

EARLY REPAYMENT OF A NON-HOUSING LOAN

Introduction

1. Under Section 13 of the Banking Ordinance, 1941, a banking corporation must allow the early repayment of a loan extended for the purchase of a residential home or for a mortgage on a residential home (hereinafter, housing loan), under certain conditions. In addition, the banking corporation may make the early repayment contingent on payment of a fee. The method for calculating the fee is determined in the Banking (Early Repayment of a Housing Loan) Order, 5762–2002 (hereinafter, the Banking Order). In order to make it easier for customers to move from one banking corporation to another, to increase competition between banking corporations and to prevent collection of excessive early repayment fees, the following directive has been established in order to regulate the early repayment of some of the other loans extended by a banking corporation and that are not covered by the above legislation.

Applicability

2. (a) The directive, except for Section 4(b) shall apply to a loan to which the Banking Order does not apply, that was extended to individuals or to very small businesses as defined in the Reporting to the Public directives.
(b) Notwithstanding the provisions of Subsection (a), Sections 5(a)a and 6 shall apply to all loans to which the Banking Order does not apply.
(c) The provisions of this directive shall not apply to a loan regarding which a banking corporation has decided to apply the provisions of the Banking Order.

Definitions

3. **“Prior notice”** - Prior notice given by the borrower to the banking corporation of his intention to repay the loan at a specific date;
“Foreign-currency loan” - A loan which is denominated in or indexed to foreign currency;

- “Variable-rate loan”** - A loan on which the interest rate varies during the term of the loan, and the variable interest rate is not known at the time the loan is received;
- “Indexed loan”** - A loan indexed to the CPI that is published once a month by the Central Bureau of Statistics (CBS).
- “Amount paid”** - The amount of principal in early repayment *plus* indexation or exchange-rate differentials, whichever applies, and interest accrued to the early repayment date.
- “Interest rate used to calculate the capitalization component”** In accordance with the regulations defined in Appendix B.
- “Average published interest rate”** The known interest rate published by the Supervisor of Banks, and notice of which was provided to banking corporations, and which was set on the basis of the weighted average interest rate on credit extended to individuals or very small businesses as defined in the Reporting to the Public Directives, in accordance with various periods and to various sectors.

Early repayment of a loan

4. (a) A banking corporation shall not unreasonably refuse a request by a borrower to repay a loan or part of it as stated in Subsection (d) before the repayment date, however, the banking corporation is entitled to make the early repayment contingent upon payments, as specified in Section 5 of this directive.
- (b) With regard to a loan to which Section 2(a) does not apply, and subject to Section 2(b), an early repayment fee shall apply as per reasonable rules that express the damage

incurred by the banking corporation as a result of the early repayment, and which will be predetermined for such cases.

- (c) If the loan agreement specifies a lower early repayment fee than that stated in this directive, the early repayment fee as agreed in the loan agreement shall apply.
- (d) The banking corporation is entitled to stipulate that the amount repaid shall not be less than 10 percent of the loan outstanding, plus accrued interest and indexation differentials not paid by the date of the actual repayment.

Early repayment fees

5. (a) In the early repayment of a loan, a banking corporation is entitled to make the early repayment contingent on payment of the following fees:
- (1) An operating fee that shall not exceed NIS 60;
 - (2) If the borrower has given a prior notice of less than 10 days, the fee may be up to 0.10 percent of the amount repaid; however, if the banking corporation has extended a loan for the purpose of the early repayment, it shall not deduct the above fee with regard to the amount of the new loan it has extended. Should the borrower become deceased, the fee noted in this section shall not be charged.
 - (3) a payment in the amount of the difference between the future payments that the borrower wishes to make through early repayment, discounted to its present value on the early repayment date using **the interest rate used to calculate the capitalization component**, and those same payments, discounted to their present value on the repayment date according to the **average published interest rate** known on the date the loan was extended, based on the term of the loan set in the loan agreement, if it is a fixed interest rate, or that is known on the last interest-rate change date based on the term of the loan remaining until the upcoming interest-rate change date, if it is a variable interest rate.

If the average interest rate was not published as of the date that the loan was extended or the last interest-rate change date, whichever is appropriate, or if the loan was a foreign-currency loan, a payment in the amount of the differential between the future payments that the borrower wishes to repay early, discounted to the present value on the early repayment date using **the interest rate used to calculate the**

capitalization component, and those payments, discounted to the present value on the early repayment date using **the interest rate that applies to the loan**.

(4) , the calculation of the fee shall be as stated in paragraph (3), and the balance of the discounted amount shall be offset from the amounts as stated in Subsections (a)(1)–(2) and (c). If the banking corporation exempts all of its customers from the payment as stated in paragraph (3) when signing the loan agreement, it is permitted not to make the stated offset.

(b) Variable-rate loan

(1) The rules determined in Subsection (a) shall also apply to a variable-rate loan, but for the purpose of calculating the fee as stated in Section 5(a)(3), the outstanding loan principal at the time when a new interest rate applies or could apply shall be regarded as the last future payment in the flow of future payments the borrower wishes to make;

(2) For a variable-rate loan regarding which the date of the interest-rate change is not known in advance, or that is known in advance but is set for once per half-year or more frequently, no fee as stated in Section 5(a)(3) shall be charged;

(3) If the early repayment is made on the day the interest rate changes, only a fee as stated in Section 5(a)(1) shall be charged;

(4) For the purpose of the formula for calculating the early repayment fee on a variable-rate loan in foreign currency, the banking corporation shall also take into account the differentials resulting from the change in the increment beyond the benchmark variable-rate.

(c) For a CPI-indexed loan—in addition to the fees as stated in Section 5(a), if the early repayment was made between the first and 15th of the month, the banking corporation is entitled to charge a fee equivalent to the repaid amount *multiplied* by half the average rate of change in the CPI, in the last twelve CPIs published before the repayment date.

(d) A banking corporation is entitled to refuse to accept early repayment of a loan without prior notice of at least 20 days in advance, in the following instances:

- (1) A foreign-currency loan.
 - (2) A loan which is indexed to the CPI and the requested early repayment date is between the first and the 15th of the month.
- (e) Miscellaneous
- (1) The publication in *Reshumot* of the updating of the amount stated in Section 3(1) of the Banking Order shall constitute an announcement of the updating to the same extent of the amount stated in Section 5(a)(1) of this directive.
 - (2) If a borrower has given prior notice but has not acted accordingly, an additional early repayment notice of the same loan given by the borrower shall not be included in the calculation of the fee, for six months from the date set for the early repayment in the first notification.

Prior notice

- 5a. (a) Prior notice shall be given in one of the following ways:
- (1) By handing it in at the branch of the banking corporation;
 - (2) By sending it by mail, and prior notice is regarded as having been given on the day it is received by the banking corporation, and if by registered mail—3 days after the date on which it was sent;
 - (3) By fax;
 - (4) By other means of communication proposed by the banking corporation, per the customer's request
- (b) Prior notice shall be given no more than 60 days prior to the date stated by the borrower for the implementation of the early repayment.

Explanatory notes and notification of early repayment

6. (a) **Explanatory notes**

A banking corporation shall provide the borrower with explanatory notes, around the time the loan agreement or the framework agreement is signed, as applicable. At that time, the contents of the explanatory notes may be included as an appendix to the loan agreement or framework

agreement, provided that it is presented prominently and emphasized. In addition, the banking corporation shall provide explanatory notes to the borrower around the time the borrower expresses the request to undertake early repayment. The banking corporation shall document the transmission of the explanatory notes to the borrower in both instances.

In this respect, “explanatory notes” refers to a sheet of paper clarifying the borrower’s right to make an early repayment of the loan, including *inter alia*:

- (1) The type of loan referred to, the outstanding balance by its various components, and the amount to which Section (5) of this directive applies;
- (2) Clarification regarding the possibility of giving prior notice of 10 days before the repayment date, and the implications of failing to give such prior notice;
- (3) Banking corporation contact details for providing prior notice of 10 days before the repayment date for each of the methods listed in Section 5a(a);
- (4) Clarification regarding the significance of undertaking early repayment of an indexed loan at various dates during the month;
- (5) All the types of early repayment fees that will be charged to the borrower by the banking corporation, and their total, inasmuch as this may be known in advance. At the time of the borrower’s request to make an early payment, the rates of reductions per the loan agreement, as they are set, should also be noted. In cases where the banking corporation has exempted the borrower from the payment of fees in respect of the early repayment of the loan, in whole or in part, the banking corporation shall provide the borrower with brief explanatory notes in which the relevant sub-sections of this section are noted.
- (6) Examples that illustrate to the borrower the rate of the early repayment fee, according to Section 5, as a function of the time remaining until final repayment of the loan and of changes in the interest rate in calculating the capitalization component.
- (7) Reference to the capitalization component formula and method of calculation, which are to be clearly displayed on the banking corporation’s website. Additionally, the banking corporation shall provide, to a borrower interested in receiving it, the capitalization component formula and method of calculation, in the manner in which

it generally sends the customer notices or in any other accepted manner selected by the borrower.

(b) Notification of implementation of early repayment

After implementation of the early repayment, the banking corporation shall provide the borrower with a notice that specifies *inter alia* the method of calculating the components and amounts of the early repayment fee charged, including the interest rate and formula used to calculate the capitalization component And reference to the capitalization component formula and method of calculation, as stated in Section 6(a)(7).

Formula for calculation

7. The amount of early repayment fee of a loan under Section 5(a)(3) shall be calculated according to the formula in Appendix A.

APPENDIX A

FORMULA FOR CALCULATING EARLY REPAYMENT FEE

(Section 5(a)(3))

a. **Definitions**

- A** - The interest rate used to calculate the periodic capitalization component.
- C** - The average published interest rate known on the date the loan was extended, based on the term of the loan set in the loan agreement, if it is a fixed interest rate, or that is known on the last interest rate-change date based on the term of the loan remaining until the upcoming interest rate-change date, if it is a variable interest rate.
- R** - The periodical interest rate that applies to the loan at the early repayment date.
- B_i** - Future periodic payments in accordance with the loan terms (including interest to be accrued).
- i** - Index for the period.
- n** - The number of periods from the early repayment date to the date of the interest rate change.
- N** - The number of periods from the early repayment date to the end of the loan period.
- PV(R)** - The amount of principal in to be repaid early, plus indexation differentials or exchange rate differentials and interest accrued up to the early repayment date.
- PV(A)** Present value of the future payments to the end of the loan period, where the payments up to the interest-rate change date and the principal on the interest-rate change date are discounted to the early repayment date using the interest rate for the calculation of the periodic capitalization component.
- PV(C)** Present value of the future payments to the end of the loan period, where the payments up to the interest-rate change date and the principal on the interest-rate change date are discounted to the early repayment date using the **average published interest rate** known on the date the loan was extended, based on the term of the loan set in the loan agreement, if it is a fixed interest rate, or that is

known on the last interest rate-change date based on the term of the loan remaining until the upcoming interest rate-change date, if it is a variable interest rate.

b. (1) The general formula

Section 5(a)(3)

$$PV(A) - PV(C) = \left[\sum_{i=1}^n \frac{B_i}{(1+A)^i} + \frac{1}{(1+A)^n} \sum_{i=1}^{N-n} \frac{B_{i+n}}{(1+R)^i} \right] \\ - \left[\sum_{i=1}^n \frac{B_i}{(1+C)^i} + \frac{1}{(1+C)^n} \sum_{i=1}^{N-n} \frac{B_{i+n}}{(1+R)^i} \right]$$

If C is not published, the calculation shall be made on the basis of the interest rate that applies to the loan:

$$PV(A) - PV(R) = \left[\sum_{i=1}^n \frac{B_i}{(1+A)^i} + \frac{1}{(1+A)^n} \sum_{i=1}^{N-n} \frac{B_{i+n}}{(1+R)^i} \right] \\ - \left[\sum_{i=1}^n \frac{B_i}{(1+R)^i} + \frac{1}{(1+R)^n} \sum_{i=1}^{N-n} \frac{B_{i+n}}{(1+R)^i} \right]$$

Note:

The principal at the interest rate date change:

$$\sum_{i=1}^{N-n} \frac{B_{i+n}}{(1+R)^i}$$

When $n = N$ (i.e., no change in interest to the end of the loan period) disregard the second component in each square brackets (i.e., assume that the principal at the interest rate date change zeros out).

The formula is appropriate for loans that are repaid in equal time intervals (even when the payments are not equal) and for loans that are repaid in unequal periodical time intervals. (i.e., if the period is defined as a month, the formula can be used for a loan that is repaid in time intervals of whole months, even if the time intervals are not equal. For example: a loan that is repaid once a month and once every three months alternately).

(2) **Variable-rate loans in foreign currency**

In the case of variable-rate loans in foreign currency, the differentials for the increment beyond the benchmark interest rate in the period after the interest rate is changed should also be taken into account.

$$PV(A) - PV(R) = \left[\sum_{i=1}^n \frac{B_i}{(1+A)^i} + \frac{1}{(1+A)^n} \sum_{i=1}^{N-n} \frac{B_{i+n}}{(1+A^*)^i} \right] - \left[\sum_{i=1}^n \frac{B_i}{(1+R)^i} + \frac{1}{(1+R)^n} \sum_{i=1}^{N-n} \frac{B_{i+n}}{(1+R)^i} \right]$$

Where:

A* is the benchmark interest rate on the loan at the time of early repayment and the banking corporation's new periodical increment beyond the benchmark interest rate.

The other variables are defined in the original formula.

c. **Partial early repayment**

- (1) In a partial early repayment under which there were specific periodic payments were repaid early (for example: shortening the loan period by early repayment of the last payments), the banking corporation may calculate the fee (in accordance with the formula) for the economic loss due to the early repayments, or alternatively, as the relative portion of the fee for full payment of the loan.
- (2) In a partial early repayment under which the periodic payments were reduced, while the original loan period remained unchanged, the banking corporation

may calculate the fee (in accordance with the formula) based on the relative portion of the loan which was repaid early.

Appendix B

Establishing the “INTEREST RATE USED TO CALCULATE THE PERIODIC CAPITALIZATION COMPONENT”

(Section 3)

Shekel loans with a fixed interest rate

The interest rate used to calculate the capitalization component is to be the last average published interest rate known on the date of early repayment, for the period remaining until the end of the loan.

In the absence of the last average published interest rate, the interest rate for calculating the capitalization component is to be set using reasonable rules that reflect the damage caused to the banking corporation as a result of the early repayment.

Shekel loans with a variable interest rate:

The interest rate used to calculate the capitalization component is to be the last average published interest rate known on the date of early repayment, for the period remaining until the next interest-rate change date.

In the absence of a published interest rate, the interest rate for calculating the capitalization component is to be set using reasonable rules that reflect the damage caused to the banking corporation as a result of the early repayment.

Foreign-currency loans

Variable rate:

The interest rate used to calculate the capitalization component is to be calculated on the external objective basis for setting the interest rate on a loan, as set in the loan agreement, known at the date of early repayment, plus the reduction or addition to the base interest rate that is set in loan.

Fixed interest rate:

The interest rate used to calculate the capitalization component is to be calculated on an external objective basis.

The components of the interest rate used to calculate the capitalization component are to be defined in advance in the loan agreement or presented clearly on the banking corporation's website. Additionally, the banking corporation shall provide, to a borrower interested in receiving it, the

capitalization component formula and method of calculation, in the manner in which it generally sends the customer notices or in any other accepted manner selected by the borrower.

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Revisions

Circular 06 number	Version	Details	Date
1741	1	Original directive	15/1/95
----	2	Updated version of Proper Conduct of Banking Business file	12/95
2037	3	Revision	1/8/01
2102	4	Revision	30/1/03
2472	5	Revision	16/6/15
2504	6	Revision	11/7/16