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**CONSUMER CREDIT
SURVEY**

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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 October 31, 2007.

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 business cycle 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), as well as 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 business cycle and development analysis of the risks of the consumer credit and mortgage markets based on data updated to June 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. 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 and the duration of the loan (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 business cycle and development analysis of consumer trends by 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 cycle 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 business cycle and perspective analysis of the household credit market in its various macro-areas. In particular, the analysis discusses the develop-

ment of the main macroeconomic areas that characterize the business cycle and development scenarios in the various regional sectors (5.1). Having stressed the main regional characterizations of the banking market for household credit (5.2), the chapter then outlines the cyclical and perspective dynamics of the overall consumer credit market (5.3) also broken down by type of lender and 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 phenomenon of credit fraud, a subject that is becoming increasingly important in the credit field. As a matter of fact, preventive and precautionary measures are spreading among both the large market players and the smaller institutions. The study reports on the Italian situation and the international trends and developments regarding the extent of fraud, its prevention and its management procedures.

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, whose content has been enriched since previous editions of the survey, 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

The first half of 2007 was characterized by a gradual deceleration in the growth of the GDP, following the end in 2006 of a long period of stagnation in Italian industry. Against this background, the financial market crisis was introduced, whose repercussions on the Italian economy have so far been a worsening of monetary conditions (increased rates on adjustable rate mortgages for households, growing rates on business investments) linked to a climate of uncertainty as reflected by indicators on the climate of business confidence.

The crisis of the credit market generated a worsening of monetary conditions...

The changed international circumstances will likely have the most impact on the prospects for growth of the Italian economy in 2008, a year characterized by a more intense cyclical slowdown, accompanied by a gradual strengthening of the Euro, by inflation impulses arising from oil and agricultural products and by household and business credit that, although not rationed, has become more expensive. The outlook for 2008 is therefore for a slowdown in growth that could go from 1.8% in 2007 to 1.2%. In 2009, the situation should reverse, resulting in a relative improvement in the economic cycle.

...and a more visible economic slowdown in 2008

The growth of household credit to June 2007, although remaining high, showed reinforced signs of slowdown, which has characterized the sector since the end of 2005. As for the overall group of lenders, the market experienced a 9.3% increase in lending in the first half of 2007. The slowdown, which is the average throughout the Eurozone, is mainly due to the gradual weakening of the real estate market and the increasing interest rates.

Signs of slowdown of growth in household credit were reinforced

As of June 2007, the consumer credit sector, which saw lending set at over 96 billion euros, recorded the most dynamic trend (+14.2%) compared to other household credit forms, although slower than the 16.9% recorded at December 2006. This has resulted in a further increase in the impact of consumer loans on total loans, which increased to 19.6%. However, despite a trend that is still higher than the European average (which stood at 4.5% at June 2007), a high incidence gap on gross domestic product remains compared to the main European countries.

In June 2007, the most dynamic trend was also that of consumer credit...

The development of the main economic aggregates of households continued to provide support for the demand for consumer loans, which were accompanied during the first half of 2007 by tax benefits connected to expenditure in cars and appliances. In addition, an enlargement of the pool of potential clients interested in access to credit, represented mainly by elderly people and immigrants, was an incentive for the sector in terms of growth of amounts brokered.

...supported by tax incentives and an enlargement of the client pool

The share of consumer credit managed by specialist financial institutions, which in June 2007 stood at 77%, continues to grow. Increasing specialization underlies both the increased dynamic in the amounts granted by specialized companies and the process of integration between specialist financial institutions and banking groups. This integration is more and more favorable for both types of lenders: the banking institutions do not bear the risks of managing the service offered to the clientele and, at the same time, the specialist financial institutions, taking advantage of the potential arising from the widespread banking distribution network, have the chance to expand their business opportunities.

The presence of specialist financial institutions continues to grow as of June 2007

As of June 2007, the growth of the mortgage sector still shows a slowdown although maintaining lending levels that are still relatively dynamic (+9.4%). The trend reflects banking lenders' broad recourse to securitization operations. It also shows an increased weakening of the real estate market and a gradual increase of loan costs. In correspondence to the increase in market rates, there was indeed recourse to indexed mortgages, passing in terms of flow from 92% in 2004 to about 50% in June 2007.

Loan dynamics slowdown compared to the past

The positive growth of mortgages underlies both some elements of change in the Italian population's socio-demographic characteristics that can be considered in the medium term (such as labor mobility, the greater presence of foreigners, lower intra-household financial transfers and the fragmentation of the family), and the enlargement of the range of supply in terms of the financial characteristics of products and target clientele.

An overall good credit quality is confirmed....

The household credit market also confirmed in the first half of 2007 an overall good credit quality, expressed by a substantial stability in risk indices. In particular, an improved delinquency rate was reported; in this period it reached its lowest level in the last two years (3.2%). This aspect has an even more positive impact on the general banks that saw a reduction in their overall risks, thanks mainly to the contraction of the delinquency rate. The financial institution and specialist bank sectors experienced mild gradual growth in the delinquency rate, while facing maintenance of the overall risk levels recorded at the end of 2006.

...although with a slight worsening in the mortgage sector

Actually, in the first part of 2007, some weak signals of worsening credit quality emerge for the real estate mortgage sector, probably reflecting the effects of the restrictive monetary policy adopted by the ECB.

The default rates trend displays substantial stability both for the different credit forms and for the various lender categories. In particular, we note the return of the worsening detected in the first half of 2006 of the default rate for real estate mortgages, arriving at around 1.1%.

The slowdown of household credit growth continues due to weakening of the real estate market and an increase in interest rates

For the next few years, the development of the household loan market will be linked to the American subprime mortgage crisis. However, the dynamics of the Italian market do not seem, at least in this early stage, to be directly affected by the turbulence generated on the money markets, unless we include increased lender prudence and caution among the effects. The gradual slowdown of growth compared to 2006, a phenomenon which is common to the Eurozone, seems rather to reflect a trend that was already in place before the crisis, attributable mainly to the dynamics of the real estate market and interest rates. The most immediate effects of the subprime crisis are instead evident in the increase in the cost of funding, which is transferring to the rate on loans, and in this way could generate an increase in the trend of slowdown of household loans in the coming months.

A comparison with the American market, in which insolvency rates on mortgages showed a significant worsening, highlights some of the substantial differences that result in greater weakness in the American system. The main differences are the credit policy, which has been very aggressive in the United States, even on non-traditional products, the greater orientation towards secondary clientele and the level of household indebtedness, which in the U.S. is about three times the level in Italy.

In 2007 and in the two-year forecast, the expectations of growth of household loans will continue to be positive although in a gradual slowdown, just like the trend of the rate of household indebtedness. Consolidating the forecasts given in previous editions of the survey, market growth will find support in the development of the financial behavior and structure of households.

Overall, the growth of household loans granted by specialized banking and financial institutions should reach 9% at the end of 2007 and 7.7% and 7.1% in 2008 and 2009, respectively.

The importance of the consumer credit component increases

Reorientation towards the consumer credit component is expected to continue. It should record a more dynamic trend compared to other credit forms for the whole period under consideration, faced with the relative stabilization of the incidence of real estate mort-

gage loans on the total. The volume of consumer loans will still register strong expansion although the rates of growth will likely slow down slightly during the course of the period under consideration. In particular, the lending dynamic is expected to reach 13.9% at the end of 2007, and then record 11.9% for the average of the 2008-2009 period. The Italian Northeast should record the greatest growth, in line with a greater demand potential and highlighted by lower per capita values than the national average. Both for the specialist financial institutions and for the general banks, reorientation towards direct forms of credit should continue. In particular, loans on salaries and pensions should increase dynamically, thanks to recent regulatory measures. This will promote accessibility of credit to target clientele that otherwise would be penalized by the system.

Increased levels of market competitiveness should be accompanied by a greater concentration, also in the wake of important integration operations which are characterizing the main players in Italian banking. Furthermore, the new development of business models seems increasingly to indicate a greater integration between specialized companies and general banks: the former being supported by specialized activity management skills and know how that often derive from experience gained in other countries, and the latter having a widespread presence in the region.

Greater integration between general banks and specialist financial institutions

The end of 2007 is also expected to record a more dynamic specialist financial institutions sector, accompanied by a consolidation of their presence in terms of lending levels which will come to 77.2% of the total market. During the two-year forecast the trend of the general banks' consumer credit stock will be slightly higher than that of the specialist financial specialist institutions.

The presence of the specialist financial institutions increases in 2007,

At the end of 2007 and for the whole two-year period, the mortgage sector should show a further slowdown, in line with the expectations of return of the real estate cycle and the trend of progressive increase of interest rates. In particular, by the end of this year the growth of household real estate mortgage stock should reach 8.5%. The 2008-2009 period, having absorbed for the most part the impact of the subprime mortgage crisis, will see a growth in loans for the purchase of homes, which should reach respectively 7.6% and 6%. Market development will continue to support the Southern regions of Italy and the Italian islands which, however, will continue to maintain a structural gap compared to Italy's average.

The mortgage sector should confirm its slowdown ...

In the face of the changed market conditions, lenders must continue to meet the new competitive challenges through innovation, both in terms of technical and financial product features and in terms of target clientele to whom they aim their supply.

The distribution of mortgages should gradually reorient towards specialized intermediaries, consistent with the development experienced in foreign markets, which suggests that in the development of the market, mortgage distribution passes from the direct network of banking institutions to intermediation through third parties, be they agencies, brokers or even the remote channel.

.... recording an increase in the distribution through third party networks

In a context of increased rates and structure of household debt particularly linked to the development of the money market, the increase foreseen for loan rates could generate a relative increase of emergence of dubious situations in loans to households at the end of 2007. During 2008-2009, the increase in unpaid credit situations should gradually slow down while maintaining a higher level than that experienced in the 2005-2006 period. This outlines a scenario of risk control by the credit system: the delinquency rate relative to the whole sector of household consumers should stabilize at around 3%.

Despite the weak signals of a worsening in 2007, risk is predicted to be under control

Looking in detail at consumer credit risk at the closure of 2007, the scenario presents a largely stable trend in the relationship between unpaid debt and lending in the face of a

slight increase in 2008-2009. This trend should be differentiated by type of lender: the greater risk trend for specialist financial institutions is related to a greater presence in the segment of non-standard clientele.

In the mortgage sector, after the increase in the delinquency rate observed in June 2007, which mostly reflects the strong expansion of loans in recent years, there should be a substantial stabilization of the indicator throughout the period.

The in-depth monographic study is devoted to an analysis of the phenomenon of credit fraud

The in-depth monographic study is devoted to an analysis of the phenomenon of credit fraud, a subject of increasing importance. As a matter of fact, preventive and precautionary measures are spreading among both the large market players and the smaller institutions. The study reports on the Italian situation with the international trends and developments as regards the extent of fraud, its prevention and its management process.

Analyzing the risk factors that contribute to the growth of the phenomenon, an increasingly close relationship is detected between credit fraud and identity theft. This is defined as a risk of impersonation that for credit underwriters translates both into a lack of certainty about the authenticity of the personal identity of clients and into an inadequacy of prevention resources and tools as well as the need to address and manage the risks related to the applications submitted through its own network of agents, promoters and dealers.

In this particular context, the study highlights main methods that are used to steal personal data and implement fraud activity such as *phishing*, *pharming* and *malware*. It identifies both the traditional techniques used by fraudsters to collect the data and documents of others as well as the techniques based on the use of new technology.

In the Anglo-Saxon world, which first gave substance to the need for observations and the sharing of statistics related to the phenomenon, the estimated costs of these crimes result in very high values (in Great Britain, a cost of 1.7 billion pounds a year is estimated). In Italy the phenomenon of credit fraud is taking on considerable dimensions: in 2006 over 17 thousand cases of fraud were reported for a value of about 80 million euro.

This underlines the need for prevention procedures and the implementation of tools for resolving the situation. A review of national and international initiatives on this subject, amply discussed in the monographic study, provides an interesting starting point for reflection for those who work in fraud prevention.