ROUTLEDGE

Paul C. Lubin

PROTECTING MAIN ST

Measuring the Customer Experience in Financial Services for Business and Public Policy

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PREFACE

Buyer Beware and Dealing with Imperfect Markets

Unlike other books which focus solely on the business or profit aspects of measuring the customer experience, this book focuses on the benefits to the consumer as well as the company or financial institution. As such the applications of monitoring the customer experience are broader than helping a financial institution or any business improve revenues and customer retention by providing high quality service and products.

The applications of monitoring the customer experience include the formulation and setting of public policy and proper oversight of the consumer lending and the financial services marketplace to help ensure fair and reasonable treatment and sound financial decisions by consumers. The same monitoring programs verify sound business practices and help to ensure the optimal long term revenues and profits of financial institutions.

A precept of consumer protection is the assumption that the marketplace is the enforcement mechanism for preventing and correcting unfair and unsound business practices. The free flow of accurate and understandable information is critical. Given accurate, material, and understandable information, consumers make optimal decisions based on their best interests. Firms providing the highest quality and best value garner more customers and revenues. Consumers therefore police or weed out products and services that are faulty.

However, the information provided to consumers is not always understandable and is subject to imperfections and inconsistency, especially in the information gathering stage of a financial decision concerning products which by their very nature are complex.

Events in 2007, 2008, and 2009, namely the credit and liquidity crisis, housing crisis, consumer loan delinquencies and late payments, home foreclosures, and stock market crash point out the importance of proper monitoring of the consumer experience when dealing with lenders and providers of financial services. The absence of monitoring precludes the ability to discern whether the marketplace and an individual financial institution are providing consumers with the information and products needed to carry out decisions and transactions which optimize financial well-being and with it consumer wealth.

Customer experience monitoring gained increasing popularity in the mid- to late 1990s and their use by financial institutions and most businesses has accelerated into the new century. Service and product differentiation is recognized as critical to growth and profits, and its importance has been magnified by increased competition. Financial institutions view reliable measures of the customer experience as essential for determining whether or not they are meeting consumer needs. Government regulatory agencies in the early to late 1990s encouraged the use of these programs to assess adherence to regulatory guidelines and the law. These measurement programs aided financial institutions in managing risk by helping to ensure the optimization of revenue and profit by meeting customer needs. Customer experience measurement pointed out gaps in service and product offerings and helped identify changes necessary to ensure sound business practices.

At the turn of the 21st century a fundamental shift took place in the orientation of the government's role of ensuring that financial markets foster optimal consumer and business decisions. Oversight by the government and self-critical evaluation by financial institutions in the early to late 1990s was more intensive and focused than in the years between 2000 and 2009. Serious and focused regulatory oversight and enforcement was not needed to ensure fair treatment of consumers. Instead, it was deemed that the marketplace would serve as the enforcer of sound business practices and consumer protection. Consumers would elect to use those institutions with the best products and services and make decisions in their best interest. Regulatory oversight shifted focus to privacy, bank secrecy, and money laundering. There was a decline in the use of customer experience measurement as a tool to ensure sound, fair, and reasonable business practices. This shift in focus contributed to major disruptions in financial markets and more importantly household wealth and economic growth.

As the government changed its focus on oversight at the turn of the century so did financial institutions. Whether or not consumers were satisfied, would recommend those products, and would remain customers became more important than determining whether consumers were given accurate information and sold products that met their needs. Measures such as customer satisfaction, willingness to recommend, and likelihood to remain a customer became key performance metrics. Suppliers of these metrics gained business and these metrics also became sales tools. Increasingly, financial institutions and companies of all types touted their customer satisfaction ranking. A high customer satisfaction ranking attracted customers and reinforced the financial institution's image with consumers. However, whether consumers were being provided with accurate information and the information needed to make informed financial decisions was often neglected and instead financial institutions relied on a "buyer beware" philosophy. Consumers would judge whether or not they were provided with appropriate information and products to make optimal financial decisions. A "buyer beware" or "the marketplace as the protector of consumers" belief is particularly problematic in markets where products are complex, difficult to understand, where information does not flow freely, and where consumers are easily misled. Indeed these issues may have greater impact on consumers and households that are less familiar and comfortable with financial products, such as lower income households, first time home buyers, minorities, and immigrants.

Self-testing techniques in the form of traditional and time tested marketing research methods including mystery shopping, matched pair testing, and consumer surveys represent powerful tools for uncovering problems in business practices and policies in consumer lending and financial services.

The methods which have been used by government and business for decades can help detect and prevent unsound and unfair practices. For the consumer seeking credit and financial services products these problems may result in the inability to obtain information to make appropriate credit and financial decisions. For the financial institution it can result in unsafe business practices, discrimination, and misleading or unfair practices which in turn result in lost business, damage to reputation, and hefty financial penalties. For the nation these problems can result in inefficient and unsound financial markets where inappropriate decisions are made by the consumer and financial institution.

Customer experience measurement and self-testing can help assess whether the financial services markets are functioning properly for the consumer and they can serve to guide government policy and enforcement activities to ensure that the allocation of credit and purchase of financial products is based on sound sales, business, and underwriting practices that support the best long term interests of the consumer and the financial institution. For the financial institution, the techniques help limit risk and thereby foster profits by identifying and helping to correct problems in its sales and business practices.

Market research and self-testing over the last 20 years have shown changes in the financial marketplace that have affected consumers' ability to make optimal decisions. Such programs if conducted and acted upon continuously can help the nation build wealth by fostering a marketplace where consumers make appropriate decisions while financial institutions build customer loyalty and revenues.

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CONSUMER LENDING AND SELF-TESTING

1.1 SELF-TESTING DEFINED

Self-testing is a voluntary undertaking that provides a critical window into the experience encountered by a consumer who purchases a product or conducts a transaction. When the financial institution measures the customer experience it is helped by ensuring adherence to business protocols and guidelines designed to satisfy customer needs and comply with government regulations and the law.

If the government is to develop and monitor the effects of public policy and determine whether financial institutions and the financial services sector are adhering to laws and guidelines intended to ensure efficient and fair markets, it needs to understand the experience customers encounter when they purchase a financial product (e.g., a mortgage loan, home equity loan, small business loan, credit card, or investment product). By measuring the customer experience, the financial institution as well as the government can help ensure that consumers are provided with the necessary information to make appropriate financial and credit decisions at every phase of the purchase process. This is vitally important from a business and public policy viewpoint. In the consumer credit market, for example, self-testing helps ensure compliance with a web of fair-lending rules and guidelines intended to ensure that minority and non-minority customers receive equal and fair treatment.

In light of laws, rules, and guidelines, overseen by the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and other federal agencies, financial institutions and government agencies have developed and undertake monitoring techniques to assess the customer experience and detect whether customers are being treated fairly or unfairly, and if unfairly whether this is due to race, ethnicity, national origin, age, or gender.

1.2 THE IMPORTANCE OF SELF-TESTING FOR THE CONSUMER

Self-testing helps ensure that the consumer will receive the information required to make appropriate credit and financial decisions. Access to credit and financial products is critical to the economy. It enables consumers to more easily and quickly purchase fast moving products and services on a daily basis and purchase more expensive and capital intensive products such as a home, business, or automobile, or to finance education. All are critical to wealth and economic growth.

The consumer faces a myriad of credit and financial product alternatives. The consumer's ability to build assets is impaired if an individual chooses a credit product he or she cannot repay or makes the wrong choice of investment product. Many consumers do not have the knowledge to select the best product and rely on the advice of a financial institution. Given the complexity of credit and investment products the consumer can easily make decisions based on inadequate or misleading information.

Changes in the financial marketplace since the late 1990s have complicated an already difficult consumer decision process. A perfect example of this is the credit marketplace. Credit providers increased their product offerings, expanded sales channels, and accessed third parties to market their products and services. Technological advances enabled lenders to change the application process. Lenders can require the consumer to apply first, before the lender has provided information. Once the application is completed the lender can provide almost instant approval, thereby cutting short the consumer's search process and the period needed to gather information from multiple lenders and information sources. In fact the lender is motivated to cut the consumer's search process short in order to book the loan and generate revenues. When searching for a loan the consumer can choose from an even wider array of lenders and sales channels. The consumer can look toward his or her local bank, mortgage company, mortgage broker, finance company, sub-prime lender, credit card company, and investment company with a mortgage subsidiary. Indeed even a realtor can have a relationship with a mortgage company and can work with and refer the consumer to a lender. And then there are financial institutions that operate banks, mortgage companies, and finance companies all offering similar products but at different rates and terms. Depending upon the company or sales channel chosen the consumer can receive a variety of information and rates and terms. Gone is the day when a limited product set and information is provided through one or two types of financial institutions and delivery channels.

The increased number of financial products and credit products and delivery channels combined with greater reliance on third party relationships and sophisticated sales and marketing programs has created more risk for both the financial institution and the consumer. The financial institution is exposed to the business and legal risk associated with charges and allegations of unfair practices, discrimination, and violations of the law. The consumer faces the difficult job of choosing the right product. Choosing the wrong product may result in the consumer being unable to repay the loan or repaying a loan under less than optimal terms, both of which situations limit the individual's ability to build wealth. Choosing the wrong investment product can affect the consumer's current and future income as well as his or her financial security.

1.3 THE IMPORTANCE OF SELF-TESTING FOR THE FINANCIAL INSTITUTION

Self-testing helps the financial institution ensure that it is meeting consumer needs and verifies that its business practices are fair and sound and in compliance with the law and regulatory guidelines. Self-testing designed specifically to measure adherence to the law and regulatory guidelines (e.g., Fair Housing Act, Equal Credit Opportunity Act, Fair Trade Act, and Non-Deposit Investment Inter-Agency Guidelines and Rules of Fair Practice) also provides valuable information about the sales and service process and suggest areas where the financial institution can improve to better meet consumer needs. This in turn helps consumers make appropriate financial, credit, and investment decisions that build financial security for the consumer and the community.

By regular monitoring of consumer experiences, the financial institution can detect and resolve issues on a continuous basis. Ongoing monitoring helps detect potential and current violations of the law. It enables the financial institution to take action to resolve the issue before it results in complaints and allegations that can negatively impact reputation and sales. A plan that systematically tests sales and service practices is positively viewed by third parties, government regulators, and enforcement agencies. It is a pro-active step to help ensure that consumers are treated fairly and honestly. Hence it has been viewed as a mitigating factor by regulators and enforcement agencies when responding to complaints and when conducting investigations and reviews of lenders' and financial institutions' business practices. For the consumer it means a process that provides the information needed to choose the right loan at the most appropriate rates and terms.

The tests that have the specific objective of ensuring adherence to the Equal Credit Opportunity Act and Fair Housing Act are a good example of self-testing. The data or information generated through self-testing designed specifically to measure discrimination is privileged under the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act (FHA). In order to encourage self-testing Congress in 1996 created a legal privilege for data gathered on a voluntary basis to specifically assess compliance with ECOA and the FHA. Government regulators defined self-testing as voluntary activities carried out by a third party that collect information assessing compliance that is not readily available or collected in a lender's loan files, applicant records, or through the lender's everyday normal business practices.

The self-testing privilege encouraged financial institutions to use more creative types of activities—mystery shopping, post-application surveys, and customer feedback—to help detect those issues that cannot readily be identified through reviews of customer loan files and on-site inspections by field auditors. Since then the definition of a self-test has been expanded to include activities to classify protected and non-protected classes of consumers applying for non-mortgage loan products in order to specifically assess compliance with ECOA.

Civil rights groups, community activists, government regulators, and enforcement agencies regularly use mystery shopping and post-application surveys to help detect violations of the law and to help guide and influence public policy. The HUD Matched Pair Testing program that assesses the treatment of minorities and non-minorities in the pre-application stage of the loan process is an example of this. In addition, HUD provides Fair Housing Initiative Program (FHIP) funds to community groups to test for discrimination in lending. And then there are the activist organizations, news organizations, and class action attorneys that use mystery shopping and other methods to test the sales practices of financial institutions.

1.4 PRO-ACTIVE SELF-TESTING

Ideally self-testing programs pro-actively seek to uncover (and correct) problems before they result in allegations of discrimination or unfair sales practices. However, many times financial institutions undertake self-testing as a response to a government enforcement or regulatory agency investigation or allegations of discrimination or misleading sales practices. The most effective approach is one that seeks to uncover (and correct) any deficiencies in marketing, sales, and service processes before they result in inappropriate credit and investment decisions, customer complaints, or allegations of unfair sales practices, discrimination, and referrals to regulatory authorities.

Too often a financial institution's orientation is not to be pro-active in terms of self-testing. Typical reasons for not being pro-active are: "We don't discriminate or mislead"; "Our business is to meet the consumers' financial needs; race does not play a factor"; "The consumer is responsible for his or her financial decisions; we don't mislead or force consumers to buy our products"; "The government is pressuring us to spend money to enforce social policy and aid groups perceived as disadvantaged. We all know why we are more careful with minorities; it's riskier to do business with them."

The most popular and accepted pro-active methods of self-testing are pre-application inquiries or mystery shops in the form of matched pair testing, triad testing, monadic testing, and post-application customer surveys.