FACT SHEET

COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

The Credit Contracts and Consumer Finance Act

Interest charges under a consumer credit contract

This fact sheet provides an overview of the rules that apply to interest charges under a consumer credit contract. It explains a lender's obligations when calculating and charging a borrower interest or default interest.

Typically under a consumer credit contract, a lender charges a borrower for the use of the money. This charge is called interest.

Interest is calculated by applying a rate (generally expressed as a percentage) to the amount a borrower owes under a consumer credit contract.

The Credit Contracts and Consumer Finance Act (CCCF Act) lets lenders charge interest, but it sets out rules about how lenders charge interest under consumer credit contracts. This includes rules about:

- disclosure
- charging interest in advance
- calculating interest
- default interest.

Disclosure

There are a number of things a lender must disclose in the initial disclosure statement.

- The annual interest rate or rates that apply, as a percentage (for example 5.75% per annum) and how and when each rate will apply.
- Any fixed term that applies, for example 9.5% interest fixed for five years.
- What method the lender will use to charge interest and how often they will charge it.
- How interest is calculated if the lender is using some sort of benchmark, such as the official cash rate. The lender must disclose what the benchmark they are using is, what they will charge above (or below) that benchmark and where and when it is published, for example, "interest will be 2.5% above the official cash rate, details of the current official cash rate can be found at www.rbnz.govt.nz".
- The total amount of interest charges (if known and the contract is to be repaid within seven years).
- If there is an interest-free period, how long it is for, and when the lender will start charging interest.
- What default interest charges apply, and how and when these may apply.

You can read more about disclosure under a consumer credit contract in our other CCCF Act fact sheets, available at www.comcom.govt.nz/disclosure

Know what you're getting into

Borrowers should check their disclosure documents to make sure the contract they are getting is what they thought they were getting. If loans or other credit contracts are sold at different prices, or on different terms and conditions than the lender and borrower agreed, the lender may breach the Fair Trading Act.

Charging interest in advance

A lender can't make a borrower pay interest, or deduct any interest charge from a borrower's account, before the end of the day the interest charge relates to. In other words, the lender can't collect the interest before it is earned.

There are only two exceptions to this rule.

- A lender can charge interest in advance if the first payment period is shorter than later payment periods, but this is only allowed for the first repayment.
- A lender can charge interest on the last day of a payment period (for example, the last day of the month) as long as, when the interest is calculated, the lender does not treat the interest charge as part of the unpaid balance on that day (in other words, the lender can't charge interest on interest).

Want to save money on your loan?

Borrowers can save money by shopping around and comparing different loans. Ask your lender what annual interest they will charge over the term you want, and what fees apply.

Picking the loan with the cheapest repayments will not necessarily mean the loan is cheaper in the long term – the longer you take to pay off loan, the more interest you will pay. It's a good idea to pick the loan that gives you both regular loan repayments that you can afford and the lowest overall cost.

And remember you can still shop around when you have an existing loan – just remember to find out if there are any prepayment or other fees before switching between lenders.

Calculating interest

While the CCCF Act does not impose a cap on interest rates, it does set out rules about how a lender charges interest. It does this by setting out two alternative methods a lender can use to calculate the maximum interest they can charge.

The CCCF Act requires lenders to apply an interest rate to the borrower's unpaid daily balance. The unpaid daily balance is the amount a borrower owes under a contract at the end of the day.

EXAMPLE

A pawnbroker offered personal loans to borrowers and calculated interest on the total amount of the initial loan, as opposed to charging interest on the decreasing unpaid balance under the loan. As a result, the pawnbroker overcharged borrowers. The pawnbroker was convicted under the CCCF Act, fined and ordered to repay customers the overcharged amount.

A lender can specify in the contract when a day ends for the purposes of charging interest. This means a lender may debit interest from a borrower's account at 10am if that is the time they specified in the contract as the "day's end".

Default interest

Default interest is a different interest charge that a borrower may have to pay if they breach their contract, for example by missing a scheduled payment, making a late payment or not making a full payment.

A lender must disclose what default interest charges might apply in the initial disclosure statement.A lender can only charge default interest on the amount that is in default and only for the period that a borrower is in default or is exceeding their credit limit. In addition, where a contract is not an on demand facility you cannot call up a loan and charge default interest on the entire unpaid balance.

Default interest charges cannot be recovered if they are a penalty. They must reflect the loss you will suffer and any amounts required to protect your legitimate business interests. The law also allows for a court to reopen a contract that it finds oppressive. This could in some cases include the level of interest charged.

You can read more about oppressive contracts at www.comcom.govt.nz/oppressive-contracts

A lender cannot include an annual interest rate in a contract that increases if a borrower defaults or decreases if a borrower makes payment on time.

Lenders and borrowers

The CCCF Act uses a number of different terms to describe lenders and borrowers, depending on the transaction:

- consumer credit contracts – creditors and debtors
- consumer leases – lessors and lessees
- buy-back transactions – transferees and occupiers.

In these fact sheets we use the terms **lender** and **borrower** to talk generally about credit transactions, but use the specific terms for consumer leases and buy-back transactions where it makes things clearer.

This fact sheet provides guidance only. It is not intended to be definitive and should not be used in place of legal advice. You are responsible for staying up to date with legislative changes.

You can subscribe for information updates at www.comcom.govt.nz/subscribe

Contact us with information about possible breaches of the laws we enforce:
Phone: 0800 943 600 **Write**: Contact Centre, PO Box 2351, Wellington 6140 **Email**: contact@comcom.govt.nz