

Mississippi Department of Banking and Consumer Finance

WHAT IS THE RULE OF 78s

It's difficult to understand; yet nearly all financial institutions use it. In Mississippi and other states, it is a method of figuring your cost and refund of credit insurance and/or finance charges on a precomputed credit transaction. A "precomputed" account is one which the account balance includes the finance charge and each month the full payment is subtracted from the balance. If the account pays off before maturity, a rebate of the unearned finance charge is given based on a method called "the Rule of 78s."

The Rule of 78s is commonly, even widely, used but is understood by very few people. It is a method of refunding finance charges and/or credit insurance premiums on consumer credit precomputed transactions when the borrower prepays the account in full. More interest and insurance premiums are earned in the early stages of a contract since the amount owing is greater. As the balance decreases, the earned charges are proportionately less for each unit period.

The Rule of 78s is also known as the sum of the digits. In fact, the 78 is a sum of the digits of the months in a year: 1 plus 2 plus 3 plus 4, etc., to 12, equals 78. Under the rule, each month in the contract is assigned a value which is exactly the reverse of its occurrence in the contract. Hence, the 1st month of a 12 month contract gets the value of 12, the second month 11, etc., until the 12th month gets a value of 1. As the months elapse, the interest is earned by the lender equal to the total value of the expired months.

For example, prepaying after 2 months of a 12 month contract would result in the lender being able to keep 29.49% of the finance charges (1st month 12 plus 2nd month 11 = 23/78 or 29.49%). In another example, if the borrower prepays after 6 months, the lender would have earned 57/78s or 73.08% of the finance charges.

EXAMPLE OF RULE OF 78s:

12 Month Loan - Made December 1 - First Payment on January 1

#	Month	Earned Units	Unearned Units	% Rebate
12	Jan	12/78	66/78	84.62%
11	Feb	23/78	55/78	70.52%
10	March	33/78	45/78	57.69%

9	April	42/78	36/78	46.15%
8	May	50/78	28/78	35.90%
7	June	57/78	21/78	26.92%
6	July	63/78	15/78	19.23%
5	Aug	68/78	10/78	12.82%
4	Sept	72/78	6/78	07.69%
3	Oct	75/78	3/78	03.85%
2	Nov	77/78	1/78	01.28%
1	Dec	78/78	0/78	00.00%
78				

FINANCE CHARGE REFUND

EXAMPLE:

If the finance charge on a 12 month precomputed consumer credit transaction is \$100.00 and the account is paid-in-full in the 3rd month; the total of the 1st, 2nd, and 3rd monthly earned units is 33/78 and the total unearned units is 45/78 (78 - 33). 45/78 converted to a percent is 57.69%. The unearned finance charge refund would be 57.69% of the \$100.00 finance charge which would be \$57.69.

As you can see in this example, 42.31% of the finance charge was earned in the first three months of the 12 month contract.

In Mississippi, if loans made or handled by a licensee under the provisions of the Small Loan Privilege Tax Law are paid in full prior to maturity, after July 1, 1974, whether by cash, renewal or otherwise, the licensee shall refund to the borrower the finance charge exceeding one dollar (\$1.00) calculated on the rule of the sum of the digits, commonly known as the "Rule of 78ths." The refund shall be based and calculated on the number of days by which the loan is paid in advance, less twenty (20) days. Using the above example, if a loan was granted January 1, 2002, and paid off March 27, 2002, the finance charge computation is based on four (4) months unearned or 46.15% of \$100.00 or an unearned finance charge refund of \$46.15. However, using the same example, if the loan paid off March 26, 2002, the finance charge computation is based on three (3) months unearned or 57.69% of \$100.00 or an unearned finance charge refund of \$57.69. The difference in the two refunds is the affect of the 20 day rule.

CREDIT INSURANCE PREMIUM REFUNDS

Mississippi Credit insurance premium refunds are computed in the same manner as finance charge refunds using the Rule of 78s except that the twenty (20) day rule does not apply and one day in the next month constitutes another full month. In the event of the payment of a loan in full one or more months prior to maturity date, whether by cash, new loan, renewal, or refinancing, the insurance policy(ies) or certificates shall be cancelled and the borrowers shall be entitled to a refund of the unearned portion (in excess of \$2.00) of the premium on any property insurance written through the Licensee, with such refund being calculated under the Rule of 78's,

unless the policy or certificate calls for a greater refund amount. Calculations shall be based on the date of the loan to the date the loan is paid-off. In calculating a Rule of 78's refund, one (1) day shall constitute a full month earned.

In the example of a contract dated December 1 with a credit insurance premium of \$100.00 for a term of 12 months, the \$57.69 refund would apply to accounts paid-in-full from February 2 to March 1.

EXAMPLE OF A RULE OF 78s

The following formula is the simplest method of computing the refunds by the Rule of 78s.

FORMULA . . .

$(U * (U + 1)) \backslash (T * (T + 1)) = \text{Rule of 78s refund decimal} * F = \text{Rebate}$

U = Unearned term periods - U = 9	\ = Divided by
T = Term periods - T = 12	* = Times
F = Finance Charge - F = \$100.00	

Example:

This example is for a **12 month** contract which prepaid at **3 months (9 months unearned)** with a finance charge of \$100.00.

U = 9
T = 12
F = \$100.00

$(9 * (9 + 1)) \backslash (12 (12 + 1)) = (9 * 10) \backslash (12 * 13) = 90 \backslash 156 = .5769$ Rule of 78s refund decimal,
 $.5769 * \$100.00 = \mathbf{\$57.69 \text{ Refund}}$

Charts and other calculating devices are available to creditors for accurately computing the unearned charges under the Rule of 78s.

TERMS OVER 61 MONTHS

Since July 1, 1992, the Rule of 78s refund can not be used on contracts with a term over 61 months. Refunds are computed by applying the disclosed annual percentage rate to the unpaid balances of the amount financed for the full computational periods following the prepayment, as originally scheduled or as deferred.

If you think that your refund has been computed incorrectly or if you have other questions regarding consumer credit, contact this Department.