
Bank Discount and Negotiable Instruments

Bank Discount – Interest Deducted in Advance

When a bank loan is made, the interest is usually computed on the basis of the *maturity value*, the final amount of the loan on the due date. The interest rate used in computing the loan is called the *bank discount*, or simply the *discount rate*. The time used in computing is called the *period of discount*, which is the period from the date of discount to the maturity date. The interest thus computed is deducted immediately from the maturity date. This deduction is known as the *bank discount*, or *interest deducted in advance*. The value received by the borrower after the deduction is called the *proceeds*.

General Computation

In general Bank Discount and proceeds may be expressed as follows:

Bank Discount = Maturity Value x Discount Rate x Period of Discount
Proceeds = Maturity Value – Bank Discount

Finding the value of Bank Discount and Proceeds

Example:

Adell promises to repay a bank loan of €700 at the end of 60 days.

- If the bank charges 18% interest in advance, what is the discount?
- How much does Adell receive?

Example:

A man borrows €300 for three months from a bank that charges a discount rate of 15%. Find the proceeds.

Example:

Johnson wants €5000 in cash as the proceeds of a 90-day loan from a bank that charges 16% discount. What is the loan that Johnson must pay on the maturity date?

Finding the Annual Discount Rate

Example:

A man received a 30-day loan of €550 from the bank. The proceeds were €544.50. What is the discount rate?

Finding the Period of Discount

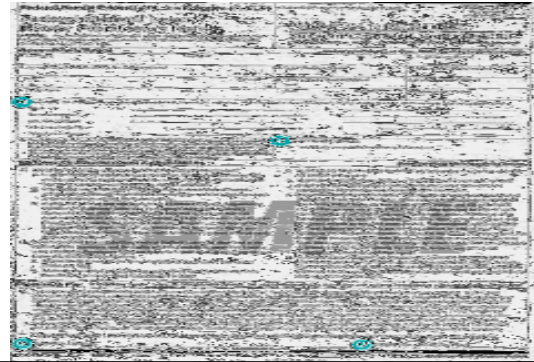
Example:

A man borrowed €800 from a bank that charges 15% interest in advance. He received €770 from the loan. When will the loan be due?

Nature of Negotiable Instruments

Negotiable instruments are written promises or orders to pay money. They are transferable or can be sold by one person to another person or bank. Frequently negotiable instruments are discounted by the bank discount method. Generally speaking, there are two types of negotiable instruments – *promissory notes* and *bills of exchange*.

Promissory Notes



Information found on Promissory Note

- Face Value
- Date of Note
- Term of the Note
- Interest Rate
- Maturity Date
- Maturity Value

Bill of Exchange

A bill of exchange has three parties: the *drawer*, the person who draws the bill; the *drawee*, the person to whom the bill is addressed; and the *payee*, the person to whom the payment is made.

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- A cheque is always drawn upon a bank as the drawee and is always payable upon demand.
 - Drafts are classified as *sight drafts* or *time drafts*.