Loans for Individuals - Things to know

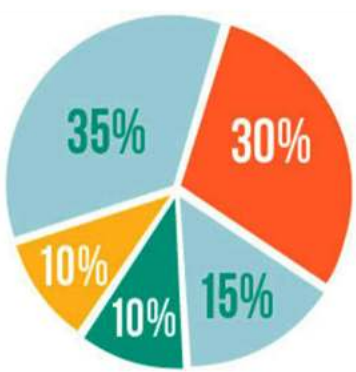
IFE Academy
Education Simplified

INVESTORS FINANCIAL EDUCATION ACADEMY

Phone : 044 - 2814 3044 email : bulletin@ifea.in www.ifea.in

Breaking down your CREDIT SCORE

Credit Score is determined by these factors of differing importance:[1]



35% PAYMENT HISTORY

Late payments may lead to a lower score.

15% LENGTH OF HISTORY

A longer history of responsible credit use will likely lead to a higher score.

30% AMOUNTS OWED

Less is more! Lowering debt can be the key to a better credit score.

10% NEW CREDIT

Opening several accounts in a short time can lower your credit score.

10% TYPES OF CREDIT USED

Having experience with different types of credit [e.g., a car loan and a credit card] can help your score.

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LOANS

The term loan refers to a type of credit vehicle in which a sum of money is lent to another party in exchange for future repayment of the value or principal amount. The lender also adds interest and/or finance charges to the principal value which the borrower must repay in addition to the principal balance. Loans are for a specific, one-time amount, or be available as an open - ended line of credit up to a specified limit. Loans come in many different forms including secured, unsecured, commercial, and personal loans.

In simple words Loans can be meant as:

- A loan is when money or assets are given to another party in exchange for repayment of the loan principal amount plus interest.
- Loans with high interest rates have higher monthly payments—or take longer to pay off—versus low-rate loans.
- Loans can be secured by collateral such as a mortgage or unsecured such as a credit card.
- Revolving loans or lines can be spent, repaid, and spent again, while term loans are fixed-rate, fixed-payment loans.

TYPES OF LOANS

A short-term loan is a type of loan that is obtained to support a temporary personal or business capital. As it is a type of credit, it involves a borrowed capital amount and interest that needs to be paid by a given due date, which is usually within a year from getting the loan.

Short-term loans are usually extended by financial institutions generally for a period of 1-2 years. These are mostly unsecured, and need not required to pledge collateral as security to avail them. These are “short-term” as the associated repayment tenor can be paid off in full within 6-18 months rather than the speed of funding.

The following are the different types of short-term loans available in the market and their specific characteristics that make these loans useful to their borrowers.

Personal Loans

A personal loan is a type of unsecured loan and helps you meet your current financial needs. You don't usually need to pledge any security or collateral while availing a personal loan and your lender provides you with the flexibility to use the funds as per your need. It can serve as your solution for managing your travel costs and wedding expenses as well as the expenses of a medical emergency, home renovation, debt consolidation and others. The personal loan interest rate is calculated based on factors such as credit history, monthly income, the amount being borrowed and others. Lenders usually prefer applicants viewed as a low credit risk those who have repaid their previous loans and bills on time.

Types of Personal Loan Interest Rates

There are basically two types of Interest rates applicable on a personal loan, these are:

a) **Fixed Rate of Interest:** In this case, the rate of interest remains constant throughout the loan tenure. Consequently, monthly EMI amount also remains fixed throughout the loan repayment period.

b) **Floating Rate of Interest:** It depends on either the internal benchmark set by the lender or as current market conditions. As a result, floating interest rate is liable to change periodically which leads to increase/decrease in loan tenure or monthly EMI payouts depending on whether the rate moves upwards or downwards.

Interest rate range: The current interest rates as per the recent changes range approximately 8.45% to 14%.

Repayment tenure range: A personal loan is offered for a maximum of five years by lending institutions such as banks. However, the tenure can vary from lenders and borrowers. *(Ready reckoner given at the end of the book to help you assess the approximate EMI at different rates/ tenure.)*

Gold (Jewel) Loan

Gold loan (also called loan against gold) is a secured loan taken by the borrower from a lender by pledging their gold articles (within a range of 18-24 carats) as collateral. The loan amount provided is a certain percentage of the gold, typically up to 80%, based on the current market value and quality of gold. Gold loan is similar to personal loan in meeting the immediate financial requirements.

Car and two-wheeler loan (Auto Loan):

A car loan (also known as an automobile loan, or auto loan) is a sum of money a consumer borrows in order to purchase a car. Many consumers apply for car loans at their local bank. When applying for a car loan a borrower will usually begin by specifying how much money he or she wants to borrow. Just like Car loan, a Two-wheeler loan

helps you purchase a motorcycle or a scooter of your choice and pay for it in equated monthly instalments (EMIs). Two-wheeler loans are available for both salaried and self-employed individual. Lenders are extremely cautious and sanction the loan only after checking the repayment capacity of the borrower. Thorough background checks are conducted before the loan is disbursed as there has been a sudden rise in number of defaulters over a period of time. If in case if you do not pay the instalments on time and clear your debt, the insurer will take back your car or two-wheeler to recover the loan amount.

Interest rate range: Auto loans at both fixed and floating rate of interest rates ranges between 8.00% to 15.50%.

(Please check the last page to find out your estimated loan amount for EMI you can afford.)

Loan against securities

Loans against Securities are available in the form of an overdraft facility which is pledged against financial securities like shares, units and bonds. Loan against Shares/ Bonds/Mutual Funds are loans wherein the securities can be pledged that have been invested in as collateral against the loan amount. Loan against securities is in the form of an overdraft extended against a number of securities pledged with the lender/bank, which could be:

- Listed shares (held in demat form)
- Units of mutual funds
- Listed bonds
- Non-Convertible Debentures (NCDs)
- Life insurance policies

Loan against conversion of Credit Card

A credit card comes with a specified pre-approved credit limit which can be used by the holder in a month. However, if there is an urgent need for cash, most banks offer the facility of loans against credit card. Once the bank approves the loan request, the limit will be credited to the respective account. Bank charge a certain interest rate for the repayment of the loan. Repayment on this loan can be through Equated Monthly Instalments (EMI) for a specified tenure.

Loans on Credit Cards are pre-approved loans extended based on the Credit Card usage, repayment and history. Since a Loan on Credit Card are pre-approved and extended without any documentation or collateral, a bank typically looks at the credit history and repayment record. Not everyone who has a Credit Card can get a loan.

Interest rate range: Interest rate on these loans depends on the amount and credit history.

Repayment tenure range: The repayment tenure ranges from 12 to 60 months.

Pay later option in Online Store

With the development in Online shopping, the online stores have introduced a new type of payment method called "Pay later option". Under this method the customer can choose their favourite online store and shop their items and apply pay later option for 3/6/9/12 month EMI plans and activate the credit limit. These kinds of facilities are available in Amazon, Flipkart etc.

Pay Later is the hassle-free way to get instant credit, via a completely digital process, for purchases using EMI on online stores. Once the setup is complete, they can avail Pay Later payment option during checkout and pay later next month or over EMIs ranging from 3 to 12 months.

Long Term Loans

Long-term business loans are defined as a type of debt that can be repaid over an extended time, typically exceeding the time frame of a few years. This time period ranges between 3-30 years. These loans may have a fixed interest rate, or a floating rate based upon the prime rate or other benchmarks. These loans generally offer a hefty loan amount and are thus spread over a considerable period of repayment tenure. Features of long-term loans can vary considerably depending upon the cause for which these loans are being taken. Long-term loans almost always offer pre-payment option to customers so that people who want to pay-off their loan earlier than the stipulated time frame do not have to pay continuously for long tenures.

The following are the types of Long-term loans available in the market and their specific characteristics that make these loans useful to their borrowers.

Home Loan

A home loan (or mortgage) is a contract between a borrower and a lender that allows someone to borrow money to buy a house, apartment, condo, or other liveable property. A home loan is typically paid back over a term of 10, 15 or 30 years. It is an amount of money that an individual borrows from a bank or money lending company at a certain rate of interest to be paid with the EMI every month. The property is taken as a security by the money lending company for the Home Loan. The property can either be commercial or personal in nature. When the borrower cannot pay the dues, the lender will possess all the legal rights to recover the outstanding loan amount by sale of the property. Home loans are primarily taken for buying new homes. However, these loans can also be used for home renovations, home extensions, purchasing land property, under-construction, under - construction houses, etc.

Income tax benefit in Home Loans

The Government of India offers tax benefits on home loans under the Income Tax Act of 1961. Home loan borrower can get the benefit of tax deduction on principal repayment under Section 80C, tax deduction on interest under Section 24 (b), and additional home loan interest tax benefit for first-time homebuyers under section 80EE.

Sections in the IT Act	Nature of home loan deduction in income tax	Maximum amount deductible
Section 80C	Tax deductions on the principal repayment	Rs. 1.50 Lakh
Section 24	Tax deductions on the interest amount payable	Rs. 2.00 Lakh
Section 80EE	Additional home loan interest tax benefit for first-time home buyers	Rs. 50,000
80EEA	Affordable Housing (some conditions to be fulfilled)	Rs. 1.50 lakh

Home Improvement Loan

Home Improvement Loans are secured loans taken against the mortgage of the property and can be used for remodelling, renovating, updating or making repairs to the present home.

Interest rate range: The interest rates for these kinds of loans approximately range from 6% to 11%.*(You may check the approximate EMI for various tenures from the ready reckoner given at the end of this book).*

Education loan

An education loan is availed specifically to finance educational requirements towards school or college. Depending on the lender, it will cover the basic fees of the course, the exam fees, accommodation fees, and other miscellaneous charges. The student is the borrower with any other close relative being the co-applicant, such as a parent,

Repayment holiday

grandparent, spouse, or sibling. It can be availed for courses in India or abroad. It can be taken for a wide variety of recognised courses which are either part time or full time. They cover vocational courses as well as undergraduate and postgraduate courses.

Interest rate range: The interest rates range approximately from 6% to 15%

Income tax benefit

The interest paid on the education loan can be claimed as deduction, as per Section 80E of the Income Tax Act of India, 1961.The deduction is applicable under Section 80E for only the interest paid on the loan taken for higher studies.

Repayment holiday

Repayment starts after a 'moratorium period' or 'repayment holiday', that is, one year after the end of studies or six months after getting a job, whichever is earlier. The borrower must have a repayment strategy in place before EMIs start. Student borrowers get many relaxations.

LOANS LENDING INSTITUTIONS

A lending institution is any type of financial organization or institution that provides loans to borrowers. There are many different types of lenders in the marketplace today, ranging from banks to private loan companies. The range of loan types offered by any one financial institution will vary, depending on the structure of the organization. Typically, all lenders will charge some rate of interest for the amount of funds borrowed, and require the borrower to commit to a contract that spells out the terms for repayment.

Choosing the right lending institution is important when seeking a loan. Taking the time to compare interest rates, how the interest is compounded, and even the other terms and conditions associated with the loan agreement is very important. In addition, investigating the background of each lending institution is crucial, since working with a lender who has less than a sterling reputation could mean trouble later on.

Banks

One of the more common examples of a lending institution is a bank. The ability to provide loans is one of several services offered by banks, but consumers often think of approaching the bank where they already have existing accounts such as savings Account when they are in need of financing for the purchase of a home, a car, or even a personal loan of some type.

NBFC

Non-Banking Financial Institutions (NBFC) caters to the diverse financial needs of bank excluded customers. NBFCs are financial intermediaries engaged in the business of accepting deposits, providing credit and play an important role in economy.

These institutions have been under the regulatory structure of the Reserve Bank of India.

NBFCs being financial intermediaries are engaged in the activity of bringing the saving and the investing community together. In this role they are perceived to be playing a complimentary role to banks rather than competitors, as it is a known fact that majority of the population in the country do not yet have access to mainstream financial products and services including a bank account and therefore the country needs institutions beyond banks for reaching out in areas where banks' presence may be lesser.

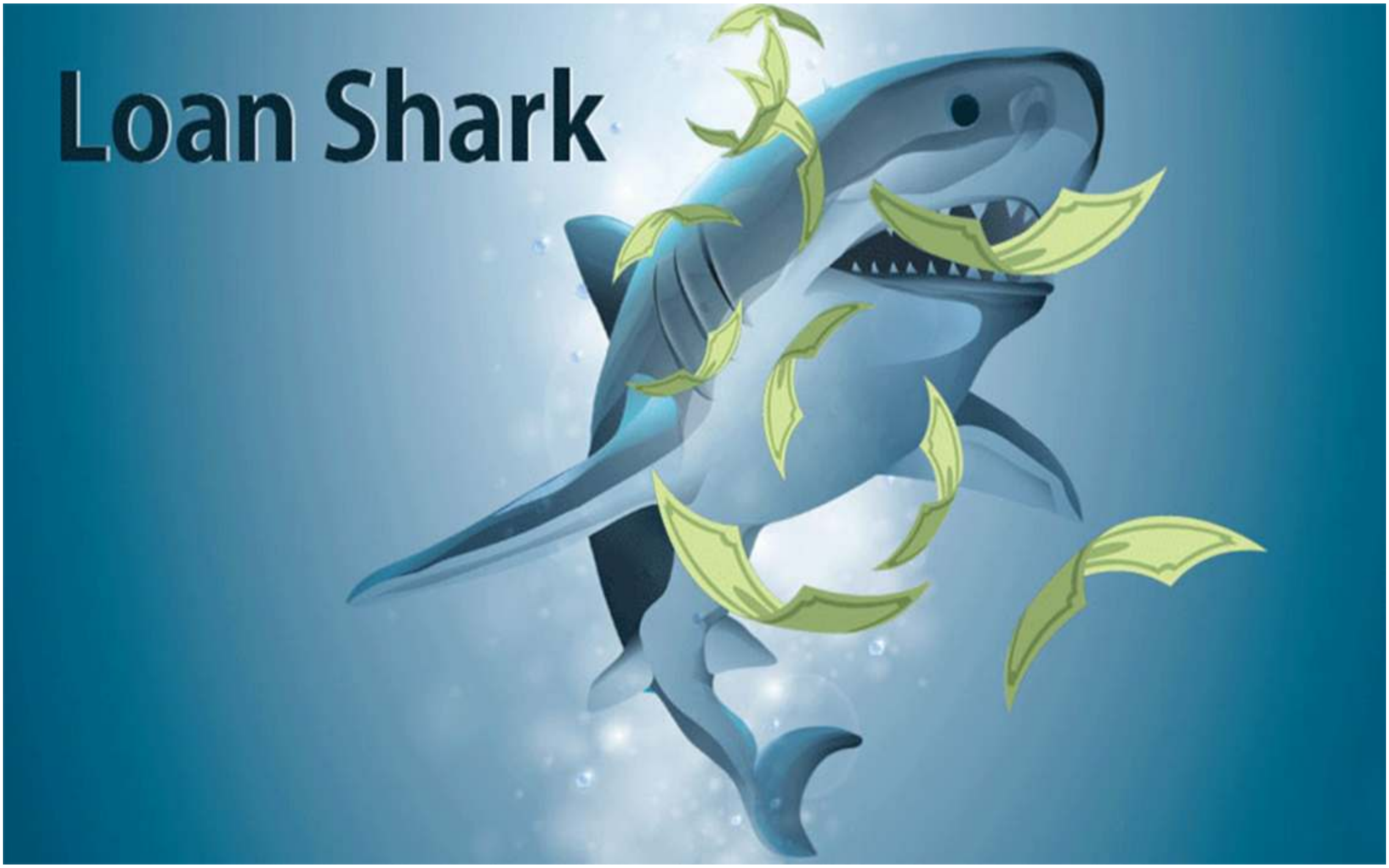
NBFCs have also carved niche business areas for them within the financial sector space and are also popular for providing customized products like second hand vehicle financing, mostly at the doorstep of the customer.

Reserve Bank of India has deregulated interest rates to be charged to borrowers by financial institutions (other than NBFC- Micro Finance Institution). The rate of interest to be charged by the company is governed by the terms and conditions of the loan agreement entered into between the borrower and the NBFCs. However, the NBFCs have to be transparent and the rate of interest and manner of arriving at the rate of interest to different categories of borrowers should be disclosed to the borrower or customer in the application form and communicated explicitly in the sanction letter etc.

Unregistered lenders

There are a lot players in the market, who are into lending business without any registration with RBI. These entities may lure the borrowers to fund their requirements without insisting on collaterals, guarantee, KYC etc. But there is a catch. They charge exorbitant rates of interest and there would be no legally accepted practices for grievance redressal.

These unregistered lenders are popularly known as “Loan Shark”. A loan shark is a person who or an entity that provide loans at extremely high interest rates and often uses threats of violence to collect debts. The interest rates are generally well above an established legal rate, and often loan sharks are members of organized crime groups.



How to spot a loan shark

A loan shark might:

- Offer little or no paperwork, such as a credit agreement or record of payments
- Refuse to give information, such as the interest rate or how much you owe
- Take items as security, such as passports, bank cards or driving licenses
- Increase the debt or add additional charges at any time
- Refuse to allow you to settle your debt
- Get nasty - they might resort to intimidation, threats or violence.

THINGS TO BE KEPT IN MIND WHILE TAKING UP LOANS

The following are the points that are to be kept in mind while taking up loans from the Financial Institutions and banks:

- **Don't borrow more than you can repay:** While taking up loans the individual should keep in mind regarding their monthly income, their personal need that would be required on regular basics. The repayment of loan amount on monthly basics shouldn't affect their regular month on month needs. Loan should be taken that can be easily paid. The monthly outgo towards all the loans put together should not be more than 50% of their monthly income. With banks falling over each other to attract business, taking a loan appears very easy. But don't take a loan just because it is available. Make sure that the loan-to-income ratio is within acceptable limits.

- **Keep Tenure as short as possible**: Tenure is the period or duration for which the loan amount is sanctioned. However, it is best to take a loan for the shortest tenure you can afford. In a long-term loan, the interest outgo is too high. The longer the tenure, the higher is the compound interest that the bank earns from the individual.
- **Ensure Timely and Regular payment:** It pays to be disciplined, especially when it comes to repayment of dues. Whether it is a short-term debt like a credit card bill or a long-term loan for your house, make sure you don't miss the payment. Missing an EMI or delaying a payment are among the key factors that can impact your credit profile and hinder your chances of taking a loan for other needs later in life.
- **Don't borrow to save or invest:** This is also a basic rule for investing. Loan should not be borrowed for saving or investing. Ultra-safe investments like fixed deposits and bonds won't be able to match the rate of interest you pay on the loan. And investments that offer higher returns, such as equities, are too volatile. If the market's decline, you will not only suffer losses but will be strapped with an EMI as well.
- **Keep spouse, family in loop about loan:** It is very much essential for the family to know about your debts and loans borrowed. This is important because the repayment will impact the overall finances of the entire household. Make sure your spouse is aware of the loan and the reasons for taking it.

QUICK WAYS TO REPAY THE LOAN DEBT

- **Repay the high-interest loan first:** It is necessary to make a list of debts according to the interest rate. Make a plan with the loans and pay off the high interest debt first as lapse in the repayment of those loans would incur more financial crises to the individual. A Home Loan or Student Loan is likely to have lower interest rates while offering tax benefits. Credit Card debts and Personal Loans, on the other hand, tend to come with slightly higher rates of interest. It is, therefore, a good idea to pay these before moving on to 'safer' ones.
- **Increase the EMI when there is an increase in Salary income**: Whenever you get a raise at work, increase your EMIs as well. The more you

push up your EMIs, the faster you can repay your debts – and the less you will need to pay by way of interest.

- **Request a lower interest rate:** If you're an old and established customer of the lender and have a good credit score, try to negotiate for a lower interest rate.
- **Make timely payments:** Paying several EMIs is bad enough. Do not add late payment fees to it. Besides, this affects your credit history. Hence, it's a good habit to make your payments on time.
- **Cut expenses:** If all else fails, this is what you should do. Cut down on avoidable luxuries such as eating out and going out on weekend trips. Lead a low-key life until you have repaid all your debts. You'll get enough chances to make up when you are clear of them again.
- **Make a prepayment with Bonus or Incentives:** When you receive an unexpected bonus or investment return it would be more practical to way out the repayment of loan first. Any windfall should ideally go towards debt repayment.

FAQ

1. **What is difference between home loan and mortgage?**

   As the name suggests, a loan taken against a property or mortgage is defined as a loan against property. The main difference between a home loan and loan against property is that a home loan is taken for the property and mortgage loan is taken against the property.

2. **Is EMI good or bad?**

   Although a good EMI scheme is easy on your wallet, you must try to avoid it as the first option. You may not only be spending more than the actual worth of the product, but also splurging first and then relying on EMI payments is not healthy for your finances.

3. **What is security for loan?**

   With reference to lending, security or collateral is an asset that is pledged by the borrower as protection in case he or she defaults on the repayment. Security should be important to the lender, whether the borrower is an individual, or a company.

4. **What is the difference between Secured and Unsecured loans?**

SECURED VS UNSECURED	
Secured	**Unsecured**
"Backed" by some sort of collateral	Not backed by collateral
Approved more easily	Approval is usually more difficult. (except for credit cards)
Lower interest rate	Higher interest rates
Longer term	Shorter term.

5. **Can break from student loan repayments are possible?**

When graduates face significant new out-goings in their lives, such as buying their first home or starting a family, they will have the option of taking a break from their loan repayments. They will be able to take a break of one year, two or more, for up to five years

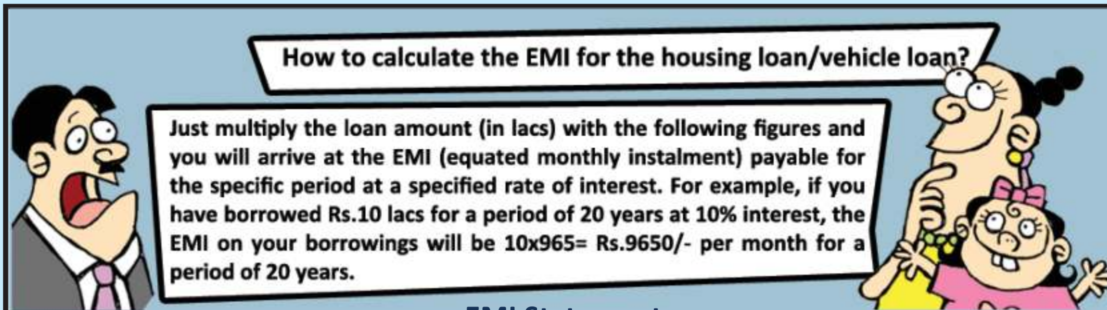
6. **Why is loan shark illegal?**

Loan sharking is usually illegal, but predatory lending with extremely high interest rates such as payday or title loans is sometimes considered loan sharking. ... Loan sharks sometimes enforce repayment by blackmail or threats of violence. Historically, many moneylenders skirted between legal and criminal activity.

7. **Can an NBFC give unsecured loans to its customers?**

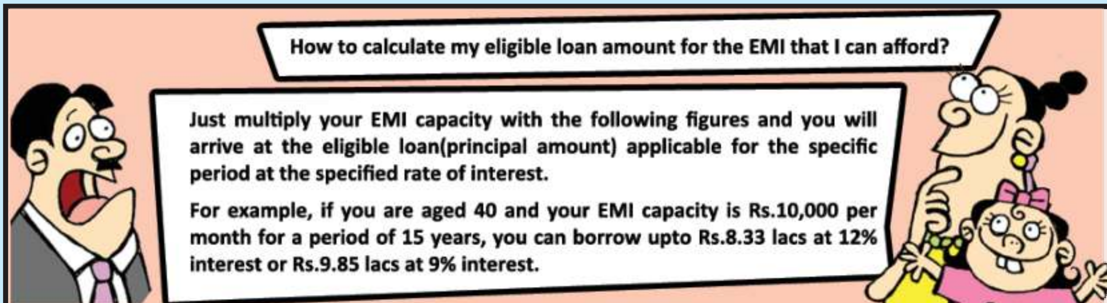
Yes, NBFC can provide unsecured loans in the form of overdraft, cash credit, and bill discounting. The minimum amount for the loan will be higher than that of nationalized banks.

Ready Reckoner for EMI estimation



EMI Statement

Period	9%	10%	11%	12%	Period	9%	10%	11%	12%
3 years	3180	3227	3274	3321	15 years	1014	1075	1137	1200
5 years	2076	2125	2174	2224	20years	900	965	1032	1101
8 years	1465	1517	1571	1625	25 years	839	909	980	1054
10 years	1267	1322	1378	1435	30 years	805	878	952	1028



EMI - Loan eligibility Statement

Age	Max.Eligible Loan Period	9%	10%	11%	12%
57	3 years	31.446	30.991	30.544	30.107
55	5 years	48.173	47.065	45.993	44.955
52	8 years	68.258	65.701	63.660	61.527
50	10 years	78.941	75.671	72.595	69.700
45	15 years	98.593	93.057	87.981	83.321
40	20 years	111.145	103.624	96.881	90.819
35	25 years	119.161	110.047	102.029	94.946
30	30 years	124.281	113.950	105.006	97.218

About IFE Academy

IFE Academy was established in 2011 as a Not-for-Profit entity to promote Financial Education. IFE Academy conducts Investor Awareness Programs across the country with the support of other market participants. www.ifea.in is a comprehensive website on Financial Education. It has various sections such as Videos, Puzzles & Games, Financial Calculators and Library. It gives a holistic view on financial education combining various aspects such as Savings, Investments, Credit, Insurance and Pension at a single place. IFE Academy periodically publishes Investor Educational materials and distributes it to general public.

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Regd. office : Park View, Basement, 85/17, G.N.Chetty Road, T.Nagar, Chennai - 600 017.
email : bulletin@ifea.in www.ifea.in