

LESSON 5: CREDIT, INTEREST & DEBT

Lesson aim:

- ✚ To define financial terms such as credit, debt and interest rates and explain what they are.
- ✚ To outline the risks associated with credit, debts and interest rates.
- ✚ To provide an environment in which students can explore these issues and the effect on society.

Learning objectives:

At the end of this lesson students will be able to:

- ✚ define credit, debt and interest rates and briefly explain them;
- ✚ identify what responsibilities should be expected in this area and who has them; and
- ✚ understand how these issues might affect a student's life when they start to work.

Lesson outline:

To stimulate discussions with students ask them the following questions:

- ✚ What is credit? What is an interest rate? What is debt?
- ✚ Is credit a good or bad thing? Explain.
- ✚ What debt, if any, would you expect to have in the future?
- ✚ Is debt a good or bad thing? Explain.
- ✚ Why do you think people choose to get credit rather than saving?

In-class exercise: Calculating the cost of credit

Write the following on the board:

Debt €500

Interest 23% (standard credit card)

Minimum payment €50 per month

- ✚ Explain what a minimum payment is (an amount which the bank decides is the least amount they expect you to pay back off your credit line which is usually less than what is outlined above).
- ✚ Ask students how long would it take to pay off the debt if only the minimum payment was made?
- ✚ Ask students how long would it take to pay off the debt if only the minimum payment was paid after interest was applied?
- ✚ Explain to students simple interest and compound interest and how it works.
- ✚ Ask students when is it better to have interest compounded (ie when payments reduce the principal like the calculations on credit union loans) and when it is not beneficial (ie payments only pay a portion of interest which is the case in some mortgages).

LESSON 5: CREDIT, INTEREST & DEBT (CONTINUED)

Student activity: Getting credit

Provide students with the following exercise:

You need €500 for a holiday and decide that you will borrow it and pay back later. Investigate what your options might be such as the:

- types of credit (products) available;
- institutions which may lend to you; and
- cost of the borrowing.

Use Worksheet 3 to complete this exercise.

(NOTE: Ensure that students investigate the cost of borrowing across different institutions and over different time periods to highlight the price and cost differentials that exist. The websites of all the major banking institutions provide an online calculator and the website of the financial regulator www.financialregulator.ie and www.itsyourmoney.ie are also good sources of information and comparison purposes.)

When the exercise is finished ask students:

- Which is the best value for money?
- Obtaining a credit card is reasonably accessible but the cost of credit is more expensive. Why do you think many people continue to use credit cards? Is it wise?

Why is some credit more expensive than others? Should credit be given to people who may have difficulty paying it back? Explain. Why would people seek credit, if they are already struggling with their budget?

Class activity: Discussion

After completing some of the exercises associated with credit, use the following to stimulate discussions and review learning.

- What do you now think of the benefits of credit?
- What do you think are the disadvantages or bad elements of credit?
- Has your thinking and understanding about different types of credit changed? How? Explain.
- Is credit accessible to all people? What are the main criteria for obtaining credit?
- Are the same options for credit open to individuals on higher and lower incomes? Is this fair? Why?

(NOTE: The central bank publish figures on credit and indebtedness in Ireland and can be accessed on their website at www.centralbank.ie.)

Discuss with students how households living on a tight budget or with a low income might easily find their personal debt spiraling out of control and the consequences of this happening.

Student activity: Wrap-up worksheet

Provide students with Worksheet 4 to complete to ensure they have grasped the major elements of this lesson.