REGULATING EXCESSIVE CREDIT

ABIGAIL FAUST*

Consumer financial protection law is dominated by ex-ante, contract-centered regulatory measures. But these measures largely fail to curb lenders' incentive to lend beyond consumers' ability to repay. Accordingly, this Article suggests a different approach: discouraging lenders from extending loans that cannot be repaid by dismissing the imprudent lender's claims in consumer bankruptcy. I argue that regulation of underwriting decisions through bankruptcy is normatively desirable because it challenges the artificial separation between consumer finance law and consumer bankruptcy law. By this token, it may not only overcome the autonomy and effectiveness concerns attached to ex-ante consumer finance regulation, but also enhance the internal coherence of consumer bankruptcy law.

---

* Ph.D. (2021), Tel-Aviv University Faculty of Law; Polonsky Academy Fellow, The Van-Leer Jerusalem Institute. For valuable comments on previous drafts, I am grateful to Leon Anidjar, Shmuel Becher, Susan Block-Lieb, Michelle Harner, Ted Janger, Bob Lawless, Yifat Naftali, John Pottow, Vijay Raghavan, Jonathan Seymour, Doron Teichman, Jay Westbrook and Eyal Zamir, as well as the participants of the Sixth Annual Contracts Conference at Bar-Ilan University and the Global Bankruptcy Scholars Workshop at Brooklyn Law School. The research was supported by the Sacher Institute for Legislative Research and Comparative Law at the Hebrew University of Jerusalem.

https://doi.org/10.59015/wlr.LAIE6694

INTRODUCTION

"I was sold a 2014 Nissan Sentra for $15,900 minus $2,000 trade-in on a 72-month loan, but Santander Consumer USA charged me $31,921.76 with monthly payments of $415.58," wrote Willie H., an elderly, Black Navy veteran in his review of Santander on *Better Business Bureau.*[1] "Santander knew or should have known based on my limited income of just over $700.00 in SSI payments that I could not afford this. So[,] I was unable to pay the $415.58 after March 2017 and . . . Santander repossessed the Nissan."[2] Andrea T. provided an equally disturbing review of the largest subprime auto financing company in the United States: "[Santander] gave me a high interest rate knowing[] that I did not make the money to pay the payments," she wrote, "causing me to wind up in default."[3]

Willie and Andrea clearly made poor borrowing decisions. But as it turns out, their experience with Santander was not unusual. In May 2022, following a multistate investigation, a coalition of thirty-four attorneys general reached a settlement of approximately 550 million dollars with Santander.[4] One of the main allegations underlying the settlement was that Santander, "through its use of sophisticated credit scoring models to

1. Willie H., Comment to *Customer Reviews—Santander Consumer USA, Inc.*, BETTER BUS. BUREAU (Jan. 4, 2022), https://www.bbb.org/us/tx/dallas/profile/consumer-finance-companies/santander-consumer-usa-inc-0875-90112710/customer-reviews [https://perma.cc/7ZXE-XP96].

2. *Id.*

3. Andrea T., Comment to *Customer Reviews—Santander Consumer USA, Inc.*, BETTER BUS. BUREAU (July 29, 2021), https://www.bbb.org/us/tx/dallas/profile/consumer-finance-companies/santander-consumer-usa-inc-0875-90112710/customer-reviews [https://perma.cc/4XBS-XQHD].

4. Press Release, Kwame Raoul, Illinois Att'y Gen., Attorney General Raoul Announces $550 Million Settlement with Nation's Largest Subprime Auto Financing Company: Settlement with Santander Includes Restitution for Consumers and Loan Forgiveness (May 19, 2020), https://illinoisattorneygeneral.gov/pressroom/2020_05/20200519.html [https://perma.cc/DXB3-6WKT].

forecast default risk, knew that certain segments of its population were predicted to have a high likelihood of default," but nevertheless "exposed these borrowers to unnecessarily high levels of risk through high loan-to-value ratios, significant back-end fees, and high payment-to-income ratios."[5]

Lending practices such as Santander's may initially seem surprising. On the face of it, lenders would want to avoid excessive lending, since they hold the strongest possible interest in having their loans repaid.[6] Yet in practice, auto-finance companies, payday lenders, and other providers of consumer finance products often fail to employ basic underwriting standards, encourage consumers to borrow regardless of their ability to repay, and actively make it hard for consumers to understand the true cost of the loans they are getting.[7]

This (seemingly) self-defeating behavior may be partly explained by the emergence of "debt-based" business models in the consumer finance industry. Almost two decades ago, Professor Ronald Mann indicated that in the credit card industry, many issuers extract the bulk of their profits from the interest and fees consumers pay when they borrow.[8] Therefore, Mann explained, issuers attempt to maximize the number of customers who carry a balance and the duration of time they spend in the "sweat box" of debt, rather than encourage them to pay their credit card bills on

---

5. *Id.*

6. *See, e.g.*, NAT'L COMM'N ON CONSUMER FIN., CONSUMER CREDIT IN THE UNITED STATES 152 (1972); Ronald J. Mann, *Bankruptcy Reform and the Sweat Box of Credit Card Debt,* 2007 U. ILL. L. REV. 375, 384–85.

7. *See, e.g.*, OREN BAR-GILL, SEDUCTION BY CONTRACT: LAW, ECONOMICS AND PSYCHOLOGY IN CONSUMER MARKETS 80–81 (2012) (discussing deliberate complexity of credit card pricing); Joya Misra & Kyla Walters, *Store Credit Cards Generate Corporate Profits and Disgruntled Workers*, CONVERSATION (April 13, 2022, 8:15 AM), https://theconversation.com/store-credit-cards-generate-corporate-profits-and-disgruntled-workers-179818 [https://perma.cc/3YCD-ZBPD] (finding that retail clothing stores demand their workers to push credit card applications at customers); Octavio Blanco, *Consumers Lured Into Predatory Car Repair Loans: Report*, CONSUMER REPS. (May 11, 2022), https://www.consumerreports.org/predatory-lending/consumers-lured-into-predatory-car-repair-loans-report-a4077391316/ [https://perma.cc/72GW-AFNR] (reporting that auto repair shops affiliated with familiar brands are luring consumers into loans charging up to 189% interest); Jeff Sovern, *Former Employee of Short-Term Lender Explains How it Snared Consumers in Debt Traps*, PUB. CITIZEN: CONSUMER L. & POL'Y BLOG (May 30, 2022), https://pubcit.typepad.com/clpblog/2022/05/former-employee-of-short-term-lender-explains-how-it-snared-consumers-in-debt-traps.html?utm_source=feedburner&utm_medium=email [https://perma.cc/AJR4-MKGM] (citing a former employee of a short-term loan company in Albuquerque who testified to New Mexico legislators that "customers rarely paid off their loans because it was company policy to heavily suggest they refinance" and "many customers simply did not understand that this was refinancing").

8. Mann, *supra* note 6, at 376.

time.[9] Such lending practices "turn[] upside down the logic of financial lending: *the most profitable loans are those that are not repaid.*"[10]

Unfortunately, the inverted logic of debt-based lending has not been restricted to credit card lending. Lenders engaged in high-rate installment lending, for example, also have a considerable incentive to provide unaffordable loans.[11] This is because high-rate installment loans can be profitable even when borrowers default, provided that they pay long enough before defaulting.[12] In fact, because profits are extracted mostly from interest, a borrower who defaults after making partial payment may be a more profitable customer than a borrower who prepays the loan in full "too early."[13] The profitability of payday loans similarly depends on interest, rather than on full repayment, and is thus "significantly enhanced by the successful conversion of more and more occasional users into chronic borrowers."[14] Indeed, evidence shows that eighty percent of payday loans are rolled over or followed by another loan within fourteen days, and half of all loans are in a sequence at least ten loans long.[15] And, of course, as Santander's case exemplifies, an equivalent problem exists in the auto-finance industry.[16]

---

9. Mann, *supra* note 6, at 384–86; *see also* BRETT WILLIAMS, DEBT FOR SALE: A SOCIAL HISTORY OF THE CREDIT TRAP 3 (2005) ("The whole point of credit cards, the way they are rendered most profitable, is that we dig ourselves into debt and stay trapped there forever. . . . When the customers who paid their bills promptly turned out to be 'deadbeats' by not supporting operations through paying interest, bankers turned to people who were riskier. They sought debtors who would never be able to pay their balance in full, but would faithfully.").

10. *The Bankruptcy Reform Act of 2001: Hearing before the S. Comm. on the Judiciary*, 107th Cong. 146 (2001) [hereinafter *Senate 2001*] (emphasis added) (statement of Prof. Robert Manning); *see also* John A. E. Pottow, *Private Liability for Reckless Consumer Lending*, 2007 U. ILL. L. REV. 405, 414 ("[T]he current business model of some consumer lenders for revolving credit card debt presents an apparent paradox. Instead of adhering to the conventional perspective of minimizing risk and avoiding default, lenders are extending credit to debtors who very likely cannot repay . . . .").

11. NAT'L CONSUMER L. CTR., MISALIGNED INCENTIVES: WHY HIGH-RATE INSTALLMENT LENDERS WANT BORROWERS WHO WILL DEFAULT 1 (2016), https://www.nclc.org/wp-content/uploads/2022/09/report-misaligned-incentives.pdf [https://perma.cc/9U2N-TLV8].

12. *Id.* at 6–10.

13. *Id.* at 10–12.

14. Michael A. Stegman & Robert Faris, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, 17 ECON. DEV. Q. 8, 25 (2003).

15. CFPB OFF. OF RSCH., CFPB DATA POINT: PAYDAY LENDING 4 (2014), https://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf [https://perma.cc/8W68-EVAX].

16. In the auto-finance industry, the incentive to lend beyond ability to pay is even stronger because lenders can offset some of the losses from defaults by reselling repossessed vehicles at relatively high wholesale prices. *See* Vijay Raghavan, Safe Credit: A Probabilistic Approach 28–29 (Aug. 6, 2019) (unpublished manuscript) (on file with author).

However, the profitability of debt is not the only reason for the proliferation of excessive lending in some consumer finance markets. Another contributing factor is that lenders regularly externalize some of the costs of default. For one thing, it is often the case that third parties, notably the borrower's relatives, "bear a substantial portion of the losses, giving the lender inadequate incentive to set payment plans that will minimize the total costs of financial distress."[17] But moreover, many lenders, after failing to collect delinquent debts in-house, simply sell off the "bad debts" to third-party debt collection agencies.[18] Once the debt is sold (albeit at a significant discount), nonrepayment is no longer the loan originator's problem. By severing the relationship between the initial lending decision and its ultimate consequences, third-party debt collection agencies reduce lenders' incentive to lend only what consumers will be able to repay.[19]

So far, the excessive lending problem has not been met with an adequate regulatory response. Ex-ante ability-to-pay standards have been put in place in the realm of residential mortgage loans,[20] and to some extent in the context of credit card lending.[21] However, no comparable regulation universally applies to non-residential consumer credit.[22] An attempt by the Consumer Financial Protection Bureau to instill ability-to-pay standards with respect to certain types of short-term loans in 2017 encountered fierce objection and was subsequently dropped.[23] And, while

---

17. Ronald J. Mann, *Optimizing Consumer Credit Markets and Bankruptcy Policy*, 7 THEORETICAL INQ. L. 395, 417–18 (2006).

18. *See, e.g.*, Lisa Stifler, *Debt in the Courts: The Scourge of Abusive Debt Collection Litigation and Possible Policy Solutions*, 11 HARV. L. & POL'Y REV. 91, 95–96 (2017); Mann, *supra* note 6, at 391. According to ACA International, "the leading trade association . . . representing credit grantors, third-party collection agencies, asset buyers, attorneys and vendor affiliates," third-party collection agencies recovered over 100 billion dollars of debt in 2018. ACA INT'L, ADVOCACY BOOKLET 1, 6 (2022), https://policymakers.acainternational.org/wp-content/uploads/2022/02/Advocacy-Booklet-Feb2022-ReducedFileSize.pdf [https://perma.cc/XJ5S-ZEXY].

19. *See* Dalié Jiménez, *Dirty Debts Sold Cheap*, 52 HARV. J. ON LEGIS. 41, 41–43, 52–54 (2015) (describing the flow of debt collection).

20. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 1411, 124 Stat. 1376, 2142–45 (2010) (codified at 15 U.S.C. § 1639c). For a comprehensive review of the ability-to-pay rule in the context of residential mortgages, see John Pottow, *Ability to Pay*, 8 BERKELEY BUS. L.J. 175 (2011).

21. Credit Card Accountability Responsibility and Disclosure Act, Pub. L. No. 111–24, § 150, 123 Stat. 1734, 1743 (2009) (codified at 15 U.S.C. § 1665e).

22. Adam Levitin, *Toward a Universal Ability to Repay Requirement*, CREDIT SLIPS (Aug. 23, 2014, 5:01 PM), https://www.creditslips.org/creditslips/2014/08/toward-a-universal-ability-to-repay-requirement.html [https://perma.cc/AH54-CM4Z]; Adam Levitin, *Usury 2.0: Toward A Universal Ability-to-Repay Requirement*, CREDIT SLIPS (Jan. 1, 2019), https://www.creditslips.org/creditslips/2019/01/toward-a-universal-ability-to-repay-requirement.html [https://perma.cc/FGR9-PJ5S].

23. *See infra* notes 297–301 and accompanying text.

consumer finance contracts are regulated by various means—*i.e.*, mandatory rules, disclosures, and nudges—such contractual, ex-ante regulation suffers from substantial limitations and does not provide an effective solution.[24]

Accordingly, this Article advocates a different approach: regulating excessive credit extensions through consumer bankruptcy law, by disallowing the imprudent lender's claims against the debtor. I argue that creditors filing a claim in a Chapter 13 bankruptcy case should be required to demonstrate that they had obtained information on the borrower's regular income and expenses before extending the loan. Based on this information, courts should dismiss a creditor's claim if it finds that credit was extended with no regard to the borrower's financial status at the time the loan was granted.

Principally, such ex-post underwriting standards could (and perhaps should) be imposed in all debt collection proceedings, in and outside of bankruptcy.[25] My argument here is not that regulation of excessive lending outside of consumer bankruptcy is undesirable, but simply that there is a strong normative justification for scrutinizing excessive lending *within* consumer bankruptcy law, regardless of other means of regulation or judicial review. I argue that regulating excessive credit extensions through consumer bankruptcy is desirable because it cuts through the separation between consumer finance law and consumer bankruptcy law—a separation that is not merely artificial, but normatively harmful.

Indeed, in practice, consumer finance and consumer bankruptcy are highly interrelated phenomena, but in the legal sphere they are traditionally perceived as distinct categories.[26] Thus, for example, consumer finance and consumer bankruptcy are governed by different laws and regulations, practiced by different legal professionals and often studied by different groups of scholars.[27] In a previous article, I discussed the perverse effects of assigning consumer finance legislation and consumer bankruptcy legislation to different congressional committees.[28] This procedural bifurcation, I argued, has allowed consumer creditors to lobby for restrictions on bankruptcy access without concurrently having

24. *See* discussion *infra* Section I.B.

25. *See* Pottow, *supra* note 10 (proposing that reckless lending should be a legally recognized defense against collection).

26. *See, e.g.*, Alexandra Sickler & Kara Bruce, *Bankruptcy's Adjunct Regulator*, 72 FLA. L. REV. 159, 161 (2020) ("Bankruptcy and consumer protection law often operate in independent silos. Many consumer protection advocates view bankruptcy to be a remote and specialized field, while bankruptcy proponents tend to view bankruptcy as a complete and exhaustive system.").

27. *See* discussion *infra* Section II.A.

28. Abigail Faust, *The Acoustic Separation of Consumer Bankruptcy and Consumer Credit Laws*, 95 AM. BANKR. L.J. 671, 671, 693–95 (2021).

to concede to substantive regulation of their consumer lending practices.[29] Professor Abbye Atkinson has further demonstrated that by separating consumer finance and consumer bankruptcy legislation, Congress has been able to encourage the use of consumer credit without accounting for social and economic debt.[30]

Indeed, because consumer finance and consumer bankruptcy are so intimately linked to one another, thinking about consumer finance law and consumer bankruptcy law separately may lead legislatures to adopt suboptimal policies for both. Among other things, the separation of consumer finance and consumer bankruptcy law may explain why the idea of regulating underwriting decisions through consumer bankruptcy law—an idea which dates to the 1960s[31]—has received little attention from scholars[32] and legislatures[33] thus far.

Regulation of excessive credit extensions via consumer bankruptcy illustrates the potential benefits of bringing consumer finance and consumer bankruptcy law closer together. From the perspective of consumer finance law, bankruptcy regulation avoids the major weaknesses of ex-ante, contract-centered regulatory measures.[34] Compared with mandates, disclosures, and nudges, bankruptcy regulation is less restrictive, more effective, and provides creditors with a greater degree of certainty.[35] It is thus more likely to encourage sounder underwriting practices. From the perspective of consumer bankruptcy law, regulation of excessive lending may restore consumer bankruptcy law's internal coherence. Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), consumer bankruptcy law expressly seeks to affect the incentives of consumer borrowers but neglects the incentives of lenders.[36] This is the case even though BAPCPA was predicated on an economic, incentives-based theory of bankruptcy law, which applies to the incentives of borrowers and lenders alike.[37] Employing bankruptcy law to regulate lenders' behavior, in

29. *Id.* at 674.

30. Abbye Atkinson, *Borrowing Equality*, 120 COLUM. L. REV. 1403, 1425–57 (2020).

31. *See infra* notes 187–190 and accompanying text.

32. *See infra* note 191.

33. *See, e.g.*, Pottow, *supra* note 10, at 423–27; 147 CONG. REC. S2142–44 (daily ed., Mar. 12, 2001) (statement of Senator Wellstone); 147 CONG. REC. S2295 (daily ed., Mar. 14, 2001); 151 CONG. REC. S1920–1922 (daily ed. Mar. 2, 2005) (statement of Senator Durbin); 151 CONG. REC. S1984 (daily ed. Mar. 3, 2005).

34. *See* discussion *infra* Section II.D.

35. *Id.*

36. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109–8, 119 Stat. 23 (codified as amended at 11 U.S.C. § 101).

37. *See, e.g.*, Pottow, *supra* note 10, at 405–07.

addition to borrowers' behavior, would remedy this untenable asymmetry, making consumer bankruptcy law normatively intelligible.

Importantly, to say that regulators should discourage excessive credit extensions is not to say that consumer credit is inherently harmful. Clearly, credit provides substantial advantages for consumers: by bridging the temporal gap between present and future income, it allows consumers to increase their welfare—*e.g.*, buy homes, purchase goods and services, and obtain higher education.[38] As such, credit can be an important vehicle for promoting equality and social mobility.[39] Consumer credit also functions as a financial safety net, allowing consumers to survive periods of financial distress by smoothing their consumption over time.[40] And yet, using credit has a significant downside: it turns consumers into debtors. When consumers fail to make timely payments on their loans, interest and fees quickly accrue and debt inflates, sometimes exponentially.[41] Consequently, credit often traps borrowers in a vicious cycle of indebtedness and financial distress.[42] The negative implications of this distress are borne not only by individual borrowers, but by their spouses, their children, their elderly relatives, and society as a whole.[43] Hence, to a great extent, the fault line between "good" credit and "bad" credit runs through a consumer's ability to pay. When

38. *See, e.g.*, David Caplovitz, *Consumer Credit in The Affluent Society*, 33 LAW & CONTEMP. PROBS. 641, 644 (1968). *See generally* LENDOL CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT 5 (1999) (analyzing the pivotal role of consumer credit in making American dreams affordable).

39. *See, e.g.*, Abbye Atkinson, *Rethinking Credit as Social Provision*, 71 STAN. L. REV. 1093, 1121–47 (2019); Atkinson, *supra* note 30, at 1414–24; W. Bruce Wydick, *Credit Access, Human Capital and Class Structure Mobility*, 35 J. DEV. STUD. 131, 132–34 (1999).

40. *See, e.g.*, Christine L. Dobridge, *High-Cost Credit and Consumption Smoothing*, 50 J. MONEY, CREDIT & BANKING 407, 408 (2018) (finding that for households experiencing temporary financial distress, access to high-cost payday lending mitigates declines in overall spending and nondurable goods spending); James X. Sullivan, *Borrowing During Unemployment: Unsecured Debt as a Safety Net*, 43 J. HUMAN RES. 383, 384 (2008); David A. Moss & Gibbs A. Johnson, *The Rise of Consumer Bankruptcy: Evolution, Revolution or Both?*, 73 AM. BANKR. L.J. 311, 350 (1999).

41. Dalié Jiménez, *Ending Perpetual Debt*, 55 HOUS. L. REV. 609, 614 (2018); Doron Teichman & Eyal Zamir, *Exponential Growth Bias and the Law: Why Do We Save Too Little, Borrow Too Much and Fail to React on Time to Deadly Pandemics and Climate Change?*, 75 VAND. L. REV. 1345, 1374 (2022).

42. *See, e.g.*, LESLIE PARRISH & URIAH KING, CTR. FOR RESPONSIBLE LENDING, PHANTOM DEMAND: SHORT-TERM DUE DATE GENERATES NEED FOR REPEAT PAYDAY LOANS, ACCOUNTING FOR 76 PERCENT OF TOTAL VOLUME 2–3 (2009), www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf [https://perma.cc/U4TB-XU7K].

43. *See, e.g.*, Pottow, *supra* note 10, at 411–12; Elizabeth Warren & Oren Bar-Gill, *Making Credit Safer*, 157 U. PA. L. REV. 1, 59–62 (2008); Jiménez, *supra* note 41, at 637–40 (discussing the individual and societal costs of financial distress).

consumers borrow beyond their means, the advantages of credit are outweighed by the financial distress it precipitates. Using consumer bankruptcy law to regulate excessive lending and encourage sounder underwriting practices will allow more consumers to enjoy the benefits of credit without enduring its detriments.

The first part of Article discusses the ongoing weaknesses of consumer finance regulation in the United States and elaborates on the specific limitations of ex-ante, contract-centered regulatory measures. The second part explains why ex-post regulation of excessive lending through consumer bankruptcy law is normatively desirable, both in terms of consumer bankruptcy law and in terms of consumer finance regulation. In terms of consumer bankruptcy, I argue that the 2005 BAPCPA's exclusive focus on borrowers' incentives not only justifies complementary regulation of lenders' incentives, but requires that such regulation be set *within* bankruptcy law. In terms consumer finance regulation, I explain the advantages of regulation in bankruptcy compared with ex-ante, contract-centered regulation.

I. THE CHALLENGES OF CONSUMER FINANCE REGULATION

This Part sets forth the justification for moving from traditional, ex-ante regulation of consumer finance to ex-post regulation through bankruptcy. It begins by discussing the ongoing weaknesses of consumer finance regulation in the United States, and then moves on to the principal limitations of ex-ante regulatory measures.

A. The Regulatory Deficit in Consumer Finance

The problem of excessive lending is part of the story of consumer credit in the United States, which is "a story of growth—in variety, in access, and in freedom of choice."[44] The story begins after World War II, when installment credit allowed middle- and working-class households to achieve material prosperity that would have otherwise been out of their reach.[45] During this period, the federal government actively fostered consumer credit markets to increase access to housing and higher education.[46] The steady rise in incomes "allowed Americans easily to fill their newly mortgaged homes and attached garages with expensive,

44. Andrea Ryan, Gunnar Trumbull & Peter Tufano, *A Brief Postwar History of U.S. Consumer Finance*, 85 BUS. HIST. REV. 461, 461 (2011).

45. *See id.* at 461–66.

46. *See* GRETA R. KRIPPNER, CAPITALIZING ON CRISIS: THE POLITICAL ORIGINS OF THE RISE OF FINANCE 22–24, 58–85 (2012); LOUIS HAYMAN, DEBTOR NATION: THE HISTORY OF AMERICA IN RED INK 46–47, 71–72, 132–37 (2011); Atkinson, *supra* note 39, at 1127–33, 1144.

durable goods such as cars, televisions, and appliances,"[47] and while the use of consumer credit was on the rise, so was the rate of repayment.[48] However, beginning with the economic turndown of the 1970s, the expansion of consumer credit has occurred against a background of eroding incomes and growing employment instability.[49] Credit was increasingly employed to fill the gap between rising living costs and stagnant wages, and the result was greater debt loads and higher levels of financial risk among consumers.[50] Furthermore, the scope of consumer indebtedness, which has since continued to grow, is not evenly distributed across different societal strata.[51] More affluent consumers have access to various sources of credit on favorable terms, while low-income, minority consumers are often unbanked or underbanked, and are forced to rely on payday lenders, check cashers or other types of exorbitantly-priced credit.[52] Thus, consumers who are already socially and economically marginalized are exposed to greater financial risk because they lack reasonable financing options.[53]

Today, almost half of all Americans have credit card debt, and twenty-three percent of credit card holders took on additional debt during the COVID-19 pandemic.[54] Low-income borrowers routinely use high-cost credit to finance basic living expenses such as rent or utility bills;[55] even for the middle class, credit is now considered a necessity.[56] More

---

47. Atkinson, *supra* note 30, at 1135.

48. HAYMAN, *supra* note 46, at 132–33.

49. *See* JACOB S. HACKER, THE GREAT RISK SHIFT: THE ASSAULT ON AMERICAN JOBS, FAMILIES, HEALTH CARE, AND RETIREMENT *AND HOW YOU CAN FIGHT BACK* 12–15 (2006).

50. *See id.* at 12–15, 172; Ryan, Trumbull & Tufano, *supra* note 44, at 462; TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 30–32 (2000).

51. HACKER, *supra* note 49, at 14–15.

52. *See, e.g.*, Mehrsa Baradaran, *How the Poor Got Cut Out of Banking*, 62 EMORY L.J. 483, 483–85 (2013); SUSAN E. WOODWARD, U.S. DEP'T HOUS. & URB. DEV., OFF. POL'Y DEV. & RSCH., A STUDY OF CLOSING COSTS FOR FHA MORTGAGES (2008), https://www.huduser.gov/publications/pdf/fha_closing_cost.pdf [https://perma.cc/CQM2-B2CA] (finding African-American and Latino borrowers pay more for their loans, as do people who live in neighborhoods where adults have only high-school education); Brian K. Bucks, Arthur B. Kennickell, Traci L. Mach & Kevin B. Moore, *Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances*, 95 FED. RSRV. BULL. A1, A47 (2009) (highlighting that payday loans are used by families with lower incomes).

53. Warren & Bar-Gill, *supra* note 43, at 64–69.

54. LAURA ANTONINI & HARVEY ROSENFIELD, CONSUMER EDUC. FOUND., REBOOT REQUIRED: THE CIVIL JUSTICE SYSTEM HAS CRASHED 61 (2022), https://www.representconsumers.org/wp-content/uploads/2022/02/2022.02.15_Reboot-Required.pdf [https://perma.cc/BAV9-CGZC].

55. Atkinson, *supra* note 39, at 1107–08.

56. Adam J. Levitin, *The Law of the Middle Class: Consumer Finance in the Law School Curriculum*, 31 LOY. CONSUMER L. REV. 393, 393–95 (2019); *see also*

and more Americans depend on credit even for the smallest emergency expense.[57]

Federal and state regulators have not overlooked the unique risks associated with consumer finance transactions.[58] Nevertheless, in crucial respects, and despite the growing complexity of consumer finance instruments, consumer finance regulation has substantially eroded over the past fifty years. Up to the late 1960s, consumer lending was primarily regulated by the states.[59] State regulation addressed three facets of consumer finance transactions: (1) the price of credit, which was restricted through local interest rate ceilings (usury laws); (2) the participants in the credit market, who were regulated mainly through licensing requirements; and (3) the extent of creditors' contractual remedies in case of default.[60] However, high-cost lenders developed effective legal techniques for evading usury laws,[61] and state regulation was often ineffective in preventing excessive extensions of credit.[62]

SULLIVAN, WARREN & WESTBROOK, *supra* note 50, at 27–28, 30–33 (arguing that middle class Americans are major participants of the consumer bankruptcy system).

57. *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., REPORT ON THE ECONOMIC WELL-BEING OF U.S. HOUSEHOLDS IN 2016, at 26 (2017), https://www.federalreserve.gov/publications/files/2016-report-economic-well-being-us-households-201705.pdf [https://perma.cc/3USP-LMFM] (finding that forty-four percent of adults report they will have to sell something or borrow money to cover an emergency expense costing $400).

58. *See, e.g.*, THOMAS A. DURKIN, GREGORY ELLIEHAUSEN, MICHAEL E. STATEN & TODD J. ZYWICKI, CONSUMER CREDIT AND THE AMERICAN ECONOMY 31 (2014); Richard Hynes & Eric Posner, *The Law and Economics of Consumer Finance*, 4 AM. L. & ECON. REV. 168, 168 (2002).

59. NAT'L COMM'N ON CONSUMER FIN., *supra* note 6, at 45; DURKIN, ELLIEHAUSEN, STATEN & ZYWICKI, *supra* note 58, at 417.

60. NAT'L COMM'N ON CONSUMER FIN., *supra* note 6, at 45, 53; Durkin, Elliehausen, Staten & Zywicki, *supra* note 58, at 482; MARY ESCHELBACH HANSEN & BRADLEY A. HANSEN, BANKRUPT IN AMERICA: A HISTORY OF DEBTORS, THEIR CREDITORS, AND THE LAW IN THE TWENTIETH CENTURY 114 (2020).

61. *See* Christopher L. Peterson, *Truth, Understanding, and High-Cost Consumer Credit: The Historical Context of Truth in Lending*, 55 FLA. L. REV. 807, 852–55 (2003); *see also* NAT'L COMM'N ON CONSUMER FIN., *supra* note 6, at 56 (noting that states lacked sufficient resources for enforcement).

62. *See, e.g.*, *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civ. and Const. Rts. of the H. Comm. on the Judiciary*, 94th Cong. 207 (1975) [hereinafter *House 1975–1976*] (statement of J. Cyr) ("The nonuniformity of State regulation and the fact that it concerns itself almost entirely with legal liability rather than the ability to pay, result in propelling many consumer debtors into an insolvency proceeding, where earlier and more relevant consideration of their entire credit predicament could often prevent an overall credit collapse."); NAT'L COMM'N ON CONSUMER FIN., *supra* note 6, at 45, 57 ("States have usually failed to set up effective mechanisms for across-the-board enforcement of consumer credit laws . . . . Recourse against retailers for violations of credit laws is usually limited to suit by aggrieved consumers or to criminal or injunctive procedures instituted by state attorneys general or local district attorneys.").

Federal regulation of consumer finance commenced in 1968 with the Truth in Lending Act (TILA), which imposed elaborate disclosure duties with respect to the terms of consumer loans.[63] The hallmark of TILA—which was originally perceived by Congress as merely complementing state regulation of consumer loans[64]—was the mandated disclosure of the finance charge and the Annual Percentage Rate (APR).[65] The finance charge (*i.e.*, the total cost of the loan in dollars) and the APR (*i.e.*, the finance charge converted into a percentage rate that is standardized over an annual term) were meant to allow comparisons between the costs of loans extended for different time periods.[66] However, regulations issued over the years by the Federal Reserve Board—the federal agency originally entrusted with the implementation of TILA—substantially diluted the definition of the finance charge by exempting different types of fees.[67] Consequently, the APR became "incrementally weaker as an indicator of the true cost of the credit."[68] Moreover, in credit card agreements the APR principally understates the cost of the loan because the interest is compounded *daily*.[69] Thus, the APR is not only under-informative but may also mislead consumers with respect to the true size of the debt they are incurring.[70]

In addition to its substantive shortcomings, the enforcement of federal consumer finance regulation was scattered among seven different federal agencies.[71] For some of these agencies, such as the Federal Reserve Board or the Office of the Comptroller of the Currency, promoting consumer financial protection was hardly a top priority.[72]

---

63. DURKIN, ELLIEHAUSEN, STATEN & ZYWICKI, *supra* note 58, at 453; Mark E. Bunditz, *The Development of Consumer Protection Law, The Institutionalization of Consumerism, and Future Prospects and Perils*, 26. GA. ST. U. L. REV. 1147, 1154 (2010).

64. Anne Fleming, *The Long History of Truth in Lending*, 30 J. POL'Y HIST. 236, 237–39, 249–52, 258–60 (2018).

65. 15 U.S.C. § 1637(a)(1).

66. Elizabeth Renuart & Diane E. Thompson, *The Truth, The Whole Truth and Nothing but the Truth: Fulfilling the Promise of Truth in Lending*, 25 YALE J. ON REG. 181, 187–88 (2008); Peterson, *supra* note 61, at 880.

67. Renuart & Thompson, *supra* note 66, at 201–05.

68. *Id.* at 185.

69. *See* Teichman & Zamir, *supra* note 41, at 1380.

70. *See id.*; *cf.* Jeff Sovern, *Preventing Future Economic Crises Through Consumer Protection Law or How the Truth in Lending Act Failed the Subprime Borrowers*, 71 OHIO ST. L.J. 761, 772–79 (2010) (arguing disclosures in subprime mortgage contracts are misleading).

71. Leonard J. Kennedy, Patricia A. McCoy & Ethan Bernstein, *The Consumer Financial Protection Bureau: Financial Regulation for the Twenty-First Century*, 97 CORNELL L. REV. 1141, 1145 (2012).

72. *See id.*; Adam J. Levitin, *The Consumer Financial Protection Bureau: An Introduction*, 32 REV. BANK. & FIN. L. 321, 330–31 (2013); Warren & Bar-Gill, *supra* note 43, at 86–95.

Other agencies, such as the FTC, have only limited enforcement authority with respect to financial institutions.[73]

While federal regulation of consumer finance faltered, state regulation was almost entirely sidelined by the Supreme Court's ruling in *Marquette v. First of Omaha*.[74] In *Marquette*, the Court held that commercial lenders could charge consumers the highest legal rate in their charter state, regardless of the legal rate in the consumer's state.[75] The ruling not only induced states to revoke or relax their usury laws,[76] but also provided legal grounds for preempting state laws limiting various credit card fees.[77] Thus, it "effectively ended usury restrictions on credit card lending."[78] The increasingly porous federal disclosure law became the dominant consumer financial protection regulation in the United States,[79] leaving consumers exceedingly vulnerable to abuse.[80]

The subprime mortgage crisis that commenced in 2007 (and the global financial crisis that followed) re-focused regulators attention on the failings of financial markets. This renewed awareness produced overarching reform in the regulation of U.S. financial institutions. Markedly, as part of the Dodd-Frank Wall-Street Reform and Consumer Protection Act of 2010, Congress established the Consumer Financial Protection Bureau (CFPB): an independent federal agency within the Federal Reserve System, which consolidates a host of regulatory authorities previously dispersed among multiple regulators.[81] The CFPB's authorities include examination and supervision, enforcement, rulemaking, consumer education, responding to consumer complaints,

---

73. Warren & Bar-Gill, *supra* note 43, at 96–97. Additionally, as Luke Herrine has recently argued, the FTC has been reluctant to pursue its authority to regulate unfair and deceptive practices (UDAP) since the 1980s due to regulators' neo-liberal ideology. Luke Herrine, *The Folklore of Unfairness*, 96 N.Y.U. L. REV. 431, 433 (2021).

74. 439 U.S. 299 (1978).

75. *See id.* at 301.

76. James M. Ackerman, *Interest Rates and the Law: A History of Usury*, 1981 ARIZ. ST. L.J. 61, 105–06 (1981); Lawrence M. Ausubel, *The Failure of Competition in the Credit Card Market*, 81 AM. ECON. REV. 50, 52–53 (1991); HANSEN & HANSEN, *supra* note 60, at 132.

77. *See* Mark Furletti, Comment, *The Debate over the National Bank Act and the Preemption of State Efforts to Regulate Credit Cards*, 77 TEMP. L. REV. 425, 432–40 (2004); *Madden v. Midland Funding LLC*, 786 F.3d 246, 247–54 (2d. Cir. 2015) (invoking the same reasoning).

78. HANSEN & HANSEN, *supra* note 60, at 130; Furletti, *supra* note 77, at 426.

79. *See* OMRI BEN-SHAHAR & CARL E. SCHNEIDER, MORE THAN YOU WANTED TO KNOW: THE FAILURE OF MANDATED DISCLOSURE 3–12 (2014); Renuart & Thompson, *supra* note 66, at 184.

80. Bar-Gill & Warren, *supra* note 43, at 169; Kennedy, McCoy & Bernstein, *supra* note 71, at 1145.

81. 12 U.S.C. § 5491(a) (establishing the "Bureau of Consumer Financial Protection," better known as the CFPB).

and monitoring consumer financial markets.[82] Notably, Congress transferred to the CFPB the power to promulgate rules implementing the Truth in Lending Act, as well as other federal consumer financial laws.[83] Congress also enacted a new prohibition on "any unfair, deceptive, or abusive act or practice" (UDAAP) performed by providers of consumer financial products and tasked the CFPB with its implementation.[84] To insulate the CFPB from political influence and interest group pressure, Congress made it a self-funded agency with a guaranteed budget,[85] and placed it under the leadership of a single director, appointed by the president for a five-year term.[86]

Despite continued criticism on its institutional structure,[87] going all the way to the Supreme Court[88] and notwithstanding overt Republican hostility,[89] the CFPB has successfully employed its UDAAP authority to secure significant relief for consumers.[90] However, its specific use of the

---

82. *See* Kennedy, McCoy & Bernstein, *supra* note 71, at 1146–47; Levitin, *supra* note 72, at 343–58 (discussing the CFPB's powers at length).

83. Kennedy, McCoy & Bernstein, *supra* note 71, at 1148–49 (summarizing several laws the CFPB is congressionally charged to implement and enforce).

84. 12 U.S.C. § 5536(a)(1)(B).

85. Thomas Arning, *The Consumer Financial Protection Bureau: A Novel Agency Design with Familiar Issues*, 24 FORDHAM J. CORP. & FIN. L. 153, 168–69 (2019) (explaining why the CFPB's funding scheme is "particularly revolutionary").

86. 12 U.S.C. § 5491(b)(1)–(2); § 5491(c)(1), (3); *see also* Susan Block-Lieb, *Accountability and the Bureau of Consumer Financial Protection*, 7 BROOK. J. CORP. FIN. & COM. L. 26, 38–39 (2012).

87. *See, e.g.*, Todd Zywicki, *The Consumer Financial Protection Bureau: Savior or Menace?*, 81 GEO. WASH. L. REV. 856, 859 (2013) (describing the CFPB as "an unaccountable body, headed by a single director, insulated from both removal by the President and budgetary oversight by Congress, and charged with a tunnel vision mission to pursue one narrow goal that carries the potential for substantial harm to the economy and consumers"); Patricia A. McCoy, *Inside Job: The Assault on the Structure of the Consumer Financial Protection Bureau*, 103 MINN. L. REV. 2543, 2567–68 (2019).

88. *Seila Law LLC vs. Consumer Fin. Prot. Bureau*, 140 S. Ct. 2183, 2192 (2020) (holding that the CFPB's leadership structure, wherein the agency's director may be removed only the President only for-cause, violates the separation of powers mandated by the U.S. Constitution and that the Bureau's Director should be removable by the President at will).

89. *See, e.g.*, Jackie Wattles & Matt Eagan, *Why Wall Street and Republicans Hate the CFPB*, CNN MONEY (Nov. 27, 2017, 7:18 AM), https://money.cnn.com/2017/11/25/news/wall-street-elizabeth-warren-consumer-financial-protection-bureau/index.html [https://perma.cc/D54V-9N7F]; Mallory E. SoRelle, *Will Republicans Be Able to Dismantle the Consumer Financial Protection Bureau?*, WASH. POST (Feb. 13, 2008, 6:00 AM), https://www.washingtonpost.com/news/monkey-cage/wp/2018/02/13/this-is-why-republicans-have-the-consumer-financial-protection-bureau-in-their-crosshairs; Sylvan Lane, *GOP Slams Top Consumer Watchdog at Hearing, Alleging Overreach*, THE HILL (Apr. 26, 2022, 3:00 PM), https://thehill.com/policy/3464130-gop-slams-top-consumer-watchdog-at-hearing-alleging-overreach [https://perma.cc/2HNZ-7HK6].

90. *Seila Law*, 140 S. Ct. at 2193 ("Since its inception, the CFPB has obtained over $11 billion in relief for over 25 million consumers, including a $1 billion penalty

"abusive" standard—which arguably targets excessive lending[91]—has been quite limited.[92] In addition to the CFPB, state enforcers have been increasingly using local unfair or deceptive acts or practices (UDAP) laws to initiate public enforcement actions,[93] with some of these actions specifically directed against lenders making improvident credit extensions.[94] Yet, these targeted enforcement activities are not robust enough to counter the perverse profit incentives generated by "debt-based" lending and by lenders' ability to externalize the costs of default. American consumers are still encouraged to become heavily indebted.

Indeed, according to recent survey data, more than 45% of American families report a credit card debt with a mean balance of $6,300.[95] More than 7% of families have a debt-to-income ratio greater than 40%.[96] Student debt is steadily increasing—22% of families have student debt.[97] while its repayment rate is deteriorating.[98] And "the subprime auto loan bubble appears on the verge of collapse."[99] While the COVID-19 pandemic has currently brought consumer delinquency and bankruptcy levels to a historic low,[100] in the longer run it will likely

---

against a single bank in 2018."). For a survey of the CFPB's most recent activities, see CONSUMER FIN. PROT. BUREAU, SEMI-ANNUAL REPORT OF THE CONSUMER FINANCIAL PROTECTION BUREAU (2021), https://files.consumerfinance.gov/f/documents/cfpb_semi-annual-report-spring-2021_2021-10.pdf [https://perma.cc/6J42-EGYZ].

91. *See* Tiffany S. Lee, *No More Abuse: The Dodd-Frank and Consumer Financial Protection Act's "Abusive" Standard*, 14 J. CONSUMER & COM. L. 118, 126–27 (2011).

92. Christopher L. Peterson, *Consumer Financial Protection Bureau Law Enforcement: An Empirical Review*, 90 TUL. L. REV. 1057, 1099–101 (2016).

93. *See* Prentiss Cox, Amy Widman & Mark Totten, *Strategies of Public UDAP Enforcement*, 55 HARV. J. ON LEGIS. 37, 39 (2018).

94. Joseph Sanders & Vijay Raghavan, *Improvident Student Lending*, 2018 UTAH L. REV. 919, 925–27.

95. Neil Bhutta et al., *Changes in U.S. Family Finances from 2016 to 2019: Evidence from the Survey of Consumer Finances*, FED. RSRV. BULL., Sept. 2020, at 1, 6, 24.

96. *Id.* at 6.

97. *Id.*

98. Marshall Steinbaum, *The Student Debt Crisis is a Crisis of Non-Repayment*, PHENOMENAL WORLD (Nov. 17, 2020), https://www.phenomenalworld.org/analysis/crisis-of-non-repayment/ [https://perma.cc/3WDG-QXWF]. In a sample of one million consumers between the ages of 18 and 35 with a positive student loan balance in 2009, over 50% had not fully paid back their student loans ten years later, and "more than 25% *had a larger student loan balance ten years later.*" *Id.*

99. Natasha Sarin, *Making Consumer Finance Work*, 119 COLUM. L. REV. 1519, 1523 (2019).

100. *Delinquency Rate on Consumer Loans, All Commercial Banks*, FRED, https://fred.stlouisfed.org/series/DRCLACBS [https://perma.cc/MWL2-PQDR] (last visited Mar. 21, 2023); Bob Lawless, *Bankruptcy Filing Rate Is Lowest Since Bankruptcy Code's Enactment—The Question Is Why*, CREDIT SLIPS (Dec. 27, 2021, 4:42 PM),

perpetrate greater indebtedness and undermine consumers' repayment ability.[101] Thus, even today, regulators are a far cry from meeting the challenges posed by the prevalence of excessive lending.

Admittedly, the weakness of consumer finance regulation is somewhat endemic to the structure of the democratic political process, where organized interest groups with strong monetary incentives (*e.g.*, the consumer finance industry) have a built-in advantage over large, diffuse interest groups (*e.g.*, consumers).[102] Under the classic public choice analysis, politicians' main ambition is to stay in office. Interest groups can provide politicians with the financial resources they need to win votes; hence they will be able to secure those politicians' support for the policies they favor.[103] On this account, "once entrenched interests can capture the political process, regulation of the economy becomes more and more inefficient."[104]

However, from a historical perspective, the predictions of public choice theory have often been disproven.[105] Despite their financial and organizational advantages, commercial interests do not always get their way with legislatures, and consumer interests sometimes prevail.[106] If we accept that consumer finance regulation is not destined to lose its rigor in the face of interest group pressure, the main challenge becomes choosing the proper regulatory means. Considering the past and present of consumer finance regulation, what can be done to address excessive lending more effectively?

This Article suggests the type of ex-ante, contract-centered regulatory measures that make up the bulk of present-day consumer finance regulation do not provide an adequate solution, and regulators should consider a different approach. To curb lenders' perverse incentive to lend regardless of ability to pay, I argue, their underwriting decisions

---

https://www.creditslips.org/creditslips/2021/12/bankruptcy-filing-rate-is-lowest-since-bankruptcy-codes-enactment-the-question-is-why-.html [https://perma.cc/Z3V2-Y98X].

101. Robert M. Lawless, *The Paradox of Consumer Credit*, 2007 U. ILL. L. REV. 347, 369–70; Pamela Foohey, Dailé Jiménez & Christopher K. Odinet, *The Debt Collection Pandemic*, 11 CALIF. L. REV. ONLINE 222, 228 (2020).

102. Shmuel I. Becher, *Unintended Consequences and the Design of Consumer Protection Legislation*, 98 TUL. L. REV. 105, 110–11 (2018).

103. *See, e.g.*, John Dearlove, *Neoclassical Politics: Public Choice and Political Understanding*, 1 REV. POL'Y ECON. 208, 214, 226 (1989); Steven Pressman, *What is Wrong with Public Choice*, 27 J. POST KEYNESIAN ECON. 3, 8 (2004); STEVEN P. CROLEY, REGULATION AND PUBLIC INTERESTS: THE POSSIBILITY OF GOOD REGULATORY GOVERNMENT 16, 19 (2008).

104. Brian Galle, *In Praise of Ex-Ante Regulation*, 68 VAND. L. REV. 1715, 1736 (2015).

105. *See, e.g.*, DONALD P. GREEN & IAN SHAPIRO, PATHOLOGIES OF RATIONAL CHOICE THEORY: A CRITIQUE OF APPLICATIONS IN POLITICAL SCIENCE 6–7 (1994); Pressman, *supra* note 103; CROLEY, *supra* note 103, at 249–57.

106. *See, e.g.*, GUNNAR TRUMBULL, STRENGTH IN NUMBERS: THE POLITICAL POWER OF WEAK INTERESTS 1–32 (2012).

should be scrutinized ex-post, in the framework of consumer bankruptcy law.

B. Limitations of Ex-Ante Consumer Finance Regulation

Three types of regulatory measures constitute the bulk of consumer finance regulation in the United States: mandates, disclosures, and (to a lesser extent) nudges.[107] *Mandates* are prohibitive. They concern the content of contractual terms, and require providers of consumer financial services to design, or refrain from designing, their transactions in certain ways.[108] For example, setting a maximum permissible interest rate on a specific type of loan, or prohibiting lenders from changing the rate retroactively, are types of mandatory rules. However, mandates may also take the form of general standards rather than clear-cut rules[109] (*e.g.*, limiting credit card penalties and fees to the amount "reasonable and proportional" to the omission or violation that triggered them).[110] Unlike mandates, *disclosures* do not compel lenders to adopt or eschew any type of contractual design, but merely require them to inform consumers with respect to different features of the transaction (*e.g.*, the annual interest rate).[111] The goal of disclosures is to equip consumers with the knowledge that will allow them to "shop around" the credit market and avoid abusive transactions independently.[112]

Nudges, like disclosures, are not prohibitive and seek to affect the conduct of consumer borrowers, rather than lenders.[113] The idea of nudges is to alter people's behavior—to affect their choices—without forbidding or significantly changing the cost of any option.[114] For example, the setting of "no overdraft coverage" as the default choice for bank checking accounts in 2010 was a nudge that was meant to help consumers avoid frequent overdrafts and the accumulation of unmanageable debt loads.[115] Consumers can affirmatively choose to opt out of the default—*i.e.*, opting into the overdraft fees—which means that

---

107. Disclosures are sometimes referred to as a type of nudge; however, because disclosures provoke a distinct set of regulatory concerns, I discuss them separately from other types of nudges.

108. Eyal Zamir & Ian Ayres, *A Theory of Mandatory Rules: Typology, Policy and Design*, 99 TEX. L. REV. 283, 285 (2020).

109. *Id.* at 315–16.

110. Such a mandate is included in the 2009 Credit Card Accountability, Responsibility and Disclosure Act, 15 U.S.C. § 1665d(a).

111. BEN-SHAHAR & SCHNEIDER, *supra* note 79, at 3–7.

112. *See id.*

113. *See* RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS 6 (rev. ed. 2009).

114. *Id.*

115. Sarin, *supra* note 99, at 1554–55.

they will be able to overdraft.[116] Yet, it is assumed that most consumers will simply stick to the default and thus avoid overdrafts.[117]

The problem is that each of these regulatory measures—mandates, disclosures, and nudges—suffers from inherent limitations, which make it practically or normatively inadequate for regulating excessive lending. Mandates inflict autonomy, are politically contested, and (arguably) tend to backfire; disclosures are ineffective; and nudges are both ineffective and morally objectionable. Before exploring an alternative, I elaborate on these limitations.

1. LIMITATIONS OF MANDATES

Mandates seem to provide the most straightforward type of consumer protection: simply eliminating certain types of abusive contractual provisions. Moreover, in the consumer finance context, where standard form contracts are used and no actual negotiation occurs, "substantive mandatory rules may actually reflect customers' expectations more accurately than the formal contract."[118] Nevertheless, mandates are probably the most contested type of consumer finance regulation in the United States.[119] For one thing, mandates are criticized from a liberal, autonomy-regarding perspective because they substantially limit the parties' freedom of contract.[120] By prohibiting certain contractual provisions, critics argue, regulators paternalistically and erroneously assume that they have superior knowledge about

---

116. *See* FDIC, FDIC STUDY OF BANK OVERDRAFT PROGRAMS 15 (2008), https://www.fdic.gov/bank/analytical/overdraft/fdic138_report_final_v508.pdf [https://perma.cc/BKP9-BXBK].

117. Sarin, *supra* note 99, at 1555–56. A CFPB study found that after the default was switched, just over sixteen percent of consumer checking accounts affirmatively opted in for fee-based ATM/POS debit card overdraft coverage. CONSUMER FIN. PROT. BUREAU, CFPB STUDY OF OVERDRAFT PROGRAMS 29 (2013), https://files.consumerfinance.gov/f/201306_cfpb_whitepaper_overdraft-practices.pdf [https://perma.cc/JW34-C7CD]. However, among frequent overdrafters the percentage was higher, which suggests that the default policy had only moderate influence on those consumers who were most vulnerable to the harms of overdraft. *See* Lauren E. Willis, *When Nudges Fail: Slippery Defaults*, 80 U. CHI. L. REV. 1155, 1184–85 (2013).

118. Zamir & Ayers, *supra* note 108, at 293.

119. This seems to be the case with respect to the political and academic discourse. Recent evidence suggests that among the general public, mandates are perceived more favorably. *See, e.g.*, Eyal Zamir & Ori Katz, *Do People Like Mandatory Rules? The Impact of Framing and Phrasing*, 45 LAW & SOC. INQ. 1052 (2020); Ori Katz & Eyal Zamir, *Do People Like Mandatory Rules? The Choice Between Disclosures, Defaults, and Mandatory Rules in Supplier-Customer Relationships*, 18 J. EMPIRICAL LEGAL STUD. 421, 454 (2021) (gauging "people's attitudes toward the setting of mandatory rules in supplier-customer relationships").

120. Zamir & Ayers, *supra* note 108, at 293; Anthony T. Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763, 763–64 (1983).

consumers' interests, instead of letting consumers decide what is best for them.[121] Where mandates are articulated as open-ended standards rather than as rules, they are considered especially detrimental to lenders' autonomy, as they create uncertainty with respect to the prospect of state sanction.[122]

But perhaps the most dominant strand of criticism, which has been invoked mostly in the context of mandatory price regulation, is that in the long run mandates are simply counterproductive.[123] Thus, it is argued, because mandates eliminate contract terms that are beneficial to lenders (*e.g.*, high interest rates, penalties), they increase the financial risk associated with lending. To compensate for this greater risk, lenders must decrease the supply of credit or increase its price, and credit becomes less available, especially for low-income consumers. Accordingly, critics argue, mandatory rules end-up hurting those poor consumers whom legislatures set out to protect.[124] While evidence that mandatory regulations compromise the supply of credit or increase its price are ambiguous at best,[125] the threat of this occurrence has gained considerable traction in legislative debates over consumer finance regulation in the United States.[126] In fact, it was exactly this type of objection that led the CFPB to rescind its 2017 proposal to impose underwriting requirements with respect to certain types of short-term consumer loans.[127] Hence, the strong opposition from the consumer

121. *See, e.g.*, Mario J. Rizzo & Douglas Glen, *The Knowledge Problem of New Paternalism*, 2009 BYU L. REV. 905; A. J. Duggan, *Some Reflections on Consumer Protection and the Law Reform Process*, 17 MONASH U. L. REV. 252, 263 (1991).

122. *See* Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1688–89 (1976); John E. Calfee & Richard Craswell, *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 VA. L. REV. 965, 966–67 (1984).

123. THALER & SUNSTEIN, *supra* note 113, at 256.

124. *See, e.g.*, Christopher C. DeMuth, *The Case Against Credit Card Interest Rate Regulation*, 3 YALE J. ON REG. 201 (1986); Vincent D. Rougeau, *Rediscovering Usury: An Argument for Legal Controls on Credit Card Interest Rates*, 67 U. COLO. L. REV. 1, 13–14 (1996); Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373, 1422–23 (2004); Tiago Pinheiro & Joshua Ronen, *Unintended Consequences of the Credit Card Act*, 1 J.L. FIN. & ACCT. 93, 95–96 (2016).

125. In the American context, compare, for example, Sarin, *supra* note 99, at 1525, 1551, 1578–87, with Gregory Elliehausen & Simona M. Hannon, *The Credit Card Act and Consumer Finance Company Lending*, 34 J. FIN. INTERMEDIATION 109, 110 (2018). For contradicting evidence, see also Hynes & Posner, *supra* note 58, at 180 n.11.

126. *See* source cited *infra* note 219. A comparable threat had considerable influence on the passage of the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act. *See* HANSEN & HANSEN, *supra* note 60, at 145–46.

127. Atkinson, *supra* note 39, at 1111–12. Similarly, when the CFPB sought to regulate the price of car loans by eliminating markups, it was immediately met with the contention that it would raise auto financing costs. *See* Blair Evans, *CFPB's Auto Finance Push Hurts Consumers*, AM. BANKER (Jan. 25, 2016, 9:30 AM), https://www.americanbanker.com/opinion/cfpbs-auto-finance-push-hurts-consumers.

finance industry and sympathetic politicians makes it practically challenging to enact effective mandates.[128] Alas, even when mandates make their way into the law, they are likely to include various carve-outs and exemptions[129] or simply to be circumvented by the regulated industry.[130] Thus, for example, in what is known as "rent-a-bank" schemes, some predatory lenders channel their loans through banks that are exempt from state usury laws to evade interest rate limitations.[131] "Loans made through 'rent-a-bank' schemes are some of the most predatory on the market," with APR's exceeding one hundred percent.[132]

2. LIMITATIONS OF DISCLOSURES

As opposed to mandates, disclosures are perceived as a minimal disturbance to the parties' contractual freedom. Champions of disclosure maintain that by providing information that helps consumers decide whether or not to enter a specific transaction, disclosures actually enhance consumer choice and autonomy.[133] More importantly, it is argued, as they allow consumers to "shop around" and compare different potential transactions, disclosures encourage competition among suppliers and induce them to offer better terms.[134] Because disclosures

---

128. *See* BEN-SHAHAR & SCHNEIDER, *supra* note 79, at 146–48 (comparing political support for mandates and disclosures and demonstrating that the former is more contested).

129. *See, e.g.*, Joseph U. Schorer, *The Credit Card Act of 2009: Credit Card Reform and the Uneasy Case for Disclosure*, 127 BANKING. L.J. 924, 929–30 (2010); David Lazarus, *California's Usury Law Caps Loan Rates. Bizarrely, Most Lenders Are Exempt*, L.A. TIMES (Jul. 30, 2021, 6:00 AM), https://www.latimes.com/business/story/2021-07-30/column-california-usury-law [https://perma.cc/KL2Y-YJ7P].

130. Duggan, *supra* note 121, at 263–64 (arguing that regulated parties are likely to react to mandates "by looking for ways around the prohibition," because it compels them "to act in a way that is contrary to where they perceive their own interests to lie").

131. *See, e.g.*, Adam Levitin, *Rent-a-Bank: Bank Partnerships and the Evasion of Usury Laws*, 71 DUKE L.J. 329, 332–33 (2021); CONSUMER FED'N OF AM. & THE U.S. PUB. INT. RSCH. GRP., RENT-A-BANK PAYDAY LENDING: HOW BANKS HELP PAYDAY LENDERS EVADE STATE CONSUMER PROTECTIONS 14–16 (2001), https://publicinterestnetwork.org/wp-content/uploads/2013/05/Payday_Lending_2001_USPIRG.pdf [https://perma.cc/SL2Y-DYHV]. On evading state usury laws, see Hynes & Posner, *supra* note 58, at 177, and Mann, *supra* note 17, at 413.

132. SUNNY GLOTTMANN, CHARLA RIOS & PETE SMITH, UNSAFE HARBOR: THE PERSISTENT HARMS OF HIGH-COST INSTALLMENT LOANS 2 (2022), https://www.responsiblelending.org/research-publication/unsafe-harbor-persistent-harms-high-cost-installment-loans [https://perma.cc/LP5G-ZTKW].

133. BEN-SHAHAR & SCHNEIDER, *supra* note 79, at 5.

134. *See, e.g.*, Florencia Marotta-Wurgler, *Does Contract Disclosure Matter?* 168 J. INST. & THEORETICAL ECON. 94, 98 (2012); Fleming, *supra* note 64, at 259 (arguing that the dominant rationale behind federal disclosure legislation was encouraging

are less intrusive than mandates and conform with free-market ideology, they also enjoy bipartisan support and legislating them is politically feasible.[135] No less important, from the government's point of view, disclosure regulation is cheap: "[i]t requires minimal budget, bureaucracy, or oversight."[136]

Alas, in recent decades it has become increasingly evident that disclosures do very little to protect consumers.[137] First, while disclosure-advocates assume that more information is always a blessing for consumers, behavioral research has demonstrated that having more information often yields poorer, rather than better, purchasing decisions.[138] Because people's capacity to absorb and process information is limited, they tend to focus on the salient features of the product or service and ignore the rest.[139] Thus, if all the relevant information is disclosed, consumers may suffer from "information overload" and experience confusion and frustration rather than empowerment.[140] However, disclosing only the core terms of the deal is equally problematic, because the terms that are conspicuously disclosed become more salient at the expense of others. Consequently, sellers are able to shift costs from the salient terms to the non-salient terms (*e.g.*, decrease the annual interest rate but increase late fees)[141] or simply mislead consumers with respect to the true cost of the loan.[142]

In practice, however, the overload and saliency problems are often theoretical, as most consumers simply do not read form contracts and the disclosures they contain.[143] Disclosures tend to be extremely lengthy and

---

"consumers to comparison shop for credit, thereby increasing price competition among lenders").

135. BEN-SHAHAR & SCHNEIDER, *supra* note 79, at 5–6; Matthew A. Edwards, *The Virtue of Mandatory Disclosure*, 28 NOTRE DAME J.L. ETHICS & PUB. POL'Y 47, 48–49 (2014).

136. BEN-SHAHAR & SCHNEIDER, *supra* note 79, at 145.

137. *Id.* at 6–7, 146–47.

138. *See, e.g.*, EYAL ZAMIR & DORON TEICHMAN, BEHAVIORAL LAW AND ECONOMICS 285 (2018); Shmuel I. Becher, *Behavioral Science and Consumer Standard Form Contracts*, 68 LA. L. REV. 117, 168 (2007); Kevin Lane Keller & Richard Staelin, *Assessing Biases in Measuring Decision Effectiveness and Information Overload*, 15 J. CONSUMER RSCH. 504 (1989).

139. Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. REV. 429, 451–52 (2002); Becher, *supra* note 138, at 169–72.

140. Becher, *supra* note 138, at 174–75.

141. Oren Bar-Gill & Ryan Bubb, *Credit Card Pricing: The Credit CARD Act and Beyond*, 97 CORNELL L. REV. 967, 971 (2012); Hynes & Posner, *supra* note 58, at 194.

142. Teichman & Zamir, *supra* note 41, at 1373–74, 1380.

143. *See, e.g.*, Ian Ayers & Alan Schwartz, *The No-Reading Problem in Consumer Contract Law*, 66 STAN. L. REV. 545, 546–47 (2014); Yannis Bakos,

written in complex legal jargon, and therefore the average consumer cannot understand them.[144] In 2006, the Government Accountability Office reported that, on average, credit card disclosure documents "were written at a reading level commensurate with about a tenth- to twelfth-grade education," whereas "nearly half of the adult population in the United States reads at or below the eighth-grade level."[145] Hence, disclosures hardly influence consumer choice.[146] Disclosures may be useful for highly literate, sophisticated and motivated consumers,[147] but available evidence suggests that this "informed minority" is too small to induce price competition between suppliers.[148] For the non-reading majority, disclosure is not only unhelpful, but may actually be harmful, as it lends legitimacy to the disclosed terms and may deter consumers from challenging them in court.[149]

3. Limitations of Nudges

"Choice architecture" is a relatively novel theory of regulation that is informed by behavioral research.[150] Acknowledging that humans suffer from cognitive biases and do not abide by the economic model of rationality, choice architecture suggests that governments can improve people's decisions simply by reorganizing the context in which the

---

Florencia Marotta-Wurgler & David R. Trossen, *Does Anyone Read the Fine Print? Consumer Attention to Standard-Form Contracts*, 43 J. LEGAL STUD. 1, 19–22 (2014).

144. *See, e.g.*, Bakos, Marotta-Wurgler & Trossen, *supra* note 143, at 22; Uri Benoliel & Shmuel I. Becher, *The Duty to Read the Unreadable*, 60 B.C. L. REV. 2255, 2277–81 (2019) (finding that on linguistic readability tests, the average readability level of the sign-in-wrap contracts used in many popular websites is comparable to the usual score of articles in academic journals).

145. U.S. GOV'T ACCOUNTABILITY OFF., GAO-06-929, CREDIT CARDS: INCREASED COMPLEXITY IN RATES AND FEES HEIGHTENS NEED FOR MORE EFFECTIVE DISCLOSURE TO CONSUMERS 37–38 (2006), https://www.gao.gov/assets/gao-06-929.pdf [https://perma.cc/9L9T-3FU4]; *see also* Bar-Gill, *supra* note 7, at 79–80 (citing a 2008 study by the Center for Responsible Lending which "found that only 3 percent of borrowers have the knowledge and capacity to evaluate credit card companies' payment allocation policies").

146. *See* Sovern, *supra* note 70, at 781–86 (reporting on a survey of mortgage brokers conducted in July of 2009, wherein brokers were nearly unanimous in reporting that "borrowers never withdrew from a loan after reading the final TILA disclosures at the closing").

147. Hynes & Posner, *supra* note 58, at 194 (citing evidence that the beneficial effects of disclosure are limited to well-educated, affluent borrowers).

148. *See* Bakos, Marotta-Wurgler & Trossen, *supra* note 134, at 5, 22–29; *see also* Warren & Bar-Gill, *supra* note 43, at 21–22.

149. *See* Tess Wilkinson-Ryan, *The Perverse Consequences of Disclosing Standard Terms*, 103 CORNELL L. REV. 117, 159–60 (2017).

150. Robert Münscher, Max Vetter & Thomas Scheurle, *A Review and Taxonomy of Choice Architecture Techniques*, 29 J. BEHAV. DECISION MAKING 511, 511 (2016).

decisions are made.[151] "Nudges" are a form of choice architecture "that alters people's behavior in a predictable way without forbidding any options or significantly changing their economic incentives."[152] Notably, though definitely not exclusively, the term "nudge" is associated with the design of default options, namely setting the "superior" option as the default option and requiring consumers who favor the "inferior" option to actively opt out.[153]

Since its exposition, choice architecture has gained considerable influence and has been implemented by governments worldwide.[154] A main source of attraction is that choice architecture, like disclosure regimes, can be implemented at a relatively low cost.[155] Choice architecture is also politically appealing insofar as it is "a form of paternalism, libertarian in spirit, that should be acceptable to those who are firmly committed to freedom of choice on grounds of either autonomy or welfare."[156] It is libertarian in maintaining that "people should be free to opt out of specified arrangements if they choose to do so"[157] and paternalist in holding "it is legitimate for private and public institutions to attempt to influence people's behavior even when third-party effects are absent."[158] Reflecting both paternalistic and libertarian principles, choice architecture supposedly offers a political third way between Democratic progressivism and Republican conservatism.[159]

However, like mandates, nudges also generate autonomy-related concerns. While they are not prohibitive, nudges "[work] best when people are unaware that their behavior is being influenced."[160] Some critics maintain that by covertly manipulating the range of available options, nudges violate personal autonomy no less—and possibly even more—than straightforward prohibitive mandates.[161] Ryan Bubb and

---

151. *See id.*

152. THALER & SUNSTEIN, *supra* note 113, at 6.

153. *See id.* at 85–89; Willis, *supra* note 117, at 1157. For other forms of choice architecture, see Münscher, Vetter & Scheuerle, *supra* note 150.

154. *See* Ryan Bubb & Richard H. Pildes, *How Behavioral Economics Trims Its Sails and Why*, 127 HARV. L. REV. 1593, 1595–96 (2014).

155. *See* Avishalom Tor & Jonathan Klick, *When Should Governments Invest More in Nudging? Revisiting Benartzi et al. (2017)*, 18 REV. L. & ECON. 347, 348 (2022).

156. Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron*, 70 U. CHI. L. REV. 1159, 1160 (2003).

157. *Id.* at 1161.

158. *Id.* at 1162.

159. THALER & SUNSTEIN, *supra* note 113, at 255.

160. Tom Goodwin, *Why We Should Reject 'Nudge,'* 32 POL. 85, 89 (2012).

161. *See* Daniel M. Hausman & Brynn Welsch, *Debate: To Nudge or Not to Nudge*, 18 J. POL. PHIL. 123, 131 (2010); Thomas Hove, *Between Complacency and Paternalism: Ethical Controversies over Influencing Political and Consumer Choice*, 644 ANNALS AM. ACAD. POL. & SOC. SCI. 272, 275 (2012).

Richard Pildes further argue that the welfare consequences of default-swapping nudges "are essentially the same as a direct mandate," because "few people actually make use of the opt-out option."[162] Thus, they argue, such nudges provide consumers only "an illusion of choice," while allowing regulators to avoid a reasoned choice between nudges and direct mandates.[163] Other critics doubt that the "third-way" concept that underlies choice architecture is sustainable, arguing that seemingly moderate, choice-preserving policies will eventually generate substantial restrictions on individual autonomy.[164]

In addition to these autonomy-related objections, the effectiveness of nudges has also been questioned. One problem is that as opposed to mandates, nudges are available to lenders just as they are to regulators. Lenders can employ their own choice architecture techniques or otherwise manipulate consumers to counter the effect of regulatory nudges.[165] Since lenders usually enjoy more financial and professional resources and fewer ethical constraints, they are also likely to be more successful than regulators in harnessing human psychology on their side.[166] Another problem is that choice architecture is relevant where consumers actually have a choice, that is, where there are "more valuable options than can be chosen."[167] Accordingly, changing the default is irrelevant where abusive terms are one-sidedly dictated by the lender with no opt-out option (*i.e.*, where consumers lack intra-contractual choice). In the same vein, consumers can be nudged into using safer types of credit where such types are available. But, what about consumers who, for example, due to low credit scoring or geographical location, can only obtain high-interest, risky credit (*i.e.*, where consumers lack inter-contract choice)? Where the only choice is between risky credit or no credit, it seems that choice architecture can do little to help consumers. For these reasons, most commentators agree that nudges have only a limited effect and that they must be complemented by other, more rigorous regulatory means.[168]

Mandates, disclosures, and nudges suffer from substantial limitations. Mandates significantly curb autonomy, and therefore face strong opposition from the regulated industry and are often

---

162. Bubb & Pildes, *supra* note 154, at 1599.

163. *Id.* (emphasis omitted).

164. Rizzo & Glen, *supra* note 121, at 910.

165. *See* Willis, *supra* note 117, at 1174, 1185–200.

166. Stephanie M. Stern, *Outpsyched: The Battle of Expertise in Psychology-Informed Law*, 57 JURIMETRICS 45, 48 (2016).

167. JOSEPH RAZ, THE MORALITY OF FREEDOM 398 (1986).

168. *See, e.g.*, On Amir & Orly Lobel, *Stumble, Predict, Nudge: How Behavioral Economics Informs Law and Policy*, 108 COLUM. L. REV. 2089, 2100 (2008); Tor & Klick, *supra* note 155, at 18 (cautioning governments against diverting resources from traditional interventions to nudges).

circumvented. They are bound to backfire against consumers. Disclosures are relatively consensual, but entirely ineffective—especially for those less sophisticated and less educated consumers who need protection most. Nudges are morally objectionable, relevant in limited contexts and may be effectively countered by the industry. Hence, to successfully cope with excessive lending, regulators should adopt a different approach—one that departs from the familiar regulatory toolkit used in consumer finance regulation.

C. Going Ex-Post

In legal discourse, regulatory measures are often categorized as either "ex-ante" or "ex-post," according to the timing of regulatory intervention vis-a-vis the regulated activity.[169] *Ex-ante* forms of regulation "are public in character and modify behavior in an immediate way through requirements that are imposed before, or at least independently of, the occurrence of actual harm."[170] Taxes, subsidies, and workplace- or auto-safety regulations are common types of ex-ante regulatory interventions. *Ex-post* measures, in contrast, are applied after the regulated conduct has transpired and work "indirectly, through the deterrent effect of damage actions that may be brought once harm occurs."[171] Here the classic example is tort liability for negligent conduct.

Like ex-ante regulation, ex-post regulation also aims to prevent (or encourage) certain types of conduct. But the different timing yields different strengths and weaknesses. The benefit of ex-ante interventions is almost intuitive: "an [o]unce of [p]revention is worth a [p]ound of [c]ure."[172] However, they also require the regulator to gather a great deal of information about the harm that the regulated activity is expected to produce.[173] Ex-post intervention, on the other hand, allows the regulator to determine the extent of the harm only if, and after, the harm has actually occurred.[174] Ex-post interventions also leave greater room for

---

169. Galle, *supra* note 104, at 1718.

170. Steven Shavell, *Liability for Harm Versus Regulation of Safety*, 13 J. LEGAL STUD. 357, 357 (1984) (emphasis added).

171. *Id.* (emphasis added); Galle, *supra* note 104, at 1724; *see also* Charles D. Kolstad, Thomas S. Ulen & Gary V. Johnson, Ex Post *Liability for Harm vs.* Ex Ante *Safety Regulation: Substitutes or Complements?*, 80 AM. ECON. REV. 888, 888 (1990) (describing how regulating externalities after the harm has occurred causes the potential injurer to consider possible social damages and exercise precaution).

172. The phrase was originally coined by Benjamin Franklin to encourage the citizens of Philadelphia to remain vigilant about fire awareness and prevention. *See* 2 THE PAPERS OF BENJAMIN FRANKLIN, JAN. 1, 1735, THROUGH DEC. 31, 1744, 12–15 (Leonard W. Labaree ed., 1961).

173. Galle, *supra* note 104, at 1725–29.

174. Kyle D. Logue, *In Praise of (Some) Ex Post Regulation: A Response to Professor Galle*, 69 VAND. L. REV. EN BANC 97, 108 (2016).

the regulated party's discretion in performing the regulated activity. For better or worse, "it is the private market actors who must make the educated guesses ex ante about what the consequences of their actions will be, what steps to take to minimize harms and maximize benefits, and so on."[175]

Legislative mandates, disclosures and nudges can all be characterized as ex-ante regulatory measures.[176] They all kick in *once the finance contract is made, regardless of its ultimate consequences*. In contrast, I suggest that, to effectively counter perverse lending incentives, regulators consider an ex-post measure of consumer finance regulation—one that does not universally apply at the contractual stage, but is *triggered only in cases where the consumer was in fact unable to repay the loan and consequently filed for bankruptcy*. Of course, the filing of bankruptcy is not conclusive evidence of excessive lending, and conversely, many consumers who borrow excessively do not file for bankruptcy. But bankruptcy is at least a prima facie indication for an imprudent extension of credit, which warrants specific review, and regulating lending decisions at the bankruptcy stage allows regulators to influence lenders' incentives without overruling their judgment.[177]

Obviously, some ex-post regulation of consumer finance transactions already exists. Consumer finance transactions are subject to the law of contract, thus courts may strike down an entire transaction or specific contractual provisions under the doctrine of unconscionability.[178] Indeed, since *Williams v. Walker Thomas Furniture Co.*,[179] the unconscionability doctrine has been applied by courts mostly to police abusive consumer contracts.[180] Additionally, some consumer financial protection laws provide consumers with a private right of action for damages against a lender who violates their provisions.[181] However,

175. *Id.*

176. Admittedly, the distinction between ex-ante and ex-post is a bit muddy here. Some laws allow for (ex-post) individual legal action for the violation of (ex-ante) mandates or disclosure duties; and ex-post regulation clearly generates some ex-ante incentives. Nevertheless, since the distinction is generally intelligible and prevalent among lawyers, I find it useful for the purposes of my discussion here.

177. In Section II.D, I elaborate on the strengths and weaknesses of regulation through bankruptcy.

178. *See* U.C.C. § 2-302 (AM. L. INST. & NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2021).

179. 350 F.2d 445 (D.C. Cir. 1965).

180. *Id.*; Bar-Gill & Warren, *supra* note 43, at 71. For a detailed discussion of the history of the doctrine and its current application, see Susan Block-Lieb & Edward J. Janger, *Fit for its Ordinary Purpose: Implied Warranties and Common Law Duties for Consumer Finance Contracts*, 59 HOUS. L. REV. 551, 587–96 (2022).

181. *See, e.g.*, 15 U.S.C. § 1640 (lenders failing to comply with the TILA's disclosure requirements are liable for actual and statutory damages, attorney's fees and court costs); CAL. CIVIL CODE 1916-3 (West 2022) (a borrower who has made interest

neither form of ex-post judicial review has proven effective. Unconscionability litigation is rare and often futile; the doctrine has been narrowly construed by the courts,[182] and for every judicial decision upholding the defense, "there are more than a handful of rulings reaching a contrary result."[183] Therefore, at least under its current interpretation and application, unconscionability is not a sufficient deterrent against precarious lending practices.

Private actions for violations of consumer financial protection laws are an equally weak regulatory tool. Many consumers are unaware of their legal rights and have no access to legal representation,[184] and even if they are aware, the incentive to sue is low given the small pecuniary gain that may be expected if the case succeeds.[185]

Therefore, I suggest not to make do with existing types of ex-post regulation, but to complement it with ex-post regulation through consumer bankruptcy law.[186] Using consumer bankruptcy law to regulate consumer finance transactions may seem odd, as consumer finance law and consumer bankruptcy law are usually perceived as distinct legal categories. But this perceived disparity is unfounded, because consumer bankruptcy law and consumer finance law are conceptual and normative

---

payments that are considered usurious under California law can recover damages of three times the amount paid to the lender); TEX. FIN. CODE ANN. §§ 305.001–.004 (West 2021) (a creditor who charges usurious interest under Texas law is liable three times the amount computed by subtracting the amount of interest allowed by law from the total amount of interest contracted for, charged, or received; or $2,000 or twenty percent of the amount of the principal, whichever is less; additional liability is imposed for charging more than twice the authorized rate).

182. Warren & Bar-Gill, *supra* note 43, at 76.

183. Janger & Block-Lieb, *supra* note 180, at 596.

184. *See, e.g.*, LEGAL SERVS. CORP., THE JUSTICE GAP: THE UNMET CIVIL LEGAL NEEDS OF LOW-INCOME AMERICANS 7 (2022), https://justicegap.lsc.gov/the-report/; Rebecca Buckwalter-Poza, *Making Justice Equal*, CAP (Dec. 8, 2016), https://www.americanprogress.org/article/making-justice-equal/ [https://perma.cc/UZE9-MWEE].

185. Warren & Bar-Gill, *supra* note 43, at 77; Yehuda Adar & Shmuel I. Becher, *Ending the License to Exploit: Administrative Oversight of Consumer Contracts*, 62 B.C. L. REV. 2405, 2440 (2021). This problem is characteristic of parties who are "one-shotters," as opposed to "repeat players." *See* Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC'Y REV. 95, 97–98 (1974).

186. In suggesting that regulators should opt for regulation that is both ex-post *and* non-contractual, my approach differs from other approaches that have been recently invoked in the literature. *See, e.g.*, Adar & Becher, *supra* note 185, at 2442–43 (proposing a system of administrative oversight over the content of consumer form contracts); Block-Lieb & Janger, *supra* note 180, at 558 (arguing that consumer finance transactions should be regulated through tort-like doctrines in the common law of contract: unconscionability, good faith and warranty); *see also* Michael Simkovic & Meirav Furth-Matzkin, *Proportional Contracts*, 107 IOWA L. REV. 229, 234–39 (2021) (suggesting a Pigouvian tax on sellers in proportion to the attention costs that reading and comprehending the contract would impose on consumers).

counterparts. Notably, when the potential risks of consumer finance transactions materialize and consumers find themselves unable to repay their debts, it is consumer bankruptcy law that provides them legal protection. Therefore, consumer bankruptcy law is a natural location for the regulation of excessive credit transactions. Instead of expecting financially struggling consumers to take up costly litigation with low prospects of success and no significant compensation, as in the case of unconscionability or consumer protection law litigation, ex-post regulation through bankruptcy law will simply follow from the consumer's decision to seek bankruptcy protection, with no additional costs attached.

In fact, the idea that bankruptcy law could be used to regulate consumer finance transactions is not new. It was originally contemplated by Harvard Law Professor Vern Countryman in a proposed consumer bankruptcy bill he drafted for the National Bankruptcy Conference in the 1960s.[187] The original provision drafted by Countryman pertained to Chapter 13 bankruptcy and allowed the court to determine "that a [creditor's] claim, secured or unsecured, was based on '*an improvident extension of credit in view of the information reasonably available to the creditor at the time of extending credit*, and such claim may then be separately provided for in the plan, or may be excluded from the plan.'"[188] While the National Consumer Finance Commission, in its 1972 report to Congress, supported the notion of improvident credit extension as a basis for disallowing claims in bankruptcy,[189] and while Countryman himself repeated the idea in his testimony before the House Judiciary Committee in 1975,[190] it never became law and was largely forgotten.[191]

187. Vern Countryman, *Improvident Credit Extension: A New Legal Concept Aborning*, 27 ME. L. REV. 1, 8–9 (1975).

188. *Id.* at 9 (emphasis added).

189. NAT'L COMM'N ON CONSUMER FIN., *supra* note 6, at 42.

190. *House 1975–1976*, *supra* note 62, at 351 (statement of Vern Countryman).

191. *See* Pottow, *supra* note 10, at 423–27. The literature has occasionally discussed proposals for regulating the credit-granting process via bankruptcy, but (1) not on the general basis of excessive credit extension, or (2) not as grounds for disallowing a debt claim, but as a defense against a nondischargeability claim by the creditor or as grounds for subordinating a creditor's debt claim, and (3) only in addition to proposing ex-ante measures for policing consumer finance transactions (in contrast, I maintain that resorting to bankruptcy is justified because ex-ante measures are insufficient). *See, e.g.*, Mann, *supra* note 17, at 426; Bar-Gill, *supra* note 124, at 1426–27; Warren & Bar-Gill, *supra* note 43, at 72–74; Ron Harris & Einat Albin, *Bankruptcy Policy in Light of Manipulation in Credit Advertising*, 7 THEORETICAL INQ. L. 431, 463–65 (2006).

The only work I am aware of that develops Countryman's original proposal is Pottow's 2007 article on private liability for reckless consumer lending. *See* Pottow, *supra* note 10. However, my proposal differs from Pottow's in three (related) respects: First, because my broader goal is to stress the normative proximity between consumer finance and consumer bankruptcy law, I argue that ex-post regulation of excessive credit extensions is desirable not only in terms of bankruptcy policy, but in terms of consumer

I argue the time is now ripe to reevaluate the merits of regulating imprudent credit extensions through consumer bankruptcy. The application of ex-ante ability-to-pay standards to residential mortgage loans and credit cards indicates public awareness of the importance of sound underwriting in consumer finance markets, while at the same time, the CFPB's failure to promulgate comparable ex-ante standards for short-term credit in 2017 suggests that universally regulating non-mortgage consumer credit may require a different approach.

Moreover, considering the challenges of consumer credit regulation since the mid-twentieth century and the recent developments in consumer bankruptcy law, using bankruptcy law to regulate consumer credit transactions ex-post may yield a double benefit. First, regulating excessive credit extensions via bankruptcy law potentially avoids many of the limitations of ex-ante, contract-centered types of regulation—whether mandates, disclosures, or nudges. Therefore, it may increase the effectiveness of consumer finance regulation and mitigate some of the autonomy-related concerns it provokes. Equally important, ex-post regulation of consumer lending in bankruptcy may substantially improve bankruptcy law's internal coherence. When Professor Countryman first made his proposal, using bankruptcy law to regulate consumer finance transactions was perceived as a deviation from bankruptcy law's proper function.[192] The Congress-appointed Bankruptcy Commission, whose work heavily informed the enactment of the 1978 Bankruptcy Code, maintained that "it is inappropriate for a process whose chief function is to continue the law-based orderliness of the open credit economy in the event of the debtor's inability or unwillingness generally to pay his debts to assert directly a regulatory role on conduct in the open credit economy."[193] Accordingly, the Commission noted that even if consumer credit was excessive, "*the Bankruptcy Act would [not] be the place to*

---

finance policy (*i.e.*, in terms of its comparative advantage vis-à-vis other common measures of consumer finance regulation and ex-post judicial review). Pottow does not address this point and compares bankruptcy regulation only with Pigouvian taxes. *Id.* at 434–40. Second, Pottow suggests that reckless credit extensions be regulated primarily through contract and tort litigation, and only residually through bankruptcy, whereas I focus strictly on regulation through bankruptcy. *Id.* Third, in practical terms, Pottow suggests that the courts apply a comparative liability rule based on the parties' causal contribution to the default. *Id.* at 443–46, 460. In contrast, I suggest dismissing the creditor's entire claim if the court finds that the loan was extended with no regard to the borrower's ability to pay, without the court having to establish causality. The relative certainty that this rule provides for creditors is one of its major advantages compared with ex-ante mandates. *See infra* Sections II.C and II.D.

192. *See* COMM'N ON THE BANKR. L. OF THE U.S., REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, pt. 1, at 74 (1973).

193. *Id.* at 74, 93.

deal with the problem."[194] However, in subsequent decades Congress substantially changed its attitude toward bankruptcy law. As amended by Congress in 2005, the Bankruptcy Code subjects consumer debtors to a rigorous review of their income and expenses (*i.e.*, "means-testing"),[195] and thus clearly functions as ex-post regulation of consumers' borrowing decisions.[196] Hence, there is no reason why consumer bankruptcy law should not similarly regulate creditors' lending decisions.[197] In fact, a considerable body of behavioral research indicates that the use of bankruptcy law to regulate lenders' behavior will be much more effective than its use to regulate consumer borrowers' behavior.[198]

Part II elaborates on these two justifications for using consumer bankruptcy to regulate excessive credit extensions but in reverse order. Sections A–C explain how bankruptcy regulation may restore the internal coherence of consumer bankruptcy law. Section D explains why bankruptcy regulation may do better than ex-ante, contractual regulatory measures.

II. CONSUMER BANKRUPTCY AS CONSUMER FINANCE REGULATION

This Part explains why ex-post regulation of excessive lending through consumer bankruptcy law is normatively desirable, both in terms of consumer bankruptcy law and in terms of consumer finance regulation. Beginning with consumer bankruptcy, Sections II.A and II.B provide a critical assessment of the BAPCPA, arguing that the law's exclusive focus on borrowers' incentives not only justifies complementary regulation of lenders' incentives but requires that such regulation be set *within* bankruptcy law. Section II.C proceeds with a model for the regulation of lending decisions through consumer bankruptcy, and a discussion of some potential objections. In Section II.D, I address the benefits of regulation in bankruptcy from the perspective of consumer finance regulation, explaining its advantages both compared with ex-ante, contract-centered regulation and with other types of ex-post judicial review.

194. *Id.* at 9 (emphasis added).

195. Under the means-testing provisions, a Chapter 7 petition is deemed abusive and subject to dismissal or conversion if, after deducting allowable expenses from the debtor's current monthly income, the debtor's disposable monthly income (1) exceeds $166.67, or (2) exceeds $100 and is sufficient to pay at least 25% of the debtor's nonpriority unsecured claims. The debtor may rebut the presumption against Chapter 7 relief by demonstrating the existence of additional expenses or income reductions, but only if they were caused by "special circumstances." *See* 11 U.S.C. § 707(b)(2)(A)–(B).

196. *See infra* notes 240–47 and accompanying text.

197. *Cf.* Pottow, *supra* note 10, at 407, 429–30, 464.

198. *See infra* notes 260–71 and accompanying text.

A. The Consumer Finance–Consumer Bankruptcy Divide

Proposals to enhance consumer financial protection have largely neglected the role of consumer bankruptcy, and for good reason. Consumer finance law and consumer bankruptcy law are typically perceived as autonomous regulatory realms, which operate towards distinct policy goals.[199] Consumer finance law is associated with the broader field of consumer law—"the set of consumer protection, antitrust, and entry-barrier laws that govern consumer transactions."[200] Its stated objectives are to guarantee the safety and soundness of financial institutions providing consumer credit, and to protect consumers by regulating the availability of consumer credit and the terms by which it is extended.[201] Consumer bankruptcy law, in contrast, is perceived as a subset of debt collection law, which kicks-in when individual debtors' liabilities exceed their assets. It allows consumer debtors to suspend all individual collection procedures and commence a single, collective procedure administered by the bankruptcy court, at the conclusion of which they are discharged from all remaining debt.[202] Consumer bankruptcy law's primary goals are to "[provide] creditors with a compulsory and collective forum to sort out their relative entitlements to a debtor's assets" and "[allow] for some sort of a financial fresh start for individuals" who are overburdened by debt.[203]

Accordingly, "Congress [has] bifurcated its treatment of 'credit' and 'debt,'"[204] legislating separate laws to govern consumer finance and consumer bankruptcy. In fact, even the policymaking processes pertaining to consumer finance and consumer bankruptcy are entirely separate, taking place in different House and Senate Committees.[205]

---

199. *See, e.g.*, *Midland Funding LLC v. Johnson*, *No. 16-348*, 581 U.S. 224, 233–34 (2017) (stating that the Fair Debt Collection Practices Act and the Bankruptcy Code "have different purposes"). I thank Ed Boaltz for bringing the *Midland* decision to my attention.

200. Rory Van Loo, *Broadening Consumer Law: Competition, Protection and Distribution*, 95 NOTRE DAME L. REV. 211, 211 (2019).

201. *See, e.g.*, REGULATION OF CONSUMER FINANCIAL SERVICES 3 (Arnold A. Heggestad ed. 1981); Levitin, *supra* note 72, at 330–31; DURKIN, ELLIEHAUSEN, STATEN & ZYWICKI, *supra* note 58, at 31–32.

202. *See, e.g.*, TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 20, 23–24 (Beard Books 1999) (1989).

203. THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 3–4 (1986); *see also* COLLIER ON BANKRUPTCY ¶ 1.01 (Richard Levin & Henry J. Sommer eds., 16th ed. 2022) (discussing the purpose of bankruptcy law).

204. Atkinson, *supra* note 30, at 1435.

205. *See* STANDING RULES OF THE SENATE, S. DOC. NO. 113-18, at 20, 25 (2013); CONSTITUTION JEFFERSON'S MANUAL AND RULES OF THE HOUSE OF REPRESENTATIVES, H.R. Doc. No. 115-177, at 463–64, 473 (2019); Faust, *supra* note 28, at 673, 694.

The putative disparity between consumer finance law and consumer bankruptcy law is further reinforced by professional barriers. Practicing attorneys tend to specialize either in consumer bankruptcy law or in consumer protection law and have formed distinct professional associations—*e.g.*, the National Association of Consumer Advocates (NACA) and the National Association of Consumer Bankruptcy Attorneys (NACBA). With some notable exceptions, academic research and teaching in law schools also reproduce the same division. The "consumer law" people study and teach consumer protection law or financial services regulation, while the "bankruptcy law" folks study and teach corporate and consumer bankruptcy.

Yet, despite these manifestations of disparity, consumer finance and consumer bankruptcy are inherently related legal categories.[206] Both fields of law regulate the behavior of the same agents (*e.g.*, consumer borrowers and providers of consumer financial services—banks, thrifts, credit unions, finance companies, retailers, etc.). They do so with respect to the same practice (provision of consumer credit).[207] The principal difference is that each field applies at a different *temporal* stage vis-à-vis consumer debt—consumer finance law operates ex-ante, controlling how debt is initially created, while consumer bankruptcy law operates ex-post, controlling how such debt may be eliminated.[208] Yet the relation between these temporal stages is not linear but cyclical, such that each stage conditions the next one. Personal bankruptcy necessarily follows from the use of consumer finance,[209] and while most consumers will never go bankrupt, *all* consumer finance transactions are designed and executed in the shadow of potential bankruptcy.[210] Ultimately, credit and debt are one and the same.[211] Therefore, the phenomena of consumer finance and consumer bankruptcy cannot be considered entirely independently of one another.

Indeed, different aspects of the interdependence between consumer finance and consumer bankruptcy have been extensively studied by economists, sociologists, and legal scholars. Numerous empirical studies have identified a positive relationship between bankruptcy filing rates and households' debt-to-income ratio.[212] Bankruptcy filing rates have been

206. Mann, *supra* note 17, at 402–07.

207. *See id.*

208. *See* Barry Adler, Ben Polak & Alan Schwartz, *Regulating Consumer Bankruptcy: A Theoretical Inquiry*, 29 J. LEGAL STUD. 585, 585–87 (2000).

209. Mann, *supra* note 17, at 402.

210. *See* Adler, Polak & Schwartz, *supra* note 208, at 589; Adam Feibleman, *Defining the Social Insurance Function of Bankruptcy*, 13 ABI L. REV. 129, 142 (2005).

211. Atkinson, *supra* note 30, at 1458–61.

212. *See, e.g.*, DAVID T. STANLEY & MARJORIE GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM 24–27 (1971); Lawrence Shepard, *Accounting for the Rise in Consumer Bankruptcy Rates in the United States: A Preliminary Analysis of Aggregate*

found to correlate with the overall volume of consumer credit,[213] as well as with the supply of credit for lower-income borrowers.[214] Several studies have identified a relationship between bankruptcy filing rates and credit card debt.[215] Conversely, some studies have indicated that generous bankruptcy exemptions create a moral hazard problem by increasing consumers' incentive to file for bankruptcy—thereby causing lenders to reduce the availability of credit for lower-income households.[216] Similarly, strict bankruptcy legislation has been found to benefit credit markets by discouraging opportunistic borrowing by consumers.[217]

Given this interdependence, it should come as no surprise that despite their institutional bifurcation, legislative debates over consumer finance policy and consumer bankruptcy policy have turned on remarkably similar questions. In both contexts, legislators have acknowledged the need to protect consumers from irresponsible lending practices that lead to unsustainable debt loads.[218] But in both contexts,

---

Data (1945–1981), 18 J. CONSUMER AFFS. 213, 223 (1984); Jagdeep S. Bhandari & Lawrence A. Weiss, *The Increasing Bankruptcy Filing Rate: An Historical Analysis*, 67 AM. BANKR. L.J. 1, 1–2 (1993); Lawrence M. Ausubel, *Credit Card Defaults, Credit Card Profits, and Bankruptcy*, 71 AM. BANKR. L.J. 249, 250 (1997).

213. Robert M. Lawless, *The Paradox of Consumer Credit*, 2007 U. ILL. L. REV. 347, 363, 369–70 (finding that in the short run, nonmortgage consumer credit is negatively associated with consumer bankruptcy filing rates, because taking on more debt allows consumers to delay filing; but that in the long run, such credit is indeed positively associated with bankruptcy filing rates).

214. *See* HANSEN & HANSEN, *supra* note 60, at 155–57; Moss & Johnson, *supra* note 40, at 332–46.

215. TERESA A. SULLIVAN, ELIZABETH WARREN & JAY WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 131–32 (2000) (demonstrating that starting in the 1980s, the proportion of credit card debt within bankruptcy debt has substantially grown); RONALD J. MANN, CHARGING AHEAD: THE GROWTH AND REGULATION OF PAYMENT CARD MARKETS 64–70, 182 (2006) (using comparative data from Australia, Canada, Japan, U.K., and U.S. to demonstrate that credit card debt correlates with subsequent increases in consumer bankruptcy).

216. Adler, Polak & Schwartz, *supra* note 208, at 589; Reint Gropp, John Karl Scholz & Michelle J. White, *Personal Bankruptcy and Credit Supply and Demand*, 112 Q.J. ECON. 217 (1997); Michelle J. White, *Why It Pays to File for Bankruptcy: A Critical Look at the Incentives Under U.S Personal Bankruptcy Law and a Proposal for Change*, 65 U. CHI. L. REV. 685, 686 (1998); *see also* Feibleman, *supra* note 210, at 167.

217. Michelle J. White, *Abuse or Protection? Economics of Bankruptcy Reform Under BAPCPA*, 2007 U. ILL. L. REV. 275, 303.

218. In the consumer finance context, see, for example, *Truth in Lending—1967: Hearings on S. 5 Before the Subcomm. on Fin. Insts. of the S. Comm. on Banking & Currency*, 90th Cong. 44 (1967) [hereinafter *Truth in Lending—1967*] (statement of Paul H. Douglas, Chairman, National Commission on Urban Affairs); *Consumer Credit Protection Act: Hearings on H.R. 11601 Before the Subcomm. on Consumer Affs. of the H. Comm. on Banking & Currency*, 90th Cong. 140, 195, 202–03 (1967) (statements of Rep. Leonor K. Sullivan); NAT'L COMM. ON CONSUMER FIN., *supra* note 6, at 172; *Credit Card Interest Rates: Hearing on H.R. 1197 and H.R. 3408 Before the Subcomm. on Consumer Affairs & Coinage of the H. Comm. on Banking, Fin. & Urban Affs.*, 99th Cong. 25–29, 61 (1985) (statement of Rep. Mario Biaggi); 133 CONG. REC. 878–79

legislators were also confronted with the contention that enhancing consumer financial protection will increase creditors' cost of doing business, and therefore increase the price and reduce the availability of consumer credit.[219] Hence in both contexts, policymakers encountered

(1987) (statement of Rep. Toby Roth); *Examining the Billing, Marketing, and Disclosure Practices of the Credit Card Industry, and Their Impact on Consumers: Hearing Before the S. Comm. On Banking, Hous. & Urban Affs.*, 110th Cong. 2–4 (2007) [hereinafter *Credit Card Industry Hearing*] (statement of Chairman Christopher J. Dodd); *Credit Card Practices: Fees, Interest Charges, and Grace Periods: Hearing before the S. Comm. On Homeland Security & Governmental Affairs*, 110th Cong. 1–5 (2007) (statement of Senator Carl Levin); *H.R. 5244, The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers: Hearing before the Subcomm. on Fin. Insts. & Consumer Credit of the H. Comm. on Fin. Servs.*, 110th Cong. 2–3 (2008) [hereinafter *H.R. 5244 Hearing*] (statement of Chairwoman Carolyn B. Maloney).

In the consumer bankruptcy context, see, for example, *Bankruptcy Act Revision Hearings*, *supra* note 62, at 115 (statement of Rep. Don Edwards); *Personal Bankruptcy: Oversight Hearings Before the Subcomm. on Monopolies & Com. L. of the H. Comm. on the Judiciary*, 97th Cong. 820–21 (1982) (statement of Chairman Peter Rodino); *Bankruptcy Improvements Act: Hearing on S. 333 and S. 445 Before the S. Comm. on the Judiciary*, 98th Cong. 147 (1983) (statement of Sen. Howard M. Metzenbaum); *The Increase in Personal Bankruptcies and the Crisis in Consumer Credit: Hearing Before the Subcomm. on Admin. Oversight & the Cts. of the S. Comm. on the Judiciary*, 105th Cong. 2 (1997) [hereinafter *Crisis in Consumer Credit Hearing*] (statement of Sen. Charles E. Grassley); *Senate 2001*, *supra* note 10, at 122 (statement of Sen. Edward Kennedy); 147 CONG. REC. 2555–56 (2001) (statement of Rep. John J. LaFalce).

219. In the consumer credit context, see, for example, *Truth in Lending—1967*, *supra* note 218, at 386–90 (statement of Prof. Hans F. Sennholz); *Consumer Credit Protection Act Hearings*, *supra* note 218, at 351, 398 (statement of Charles E. Walker, Executive Vice President, American Bankers Association); *Credit Deregulation and Availability Act of 1981: Hearings before the Subcomm. on Financial Institutions of the S. Comm. on Banking, Hous. & Urban Affs.*, 97th Cong. 120–21 (1981) (statement of Dr. Robert W. Johnson); *Credit Deregulation and Availability Act of 1981: Hearings on S. 963 and S. 1406 Before the Subcomm. on Fin. Insts. of the S. Comm. on Banking, Hous. & Urban Affs.*, 97th Cong. 120–21 (1981) (statement of Robert W. Johnson, Director, Credit Research Center, Purdue University); *id.* at 127–29 (statement of W.P. Conners, Executive Vice President, Ford Motor Credit Co.); *id.* at 153 (statement of Hugh B. Chalmers, President, Arkansas Automobile Dealers Association); *id.* at 188–89 (statement of B. Douglas Brandon, National Home Furnishing Association); *id.* at 171, 183 (statement of Robert B. Evans, Senior Vice President and General Counsel, National Consumer Finance Association); *id.* at 299–300, 306–08 (statement of Lee E. Gunderson, President, American Bankers Association); *id.* at 493–94 (statement of Harold A. Black, Board Member, National Credit Union Administration); *To Authorize a National Usury Ceiling: Hearings Before the Subcomm. on Domestic Monetary Pol'y of the H. Comm. on Banking, Fin. & Urban Affs.*, 97th Cong. 40 (1982) (statement of Kenneth Larkin, Consumer Bankers Association); *id.* at 76 (statement of James W. Christian, Chief Economist, United States League of Savings Association); *id.* at 88–89 (statement of John H. Kalchbrenner, American Bankers Association); *The Credit Cardholders' Bill of Rights: Providing New Protections for Consumers: Hearing Before the Subcomm. on Fin. Insts. & Consumer Credit of the H. Comm. on Fin. Servs.*, 110th Cong. 19 (statement of Gregory Baer, Deputy General Counsel, Regulatory and Public Policy, Bank of America); *id.* at 23 (statement of John G. Finneran, Jr., General Counsel, Capital One); *id.* at 62 (statement of John P. Carey, Chief Administrative Officer and Executive Vice President, Citigroup Inc.); *id.* at 362 (statement of Larry Sharnak, Executive Vice

the same (presumed) dilemma: whether to uphold the supply of consumer credit by affording minimal consumer protection measures, or to strengthen consumer protection while potentially denying some consumers of access to credit.

In each legal context and in different periods in time, legislatures have opted for a different balance between sustaining and restraining the supply of credit. For example, in the 1960s and again in the 1980s, Congress rejected the idea of imposing a federal interest rate ceiling and relied mostly on disclosure duties to guarantee consumer protection in credit transactions.[220] In contrast, in the 1970s Congress chose to enhance the protection afforded to consumer debtors in the framework of bankruptcy law, notwithstanding creditors' threat of higher pricing and

---

President and General Manager, American Express); *Problem Credit Card Practices Affecting Students: Hearing Before the Subcomm. on. Fin. Insts. & Consumer Credit of the H. Comm. on Fin. Servs.*, 110th Cong. 31 (2008) (statement of Kenneth J. Clayton, Managing Director & General Counsel, American Bankers Association); Countryman, *supra* note 187, at 17 n.76 (highlighting that arguments with respect to the increase in the cost of credit "have been made against all of the consumer credit legislation now on the books").

In the consumer bankruptcy context, see, for example, *Bankruptcy, Hearings on S.J. Res. 88 and H.R. 6665 and H.R. 12250 Before Subcomm. No. 4 of the H. Comm. on the Judiciary*, 91 Cong. 85 (1969) (statement of Max A. Denney, Executive Vice President, American Industrial Bankers Association); *The Bankruptcy Reform Act: Hearings on S. 235 and S. 236 Before the Subcomm. on Improvements in Judicial Mach. of the S. Comm. on the Judiciary*, 94th Cong. 128, 137 (1975) (Statement of Walter W. Vaughn, American Bankers Association and Consumer Bankers Association); *id.* at 191 (statement of Linn K. Twinem, Special Counsel, Beneficial Finance System); *Bankruptcy Reform Act of 1978: Hearings before the Subcomm. on Cts. of the S. Comm. on the Judiciary*, 97th Cong. 17, 34, 37 (1981) (statement of Andrew F. Brimmer, President, Brimmer & Co., Economic & Financial Consultants); *id.* at 59 (statement of Claude Rice, Alvin O. Wiese, Jr., and Jonathan M. Landers); *id.* at 146 (statement of Walter W. Vaughan, Senior Vice President, American Bankers Association); *id.* at 162 (statement of Richard F. Kerr, National Retail Merchants Association); *id.* at 181, 184 (statement of Eldon Hoekstra, Secretary, Credit Union National Association); *Bankruptcy Reform Act of 1978 (Future Earnings): Hearing Before the Subcomm. on Cts. of the S. Comm. on the Judiciary*, 97th Cong. 20 (1981) (statement of Robert W. Johnson, Director, Krannert Graduate School of Management, Purdue University); *id.* at 199 (statement of Donald V. Beall, Credit Union National Association & National Association of Federal Credit Unions); *id.* at 207, 211–13 (statement of Paul G. Tongue, Senior Vice President, Chase Manhattan Bank); *id.* at 242 (statement of Robert B. Evans, Senior Vice President & General Counsel, National Consumer Finance Association); *Bankruptcy Reform and financial Services Issues: Hearing before the S. Comm. On Banking, Hous. & Urban Affs.*, 106th Cong. 122 (1999) [hereinafter *Senate 1999*] (statement of The Consumer Bankers Ass'n); 146 CONG. REC. 22,362–63 (statements of Rep. Bob Goodlatte & Rep. George Gekas).

220. *See* Bar-Gill, *supra* note 124, at 1417; BEN-SHAHAR & SCHNEIDER, *supra* note 79, at 50.

lesser availability of consumer credit.[221] But despite these oscillations between stronger consumer protection and greater credit availability, the principle tradeoff has not changed and consistently stands at the heart of both consumer finance and consumer bankruptcy policy.

The common ground between consumer finance and consumer bankruptcy is not a mere theoretical or historical insight but suggests a practical takeaway. Given (1) that consumer finance law and consumer bankruptcy law regulate the same actors, (2) given that they govern legal phenomena that are interdependent, and (3) given that they are informed by common policy considerations, their perceived autonomy is not only (conceptually) illusory, but (normatively) detrimental. It simply produces bad law. Indeed, as I argue in the next Section, the Bankruptcy Code indirectly regulates borrowing decisions made by consumers but neglects to regulate underwriting decisions made by lenders, reflects Congress' failure to fully account for the reciprocal relationship between consumer finance and consumer bankruptcy. Employing bankruptcy law to prevent excessive credit extensions, as the Article suggests, would remedy this untenable asymmetry by articulating both facets of the relationship between consumer finance and consumer bankruptcy.

B. Using Bankruptcy Law to Regulate Borrowing Decisions

This Section describes the emergence of the economic approach to bankruptcy law, which focuses on designing consumers' borrowing decisions, and explains how this approach came to dominate the BAPCPA. It then builds on the behavioral law and economics literature to reveal the faults of the economic approach and explain why bankruptcy law should take up the regulation of lenders' underwriting decisions.

1. THE LAW AND ECONOMICS OF CONSUMER BANKRUPTCY

Consumer bankruptcy law has historically centered around two goals: maximizing debt collection by facilitating cooperation between creditors and enabling a fresh financial start for debtors.[222] The 1978 Bankruptcy Code was arguably dominated by the latter goal: it made entrance to bankruptcy proceedings easier and less costly, gave the debtor more control over the proceedings, and widened the scope of discharge.[223] However, as explained below, the persistent growth in

---

221. *See, e.g.*, DAVID A. SKEEL, DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 162–65 (2001); HANSEN & HANSEN, *supra* note 60, at 121–22.

222. *See supra* note 198 and accompanying text.

223. *See* Ian Domowitz & Thomas L. Eovaldi, *The Impact of the Bankruptcy Reform Act of 1978 on Consumer Bankruptcy*, 36 J.L. & ECON. 803, 807–09 (1993);

consumer bankruptcy filing rates, which intensified after the Code was enacted, gradually changed policymakers' approach toward the fresh-start policy.

Since the postwar era, consumer bankruptcy filing rates have largely tracked the growth of consumer credit.[224] From 1945 to 1960 the filing rate increased nearly tenfold, and during the 1960s it almost doubled.[225] But up to the enactment of the Code, the increase was perceived by policymakers as a necessary evil. A Commission Congress established to review bankruptcy law concluded, in its 1973 report, that an "increase in bankruptcy filings is a *natural if not inevitable result of the increased availability of consumer credit in this country*."[226] Consequently, the Commission's recommendations for bankruptcy reform—that later served as the basis for the 1978 Code—were not meant to reduce the relief provided by the bankruptcy system, but to streamline the operation of the credit economy and "rehabilitate debtors for continued and more value-productive participation [in the credit economy], *i.e.*, to provide a 'fresh start.'"[227]

Eventually, while not all of the Commission's recommendations with regard to the scope of discharge were made part of the Code, enough was included to make the fortification of the fresh-start policy one of the Code's most notable innovations.[228] The provisions of the Code, it was (critically) said, "extended a variety of new benefits to . . . bankrupt debtors and enhanced their position in relation to creditors."[229]

However, from the late 1970s onwards, the continuous tide in consumer bankruptcy filings came to be perceived as a problem—

Doug Rendleman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C. L. REV. 723, 750–53 (1980).

224. *See, e.g.*, Vern Countryman, *Consumer Bankruptcy—Some Recent Changes and Some Proposals*, 19 KAN. L. REV. 165, 165 (1970) (explaining the 2,000 percent increase in consumer bankruptcy filings between 1946 and 1969 by the fact that "[t]otal consumer credit, exclusive of real estate mortgages, has also increased 2,000 percent").

225. SKEEL, *supra* note 221, at 136–37.

226. H.R. DOC NO. 93-137, pt. 1, at 9 (1973) (emphasis added).

227. *Id.* at 71. Among other things, the Commission recommended that indigent debtors be authorized to file bankruptcy without filing fees, that waivers of exemptions be unenforceable in bankruptcy, that reaffirmations of debts after discharge be prohibited, that creditors be prohibited from using false financial statements as grounds for nondischargeability claims, and that the time bar between subsequent bankruptcies not apply if the debtor's inability to pay his debts is due to causes beyond his control and enforcement of the payment would impose undue hardship. *Id.* at 11–12.

228. Marc S. Cohen & Kenneth N. Klee, *Caveat Creditor: The Consumer Debtor Under the Bankruptcy Code*, 58 N.C. L. REV. 681, 681–82 (1980).

229. Domowitz & Eovaldi, *supra* note 223, at 803; HANSEN & HANSEN, *supra* note 60, at 121; *see also Crisis in Consumer Credit Hearing*, *supra* note 218, at 141 (statement of American Bankruptcy Institute) ("When Congress created the modern bankruptcy Code in 1978, it made bankruptcy a much more debtor-friendly law.").

perhaps *the* problem—that consumer bankruptcy law ought to address. From 1979 to 1980 alone filings rose by sixty percent, exceeding 300,000 per year. By 1990 the rate had more than doubled, reaching 718,107 filings per year; and in 1996 over one million consumers filed for bankruptcy.[230] In light of this dramatic leap, policymakers were no longer occupied with facilitating consumers' transition from bankruptcy back to the credit market, but with policing the transition from the credit market to bankruptcy. And while this attitudinal shift was largely motivated by the consumer creditor industry, which had a strong interest in curbing consumers' access to bankruptcy,[231] the growing dominance of economic analysis of law in legal academia played a central role in its successful realization.[232]

As compared with other types of legal analysis, economic analysis of law prioritizes the view of individuals as rational and forward-looking, and therefore responsive to incentives.[233] In the context of bankruptcy, employing the economic perspective meant that instead of thinking about bankruptcy law's effect on debtors *after* they file for bankruptcy, as consumer bankruptcy scholars traditionally did, scholars and policymakers emphasized the role of law in designing consumers' borrowing decisions, as well as their decision to file for bankruptcy.[234] A basic premise in economic analysis of consumer bankruptcy is that consumers are well aware of the law and plan their financial conduct accordingly.[235] Hence, "[i]f discharge of debts is easy in bankruptcy,

230. *See* SKEEL, *supra* note 221, at 188.

231. *See* Faust, *supra* note 28, at 704; Michael Simkovic, *The Effect of BAPCPA on Credit Card Industry Profits and Prices*, 83 AM. BANKR. L.J. 1, 2 (2009); *see also infra* Section II.C.1.

232. *See, e.g.*, DANIEL T. RODGERS, AGE OF FRACTURE 59–63 (2011); JAMES ARNT AUNE, SELLING THE FREE MARKET: THE RHETORIC OF ECONOMIC CORRECTNESS 5, 17 (2001); ELIZABETH POPP BERMAN, THINKING LIKE AN ECONOMIST: HOW EFFICIENCY REPLACED EQUALITY IN U.S. PUBLIC POLICY 81–84 (2022) (discussing the ascendence of economic analysis of law since the 1970s).

233. STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 1, 4 (2004); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CALIF. L. REV. 1051, 1054 (2000); Aune, *supra* note 232, at 22; *see also* Galle, *supra* note 104, at 1724 (stating, under the economic theory of regulation, "[a] rational forward-looking person takes care to avoid injuring others in order to avoid paying tort liability or serving jail time later").

234. *See, e.g.*, William H. Meckling, *Financial Markets, Default, and Bankruptcy: The Role of the State*, 41 LAW & CONTEMP. PROBS. 13 (1977); Michelle J. White, *Personal Bankruptcy Under the 1978 Bankruptcy Code: An Economic Analysis*, 63 IND. L.J. 1 (1987); *see also* White, *supra* note 216.

235. *See, e.g.*, Edith H. Jones & Todd J. Zywicki, *It's Time for Means-Testing*, 1999 BYU L. REV. 177, 210–13; Todd J. Zywicki, *An Economic Analysis of the Consumer Bankruptcy Crisis*, 99 NW. U. L. REV. 1463, 1525–38 (2005); *see also* Susan Block-Lieb & Edward J. Janger, *The Myth of the Rational Borrower: Rationality, Behavioralism, and the Misguided "Reform" of Bankruptcy Law*, 84 TEX. L. REV. 1481, 1484 (2006) (according to the economic point of view, borrowers are assumed to be

debtors will incur more debt. Conversely, if obtaining bankruptcy relief is difficult, debtors will be more reluctant to incur debts."[236]

In politics, the availability of policy solutions often dictates the choice of policy problems.[237] Perhaps, then, what made incentive analysis so appealing to legislatures since the 1990s was that it required a very limited type of legal reform. If bankruptcy filing rates were up because consumers were sophisticatedly strategizing around the Bankruptcy Code, not because they were increasingly unemployed, divorced, or overwhelmed by medical debt,[238] then policymakers could control the rate of consumer bankruptcy filings without having to open the pandora's box of health or welfare policy. Rather, they could solve the problem and gain a publicly visible accomplishment simply by changing the provisions of consumer bankruptcy law. And that is exactly what the BAPCPA did.

BAPCPA erected various barriers for obtaining bankruptcy relief.[239] But the cornerstone of the legislation was the adoption of means-testing into consumer bankruptcy law.[240] The means-testing provisions condition access to Chapter 7 bankruptcy on a finding that the debtor's available income is below a certain threshold. Debtors whose available income exceeds the threshold can file only under Chapter 13, where they must commit to a court-imposed repayment plan.[241]

In almost a decade of Congressional debates that preceded the enactment of BAPCPA, the means-testing provisions were grossly justified on grounds of incentives analysis.[242] Importantly, proponents of means-testing argued that conditioning "straight" (*i.e.*, Chapter 7) bankruptcy on ex-post review of consumers' income and expenses would

---

rational and to operate in accordance with cost-benefit analysis, and therefore, any measure decreasing the cost of bankruptcy or increasing its benefits increases borrowers' incentives to go bankrupt).

236. Jones & Zywicki, *supra* note 235, at 209.

237. JOHN W. KINGDON, AGENDAS, ALTERNATIVES, AND PUBLIC POLICIES 3–4, 138–51 (1984).

238. *But see Bankruptcy Reform and Financial Services Issues Hearing*, *supra* note 219, at 36; *Bankruptcy Abuse Prevention and Consumer Prevention Act of 2001: Hearings on H.R. 333 Before the H. Comm. on the Judiciary*, 107th Cong. 195 (2001) (statement of Damon A. Silvers, Office of the General Counsel, AFL-CIO); 147 CONG. REC. 2627 (2001) (statement of Rep. LaFalce).

239. Linda Coco, *Debtor's Prison in the Neoliberal State: "Debtfare" and the Cultural Logics of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 49 CAL. W. L. REV. 1, 8–9, 28–29 (2012); Mann, *supra* note 17, at 406.

240. Mann, *supra* note 6, at 379, 383.

241. 11 U.S.C. § 707(b)(2)(A); *see also, e.g.*, Eugene R. Wedoff, *Means-Testing in the New § 707(b)*, 79 AM. BANKR. L.J. 231, 241–42 (2005).

242. Block-Lieb & Janger, *supra* note 235, at 1486–87.

positively affect not only their incentive to file for bankruptcy,[243] but also their incentive to borrow responsibly to begin with.[244] Thus, for example, Professor Michael E. Staten, head of the Credit Research Center at Georgetown University, testified that means-testing

> bolsters consumer incentives to use credit cautiously by removing the temptation of a free ride for those who can pay but would choose not to. In contrast, by offering the lure of a Chapter 7 discharge without demonstration of need, the current bankruptcy does little to encourage the responsible use of credit.[245]

In a similar vein, James I. Shepard—a California tax consultant who served as a member of the Congress-appointed National Bankruptcy Review Commission—suggested that "where bankruptcy becomes too appealing and causes people to be less responsible, the law must be changed," and that "[b]ankruptcy reform will encourage responsible use of credit."[246] Pennsylvania Republican Representative George Gekas, argued that the traditional bankruptcy system was doing consumers "a disservice by not encouraging them to manage their finances and control their debt."[247] Instead, Alabama Republican Senator Jeff Sessions advised, legislatures should "set the kind of policy that encourages good behavior on the part of our citizens."[248]

Given the interdependence between consumer finance and consumer bankruptcy, Congress was right to consider bankruptcy law's effect on incentives to borrow. However, for a consumer to borrow, someone must

243. *See, e.g.*, *Bankruptcy Reform and Financial Services Issues Hearing*, *supra* note 219, at 47 (statement of Sen. Jim Bunning) ("Currently, there is very little disincentive for people not to declare bankruptcy . . . .").

244. Mann, *supra* note 6, at 378.

245. *Bankruptcy Reform Act of 1998; Responsible Borrower Protection Act; and Consumer Lenders and Borrowers Bankruptcy Accountability Act of 1998 Part II: Hearing on H.R. 3150, H.R. 2500, & H.R. 3146 Before the Subcomm. on Com. & Admin. L. of the H. Comm. on the Judiciary*, 105th Cong. 8 (1998) [hereinafter *Bankruptcy Reform Act of 1998 Hearing*] (statement of Michael E. Staten, Credit Research Center, Georgetown School of Business).

246. *Bankruptcy Reform Act of 1999 (Part I): Hearing on H.R. 833 Before the Subcomm. on Com. & Admin. L. of the H. Comm. on the Judiciary*, 106th Cong. 42, 46 (1999) [hereinafter *Bankruptcy Reform Act of 1999 (Part I) Hearing*] (statement of James I. Shepard, Bankruptcy Tax Consultant, Former Member of the National Bankruptcy Review Commission).

247. *National Bankruptcy Review Commission Report: Hearing Before the Subcomm. on Com. & Admin. L. of the H. Comm. on the Judiciary*, 105th Cong. 3 (1997) [hereinafter *National Bankruptcy Review Commission Hearing*] (statement of Chairman George Gekas).

248. *Crisis in Consumer Credit Hearing*, *supra* note 218, at 6 (statement of Sen. Jeff Sessions).

also be willing to lend. Therefore, a full commitment to the idea that bankruptcy law structures incentives would have necessitated a consideration of lenders' incentives along with borrowers' incentives.[249] As economist Lawrence Ausubel advised the Senate Banking Committee, if means-testing is adopted, "[l]enders should be expected to rationally recognize that their probability of loss has been reduced by the change in law and, thus, they should be willing to lend increased quantities of unsecured debt at any given price."[250] That is, while limiting access to bankruptcy discharge may reduce consumers' incentive to borrow beyond their means, it may also enhance lenders' incentive to extend credit without regard to borrowers' ability to repay.[251] However, in enacting BAPCPA, Congress disregarded this prediction, and addressed lenders' incentives in a strikingly partial manner.[252] The contention that the Bankruptcy Code's generous fresh-start policy was incentivizing lenders to provide *too little* credit was taken seriously.[253] The counter-

249. Block-Lieb & Janger, *supra* note 235, at 1556–57 ("Borrowing and lending present complimentary perspectives on the same transaction. It is senseless to look at consumers' incentives to borrow without also considering lenders' incentives to extend credit. . . . [C]onsumer bankruptcy law (and, indeed, all consumer law) should be crafted with an understanding of both sides of a consumer finance transaction."); Pottow, *supra* note 10, at 429–30 ("It takes two to tango with reckless loans . . . . [D]ata do[es] suggest that the lending parties are not blameless in originating [loans that are not paid].").

250. *Bankruptcy Reform: Hearing on the Ease with Which Bankruptcy Can Be Filed and its Effects on Consumers, Creditors, Businesses, and the Economy Before the Subcomm. on Fin. Insts. & Regul. Relief of the S. Comm. on Banking, Hous. & Urb. Affs.*, 105th Cong. 86 (1998) [hereinafter *Bankruptcy Reform Hearing*] (statement of Lawrence M. Ausubel, Department of Economics, University of Maryland); *see also The Consumer Bankruptcy Reform Act: Seeking Fair and Practical Solutions to the Consumer Bankruptcy Crisis: Hearing on S. 1301 Before the Subcomm. on Admin. Oversight & the Cts. of the S. Comm. on the Judiciary*, 105th Cong. 229 (1998) (statement of Stephen Brobeck, Executive Director, Consumer Federation of America) ("Restricting consumer access to bankruptcy will surely encourage lenders to extend even more unaffordable credit, thus worsening the consumer insolvency problem.").

251. *See* JACKSON, *supra* note 203, at 248–49 ("Discharge . . . heightens creditors' incentives to . . . oversee the individual's credit decisions . . . . The availability of the right of discharge induces creditors to restrict the individual's credit intake . . . ."); *see also* Moss & Johnson, *supra* note 40, at 345, 348 (suggesting that the 1984 amendments to the Bankruptcy Code, which tightened access to discharge, "did more to encourage consumer creditors to lend—particularly to lower-income households—than it did to discourage prospective debtors from borrowing and filing").

252. *See* Pottow, *supra* note 10, at 455 ("Much hand wringing occurred in Congress regarding the death of personal responsibility . . . . But, unlike in Europe, this call was a one-sided summons; there was no concomitant call for personal responsibility of lenders.").

253. *See National Bankruptcy Review Commission Hearing*, *supra* note 247, at 3 (Statement of Chairman Gekas); *see also Bankruptcy Reform Act of 1998 Hearing*, *supra* note 245, at 107–08 (statement of Rep. Bryant); *Bankruptcy Reform Act of 1999 (Part I) Hearing*, *supra* note 246, at 3 (statement of Rep. Nick Smith); *Bankruptcy Reform and Financial Services Issues Hearing*, *supra* note 219, at 18 (statement of Chairman Gramm).

scenario, wherein means-testing would incentivize lenders to provide *too much* credit, was dismissed.

Congress' deficient account of how bankruptcy law structures incentives calls for a critical evaluation of BAPCPA's "success" in bringing down consumer bankruptcy filing rates. First, while bankruptcy filing rates dramatically descended after the enactment of BAPCPA, they quickly went up again, and a consistent downward trend began only in the wake of the great recession.[254] But more importantly, even when bankruptcy filing rates came down, the levels of outstanding consumer credit have consistently risen.[255] Hence, rather than encouraging consumers to borrow more prudently, as some of its proponents rationalized, it now seems that means-testing simply encouraged them to avoid filing for bankruptcy, or to postpone it.[256] Hence, BAPCPA's effect on consumer borrowing was either insignificant, or entirely trumped by its countervailing effect on creditors' (increased) incentive to extend credit. One way or another, the BAPCPA experience indicates that if Congress ever intended to prevent consumers from borrowing beyond their ability to pay, focusing solely on consumer incentives was the wrong way to go about it.

2. The Behavioral Law and Economics of Consumer Bankruptcy

Where did Congress go wrong? In their forceful critique of BAPCPA, Professors Susan Block-Lieb and Edward Janger have argued that Congress erred in applying incentive analysis to consumers.[257] Between lenders and consumer borrowers, they argue, only the former may be considered rational in the sense imagined by economic analysis of law and, thus, effectively responsive to incentives-based policy.[258]

---

254. *See* Bob Lawless, *Bankruptcy Filing Rate Is Lowest Since Bankruptcy Code's Enactment—The Question Is Why*, CREDIT SLIPS (Dec. 27, 2021, 8:30 AM), https://www.creditslips.org/creditslips/2021/12/bankruptcy-filing-rate-is-lowest-since-bankruptcy-codes-enactment-the-question-is-why-.html [https://perma.cc/WH5K-9355].

255. *Total Consumer Credit Owned and Securitized*, FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/series/TOTALSL [https://perma.cc/H9VE-L8VX] (last updated Feb. 7, 2023).

256. *See, e.g.*, HANSEN & HANSEN, *supra* note 60, at 160 ("With BAPCPA in place, fewer people in default choose to use the federal bankruptcy law. More people simply remain in default. BAPCPA caused the insolvency rate to rise by 25 percent."); *see also* Coco, *supra* note 239, at 4–6; Margaret Howard, *The Law of Unintended Consequences*, 32 S. ILL. U. L. REV. 451, 458 (2007); Mann, *supra* note 17, at 427–29.

257. Block-Lieb & Janger, *supra* note 235, at 1559, 1565.

258. *Id.* at 1525–26 ("[I]f consumers are not rational decisionmakers, tinkering with ex-ante incentives by increasing the cost of default to deter overborrowing is likely to be noisy at best, and counterproductive at worst."); *id.* at 1557 (noting that the rational actor model could be applied to the lender side of the transaction, but not to the consumer

As noted above, in enacting BAPCPA Congress embraced economic analysis of law's emphasis on incentives. Economic analysis of law, like its parent discipline, assumes that individuals are rational utility-maximizers.[259] It also assumes that if legal rules are properly designed, these human attributes may be harnessed to achieve socially desirable goals. Accordingly, means-testing was justified on the assumption that consumers would "rationally" respond to the added cost of consumer bankruptcy by avoiding it. However, as Block-Lieb and Janger point out, the assumption of human rationality has been severely undermined by a growing body of research in the field of behavioral economics.[260] Myriad experiments mimicking human decision-making in various contexts have demonstrated that people's decisions systematically defy standard economic predictions.[261] The consistent, identifiable patterns of deviation from rational decision-making, commonly referred to as "biases," have led behavioral economists to relax the economic ideal of rationality and substitute it with the more realistic notion of "bounded rationality."[262]

In the context of consumer credit, behavioral economics' findings demonstrate that consumers' borrowing decisions are exceedingly vulnerable to cognitive biases[263]—*e.g.*, consumers may be over-optimistic and over-confident about their future repayment ability; their judgement is heavily influenced by the way (financing) options are presented; they tend to ignore information when there is too much of it; and they disproportionately prefer short-term over long-term benefits.[264] These biases explain why consumers may borrow beyond their means regardless of the cost of bankruptcy. Consumers' bounded rationality further entails that they often fail to plan more than a few steps ahead,[265]

side). Professor Pottow has made a comparable (though less elaborate) argument. *See* Pottow, *supra* note 10, at 407, 413–14, 429–30, 455, 464.

259. *See, e.g.*, SHAVELL, *supra* note 233, at 1; Korobkin & Ulen, *supra* note 233, at 1066.

260. Block-Lieb & Janger, *supra* note 235, at 1488–90, 1526–27.

261. *See, e.g.*, Richard Thaler, *Toward A Positive Theory of Consumer Choice*, 1 J. ECON. BEHAVIOR & ORG. 39 (1980); Colin F. Camerer & George Lowenstein, *Behavioral Economics: Past, Present, Future*, *in* ADVANCES IN BEHAVIORAL ECONOMICS 3 (Colin F. Camerer, George Loewenstein & Matthew Rabin eds., 2004); Joshua D. Wright & Douglas H. Ginsburg, *Behavioral Law and Economics: Its Origins, Fatal Flaws, and Implications for Liberty*, 106 NW. U. L. REV. 1033, 1034 (2012).

262. *See, e.g.*, Korobkin & Ulen, *supra* note 233, at 1075–76.

263. *See* Cass R. Sunstein, *Boundedly Rational Borrowing*, 73 U. CHI. L. REV. 249, 249–53 (2006); Block-Lieb & Janger, *supra* note 235, 1534–47; Pottow, *supra* note 10, at 413–14.

264. ZAMIR & TEICHMAN, *supra* note 138, at 46–48, 61–66, 88–92, 103, 284–87, 299 (2018); Block-Lieb & Janger, *supra* note 235, at 1529–46; Korobkin & Ulen, *supra* note 233, at 1091, 1119–22.

265. Oren Bar-Gill & Nicola Persico, *Bounded Rationality and the Theory of Property*, 94 NOTRE DAME L. REV. 1019, 1034 (2019). The problem is especially acute for financially distressed consumers. *See* Shmuel I. Becher, Yuval Feldman & Orly

and tend to discount the probability of adverse events (such as those that may result in bankruptcy).[266] Therefore, it is unlikely that a "tougher" consumer bankruptcy law will deter consumers from borrowing irresponsibly.[267]

Importantly, however, the effect of such cognitive biases is considerably weaker when it comes to lenders. Lenders, as opposed to consumers, are overwhelmingly not individuals but commercial, profit-seeking entities. They employ experts, use sophisticated algorithms[268] and enjoy legal counseling. Their decision-making processes are institutional rather than individual. Hence, while they are not entirely immune to behavioral biases, their decisions are much more likely to reflect cost-benefit analysis and conform to the predictions of economic theory.[269] Also, because lenders are "repeat players" with a large financial stake in the law, they are much more likely than consumers to be aware of any legal reform and plan their business activities accordingly.[270] As such, lenders are by far a more promising target for incentives-based policy than consumers.[271]

However, means-testing—as consumer-directed, incentives-based policy—is misguided in yet another sense: it wrongly assumes that consumers are better situated than lenders to prevent over indebtedness. A fundamental maxim of law and economics analysis, originally developed in the writings of Guido Calabresi, is that liability for harm should be imposed on the party who is the cheapest cost avoider—*i.e.*, the party who is best situated to prevent the harm in the first place.[272] Setting means-testing as a threshold for Chapter 7 bankruptcy meant shifting much of the social cost of default to consumers, and thus implied that legislatures see consumers as the cheapest cost-avoiders.

Lobel, *Poor Consumer(s) Law: The Case of High-Cost Credit and Payday Loans* 10–11 (Aug. 20, 2018), *in* LEGAL APPLICATIONS OF MARKETING THEORY (Jacob Gersen & Joel Steckel eds., forthcoming 2022–23) (manuscript at 10–11), https://ssrn.com/abstract=3235810.

266. *See, e.g.*, Bar-Gill, *supra* note 124, at 1400; Harris & Albin, *supra* note 191, at 434–37*; see also* Willis, *supra* note 117, at 1177 (noting that consumers overoptimistically assume they will not overdraft).

267. Of course, it may encourage other types of decisions: namely, a decision not to file for bankruptcy. Some critics of BAPCPA have argued that that was precisely the purpose, and the outcome, of the legislation. *See* sources cited *supra* note 256.

268. *See, e.g.*, DURKIN, ELLIEHAUSEN, STATEN & ZYWICKI, *supra* note 58, at 216–19.

269. Harris & Albin, *supra* note 191, at 449.

270. *See, e.g.*, Galanter, *supra* note 185, at 97–109.

271. *See* Pottow, *supra* note 10, at 431–32.

272. *See* GUIDO CALABRESI, THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS 135–40 (1970); Guido Calabresi & Jon T. Hirschoff, *Toward a Test for Strict Liability in Torts*, 81 YALE L.J. 1055 (1972) (discussing Calabresi's theory that strict liability should be based on who is the cheapest cost avoider).

Indeed, since consumers are the ones who decide if, how, and how much to borrow, it has often been assumed that they possess the most extensive and reliable information about their income and expenses and are optimally situated to avoid over-borrowing.[273] However, in recent decades it has become increasingly apparent that in consumer finance transactions, sellers are often the ones who hold superior information. This is so not only with respect to the terms of the transaction (*i.e.*, the attributes of the financial product), but also with respect to the consumer's own borrowing behavior.[274] While consumers' information about their own borrowing patterns depends on their recollection of past behavior and their use of the information is subject to overoptimism and other biases, sellers use technology to gather masses of information about consumers' borrowing history, and can much more reliably predict how much they will borrow and whether they will be able to repay.[275] Hence, as Professor John Pottow has argued, "lenders are the cheaper and better situated parties to avoid a doomed loan in the first place,"[276] and efficiency considerations justify that they bear the burden of loss in a case of bankruptcy.[277]

C. Using Bankruptcy Law to Regulate Lending Decisions

For Professors Block-Lieb and Janger, as well as for Professor Pottow, the main problem with BAPCPA is that Congress chose to regulate only consumer borrowers and ignore lenders, who are the more rational and informed side of the consumer finance transaction. According to Block-Lieb and Janger, "the locus of responsibility [should shift] from the borrowers themselves to the lenders who market debt and encourage borrowing,"[278] and similarly for Pottow, there is "a strong case for Congress to swing its sticks at [lenders] in patrolling the reckless extension of credit."[279] But if properly regulating lenders is the primary

273. *See* Mann, *supra* note 17, at 422 ("[A]ll of the existing literature rests on the assumption that borrowers are better situated than lenders to avoid financial distress and bankruptcy."); BAR-GILL, *supra* note 7, at 13 (noting that disclosure regulation implicitly assumes that use patterns are known to consumers because they are a function of consumer preferences).

274. Oren Bar-Gill & Oliver Board, *Product-Use Information and the Limits of Voluntary Disclosure*, 14 AM. L. & ECON. REV. 235, 236, 241 (2012); BAR-GILL, *supra* note 7, at 34 ("[C]onsumers do not have access to reliable product-use information and, as a result, systemically make mistakes about their future use patterns."); Mann, *supra* note 17, at 422.

275. Bar-Gill & Board, *supra* note 274, at 241–42; Pottow, *supra* note 10, at 432–34.

276. Pottow, *supra* note 10, at 432.

277. *See* Countryman, *supra* note 187, at 17.

278. Block-Lieb & Janger, *supra* note 235, at 1556.

279. Pottow, *supra* note 10, at 441.

problem, the solution does not necessarily lie within the province of bankruptcy law. Indeed, Block-Lieb and Janger suggest regulating lenders' marketing practices by outlawing or scrutinizing certain contract terms,[280] while Pottow proposes to make reckless credit "a legally recognized defense to collection . . . and possibly even an affirmative cause of action in tort."[281]

In contrast, I suggest that the problem posed by BAPCPA goes beyond the need to regulate the more sophisticated side of the credit transaction. It is a problem of legislative coherence that goes to the basic principle of the rule of law. As noted above, BAPCPA advocates justified it by invoking an innovative theory of consumer bankruptcy law, that expressly recognized the law's effect on the incentives of actors in credit markets. This theory substantially deviated from the traditional view, that deemed the use of bankruptcy law to regulate the credit economy inappropriate.[282] But in applying incentives analysis only to consumers and ignoring bankruptcy law's effect on lenders' incentives, Congress defied its own theory. It stated that the law had a rationale but acted on that rationale only half-way. From this perspective, BAPCPA's asymmetrical treatment of consumer borrowers and lenders undermines the legitimacy of bankruptcy law and can truly be remedied only *within that law*. Enhancing lender regulation through contract or tort law may no doubt increase consumer protection, but it will not restore consumer bankruptcy law's internal coherence. To achieve the latter goal, I argue, consumer bankruptcy law should regulate lending decisions just as it now regulates borrowing decisions.

1. Pinning Down Lenders' Incentives

In addition to restoring consumer bankruptcy law's internal coherence, a major strength of regulating excessive lending through bankruptcy is that it specifically targets the perverse incentives generated by lenders' "debt-based" business model, and may thus prove more efficient than ex-ante, contractual regulation. Indeed, the consumer financial services industry fought for BAPCPA to maintain the high profits of consumer lending, notably credit card lending.[283] The Chapter 7 bankruptcy option threatens lenders' profits because when consumers

280. Block-Lieb & Janger, *supra* note 235, at 1562. Block-Lieb and Janger have recently followed-up on this recommendation and proposed to use warranties and the doctrine of unconscionability to enhance consumer finance regulation. *See* Block-Lieb & Janger, *supra* note 180.

281. Pottow, *supra* note 10, at 407.

282. *See supra* notes 193–196 and accompanying text.

283. HANSEN & HANSEN, *supra* note 60, at 140, 146–47; Mann, *supra* note 6, at 376; *cf.* Mann, *supra* note 17, at 398 (noting that the legislature's desire to protect credit cards was an important motivation in adopting the BACPA).

file for Chapter 7, lenders lose any chance of collection. But when consumers have limited access to Chapter 7, as is the case under the means-testing regime, they can either avoid bankruptcy altogether (become "informal bankrupts")[284] or delay filing until their financial situation is worse and they finally qualify for Chapter 7. Either way, lenders can turn on the pressure in the "sweat box" and keep on collecting, while interest and fees on the preexisting debt continue to accrue exponentially.[285] As Professor Mann explains,

> [T]he successful credit card lender profits from the borrowers who become financially distressed . . . . As the credit card borrower spirals downward . . . with the monthly balances growing to amounts that equal, or even surpass, the borrower's annual income, the issuer begins to earn large monthly profits on the relationship. The question for the lender is how long the borrower will remain in the unstable position before failure occurs.[286]

Indeed, testimony brought to Congress in hearings leading to the enactment of BAPCPA and the 2009 Credit Card Accountability, Responsibility and Disclosure Act,[287] suggested that credit card issuers prefer users who keep rolling over their debts over long periods of time, because they incur more interest and fees.[288] If consumers can repay the loan quickly, issuers lose some of their potential profits. Accordingly, credit card issuers have a significant incentive to provide credit to

---

284. *See* Amanda E. Dawsey, Richard M. Hynes & Lawrence M. Ausubel, *Non-Judicial Debt Collection and the Consumer's Choice Among Repayment, Bankruptcy and Informal Bankruptcy*, 87 AM. BANKR. L.J. 1, 2 (2013).

285. Mann, *supra* note 6, at 389–93.

286. *Id.* at 385–87.

287. Credit CARD Act of 2009, Pub. L. No. 111–24, 123 Stat. 1734.

288. *Bankruptcy Reform Hearings*, *supra* note 245, at 100 (prepared statement of Gary Klein, Staff Attorney, National Consumer Law Center); *Bankruptcy Reform Act of 1999 (Part II): Hearing on H.R. 833 Before the Subcomm. on Com. & Admin. L. of the H. Comm. on the Judiciary*, 106th Cong. 140 (1999) (statement of Kenneth Klee, Professor, University of California-Los Angeles School of Law); *Giving Consumers Credit: How is the Credit Card Industry Treating its Customers?: Hearing Before the Subcomm. on Fin. Insts. & Consumer Credit of the H. Comm. on Fin. Servs.*, 107th Cong. 35 (2001) (statement of Elisabeth DeMarse, President & CEO, Bankrate, Inc.); *Credit Card Industry Hearings*, *supra* note 213, at 19 (statement of Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School); *Modernizing Consumer Protection in the Financial Regulatory System: Strengthening Credit Card Protections*: *Hearing Before the S. Comm. on Banking, Hous., & Urb. Affs.*, 111th Cong. 41–42 (2009) (statement of Adam J. Levitin, Associate Professor of Law, Georgetown University Law Center).

consumers who will struggle to repay and have a high probability of default.[289]

Because means-testing—which deters consumers from filing for bankruptcy—fortifies the debt-based business model, the counterincentive for excessive lending should also be set *within consumer bankruptcy law*. To incentivize responsible lending, the law should limit lenders' ability to collect from consumer debtors in cases where credit was extended with no regard to the consumer's repayment ability. This will not only limit lenders' ability to collect independently in cases of reckless lending but will make it harder for them to sell defaulted debt to third-party collection agencies. If collection agencies know that their claims might be dismissed where credit was extended excessively, they are likely to demand a greater discount on the price of the purchased debt. This way or the other, lenders will internalize more of the cost of default and will have a smaller incentive to push credit at consumers who cannot repay.

2. Crafting an Informative Standard

In the course of debates over BAPCPA, opponents of the legislation have indeed suggested that consumer financial protection could be enhanced by disallowing certain claims in bankruptcy. Minnesota Democrat Senator Paul Wellstone proposed to prevent claims in bankruptcy on high-cost credit transactions in which annual interest rate exceeds one hundred percent,[290] and Illinois Democrat Senator Dick Durbin proposed prohibiting high-cost mortgage lenders that violate provisions of TILA from collecting their claim in bankruptcy.[291] A more expansive version of Senator Durbin's proposal—applying to any violation of federal consumer financial law—is incorporated in Massachusetts Democrat Senator Elizabeth Warren's recent Consumer Bankruptcy Reform Bill.[292] However, these suggestions do not target lenders' discretion with respect to the borrower's repayment ability. Senator Wellstone's proposal is too specific; an annual interest rate well below one hundred percent may be excessive, depending on a specific consumer's repayment ability. Responsible lending decisions should necessarily be taken ad-hoc, based on the attributes of the individual borrower, and cannot be guided by a bright-line rule. Therefore, an appropriate limitation on claims in bankruptcy should draw on a standard of responsible lending that will leave room for lenders' discretion case-

289. *See* Harris & Albin, *supra* note 191, at 450.

290. 147 CONG. REC. 3374 (2001) (statement of Sen. Paul Wellstone).

291. *Id.* at 3143 (statement of Sen. Dick Durbin).

292. *See* Consumer Bankruptcy Reform Act of 2020, S. 4991, 116th Cong. § 104(aa)(1)(D) (2020).

by-case.[293] Senator Durbin's proposal, on the other hand, may indeed reinforce preexisting regulation, but, as explained above, existing regulatory measures have proven insufficient. Therefore, bankruptcy law should be used to impose a new standard of prudent lending, in addition to the regulatory measures currently in force.

While regulators cannot prescribe a bright-line rule for responsible lending, professional creditors have the competence to assess the risks involved in individual transactions and should be held accountable for failing to do so. If lenders know that reckless lending may result in losing their claim in bankruptcy, they will be incentivized to use their discretion more judiciously. However, creditors do need some guidance as to what conduct might disqualify their claim. What is needed is not a bright-line rule nor a vague standard, but an *informative standard*—one that "enables its addressees . . . to figure out its intended content and thus to predict its future unfolding and realm of application, monitoring or modifying their behavior accordingly."[294]

With respect to residential mortgage loans, regulators have long adopted an ex-ante informative underwriting standard. According to section 1411 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, a creditor extending a residential mortgage loan must "[make] a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms . . . ."[295] The rule promulgated by the CFPB to implement section 1411 makes this vague standard into an informative standard: it "describes certain minimum requirements for creditors making ability-to-repay determinations, but does not dictate that they follow particular underwriting models."[296]

For non-residential credit, a comparable informative standard may be derived from the Bureau's (revoked) Payday Lending Rule. The rule, that was issued in November 2017, reflected the Bureau's concern that lenders providing certain types of non-residential loans are "failing to assess consumers' ability to repay" and that as a result of this failure "a

---

293. *Cf.* Levitin, *supra* note 22 (noting that as opposed to usury caps, ability to repay standards are flexible and adapt to the specifics of the borrower and the interaction between the borrower and the product).

294. Hanoch Dagan, *Property's Structural Pluralism: On Autonomy, The Rule of Law, and the Role of Blackstonian Ownership*, 3 BRIGHAM-KANNER PROP. RTS. CONF. J. 27, 37–38 (2014). Dagan argues that the use of informative standards, rather than vague standards, is a necessary component of the rule of law. *See* Hanoch Dagan, *Lawmaking for Legal Realists*, 1 THEORY & PRAC. LEGIS. 187, 196–99 (2013).

295. Dodd-Frank Wall Street Reform and Consumer Protection Act § 1411, 15 U.S.C. 1639c(a)(1).

296. Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 6408, 6408 (Jan. 30, 2013) (to be codified at 12 C.F.R. pt. 1026).

substantial population of consumers ends up in extended loan sequences of unaffordable loans."[297] With respect to covered short-term loans (45 days or less) and longer-term balloon-payment loans, the rule required lenders to reasonably determine that consumers will have the ability to repay the loans according to their terms.[298] Under the rule, such a determination would involve verification of the consumer's net monthly income, debt obligation, and housing costs, as well as a forecast of a reasonable amount for basic living expenses.[299] Expectedly, the underwriting provisions of the rule triggered sharp controversy between those who saw them as a common-sense measure for curbing the abuse by fringe lenders and those who considered them a threat to the availability of small loans for financially distressed consumers.[300] Ultimately, however, opponents had the upper hand: within a few months the Bureau suspended the Rule, and in July 2020, the underwriting provisions of the Rule were formally rescinded.[301]

I suggest that the underwriting provisions of the Payday Lending Rule can serve as a suitable model for ex-post regulation of consumer finance in consumer bankruptcy. Instead of imposing the underwriting requirements ex-ante, they should serve as a threshold requirement for filing a claim against the debtor's estate in bankruptcy.

In practical terms, this would mean that creditors filing secured or unsecured claims in a Chapter 13 bankruptcy case (excluding mortgage-based claims)[302] would be required to submit documents showing that they had obtained information on the consumer's regular income and expenses before extending the loan. The submission of these documents would be a threshold requirement for making a claim, and failure to submit them should result in immediate dismissal of the claim.[303] Then, upon review of the documents filed by the creditor, the court would be authorized to dismiss a creditor's claim if it finds that credit was extended with no regard to the consumer's repayment ability.[304] Importantly, the standard should not be one of mere negligence. It should be obvious that

---

297. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54,472, 54,472 (Nov. 17, 2017) (to be codified at 12 C.F.R. pt. 1041).

298. *Id.*

299. *Id.* at 54,473.

300. *See* Atkinson, *supra* note 39, at 1110–12.

301. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 85 Fed. Reg. 44,382, 44,382 (July 22, 2020) (to be codified at 12 C.F.R. pt. 1041).

302. I exclude mortgages because they are already subject to rigorous, ex-ante ability-to-pay regulation.

303. It would thus be equivalent to the requirement that the debtor submit documents for the purposes of means-testing. *See* FED. R. BANKR. P. 1007; 11 U.S.C. § 521(a)(1).

304. This would be the equivalent of the court's authority to dismiss a Chapter 11 or 13 petition that does not meet the means-testing requirements. *See* 11 U.S.C. § 707(b).

the consumer's projected available income was not sufficient to repay the loan according to its terms—*i.e.*, that the creditor could have known, *at the time the loan was granted*, that the consumer would have to obtain additional credit or roll over the loan in order to repay. However, once this criterion is met, the court would not be required to establish a causal relation between the improvident credit extension and the occurrence of bankruptcy.

3. SOME OBJECTIONS

Having presented the basic contours of my proposal for ex-post regulation of consumer finance, it is now time to consider three potential objections: (1) that bankruptcy law has only a negligent effect on lenders incentives; (2) that regulation through bankruptcy creates inequality among lenders; and (3) that it increases borrowers' incentive to go bankrupt.

a. Bankruptcy Law Has a Negligent Effect on Lenders' Incentives

Since many defaulting consumers never file for bankruptcy and only a fraction of delinquent loans gets discharged,[305] one may argue that consumer bankruptcy law cannot provide effective regulation of all consumer credit transactions.[306] I suggest that this objection underestimates the importance of bankruptcy for lenders. The extensive lobbying efforts and considerable campaign contributions made by members of the financial services industry to promote BAPCPA demonstrate that they have a very strong interest in the extent of bankruptcy relief.[307] Therefore, I argue, ex-post regulation of consumer finance via consumer bankruptcy law can be a forceful regulatory tool. The prospect of having their claims dismissed in bankruptcy may reasonably be expected to affect creditors' incentives and encourage the use of sounder underwriting practices across the board. At the same time, because regulation through bankruptcy is more limited in scope (compared with ex-ante regulation or regulation through all debt-collection proceedings), it should trigger less objection from the industry and be more politically feasible.

305. Richard M. Hynes, *Broke But Not Bankrupt: Consumer Debt Collection in State Courts*, 60 FLA. L. REV. 1, 3 (2008); *see also* Dawsey, Hynes & Ausubel, *supra* note 284, at 18–19.

306. *See, e.g.*, Bar-Gill & Warren, *supra* note 43, at 78–79.

307. *See* HANSEN & HANSEN, *supra* note 60, at 146; Simkovic, *supra* note 231, at 4; Mann, *supra* note 6, at 376.

b. Regulation Through Bankruptcy Creates Inequality Among Lenders

Regulating excessive credit extensions through bankruptcy also means that the borrower's decision about filing will determine whether the lender will bear the sanction. Where lender A and lender B extend equally excessive loans to borrowers X and Y (respectively), but only Y decides to file for bankruptcy, only lender B will lose the right to collect. Thus, from creditors' point of view, regulation through bankruptcy generates a problem of legal luck.[308] However, this problem is hardly unique to regulation through bankruptcy and exists whenever enforcement is less than perfect. Two drivers may equally exceed the speed limit, but only one happily gets to go home while the other is caught by the police and incurs a heavy fine. Two manufacturers may sell equally defective products to two respective consumers, but only one gets sued for damages and the other is not. From a moral perspective, we may want legal sanctions to apply as equally as possible; but in terms of affecting incentives, partial enforcement is enough to generate deterrence. Ultimately, the point of ex-post regulation through bankruptcy is to encourage lenders to apply better underwriting standards ex-ante. Knowing that some borrowers may file for bankruptcy is enough to deter all, or at least most, lenders from excessive lending.

c. Regulation Through Bankruptcy Increases Borrowers' Incentive to Go Bankrupt

Since the proposed regulation is triggered by the borrower's decision to file for bankruptcy, inequality exists among borrowers as well. Borrowers who file for bankruptcy may have their creditors' debt claims dismissed, while borrowers who do not file will continue to face creditors' debt collection efforts. Therefore, it may be argued that ex-post regulation through bankruptcy will increase borrowers' incentive to file for bankruptcy. My response to this objection is to bite the bullet. Indeed, the type of ex-post regulation through bankruptcy that I suggested can make Chapter 13 more attractive to debtors. But the benefits of this regulation kick-in only if the court finds that the creditor indeed extended credit with no regard to the consumer's repayment ability. Therefore, borrowers should be incentivized to file for Chapter 13 only if they have (or have reason to believe they have) in fact been subject to an excessive credit extension. Increasing the incentive of *these* borrowers to file for bankruptcy is a welcome result, as it will increase the effectiveness of the regulation and encourage sound underwriting. To the extent that lenders apply careful underwriting standards and produce the documents

308. *See, e.g.*, David Enoch, *Luck Between Morality, Law, and Justice*, 9 THEORETICAL INQ. L. 23 (2008).

that evidence the application of these standards, they need not worry that bankruptcy will become more attractive. Borrowers who have been extended credit reasonably will soon find that they will not be able to dismiss their creditors' claims, and that bankruptcy carries no greater advantage for them than it did before.

D. Comparative Benefits of Bankruptcy Regulation

In Section I.B, I elaborated on the limitations of ex-ante, contract-centered means of consumer finance regulation—mandates, disclosures, and nudges. I now return to these limitations to explain the benefit of ex-post regulation via bankruptcy in terms of consumer finance law. After addressing the advantage of ex-post, bankruptcy regulation vis-à-vis ex-ante, contract-centered regulation, I further discuss its advantage compared with other types of ex-post judicial review.

1. BANKRUPTCY REGULATION VS. EX-ANTE, CONTRACT-CENTERED REGULATION

Ex-post regulation of consumer finance transactions via bankruptcy law avoids the most objectionable aspects of ex-ante, contract-centered mandates. First and foremost, as opposed to ex-ante mandates, it does not prohibit or proscribe any specific contract term. Lenders are free to extend credit as they wish, and they are free to ignore consumers' repayment ability—subject to the risk of having their claims dismissed in a case of bankruptcy. Since the suggested standard for ex-post evaluation of creditors' discretion is informative, and the proposed liability rule is binary rather than comparative, uncertainty should be minimal. Creditors should be able to reliably appreciate the probable outcomes of litigation and conduct themselves accordingly. Moreover, unlike ex-ante mandates such as the CFPB's Payday Lending Rule, not every transaction will be exposed to scrutiny. Creditors' credit-granting decisions will be reviewed only where the consumer has filed for bankruptcy—a small fraction of all cases where credit is extended.[309] Therefore, the costs of regulation will be imposed on creditors only in those cases where review of their credit-granting decisions is particularly justified. Of course, the occurrence of bankruptcy is not in itself evidence that credit was extended regardless of the consumer's repayment ability, no more than a car accident is sufficient evidence of the driver being negligent. Yet cases of bankruptcy are at least prima facie more suspicious and, thus, justify specific judicial review.[310] For these reasons—the preservation of creditor

309. *See* Hynes, *supra* note 305, at 3.

310. *See* Harris & Albin, *supra* note 191, at 460–61 ("It is at the point of bankruptcy that consumers are in a position in which their borrowing can clearly be

discretion, the relative certainty provided due to the informative nature of the standard, and the limited scope of judicial review—ex-post regulation of consumer finance transactions in bankruptcy should not substantially increase the honest creditors' risk of doing business. Hence, while creditors will surely oppose this type of regulation as well, the potential grounds for objection will be substantially weaker.

Nevertheless, more needs to be said with respect to the politically powerful threat that such regulation will backfire. It is true that ex-post regulation will (and should) induce creditors to extend less credit in those cases where a substantial risk of future bankruptcy can be identified.[311] But as Professor Countryman concluded, the risk of some credit deprivation "[provides] no more than reasons for proceeding cautiously, perhaps even experimentally, rather than reasons for not proceeding at all."[312] And there are in fact good reasons to proceed with ex-post regulation of consumer lending in bankruptcy despite the risk of backlash: First, since creditors have such a strong financial incentive to provide credit, they will be incentivized to accurately diagnose those cases where the risk actually justifies a restriction of credit, rather than indiscriminately cut the availability of credit for all low-income consumers. Second, those cases where creditors will refuse to provide credit may very well be the cases where credit indeed should not be granted.[313] While credit is a necessity for many and maintaining access to credit is a highly important social goal, credit is truly helpful only where having more time to pay actually facilitates payment.[314] Where repayment ability is altogether absent and time only serves to increase indebtedness, the answer is not more credit but government-supplied means of social provision.[315]

With respect to disclosures, the main advantage of ex-post regulation in bankruptcy is its (potential) effectiveness. The problem of

---

viewed as overborrowing. . . . Policy considerations should aim at focusing legal intervention on those stages in which the effect of biases and manipulation are most evident, stages which can be regulated without affecting debtors, transactions, or creditors not involved in undesirable over-borrowing and default.").

311. Pottow, *supra* note 10, at 446–47.

312. Countryman, *supra* note 187, at 17 n.76.

313. Pottow, *supra* note 10, at 448–50.

314. *See, e.g.*, Atkinson, *supra* note 39, at 1147–53; Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, 126 Q.J. ECON. 517, 550 (2011) (finding that, "contrary to the view that improving credit access facilitates important expenditures," the debt service burden imposed by payday loans inhibits the ability of some low-income households to pay mortgage, rent and utility bills).

315. Atkinson, *supra* note 39, at 1153–62; NAT'L COMM'N ON CONSUMER FIN., *supra* note 6, at 58. Additionally, Mann argues that a contraction of lending to distressed borrowers may be a welcome result because it would "cause borrowers to file for bankruptcy earlier in their downward spiral" and earlier filing might solve their financial problems "with lower total costs." Mann, *supra* note 17, at 419–20.

ineffectiveness is endemic to disclosures as a type of regulation that is directed at consumer borrowers, rather than lenders. While lenders are the ones required to include the disclosures in their paperwork, disclosures target consumers and cannot work without active consumer cooperation. Consumers must read and understand the disclosures; and no less important, they need to act upon them—that is, to comparison shop and walk away from bad deals. However, as discussed in Section II.B, consumers generally do not fulfill their expected part of the deal. They simply do not read disclosures, and probably would not understand them even if they did. Ex-post regulation in bankruptcy avoids this limitation because it seeks to change not consumer behavior, but *lender* behavior. It does not require literacy or "rationality" from consumers, but rather relies on the financial incentives that are already built into lenders' credit-granting operations. As such, it promises to be more effective than disclosure regulation.

Lastly, regulation of excessive lending through bankruptcy also avoids the limitations of nudges. First, unlike nudges, ex-post regulation in bankruptcy is not covert and requires no manipulation of choice. To the contrary: the standard for ex-post review should be as informative as possible, and thus minimize any impairment of the parties' autonomy. Second, because ex-post regulation in bankruptcy seeks to change the behavior of lenders, not consumer borrowers, there is no risk of lenders employing their own behavioral techniques, or otherwise manipulating consumers in order to counter the effect of the regulation. The focus on lenders also means that, as opposed to nudges, the application of the regulation does not require that consumers have inter- or intra-contractual choice. Finally, to the extent that default-nudges function as de facto mandates, as Bubb and Pildes have argued, regulators should defer to ex-post regulation in bankruptcy for the same reasons discussed above—*i.e.*, it is less offensive to autonomy and thus less likely to be counterproductive.

To summarize: compared with mandates, the main advantage of ex-post regulation in bankruptcy is that it is less prohibitive. Compared with disclosures and nudges, the main advantage of ex-post regulation in bankruptcy is greater effectiveness, because it targets lenders rather than consumer borrowers. Put differently, ex-post regulation in bankruptcy combines the most positive feature of mandates (targeting lenders) with the most positive feature of disclosures (minimal impairment of autonomy). Thus, placed on an imaginary spectrum of regulatory measures, it is probably ex-post regulation in bankruptcy, rather than nudges, that presents a true "third-way."

	Autonomy-Related Concerns?	**Which Party is Targeted?**
Mandates	Yes	Lender
Disclosures	No	Borrower
Nudges	Yes	Borrower
Bankruptcy	No	Lender

2. BANKRUPTCY REGULATION VS. EX-POST JUDICIAL REVIEW

The special features of the bankruptcy procedure make ex-post regulation in bankruptcy appealing not only compared with ex-ante, contractual regulatory measures, but also compared with other types of ex-post judicial review (*e.g.*, in contract or tort). Whether we consider unconscionability/consumer protection law litigation, or a "reckless lending" defense in debt collection proceedings, as Professor Pottow has suggested, power disparities between the lender and the consumer borrower may compromise the effectiveness of civil litigation as a regulatory tool.[316]

As noted above, many consumers are unaware of their legal rights, and are therefore unlikely to exercise available defenses or causes of action.[317] Yet even if consumers know their rights and want to pursue them, they face considerable barriers. First, consumers are usually "one-shotters," whereas lenders are "repeat players." As such, lenders "develop expertise and have ready access to specialists. They enjoy economies of scale and have low start-up costs for any case."[318] To meet lender expertise, consumer borrowers need adequate legal representation.[319] But given their precarious financial status and the small pecuniary gain that may be expected if their case succeeds, consumer borrowers have a very weak incentive to incur substantial legal expenses.[320] Additionally, to demonstrate that credit was unduly extended to them, consumers need to provide evidence of their financial status at the time the loan was granted, a potentially burdensome requirement given the passage of time. Finally, if liability is determined according to a comparative fault rule, as Professor Pottow suggested,[321] consumers

316. *See supra* notes 23, 181 and accompanying text.
317. *See* sources cited *supra* note 179 and accompanying text.
318. Galanter, *supra* note 185, at 98.
319. *Id.* at 114, 118.
320. *See* sources cited *supra* note 180 and accompanying text.
321. Pottow, *supra* note 10, at 443–44.

will further need to defeat their creditors' attempts to prove that they are the ones responsible for their financial failure. Either way, given the wealth and information disparities between the parties, consumer borrowers are not likely to outweigh their creditors in civil litigation.

The advantage of the proposed bankruptcy regulation vis-à-vis civil litigation is that it mitigates the gaps between the parties. First, the consumer is not required to initiate a civil proceeding or to expressly invoke an affirmative defense.[322] Instead, the proposed regulation simply taps into the consumer's decision to file for chapter 13 bankruptcy. Second, because the creditors are the ones who file debt claims, they—rather than the consumer—will be the ones required to provide the relevant documentation. Hence to some extent, the bankruptcy procedure gives an excessive lending defense better chances than equivalent claims in other venues.

CONCLUSION

Consumer finance contracts are form contracts, and they suffer from all the problems associated with such contracts. Notably, their terms are one-sidedly imposed by the lender, and are rarely understood by the consumer. But they are a particularly dangerous type of form contract, because they have the potential of implicating the consumer's entire future. When consumers borrow beyond their means, they may find themselves in a trap of perpetual debt; and with respect to certain types of credit, lenders have a strong incentive to lure consumers right into that trap.

Consumer finance regulation needs to respond to this unique feature of consumer finance products in a way that is effective, but not overly restrictive of the parties' autonomy. Notably, because lenders are the more sophisticated side of the credit transaction, it is *lender* decision-making, not only consumer decision-making, that consumer finance regulation ought to address. By targeting lenders' "debt-based" business model, ex-post regulation of lending decisions in consumer bankruptcy can avoid the main limitations of ex-ante, contract-centered regulatory measures and mitigate the problem of excessive lending.

However, as this Article has argued, regulation of consumer finance transactions through bankruptcy can do more than improve consumer finance regulation; it can also restore the internal coherence of consumer bankruptcy law, which was disturbed by the legislation of BAPCPA. By regulating lenders' decisions just as it now regulates borrowers' decisions, consumer bankruptcy law will fully realize the legislative

322. FED. R. CIV. P. 12(b).

theory underlying BAPCPA and become a more effective regulator of consumer finance markets.

Indeed, because consumer finance law and consumer bankruptcy law are often perceived as worlds apart, the idea of using bankruptcy law to regulate consumer finance transactions is not intuitive. But once we recognize that consumer finance and consumer bankruptcy are inherently intertwined phenomena, it becomes clear that their legal ordering cannot be—and should not be—entirely separate. Congress has already acknowledged that consumer bankruptcy law might influence consumer credit markets, but it chose to consider only half of the picture: the law's effect on borrowers' incentives. It is time to account for the other half and employ bankruptcy law to shape lenders' incentives as well.