordination and the need for learning and review in designing and implementing regulatory governance.<sup>409</sup>

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<sup>399</sup> Financial Services Act 2012, c. 21, § 64(5) (UK); Financial Services and Markets Act 2000, c. 3, § 3D-3Q (UK).

<sup>400</sup> See Iris H-Y Chiu, *Power and Accountability in the EU Financial Regulatory Architecture: Examining Inter-agency Relations, Agency Independence and Accountability* 8 EUR. J. LEGAL STUD. 68, 68, 72 (2015).

<sup>401</sup> See *supra* Section II.A.

<sup>402</sup> See *supra* Section II.D.

<sup>403</sup> Baxter, *supra* note 400 at 176.

<sup>404</sup> ADAIR TURNER, *THE TURNER REVIEW: A REGULATORY RESPONSE TO THE GLOBAL BANKING CRISIS* 34-49, FIN. SERVS. AUTH. (2009), [http://www.actuaries.org/CTTEES\\_TFRISKCRISIS/Documents/turner\\_review.pdf](http://www.actuaries.org/CTTEES_TFRISKCRISIS/Documents/turner_review.pdf).

<sup>405</sup> See Saule T. Omarova, *Bankers, Bureaucrats, and Guardians: Toward Tripartism in Financial Services Regulation*, 37 J. CORP. L. 622, 623 (2012).

<sup>406</sup> See Black, *supra* note 353 at 103-04; Julia Black, *Mapping the Contours of Contemporary Financial Services Regulation*, 2 J. CORP. L. STUD. 253, 254-55 (2002).

<sup>407</sup> Charles F. Sabel & Jonathan Zeitlin, *Introduction to EXPERIMENTALIST GOVERNANCE IN THE EUROPEAN UNION: TOWARDS A NEW ARCHITECTURE* 9 (Charles F. Sabel & Jonathan Zeitlin eds., 2010).

<sup>408</sup> *Ibid.*

<sup>409</sup> See Ittai Bar-Siman-Tov, *Temporary Legislation, Better Regulation and Experimentalist Governance: An Empirical Study*, 12 REG. & GOVERNANCE 192 (2018).

Commentators opine that subjecting legislation to subsequent review is not an oddity in many jurisdictions.<sup>410</sup> The benefits of mandating temporality include building in processes for learning, subsequent information discovery, the opportunity to correct earlier assumptions and errors,<sup>411</sup> and subjecting new norms to continuing scrutiny in terms of relevance and social and political acceptance.<sup>412</sup> Moreover, temporary legislation may serve “legisprudential” objectives<sup>413</sup> (i.e., to subject new norms to a period of experimental outworking to determine if permanence should be hardened in law). Mandatory review also compels responsible agencies to be accountable for their implementation and learning. In this manner, perspectives in the theoretical literature on temporary legislation can be brought together with the paradigm of legal elasticity.<sup>414</sup> Not only does legal elasticity hold out the importance, or even primacy, of legal adjustment in crisis management, it also arguably offers a continuing vision of learning and adjustability.

An experimental approach can be taken towards the policy/regulatory choices mapped out above in order to test the relevance of the continuity of certain measures. This approach is warranted as commentators often support temporality for crisis management<sup>415</sup> and warn against excessively rapid legalization on a permanent basis in response to a crisis.<sup>416</sup> For example, if new norms recalibrate established rights in debt relations, an experimental period of learning, information gathering, and observation is warranted to ascertain how market behavior is shaped.

At the same time, some of the proposed policy and regulatory choices in the tables need time to be fashioned and instituted, such as the facilitation of social finance or the growth of government-engaged investment outfits. It can be argued that these enabling measures, designed to stimulate institutional and market responses, should not be subject to temporality so that economic actors have greater certainty to make investment towards them. Further, Gersen warns that the temporality of the “right policy choices” could undermine their continuity,<sup>417</sup> especially if political lobbying opposes such choices. Policy makers should also carefully consider any adverse effect of temporality that may cause regression and uncertainty.

### ***C. Wider Structural Issues and Concerns***

Finally, regulators and policy makers should be mindful of wider structural issues contributing to the hitherto high levels of corporate and household debt. They may wish to consider the balance between private sector financialization and desirable levels of deleveraging as a matter of public interest. We map these broader structural options below in an extended application of the methodological framework for legal elasticity, in order to

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<sup>410</sup> Jacob E. Gersen, *Temporary Legislation*, 74 U. Chi. L. Rev. 247, 247, 257-258 (2007).

<sup>411</sup> *Id.*; Ittai Bar-Siman-Tov & Gaya Harari-Heit, *Legisprudential Functions of Temporary Legislation: Chapter 10 in TIME, LAW AND CHANGE: AN INTERDISCIPLINARY STUDY* 227, 244 (Sofia Ranchordas and Yaniv Roznai eds., 2020).

<sup>412</sup> *See* Gersen, *supra* note 414 at 247-48 (2007).

<sup>413</sup> *Id.* at 236-37.

<sup>414</sup> *See generally, e.g.*, Bar-Siman-Tov, *supra* note 415 (discussing findings of a study of temporary legislation); Gersen, *supra* note 414 (discussing and analyzing the use of temporary legislation); Ittai Bar-Siman-Tov & Gaya Harari-Heit, *supra* note 415 (exploring the different uses of temporary legislation).

<sup>415</sup> *See* Bar-Siman-Tov & Harari-Heit, *supra* note 415, at 232-33.

<sup>416</sup> Luca Enriques, *Regulators’ Response to the Current Crisis and the Upcoming Reregulation of Financial Markets: One Reluctant Regulator’s View*, 30 U. PA. J. INT’L L. 1147, 1150, 1152-53 (2009).

<sup>417</sup> Jacob E. Gersen, *Temporary Legislation*, 74 U. CHI. L. REV. 247, 254-55, 267-8, 279-80 (2007).



consider how broader legal and regulatory framing may affect financing choices and financial management by households and corporations.

**Table 3. Mapping of Wider Structural and Policy Choices**

Regulatory Objectives / Policy Framing Relating to High Debt Levels	Financing Choices	Financial Management
Promoting long-term corporate financial resilience	<ul style="list-style-type: none"> <li>(a) Addressing incentives for equity reduction, share buybacks,<sup>418</sup> (e.g., institutional investors’ structures and incentives, corporate governance norms, and law in relation to short-termism and shareholder wealth maximization);<sup>419</sup></li> <li>(b) Changes to corporate law/purpose/governance for long-term management<sup>420</sup> of corporate success and viability;</li> <li>(c) Addressing the balance between competition<sup>421</sup> objectives and corporate sector health.</li> </ul>	<ul style="list-style-type: none"> <li>(a) Incentivizing long-term investment decisions<sup>422</sup> by corporations;</li> <li>(b) Assisting corporations in sectors facing transition risks<sup>423</sup> such as climate change;</li> <li>(c) Meaningful and integrated financial accountability.<sup>424</sup></li> </ul>

<sup>418</sup> BAKER ET AL., CTR. FOR RESEARCH ON ACCOUNTING & FIN. IN CONTEXT, AGAINST HOLLOW FIRMS: REPURPOSING THE CORPORATION FOR A MORE RESILIENT ECONOMY 8 (2020), <http://eprints.whiterose.ac.uk/163163/1/Against-Hollow-Firms%20%281%29.pdf>.

<sup>419</sup> See generally EPSTEIN, *supra* note 182 (discussing the consequences of the financialized context).

<sup>420</sup> See generally JOHN KAY, THE KAY REVIEW OF UK EQUITY MARKETS AND LONG-TERM DECISION MAKING FINAL REPORT (2012) (discussing the problems of short-termism and advocating for long-term policies); THE BRITISH ACADEMY, PRINCIPLES FOR PURPOSEFUL BUSINESS: HOW TO DELIVER THE FRAMEWORK FOR THE FUTURE OF THE CORPORATION (2019) (advocating for changing corporate law to encourage long-term focused actions).

<sup>421</sup> Communication from the Commission, Third Amendment to the Temporary Framework for State Aid Measures to Support the Economy in the Current COVID-19 Outbreak, 2020 O.J. (C 218) 3, [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C\\_.2020.218.01.0003.01.ENG&toc=OJ:C:2020:218:TOC](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2020.218.01.0003.01.ENG&toc=OJ:C:2020:218:TOC).

<sup>422</sup> NICOLETTE C. PRUGSAMATZ, IN(EX)TERNAL CORPORATE GOVERNANCE AND INNOVATION: A REVIEW OF THE EMPIRICAL EVIDENCE (2015), <http://ssrn.com/abstract=2664401> reviews in detail that corporate investment in innovation can be carried out with a view to long-term success.

<sup>423</sup> See generally Carol M. Boyer & Catherine Boulatoff, *What is the Impact of Private and Public R&D on Clean Technology Firms’ Performance? An International Perspective*, J. SUSTAINABLE FIN. & INV. 147 (2017) (exploring how public and private research affects profitability); Jakob Thomä & Hugues Chenet, *Transition Risks and Market Failure: A Theoretical Discourse on Why Financial Models and Economic Agents May Misprice Risk Related to the Transition to a Low-Carbon Economy*, 7 J. SUSTAINABLE FIN. & INV. 82 (2017) (discussing whether the market is mispricing transition risk associated with a low-carbon economy); Ronan Bolton & Matthew Hannon, *Governing Sustainability Transitions Through Business Model Innovation: Towards a Systems Understanding*, 45 RES. POL’Y 1731 (2016) (exploring how new business models are used to deploy new sustainable technology).

<sup>424</sup> This is discussed in The Sharman Inquiry, FIN. REPORTING COUNCIL, THE SHARMAN INQUIRY GOING CONCERN AND LIQUIDITY RISKS: LESSONS FOR COMPANIES AND AUDITORS 10-11 (2012), <http://www.frc.org.uk/getattachment/591a5e2a-35d7-4470-a46c-30c0d8ca2a14/Sharman-Inquiry-Final-Report.aspx> (discussing the moderation of the narrow orientations of financially focused accounting information). See *The Tool for Better Reporting*, INT’L INTEGRATED REPORTING COUNCIL, <https://integratedreporting.org>.

Promoting long-term household resilience	<ul style="list-style-type: none"> <li>(a) Policies to improve distributive inequalities and share of economic wealth held by middle-to-lower income workers in an age of wage stagnation;<sup>425</sup></li> <li>(b) Policies to improve social mobility including regulating new economic structures, such as the gig and platform economies, to advance human-capital interests;<sup>426</sup></li> <li>(c) Policies to facilitate diversity of sources and terms in entrepreneurial finance,<sup>427</sup> including the regulation of small business lending;</li> <li>(d) Balancing state welfare provision for key social goods, such as education and healthcare, which have been empirically found to be significant proportions of household debt.<sup>428</sup></li> </ul>	<ul style="list-style-type: none"> <li>(a) Policies to rebalance a consumption-fueled economy and to discourage consumption-driven leverage;</li> <li>(b) Policies to encourage pensions<sup>429</sup> and precautionary savings,<sup>430</sup> coupled with robust regulation of financial-sector intermediaries in their conduct of business and product governance;</li> <li>(c) Improving financial education and literacy through public-sector programs.<sup>431</sup></li> </ul>
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<sup>425</sup> THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY 11-12 (Arthur Goldhammer trans., 2014).

<sup>426</sup> See generally Andrew Stewart & Jim Stanford, *Regulating Work in the Gig Economy: What are the Options?*, 28 ECON. & LAB. REL. REV. 427 (2017) (discussing the various proposals for regulating work in the gig economy and recommendations for policy makers).

<sup>427</sup> Such as online equity crowdfunding, but it is arguable that the US JOBS Act, Regulation A, and the EU Crowdfunding Regulation 2020 impose more regulatory barriers than are constructive for building up these markets. Council of the EU Press Release, Capital Markets Union: Council Adopts New Rules for Crowdfunding Platforms (July 20, 2020). See generally Eugenia Macchiavello, *The European Crowdfunding Service Providers Regulation and the Future of Marketplace Lending and Investing in Europe: The ‘Crowdfunding Nature’ Dilemma*, EUR. BUS. L. REV. (forthcoming 2021) (analysing regulations for crowdfunding activities), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3594353](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3594353).

<sup>428</sup> Long, *supra* note 304 at 227.

<sup>429</sup> See generally Pensions Act 2008, c. 30 (Eng.) (discussing the mandatory enrollment into occupational pensions).

<sup>430</sup> Alba Lugilde, Roberto Bande & Dolores Riveiro, *Precautionary Saving in Spain During the Great Recession: Evidence from a Panel of Uncertainty Indicators* 16 REV. ECON. HOUSEHOLD 1151 (2018).

<sup>431</sup> Financial literacy programmes are not an excuse for pushing responsibility onto consumers for poor financial decisions, and it remains imperative to regulate financial marketing and product sales. See generally Toni Williams, *Empowerment of Whom and for What? Financial Literacy Education and the New Regulation of Consumer Financial Services*, 29 L. & POL’Y 226 (2007) (questioning the use of consumer education rather than regulating financial product sales); Jason West, *Financial Literacy Education and Behaviour Unhinged: Combating Bias and Poor Product Design* (Griffith Univ. Bus. Sch., Working Paper No. 2012-01, 2012) (arguing that greater financial education is not linked to better financial behavior), <https://research->

Preventing systemic risk to the financial sector	<ul style="list-style-type: none"> <li>(a) Considering the impact of monetary policies, especially the adverse effects of long-term low interest rates<sup>432</sup> and asset-purchase programs;</li> <li>(b) Considering the balance between policies that underpin access to debt and access to capital markets to facilitate real-economy growth and investment;</li> <li>(c) Revisiting the systemic importance of asset managers and their allocative responsibilities and roles.<sup>433</sup></li> </ul>	<ul style="list-style-type: none"> <li>(a) Greater willingness to develop macroprudential tools to deal with toxic levels of corporate and household debt;<sup>434</sup></li> <li>(b) Macroprudential perspectives for financial innovation in general.<sup>435</sup></li> </ul>
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## VI. Conclusion

Policy makers and financial regulators have turned to quick debt-expansion programs to promote the recovery of the corporate economy and alleviate household suffering during the Covid-19 pandemic. However, debt expansion in highly leveraged economies, such as the US, UK, and EU, is a double-edged sword, as adverse consequences could result in the long-term for corporations and households, and systemic risk for the financial sector could also be heightened,<sup>436</sup> threatening to impede the financial sector’s uninterrupted support for real economy needs.

We drew upon the legal theory of finance to argue that its theoretical support for legal elasticity can offer a framework for long-term and structural changes in law and regulation to address the adverse consequences of excessive corporate and household indebtedness. Such a framework reflects the importance of adjustments in legal and regulatory framing for crisis management and beyond. We endeavored to enrich the theoretical understanding and practical application of legal elasticity by (a) arguing that the theoretical insights from the legal theory of finance pave the way for structural consequences of applying legal elasticity, (b) providing

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repository.griffith.edu.au/bitstream/handle/10072/390304/2012-01-financial-literacy-education-and-behaviour-unhinged-combating-bias-and-poor-product-design.pdf.; Lauren E. Willis, *Evidence and Ideology in Assessing the Effectiveness of Financial Literacy Education*, 46 SAN DIEGO L. REV. 415, 417-19 (2009) (recommending other regulatory solutions rather than financial literacy programmes).

<sup>432</sup> COMM. GLOB. FIN. SYS., *Financial Stability Implications of a Prolonged Period of Low Interest Rates* 8-9 (Bank for Int’l Settlements, Working Paper No. 61, 2018), <https://www.bis.org/publ/cgfs61.pdf>.

<sup>433</sup> See generally FIN. STABILITY BD., POLICY RECOMMENDATIONS TO ADDRESS STRUCTURAL VULNERABILITIES FROM ASSET MANAGEMENT ACTIVITIES (2017), <https://www.fsb.org/2017/01/fsb-publishes-policy-recommendations-to-address-structural-vulnerabilities-from-asset-management-activities/> (discussing various policy recommendations to aid asset managers in mitigating the various vulnerabilities associated with their jobs).

<sup>434</sup> E.g., Anna Zabai, *Household Debt: Recent Developments and Challenges*, BANK FOR INT’L SETTLEMENTS Q. REV., 39, 52 (2017), [https://www.bis.org/publ/qtrpdf/r\\_qt1712f.htm](https://www.bis.org/publ/qtrpdf/r_qt1712f.htm).

<sup>435</sup> Regulators need a more comprehensive framework to deal with financial innovation and social utility, Cristie Ford, *Innovation and the State: Finance, Regulation, and Justice* (Cambridge: CUP 2017), chs.6-7.

<sup>436</sup> Alissa Kleinnijenhuis, Laura Kodres & Thom Wetzer, *Usable Bank Capital*, VOX (June 30, 2020), <https://voxeu.org/article/usable-bank-capital#.XwA9ibxoIRc.twitter>; Simon Samuels, *Banks Need to Prepare Now for Covid-19 Losses Later*, FIN. TIMES (July 8, 2020), <https://www.ft.com/content/918fe325-8a7f-4646-9031-6e7f2d61b3db>.

a methodological framework for mapping appropriate legal and regulatory reforms that can be subject to elasticity, and (c) relating legal elasticity to other theoretical frameworks such as legal autopoiesis and temporality of regulation.