



ASSOCIAZIONE ITALIANA DEL CREDITO AL CONSUMO E IMMOBILIARE

CONSUMER CREDIT AND THE EVOLUTION OF REQUIREMENTS FOR FINANCIAL POSITION

Introduction

Assofin (Associazione Italiana del Credito al Consumo e Immobiliare – Italian Association of Real Estate and Consumer Credit) represents major Italian suppliers of financing for consumer households.

Though the association contributed to the preparation of the *Position Paper* offering the comments of Italy's entire banking system on Basel Committee and the European Commission documents, Assofin wishes to send this note to the national and international surveillance Authorities to set forth a number of specific requests it intends to make which take into account the specific nature of the business practised by the association's members.

We hope that discussion of the issues set forth below with the surveillance authorities will continue beyond the deadline set by the consultation procedure (May 31 2001).

Definition of default

It is our opinion that a definition of *default* based on a 90-day late payment is inadequate for financing for consumer households in Italy; the industry is characterised by a considerable number of "late" payments but also by a high percentage of returns to good standing. In addition, the definition is not in line with practice or with the regulations governing the matter.

We therefore consider it advisable to request application of a definition of default which refers to a longer delay in payment (such as 150 days).

If the 90-day definition of default is not altered, the LGD percentage (set at 50% by the *Foundation Approach* in the New Agreement) should be reduced significantly, as it greatly overestimates the credit risk involved.

Exposure toward financial intermediaries other than banks subject to surveillance

Taking into account the weighting to be applied to exposure toward financial intermediaries other than banks subject to surveillance, including institutions which provide credit to consumers under art. 107 T.U.B. in the Bank of Italy's List, treatment is excessively onerous: intermediaries of this kind may be required to comply with the minimum requirements for financial position and specific risks but nonetheless receives a 100%



weighting. The New Agreement confirms application to financial intermediaries which are banks under surveillance of this treatment of exposure to companies, a treatment which, under certain conditions, may be much less favourable than the treatment of exposure to banks and intermediaries providing credit on personal property, the latter being subject to application of weightings specified for banking counterparts if subject to comparable regulations and surveillance. The possible effect of stricter financial requirements for financial intermediaries which are not banks subject to surveillance is an increase in the cost of financing the activities of a specialised company as compared to those of a bank working in the same field (with the result effect of skewing competition), in the absence of any greater risk to justify the greater severity.

Exposures to be included in the retail portfolio

Assofin is well aware of the Italian situation characterised by an extensive structure of small businesses, and understands and shares the concern expressed by other representatives of the banking industry in Italy with regard to the risk weight function of the portfolio in relation to positions other than retail and backs the request for introduction of a third curve, alongside the curves for determining retail and corporate positions, to be applied to determination of specific risk weights for small businesses.

Assofin, however, strongly opposes the solution which some consider an alternative to the above: the broadest possible inclusion of positions in relation to small businesses in the retail portfolio.

Assofin holds that lower risk weight for retail positions as compared to the corporate portfolio weight set by the New Agreement is logically based on the specific characteristics of such forms of exposure in terms of amount (very low), number (quite high), average duration (low), the nature of the counterpart (individuals/families of consumers), etc. These characteristics together permit a breakdown of the credit risk which justifies application of financial requirements which are less strict than those required for other types of exposure.

The conditions of the New Agreement for inclusion of positions in relation to small businesses in the retail portfolio (with the explicit approval of the national surveillance authority) are quite specific. One of these is the requirement that exposure of this type be subjected to internal management and assessment systems which are constant over time (such as scoring systems and use of systems for centralising specific risks) and the same as those applied to other types of exposure to retail customers (typically consumer households).

For this reason unselective inclusion of exposure toward small businesses in the retail portfolio is inadvisable; inclusion would attenuate and dilute the characteristics justifying a more favourable treatment of this category, and could thereby induce the surveillance authorities to review the weighting coefficient applied to this segment of the market unfavourably, unjustly penalising intermediaries with a composite retail portfolio composed mainly or exclusively of financing for consumer households.



Risk mitigation techniques

Financing of consumer credit is characterised by limited unitary amounts and is not normally backed by guarantees. Despite this, in a number of operations, especially in the field of direct credit, personal guarantees are present. In this regard we wish to emphasise that application of the "w" coefficient appears inadequate, as ongoing review of credit quality is already an integral part of the work involved in obtaining accurate, constant measurement of risk and an obligation to take into account possible legal and documentary risks would result in duplication of the assets required for this risk.

The range of consumer credit products includes financing against transfer of one fifth of the consumer's salary¹: the operation is extended to non-primary clients provided that the quota is paid to the financier directly by the employer and a policy is drawn up insuring the financier against death or firing of the employee. From the legal point of view, there is no real or personal guarantee, whilst from the economic point of view, there is undeniably a technique for mitigating risk. The New Agreement does not recognise insurance policies as collateral², so that this form of risk mitigation in financing against transfer of one fifth of the salary is not recognised. On the other hand, the presence of a third party, the employer, who stands in for the person to whom the financing is granted in making payments, generates a positive impact on risk mitigation.

¹ This subject is governed by specific regulations contained in Presidential Decree 180 dated 5.1.1950 and Presidential Decree regulation 895 dated 28.7.1950

² Cf. par. 76 of the New Agreement