Louisiana Consumer Credit Law
Rule of 78's Rebates

OFI Advisory Opinion No. 6
August 29, 2008

This advisory opinion addresses the interest rebate method commonly referred to as the Rule of 78's.

The Louisiana Consumer Credit Law authorizes lenders to make precomputed consumer loan transactions, which are defined in LSA-R.S. 9:3516 (25) as, "…a consumer credit transaction under which loan finance charges or credit service charges are computed in advance over the entire scheduled term of the transaction and capitalized into the face amount of the debtor's promissory note or other evidence of indebtedness." The finance charge calculation on precomputed loans assumes that customers will repay loans in equal, monthly installments until maturity. In the event that a customer prepays a precomputed loan before maturity, the extender of credit is required to refund (rebate) unearned loan finance charges previously capitalized and included in the promissory note.

In addition to other acceptable methods of calculating the rebate of unearned finance charges, LSA-R.S. 9:3532 allows lenders to use a method commonly referred to as the Rule of 78's. This method is based on equal, monthly installments and allows the creditor to earn one month of interest on the first day of each installment due date. Under the Rule of 78's, if a borrower prepays a precomputed consumer loan, the creditor earns interest for the entire month in which the prepayment occurs, as well as interest paid in previous monthly installments (expired months). The customer is not charged for interest relating to the remaining monthly installments (unexpired months). (See the attached supplement for more detail regarding this calculation.)

For purposes of calculating the Rule of 78's rebate, creditors earn the entire amount of the finance charge assessed on the expired months in the promissory note, as well as the entire month of the prepayment, regardless of the actual number of days that expired in the month of prepayment. The rebate of unearned finance charges relates to the finance charges assessed for the month following the month of prepayment and each subsequent month until the final payment date.

John Ducrest

John Ducrest, Commissioner
Office of Financial Institutions
August 29, 2008

Supplement

The “Rule of 78’s” is used to determine the amount of interest that must be rebated to borrowers who pay precomputed consumer credit contracts before their maturity date. This method calculates a rebate ratio which is applied to the total finance charge capitalized and included in a precomputed consumer credit contract, to determine the amount of the total finance charges that must be rebated to the customer in the event of a prepayment.

The rebate ratio is computed as follows:

$$\frac{\text{Sum of the Digits of the unexpired months in the contract}}{\text{Sum of the Digits of the total number of months in the contract}}$$

On the origination date of a 12 month contract, all 12 months are unexpired. After the first monthly payment, 11 months are unexpired. After the second monthly payment, 10 months remain unexpired, and so forth. The sum of all months at the inception of a 12 month contract (denominator) is 78 (12 + 11 + 10 + 9 + 8 + 7 + 6 + 5 + 4 + 3 + 2 + 1). If the contract is prepaid in full during the 4th month, the sum of the digits of the 8 unexpired months (numerator) is 36 (8 + 7 + 6 + 5 + 4 + 3 + 2 + 1). This method disregards the number of days in a month and calculates the rebate based on the assumption of equal, monthly installments. The number of elapsed days in the month of prepayment is ignored. Prepayment on any day during the installment period is treated as prepayment in that month and the rebate calculation of the numerator portion of the formula begins on the following month.

Example

Amount Financed:	$1,000	Annual Interest Rate:	35%
Monthly Installments:	$ 100	Finance Charge:	$200
Months in Agreement:	12		

Assumptions: No other fees or charges are included in the agreement.

Installments on a 12-month, precomputed loan begin on January 1, 2008 (1st payment due date) and are payable on the first of every month until the final payment is made on December 1, 2008. If prepayment occurs on April 2, 2008, the rebate calculation begins with May, the month after the month of prepayment. The creditor earns the finance charges for the months of January, February, March and April. The months included in the rebate of unearned finance charges are May – December. If the prepayment occurred on April 30, the calculation is the same.

Formula

Rule of 78's Ratio (expressed as a decimal) x Finance Charge = Amount of Rebate

Calculation

$$\frac{8 + 7 + 6 + 5 + 4 + 3 + 2 + 1}{12 + 11 + 10 + 9 + 8 + 7 + 6 + 5 + 4 + 3 + 2 + 1} = \frac{36}{78} = .461538, \text{ therefore}$$

.4615 x $200 (Finance Charge) = $92.30 (rebate)

A short-cut to determine the refund percentage is:

((E/2) x (E+1)) ÷ ((N/2) x (N+1)) where,

E = the number of unexpired months in the contract, and

N = the total number of months in the contract

Using the above example:

((8/2) x (8+1)) ÷ ((12/2) x (12+1)) = 36 ÷ 78 = .46154

The payout for the customer during the 4th month is calculated as follows:

Total note (including capitalized interest)	$1,200.00
Less:	
Three monthly payments	(300.00)
Rebate	(92.30)
Payout Amount Due in Month 4	$ 807.70