FIN 360: PRINCIPLES OF FINANCIAL MANAGEMENT
COMPOUNDING PERIODS AND AMORTIZING LOANS
CRITICAL THINKING & CONCEPTUAL QUESTIONS

1. Why should the EAR be used to compare loans or bank accounts instead of APR?
2. Can the EAR ever be less than the APR? Can the EAR and the APR ever be the same?
3. Why do lenders present the APR and savings institutions present the EAR? Why might this be problematic for consumers?
4. What effect does increasing compounding periods have on present values and future values?
5. Explain the concept of *continuous* compounding. Does it ever happen in practice?
6. What is an APY?
7. What are the pros and cons of a certificate of deposit relative to saving in a traditional bank account?
8. Why would a bank offer a CD? What is the advantage from their perspective?
9. Why would a bank offer continuous compounding to a saver if they know that annual or monthly compounding would result in their paying less interest?
10. If you decide to pay several months of your mortgage early, why is it important that these payments be applied to the mortgage's *principal* and not the mortgage's interest?
11. In an amortizing loan, why is a greater portion of the monthly payment applied to interest than the principal? Through time, why is a greater portion of the monthly payment applied to the principal than the interest?
12. Why is the interest paid over the life of an amortizing loan not just the interest rate multiplied by the principal? For example, one would pay $529,200 in interest on a 30-year $400,000 mortgage with a 6.70% APR, not simply $400,000 × 0.0670 = $26,800 in interest. (*Yes*, you pay $529,200.29 + $400,000 = $929,200.29 for a $400,000 house!)