American Financial Services Association

TRADITIONAL INSTALLMENT v. PAYDAY LOANS

Traditional Installment Loans (TILs) are radically different from payday loans in the way they are structured, priced, and regulated. These differences are what make TILs a smarter option for borrowers, offering them better rates and significantly higher levels of safety and affordability.

Payday loans are repaid in single balloon payment at the end of the loan period. Because this payment is usually due in less than 30 days (frequently the term is as short as 14 days), this single lump-sum payment can lead to significant problems for the borrower. In contrast, TILs are fully amortized and repaid in manageable monthly installments made up of both principal and interest.

Traditional installment lenders assess a borrower's ability to repay a loan by calculating a monthly net-income/expense budget to ensure that proposed installment payments can be met through the borrower's monthly cash flow. Payday lenders do not assess this ability to repay, relying instead on a postdated check or on similar access to a borrower's bank account as their assurance that the loan will be repaid.

If a borrower cannot afford to repay a payday loan in full when it comes due, they are left with no option but to refinance that loan. This results in what observers call the "cycle of debt," in which the entire balance of an initial loan is refinanced multiple times, to the borrower's detriment. TILs avoid a cycle of debt by scheduling regular, manageable payments of principal and interest, giving the borrower a clear roadmap out of debt.

TILs have long operated within a legal framework; lenders are licensed and TILs are thoroughly regulated by state and federal consumer protection agencies**.** Regulation of payday loans has a shorter history and is less robust, varying widely from state to state and being completely absent where current laws force consumers to use Internet and unregulated offshore or underground loans.

Traditional installment lenders report to credit bureaus, allowing borrowers to establish new creditworthiness or rehabilitate damaged credit. This in turn allows borrowers access to more credit options, often at even lower interest rates. Credit bureaus do not accept data from payday loan companies, so the successful repayment of a payday loan brings no benefits to a borrower's credit score.

TILs are often a less expensive form of credit than payday loans, which, even if the borrower avoids the cycle of debt, can end up more expensive than originally envisaged:

- Payday loans are less affordable than TILs in real dollar terms and typically carry APRs that are three to ten times higher than those of TILs.

- The fact that TILs are fully amortized allows the borrower to save by paying off the loan early. This benefit is not available to borrowers of payday loans.

- TILs differ from payday loans in that they refund unearned charges in the event that a loan is repaid early. Payday loans do not.

- Payday loans have a significant punitive effect on defaulters through a bank's NSF fees, which are in addition to the default fees imposed by the payday lender. In contrast, TIL lenders work with borrowers who are late with payments and often work out terms to see the loan to completion. TIL lenders never invoke the criminal process to collect a loan.