ASSOFIN ***- CRIF*** - prometeia

CONSUMER CREDIT SURVEY

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CONTENTS

INTRODUCTION

This survey analyzes the overall market of household loans, paying particular attention to the consumer credit business, which is analyzed by product type and lender.

The findings are based on the official information available as of May 31, 2008.

The survey is divided into six chapters, each of which addresses different aspects of the household credit market, according to the framework described below.

Chapter 1 describes both the Italian and international macroeconomic scenarios, with a special focus on the drivers of household credit demand.

Chapter 2 focuses on a trend analysis of overall household credit, comparing the development pattern that has characterized the main lenders on the market (general banks, financial institutions and specialist banks). Using the official information available, the distinctiveness of this analysis is based on an estimation of the overall household credit market, separated into the consumer credit and mortgage sectors and by loan types. Specifically, the first part of the Chapter (2.1) is focused in general on household borrowing and its overall historical development. The analysis then focuses on the consumer credit market as a whole (2.2), also analyzing, starting from this issue, the distributive methods used by the lenders and the underlying strategic choices. The market is then studied separated into the two sectors of market lenders: general banks on the one hand (2.3) and financial institutions and specialist banks on the other (2.4). Finally, the chapter provides an in-depth study of the developments in the household mortgage market (2.5) through an analysis of the characteristics of the mortgages granted in terms of amount and average duration, type of rate applied and distribution channel.

Chapter 3 focuses on a development analysis of the risks of the consumer credit and mortgage markets based on data updated to December 2007. Risk analysis is carried out both with static indexes indicators, such as write-off, serious insolvency and slight insolvency rates, and with other risk indexes of a dynamic nature, such as default rates and mortality rates. In particular, the first section of the Chapter analyzes the development of the risk of the consumer credit market for lenders as a whole (3.1) as well as separated into the two sectors of general banks and financial institutions and specialist banks (3.2). The in-depth focus on consumer loans for Italian households continues with an analysis of the development of default rates, calculated with respect to the amount loaned, the duration of the loan and mortality rates (3.4). The second and last part of the Chapter (3.5) is instead focused on the quality of mortgage market credit, whose development is analyzed through the risk indicators discussed in the section on consumer credit.

Chapter 4 provides the forecast scenario for the household credit market on a national level. The Chapter is divided ideally into two parts. The first part (4.1) is focused on a trend and forecast analysis product sector, focusing in particular on durable goods, the sector that is most involved in household consumer credit demand. The second part focuses on the forecast loan scenario. Consistent with the market trend analysis, the analysis starts with the overall loans granted to households by specialized banking and financial institutions (4.2), then it looks at the overall consumer credit market (4.3) also by type of lender (4.3.1 and 4.3.2) and finally it focuses on the mortgage market (4.4). The forecast concludes with an analysis of the development of the quality of household credit through some of the market risk indicators (4.5).

Chapter 5 is devoted to a trend and perspective analysis of the household credit market in its various macro-areas. In particular, the analysis discusses the development of the main macroeconomic areas that characterize general trends in the various regional sectors (5.1). Having stressed the main regional characterizations of the overall market for household credit (5.2), the chapter then outlines the trend and perspective dynamics of the overall consumer credit market (5.3) and the mortgage market (5.4). Finally, the chapter analyzes the main differences in quality of credit between the different macro-areas through the development of write-off rates (5.5).

Finally, Chapter 6 of this edition of the survey features a monographic examination focused on an analysis of the impact of the Community Directive on the consumer credit market. Specifically, the study focuses on an examination of the effects that some of the Directive's innovations may entail for sector lenders, for the market as a whole and for consumers. Particular attention is paid to the effects of the introduction of the right of withdrawal and the enlargement of the limits of related loan agreements.

With the aim of offering as complete a picture as possible of the different characteristics of the consumer credit market in the individual regions, the final part of the survey includes a series of regional data. This data gives a detailed analysis of the main parameters specifically characterizing the consumer credit and mortgage markets on a regional level and their trends over time.

As always, the survey relies on:

- CRIF Credit Information System's database on installment credit, as well as CRIF's expertise in processing data on credit risks and the performance of this market;
- Prometeia's information structure, business skills and forecasts as regards both the development of the external environment and the specific trends in household credit in the various business sectors on a regional level;
- the contribution of ASSOFIN, Italian Association of Consumer and Real Estate Credit, which represents the most important financial institutions operating on the consumer credit and real estate credit markets and is the most accredited source of statistics pertaining to this market.

REPORT TOPICS

During 2007, the environmental framework worsens…

The scenario described in this edition of the study is part of a worse environmental context than that outlined six months ago, both from a macroeconomic standpoint and because of the not yet contained effects of the American subprime mortgage crisis on the effectiveness of market players.

…in the wake of tension generated by last summer's crisis…

As early as the second half of 2007, signs of weakness in economic growth intensified in the wake of the turbulence that hit the financial markets. The possibility of a rapid absorption of the crisis gradually diminished. As of today, the emergence of substantial losses suffered by banking institutions and the involvement of central banks have not been sufficient to restore the markets to a pre-crisis situation with reference to the climate of uncertainty and the supply of liquidity. In this context, the risk of inflation on a global level and the risk of recession in the U.S. imply a long cyclical slowdown worldwide.

…deferring the Italian economy's recovery of growth rates above 1% to 2010

In 2008, the Italian economy will record growth not much above zero, which particularly penalizes families, thus influencing the climate of confidence. Although the economy's expansion rate will gradually speed up over the next two years, it will still remain below its potential. Only in 2010 should recovery of growth rates above 1% occur.

The slowdown in household credit grows…

Against this background, overall household credit recorded growth in 2007 that is still sustained, equal to 8.7% compared to the same period in 2006, although in more of a slowdown than in the past. This trend also unites the main countries of the Eurozone; in fact, it stops a cycle of strong growth of credit. The reflective phase of the market, already in place at the end of 2005, settles into a progressive weakness of the economic framework for households during the year, accompanying the change in funding conditions for lenders.

…supported by the development of supply policies

In the face of the fragility of demand, although against a background of structural development of household financial behavior, lenders have reacted in any case by redirecting policies of supply in terms of innovation/restructuring of products and greater flexibility of proposed solutions, also in order to promote the sustainability of the burden of debt for households. This approach was also encouraged by the rise of the competitive tone in addition to the regulatory measures introduced at the beginning of the year.

Consumer credit is still the most dynamic sector…

Consumer credit continued to be characterized as the most dynamic section in retail financing, recording an increase of 11.3% for market lenders overall. This leads business to exceed 98 billion in terms of worth, but diminishes compared to the past. In the second half of the year in particular, this development reflected a climate of uncertainty and the gradual slowing of the growth of consumption, confirming the pro-cyclic nature of the sector. The renewed attention to the sector, witnessed by the development of supply policies, under the support that it provides to households in terms of financial planning, has encouraged, even in this sector, the intensification of competitive pressure. This occurs, however, in a context of reduction in unitary margins which is also due to the increase in funding costs, reinforcing the already present trend of refocusing towards forms of direct credit.

…in the face of greater integration between SFI and banking networks in the distribution of household financing

Due to the centrality of specialization in the management of financing as critical to the success of market development, the industry's business models continued to evolve towards the increasing integration of the SFI's with banking networks. In this context, the growth of the sector continued to be livelier for the SFI's, which increased their market share at the expense of that of general banks. This was also the result of further shifting of business by these general banks towards specialized product companies. The analysis of distribution channels used to arrange products of consumer financing indeed shows a significant increase in the share of credit arranged through group bank branches or third party banks with commercial partnership agreements. This phenomenon indicates how integration of banks and specialized institutions is currently a strong opportunity where the specialized institution can boast experience and know how in terms of management, marketing and operation, while the bank is strong with a wide distribution network through its branches.

Increased competition and innovation and the flexibility of supply have encouraged the growth of mortgages, limited by the weakness of the real estate cycle

The further weakening of the real estate market and the increase of funding costs for financial intermediaries strengthened the trend of loan slowdown for the purchase of homes, which closes 2007 with an downturn (albeit slight) in credit underwriting. Business is, however, significant, with a value increase of 8.7% compared to the end of 2006, especially given the considerable growth in recent years. The change in environmental conditions accelerated the shift to fixed rate mortgages, reflecting the change of household preferences. This is also highlighted by the greater popularity of replacement mortgages and operations in terms of portability.

The Italian market is still at a disadvantage in international comparisons, not showing phenomena of socially significant over-borrowing

The Italian market is still less developed than the European average, highlighting a level of borrowing that, in aggregate data, is distanced from the risk of household over-borrowing. While some structural features such as, for example, the lower LTV level have slowed the debt capacity of Italian families in the past, on the other hand they currently limit Italian banking systems' exposure to risks linked to the dynamics of the real estate market, thus constituting an opportunity for growth in the coming years.

The quality of household credit remains generally good even if there are some signs of tension. Among the risk indicators which describe credit performance of the different technical forms there is indeed a slight increase of default for consumer credit in the face of a substantially stable write-off rate. The segment of mortgages also shows an increase in risk both in static and in dynamic indicators. These findings reflect a trend that is not positive for some of the main macroeconomic variables that have a significant impact on the quality of credit, such as the increase in consumer prices for food goods and energy which affects household purchasing power and the increase in interbank rates that affect the burden of debt.

Market growth is forecast to grow gradually but will remain lower than in the past…

The development of the household credit market in the coming years will reduce the weakness of economic growth and the reaction of market lenders to the changed funding conditions. In particular, 2008 is a transition period between growth that is still contained due to the slow and gradual absorption of current tensions in the financial markets, and the greater vitality of the sector in the period 2009-2010. Recovery will incorporate the changes dictated by the 2007 experience but will, however, stay lower than in the past, also reflecting the rhythms of growth sustained in recent years.

Overall, at the end of 2008, the growth of household financing granted by banking and specialized financial institutions should arrive at 3.9%, reaching 6.3% and 6.5% in 2009 and 2010 respectively. The weakness of the real estate cycle and the gradual increase of the real cost of credit should slow the growth rates of mortgages in the face of greater vitality of consumer credit, encouraged, particularly in the next two years, by a steady improvement in household income and the dynamics of durable goods consumption.

…supported by innovation in supply in a renewed competitive context to favor the development of household needs and the sustainability of debt…

In a context of increasing competition and renewed attention to risk, the increase of volumes brokered will be one of the priority objectives of lenders in order to maintain a good position in a market that is more complex than in the past, with a reduction of unitary margins. Household demand will therefore be favored by the development of supply policies through product innovation, enlargement of customer base and the search for increasingly flexible financial solutions aimed at promoting the sustainability of debt burdens.

…making the differentiation between mortgages and consumer credit less and less clear

The adjustment of supply with the development of financial behavior and household needs, which also reflect socio-demographic changes, will make the line between mortgages and consumer credit less and less clear, accompanied by a shifting focus on amounts and longer time limits. In this context, the industry should turn to greater efficiency in the management of credit, also through an increase in externalization of some activities and business management processes.

During 2009-2010, consumer financing will progressively record greater expansion with growth rates respectively at 8.2% and 9.6%, with 7.2% estimated for the end of 2008. The development of the consumer credit market is still characterized by greater integration between banking groups and specialized companies and will continue to be livelier in the sector of specialized lenders (SFI); in this context, the process of disintermediation of the long, overly costly channel is expected to continue, encouraging the shift in focus towards forms of direct credit.

At the end of 2008, the growth of household real estate mortgage stock should reach 2.5%, also reflecting important extraordinary operations recorded during the year. In the period 2009-2010, having reabsorbed the extraordinary effects, the growth of loans for the purchase of homes should reach 5.9% and 5.3% respectively.

The growth of the borrowing rate will be lower than in the past

Overall, the household borrowing rate is expected to reach 52.7% in 2010 as opposed to about 50% in 2007. The growth rate is, however, slowing compared to that shown in the recent past and is staying below the average of the Eurozone. The increase of the financial burden on debt draws attention to risk analysis but generally does not limit market growth: effective experiences in other countries bear witness that the development of borrowing is not a negative factor if accompanied by careful evaluations of the actual economic/financial situation of the household by lenders beforehand and by tools/products effective from the point of view of financial innovation.

In the face of changed environmental conditions, the emergence of write-offs will remain under control

The emergence of dubious outlook positions will reflect the general worsening of household earnings and growth rates of the market in recent years, against a background of a refocus on expirations and higher amounts and of a growing exposure to variable rates in the mortgage sector. The flexibility of supply policies and the greater efficiency of scoring techniques and prudential control should, however, constitute a factor of risk containment. This is also due to the regulatory measures on portability and the recent agreement signed between ABI (Italian Bankers' Association) and the Italian government, which should support the sustainability of the burdens of debt by households. The expected increase in write-off rates will, however, be relatively contained and in gradual minimization as early as 2009, highlighting overall risk that will remain under control.

The new Community Directive on consumer credit

The in-depth monographic study of this issue is devoted to the Directive on consumer credit and to the implications for the market arising from the introduction of the right of withdrawal and the discipline of related loan agreements. Under the regulatory profile, the Directive broadens the credit market through the extension of the regulatory requirements to credit intermediaries and through the quality-quantity extension of the definition of consumer credit. It intervenes at all stages of the process, from commercial communication to the redemption of the loan and makes it necessary to revise-reorganize relations between financial intermediaries, dealers and credit intermediaries.

The right granted to the consumer to withdraw without any justification from the financing agreement within 14 days may affect the delivery times of goods within the framework of credit for specific purposes. The lack of clarity of the Directive on the recoverability of costs incurred introduces a significant criticality for the profit and loss statement of lenders on the supply side: creditor and credit intermediaries.

The regulation's capacity to increase competition seems to be reduced because of the contained times for intercepting consumers, offering an alternative financing solution and the behavioral inertia characterizing consumers. Furthermore, the margins of profitability are such that they do not justify, for the creditor, financing solutions at a considerably lower cost and, for the consumer, significant savings. The right of withdrawal, therefore, is mainly a function of consumer protection in the event of decisions made lightly rather than a stimulus for competition.

In the event of faulty supply of goods or services, a greater responsibility, although not directly imputable to financial intermediaries, increases their operating risk. We do not expect the phenomena of dealer rationing, even if the most problematic sectors could experience a degree of stricter selection. The system is already equipped to manage the consequences of dealer behavior so that the increase in the cost of litigation is not expected to be significant. The outlook is different in terms of abuse of secondary responsibility by some customer segments that could create a cumbersome management of judicial proceedings.

The regulations analyzed constitute valid protection for the consumer, subjected to opportunistic behavior by secondary lenders or commercial techniques that are particularly aggressive. They cause, however, a significant impetus towards the disintermediation of consumer credit and towards recourse to direct forms of credit that provide the consumer with a more reasoned buying process, greater evaluation time compared to the act of purchase for which credit is fixed in advance, if necessary, and eliminate problems related to the delivery of the goods due. From the point of view of financial intermediaries, moreover, credit not for specific purposes reduces the operating risks linked with the conduct of the supplier of goods or services. Finally, a further indirect increase in the form of direct credit, although more uncertain, comes from the natural use of such forms of financing for the purposes of replacement, in the event of withdrawal from loan agreements for specific uses.