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AK Position Paper

AK-Position on the study of the European Commission on interest rate restrictions in the EU

About us

The Federal Chamber of Labour is by law representing the interests of about 3.2 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore the Austrian Federal Chamber of Labour is a part of the Austrian social partnership.

The AK EUROPA office in Brussels was established in 1991 to bring forward the interests of all its members directly vis-à-vis the European Institutions.

Organisation and Tasks of the Austrian Federal Chamber of Labour

The Austrian Federal Chamber of Labour is the umbrella organisation of the nine regional Chambers of Labour in Austria, which have together the statutory mandate to represent the interests of their members.

The Chambers of Labour provide their members a broad range of services, including for instance advice on matters of labour law, consumer rights, social insurance and educational matters.

Herbert Tumpel
President

More than three quarters of the 2 million member-consultations carried out each year concern labour-, social insurance- and insolvency law. Furthermore the Austrian Federal Chamber of Labour makes use of its vested right to state its opinion in the legislation process of the European Union and in Austria in order to shape the interests of the employees and consumers towards the legislator.

All Austrian employees are subject to compulsory membership. The member fee is determined by law and is amounting to 0.5% of the members' gross wages or salaries (up to the social security payroll tax cap maximum). 560.000 - amongst others unemployed, persons on maternity (paternity) leave, community- and military service - of the 3.2 million members are exempt from subscription payment, but are entitled to all services provided by the Austrian Federal Chambers of Labour.

Werner Muhm
Director

Executive Summary

Interest rate restrictions represent an important element of consumer protection and debt prevention

The AK welcomes that the Commission has taken up the subject of interest rate restrictions and its intention to ascertain the status quo through the study. Interest rate restrictions represent an important element of consumer protection and debt prevention. Statutory **interest rate restrictions as protective regulations are essential** in particular for consumers, who are due to financial difficulties in default with (instalment) payments.

A ban or a limitation of interest rate restrictions based on market considerations is totally inappropriate from a consumer's point of view and must therefore be firmly rejected. On the contrary, looking at the excesses, which interest receivables might entail in practice, it is required to expand the protective regulations.

The AK position in detail

On Question 2

Debt problem – default and compound interest

High interest rates are frequently responsible for the fact that in spite of years of repayment resp. attachments of salary the debt continues to rise

The situation in Austria is such that in practice the consumer and debt advice centres have come across a large number of cases where **demands due to the calculation of default interest** (and subsequent capitalisation = **compound interest**) were **exorbitant** even though consumer contracts included a statutory restriction of the default interest rate. Maximal 5 % may be added to the rate of interest agreed. However, this has the effect that in the case of default, apart from the extra charges for late payment and collection costs, which are added in any case to cover the creditor's loss because of delay, rates of interests are charged, which are far higher than the refinancing costs of the creditors, which are reflected in the contractually agreed rate of interest of the underlying transaction. Apart from that, the contractually agreed rate of interest does already include a risk surcharge.

In one case, spanning a period of 15 years during which the consumer did not generate an adequate income to afford payments to the creditor resp. private insolvency, the debt had increased from originally Euro 35,000 to Euro 820,000. A restriction of default

interest rates, which actually tackles the roots of indebtedness, appears to be justified in view of the results of this practice.

However, time and again it has happened that in case of financial problems, an "interest and cost mechanism" based on high collection costs and interest payments **also for small debts** (e.g. mobile telephone or mail order invoices) have put a **debt spiral** into motion. This often affects young consumers.

This is the case in both constellations and it has been demonstrated by many advisory cases that debtors in accordance with the current legal position in Austria and in spite of the restriction of default interest after falling due for repayment and judicial pursuit of the debt have to expect **fixed** interest rates of up to 21 %. These high interest rates are frequently responsible for the fact that in spite of years of repayment resp. attachments of salary the debt continues to rise.

Another reason for growing debts is that based on the current **calculation rules payments** are first offset against interest and collection costs and **last against the high-interest capital**. No debtor has a chance in the credit market to reschedule his debt at lower and market conform interest terms. There

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is no free competition enabling the debtor to change providers. This regularly results in the fact that someone, who has only temporary financial problems - for example because of a short spell of unemployment -, is also permanently faced with exorbitant interest rates. Due to the high interest rates this situation inevitably escalates after some time leading to the fact that private insolvency is often the only way out of this dilemma. Because of the high cost and interest charges even consumers with relatively low levels of debt regularly end up before the bankruptcy court, which always goes hand in hand with a certain stigmatisation and a looming stabilisation of low chances in the labour market. In Austria, indebtedness and attachments of salary associated with it as well as part of the private insolvency proceedings are only possible with the participation of the employer; hence they represent a **barrier for accessing the labour market**.

In our opinion, this requires a certain level of regulation as consumers in a financial predicament - due to their low degree of credit worthiness - have no access to offers of the free market. Instead of benefiting from the advantages of customer mobility in the financial market, debtors are forced - possibly to the end of their life - to remain with one provider. **Civil protection measures for debt prevention should therefore be considered at EU level as they help to reduce the costs of the society as a whole for this market failure.**

Austria is currently preparing a **legislative initiative**, which, due to new

civil measures should bring **more protection for private persons against indebtedness**. This concerns the **ban on compound interest** in case of default and changing the **sequence of offsetting payments** so that the interest payment can be repaid faster than previously possible. In the discussion process on this legislative initiative, the AK, other consumer representatives as well as Austria's state-recognised debt advice centres have supported the proposal that with regard to offsetting not only interest rates will be repaid later but also the collection costs, which means **that the capital will always be repaid first**. In addition, these protective regulations should be part of a **wide area of application** and not only apply to consumer loan agreements, where default has been declared. A **further restriction of the amount of the default interest** is also necessary from a consumer's point of view as the excessive growth of debt has to be halted because the current rule based on a permitted additional interest increase of 5 % in case of default is not appropriate and favours creditors.

Contractual interest rate restrictions

The system of **building society loans (in accordance with the Building Societies Act) with contractually agreed interest rate limits (lower interest rate limit, upper interest rate limit) has worked well in Austria**. Until the end of the 1990ies, the interest rates of building society loans of all building societies were fixed at six percent. In 1999, the four building societies in Austria changed interest rates to a system of contractually agreed inter-

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est rate floors (for example 3 percent) and interest rate ceilings (6 percent). In the meantime, there is a wide range of different contract options; however, the basic principle of offsetting interest payments is the same everywhere: the contractually agreed interest rate charged is linked to a (also contractually agreed) reference interest rate (frequently: European Interbank Offered Rate - Euribor). The interest rate charged is periodically adjusted to the reference interest rate in a market conform manner; however, it always remains within the contractually agreed interest rate range. The variable interest rate charged can in particular not exceed the interest rate ceiling of 6 percent, which is offered by all building societies, which guarantees borrowers not only a long-term calculability of the mortgage rate but also provides them with effective protection against sharply rising average interest rates. This reduces the danger of over-indebtedness.

On Question 8

The AK supports the notion that for the protection of consumers against excessive indebtedness, at least in respect of default and compound **interests, interest rate restrictions** should be regulated by EU legislative **on the basis of minimum harmonisation**.

Should you have any further questions
please do not hesitate to contact

Benedikta Rupprecht

T: +43 (0) 1 501 65 2694

benedikta.rupprecht@akwien.at

or

Christian Prantner

T: +43 (0) 1 501 65 2511

christian.prantner@akwien.at

as well as

Frank Ey

(in our Brussels Office)

T +32 (0) 2 230 62 54

frank.ey@akeuropa.eu

Bundesarbeitskammer Österreich

Prinz-Eugen-Strasse, 20-22

A-1040 Vienna, Austria

T +43 (0) 1 501 65-0

F +43 (0) 1 501 65-0

AK EUROPA

Permanent Representation of Austria
to the EU

Avenue de Cortenbergh, 30

B-1040 Brussels, Belgium

T +32 (0) 2 230 62 54

F +32 (0) 2 230 29 73