THE CHURCH OF ENGLAND
Ethical Investment Advisory Group

Church of England Ethical Investment Advisory Group

High interest rate lending investments policy

November 2011

The EIAG recommends that the national investing bodies should exclude from their investments:

- Any company, whose main business activity or focus (defined as exceeding 10% of Group turnover) is the provision of home-collected credit ('doorstep lending'), unsecured short-term loans ('payday loans') or pawnbroker loans, directly or through owned-subsidiaries.

The EIAG's intent is that, under this policy, investment should be avoided in specialist consumer finance businesses that may exploit, or over-burden with debt, lower income borrowers.

Typical indicators of potentially exploitative lending will be triple-digit, or close to triple-digit, Annual Percentage Rates (APRs); short loan term durations (less than 18 months); and no requirement for security. The products may have associated charges and loan rollover facilities that will compound the debt burden. Lenders may provide funds without undertaking credit checks (or sufficient checks) on the borrower. In extreme cases where companies do not operate responsible collection practices there may be undue pressure on the borrower associated with repayment.

The EIAG will be advised by its ethical screening service provider on companies for exclusion from investment under this policy but will make bespoke recommendations to the national investing bodies where appropriate.

Church House, Great Smith Street, London SW1P 3AZ
Chairman: James Featherby. Secretary: Edward Mason
Email: eiag@churchofengland.org
Website: http://www.churchofengland.org/about-us/structure/eiag

POLICY THEOLOGY, ETHICS AND REASONING

Introduction

1. The EIAG advised the national investing bodies in 2001 not to invest in companies whose main business was weekly collected home credit ('doorstep lending') out of concern that weekly collected home credit lending was incompatible with the Church's mission to provide pastoral care in areas of need and poverty, and because the service came at a substantial cost to the user.

2. The investing bodies now have a global investment focus and this policy builds on the established approach to UK weekly collected home credit to establish a global high interest rate lending policy.

Biblical guidance

3. The ecumenical Church Investors Group for Christian churches in the British Isles (CIG) published a detailed report on usury in 2007 which is a helpful biblical and theological reference[1].

4. The Old Testament is clear that money should not be lent with interest to fellow Israelites. Deuteronomy 23:19-20 states 'You shall not charge interest on loans to another Israelite, interest on money, interest on provisions, interest on anything that is lent. On loans to a foreigner you may charge interest, but on loans to another Israelite you may not charge interest, so that the Lord your God may bless you in all your undertakings in the land that you are about to enter and possess.'

5. Particular concern is expressed that money should not be loaned with interest to the poor and that those who have fallen upon hard times should be treated supportively and with compassion.

Exodus 22:25: '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'.

Leviticus 25:35-37: 'If any of your kin fall into difficulty and become dependent on you, you shall support them; they shall live with you as though resident aliens. Do not take interest in advance or otherwise make a profit from them, but fear your God; let them live with you. You shall not lend them your money at interest taken in advance, or provide them food at a profit.'

6. The New Testament lacks similarly specific injunctions about lending with interest, but Jesus consistently shows sympathetic understanding of debt-induced hardship. In particular, when Jesus proclaimed God's willingness to forgive sins, he used the analogy of the burden of debt being lifted. Jesus called for generosity in all his teaching, and on lending urged his disciples to 'lend, without expecting anything in

1 http://www.churchinvestorsgroup.org.uk/documents/usury-investment-and-sub-prime-sector

return' (Luke 6:34–35).

7. The New Testament offers other guidance as to why the business of lending money should be entered into cautiously. Jesus makes clear that money is not like other commodities or parts of the created order. Because it has the quality of a promise, it is a rival promise to God's.

Matthew 6:24: 'No one can serve two masters; for a slave will either hate the one and love the other, or be devoted to the one and despise the other. You cannot serve God and wealth.'

The theology and approach of the pre-modern Christian Church

8. Early Christians did not see the Old Testament distinction between lending to Jews and non-Jews as relevant to Christians. Thomas Aquinas, for example, argued that Christians should treat *everyone* as their brothers and neighbours and should not lend with interest to anyone. Church Councils from Nicea (325) to Vienna (1311) condemned the lending of money with interest. The third Lateran Council (1179) denied those who lent with interest – usurers – the sacrament or Christian burial. For centuries from late medieval to early modern times many European Christian states maintained bans on lending with interest.

9. Generally held opinion only began to change in the light of the development of business in the early modern period. Theologians like John Calvin argued that the injunctions of the Old Testament were specific to their time and place and that, in sixteenth century Geneva, loans at modest rates between parties who had good business reasons to lend and borrow were acceptable and conducive to the common good. Calvin remained very clear, however, that no one should take interest from the poor.

Judaism and Islam

10. Judaism came to a similar position as Calvin much earlier. The Torah has long been understood as an injunction against making loans with interest to fellow Jews in need, not an injunction against making commercial loans. In Judaism it is a religious obligation – not an act of charity – to advance money to the needy without charging interest.

11. Islam takes a different view and regards all lending at interest as unacceptable. Islamic finance works on the basis that money should be advanced in relationships of partnerships, not of lender and borrower.

Contemporary theology

12. The refinement of Christian thinking in modern times reflects the way economic life has changed since biblical times. The scriptures were written in a static agrarian economy. The overwhelming majority of people were poor. If people needed to borrow money it was because they were in desperate need, say if crops failed. Without

being advanced money or support in kind they would starve. Charging interest in these circumstances was clearly wrong.

13. We now live in a different economic system in which there is economic growth. A world of economic growth is not a zero-sum game. Unlike in biblical times a person can grow richer without making someone else poorer and lending and borrowing contribute to wealth creation. Through borrowing – 'leverage' – businesses can serve more customers at lower prices, generating more profit and creating economic growth. For many the parable of the talents gives insight into the appropriateness of Christians putting wealth to work, not sitting on it.

14. Similarly consumer credit, like the provision of capital to business, can play a positive role in the economy. It puts homes, cars, degrees and so on within the reach of those who would not otherwise have the capital to pay for them. It can enable people to buy goods when they need them rather than having to remain in need while they save up. This too can help to create economic growth in difficult times, for example in the wake of the Second World War. Responsible lending can serve the common good.

15. That lending should be responsible is the key. There is theological concern about the massive role that credit and indebtedness plays in the modern economy, which, as we have seen with the financial crisis and recession which followed, easily gets out of hand in an unbridled capitalist economy. The power of the lender over the borrower must be exercised with great care.

16. In contemporary theology, therefore, usury is typically understood as lending in which the poor are treated inappropriately and unjustly, and are exploited. Concern focuses on lending at high rates of interest, where asymmetric power is abused, to the detriment of the individual and often the community.

<u>The Church of England today</u>

17. There remains in the Church of England widespread concern about the harm indebtedness causes to individuals and families. The notion that debt can enslave the vulnerable, just as it could in biblical times, is widely held. Ethical concerns about the irresponsible expansion of credit and the use of credit to lubricate the economy unsustainably were expressed at the General Synod debate on the financial crisis in February 2009. Strong concern was expressed during this debate about the making of loans to borrowers who could not pay them back.

18. Many members of the Church of England would subscribe to the view that credit provision to the poor requires such sensitivity that for-profit provision is inappropriate. Anglicans actively contribute to ecumenical and secular debt advice charities (see, for instance, Christians Against Poverty and Community Money Advice) and campaign groups (for example, Church Action on Poverty). They also widely support credit unions and micro-finance institutions as alternatives.

19. A range of other views are also held. Some members of the Church are uneasy

about any lending of money at interest; others accept that short-term high-interest 'sub-prime' lending, including weekly collected home credit, meets a need. There is not a single Christian or Anglican view and the position adopted by the EIAG should not be taken to imply that other theological or ethical interpretations are not legitimate.

Home collected credit ('doorstep lending')

20. Home collected credit is a form of lending distributed by local agents. Agents market the service, take loan applications and collect repayments. They are paid in commission either on repayments collected (which is considered best practice) or on the number of loan originations. Loan amounts are small, typically £100-£500, and are paid in cash. The loans are unsecured and are normally repaid, again in cash, over a period of about a year. Due to the high costs of weekly home collections on short-term loans, interest rates expressed in APR terms, at the time of writing, typically exceed 250%.

21. Home collected credit is predominantly a UK phenomenon, although the service is now also offered in other markets, predominantly in Central Europe.

Unsecured short-term loans ('payday loans')

22. Providers of unsecured short-term loans advance money that is typically repaid on the customer's next payday with a post-dated cheque or authorisation to make an automatic withdrawal from the customer's bank account. The practice is mainly associated with the US but is growing in the UK, including as a solely internet-based service without a formal payday link. Charges in the UK range from £13-30 interest for every £100 borrowed which can generate APRs in the region of 1000% or 2000% due to the very short period of the loans. Charges and costs escalate if borrowers defer payments or take out repeat loans.

Pawnbroking

23. Pawnbroking differs from home collected credit and unsecured short-term lending in that loans are secured against personal property deposited by the borrower as collateral, but the cost of the short-term credit offered is similar. Monthly interest payments levied by UK pawnbrokers range from five per cent to 12%, with a loan of £100 over six months attracting an APR of 70% to 200%. Between 2003 and 2010, the number of pawnshops in the UK increased from 500 to 1,300, holding a loan book of around £192m. The majority of customers seek loans of less than £100.

Regulation

24. Approaches to regulating high interest rate lending differ from market to market. At the time of writing, interest rate caps below 100% APR (or equivalent) are enforced, for example, in 11 states of the USA, four states and territories of Australia, and Japan.

25. In the UK many forms of high interest rate lending remain unregulated. However, debates surrounding the appropriateness of interest rate caps are ongoing in

Parliament.

Policy reasoning

26. The EIAG acknowledges that home collected credit, unsecured short-term lending and pawnbroking can provide access to credit to people who are excluded from mainstream financial services. It acknowledges that the APRs associated with these forms of lending are affected by the short duration of the loans and the costs of making, and collecting repayment of, small advances. Finally it notes that customer satisfaction rates are often high.

27. However, the EIAG's view is that investment in weekly collected home credit, unsecured short-term lending and pawnbroking is inconsistent with biblical guidance, contemporary theology, and the practice and values of the Church on high interest rate lending and lending to poorer members of society.

28. Key concerns are:

- The burden of interest. In the case of weekly collected home credit loans, a customer in the UK taking out a typical loan for £300, and paying it back over 52 weeks, will incur a total cost of £546 – i.e. an interest charge of £246. Customers in the UK typically take out two loans a year. A recent report on UK payday lending[2] estimated that payday loan borrowers were taking out an average of 3.5 loans a year. A recent report on UK pawnbroking[3] stated that 42% of surveyed customers surveyed had renewed their most recent loan; and that 15% of those who had renewed has done so three to five times. 32% of surveyed customers had used home credit and/or payday lending as well as pawnbroking in the last 12 months. These recurring high interest charges represent a very heavy burden of interest for the poorer members of society.

- Exploitation of the desperate and the less financially literate. Research in the UK has documented that some high interest lending customers are using the money they borrow to pay off other debts or to meet day-to-day living expenses. The recent University of Bristol report on pawnbroking (referenced previously in footnote 3) found that 78% of surveyed customers had used their most recent loan to pay for day-to-day living expenses, such as food and groceries, or to pay household bills. 53% lived in households with no one in work. Default rates for high interest lending are high – at the time of writing typically around 30% for UK weekly collected home credit – indicating that inappropriate loans are being made and that many loan recipients lack the financial literacy to determine whether their borrowing is appropriate. It is hard to imagine customers who are not desperate for money, or lacking financial literacy, taking loans with the level of interest payments associated with home collected credit, unsecured short-term lending and pawnbroking.

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[2] 'Keeping the plates spinning', Consumer Focus, August 2010

[3] http://www.bristol.ac.uk/geography/research/pfrc/themes/credit-debt/pfrc1005.pdf

- Harm to communities. The leading UK weekly collected home credit provider has nearly two million customers in 1 in 20 UK households. Research carried out in Leeds in 2004 found that for all the regional development money put in to the City's most deprived communities to address poverty, more was being taken out of the same communities by home collected credit lending.

29. It is sometimes said that legal high interest lending is at least better than leaving people at the mercy of illegal loan sharks. This can certainly be the case, but the fact that regulated high interest lending businesses are 'the lesser of two evils' does not mean that the businesses are appropriate investments or sources profit for Church investing bodies.

30. In short, home collected credit, unsecured short-term lending and pawnbroker loans, advanced on a for-profit basis, will rarely be financial transactions from which lender and borrower benefit mutually. It is this which has been the post-reformation standard for judging fair lending of money with interest.

Possible corporate responsibility improvements

31. Proponents of home collected credit point out that the finance is expensive because seeing customers at home every week takes a lot of staff resource – a 2005 report commissioned by the Joseph Rowntree Foundation (JRF) estimated that providing home credit on a not-for-profit basis would require an interest rate of 123% even with a public subsidy to cover the cost of funding.

32. The EIAG contends that costs could be reduced by adjusting the business model. Giving customers the option to visit the lender would greatly reduce costs as would allowing re-payment by direct debit where the borrower has a bank account (which is in many instances the case). The EIAG notes that the UK's leading weekly collected home credit provider has begun to offer loans at lower interest rates that can be accessed directly without going through doorstep agents, and are repaid by direct debit. The EIAG very much welcomes this and encourages the further development of new business models for 'sub-prime' lending that reduce the cost of credit.

33. High interest lenders could also seek to develop saving, as well as borrowing, products. The ready availability of high interest short-term lending can make borrowing and buying a way of life, draining hundreds of much needed pounds out of family finances. How much better to support saving – budgeting and buying – as well. This is the route to economic freedom.

34. There are other corporate responsibility measures that providers of small-scale, short-term 'sub-prime' lending ought to take:

- In-depth assessment of the borrower's financial circumstances and ability to repay
- Provision of 'wealth warnings' to indicate the financial impact of high

interest charges
- Support for the graduation of customers into mainstream financial services e.g. by sharing information with credit reference agencies
- Establishment of policies to prevent customers getting into difficulty through the rolling over of loans
- Support for financial education, debt counselling and community programmes
- Commissioning, supporting and acting on research into how customers use their services.

35. Some providers of short-term 'sub-prime' lending who have strong corporate responsibility policies are already taking some of these measures, and again the EIAG welcomes and encourages this.

36. The EIAG noted the findings of the June 2010 Office of Fair Trading Review of High-Cost Credit and the 2005 JRF report, both of which called for increased competition. Increased competition ought to help to drive interest rates down.

37. Stronger regulation may also be required. The EIAG noted that while there is a legal onus on the sellers of investment products to undertake a 'test of appropriateness' of the product for the customer, there is no such requirement for providers of unsecured credit.

More appropriate vehicles for short-term 'sub-prime' lending

38. Although improvements in corporate responsibility practices would reduce the level of ethical concern about for-profit, short-term 'sub-prime' lending, it is unlikely that the sector would be able to offer a better deal to poorer borrowers than credit unions, community development finance institutions, micro-finance institutions and mainstream basic banking.

39. Credit unions, community development finance institutions and micro-finance institutions are typically able to offer loans at APRs below 50%, often well below, in a supportive context in which borrowers' financial needs are fully assessed, financial education is part of the service, saving is encouraged as well as borrowing, business models are kept as cheap as possible, and borrowing is used as far as possible to improve customers' long-term financial circumstances.

40. An interesting and encouraging development in the for-profit marketplace in recent years has been the development of peer-to-peer, internet-based services to match lenders and borrowers together at mutually agreeable interest rates typically below the personal loan rate of mainstream banks. However, the credit-checking process associated with such services is likely to exclude 'sub-prime' borrowers.

41. The EIAG strongly supports and encourages continued support from Church members for credit unions, community development finance institutions and micro-

finance, and continued pressure for the widening of access by mainstream banks to basic banking (in which regard much has already been achieved).

Engagement

42. For its part, the EIAG will continue to engage with mainstream financial institutions in which the national investing bodies hold shares on issues relating to responsible personal banking such as: the provision of basic banking; support for credit unions, community development finance institutions and micro-finance; responsible credit card and overdraft lending; and the avoidance of mis-selling of financial products.

43. The EIAG will also maintain occasional dialogue with major specialist providers of short-term ‘sub-prime’ lending whose exclusion from investment is recommended under this policy in order to continue to encourage ethical practice and to keep up to date our assessment of the ethics of investment in the sector and the businesses concerned.

<u>Policy conclusion</u>

44. The EIAG's recommendation is that specialist providers of home-collected credit, unsecured short-term loans ('payday loans') and pawnbroker loans should be excluded from investment. Characteristics of inappropriate high interest lending are set out in order to provide further guidance for the EIAG’s ethical screening service provider and for EIAG decisions, but a company will not have to display all of these characteristics to be inappropriate for investment. Bespoke recommendations may be made by the EIAG to the national investing bodies whenever appropriate.

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