BANK OF SIERRA LEONE

Financial Literacy

Core Messaging: Module 4, Edition 1

Loans

Developed by the Financial Education, Financial Literacy and Consumer Protection Technical Working Group, under the implementation of the National Strategy for Financial Inclusion (2022 – 2026).

ABOUT THIS MODULE

Like anything in life, having a loan has its own advantages and disadvantages. This module is not meant to discourage individuals from getting a loan but to make sure you are aware of the responsibilities and risks that come with a loan.

Many people think that a loan will solve their financial problems. But if you do not understand the risks, having a loan can be more harmful than helpful.

In this module, you will learn about loans, helpful tips about loans, and the risks related to taking a loan.

WHAT IS A LOAN?

A loan is an amount of money that you borrow from someone or a financial institution that you will have to pay back. The loan will also have some interest that you will need to pay. Sometimes, you may have to pay additional fees for getting a loan such as processing fees.

Here is a summary of the advantages and disadvantages of taking a loan.

ADVANTAGES / BENEFITS

- Loans can provide fast access to cash to help pay for expenses in times of need (e.g., education, housing, medical expenses)
- They can be flexible and be used for almost anything
- Repayments can be made over time to give flexibility
- Helps grow the economy by supporting the financial sector
- Loans can be used to expand businesses and other productive uses which will also help economic growth and job creation

DISADVANTAGES / RISKS

- There can be high interest rate charges – over time you can end up paying more money in interest than your initial loan amount
- Loans can come with additional fees and penalties for late repayments
- If you do not repay your loan on time, it can impact your future ability to get loans
- It can result in unnecessary debt, especially if you cannot repay your loan it can lead to more challenges

WHAT ARE THE COMPONENTS OF A LOAN?

Applying for a loan:
- Application
- Collateral
- Guarantor

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The loan itself:
- Principal
- Interest
- Duration

Repayment

Understanding the application process:

- Application
  - First, you must fill out an application form with some personal details (e.g., name, gender, age, address, income, etc.).
  - You will be asked how much money you want, why you want the loan, and how you will spend the money.
  - For a business loan, you may be asked to give a business plan.

- Collateral
  - It is common to ask the borrower of a loan for collateral. This will depend on the size and type of the loan, and lender (one giving the money).
  - Collateral is an asset (or something of value) that the lender will accept as a security for providing the loan.
  - If you do not repay your loan, the lender can take the collateral.
  - The Bank of Sierra Leone has made it easier to provide and register different types of assets as collateral (e.g., land, house, car, kekeh, fridge, future sales, etc.) with its Collateral Registry.

- Guarantor
  - Some loans will require a guarantor – especially if no collateral is required.
  - A guarantor is someone who promises to repay the loan if you (the borrower) are unable or do not repay your loan obligation

Once you complete your application and provide the necessary information, the financial service provider will do a review of the risk and process the loan.

The loan will have three components:

- Principal
  - The principal amount is the original amount that is borrowed.
    - *If you applied for a loan of Le1,500 but the lender only approved and gave a loan of Le1,000 – the principal amount is equal to Le1,000.*
  - Principal can also be referred to as the outstanding balance which is the amount remaining that needs to be paid back.
    - *If you received a loan of Le1,000, and you have paid back Le800, the outstanding balance is now Le200.*

- Interest
  - When you take a loan, you will have to repay the original loan amount (principal) plus an additional cost called "interest".
  - Interest is the "price" you pay for borrowing money. This is normally expressed as a percentage (%) of your loan amount.
  - The percentage that is given is call your interest rate. This can be calculated on a yearly or monthly basis.
    - *If you have a loan of Le1,000, and an interest rate of 10% per year, you will have to pay an extra Le100 per year. This Le100 is your interest amount.*

- Duration
  - Every loan has a duration. This is how long you will have until you must repay your loan (or how long the loan lasts).
  - You can have a short-term loan (6 months), medium-term loan (1-2 years) or a very long-term loan (25-30 years).
    - *If you have a 1-year loan duration on your Le1,000 loan, you will have to pay both the principal and interest by the end of the year.*

When your loan is approved, you will receive a contract.

The loan contract will give details on all the different elements of the loan, and any other requirements or obligations you may have. This can include additional fees. **Make sure you read your contract carefully before signing or accepting the loan.**

Your loan has been approved and you have started to use the funds. The time has come to start making your repayments.

Repaying your loan:

- Repayment Schedule
  - Your loan contract should include a repayment schedule.
  - <u>A loan repayment schedule is a timeline for when the lender wants you to make repayments on the loan.</u>
  - Every loan will have a different repayment schedule based on the principal amount, interest rate, and duration of the loan.
  - Some schedules have equal monthly payments.
    - *The same amount of money paid every month (some of it will be the principal and some will be interest amount).*
  - Some schedules will have a flat interest rate, and some will have a declining interest rate:
    - *Flat interest rate – pay the interest on the original principal amount*
    - *Declining interest rate – pay interest on only the*

SAMPLE REPAYMENT SCHEDULE **(flat interest rate)**

You received a Le1,000 loan, with a 10% interest rate for 12 months. You are asked to pay every month.

(a) Le1,000 (principal) × 10% interest = Le100 (total interest)
(b) Le1,000 + Le100 = Le1,100 (total repayment)
(c) Le1,100 ÷ 12 months = Le91.67 (monthly repayments)

WHERE CAN I GO TO GET A LOAN?

There are both informal and formal channels to get a loan.

Informal channels

- These include family and friends, money lenders, and village savings and loan groups.
- These methods might be easier, but they are often very unsafe, unprotected and unregulated.
- Informal money lenders can charge very high interest rates.
- The BSL does not recommend that you take a loan from informal channels.

Formal channels

- These include regulated microfinance institutions, community banks, financial service associations and commercial banks.
- These institutions are regulated by the Bank of Sierra Leone. This means they must have a license to operate and must follow all laws and regulations.
- Customers can issue formal complaints against these channels and are protected by consumer protection guidelines.
- The financial institutions are also protected in scenarios where borrowers do not repay. These regulations also ensure financial institutions operate in a safe and professional manner.
- In the event of a collapse, the BSL will come to their rescue, so customers' funds will not be lost.

Why should I be careful when I take a loan? What are some of the risks that I should be aware of?

- It is easy to get into debt, but hard to get out. If you take a loan, be careful how you use it and make sure you have a plan to repay. It is easy to have multiple loans at the time, and then become unable to make repayments for all the loans.
- The "cost of the loan" might be more than just interest. Be aware of any additional fees charged on top of the interest. Some loans have a one-time fee for processing loans, and late payment fees. If you are unable to pay the loan, you will have to give your collateral, or your guarantor will be at risk of repaying your loan.

SOME TIPS / BEST PRACTICES

- **Plan before you take a loan.**
  Before you take a loan, make sure you have a plan on how you will use the loan and how you will repay it. You have a responsibility to pay all aspects of the loan. If you think you will not be able to repay the loan, do not take the loan. Find other ways to get the money before you take a loan.

- **Shop around.**
  When you take a loan, compare different financial institutions and their rates. Some institutions will have lower interest rates or lower processing fees. Learn from other people's experience. Ask questions on the terms and conditions – it is their responsibility to share the information but your decision to make.

- **Use your loan wisely.**
  Use the loan to make more money – try to buy assets and investments that will help generate more income for you (e.g., equipment, land, seeds, etc.). Do not use your loan to pay off other borrowed money. This will become a cycle and you will be in a worse situation.

- **Know your rights and responsibilities.**
  As a customer of a loan or any financial product/service, you have rights and responsibilities. It is your responsibility to repay all your obligations (e.g., principal, interest, fees, etc.) but it is your right to ask questions and refuse to take the loan in the beginning. There are also certain rights on how the lender can collect money. It is best to review Bank of Sierra Leone's *Financial Consumer Protection Guidelines* to understand all your rights and responsibilities.

- **It is good to take a loan, better to use it well, and best to repay it.**

Now that you have all the information, before getting a loan, ask yourself – is a loan right for me?

A loan might be right for you if:

- [ ] You have a good track record of paying back previous loans
- [ ] You have room in your budget for a new monthly expenses (interest)
- [ ] You have a consistent income source to pay your monthly payments
- [ ] The loan you get will be used for something that will add value
- [ ] You have enough collateral or assets
- [ ] You do not have other loans and do not have to make multiple payments
- [ ] You have a good plan on how you will use the loan and how you will repay it

Bank of Sierra Leone (BSL)'s *Financial Literacy Core Messaging* is an initiative under the National Strategy for Financial Inclusion (2022 – 2026). Topics and messaging presented have been developed in consultation with the Financial Education, Financial Literacy and Consumer Protection Technical Working Group. The Working Group consists of a variety of stakeholders and partners from different sectors. The Financial Inclusion Secretariat is grateful for the knowledge, input and support of the Working Group in the development of these core messages.

Disclaimer:
BSL's *Financial Literacy Core Messaging* only provides the foundation for key topics. It is expected that consumers and businesses continue to seek out other resources to further develop their financial literacy skills. It is the responsibility of the Bank of Sierra Leone to provide accurate and unbiased information in alignment with existing legal frameworks. While the BSL does not guarantee that the core messaging will result in greater levels of income or prosperity, guidance from the core messaging will allow individuals and businesses to better manage their finances.

For inquiries, comments and/or suggestions on the *Financial Literacy Core Messaging*, please email: fkamara@bsl.gov.sl

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