

COMPOUND INTEREST AND HOW TO CALCULATE INTEREST



There is a new rule on how to calculate interest for banking transactions

Let's help Giulia to understand what's changed

1 COMPOUND INTEREST IS FORBIDDEN

Banks cannot use a compound interest formula to calculate the interest owed by any of their customers.

Compound interest is the calculation of the interest on interest that has already accrued on a sum of money that is owed.

Compound interest means that the interest accrued is converted into capital (in technical jargon we say it is capitalized) or it is added to the sum of money owed, which in turn produces more interest. When this happens, we talk about compound interest.



**LET'S LOOK AT AN EXAMPLE
OF COMPOUND INTEREST**



I have to pay €1,000 back to the bank at an interest rate of 1 per cent on a yearly basis. How do I calculate the compound interest?

1st Year

1
January



€ 1.000

Initial amount
(or principal)

31
December



€ 10

of interest
accrued
over the
year

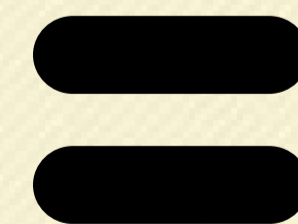


calculated on the
initial amount
(1 per cent of €1,000)

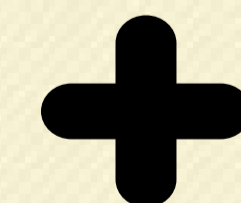


€ 1.010

Total debt



€ 1.000



€ 10

2nd Year

1
January



€ 1.010

Initial amount +
interest accrued
in the previous year

31
December



€ 10,10

Interest
accrued
during the
current year

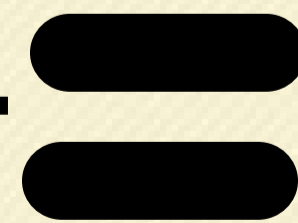


calculated on €1,000 of
initial amount + €10 of
interest accrued in the
previous year
(1 per cent of €1,010)

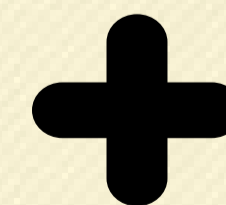


€ 1.020,10

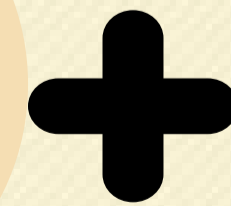
Total debt



€ 1.000



€ 10



€ 10,10

2 CALCULATING THE INTEREST

The following are calculated for CURRENT ACCOUNTS:

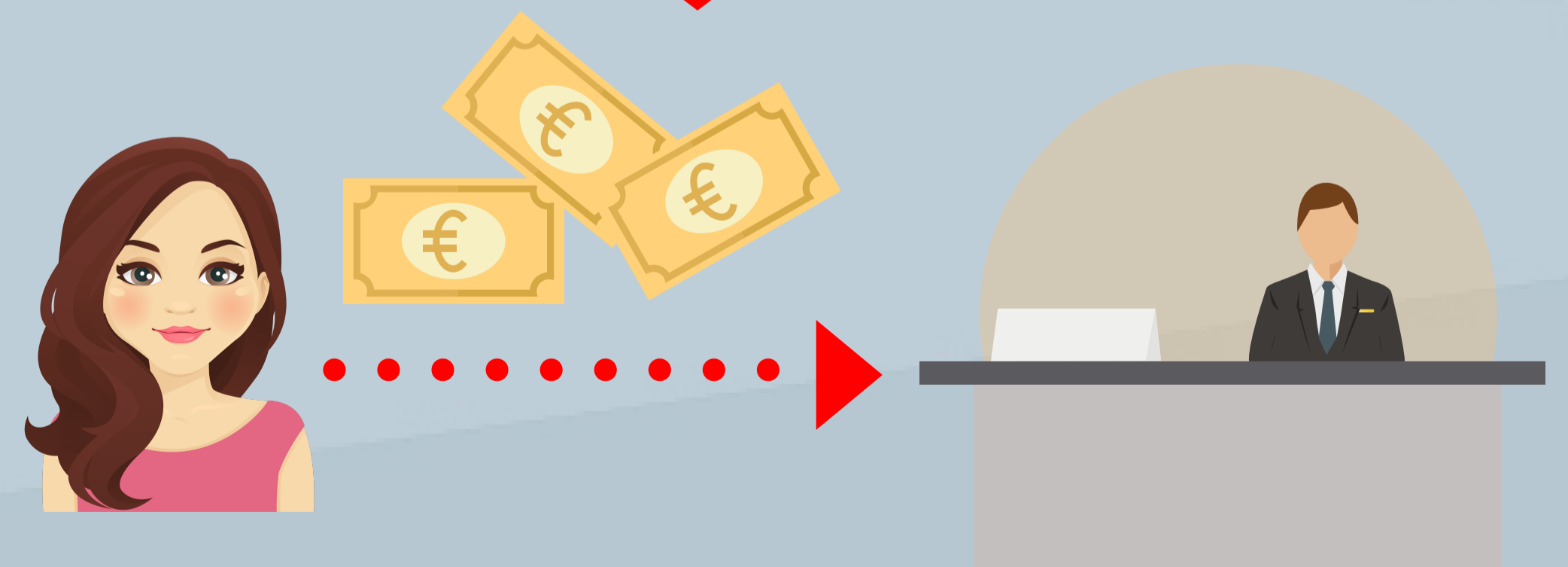
CREDIT INTEREST or INTEREST EARNED is what the bank has to pay Giulia on the money she has deposited in her account

DEBIT INTEREST or INTEREST OWED is what Giulia has to pay the bank on any money she has borrowed and actually used

INTEREST EARNED



INTEREST OWED



The basic rules

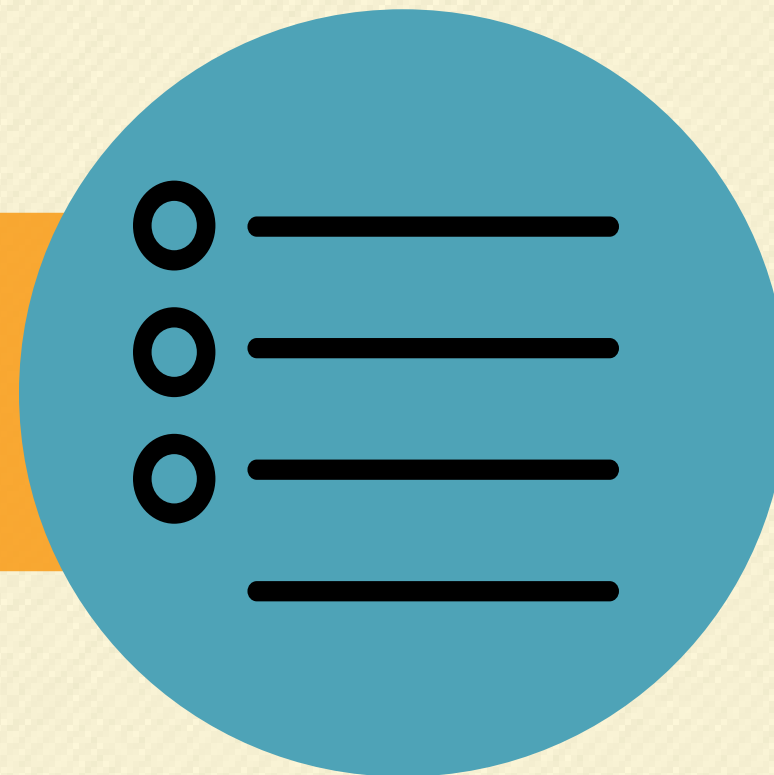
Interest owed can't produce further interest



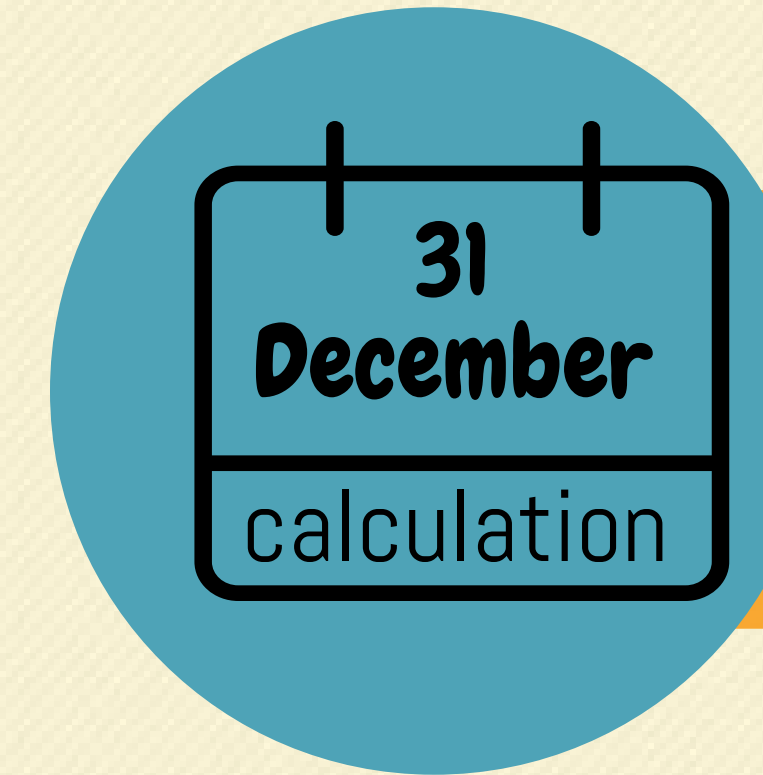
Interest earned and owed must be calculated using the same time frame



The time frame for calculating interest can't be less than one year



The interest must be calculated on 31 December of every year and at the end of the contract with the bank

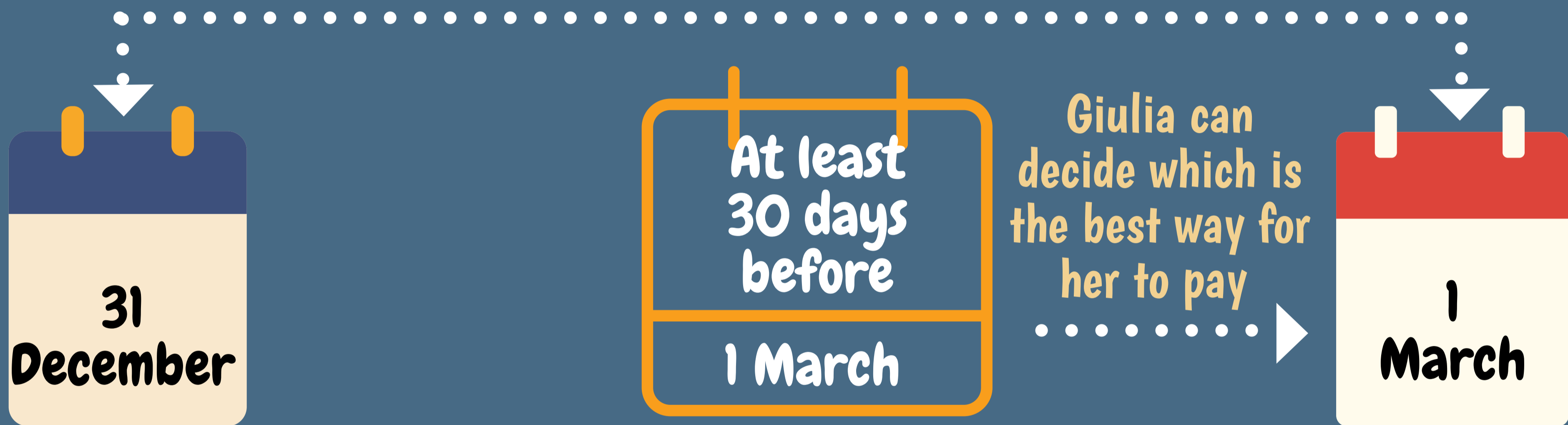


All existing current accounts must conform to the new rules, so it is very important that you:

- 1) contact your bank to ask for information and explanations**
- 2) read anything the bank sends you very carefully**

3 PAYMENT OF INTEREST OWED

In these two months the bank can't ask Giulia to pay interest owed

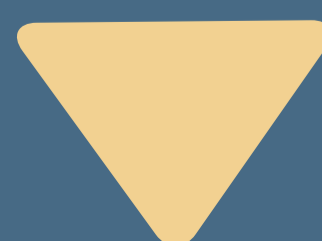


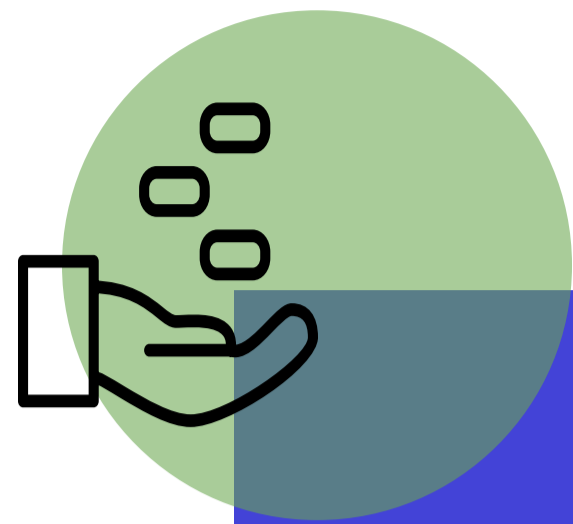
The bank calculates the interest owed

The bank must tell Giulia how much she has accrued in interest owed

Giulia has to pay the bank the interest owed

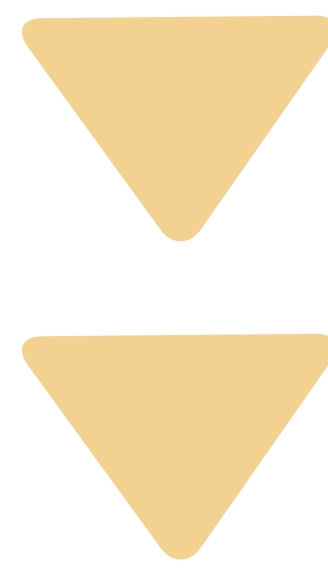
Giulia can choose one of the following:



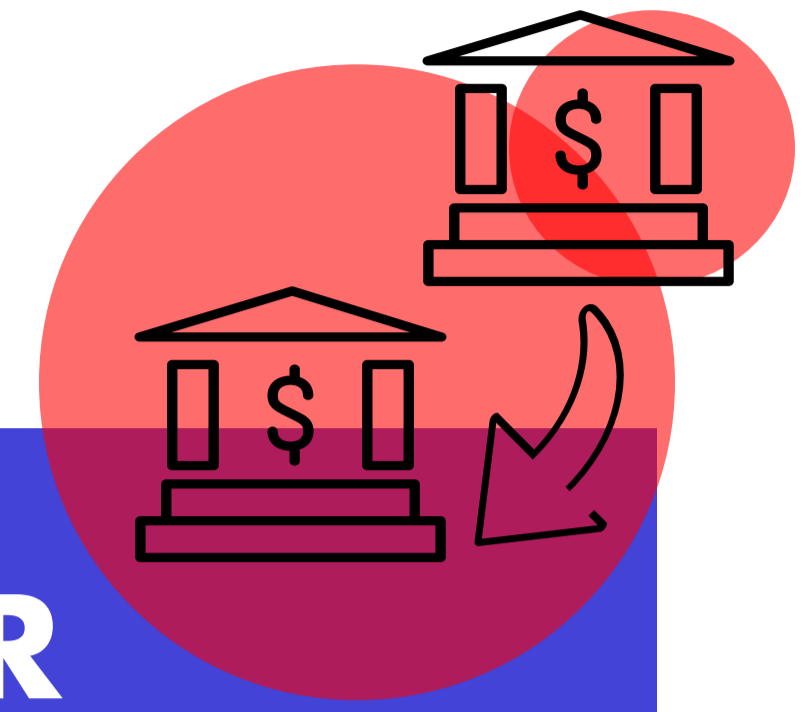


CASH

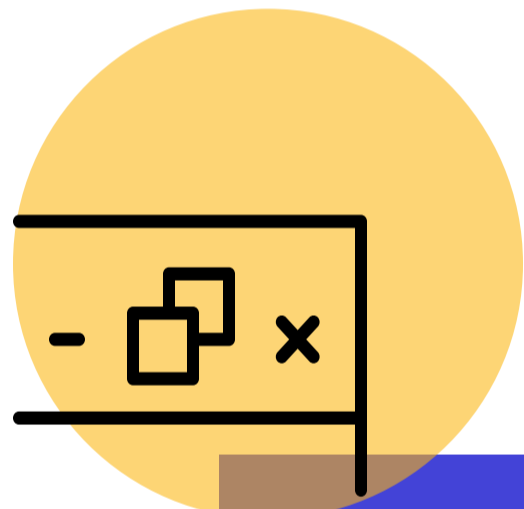
Pay directly in cash



CREDIT TRANSFER

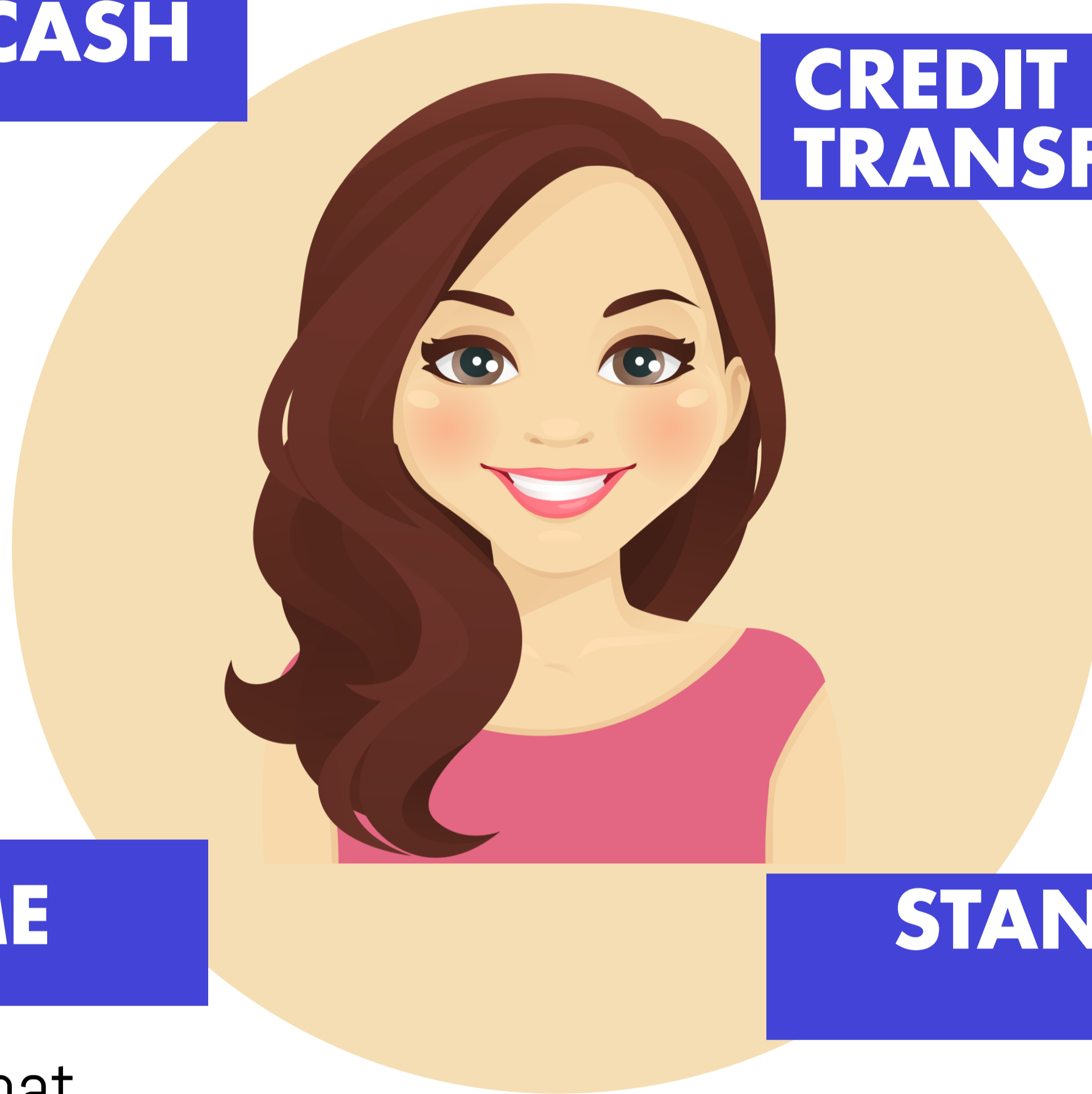


Pay directly with a credit transfer from another account



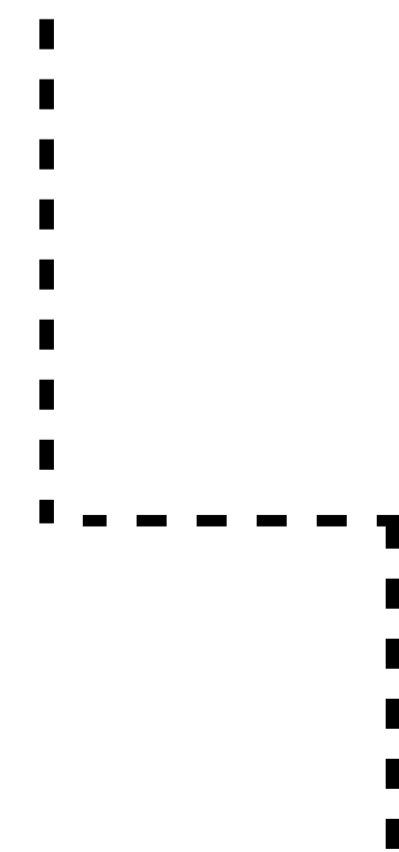
FUTURE INCOME

Arrange with the bank that the money that comes into her account will be used to pay off interest debts



STANDING DEBIT ORDER

Authorize a standing debit order to pay interest owed



Let's focus on a standing debit order



It will ensure that Giulia can PAY her interest owed ON TIME and AUTOMATICALLY



If Giulia has no other options for paying her interest owed, it will help her AVOID the consequences of NON-PAYMENT



If Giulia doesn't have enough money in her account to pay the interest owed, it will be added to the capital from 1 March and produce more interest. This is how her DEBT INCREASES

FOR FURTHER DETAILS GO TO THE BANK OF ITALY'S WEBSITE

www.bancaditalia.it/servizi-cittadino/cultura-finanziaria/informazioni-base/anatocismo/index.html