Monitoring Customer Financial Wellbeing Outcomes with Safe Loan Insights Paper

Preliminary 2021 Findings

Introduction – A Great Start to the Safe Loan Program

After a COVID pause in 2020, the Safe Loan Survey[1] is now live and delivering financial wellbeing self-assessment and monitoring in market. This Insights Paper provides a sense of the early results from the work to date in 2021 and shares more details about the future direction for the Program, both at lender and policy level.

We are delighted to report good response rates. Additionally, we have deployed a state-of-the-art measure of financial wellbeing as part of Safe Loan and have tested and confirmed its performance in collaboration with our academic partner, The Melbourne Institute: Applied Economic & Social Research[2] (the Melbourne Institute) Respondents have clearly considered their answers and accordingly there is a high information content as evidenced by the Melbourne Institute analytics.[3]

The Goal – Orienting Lending Policy and Practice to Consumer Financial Wellbeing

Good lending and good borrowing are the foundations of a sustainable lending sector. Safe Loan brings consumer financial wellbeing into focus for both groups:

- **Responsible Borrowers:** empowering consumers by providing them with resources and feedback that promote their level of financial literacy
- **Responsible Lenders**: supporting lenders to develop appropriate product, distribution, and loan origination approaches that result in higher consumer financial wellbeing. Financial wellbeing monitoring can support both compliance with Responsible Lending laws and the new Design and Distribution regime but, more than that, monitoring financial wellbeing helps build sustainable, profitable portfolios - based in turn on happy customers.

1 For more information on the Safe Loan methodology or program, all materials reference in this Insights Paper can be seen on our website (www.verifier.me) or accessed directly from Verifier at info@verifier.me (or your own contact in our team).
2 The University of Melbourne
3 The Melbourne Institute's validation tests included Item Response Theory analysis on the scale and its five components, as well as correlation on the scale and other questions and socio-demographic data.

If lending laws and regulation are viewed as a form of 'public health' policy, then Verifier has argued for the need for a financial wellbeing metric (or set of metrics) that can assess how well the policy is working in order to create an evidence base for these policies.

A good analogy is the road toll as the metric for developing effective and targeted road safety laws that inform the evolution of car safety, from seatbelts to airbags. We describe this gap in the first whitepaper of the Expense Verification Framework Initiative in May 2019.[4]

The Safe Loan survey is designed to plug that gap, and to enable and encourage policy makers to develop lending laws based on 'road toll' evidence in the borrowing community.

When we look at the lowest quartile of financial wellbeing scores from the survey, we can start to investigate whether there is evidence of consumer financial difficulty that is hidden from lenders. The consumers reporting financial difficulty on the Safe Loan survey may still be paying their loans on time but struggling overall.

As more lenders join the Safe Loan Program, Verifier, and its academic partner – The Melbourne Institute – will use the industry level data set to explore financial wellbeing and the intersection between consumer outcomes and the loan journey to support the goal of evidence-based regulatory policy.

Response Rates Higher Than Expected - Getting to Under 35s the Next Challenge

The Safe Loan survey has a higher than expected 5.34% response rate in the latest sample. Prior published results on the financial wellbeing scale[5] have had response rates in the order of 1.6-2.7%.

The Safe Loan survey is shorter than prior published results using the scale (under 5 minutes v. 15-20 minutes) and offered instant feedback on financial wellbeing.

While sample differences and other factors may well be playing a part in these results, Verifier's experience in customer responsiveness suggest it is likely that these two factors played at least some role. Certainly, the team at Verifier put a lot of effort into the user journey based on that expectation!

Beneath the headline response rate, there is a marked variation by age with lower responses in the younger cohorts. Lifting response rates in the younger cohorts with communication that is tailored to them is a key focus for Verifier's Safe Loan team. This requires working with each lender's marketing agency to get the copy right for each cohort. Low engagement with younger cohorts is a familiar issue for anyone who has tried to talk to the under 35s about money, but still, it is a crucial cohort to reach and tailored messaging will be critical going forward.

4 Responsible Lending, Automated. Better Outcomes For Everyone (May 2019). See https://www.verifier.me/business/expense-initiative for a summary of the policy output and to download the policy papers
5 https://fbe.unimelb.edu.au/__data/assets/pdf_file/0005/2839433/CBA_MI_Tech_Report_No_1_Chapters_1_to_6.pdf Page 14/15

Observation #1: Evidence Suggests That Responsible Lending Works

In the results to date, Verifier notes that wellbeing is **higher** in the borrower population surveyed than general populations previously analysed. This is somewhat unremarkable, since the entire lender assessment process is geared to filtering out those who are financially unfit, and to only approve more financially-fit cohorts. On the other hand, this finding might surprise some of those following the policy debates around the Responsible Lending laws.

Getting underneath this finding and teasing out what policies - both lender and regulation initiated - are particularly supportive of lender financial wellbeing (and conversely which are not) is one of the goals of Verifier's policy work in the Safe Loan Program.

While it is too early to make any firm conclusions, at least in the sense of whether responsible lending policy is causing improvements in financial wellbeing, the reassurance is that at least this sample of the borrower population looks to be more financially fit than the general population.

The Design and Distribution Obligations are in effect from 5 October 2021, and this is where having the Safe Loan tool **to identify pockets of emergent financial difficulty and their cause** will be critical. Safe Loan, as previously discussed, plugs a known gap in customer monitoring.

While in this Insights Paper we are not publishing a Safe Loan histogram to compare with the one published by The Melbourne Institute in 2020, shown right, we would note that the Safe Loan (borrower) distribution is **shifted to the right**, so higher financial wellbeing results are being seen for the borrower population. The overall shape of the distribution is similar.

When looking at the histogram from a general population, note that it is based on results from responses pre-COVID.

If this was repeated today, we might expect the histogram below to have shifted to the left.

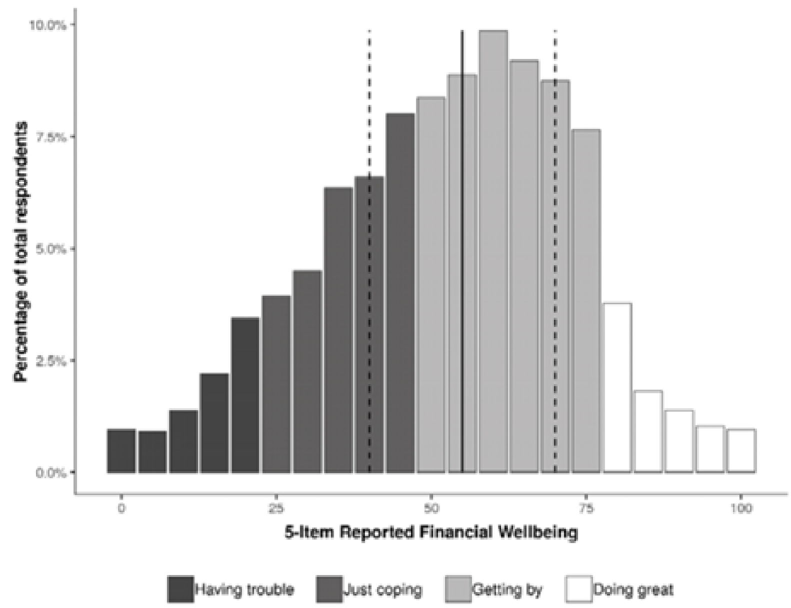

Figure 1 CBA-MI Analysis (March 2020), Ave: 52.6, Median:55 Mode: 60[6]

Observation #2: Verifier's Product Questions Appear Correlated With Reported Financial Wellbeing

Our early investigations suggest that **financial wellbeing is most highly correlated**[7] **with financial habits followed by product satisfaction.** While it is not clear whether higher financial wellbeing is causing more satisfaction with product choices, or better product choices are leading to better financial wellbeing outcomes, it is clear that product satisfaction and financial wellbeing are entwined.

Interestingly, while the importance of product design for financial wellbeing is clear, product factors also seem to be more important than loan originations practices in driving outcomes. This could suggest that responsible lending is working as well as it could, and that what then impacts consumers are the product dynamics. Obviously, more work is needed here, but it does reinforce the focus of Design and Distribution Obligations on product and channel decision-making and governance.

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6 Botha F., de New J., Nicastro A. (March 2020) Commonwealth Bank of Australia and Melbourne Institute Financial Wellbeing Scales Technical Report No. 5, link here
7 Using Spearman's rank-order correlation coefficients.

Observation #3: Life Issues the Main Driver of Low Reported Financial Wellbeing

Verifier has analysed the lowest quartile of reported financial being, using machine learning[8] methodologies, and has been able to identity that after actual repayment behaviour, the strongest predictor of low financial wellbeing, is changes in employment circumstance (reducing from full time to part time employment). This accords with the desk research that Verifier conducted in the Expense Verification Framework Initiative which suggested that the majority of financial difficulty[9] is likely to be related to life events, far removed from the loan origination process.

This is an area we will continue to explore on our pooled data set.

Putting Safe Loan Into Practice in Portfolio Management and Beyond

As a customer monitoring tool, Safe Loan can support product owners, risk managers, compliance teams and business owners to monitor their products for sustainability. Uses include:

- Fine tuning origination processes and experiences (in part to comply with responsible lending requirements, but additionally to manage risk and decrease attrition)
- Review of target market determinations (for Design and Distribution Obligation compliance, but also just because it is good product practice)
- Customer advocacy – raising awareness of financial wellbeing and looking for pockets where issues require proactive intervention
- Using Verifier's machine learning algorithms (trained on Safe Loan) to hunt for pockets of lower financial wellbeing using lender operational data

The Safe Loan program also feeds into Verifier's policy work in the search for innovation in the lending sector to support customer experiences that are **frictionless and fair**.

In Summary

This Insights Paper demonstrates the opportunity for Safe Loan customer monitoring to capture more accurately the impact of lender decisions on product, distribution and process on financial wellbeing and, therefore, to improve outcomes for borrowers. At the same time, Safe Loan delivers an immediate feedback loop for consumers on their personal financial wellbeing outcomes and the results to date show that this is welcomed support.

Over time, the Safe Loan Program aims to support better outcomes for lenders and borrowers alike. And yes, in doing that, Safe Loan is a key tool to support compliance with the Responsible Lending and Design and Distribution Obligations regimes.

For more information, please reach out to your Verifier contact or reach out to the team via our website. We are passionate about helping the lending industry power their portfolios with smart use of data and a true orientation to what matters – the consumer.

8 Machine learning results are preliminary given low sample sizes. The methodology used was machine learning based on logistic regression, however over time as the sample size increases, more complex techniques will be deployed.
9 Verifier (August 2019), Responsible Lending, Automated . Towards A Consumer-Centric Operational Approach. P.23. Using an ARCA survey of lenders on the cause of a sample of each lender's hardship applications, only 18.4% of them related to financial overcommitment due to a loan.