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Rethinking the Effectiveness of Consumer Protection Policies and Measures in the Financial Marketplace

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ABSTRACT

This paper aims to identify and challenge the common practice among financial institutions of designing and selling complex financial products to consumers who lack full comprehension, thus preventing them from making informed decisions before consuming such financial products. This deceptive approach leads many consumers to experience financial losses, with significant negative consequences for society as a whole. The paper delves into the motivations behind financial institutions to produce and successfully sell complex financial products; they flourish, mainly because they often take advantage of the inadequate regulatory systems, amongst other things. Furthermore, it explores the enabling environment created by *laissez-faire* contract, which prioritizes principles like *pacta sunt servanda* and *caveat emptor*, resulting in regulators overlooking and undervaluing the abuse faced by financial consumers, leaving them largely responsible for resolving their own challenges. The paper exposes the shortcoming of policy measures aimed at preventing consumer exploitation, including the flawed disclosure rules that place the burden of comprehension on consumers while being manipulated to undermine their full understanding.

Additionally, it critiques the use of complicated language and heavy use of financial jargon in financial information booklets, which, although meeting legal disclosure requirements, hinder the comprehension of consumers.

To address these issues, the paper proposes a new disclosure rule grounded in the concepts of *caveat venditor* and *contra proferentem*. This rule would require financial institutions to present information against their own self-interest and provide an equal number of disadvantages alongside advantages for the products they offer. Furthermore, it suggests that regulators and courts should play a pivotal role in supervising and assessing compliance, issuing annual performance-rated certificates that financial institutions must prominently display in their establishments and incorporate into their product information leaflets. This approach would allow consumers to easily identify consumer-friendly financial institutions.

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Repensar la eficacia de las políticas y medidas de protección del consumidor en el mercado financiero

RESUMEN

Este documento identifica y desafía la práctica frecuente de las instituciones financieras en el diseño y venta de productos financieros complejos a consumidores que no pueden comprender completamente y, por lo tanto, no pueden tomar decisiones informadas antes de consumir dichos productos financieros. Engañar a los consumidores para que compren inadvertidamente productos financieros complejos, hace que muchos de ellos sufran pérdidas financieras, y esta situación, en conjunto, tiene muchos efectos negativos en la sociedad. El documento analiza además por qué las instituciones financieras están motivadas para producir y vender con éxito productos financieros complejos; florecen, principalmente porque, se aprovechan de los sistemas regulatorios inadecuados, entre otras cosas. Del mismo modo, el entorno propicio creado por la ley de contratos, que exalta los principios de *Pacta Sunt Servanda* y *Caveat Emptor*, hace que el abuso de los consumidores financieros no sea completamente perceptible y apreciado por los reguladores, y deja que los primeros se enderecen en gran medida por sus propios medios. El documento señala las debilidades en las medidas de política contra la explotación del consumidor; las reglas de divulgación destrozadas que imponen a los consumidores la carga de la comprensión de productos financieros complejos a pesar de la forma en que se manipulan estas reglas de divulgación para disminuir la posibilidad de que los consumidores comprendan por completo los productos financieros; y el hecho de que la mayoría de los folletos de información financiera están salpicados en gran medida de terminologías financieras y se presentan en un lenguaje complicado sin dejar de satisfacer el requisito legal de divulgación.

El documento propone una nueva forma de regla de divulgación basada en los conceptos de proveedor de advertencia y *contra proferentem*, que respectivamente deben requerir la presentación de información por parte de las instituciones financieras contra el interés propio, y la presentación inequívoca del mismo número de desventajas junto con las ventajas de productos que ofrecen a los consumidores. Además, la función principal de los reguladores y los tribunales en esta circunstancia debe ser supervisar y evaluar el nivel de cumplimiento y, en consecuencia, emitir un certificado de calificación anual de desempeño que todas las instituciones financieras deben publicar de manera notable en sus lugares de negocios y también incorporarlo en los folletos informativos en los que describen sus productos, para que los consumidores puedan conocer de un vistazo aquellas instituciones financieras que son o no tan amigables para el consumidor.

1.1. Introduction: Consumers Are Still Relatively ‘New Kids’ in the Financial Marketplace

Before the 20th century, credit borrowing was primarily limited for merchants, those engaged in the buying and selling of goods (Simpson, 1975). Borrowing credit for personal consumption by individuals was frowned upon, and it was considered a last resort in such cases. The strong stigma against borrowing for personal use during that time is evident in the severe punishments imposed on defaulters, including the confiscation of their assets, imprisonment, and in extreme cases, even death (Solicitor, 1932).

The Industrial Revolution brought about a significant increase in the production of goods and services through the use of machines. Although more goods were available for sale, many individuals could not afford to purchase them outright. This led to the emergence of consumer credit, particularly sale credit, where individuals could acquire equitable or legal ownership of a property without fully paying for it at the time of acquisition. Instead, they would agree to repay the full amount at a later date. This arrangement allowed producers to align their sales with the increased production capacity (Tolmie, 2003).

In the 21st century, individuals have numerous reasons to engage with financial institutions. However, the relation between financial institutions and their consumers can sometimes resemble an unequal partnership, with the institution being the horse and the customer being the ass (Chianu, 2007). Since the 2008 financial crisis, consumer credit, the wide range of financial products available in the market, and the associated risks for consumers have increasingly become a topic of discussion (Turgeon, 2009). It is now recognized that many aspects of daily life cannot be sustained on the cash-and-carry basis. Whether it is student loans, mortgages, sale credits, or other forms of credit, these avenues allow individuals to realize their full potential without having all the necessary financial resources upfront (Gang and Guangzi, 2017). The multitude of financial products in the market

implies that consumers must be financially literate in order to make informed and prudent financial decisions. Without such knowledge, consumers and their families may face financial difficulties (Lusardi and Mitchell, 2014).

However, achieving financial literacy is challenging for individuals without formal training in finance (Emmons, 2005). It requires more than just the ability to read and understand everyday words from a dictionary. The author of this paper has a personal experience regarding the consumption of financial services, which shows that having a college degree is only a necessary, but not a sufficient condition in attaining financial literacy. In June 2012, a friend of the author secured admission to a school in France and requested that the author pay the 200 Euro acceptance fee through their Euro bank account in Nigeria, with the agreement to be reimbursed the equivalent in Naira currency. The author processed the payment through their Nigerian bank, but upon reviewing their bank statement a few days later, they discovered that around 265 Euro had been deducted. When the author enquired with their bank, they were informed that the extra 65 Euro was a fee charged by the corresponding bank in New York. The author was surprised to learn that the transaction initiated with his Nigerian bank had a connection with a New York bank, resulting in a 65 Euro charge. This “corresponding fee” had not been disclosed to the author at the beginning of the transfer. If the author had been informed beforehand, they would have explored other, more cost-effective options for transferring the fee.

This story is a common experience for many financial consumers, whether dealing with mainstream banks or other financial institutions in the context of home mortgages, credit cards, hire purchase, fund transfers, and more. The difficulty lies in understanding the numerous financial terminologies presented in credit terms, often on standardized contracts with a take-it-or-leave-it approach (Crawford, 2013). In addition to the 2008 financial crisis and subsequent legislative responses, there is widespread scholarly agreements that the framework governing consumer finance is complex and does not currently provide adequate protection for financial consumers.

1.2. Research Questions and Methodology

In this paper, the author aims to address these questions by utilizing existing qualitative and quantitative data. Additionally, the paper examines decided cases and legal provisions to determine whether the current framework provides sufficient protection for financial consumers. The analysis of facts and law presented in the paper allows the reader to form their own conclusions. While a significant portion of the data and sources is based on laws and experiences from the United States and the European Union, it is argued that consumer protection laws are largely uniform globally. Therefore, the research conducted in this paper can be valuable to various systems, particularly those in countries with market-based economies. The questions below are explored:

- i. What are the overall challenges faced by consumers in the financial marketplace, and to what extent are they affected?
- ii. Why are financial products offered by financial institutions often complex for consumers?
- iii. What are the hidden costs associated with complex financial products for consumers?
- iv. How do regulatory bodies responsible for consumer protection address issues of consumer exploitation, and are the current policies and measures adequate in providing protection?

1.3. What are the overall challenges faced by consumers in the financial marketplace, and to what extent are they affected?

In relation to consumer financial contracts, there are numerous complexities that consumers face due to the knowledge imbalance between consumers and their financial institutions (Gikay, 2019). However, in the pursuit of financial prosperity in the 21st century, most consumers cannot afford to avoid engaging in financial activities. Nowadays, consumers engage in various financial undertakings such as opening salary accounts, obtaining car loans or hire purchase agreements, buying from online retail stores, and owning and operating borderless bank accounts, as well as making remote payment for household bills. These transactions are facilitated deposit-based products, third-party payment systems like PayPal, mainstream means of payment, and other emerging financial products (Haim, 2013). In the past, it was possible to avoid using these financial products, but nowadays, the exclusion of consumers from mainstream financial products would negatively impact their social existence. The COVID-19 pandemic had a detrimental effect on the global economy, leading to lockdowns and restrictions on physical banking services. Consequently, both government and corporate institutions swiftly transitioned their financial services online, and consumers were forced to quickly learn and adapt. This sudden shift to online operations, particularly in areas with low literacy levels, exposed financial consumers to cyber-attacks, resulting in many falling victim to online scammers posing as their financial institutions (See: *Theme*, 2020).

The constant emergence of financial products today makes it challenging even for college-educated consumers to fully comprehend the associated risks and benefits. As argued by Anderson (2016), when consumers use financial products without sufficient understanding, the consequences can be severe, jeopardizing their sustainable wellbeing and, at times, also that of their families¹. For instance, inadequate comprehension of credit terms can lead to consumers losing their

¹The victims of investment and business opportunity frauds tended to be more educated than the population as a whole, while lottery fraud victims had lower levels of education (Pak and Shadel, 2011).

mortgages or becoming over-indebted due to poor understanding of concepts like “compound interest.” These outcomes can negatively impact their credit rating and future borrowing in the financial marketplace (Anderson, 2016, p. 23).

Upon closer examination, it becomes evident that consumers’ improper understanding of complex financial products can have a negative impact on their overall confidence and trust in their financial industry. This, in turn, can have both market and social consequences. Recent data reveals that over 30 percent of consumers were initially unaware of the fees associated with the financial products they subscribed to.² In the United States, statistical data from 2018 showed that 99 percent of consumer complaints filed with the Consumer Financial Protection Bureau (CFPB) were resolved once the relevant financial institutions provided explanations (United States of America, 2018). This indicates that consumers proceeded with the transactions despite lacking the necessary information at the time of entering into the contracts.

A sufficient understanding of any product is crucial to avoid misuse and its associated consequences. This holds true for consumer financial products, where understanding the prices, risks and obligations burdens making purchases is essential for consumer protection. Insufficient knowledge of the risks and terms of purchase, including the availability of exit options, weakens the ability to make informed decisions. Even when a financial consumer eventually realizes the full implications of the products they have acquired, the transactions cost of switching to another product can be high. This includes the possibility of suffering losses due to early termination of contracts, which may not have been properly disclosed by the financial institution initially (Klemperer, 1987).

In a market economy, the principle of *laissez faire* can easily undermine consumer visibility in making informed decisions, leaving them to bear the underlying consequences (Nilsson, et al., 2016). From a market perspective, consumers are expected to conduct independent searches to discover the best financial products available. They can choose their financial service providers after carefully reviewing the terms and conditions, which should be presented in language that consumers can understand. However, statistical data shows that consumers rarely switch banks based on research findings regarding better services or prices offered by other competitor banks (Kiser, 2002).

There is a prevailing assumption among financial consumers that all banks are essentially the same, and the transaction costs associated with switching banks may discourage them from considering alternatives. Moreover, despite the crucial nature of financial products in the lives of consumers, they seem to rely on banking and

² In general, many consumers expressed dissatisfaction of how their mortgage and other financial decisions turned out due to insufficient knowledge to make healthier financial choices (The Harris Poll, 2019).

financial institution regulators to discover the best available products and services in the market. Paradoxically, these regulators often share similar perspectives with the institutions they are supposed to oversee. This raises the question of how the financial sector, arguably the most important sector for financial consumers, is allowed to develop and sell complex financial products and services without effective regulation.

2. Why are Financial Products Offered by Financial Institutions often Complex for Consumers?

2.1. The First Diagnosed Reason: The Caveat Emptor Rule Requires Consumers to Pull Themselves Up by Their Own Bootstraps

The average expectation is to have a system where consumer financial products are simplified to assure a better understanding of the associated risks and benefits. However, the reality in today's financial systems is the proliferation of complex products. Several reasons contribute to this situation. Firstly, financial institutions in a market economy primarily exist to maximize profits, often driven by short-term behavior. This focus on profit is not aligned with the well-being of financial consumers. Consequently, it is common for financial institutions to present the terms of financial contracts in an enticing manner, highlighting the benefits, while downplaying the risks and side effects associated with the products (Ellison, 2004; DellaVigna and Malmendier, 2004). As these deceptive practices are prevalent across the industry, there is little incentive for financial institutions to engage in altruistic behavior by presenting both risks and benefits equally. They fear losing customers, as consumers are generally not well-equipped to comprehend financial risks and tend to prefer products that appear risk-free. Therefore, financial institutions have learned over time to only emphasize the advantages of the products they sell to them, leaving consumers to discover the hidden costs and terms at their own expense, usually after they have been exploited for some time (Jager, 2017).³

The insightful work of Gabaix and Laibson sheds light on the phenomenon described above, revealing the challenges consumers face in choosing financial products based on price and benefits considerations. This is attributed to the concept of "shrouding," where firms strategically market the appealing sides of products while obscuring or masking the less favorable aspects such as backend fees, penalties, surcharges, and more (Gabaix and Laibson, 2006; Ko and Williams, 2013). An example from personal experience is the way banks present standard form contracts to potential customers when opening bank accounts. Often, customers are only given limited time or opportunity to read the terms and conditions, with a focus on quickly signing the document. This practice is widespread in the industry,

³ Jager explained that "[t]he drafting, sending, and interpreting of questionnaires costs time and money, meaning that there are incentives for banks to keep them short and to let investors categorize themselves."

discouraging customers from raising objections or refusing to open an account based on unfavorable terms (Ko and Williams, p.40).⁴

As a result, many customers, including myself, have discovered additional charges on their bank statements such as “ATM withdrawal charges,” “account maintenance fees,” “debit card maintenance fees,” and more, which were not disclosed at the time of opening the bank account. Shrouded financial products have become ingrained in a free market system where the principle of caveat emptor (let the buyer beware) places the burden on consumers to conduct independent inquiries before purchasing products. The caveat emptor rule does not impose a heavy obligation on sellers to actively disclose defects. Thus, with a free market system coupled with the caveat emptor rule, there is a strong incentive for financial institutions to create complex products for consumers, as they are not compelled to explicitly reveal all terms and costs associated with their offerings.

2.2. The Second Diagnosed Reason: Most Consumers Do Not Always Focus on the Long Term Effects of their Financial Decisions

The average financial consumer often overlooks the long term effects of their decisions when selecting financial products (Howcroft, et al., 2003). They are primarily attracted to the relative ease of initial costs, seeking products that are simpler, cheaper and offer immediate benefits compared to alternatives that may be more advantageous in the long run (O’Donoghue and Rabin, 1999). Moreover, consumers have the freedom to switch to a comparable product offered by another financial institution in the future if they feel that they are not receiving a satisfactory deal. This opportunity further reduces their focus on long-term considerations for the chosen product. Consequently, financial institutions have tailored their products to align with this consumer behavior. To attract consumers initially, financial institutions design and offer products that are competitively appealing in the short term. Once a consumer begins using a product, they may develop endowment effect, becoming hesitant to switch to another product that would require them to invest time and resources to learn its features (Court, et al., 2009).⁵

However, over time, hidden charges and unfavorable terms associated with the product become effective as per the contract. Busy consumers may find it challenging to discontinue the product or may assume that all financial institutions offer similar products, especially when access to regulators or consumer protection bureaus for

⁴ Ko and Williams, explained that “a number of studies find that a large proportion of consumers, in fact, do not understand key lending terms and underestimate future costs. Such obscured costs can cause certain consumers to unknowingly enter into transactions that are ultimately welfare-reducing. For example, a college student may choose a debit card as his method of payment because it is more convenient than cash. He may then regret this decision once he learns about the penalty fees that are eventually imposed. In addition, markets with hidden add-on costs can allow for implicit transfers between consumers who use the product differently...”).

⁵ The author explained the factors that influence consumers in their decisions-making journey and how bank marketers should approach issues towards enhancing consumers’ benefit and experience.

complaint resolution is limited. The low initial costs of products in the short term obscure the visibility of hidden and unfavorable terms that become apparent in the long run. This is one of the reasons why consumers, despite the complexity of financial products, continued to patronize them. They are enticed by the prospect of reaping immediate benefits in the short term and the option to discontinue the product in the long term (Ko and Williams, 2017, p. 41).

2.3. The Third Diagnosed Reason: The Bundling of Financial Products by Financial Institutions

The prevalent wisdom in the financial service industry is to bundle multiple services together and market them as one product (Bar-Gill, 2006). The competitiveness of a financial product is often measured by the number of services included, a marketing strategy extensively employed by the marketing departments of financial institutions (Nalebuff, 2013). Since these products consist of a group of services combined into one, consumers, who may lack knowledge or sophistication, find it challenging to assess the quality of each individual service. Additionally, some of the bundled services may not be useful to the consumer. In 2018, the author personally experienced an example of this phenomenon. A bank marketer in Nigeria offered the author a financial product called “Xclusive Plus” from Access Bank Plc. This product was specifically designed to recognize and prioritize the author as an important customer, based on their substantial deposits over the past five years. Along with priority treatment for bank-related requests, the product offered monthly availability of a movie ticket at a distant cinema, a body massage at a designated center far from the residential address of the author and access to the bank’s lounge at certain airports in case of flight delays.

However, despite the enticing offer, the author discovered that approximately six thousand naira (approximately US\$25) was deducted from their account each month for the product. This fee exceeded the initially disclosed amount and the author seldom utilized the additional services. Dissatisfied with the price and limited usage, the author chose to discontinue the “Xclusive Plus” product. This scenario highlights one of the reasons financial products are often complex for consumers to comprehend. Financial institutions frequently bundle numerous services to justify higher charges, even when they anticipate low utilization or lack of interest and resources from consumers to evaluate and report on the delivery of these bundled services. As previous studies have shown, a consumer’s understanding of bundled products significantly decreases when the number of bundled services exceeds three (Schwartz, et al., 1986).

2.4. The Fourth Diagnosed Reason: Consumer's Difficulty in Comprehending Financial Terminologies

Financial terminologies are inherently complex and encompass terms from various disciplines such as law, accounting, banking and finance, information technology. Financial institutions possess the necessary expertise to integrate these terminologies into the descriptions of financial products. Consequently, the contracts underlying these products often incorporate complex terms that require knowledge of in the aforementioned fields. However, the average consumer lacks the necessary understanding of these disciplines. While seeking professional advisory services is an option, it is often impractical due to the high cost compared to potential short-term financial losses associated with a specific product.

In 2010, Lacko and Pappalardo, conducted qualitative experiments that confirmed these concerns. They discovered that most financial consumers were unable to comprehend basic terms such as 'amount financed', 'discount fee', 'back-end fee', and so on. Without seeking professional interpretation of such terms, consumers may make financial decisions that can be detrimental to their long-term financial well-being.

The use of complicated financial terminologies, which may have meanings distinct from those provided by common sense or ordinary language dictionary, contributes to the complexity of financial products for consumers. However, from a market perspective, financial institutions profits over altruistic actions that could benefit consumers at the expense of their own profitability. Considering the design of financial market systems and the doctrine of sanctity of contract, there is little or no incentive for financial institutions to engage in activities that would reduce complexities surrounding their products, as they benefit greatly from consumer deception. Unfortunately, product complexities negatively impact the financial well-being of consumers, leading to a potential economic disaster due to diminished trust in the financial industry and the subsequent erosion of social cohesion and economic prosperity.

3. What Are the Hidden Costs Associated with Complex Financial Products for Consumers?

3.1. What is the General Transaction Cost?

In every market economy, the pursuit of profits through efficient production is a fundamental principle. When considering the profitability of a financial product, if the cost of obtaining information about that product exceeds the perceived benefits by the consumer, the rational choice for profit maximization would be to forgo acquiring the information. However, unlike other products where a simple economic calculation of opportunity cost can be made, the realm of finance is unique due to its high importance in the life of a consumer. The exorbitant costs associated

with acquiring and processing information can lead consumers to abandon their efforts to comprehend these products. Consequently, they may succumb to the consequences associated with using complex and incomprehensible financial products.

3.2. What is the Cost of Digesting a Large Quantum of Information?

As previously mentioned, information and knowledge play a crucial role in unraveling the complexities of financial products. Financial institutions, including banks, and their regulatory bodies do provide information with the intention of assisting consumers in understanding the intricacies of the financial products they purchase and utilize. However, despite the provision of information, whether as a corporate practice or mandatory disclosure, the overwhelming volume of information presented, often spanning tens of pages, can deter consumers from thoroughly examining the terms, conditions and underlying risks of the products (Lyengar and Lepper, 2000)⁶. Furthermore, many consumers struggle to sufficiently understand the complex language employed by financial institutions to describe their products. They may also lack the ability to analyze numerical data, which often requires a certain level of financial expertise to fully grasp. Examples of financial terms that can be challenging for consumers to understand include ‘compound interest’, ‘double cycle billing,’ and ‘back-end fee’ (Lusardi and Mitchell, 2007).⁷ Consequently, treating all financial consumers as equal and assuming they possess the same level of sophistication is based on a flawed assumption that they will be able to fully comprehend the information provided and make well-informed financial decisions.

The complexity of financial products remains a challenge for individuals with sufficient literacy and numeracy skills. It is worth noting that comprehension of product risks can be particularly difficult. This challenge is further highlighted by the fact that judges, who are called upon to examine the contents of disputed financial products, often struggle to fully understand the terminologies and intricacies involved. A notable example dates back to 1956 in the case of *J. Spurling Ltd v Bradshaw*,⁸ where English judges expressed their frustration with the obscure contractual terms of financial products. In that case, relying on the doctrine of *contra*

⁶The authors generally discussed the effects of information overload on consumers which whittles their ability to make real choices.

⁷The authors conducted a survey, in which “[T]he surveys consisted of a 24-item questionnaire on topics grouped into categories including “Economics and the Consumer;” “Money, Interest Rates and Inflation;” and “Personal Finance.” When results were tallied using standard grading criterion, adults had an average score of ‘C’, while high school participants did more poorly, primarily scoring F (average score of 53%). Particularly troublesome were the sections dealing with money, interest rates, inflation, government and trade, and personal finance. The report also indicated gender and minority gaps: White students and adults tended to score higher than their Black and Hispanic peers, and women scored lower than men.”

⁸ *J. Spurling Ltd. v. Bradshaw* [1956] 1 WLR 461, 466.

proferentem, the judges ruled that the party (the financial institution) responsible for drafting the contract should bear the burden of ambiguous terms.

Typical disputes concerning financial products often require a significant amount of time for courts to resolve. In some cases, judges may even seek expert opinions to aid comprehension and enable them to provide authoritative comments on the financial products in question. This begs the question: if it takes experts considerable time to digest and analyze complex financial products, how realistic is it to expect consumers, who face various barriers such as limited literacy and numerical skills and time constraints, to fully comprehend these products and make informed decisions? (Campbell, et al., 2010).

3.3. High Searching and Switching Costs Promote the Existence of Product Complexities

In a market system, it is generally assumed that consumers are motivated to search for price-competitive financial products to maximize their limited financial resources. This price-based competition is expected to optimize the economy as financial institutions strive to provide efficient and competitive services in all aspects (Campbell, et al., 2010, p.7). However, this assumption relies on the premise that consumers are not hindered by barriers that impede their understanding of complex financial products and that they actively engage in searching for better alternatives. The high cost associated with conducting constant searches to find financially advantageous products often discourages many consumers from even attempting to do so. Research by Kiser (2002, pp. 6-7) highlights this apathy towards searching for better financial products across banks and other financial institutions. In the United States, around 32 percent of households have never changed their banks, and even those who have switched often did so for reasons unrelated to dissatisfaction with the products offered by their banks. The primary factor contributing to this lack of active searching is that the cost of search exceeds the short-term losses experienced by consumers, reducing their willingness to switch to comparable products (Kiser, 2002, p.10). Furthermore, in the relationship between financial institutions and consumers, it can be argued that consumers bear the costs associated with complex products. The costs incurred in producing these complex products are ultimately transferred to consumers through product prices. This creates a strong incentive for financial institutions to produce complex products, as the complexities hinder consumers' full understanding of the associated risks, thus increasing their likelihood of purchasing such products. The cost incurred in producing the products, including the production of informational booklets as mandated by industry practice or financial regulators, employee training to understand the products, and the distribution of information are ultimately transferred to consumers through product prices (Melecky and Rutledge, 2016).

4. How Do Regulatory Bodies Responsible for Consumer Protection Address Issues of Consumer Exploitation, and Are the Current Policies and Measures Adequate in Providing Protection?

The discussion thus far has highlighted that financial institutions in a market system are driven by motives to produce complex financial products. This is primarily due to the barriers that inhibit consumers from fully understanding these products, such as the lack of required literacy and numerical skills, the general discomfort and costs associated with analyzing and comparing products, and the high costs of switching to better alternatives. Financial institutions take advantage of these barriers, leading to the exploitation of vulnerable of financial consumers. The policy questions that arise are whether the existing legal framework provides sufficient protection for financial consumers and to what extent such framework is sufficiently protective of financial consumers. (Federal Trade Commission, 2013).

4.1. The First Type of Response: Mandatory Rules of Disclosure

The presumption is that consumers will make better-informed financial decisions when the full benefits and burdens associated with the financial products offered to them are disclosed at the offer stage and subsequently as mandated. Disclosure is considered a strong remedy against deceptive practices that encourage the development and sale of obscure financial products. However, while on a *prima facie* consideration, financial consumers benefit from disclosure, there is an irony in the fact that disclosure itself can overwhelm consumers with a wealth of information, discouraging them from digesting it (Ben-Shahar and Schneider, 2011). This, in turn, reinforces the barriers that make it difficult for consumers to understand complex financial products.

Disclosure, whether required by the Dodd Frank Act,⁹ the Truth and Lending Act,¹⁰ the Real Estate Settlement Procedures Act, or any other comparable legislation,¹¹ is largely based on the assumption that all or nearly all consumers of financial products possess the necessary ability and resources to comprehend the complex financial information provided to them. Undeniably, for an information disclosure to

⁹ See Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which amongst other things, established the Bureau of Consumer Financial Protection.

¹⁰ See generally, the protection of financial consumers in "Truth in Lending Act – Consumer Rights and Protections", stating that "Lenders must provide a Truth in Lending (TIL) disclosure statement that includes information about the amount of your loan, the annual percentage rate (APR), finance charges (including application fees, late charges, prepayment penalties), a payment schedule and the total repayment amount over the lifetime of the loan" (Fay, 2021).

¹¹ Other pieces of notable legislation in this regard are the Home Owners Protection Act, the Home Mortgage Disclosure Act, and the Secure and Fair Enforcement for Mortgage Licensing Act, the Electronic Funds Transfer Act, the Credit Repair Organization Act, and the Truth in Savings Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, etc.

be truly effective, the unique circumstances of each consumer should be taken into consideration instead of treating all consumers the same way. However, this would necessarily increase the cost of disclosure for financial institutions, ultimately borne by consumers through product prices. Regardless, the presumption that consumers possess sufficient knowledge to properly analyze disclosed information, is factually inaccurate since a significant number of consumers in the financial market struggle to process sophisticated information characterized by financial terminology and presented in a manner requiring a degree of financial expertise.

The ultimate question, then, is to what extent disclosure has truly benefitted financial consumers. Firstly, disclosures can be counterproductive if consumers are inundated with an array of information about a particular product. As Ben-Shahar and Schneider argued in 2011, when certain provided pieces of information lack direct relevance to the product and instead consist of miscellaneous and unrelated figures on various products offered by the financial institution, the chances of filtering and locating useful information are greatly diminished (Ben-Shahar and Schneider, 2011, pp. 710-723). Secondly, as financial institutions are driven by profit maximization, their default position is not to comply with mandatory disclosure rules in a way that benefits consumers, but to find ways to meet minimum statutory requirements while effectively bypassing the ultimate goal. Consequently, financial institutions who invest in product innovations will always stay ahead of regulators by studying and comprehending the mandatory rules and restructuring their pricing techniques to circumvent them (Bar-Gill, 2012, p.85).

Concluding on this point, it can be asserted that disclosure rules can only be effective if regulators ensure that the information provided to consumers is simplified, easily comprehensible, and designed to promote consumer engagement. It is crucial for the disclosed information to capture the essential points, be presented in a digestible manner, and avoid tactics that frustrate the interest of consumers in reading the provided information. In this regard, several factors such as the word count, font size, graphs, and statistical tables must be carefully controlled to fulfill the ultimate purpose of disclosure, which is to empower financial consumers in making well-informed and sound financial decisions. Disclosure acts as an *ex ante* remedy by reducing the financial losses that consumers may incur if they were not equipped with adequate and relevant information regarding financial products they consume.

4.2. The Second Type of Response: Increasing Consumer Financial Education and Literacy

Another *ex-ante* remedy that safeguards financial consumers is education aimed at enhancing financial literacy, particularly regarding complex financial products and decisions-making in general. When financial consumers are adequately educated, they gain better understanding of the risks associated with their consumption choices. They learn to assess credit offers from both short-term and long-term perspectives,

comprehend concepts such as interest rates, compound interest, double-cycle billing, back-end fees, corresponding fees, etc.¹² Consumer education can be highly effective when the content is tailored to match the interests and comprehension levels of different demographic groups within society.¹³ Interestingly, even the European Union, often regarded as highly protective of consumers,¹⁴ seems to have adopted a similar approach as the U.S. concerning financial consumers. As observed by Stanescu (2019, p.50), “consumers are now expected to help themselves by pursuing financial education, increasing their knowledge and awareness, seeking advice, staying updated with technological and financial advancements, and making rational decisions, despite the increasing complexity of the products and services offered. This stance of EU policy makers and the judiciary raises the question of whether consumer protection has turned into a self-help mechanism for most consumers, starting from vulnerable groups and upward.”

However, critics argue that measuring the true impact of consumer education can be challenging since it is a preventive measure. There is no way to retrospectively determine the number of consumers who would have suffered financial losses if not for the benefits of consumer education (Willis, 2009; Mann, 2012). As a result, it can be difficult for advocates of consumer education to justify the resources allocated to such educational programs and campaigns, especially considering the constant innovation of financial products. The knowledge imparted to consumers today may become obsolete within a short period of time (Haim, 2013, p.54). One commendable aspect is that the Dodd-Frank Act has incorporated consumer education as a long-term viable solution to prevent financial crises, with the Consumer Financial Protection Bureau (CFPB) enforcing it.¹⁵ An example of a sustainable consumer education is the “Ask CFPB”¹⁶ online platform, which provides answers to frequently asked questions by consumers.

4.3. How Should the Gaps in the Extant Nature of Responses Be Closed?

4.3.1. Prevention of ‘Regulatory Capturing’ by Financial Institutions

Financial institutions are undeniably powerful and possess significant resources that allow them to shape and manipulate policies in their favor. Consumers, as regular citizens, often place their trust and confidence in public institutions (regulators) to protect their interests. The high level of trust in regulatory bodies can make consumers complacent in equipping themselves with financial knowledge, as they believe that

¹² See Cole and Shastry (2008).

¹³ See Financial Literacy and Education Commission. (2016, p.7).

¹⁴ See Art. 169, Treaty of the Functioning of the European Union; Art 38 Charter of Fundamental Rights of the European Union. (European Communities, 2000)

¹⁵ See Dodd-Frank Wall Street Reform and Consumer Protection Act, 111 Public. Law. No. 203 (2010), Section 1205(b)(2)

¹⁶ See: Ask CFPB. (s. f.).

the institutions funded by their tax contributions are actively looking out for their well-being. However, since lawmakers and policymakers are typically elected into office, their campaigns and elections require substantial financial resources. These resources may not be readily available to politicians during elections, so they heavily rely on donations from the public to fund their campaigns. It is reasonable to assume that politicians who receive financial donations from financial institutions cannot be expected to enact strict regulations against those very institutions that may exploit consumers. In this case, the one who provides the funds can influence the decisions made (Poulain, 2017; Albino and Bar-Yam, 2013).¹⁷

The current approach taken by regulators, which places the burden on consumers to educate themselves or strengthen their financial knowledge, resembles victim-blaming and leads to a futile pursuit. Even if we temporarily assume that consumers fully comprehend the complexities surrounding financial products, their knowledge would not yield substantial benefits if all other financial institutions offer products of comparable complexity, thereby eliminating any real choice for consumers. Thus, the current emphasis on consumer education and mandatory disclosure rules misses the main point, as financial institutions can always find ways to circumvent regulations by designing products that fall outside the regulatory scope.

Furthermore, financial institutions are presently regulated by their national or reserve banks, and which is akin to being a judge in one's own case. Regulators, who are trained within the financial industry, may struggle to have a perspective distinct from the practices of the commercial banks they oversee, as these banks are primarily motivated by profits. Consumer bureaus, such as the CFPB, are relatively recent developments and can only strive to catch up with the ever evolving financial innovations, products and services. As Tajti (2019, p.5) states, "[s]ome level of consumer protection exists in every system; the problem lies in its adequacy."

4.3.2. Financial Institutions Are Not Sufficiently Bearing the Costs of Complex Products – The Need to Require Delivery of Education Against Self-Interest

Instead of placing the burden on consumer bureaus to determine the complexity and acceptability of financial products in the marketplace, it should be the responsibility of financial institutions to ensure that the consumers who purchase their products have a sufficient understanding of them. In other words, *caveat venditor* (let the seller beware). If we assume that financial institutions are best positioned to comprehend the risks and benefits associated with their products, then there should be a requirement for them to ensure that consumers attain the necessary level of literacy to understand the complexities surrounding their

¹⁷ As Professor Poulain explained, "at all times, industries have tried to protect and promote special interests. Their behaviour is completely rational: they apply pressures on the regulatory bodies in order to influence the decision-making process. Nevertheless, the industry should not have a disproportionate impact on this process." (p.108)

offerings. Consumer regulatory bodies and courts can then supervise compliance with this requirement. One possible approach is to mandate financial institutions to present an equal number of disadvantages and risks alongside the benefits of their products in the information booklets provided to consumers.

The role of financial consumer regulators, policymakers and courts would be to assess whether financial institutions have truly disclosed information in a manner that is against their self-interest. Providing information against self-interest would most likely inform consumers about the full extent of product risks. This information should be comprehensible and presented in clear formats, with an equal number of risks or disadvantages compared to the underlying benefits (Haim, 2013, p. 65). Ultimately, this approach would increase transparency in the financial marketplace (p. 66), increase consumers' trust and confidence in the system (Cremer, 2015),¹⁸ which is crucial for depository banks to thrive, and reduce the supervision costs for consumer regulators and courts.

Requiring financial institutions to produce consumer education that goes against their own narrow interests might lead to increase in the cost of financial products, as these institutions would factor in the associated costs. However, ensuring more transparent processes in the financial products being sold to consumers would foster a healthy financial system in the long run. It would have positive impacts on banks since their long-term business would be better secured if consumers avoid financial losses resulting from poor decisions. Additionally, as Apaam, et al. (2017) observed, increased consumer trust is likely to encourage the unbanked population to join the mainstream banking system,¹⁹ thus boosting the capital of financial institutions, increasing their profits, and potentially reducing the need to raise product prices.

In addition to the suggested protective measures for improving regulation and consumer well-being, courts can consider the concept of constructive trust when addressing losses suffered by financial consumers due to deceptive sales of complex financial products. In this case, as Tajti (2019) explained, the extent to which losses are deemed to have been obtained through deception, can be considered as being held in trust by the financial institution for the consumers.²⁰

¹⁸ Cremer, explained that "both competence and integrity are recurring themes in many discussions concerning the financial crisis. Benevolence, however, is not used very often – if at all. At the same time, banking clients particularly express concerns about whether the bank cares about their interests as well as its own interests. Put simply, a certain "morality of care" is missing in the discussion. As a consequence, it also seems to be missing from efforts to restore trust in banks." (Available at: <https://hbr.org/2015/03/why-our-trust-in-banks-hasnt-been-restored>)

¹⁹ The authors explained that "almost one-third (30.2 percent) of unbanked households cited "Don't trust banks" as a reason for not having an account, the second-most commonly cited reason".

²⁰ Tajti, explained that "the victims of fraud could also be prepaying consumers. The property subject to a constructive trust does not become part of the bankruptcy estate and hence is to be given back to creditors to the benefit and protection of whom the trust was imposed by the court. Therefore, the prepaying consumer-creditor would get the asset itself instead of the minimal recovery as an unsecured creditor." (p.16)

5. Conclusion: The Stronger Need to Reinforce Existing Protective Measures

It is evident that legal systems, particularly in the realm of commerce, have historically favored trading merchants and corporations, who often exert influence over the creation of laws and policies in their favor – a phenomenon known as “regulatory capture” (Tajti, 2022). However, since corporations produce goods and services ultimately for the benefit of consumers, it is crucial to protect consumers from unfair and unconscionable practices by corporations. Therefore, it is necessary to smoothen the rocky paths of consumers, as discussed above, by reinforcing existing protective measures.

Given the inadequate safeguards currently available to financial consumers, it is recommended that both common law and civil law systems adopt the practice of class action, particularly in light of the increasing volume of consumer transactions, facilitated by the global reach of the Internet. Moreover, in appropriate cases, banks and financial institutions should be required to disgorge any ill-gotten profits obtained through the sale of opaque and deceptive products to consumers. Contrary to the privity rule of contract, consumers should be able to initiate class actions that benefit others who have fallen victim to similar deceitful practices. Regulators and courts must ensure that any damages paid by banks and financial institutions are not indirectly transferred back to consumers.

Lastly, it is advisable that the laws establishing consumer protection bureaus prohibit the directors of these entities from accepting gifts from individuals or companies. Granting such power to directors becomes an avenue for potential bribes from financial institutions, which could be disguised as gifts. To ensure the independence and impartiality of consumer bodies, their activities should be exclusively funded by taxpayers’ funds. This way, consumer protection bureaus will bear the sole responsibility of fulfilling their regulatory duties without any fear or favor.

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