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Salary and pension-backed loans
Risk profiles and supervisory guidelines

For some time now, salary and pension-backed loans (*cessione del quinto* or CQS/CQP for short),[1] which can be disbursed by banks and financial intermediaries pursuant to Article 106 of the Consolidated Law on Banking (TUB), have been an important form of financing for consumers, also from a financial inclusion perspective.

The special characteristics of this product, for which the provision of guarantees is mandatory, along with the recent amendments to the prudential provisions introduced by Regulation (EU) 2020/873, which recognized its lower riskiness, enabling a lower risk weighting to be assigned to these loans for the purposes of calculating the capital requirements (known as the CRR 'quick fix'), have helped to fuel the growing interest of operators in this market.

The purpose of this communication is therefore to focus the attention of the banks and financial intermediaries listed in the register referred to in Article 106 of the TUB on the need to carry out an adequate assessment of the risks that in any event characterize this form of loan and on compliance with the provisions on transparency and fairness in customer relations.

Regarding **credit risk**, the Bank of Italy is aware that this is mitigated by the repayment method i.e. deductions at the source of a portion of monthly salaries or pensions owed to the borrower and paid out by third parties, as well as by the abovementioned obligation to obtain insurance coverage against the risk of the borrower predeceasing full repayment or of loss of employment. This smaller risk has also been recognized at prudential level, by the abovementioned changes to CRR2, which lowered the risk weighting from 75 per cent to 35 per cent.

Moreover, lower credit risk does not mean that lenders do not have to adhere to the creditworthiness assessment obligations in relation to customers and to take account of the overall economic-financial situation of the debtor, since the employer's assessment of a financial position is not in itself sufficient.[2] An adequate assessment of the customer's creditworthiness is also designed to prevent risks of over-indebtedness of the latter. In this respect, we recall banks' attention to the recent legislative intervention on crisis composition owing to over-indebtedness,[3] which explicitly envisages the possibility of debt relief or restructuring for CQS/CQP loans

[1] The CQS/CQP, originally introduced in Italy by Presidential Decree 180/1950 to facilitate access to credit for state employees, was subsequently extended to workers in the private sector and to pensioners in both the public and private sectors.
[2] See 'Supervisory guidelines on the transfer of salary and pension-backed loans', Section I.
[3] See Decree Law 137/2020 ('Relief Decree'), converted with amendments by Law 176/2020, which introduced a number of changes to Law 3/2012 on the over-indebtedness crisis composition procedures.

and, more in general, the need by the crisis composition body to indicate in its report whether the lender took due account of the borrower's creditworthiness during its appraisal of the loan application.

This form of financing requires, among other things: i) dialogue with third parties for the collection of the instalments (*Amministrazione Terza Ceduta* – ATC); ii) suitable IT systems for managing and monitoring the particular forms of collection of these loans; iii) management of dealings with the insurance companies for the stipulation and any payment of claims on insurance policies; iv) management of eventual early repayment of the loan, with the consequent obligations to reduce the total cost of the credit pursuant to Article 125-*sexties* of the TUB; v) control of the distribution network. Lenders are, therefore, bound to implement specific organizational and control safeguards to monitor exposure to operational risks, which are especially significant when entering a new market.

Similar observations could be made when the business model – followed especially by various companies active in the sector that are entered in the register kept in accordance with Article 106 of the TUB – calls for periodically and systematically selling 'CQS/CQP' loans to third parties without recourse (so-called 'originate-to-distribute' loans, OTD). In these cases, the originator often continues to be responsible for managing collections, processing early repayments, fulfilling periodic disclosure requirements and handling any complaints. Nonetheless, the acquiring intermediary is still required – in order to better protect against its own operational and reputational risks and to not harm the rights of customers – to adopt appropriate systems for monitoring the originator's conduct, establishing suitable flows of information and carrying out regular, structured audits. As a general rule, the acquiring intermediary should perform, on a case by case basis, appropriate due diligence of the portfolio acquired in order to assess, not just credit risk, but also the aforementioned legal and reputational risks, including in light of changes in the applicable regulations.[4]

For this technical form of lending, it is standard practice for lenders to use an external network of agents and/or brokers and/or other financial intermediaries to place their products. In such case, the lenders are exposed to additional **legal and reputational risks** connected with any non-compliance by the network.[5] They must therefore ensure that they have put in place suitable systems for selecting and for monitoring their distribution network in order to prevent any problems, to promptly detect them if they arise and to take remedial action.[6]

In addition, internal rules on **remuneration and incentive schemes** must be aligned with the regulations in force and not serve to encourage the placement of products that are inconsistent with the customer's overall financial situation.[7]

Furthermore, due weight should be given, especially for companies that adopt the OTD model, to the **liquidity risk** and **market risk** connected with operations that could arise: a) from possible delays in transfers of loans to third parties, including those linked to contingent adverse market situations; b) from the sale of loans at

[4] 'Supervisory guidelines on the transfer of salary and pension-backed loans', Section IX.
[5] See, e.g., Article 128-*decies*, paragraph 2, of the Consolidated Law on Banking, which explicitly provides that the financial intermediary is responsible for its agents' compliance with the transparency obligations.
[6] See 'Supervisory guidelines on the transfer of salary and pension-backed loans', Section VI.
[7] See 'Supervisory guidelines on the transfer of salary and pension-backed loans', Section VII.

prices below their current market value.

Finally, bearing in mind the **digitalization** process currently under way in the banking and financial system and, going forward, the potential development of the lending process through the use of IT platforms, it should be stressed that there is the need to ensure that remote loan origination complies with the regulatory frame of reference, given that liability remains with the supervised intermediaries.

In relation to the foregoing, the Bank of Italy will intensify its supervision of those supervised entities active in the 'CQS/CQP' sector; off-site and on-site inspections offer the opportunity to check that effective safeguards are in place to protect against all the risks associated with this form of lending and to ensure that market practices comply with the regulatory frame of reference.