

## BANKS CONCEAL COSTS OF PREPAYMENT FEES – A DANGEROUS PRACTICE

April 7, 2014 | Adv. Shaul Kotler and Adv. Shai Piade

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The prepayment fee is one of many charged by the bank in the framework of providing current loan account services to its clients (in this case, index linked loans). Unlike others, the principal rate of the fee, save for a low fixed amount, is not disclosed by the bank and therefore clients are not able to assess the scope of the fees to be collected from them.

Capitalization calculations (interest differentials) are at the base of this fee, however generally speaking and excluding residential loans of up to NIS 750 thousand, the bank's method of calculation remains a "mystery" to the client desiring to prepay loans not according to the amortization schedule in the loan agreement they signed.

According to the directives of the Supervisor of Banks, clients are to be charged such fee according to reasonable principles reflecting the damage caused to the bank as result of prepayment of the loan. The Bank of Israel even provided a formula for calculation however these are not enough to reveal the banks' method of calculation.

The calculation principles and variables required to be included in the formula are internally determined by the bank, are subject to frequent change, are not specified by the bank, and not disclosed to the client in the framework of full disclosure. Thus, a reasonable client has no way of checking such calculation.

In the price list of fees published by the banks, the prepayment fee usually indicates a negligible amount of several dozens of Shekels. With respect to the capitalization component of the fee, the price list notes there are additional financial costs to prepayment. In the loan agreement signed by the client, the bank includes a standard clause pertaining to its right to collect such fee upon prepayment of the loan for damages incurred by the bank due to prepayment, however there is no indication regarding the base of the fee and the manner of calculating the damage. This concludes the bank's disclosure obligations towards the client with respect to the costs of loan prepayment. To make it clear, this cost may sum up to millions of NIS or more.

Bank clients remain baffled with respect to the manner of calculating the prepayment fee. In fact, banks charge their clients with such fee without any explanation and/or prior disclosure with respect to the manner of calculation, contrary to the directives of the Supervisor of Banks and contrary to the duties of care, fiduciary and transparency that apply to banks.

In the case of Nave Gil Hazahav Ltd. v. Bank Hamizrahi Hameuhad, the court ordered restitution of the amount excessively collected by the bank as prepayment fees. In her judgment, Judge Reich ruled that the provisions of Regulation 454 apply, whereby prepayment fees must reflect

the damage caused to the bank as result of prepayment however the rate of the fees must be based on reasonable principles determined in advance.

The judgment sets forth that “the provisions of the regulation do not impose new obligations or limitations with respect to the relationship between banks and clients, rather point to principles for examining whether the rate of the fee is reasonable, principles which may act as reference points. Even without these provisions, the clause granting the bank the right to collecting prepayment fees would be subject to reasonable standards, and in any event the bank’s calculation would be examined in light of the reasonable expectations of the parties to the contract”.

Same was the case in Moshe Herbet v. Bank Discount LeIsrael. In this case Judge Raviv ruled that in the event repayment of the loan resulted from procedures forced by the bank (accelerating to immediate payment), contrary to the opposite situation where the client seeks prepayment of the loan, there are no grounds for collecting the prepayment fees.

The banks’ conduct with respect to collecting prepayment fees warrants legal intervention, which can be expected to prevent excessive charges in large amounts. Negotiating with the bank together with a proper request to reduce the fees can be anticipated to yield significant results and benefit the client.

Recently, for example, negotiations with a bank for purpose of reducing the rate of the fee while the client was represented by counsel, brought significant reduction of fees demanded by the bank; from the bank’s demand of NIS 3 million for a client asking to prepay a loan in the amount of NIS 15 million, the bank agreed to reduce the fee to NIS 1.6 million. Such reduction in itself proves that the banks charge excessively often not reflecting any damage and warrants legal intervention and examination.

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