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

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Abstract:
Policymakers and financial regulators have embarked on financial relief and rescue programs to promote the recovery of the corporate economy and alleviate household suffering during the Covid-19 pandemic. However, such programs are heavily skewed in favor of debt expansion, which is a double-edged sword for highly leveraged households and corporations in the US, UK and EU. We argue that policy-makers are too focused on the temporality of relief and rescue measures, and need to engage with the potential longer-term adverse consequences of debt expansion. We draw upon the legal theory of finance to argue that the longer-term adverse consequences of debt expansion can be ameliorated by reaching into legal elasticity, which although temporarily applied during the Covid-19 pandemic to support debt expansion, is not yet extended to its effects. We show how legal elasticity can be enriched in its theorization and provide practical support for mapping out policy choice sets for policymakers to consider in addressing post-Covid-19 implications from debt expansion.

I. Introduction

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

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[1] 'Coronavirus: The world in lockdown in maps and charts' (7 April 2020), https://www.bbc.co.uk/news/world-52103747.

[2] 'Leicester lockdown latest as city's restrictions continue' (7 July 2020), https://www.leicestermercury.co.uk/news/leicester-news/live-updates-leicester-lockdown-latest-4297621.

[3] 'UK GDP falls by record 20.4% in April as lockdown paralyses economy' (The Guardian, 12 June 2020), https://www.theguardian.com/business/2020/jun/12/britains-gdp-falls-204-in-april-as-economy-is-paralysed-by-lockdown.

[4] 'A Collapse that Wiped Out 5 Years of Growth, With No Bounce in Sight' (NY Times, 30 July 2020), https://www.nytimes.com/2020/07/30/business/economy/q2-gdp-coronavirus-economy.html.

The financial implications of economic lockdown in so many sectors were immediate as the corporate sector is heavily financialized.[5] The freezing of business activity in hard-hit sectors has implications for their cash flow, servicing of debt, solvency, and market valuation and credit rating assessments. The economic woes for corporations inevitably affect households as redundancies have been gradually announced[6] and wider macro-economic uncertainties affect household income and welfare.[7]

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

The legal implementation of 'relief and rescue' policies in the US, UK and EU involves legal and regulatory suspensions in order to facilitate a level of debt expansion that would normally have been constrained by the operation of microprudential regulation for lenders and contractual constraints in debt arrangements. Further, the legalization of extraordinary fiscal and monetary policies has been carried out. This episode reflects how law and regulation have been made elastic in order to address crisis management and social needs.[11] Reis and Vasconcelos[12] argue that such elasticity is institutionally supported based on the expected

[5] Karen Ho, 'Corporate Nostalgia? Managerial Capitalism from a Contemporary Perspective' in Greg Urban (ed), *Corporations and Citizenship* (Philadelphia: University of Pennsylvania Press 2014).

[6] 'Coronavirus: Redundancy 'stressful and upsetting' (BBC News, 9 August 2020), https://www.bbc.com/news/business-53680671; 'Coronavirus job cuts: Which companies in Europe are slashing their workforces because of COVID-19?' (18 August 2020), https://www.euronews.com/2020/07/24/coronavirus-job-cuts-which-companies-in-europe-are-slashing-their-workforces-because-of-co; 'US job losses pass 40m as coronavirus crisis sees claims rise 2.1m in a week' (28 May 2020), https://www.theguardian.com/business/2020/may/28/us-job-losses-unemployment-coronavirus.

[7] Stephanie Chok, 'Covid-19: Impacts on Employment & Household Income' (18 March 2020), http://beyondresearch.sg/covid-19-impacts-on-employment-household-income/; World Bank, 'Poverty and Distributional Impacts of COVID-19: Potential Channels of Impact and Mitigating Policies' (April 2020), http://pubdocs.worldbank.org/en/980491587133615932/Poverty-and-distributional-impacts-of-COVID-19-and-policy-options.pdf, although focusing on developing countries, provides insights for channels of welfare impact applicable to developed countries too.

[8] A scheme in the UK where the government sponsored the wages of employees who were temporarily unable to work or undeployable, 'Claim for wages through the Coronavirus Job Retention Scheme', https://www.gov.uk/guidance/claim-for-wages-through-the-coronavirus-job-retention-scheme.

[9] Section 1105, US Coronavirus Aid, Relief, and Economic Security Act, (CARES Act), HR 748, March 27, 2020.

[10] IMF, 'Policy Responses to Covid-19', https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19.

[11] Katharina Pistor, 'A Legal Theory of Finance' 41 Journal of Comparative Economics 315 (2013).

[12] Marcos Reis and Daniel Vasconcelos, 'The Legal Theory of Finance and the Financial Instability Hypothesis: Convergences and Possible Integration' 39 Journal of Post Keynesian Economics 206 (2016).

macro-economic behavior of agents in markets, and empirical evidence also offers support for the *ex post* efficiency and welfare effects of certain suspensions, particularly in private law agreements such as debt moratoria.[13] Carruthers[14] characterizes contractual suspensions as 'financial decommodification' that is necessary when markets are temporarily dysfunctional.

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

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

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

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

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[13] Patrick Bolton and Howard Rosenthal, 'Political Intervention in Debt Contracts' 110 Journal of Political Economy 1103 (2002); Carmen M. Reinhart and Christoph Trebesch, *A Distant Mirror of Debt, Default, and Relief* (NBER Working Paper 2014), http://www.nber.org/papers/w20577 in relation to sovereign debt.

[14] Bruce G. Carruthers, 'Financial Decommodification: Risk and the Politics of Valuation in US Banks' in Edward J. Balleisen, Lori S. Bennear, Kimberly D. Krawiec, and Jonathan B. Wiener (eds), *Policy Shock* (Cambridge: CUP 2017), ch.14.

[15] Pistor (2013), 317.

[16] The literature is copious, see for example, Dan Awrey, 'Law, Financial Instability and the Institutional Structure of Financial Regulation;, and Rosa Maria Lastra, 'Emergency Liquidity Assistance and Systemic Risk', in Anita Anand (ed), *Systemic Risk, Institutional Design, and the Regulation of Financial Markets* (Oxford: OUP 2016), chs.3, 7 respectively.

[17] Explored in Sections IV and V.

In Section V, we apply our theoretical insights to construct a methodological framework for mapping long-term policy and reform considerations, in order to address the adverse consequences of corporate and household fragility, as well as risks to the financial system as a whole. In so doing, we offer a blueprint for substantive policy choices, without being unduly prescriptive. The theoretical insights of legal elasticity provide us with a platform to consider more broadly and holistically the problems of over-indebtedness in the corporate and household sectors in developed jurisdictions, heightened and sharpened during the Covid-19 pandemic. It is time for policy makers to reflect on the structural implications of addressing these problems. Section VI concludes.

II. Advancing 'Relief and Rescue' in the UK, US, and EU

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

A. Loan repayment holidays for households

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

In the UK, temporary relief has been mandated in relation to all forms of regulated consumer credit. The Financial Conduct Authority (FCA), which regulates all financial institutions in relation to conduct of business, has introduced loan payment holidays for the consumer credit products it regulates. In terms of mortgages, FCA guidance requires firms to grant a payment holiday originally for three months from March 2020 (and subsequently extended for a further four months) to any customer who indicates that they may potentially experience difficulties.[21] This measure does not affect the accrual of interest on the loan and firms are not required to investigate the individual circumstances of each customer who requests for such a payment holiday or extension. The balance achieved in this measure is

[18] Discussed below.
[19] Discussed in Section II.E.
[20] Section III.
[21] Financial Conduct Authority, *Mortgages and coronavirus: information for consumers* (20 March 2020), https://www.fca.org.uk/consumers/mortgages-coronavirus-consumers (updated on 19 June 2020).

that customers are not imposed with burdens to prove that they can afford a payment holiday, but banks are also not asked to forego their expected earnings on these assets in due course. In cases where a customer is already in default at the commencement of the guidance, the guidance prevents firms from commencing or continuing repossession proceedings and any possession order already made must not be enforced.

In parallel, the FCA also requires banks and other regulated lenders to offer a temporary payment holiday for personal loans and credit cards for a period of up to three months from March 2020 to any consumers negatively impacted during the pandemic and, in the case of consumers with an arranged overdraft, to provide an additional interest-free overdraft facility of £500 for a three-month period. These have, at the end of June been extended until 31 October.[22] The FCA has also taken temporary measures to freeze repayments within the context of high-cost short-term credit loans, initially for a period of one month from April 2020 but now extended to deferral requests that may be made up to 31 October 2020.[23] Deferral requests again do not have to be based on the lenders' investigations of borrowers' individual circumstances. The FCA also expects high-cost short-term credit firms to deal with vulnerable customers sensitively in relation to working out how obligations are to be resumed or eventually repaid after the deferral period.[24] Other forms of consumer credit such as motor finance and 'buy-now-pay-later' or 'rent-to-own' credit in relation to consumer goods purchases also benefit from the extension of up to 31 October 2020 for deferred payments.[25] A consistent approach to payment holidays has been taken by the FCA in relation to all consumer credit arrangements it regulates.

In the EU, there is no single regulator for consumer credit. Consumer credit rules are not completely harmonized across the EU,[26] so national regulators administer and implement both national and harmonized regulations in their jurisdictions. However, pan-European agencies coordinate the continuing work of regulatory harmonization and supervisory

[22] FCA, *FCA confirms further support for consumer credit customers* (1 July 2020), https://www.fca.org.uk/news/press-releases/fca-confirms-further-support-consumer-credit-customers.

[23] FCA, *Coronavirus: information for consumers on personal loans, credit cards, overdrafts, motor finance and other forms of credit* (3 April 2020), https://www.fca.org.uk/consumers/coronavirus-information-personal-loans-credit-cards-overdrafts; *High-cost short-term credit and coronavirus: temporary guidance for firms* (24 April 2020), https://www.fca.org.uk/publications/finalised-guidance/high-cost-short-term-credit-and-coronavirus-temporary-guidance-firms. This is updated in *High-cost short-term credit and coronavirus: updated temporary guidance for firms* (3 July 2020), https://www.fca.org.uk/publications/guidance-consultations/high-cost-short-term-credit-coronavirus-updated-temporary-guidance-firms.

[24] Id.

[25] FCA, *FCA announces proposals to further support motor finance and high cost credit customers* (3 July 2020), https://www.fca.org.uk/news/press-releases/fca-announces-proposals-further-support-motor-finance-high-cost-credit-customers.

[26] The Consumer Credit Directive Directive 2008/48/EC harmonised certain protections for consumers but excludes secured consumer credit such as mortgages. It also omits dealing with responsible lending, see Financial Services User Group to the European Commission, 'Responsible consumer credit lending: FSUG opinion and recommendations for the review of the Consumer Credit Directive' (2019), https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/fsug-opinions-190408-responsible-consumer-credit-lending_en.pdf. The lack of EU regulation of payday lending is criticized in Olha O. Cherednychenko and Jesse M. Meindertsma, 'Irresponsible Lending in the Post-Crisis Era: Is the EU Consumer Credit Directive Fit for Its Purpose?' 42 Journal of Consumer Law and Policy 483 (2019).

convergence.[27] The European Banking Authority (EBA) has taken the lead in providing steer to national regulators regarding consumer credit arrangements during the pandemic, and has welcomed national regulatory initiatives regarding legislative moratoria on loan repayments, payment holidays, default and forbearance.[28]

In the US, relief measures for different forms of consumer credit have been more fragmented. Under the CARES Act banks are required to provide homeowners with mortgages insured by the federal government up to six months in deferred payments upon request. Specifically, the Act provides an initial forbearance period of 180 days for borrowers, extended to an additional 180-day upon request, and mortgage foreclosures are suspended for a 60 day period from 18 March 2020.[29] In terms of mortgage forbearance, Fannie Mae and Freddie Mac have also provided a four-month cap on servicers' obligations to deliver missed payments[30] Fannie Mae has also guaranteed payments to investors in mortgage-backed securities insured or securitized by the Federal Housing Administration and the Department of Veterans Affairs, effectively extending a lending facility for homeowners during payment holidays.[31] However, temporary relief from other forms of consumer credit are provided at the initiative of the private sector, working in tandem with state regulators.[32] For example, mortgage forbearance and deferments on consumer credit have been introduced under private sector coordination, although some have criticized the limited nature of available relief to homeowners and renters.[33]

Loan repayment holidays are crucially supported by suspensions of lenders' regulatory obligations, preventing lenders from becoming too risk averse vis a vis their borrowers on payment holidays. Regulated lenders are subject to microprudential regulation to ensure that their lending profiles do not pose hazards to the stability of the financial system. In particular, microprudential tools focus on calibrating lenders' lending behavior and appetite for risk by imposing capital, leverage and liquidity requirements. One of the *intended* effects of microprudential rules is to constrain excessive lending, a policy theme that has dominated

[27] The European Banking Authority, European Securities and Markets Authority and European Insurance and Occupational Pensions Authority.

[28] EBA, 'Statement on the application of the prudential framework regarding Default, Forbearance and IFRS9 in light of COVID19 measures' (25 March 2020), at 3, https://eba.europa.eu/eba-provides-clarity-banks-consumers-application-prudential-framework-light-covid-19-measures. See also 'EBA Guidelines on reporting and disclosure of exposures subject to measures applied in response to the COVID-19 crisis' (2 June 2020) EBA/GL/2020/07.

[29] CARES Act section 4022.

[30] Fannie Mae, 'Impact of COVID-19 on Servicing' (27 August 2020), https://singlefamily.fanniemae.com/media/22261/display; Bill Maguire, 'Temporary Servicing Requirements Related to COVID-19' (18 March 2020), https://guide.freddiemac.com/app/guide/bulletin/2020-4; https://guide.freddiemac.com/app/guide/bulletin/2020-10.

[31] 'Fannie Mae and Freddie Mac Assistance Options for Families Impacted by Covid-19', https://www.fhfa.gov/Homeownersbuyer/MortgageAssistance/Documents/FAQs-FannieMae-FreddieMac-Assistance-Options-for-Families-Impacted-by-COVID-19.pdf.

[32] Board of Governors of the Federal Reserve System, 'Agencies issue revised interagency statement on loan modifications by financial institutions working with customers affected by the coronavirus' (17 April 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200407a.htm.

[33] Emily Wavering Corcoran and Nicholas Haltom, 'Mortgage and Student Loan Forbearance During the COVID-19 Pandemic' (27 August 2020), Federal Reserve Bank of Richmond, 2-3, https://www.richmondfed.org/-/media/richmondfedorg/publications/research/coronavirus/corcoran_covid19_paper.pdf.

since the regulatory reforms after the global financial crisis 2007-09,[34] as the crisis was characterized by excessive leverage and risk-taking.[35]

Loan forbearance creates concerns that deferred loans may be non-performing in due course. After the global financial crisis, lenders have been subject to a forward-looking approach[36] to calculate the regulatory cost of their loan assets to ensure adequate levels of loss-absorbing capital at early signs of distressed loans. The accounting standard IFRS 9 applying to EU and UK banks requires lenders to account for debt instruments at fair value[37] and ensure that they have sufficient capital to absorb potential losses. Payment holidays exacerbate information asymmetry in relation to borrowers' creditworthiness and lenders may make increased loan loss provisions against these.[38] In other words, anticipating sour loans incentivizes banks towards conservation of capital, and also refrain from lending.

The UK has explicitly introduced adjustment to the interpretation of non-performing loans in order to mitigate lenders' risk aversion. The Prudential Regulation Authority[39] (PRA) clarifies[40] that lenders should not treat deferred payments as being in default. Even if deferred payments do not resume promptly, lenders should seek to understand borrowers' individual circumstances and not mechanistically treated such loans as non-performing. Although the PRA is a separate regulator from the FCA,[41] the regulatory architecture that binds them[42] is relatively coordinated and ensures complementary regulatory actions. In the EU, although consumer credit regulation is not fully harmonized, the European Central Bank's (ECB) acts as microprudential supervisor for lenders in the euro-area.[43] The ECB also steers banks to apply IFRS 9 in a similarly flexible manner, emphasizing 'case-by-case' flexibility and banks' refrain from too quickly treating loans as non-performing.[44]

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[34] Led by the international standards under the Basel III reforms, between 2009-2017, see 'Basel III: international regulatory framework for banks', https://www.bis.org/bcbs/basel3.htm.

[35] FSA, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (March 2009) http://www.fsa.gov.uk/pubs/other/turner_review.pdf, at 39-42; and more generally, Howard Davies, *The Financial Crisis: Who is to Blame?* (London: Polity 2010).

[36] Rosa M. Lastra, 'Defining Forward Looking, Judgement-Based Supervision' 14 Journal of Banking Regulation 222–223 (2013).

[37] Unless they satisfy the contractual cash flow test and business model assessment requirement.

[38] "European bank investors brace for loan-loss provisions", *Financial Times* (27 April 2020), https://www.ft.com/content/1d9d862a-df05-47c1-8245-cf798127165f; "BoE warns bank loan reserves risk choking business funding." *Financial Times*, 26 April 2020, https://www.ft.com/content/75767049-edfb-4074-942c-f9ce4d07f861; Jon Rees and Mohammad Taqi, "UK banks' loan loss provisions soar in face of pandemic." *S&P Global Market Intelligence* (7 May 2020), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/uk-banks-loan-loss-provisions-soar-in-face-of-pandemic-58478176.

[39] The UK regulatory authority for the microprudential supervision of banks and systemically important financial institutions, Section 2B, Financial Services and Markets Act 2000 amended by Financial Services Act 2012.

[40] PRA, *Letter from Sam Woods, Covid-19: IFRS 9, capital requirements and loan covenants* (26 March 2020), https://www.bankofengland.co.uk/prudential-regulation/letter/2020/covid-19-ifrs-9-capital-requirements-and-loan-covenants; PRA, *Statement by the PRA on regulatory capital and IFRS 9 requirements for payment holidays* (22 May 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/statement-on-application-regulatory-capital-ifrs9.

[41] Sections 1B, 2B, Financial Services and Markets Act 2000 amended by Financial Services act 2012.

[42] Sections 3D, 3E, ibid.

[43] Single Supervisory Mechanism Regulation (EU) No 1024/2013.

[44] ECB, 'FAQs on ECB supervisory measures in reaction to the coronavirus' (28 July 2020), https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320_FAQs~a4ac38e3ef.en.html.

In the US, legislative centralization is the main tool for mitigating banks' risk aversion to borrowers on payment holidays. Under the CARES Act, banks are to delay their implementation of the initially imposed forward-looking approach to expected loan loss provision[45] which is more stringent than that under IFRS9 discussed above. In the US, the Financial Accounting Standards Board introduced the CECL (current expected credit losses) so that banks would provision regulatory cost for the expected lifetime losses of a loan at the point of origination. The implementation of the CECL is to be delayed for two years in the wake of the Covid-19 pandemic.

Although loan forbearance measures seem decentralized in the EU and US, the UK, US, and EU have implemented regulatory support through relatively centralized measures that are binding. This is arguably also necessary due to the stringency of microprudential regulation, which has attained a highly demanding and numerical character,[46] after the global financial crisis 2007-09.

B. Loan repayment holidays for corporations

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

In the UK, as the FCA does not have regulatory perimeter over business lending, an Act of Parliament was passed to give temporary relief for business borrowers.[47] This fast-tracked piece of legislation allows companies with debt obligations to apply for a moratorium. Directors can make such an application if they are of the view that the company is unable to pay its debts. They however need to appoint an insolvency practitioner as 'monitor' to verify that rescue for the company is possible.[48] A successful application for moratorium allows the company to enjoy relief from its debt obligations, except specified obligations such as rent and employees' wages, for an initial 20 days with a possible extension for another 20 days.[49] During the period of the moratorium, no insolvency proceedings can commence against the company. It is envisaged that this period will be used for the company to seek arrangements with its creditors or explore avenues of raising finance. Furthermore, the Bank of England has provided a new Coronavirus Corporate Financing Facility[50] which is designed to help businesses tide over liquidity squeezes through their bank. This could help prevent banks from being dragged into liquidity hazards by corporate customers.

[45] 'SR 20-9: Joint Statement on Interaction of the Regulatory Capital Rule: Revised Transition of the CECL Methodology for Allowances with Section 4014 of the Coronavirus Aid, Relief, and Economic Security Act' (31 March 2020), https://www.federalreserve.gov/supervisionreg/srletters/SR2009.htm.

[46] Iris H-Y Chiu, 'Rethinking the Law and Economics of Post-Crisis Micro-prudential Regulation- The Need to Invert the Relationship of Law to Economics?' 38 Review of Banking and Financial Law 639 (2019).

[47] Corporate Insolvency and Governance Act 2020.

[48] S3, 6, 7, ibid.

[49] S9-10, 18, 20, 21, ibid.

[50] BOE, *Covid Corporate Financing Facility (CCFF): information for those seeking to participate in the scheme* (17 March 2020), https://www.bankofengland.co.uk/news/2020/march/the-covid-corporate-financing-facility.

In the EU, debt relief measures for corporations are not centrally coordinated, and are left to each Member State to implement. What is observed is similarity in most EU jurisdictions[51] in the manner of legislative enactment to provide corporate debt relief, such as mandatory payment holidays as well as moratoria from insolvency proceedings.[52] There are slight differences in terms of whether only small businesses benefit from these measures[53] or that they are applied to all corporate entities.

In the US, debt moratoria for companies is arranged between lenders and borrowers, although lenders work with the Conference of State Bank Supervisors towards constructive treatment of borrowers.[54] There is a significant level of corporate bankruptcies in the US since the onset of the pandemic, although some companies have been nearing bankruptcy for some time.[55] The lack of coordination in debt moratoria is, however, likely balanced by the expansion and facilitation of corporate borrowing in the US, perhaps the most pronounced package for financial boost amongst the jurisdictions surveyed here.

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

Nevertheless, there are signs of EU policymakers becoming cognisant of longer-term effects. The ECB is considering flexibility in the treatment of non-performing loans by banks.[56] For example, such loans can in theory be restructured and transferred to a separate asset management company, in order to perform workouts or liquidations of the stressed loan portfolios at a more opportune time to amortize losses.[57] Alternatively, the European

[51] 'Europe needs to avoid a 'decade of forbearance'', *Financial Times* (30 August 2020), https://www.ft.com/content/9a2532e5-0b1f-46b2-b7b5-d474b2a9dd08.

[52] 'Covid 19-Overview on Moratoria' (29 July 2020), https://www.schoenherr.eu/publications/publication-detail/covid19-overview-on-moratoria/; Ordinance 2020-306, France, summarized in Eran Chvika, 'Coronavirus: impact of French measures on financing agreements' (17 April 2020), https://www.pinsentmasons.com/out-law/analysis/coronavirus-finance-agreements-france; 'Economic stimulus measures' with regard to the German position, summarised in 'Government and institution measures in response to COVID-19' (22 July 2020), https://home.kpmg/xx/en/home/insights/2020/04/germany-government-and-institution-measures-in-response-to-covid.html.

[53] E.g. Austria see 'Covid 19-Overview on Moratoria' (n 52).

[54] See 'Government and institution measures in response to COVID-19' (3 June 2020), https://home.kpmg/xx/en/home/insights/2020/04/united-states-of-america-government-and-institution-measures-in-response-to-covid.html.

[55] 'The Covid Bankruptcies: Donut Shops to Texas Crane Company' (Bloomberg, 29 August 2020), https://www.bloomberg.com/graphics/2020-us-bankruptcies-coronavirus/.

[56] See 'ECB Banking Supervision provides temporary capital and operational relief in reaction to coronavirus', 12 March 2020, https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200312~43351ac3ac.en.html.

[57] Douglas W. Arner, Emilios Avgouleas and Evan C. Gibson, 'Financial Stability, Resolution of Systemic Banking Crises and COVID-19: Toward an Appropriate Role for Public Support and Bailouts' (August 2020) University of Hong Kong Faculty of Law Research Paper, 5, https://ssrn.com/abstract=3664523.

Commission is looking to the private sector i.e. capital markets to absorb and spread the risk of lending by banks during the pandemic. To this end, the Commission proposes amending the Securitisation Regulation to facilitate the synthetic securitization of non-performing loans.[58] Under the EU Securitisation Regulation,[59] securitized assets need to comply with certain rules in relation to design and marketing to institutional investors in the EU. These standards have been introduced to correct poor securitization practices and disclosures prior to the global financial crisis 2007-09,[60] so as to facilitate a credible and liquid refinancing market for bank loans. It is now proposed that banks' non-performing loans can be synthetically securitized by obtaining credit protection arrangements for them, such as guarantees from investors.[61] In this manner, investors underwrite potential bank losses in the non-performing loans but benefit from the premiums paid by banks for such protections. The recognition of such synthetic securitization in the Regulation allows for marketability across the EU.

We will, however, argue in Section III that the perception of temporariness in financial relief and rescue measures during the pandemic is hazardously decoupled from the reality of harsh financial consequences for the economy and society in the longer term. The implicit reliance on the eventual resumption to normal is a reflection of the dominant paradigm of financialization[62] in the UK, US and EU. We doubt that increased financialization and reliance on the private financial sector's contractual and pricing mechanisms would serve the policy goals of combatting the adverse financial consequences of the pandemic for households and corporations. Before we turn to that, we explore two further pillars of 'relief and rescue' implemented in the UK, US, and EU. Although these measures appear to implement significant public intervention, the private order of financialization is not fundamentally affected. This provides the crucial context for the longer-term problems for households and corporations explored in Section III.

C. Salary support schemes

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

In March 2020, the UK government introduced a comprehensive salary support scheme. The Coronavirus Job Retention Scheme is aimed at protecting jobs by alleviating wage expenses for businesses during the pandemic and to alleviate the social consequences stemming from rising unemployment levels. The scheme applies to employees and workers put on what is technically known as furlough leave whereby an employee or worker agrees in writing with

[58] European Commission, 'Coronavirus response: Making capital markets work for Europe's recovery' (24 July 2020) https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1382 on the Capital

[59] Securitisation Regulation (EU) 2017/2402.

[60] Richard E. Mendales, "Collateralized Explosive Devices: Why Securities Regulation Failed To Prevent The CDO Meltdown, And How To Fix It" (2009) University of Illinois Law Review 1359.

[61] European Commission, 'Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation to help the recovery from the COVID-19 pandemic' COM(2020) 282 final, preamble 8.

[62] Section II.E.

their employer to stop working temporarily while remaining employed. Such employers may then claim from the government 80% of their workers' salaries up to an upper limit of £2,500 per month, as well as the employer's 'national insurance' contributions (the equivalent of social security contributions).[63] The scheme will last until the end of October 2020. From 1 July 2020, the rules of the scheme were made more flexible by permitting employers to bring furloughed employees partially back to work for any amount of time without losing the possibility to claim from the government for unworked hours.[64] From the beginning of November 2020 the Scheme will be replaced by the Job Retention Bonus. The Job Retention Bonus will be a one-off payment of £1,000 that employers will be able to claim in February 2021 for every employee that will have been paid at least £520 a month on average between 1 November 2020 and 31 January 2021.[65] These undoubtedly raise fiscal indebtedness,[66] a problem that the UK is struggling to solve.[67]

In the EU, fiscal measures to support employment are within the exclusive jurisdiction of individual Member States, and many have implemented schemes similar to the one adopted by the UK.[68] These schemes are expected to increase European Member States' fiscal deficits,[69] and may jeopardize the Stability and Growth Pact agreed amongst euro area countries to maintain fiscal discipline.[70] Member States are already justifying deviation from the Pact by applying the 'general escape clause' that allows them to adopt discretionary fiscal measures to address emergency situations.[71]

On the contrary, in the US, salary support is legally framed as private debt, thus directly increasing the indebtedness of corporations seeking such support, albeit with a prospect of

[63] 'Claim for wages through the Coronavirus Job Retention Scheme', https://www.gov.uk/guidance/claim-for-wages-through-the-coronavirus-job-retention-scheme.

[64] To be eligible to make a claim for the period after 1 July 2020, employers must have previously submitted a claim for a particular employee before 31 July in relation to a period of furlough lasting at least three consecutive weeks that took place any time between 1 March 2020 and 30 June 2020.

[65] HMRC, 'Job Retention Bonus' (31 July 2020), https://www.gov.uk/government/publications/job-retention-bonus/job-retention-bonus.

[66] At the end of July 2020, UK public sector net debt exceeded £2 trillion. It was £227.6 bn more than at the same point in 2019 and stood at 100.5% of gross domestic product, compared to 80.1% of GDP at the end of July 2019, Office for National Statistics, 'Public sector finances, UK: July 2020' (August 2020), https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/july2020#:~:text=Debt%20(public%20sector%20net%20debt,the%20same%20point%20last%20year.

[67] Ethan Ilzetzki, 'Covid-19 and UK Public finances' (11 June 2020), https://voxeu.org/article/covid-19-and-uk-public-finances.

[68] Germany, France, Italy and Spain have all adopted schemes comparable to the UK scheme. These schemes have been taken up by 20% of workers in the five economies, 'Over 30m workers in Europe turn to state for wage support', Financial Times, (28 April 2020) https://www.ft.com/content/3e68bb70-1b17-4fd3-82f5-dfa4ea7454a2.

[69] 'ECB: Coronavirus downturn could put strain on eurozone' (26 May 2020), https://www.dw.com/en/ecb-coronavirus-downturn-could-put-strain-on-eurozone/a-53578028.

[70] ECB, https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact_en.

[71] See 'Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact' COM(2020) 123 final; Angelos Delivorias, 'The 'general escape clause' within the Stability and Growth Pact: Fiscal flexibility for severe economic shocks' (March 2020) European Parliamentary Research Service, https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/649351/EPRS_BRI(2020)649351_EN.pdf.

loan forgiveness. The CARES Act introduced the Paycheck Protection Program (PPP),[72] a loan program to support small-to-medium sized businesses (less than 500 employees except for specific sectors i.e. restaurants, hotels, and franchises where the eligibility is based on location) in order to maintain workers on their payroll. The Act provides that loans will be partly or fully forgiven insofar as the amount borrowed is used to cover payroll costs, mortgage repayments, renting and other eligible costs, but full forgiveness is based on strict conditions regarding the retention of employees and salary levels for a period of time.[73] The PPP program is administered by the Small Business Association (SBA) that originates and services the loans from private lenders. Despite its immediate success the PPP program has been criticized for the unclear eligibility requirements and terms of application,[74] and it is doubtful the intended effects of job protection are achieved.[75] The PPP has, however, ended on 8 August 2020, somewhat prematurely, as the Covid-19 pandemic was far from over at that time. Small businesses would need to reckon with continuing needs by seeking avenues of private sector finance.[76] Nevertheless, in terms of social provision, the CARES Act has expanded unemployment benefits including unemployment insurance eligibility.[77]

D. Government-backed borrowing for corporations

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

The UK government provides fiscal support for two loan schemes. UK businesses with turnover of less than £45mn can benefit from the Coronavirus Business Interruption Loan Scheme, which is administered by the government-owned British Business Bank. The loan scheme enables accredited lenders to provide loans and overdraft facilities of up to £5mn, guaranteed at 80% by the government, to be repaid over up to six years.[78] UK small and medium sized businesses will also benefit from the Bounce Back Loan Scheme that provides loan facilities of up to £50,000, guaranteed at 100% by the government to be repaid over up to six years with no payments in the first twelve months.[79] Lenders are expected to assess whether businesses should access such government-guaranteed finance, the principle being that loans should only be available to otherwise healthy businesses that need to trade through the short to medium-term revenue loss caused by the lockdown.

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[72] CARES Act, sections 1101-1102.

[73] CARES Act, section 1106.

[74] See Ilya Beylin, 'The Ignominious Life of the Paycheck Protection Program' (2020), at 16-17, https://ssrn.com/abstract=3661005.

[75] Michael Barr, Howell Jackson and Margaret Tahyar, 'The Financial Response to the Covid-19 Pandemic' (August 2020), at 9, https://ssrn.com/abstract=3666461.

[76] 'PPP loans are ending. Here's where small businesses can turn now' (CNBC, 30 June 2020), https://www.cnbc.com/2020/06/30/ppp-loans-are-ending-heres-where-small-businesses-can-turn-now.html.

[77] CARES Act, sections 2102-2104.

[78] Great Britain. Department for Business, Energy and Industrial Strategy, *Coronavirus Business Interruption Loan Scheme* (23 March 2020), https://www.gov.uk/guidance/apply-for-the-coronavirus-business-interruption-loan-scheme.

[79] Great Britain. Business, Energy and Industrial Strategy Dept, *Apply for a coronavirus Bounce Back Loan* (27 April 2020), https://www.gov.uk/guidance/apply-for-a-coronavirus-bounce-back-loan.

Fiscal support is also introduced in the US for corporate borrowing, trade credit and commercial paper.[80] The Federal Reserve in the US introduced the Main Street Lending Program (MSLP) that provides support to small and mid-size non-financial firms hit by the pandemic.[81] The MSLP allows the Fed to set up special purpose vehicles to purchase participations in bank business loans, therefore supporting private financial sector lending to non-financial businesses, as long as they have been financially healthy prior to the pandemic. The basis for the Fed's program is the CARES Act which empowers the Fed and the Treasury to act as guarantors while private sector banks underwrite and allocate credit.[82] Further, the US CARES Act allows the Treasury to directly lend to significantly impacted sectors.[83] The Economic Injury Disaster Loans are also available to small businesses and non-profit organizations that have been experiencing a temporary loss of revenue due to the pandemic, which can be used to cover standard operational expenses.[84]

In the EU, fiscal support for corporate borrowing is administered at the national level.[85] However, EU-level agreements have been secured to support national level actions. These schemes are not directly open to corporations. First, Member States may borrow from the European Stability Mechanism (ESM), a pan-European funding facility established after the global financial crisis 2007-09 to address the fiscal crises suffered by several European countries whose banking sectors had been impaired during the crisis.[86] The ESM now provides specific 'Pandemic Crisis Support' based on the existing credit lines.[87] A new pan-European

[80] CARES Act Sections 1102, 1105 for small businesses, sect. 3102 for sectors affected severely, with a total cap of $208bn for loan assistance.

[81] Board of Governors of the Federal Reserve System, 'Main Street Lending Program' (8 September 2020), https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm. The Program provides the following facilities: the Main Street New Loan Facility (MSNLF), the Main Street Priority Loan Facility (MSPLF), the Main Street Expanded Loan Facility (MSELF), the Nonprofit Organization New Loan Facility (NONLF) and the Nonprofit Organization Expanded Loan Facility (NOELF). Loans will be offered by banks, who retain 5 percent of the loan and sell the remaining 95 percent to one of three Main Street facilities (the New Loan Facility, the Priority Loan Facility, and the Expanded Loan Facility). These facilities vary by the type of loan such as loan size, borrower leverage, and whether the loan is new or expands an existing loan. All Main Street loans have a five-year maturity, deferring interest payments for one year and principal payments for two years, can be prepaid without penalty, and have a loan rate of LIBOR plus 3 percentage points. See William B. English and J. Nellie Liang, 'Designing the Main Street Lending Program: Challenges and Options' (June 2020), Hutchins Center for Fiscal and Monetary Policy Working Paper No. 64, https://www.brookings.edu/research/designing-themain-street-lending-program-challenges-andoptions.

[82] Steve Cecchetti and Kim Schoenholtz, 'The Fed Goes to War: Part 3', (12 April 2020), https://www.moneyandbanking.com/commentary/2020/4/12/the-fed-goes-to-war-part-3. The authors argue that the Fed should limit its involvement in the allocation of credit to the private nonfinancial sector.

[83] S3102, CARES Act 2020.

[84] U.S. Small Business Administration, 'Economic Injury Disaster Loans', https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/economic-injury-disaster-loans.

[85] Squire Patton Blogs, 'Covid-19 Summary of Government Financial Support in Europe and the Middle East' (28 August 2020), https://www.squirepattonboggs.com/-/media/files/insights/publications/2020/04/updated-covid19-summary-of-government-financial-support-across-europe-and-the-middle-east/covid19-summary-of-government-financial-support.pdf.

[86] ESM, 'Programme Overview', https://www.esm.europa.eu/assistance/programme-database/programme-overview.

[87] Subject to standardized terms agreed in advance by the ESM governing bodies, see 'ESM's role in the European response', https://www.esm.europa.eu/content/europe-response-corona-crisis.

commitment has been secured to financially support Member States' economy recovery.[88] A Recovery Fund[89] of over 1,800bn euros has been agreed to be disbursed to Member States in the form of both grants and loans for rebuilding their economies after the pandemic. The Recovery Fund is itself based on the European Commission borrowing 750bn euros from the financial markets. Next, the ECB is also able to support European government debt, by temporarily easing certain collateral requirements for borrowing countries.[90] Finally, the Emergency Support Instrument, funded at 2.7bn euros[91] is available to Member States or private sector entities for financial support to undertake specific activities that meet the needs of the public health crisis, such as mask procurement. These would be in the form of grants. Outright grants therefore feature much less importantly than debt-discipline for financial support, although fiscal support distorts market-based debt discipline anyway.

That said, contrary to the UK or US, significant support for some European companies has been in the form of public sector equity investments, such as the German government's 6bn euros stake in Lufthansa.[92] The EU has also in principle mobilized 300bn euros in the form of the Solvency Support Instrument under the EU Fund for Strategic Investments for equity support,[93] although it is observed that policy push for equity instead of debt support is still lacking.[94] The UK has introduced regulatory relaxations for emergency corporate equity fund-raising,[95] but companies' predominant turning to debt is observed by most commentators.[96] The preference for increased indebtedness for corporations is driven by pronounced regulatory adjustments made to incentivize lending and by central banks' liquidity operations to support corporate bond markets.

i. Regulatory Suspensions to Facilitate Increased Lending

Pronounced regulatory relaxations of microprudential regulatory rules applicable to lenders are key to incentivizing increased debt expansion for corporations needing financial support.

First, an inherently flexible capital measure known as the countercyclical buffer (CCyb) is relaxed for banks. The CCyb was introduced in the wake of the global financial crisis to allow

[88] European Council, 'A Roadmap for Recovery. Towards a more resilient, sustainable and fair Europe' (21 April 2020), https://www.consilium.europa.eu/media/43384/roadmap-for-recovery-final-21-04-2020.pdf.

[89] Kajus Hagelstam, Alice Zoppè and Cristina Sofia Dias, 'An EU Recovery Fund: How to square the circle?', SUERF Policy Brief, May 2020, https://www.suerf.org/docx/f_f2d34fcd37e85f9867708bf71782cda6_12945_suerf.pdf; 'EU recovery fund: how the plan will work' (Financial Times, 21 July 2020), https://www.ft.com/content/2b69c9c4-2ea4-4635-9d8a-1b67852c0322.

[90] Council Decision (EU) 2020/506 "amending Guideline (EU) 2015/510 on the implementation of the Eurosystem monetary policy framework and Guideline (EU) 2016/65 on the valuation haircuts applied in the implementation of the Eurosystem monetary policy framework (ECB/2020/20)".

[91] European Commission, 'Questions and Answers on Emergency Support Instrument' (26 June 2020), https://ec.europa.eu/commission/presscorner/detail/en/QANDA_20_1164.

[92] 'State equity supports runs risk of moral hazard', *Financial Times* (30 July 2020), https://www.ft.com/content/f90e4824-1d66-4454-bb36-c61e96e57fc3.

[93] https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_946.

[94] Martin Sandbu, 'The corporate zombies stalking Europe', *Financial Times* (9 September 2020), https://www.ft.com/content/cd90dfbe-3089-4cec-8436-39aed04cafc3.

[95] FCA, 'Statement of Policy: listed companies and recapitalisation issuances during the coronavirus crisis' (8 April 2020), https://www.fca.org.uk/news/statements/listed-companies-recapitalisation-issuances-coronavirus.

[96] Michael Halling, Jin Yu and Josef Zechner, 'Bond and Equity Issuance Activity During Covid-19' (May 2020), https://ssrn.com/abstract=3596114 focusing on the US.

regulators to impose capital cost on banks to dampen pro-cyclical creation of debt in bubbly times.[97] In times of excessive market confidence in leverage and asset prices, the introduction of the CCyb would make it more costly for banks to extend credit. This measure plays a part in moderating financial institutions' behavior and markets' tendencies towards a cycle of Minskian instability.[98] As Masur and Posner[99] argue, such regulation is designed to address the need for financial regulators to shape the incentives of financial actors that are inherently biased towards procyclicality, in order to moderate potential market excesses that are not self-correcting. In downturns, as has been caused by the onset of the Covid-19 pandemic, the relaxation of prudential regulation that is inherently adjustable is merely counter-cyclical regulation that counteracts sub-optimal market behavior.

Prior to the onset of the Covid-19 pandemic, the CCyb was set at 1% for UK banks to be elevated to 2% by December 2020 as economic activity looked strong and banks should be prevented from excessive risk-taking. This was abruptly adjusted to 0% during the pandemic,[8] freeing up for banks an estimated capital cost of £190bn.[100] The reduction of the CCyb is also observed in a number of European countries,[101] as this is not centralized at the EU level. At the EU, the European Systemic Risk Board[102] has the remit to recommend levels of CCyb to Member States but implementation is left to Member states. In the US, the CCyb has been held at 0% even before the onset of the pandemic,[103] reflecting a long-held desire to prevent micro-prudential regulation from adversely affecting economic growth.[104]

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

Banks in the UK, US and EU are permitted to draw down regulatory capital buffers. Regulatory capital buffers such as the capital conservation, systemic risk, Pillar-2 buffer and buffers

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[97] Art 128(7), Capital Requirements Directive 2013/36/EU.

[98] Hyman P. Minsky, *The Financial Instability Hypothesis*. Levy Economics Institute Working Paper, No. 74. 1992, http://www.levyinstitute.org/pubs/wp74.pdf.

[99] Jonathan S Masur and Eric A Posner, 'Should Regulation be Counter-cyclical?' 34 *Yale Journal on Regulation* 857 (2017).

[100] Bank of England, *Bank of England measures to respond to the economic shock from Covid-19* (11 March 2020), https://www.bankofengland.co.uk/news/2020/march/boe-measures-to-respond-to-the-economic-shock-from-covid-19; PRA, *Statement by the PRA accompanying measures announced by the Financial Policy Committee*. (11 March 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/statement-by-the-pra-accompanying-measures-announced-by-the-fpc.

[101] Council Regulation (EU) No 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM%3Ami0068.

[102] ESRB, 'Counter-cyclical buffer', https://www.esrb.europa.eu/national_policy/ccb/html/index.en.html, reporting notifications of CCyb changes made in Member States.

[103] Board of Governors of the Federal Reserve System, 'Federal Reserve Board votes to affirm the Countercyclical Capital Buffer (CCyB) at the current level of 0 percent' (6 March 2019), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306c.htm.

[104] In 2019, the Economic Growth, Regulatory Relief and Consumer Protection Act was passed to 'roll back' on the 2010 Dodd-Frank Act that paved the way for implementing stringent microprudential regulation. See summary, 'What Does The Partial Rollback Of Dodd-Frank Mean For The Largest U.S. Banks?' (29 May 2018), https://www.forbes.com/sites/greatspeculations/2018/05/29/what-does-the-partial-rollback-of-dodd-frank-mean-for-the-largest-u-s-banks/#76716e9b2f19.

applying to systemically important banks are required to be maintained as risk-constraining measures since the post-crisis reforms.[105] The UK PRA allows banks to draw down on all regulatory buffers, but maintaining the notional levels of mandatory regulatory buffers (such as firms' systemic risk buffer rates) so as to maintain market confidence regulation.[106] Similar regulatory action has been taken in the US to allow banks to use their regulatory buffers to respond to needs during pandemic in an open-ended 'prudent' manner.[107] In the EU, the ECB as single supervisor for banks in the euro area also allows banks to draw down their Pillar-2 and capital conservation buffers.[108]

Next, liquidity and leverage thresholds have been relaxed for banks, many of these not thought to be inherently flexible as they relate to moderating banks' risk-taking behavior. In the UK, US and EU, banks are encouraged to allow businesses with credit lines and undrawn credit to draw upon such lines, even if this means banks' liquidity ratios may fall below the mandatory 100% they are supposed to maintain.[109] The liquidity coverage ratio is intended to be maintained at all times at 100% which effectively means that a firm can meet its cash outflows for a period of 30 days so as to prevent a liquidity-driven systemic crisis.[110]

A post-global financial crisis initiative, the leverage ratio is also relaxed. The leverage ratio limits all leverage created by banks to be supported by at least 3% of CET1 capital.[111] This backstops bank lending and compliments other microprudential regulation. During the Covid-19 pandemic, the US introduced measures to prevent the leverage ratio from hindering important lending activities. First, the ratio is reduced for community banks perceived to support real economy needs.[112] Next, holdings of Treasury bills and deposits are not counted towards the leverage ratio.[113] This allows banks to enjoy expanded capacity to lend, including sovereign lending. The loosening of the leverage ratio is more modest in the UK and EU as

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[105] Iris Chiu and Jo Wilson, *Banking Law and Regulation* (Oxford: OUP 2019), ch.8.

[106] PRA, *Q&A on the usability of liquidity and capital buffers* (20 April 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/buffer-usability-qanda; *PRA decision on Systemic Risk Buffer rates* (9 April 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/pra-decision-on-srb-rates.

[107] Joint release, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and Office of the Comptroller of Currency, 'Statement on the Use of Capital and Liquidity Buffers' (17 March 2020), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200317a1.pdf.

[108] ECB, 'FAQs on ECB supervisory measures in reaction to the coronavirus' (28 July 2020), https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320_FAQs~a4ac38e3ef.en.html.

[109] PRA, *Q&A on the usability of liquidity and capital buffers* (20 April 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/buffer-usability-qanda.

[110] Basel Committee, *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (2013), https://www.bis.org/publ/bcbs238.pdf, enacted in EU and UK legislation.

[111] Arts 429, 430, Capital Requirements Regulation 2013. CET1 capital relates to shareholders' equity, regarded as best quality loss absorbing capital, applicable to the UK.

[112] Joint release, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and Office of the Comptroller of Currency, 'Agencies announce changes to the community bank leverage ratio' (6 April 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200406a.htm.

[113] Joint release, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and Office of the Comptroller of Currency, 'Regulators temporarily change the supplementary leverage ratio to increase banking organizations' ability to support credit to households and businesses in light of the coronavirus response' (15 May 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200515a.htm.

sovereign debt is still counted. A new EU Regulation,[114] the 'CRR Quick Fix' package, was introduced to provide temporary flexibility in implementing the leverage ratio.[115] It specifically facilitates increased borrowing,[116] by allowing exposures such as guaranteed loans by national governments to be excluded from the ratio.[117] The PRA also clarifies that loans made under the Bounce Back Scheme are not counted in the leverage ratio.[118] In sum these regulatory suspensions roll back, albeit temporarily, all major enhancements to microprudential regulation since the global financial crisis. These raise concerns about the balancing of short-term crisis management objectives against prudential regulatory objectives.

In order to prevent regulatory suspensions from being taken advantage of for perverse incentives such as rewarding shareholders, the PRA, ECB and Fed have provided strongly phrased guidance to banks to suspend capital distributions to shareholders including the payment of dividends and share buy-backs.[119] In the UK, this restraint also applies to payment of cash bonuses to certain material categories of staff.[120] Regulators' power over dividend restrictions is warranted under existing regulation[121] in order to promote the resilience of banks and financial stability. This use of discretionary power, outside of its original rationale, may, however, raise long-term problems relating to banks' cost of capital and ability to attract and retain talented staff.

Finally, the relaxation of microprudential requirements to incentivize lending is complemented by the suspension of supervisory activities that may put pressure on banks towards conservative microprudential compliance. In the UK, the Bank of England is suspending externally administered stress testing for banks. Stress tests are a useful exercise for supervisors to understand whether banks have enough capital to continue to intermediate

[114] Regulation (EU) 2020/873, OJ L 204/2020, p. 4.
[115] EBA, 'Guidelines on reporting and disclosure of exposures subject to measures applied in response to the COVID-19 crisis. Final Report' (2 June 2020), https://eba.europa.eu/regulation-and-policy/supervisory-reporting/guidelines-covid-19-measures-reporting-and-disclosure.
[116] Ibid.
[117] Recital 9, Regulation (EU) No 873/2020.
[118] BOE, *Statement on credit risk mitigation eligibility and leverage ratio treatment of loans under the Bounce Back Loan scheme* (4 May 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/pra-statement-on-crm-and-leverage-ratio-loans-under-bbls.
[119] PRA, *PRA statement on deposit takers' approach to dividend payments, share buybacks and cash bonuses in response to Covid-19* (31 March 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/pra-statement-on-deposit-takers-approach-to-dividend-payments-share-buybacks-and-cash-bonuses; 'Federal Reserve Board releases results of stress tests for 2020 and additional sensitivity analyses conducted in light of the coronavirus event' (15 June 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625c.htm; ECB, 'Recommendation of the European Central Bank of 27 July 2020 on dividend distributions during the COVID-19 pandemic and repealing Recommendation ECB/2020/19 (ECB/2020/35) 2020/C 251/01', https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020HB0035.
[120] PRA, *PRA statement on deposit takers' approach to dividend payments, share buybacks and cash bonuses in response to Covid-19* (31 March 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/pra-statement-on-deposit-takers-approach-to-dividend-payments-share-buybacks-and-cash-bonuses.
[121] Art 141 on restrictions of dividends that jeopardises the level of banks' CET1 capital ratio.

and lend in disrupted scenarios.[122] The tests are forward-looking and facilitate supervisory judgments and cross-bank comparisons. The BoE has postponed its 2020 stress test,[123] to keep credit flowing to households and businesses and reduce pressure on banks induced by the stress test.[124] The EBA has also decided to postpone its scheduled stress-test.[125] The ECB has postponed the enforcement of major supervisory decisions, such as deadlines for remedial actions imposed on banks as a result of on-site inspections.[126] In the US, the Fed initially announced a reduction in its examination activities for banks, focusing on outreach and helping banks cope with meeting the needs from the pandemic.[127] Although the Fed has since announced the resumption of examination,[128] such examination may be less intense and offsite in nature.

The extensive regulatory suspensions of microprudential rules introduced to incentivize lending are arguably near-termist and sideline issues of moral hazard and adverse financial consequences for increased household and corporate indebtedness.[129] Next, we discuss central banks' actions to facilitate liquidity conditions in financial markets supporting corporate and public sector bond issuance. These measures crucially underpin the use of debt expansion as the mainstay of financial rescue during the pandemic.

ii. Central Bank Policies Facilitating Increased Liquidity for Debt Markets

Central banks in the UK, US and EU have undertaken expansive monetary policy measures to support liquidity in the markets for sovereign and corporate bonds. Central bank asset purchases provide constant liquidity to investors in capital markets such as where there are intense selling pressures by exchange-traded funds[130] The maintenance of liquidity conditions

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[122] Donald Kohn, *Stress tests: a policymaker's perspective* (5 February 2020), https://www.bankofengland.co.uk/speech/2020/donald-kohn-speech-at-2020-ecb-conference-on-macroprudential-stress-testing.

[123] BOE, *Bank of England announces supervisory and prudential policy measures to address the challenges of Covid-19* (20 March 2020), https://www.bankofengland.co.uk/news/2020/march/boe-announces-supervisory-and-prudential-policy-measures-to-address-the-challenges-of-covid-19.

[124] 'BoE cancels stress tests to ease pressure on lenders', *Financial Times*, (20 March 2020), https://www.ft.com/content/7433d55c-6a89-11ea-800d-da70cff6e4d3.

[125] 'EBA statement on actions to mitigate the impact of COVID-19 on the EU banking sector' (12 March 2020), https://eba.europa.eu/eba-statement-actions-mitigate-impact-covid-19-eu-banking-sector.

[126] 'FAQs on ECB supervisory measures in reaction to the coronavirus' (28 July 2020), https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320_FAQs~a4ac38e3ef.en.html.

[127] Board of Governors of the Federal Reserve System, 'Federal Reserve provides additional information to financial institutions on how its supervisory approach is adjusting in light of the coronavirus' (24 March 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200324a.htm.

[128] Board of Governors of the Federal Reserve System, 'Federal Reserve Board announces it will resume examination activities for all banks, after previously announcing a reduced focus on exam activity in light of the coronavirus response' (15 June 2020), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200615a.htm.

[129] See Sect III.

[130] Agnès Bénassy-Quéré et al., 'A proposal for a Covid Credit Line' (21 March 2020), https://voxeu.org/article/proposal-covid-credit-line.

prevents bond prices from suffering systemic collapse, in particular protecting large and listed corporations, as well as investors.[131]

In the UK, the Monetary Policy Committee of the Bank of England decided unanimously in March 2020 to increase the Bank's holdings of UK government bonds and of non-financial investment-grade corporate bonds by £200bn financed by central bank reserves. Out of the £200bn at least £10bn would be used to purchase corporate bonds. For a bond issuer to be eligible it must be a company that makes a material contribution to economic activity in the UK either directly or via a subsidiary. Eligible bonds must have the following characteristics: (a) conventional senior unsubordinated debt either secured or unsecured; (b) rated investment grade by at least one major rating agency; (c) cleared and settled through Euroclear and/or Clearstream; (d) Minimum amount in issue of £100mn; (e) minimum residual maturity of twelve months; no perpetual debt is eligible; (f) at least one month to have lapsed since the bond was issued; and (g) admitted to official listing on an EU stock exchange.[132]

In the EU, the ECB has been purchasing government bonds on the secondary market from commercial banks as well as purchasing public and private assets[133] under its Corporate Sector Purchase Programme (CSPP).[134] However, as part of dedicated efforts to support debt markets during the pandemic, the Pandemic Emergency Purchase Programme (PEPP)[135] has been introduced to allow the ECB and national central banks collectively to purchase 'private and public sector securities' up to 750bn euros.[136] Moreover, the emergency nature of this measure allows waivers of eligibility criteria, potentially introducing moral hazard for bond issuers and investors alike.[137] The massive injection of liquidity in the banking sector and capital markets inevitably raises inflation and exacerbates increased indebtedness.[138]

In the US, quantitative easing tools which rely on asset purchases are extensively used by the Fed.[139] The Fed's MSLP[140] is the largest liquidity stimulus package with over 2 trillion dollars

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[131] 'The liquidity 'doom loop' in bond funds is a threat to the system', *Financial Times* (25 March 2020), https://www.ft.com/content/b7c15426-6e1b-11ea-89df-41bea055720b.

[132] Bank of England, 'Asset Purchase Facility (APF): Additional Corporate Bond Purchases – Market Notice 2 April 2020' (April 2020) https://www.bankofengland.co.uk/markets/market-notices/2020/asset-purchase-facility-additional-corporate-bond-purchases.

[133] Sage Belz, Jeffrey Cheng, David Wessel, Daniel Gros and Angela Capolongo, 'What's the ECB doing in response to the COVID-19 crisis?' (4 June 2020), The Brookings Institution, https://www.brookings.edu/research/whats-the-ecb-doing-in-response-to-the-covid-19-crisis/.

[134] ECB, 'Corporate sector purchase programme (CSPP) – Questions & Answers' (8 April 2020), https://www.ecb.europa.eu/mopo/implement/omt/html/cspp-qa.en.html for eligible corporate debt.

[135] Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17).

[136] Ibid.

[137] ECB, 'Asset purchase programmes', https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html.

[138] Moritz Schularick, Sascha Steffen and Tobias Tröger, 'Bank capital and the European recovery from the COVID-19 crisis' (June 2020) SAFE White Paper, https://safe-frankfurt.de/fileadmin/user_upload/editor_common/Policy_Center/SAFE_White_Paper_69.pdf.

[139] Jonathan Hartley and Alessandro Rebucci, 'An Event Study of COVID-19 Central Bank Quantitative Easing in Advanced and Emerging Economies' (2020) NBER Working Paper, http://www.nber.org/papers/w27339.pdf.

[140] Public Law 116–136—Mar. 27, 2020 134 Stat. 281. The CARES Act was preceded by the other legislative interventions, namely the Coronavirus Preparedness and Response Supplemental Appropriations Act 2020 and the Families First Coronavirus Response Act both promulgated on March 2020.

supporting the trading of US Treasuries, mortgage-backed securities and commercial paper, as well as municipal and corporate bonds.[141] Further, the Fed has set up facilities to provide dollar liquidity to foreign central banks and monetary authorities so that commercial transactions with the US corporate sector or dollar-settled transactions can continue without disruption.[142] Foreign central banks and international organizations with accounts at the New York Fed can temporarily exchange their US Treasury securities held with the Fed for dollars, which can then be made available to institutions in their jurisdictions for dollar-denominated transactions and commerce. The extensive liquidity operations assumed by the Fed, at a global level, has moved the Fed into uncharted territory,[143] giving rise to concerns regarding its mandate.[144]

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

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

Financialization is defined as 'the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies'.[145] In other words, private sector finance is dominant in meeting financial needs, whether on the part of households, corporations and sovereigns. The process of financialization dates back to the late 1970s and early 1908s, and marks the transition from the post-war social consensus era to the current neo-liberal era, and from industrial domination of the economy to financial domination of the economy.[146] With state retreat from social welfare, households need to rely on the private sector to meet various saving and

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

[142] 'Federal Reserve Board announces the extensions of its temporary U.S. dollar liquidity swap lines and the temporary repurchase agreement facility for foreign and international monetary authorities (FIMA repo facility) through March 31, 2021' (29 July 2020), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200729b.htm; Kathryn Judge, 'Congress Should Endorse the Federal Reserve's Extraordinary Measures' (24 March 2020), Columbia Law School's Blog on Corporations and the Capital Markets, https://clsbluesky.law.columbia.edu/2020/03/24/congress-should-endorse-the-federal-reserves-extraordinary-measures/.

[143] 'The Fed's radical policies are uncharted territory', Financial Times, 9 April 2020, https://www.ft.com/content/70a0d2ca-7987-11ea-af44-daa3def9ae03.

[144] David Zaring, 'The Government's Economic Response to the Covid Crisis' (2020), 9, https://ssrn.com/abstract=3662049; Christine A. Desan and Nadav Orian Peer, 'The Constitution and the Fed after the COVID-19 Crisis' (2020), 5-6, https://ssrn.com/abstract=3635059.

[145] Gerald A Epstein, 'Introduction: Financialization and the World Economy' in Gerald A Epstein ed, Financialization and the World Economy (Cheltenham: Edward Elgar, 2005), 3.

[146] Thomas I. Palley, *Financialization: The Economics of Finance Capital Domination* (London: Palgrave Macmillan 2013).

consumption needs such as education, housing and health (US),[147] giving rise to a cultural shift towards debt-financed consumption.[148] Debt, however, is framed as a transactional paradigm, obscuring its social underpinnings.[149]

The rise in saving and investment needs has driven 'money manager capitalism'[150] where the financial sector is entrusted to allocate financial resources. However, such financial intermediation has only led to generation of yield and financial value, decoupled from long-term investment in real economy productivity.[151] In this manner, corporations as engines of real economy wealth creation have been affected in fundamental ways, as corporations' focus have turned to their financial values i.e. share price, often on a short-term basis,[152] and corporate wealth has become skewed in distribution in favor to those contributing to financial value[153] rather than productive value.

Against the financialization backdrop, there is heavy reliance on private sector provision for financial support[154] during the Covid-19 pandemic even if interlaced with public sector support. Indeed, even in government-backed borrowing, the transactional and underwriting expertise of private sector lenders is relied upon although the incentives for moral hazard cannot be underestimated. The regulated lending industry is also the primary mediator of loan performance and the outworking of debt relations with borrowers. Further, central banks' liquidity support shows the inevitability of relying on market forces to sustain the corporate sector, whose funding needs and financialized valuations have become inextricably intertwined.

We critically question whether the financialized context in which relief and rescue policies are implemented can bring about the public interest outcomes needed in combatting the adverse impact of the Covid-19 pandemic. Ultimately, financial relief and rescue is intended to support the economic recovery of businesses[155] and the alleviation of households' economic

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[147] Jacob S Hacker, *The Great Risk Shift: The Assault on American Jobs, Families, Health Care and Retirement and How You Can Fight Back* (Oxford: OUP 2006).

[148] Neil Fligstein and Adam Goldstein, 'The emergence of a finance culture in American households, 1989–2007' 13 Socioeconomic Review 575 (2015), Bruce G Carruthers and Laura Ariovich, *Money and Credit: A Sociological Approach* (Cambridge, Polity 2010).

[149] E.g. Seth Frotman, 'Broken Promises: How Debt-Financed Higher Education Rewrote America's Social Contract and Fueled a Quiet Crisis' 4 Utah Law Review 1 (2018).

[150] L. Randall Wray, 'Money Manager Capitalism and the Global Financial Crisis' (2009), http://ssrn.com/abstract=1478508.

[151] BIS, *The Kay Review of UK Equity Markets and Long-Term Decision Making* (Final Report, 23 July 2012).

[152] Lynne Dallas, 'Short-Termism, the Financial Crisis, and Corporate Governance' (2012) 37 Journal of Corporation Law 265.

[153] See William Lazonick, 'The Financialization of the U.S. Corporation: What has been Lost, and How it can be Regained' 36 Seattle University Law Review 857 (2012-2013); Paddy Ireland, 'Financialization and Corporate Governance' 60 Northern Ireland Legal Quarterly 1 (2009); Anat R. Admati, 'A Skeptical View of Financialized Corporate Governance' 31 Journal of Economic Perspectives 131 (2017).

[154] Natascha van der Zwan, 'Making sense of financialization' 12 Socioeconomic Review 99 (2014).

[155] In the UK, Minister for Regional Growth and Local Government, Simon Clarke MP has stated that: "We have always said that we would stand behind our businesses and communities as we rebuild following the coronavirus pandemic. […] Small and medium sized businesses are the beating heart of communities." See Hm Government, '£20 million in new grants to boost recovery of small businesses' (30 July 2020) https://www.gov.uk/government/news/20-million-in-new-grants-to-boost-recovery-of-small-businesses.
In the EU, Valdis Dombrovskis has emphasized that the importance of private funding for economic recovery- "…Capital markets are vital to the recovery, because public financing alone will not be enough to get our economies back on track." See 'Coronavirus response: Making capital markets work for Europe's recovery' (24

suffering.[156] Both these objectives combine economic and social rationales and values. Supporting corporate recovery is not only about preserving financial value but about productive value and job-creation capacity. Similarly, providing financial relief for households is not only about maintaining levels of aggregate demand but about substantive well-being. However, economic rationales are often not well juxtaposed with the social consequences of excessive indebtedness, which we discuss in the next Section as fundamentally important to meet the objectives of promoting business recovery and alleviating household suffering.

Further, near-termist financial relief and rescue policies need to be balanced against a third important objective: the preservation of the stability of the financial system and mitigation of systemic risk which can be caused both by failures or distress in large banks and by accumulation of risk in other firms or markets.[157] Financial stability remains essential as a robust financial system is necessary for the other two regulatory objectives to be achievable. In this respect, there is insufficient regulatory consideration of how excessive indebtedness adversely affects financial institutions' capacities.[158] Further, to what extent can the extraordinary liquidity operations of central banks be sustainable? Asset prices in bond and equity markets are already viewed by many as artificially high,[159] and divorced from economic fundamentals.[160]

July 2020), https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1382. In the US, the Government has clearly indicated that providing economic support to families and businesses is a major priority, 'President Donald J. Trump Is Supporting American Businesses, Workers, and Families Impacted by the Coronavirus' (18 March 2020), https://www.whitehouse.gov/briefings-statements/president-donald-j-trump-supporting-american-businesses-workers-families-impacted-coronavirus/.

[156] The UK government has stated that their first objective is to save lives and the second is "protecting and restoring people's livelihoods and improving people's living standards." See HM Government, 'Our Plan to Rebuild: The UK Government's COVID-19 recovery strategy' (May 2020) CP239, 16. The EU Commission also emphasizes the need to "protect citizens and mitigate the severely negative socio-economic consequences of the coronavirus pandemic". See Commission, 'Coronavirus: Commission proposes to provide €81.4bn in financial support for 15 Member States under SURE' (24 August 2020) https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1496; ibid for the US position.

[157] The Bank of England has emphasized the continuing importance of safety and soundness for banks, 'Bank of England announces supervisory and prudential policy measures to address the challenges of Covid-19' (20 March 2020) https://www.bankofengland.co.uk/news/2020/march/boe-announces-supervisory-and-prudential-policy-measures-to-address-the-challenges-of-covid-19. In the EU, the importance of financial stability during the pandemic is emphasized, Luis de Guindos, 'Financial stability and the pandemic crisis' (speech, Frankfurt am Main, 22 June 2020), https://www.ecb.europa.eu/press/key/date/2020/html/ecb.sp200622~422531a969.en.html. In the US, the Fed recently warned that the financial system is vulnerable, highlighting financial stability concerns, Federal Reserve System, 'Financial Stability Report' (15 May 2020) https://www.federalreserve.gov/publications/financial-stability-report.htm.

[158] Alissa Kleinnijenhuis, Laura Kodres, Thom Wetzer, *Usable Bank Capital* (30 June 2020), https://voxeu.org/article/usable-bank-capital#.XwA9ibxoIRc.twitter.

[159] 'Stocks soar despite coronavirus and a recession. It's time for a reality check, and a crash' (8 June 2020), https://www.nbcnews.com/think/opinion/stocks-soar-despite-coronavirus-recession-it-s-time-reality-check-ncna1227771; 'ESMA Sees High Risk Of Decoupling Of Financial Market Performance And Underlying Economic Activity' (2 Sep 2020), https://www.esma.europa.eu/press-news/esma-news/esma-sees-high-risk-decoupling-financial-market-performance-and-underlying.

[160] 'Central Bankers Have Crossed Bright Lines to Aid Economies' (New York Times, 9 June 2020), https://www.nytimes.com/2020/06/09/business/economy/central-banks-coronavirus-economies.html.

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

III. Adverse Implications of Debt Expansion

Although private debt expansion provides relief and rescue for the near-term, high levels of indebtedness entail longer-term consequences that could exacerbate corporate fragility and household suffering. There is significant empirical literature that demonstrates how corporations become more financially fragile, i.e. edge closer to the risks of insolvency and distress, due to high levels of indebtedness.[161] Corporate insolvencies, reflecting micro-level financial fragility, are often related to macro-level financial fragility in the financial system.[162] This is because corporate insolvencies and defaults exacerbate stress for lenders, and large losses can cause lenders to become financially fragile themselves. At scale, the banking sector could be greatly reduced in its capacity to support the real economy.[163]

Household indebtedness can also lead to financial fragility.[164] Personal bankruptcies or financial distress is not merely a micro-level issue but more broadly implicates household suffering. Indebted households may suffer from stress, affecting individuals' states of mental well-being,[165] relational well-being[166] at a social level, and workplace productivity.[167] In the worst cases, financial fragility for individuals and households contributes to social cost, including issues of poverty[168] and homelessness.[169] The global financial crisis 2007-09 crucially showed the tight relationship between dispossessed sub-prime home-owners, a sight of distress during the global financial crisis,[170] and systemic crisis for the banking

[161] Sander van der Hoog, 'The Limits to Credit Growth: Mitigation Policies and Macroprudential Regulations to Foster Macrofinancial Stability and Sustainable Debt', 52 Computational Economics 873 (2018).
[162] C. Bruneau, O. de Bandt, W. El Amri, 'Macroeconomic Fluctuations and Corporate Financial Fragility', 8 Journal of Financial Stability 219 (2012); Laura Alfaro, Gonzalo Asis, Anusha Chari and Ugo Panizza, 'Corporate Debt, Firm Size and Financial Fragility in Emerging Markets', 118 Journal of International Economics 1 (2019); generally E Philip Davis, Debt, *Financial Fragility and Systemic Risk* (Oxford: OUP 1995).
[163] Davis (1995), ibid.
[164] Paola D'Orazio, 'Income Inequality, Consumer Debt, and Prudential Regulation: An Agent-Based Approach to Study the Emergence of Crises and Financial Instability' 82 Economic Modelling 308 (2019).
[165] Chris Fitch, Sarah Hamilton, Paul Bassett and Ryan Davey, 'The Relationship Between Personal Debt and Mental Health: A Systematic Review' 16 Mental Health Review Journal 153 (2011). See also Randy Hodson, Rachel E. Dwyer and Lisa A Neilson, 'Credit card blues: the middle class and the hidden costs of easy credit' 55 Sociological Quarterly 315 (2014).
[166] Explored in Isabelle Guérin, Solène Morvant-Roux and Magdalena Villarreal, *Microfinance, Debt and Overindebtedness* (Abingdon: Routledge, 2013), chs.3, 6, 9.
[167] Raminder Luther, Irene E. Leech and E. Thomas Garman, 'The Employer's Cost for the Personal Financial Management Difficulties of Workers: Evidence from the U.S. Navy' 2 Personal Finances and Worker Productivity (1998), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2594339.
[168] Lungile Ntsalaze and Sylvanus Ikhide, 'The Threshold Effects of Household Indebtedness on Multidimensional Poverty' 44 International Journal of Social Economics 1471 (2017).
[169] A. Mechele Dickerson, 'Over-Indebtedness, the Subprime Mortgage Crisis, and the Effect on U.S. Cities' 36 Fordham Urb. L.J. 395 (2009).
[170] Lauren M. Ross and Gregory D. Squires, 'The Personal Costs of Subprime Lending and the Foreclosure Crisis: A Matter of Trust, Insecurity, and Institutional Deception' 92 Social Science Quarterly 140 (2011).

sector.[171] Household financial fragility is also likely to affect aggregate demand,[172] thus limiting the corporate sector's economic output and contributing to its economic woes and financial fragility.

In this manner, household, corporate, and financial sector fragility are intertwined, and it is queried how increased indebtedness would really meet the three policy objectives of: (a) corporate economic recovery; (b) alleviation of household economic suffering; and (c) preserving the stability of the financial system.[173]

It may be argued that the picture of indebtedness and fragility depicted above is exaggerated given the purely near-term needs of corporations and households that seek relief and rescue during the pandemic.[174] However, increased indebtedness for corporations and households raises heightened concerns for financial fragility as extant levels of indebtedness are already high in the corporate[175] and household sectors[176] in the jurisdictions surveyed. Financial fragility is a result of the rigidity of the demands of debt upon borrowers. The demands of debt are legally framed, and, as a result, legal framing contributes to financial fragility for corporations and households. In particular, we argue that the legal framing of debt underwritten during the pandemic exacerbates such financial fragility.

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

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

In relation to the first respect, although the Modigliani-Miller theorem[177] posits that firms' decisions on capital structure, i.e. the mix of debt financing and equity financing, do not matter for firm value under assumptions of perfect market conditions, the absence of perfect conditions in the real world means that firms do grapple with attaining an optimal capital

[171] Howard Davies, *The Financial Crisis: Who is to Blame?* (London: Polity 2010), chs.6, 13, 14; Francis A Longstaff, 'The Subprime Credit Crisis and Contagion in Financial Markets' 97 Journal of Financial Economics 436 (2010).
[172] Paulo L. dos Santos, 'A Cause for Policy Concern: The Expansion of Household Credit in Middle-Income Economies', 27 International Review of Applied Economics 316 (2013).
[173] Section II.E.
[174] Indeed, the Bank of England survey shows near-term benefits for households averting financial shock by resorting to payment holidays, 'How has Covid-19 affected the finances of UK households?' (25 August 2020), https://www.bankofengland.co.uk/bank-overground/2020/how-has-covid-19-affected-the-finances-of-uk-households.
[175] Davis (1995), ch.2.
[176] Michael Kumhof, Romain Rancière and Pablo Winant, 'Inequality, Leverage, and Crises' 105 American Economic Review 1217 (2015); Charles Randell, 'A financial system to support the recovery' (16 June 2020), https://www.fca.org.uk/news/speeches/financial-system-support-recovery on high levels of household indebtedness in the UK.
[177] Franco Modigliani and Merton Miller, 'The Cost of Capital, Corporation Finance and the Theory of Investment' 48 American Economic Review 261 (1958).

structure.[178] In making decisions about whether to borrow more or raise funds from capital markets, commentators posit that corporations' decisions are influenced at the micro-level by their incentives[179] and preferences[180] as well as by broader industry factors, such as competition[181] and institutional factors, such as legal and regulatory regimes.[182] Indeed, legal and regulatory framing pervades the micro-level factors too, as legal and regulatory framing affects corporations' calculations on cost. It has been observed that tax regulatory treatment that favors debt reduces the cost of debt,[183] and strong creditor rights[184] and protections contribute to ease of access to debt as supply side confidence is fostered.

Equity fund-raising is relatively more expensive due to regulatory framing in relation to securities regulation[185] and corporate law (in relation to shareholder rights and protections).[186] However, such regulatory framing boosts supply side confidence and enhances ease of access to capital markets.[187] In countries with weaker legal and regulatory framing for capital markets protections, it is observed that reliance on debt financing is even stronger.[188] Legal framing of private debt correspondingly enhances lender protection in relation to the terms of debt, such as duration and monitoring.[189]

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[178] Peter H. Huang and Michael S. Knoll, 'Corporate Finance, Corporate Law and Finance Theory' 74 S. Cal. L. Rev. 175 (2000); Michael S. Knoll, 'The Modigliani-Miller Theorem at 60: The Long-Overlooked Legal Applications of Finance's Foundational Theorem' 36 JREG Bulletin 1 (2018-2019).

[179] Such as the trade-off theory that posits that firms balance the cost and benefits of equity and debt in order to decide on the capital mix, Franck Bancel and Usha R Mittoo, 'Cross-Country Determinants of Capital Structure Choice: A Survey of European Firms' 33 Financial Management 103 (2004); Thiess Buettner, Michael Overesch, Ulrich Schreiber, Georg Wamser, 'Taxation and Capital Structure Choice—Evidence from a Panel of German Multinationals' 105 Economics Letters 309 (2005).

[180] Such as the pecking order theory that posits that firms prefer to use retained earnings to finance themselves followed by debt, then equity, Wolfgang Bessler, Wolfgang Drobetz and Robin Kazemieh, 'Factors Affecting Capital Structure Decisions' in H Kent Baker and Gerald S Martin (eds), *Capital Structure and Corporate Financing Decisions: Theory, Evidence, and Practice* (Chicester: John Wiley & Sons, 2011), ch.2; Mark T. Leary and Michael R. Roberts, Do Firms Rebalance Their Capital Structures? 60 Journal of Finance 2575 (2005).

[181] Maurizio La Rocca, 'Capital Structure and Corporate Strategy' in H Kent Baker and Gerald S Martin (eds), *Capital Structure and Corporate Financing Decisions: Theory, Evidence, and Practice* (Chicester: John Wiley & Sons, 2011), ch.3.

[182] Carmen Cotei and Joseph Farhat, 'Worldwide Patterns in Capital Structure' in H Kent Baker and Gerald S Martin (eds), *Capital Structure and Corporate Financing Decisions: Theory, Evidence, and Practice* (Chicester: John Wiley & Sons, 2011), ch.7; Joseph P. H. Fan, Sheridan Titman, and Garry Twite, 'An International Comparison of Capital Structure and Debt Maturity Choices' 47 Journal of Financial and Quantitative Analysis 23 (2012).

[183] Huang et al (2000); Fan et al (2012); Silke Rünger, Rainer Niemann and Magdalena Haring, 'Investor Taxation, Firm Heterogeneity and Capital Structure Choice' 26 International Tax and Public Finance 719 (2019).

[184] Thomas Hall and Frederick Joergensen, 'Legal Variation and Capital Structure: Comparing Listed and Non-Listed Companies' 40 European Journal of Law and Economics 511 (2015).

[185] On the cost of complying with securities regulation, see Elizabeth Howell, 'An Analysis of the Prospectus Regime: The EU Reforms and the 'Brexit' Factor' 15 European Company and Financial Law Review 69 (2018).

[186] Nam H. Nguyen, Hieu V. Phan and Eunju Lee, 'Shareholder Litigation Rights and Capital Structure Decisions' 62 Journal of Corporate Finance 10161 (2020); Zhe An, Donghui Li, Jin Yu, 'Earnings Management, Capital Structure, and the Role of Institutional Environments' 68 Journal of Banking and Finance 131 (2016).

[187] Nguyen et al (2020).

[188] Cotei and Farhat (2011).

[189] Rima Turk Ariss, 'Legal Systems, Capital Structure, and Debt Maturity in Developing Countries' 24 Corporate Governance: An International Review 130 (2016).

Section II shows how developed jurisdictions have almost unanimously steered corporations towards increased indebtedness during the Covid-19 pandemic in order to tide over their difficulties. However, increased indebtedness is not necessarily beneficial for all firms alike, as the demands of the terms of loans may exert greater pressure on certain firms over others. For example, in sectors hardest hit, such as tourism and travel, revenue predictions remain highly uncertain for the foreseeable future.[190] Firms in this sector would likely suffer from cash flow volatility and constraints. Arguably, the cash flow discipline for managers that comes from the legal framing of debt, in relation to obligations of periodic payments contractually agreed, could be contrary to firms' needs.[191] It is also queried whether strong debt covenant burdens in favor of creditor monitoring are compatible with effective corporate crisis management. This is because managers who can exercise significant discretion are usually needed to steer corporations out of a crisis.[192] Empirical research also suggests that where firms are highly indebted and unable to be productive, financial fragility risks are enhanced.[193] Firms battling the economic woes caused by the pandemic may deploy debt to 'fight fire' and pay expenses, or may deploy debt to switch to forms of productivity relevant to needs during the pandemic.[194] Debt finance would likely be sub-optimal for a struggling firm that is unable to turn productivity around for revenue generation. For instance, a retailer suffering from consumer consumption aversion during the pandemic would probably not benefit from taking on more debt just to foot its rent and other fixed cost.

However, regulatory suspensions of microprudential regulation and government support for increased lending are two key aspects of regulatory framing that steer increased demand, as well as supply, for loans. Lenders may be incentivized towards quick and significant amounts of loan generation with minimal diligence standards as they do not have much incentive to price conservatively. In this case, regulatory framing overcomes risk aversion on the part of lenders during a time of information asymmetry[195] as borrowers' financial circumstances become volatile. However, moral hazard in lending and indiscriminate borrowing on the part of debtors entail longer-term sub-optimal effects.

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[190] 'Over a third of UK's SMEs in the travel sector will need 2 years to recover from coronavirus' (28 May 2020), https://www.traveldailynews.com/post/over-a-third-of-uks-smes-in-the-travel-sector-will-need-2-years-to-recover-from-coronavirus.

[191] Cash flow constraints impede investment by firms, see Matei Tămășilăa, Șerban Micleaa, Mihaela Vartolomeia, Dan Pascua and Claudiu Tiberiu Albulescu, 'Cash Flow and Investment Decision: An Application on the Romanian Agriculture Sector' 238 Procedia - Social and Behavioral Sciences 704 (2018).

[192] Decisive and powerful managers who are able to make decisions quickly and with a large berth of discretion have been observed to be key to crisis-struck firms' recovery, Marc van Essen, Peter-Jan Engelen and Michael Carney, 'Does "Good" Corporate Governance Help in a Crisis? The Impact of Country- and Firm-Level Governance Mechanisms in the European Financial Crisis' 21 Corporate Governance 201 (2013); Chris Nichols, Shoma Chatterjee Hayden and Chris Trendler, '4 Behaviors That Help Leaders Manage a Crisis' (Harvard Business Review, 2 April 2020), https://hbr.org/2020/04/4-behaviors-that-help-leaders-manage-a-crisis.

[193] Dirk Bezemer and Maria Grydaki, 'Financial Fragility in the Great Moderation' 49 Journal of Banking and Finance 169 (2014).

[194] The appropriateness of increased debt finance is not the same for all firms. Some firms may strategically reinvent themselves but others may hoard cash and contribute little to economic recovery, or become hard-pressed, 'Why rescue finance will slow recovery for businesses', *Financial Times* (26 August 2020), https://www.ft.com/content/3afb13c5-99d1-418f-ad51-33f3d6db81ca.

[195] Peter Lee, "CBILS faulty: Sunak's flagship UK lending scheme looks unfit for purpose", *Euromoney*, 24 April 2020, https://www.euromoney.com/article/b1lbgfwrx72nn3/cbils-faulty-sunaks-flagship-uk-lending-scheme-looks-unfit-for-purpose.

Arguably, firms with certain long-term needs and longer-term horizons for economic recovery could benefit from turning to equity rather than debt during this crisis.[196] However, compared to regulatory suspensions for lenders, only the UK and EU have implemented limited measures to facilitate equity fund-raising, while maintaining much of the securities regulatory investor protection regime.[197] Market sentiment in capital markets is unfortunately procyclical and investors are behaviorally risk averse, as reflected in their preference for cash (using Lo's adaptive capital markets hypothesis).[198] Indeed, levels of private investment in the corporate sector have fallen,[199] while companies are turning more to debt than equity issuances.[200] The legal and regulatory framing adopted by policy-makers during the pandemic has arguably not done enough to facilitate equity capitalization as a realistic alternative to increased debt.

Commentators already expect at least 40% of Bounce Back loans in the UK to default in due course.[201] In general, the level of loans made during the pandemic that can be expected to be non-performing would increase.[202] This is likely to cause hardship for corporations as banks have no incentive to work things out with corporations and support them in a more relational manner. This is because government guarantees introduce perverse incentives for banks to accelerate treating borrowers as in default so as to call upon the guarantee and remove these borrowers from banks' balance sheets. Although moratoria have been introduced to prevent lenders from initiating action against debtor firms,[203] these are temporary in most countries, and would expire by the time borrowers reckon with loan repayment. It is left to the private outworking between lenders and firms to determine how debt is to be restructured within

[196] Companies that are healthily capitalised and have cash buffers are seen as more resilient, Stefano Ramelli and Alexander F. Wagner, Feverish Stock Price Reactions to Covid-19 (June 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3550274.

[197] FCA, *Statement of Policy: listed companies and recapitalisation issuances during the coronavirus crisis* (8 April 2020), https://www.fca.org.uk/news/statements/listed-companies-recapitalisation-issuances-coronavirus. The EU Commission has recently proposed a Capital Markets Recovery Package to permit a short-form prospectus for established issuers, and lower compliance burdens for investment advisors when dealing with experienced investors respectively, https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1382.

[198] Andrew W. Lo, 'The Adaptive Markets Hypothesis: Market Efficiency from an Evolutionary Perspective' 30 The Journal of Portfolio Management 15 (2014).

[199] 'Investors pull record €250bn from European funds', *Financial Times* (22 April 2020), https://www.ft.com/content/29d69ff6-749b-45dc-b53e-85a236186983; "UK investors flee equity funds on coronavirus fears." *Financial News*, February 27, 2020, https://www.fnlondon.com/articles/uk-investors-flee-equity-funds-on-coronavirus-fears-20200227.

[200] Halling, Yu and Zechner (2020).

[201] "UK banks warn 40%-50% of 'bounce back' borrowers will default", *Financial Times* (31 May 2020), https://www.ft.com/content/8a551c37-2de8-446b-a8b8-d4a61d33ef73.

[202] Ivan Huljak, Reiner Martin, Diego Moccero and Cosimo Pancaro, 'Do Non-Performing Loans Matter for Bank Lending and the Business Cycle in Euro Area Countries?' (May 2020) ECB Working Paper, 2-3, https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2411~839bc74726.en.pdf; IMF and World Bank, *COVID-19: The Regulatory and Supervisory Implications for the Banking Sector* (21 May 2020), https://www.imf.org/en/Publications/Miscellaneous-Publication-Other/Issues/2020/05/20/COVID-19-The-Regulatory-and-Supervisory-Implications-for-the-Banking-Sector-49452; 'Three US banks set aside record $28bn for loan losses', *Financial Times* (14 July 2020), https://www.ft.com/content/f1bbaf65-7cb7-4855-ba7f-d9bda5f4b053; 'European banks braced for €800bn of loan losses if pandemic worsens', *Financial Times* (21 July 2020), https://www.ft.com/content/1c4faf6c-975c-4566-8e0e-c9cbd613db42.

[203] UK Corporate Insolvency and Governance Act 2020.

the legal frameworks of insolvency law. One doubts whether corporate insolvency law is appropriate to deal with a macro-economic scale of corporate distress.[204]

The legal and regulatory framing is arguably too focused on supply-side enhancement to promote ease of access to loans. Such legal and regulatory framing does not encompass demand-side considerations such as loan terms that should be tailor-made for pandemic-related needs, including relational restructuring possibilities and business conduct considerate of borrowers' extraordinary situations.[205] Legal and regulatory framing has also refrained from regulating business lending, leaving lenders and corporate borrowers full freedom to negotiate, or to rely on loan terms standardized by lenders' trade associations.[206] Such legal and regulatory framing, although supportive of the supply side of credit and promotes ease of access, fails to subject lenders to social and ethical considerations for borrowers in such extraordinary times.

The resumption of full microprudential regulatory compliance for banks may also have the impact of constraining them in their future ability to support the real economy if bank resilience[207] is weakened from increased lending during the pandemic. The UK PRA seems to assume that the regulatory framework would simply resume after a likely 12-month period of suspension of the CCyb, and maintains that other unadjusted capital requirements remain the same.[208] The ECB has opined that banks would not resume full microprudential compliance until the end of 2022.[209] However, with great uncertainty regarding when and how the public health crisis will recede, these timelines may add pressure to banks, in turn having adverse implications for the treatment of borrowers.

It may be argued that the fiscal backstop for government-guaranteed loans would mitigate the adverse aspects of bank-borrower relationships described above. This is precisely what the guarantees are for. At a macro level, however, would a fiscal backstop not create a vicious circle problem for banks, as banks are also the principal funders for sovereigns? If banks suffer

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[204] The limitations of corporate insolvency law in dealing with potential financial institution insolvencies during the global financial crisis 2007-09 paved the way for the development of 'lex specialis' for the resolution of financial institutions, see Rosa Lastra, 'Northern Rock and Banking Law Reform in the UK' in Franco Bruni and David T Llewellyn (eds), *The Failure Of Northern Rock: A Multi-Dimensional Case Study* (2009), 131, www.suerf.org/download/studies/study20091.pdf. However, it is queried if a *lex specialis* can be extended to large-scale corporate distress in the non-financial sector, highlighted in Section V.

[205] Thomas Huertas, "Here is How Banks Can Help Save the Economy", *Financial Times* (11 May 2020), https://www.ft.com/content/f02df444-8f78-11ea-bc44-dbf6756c871a.

[206] E.g. the Loan Market Association's recommended standard terms for a variety of business lending, https://www.lma.eu.com/documents-guidelines/documents.

[207] Anil Ari, Sophia Chen and Lev Ratnovski, *COVID-19 and Non-Performing Loans: Lessons from Past Crises* (27 May 2020) European Central Bank Research Bulletin, 6-7, https://www.ecb.europa.eu/pub/economic-research/resbull/2020/html/ecb.rb200527~3fe177d27d.en.pdf; Elena Carletti, Stijn Claessens, Antonio Fatás and Xavier Vives, *Introduction*, in Elena Carletti, Stijn Claessens, Antonio Fatás and Xavier Vives (eds), *The Bank Business Model in the Post-Covid-19 World* (CEPR 2020) 19-20, https://cepr.org/content/bank-business-model-post-covid-19-world.

[208] PRA, *Pillar 2A: Reconciling capital requirements and macroprudential buffers* (July 2020), https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2020/ps1520.pdf?la=en&hash=8FEBCB779D8FE8FB6328AB57AF79AA47B4914614.

[209] 'FAQs on ECB supervisory measures in reaction to the coronavirus' (updated 28 July 2020), https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320_FAQs~a4ac38e3ef.en.html.

from impaired balance sheets from excessive credit creation during the pandemic, governments' own fiscal backstops may not be credible since governments rely on private sector funding themselves.

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

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

Consumer credit is regulated, in the UK by the FCA[210] and in the US by the Consumer Financial Protection Bureau (CFPB).[211] In the EU, the European Banking Authority[212] and European Securities and Markets Authority[213] both have mandates to recommend pan-European financial consumer protection policies but regulatory implementation is left to national regulators. In liberal market economies such as the UK and US, market choice is a prized policy objective, as choice mitigates the likelihood of consumer exploitation.[214] Indeed, the FCA has an explicit pro-competition regulatory objective[215] alongside its consumer protection objective,[216] seen as complementing the latter. In this light, highly risky consumer credit products such as doorstep lending,[217] high-cost short-term credit[218] or payday lending,[219] and consumer goods-based purchase credit[220] are often available to consumers, not outlawed. Regulators may, however, intervene *ex post,* in response to empirically observed problems. For instance, in 2015 the FCA introduced a cap on interest charges levied by payday and rent-

[210] FCA, 'Consumer credit firms', https://www.fca.org.uk/firms/consumer-credit.
[211] CFPB, 'Protect yourself financially from coronavirus', https://www.consumerfinance.gov.
[212] EBA, https://eba.europa.eu.
[213] ESMA, https://www.esma.europa.eu.
[214] Neelie Kroes, 'European Competition Policy – Delivering Better Markets and Better Choices' (Speech, European Commission, 1 Sep 2005), https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_05_512.
[215] Section 1E, Financial Services and Markets Act 2000 amended by Financial Services Act 2012.
[216] Section IC, ibid.
[217] 'FCA should go further in crackdown on doorstep lending, consumer groups say' (31 May 2018), https://www.independent.co.uk/news/business/news/fca-doorstep-lending-crackdown-citizens-advice-credit-price-cap-debt-overdrafts-a8377316.html.
[218] FCA, 'PS14/16: Detailed rules for the price cap on high-cost short-term credit - Including feedback on CP14/10 and final rules' (2 January 2015), https://www.fca.org.uk/publications/policy-statements/ps14-16-detailed-rules-price-cap-high-cost-short-term-credit.
[219] Payday lending is allowed in a majority of states in the US, but banned in 15 states, 'State Payday Loan Regulation and Usage Rates', https://www.pewtrusts.org/-/media/data-visualizations/interactives/2014/state-payday-loan-regulation-and-usage-rates/report/state_payday_loan_regulation_and_usage_rates.pdf.
[220] Such as rent-to-own, catalogue credit, see FCA, 'PS19/6: Rent-to-own price cap – feedback on CP18/35 and final rules' (5 March 2019), https://www.fca.org.uk/publications/policy-statements/ps19-6-rent-own-price-cap-feedback-cp18-35-and-final-rules; FCA, 'High-cost Credit Review Feedback on CP18/12 with final rules and guidance and consultation on Buy Now Pay Later offers', Consultation Paper CP18/43 (December 2018), https://www.fca.org.uk/publication/consultation/cp18-43.pdf#page=29.

to-own lenders[221] when problems such as extortionate interest charges were discovered.[222] In the US, *ex post* interventions are also often the norm,[223] based on broadly framed powers conferred upon the CPFB under the Dodd-Frank Act.[224] The FCA also undertakes some pro-active review of consumer credit sectors. [225] Access to consumer credit is often regarded as key to financial inclusion[226] and regulatory policies have favored the supply-side by erecting few barriers to consumer access. Regulatory intervention into terms of consumer credit are selective, [227] and many such interventions rely on *ex post* actions, such as consumers' challenge over unfair terms,[228] or actions for limited sums brought before the UK's Financial Ombudsman, a regime for informal resolution of disputes on the basis of fairness rather than on strict application of the law.[229]

The protection of financial consumers is a relatively more recent development,[230] driven by post-crisis reforms that push back against the neoliberal political preferences that have prevailed before the global financial crisis of 2007-09.[231] In the UK and US, the FCA and CFPB, having dedicated mandates to secure consumer protection, started to introduce *ex ante* responsibilities for lenders in the context of consumer credit, such as creditworthiness assessments of borrowers ahead of lending, including customers' incomes and non-discretionary expenditure in order to ascertain affordability of debt and the impact on consumers' basic living needs.[232] However, there is limited application in the US, as the 'ability to repay' rule is only imposed on mortgage assessments, and has been scrapped from application to payday lending only after a year from its introduction,[233] in order not to limit

[221] See n218, 220.

[222] Price caps were frowned upon as intervening in market price formation mechanisms, but this leaves consumers few avenues to challenge poor credit deals, s140A-C, Consumer Credit Act 1974. The 2015 interventions signal a significant shift in regulatory policy.

[223] CFPB, 'Enforcement actions', https://www.consumerfinance.gov/policy-compliance/enforcement/actions/. See Christopher L Peterson, 'Consumer Financial Protection Bureau Law Enforcement: An Empirical Review' 90 Tulane Law Review 1057 (2016); but see critique of the CFPB's enforcement as ultimately increasing cost for access to finance, Todd Zwyicki, 'Consumer Financial Protection Bureau: Savior or Menace' 81 Geo. Wash. L. Rev. 856 (2013).

[224] Sections 1031-1036, Dodd Frank Wall Street Reform and Consumer Protection Act 2010, https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.

[225] The most recent being the High-cost Credit Review (2018), n260.

[226] Thorsten Beck, Asli Demirguc-Kunt and Ross Levine, 'Finance, Inequality and the Poor' 12 Journal of Economic Growth 27 (2007).

[227] N218, 220.

[228] S62, Consumer Rights Act 2015, but see limitation in s64, and unsuccessful challenge in *OFT v Abbey National plc & others* [2009] UKSC 6.

[229] S225-230A, UK Financial Services and Markets Act 2000.

[230] Neoliberalism pervades consumer financial laws/regulations before the global financial crisis 2007-09, *UK Consumer Credit: Report of the Committee, Crowther Report* Cmnd 4596, (London, The Stationary Office, March 1971) para 3.9.1, p151; A. Karim Aldohni, 'The Accessibility of Credit and the Protection of Consumers in the High Cost Credit Sector: A Multifaceted Challenge' Law and Contemporary Problems (2020), forthcoming.

[231] Niamh Moloney, 'The Legacy Effects of the Financial Crisis upon Regulatory Design in the EU' in Eilis Ferran, Niamh Moloney, Jennifer G Hill and John C Coffee Jnr, *The Regulatory Aftermath of the Global Financial Crisis* (Cambridge: Cambridge University Press, 2012) 111, 112.

[232] FCA Handbook CONC 5.

[233] In the US, the 'ability to repay' rule applies only to residential mortgages, being a response to combat the problems of the sub-prime mortgage market, 'Consumer Financial Protection Bureau Takes Steps to Address GSE Patch' (22 June 2020), https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-steps-address-gse-patch/; for the high-cost short-term credit sector, see 'Rules juggle protection of payday loan borrowers

access to such credit.[234] In the UK, there is proportional application of responsible lending rules, depending on the nature of the transaction and the scale and size of the firm.[235] Small amounts of short-term credit or the purchase of a single item on catalogue credit would unlikely entail detailed assessment by lenders. In this manner, consumers may incur small amounts of catalogue credit or payday lending with several lenders, creating disparate pictures of their credit profile that could fall into a gap of insufficient scrutiny. Questions continue to be asked whether more paternalistic[236] and *ex ante* interventions are necessary, such as *ex ante* product governance and regulation of consumer credit. The EU's recent product governance rules can provide a template for more *ex ante* responsibility on the part of product providers,[237] but they are highly procedural for product providers and consumer enforcement may not be available.[238] Consumer protection, which is relatively more developed in the EU, may also be achieved by financial regulators' 'product intervention' powers. Regulators can impose *ad hoc* restrictions on the distribution and marketing of financial products that may be detrimental to consumers.[239] Still, the exercise of such powers has tended to concentrate upon risky and complex investment products,[240] not credit products.[241]

During the Covid-19 pandemic, regulatory framing is aimed at debt forbearance and deferred payments, as well as increasing access to debt.[242] The FCA's policies of loan forbearance for consumer credit, that can effectively allow consumers to defer consumer credit payments until end of January 2021,[243] and to enjoy £500 extra in bank overdrafts up to October 2020

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and lending market', *Financial Times* (17 October 2019), https://www.ft.com/content/6c7eb0e2-cf26-11e9-b018-ca4456540ea6. Unfortunately the rule was scrapped for payday lending in 2020, see Claire Williams, 'CFPB Scraps Ability-to-Repay Provision From Payday Rule: Instant Reaction' (7 July 2020), https://morningconsult.com/2020/07/07/cfpb-payday-lending-rule-instant-reaction/.

[234] For policy dilemmas and the need to regulate this sector, see Ronald J Mann and Jim Hawkins, 'Just Until Payday' 54 UCLA Law Rev (2007), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=921844.

[235] The affordability or 'creditworthiness' assessment applies to all consumer credit, FCA Handbook CONC 5.

[236] John Y Campbell, 'Restoring Rational Choice: The Challenge of Consumer Financial Regulation' 106 American Economic Review 1 (2016).

[237] Art 24(2), EU Markets in Financial Instruments Directive 2014, Art 9, 10, MiFID Commission Delegated Directive 2017/563, FCA Handbook PROD 3.2, and The ESMA's Guidelines on MiFID II product governance requirements' ESMA35-43-620 (5 February 2018), https://www.esma.europa.eu/sites/default/files/library/esma35-43-620_guidelines_on_mifid_ii_product_governance_requirements_0.pdf; Antonio Maracci, 'European Regulatory Private Law Going Global? The Case of Product Governance' (2017) 18 European Business Organisations Law Review 305.

[238] Veerle Colaert, 'Product Governance: Paternalism Outsourced to Financial Institutions?' (2019) at https://ssrn.com/abstract=3455413.

[239] Art 17, Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs); Arts 39-43, Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Regulation (EU) No 648/2012.

[240] Largely exercised by the European Securities and Markets Authority, for example in relation to marketing contracts for differences to retail investors, ESMA, 'Product Intervention', https://www.esma.europa.eu/policy-activities/mifid-ii-and-investor-protection/product-intervention.

[241] No instance of exercise is recorded by the European Banking Authority at the time of writing, 'Product intervention powers under MiFIR', https://eba.europa.eu/consumer-corner/product-intervention-powers.

[242] Section II.

[243] Section II.A.

interest free,[244] incentivize consumers towards these sources of short-term debt and to defer payments as well.[245] In particular, the FCA, by relieving lenders from excessive diligence of borrowers who request deferment of loan repayments,[246] shifts the burden onto borrowers to ensure that they can afford such requests. Borrowers focusing on their near-term troubles may behaviorally[247] postpone any long-term thinking about affordability and their own financial fragility, accumulating arrears that may become even more unmanageable in the future.[248] With imminent closure of furlough schemes[249] or the end of the paycheck protection program in the US,[250] would debtors be tempted to finance living costs and debt repayment with new debt, such as by accessing bank overdrafts, credit card debt and payday lending? These are easily accessible, especially if consumers are existing customers. Easily accessible forms of credit also have the tendency to exert more demands on borrowers as they are high cost and mostly structured as short-term thus exacerbating their financial fragility. Catalogue and other retailers that offer purchase credit may also tempt customers in their bid to boost sales and consumption during this period.

Legal and regulatory framing in relation to loan forbearance, although appealing to near-term needs, do not provide sufficiently for the protection of borrowers in terms of business conduct between them and lenders during such extraordinary times. In particular, would there be moderation of the usual strong creditor protection rights in terms of demands for periodic payments, accrual of interest, default and enforcement after mandated forbearance is over?[251] Although in the UK, the regulator urges banks to enter into tailored forbearance agreements with their borrowers,[252] this is soft law at best. Delegating to borrowers to negotiate how creditors' rights would be exercised is arguably sub-optimal in the absence of clearer and more legalized obligations to offer borrowers relational restructuring or outworking. The FCA's guidance for firms in treating their 'vulnerable' customers may pave the way for more cautious approaches on the part of lenders at point of sale or in relational

[244] Ibid.

[245] The Bank of England survey shows approximately one in six UK mortgage-holders having taken out a payment holiday, 'How has coronavirus affected the finances of UK households?' (25 August 2020), https://www.bankofengland.co.uk/bank-overground/2020/how-has-covid-19-affected-the-finances-of-uk-households.

[246] Ibid.

[247] Consumers' bounded rationality is discussed in Campbell (2016); and implicit trust in regulated financial products is canvassed in Niamh Moloney, *How to Protect Investors* (Cambridge: Cambridge University Press 2010), ch.1 on the retail profile.

[248] "Lenders sound warning on mortgage holidays", *Financial Times* (25 March 2020), https://www.ft.com/content/3a6b82b0-6e77-11ea-89df-41bea055720b.

[249] 'UK business leaders warn over closure of furlough scheme' (The Guardian, 8 July 2020), https://www.theguardian.com/business/2020/jul/08/uk-business-leaders-warn-closure-furlough-scheme-chancellor.

[250] Which ended on 8 August 2020, also discussed in Michael Barr, Howell Jackson, Margaret Tahyar, 'The Financial Response to the Covid-19 Pandemic' (2020), https://ssrn.com/abstract=3666461.

[251] 'U.S. borrowers struggle to get coronavirus relief from big banks' (Reuters, 3 April 2020), https://www.reuters.com/article/us-health-coronavirus-banks-forbearance/u-s-borrowers-struggle-to-get-coronavirus-relief-from-big-banks-idUSKBN21K2YB.

[252] PRA, 'PRA statement on Covid-19: IFRS 9 and capital requirements – Guidance as Covid-19 specific payment deferrals come to an end' (26 August 2020), https://www.bankofengland.co.uk/prudential-regulation/publication/2020/statement-covid19-ifrs9-capital-requirements-specific-payment-deferrals.

outworking with borrowers.[253] However, the definition of 'vulnerable' is open-ended,[254] and consumer protection derived from such guidance if any, is likely *ex post* in nature.

In a broader context, consumer credit would be a less hazardous issue for individual and social well-being if households had higher savings levels and were more resilient to macro-economic shocks.[255] In this respect, legal and regulatory framing in financial regulation, as well as economic and corporate regulation more broadly, has arguably not provided sufficient incentives towards household saving. The FCA's regulatory intervention into poor savings products provided by banks only took place in 2020.[256] Although tax benefits encourage saving,[257] the unregulated nature of some 'tax-free' financial products has entailed scandals[258] and highlights regulatory gaps in the savings product market. Further, general pro-business policies that tolerate corporate short-termism[259] and consumption-fueled economies[260] in the surveyed jurisdictions underpin narratives that support access to consumption-led consumer credit,[261] which has been found to be systemically risky for the financial sector[262] and diminishes social well-being in the long-term. This is because consumer credit is often used to bridge consumption needs not met by long-term stagnation of workers' incomes.[263] Without improvement in social mobility, individual and household welfare may not be improved.[264] Increased indebtedness during the pandemic can be counter-productive to household resilience and recovery, economically sub-optimal and detrimental to long-term human well-being.

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[253] FCA, 'GC20/3: Guidance for firms on the fair treatment of vulnerable customers' (29 July 2020), https://www.fca.org.uk/publications/guidance-consultations/gc20-3-guidance-firms-fair-treatment-vulnerable-customers.

[254] Characteristics of vulnerability are left unspecified, ibid.

[255] Christoph Basten, Andreas Fagereng and Kjetil Telle, 'Saving and Portfolio Allocation Before and After Job Loss' (2016) 48 Journal of Money, Credit and Banking 293.

[256] FCA, 'FCA acts to help customers get better rates for cash savings' (9 January 2020), https://www.fca.org.uk/news/press-releases/fca-acts-help-customers-get-better-rates-cash-savings.

[257] E.g. the tax-free allowance implemented in the UK for a variety of retail savings and investment products, known as 'ISAs'.

[258] 'Investors face £230m loss in London Capital & Finance collapse' (9 January 2020), https://www.theguardian.com/uk-news/2020/jan/09/investors-face-230m-loss-in-london-capital-finance-collapse, a scandal involving sales of unregulated tax-free bond products to retail investors.

[259] Corporate Values Strategy Group, *Overcoming Short-termism: A Call for a More Responsible Approach to Investment and Business Management* (New York: Aspen Institute Business and Society Programs, 2009), http://www.aspeninstitute.org/publications/overcoming-short-termism-call-more-responsible-approach-investment-business-management; BIS, *The Kay Review: terms of reference* (June 2011), BIS/11/1015.

[260] Halina Szejnwald Brown, 'The US economy is reliant on consumer spending – can it survive a pandemic?' (13 August 2020), https://theconversation.com/the-us-economy-is-reliant-on-consumer-spending-can-it-survive-a-pandemic-141244; 'It'll take more than shopping to save our debt-addled economy' (20 August 2018), https://www.theguardian.com/commentisfree/2018/aug/20/shopping-debt-economy-britain-growth-model-consumption-production-inequality.

[261] Alberto Russo, Luca Riccetti and Mauro Gallegati, 'Increasing Inequality, Consumer Credit and Financial Fragility in an Agent Based Macroeconomic Model' 26 J Evol Econ 25 (2016); D'Orazio (2019).

[262] Dos Santos (2013).

[263] Income inequality drives consumer credit for consumption and stagnation of wages does not help future household deleveraging or mobility, D'Orazio (2019).

[264] Melanie G. Long, 'Pushed into the Red? Female-headed Households and the Pre-crisis Credit Expansion' 47 Forum for Social Economics 224 (2018).

IV. Mitigating the Adverse Consequences of Debt Expansion- Drawing upon the Legal Theory of Finance

We argue that corporate and household financial fragility has been exacerbated during the Covid-19 pandemic, and attribute this to legal and regulatory framing that promote distorted ease of access to private debt which involves relatively inflexible obligations that secure creditors' protection. In this Section, we reach into the legal theory of finance, particularly its application in explaining the mammoth scale of debt forgiveness for systemically important banks during the global financial crisis of 2007-09,[265] to derive insights for addressing the adverse consequences of private debt expansion. This is because the legal theory of finance provides a conceptual basis for elasticity to be introduced in law which leads to changes both temporary and permanent.

Legal elasticity is argued to be a function of the legal theory of finance posited by Pistor.[266] The legal theory of finance frames finance in legal terms, as financial transactions and obligations are constructed as legal structures in order to work as intended. In particular, the legal theory of finance conceptualizes finance as being underpinned by the crucial qualities of certainty and enforceability that law supplies. However, during the global financial crisis, it was observed that the very qualities of certainty and strict enforceability of financial obligations and transactions in various markets would collectively lead to damaging consequences, a manifestation of systemic risk.[267] As such, the solution was also found in law, i.e. to resort to legal elasticity in order to suspend and mitigate the adverse impacts driven by law, in order to meet the needs of crisis management.

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

The above conceptualization of legal elasticity in finance provides a framework for institutional change from the previous law. Indeed, it can be argued that the post-crisis reforms to the banking and financial sector reflected this conceptualization of legal elasticity. Where banks had been unable to absorb their losses during the global financial crisis, legal elasticity was applied so that regulatory discipline was not meted out to them for being inadequately capitalized. Instead, many jurisdictions bailed out their banks by injecting state capital[268] and then proceeded to reform capital rules to tie banks to higher and more robust levels of capitalization for loss absorption.[269] Banks that tethered upon the edge of insolvency

[265] See below, ns269-271.
[266] Pistor (2013), 320.
[267] Steven Schwarz, *Systemic Risk*, 97 Georgetown Law Journal 193 (2008).
[268] Mike Collins, 'The Big Bank Bailout' (14 July 2015), https://www.forbes.com/sites/mikecollins/2015/07/14/the-big-bank-bailout/; 'Rescue packages: what governments have offered' (20 October 2008), https://www.telegraph.co.uk/finance/3229434/Rescue-packages-what-governments-have-offered-financial-crisis.html.
[269] Basel Committee on Banking Supervision, *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems* (rev June 2011, Basel: BIS 2010), http://www.bis.org/publ/bcbs189.pdf; Basel Committee, *Finalising Post-crisis Reforms* (2017), https://www.bis.org/bcbs/publ/d424.pdf. The European Union introduced

were in most cases rescued,[270] and spared the full force of private sector insolvency laws, leading to subsequent development of a bespoke bank crisis management and resolution regime in many jurisdictions.[271]

Although the prevailing perception of US, UK and EU policy makers is that financial regulatory measures during the Covid-19 pandemic are temporary in nature, it is questioned whether these measures can and should be conceived of in such limited terms. It has been argued that UK corporate and financial law would unlikely experience permanent change in response to the pandemic as formal legal change has been resisted in favor of temporary and practical *de facto* adjustments.[272] However, we envisage that the structural nature of legal elasticity would be called upon to manage longer-term consequences, i.e. the significant hazards of debt expansion in the post-Covid world.

It is fully understandable that financial regulators have no appetite for major institutional changes as the post-crisis financial regulatory reforms have only recently been completed after more than a decade.[273] Further, the current financial stresses are caused by an exogenous public health crisis and is therefore not perceived as entailing existential consequences for the substance of financial laws/regulations. However, we caution against assumptions of temporariness and the lack of recognition of longer-term financial consequences and urge policy makers and regulators to consider more structural adjustments based on legal elasticity.

Nevertheless, objections can be raised against our proposal to apply legal elasticity to address post-Covid hazards and consequences for the economy and society. There are three possible objections. One is that the legal theory of finance which introduces legal elasticity is crucially based on the interests of powerful structures in finance who would unlikely support the introduction of significant policy changes affecting creditors' rights. Second, it can be argued that our conception of legal elasticity is incorrect as our expectations of its responsiveness to policy change are misplaced. The legal precepts in relation to debt are not merely porous to social demands and form a relatively autopoietic system.[274] Third, it can be argued that we over-estimate what legal elasticity can do to alleviate the hazards of debt expansion, as many solutions lie outside of the law. We counter each of these in turn. The theorization of legal elasticity yields structural insights that support expressing policy goals through the qualities of legal and regulatory framing. We do not exclude the relevance of extra-legal policy

additional prescriptive rules apart from adopting Basel III in Directive 2013/36/EU (Capital Requirements IV Directive 2013); Regulation (EU) No 575/2013 (Capital Requirements Regulation 2013) both further amended in 2019 by Regulation 2019/876.

[270] Except the failure of Lehman Brothers in the US.

[271] Financial Stability Board, *Key Attributes of Effective Resolution Regimes for Financial Institutions* (15 October 2014), https://www.fsb.org/2014/10/key-attributes-of-effective-resolution-regimes-for-financial-institutions-2/, implemented in the European Union in the Bank Recovery and Resolution Directive 2014/59/EU.

[272] Iain MacNeil and Irene-marie Esser, 'The Pandemic Response in the UK in the context of corporate and financial law – within and without Law' (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3636292.

[273] The Basel Committee's reforms were issued between 2009-2017, see https://www.bis.org/bcbs/basel3.htm; and the EU's regulatory regime firmed up only in 2013, followed by amendments in 2019.

[274] See explanation and definition in Gunther Teubner (ed), *Autopoietic Law - A New Approach to Law and Society* (EUI, De Gruyter, 1987), 1-11.

measures[275] but have chosen to focus on legally framed ones for the purposes of this article. We also argue that legal elasticity based on the legal theory of finance provides a robust methodological framework that is less susceptible to arbitrary discretion by policy makers.[276]

Pistor's legal theory of finance constructs a hierarchical structure with sovereigns at its heart, to the extent that they control their own currency, borrow mostly in that currency, and can therefore act as true lenders of last resort. Private parties fit into this hierarchical structure depending on their size and economic power from large systemic banks down to retail investors and borrowers. Pistor posits that elasticity tends to be more accentuated at the top of the system to the benefit of sovereigns and large banks, while those at the bottom are left to face the full rigor of the law. This conceptualization resonates very closely with the events of the global financial crisis during which most distressed large financial institutions were rescued with the use of public money while individual investors and borrowers were left to face the financial consequences of the crisis.

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

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

[275] Edward J. Balleisen, Lori S. Bennear, Kimberly D. Krawiec and Jonathan B. Wiener (eds), *Policy Shock* (Cambridge: CUP 2017) generally.

[276] Discretion and uncertain regulatory mandates are criticized in David Zaring, 'The Government's Economic Response to the Covid Crisis' (2020), https://ssrn.com/abstract=3662049.

We are skeptical that financial regulatory goals or objectives would remain untouched by the impending social effects entailing from 'temporary' measures of relief and rescue that facilitate a significant level of debt expansion. The onset of corporate and household fragility, as well as financial sector weaknesses, would raise questions regarding longer-term social and economic welfare, and normative questions regarding what finance's role is and should be. Is it *right* at the tailing-off of the Covid-19 pandemic for banks simply to return to an 'enforcement' mode in relation to borrowers who have been on payment holidays? Is this issue only a matter of conduct of business?[277] Would consumer protection require more radical distributive treatment such as some extent of debt forgiveness? Economic and social welfare effects are likely to follow the winding down of the public health crisis and cannot be addressed by a simple resumption of regulatory regimes and contractual obligations.

We posit that power structures alone are not likely to sustain institutional stability, as bottom-up social appetite and demands can exert new pressures in the future. One of us has argued that social movements have contributed to a gradual institutional change in corporate regulation for example.[278] Lothian[279] and Arup[280] have also, in the wake of the global financial crisis, called for greater socialization of the objectives of financial regulation. Such a radical re-orientation is not yet seen, as financial regulation is generally dominated by an economic paradigm.[281]. Post-crisis reforms have only edged closer to macro-level economic perspectives such as financial stability.[282] However, there is a consistent social cry for financial regulation reform especially in the direction of protecting consumer welfare.[283] The undercurrents of dissatisfaction with the myopic paradigms of financial regulation may again be raised in the wake of adverse consequences of debt expansion that would be practically felt by economic actors and society. The powerful structures in financial systems are not immune to these forces even if they have not demonstrated a preference for institutional change.[284] Our conceptualization of legal elasticity potentially adds to the legal theory of finance by recognizing a wider range of drivers of institutional change beyond the needs and preferences of powerful structures.

Second, it may be argued that even if legal elasticity does not merely respond to powerful financial actors' initiatives, it is too simplistic to think that bottom-up demands would result in radical shifts in the legal conception of private debt. This assumes that the legal regime for private debt is entirely porous to social demands, an assumption that is inconsistent with the

[277] Such as 'treating customers fairly' under the FCA's Principles for Conduct of Business, FCA Handbook, PRIN ch.2.
[278] Iris H-Y Chiu, 'An Institutional Theory of Corporate Regulation' 71 Current Legal Problems 279 (2018).
[279] Tamara Lothian, *Law and the Wealth of Nations: Finance, Prosperity, and Democracy* (Columbia University Press, 2017) on re-orienting the service of finance to the real productive economy instead of leaving to a free-market approach.
[280] Christopher Arup, 'The Global Financial Crisis: Learning from Regulatory and Governance Studies' 32 Law and Policy 363 (2010).
[281] FCA, *Economics for Effective Regulation* (2016), https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-13-economics-effective-regulation.
[282] Mads Andenas and Iris H-Y Chiu, *The Foundations and Future of Financial Regulation* (Oxford: Routledge 2014) ch.2.
[283] Such as the role of the US CFPB. The UK FCA was compelled to consider reform to customer protection in its 'Duty of Care' inquiry, see result at https://www.fca.org.uk/news/press-releases/financial-conduct-authority-publishes-feedback-statement-duty-of-care.
[284] See ns 208-209.

influential autopoietic conception of law.[285] The legal conception of private debt is arguably a relatively closed system of established contractual, governance and property rights,[286] constituting a particular transactional regime of debt relations. This legalization is even reinforced in regulatory treatment as microprudential regulations absorb established tenets of debt structuring in order to assign risk weightings and regulatory cost.[287] Even flexibility in the enforcement of private debt is legally structured within established processes such as company voluntary arrangements.[288]

Nevertheless, even in a theorized autopoietic conception of the legal nature of private debt, the proponents of legal autopoiesis accept that legal systems are normatively closed – i.e. the way law constructs meaning within its system is autonomous and independent of other social systems – but cognitively open, i.e. law's mediation of social evolution does take place when confronted with changes in social reality.[289] The relatively strong and inflexible nature of creditors' rights agreed *ex ante* and the certainty of contractual enforcement are legal tenets of private debt relations that have become almost universal in the US, UK and EU.[290] Such legal framing is not merely an independent abstraction, as it is underpinned by policies promoting financialized and liberalized societies.[291] The US, UK and EU treat debt as part and parcel of financial welfare provision[292] in light of the retreat of the state from public welfare. Private debt can only play this role if the legal framing of its relations facilitates commoditization[293] for market confidence. In other words, political and social acceptance of the role of private debt is not divorced from the legality of debt as an autopoietic regime.

[285] Gunther Teubner (ed), *Autopoietic Law - A New Approach to Law and Society* (EUI, De Gruyter, 1987), 1-11. The maintenance of law as an autonomous system of internal sense-making and ordering is however a matter of degree as it remains cognitively open to changing social facts, also Michael King, 'The Truth about Autopoeisis' 20 Journal of Law and Society 218 (1993).

[286] Debt is enforceable as a contractual right, but it is also characterized by proprietary notions, being assignable claims, Geoffrey Samuel, 'Property Notions in the Law of Obligations' 53 Cambridge L.J. 524 (1994).

[287] Risk weightings for debt can depend on whether there are contractually agreed credit mitigation arrangements, Basel Committee, *CRE22* (2019, effective Jan 2022), https://www.bis.org/basel_framework/chapter/CRE/22.htm?tldate=20220101&inforce=20220101.

[288] Part I, UK Insolvency Act 1986, referring to an insolvent company's arrangements with creditors that are negotiated through the facilitation of an insolvency practitioner.

[289] Teubner (1987); King (1993), critically see Hugh Baxter, 'Autopoiesis and the 'Relative Autonomy' of Law' 19 Cardozo law Review 1987 (1998).

[290] On the EU, see Irina Domurath, 'Mortgage Debt and the Social Function of Contract' 22 European Law Journal 758 (2016). On the inflexibility of common law debt relations, e.g. Lynn M Fisher, 'Renegotiation in the Common Law Mortgage and the Impact of Equitable Redemption' 32 Journal of Real Estate Finance and Economics 61 (2006).

[291] Guido Comparato, *The Financialisation of the Citizen: Social and Financial Inclusion through European Private Law* (Oxford: Hart 2018), 8-11, insights arguably applicable to similarly financialised societies in the even more neoliberal economies of the US and UK.

[292] Abbye Atkinson, 'Rethinking Credit as Social Provision' 71 Stan. L. Rev. 1093 (2019).

[293] Teemu Juutilainen, 'Law-Based Commodification of Private Debt' 22 European Law Journal 743 (2016).

If the social reality of excessive corporate and household indebtedness in the post-Covid world presents a picture of successive bankruptcies,[294] homelessness,[295] unemployment and poverty,[296] social and even political forces of public interest and the needs of social welfare would be unleashed. These would challenge interpretive systems within the law in relation to its conception of private debt relations. To be clear, we are not positing legal elasticity as a thesis asserting socio-legal dominance of substantive law that disregards the conceptual value of autopoiesis. Legal elasticity, drawn from the legal theory of finance, does not damage the autopoietic conception of law as an internal framing system. Rather, we argue that it is possible to enrich the conception of legal autopoiesis by providing a methodology that explains how its cognitive open-ness is able to mediate forces of change from sociological spheres.[297]

Indeed, in the legal framing of debt, public interest level challenges have already been unleashed consistent with notions of democratic accountability and social justice. Such discussions can, for example, be found in relation to sovereign debt restructuring,[298] which implicates the welfare of an indebted country's citizens, and where the limits of private debt as a financialized form of social provision[299] have proven to be counterproductive.[300] In addition, legal evolution in the framing of debt relations has gradually been observed in regulatory intervention into consumer credit, such as the UK FCA's price cap intervention for certain types of short-term and predatory consumer credit that the agency oversees.[301] Regulatory intervention has also been observed in the UK pertaining to the manner of debt enforcement where lender conduct creates excessive unfairness to consumers, even if

[294] Lee Clifford and Phil Wahba, 'A running list of companies that have filed for bankruptcy during the coronavirus pandemic' (12 August 2020), https://fortune.com/2020/08/04/companies-filing-bankruptcy-2020-due-to-covid-list-filed-chapter-11-coronavirus-pandemic/. In the UK, insolvency moratoria periods are in progress for many companies, but STA Travel (whose parent company is in New Zealand) for example has announced insolvency, 'Coronavirus forces STA Travel out of business' (21 August 2020), https://www.bbc.com/news/business-53868447.

[295] Tenant evictions and potential homelessness is due to be on the rise in the UK, temporarily stalled by government intervention, 'Coronavirus: Eviction ban to be extended by four weeks' (21 August 2020), https://www.bbc.com/news/business-53851945.

[296] Although developing countries are likely to suffer most in relation to regression of development goals and increased poverty, see Andy Sumner, Chris Hoy and Eduardo Ortiz-Juarez, 'Estimates of the Impact of COVID-19 on Global Poverty' (WIDER working paper 2020), https://www.wider.unu.edu/sites/default/files/Publications/Working-paper/PDF/wp2020-43.pdf; increased poverty would also hit developed countries, see 'They are the new poor': Covid-19 fuels rising poverty in Italy' (The Guardian, 29 June 2020), https://www.theguardian.com/world/2020/jun/29/they-are-new-poor-covid-19-fuels-rising-poverty-italy.

[297] Debt or money relations are argued to be socially-framed or else the human aspect can be marginalised in transactional, utilitarian conceptualisation, Geoffrey Ingham, 'Money is a Social Relation' 54 Review of Social Economy 507 (1996), also Carlo Trigilia, *Economic Sociology* (Oxford: Blackwell 2002), ch.2 on Simmel's conception of money relations.

[298] Matthias Goldmann, 'Public and Private Authority in a Global Setting: The Example of Sovereign Debt Restructuring' 25 Ind. J. Global Legal Stud. 331 (2018); Matthias Goldmann and Silvia Steininger, A Discourse Theoretical Approach to Sovereign Debt Restructuring: Towards a Democratic Financial Order, 17 German L.J. 709 (2016).

[299] Atkinson (2019).

[300] Ibid.

[301] ns 218, 220.

stipulated in contract.[302] In this manner, we argue that legal elasticity provides a framework for charting legal and regulatory changes that address the adversities of post-Covid 19 debt relations.

Finally, it can be argued that drawing solutions from within the law, i.e. via legal and regulatory framing in order to address the hazards and adverse consequences of private debt expansion during the pandemic, is a limited exercise. This is because legal elasticity and its application cannot address the wider policy context that incentivizes economic actors towards debt expansion. For instance, non-legal policies contribute significantly to marginalizing non-debt options in financial provision, such as equity-based[303] or solidarity-based.[304] There is a lack of imagination in policy options for corporate recapitalization such as by long-term government-led investment,[305] as a matter of industrial policy, or in the form of public-private partnerships.[306] There is also a lack of imagination in relation to solidarity-based financial provision, such as through policies that facilitate the growth of social and community-based institutions like co-operative financing [307] and social banking and investment instruments.[308] It follows that what needs to be addressed is the wider policy context that encourages over-reliance on conventional commercial debt, such as in the context of central bank monetary transactions in supporting liquidity in corporate debt markets. [309] However, we contend that maintaining a clear 'law vs non-law' divide is conceptually limiting. The application of legal elasticity affects many policy measures that are expressed as law or regulation.[310]

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[302] 'FSA fines Kensington Mortgages £1.2m' (The Guardian, 12 April 2010), https://www.theguardian.com/money/2010/apr/12/fsa-kensington-mortgages-fine.

[303] See Section III.

[304] E.g. co-operative finance that can be based on more long-termist and relational outworking, eg https://loanfund.coop.

[305] A private sector-led business growth fund is preparing to invest in the UK corporate economy to help its recovery as reliance cannot be placed on private debt financing alone, "Investor plans £15bn support for UK companies toiling with crisis loans". *Financial Times* (1 June 2020), https://www.ft.com/content/e38f23da-4147-4bd3-b613-c7e6f1096cc6.

[306] UNECE, 'UNECE mobilizes experts to develop guidance on Public-Private Partnerships to help build back stronger from the COVID-19 pandemic' (2020), https://www.unece.org/info/media/news/trade/2020/unece-mobilizes-experts-to-develop-guidance-on-public-private-partnerships-to-help-build-back-stronger-from-the-covid-19-pandemic/doc.html.

[307] N304.

[308] Olaf Weber, 'Social Banks' Mission and Finance'; Daniel Tischer and Sven Remer, 'Growing Social Banking Through (Business) Associations'; in Othmar M Lehner (ed), *Routledge Handbook of Sustainable and Social Finance* (Oxford: Routledge, 2016); Also impact investing, see 'COVID-19 Response and Resources', https://socialfinance.org/covid/, 'Maximilian Martin, 'Building The Impact Investing Market'; Lisa Brandstetter and Othmar M. Lehner, 'Opening The Market For Impact Investments' in Othmar M Lehner (ed), *Routledge Handbook of Sustainable and Social Finance* (Oxford: Routledge, 2016).

[309] Paolo Cavallino and Fiorella De Fiore, 'Central Banks' Response to Covid-19 in Advanced Economies' (BIS Bulletin, 5 June 2020), https://www.bis.org/publ/bisbull21.pdf. There is a concern that policymakers tend to over-rely on the central bank as 'the only game in town'. The Fed's role in the US is critically reviewed Zaring (2020).

[310] For general remarks on how law or regulation is the dominant instrument to effect policy, extensive discussion can be found in European commentary regarding the role of law and regulation to effect economic policies such as building an integrated European market, e.g. Iris H-Y Chiu, *Regulatory Convergence in EU Securities Regulation* (The Hague: Kluwer Law International 2008), ch.2 and citations within.

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

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

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

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

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

Regulatory Objectives/Aspects of legal framing-Corporate Debt	Legal/Regulatory Framing Affecting Corporate Capital Structure	Legal/Regulatory Framing for Debt Servicing Terms
Facilitating economic recovery	(a) Balancing government-backed loans with government-engaged equity, such as by government investment vehicles, sovereign wealth	(a) Regulatory scrutiny of industry developed Covid-specific loan terms[316] and consideration of the wider

[316] Such as the Loan Market Association's guidance on loan terms for UK government-backed loans, https://www.lma.eu.com/documents-guidelines/documents/category/issues-and-guidance#relevant-documents145.

	investment[311] and public-private partnerships;[312] (b) More adjustments to securities and rights offering processes to facilitate quicker and cost-effective fund-raising;[313] (c) Address distortions in tax regulation that favors debt (i.e. the deduction of interest payments as expenses from corporate tax liability) to achieve tax neutrality in corporate capital structure;[314] (d) Facilitating or mandating the issue of convertible debt instruments, drawing upon lessons from mandatory 'bail-in' debt for banks;[315] (e) Encouraging supply side diversity for finance e.g. cooperative-based or social finance.	policy of regulating business lending;[317] (b) Regulatory requirements (in principles/rules) to be incorporated into government-backed loans; (c) Loan terms requiring relational outworking with debtors;[318] (d) Regulatory requirement or nudge to private sector to introduce/standardize debt covenants in relation to debtor companies' long-termism and inclusion of relevant aspects of sustainability, social responsibility and good governance;[319] (e) Consider a *lex specialis*[320] for non-financial sector corporate resolutions where the scale of corporate distress may

[311] 'Covid-19 hastens sovereign wealth funds' refocus to home' (Singapore Straits Times, 26 June 2020), https://www.straitstimes.com/business/economy/covid-19-hastens-sovereign-wealth-funds-refocus-to-home.
[312] See n306.
[313] Perhaps the shortening of offer periods or dispensation of offer disclosure documents altogether, Eilis Ferran, *Limits of Private Sector Solutions for Banks: Recent UK Rights Issues* (2008), http://ssrn.com/abstract=1290717, going further than the UK's and EU's temporary adjustments, n239.
[314] Herwig J. Schlunk, 'The Zen of Corporate Capital Structure Neutrality' 99 Mich. L. Rev. 410 (2000).
[315] International policy is developed for globally systemically important banks to issue mandatory convertible debt which 'bails-in' debtors to become equity holders to absorb losses and prevent disorderly insolvency. See Financial Stability Board, *Key Attributes for Effective Resolution* (2011, amended 2014, 2019), https://www.fsb.org/wp-content/uploads/r_111104cc.pdf; *Principles on Bail-in Execution* (21 June 2018), https://www.fsb.org/2018/06/principles-on-bail-in-execution-2/.
[317] 'FCA urged to regulate commercial lending' (14 June 2019), https://www.ftadviser.com/regulation/2019/06/14/fca-urged-to-regulate-commercial-lending/.
[318] See Ian R MacNeil, 'Relational Contract: What We Do and Do Not Know' 1985 Wisconsin Law Review 483 (1985), providing for reflections of the reality of human and social interactions for long-term post-contract adjustments.
[319] Gillian Tett, 'Business faces stern test on ESG amid calls to 'build back better', *Financial Times* (18 May 2020), https://www.ft.com/content/e97803b6-8eb4-11ea-af59-5283fc4c0cb0.
[320] Extending from the regulation of bank recovery and resolution, see Financial Stability Board, *Key Attributes of Effective Resolution Regimes* (2011 and 2014), and the EU Bank Recovery and Resolution Directive 2014/59/EU.

		have macro-economic or systemic risk impact.[321]
Alleviating household suffering	(a) Policies to support re-deployment of human capital, adequate redundancy support; (b) considerate transition by government out of any fiscal support such as furlough or the Paycheck Protection program and clarify the relationship between government support for wages/employment and employment law.[322]	(a) Policy and regulatory choices regarding banks and relationships with zombie companies, including *lex specialis* for non-financial corporate restructuring above; (b) Consider distributive effects in creditor priorities e.g. wages, in the enforcement of corporate debt or insolvencies.
Prevention of systemic risk to finance sector	(a) Public-backed 'bad bank' for bailing out of non-performing assets, such as distressed corporations' debt;[323] which likely preserves financial stability;[324] (b) Macroprudential policies for corporate sector borrowing, such as debt-to-equity ratio.	(a) Regulatory forbearance towards lenders in relation to resumption of micro-prudential compliance, reporting and stress-testing;[325] (b) Macroprudential oversight of levels of corporate debt and distress.[326]

[321] Kristin van Zwieten, Horst Eidenmueller and Oren Sussman, 'Bail-outs and Bail-ins are better than Bankruptcy: A Comparative Assessment of Public Policy Responses to COVID-19 Distress' (August 2020) ECGI Law Working Paper, 23-24, https://ssrn.com/abstract=3669541.

[322] 'Furloughed from work? It pays to know your rights' (The Guardian, 3 May 2020), https://www.theguardian.com/money/2020/may/03/furloughed-from-work-it-pays-to-know-your-rights.

[323] 'Exclusive: ECB prepares 'bad bank' plan for wave of coronavirus toxic debt' (Reuters, 10 June 2020), https://www.reuters.com/article/us-health-coronavirus-ecb-badbank-exclus/exclusive-ecb-prepares-bad-bank-plan-for-wave-of-coronavirus-toxic-debt-sources-idUSKBN23H0MV. Bailouts are also supported (under certain considerations) in van Zweiten et al (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3669541.

[324] Douglas W Arner, Emilios Avgouleas and Evan Gibson, 'Financial Stability, Resolution of Systemic Banking Crises and COVID-19: Toward an Appropriate Role for Public Support and Bailouts' (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3664523.

[325] Delayed stress-testing is discussed in Section II.D.

[326] Macro-prudential regulation relates to oversight for financial systems' overall health and is a shift from incentive-based micro-prudential regulation, Andrew Baker, 'The Gradual Transformation? The Incremental Dynamics of Macroprudential Regulation' 7 Regulation and Governance 417 (2012); UK's Financial Policy Committee, S9Aff, Financial Services and Markets Act 2000 amended in 2012; and the US equivalent, the Office of Financial Research established in the Dodd-Frank Act 2010.

Table 2: Mapping the Policy Choices in Relation to Consumer Credit- Debt-specific and Wider Complimentary Measures

Regulatory Objectives/ Aspects of legal framing – Household debt	Legal/Regulatory Framing Affecting Credit Product Design and Access	Legal/Regulatory Framing for Debt Servicing Terms
Alleviating household suffering/ facilitating economic recovery if households are able to maintain aggregate demand	(a) More paternalism in the regulation of the sales and marketing of credit and hybrid-credit,[327] e.g. presumptions in favor of consumers in relation to aggressive sales and marketing tactics; to consider banning the most predatory forms of lending such as doorstep credit; (b) Creating disincentives to excessive household leverage e.g. imposing higher due diligence for repeat lending; introducing penalties such as nullification of loan for egregious conduct of business; (c) Improving access to justice for mis-selling and unfair treatment;[328] (d) Mandatory requirement to assess for creditworthiness/affordability in all consumer credit products and assess especially for vulnerability[329] before lending;	(a) Mandatory relational contractual terms in debt servicing, perhaps on a scale relevant to customer vulnerability; (b) Regulatory scrutiny in relation to the enforcement of foreclosure powers and possible impositions of debtor protections;[331] (c) Loan forgiveness as a penalty for lenders engaged in egregious conduct of business; (d) Constant review of consumer credit terms; to consider extensive product regulation[332] for consumer credit;[333] (e) Extension of out-of-court dispute resolution systems (such as the UK

[327] Even relatively sophisticated consumer protection emanating from the EU is based on disclosure to investors, assuming consumers' ability to make informed choices and the lack of need for paternalism, see Arts 5-14, Packaged Retail and Insurance-based Investment Products Regulation (EU) No 1286/2014.

[328] Particularly out-of-court dispute resolution such as the UK Financial Ombudsman, s225, Financial Services and Markets Act, or specialist financial services disputes tribunal proposed in Richard Samuel, 'Tools for Changing Banking Culture: FCA Are You Listening?: Why the FCA's IRHP Mass Dispute Resolution System Has Failed and What the FCA Can Do about It' 11 Capital Markets Law Journal 129 (2016); 'The FCA Has Now Listened: Banks, It Is in Your Interests to Listen Too' 13 Capital Markets Law Journal 3 (2018).

[329] See n253.

[331] E.g. Grant S. Nelson and Dale A. Whitman, 'Reforming Foreclosure: The Uniform Non-Judicial Foreclosure Act' 53 Duke Law Journal 1399 (2004).

[332] Oren Bar-Gill and Elizabeth Warren, 'Making Credit Safer' 157 U PA Law Rev (2008), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1137981.

[333] Regulation could reduce ease of access to credit, but quantitative reduction may be accompanied by qualitative improvement in welfare i.e. less defaults and distress for households, Anthony Defusco, Stephanie Johnson and John Mondragon, 'Regulating Household Leverage' 87 Review of Economic Studies 914 (2020). See contrary findings that customer access and welfare are unaffected by regulation of credit card fees, Sumit Aggarwal et al, 'Regulating Consumer Financial Products: Evidence from Credit Cards' (2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2330942.

	(e) Regulatory scrutiny of algorithmic and automated systems of credit generation for bias[330] towards over-inclusion, over-exclusion and other distortions; (f) Encouraging supply side diversity in terms of type of lender e.g. cooperative-based or social finance.	Financial Ombudsman) mandate[334] to deal with household debt restructuring.
Prevention of systemic risk to financial sector	(a) Public-backed 'bad bank' for bailing out of non-performing assets in distressed consumer debt; (b) Policy balance between state financial welfare provision, and financialization such as public sector involvement in housing and regional development projects; (c) Fiscal policies such as "helicopter drops".[335]	(a) Mandatory relational contractual terms in debt servicing; (b) Considering how securitization channels may adversely affect relational outworking of distressed consumer debt.[336]

It may be argued that the above frameworks are limited as they only identify issues for consideration and provide a starting blueprint. To be sure, a proposal for terms of relational outworking does not necessarily indicate what a standardized term to this effect would look like. Regulators could impose a mandatory negotiation period with borrowers, or lenders could be prevented from formal enforcement action such as foreclosures until a minimum number of workouts have been attempted. However, our aim is not to argue for or support specific regulatory designs, but rather to supply a methodological framework for mapping out the issues susceptible to legal elasticity and structural policy choices.

In parallel, we argue that regulatory design involves further considerations of: (a) macro-level choices vs micro-level choices, such as whether the regulatory design should work on incentives,[337] or mandatory norms in order to address a commons;[338] (b) soft vs hard legal framing and enforceability, such as whether private sector actors may play an effective part

[330] Katja Langenbucher, 'Responsible A.I.-based Credit Scoring – A Legal Framework' (2020) 31 European Business Law Review 527; Nikita Aggarwal, 'The Norms of Algorithmic Credit Scoring' (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3569083.

[334] S225, UK Financial Services and Markets Act 2000.

[335] 'Coronavirus: the moment for helicopter money', Financial Times (20 March 2020), https://www.ft.com/content/abd6bbd0-6a9f-11ea-800d-da70cff6e4d3.

[336] Tomasz Piskorski, Amit Seru and Vikrant Vig, 'Securitization and Distressed Loan Renegotiation: Evidence from the Subprime Mortgage Crisis' (2010), http://ewget.uek.krakow.pl/papers/Piskorski-paper.pdf.

[337] Such as regulation focused on letting markets work optimally, see FCA, *Economics for Effective Regulation* (2016), https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-13-economics-effective-regulation.

[338] Elinor Oström, *Governing the Commons: The Evolution of Institutions for Collective Action* (Cambridge: Cambridge University Press 1990).

in standards generation and/or enforcement;[339] (c) underpinnings of legal traditions in relation to common-law, civil law and hybrid legal systems, in relation to the mixture of *ex ante* and *ex post* legal designs,[340] and (d) underpinnings of political economy, as social contract bargains forged in different political economies provide different distributive preferences.[341] In this manner, regulators in the UK, US and EU can apply the methodological framework above to identify where legal elasticity should be applied for regulatory adjustments and new policy choices. We cannot be overly prescriptive.

We also urge regulators to engage in substantive regulatory decision-making in the holistic manner proposed by Sunstein[342] and honest discourse and narratives that do not conceal underlying assumptions and normative choices. Sunstein's approach to regulatory decision-making is grounded in cost-benefit analysis in the broadest terms.[343] This approach goes beyond merely looking to monetary values of benefits and drawbacks in the marketized sense, and seeks to encompass 'hard to value', controversial and subjective evaluations in order to interrogate what each policy proposal may achieve. The evaluative compass is anchored upon the human perspective, including difficulties in putting a value on societal values and preferences.[344] This approach responds to extant criticism levelled against cost-benefit approaches in regulatory decision-making, in relation to being narrowly defined, in order to avoid hard questions,[345] highly proceduralized in order to show that formalities are completed for advancing a particular law reform,[346] and oftentimes vague and weak when grappling with variables that are difficult to value.[347] However, as Wiener[348] argues, evaluative approaches like cost-benefit analysis need not be implemented in narrow, formalistic and meaningless terms.

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[339] Such as 'smart regulation' where private sector actors play a part in co-supervising regulatory compliance, Neil Gunningham and Darren Sinclair, 'Designing Smart Regulation' (OECD Global Forum on Sustainable Development, Paris, 2-3 December 2004) http://www.oecd.org/environment/environmentinemergingandtransitioneconomies/37719119.pdf; Neil Gunningham, Peter Grabosky and Darren Sinclair, *Smart Regulation: Designing Environmental Policy* (Oxford: Oxford University Press 1998, rep 2004); meta-regulation where regulated entities are delegated the details of implementing regulatory frameworks and principles, Christine Parker, *The Open Corporation* (Cambridge: CUP 2002); 'Meta-Regulation: Legal Accountability for Corporate Social Responsibility' (2006), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=942157.

[340] The balance between regulatory and private law is discussed in Susan Rose-Ackermann, 'Regulation and the Law of Torts' 81 American Economic Review 54 (1991).

[341] PA Hall and D Soskice, 'An Introduction to Varieties of Capitalism' in PA Hall and D Soskice (eds), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (OUP 2001) ch.1.

[342] Cass R. Sunstein, *Valuing Life: Humanizing the Regulatory State* (Chicago: University of Chicago Press 2014).

[343] Cass R. Sunstein and Robert W. Hahn, *A New Executive Order for Improving Federal Regulation? Deeper and Wider Cost-Benefit Analysis*, John M. Olin Program in Law and Economics Working Paper, 2002, https://chicagounbound.uchicago.edu/law_and_economics/10/.

[344] Cass R. Sunstein, *The Limits of Quantification*, 102 California Law Review 1369 (2014).

[345] Julie Froud and Anthony Ogus, 'Rational Social Regulation and Compliance Cost Assessment' 74 Public Administration 221 (1996).

[346] Christopher Carrigan and Stuart Shapiro, 'What's Wrong with the Back of the Envelope? A Call for Simple (And Timely) Benefit–Cost Analysis' 11 Regulation and Governance 203 (2016).

[347] Mark Harrison, 'Assessing the Impact of Regulatory Impact Assessments', 16 Agenda 41 (2009), http://ssrn.com/abstract=1906482.

[348] Jonathan Wiener, 'Better Regulation in Europe', Duke Law School Working Paper Series, No. 65, 2006, http://www.osservatorioair.it/wp-content/uploads/2009/08/wiener2006.pdf.

It may be argued that the regulatory/policy choices offered in the Tables above include well-trodden issues such as improving companies' long-termism and sustainability profiles, and ongoing consumer protection issues. These have already been discussed before the onset of the Covid-19 pandemic,[349] and reiteration of these issues under the cover of the pandemic appears to be furthering an existing agenda. However, the pandemic provides an opportunity for acceleration of regulatory thinking and sharper focus upon the achievement of the three regulatory objectives enumerated earlier. Further, mapping regulatory/policy choices in this manner allows an integrated, not siloed, view of choice sets and policy mixes.

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

A. Multi-stakeholder Regulatory Decision-making

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

The following relational linkages should be fostered:

(a) The relational dimension amongst financial regulators and all relevant policymakers. Crisis management by the public sector is often not taken for granted to be integrated due to the delineations between government bodies, independent agencies and how government and bureaucracy is structured.[350]

(b) The relational dimension between regulated entities and their relevant regulators. This relationship is often fraught with depictions of capture,[351] polarization, excessive delegation (resulting in self-regulation)[352] etc. Although the regulated-regulator relationship remains a work in progress in regulation theory studies, we suggest that constructive engagement is inevitable although relational dynamics may not be perfect.

(c) The relational dimension between regulators, policymakers and stakeholders or society more broadly, as crisis management benefits from multi-stakeholder participation and drawing together of resources,[353] social mobilization and solidarity.

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[349] For example, the collection of essays in Beate Sjåfell and Christopher Bruner, 'Corporations and Sustainability' in Beate Sjåfell and Christopher Bruner (eds), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (Cambridge: CUP 2019), ch.1 point to reforms needed in corporate law for long-termism and sustainable purposes.

[350] Charles Baubion, 'OECD Risk Management: Strategic Crisis Management', OECD Working Papers on Public Governance 23 (OECD Publishing 2013),

[351] Edward Baxter, *Capture in Financial Regulation: Can We Channel It Toward the Common Good?* 21 Cornell Journal of Law and Public Policy 3 (2011).

[352] Cristie Ford, 'New Governance, Compliance, and Principles-Based Securities Regulation' 45 American Business Law Journal 1 (2008).

[353] Julia Black, 'Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a 'Post-Regulatory' World' 54 Current Legal Problems 103 (2001).

One of the lessons from the global financial crisis for financial regulators was the need to coordinate amongst each other and with relevant government agencies and Treasury departments. After the global financial crisis, the UK and EU reorganized regulatory coordination, such as the formalization of Treasury, Bank of England, PRA and FCA relations,[354] and the establishment of EU financial regulatory agencies, a Joint Committee between them and relations with the ECB in microprudential and macroprudential supervision.[355] The management of the Covid-19 crisis is now a joint effort by the PRA and FCA[356] and in the US, we also see joint releases by the Fed, FDIC, OCC and the CFPB,[357] showing the necessity of coordination even if regulatory architecture is dispersed.

Although the regulated-regulator relationship has been depicted in relation to lobbying, informal 'capture or sympathy'[358] or excessive trust (especially before the global financial crisis),[359] it remains imperative that regulators maintain informational and supervisory proximity to the regulated. Omarova[360] argued, in the wake of the global financial crisis, that a system of tripartite financial regulation should be introduced where 'bankers' and 'bureaucrats' would enroll 'guardians' who are stakeholders representing public interest to co-govern in the realm of financial regulation. This would allow public interest issues to be brought to bear in financial regulation, and weaknesses in the relational paradigm between the regulator and regulated to be moderated. Such a multipartite form of networked governance is consistent with, and has always been envisaged in, regulatory theory.[361]

B. Mandatory Review of Legal Elasticity Measures

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

Mandatory review for continuation of policy is a technique frequently employed in EU legislation, consistent with the theoretical paradigm of 'experimentalist governance'.[362] 'Experimentalist governance' is a theoretical conception for governance in the EU due to the multi-level nature of EU regulation which requires forms of national and EU level participation in decision-making and implementation. Although experimentalist governance addresses a regulatory architecture problem of coordination between EU member states and EU level

[354] S64-5, Financial Services Act 2012; Sections 3D to 3Q, UK Financial Services and Markets act 2020, amended 2012.
[355] Iris H-Y Chiu, 'Power and Accountability in the EU Financial Regulatory Architecture: Examining Inter-agency Relations, Agency Independence and Accountability' 8 European Journal of Legal Studies 68 (2015).
[356] Section II.A.
[357] See Section II.D.
[358] Baxter (2011).
[359] Financial Services Authority, *The Turner Review* (2009), ch.1.4, http://www.actuaries.org/CTTEES_TFRISKCRISIS/Documents/turner_review.pdf.
[360] Saule T. Omarova, 'Bankers, Bureaucrats, and Guardians: Toward Tripartism in Financial Services Regulation' 37 Journal of Corporation Law (2012).
[361] Black, *supra* n353; Julia Black, *Mapping the Contours of Contemporary Financial Services Regulation*, 2 Journal of Corporate Law Studies 253 (2002).
[362] Charles F Sabel and Jonathan Zeitlin, *Experimentalist Governance in the European Union: Towards a New Architecture* (Oxford: OUP 2010), 'Editors' Introduction'.

institutions, it can offer broader insights in relation to regulatory coordination and the need for learning and review in designing and implementing regulatory governance.[363]

Commentators opine that subjecting legislation to subsequent review is not an oddity in many jurisdictions.[364] The benefits of mandating temporality include building in processes for learning, subsequent information discovery and the opportunity to correct earlier assumptions and errors,[365] as well as subjecting new norms to continuing scrutiny in terms of relevance, and social and political acceptance.[366] It is opined that temporary legislation can serve "legisprudential" objectives[367] i.e. to subject new norms to a period of experimental outworking to determine if permanence should be hardened in law. Mandatory review also compels the responsible agency/agencies to be accountable for their implementation and learning. In this manner, perspectives in theoretical literature on temporary legislation[368] can be brought together with the paradigm of legal elasticity. Not only does legal elasticity hold out the importance or even primacy of legal adjustment in crisis-management, it also arguably offers a continuing vision of learning and adjustability.

An experimental approach can be taken towards the policy/regulatory choice sets mapped out above, in order to test the relevance of the continuity of certain measures. This approach is warranted as commentators often support temporality for crisis-management[369] and warn against excessively rapid legalization on a permanent basis in response to a crisis.[370] For example, if new norms recalibrate established rights in debt relations, an experimental period of learning, information gathering and observation is warranted to ascertain how market behavior is shaped.

At the same time, some of the proposed policy/regulatory choices in the tables need time to be fashioned and instituted, such as the facilitation of social finance or the growth of government-engaged investment outfits. It can be argued that these enabling measures, designed to stimulate institutional and market responses, should not be subject to temporality so that economic actors have greater certainty to make investment towards them. Further, Gersen warns that the temporality of "right policy choices" could undermine their continuity,[371] especially if political lobbying is in opposition to such choices. Policymakers should also carefully consider any adverse effect of temporality that may cause regression and uncertainty.

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[363] Ittai Bar-Siman-Tov, 'Temporary Legislation, Better Regulation and Experimentalist Governance: An Empirical Study' 12 Regulation and Governance 192-219 (2018).
[364] Jacob E Gersen 'Temporary Legislation' 74 University of Chicago Law Review 247 (2007).
[365] Ibid.; Ittai Bar-Siman-Tov and Gaya Harari-Heit, 'The Legisprudential and Political Functions of Temporary Legislation' in Sofia Ranchordas and Yaniv Roznai (eds.), *Time, Law and Change: An Interdisciplinary Study* (Hart Publishing 2020) ch.10.
[366] Gersen (2007).
[367] Ibid.
[368] E.g. ns 363-365.
[369] Bar-Siman-Tov and Harari-Heit (2020).
[370] Luca Enriques, 'Regulators' Response to the Current Crisis and the Upcoming Reregulation of Financial Markets: One Reluctant Regulator's View' 30 University of Pennsylvania International Law Journal 1147 (2009).
[371] Gersen (2007).

C. Wider Structural Issues and Concerns

Finally, regulators and policymakers should be mindful of wider structural issues contributing to the hitherto high levels of corporate and household debt. They may wish to consider, in particular, the balance between private sector financialization and desirable levels of deleveraging as a matter of public interest. We map these broader structural options below in an extended application of the methodological framework for legal elasticity, in order to consider how broader legal and regulatory framing may affect financing choices and financial management by households and corporations.

Table 3: Mapping of Wider Structural and Policy Choices

Regulatory Objectives/ Policy framing relating to high debt levels	Financing Choices	Financial Management
Promoting long-term corporate financial resilience	(a) Addressing incentives for equity reduction, share buybacks,[372] e.g. institutional investors' structures and incentives, corporate governance and law in relation to short-termism and shareholder wealth maximization;[373] (b) Changes to corporate law/purpose/governance for long-termist management[374] of corporate success and viability;	(a) Incentivizing long-termist investment decisions[376] by corporations; (b) Assisting corporations in sectors facing transition risks[377] such as climate change; (c) Meaningful and integrated financial accountability.[378]

[372] Andrew Baker, Colin Haslam, Adam Leaver, Richard Murphy, Leonard Seabrooke, Saila Stausholm and Duncan Wigan, 'Against Hollow Firms: Repurposing the Corporation for a More Resilient Economy' (2020), http://eprints.whiterose.ac.uk/163163/1/Against-Hollow-Firms%20%281%29.pdf.

[373] Discussed as consequences of the financialized context, see citations n145.

[374] Kay Review (2012), also British Academy, *Principles for Purposeful Businesses* (2020), https://www.thebritishacademy.ac.uk/publications/future-of-the-corporation-principles-for-purposeful-business/.

[376] Nicolette C. Prugsamatz, 'In(Ex)ternal Corporate Governance and Innovation: A Review of the Empirical Evidence' (2015) at http://ssrn.com/abstract=2664401 reviews in detail that corporate investment in innovation can be carried out with a view to long-term success.

[377] Catherine Boulatoff and Carol Marie Boyer, 'What is the Impact of Private and Public R&D on Clean Technology Firms' Performance? An International Perspective' 7 Journal of Sustainable Finance & Investment 147 (2017); Jakob Thomä and Hugues Chenet, 'Transition Risks and Market Failure: A Theoretical Discourse on Why Financial Models And Economic Agents May Misprice Risk Related to the Transition to a Low-Carbon Economy' (2017) 7 Journal of Sustainable Finance & Investment 82; Ronan Bolton and Matthew Hannon, 'Governing Sustainability Transitions Through Business Model Innovation: Towards a Systems Understanding' 45 Research Policy 1742 (2016).

[378] Discussed in The Sharman Inquiry, *Going Concern and Liquidity Risks: Lessons for Companies and Auditors, Final Report and Recommendations of the Panel of Inquiry* (June 2012), http://www.frc.org.uk/getattachment/591a5e2a-35d7-4470-a46c-30c0d8ca2a14/Sharman-Inquiry-Final-Report.aspx on moderating the narrow orientations of financially focused accounting information. Integrated reporting is an emerging initiative, see https://integratedreporting.org.

	(c) Addressing the balance between competition[375] objectives and corporate sector health.	
Promoting long-term household resilience	(a) Policies to improve distributive inequalities and share of economic wealth held by middle to lower income workers in an age of wage stagnation;[379] (b) Policies to improve social mobility including regulating new economic structures such as the gig and platform economies in order to advance human capital interests;[380] (c) Policies to facilitate diversity of sources and terms in entrepreneurial finance,[381] including the regulation of small business lending; (d) Balancing state welfare provision for key social goods such as education and healthcare which have been empirically found to be significant proportions of household debt.[382]	(a) Policies to rebalance a consumption-fueled economy and to discourage consumption-driven leverage; (b) Policies to encourage pensions[383] and precautionary savings,[384] coupled with robust regulation of financial sector intermediaries in their conduct of business and product governance; (c) Improving financial education and literacy through

[375] Indeed the European competition commission needed to set out guidance to clarify that support for companies under certain conditions during the pandemic is not a breach of state aid rules, Communication from the Commission Third amendment to the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak 2020/C 218/03, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2020.218.01.0003.01.ENG&toc=OJ:C:2020:218:TOC.

[379] Thomas Piketty, *Capital in the 21st Century* (London: Penguin 2014).

[380] Andrew Stewart and Jim Stanford, 'Regulating Work in the Gig Economy: What Are the Options?' 28 The Economic and Labour Relations Review 427 (2017).

[381] Such as online equity crowdfunding, but it is arguable that the US JOBS Act and Regulation A and the EU Crowdfunding Regulation 2020 (version as of 8 July 2020), https://www.consilium.europa.eu/en/press/press-releases/2020/07/20/capital-markets-union-council-adopts-new-rules-for-crowdfunding-platforms/ impose more regulatory barriers than are constructive for building up these markets, Eugenia Macchiavello, 'The European Crowdfunding Service Providers Regulation and the Future of Marketplace Lending and Investing in Europe: The 'Crowdfunding Nature' Dilemma', European Business Law Review, forthcoming, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3594353.

[382] Long (2018).

[383] Such as mandatory enrolment into occupational pensions under UK Pensions Act 2008.

[384] Alba Lugilde, Roberto Bande and Dolores Riveiro, 'Precautionary Saving in Spain During the Great Recession: Evidence from a Panel of Uncertainty Indicators' 16 Rev Econ Household 1151 (2018).

		public-sector programs.[385]
Preventing systemic risk to the financial sector	(a) Considering the impact of monetary policies especially the adverse effects of long-term low interest rates[386] and asset purchase programs; (b) Considering the balance between policies that underpin access to debt and access to capital markets to facilitate real economy growth and investment; (c) Revisiting the systemic importance of asset managers and their allocative responsibilities and roles.[387]	(a) Greater willingness to develop macroprudential tools to deal with toxic levels of corporate and household debt;[388] (b) Macroprudential perspectives for financial innovation in general.[389]

VI. Conclusion

Policymakers and financial regulators have turned to quick debt expansion programs to promote the recovery of the corporate economy and alleviate household suffering during the Covid-19 pandemic. However, debt expansion in highly leveraged economies, such as the US, UK and EU, is a double-edged sword, as adverse consequences could entail in the longer-term for corporations and households, and systemic risk for the financial sector can also be heightened,[390] threatening to impede the financial sector's uninterrupted support for real economy needs.

[385] Financial literacy programmes are not an excuse for pushing responsibility onto consumers for poor financial decisions, and it remains imperative to regulate financial marketing and product sales, Toni Williams, 'Empowerment of Whom and for What? Financial Literacy Education and the New Regulation of Consumer Financial Services' 29 Law and Policy 226 (2007); Jason West, 'Financial Literacy Education and Behaviour Unhinged: Combating Bias and Poor Product Design' (2012), https://research-repository.griffith.edu.au/bitstream/handle/10072/390304/2012-01-financial-literacy-education-and-behaviour-unhinged-combating-bias-and-poor-product-design.pdf. The effectiveness of financial literacy programmes has also been criticized, Lauren E Willis, 'Evidence and Ideology in Assessing the Effectiveness of Financial Literacy Education' 46 San Diego Law Review 415 (2009).

[386] Committee on the Global Financial System, 'Financial Stability Implications of a Prolonged Period of Low Interest Rates' (BIS Working Paper, 2018), https://www.bis.org/publ/cgfs61.pdf.

[387] Financial Stability Board, 'Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities' (2017), https://www.fsb.org/2017/01/fsb-publishes-policy-recommendations-to-address-structural-vulnerabilities-from-asset-management-activities/.

[388] E.g. Anna Zabai, 'Household Debt: Recent Developments and Challenges', BIS Working Paper 2017, https://www.bis.org/publ/qtrpdf/r_qt1712f.htm.

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

[390] Alissa Kleinnijenhuis, Laura Kodres and Thom Wetzer, *Usable Bank Capital* (30 June 2020), https://voxeu.org/article/usable-bank-capital#.XwA9ibxoIRc.twitter; "Banks need to prepare now for Covid-19 losses later", *Financial Times* (8 July 2020), https://www.ft.com/content/918fe325-8a7f-4646-9031-6e7f2d61b3db.

We drew upon the legal theory of finance to argue that its theoretical support for legal elasticity can offer a framework for longer-term and structural changes in law and regulation to address the adverse consequences of excessive corporate and household indebtedness. Such a framework reflects the importance of adjustments in legal and regulatory framing for crisis management and beyond. We endeavored to enrich the theoretical understanding and practical application of legal elasticity by: (a) arguing that the theoretical insights from the legal theory of finance pave the way for structural consequences of applying legal elasticity; (b) providing a methodological framework for mapping appropriate legal/regulatory reforms that can be subject to elasticity; and (c) by relating legal elasticity to other theoretical frameworks such as legal autopoiesis and temporality of regulation.