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Lenders' Roles and Responsibilities in Sovereign Debt Markets

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LENDERS' ROLES AND RESPONSIBILITIES IN SOVEREIGN DEBT MARKETS

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Academic and policy debates about the multi-trillion-dollar sovereign debt markets presume these markets are unique. The reason is that sovereigns differ from other borrowers. To the extent observers look elsewhere for guidance, they turn to corporate debt as a comparison. For example, official actors have repeatedly intervened in sovereign debt markets by prodding market participants to draft loan contracts that simulate aspects of corporate bankruptcy. We argue that the conventional view of sovereign debt—though useful to a point—has substantially and unjustifiably limited the academic and policy agenda. Rather than dwell on the unique characteristics of sovereign borrowers, we examine the practices and incentives of sovereign lenders. We show that, when viewed through this lender-focused prism, sovereign debt has as much or more in common with consumer than with corporate debt. Using consumer debt as a metaphor, we reveal gaps in the debate over how to reform sovereign debt markets. First, assessments of the sustainability of sovereign debt presently—and unjustifiably—overlook the negative consequences of excessive debt for the borrower's citizens. Second, reform initiatives designed to promote "responsible lending" lack clearly articulated goals, an omission that will impair the development of a coherent reform agenda. While not a perfect metaphor, experience with consumer lending and financial regulation can help fill these gaps in our understanding of sovereign lending, producing a clearer vision of the roles and responsibilities of lenders in sovereign debt markets.

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I. INTRODUCTION

Governments around the world are tens of trillions of dollars in debt.[1] Not all of this will be repaid.[2] When it occurs, government debt default can prompt wider financial crisis, as with Greece in 2010, and will in any event be the proximate cause of much human suffering.[3] In Venezuela, the government labors to

1. *See* MCKINSEY GLOBAL INSTITUTE: DEBT AND (NOT MUCH) DELEVERAGING 1, 15, 20 (Feb. 2015) (reporting $58 trillion in government debt in mid-2014, including debt of state and local governments but not state-owned enterprises).

2. On the recurring history of financial crisis and debt default, see CARMEN M. REINHART & KENNETH S. ROGOFF, THIS TIME IS DIFFERENT: EIGHT CENTURIES OF FINANCIAL FOLLY 10–12 (Princeton Univ. Press ed., 2009).

3. *See* Dan Bilefsky & Landon Thomas Jr., *Greece Takes its Bailout, but Doubts for the Region Persist*, N.Y. TIMES (May 2, 2010), https://www.nytimes.com/2010/05/03/business/global/03drachma.html.

repay external bond creditors while the Venezuelan people lack basic goods and services like food, water, and electricity.[4] A similar story continues to unfold in Puerto Rico, where a crisis prompted by the government's belated acknowledgement of its unsustainable debt burden was amplified by hurricane-related devastation.[5]

The problem of unsustainable sovereign debt to date has mostly been viewed as a restructuring problem and, to be sure, sovereign debt restructuring is uniquely difficult. One reason derives from the law of sovereign immunity, which leaves creditors with relatively ineffective legal remedies if a sovereign borrower does not repay.[6] Another reason is that sovereigns cannot file for bankruptcy.[7]

These attributes of sovereign debt—weak legal enforcement and the lack of bankruptcy—have substantially defined and substantially limited the agenda for scholars and policy actors. For instance, the central puzzle addressed by the academic literature is why lenders without effective collection remedies make loans at all.[8] Policy actors have repeatedly intervened in the bond markets to promote mechanisms for improving creditor coordination in response to a sovereign's default or restructuring proposal, while relegating to the periphery the task of understanding and improving upon initial decisions to lend.[9] These traditional approaches reflect the view that the problems of sovereign borrowing and

4. *See* Allan Dodds Frank, *Who Gets Venezuela's Oil?*, CNN (May 16, 2019), https://www.cnn.com/2019/05/16/americas/venezuela-oil-debt-opinion-intl/index.html; Jeff Jacoby, *Venezuelan Bonds are a Fabulous Investment, if You Don't Mind the Starvation*, BOS. GLOBE (June 23, 2017), https://www.bostonglobe.com/opinion/2017/06/23/venezuelan-bonds-are-fabulous-investment-you-don-mind-starvation/qplQj6i5Rq2JXSXJgrG WHO/story.html. A corrupt, dictatorial regime has magnified the hardship in Venezuela, paying bond debt for years while citizens went hungry. *Id.* Eventually, the government was forced to default on virtually all of its debt. Ben Bartenstein, *Venezuela's Lone Undefaulted Bond is Set for Guiado Lifeline*, BLOOMBERG (Apr. 24, 2019), https://www.bloomberg.com/news/articles/2019-04-24/venezuela-s-only-bond-not-in-default-set-to-get-guaido-lifeline.

5. *See* Rachel Frazin, *Judge Approves Debt Restructuring Plan for Puerto Rico*, THE HILL (Feb. 5, 2019), https://thehill.com/latino/428552-judge-approves-debt-restructuring-plan-for-puerto-rico; Lauren Lluveras, *Puerto Rico's Bankruptcy Will Make Hurricane Recovery Even Harder,* WASH. POST (Sept. 27, 2017), https://www.washingtonpost.com/news/posteverything/wp/2017/09/27/puerto-ricos-bankruptcy-will-make-hurricane-recovery-even-harder/?noredirect=on&utm_term=.a147d2d9d105. In 2016, Congress passed legislation creating a bankruptcy process for Puerto Rico. Because in this Article we focus on "true" sovereigns, defined under international law as entities with defined territory and permanent population, self-governance, and the capacity to engage in formal relations with similar entities, *see* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 201 (AM. LAW INST. 1987), we mostly leave the issues of Puerto Rico's unsustainable debt to one side.

6. *See* Mark Aguiar & Manuel Amador, *Sovereign Debt*, *in* 4 HANDBOOK OF INTERNATIONAL ECONOMICS 647, 647 (2014); Ugo Panizza et al., *The Economics and Law of Sovereign Debt and Default*, 47 J. ECON. LIT. 1, 2–3 (2009); W. Mark C. Weidemaier & Mitu Gulati, *The Relevance of Law to Sovereign Debt*, 31 ANN. REV. L. & SOC. SCI. 395, 396–401 (2015).

7. *See* Weidemaier & Gulati, *supra* note 6, at 396–402.

8. For classic examples, see Jeremy Bulow & Kenneth Rogoff, *A Constant Recontracting Model of Sovereign Debt*, 97 J. POL. ECON. 155, 156–57 (1989); Jonathan Eaton & Mark Gersovitz, *Debt with Potential Repudiation: Theoretical and Empirical Analysis*, 48 REV. ECON. STUD. 289, 289 (1981).

9. *See* W. Mark C. Weidemaier, Mitu Gulati & Anna Gelpern, *When Governments Write Contracts: Policy and Expertise in Sovereign Debt Markets*, *in* CONTRACTUAL KNOWLEDGE: ONE HUNDRED YEARS OF LEGAL EXPERIMENTATION IN GLOBAL MARKETS 92, 92 (Grégoire Mallard & Jérôme Sgard eds., Cambridge Univ. Press

restructuring are *sui generis*, uniquely shaped by the fact of borrower sovereignty.[10] When observers do try to draw insight from other kinds of debt, they generally look to corporate debt, in particular to corporate restructuring.[11]

In this Article, we seek to reorient academic and policy discourse away from problems of restructuring and toward problems of *lending*. Sovereigns differ from other borrowers, to be sure, but the banks and financial intermediaries that sovereigns borrow from play relatively traditional roles as lenders.[12] In most lending markets, the role of lending institutions is a key topic of debate, including debate over how to best regulate these entities. In the sovereign debt markets, that debate has been muted.

The failure to consider lending-focused regulatory strategies is puzzling, but this gap in the discourse is slowly narrowing. Recent reform initiatives, launched by civil society groups and intergovernmental organizations with an interest in sovereign debt markets, have emphasized the need to promote responsible lending.[13] These initiatives, however, embrace an elastic definition of "lender responsibility" that encompasses a wide range of problematic behavior associated with making and enforcing sovereign loans.[14] As a rhetorical matter, this definitional opacity might be necessary to prompt across-the-board consideration of how to improve lending practices. But opacity also makes it hard to translate textual cues into policy action.

Part I lays the groundwork for a more extensive discussion of lenders' roles and responsibilities in sovereign debt markets, but we resist the usual comparison to corporate debt and restructuring. We look elsewhere for insight, to the market for consumer debt. It may seem odd to compare governments—which often conduct borrowing through professional finance ministries advised by expensive lawyers and financial advisors—to consumer borrowers. But to focus on the characteristics of the borrower is to miss the point, for there are important parallels between sovereign and consumer debt.[15] In both markets for "noncorporate" debt, lenders decide whether to lend, and whether to grant debt relief, based primarily on an assessment of the borrower's ability and willingness to pay, rather than on a valuation of the borrower's assets.[16] Moreover, both markets feature

2016); Anna Gelpern & Mitu Gulati, *Public Symbol in Private Contract: A Case Study*, 84 WASH. U. L. REV. 1627, 1640 (2006).

10. Weidemaier & Gulati, *supra* note 6, at 400.

11. *See, e.g.*, Barry Eichengreen, *Restructuring Sovereign Debt*, 17 J. ECON. PERSP. 75, 91–92 (2003); Panizza et al., *supra* note 6, at 2–9; Patrick Bolton, *Toward a Statutory Approach to Sovereign Debt Restructuring: Lessons from Corporate Bankruptcy Practice Around the World* (Int'l Monetary Fund, Working Paper No. 03/13, 2003); Eduardo Borensztein et al., *Sovereign Debt Structure for Crisis Prevention* 3–5, 11–13 (Int'l Monetary Fund, Working Paper No. 237, 2004).

12. We use the term broadly to encompass not only commercial banks but also the financial institutions that manage and underwrite sovereign bonds.

13. *See infra* Subsection V.C.2 (discussing responsible lending initiatives).

14. BODO ELLMERS & KONSTANTINOS TODOULOS, THE UNCTAD PRINCIPLES ON PROMOTING RESPONSIBLE SOVEREIGN LENDING AND BORROWING 1 (2013).

15. Susan Block-Lieb, *Austerity, Debt Overhang, and the Design of International Standards on Sovereign, Corporate, and Consumer Debt Restructuring*, 22 IND. J. GLOBAL LEGAL STUD. 487, 540 (2015).

16. *Id.* at 528, 539.

potent incentives for over-borrowing and for excessive, occasionally abusive, lending.[17] If the global financial system is "rife with moral hazards, perverse incentives, and unintended consequences," these deficiencies are readily apparent in both markets.[18] The concept of "responsible lending" originated in regulation of residential mortgage, credit card credit, and similar consumer lending transactions.[19] Experience in these contexts can help clarify the goals and potential content of responsible sovereign lending edicts.

Part II identifies incentives that induce lenders to extend vast amounts of credit to sovereign borrowers, sometimes with scant consideration for the risk of default. It also describes the responsible sovereign lending proposals recently put forward by United Nations Conference on Trade and Development ("UNCTAD"), Eurodad, and other civil society groups. Paralleling this discussion, Part III next identifies comparable lender incentives in consumer debt markets and describes an emerging global convergence on consumer finance regulations that looks to promote responsible lending. Although there are no precise internationally recognized standards on responsible consumer lending,[20] there is broad agreement that regulation should govern consumers' financial decisions and some convergence on what responsible lending should entail.[21]

The comparison, while unconventional, has payoffs. Part IV closes by identifying examples of consumer financial regulation that might—depending on how responsible lending is conceptualized in connection with loans to sovereigns—be translated into the sovereign context. Our aim is to prompt more concrete discussion about how to define responsible lending and how to moderate incentives toward imprudent (or abusive) lending. We do not envision a radical transformation, especially as soft international standards on responsible lending would need to be translated into something both coordinated and subject to enforcement across global markets. Nevertheless, consumer debt offers an important, alternative lens through which to examine the problems of sovereign debt. Among other benefits, experience with consumer financial protection regulation highlights the importance of developing concrete substantive standards of lender responsibility and hints at how these substantive standards might look.

17. *Id.* at 541.

18. Jay Lawrence Westbrook, *SIFIs and States*, 49 TEX. INT'L L.J. 329, 330 (2014).

19. *See, e.g.*, THE WORLD BANK, RESPONSIBLE LENDING: OVERVIEW OF REGULATORY TOOLS 4 (2013) [hereinafter RESPONSIBLE LENDING].

20. *G20 High-Level Principles on Financial Consumer Protection*, OECD (Oct. 2011), https://www.oecd.org/g20/topics/financial-sector-reform/48892010.pdf [hereinafter *G20 HLP on FCP*].

21. Through its International Financial Corporation, the World Bank has promoted its "Global Responsible Finance Program" since 2009. *See* WORLD BANK GROUP, GLOBAL MAPPING OF FINANCIAL CONSUMER PROTECTION & FINANCIAL LITERACY INITIATIVES 3 (2015), http://responsiblefinance.worldbank.org/~/media/GIAWB/FL/Documents/Publications/Global-CPFL-Mapping-2015-FINAL.pdf; *see also* THE WORLD BANK, GLOBAL SURVEY ON CONSUMER PROTECTION AND FINANCIAL LITERACY: OVERSIGHT FRAMEWORKS AND PRACTICES IN 114 ECONOMIES 24 (2014), http://documents.worldbank.org/curated/en/775401468171251449/pdf/887730WP0v20P10port0CPFL0Box385258B.pdf [hereinafter GLOBAL SURVEY]; THE WORLD BANK, GOOD PRACTICES FOR FINANCIAL CONSUMER PROTECTION 3 (2012), http://documents.worldbank.org/curated/en/583191468246041829/pdf/701570WP0P12260REWRITE0THE0ABSTRACT.pdf [hereinafter GOOD PRACTICES]; RESPONSIBLE LENDING, *supra* note 19, at 13.

II. BUILDING A BETTER METAPHOR

The corporate debt metaphor has been instrumental both as an analytical tool and as a rhetorical device in academic and policy discourse about sovereign debt. It has been central to literature reviews,[22] classic academic treatments,[23] and major policy proposals.[24] In the sovereign debt restructuring context, for example, there has been recurring debate over the need for a treaty-based international restructuring tribunal.[25] Proponents of such a tribunal have justified their position by invoking corporate restructuring as a model, as have their opponents (who favor the use of loan contracts designed to simulate certain features of corporate bankruptcy).[26]

Despite its utility, however, the corporate debt metaphor encourages an unduly narrow conception of both problems and regulatory possibilities in sovereign debt markets. Indeed, sovereign debt has as much or more in common with consumer as with corporate debt.[27] There are at least two important parallels. First, while corporate lending is typically asset-based, lenders to both sovereign and consumer borrowers instead act based on assessments of ability and willingness to repay. Second, both sovereign and consumer debt markets create similar incentives for excessive and abusive borrowing and lending.

With regard to the first point, legal enforcement entails, with limited exceptions, only the right of a judgment holder to proceed against assets of a corporate debtor.[28] The limits of corporate form are well understood and rest importantly on the defining feature of corporate structure—that is, the notion that shareholders' ownership interests in a limited liability structure are explicitly intended to partition corporate assets from owners' assets. Indeed, it is because of this unique attribute of corporate form that many observers distinguish sovereign from corporate debtors.[29] The former can keep assets safe within their borders;

22. *See, e.g.*, Panizza et al., *supra* note 6, at 2–9.

23. *See, e.g.*, Eichengreen, *supra* note 11, at 91–92; Bolton, *supra* note 11, at 880.

24. *See, e.g.*, Anne O. Krueger, IMF, *A New Approach to Sovereign Debt Restructuring*, at 11 (Apr. 2002) (discussing a treaty-based Sovereign Debt Restructuring Mechanism modeled substantially on corporate reorganization, but acknowledging differences between sovereign and corporate borrowers).

25. *See* IMF, *Report of the Working Group on International Financial Crises* at 45 (Oct. 1998), http://www.bis.org/publ/othp01d.pdf.

26. *See id.* at 19 (recommending inclusion of collective action clauses in sovereign bonds, with corporate insolvency as a model); Krueger, *supra* note 24, at 10–12 (discussing aspects of corporate insolvency relevant to SDRM); CHRISTOPH G. PAULUS, ED., A DEBT RESTRUCTURING MECHANISM FOR SOVEREIGNS: DO WE NEED A LEGAL PROCEDURE?, at Preface (2014) (with a series of essay-chapters, asking whether "a procedure (however close or however distant)" to insolvency law could "be a solution to the future sovereigns' debt crises"); NOURIEL ROUBINI & BRAD SETSER, IMPROVING THE SOVEREIGN DEBT RESTRUCTURING PROCESS: PROBLEMS IN RESTRUCTURING, PROPOSED SOLUTION, AND A ROADMAP FOR REFORM 7 (2003) (comparing corporate bankruptcy and sovereign debt restructuring, and evaluating proposed reforms); Patrick Bolton & Olivier Jeanne, *Structuring and Restructuring Sovereign Debt: The Role of Seniority*, 76 REV. ECON. STUD. 879, 880–82 (2009) (lamenting lack of enforceable priority rules in sovereign lending); Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 CORNELL L. REV. 956, 958 (2000) (using corporate bankruptcy as a model for sovereign debt restructuring).

27. Block-Lieb, *supra* note 15, at 492–93.

28. Henry Hansmann et al., *Law and the Rise of the Firm*, 119 HARV. L. REV. 1335, 1337 (2006).

29. *See, e.g.*, Panizza et al., *supra* note 6, at 2–3.

the latter cannot (so easily) engage in judgment-proofing strategies.[30] This distinction is real, although its significance should not be overstated.[31] But the distinction does not merely distinguish sovereign from corporate debt. It also highlights an important similarity of sovereign to consumer debt.

In the corporate context, a creditor's power to seize assets is partitioned—limited to assets of the corporation. Because courts almost always respect the corporate form, shareholders enjoy "entity protections."[32] The corporation's creditors cannot force the sale of assets owned by shareholders or by other entities.[33] The result is that, from the perspective of a creditor's remedies on default, all corporate lending, whether secured or unsecured, is asset-based.

By contrast, neither consumer nor sovereign lending is asset-based in this manner for somewhat different reasons. In the consumer context, lenders can force a sale of borrower assets after a default, but these often have little value. Thus, consumer lenders, such as credit card issuers, extend credit primarily based on assessments of the borrower's income and willingness and ability to repay. Even consumer lending tied to valuable assets, such as a residential mortgage agreement in which the borrower grants a lien against his or her home to secure repayment, may not be constrained by the value of the asset in question. If the proceeds of foreclosure and forced sale are insufficient to repay the debt in full, the mortgage lender generally can garnish the borrower's wages to cover the deficiency.[34] Here, too, the result is that residential mortgage lenders extend credit based only partly on the value of the home that secures the debt.[35] All consumer lenders focus mostly on the borrower's ability to repay.

30. Corporate debtors can engage in judgment-proofing strategies with respect to many creditors. *See* Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 5, 14–32 (1996). But corporate debtors, unlike sovereign debtors, can readily create enforceable security interests; many also have easily-identified owners who can guarantee corporate debts. Contract creditors can therefore protect their interests when dealing with corporate debtors. *Id.* at 7.

31. *See* Stephen Kim Park & Tim R. Samples, *Towards Sovereign Equity*, 21 STAN. J.L., BUS. & FIN. 240, 247–54 (2016); Weidemaier & Gulati, *supra* note 6, at 400–01. Recent scholarship documents an increase in litigation against foreign governments. *See* Julian Schumacher et al., *What Explains Sovereign Debt Litigation?*, 58 J. LAW & ECON. 585, 585–86 (2015). Though many view this development skeptically, *see, e.g.*, Rodrigo Olivares-Caminal, *The Pari Passu Clause in Sovereign Debt Instruments: Developments in Recent Litigation*, *in* SOVEREIGN RISK: A WORLD WITHOUT RISK-FREE ASSETS 121, 126 (Bank for International Settlements 2013), some ask whether potent legal enforcement might improve the functioning of debt markets. *See* Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1044 (2004); Veronica Santarosa & Benjamin Chabot, *Don't Cry for Argentina (or Other Sovereign Borrowers): Lessons from a Previous Era of Sovereign Debt Contract Enforcement*, 12 CAP. MKTS. L.J. 9, 11, 29 (2017).

32. *See* Hansmann et al., *supra* note 28, at 1348.

33. *Id.* at 1338.

34. Because the law governing foreclosure is non-uniform state law, there are many exceptions. California, for example, is a "non-deficiency state," which means that generally residential mortgage foreclosure ends collection on the basis of such default. *See, e.g.*, CAL. CODE CIV. PROC. § 580b(a)(3) (2015).

35. Indeed, "asset-based lending," premised on the notion that a consumer borrower's income level and ability to repay is irrelevant to the lender's decision to lend, is often referred to as "predatory" because consumers may be surprised, and harmed financially, by a lender's motivations favoring default and foreclosure. *See, e.g.*, Edward Gramlich, Governor, Fed. Reserve Bd., Remarks at the Housing Bureau for Seniors Conference, Ann Arbor, Michigan: Predatory Lending (Jan. 18, 2002), https://www.federalreserve.gov/boarddocs/speeches/2002/20020118/default.htm.

Lenders to sovereign governments make a similar calculus. True, a sovereign's "income" is a rather different thing from a consumer's income, consisting not only of revenue generated by the economy but of the power to tax. Likewise, a sovereign's willingness to pay derives from different considerations, such as the political feasibility of imposing necessary tax increases.[36] In both contexts, however, lenders understand that the threat of forced asset seizure does not assure repayment. And in both contexts, lenders rely on mathematical models—and, in the sovereign context, assessments of political risk—to assess ability and willingness to repay. In short, both sovereign and consumer lending are "income-based."[37] Consumer and sovereign debt markets work not because of any threat of asset seizure, but because, for other reasons, both types of borrowers generally repay eventually, if not always on time.

The similarities between sovereign and consumer lending have been largely overlooked. A few academics have drawn lessons from consumer debt in the context of sovereign lending.[38] But for the most part, the corporate debt analogy—with its implications for sovereign restructuring—has dominated.[39] We do not claim the consumer metaphor is perfect. Regulatory models from the consumer debt markets cannot simply be transplanted into the sovereign debt markets. But metaphors, like theoretical models, can be useful even if they are wrong in material respects.[40] And we think the metaphor is useful in distinguishing between corporate and "noncorporate" lending.

III. THE SUPPLY SIDE OF EXCESSIVE SOVEREIGN DEBT

Lending to sovereign governments takes many forms and involves many actors in the public and private sectors. Examples include: direct government-to-government loans, the extension of credit by multilateral financial institutions such as the IMF, loans to support development projects made either by commercial banks or by (or with the support of) national or multilateral development banks, direct lending by syndicates of commercial banks, and bond issues in

36. Thus, the International Monetary Fund's framework for determining debt sustainability regards debt as sustainable when the primary balance needed to at least stabilize the debt is both economically and *politically* feasible. *See* IMF, *Staff Guidance Note for Public Debt Sustainability Analysis in Market-Access Countries*, Policy Paper, at 4 (May 2013); *see also* COMM. ON INT'L ECON. POLICY AND REFORM, REVISITING SOVEREIGN BANKRUPTCY 36 (BROOKINGS 2013) (discussing how solvency measures must take factors such as willingness to tax into account) [hereinafter BROOKINGS REPORT].

37. Block-Lieb, *supra* note 15, at 528.

38. *See* MATTHIAS GOLDMANN, RESPONSIBLE SOVEREIGN LENDING AND BORROWING: THE VIEW FROM DOMESTIC JURISDICTIONS: A COMPARATIVE SURVEY WRITTEN FOR THE UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (2012) (evaluating the UNCTAD Principles in light of national regulation of non-sovereign lending, including lending to consumers); A. Mechele Dickerson, *Insolvency Principles and the Odious Debt Doctrine: The Missing Link in the Debate*, 70 LAW & CONTEMP. PROBS. 53, 74–76 (2007) (drawing on insolvency principles applicable to consumer bankruptcy to analyze the doctrine of odious sovereign debt); Robert K. Rasmussen, *Integrating a Theory of the State into Sovereign Debt Restructuring*, 53 EMORY L.J. 1159, 1181 (2004) (briefly comparing underwriting practices in consumer and sovereign lending markets).

39. *See supra* notes 22–25 and accompanying text.

40. GEORGE E.P. BOX & NORMAN R. DRAPER, EMPIRICAL MODEL-BUILDING AND RESPONSE SURFACES 74 (1987).

which investment banks and other financial intermediaries place government-issued securities in global capital markets.[41]

It should be obvious that, in a global market with varied actors pursuing such varied motives, the definition of responsible lending will be contested and context-dependent. Whether the IMF has acted responsibly by lending to a distressed government under its Exceptional Access policy,[42] for example, should not be judged by the same standards that might apply to a syndicate of for-profit commercial banks funding a government infrastructure project.

Our primary, if not exclusive, interest is in exploring and clarifying the obligations of for-profit lenders operating in the sovereign debt markets and in the possibilities for regulating these entities in some sense. In such a vast market, involving many trillions of dollars in outstanding debt, it is odd to find discussions of responsible lending relegated largely to the sidelines. Yet that is the reality. To be sure, some regulatory initiatives indirectly impact the behavior of lenders in the sovereign debt markets. For instance, the risk weighting to be assigned sovereign debt under the Basel capital framework impacts the willingness of banks to hold government securities.[43] But these exceptions do not represent any serious effort to determine appropriate standards of conduct for lenders. The explanation cannot be that the sovereign debt markets are functioning optimally.

Indebtedness has declined from a peak in the late 1980s but remains dangerously high for many countries.[44] High debt leaves a government exposed to output shocks, contractions in the supply of global credit, and other negative events (such as infirmities in the banking sector).[45] These risks are compounded when a government's debt is denominated in a foreign currency, leaving it ex-

41. *See, e.g.*, Anna Gelpern, *Sovereign Debt: Now What?*, 41 YALE J. INT'L L. 45, 58–61 (2016) (describing mix of creditors involved in sovereign lending); Eugenio Cerutti, Galina Hale & Camelia Minoiu, *Financial Crises and the Composition of Cross-Border Lending* 5–25 (IMF Working Paper No. WP/14/185, 2014) (describing syndicated lending market), http://www.imf.org/en/publications.

42. *See, e.g.*, IMF, *The Fund's Lending Framework and Sovereign Debt—Further Considerations* (Apr. 2015) (describing exceptional access framework).

43. On the link between risk weighting and bank incentives to hold sovereign debt in the run-up to the European debt crisis, see Jeffrey N. Gordon & Wolf-Georg Ringe, *Bank Resolution in the European Banking Union: A Transatlantic Perspective on What it Would Take*, 115 COLUM. L. REV. 1297, 1304–05 (2015). *See also* Bank for International Settlements, *International Banking and Financial Market Developments*, BIS Q. REV. 1, 10–11 (2013) (describing treatment of sovereign risk under Basel capital framework).

44. Michael Tomz & Mark L. J. Wright, *Empirical Research on Sovereign Debt and Default*, 5 ANN. REV. ECON. 247, 251–52 (2013); Daniel A. Dias, Christine J. Richmond & Mark L. J. Wright, *The Stock of External Sovereign Debt: Can We Take the Data at 'Face Value'?* 11–13 (Nat'l Bureau of Econ. Research, Working Paper 17551, 2011).

45. Output contractions often precede default, although causal relationships are unclear. *See, e.g.*, Michael Tomz and Mark L. J. Wright, *Do Countries Default in "Bad Times"?*, 5 J. EUR. ECON. ASS'N. 352, 353 (2007); Eduardo Levy-Yeyati & Ugo Panizza, *The Elusive Costs of Sovereign Defaults* 14 (Inter-Am. Dev. Bank Research Dep't Working Paper 581, 2006).

posed to exchange rate fluctuations that can imperil its ability to respond to adverse economic conditions.[46] High debt levels can also have systemic consequences quite apart from the risk of default.

Although there is no clear causal relationship between government debt overhang and broader financial crisis,[47] high levels of public debt are associated with lower growth.[48] Moreover, high public debt can prolong a financial crisis that originates in the private sector by limiting the government's ability to recapitalize financial institutions, adopt countercyclical fiscal policy, or otherwise mitigate the effects of private sector deleveraging.[49] Because governments cannot borrow if lenders will not lend, the fact of widespread over-indebtedness implies a need to examine more closely the behavior and incentives of lenders when making or arranging loans.

A. Lender Incentives in the Sovereign Debt Markets

From a sovereign borrower's perspective, debt is excessive when "the social cost of an additional unit of debt is higher than the social value of an additional unit of expenditure."[50] The assumption embedded in this definition is that governments should not borrow except to advance social welfare. It is harder to define over-lending. Certainly, lenders do not seek to maximize social welfare in the borrowing state. At the least, any definition must include lending decisions that "differ from what we would observe in the presence of perfect markets."[51] This is a minimalist definition, extending to loans that are mispriced (in the sense that expected return does not correspond to risk), but perhaps not much further. As will become clear from our discussion of responsible consumer lending regulation, there is no obvious reason why the definition of lender responsibility should be so limited. For present purposes, however, we focus our attention on reasons why lenders might make or facilitate loans without adequately accounting for the risk of default.

1. Agency Problems

Some incentives for over-lending stem from agency problems within lenders and lending markets. In a stylized commercial loan, the lender will carefully assess the borrower's ability and willingness to repay before making the loan. In

46. *See, e.g.*, Barry Eichengreen, Ricardo Hausmann & Ugo Panizza, *The Pain of Original Sin*, *in* OTHER PEOPLE'S MONEY: DEBT DENOMINATION AND FINANCIAL INSTABILITY IN EMERGING MARKET ECONOMIES 13 (2005).

47. IMF, *Debt: Use it Wisely*, Fiscal Monitor, at 11 (Oct. 2016); Oscar Jorda, Moritz Schularick & Alan Taylor, *Sovereigns Versus Banks: Credit, Crises, and Consequences*, 14 J. EUR. ECON. ASS'N 45, 64 (2016).

48. Carmen M. Reinhart, Vincent R. Reinhart & Kenneth S. Rogoff, *Public Debt Overhangs: Advanced Economy Episodes Since 1800*, 26 J. ECON. PERSP. 69, 83–85 (2012).

49. IMF, *Debt: Use it Wisely*, *supra* note 47, at 11; Jorda, Schularick & Taylor, *supra* note 47, at 47.

50. Yuefen Li & Ugo Panizza, *The Economic Rationale for the Principles on Promoting Responsible Sovereign Lending and Borrowing*, *in* SOVEREIGN FINANCING AND INTERNATIONAL LAW 15, 28–29 (Oxford Univ. Press 2013).

51. *Id.* at 29.

a stylized bond issuance, the underwriter has some incentive to undertake a similar assessment, for it may incur reputational and legal costs if the issuer defaults (in addition, of course, to the losses it may take on any bonds it holds).[52] In practice, a number of factors cause departures from these stylized models.

For instance, markets may be structured to diminish the loan originator's incentive to assess default risk. To use an example from outside the world of sovereign debt, securitization of residential home mortgages, and the shift from an investment to a "sales" business model, created incentives for originators to maximize the supply of home loans without adequately accounting for default risk.[53] In sovereign debt markets, the ability to transfer risk to third parties may likewise diminish incentives for originators or underwriters to realistically assess (or disclose) the probability of default.[54] In bond lending, underwriters may also have some incentive to downplay risks, for fear of losing business from high-volume issuers of securities.[55]

In theory, credit rating agencies can mitigate these tendencies, but there is cause for doubt. For instance, the use of credit ratings in regulatory capital standards may create incentives to inflate ratings of investment grade sovereign issuers.[56] An issuer-pays compensation model also may give credit-rating agencies an incentive to inflate ratings.[57]

Agency problems within lending institutions may also contribute to excessive lending. One reason is that agents with the power to influence lending or

52. In the early 20th century, investors may have used underwriter reputation as a proxy for the quality of a bond issue. *See* Marc Flandreau, Norbert Gaillard & Ugo Panizza, *Conflicts of Interest, Reputation, and the Interwar Debt Crisis: Banksters or Bad Luck*? 4 (Graduate Inst. of Int'l and Dev. Studies, Working Paper No. 02/2010, 2010); Marc Flandreau, Juan H. Flores Norbert Gaillard & Sebastián Nieto-Parra, *The Changing Role of Global Financial Brands in the Underwriting of Foreign Government Debt (1815-2010)* 23–28 (Graduate Inst. of Int'l and Dev. Studies, Working Paper No. 15-201, 2011). Lawyers may play a similar role. *See* Michael Bradley, Irving De Lira Salvatierra & Mitu Gulati, *Lawyers: Gatekeepers of the Sovereign Debt Market?* 38 INT'L REV. L. & ECON. 150, 150 (2013) (finding, however, that hiring outside lawyers sends a negative signal as to issue quality).

53. Susan Block-Lieb & Edward Janger, *Demand-Side Gatekeepers in the Market for Home Loans*, 82 TEMP. L. REV. 465, 469–75 (2009) (describing how changes in mortgage underwriting created incentives to make risky loans); Jonathan Macey, Geoffrey D. Miller, Maureen O'Hara & Gabriel Rosenberg, *Helping Law Catch Up to Markets: Applying Broker-Dealer Law to Subprime Mortgages*, 34 J. CORP. L. 789, 842 (2009) (noting the role of securitization in shaping the incentives of mortgage brokers).

54. *See, e.g.*, Li & Panizza, *supra* note 50, at 30. Moreover, regulatory schemes may undermine underwriting standards. *See, e.g.*, CLAIRE A. HILL & RICHARD W. PAINTER, BETTER BANKERS, BETTER BANKS 81–82 (Univ. of Chicago Press 2015).

55. PAUL BLUSTEIN, AND THE MONEY KEPT ROLLING IN (AND OUT) 62–74 (2005).

56. For general discussion of criticisms of credit rating agencies in sovereign debt markets, and evidence on the historic role and function of these agencies, see generally NORBERT GAILLARD, A CENTURY OF SOVEREIGN RATINGS (Springer 2012).

57. Similar concerns have been expressed about the role of credit rating agencies in the residential home mortgage context. *See* Block-Lieb & Janger, *supra* note 53, at 474; Timothy E. Lynch, *Deeply and Persistently Conflicted: Credit Ratings Agencies in the Current Regulatory Environment*, 59 CASE W. RES. L. REV. 227, 246–48 (2009); Frank Partnoy, *How and Why Credit Rating Agencies Are Not Like Other Gatekeepers*, *in* FINANCIAL GATEKEEPERS: CAN THEY PROTECT INVESTORS? 59, 60 (Yasuyuki Fuchita & Robert E. Litan eds., 2006); *see also* Claire A. Hill, *Regulating the Rating Agencies*, 82 WASH. U. L.Q. 43, 50–51 (2004) (noting risk of issuer-pays model but emphasizing potentially greater risk that issuers might withhold ancillary (*i.e.*, non-ratings) business from ratings agencies that do not provide favorable ratings).

underwriting decisions often benefit if a loan is made but bear no personal risk if the loan is not repaid.[58] For instance, a bank's compensation structure may not tie compensation to loan performance. Buchheit and Gulati partially attribute excessive sovereign lending by commercial banks during the 1970s and 1980s to the practice of charging high origination fees, which banks treated as income during the year of origination rather than amortizing over the life of the loan.[59] Because loan officers were compensated as a function of the bank's income for the year, this produced incentives to push large loans.[60]

2. *Excessive Optimism and Herd Behavior*

Incentives to over-lend can be magnified by herd behavior—*i.e.*, widespread over-optimism leading to excessive risk-taking.[61] Commercial loan officers, investment bankers, and other professionals involved in sovereign lending are sophisticated actors. But even they may "suffer from the behavioral biases that drive investor confidence and stock market bubbles."[62] Financial professionals may be susceptible to groupthink, may overestimate their capacity to judge risk, and may exhibit a range of cognitive errors that cause them to underestimate risks.[63] These tendencies may partially explain the short memory of market participants—the recurring belief, in the terms of Reinhart and Rogoff, that "this time is different."[64]

If lenders are prone to over-optimism, this may help explain the surprising procyclicality of sovereign borrowing. Models of sovereign debt often assume borrowing is countercyclical; the idea that when economic activity slows, governments borrow to smooth consumption.[65] Evidence indicates, however, that borrowing is often procyclical.[66] That is, borrowing increases when times are

58. Li & Panizza, *supra* note 50, at 30 ("[A]sset managers may try to generate fake alpha by adopting a strategy that leads to excess returns in most states of the world but hides an enormous tail risk."); Christian Barry & Lydia Tomitova, *Fairness in Sovereign Debt,* 73 SOC. RES. 649, 671 (2006) (noting that the originator of a sovereign loan "may benefit himself by broadening his portfolio, yet be long gone when the sovereign becomes unable to repay . . . ."). For a proposal to address this mismatch of incentives, see HILL & PAINTER, *supra* note 54, at 190–92.

59. Lee C. Buchheit & Mitu Gulati, *Responsible Sovereign Lending and Borrowing*, 73 LAW & CONTEMP. PROBS. 63, 78–79 (2010).

60. In the United States, federal law now requires loan origination fees to be amortized over the loan term in many cases. *See* 12 U.S.C. § 3905(a)(1) (2018).

61. BROOKINGS REPORT, *supra* note 36, at 9.

62. ERIK F. GERDING, LAW, BUBBLES, AND FINANCIAL REGULATION 207 (New York: Routledge 2014). *See also* Stephen G. Cecchetti, MS Mohanty & Fabrizio Zampolli, *The Future of Public Debt: Prospects and Implications* 1 (Bank for Int'l Settlements, Working Paper No. 300, 2010) (noting that "bond traders are notoriously short-sighted").

63. Roland Bénabou, *Groupthink: Collective Delusions in Organizations and Markets*, 80 REV. ECON. STUD. 429, 457 (2013).

64. *See generally* REINHART & ROGOFF, THIS TIME IS DIFFERENT, *supra* note 2.

65. *See, e.g.*, Panizza et al., *supra* note 6, at 14–17 (discussing assumption of counter-cyclicality and contrary evidence).

66. Eduardo Levy Yeyati, *Optimal Debt? On the Insurance Value of International Debt Flows to Developing Countries*, 20 OPEN ECONOMIES REV. 489, 491 (2009); Enrique Alberola and José Manuel Montero, *Debt Sustainability and Procyclical Fiscal Policies in Latin America* 9 (Banco de España, Working Paper No. 0611,

good and international capital is plentiful and cheap. Of course, someone must make these loans in the first place, and if sovereigns are running up large debts in good times, one might question whether they will be able to repay when the bad times arrive. Lender over-optimism may be part of the explanation.

3. Debt Dilution and the Lack of Priority Rules

Weak legal enforcement is an important characteristic of sovereign debt.[67] No tribunal can compel a sovereign to repay or surrender enough assets to satisfy creditor claims.[68] The net result may be a reduction to the overall amount of sovereign debt. Lenders should more readily extend credit when courts have power to enforce their claims.[69] In at least one respect, however, weak enforcement can provide a perverse incentive to over-lending. The risk stems from the fact that no tribunal can enforce payment priorities specified in sovereign loan contracts.[70]

The risk of debt dilution is one consequence of the lack of enforceable priorities. New loans incurred by a financially distressed borrower may increase default risk and reduce the recovery value of existing loans (because more creditors will have claims against the borrower's resources).[71] New lenders can price these risks into their loans; old lenders cannot. Anticipating this risk, lenders may demand a premium to compensate for the risk of dilution[72] or may structure loans in suboptimal ways.[73] In corporate lending markets, secured debt mitigates these concerns.[74] Lenders entitled to priority have less reason to fear dilution; they are entitled to be paid in full before junior creditors receive anything. But sovereign borrowers cannot easily make credible promises of seniority.[75] Without an enforceable priority structure, new lenders have an incentive to lend, even as the sovereign nears financial distress.[76]

2006); Michael Gavin et al., *Managing Fiscal Policy in Latin America and the Caribbean: Volatility, Procyclicality, and Limited Creditworthiness* 3 (Inter-American Development Bank, Working Paper No. 326, 1996); Graciela L. Kaminsky et al., *When it Rains, it Pours: Procyclical Capital Flows and Macroeconomic Policies* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 10780, 2004).

67. *See, e.g.*, Aguiar & Amador, *supra* note 6, at 647.

68. *Id.*

69. Patrick Bolton & David A. Skeel, Jr., *Redesigning the International Lender of Last Resort*, 6 CHI. J. INT'L L. 177, 189 (2005).

70. *Id.* at 185–86.

71. *Id.* at 185.

72. Borensztein et al., *supra* note 11, at 4.

73. For example, lenders might insist on short-term loans that create repeat rollover risk. *See* Kenneth M. Kletzer, *Asymmetries of Information and LDC Borrowing with Sovereign Risk*, 94 ECON. J. 287, 299–300 (1984); Juan Carlos Hatchondo et al., *Debt Dilution and Sovereign Default Risk* 3 (Int'l Monetary Fund, Working Paper No. 11/70, 2011).

74. *See generally* EUGENE F. FAMA & MERTON H. MILLER, THE THEORY OF FINANCE (1972).

75. A sampling of the academic literature on the problem of debt dilution includes, Bolton & Jeanne, *supra* note 26, at 881; Bolton & Skeel, *supra* note 69, at 198; Borensztein et al., *supra* note 11; Hatchondo et al., *supra* note 73, at 3.

76. Christine Jenkins Tanzi & Fabiola Zerpa, *Goldman Sachs Just Ignited the "Hunger Bonds" Movement*, BLOOMBERG (May 31, 2017, 9:54 AM), https://www.bloomberg.com/news/articles/2017-05-31/goldman-sachs-gave-big-hand-to-venezuela-hunger-bonds-movement.

4. *Moral Hazard*

Lenders may also discount the risk posed by a sovereign borrower because they expect other governments or official lenders to intervene. The Euro area is an often-cited example. The convergence of bond yields across countries within the monetary union[77] implies that investors did not consider the different default risks presented by EU member states. One reason may be the perception that governments, worried about the systemic consequences of a member state's default, will step in with emergency loans, the proceeds of which may be used to repay private lenders.[78]

5. *Capitalizing on Information Asymmetries and Other "Predatory" Practices*

At first glance, governments would appear to be exceptionally well-informed borrowers. Many manage debt through professionalized finance ministries staffed by economists and other highly trained staff.[79] Many also retain external advisors to guide debt management decisions.[80] Yet there is also risk that, in some cases, lenders seek higher returns by offering complicated products whose costs are not readily apparent to government officials. At least some civil society groups have expressed this concern,[81] which echoes similar concerns expressed in the context of U.S. municipal finance.[82]

6. *Some Examples*

One need not look far to find examples consistent with the incentives described above. As noted, Venezuela is experiencing an economic and humanitarian crisis.[83] During the pre-crisis boom fueled by high oil prices (roughly 2006–2012), the country found plenty of lenders willing to fuel a procyclical borrowing binge.[84] Its foreign debt sharply increased even as expenditures far outpaced revenues.[85] As its financial position deteriorated—indeed, even as Venezuela became the world's most indebted country and citizens took to the streets to protest

77. Michael Ehrmann et al., *Convergence and Anchoring of Yield Curves in the Euro Area*, 93 REV. ECON. & STAT. 350, 350 (2011).

78. Greece is the most notable recent example. *See, e.g.*, Paul Blustein, *Laid Low: The IMF, the Euro Zone and the First Rescue of Greece* 6 (Centre for International Governance Innovation, Working Paper No. 61, 2015).

79. Anna Gelpern et al., *If Boilerplate Could Talk: The Work of Standard Terms in Sovereign Bond Contracts*, 44 L. & SOC. INQUIRY 617 (2019).

80. *Id.* at 44.

81. *See* ELLMERS & TODOULOS, *supra* note 14.

82. *See generally* Adam Feibelman, Fiduciary Duties and Public Finance: Experimenting with Municipal Financial Advisors (June 24, 2016) (unpublished manuscript) (on file with author).

83. Jacoby, *supra* note 4.

84. Anabella Abadi M., *Corruption and Phantom Bonds*, CARACAS CHRONICLES (June 9, 2017), https://www.caracaschronicles.com/2017/06/09/corruption-and-phantom-bonds.

85. *Id.*; Dany Bahar & Miguel Ángel Santos, *The Road Ahead in Venezuela: Navigating through a Rough Sea of Economic Crisis*, BROOKINGS (Jan. 4, 2016), https://www.brookings.edu/blog/up-front/2016/01/04/the-road-ahead-in-venezuela-navigating-through-a-rough-sea-of-economic-crisis.

food shortages[86]—the government was able to tap new sources of foreign capital, albeit at extravagant interest rates.[87]

Perhaps the most notable example involves the issuance of substantial amounts of debt at a dramatic discount from face value ("original issue discount").[88] That the financially strapped Venezuelan government was issuing such debt came to light in May 2017 in connection with the so-called "Hunger Bonds."[89] These bonds were issued by state oil company PDVSA with a face value of $2.8 billion and a 6% coupon, but reportedly sold to Goldman Sachs for only $865 million (thirty-one cents on the dollar).[90] This may be the tip of the iceberg. The Venezuelan government reportedly has a history of issuing bonds to its central bank, which later resells the bonds at substantial discounts when the government needs funds.[91] Many of PDVSA's bonds, as well as promissory notes issued to unpaid suppliers, also reportedly involve substantially inflated face values.[92] By incurring new debt of any type, the government likely reduced the value of its existing debt. This is the nature of debt dilution.[93] But debt issued with inflated face values has an additional consequence: forcing existing creditors to bear a disproportionate share of the pain of default.[94]

86. *See* Ricardo Hausmann, *Venezuela's Unprecedented Collapse*, PROJECT SYNDICATE (July 31, 2017), https://www.project-syndicate.org/commentary/venezuela-unprecedented-economic-collapse-by-ricardo-hausmann-2017-07?barrier=accesspaylog.

87. Frank Muci, *Meth Finance*, CARACAS CHRONS. (May 29, 2017), https://www.caracaschronicles.com/2017/05/29/meth-finance. In 2017, sanctions effectively shut Venezuela out of US credit markets. *See* Anne Gearan & Anthony Faiola, *Trump Tightens Venezuela's Access to U.S. Financial System*, WASH. POST (Aug. 25, 2017), https://www.washingtonpost.com/world/national-security/trump-administration-moves-to-restrict-venezuelan-access-to-us-financial-system/2017/08/25/18b22a5e-89ad-11e7-a50f-e0d4e6ec070a_story.html?utm_term=.da6fda7845c6.

88. As an example, consider a bond with a face amount of $100 payable at maturity and a $5 yearly coupon, for which the issuer receives proceeds of only $60. The difference between the issue price and the bond's par value ($40) is a form of interest, realized by holding the bond to maturity. 1 HANDBOOK OF FINANCE: FINANCIAL MARKETS AND INSTRUMENTS 250–51 (Frank J. Fabozzi ed., 2008). In a corporate bankruptcy, unamortized OID constitutes unmatured interest and is not part of a creditor's allowable claim. *See, e.g.*, LTV Corp. v. Valley Fid. Bank & Trust Co., 961 F.2d 378, 380–81 (2d Cir. 1992).

89. Jacoby, *supra* note 4.

90. Ricardo Hausmann, *The Hunger Bonds*, PROJECT SYNDICATE (May 26, 2017), https://www.project-syndicate.org/commentary/maduro-venezuela-hunger-bonds-by-ricardo-hausmann-2017-05?barrier=accesspaylog. Goldman reportedly purchased the bonds on the secondary market, although under circumstances suggesting that the secondary market price may determine the extent of original issue discount. (The bonds were originally held by the Venezuelan central bank). *See* Kejal Vyas & Anatoly Kurmanaev, *Goldman Sachs Bought Venezuela's State Oil Company's Bonds Last Week*, WALL ST. J. (May 28, 2017, 10:19 PM), https://www.wsj.com/articles/goldman-sachs-bought-venezuelan-oil-co-bonds-last-week-1496020176.

91. Lewis McLellan, *Venezuelan Bonds: A Moral Minefield*, GLOBALCAP. (June 13, 2017) https://www.globalcapital.com/article/b13f4gk8d5mc7b/venezuelan-bonds-a-moral-minefield.

92. Mark A. Walker & Richard J. Cooper, *Venezuela's Restructuring: A Realistic Framework* 27–28 (Sept. 19, 2017) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3039678.

93. *See* discussion *supra* Subsection III.A.3.

94. To take a stylized example: Assume a debt default followed by an acceleration, leaving all bondholders with claims for the full principal amount of the debt plus accrued (but not unaccrued) interest. Assume further that the government must reduce the principal amount of its outstanding debt by 50% to regain financial footing. Using the facts reported about the Hunger Bonds as an example, a restructuring with a 50% loss of principal would still result in a tidy profit over the reported sale price of $865 million. By contrast, had the bonds been

Or take Greece, which continues to struggle more than nine years after an unprecedented bailout from other eurozone governments, and more than seven years after undertaking the largest sovereign debt restructuring in history.[95] Before the crisis, Greek government debt ballooned, as financial institutions underwrote, and investors eagerly bought, government debt seemingly without regard to risk.[96] The fact that pre-crisis Greek bond yields closely approximated yields on German bonds implies moral hazard,[97] the expectation of a bailout was ultimately validated in 2010, when other eurozone governments backstopped Greek debt to save their own banks.[98]

As a final example, also involving Greece, consider a complex loan structured as a currency swap and arranged by Goldman Sachs in 2001.[99] The apparent goal of the transaction was to reduce the amount of debt Greece would have to report, helping it comply with the Maastricht Treaty, which limits the debt that can be taken on by eurozone member countries.[100] Although the transaction apparently broke no rules, it left the government saddled with payment obligations that vastly exceeded expectations, at least as government officials later characterized the transaction.[101] If this account is accurate, then the transaction raises concerns about the use of complex loan structures to exploit information asymmetries. In the words of one subsequent official, the Greek government simply "didn't understand what it was buying."[102]

B. Responsible Sovereign Lending Proposals

Observers of the sovereign debt markets have recognized incentives for lenders to extend credit without adequately accounting for risk.[103] Yet there is little in the way of mainstream policy discourse about appropriate responses. The exceptions tend to originate from civil society groups such as the European Network on Debt and Development and intergovernmental bodies such as

purchased for par, with a coupon significantly over 6% to compensate for default risk, the same restructuring would result in a significant loss, as the investor would not be compensated for unaccrued interest.

95. *See* Miranda Xafa, *Lessons from the 2012 Greek Debt Restructuring*, VOX (June 25, 2014), https://voxeu.org/article/greek-debt-restructuring-lessons-learned.

96. James Mackintosh, *Playing Morality with Greek Markets*, FIN. TIMES (July 6, 2015), https://www.ft.com/content/8db1ae58-23b9-11e5-9c4e-a775d2b173ca.

97. *See* Matt Phillips, *The Complete History of the Greek Debt Drama in Charts*, QUARTZ (June 30, 2015), https://qz.com/440058/the-complete-history-of-the-greek-debt-drama-in-charts/.

98. *See* Steve Slater & Lionel Laurent, *Europe's Banks Bleed from Greek Debt Crisis*, REUTERS (Feb. 23, 2012, 4:24 AM), https://www.reuters.com/article/us-europe-banks/europes-banks-bleed-from-greek-debt-crisis-idUSTRE81M0LT20120223.

99. For details, see HILL & PAINTER, *supra* note 54, at 54–55; Nicholas Dunbar & Elisa Martinuzzi, *Goldman Secret Greece Loan Shows Two Sinners as Client Unravels*, BLOOMBERG (Mar. 5, 2012, 6:01 PM), https://www.bloomberg.com/news/articles/2012-03-06/goldman-secret-greece-loan-shows-two-sinners-as-client-unravels.

100. HILL & PAINTER, *supra* note 54, at 54-55.

101. *See* Dunbar and Martinuzzi, *supra* note 99 (reporting debt management official's report that Greece initially owed 600 million euros on a loan of 2.8 billion euros, but that the price of the transaction later rose to 5.1 billion euros).

102. *Id.*

103. *See, e.g.*, BROOKINGS REPORT, *supra* note 36, at 8–9; ELLMERS & TODOULOS, *supra* note 14.

UNCTAD.[104] Eurodad's Responsible Finance Charter, for instance, seeks to identify substantive standards to govern loans or investments made with a developmental purpose.[105] The UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing aim to encourage "prudent and disciplined" lending and borrowing.[106] Though framed as an effort to identify best practices, the Principles often speak in terms of responsibilities or duties owed by lenders and borrowers in the sovereign debt markets.[107]

These and similar initiatives aim to promote reform across a wide range of substantive domains.[108] With regard to the regulation of lenders, for example, both the Eurodad Responsible Finance Charter and the UNCTAD Principles articulate standards to govern not just the making of loans but also a range of post-loan conduct, such as, enforcement by entities that may have played no role in the decision to extend credit. As an example, Eurodad's conception of "responsible" finance includes, among other things: (1) disclosure obligations (*e.g.*, with regard to loan terms and repayment assumptions);[109] (2) a ban on assignment of loans without borrower consent;[110] and (3) an apparent requirement that enforcement occur only in the borrower's domestic courts or international arbitration.[111] Likewise, UNCTAD's Principles describe the responsibilities of lenders at the time the loan is made,[112] but also recognize obligations associated with debt enforcement, effectively regulating distressed debt buyers and other entities not involved in the making of the loan.[113]

104. ELLMERS & TODOULOS, *supra* note 14.

105. EUROPEAN NETWORK ON DEBT & DEV., RESPONSIBLE FINANCE CHARTER 1 (2011) [hereinafter RESPONSIBLE FINANCE CHARTER].

106. UNITED NATIONS CONFERENCE ON TRADE & DEV., PRINCIPLES ON PROMOTING RESPONSIBLE SOVEREIGN LENDING AND BORROWING 4 (2012) [hereinafter UNCTAD Principles]. For background on the UNCTAD Principles, see GOLDMANN, *supra* note 38.

107. UNCTAD Principles, *supra* note106, at 4 (characterizing the project as an effort to identify "basic principles and best practices").

108. For instance, the Principles for Stable Capital Flows and Fair Debt Restructuring in the Emerging Markets aims among other things to improve disclosures regarding the borrower's political and economic conditions. *See* Eric Helleiner, *Filling a Hole in Global Financial Governance? The Politics of Regulating Sovereign Debt Restructuring*, *in* THE POLITICS OF GLOBAL REGULATION 89, 90–91 (Walter Mattli & Ngaire Woods eds., 2009). For a summary of related initiatives, see Anna Gelpern, *Hard, Soft, and Embedded: Implementing Principles on Promoting Responsible Sovereign Lending and Borrowing*, *in* SOVEREIGN FINANCING AND INTERNATIONAL LAW: THE UNCTAD PRINCIPLES ON RESPONSIBLE SOVEREIGN LENDING AND BORROWING 347, 358 (2013).

109. For instance, provisions A(i)(5)–(7) of Eurodad's Technical and Legal Terms and Conditions require disclosure of repayment assumptions, interest rates, and debt service obligations. *See* RESPONSIBLE FINANCE CHARTER, *supra* note 1055, at 14.

110. Provision A(i)(12) forbids secondary market sales without "the free and informed consent of the borrower." *Id.* at 14.

111. *See id.* at 18 (Dispute Settlement Provisions G(II)(2) & (3)). Lenders, and investors who buy distressed loans, prefer clauses providing for enforcement in foreign courts. *See* W. Mark C. Weidemaier, *Disputing Boilerplate*, 82 TEMP. L. REV. 1, 6, 26–27 (2009).

112. For example, lenders must "provide information . . . to assist borrowers in making informed credit decisions." UNCTAD Principles, *supra* note 106, at 5 (Principle 2: Informed Decisions).

113. Principle 7, for instance, recognizes a duty to negotiate in good faith over a restructuring. The comments assert that a creditor that acquires sovereign debt "with the intent of forcing a preferential settlement of the claim outside of a consensual workout process is acting abusively." *Id.* at 7–8.

Even when responsible lending standards target narrower domains, they can be imprecise about the conduct they seek to regulate. For example, UNCTAD Principle 4 asserts that lenders must "make a realistic assessment of the sovereign borrower's capacity to service a loan."[114] This phrasing indicates a relatively modest obligation—akin, as we will discuss, to some "ability to pay" regulation in the consumer finance context—to assess the borrower's ability to make periodic interest or coupon payments, rather than a duty to assess the borrower's capacity to repay the loan in full without new borrowing.[115] The explanatory text accompanying Principle 4, however, arguably implies a broader duty to account for the borrower's financial context and even the impact of the loan on other creditors.[116]

Our point is twofold. First, the mainstream sovereign debt literature recognizes that lenders can have problematic incentives but makes little effort to define appropriate lender behavior or to explore regulatory solutions. Second, the exceptions—largely civil-society-led reform initiatives—tend to use "responsible" lending as a catch-all term encompassing a wide range of prescriptions aimed at a wider range of problematic behaviors associated with making or enforcing sovereign loans.

We do not mean this as serious criticism of these reform initiatives. Eurodad's Charter, UNCTAD's Principles, and similar proposals seek to produce change through a process of engagement and consensus-building, and this instrumental goal requires a certain breadth of scope and conceptual generality.[117] Nonetheless, painting with such broad strokes leaves a gap in the sovereign debt literature. With such a vast lending market, it is odd that one side of the lender-borrower equation receives such little attention and that existing proposals to promote responsible sovereign lending are so short on details. Experience with consumer debt and lending regulation provides potentially important insights, to which we now turn.

IV. PARALLELS IN CONSUMER LOAN MARKETS

Like sovereign debt, consumer lending can take many forms: short and long term debt; secured and unsecured debt; and term loans and loans extended on a revolving basis. Like loans extended to sovereign borrowers, lending to individuals for household purposes has grown exponentially,[118] to an extent that the recent global financial crisis has been attributed, at least in part, to its very size and

114. *Id.* at 6.

115. *See infra* Subsection III.C.1.

116. The explanatory text abandons the term "service" for the (potentially broader) "capacity to repay." And by emphasizing that new lending can "adversely affect[] the position of all other creditors," the explanatory text invokes concerns about debt dilution and hints at inter-creditor duties. UNCTAD Principles, *supra* note106, at 6.

117. Gelpern, *supra* note108, at 3.

118. The Board of Governors of the Federal Reserve System has collected data on consumer credit outstanding in US markets since 1943. FED. RESERVE SYS., CONSUMER CREDIT-G19: HISTORICAL DATA, https://www.federalreserve.gov/releases/G19/HIST/default.htm. Broadly, these data show levels of consumer credit, defined as credit extended to individuals for household, family, and other personal expenditures, including both

volatility.[119] As in the sovereign context, many argue that outstanding household credit is not only growing but a growing source of problems.

In addition to these similarities, this Part illustrates a key difference between sovereign and consumer debt. In the consumer context, the decision to lend (or borrow) is considered an important point of regulatory intervention. Much consumer financial regulation is designed to enhance consumers' access to information about credit markets and protect against ingrained decision-making biases, and that need is reduced—although not entirely absent—in sovereign debt markets. But other consumer lending regulation attempts to alter lenders' incentives to engage in imprudent, excessively risky lending, and here there are striking similarities between consumer and sovereign debt.

A. The Incentives of Consumer Lenders

Consumer lending involves incentives for over-lending analogous to those present in sovereign debt markets. Commentators generally agree that consumers borrow to smooth income levels that are mismatched with life cycle demands for expenditure on housing and capital goods,[120] and more recently accept that over-borrowing may be the result of an individual's financial imprudence and unforeseen shocks to his or her income.[121] A few argue that borrowers' strategic behavior best explains borrowing behaviors.[122] This exclusive focus on borrowers

revolving and terms loans, secured and unsecured loans, but excluding loans secured by real estate, outstanding as of January 1943 at $6.6 billion and $4 trillion by January 2019. *Id.* The Federal Reserve Board also collects data on residential and other mortgage debt obligations, and has done so since 1949. These data show that consumer residential mortgage debt rose at similarly steep rates, from $29 billion in Q4 1949 to $10.9 trillion in Q4 2018. *See* FED. RESERVE SYS., MORTGAGE DEBT OUTSTANDING, https://www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm. For easily comprehensible reasons, residential mortgage debt outstanding peaked in Q1 2008 at roughly $11.3 trillion, and has not yet returned to this pre-Crisis level. *Id.*

119. *See, e.g.*, FINAL REPORT, NAT'L COMM'N ON THE CAUSES OF THE FIN. AND ECON. CRISIS IN THE U.S. 83–101 (2011), https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf. [hereinafter Federal Crisis Inquiry Commission] ("The Commission concludes that there was untrammeled growth in risky mortgages. Unsustainable, toxic loans polluted the financial system and fueled the housing bubble.").

120. For classic citations of this "life-cycle" theory of consumer borrowing, see, for example, ANGUS DEATON, UNDERSTANDING CONSUMPTION 45–59 (Oxford Univ. Press eds. 1992); MILTON FRIEDMAN, A THEORY OF THE CONSUMPTION FUNCTION 214–19 (Princeton Univ. Press eds. 1957); Franco Modigliani & Richard Brumberg, *Utility Analysis and the Consumption Function: An Interpretation of Cross-Section Data*, *in* POST-KEYNESIAN ECONOMICS (K. K. Kurihara ed. 1954).

121. For discussion of the range of life circumstances that "push" individuals into consumer bankruptcy, see Barry Z. Cynamon & Steven M. Fazzari, *Too Much Spending or Too Little Income? The Macroeconomics of Household Spending and Debt*, *in* WORKING AND LIVING IN THE SHADOW OF ECONOMIC FRAGILITY 44–47 (Marion G. Crain & Michael Serraden eds., Oxford Univ. Press 2014); TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 80–85 (Yale Univ. Press 2001); RESPONSIBLE LENDING, *supra* note 19, at 5.

122. For discussion of the claim that consumer borrowers "gamed" the system by incurring excessive debt obligations, knowing that a discharge in bankruptcy would right the situation, see, for example, Edith H. Jones & Todd J. Zywicki, *It's Time for Means Testing*, 1999 B.Y.U. L. REV. 177, 183 (1998). For less moralistic statements of rational actor models of consumer borrowing, see, for example, Barry Adler et al., *Regulating Consumer Bankruptcy: A Theoretical Inquiry*, 29 J. LEGAL STUD. 585, 591 (2000). Jones and Zywicki's "strategic actor" model of consumer financial decision-making prompted Congress to enact the "means testing" proposal they offered. For discussion of the politics of enactment of the 2005 Bankruptcy Abuse Prevention and Consumer

leaves lenders out of the equation. Loans are bilateral. In the absence of fraud or deceptive practices, both a lender and borrower must agree to the transaction.

What, then, explains over-lending? Motivations to extend credit seem straightforward for rational lenders: they look to earn a profit.[123] More specifically, consumer lenders expect the aggregate revenue they earn from their lending portfolios (interest income plus other income plus expected benefit of principal repaid over time) to exceed their aggregate costs from extending loans (cost of funds + administrative costs + [default risk multiplied by outstanding principal]).

Why would rational lenders extend credit to borrowers who do not understand the transaction and, as a result of this imprudence, are unlikely to weather unforeseen (but not unforeseeable) events? Extensive defaults undermine lenders' profits. As a result, we would expect lenders with imperfect information about borrowers' strategic incentives to invest in efforts to weed out bad credit risks and thereby to minimize the aggregate risk of default.[124] Credit reporting and credit scoring tools assist in this sorting, but do not perfectly predict default.[125] From this perspective, over-lending is mostly the result of lenders' informational asymmetries: that is, lenders extend too much credit because they cannot perfectly predict which borrowers will default.[126]

The recent global financial crisis, which most agree was at least in part a crisis of unregulated over-lending to consumers,[127] raised questions about this conventional story of lenders' incentives. Modern scholarship posits several explanations for why well-informed, rational lenders might lend excessively.

1. Agency Problems

Commentators focus on the problematic externalization of default risk caused by widespread securitization of household debt.[128] Where a loan is extended with the expectation that it will be distributed to a securitization vehicle,

Protection Act, P.L. No. 109-8, 119 Stat. 23 (April 20, 2005), and alternative solutions to the "problem" of consumer borrowing, see, for example, Susan Block-Lieb & Edward J. Janger, *The Myth of the Rational Borrower: Behaviorism, Rationality, and the Misguided Reform of Bankruptcy Law*, 84 TEX. L. REV. 1481, 1481–82 (2006); John A.E. Pottow, *Private Liability for Reckless Consumer Lending*, 2007 U. ILL. L. REV. 405, 407 (2007).

123. *See* Adler et al., *supra* note122, at 586–88.

124. For several classical statements of economic theory of borrowing, see, for example, William H. Meckling, *Financial Markets, Default, and Bankruptcy: The Role of the State*, 41 L. & CONTEMP. PROBS. 13, 22 (1977); Joseph E. Stiglitz & Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 AM. ECON. REV. 393, 394 (1981).

125. *But see* Liran Einav et al., *The Impact of Credit Scoring on Consumer Lending,* 44 RAND J. ECON. 249 (2013) (empirically identifying two distinct benefits of risk classification through credit scoring models: the ability to screen high-risk borrowers and the ability to target more generous loans to lower-risk borrowers and demonstrating the magnitude of these beneficial effects for one segment of markets for consumer finance).

126. Stiglitz & Weiss, *supra* note124, at 393.

127. Federal Crisis Inquiry Commission, *supra* note 119, at *xvii*; RESPONSIBLE LENDING, *supra* note 19, at 11–13; *see also* Block-Lieb & Janger, *supra* note 122, at 1486–90.

128. For description of the agency problems caused by securitization of residential mortgage-backed securities, see, for example, KATHLEEN C. ENGEL & PATRICIA A. MCCOY, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS 17–19 (2011); Block-Lieb & Janger, *supra* note 53, at 470.

with the vehicle thereafter issuing bonds secured by the transferred debt that are, in turn, sold to the capital markets, loan originators face distinctly greater incentives to extend credit than they otherwise would have.[129] Loan originators with no intent to retain long term the payment streams associated with a lending agreement face little incentive to optimize default risks and every incentive to obfuscate those risks to assignees and ultimately to the capital markets likely to purchase securitized loan products. Over-lending is the result.

2. *Predatory Practices, Cognitive Biases, and Price Discrimination*

Even where the lender (or loan originator) retains the loan as an asset on its books and records, over-lending may result where lenders expect to earn a profit although specializing in high-risk lending. Behavioral decision research[130] predicts that subprime lenders may design fringe products that offset higher than average default risks with higher than average interest income.[131] So does research on the financial illiteracy of consumer borrowers.[132] Payday lenders, creditors relying on a borrower's nonpurchase-money assignment of the title to their car as security, and other high-risk, short-term extensions of consumer credit charge exceedingly high interest rates: payday loans, for example, often bear Annual Percentage Rates ("APR") in excess of 500%.[133] Other short-term fringe lenders have been documented as charging something more like 36% APR.[134]

129. Block-Lieb & Janger, *supra* note 53, at 471.

130. Behavioral decision research (BDR) suggests that consumers may systematically underestimate the likelihood of future borrowing, and overestimate their ability to repay outstanding loans, as a result of hyper-discounting, over-optimism, and framing biases. *See, e.g.*, OREN BAR-GILL, SEDUCTION BY CONTRACT: LAW, ECONOMICS AND PSYCHOLOGY IN CONSUMER MARKETS 121 (2012); Lawrence Ausubel, *The Failure of Competition in the Credit Card Market*, 81 AM. ECON. REV. 50, 71 (1991); Block-Lieb & Janger, *supra* note 122, at 1537–38. For a rebuttal of the implications of BDR for consumer credit markets, including an effort to collect contrary empirical findings, see THOMAS DURKIN, GREGORY ELLIEHAUSEN, MICHAEL E. STATEN & TODD ZYWICKI, CONSUMER CREDIT AND THE AMERICAN ECONOMY 439–44 (2014).

131. *See, e.g.*, Ronald J. Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2007 U. ILL. L. REV. 375, 384–85 (2007) (describing "the sweat box of credit card debt" as the result of a data-driven, highly competitive market in which "[t]he successful credit card lender profits from the borrowers who become financially distressed").

132. *See, e.g.*, STEPHEN REDER & JOHN BYNNER, TRACKING ADULT LITERACY AND NUMERACY SKILLS: FINDINGS FROM LONGITUDINAL RESEARCH (2009); Tullio Jappelli & Mario Padula, *Investment in Financial Literacy and Saving Decisions*, (Ctr. for Studies in Econ. & Fin., Working Paper No. 272, 2012) (on file with University of Illinois Law Review). For discussion of the diverse definitions of financial literacy, see David L. Remund, *Financial Literacy Explicated: The Case for a Clearer Definition in an Increasingly Complex Economy*, 44 J. CONSUMER AFF. 276, 278 (2010).

133. Megan Leonhardt, *This Map Shows the States Where Payday Loans Charge Nearly 700 Percent Interest*, CNBC (Aug. 3, 2018, 11:27 AM), https://www.cnbc.com/2018/08/03/states-with-the-highest-payday-loan-rates.html.

134. For discussion of the findings of extensive empirical study of payday lending and related fringe lending markets, see CONSUMER FINANCIAL PROTECTION BUREAU, SUPPLEMENTAL FINDINGS ON PAYDAY, PAYDAY INSTALLMENT, AND VEHICLE TITLE LOANS, AND DEPOSIT ADVANCE PRODUCTS (2016). On the basis of these findings, the CFPB issued a rule to regulate these markets. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54,472 (Nov. 17, 2017) (codified at 12 C.F.R. 1041) [hereinafter Payday Rule]. On February 6, 2019, the CFPB issued two proposed rules relating to the Payday Rule. One would rescind certain underwriting provisions in the Rule, *see* 84 Fed. Reg. 4252 (Feb. 14, 2019), while the other would delay the Rule's compliance deadline by a year and several months so that it extends beyond the Presidential election

In addition to profiting from higher than expected interest rates, payday lenders and other consumer lenders, including mainstream credit card issuers, generate substantial noninterest income.[135] Examples include annual fees for holding a credit card, as well as other fees that consumers are less likely to view as salient terms to their lending agreement[136]—the so-called "tricks and traps" now-Senator Elizabeth Warren and her co-author Oren Bar-Gill identified as justifying creation of an independent administrative agency governing issues of consumer financial protection.[137] Lenders may have incentives to obfuscate these terms.[138] When obscured terms take the form of late fees, overdraft fees, default interest rates and the like, lenders not only look to profit from this noninterest income; they look to profit from their borrowers' default in what Ronald Mann has termed the "sweat box" of consumer credit.[139] Credit extended through this "sweat box" model is most directly connected to concerns about over-indebtedness, especially where measures of over-indebtedness consider consumer borrowers' self-identified discomfort with debt levels.[140] Debt constructed to result in noninterest income from default fees often causes psychological stress to borrowers precisely because it was not anticipated.

3. *Moral Hazard*

Finally, protections enshrined in bankruptcy laws may encourage consumer lenders to overextend credit in specific markets. Where domestic law permits the discharge in bankruptcy of most types of debt, but makes exceptions for some types of indebtedness, lenders have incentives to extend the statutorily favored types of credit. Household credit secured by an individual borrower's primary residence is not subject to modification in a United States chapter 13 debt repayment plan;[141] nor are many car loans incurred by individual debtors within 910

results of 2020. *See* 84 Fed. Reg. 4298 (Feb. 14, 2019) (extending compliance deadline from August 18, 2019 to November 19, 2020).

135. Block-Lieb & Janger, *supra* note 53, at 467

136. *See, e.g.*, Mann, *supra* note131, at 382–94 (distinguishing "transaction based" credit card issuers, who "attempt to maximize the number of cardholders that use their cards frequently for high-value purchases," and "debt based" issuers, who "attempt to maximize the number of customers who do not repay their account balances in full each month" and recognizing that the latter type counter-intuitively seek out borrowers more likely to repay while in default).

137. Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PENN. L. REV. 1, 6 (2008). Dodd-Frank, Title X, created the CFPB in the wake of the financial crisis. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter Dodd-Frank]. That Sen. Christopher Dodd and Cong. Barney Frank were inspired to do so by Warren and Bar-Gill's scholarship is no secret. *See, e.g.*, Leonard J. Kennedy et al., *The Consumer Financial Protection Bureau: Financial Regulation for The Twenty-First Century*, 97 CORNELL L. REV. 1141, 1146 n.14 (2012).

138. *See,* e.g., Xavier Gabaix & David Laibson, *Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets*, 121 Q. J. ECON. 505, 505–07 (2006) (arguing that competitive firms exploit myopic consumers through marketing schemes that shroud high-priced add-ons, and that sophisticated consumers exploit these marketing schemes to the long-term detriment of those less-sophisticated buyers and borrowers).

139. Mann, *supra* note 131, at 384–92.

140. *Id.* at 385.

141. 11 U.S.C. § 1322(b)(2) (2018).

days of filing.[142] Student loan debt is nondischargeable under U.S. bankruptcy law, unless it is shown to inflict undue hardship on the borrower, a term of art mostly requiring individuals to endure years of struggle.[143] Some have argued, for example, that a brewing crisis in student loan debt markets is in part the consequence of incentives for over-lending created by United States bankruptcy laws.[144]

B. Consumer Finance Regulation

As noted earlier, an important distinction between sovereign and consumer lending markets is that the latter are highly regulated. Mostly, this regulation exists at the national rather than international level. Lending and the problems associated with consumer over-indebtedness, however, increasingly reach across national borders.[145] As a consequence, national regulators invest in regional and international efforts to coordinate financial consumer protection regimes. Particularly since the G-20's adoption of High Level Principles on Financial Consumer Protection in 2011,[146] regulation of lenders in the market for household credit has expanded along an emerging consensus (1) on the importance of financial consumer protection regulations, including both mandatory and standardized disclosure regulation and "responsible lending" regulation, (2) on initiatives to educate and counsel consumer borrowers on the complicated options available to them, and (3) on the consequences of choices in institutional design.[147]

142. 11 U.S.C. § 1325(a)(9) (2018) (often referred to as the "hanging paragraph" in section 1325).

143. 11 U.S.C. § 523(a)(8) (2018). For several empirical studies of courts' disparate application of this "undue hardship" standard, see Jason Iuliano, *An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard*, 86 AM. BANKR. L.J. 495 (2012); Rafael I. Pardo, *Illness and Inability to Repay: The Role of Debtor Health in the Discharge of Educational Debt*, 35 FLA. ST. U. L. REV. 505, 505 (2008); Rafael I. Pardo & Michelle R. Lacey, *The Real Student-Loan Scandal: Undue Hardship Discharge Litigation*, 83 AM. BANKR. L.J. 179, 180 (2009); Rafael I. Pardo & Michelle R. Lacey, *Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt*, 74 U. CIN. L. REV. 405, 405 (2005).

144. *See, e.g.*, Helaine Olen, *One Way to Tackle the Student Loan Debt Crisis: Bankruptcy Court*, WASHINGTON POST (May 15, 2019), https://www.washingtonpost.com/opinions/2019/05/15/one-way-tackle-student-loan-crisis-bankruptcy-court/ (noting that student loan debt ballooned after Bankruptcy Code was amended in 2005 to expand limits on discharge of such debt in bankruptcy); Adam Looney & Constantine Yannelis, *A Crisis in Student Loans? How Changes in the Characteristics of Borrowers and in the Institutions They Attended Contributed to Rising Loan Defaults*, (Brookings Papers on Econ. Activity, Fall 2015), https://www.brookings.edu/wp-content/uploads/2015/09/LooneyTextFall15BPEA.pdf (describing student loan debt outstanding at historically high levels–more than $1 trillion–and with historically high default rates–and increasingly owed to "non-traditional" educational institutions–for-profit and trade schools).

145. RESPONSIBLE LENDING, *supra* note 19, at 6; *see also, e.g.*, Organization for Economic Co-operation and Development [OECD], *National Accounts at a Glance 2015*, at 49 (2015), https://read.oecd-ilibrary.org/economics/national-accounts-at-a-glance-2015_na_glance-2015-en#page1 (collating data on household debt as a percentage of disposable income across 28 countries); CIVIC CONSULTING, *The Over-Indebtedness of European Households: Updated Mapping of The Situation, Nature and Causes, Effects and Initiatives for Alleviating Its Impact* (Dec. 2013), https://ec.europa.eu/info/sites/info/files/final-report-on-over-indebtedness-of-european-households-synthesis-of-findings_december2013_en.pdf.

146. *See* G-20 HLP on FCP, *supra* note 20.

147. *Id.* at 7; *see also* RESPONSIBLE LENDING, *supra* note 19, at 13.

We put aside for purposes of this paper discussion of financial disclosure and financial literacy education initiatives, which probably are better termed responsible *borrowing* regulations. We concentrate instead on the regulation of responsible *lending*.[148] Moreover, while the term "responsible lending regulation" might be applied to a wide range of regulation in markets for consumer loans, we mostly exclude discussion of disclosure mandates as well as prohibitions on unfair lending practices and unfair provisions in lending agreements.

Our exclusion of these regulations is not because countries disagree on their wisdom.[149] Indeed, there is increasingly broad convergence in this context. United States legislation has proscribed consumer lenders' "unfair and deceptive practices" for nearly eighty years.[150] And for almost fifty years, the United States has mandated standardized disclosures for nearly all consumer-lending products and at multiple stages in the relationship between consumer borrowers and their

148. Our focus on responsible lending regulation in consumer credit markets is motivated by correlative proposals, or at least correlative labeling of proposals, pertaining to sovereign lending. This is not to say that responsible sovereign lending proposals have not also urged enhanced disclosure—they have—but the parallels between disclosure mandates in the two markets are more attenuated and we leave this issue for another time.

149. If there is lack of consensus in consumer finance regulation it is on the question of whether regulation should concentrate on delimiting certain contract terms deemed by regulators to be unfair, or whether such regulation should focus on providing disclosure mandates and imposing limits on unfair and deceptive practices. *See, e.g.*, THOMAS A. DURKIN & GREGORY ELLIEHAUSEN, TRUTH IN LENDING: THEORY, HISTORY, AND A WAY FORWARD 20 (2011) (describing consumer financial protection regulation in the US as consisting "predominately" of disclosure mandates). U.S. law on unfair contract terms has been limited to specific sorts of credit agreements, such as credit card agreements, with the Credit Card Accountability Responsibility and Disclosure (CARD) Act of 2009, Pub. L. No. 111-24, §102(a)(5)(B), 123 Stat. 1739 (2009), and residential mortgage agreements, with Title XIV of the Dodd-Frank Act, Pub. L. No. 111-203, § 1031(a), 124 Stat. 2005 (2010), and thus is more recent than other sorts of consumer financial protection regulation. Terms regulation in this context mostly emanates out of Europe. The European Council's Directive on Unfair Contract Terms, EC Directive 93/13/EEC, dates from 1993 and predates its other directives on consumer credit and consumer contracting. *See* Council Directive 93/13, 1993, O.J. (L 95) 29, 31 (EC).

150. Section 5 of the Federal Trade Commission Act has since 1914 granted the FTC the power to prevent unfair methods of competition; in 1938, the Wheeler-Lea Amendments to the FTCA expanded this grant to empower the Commission also to regulate "unfair and deceptive acts or practices" in commerce, although not as to financial institutions who were subject to similar limits but these were only enforceable by distinct financial services regulators. 15 U.S.C. § 45 (2018). Perhaps because courts construed Section 5 of the FTCA not to grant "private right of action," numerous states have adopted Little FTC Acts or other statutes prohibiting "unfair and deceptive practices" and mostly granting individuals to right to bring suit on the basis of violations of these state laws. For discussion of state UDAP laws, see generally Carolyn L. Carter, *Consumer Protection in the States: A 50-State Report on Unfair and Deceptive Acts and Practices Statutes*, (Nat'l Consumer L. Ctr., Feb. 2009), https://www.nclc.org/images/pdf/udap/report_50_states.pdf. Dodd-Frank similarly granted the CFPB the power to prevent "unfair, deceptive or abusive acts or practices" pertaining to "covered persons" within the CFPB's jurisdiction over consumer finance and related services. Dodd-Frank Wall Street Reform and Consumer Protection, § 1031.

lenders.[151] European consumer protection law similarly prohibits unfair, misleading, and aggressive practices,[152] and mandates disclosure of key credit terms.[153]

Instead, we view discussion of unfair consumer lending practices and unfair terms in consumer contracts as largely outside the scope of this paper because proposals for responsible sovereign lending regulation have been largely silent on this front. To be sure, some sovereign borrowers arguably commit to repayment or other terms they do not fully understand: the currency swap arranged for Greece by Goldman Sachs may be an example, at least if one accepts the account of that transaction offered by Greek officials.[154] Yet relatively few observers worry that sovereign lending agreements contain predatory contract terms to the extent complained of in the consumer context.[155] Nor has the same degree of attention been paid to allegations of deceptive or misleading marketing or other sales practices in the market for sovereign loans.[156] Moreover, we put to one side most conversation about disclosure mandates, since the justification for mandatory disclosure in consumer lending contexts differs considerably from the case for enhanced disclosure in sovereign lending.

We focus in the next section, narrowly, on laws obliging lenders to assess consumers' creditworthiness and, in some cases, to undertake fiduciary-like duties to assess the propriety of credit products offered to consumers. We term these obligations "responsible lending" regulations. We return in the section that follows to differentiate responsible consumer lending regulation from other sorts of consumer finance regulation, mostly to emphasize the frequent connections between the two.

C. *Responsible Lending Regulation in Consumer Credit*

Although there are no internationally recognized standards on responsible consumer lending,[157] there is broad consensus that responsible lending regulation should govern consumer debt markets, in some form and to some degree.[158]

151. *See* Truth in Lending Act, 15 U.S.C. § 1601 (2018) (originally enacted as Title I of the Consumer Credit Protection Act of 1968, Pub. L. No. 90-321, 82 Stat. 146 (1968)). For discussion of TILA as "the centerpiece of federal consumer protection efforts in the credit area," see DURKIN & ELLIEHAUSEN, *supra* note 149, at 82.

152. *See* EU Council Directive 2005/29, Concerning Unfair Business-to-Consumer Commercial Practices in the Internal Market, 2005 O.J. (L 149) 22, 24 (EC). *See also* EU Council Directive 2006/114, Concerning Misleading and Comparative Advertising 2006, O.J. (L 376) 21, 22 (EC).

153. *See* EU Council Directive 2008/48, Concerning the Credit Agreement for Consumers, 2008, O.J. (L 133) 66, 68 (EC).

154. *See supra* Subsection III.A.6.

155. *See* Gelpern, *supra* note 108, at 353 ("From the perspective of the regulators, sovereign debt markets are generally the province of sophisticated issuers and investors, who need little by way of consumer protection.").

156. *Id.*

157. RESPONSIBLE LENDING, *supra* note 19, at 13.

158. *See, e.g.*, G-20 HLP on CFP, *supra* note 20, at 4; RESPONSIBLE LENDING, *supra* note 19, at 13; *see also* EUROPEAN COMMISSION, PUBLIC CONSULTATION ON RESPONSIBLE LENDING AND BORROWING IN THE EU 3 (2009) (defining responsible lending as ensuring that "credit products are appropriate for consumers' needs and

The World Bank reports responsible lending regulation in place in eighty countries, with forty of these countries imposing lending limits such as loan to value or debt service ratios.[159] It also notes that many countries combine mandatory disclosure regulation with additional regulation of business practices, including assessment of consumers' financial capability or creditworthiness.[160] This agreement on the need for responsible lending regulation in consumer lending markets, however, has not produced agreement on the contours this regulation should take.

1. Ability to Repay and Related Regulation

One common means for regulating responsible consumer lending involves the imposition of "ability to pay" requirements, generally in the form of requirements to verify a consumer borrower's income, credit history or other indicia of creditworthiness.[161]

Ideally, the test of a loan's affordability should consider the borrower's ability to repay a debt in full rather than simply the borrower's ability to service the loan.[162] On this question, however, international aspirations and national practices differ. In the United States, for example, consumer finance regulation mandates consideration of a consumer borrower's ability to repay a residential mortgage in full,[163] but only requires credit card issuers to consider a credit card holder's ability to make monthly payments.[164] It is an open question whether these differences will persist.

are tailored to their ability to repay," noting that the EU Consumer Credit Directive, Directive 2008/48/EC of the European Parliament and Council (23 April 2008), creates incentives for covered financial institutions to lend responsibly, but conceding that there may remain "significant room for irresponsible lending and borrowing to take place").

159. RESPONSIBLE LENDING, *supra* note 19, at 11.

160. *Id*. at 13.

161. *Id*. at 32 ("Some governments prescribe the minimum information lenders must collect from customers to ensure comparability and allow for verification of borrower's creditworthiness.").

162. *Id*. at 35. In theory, there should be no distinction between the operation of the two standards, since if a borrower is able to meet periodic payment obligations she should be able to repay the debt obligation in full and on time. To the extent there is a distinction between the two, a borrower's ability to repay the outstanding debt would seem to be the more relevant aim of such a regulatory inquiry. Arguably an ability to repay test is more difficult to comply with as applied to a revolving loan, however, given uncertainties pertaining to variability in the length of time the borrower may take to repay the non-term loan in full. The distinction between a term and revolving loan is not always clear, however. Consider, for example, certain residential mortgage obligations and certain short-term installment loans, which are framed as term loans but may instead operate more as a revolving loan in practice given lenders' assumptions regarding the borrower's likelihood of refinancing.

163. 15 U.S.C. § 1639(c)(A)(1) (2018). This provision was added in 2010 by Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376. Consistent with a congressional mandate set out in this statutory provision, the CFPB has promulgated regulations implementing and explicated this "ability to repay" standard. *See* Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 35,430 (June 12, 2013) (codified at 12 C.F.R. pt. 1026). (Jan. 30, 2013) (promulgating final regulation, effective Jan. 10, 2014). For scholarly commentary on this "ability to repay" standard and significance for consumer financial protection regulation more generally, see generally John Pottow, *Ability to Pay*, 8 BERKELEY BUS. L.J. 175 (2011).

164. 15 U.S.C. § 1665e (2018). This provision was added in 2009 by the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act of 2009), Pub. L. No. 111-24 (2009), § 109, 124 Stat. 1734

American regulation of responsible lending in the market for small loans is especially in flux. Numerous states either prohibit, prescribe, or require the licensure[165] of payday lenders,[166] and this state regulation varies considerably. Payday lenders and other similar small loan providers are subject to mandatory disclosure regulation as a matter of federal law but, for the moment, little else.[167] The Consumer Financial Protection Bureau finalized a regulation requiring assessment of consumer borrower's ability to repay payday and other short term loans,[168] and also contains "safe harbors from the Rule's ability-to-repay requirements that are keyed to price or [a] longer repayment term."[169] Although the CFPB's Payday Rule was finalized, and although Congress did not reverse this regulation,[170] its future remains unclear.[171]

("A card issuer may not open any credit card account for any consumer under an open end consumer credit plan, or increase any credit limit applicable to such account, unless the card issuer considers the ability of the consumer to make the required payments under the terms of such account."). The CFPB has twice amended Regulation Z to implement this statutory provision. For the most recent such amendment, see 12 C.F.R. § 1026.51 (2013).

165. There is enormous variation in state law surrounding payday lending. For 50-state surveys of these laws, see, for example, PEW, *State Payday Loan Regulation and Usage Rates*, (Jan. 14, 2014), http://www.pewtrusts.org/en/multimedia/data-visualizations/2014/state-payday-loan-regulation-and-usage-rates; NATIONAL CONFERENCE OF STATE LEGISLATURES, *Payday Lending State Statutes* (Sept. 6, 2016), http://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx.

166. The CFPB finalized its federal regulation of payday and other short-term lending. For discussion of current status of this Payday Rule, see Payday Rule, *supra* note 134.

167. For discussion of additional federal regulation to which federal banks engaging in payday lending are subject, see *Financial Institution Letters: Guidelines for Payday Lending*, FED. DEPOSIT INS. CORP., https://www.fdic.gov/news/news/financial/2005/fil1405a.html (last revised Nov. 2015) (noting that its Guidance is "necessitated by the high risk nature of payday lending and the substantial growth of this product" but also that the Guidance is only applicable to financial institutions subject to its regulatory jurisdiction).

168. An important part of the final Payday Rule is its incorporation of an "ability to repay" standard to regulate this sort of lending. *See* CFPB, Notice of Proposed Rulemaking, Payday, Vehicle Title, and Certain High-Cost Installment Loans, 84 Fed. Reg. 4252 (noting that the Bureau proposes rescinding the ability to repay determination requirements proposed for certain high-coat installment loans). For discussion of the regulatory history of the Payday Rule and its current uncertainties, see Payday Rule, *supra* note 134.

169. Adam Levitin, *OCC Payday Lending Bulletin*, CREDIT SLIPS (May 24, 2018), https://www.creditslips.org/creditslips/2018/05/occ-payday-lending-bulletin.html (comparing CFPB's Final Payday Rule with a recent Bulletin issued by the Office of the Comptroller of the Currency on the same topic); *see also Core Lending Principles for Short-Term, Small-Dollar Installment Lending*, OCC BULL. 2018-14 (Office of the Comptroller of the Currency, Washington D.C.) (May 23, 2018), https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html (providing that "responsible short-term, small-dollar installment loans" should follow "sound risk management practices" and strategies, which "could include working with consumers who have an ability to repay a loan despite a credit profile that is outside a bank's typical underwriting standards for credit scores and repayment ratios").

170. Legislation was introduced to reverse the Final Payday Rule under the Congressional Review Act of 1996, 5 U.S.C. §§ 801–808 (1996); *see* H.R.J. Res. 122, 115th Cong. (2017). This bill, however, did not secure the needed votes.

171. In February 2019, the CFPB proposed a "reconsideration" of the ability to pay standard in the Payday Rule and to "address the rule's compliance date." For discussion of this regulatory history, see Payday Rule *supra* note 134. Moreover, two trade groups have brought suit against the CFPB in a Texas district court challenging the Final Payday Rule as unlawful. *See* Alan S. Kaplinsky, *A Third Bite at the Apple: Trade Groups File Lawsuit Challenging CFPB Payday Rule*, JDSUPRA: CONSUMER FIN. MONITOR (Apr. 11, 2018), https://www.jdsupra.com/legalnews/a-third-bite-at-the-apple-trade-groups-17707/ (describing complaint filed in Consumer Financial Service Assoc. of American, Ltd., et al, v. Consumer Financial Protection Bureau).

Regardless of whether consumer financial protection regulations require assessment of a consumer's ability to repay a loan in full or simply to continue to make periodic payments, these sorts of responsible lending regulations also differ in form. Some responsible consumer lending regulations specify regulatory goals in broad terms, such as the mandate in Art. 8 of the EU Consumer Credit Directive to ensure that creditors "assess the consumer's creditworthiness on the basis of sufficient information."[172] Other responsible lending regulations prescribe specific business practices or contractual terms. For example, a number of countries require lenders to keep within specified debt limits or debt ratios, such as debt-to-income or loan-to-value ratios.[173] Others, like in the United States, combine the two by overlapping an open-ended standard that requires lenders to determine a consumer borrower's ability to repay[174] together with a safe harbor for compliance with specified underwriting practices, such as income verification, and in limited circumstances the presence or absence of particular contractual terms.[175]

Regulation of responsible consumer lending, thus, mandates a lender's assessment of a consumer borrower's "ability to pay" or repay. It is directed at the lender's underwriting (or loan approval) practices, and not at its marketing or other lending practices, and not at the provisions or terms of the loan itself.[176]

172. Council Directive 2008/48/EC, of the European Parliament and of the Council of 23 April 2008 on Credit Agreements for Consumers and Repealing Council Directive 87/102/EEC, art. 8(1), 2008 O.J. (L 133) 66, 82 (providing that "[m]ember States shall ensure that, before the conclusion of the credit agreement, the creditor assesses the consumer's creditworthiness on the basis of sufficient information, where appropriate obtained from the consumer and, where necessary, on the basis of consultation of the relevant database . . . ."). For a report on implementation under this Directive, see *Framework Contract on Evaluation, Impact Assessment and Related Services: Study on the Impact of the Legal Choices of the Member States and other Aspects of Implementing the Directive 2008/48/EC on the Functioning of the Consumer Credit Market in the European Union*, RISK & POLICY ANALYSTS LTD. 7 (Oct. 2013), https://rpaltd.co.uk/uploads/report_files/j812-study-on-impact-of-the-legal-choices-en.pdf.

173. RESPONSIBLE LENDING, *supra* note 19, at 45–46 (referring to specific examples).

174. Dodd-Frank, *supra* note 137, at tit. XIV, §§ 1411 & 1412. Sections 1411 and 1412 of Dodd-Frank generally require creditors to make "a reasonable, good faith determination of a consumer's ability to repay any consumer credit transaction secured by a dwelling" (although excluding open-end credit plans, timeshare plans, reverse mortgages and temporary loans) and set out "certain protections from liability under this requirement for qualified mortgages." They also grant jurisdiction to the CFPB to adopt regulations implementing these provisions, which it has exercised. *Ability to Repay Standards Under the Truth in Lending Act (Regulation Z)*, CONSUMER FIN. PROTECTION BUREAU, https://www.consumerfinance.gov/policy-compliance/rulemaking/rules-under-development/ability-repay-standards-under-truth-lending-act-regulation-z/ (last visited Aug. 5, 2019).

175. The CFPB's Final Qualified Mortgage Regulation (generally referred to as its QM Reg) was published as the Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z). *See supra* note 163. The CFPB revised the scope of this rule to reflect distinct practices, for example, in certain rural markets, and recently published a report to assess overall practice experiences under the QM Reg. *See* CFPB, Ability-To-Repay and Qualified Mortgage Rule Assessment Report (Jan. 2019), https://files.consumerfinance.gov/f/documents/cfpb_ability-to-repay-qualified-mortgage_assessment-report.pdf. It has also signaled its intention to allow certain aspects of the QM Reg to lapse after expiration of a sunset provision. *See* CFPB, Qualified Mortgage Definition Under the Truth in Lending Act (Regulation Z), 84 Fed. Reg. 37,155 (July 31, 2019), https://www.federalregister.gov/documents/2019/07/31/2019-16298/qualified-mortgage-definition-under-the-truth-in-lending-act-regulation-z.

176. For example, the CFPB describes its QM Regulation in this way:

> The final rule describes certain minimum requirements for creditors making ability to repay determinations, but does not dictate that they follow particular underwriting models. At a minimum, creditors generally

Efforts to specify satisfaction of open-ended underwriting standards may, especially in the United States, get entwined with regulation that differentiates between different credit products. The safe harbors set out in these regulations indirectly favor inclusion of certain contract terms over others, mostly as relates to "high-cost mortgages"[177] and "high-cost installment loans," including short-term, small-dollar payday loans.[178]

2. *Regulation of Loan Suitability*

While the World Bank reports convergence on consumer financial protection regulation requiring lenders to assess a borrower's "ability to repay," countries such as the United Kingdom provide another layer of protection by requiring consumer lenders also to assess the suitability of a consumer debt obligation to the borrower's situation.[179] Suitability requirements are commonplace in regulation of consumer investment decisions under both United States and European Union law. The United Kingdom has extended these suitability requirements to financial decision-making on debt, as well.[180] While some academics argued that a suitability standard should apply both to stock and mortgage brokers,[181] the United States explicitly rejected this approach under the Dodd-Frank Act.[182]

Suitability standards impose fiduciary or near-fiduciary obligations of advice to consumer borrowers. Historically, however, debtor-creditor relationships between borrowers and lenders have not been construed to create fiduciary obligations to act in the borrower's best interest.[183] The strongest case for fiduciary obligations to assess the suitability of consumer credit may extend to financial intermediaries in the household loan markets, such as mortgage brokers, since brokers often hold such obligations in other contexts.

must consider eight underwriting factors: (1) Current or reasonably expected income or assets; (2) current employment status; (3) the monthly payment on the covered transaction; (4) the monthly payment on any simultaneous loan; (5) the monthly payment for mortgage-related obligations; (6) current debt obligations, alimony, and child support; (7) the monthly debt-to-income ratio or residual income; and (8) credit history. *Id.* at 35, 438–39.

177. *See generally id.*

178. *See, e.g.*, Payday Rule, *supra* note 134, at 54,472.

179. RESPONSIBLE LENDING, *supra* note 29, at 40–43 (describing suitability test as relating to three factors: assessment of the consumer's best interests; her understanding of the product; and the long-term affordability of the loan).

180. *Id.* at 41–42.

181. Jonathan R. Macey et al., *Helping Law Catch Up to Markets: Applying Broker-Dealer Law to Subprime Mortgages*, 34 J. CORP. L. 789, 814–37 (2009).

182. Although something like a suitability standard was contained in a pre-cursor to the Dodd-Frank Act passed by the US House of Representatives, the Senate rejected this approach. *See* Block-Lieb & Janger, *supra* note 53, at 493 (discussing this legislative history).

183. *See generally* Warren L. Dennis & Mark Masling, *Death Knell for Fiduciary Duties of Lenders to Consumer Borrowers*, 46 BUS. LAW. 1223 (1991).

3. Lack of Consensus on Details, or Overarching Goals?

Responsible consumer lending regulation looks to prevent, or at least curb, consumer over-indebtedness.[184] By mandating that lenders use sound underwriting practices for assessing a consumer's creditworthiness or "ability to repay," responsible lending regulation presumes that market forces alone do not deter "irresponsible" lending. Policymakers justify this presumption with references to rational lenders' incentives to lend excessively—that is, the agency problems, cognitive biases, price discrimination, and moral hazard referred to above.[185]

But responsible lending regulation is not the only means through which regulators have addressed problems of consumer over-indebtedness. Consumer finance regulation also tackles problems of information asymmetries and cognitive biases through disclosure mandates and financial education initiatives, agency problems and predatory practices through regulation of unfair and misleading marketing and lending practices, and moral hazard through regulation of the price and nonprice terms in consumer finance contracts.[186] A failure to converge on the contours of the sorts of lending regulations described above is partly related to distinctions in the broad range of consumer financial transactions available in the marketplace, partly a function of regulatory tastes and preferences, but also in important ways a signal of a more foundational disagreement on the underlying purposes for layering responsible lending regulation on top of other consumer financial protection regulation.

For example, under United States law, an "ability to pay" standard governs extensions of credit card credit.[187] A related "ability to repay" standard governs residential mortgage markets[188] and possibly certain short-term revolving extensions of credit, such as payday loans.[189] Although the "ability to pay" requirement for responsible lending in United States credit card markets is not clarified

184. RESPONSIBLE LENDING, *supra* note 19, at 12 (overviewing regulatory tools).

185. *See* Title XIV of the Dodd-Frank Act, Pub. L. No. 111-203, § 1031(a), 124 Stat. 2005 (2010); *supra* Section III.A.

186. *See supra* Subsection III.A.4–5.

187. CARD Act, *supra* note 164, at 123 Stat. at 1743.

188. Title XIV of the Dodd-Frank Act, Pub. L. No. 111-203, § 1031(a), 124 Stat. 2005 (2010). For discussion of the regulatory history that followed enactment of this provision, see *supra* note 163.

189. Payday Rule, *supra* note 134, at 54,472.

by an explicit "safe harbor," [190] the "ability to repay" standards applicable to residential mortgage[191] and certain payday and other small amount, short term lending are coupled with "safe harbor" provisions to clarify when a lender has satisfied these open-ended standards for responsible lending.[192]

The details of these safe harbor provisions are best understood in light of other United States consumer finance regulation, which mostly does not regulate the price terms in consumer credit transactions and only recently looks to regulate the nonprice terms (that is, the contract provisions) in specific consumer credit transactions. Thus, while the high interest rates charged by certain subprime lenders are not directly regulated, Dodd-Frank and the QM Regulations promulgated pursuant to Dodd-Frank establish safe harbors that are harder to satisfy in the case of "high-cost mortgages."[193] Similarly, while currently the CFPB's regulation of payday and other small amount, short-term lending does not impose caps on interest rates and related fees, it would more harshly regulate shorter-term (and so, likely higher-cost) loans. The result is to create regulatory incentives for extending small loans over a longer two-year period at a lower 36% APR.[194]

V. IMPLICATIONS

If there is no consensus as to the form or objectives of consumer lending regulation, neither is there consensus in the context of sovereign debt. With sovereign lending markets, regulatory debates take place in the shadow of two important limitations. First, because borrowers are sovereign governments, they are immune from coercive regulation.[195] Second, regulatory actors have shown little appetite for policing the conduct of the global banks and financial intermediaries that dominate the market for sovereign debt.[196] Nevertheless, consumer lending

190. *See, e.g.*, CARD Act, *supra* note 164; *see also* Obrea O. Poindexter & Matthew W. Janiga, *The CFPB Amends Regulation Z's Credit Card Issuer "Ability-to-Pay" Requirement*, 69 BUS. LAWYER 593, 596 (2014). Increasingly, US credit card regulation prohibits credit card issuers from relying on specific terms in credit card agreements (such as universal default clauses or clauses permitting modification of credit card credit agreements with little notice although the card holder is not otherwise in default). Although Regulation Z provides a sort of safe harbor for the "ability to pay" requirements applicable to credit card lending, it is not very detailed. CARD Act, *supra* note 164.

191. Adam Levitin has summarized the safe harbors in the QM Regulation as follows:

> QM is defined as a mortgage that meets the following six criteria: 1. regular payments that are substantially equal (ARMs and step-rate mortgages excepted) and always positively amortizing; 2. term ≤30 years; 3. [with] limited fees/points (caps vary with mortgage size); 4. [that was] underwritten using the maximum interest rate in the first five years to ensure repayment; 5. income verified; [with] backend DTI ≤43% (including simultaneous loans).

Levitin, *supra* note 169.

192. For discussion of the safe harbors set out the CFPB's Payday Rule, see *id.* Whether the ability to repay portions of the Payday Rule will survive remains an open question. For discussion of this regulatory history, see Payday Rule, *supra* note 134.

193. *See* Dodd-Frank, *supra* note 137; *supra* note 163.

194. *See* Payday Rule, *supra* note 134, at 54,485.

195. *See* Panizza, *supra* note 6, at 3.

196. *See* Adam Feibelman, *The IMF and Regulation of Cross-Border Capital Flows*, 15 CHI. J. INT'L L. 409, 431, 431 n.125 (2015).

regulation offers lessons for the sovereign debt markets. We address two such lessons in this Part. The first involves assessments of debt sustainability. The second implicates debates about the roles and responsibilities of lenders to sovereign borrowers.

A. Defining and Assessing Sustainability

Sovereign debt sustainability assessments are most commonly associated with the practices of the IMF, which primarily assesses sustainability in two settings.[197] The IMF regularly monitors the economic and financial policies of member states in an activity known as surveillance.[198] This includes periodic analysis of debt sustainability, for which the fund has separate methodologies for low-income countries (*i.e.*, those that depend heavily on concessional financing) and market-access countries (those with consistent access to capital markets).[199] From the IMF's perspective, debt sustainability means that "the primary balance needed to at least stabilize debt . . . is economically and politically feasible, such that the level of debt is consistent with an acceptably low rollover risk and with preserving potential growth at a satisfactory level."[200] The assessment of sovereign debt sustainability, thus, focuses on whether the borrower has sufficiently robust political institutions and economic prospects to tax or grow to the extent needed to maintain debt service.[201]

In addition to regular monitoring, some IMF lending decisions also require assessments of sustainability. This includes the Exceptional Access Framework, which grants member states access to financing above normal access limits, typically in the context of a debt crisis.[202] When a member state has lost access to

197. The IMF was created to address the instability in monetary and exchange rate policies that contributed to the Second World War. *See id.* at 426.

198. *See* Articles of Agreement of the IMF, art. IV, § 3(a); Feibelman, *supra* note 196, at 426–29 (describing the scope of IMF authority).

199. IMF, *Debt Sustainability Analysis: Introduction* (last updated July 29, 2017), http://www.imf.org/external/pubs/ft/dsa/.

200. IMF, *Staff Guidance Note for Public Debt Sustainability Analysis in Market-Access Countries* (May 9, 2013), http://www.imf.org/external/np/pp/eng/2013/050913.pdf. Thus, debt is unsustainable when "a debt restructuring is already needed (or expected to be needed)," when a government accumulates debt "faster than its capacity to service these debts is growing," and when debt levels increase although "major retrenchment will be needed to service these debts." IMF, *Assessing Sustainability* at 4 (May 28, 2002), http://www.imf.org/external/np/pdr/sus/2002/eng/052802.pdf.

201. *See* BROOKINGS REPORT, *supra* note 36, at 36.

202. Susan Schadler, *Living With Rules: The IMF's Exceptional Access Framework and the 2010 Stand-By Arrangement with Greece*, IEO Background Paper BP/16-02/08, at 2–6 (July 8, 2016) (explaining pre-2010 history and evolution of IMF exceptional access policy). For current policy, see IMF, *The Fund's Lending Framework and Sovereign Debt—Further Considerations*, Policy Paper, 6–7 (Apr. 9, 2015), http://www.imf.org/external/np/pp/eng/2015/040915.pdf.

market financing, the IMF often acts as lender of last resort, albeit one with important resource constraints.[203] This role requires special attention to safeguarding Fund resources.[204] Until recently, IMF policy conditioned access to emergency loans on a finding that a member's debt load was sustainable with high probability in the medium term.[205] The lack of such a finding effectively conditioned Fund support on a debt restructuring deep enough to bring the borrower's debt to sustainable levels.[206] Current policy modifies this framework to permit IMF financing in cases involving greater uncertainty as to debt sustainability.[207] Under current policy, where a member's debt is deemed sustainable but not with high probability, it can qualify for Fund support by conducting a debt reprofiling (*i.e.*, deferring coupon and principal payments) rather than an outright restructuring (*i.e.*, reduction of outstanding principal).[208]

Several things should be clear from this summary. First, IMF sustainability assessments are technical and involve both quantitative and qualitative assessments of the member's economic and political situation.[209] As an example, low-income countries not already having repayment difficulties are sorted into low, medium, and high risk categories depending on whether a series of debt burden indicators exceed defined thresholds in a baseline scenario and in "stress test" scenarios involving external shocks or macroeconomic policy shifts.[210] Three indicators examine the present value of the member's outstanding debt as a percentage of its exports, GDP, and revenues.[211] Two more examine debt service payments as a percentage of exports and revenues.[212] For each indicator, the relevant threshold varies depending on whether the member's policies and institutions fall into weak, medium, or strong categories.[213] These categories are proxies for whether the member has the political and economic capacity to tax or otherwise engage in the fiscal adjustment necessary to avoid balance of payment difficulties.[214]

203. *See, e.g.*, Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT'L L. 299, 330, 330 n.84 (2005); Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 CORNELL L. REV. 956, 957 (1999).

204. Hagan, *supra* note 203, at 300-31.

205. *See* IMF, *The Fund's Lending Framework and Sovereign Debt—Further Considerations*, *supra* note 202, at 6–7.

206. *Id.* at 7.

207. *Id.* at 9–10.

208. *Id.* at 10.

209. *Id.* at 18.

210. IMF, *The Joint World Bank-IMF Debt Sustainability Framework for Low-Income Countries*, Factsheet (Aug. 15, 2018), https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/39/Debt-Sustainability-Framework-for-Low-Income-Countries.

211. *Id.*

212. *Id.*

213. *Id.* These metrics are slightly modified when remittances are taken into account. *See* IMF, *Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries*, Policy Paper, 10 (Nov. 5, 2013), https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Staff-Guidance-Note-on-the-Application-of-the-Joint-Bank-Fund-Debt-Sustainability-Framework-PP4827.

214. *See* IMF, *Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries*, *supra* note 213, at 14.

A second important area to emphasize regarding IMF assessments of debt sustainability is that they are focused on the ability to avoid default. To be clear, in the context of the Exceptional Access Framework, the purpose of the IMF's inquiry is to ensure that the Fund is repaid in full for any emergency access financing.[215] Yet, the assessment of sustainability does not otherwise ask whether the government can be expected to reduce its debt, nor does it explicitly consider the impact of the member's debt on citizens or on the member's ability to pursue development or other policy objectives.[216] This is not because the IMF considers such matters unimportant. Instead, the Fund defers to members in the definition of policy objectives and spending priorities.[217] The limited role of a debt sustainability assessment is to determine whether the member is likely to be able to continue to pursue these without a politically or economically infeasible adjustment to its primary balance.[218]

Finally, IMF sustainability assessments occur largely ex post—that is, after the borrower has already incurred much debt. To be sure, these assessments are predictions of the likelihood of balance of payments difficulties in the future, and the IMF may condition its own lending on a finding of sustainability. Other lenders, however, need not take assessments of debt sustainability by the IMF or any other entity into account when making loans.[219] In consequence, IMF sustainability assessments tend to matter most when a government is already in financial crisis.[220] By that point, the horse is out of the barn.

This is not meant to be unduly critical of the IMF. As mentioned, the IMF seeks to perform a technical function, one as to which it can claim both expertise and relative legitimacy, while leaving governments room to set policy objectives.[221] Its practices are dwelled on because the IMF is the most prominent and well-established institutional mechanism for incorporating judgments as to debt sustainability into policy action in the context of sovereign lending.[222] Because

215. *See generally id.*

216. The Fund's definition of sustainability does recognize that debt is sustainable only when the rollover risk is "acceptably low" and debt service obligations preserve "potential growth at a satisfactory level." IMF, *Staff Guidance Note for Public Debt Sustainability Analysis in Market-Access Countries*, Policy Paper, 4 (May 9, 2013), http://www.imf.org/external/np/pp/eng/2013/050913.pdf.

217. *Id.* at 27; *see also* IMF, *Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries*, *supra* note 213, at 20 (noting that sustainability analysis is intended to guide borrowing decisions for low-income countries "in a way that balances their development goals with preserving debt sustainability").

218. *See* Hagan, *supra* note 203, at 307 ("[A]n assessment of debt sustainability requires not only a judgment as to whether, for example, the projected primary fiscal surplus is sufficient to cover forthcoming debt payments, but also whether, as a political matter, such a surplus can actually be achieved and sustained.").

219. *See* AFR. FORUM AND NETWORK ON DEBT AND DEV. ET AL., CIVIL SOCIETY POSITION ON THE IMF AND WORLD BANK DEBT SUSTAINABILITY FRAMEWORK REVIEW 2 (2016).

220. *See id.*

221. *See supra* text accompanying notes 216–19.

222. This is not to say the IMF enjoys unquestioned legitimacy. The link between the IMF's analysis of debt sustainability and its role as a creditor presents acknowledged challenges. *See, e.g.*, Anna Gelpern, *A Skeptic's Case for Sovereign Bankruptcy*, 50 HOUS. L. REV. 1095, 1120–22 (2013); Hector R. Torres, *Reforming the International Monetary Fund–Why Its Legitimacy is at Stake*, 10 J. INT'L ECON. L. 443, 447–50 (2007).

of its prominent role, however, IMF assessments present some risk of crowding out other perspectives on how to define debt sustainability.

The sustainability of a country's debt need not be assessed in such a limited, ex post manner, however. It is not a given, for instance, that a country's debt is "sustainable" simply because the country can remain current on its debts.[223] At minimum, such a standard may enable debt restructurings that occur too late or that provide too little debt relief.[224] Politicians in financially distressed countries have incentives to put off the day of reckoning.[225] Because IMF sustainability determinations "have a decisive influence on the timing of sovereign debt restructuring,"[226] a standard that is too easily satisfied may enable politicians to delay the inevitable. Moreover, a level of debt that impairs the ability to provide public services, pursue development objectives, or otherwise enhance citizen welfare could properly be called unsustainable, whether or not the government is expected to keep paying its debts for the foreseeable future. For some large governments, moreover, default may present systemic risks to the global financial system in the modern context.[227] Perhaps assessments of debt sustainability should take such risks into account in determining the level of debt that is appropriate for a given borrower.

Concerns like these have led some actors to push for a broader conception of debt sustainability. For instance, a 2015 United Nations General Assembly resolution on sovereign debt restructurings explicitly injects development and human rights objectives, as well as systemic concerns, into the definition:

> Sustainability implies . . . a stable debt situation in the debtor State, preserving at the outset creditors' rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, warranting the stability of the international financial system and respecting human rights.[228]

Civil society groups have also urged a broader conception of debt sustainability, one that looks beyond macroeconomic indicators of debt servicing capacity and takes into account the borrower's ability to foster human development.[229] More recently, Juan Pablo Bohoslavsky and Matthias Goldmann argued that debt sustainability is emerging as a principle of public international law, one

223. *See, e.g.*, Martin Guzman, *Definitional Issues in the IMF Debt Sustainability Analysis Framework*, CIGI Policy Brief No. 77 (May 2016) (criticizing IMF debt sustainability framework for contributing to delayed and insufficient debt restructurings).

224. *Id.*

225. Eduardo Borensztein & Ugo Panizza, *The Costs of Sovereign Default* 19–20 (IMF, Working Paper No. WP/08/238, 2008).

226. Guzman, *supra* note 223.

227. For example, Italy has raised concern, given the size of its economy, substantial debt, and fragile banking system. *See* Landon Thomas Jr., *Worries Grow Over Euro's Fate as Debts Smolder in Italy and Greece*, N.Y. TIMES (Feb. 8, 2017), https://www.nytimes.com/2017/02/08/business/dealbook/worries-grow-over-euros-fate-as-debts-smolder-in-italy-and-greece.html.

228. G.A. Res. 69/319, ¶ 8 (Sept. 10, 2015).

229. For example, Eurodad's Responsible Finance Charter urges: "While debt sustainability has traditionally been assessed along strict macroeconomic criteria . . . [,] debt sustainability should also be a function of crucial human indicators." RESPONSIBLE FINANCE CHARTER, *supra* note 105, at 5.

that includes "two important public interests, namely a concern for economic development and growth, and increasingly also for the protection of human rights."[230] Whether or not one accepts their claim about public international law, they correctly note that international actors have increasingly recognized the negative impact of high debt levels on the ability of governments to advance the welfare of citizens.[231]

Even these exceptions, however, highlight the limits of current discourse about sovereign debt. Most notably, many of the voices arguing for a broader conception of debt sustainability are focused on the context of debt restructuring.[232] In the next Section, we accept this limitation—asking whether consumer finance offers any insight into how debt sustainability should be assessed in the ex post context of a debt crisis. We then shift focus, examining whether lessons from consumer debt can inform debates over the ex ante practices of lenders in sovereign debt markets.

B. Debt Sustainability Parallels to Consumer Protection

Our critique of the ex post orientation of sustainability analysis does not render this inquiry unnecessary. As noted, the IMF cannot justify extending emergency loans without assurance it will be repaid. In that narrow context, the Fund might properly focus its inquiry on the likelihood of default during the period of an IMF program. Yet it should be obvious that this is not the goal of a debt *restructuring*. Broadly speaking, that goal is to return the government to financial health in a way that fairly allocates the costs of financial crisis among citizens, bondholders, and other competing claimants.[233] As Anna Gelpern puts it: "The existing regime tends to approach debt sustainability as a fact, an ascertainable threshold . . . . It is generally understood, but less commonly discussed, that sustainability is also a political judgment about distribution of resources between debtors and creditors."[234]

The question is how this judgment should be made. The task of defining debt sustainability involves both technical decisions (*e.g.*, Which macroeconomic and social indicators reliably indicate the presence or absence of sustainable debt?) and normative ones (*e.g.*, What makes debt problematic, and what are the characteristic of an "appropriate" restructuring?). Analogous debates in consumer lending confirm the difficulty of resolving these questions, both because of technical complexity and because the need for normative judgments implies that technocratic assessments made at the international level should defer to national resolution of questions of social and cultural dimension.

230. Juan Pablo Bohoslavsky & Matthias Goldmann, *An Incremental Approach to Sovereign Debt Restructuring: Sovereign Debt Sustainability as a Principle of Public International Law*, 41 YALE J. INT'L L. ONLINE 13, 21 (2016).

231. *Id.* at 21–27.

232. *See, e.g.*, G.A. Res. 69/319, *supra* note 229; ELLMERS & TODOULOS, *supra* note 14; Bohoslavsky & Goldmann, *supra* note 230.

233. ELLMERS & TODOULOS *supra* note 14.

234. Gelpern, *supra* note 41, at 86–87.

On the technical front, the process of defining consumer over-indebtedness has been fraught with complication. If one goal of responsible lending regulation is to reduce over-indebtedness, policymakers would be aided in measuring the success of their proposals by converging on an agreed upon definition of the term. Instead, they struggle with definitions,[235] disagreeing on when aggregate household debt levels become problematic enough to justify intervention. While recent research has converged to some degree on indicators of over-indebtedness, researchers still track as many as seven different indicators.[236]

Despite the failure to agree on a single definition of consumer over-indebtedness, researchers seem to have converged on the principles or goals underlying such a definition.[237] Policymakers agree that the definition must call for an assessment of the effects of indebtedness after it was incurred.[238] These effects transform a heavy debt burden into one that is problematic. Debt levels are viewed as problematic if the debtor suffers (i) difficulties in repayment (ii) that are more than temporary and (iii) that negatively affect long-term consumption decisions of the debtor and the debtor's dependents.[239] Importantly, (iv) debt is viewed as problematic not simply because of its effects on the consumer,[240] but also because of negative externalities that impair the welfare of dependents and other third parties.[241]

There is less agreement on normatively tinged questions involving when consumer debt shifts to problematic levels and how to respond when this happens. Although the notion of debt adjustment controverts foundational principles regarding the sanctity of contract, many would argue that these principles face normative limits.[242] The latter contend that consumer borrowers should be allowed to restructure or discharge debt that cannot be repaid over the long-term in order to fix problems of over-indebtedness, and support the case for restructuring or discharge of unsustainable debt on a combination of pragmatic and principled notions.[243] They argue that efforts to collect unsustainable debt involve expensive and mostly unproductive "wheel spinning," and also harm a consumer borrower's will to work and health, as well as the borrower's ability

235. *See, e.g.*, RESPONSIBLE LENDING, *supra* note 19, at 6; EUROPEAN COMMISSION, TOWARDS A COMMON OPERATIONAL EUROPEAN DEFINITION OF OVER-INDEBTEDNESS (2008); Nicole Fondeville, Erhan Őzdemir & Terry Ward Applica, Research Note, *Over-Indebtedness: New Evidence from the EU-SILC Special Module* (Eur. Comm'n Note 4, 2010).

236. RESPONSIBLE LENDING, *supra* note 19, at 7.

237. *Id.* at 30.

238. *Id.* at 6.

239. *Id.* at 42–43.

240. *Id.* at 5.

241. *Id.* at 2.

242. *See* WORLD BANK, INSOLVENCY AND CREDITOR/DEBTOR REGIMES TASK FORCE WORKING GROUP ON THE TREATMENT OF THE INSOLVENCY OF NATURAL PERSONS, REPORT ON THE TREATMENT OF THE INSOLVENCY OF NATURAL PERSONS 19–39 (2013), http://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport_01_11_13.pdf (laying out normative foundations of debt adjustment and discharge of indebtedness owed by over-indebted natural persons).

243. *Id.* at 115.

to provide for dependents and participate as a functioning member of the economic community.[244] Among those willing to consider remedies of discharge, restructuring or rescission, there is also disagreement on when a consumer's debts should be viewed as unlikely to be repaid over the long-term and what constitutes a sufficiently long period of time for such repayment efforts.[245]

We would not expect greater consensus among policy actors in the sovereign debt world. But this does not mean reform is impossible. One possibility is to emphasize structural changes that do not require consensus on technical questions or normative policy objectives. Another is to agree at least on the breadth of the normative questions involved in assessing sovereign debt sustainability. As Bohoslavsky and Goldmann point out, policy actors increasingly acknowledge that the goal of a sovereign debt restructuring is to restore debt sustainability.[246]

Although policy actors may define sustainability in different ways, they also seem to agree that the term means more than that the borrower's primary balance is sufficient to "at least stabilize [its] debt."[247] Synthesizing sovereign debt practices as they have evolved since the 1970s, Bohoslavsky and Goldmann identify the emergence of a "public interest in debt practices that foster economic development and growth."[248] This developing consensus implies that a technical inquiry into the borrower's ability to avoid default (akin to assessing "ability to pay" in the consumer context) is simply not adequate.

If, given realistic (*i.e.*, nonextreme) assumptions about future economic shocks, a country cannot remain current on its debt without adopting macroeconomic policies that seriously compromise development objectives and citizen welfare, we do not think its debt can properly be called sustainable. Simple reference to the sanctity of contract does not end debate on whether sovereign debt judged unsustainable by this definition should be restructured. Insistence on repayment in such cases raises normative considerations that sit in tension with the principle that *pacta sunt servanda*.[249]

If it is agreed that a finding of debt sustainability requires both technical and normative judgments, a number of implications follow. Some are structural. Put simply, the IMF is not the right institutional actor to assess debt sustainability in the broader sense we have described. On this basis, Anna Gelpern proposes that judgments about debt sustainability be made by "standing or *ad hoc* expert panels, drawn from agreed lists including market, civil society, and public sector representatives."[250] The IMF would continue to make sustainability assessments, of course, especially when assessing whether to lend to a financially-distressed

244. *Id.* at 37.
245. *Id.* at 115–122.
246. Bohoslavsky & Goldmann, *supra* note 230, at 21–27.
247. IMF, *Staff Guidance Note for Public Debt Sustainability Analysis in Market-Access Countries*, *supra* note 36, at 4.
248. Bohoslavsky & Goldmann, *supra* note 230, at 22.
249. *Id.*
250. Gelpern, *supra* note 41, at 87.

government.[251] In that context, the technocratic nature of the Fund's inquiry makes sense. But the IMF's judgment would not necessarily be tied to broader questions about whether a government should restructure,[252] or how to allocate a government's limited resources among its various claimants.

Though this proposal has a great deal of merit, there is also a danger in relying on structural solutions to problems with normative dimensions. The fact that sustainability assessments are unavoidably political does not mean that they are *entirely* political. Even if sustainability assessments are conducted by panels whose membership is more representative of the diverse interests in play in a debt restructuring,[253] decision-makers would benefit from having a shared sense of why sustainability matters.

The recent General Assembly Resolution on sovereign debt restructuring presents a useful shift in this regard, defining "sustainability" with respect to national objectives for economic development and more basic concerns for human rights.[254] The Eurodad Responsible Finance Charter similarly emphasizes the human rights aspects of assessing the sustainability of sovereign debt.[255] We would go a step further: Decision-makers assessing the sustainability (or unsustainability) of sovereign debt, whether the IMF or some more inclusive panel of experts, should be cognizant of similar questions asked when considering how best to address consumer over-indebtedness. In the consumer debt context, despite lack of agreement on how to define or respond to over-indebtedness, there is relatively widespread agreement that negative externalities are part of what makes debt problematic.[256] There is also agreement that, because over-indebtedness is problematic on multiple levels, consumer debt must sometimes be reduced even though this means that the consumer's contracts will not be honored in full.[257]

At a minimum, the parallels we raise suggest that debt sustainability judgments in the sovereign debt context must consider more than whether the debtor can remain current in the medium-to-long term. Sovereign debt should be classified as unsustainable when it cannot be repaid in the reasonably-long-term without materially impairing the government's ability to ensure citizen welfare and to pursue reasonable development goals. This is true whether or not the country can continue to "pay" (if not "repay") its debt by meeting, but not reducing, debt obligations. Parallels to consumer debt also imply that, in the case of systemically significant sovereign borrowers, efforts to delay or avoid restructuring can impose unwarranted costs that extend beyond the borrower's citizens and lenders, and provide support for the notion that these externalities can justify limits on the sanctity of contract.

251. *Id.*
252. *Id.*
253. *Id.*
254. G.A. Res. 69/319, ¶ 8 (Sept. 15, 2015).
255. RESPONSIBLE FINANCE CHARTER, *supra* note 105, at 7.
256. *See, e.g.*, *id.* at 6.
257. WORLD BANK, INSOLVENCY TREATMENT OF NATURAL PERSONS, *supra* note 242, at 19–39.

C. Assessing Lender Roles and Responsibilities Ex Ante

Beyond informing ex post assessments of debt sustainability, experience from the consumer lending context can inform conversations about the roles and responsibilities private lenders should assume when making loans to sovereign borrowers. As noted, consumer and sovereign lending differ in important ways.[258] Among many other differences, national regulators have demonstrated little desire to legislate standards of conduct with regard to the making of loans to foreign sovereigns. Yet these same regulators, sometimes working in tandem with international organizations like the IMF, have often wielded regulatory power more subtly by, for example, cajoling lenders into revising loan contracts.[259]

As we have explained, the concept of lender responsibility has also gained currency through the efforts of civil society groups and intergovernmental organizations like UNCTAD and Eurodad.[260] It is not implausible to think that, if articulated with sufficient clarity, notions of responsible lending might crystallize into a set of norms or best practices that would mitigate some of the risks associated with excessive lending.[261] But this cannot happen until the concept of responsible sovereign lending has been defined more concretely.[262] Experience from the consumer context teaches not to expect consensus on precise standards of conduct. But in the sovereign debt context, the problem runs deeper. There remains no consensus on the goals of lending regulation—indeed, there is little explicit discussion of the topic. This must change.

1. Goals and Methods of Consumer Lending Regulation

In the consumer context, disagreements on how to remedy problems of over-indebtedness after they arise (ex post) parallel debates on how to prevent over-indebtedness in the first instance (ex ante). One debate is over regulatory goals. In the prevention context, this plays out as a debate over whether regulation should focus only on problematic lending practices, or whether regulation should seek more broadly to assure that borrowers do not incur loans they cannot pay (or repay) or that do not suit their risk preferences. The former model is sometimes referred to as predatory lending regulation (or regulation of unfair, deceptive, and abusive lending practices); the latter is often referred to as responsible lending regulation, although, as noted above, this term can also refer to almost any sort of lending regulation.[263]

258. *See supra* text accompanying notes 37–41.

259. *See supra* Subsection IV.C.2.

260. *See supra* Section III.B.

261. *See, e.g.*, CHRIS BRUMMER, SOFT LAW AND THE GLOBAL FINANCIAL SYSTEM: RULE MAKING IN THE 21ST CENTURY 150–51 (2015) (discussing mechanisms through which non-binding international financial law may shape behavior).

262. *See supra* text accompanying notes 108–16 (discussing the ambiguity and generality of responsible lending as a concept).

263. RESPONSIBLE LENDING, *supra* note 19, at 3–4.

Earlier, for instance, we described the lack of consensus as to whether consumer lenders should assess a borrower's "ability to pay" or "ability to repay" indebtedness.[264] One way to view this disagreement is as a reflection of a lack of agreement on foundational principles. Responsible lending regulation of consumer finance markets may be animated by the desire to address problems of over-indebtedness, the perception that many consumer lenders engage in predatory practices, or by both concerns.[265]

Given the lack of agreement about goals, it should be no surprise that regulators often disagree on the form of consumer lending regulation. Some view vague standards prohibiting, for example, unfair, deceptive, and abusive practices, or mandating responsible lending practices, as providing needed flexibility; others view clear-cut rules as the only effective way to provide guidance in this context.[266]

Importantly, even when regulation opts for clear-cut rules, this choice may implicate questions analogous to those that preclude agreement on how to define over-indebtedness.[267] The search for indicators of over-indebtedness looks to distinguish debt that is simply difficult to repay from debt that is unsustainable. A similar distinction is implicit in standards that look to a borrower's "ability to pay" or repay, which often articulate debt-to-income or loan-to-value ratios that can serve as proxies for problematic loans.

Over-indebtedness debates reveal the difficulty of identifying the time frame over which judgments about a borrower's payment (or repayment) prospects should be made and emphasize the importance of externality effects—on dependents, for example.[268] And safe harbors demonstrating responsible lending may differ depending on whether the covered loan involves a long-term mortgage, short-term payday, or other personal loan.[269] Existing policy debates in

264. *See supra* text accompanying notes 161–71.

265. RESPONSIBLE LENDING, *supra* note 19, at 3.

266. Bureau of Consumer Fin. Prot., Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z) 6 (Jan. 10, 2013), https://files.consumerfinance.gov/f/201301_cfpb_final-rule_ability-to-repay.pdf ("The final rule also establishes general underwriting criteria for qualified mortgages . . . . The Bureau believes that these criteria will protect consumers by ensuring that creditors use a set of underwriting requirements that generally safeguard affordability. At the same time, these criteria provide bright lines for creditors who want to make qualified mortgages.").

267. *See supra* text accompanying notes 236–37.

268. *See supra* note 143 and sources cited therein.

269. *See, e.g.*, Stephen Kim Park & Tim R. Samples, *Puerto Rico's Debt Dilemma and Pathways Toward Sovereign Solvency*, 54 AM. BUS. L.J. 9, 14–25 (2017) (discussing magnitude and complexity of Puerto Rico debt crisis); Dan McCrum, *Political Fears are Economic and They Trace Back to Italy*, FIN. TIMES (May 11, 2017), https://www.ft.com/content/05a0be02-3599-11e7-99bd-13beb0903fa3 (discussing risks to Eurozone of Italian sovereign and bank debt); Jamie McGeever, *Grexit Debate Down but Not Out, Argentina Lessons Remain*, REUTERS (July 22, 2015), https://ca.reuters.com/article/businessNews/idCAKCN0PW0BT20150722 (exploring lessons that Argentine debt crisis arguably offers for peripheral Eurozone economies like Greece); Valentina Romei, *Hidden Numbers Reveal Scale of Venezuela's Economic Crisis*, FIN. TIMES (May 9, 2017), https://www.ft.com/content/a6f7bdae-2f46-11e7-9555-23ef563ecf9a (detailing economic and social crisis in Venezuela).

these two contexts also emphasize the distinct social welfare implications of constraining access to mortgage credit versus access to short-term fringe loans.[270]

2. *What are the Goals of Sovereign Lending Regulation?*

In sovereign debt markets, national regulators have shown little inclination to impose requirements on banks and financial intermediaries, but this lack of explicit lawmaking should not be confused with apathy. Regulators have often used arm-twisting and moral suasion to influence behavior. For example, the United States Treasury and other official sector actors have repeatedly launched initiatives to persuade market participants to revise sovereign bond contracts to facilitate debt restructuring.[271] These efforts, paired with the fact that many countries do impose substantive obligations on commercial lenders in non-sovereign markets,[272] imply that regulators have at least some willingness to translate the concept of lender responsibility into policy action. In a similar vein, groups like UNCTAD hope to shape lender behavior by identifying principles and practices that will "promote more responsible behavior."[273]

These initiatives, however, do not articulate a clear definition of responsible lending. For instance, the UNCTAD Principles at times appear to conflate concepts of responsible lending with notions of debt sustainability.[274] As noted above, this raises a fundamental definitional problem, as there is nothing approaching consensus as to what makes debt unsustainable.[275] The lack of agreement on such basic questions can frustrate policy action or render it less coherent. Thus, the UNCTAD Principles appear to recognize that lenders have only a limited obligation to assess the borrower's ability to maintain debt service (if not repay in full),[276] while simultaneously recognizing that excessive lending can

270. This is an extensive debate, which could easily encompass a book length conversation. At one end of this debate are the questions as to whether regulation of payday and other high-cost fringe financial products will benefit or harm borrowers by constraining access to needed sources of credit. For empirical support for the contention that high-cost payday loans can exacerbate, rather than alleviate, financial distress, see, for example, Brian T. Melzer, *Spillovers from Costly Credit*, 31 REV. FIN. STUD. 3568, 3572 (2018). For a less negative picture of the effects of payday lending, see Neil Bhutta, *Payday Loans and Consumer Financial Health* 3 (FEDS Working Paper No. 2013-81, 2017), https://www.federalreserve.gov/pubs/feds/2013/201381/201381pap.pdf. At another end of this debate are disagreements about the relative importance of homeownership as compared to the risks of over-indebtedness to enable borrowing to purchase a principal residence. *See, e.g.*, MECHELE DICKERSON, HOMEOWNERSHIP AND AMERICA'S FINANCIAL UNDERCLASS: FLAWED PREMISES, BROKEN PROMISES, NEW PRESCRIPTIONS 1–18 (2014).

271. *See* Weidemaier et al., *supra* note 9, at 92 (providing a history of such efforts); Gelpern & Gulati, *supra* note 9, at 1632–42 (discussing US Treasury's involvement in encouraging use of collective action clauses in the New York market).

272. *See* GOLDMANN, *supra* note 38, at 24–25.

273. UNCTAD Principles, *supra* note 106, at 4.

274. GOLDMANN, *supra* note 38, at 23 (noting that under UNCTAD Principles 4 and 14, addressing responsible credit and lending decisions, "lenders and borrowers need to take precautions in order to avoid unsustainable borrowing practices").

275. On the difficulty of measuring sustainability, even ex post, see *supra* Section V.A.

276. *See supra* Section IV.C.

harm other creditors (*e.g.*, through debt dilution)[277] and that governments should not incur debt unless the "prospective social return" exceeds the cost of borrowing.[278] The Principles do not make clear how these underlying risks—of debt dilution and socially-unproductive borrowing—warrant such a limited conception of lender responsibility.

We would not expect there to be greater consensus about how to regulate in the sovereign debt context than in the consumer context. But we do think debates about responsible sovereign lending would benefit if participants more clearly articulated their regulatory goals. The most important question is this: Does responsible sovereign lending regulation aim to inhibit problematic or abusive lending practices, to prevent governments from incurring unsustainable debt burdens, or both?

As is clear from the consumer lending context, the answers have different regulatory implications. An emphasis on lender misbehavior naturally focuses attention on abusive practices or on the use of problematic clauses in loan contracts. In consumer lending, regulation designed to address predatory lending typically presumes a consumer borrower's harm, simplifying the inquiry to hone in on lender misconduct and contractual overreaching.[279] By contrast, responsible lending regulation focused on forestalling over-indebtedness draws a broader net, problematizing all of the debt owed by an over-indebted consumer borrower regardless of the form or terms of the loan.[280] Where regulation primarily seeks to address problems of over-indebtedness, the borrower's debt burden shifts to each lender the burden of showing that the borrower had the "ability to pay" that loan and that it was a subsequent extension of credit that put the borrower into financial danger.

Reform initiatives in sovereign debt markets sometimes appear to adopt a view of responsible sovereign lending that prioritizes problematic lender conduct. The United States Treasury's repeated efforts to encourage bond market participants to embrace broad collective action clauses—which limit holdout creditor rights in a restructuring—is an example.[281] So is the recent initiative by Treasury (supported by the IMF) to encourage governments to revise *pari passu* clauses—clauses in sovereign bonds terms that, as presently drafted, have been interpreted to allow debt restructuring holdouts to interfere with payments to creditors who agree to provide debt relief.[282] Such efforts implicitly convey the message that problems in sovereign bond markets mostly result from undesirable lending practices, such as the use of sub-optimal bond contracts. But these initiatives do not follow from any clear—or even publicly acknowledged—regulatory objectives.

277. *See* UNCTAD Principles, *supra* note 106. On the risk of debt dilution, see *supra* text accompanying notes 68–76.

278. UNCTAD Principles, *supra* note 106, at 12.

279. *See, e.g.*, Gramlich, *supra* note 35.

280. *See, e.g.*, RESPONSIBLE LENDING, *supra* note 19, at 4–5.

281. *See* Weidemaier et al., *supra* note 9, at 92; Gelpern & Gulati, *supra* note 9, at 1640–43.

282. Weidemaier et al., *supra* note 9, at 112.

Clearer articulation of these objectives might enable more coherent policy action, or at least permit debate about the proper scope of intervention. For instance, if preventing lenders from including abusive contract terms is an explicit regulatory goal, there is no reason to limit consideration only to esoteric contract terms, or to rely on moral suasion as a regulatory tactic. Although sovereign borrowers cannot be directly regulated, this is not true of the financial institutions that make or facilitate sovereign loans.[283]

By contrast, if responsible sovereign lending initiatives aim to prevent over-borrowing (and over-lending) more generally, rather than just the worst lending practices, different regulatory tools and challenges come to the fore. It may be unreasonable to expect every lender holistically to assess the sustainability of a government's debt before making a loan. Yet if it is reasonable to think standing panels might opine on debt sustainability in the restructuring context, there is also reason to think such panels could make sustainability judgments on an ongoing basis.[284] Over time, perhaps, a consensus might evolve that lender best practices include giving explicit consideration to the judgments of such a panel before making a loan. But without explicit discussion of *why* responsible lending regulation matters, it will be hard to have meaningful debate over the merits of any regulatory strategy.

Another important consideration is the need for ex ante certainty about regulatory compliance and loan enforceability. Certainty requires either clear standards or clear procedures that lenders must follow (to get safe harbor). Experience with consumer financial regulation suggests that definitional debates may plague the search for cohesive regulatory standards. This is because even clear-cut rules may refer to the same issues as preclude agreement on core definitional questions. For example, the attempt to identify indicators of over-indebtedness strives to distinguish between debt that is difficult to repay and debt that is unsustainable.[285] Likewise, "ability to pay" or repay standards look to articulate debt-to-income or loan-to-value ratios that inferentially get at the same distinction.[286] Similarly, over-indebtedness debates struggle to articulate the time horizons likely to signal actual problems in debt repayment versus difficulties in debt repayment and emphasize the importance of externalities—on dependents, for example.[287]

Nevertheless, consumer lending regulation offers some insight into the kinds of trade-offs that may be necessary to achieve ex ante certainty. For instance, the open-ended "ability to repay" standard applicable to mortgage lending—and potentially applicable to payday and other small amount, short term lending—is coupled with "safe harbor" provisions to clarify when a lender has

283. Block-Lieb, *supra* note 15, at 540.
284. *See supra* text accompanying notes 247–49.
285. *See supra* text accompanying notes 157–78, 229.
286. *See supra* text accompanying notes 163–75.
287. *See supra* note 269 and accompanying text.

satisfied these more open-ended standards.[288] These safe harbor provisions provide clear guideposts for assessing the affordability of the payday loan or residential mortgage (for example, by means of a debt-to-income ratio) and clear rules identifying problematic contract terms (such as, balloon payment obligations in the case of residential mortgages or security rights in the borrower's motor vehicle). By contrast, no explicit "safe harbor" clarifies the "ability to pay" requirement in credit card markets.[289] The explanation for this lack of parallelism is hard to fathom.

In the context of sovereign lending, certainty benefits both lenders and borrowers. Yet a vague concept of "responsible lending" cannot provide certainty, especially when enforced ex post in the context of litigation. For instance, Bohoslavsky and Goldmann suggest that courts might interpret and enforce sovereign debt contracts with regard to background principles of "responsible lending."[290] As a descriptive matter, we agree with the point. But if courts were to deny enforcement to debt contracts based on an ex post finding that a lender has acted "irresponsibly," this would risk unsettling debt markets and needlessly increasing the cost of sovereign credit.[291] An explicit discussion of regulatory goals, combined with an acknowledgement of the importance of ex ante certainty about regulatory compliance, would permit a more fruitful discussion of how to regulate sovereign lending. Whether in the form of obligatory standards of conduct imposed by national regulators, or consensus best practices agreed upon by market participants, regulation will require trade-offs, and these cannot be made in a sensible manner without clearly articulated regulatory objectives.

3. A Word on Implementation

Global financial markets pose a regulatory challenge, as "mobile market participants and capital more easily escape unilateral national regulatory supervision."[292] But this does not mean that there are no regulatory tools. To begin, regulators have power to dictate standards of conduct for market participants subject to their jurisdiction; especially when issued by regulators in important

288. For extensive discussion of these safe harbors, see CONSUMER FIN. PROTECTION BUREAU, ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE: SMALL ENTITY COMPLIANCE GUIDE 33–35 (2014).

289. *See, e.g.*, 12 C.F.R. § 1026 (2019) (final rule to revise Reg Z to implement CARD Act "ability to pay" requirements); *see also* Obrea O. Poindexter & Matthew W. Janiga, *The CFPB Amends Regulation Z's Credit Card Issuer "ability to pay" Requirements*, 69 BUS. LAW. 593, 596 (2014). Increasingly, however, US credit card regulation prohibits credit card issuers from relying on specific terms in credit card agreements (such as universal default clauses or clauses permitting modification of credit card credit agreements with little notice although the card holder is not otherwise in default). *See* Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734 (2010).

290. Bohoslavsky & Goldmann, *supra* note 230, at 40.

291. Ex post judicial regulation of contract terms can be problematic for similar reasons. This is independent of whether it is possible to reach consensus about whether particular contract clauses are problematic. For instance, the Eurodad Responsible Financing Charter would impose a flat prohibition on secondary market trading, which we view as an overbroad and potentially harmful remedy to the problem. *See* RESPONSIBLE FINANCE CHARTER, *supra* note 105, at 14.

292. BRUMMER, *supra* note 261, at 62.

capital markets, regulation of this sort also may influence conduct elsewhere.[293] Yet the utility of such regulation is limited by the ability of market participants to migrate to other capital markets and other factors.[294] In sovereign debt markets, the challenge is exacerbated by the fact that borrowers are largely immune to coercive regulation.

The result is that formal domestic and international law play a limited role in these markets. Instead, regulation is informal and fragmented, consisting largely of norms and practices that have emerged from the work of important players in the world of sovereign debt. These players include international organizations like the IMF as well as informal networks of official creditors (such as the Paris Club) and private market participants (such as the International Capital Markets Association).[295]

Even understood as soft law, regulation to promote responsible lending in sovereign debt markets requires—for the reasons we have explained—greater consensus about regulatory objectives and, ultimately, definitional clarity.[296] This will necessitate efforts to induce important stakeholders to endorse and elaborate on the general principle of lender responsibility, as well as efforts to develop agreed mechanisms to monitor compliance.[297] There are already models of such coordination with regard to lending practices in sovereign debt markets, although their impact remains uncertain.[298] Although existing coordination initiatives have not prioritized the development of coherent standards for responsible lending, there is no reason they could not do so.

Nor is there reason to doubt the ability of banks and other financial intermediaries to comply with clearly articulated responsible lending standards. Some proposals to remedy problems in sovereign debt markets require lenders to make difficult, normatively tinged judgments. For example, proponents of the "odious debt" doctrine urge that successor governments should not be responsible for debts (i) incurred by a prior despotic or authoritarian regime, (ii) used to benefit political officials or for illegitimate purposes like genocide, when (iii) lenders knew the funds would be used for such purposes.[299] The problem with such proposals—in addition to the dubious legal status of the doctrine—is that lenders

293. *Id.* at 39–41.

294. *Id.* at 48–51.

295. The Paris Club is an informal forum for negotiating debt restructuring terms for government-to-government debt. *See* Gelpern, *supra* note 108, at 356. ICMA is a membership association whose membership consists largely of private market participants on both the buy and sell sides. *See About ICMA: Mission Statement*, ICMA, https://www.icmagroup.org/About-ICMA/ (last visited Aug. 5, 2019).

296. *See supra* Section IV.C.

297. Gelpern, *supra* note 108, at 378–81.

298. As noted, for example, the Principles for Stable Capital Flows and Fair Debt Restructuring in the Emerging Markets seek to improve disclosure practices regarding the borrower's political and economic conditions. *See* Helleiner, *supra* note 108, at 90; *see also* Gelpern, *supra* note 108, at 374–78 (describing similar initiatives); RESPONSIBLE FINANCE CHARTER, *supra* note 105, at 18 (describing major responsible lending initiatives).

299. *See* Dickerson, *supra* note 38, at 60.

cannot easily identify the intended purpose of a loan, much less make the normatively tinged judgment about whether a regime is sufficiently authoritarian to place its debts in question.[300]

Our proposal need not raise such concerns, as our primary expectation is that responsible lending standards will insist that lenders make risk assessments, typical of sound underwriting practices, at the time a loan is extended. This does not mean that lenders can perfectly assess a sovereign borrower's "ability to pay" (or repay). "[S]olvency is intrinsically an intertemporal concept,"[301] requiring predictive judgments whose accuracy will depend on subsequent economic and political developments. No one can claim it is *illegitimate*, however, to expect banks to make good-faith, rigorous risk assessments, nor complain that banks and other financial institutions lack the capacity to make reasonably informed judgments about repayment capacity.

More broadly, we have also called for a broader definition of debt sustainability: one that considers the impact of debt on a sovereign's ability to pursue development objectives and otherwise promote citizen welfare.[302] As we have explained, this call for an expanded definition of sustainability has structural implications, most notably—and echoing Anna Gelpern—that the IMF is not the right institution to make such judgments.[303]

We add that there are historical parallels for such proposals. For example, the Committee for the Study of International Loan Contracts, convened by the League of Nations in 1935, proposed an independent "body of recognized financial experts," available at the request of issuing governments to opine on "the economic limits within which it would be wise to raise loans for a given borrowing country."[304] The report hinted that such a body could mitigate incentives for "excessive and uncoordinated lending."[305] The proposal was not implemented, among other reasons, because the Great Depression and ensuing war effectively shut down sovereign debt markets for decades. Yet the insight remains valid. Even in connection with technical underwriting judgments, independent assessments of "ability to pay" (or repay) might partially offset the perverse lender incentives described earlier.[306] And especially on broader questions of debt sustainability, independent, broadly-representative bodies can more appropriately make normatively tinged judgments about when debt has become problematic.

300. To account for this problem, some proposals envision an international tribunal with the power to make judgments about whether a regime qualifies as odious. *See* Seema Jayachandran & Michael Kremer, *Odious Debt*, 96 AM. ECON. REV. 82, 82 (2006).

301. FEDERICO STURZENEGGER & JEROMIN ZETTELMEYER, DEBT DEFAULTS AND LESSONS FROM A DECADE OF CRISES 298 (2006).

302. *See supra* Section V.A.

303. *See* Gelpern, *supra* note 41, at 86–87; *supra* Section V.B.

304. *Report of the Committee for the Study of International Loan Contracts*, League of Nations Doc. C.145.M.93 1939 II.A, at 8–9 (1939).

305. *Id.* at 8–9 (noting that such a body could make a "more objective" assessment of borrower finances and that investors should prefer loans vetted in this way).

306. *See supra* Section III.A.

VI. CONCLUSION

We began this Article by questioning the conventional view that the problems of sovereign debt result from the attributes of sovereignty. To be sure, that view has some merit. But the fact that sovereigns are unique borrowers does not mean that lenders and other financial intermediaries in sovereign debt markets differ from counterparts in other markets. Because governments cannot borrow if lenders will not lend, the fact of widespread over-indebtedness implies a need to examine more closely the behavior and incentives of lenders when making or arranging loans. Lending is often characterized by agency problems, excessive optimism, and other incentives for excessive lending. These commonalities suggest that academic and policy debates about sovereign debt context should pay more attention to the roles and responsibilities of lenders. But given the scant attention paid to such questions thus far, where should the discussion begin?

In our view, the answer lies not—or not exclusively—in the corporate debt metaphor. There are important parallels between sovereign debt and consumer debt. In contrast to corporate lending, where entity protections mean that all lending is asset-based, lending in sovereign and consumer markets is income-based. Lenders decide whether to lend (and whether to restructure) based primarily on an assessment ability and willingness to pay. And lenders in both markets have similar incentives toward over-lending.

The consumer metaphor highlights gaps in the debate over how to reform sovereign debt markets and offers insight into how to begin filling them. Even if regulatory interventions targeting sovereign lending cannot solve the problems associated with sovereign debt, they might mitigate some of the worst excesses. Ex post assessments of debt sustainability are not adequate, not because they are technically flawed, but because they do not recognize that over-indebtedness is problematic on multiple levels, not least because excessive debt can impair a government's ability to ensure citizen welfare. In the consumer context, there is no consensus on precisely how to measure the related concept of over-indebtedness, but there is widespread agreement that negative externalities are part of what makes this debt problematic.

The consumer lending context also makes clear that there must be more explicit discussion about how to define lender roles and responsibilities in sovereign debt markets. It may be too much to expect consensus about specific regulatory goals and methods. Even in the consumer context, this type of agreement has been elusive. But in the sovereign debt context, fundamental questions remain not only unanswered, but largely unasked. Reform initiatives cannot proceed in a coherent fashion without explicit discussion of regulatory goals.