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Banking - Austria

New Consumer Credit Act makes fixed-rate loans impossible

Contributed by BINDER GRÖSSWANG

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The EU Consumer Credit Agreement Directive (2008/48/EC) was implemented in Austria through the enactment of a new federal Consumer Credit Act. The directive aims to create a coherent legal framework and to ensure a high and equivalent level of consumer protection across the European internal market.

Under the directive, banks must provide extensive information on credit offers in order to enable consumers to compare offers. In addition, consumers are granted an early repayment option.

While banks appreciate the importance of early repayments, they risk being at a disadvantage if there is a fixed interest rate in place. If a loan is matched with long-term refinancing at a fixed rate, banks are at risk of losing out on the yield curve. For this reason the directive entitles banks to compensation for breakage costs. Such compensation must not exceed 0.5% (if the loan contract lasts for less than 12 months) or 1% of the prepaid amount. However, the directive allows banks to claim a higher compensation if they can prove that loss suffered from early repayments exceeds this amount. Mortgage credits, credits for the acquisition of real estate and credits with a loan value exceeding €75,000 do not fall under the directive at all.

However, the new Austrian Consumer Credit Act also applies to mortgage loans, loans for the acquisition of real estate, loans exceeding €75,000 and leasing contracts. In contrast to the directive, the act does not allow breakage costs of more than 1% of the prepaid amount - even if a bank can prove a higher loss.

Thus, a fixed-rate loan with a longer maturity could be costly to banks if a consumer exercises his or her statutory right to repay early either the whole loan or part of it. The penalty would be 1% at most, but if interest rates come down in the meantime, the bank must accept a lower yield when investing the prepaid amount. The longer the maturity, the higher the risk, yet nonetheless fixed-rate financing is particularly appealing to borrowers with long-term mortgages.

One possibility for banks is to raise the costs for long-term fixed-rate financing in order to prevent a potential loss due to early repayment. Alternatively, banks may stop offering long-term fixed-rate financing and start offering hedging alternatives through separate derivatives (eg, interest rate swaps or caps), which may not be in the consumers' best interests due to their level of complexity. Moreover, such moves could be considered as circumvention of the consumers' statutory prepayment option.

The risks outlined here do not affect only Austrian banks, but also any foreign banks that grant loans to Austrian consumers. Under the Consumer Credit Act, Austrian consumers are entitled to protection even if they have agreed on the application of foreign law.

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