

Early repayment costs on fixed rate loans

An early repayment cost (ERC) is a fee that a bank or other lender may charge you if you repay a fixed interest rate loan before the fixed rate term ends. Early repayment costs are also commonly known as break fees.

Why do lenders charge ERCs?

Often when a fixed rate loan is repaid early, the lender will lose money. It recovers this loss through the early repayment charge.

Calculating an ERC involves a complex formula but, very broadly, a lender will lose money if interest rates at the time of early repayment are lower than the interest rate applicable to the loan. This is because the lender cannot re-lend the repaid funds at the same rate that it could when it first loaned the money.

If interest rates have remained stable or have risen, there will not be a cost to the lender if the loan is repaid early, and they won't charge an ERC.

A lender may charge an administration fee when a loan is repaid, regardless of whether an ERC is payable. Such a fee is usually a flat fee for the administrative costs involved in processing the repayment of the loan. This is separate from an ERC.

Are lenders allowed to charge ERCs?

Yes. Lenders are entitled to require you to cover any costs that result from a loan being repaid early. But this must be set out in the terms and conditions of your loan contract.

For consumer credit contracts (such as personal loans and mortgages), how much a lender can charge is regulated by the Credit Contracts and Consumer Finance Act (CCCF Act).

The Act says that a borrower may repay a loan at any time and the lender may, if set out in the loan contract, charge the borrower for any costs that result from early repayment of the loan. The charge must be a reasonable estimate of the actual cost to the lender of the loan being paid back early.

How to contact us

Over 2009/10, the Commerce Commission investigated ERCs. It concluded that the various calculations used by the lenders were likely to produce an ERC that is reasonable and therefore compliant with the CCCF Act. In two cases, the Commission noted technical issues with the ERC formulae used by different lenders. The formulae were corrected.

Can my lender tell me how much the ERC will be when I take out the loan?

No. When you enter into a fixed interest rate loan, a lender can't know whether it will lose money if you repay your loan early. Whether they lose money, and how much the loss might be, will depend in part on interest rates at the time of early repayment, as well as how early you repay the loan.

However, the lender must set out in the contract that an ERC may be charged if you repay your loan early, and how the ERC will be calculated

What can I do if I have an issue with an ERC my lender has charged me?

In times of falling interest rates, ERCs can rise significantly. Customers can be surprised at the size of the ERC payable in the event they repay their loan early.

If you have a problem relating to an ERC you have been charged by your lender, you should give us a call. Bear in mind, simply charging an ERC is not necessarily an issue in itself.

The types of things that could be a concern are if:

- your lender didn't tell you about the ERC;
- your lender didn't tell you about how the ERC is calculated;
- the ERC has not been charged according to the loan contract. In other words, there has been a mistake in the calculation;
- you were told something incorrect about the ERC. For example, when, why or how an ERC would be charged.
- your lender gave you incorrect advice about the most appropriate type of loan for your circumstances. For example, if you sought advice from your lender and said that you intended to sell your property within a specific time period, a recommendation to fix the interest rate beyond that period may not be appropriate.

We refer any complaints about the methodology used by a lender to calculate the ERC to the Commerce Commission. The Commission enforces the CCCF Act and has greater powers to deal with lenders that may have broken the law.

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