

Your Guide to Learning Daily Simple Interest

Although daily simple interest (DSI) can be a complex topic, there are a few key things to know about how it works. With this worksheet, you can check your understanding of DSI loans and sharpen your knowledge.

Interest and payments

Let's get going with a basic question: How does interest on a daily simple interest loan accrue?

- A on a monthly basis B annually C on a daily basis

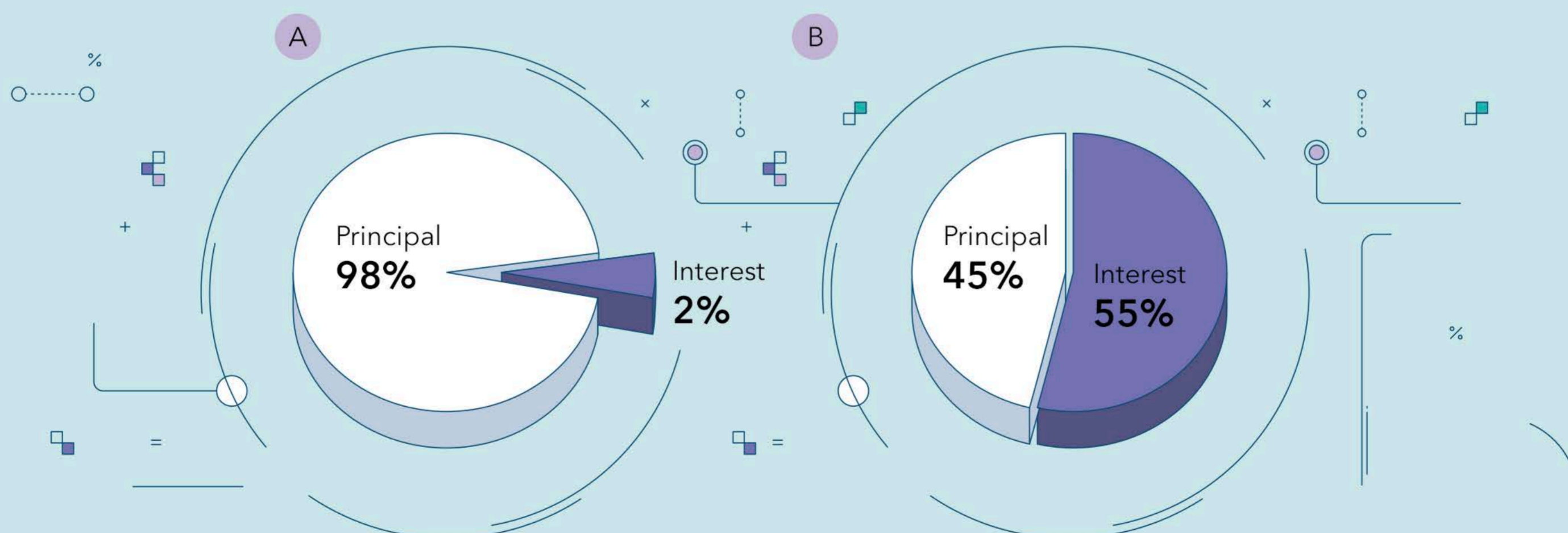
Now hold that thought for a second, because here's another question: What does a daily simple interest loan payment consist of?

- A interest on the loan B loan principal C both interest and principal

If you answered C to both questions, you are correct! DSI loans accrue interest daily, with interest calculated on the current principal balance. When you agree to the terms of a DSI loan, you commit to paying back the principal (what you borrowed) plus interest (what the lender charges you to borrow the money).

Reducing the principal

Now we're going to take a look at two pie charts, and each of them represents the split between interest and principal on a DSI loan payment. Which chart – A or B – best represents the allocations of your first regular repayment on a DSI loan, and which best reflects the allocations of your final payment?



If you think Chart A represents the way your final payment on a DSI loan will be split, you get a big thumbs up. Every time you make an on-time payment, the principal balance will go down and a larger portion of your payment will go toward the remaining balance. Chart B represents your initial payment because, in the beginning, you have a larger amount of unpaid principal to pay down and a larger percentage of interest charges are calculated on this higher principal balance. But as long as you make your monthly payments in full and on time, you will continue to see a pattern of a reducing principal balance until the loan is paid off.



One-time large payments

You can reduce the principal in less time by making an extra payment in addition to your regular monthly payments. So, what happens when you make a one-time large payment?

- A principal balance decreases
- B principal will go down and so will future interest payments
- C principal will go down and so will future interest payments, but only if you continue to make regular payments in full and on time

While A and B are both technically correct, the best answer is actually C. Did you get it right?

One of the main advantages of daily simple interest loans is that you only accrue interest on your current principal balance. If you reduce this balance by making a one-time large payment, you'll end up accruing less interest on future payments. However, this only works in your favor if you continue to make all the payments as outlined in your loan terms.

Late and missed payments

Okay, here's the last question: If you miss a payment or make a late payment, you're likely to end up paying...

- A more interest overall
- B the same amount of interest overall
- C less interest overall

This time, if you chose answer A then you've aced the final question.

A late or missed payment means you won't reduce your principal balance as scheduled. Keep in mind that interest is still accruing on a daily basis so you may be paying interest on a principal balance that is higher than it should have been, causing missed or late payments to cost you more money. Even if you catch up on payments, because you paid more in interest, it may take you longer than scheduled to completely pay off your principal, since payments are applied to interest before principal. That's not what you want.

The bottom line

If there's one thing to remember about daily simple interest loans, it's this: If you make the regular payments in full and on time, you will avoid paying additional interest charges and pay off your loan as scheduled.