Responsible Credit Is an Economic and Moral Issue

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Each year, millions of financially vulnerable Americans take out high-cost, predatory loans with interest rates so high that borrowers may never be able to pay them back. As a result, many borrowers end up trapped in an unending cycle of debt.

Consider the story of Minnesotan Sherry Shannon, a single adult who receives disability benefits. In testimony before the state legislature last year, Shannon described borrowing $140 from a payday lender at 260 percent annual interest in order to cover moving expenses. When the loan came due the next month, her fixed income did not leave her with enough money to pay off the loan while meeting her ongoing living expenses, so she had to take out a second loan. Shannon ultimately had to pay nearly $500 in fees—nearly four times the amount of the original loan—just to continue borrowing. Meanwhile, she still owed the original amount and was caught in a debt trap with virtually no exit.[1]

Shannon's experience is far from unique. About 12 million Americans—mostly those who earn less than $40,000 per year—take out at least one payday loan annually, which they usually expected to repay with their next paycheck.[2] Payday loan usage is especially concentrated in communities of color. In particular, African Americans are more than twice as likely to take out payday loans relative to other groups. But payday loans do not just afflict minority communities; 55 percent of all payday loan borrowers are white.[3] The annual interest rates on these loans are often in the triple digits: 391 percent annual interest is a fairly typical number.[4] Some borrowers are able to pay back the loan on time, but most find that the loan intended to solve their problems only made them worse. A recent study by the Consumer Financial Protection Bureau, or CFPB, found that four out of five payday loan borrowers could not pay back their loans in full when they came due. Instead, they had to borrow more money or refinance their existing loans.[5]

This issue brief examines high-cost lending and the challenges it poses to vulnerable families. Faith groups, responding to the moral call of scripture and tradition, have already taken steps to address policies that trap consumers in a cycle of debt. This brief outlines the case for responsible lending practices within the framework of faith. Finally, the brief lists policy recommendations to tackle predatory lending practices at both the federal and state levels.

Background on payday lending

Currently legal in 36 states,[6] payday loans are one of the most prevalent types of predatory loans.[7] Payday loan borrowers are often low- or moderate-income earners, and while they generally have bank accounts, many have a limited ability to use credit because of low earnings or a weak credit history. The average credit card for mainstream borrowers has an annual interest rate of less than 16 percent, but these economically vulnerable borrowers are stuck outside the mainstream and face payday lending rates that can be more than 20 times higher than average lending rates.[8] Rather than helping consumers deal with temporary setbacks, these loans exploit the financial shortfalls that struggling families face. Since 2000, the median inflation-adjusted income has declined, while the costs of raising a family have risen.[9] Meanwhile, if the federal minimum wage had kept pace with inflation since 1968, it would be more than $10 today—far greater than the current $7.25.[10]

Lending abuses and concerns over such practices are not new. At the time of the American Revolution, many states had statutes that limited interest rates at 6 percent to 12 percent.[11] Changing economic conditions and the growth of national financial institutions led to limits on states' ability and willingness to regulate interest rates. Yet 14 states and the District of Columbia currently enforce interest rate caps on payday and other short-term loans within their jurisdictions, often capping rates at 36 percent annual interest or less.[12] In 2014, nearly half of all state legislatures considered bills related to payday lending.[13]

Furthermore, high-cost lending has remained a national political issue. In 1991, Sen. Alfonse D'Amato (R-NY) sponsored an amendment to cap credit card interest rates at 14 percent as part of the Federal Deposit Insurance Corporation Improvement Act. The measure overwhelmingly passed the Senate but did not reach a vote in the House.[14] In 2006, Congress passed and President George W. Bush signed into law the Military Lending Act, which capped the maximum interest rate charged to service members and their families at an annual 36 percent.[15] While there have been gaps in the law's implementation, it has addressed some major payday loan abuses against service members.[16] Bills introduced in Congress by Sen. Dick Durbin (D-IL) and Rep. Matt Cartwright (D-PA) have sought to extend this interest cap to all Americans.[17] And while the CFPB—established as part of financial reform in 2010[18]—does not have the authority to set a rate cap on loans, it has brought energy to the debate over affordable credit. It released an initial outline of future regulation at a field hearing in late March, with a proposed rule likely to be released later this year.[19]

Yet the debate over payday loans goes beyond the domain of politics and policy. Responsible lending is also a moral issue. For millennia, faith traditions have spoken out against excessive interest—sometimes called usury—on the grounds that it leads to exploitation and hurts those who are most vulnerable. As many religious leaders have

seen members of their congregations struggling to pay back predatory loans with exorbitantly high interest rates, they are often on the frontlines of the fight for responsible lending. And predatory credit practices are far more prevalent in states where residents, on average, have stronger religious affiliations. Among 20 states where at least three-quarters of residents identify as moderately or very religious,[20] only 3—North Carolina, Georgia, and Arkansas—ban high-cost payday loans by establishing a maximum interest rate.[21]

As Rev. David Snardon, pastor at Joshua Tabernacle Missionary Baptist Church in Louisville, Kentucky, wrote in the *Courier-Journal* last year: "For too many Kentuckians payday loans are not a financial fix. They are financial quicksand. They can lead to a cascade of financial consequences—including bankruptcy. Meanwhile, churches and social services ministries work daily to serve the needs of many of these same individuals. Payday loans don't help."[22] In addition to offering guidance and support, a number of faith leaders lead advocacy efforts to end the high-cost lending practices that are risky to borrowers and devastating to human lives. Faith leaders also support socially responsible alternatives.

The challenge of payday lending today

Predatory lending is particularly dangerous given the damage that high-cost payday loans inflict on vulnerable families and communities. Although payday loans are based on the premise that the borrower can repay the loan by the next paycheck, the truth is that most borrowers remain in debt far longer than that. According to the CFPB, the median payday loan borrower is typically in debt for more than six months out of the year after taking out the loan.[23]

Payday loan products often set borrowers up to fail by charging exorbitantly high fees and instituting short repayment periods that are beyond the borrower's capacity to repay. Just as Sherry Shannon found herself in a debt spiral after attempting to cover modest moving expenses, Reneé Bergeron—a single mom in Duluth, Minnesota—eventually lost her apartment and her car after taking out a payday loan to help cover one month's rent. When the loan was due a month after Bergeron initially borrowed the money, she had to choose between paying off the loan or paying other basic bills. Bergeron had to take out another loan to cover her bills and to continue borrowing to pay off for the first loan. Nine years later, Bergeron is homeless, living in a shelter with her kids, and still paying off $4,000 in debt to her lender.[24]

While such loans are a bad deal for consumers, they can be profitable for lenders. Total revenue across storefront and online payday lenders in 2013 was approximately $9 billion.[25] To put this in perspective, if all payday lenders were a single firm, their revenue level would be slightly less than that of retail giants Family Dollar or Bed Bath & Beyond, both of which earned more than $10 billion that year.[26]

Voters tend to oppose high-cost lending at the polls, and some states have seen reforms. For example, Arizona voters chose to ban payday lending in 2008, even though the industry spent nearly $15 million on pro-payday lending campaigns in the state in the six years prior.[27] Seventy-two percent of Montanans voted to ban payday lending in 2010.[28] However, heavy lobbying and conflicts of interest have made it difficult to create lasting change. Ohioans overwhelmingly voted for an interest rate cap in 2008, only to find payday lenders using a loophole to recharter themselves as mortgage lenders—a loophole that the Ohio Supreme Court upheld last year.[29] Industry lobbying by a payday lender also led to the inclusion of a new pawnbroker license in the Ohio House budget bill this year under which payday lenders would be able to charge even higher fees by rechartering themselves once again—despite opposition from law enforcement and the pawnbroker industry itself.[30]

Some of these challenges are structural. For instance, the current chairman of the Texas Finance Commission, William White, also serves as a vice president at payday lender Cash America.[31] And the industry is lobbying forcefully to prevent regulations that would rein in exploitative practices. The payday loan industry has spent approximately $143 million in lobbying over the past 15 years, after adjusting for inflation.[32] Perhaps not surprisingly, the *St. Louis Post-Dispatch* noted in an editorial that while payday loan practices are a "national disgrace," payday loan reformers in Missouri found obstacles from industry groups even in ballot initiative qualifications.[33] When South Dakota reformers, including a nondenominational pastor, began to develop their own ballot initiative on payday lending, their efforts coincided with a bill in the legislature to require twice as many signatures to get future initiatives on the ballot.[34]

Even the bipartisan Military Lending Act has faced rollback challenges. In April, the draft National Defense Authorization bill—then pending before the House Armed Services Committee—contained a provision that would postpone implementation of new Department of Defense regulations that would further close loopholes that permit high-cost lending to service members.[35] Military veteran Rep. Tammy Duckworth (D-IL) introduced an amendment to remove this provision, which passed by only one vote.[36] Further amendments looked to challenge the Military Lending Act on the House floor as well.[37]

Faith traditions' concerns about predatory lending

Extracting unfair profits from vulnerable people is an immoral practice that runs contrary to most faith traditions, including those of Mormons,[38] Presbyterians,[39] and Jews.[40] Pope Francis has called usury an affront to human dignity.[41] And last year, the National Association of Evangelicals passed a resolution against predatory lending, asked lenders to "design loan products that do not exploit poor and vulnerable borrowers," and called on the CFPB "to investigate predatory lending abuses and to establish just regulations that protect consumers."[42]

Each of the Abrahamic religious traditions—Judaism, Christianity, and Islam—calls for economic justice around debt and lending practices. Their teachings are grounded in centuries of sacred texts and teachings that stand for justice and that speak out against taking advantage of society's most vulnerable members. For instance, the Judeo-Christian Bible teaches that, while lending can empower someone struggling financially, exploitative interest rates damage peoples' lives. Exodus warns, "If you lend money to my people, to the poor among you, you shall not deal with them as a creditor; you shall not exact interest from them."[43] And Leviticus prohibits taking advantage of families that fall on hard times, instructing that "if any of your kin fall into difficulty and become dependent on you, you shall support them ... You shall not lend them your money at interest taken in advance, or provide them food at a profit."[44] The Bible's emphasis on protecting the poor is notable, as is the specific condemnation of profiting from the vulnerability of others.

The Quran, the sacred text of Islam, teaches that individuals who exploit borrowers are defying God's will because "God permits commerce and prohibits usury,"[45] and it disapproves of those who charge interest to increase their own wealth.[46] The Quran then goes even further, saying that if a borrower is unable to repay a loan, the lender should be patient. The text even suggests that the lender's best option might be to "give up the loan as charity."[47] Hadith and Sharia—Islamic teachings and law—promote an economy of partnership, or risk sharing, between lender and borrower.[48]

Over the centuries, changing economies[49] and the growth of financial institutions have led faith groups to evolve beyond blanket prohibitions on interest to recognize the morally acceptable role that it can play in both businesses growth[50] and necessary support[51] for people experiencing poverty. However, the principle of protecting the vulnerable from predatory lenders remains unchanged.

Ultimately, intent plays a role in morally responsible lending. The Talmud,[52] a central text in Rabbinic Judaism, encourages making loans to poor individuals and prohibits the lender from reaping any financial benefits, including gains from exploitative interest. The Catholic Church also rejects exploitative interest rates, as they aggravate injustices already inherent in poverty: "The acceptance by human society of murderous famines, without efforts to remedy them, is a scandalous injustice and a grave offense. Those whose usurious and avaricious dealings lead to the hunger and death of their brethren in the human family indirectly commit homicide, which is imputable to them."[53]

How communities of faith are responding to predatory lending

Religious groups, including interfaith coalitions, are a powerful voice against exploitative lending practices, as they convey the harms of predatory lending to their members and to policymakers, engage in direct action, and lead campaigns for better financial practices. As Stephen Reeves of the Cooperative Baptist Fellowship noted at the CFPB's

payday lending field hearing this spring, "Our churches and pastors have seen firsthand the consequences of payday and auto title lending in their congregations and communities. They have used their benevolence funds to aid neighbors trapped in cycles of debt proven to be so central to this business model."[54] Religious groups also mobilize their followers to take direct action based on the challenges facing their communities.

In states where payday lending is largely unregulated, faith communities advocate for laws to protect vulnerable borrowers through caps on interest rates, limitations on how much consumers can borrow based on their income, and longer repayment periods. For example, the bishops of the Texas Catholic Conference have made regulating payday lenders a top policy priority,[55] raising public awareness of the dangers of predatory loans and the rights of borrowers[56] and organizing Catholics to contact their legislators.[57] Similar interfaith efforts have been long ongoing in states such as Virginia[58] and Minnesota.[59] And faith-based coalitions are gaining power in states such as Alabama[60] and Kentucky.

Indeed, the Kentucky Baptist Fellowship[61] is asking the CFPB to issue strong regulations to protect borrowers. It is also collaborating with interfaith partners[62] such as the Kentucky Council of Churches and the Jewish Community Federation to urge this state legislature session to cap interest rates at 36 percent. This rate cap would extend to all Americans the same regulation that protects military service members and their families from the harm of high-cost loans.[63]

The 2014 experience of Louisiana demonstrates faith-based activity across a wide range of partners, including the Jesuit Social Research Institute at Loyola University and the Louisiana Missionary Baptist State Convention, as well as other advocates such as AARP Louisiana, Habitat for Humanity, and the United Way of Southeast Louisiana.[64] These efforts are particularly poignant given the scope of the payday lending industry in the state, where there are far more lenders than McDonalds restaurants.[65] The Jesuit Social Research Institute noted in its Spring 2014 newsletter that a 36 percent annual interest rate cap "would be true to ourselves and the common good of Louisiana."[66]

Although advocates pushed the legislature to cap interest rates, lawmakers failed to do so. They also failed to pass another, watered-down provision that would have limited borrowers from taking out 10 or more loans per year. The payday lending industry opposed both of these measures as well.[67] Yet pastors implored legislators to recall Bible passages that speak out against excessive interest.[68] Together Louisiana, a coalition of faith-based and civic organizations, asked the Louisiana Legislative Black Caucus to no longer accept campaign donations from payday lenders.[69] They also pressed the CFPB to propose strong payday lending regulations when it held a field hearing in New Orleans last year.[70]

A number of Louisiana newspapers also published editorials urging reform, including the *Shreveport Times*, which called payday lending in Louisiana the "wild, wild west," and the *Daily Star* of Hammond, Louisiana, which noted that "very few industries start out with a built-in predatory advantage where the client base is often filled with people of less economic means and wherewithal."[71] The Advertiser of Baton Rouge argued that "that kind of [300 percent to 700 percent] interest rate shouldn't be legal in the United States," noting that these practices "run counter to the common good" based on Catholic social teaching.[72]

Beyond advocating for capping interest rates and regulations that would require lenders to consider a borrower's ability to repay, faith-based organizers at PICO National Network[73] federations are organizing campaigns to eliminate barriers to personal banking and reduce the number of banks associated with payday lenders. In Brockton, Massachusetts, for example, members of Brockton Interfaith Community[74] helped convince the Brockton treasurer to move the city's payroll account—approximately $170 million—to a regional bank, Eastern Bank, and out of a national bank that advocates felt was not sufficiently responsive to city residents facing foreclosure.[75]

Finally, faith communities are working to create and support alternative loan programs that meet the needs of vulnerable borrowers. In Minneapolis, for example, a Lutheran church located near a payday lender recently launched Exodus Lending, a nonprofit that refinances payday loan debts plaguing community members.[76] Faith-based credit unions in California,[77] Ohio,[78] and Florida[79] also offer financial services to keep interest rates and repayment periods reasonable. This limits the burden on already financially stressed borrowers. In New Mexico, meanwhile, faith leaders encourage cash-strapped congregants to get financial assistance from Catholic groups such as Society of St. Vincent de Paul and Catholic Charities USA.[80] Furthermore, the North Jersey Federal Credit Union;[81] Ameen Housing Co-operative[82] in Santa Clara, California; and the African Development Center[83] in Minneapolis, are serving Muslims by providing Sharia-compliant banking options. Among other things, these options limit interest and do not invest in Islam-prohibited products, such as alcohol or pork.[84]

Recommendations to address the harms of predatory lending

If policymakers were to take the following steps, they would help reduce the serious consequences of high-cost lending for families and communities:

1. **The Consumer Financial Protection Bureau should propose a strong payday lending rule to eliminate the worst practices of payday lenders.** The rule's provisions should include requiring lenders to determine the borrower's ability to repay the loan based on documented income and expenses; implementing installment payments over an extended period of time, rather than a single payment due at the time of next paycheck; requiring "cooling-off" periods in which additional credit is unavailable to

already overextended borrowers; and limiting continued access to a consumer's bank account. This will help ensure that borrowers are not permanently trapped in debt. The rule should also provide additional transparency regarding fees and costs and limit the use of highly punitive enforcement practices.

2. **Congress and the states should pass legislation that caps annual interest rates at or less than 36 percent—inclusive of all fees—in order to rein in high-cost lending.** As noted above, these interest rate caps have existed in some states for decades, and they are the law for military borrowers. Establishing across-the-board affordable rate caps will create a competitive lending environment by taking the worst products for borrowers off the market and making the sector more attractive to lower-fee lenders, as well as mainstream banks and credit unions subject to rate caps set by regulators.

3. **Financial institutions should be encouraged to offer affordable alternatives to predatory loans that help families in financial trouble, with support from the faith community.** Responsible lending by banks, credit unions, mission-driven lenders, and others can be a viable alternative to payday loans for many consumers.[85] Indeed, tighter regulation in this marketplace should be coupled with support for alternatives, including those offered by or in collaboration with faith-based institutions.

In order for these initiatives to thrive, mainstream financial institutions need to step in—possibly through enhanced incentives under the Community Reinvestment Act, which would help scale up these ventures and increase their capacities. Additionally, the Community Development Financial Institutions Fund at the U.S. Treasury Department should examine ways to better incorporate small-loan alternatives through the community development banks and credit unions it supports, as well as through relationships with churches, synagogues, and faith-based advocates. At the same time, faith groups should encourage migration to responsible lenders—just as they have successfully led divestment campaigns against other financial actors that failed to appropriately serve their communities.

Conclusion

As regulators and policymakers consider how to respond to the proliferation of high-cost, short-term predatory loans that trap struggling families in a cycle of debt, they should look not only to concerned consumer advocates but also to faith groups advocating for fair lending practices, organizing for increased consumer protection, and encouraging responsible alternatives to predatory products. These efforts reflect faith groups' commitment to our nation's communities, as well as their mission to serve.

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