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Commonwealth Bank of Australia and
Melbourne Institute Financial Wellbeing
Scales Technical Report No. 1
Executive Summary
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In partnership with

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Executive Summary

The corporate vision of Commonwealth Bank of Australia (CBA) is 'to excel at securing and enhancing the financial wellbeing of people, businesses and communities' (CBA 2017, p. 2). To achieve that vision and to design policies and products to improve Australians' financial wellbeing, an operational measure of financial wellbeing is required.

This document reports the results of collaborative research between CBA and the Melbourne Institute: Applied Economic and Social Research and the Department of Finance at the University of Melbourne to conceptualise, develop, and test operational measures of the financial wellbeing of CBA's customers and Australians generally. The goal was to design and construct one or more financial wellbeing scales with data that could be *observed* from customers' financial records and data that customers could *report* about the financial outcomes they perceive and experience.

An enormous literature has considered various aspects of financial wellbeing, especially from the fields of financial services and financial planning. Despite this, no definition or metric has been universally adopted. In addition, no financial wellbeing scale combines objective data from customer records with self-reported information from personal responses. Customer-record data have the potential to enrich current models of financial wellbeing and improve our ability to monitor and improve people's financial outcomes.

We developed a preliminary conceptualisation of financial wellbeing and how it is determined that guided our scale development. Based on this conceptualisation, we produced generalisable scales of financial wellbeing. Two separate scales capture two main dimensions of financial wellbeing: *reported financial wellbeing*—formed from people's responses to several survey questions—and *observed financial wellbeing*—formed from customers' financial records. After showing how these scales relate to one another, we used them to describe the distribution of financial wellbeing in a representative sample of CBA customers across several dimensions.

Definition and Determinants of Financial Wellbeing

Financial wellbeing has many dimensions. Our definition of financial wellbeing is grounded in CBA's conceptualisation which considers the situational and temporal dimensions of 'every day, rainy day, and one day' financial outcomes. It also adopts elements of other functional dimensions that have been emphasised by previous researchers and financial professionals. In addition, it is informed by our empirical analyses, which revealed that wellbeing has components that relate to financial outcomes that people experience and *report* through a personal, subjective lens and to financial outcomes that can be *observed* from their financial positions, spending, savings, borrowing, and payments.

We define financial wellbeing as

> *the extent to which people both perceive and have:*
> 1. *financial outcomes in which they meet their financial obligations,*
> 2. *financial freedom to make choices that allow them to enjoy life,*
> 3. *control of their finances, and*
> 4. *financial security—*
>
> *now, in the future, and under possible adverse circumstances.*

We develop a conceptualisation of the determinants of financial wellbeing based on an abstract, theoretical description of people's financial behaviour. We conceptualise financial wellbeing as having three general sets of determinants: financial behaviour, household characteristics, and external conditions. The influence of these determinants on financial wellbeing mainly operates through financial behaviour. This conceptualisation helps us sharpen the separation between measures of financial wellbeing and measures of its determinants, which is crucial for the construction of financial wellbeing scales.

The Financial Wellbeing Scales

Our empirical analyses reveal that the measures of people's financial wellbeing can be grouped into two broad categories that relate to financial outcomes that they report based on their experiences and perceptions and to outcomes that can be observed from their financial positions, spending, savings, borrowing, and payments. Because of this, CBA and the Melbourne Institute (CBA-MI) create two scales of financial wellbeing.

The *CBA-MI Reported Financial Wellbeing Scale (version 1)* is formed from people's responses to 10 questions that ask about their perceptions and experiences of how they are meeting their financial obligations, whether they have financial freedom to make choices, whether they are in control of their finances, and whether they are financially secure.

The *CBA-MI Observed Financial Wellbeing Scale (version 1)* is formed from five measures that come from customers' financial records and that describe their financial circumstances constructed from records of their financial net positions, spending, savings, borrowing, and payments.

The CBA-MI Reported and Observed Wellbeing Scales are distinct measures both in the sense that they are constructed from different measures and in the sense that they represent different things. However, they are positively related to each other—people with good wellbeing in one dimension often (but not always) have good wellbeing in the other. The observed outputs from the two scales have a positive (Spearman) correlation of 40 per cent.

The Distribution of Financial Wellbeing

The Reported Financial Wellbeing Scale shows that people are somewhat more likely to report experiencing or perceiving good outcomes for a given condition rather than neutral or bad outcomes. The Observed Financial Wellbeing Scale shows a similar pattern.

We analyse the distribution of reported and observed financial wellbeing across the socio-demographic spectrum. We report several findings:

- Women are uniformly more likely than men to have low levels of reported and, to a lesser degree, observed financial wellbeing.
- Home owners are uniformly more likely to have higher reported and observed financial wellbeing.
- Both types of financial wellbeing are uniformly lower among people with limiting health conditions.
- Metropolitan area residents have slightly better reported and observed financial wellbeing than rural residents.
- Respondents who report having a major worsening in financial circumstances have markedly worse reported and observed financial wellbeing.
- People with stronger preferences for living within their means, better understanding of financial matters, better and longer-term planning behaviour, and more regular savings habits tend to have better reported and observed financial wellbeing.

- Reported financial wellbeing does not change much from young adulthood to middle age, yet it rises between the ages of 50 and 70. In contrast, people's observed financial wellbeing declines from people's late 20s to early 40s but increases afterwards.
- There are also marked differences in both wellbeing measures depending on people's living arrangements and work situations.

Discussion

The project's most important substantive finding is the distinction between reported and observed financial wellbeing. Our quantitative analyses showed that these are separate components of financial wellbeing. Having identified these divergences, future research by the CBA-MI team will work to increase our understanding the reasons for them.

Another key innovation in this project is the use of linked self-reported and customer-record data to measure financial wellbeing. Despite some challenges, the CBA-MI team observed financial wellbeing scale has strong statistical properties. Future research by the CBA-MI team will investigate ways to improve upon this measure and may result in different versions of the scales.

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