AK SURVEY ON CREDIT INSURANCE

SUMMARY

A full version exists in German.

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Summary

- Credit insurance is a **reasonable provision a person can make to protect surviving family members from debt**. However, many of the supplemental tariffs should be carefully considered before signing a contract containing them. AK has examined the tariffs for credit insurance policies offered by six banks in Vienna. The tariffs vary greatly in their **range of coverage** and in the **premiums** associated with them:

  - The tariffs offered by the six banks for hedging a **consumer loan** (EUR 10,000, 5-year term, one borrower/insured party) cost between EUR 74.67 (Bank Austria / Ergo) and EUR 566.94 (Raiffeisen / Uniqa). The tariff of Raiffeisenlandesbank NÖ Wien covers not only death but also automatically includes work disability as supplemental protection.
  - For a **mortgage loan** (EUR 100,000, 20-year term, two borrowers / insured parties) the banks surveyed charge between EUR 1,332.66 (Oberbank / Generali) and EUR 4,581.60 (Erste Bank / Wiener Städtische). The tariff of Oberbank includes a "bonus", for example. In general, bonuses or discounts can be included in the premiums.

- There are **numerous supplemental tariffs** that are either included automatically in the tariff or that can be freely selected and added: Accidental death, disability due to an accident, occupational disability, work disability, incapacity to work, serious illness (such as cancer, heart attack, etc) or unemployment. The **supplemental tariffs** make the **premiums more complex in design**, which in turn renders them very difficult to compare with each other.

- The banks surveyed by AK emphasize that taking out credit insurance is **voluntary**. In **actual practice**, however, during credit negotiations, one frequently sees **banks insisting that the consumer take out new credit insurance**, thereby making it a mandatory component of the credit agreement. If the bank requires this insurance, it is obliged to include it in the effective annual percentage rate of charge and the total cost of the credit.

- The cost of (mandatory) required credit insurance can significantly increase the total cost of the credit. In the calculation example presented by AK (EUR 10,000 loan, 5-year term, nominal interest rate of 5.5 %) **the effective interest rate for a loan without credit insurance amounts to 6.56 %. But the effective interest rate increases to 8.96 %** if the premium (EUR 567) is included as a cost component in the credit agreement costs. That means the cost of the credit with obligatory insurance in this example increases by 2.4 %.

- AK-Beratung (the counselling and advice services at the AK) has received **many complaints about credit insurance products.** They revolve primarily around high premiums, which make the credit substantially more expensive. Complaints are constantly made about supplemental tariffs that consumers are sold alongside the credit without their being adequately aware of them. Do **not let yourself be persuaded to accept an expensive, complex tariff** – the bank is acting in self-interest given the intermediary commissions involved.

Summary assessment of credit insurance policies from the perspective of consumers

The banks' own tariffs predominate in actual practice

The surveyed banks emphasize that "non-bank" insurance companies can also be brought in to cover risk. Consumers repeatedly report that during credit agreement negotiations the customer advisors at the bank push the given "bank's own" insurance products and narrow down the range of insurance agreements offered to those arranged by the bank.

Tariff diversity arising from tariffs offered by banks and from insurance companies' (own) tariffs

There are several ways of hedging a credit against the death of the borrower/insured party. The banks offer several options. Many tariffs are (purely) term life insurance tariffs with a fixed policy value; other tariffs are (genuine) credit insurance policies with policy values geared to the outstanding credit sum (ie, on the balance of the credit still owed). A policy that is purely a term life insurance offers a higher total benefit over the term of the insurance contract and credit agreement because the contractually agreed benefit is still paid out on the death of the insured party even if the outstanding credit amount is already substantially less.

Example to illustrate the point: The total loan amounts to EUR 100,000, the term of the credit is 20 years. A term life insurance with a guaranteed policy value of EUR 100,000 would result in a death benefit of EUR 100,000 after 10 years even if only EUR 50,000 of the credit were still owed. By contrast, a policy that purely entailed credit insurance would cover the exact amount still owed after 10 years – in the above example, EUR 50,000.

Whenever talking about tariff diversity, one should mention the **supplemental tariffs**. Be aware: There are credit insurance policies that automatically include a supplemental tariff – this tends to make the tariff more expensive. In many cases supplemental tariffs can be augmented with coverage of

- Accidental death
- Disability due to an accident
- Occupational disability
- Work disability, incapacity to work
- Serious illness (such as cancer, heart attack, etc)
- Unemployment.

Credit insurance can raise the credit costs substantially

Actual practice shows that the lending banks require credit insurance or other insurance products yet refer to them as being "voluntarily" taken out by customers and consequently do not include them in the calculation of the effective annual percentage rate of charge. The law provides that insurance contracts must only be included in the credit costs if they were obligatory or required by the bank as a condition for approving the credit agreement. The fact is that the credit costs appear to be more attractive if expensive credit insurance policies are not included in the total cost/effective annual percentage rate of charge. The following example demonstrates this difference:

EUR 10,000 loan with a 5-year term (borrower is a 25-year-old woman).
Nominal interest rate per year of 5.5 % (rounded average interest rate as per the interest rate statistics of the Austrian National Bank, March 2021). One-time premium for credit insurance: EUR 567

Table 1: Cost of the credit with the premium included versus excluded from the calculation

	Credit cost version **1**	Credit cost version **2**
	Credit offer **includes** the credit insurance in the calculation (**one-time payment of EUR 576**)	Credit offer **excludes** the credit insurance from the calculation
Nominal annual interest rate (as a % per year)	5.5 %	5.5 %
Processing fee (one-time, 2 % of loan amount in euros, as a surcharge)	EUR 200	EUR 200
Effective annual percentage rate of charge (as a % per year)	8.96 %	6.56 %
Monthly instalment in euros	**EUR 206.37**	**EUR 195.51**
Total amount (in euros, total of all payments over the term)	**EUR 12,382.63**	**EUR 11,730.49**

In these model assumptions, the premium for the credit insurance amounts to EUR 567. It is incurred once (one-time premium) and is charged to the loan account. This practice is very common and culminates in the borrower/insured party not paying the premium in cash but rather financing it through his or her loan account. Applying the above figures, the credit amount is EUR 10,767: EUR 10,000 is the loan amount paid out, but the processing fee (EUR 200) and the premium for the credit insurance (EUR 567) are added as surcharges to the credit amount ("surcharge method of calculation"). This approach puts the borrower at a tangible disadvantage. He or she pays credit interest on credit insurance that is financed through the credit (which incidentally also applies to the processing fee if it is added as a surcharge to the loan amount).
In figures: the one-time premium financed that is credit financed causes the monthly instalment for version 1 to be EUR 10.86 higher than the version of the loan without credit insurance (version 2). Altogether, the borrower opting for version 1 pays EUR 652.14 more over the entire term than for version 2 (EUR 12,382.63 – EUR 11,730.49). This, in turn, means that the difference between EUR 652.14 (increased charge from version 1 versus version 2) and EUR 567 (one-time premium for credit insurance) consists of the interest (EUR 85.14) that is added as a surcharge and is therefore financed through the credit.

The figures in the above example demonstrate a further fact. If a bank requires credit insurance, the incurred premium must be included in the effective annual percentage rate of charge and the total loan cost ("total amount") under the provisions of the Austrian Consumer Credit Act (Verbraucherkreditgesetz (VKrG)) and the Austrian Mortgage and Real Estate Credit Act (Hypothekar- und Immobilienkreditgesetz (HIKrG)). **In version 1 the effective interest rate rises to 8.96 %,** which happens because the premium amount (EUR 567) must be viewed as a cost component of the loan agreement. Put simply: Nominal interest rate + costs of the loan agreement equal the effective interest rate. In version 2, this is not the case: The premium is not included in the effective interest rate; the nominal interest rate is increased only by the EUR 200 processing fee that is incurred. **The effective interest rate in version 2 – without the one-time premium for credit insurance being included – is 6.56 %.** In this example, this means the costs of the loan with an obligatory insurance increase by 2.4 %.

In selecting a loan, consumers should have the good sense to be guided not by the nominal interest rate but rather by the effective interest rate and the total amount or the total costs, which are defined as the total of all payments made to the bank. As mentioned above, it may happen that a lending bank requires credit insurance but does not include the premium in its calculation of the effective interest rate/total amount. This would be in violation of the law and have a legal consequence: If a bank “forgets” to take the premium into account in the effective interest rate, the nominal interest rate must be reduced to such an extent that the same identical effective interest rate emerges as would have resulted if the premium had been correctly included. In end effect, this means that the borrower is refunded the interest.