

# Standardized Loan Documentation in Bosnia and Herzegovina

The Bosnian microfinance industry is governed by one of the most progressive interest rate disclosure policies in existence internationally. This policy specifies calculation and disclosure requirements for effective interest rates on loans and requires that microfinance institutions (MFIs)<sup>1</sup> deliver clear, communicative repayment schedules to their clients. The objective of this case study is to provide an overview of these regulations and their effectiveness in impacting MFI practices, with the broader view to their potential value in other microfinance markets internationally.

## Regulatory Overview

In December 2006 and March 2007, the governments of the Federation of Bosnia and Herzegovina and Republic of Srpska, respectively<sup>2</sup>, instated disclosure policies specifying several new disclosure definitions and requirements for MFIs in the market, including:

- A definition and methodology for calculating the Effective Interest Rate (EIR) of a loan, including fees, compounding interest and deposit requirements
- A standard format for communicating EIRs to clients, specifying the number of decimals (two), way of stating the term (“effective interest rate”) and abbreviation of the term (“EIR”)
- A requirement that the EIR be communicated to clients through the loan contract, repayment schedule and displayed in the offices of the MFI
- A requirement that the EIR be communicated and explained to clients before they sign the loan contract
- A requirement that MFIs must also report weighted nominal and effective interest rates to the regulator on a monthly basis

This price disclosure policy is innovative in several ways. The inclusion of a definition and calculation methodology for EIR in the same regulation as disclosure requirements helps make communication of prices to clients equally important as the calculation and reporting of prices to the regulator.

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<sup>1</sup> In the Bosnian policy MFIs are referred to as microcredit organizations (MCOs).

<sup>2</sup> The Banking Agency of the Federation of Bosnia and the Banking Agency of the Republic Srpska are the entities responsible for their policy formulation in these joint republics, resulting in the existence of two similar, yet separate, laws on transparency: the *Decision on Unified Way of Calculating and Expressing Effective Interest Rate to Loans* (applying to the Republic Srpska) and the *Decree on Uniform Method of Calculation and Disclosure of the Effective Interest Rate on Loan and Deposits* (applying to the Federation of Bosnia and Herzegovina). While both laws stipulate essentially the same disclosure requirements, the law in the Federation is applicable to both banks and MFIs whereas the law in the Republic of Srpska applies only to MFIs.

*Required contents of a repayment schedule*

The emphasis in this policy on *disclosure through documentation* also sets it apart from others. To begin with, the policy outlines the required format for repayment schedules and includes a template that institutions should use. A repayment schedule shows how much money the borrower of a loan will have to pay back over time and during each period. It also displays what portion of each installment is attributed to the repayment of principle versus interest. This policy also specifies the minimum information required of repayment schedules provided to borrowers in Bosnia as including three types of interest rates: the nominal interest rate (and indication of whether it is fixed or variable), the Annual Percentage Rate (APR) and the EIR.<sup>3</sup>

The following images show the regulators’ repayment schedule template and an example of this template with sample information filled in:

**Repayment Schedule Format**

<div style="display: flex; justify-content: space-between;"> <div style="width: 45%;"> <p>_____ (Bank) / MCO</p> <p>_____ (Street)</p> <p>_____ (City)</p> <p>Tel: _____</p> <p>Fax: _____</p> </div> <div style="width: 50%; text-align: center;"> <p><b>REPAYMENT SCHEDULE</b></p> <p>Currency _____      Installment _____ KM</p> <p>Loan Amount _____      Nominal Interest Rate _____ %      <u>Fixed</u> / Variable</p> <p>Annual Percentage Rate in % (APR) _____      Effective Interest Rate in % (EIR) _____</p> </div> </div>														
Period	Date and Maturity	Loan Disbursement	Other Payments	Annuity	Principal Payment	Interest Payment	Other Payments by client	Loan Balance	Deposit (Collateral)	Note (Description)	Net Cash Flow	Discounted Net Cash Flow	Discounted Loan Payments	Discounted Deposit
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
0														
1														
2														
3														
4														
5														
<b>Total</b>														

Note: The disclosed APR is valid on the date of the repayment plan. Installment repayment includes the quota, the payment of interest, service charges, credit accounts and transaction fee.

<sup>3</sup> Both the Annual Percentage Rate (APR) and the Effective Interest Rate (EIR) are defined as the interest rate that would make the present value of the loan received by the client equal to the present value of the installments paid by the client. The EIR takes into account the effects of compounding whereas the APR does not.

## Completed Repayment Schedule Example

_____ (Bank)		_____ (Street)		_____ (City)		Tel: _____		Fax: _____		- EXAMPLE -				
Currency	KM	Installment	142.456,39		Annual Percentage Rate (%)	12,88	Effective Interest Rate (%)	13,28						
Loan Amount	1.000.000,00	Nominal Interest Rate (%)	12,00 fixed											
Period	Date and Maturity	Loan Disbursement	Other Payments	Annuity	Payment	Interest Payment	Other Payments by Client	Loan Balance	Deposit (Collateral)	Note (Description)	Net Cash Flow	Discounted Net Cash Flow	Discounted Loan Payments	Discounted Deposit
1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.	14.	15.
0	2002.03.01.						50,00	0,00		Processing credit application fee	50,00	50,00	0,00	0,00
1	2002.04.01.						10.000,00	0,00	100.000,00	Provision for loan approval and payment of cash deposit	10.000,00	9.897,66	0,00	98.976,56
2	2002.05.01.	500.000,00						500.000,00		1st installment	-500.000,00	-489.980,58	489.980,58	0,00
3	2002.07.01.						826,96	500.000,00		Fee for the unwithdrawn amount of the loan	826,96	794,15	0,00	0,00
4	2002.08.01.	250.000,00						750.000,00		2nd installment	-250.000,00	-237.623,90	237.623,90	0,00
5	2002.10.01.						420,32	750.000,00		Fee for the unwithdrawn amount of the loan	420,32	391,50	0,00	0,00
6	2002.12.01.	250.000,00						1.000.000,00		3rd installment	-250.000,00	-228.195,90	228.195,90	0,00
7	2003.01.01.						208,47	1.000.000,00		Fee for the unwithdrawn amount of the loan	208,47	188,34	0,00	0,00
8	2003.05.01.					91.443,55		1.000.000,00		Compound interest	91.443,55	79.388,80	0,00	0,00
9	2003.08.01.			142.456,39	112.456,39	30.000,00		887.543,61		1. War	142.456,39	119.958,03	0,00	0,00
10	2003.11.01.			142.456,39	115.830,08	26.626,31		771.713,53		2. War	142.456,39	116.351,12	0,00	0,00
11	2004.02.01.			142.456,39	119.304,98	23.151,41		652.408,55		3. War	142.456,39	112.855,94	0,00	0,00
12	2004.05.01.			142.456,39	122.884,13	19.572,26		529.524,42		4. War	142.456,39	109.544,18	0,00	0,00
13	2004.08.01.			142.456,39	126.570,66	15.885,73		402.953,77		5. War	142.456,39	106.259,26	0,00	0,00
14	2004.11.01.			142.456,39	130.367,78	12.088,61		272.585,99		6. War	142.456,39	103.072,84	0,00	0,00
15	2005.02.01.			142.456,39	134.278,81	8.177,58		138.307,18		7. War	142.456,39	99.979,07	0,00	0,00
16	2005.05.01.			142.456,39	138.307,17	4.149,22		0,01	-103.114,40	8. War and the payment of cash deposits with interest	142.456,39	97.069,48	0,00	-70.261,93
Total		1.000.000,00	0,00	1.139.651,11	999.999,99	231.094,67	11.505,75		-3.114,40		242.600,40	0,00	955.800,38	28.714,63

Note: The disclosed APR is valid on the date of the repayment plan. Installment repayment includes the quota, the payment of interest, service charges, credit accounts and transaction fee.

SOURCE: Translated from Instruction for Applying Decision on Unified Way of Calculating and Expressing Effective Interest Rate to Loans

Not only has the regulation specified the components of the repayment schedule, but it has provided a standard format for communicating them as well. This greatly enhances the ability of borrowers to compare the products available to them, even if they do not fully understand every figure included on the documentation.

## Market Practice

Every bank and MFI in Bosnia and Herzegovina is required to follow these policies on interest rate disclosure and loan documentation. As part of the data submission process, all 14 of the MFIs participating in the *Transparent Pricing Initiative in Bosnia and Herzegovina* submitted sample repayment schedules to MFTransparency. These 14 MFIs represent approximately 88% of total number of active clients in the country.<sup>4</sup> There are two additional MFIs that report to the MIX<sup>5</sup> but did not submit

<sup>4</sup> In the Federation, it is estimated that the total number of borrowers in 2009 was 375,000 while the estimated total microfinance portfolio was US\$832.1 million (MIX Market). The two companies in the Republic of Srpska, MICROFIN and SINERGIJA, comprise approximately 15 percent and 25 percent of market share in the Republic of Srpska, respectively.

<sup>5</sup> MIX Market. 2009. "Microfinance in Bosnia and Herzegovina" <http://www.mixmarket.org/mfi/country/Bosnia%20and%20Herzegovina>

their data to MFTransparency: ProCredit Bank (a regulated banking institution) and Intesa Sanpaolo Banka.

When comparing the actual repayment schedules submitted to MFTransparency by the MFIs and the form required by the regulator, about half of the institutions strictly follow the prescribed format. This group of MFIs consists mostly of larger institutions with more than 10,000 clients.<sup>6</sup>

Of the MFIs that do not use the regulator's repayment schedule template, the documentation they do use includes some of the same information. However, some of the repayment schedules submitted to MFTransparency are missing one or more of the following components: nominal interest rate, EIR, APR and indication of whether the interest rate is fixed or variable. Although all of these MFIs provide the exact amount in interest and principal that clients are required to pay during each period, the ability of the documentation to explain the loan product to the client would be improved with the addition of the full set of information required by law.

The following is a repayment schedule that Prizma submitted to MFTransparency for a sample loan as part of their data submission. It illustrates the use of the regulator's repayment schedule template used for a real loan and given to a real client.

### PRIZMA'S Repayment Schedule

MKF Prizma Mikro organizacioni dio Mostar				Ime i prezime: [REDACTED]							
(Banka)				JMB: [REDACTED]							
Kardinala Stepinca 19				Broj Kredita: [REDACTED]							
(Ulica)											
Mostar											
(Grad)											
Tel: +387 36 561 151											
Fax: +387 36 3 18 050											
<b>PLAN OTPLATE KREDITA</b>											
Valuta	KM	Otplatna rata	55,00	Godišnja kamatna stopa:	19,81%						
Iznos kredita:	550,00	sa valutnom klauzulom/ bez valutne klauzule	Nominalna kamatna stopa:	0,00%	Efektivna kamatna stopa:	21,72%					
			mjesecna fiksna/promjenjiva								
Period	Datum dospjeca	Ispлата kredita	Druge isplate	Anuitet	Uplata glavnice	Uplata kamate	Druge uplate	Status kredita	Tokovi novcanog depozita (kolateralna)	Napomena Opis	
1	2	3	4	5	6	7	8	9	10	11	
1	25.07.2008	550,00						550,00		Isplata	
0	25.07.2008						50,00			Administrativna provizija	
1	05.09.2008			55,00	55,00	0,00		495,00		1. rata	
2	06.10.2008			55,00	55,00	0,00		440,00		2. rata	
3	06.11.2008			55,00	55,00	0,00		385,00		3. rata	
4	05.12.2008			55,00	55,00	0,00		330,00		4. rata	
5	06.01.2009			55,00	55,00	0,00		275,00		5. rata	
6	06.02.2009			55,00	55,00	0,00		220,00		6. rata	
7	06.03.2009			55,00	55,00	0,00		165,00		7. rata	
8	06.04.2009			55,00	55,00	0,00		110,00		8. rata	
9	06.05.2009			55,00	55,00	0,00		55,00		9. rata	
10	05.06.2009			55,00	55,00	0,00		0,00		10. rata	
Ukupno		550,00	0,00	550,00	550,00	0,00	50,00		0,00		

**Napomena:** Iskazana EKS važeća je na datum izrade otplatnog plana. Otplatna rata uključuje otplatnu kvotu, uplatu kamate, naknadu za servisiranje kreditne partije i transakcijsku naknadu

Source: MFTransparency Data

<sup>6</sup> MFTransparency. "Bosnia Data" <http://mftransparency.org/data/countries/ba/>

## Takeaway Points

The policy framework for pricing disclosure in the microfinance market of Bosnia and Herzegovina provides the industry with numerous mechanisms for facilitating *transparent* pricing:

- The definition and methodology for calculating and communicating EIRs ensures that prices are standardized and accurately calculated.
- The requirements for disclosing this information, outlined in the same regulation, are thorough and clear. Borrowers must receive information on all the charges required of them as well as calculations of their overall cost of borrowing in multiple formats.
- The provision of a template for the repayment schedule greatly increases the likelihood of MFIs meeting these requirements while simultaneously allowing borrowers to compare loan products easily, even if they don't necessarily understand how EIR is calculated. Further, this initial exposure to EIR is an important first step toward improving financial literacy.

The *Transparent Pricing Initiative in Bosnia* revealed that about half of all MFIs in Bosnia use the repayment schedule template provided by the regulator and that these represent the larger institutions in the country, in terms of active borrowers and/or gross outstanding loan portfolio. However, as smaller institutions work at adapting to new requirements their practices may still be positively influenced in incremental steps toward greater disclosure.

MFTransparency believes that this policy for interest rate disclosure is an effective approach that should be considered by microfinance industries internationally. While adapting the specific information disclosed, many microfinance markets could benefit from the requirement of a range of pricing measures to be disclosed in a standardized way. MFTransparency also recommends that governments accompany this type of disclosure policy with training and education for all stakeholder groups. MFI staff should be trained on how to calculate EIRs and what they really mean, and financial literacy programs should be offered to clients to ensure that they understand the information they receive. The value of making information available, like in the Bosnian market, is enhanced significantly when it is accompanied by financial education.

MFTransparency is promoting price transparency by educating stakeholders, promoting standards for disclosure and by publishing the true costs of microfinance products in a clear, consistent fashion. To learn more please visit [www.mftransparency.org](http://www.mftransparency.org) or contact us at [resources@mftransparency.org](mailto:resources@mftransparency.org).