Annual Percentage Rate

Calculating the APR of a loan is the first step towards transparent pricing.

This is because APR expresses the **true price** of a loan. APR is a calculation method that converts all fees and commissions related to a loan into an **annualized** interest rate. This makes it a **standard measure** that allows for **comparison** of the cost of different loan products.

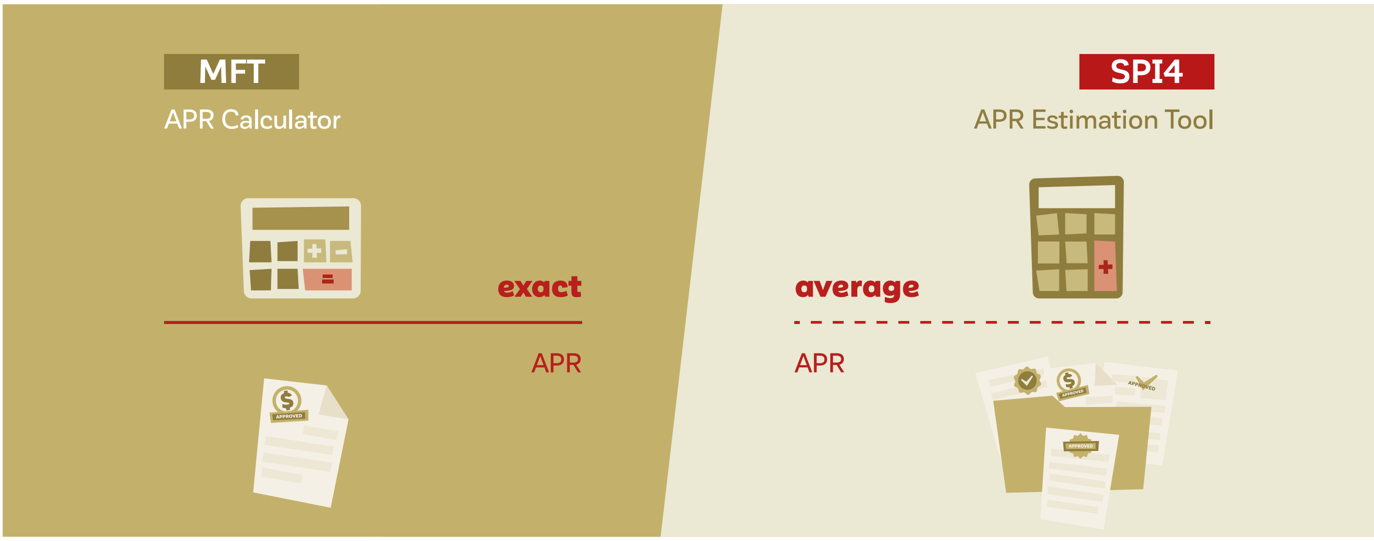
After more than a decade of efforts by the sector to increase transparency of FSPs on their loan pricing, CERISE still sees many SPI4 users giving up on filling in the interest rate indicator in the SPI4, or providing only the nominal interest rate. **But the nominal interest rate does not reflect the true price of the loan!** And it's impossible to compare the loans of different maturities, with different fees, using a nominal rate.

It's time that we use APR as the standard measure of interest rates in microfinance.

Cerise

SPI4
APR Estimation Tool

SPI4 APR Estimation Tool now includes the MFT APR Calculator



CERISE's Excel-based SPI4 APR Estimation Tool makes it easy for SPI4 users to calculate APR and complete the indicator on Loan Pricing in the Organization Information section of SPI online. And it now includes a streamlined version of the well-established Microfinance Transparency APR Calculator as a separate tab right inside the Excel file.

The SPI4 APR Estimation Tool calculates the **average** Annual Percentage Rate of a loan portfolio. The MicroFinanceTransparency APR Calculator calculates the **exact** APR for a one single loan. To know more about the difference between the two tools, and how they can be used together, to calculate the APR of a loan portfolio, check out this tutorial.

Nominal interest rate is the rate quoted to the borrower that is to be paid on a loan contract. It is may be stated as a monthly or annual percentage. It does not reflect inflation, loan fees, commissions and other expenses.

APR is a way of disclosing an annualized interest rate that includes the effects of interest, fees, commissions, calculation method and other loan requirements (forced savings) on the total cost of the loan. It is an effective interest rate.
APR represents the real financial cost paid by the clients for their loans !

EIR is also a way of disclosing annualized effective interest rate but differs from APR because the EIR formula takes into consideration the effects of compounding, i.e. the fact that for each period, interest is not calculated on the principal, but on the amount of the previous period, including capital and interest. It is also called Continuous Compounding Interest.

SPI4

APR Estimation Tool

Using APR to assess responsible pricing is only one part of the picture

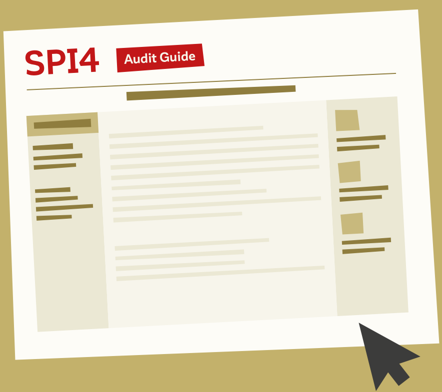
In determining whether an institution is pricing responsibly, the price itself is important but is not the only component to assess.

Interest rates are like the tip of the iceberg: it is what we see, the most visible aspect of a price. But there are several components that influence the price of a loan. Analyzing those components (against benchmarks, when available) can tell us more about whether a price is responsible than just the price itself.

Operational expenses and **profit** are the **two biggest drivers of prices**. It is therefore essential to analyze a price against profitability (ROA/Return on Assets) and operating costs (OER/Operating Expense Ratio).

In SPI4, standard 6C incorporates the indicators used to assess responsible pricing. Essential Practice 6C3 in particular focuses on the drivers of prices that the FSP has the most control over : loan loss expense ratio, operational costs and profitability.

6 C 3	The provider's financial ratios do not signal pricing issues. (Client Protection standard 4.3)
6 C 3 1	Loan Loss Expense Ratio (LLER Ratio) is within the accepted performance range. If it is outside the range, the provider can provide a valid justification.
6 C 3 2	The provider is not transferring unnecessary costs to clients: Operating Expense Ratio (OER) is within the accepted performance range. If outside of the range, the provider can provide a valid justification.
6 C 3 3	Return on Assets (ROA) is within the accepted performance range. If outside of the range, the provider can provide a valid justification.



Download the SPI4 Audit Guide ...

... for explanations on how to analyze responsible pricing taking into consideration the price itself and the ratios that affect prices.
(for indicators on pricing, see pp. 187-195)

More resources on interest rates

To learn more about EIR, APR etc. read Microfinance TRAPS, The Microfinance Transparent Pricing Supervision Handbook

For more information, on the differences between flat and declining interest rates