

Market Research for Business and Public Policy Decisions in Consumer Lending

History has shown that market research and self-assessment methods are powerful tools for uncovering problems and improving business practices while also providing guidance for public policy in consumer lending. These problems can be serious and result in inefficient and unsound credit markets where inappropriate credit decisions are made by the consumer and lender. The consumer may not receive the information needed to make appropriate credit decisions. Misguided credit decisions and the inability to access credit in turn limit the growth of wealth at the household and national level. For the lender the problems can lead to high risk and misleading business and sales practices and discrimination which may lead to lost business, damage to reputation and hefty financial penalties. Market research and self-assessment techniques are time tested and can help assess whether the market for credit is functioning properly. Market Research can guide business decisions and government policy and enforcement activities to ensure the allocation of credit is based on sound policies and practices that support the best long term interests of the consumer and the lender.

The Advantages Offered by Market Research

By regularly monitoring the experiences encountered by consumers applying for a loan lenders, consumer groups and government can detect and resolve issues that inhibit the optimal allocation of credit. This in turn will help ensure the proper use of credit. For the lender monitoring the customer experience can help prevent complaints and allegations that can negatively impact a lender's reputation and sales.

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 acts against public policy. An example of this is the HUD Matched Pair Testing program assessing the treatment of minorities and non-minorities in the pre-application stage of the loan process. In addition HUD provides funds to community groups to test for discrimination in lending. And 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.

Another example is the Financial Services Authority (FSA) in the United Kingdom, which regularly uses Mystery Shopping. The FSA is an independent body given the authority by the government to regulate the financial services industry. FSA has three strategic goals promoting efficient, orderly and fair markets; helping retail consumers achieve a fair deal; and improving business capability and effectiveness. In order to meet these goals FSA is a user mystery shopping. It views the methodology as a necessary tool to help determine whether its goals are being met.

FSA Mystery Shopping Guide

“In an evolving regulatory environment, there is an increasing need for us to gather evidence on whether our retail policy initiatives have had the intended outcomes and whether retail firms treat the customers fairly. Mystery shopping gives us a detailed insight into the way financial products are sold to consumers. We use a range of tools to measure policy impacts and assess levels of compliance with our rules among firms. We typically conduct mystery shopping because it fills the gap between retrospective consumer research – e.g. among those who have recently bought a particular product or used a specific sales process to discover their experiences – and formal supervisory

visits to regulated firms to assess their advice and sales documentation. In particular, we need to measure and evaluate the impact of FSA policy, assess levels of firms' compliance with our rules and examine the experience consumers have of the retail market. We regard mystery shopping as a necessary means of gathering such information. This is because of the problems inherent to surveying those who have recently bought products – consumers don't always accurately recall all the details and it is impractical to gather the regulated disclosure material firms give them. Our supervision visits to firms capture formally documented information about sales processes, but they do not provide the unedited version of what firms actually say in an ostensibly 'real sales' situation."

Market Research Approaches

Mystery Shopping

First used in the retail sector to observe and improve retail conditions, Mystery shopping now provides a critical window into the experience encountered by consumers applying for credit. It is a voluntary undertaking which can help minimize business and legal risk and ensure fair and safe credit practices. The procedure helps ensure consumer access to appropriate credit information, compliance with the law, adherence to business protocols and standards and thereby sound credit decisions by the consumer and lender.

The approach calls for the use of testers or mystery shoppers posing as potential or actual buyers. Unlike statistical procedures which require outcomes (loan approval, loan denial, pricing) and rely on abstract arguments and statistical principals, mystery shopping measures the experience encountered by the mystery shopper or tester. Mystery shopping can detect unfair or misleading sales practices or whether the experience differs based on race or ethnic origin of the mystery shopper.

Mystery Shopping takes the form of match pair testing and monadic testing.

Matched Pair and Monadic Testing

Matched Pair Testing

The objective is to determine the presence of disparate treatment or discrimination in the pre-application stage of the loan process. Matched pair testing involves pairs of testers, e.g. minority and non-minority or male and female, posing as potential borrowers. Sometimes matched tests can comprise triads. Triad tests comprise three testers, a control, the non-minority tester matched against two minorities (e.g. African-American and Hispanic). The testers conduct their tests (shops) separately, but each is provided with profiles or scenarios. The profiles of the testers are very similar or matched. In some cases the minority takes on a slightly better profile than the non-minority. The profiles include the purpose of the loan, (most often first time home buyer, though refinance and home equity/home improvement are also popular), loan amount, value and location of home, down payment and financial characteristics of the borrower. The only significant difference between the testers is that one tester is a minority and one is not, or one tester may be a male while the other is a female or one tester may be young while the other is old.

Monadic Testing

The focus of monadic testing is to detect patterns indicative of misleading sales practices and violations of the law including section 5 of the FTC Act as well as actions and patterns indicative of predatory lending. Monadic testing has become more prevalent with the increased number of product offerings, risk based pricing and flexibility in underwriting in consumer lending. Unlike match pair testing, monadic testing calls for the use of one tester and a specific test condition. Here the tester records his or her experience and the information and products discussed and the questions asked to

determine whether the lender provided the necessary information for the consumer to make an appropriate credit decision.

Self-testing whether performed on matched basis for fair lending or monadic basis for fair treatment can be conducted either in-person or over the telephone. Most self-testing programs are conducted in-person. However telephone based testing is frequently conducted when consumers apply over the telephone. Often concerns are expressed about testing for disparate treatment over the telephone. This author's experience as well as research studies has shown that in many cases race can be accurately determined over the telephone.

Post Application Testing Surveys

Post-application testing is a customer feedback program which investigates the quality of the assistance and treatment provided to consumers (including minority and non-minority, male/female and younger/older loan applicants) after an application has been submitted. The procedure gained increasing acceptance as a valid method to test for discrimination and unfair treatment in consumer lending after a Federal Reserve Study, which maintained that race played a role in the mortgage decision and that differential treatment can occur at different stages of the mortgage process.

Post application surveys can help ensure fair and similar treatment of protected and non-protected classes in the various stages of the loan process. It can examine the coaching, advice, negotiation and competitive shopping and the degree to which it affects loan outcomes in the form of approval/denial, product and pricing. The approach can also help ensure fair treatment by monitoring quality of assistance and the extent to which

loan applicants are informed about and understand the loan products and terms of the loan.

The post-application survey is typically done by interviewing a sample of consumers (minority and non-minority) by telephone that has completed the application process. Applicants are interviewed to evaluate whether the quality of assistance provided by the lender affected the outcome (i.e. approval or denial). A sample of recent loan applicants who have received approval or denial should be interviewed. If you interview applicants prior to their formal notification, you will be unable to discern any correlation between how they were treated and whether their application was approved or disapproved. Moreover, they might misunderstand the purpose of your call and assume you are gathering more information with which to consider their application.

The post-application survey should be conducted by telephone. Other alternatives such as mail surveys jeopardize the reliability and timeliness of the information. Mail surveys are more subject to cooperation issues and the willingness of respondents to fill out and mail back the questionnaire. Some recipients may have no interest in returning the survey (for example, those whose applications were not approved), or they may not take the time.

Categorizing the sample by minority and non-minority group, product group or income group, as well as by approved and denied applicants, requires a large sample size. To make sure you have enough respondents, you may have to over-sample, that is; interview more members of a group than the share they represent of your business.

Information from Market Research and Self-testing Approaches

Matched Pair/Monadic Mystery Shopping

Post application Telephone Survey

- Identifies disparate treatment
- Detects pre-screening and access to information
- Uncovers income/credit skepticism
- Measures products discussed and product steering
- Identifies whether different information/ products are made available to Minorities and Non-Minorities
- Detects selling without determining needs, suitable products and ability to pay
- Identifies disclosure or omission of costs, fees, terms
- Monitors unfair and misleading sales practices
- Identifies disparate treatment
- Monitors assistance and uncovers differences in assistance to Minorities and Non-Minorities
- Detects whether access differs for protected classes
- Measures whether coaching occurs for Non-Minorities but not for Minorities
- Identifies product discussed and product steering
- Measures disclosure and consumer understanding
- Targeting of consumers and different types of consumers for loans and frequent refinancing
- Assesses the extent of determining needs and ability to repay

Getting the Program Right

Mystery Shopping

- ✓ Determine if assessment should be quantitative or qualitative
- ✓ Comprehensive mystery shopper training
- ✓ Realistic scenarios depicting real life and high risk situations
- ✓ Thorough profiles to the mystery shoppers
- ✓ Design a diagnostic but easy to complete questionnaire
- ✓ Do not tell the mystery shoppers the objective of the study is to ensure compliance with the law and fair treatment of consumers. They should be told it is to measure service quality
- ✓ Limit mystery shopper detection by setting a schedule when the shoppers will conduct the tests.
- ✓ Carefully edit the questionnaires for completeness and accuracy
- ✓ Debrief the mystery shoppers
- ✓ Enter the data into an electronic database and generate cross-tabulations of the data
- ✓ Analyze the data based on the objectives of the program and determine findings and implications
- ✓ Develop an action plan to ensure problem resolution and improvement

Post Application Telephone Surveys

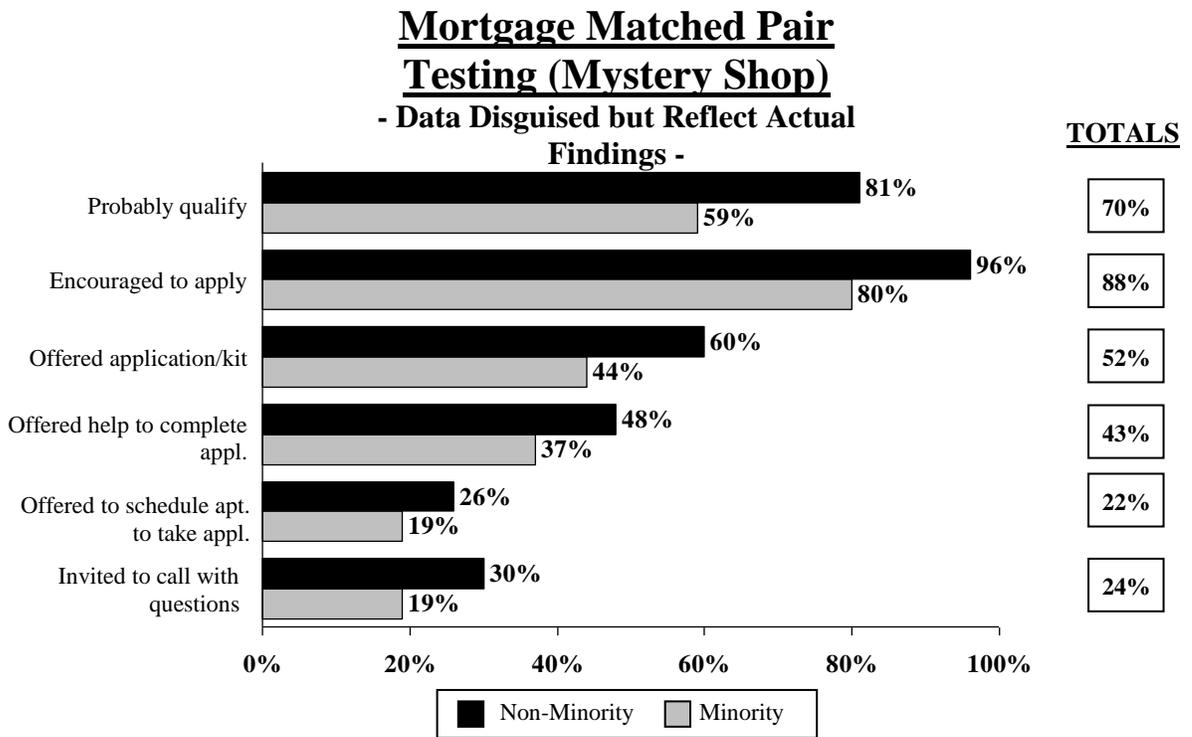
- ✓ Determine respondent definition and sample frame (e.g. interview consumers when experience is fresh in their minds)
- ✓ Telephone interviewer training
- ✓ Comprehensive diagnostic questionnaire that is easy to understand and administer
- ✓ Follow-up interviews to explore problematic issues (either over the telephone or in-person)
- ✓ Analyze the data based on the objectives of the program and determine findings and implications

- ✓ Develop an action plan to ensure problem resolution and improvement

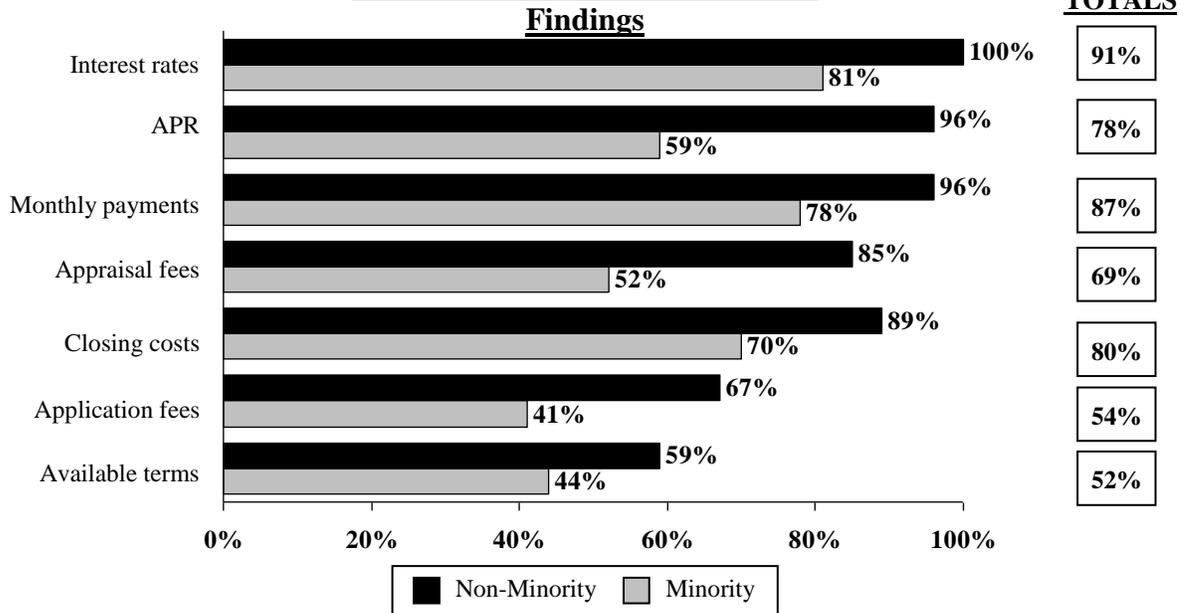
Reporting Examples

The data should be reported and analyzed based on the objective of the research. If the research is to help ensure equal and fair access to credit information for Minorities the data should be reviewed by Minority and Non-Minority. If the objective is to help ensure consumers are receiving adequate and correct information in order to make appropriate credit decisions the information can be reviewed one-off or on a monadic basis.

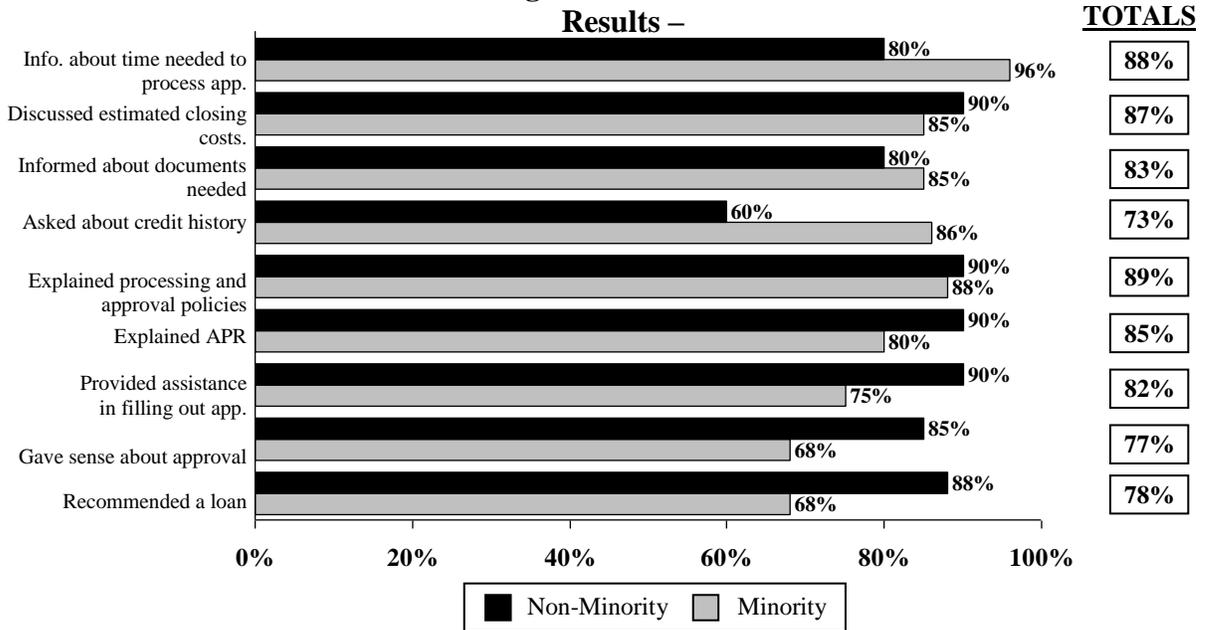
The charts below are examples of how the results of Match Pair Testing and Post Application studies have been reviewed.



**Mortgage Matched Pair
Testing (Mystery Shop)
Data Disguised but Reflect Actual**



**Mortgage Purchase Post
Application Survey
-- Data Disguised but Reflect Actual**



- Why Conduct Mystery Shopping and Market Research?

- Ensure consumers have adequate access to accurate information to make appropriate credit decisions
- Identify whether Minorities and Non-minorities are treated equally
- Verify adherence to protocols and laws and regulations
- Protect reputation of the lender

- What do you measure?

- Sales and service practices
- Treatment of Minorities and Non-Minorities
- The degree to which consumers feel welcome
- Needs discovery, ability to repay and suitability of products offered
- Advice and coaching provided
- Access to service and information
- Courtesy and comfort
- Office and employee performance

- Self-assessment and Market Research methods

- Matched pair testing
- Mystery shopping
- Post application Surveys
- Focus groups
- Complaint monitoring
- Statistical analysis

- What do you do with the results?

- Develop an action plan
- Communicate results with stakeholders that can act on the results
- Lenders should keep the results privileged and work with legal counsel
- Ensure accountability by developing and then monitoring the results of an action plan

The above Mystery Shopping and Market Research methods are powerful business and public policy tools. All businesses and government agencies involved in consumer credit owe it to consumers – and to themselves – to use these and other techniques to uncover prejudice and unfair sales practices. The costs are not great. The techniques are time-tested, and akin to the customer surveys many companies already perform.

The costs of not using them, however, can be prohibitive.

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