MODULE 5

LOANS & DEBT RISK MANAGEMENT

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"YOUR INCOME CAN ONLY GROW TO THE EXTENT YOU DO."

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Introduction

Asking for a loan has pros and cons. It will help a young person to pursue further studies and career or lifestyle options, but will create a new condition - **DEBT**.

Debt needs to be repaid and payment conditions will vary depending on many factors. Among them:

- the financial environment will dictate interest rates applicable to loans
- **personal credit history** will dictate some of the loan conditions, including interest rates and size of the loan.

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Context and Background

Many young people need loans to start off their life after they finish school for a avariety of different reasons. The main reasons why young people ask for loans are:

- Studying: University, Master Degrees, PHD courses or training courses
- Starting their own business
- Travelling and experiencing the world
- Buying property, a car, a mobile phone or any other physical "asset"

MANAGING DEBT RISK

Having a loan means having a risk, where the risk is being unable to repay the lender.

STRATEGIES FOR MANAGING RISK:

1. Understanding debt
2. Being aware of "credit history" and how to build a positive one
3. Being aware of the different types of loans
4. Being aware of alternatives to loans

In the following slides we will look at these strategies:

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UNDERSTANDING DEBT

Debt is something, usually money, owed by one party to another.

Debt is used by many individuals and companies to make purchases that they could not afford under other circumstances. Unless a debt is forgiven by the lender, it must be paid back, typically with added interest. As lending money is a RISK to the lender, the debt will be paid back with interest.

The most common forms of debt are **LOANS**, including mortgages, car loans, and personal loans, as well as credit cards. Under the terms of a most loans, the borrower receives a set amount of money, which they must **repay in full by a certain date**, which may be months or years in the future.

The terms of the loan will also stipulate the amount of **interest** that the borrower is required to pay, expressed as a percentage of the loan amount. Interest compensates the lender for taking on the risk of the loan.

CREDIT CARDS operate a little differently: They provide what's known as revolving or open-end credit, with no fixed end date. The borrower is assigned a credit limit and they can use their credit card or credit line repeatedly as long as they don't exceed that limit.

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Debt risk management Strategy #1

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STRATEGY 1:
BEING AWARE OF CREDIT HISTORY

Credit history is a detailed report or statement about your repayments for all your debts and perhaps other financial information. It names which loans you have and how often you have made payments on time or opened new credit.

Your **credit score** is a three-digit number based on this information.

Why is it important?

Lenders look at your credit history and the credit score that is based off your credit history to determine your risk as a borrower. The better your credit history, the more like you are to get approved for credit.

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Obstacles to borrowing as a young person

- **No credit score**: it means you don't have a credit history, usually because you haven't taken out any form of credit before.
- **Low credit score**: you have a history of being unreliable when it comes to paying back money. You may have defaulted or been late with payments. Another reason could be that you've applied and been rejected multiple times for credit previously.

Having no credit score is slightly better than having poor credit score

- It's easier to build your score up from scratch rather than rebuild credit that's taken a knock.
- Lenders who do offer loans to those with no rating or a low rating, will usually offer higher interest rates and lower loan amounts.

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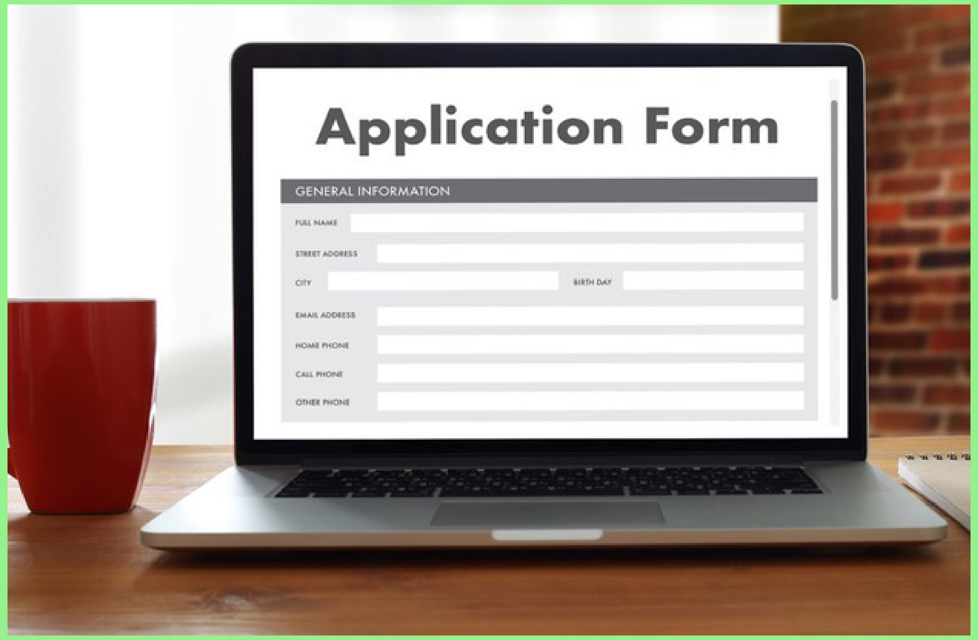
A credit score is a figure created by a credit reference agency (CRA) that reflects your financial history

KEEP UP PAYMENTS

If you do get credit, make sure you can afford to keep up with the repayments and pay them on time. This helps to gradually build up your credit score. Missed or late payments go on your record, lowering your credit rating and can indicate to lenders that you may struggle to manage financially



SPACE OUT APPLICATIONS

Each application for credit will leave a 'footprint' on your file. Frequent applications will put off lenders and lower your score

CALCULATE ONLINE

Try to check your eligibility for a loan or other type of credit using a soft search before applying. This means it won't negatively impact your credit score

BUILDING (OR IMPROVING) CREDIT HISTORY

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Debt risk management Strategy #2

BEING AWARE OF TYPES OF LOANS

Borrowed money can be used for many purposes, from paying for your studies to funding a new business or travelling the world.

But with all of the different types of loans out there, which is best—and for which purpose?

Which is more risky?

Below are the most common types of loans and how they work.

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TYPES OF LOANS

There are different types of loans that young people can apply for:

- **Student finance and Master's loans**: for studying
- **Unsecured personal loans** (ex.: for business start ups)
- **Car finance**: for buying a car
- **Guarantor loans** (ex.: for buying property)
- **Bad credit loans**: for people with low credit score

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TYPES OF LOANS - SOME DETAIL

- **Student finance and Master's loans** - These can help pay for your university tuition fees and living costs
- **Unsecured personal loans** - Only available to people aged 18 or over. The chances of getting approved for one can be low if you have no credit history or regular income. If you're accepted, you can expect high interest rates
- **Car finance** - Allows you to pay off the cost of a car in monthly instalments
- **Guarantor loans** - With this type of loan, a family member or friend who has a better credit rating co-signs and agrees to be responsible for paying the debt if you can't keep up with repayments. If you have poor or no credit history, some lenders will insist on a guarantor before they'll lend to you
- **Bad credit loans** - For people with a poor credit score or little financial history. Interest rates can be extremely high and you could end up paying a huge amount more than what you initially borrowed

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Debt risk management Strategy #3

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BEING AWARE OF ALTERNATIVES TO LOANS

A loan may not always be the best way to borrow money.

Once you are aware of the meaning of being in debt, of your credit history and of the different types of loans available to you, you may look at possible alternatives.

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PROS & CONS of asking for a loan

Pros

- A loan could help you get fast access to money to pay for an emergency car repair or replace a damaged mobile phone, for example
- Repaying your loan on time can build up your credit score, which could help you access better rates on credit in the future, like a mortgage

Cons

- You may not be offered the best interest rates
- Defaulting on the loanwill damage your credit rating and the lenders could take legal action against you
- A loan is a serious commitment which could leave you struggling financially

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ALTERNATIVES TO LOANS

STUDENT CREDIT CARDS

Some banks offer student credit cards to student bank account holders. When used responsibly, they can help build a credit history from scratch and can be useful to cover emergency expenses. Try spending small amounts and paying off the balance in full each month to make the most of your card.

0% CREDIT CARD

Choosing a 0% purchase card can provide you with free borrowing for a period. Try to keep within 30% of your credit limit and make at least your minimum monthly payments to maintain the 0% interest offer. Just make sure you pay off the debt before the introductory period ends as you'll start paying interest, which can quickly become expensive.

OVERDRAFT

You could ask your bank for an interest-free overdraft, or to extend one you already have.

If that's not available, be wary of using your overdraft as fees tend to be steep.

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ACTIVITIES MODULE 5

LOAN AND DEBT RISK MANAGEMENT

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MODULE 5

ACTIVITY 1: TO LOAN OR NOT TO LOAN?

Learning Objectives

1. During the activity, participants will gain an understanding of the fundamental aspects of loan and debt risk.
2. The session will provide resources, tips, and personalized advice to assist participants in applying for short- and long-term loans and in understanding the risks.
3. Participants will then learn how to apply for a loan from banks, understand the various types of loans that exist and understand which solutions are best for them.

Duration

2 hours

Level

☑ Beginner
☐ Intermediate
☐ Advanced

Materials /Resources

- Cards with different types of loan and possible debt risks may be created by the trainer if useful
- Paper
- Pencils

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Descriptions

- **Prepare the materials**: Prepare the materials that will be used in the activity. This includes cards with types of loan. There can also include resources such as articles, videos, and online tools for debt risks. Example:
  - A glossary of loan terms, so participants can become familiar with industry jargon and technical language.
  - Examples of successful loans, including the process and the reason behind the application.
  - Websites of banks explaining their personal loan types.

- **Start the activity:** begin the activity by introducing the topic and explaining the basics of loan. Cover topics such as typologies, reasons to apply. Provide examples of different types of loan options and their benefits and risks.

- **Navigate websites**: each participant will have to explore the websites of banks in their own country (or countries participating in the project) and collect as many existing loan modalities as possible.

- **Simulation game:** participants will be divided into groups of 2/3 people. Based on the knowledge they have acquired, they will have to simulate applying for a loan at a bank. They will have to present the appropriate documents, have strong and convincing motives. One by one, they will play the two roles (applicant and banker).

- **Round-table discussion:** end the activity with a round-table discussion where participants can justify their initial choice and the changes they made. This will help them reflect on their decisions and share the knowledge they have acquired with others. Encourage participants to ask questions and engage in a constructive discussion.

- **Wrap up:** Finally, wrap up the activity by summarizing the key takeaways and providing participants with additional resources for learning more about loan. Encourage participants to continue learning and practicing their skills.

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ACTIVITY 2: GRANT FUNDING VS LOAN

Learning Objectives

1. The participants will learn the difference between a grant and a loan and how to apply for both.
2. The session will provide resources, tips, and personalized advice to assist participants in finding out the main differences
3. In a final evaluation the participants will have to use their personal knowledge to try and obtain a grant based on the material they will receive.

Duration

1 hour

Level

- ☑ Beginner
- ☐ Intermediate
- ☐ Advanced

Materials /Resources

- Cards with different types of loan and possible debt risks may be created by the trainer if useful
- Paper and pencils
- Additional material for the final evaluation.

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Activity 2: Grant funding vs Loan

Descriptions

- **Prepare the materials:** This includes cards with types of loan and the main differences between a loan and grant funding. There can also include resources such as articles, videos, and online tools. Example:
  - Websites of banks explaining their personal loan types.
  - Grant funding available in their own country (or a partner country)

- **Start the activity:** begin the activity by introducing the topic and explaining the basics of grant funding. Cover topics such as typologies, reasons to apply, main differences. Provide examples of different types of loan options and their benefits and risks.

- **Navigate websites:** Each participant will have to explore the websites of banks in their own country (or countries participating in the project) and collect as many existing loan modalities as possible. Moreover, they will have to find different types of grants funding.

- **Final Evaluation:** Participants, based on the knowledge they have acquired, will have to simulate applying for a grant from an agency. They will have to present the appropriate documents, have strong and convincing motives. They will be helped by the materials they will receive to have a general knowledge on the matter.

- **Round-table discussion:** End the activity with a round-table discussion where participants can justify their initial choice and the changes they made. This will help them reflect on their decisions and share the knowledge they have acquired with others. Encourage participants to ask questions and engage in a constructive discussion.

- **Wrap up:** Finally, wrap up the activity by summarizing the key takeaways and providing participants with additional resources for learning more about loan and grant funding. Encourage participants to continue learning and practicing their skills.

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ACTIVITY 3: BUILD YOUR CREDIT HISTORY

Learning Objectives

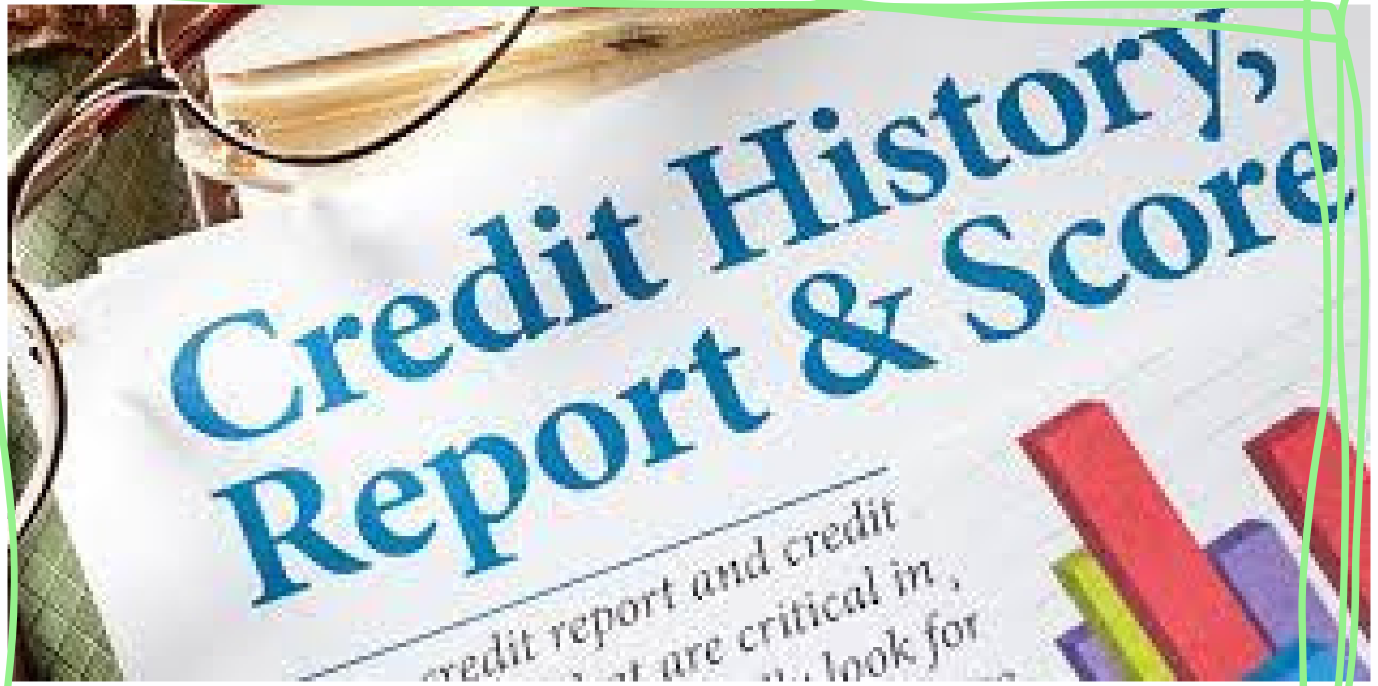
1. The participants will learn how to create their own credit history and the general value of a credit score.
2. The session will provide resources, tips, and personalized advice to assist participants in finding out how to make the right steps in building their own credit identity.
3. In a final evaluation the participants will have to use the skills they have obtain to try and create a new credit history from scratch.

Duration

1 hour and half

Level

- ☑ Beginner
- ☐ Intermediate
- ☐ Advanced



Materials /Resources

- Cards with different types of credit histories may be created by the trainer if useful.
- Articles about credit score.
- Paper, pencils and additional material for the final evaluation.

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Descriptions

- **Prepare the materials:** This includes cards with general knowledge about credit history, successful types and how to maintain a high credit score. There can also include resources such as articles, videos, and online tools. Example:
  - Websites of banks explaining credit history.
  - Successful types of credit history.

- **Start the activity:** begin the activity by introducing the topic and explaining the basics of credit history. Cover topics such as typologies, reasons to have one, how to have a high credit score. Provide examples of a positive and negative types of credit history.

- **Navigate websites:** Each participant will have to explore the websites and collect as many examples as possible of good and bad credit history types. Moreover, they will have to understand the value of credit score.

- **Final Evaluation:** Participants, based on the knowledge they have acquired, will have to create, with as much help possible, their credit history. They will have to explain what they think is useful and what not. They will be helped by the materials they will receive to have a general knowledge on the matter.

- **Round-table discussion:** end the activity with a round-table discussion where participants can justify their initial choice and the changes they made. This will help them reflect on their decisions and share the knowledge they have acquired with others. Encourage participants to ask questions and engage in a constructive discussion.

- **Wrap up:** Finally, wrap up the activity by summarizing the key takeaways and providing participants with additional resources for learning more about credit history. Encourage participants to continue learning and practicing their skills.

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ACTIVITY 4: LAL – LEARN ALTERNATIVES TO LOANS

Learning Objectives

1. The participants will learn about possible alternatives to loans and the different types of credit cards.
2. The session will provide resources, tips, and personalized advice to assist participants in finding out how to make the right steps in choosing the right credit card or debit card for their own personal needs.
3. With the help of the websites of the national banks, they will be able to discover the various types of cards available and other types of support.

Duration

1 hour

Level

- ☑ Beginner
- ☐ Intermediate
- ☐ Advanced

Materials /Resources

- Cards with different types of alternatives to loans and articles about it. may be created by the trainer if useful
- A personal computer.
- Paper, pencils and eventual additional material.

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Activity 4: LAL – Lean alternatives to loans

Descriptions

- **Prepare the materials:** This includes cards with general knowledge about alternatives to loans, different types of credit cards and how to eventually apply for them. There can also include resources such as articles, videos, and online tools. Example:
  - Websites of banks explaining different types of cards.
  - Other types of helpful instruments.

- **Start the activity**: begin the activity by introducing the topic and explaining the basics of alternatives to loans. Cover topics such as typologies, reasons to apply for a credit card or a debit card. Provide examples of a positive and negative outcomes.

- **Navigate websites**: Each participant will have to explore the websites and collect as many types of alternatives to loans as possible. Moreover, they will have to browse the websites of national banks and find out about the various cards available, alternatives to loans, and how to apply for them.

- **Round-table discussion:** end the activity with a round-table discussion where participants can justify their initial choice and the changes they made. This will help them reflect on their decisions and share the knowledge they have acquired with others. Encourage participants to ask questions and engage in a constructive discussion.

- **Wrap up:** Finally, wrap up the activity by summarizing the key takeaways and providing participants with additional resources for learning more about alternatives to loans. Encourage participants to continue learning and practicing their skills.

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ACTIVITY 5: QUIZ MY LOAN

Learning Objectives

1 In this final quiz, participants will use the knowledge they have learnt to challenge each other in a friendly manner and win.

2 This session will highlight what they have learned and allow them to ask questions about what is unclear.

Duration

1 hour

Level

- ☑ Beginner
- ☐ Intermediate
- ☐ Advanced

Materials /Resources

- Final quiz on knowledge acquired from previous activities.
- Paper, pencils may be needed.

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Descriptions

- **At the beggining**, create a board with categories such as loan, credit history, debt risk management and and general financial terminology. Write down financial quiz questions that align with each category. For beginner level participants, you may want to consider using simpler financial quiz questions or reducing the number of categories. You can also provide hints or explanations for each question to help reinforce financial concepts.

- **Moving on**, introduce the game and explain the rules. Divide the participants into teams and give each team a buzzer. Explain that they will need to use the buzzer to answer the questions and earn points.
  Set the timer for one hour.

Begin the game and select a team to start. The team can choose a category and point value, and you can read out the corresponding financial quiz question. The team that buzzes first will get the opportunity to answer the question. If they answer correctly, they earn the point value of the question. If they answer incorrectly, the opportunity to answer goes to the other team. After each team has had a chance to answer, it's the next team's turn to choose a category and point value.

- At the end of the game, add up the points and declare the winning team.
- Conclude the activity with a discussion on the financial concepts covered and how to apply them in real life. Encourage participants to share their insights and ask questions.

- **Round-table discussion:** end the activity with a round-table discussion where participants can justify their initial choice and the changes they made. This will help them reflect on their decisions and share the knowledge they have acquired with others. Encourage participants to ask questions and engage in a constructive discussion.

- **Wrap up:** Finally, wrap up the activity by summarizing the key takeaways and providing participants with additional resources for learning more about loans and debt risk management. Encourage participants to continue learning and practicing their skills.

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Educación Financiera para Jóvenes
2021-1-IT03-KA220-YOU-000028694

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