

**Department of Legislative Services**  
Maryland General Assembly  
2006 Session

**FISCAL AND POLICY NOTE**  
**Revised**

Senate Bill 275

(Senator Exum)

Finance

Economic Matters

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**Premium Finance Companies - Calculation of Finance Charge - Return of  
Unearned Interest After Cancellation of Insurance Contract**

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This bill requires the computation of the finance charge on an insurance premium financed through a premium finance company to be based on the outstanding balance of the premium finance loan. The bill repeals the provision specifying that interest on the loan is charged in advance. The bill also provides that, after an insurer returns to a premium finance company any gross unearned premium upon cancellation of an insurance policy, the premium finance company must return to the insured the following amounts that exceed any amount due under the premium finance agreement: (1) the amount of unearned premium; and (2) the amount of gross unearned interest computed in accordance with the actuarial method and excluding any fees or charges for initial service, delinquency and collection, cancellation, reinstatement, or dishonored checks.

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**Fiscal Summary**

**State Effect:** Special fund revenues from the \$125 filing fee collected by the Maryland Insurance Administration could increase in FY 2007 to the extent premium finance companies file forms to reflect the bill's changes. The number of these filings cannot be accurately estimated but is assumed to be minimal. Expenditures would not be affected.

**Local Effect:** None.

**Small Business Effect:** Minimal.

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## Analysis

**Current Law:** A premium finance company may charge a finance charge on insurance premiums that it finances through a premium loan. The finance charge must be computed: (1) on the amount of the entire premium loan advanced, after subtracting any down payment on the premium loan; (2) from the inception date of the insurance contract or from the premium's due date through the final installment's payable date, disregarding any grace period or credit allowed for payment of the premium; and (3) at a maximum rate of 1.15% for each 30 days, charged in advance.

When an insurance contract is canceled, the insurer must return any gross unearned premiums that are due under the insurance contract, computed *pro rata*, to the premium finance company for the account of the insured within 45 days after: (1) receiving a notice of cancellation from the premium finance company or the insured; (2) the date that the insurer cancels the contract; or (3) completion of any payroll audit necessary to determine the amount of premium earned while the insurance contract was in force. Such an audit must be performed within 45 days after the insurer receives the notice of cancellation.

After the insurer returns to the premium finance company any gross unearned premiums that are due under the contract, the premium finance company must refund to the insured the amount of unearned premium that exceeds any amount due under the premium finance agreement. A premium finance company is not required to refund any amount that would be less than \$5.

**Background:** Many premium finance companies use a method of computing interest that heavily weights the early payments of a loan to interest. Upon cancellation of an insurance policy procured through a premium finance company – and the loan to purchase the insurance policy – an insured would receive a lower refund under this computation method because the early payments would have been credited to interest.

This interest computation method, frequently called the “rule of 78” or “rule of 78’s,” is prohibited under federal law for closed-end consumer loans of 61 months or longer. The method is not permitted for closed-end consumer loans of 60 months or less under State law. Sixteen other states have similar prohibitions against the use of the rule of 78.

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## Additional Information

**Prior Introductions:** None.

**Cross File:** None.

**Information Source(s):** Maryland Automobile Insurance Fund, Maryland Insurance Administration, Department of Legislative Services

**Fiscal Note History:** First Reader - February 10, 2006  
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