2002–03

MacroMonitor

PRODUCTS AND SERVICES ANALYSIS VOLUME

SRI CONSULTING BUSINESS INTELLIGENCE

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CONTENTS

SAVINGS AND INVESTMENTS

CREDIT

INFORMATION AND ADVICE

BALANCE SHEETS

APPENDIXES

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INTRODUCTION

The Consumer Financial Decisions (CFD) group's Products and Services Analysis Volume for the **2002–03 MacroMonitor** program covers the full range of retail and institutional household financial products and services. The five major sections correspond to the five basic financial needs: transactions, savings and investments, credit, protection, and information and advice. Each section presents information about products and services that serve one of those basic financial needs. The product subsections provide key product statistics, executive summaries, and analysis of survey results using CFD's proprietary Age Cohort, Socioeconomic Level, and Life Stage segmentation schemes (see Appendix F for segment definitions). We include data from the **1998–99** and **2000–01 MacroMonitor**, where comparable. "n.a." indicates that we did not ask the item.

OVERALL TRENDS

No two-year survey cycle period that the **MacroMonitor** has conducted since 1978 experienced as much turmoil in the financial markets, as much corporate malfeasance, and as many shifts in economic indicators (including changing levels of consumer confidence and interest rates) as the 2002–03 survey period did. But even as the financial markets hit bottom, trends in financial-product ownership and behavioral measures moved in expected and predictable directions. The **MacroMonitor** data thus reinforce the often-overlooked notion that the average consumer is not prone to making radical decisions and major changes. And when uncertainty increases, the tendency is either to keep doing what one has always done or simply to do nothing.

Equity ownership continued to rise in spite of market corrections, wrongdoings of corporate executives, and misleading reports of financial analysts. Overall penetration of household exposure to equities in any form is now more than 50% of households. Similarly, ownership of any type of retirement account continues on an upward curve, with more than six in ten households now having some type of retirement account or fully vested pension plan. And despite the market's lackluster performance, households continued their contributions to retirement accounts, raising total U.S. households' retirement-account median balance to $38,000 in 2002, $7,000 higher than in 2000. The U.S. economy and stock market's rebound in 2003 will likely reinforce these positive trends in the next measurement.

With historically low interest rates, more households were able to buy their own homes. More than 80 million U.S. households (or 68%) were homeowners in 2002, up from 72 million households (or 65%) in 1998. The combination of low interest rates and increasing home values has enabled more homeowners to refinance and take cash out and pay for home improvements, vehicles, vacations, college costs, and so forth. Consequently, the 2002 median balance outstanding on all mortgage loans ($74,000) was 9% higher than in 2000 and 23% higher than four years previously.

At the same time, the overall incidence of households with consumer credit (education loans, installment loans, other secured loans, unsecured personal loans, and so forth) has declined. So has the incidence of credit-card revolvers (that is, households that admit that they do not regularly pay their credit-card balance in full each month). These trends are likely the consequence of real estate loan trends—that is, more households are refinancing to pay off or

consolidate these higher-interest consumer loans along with consumers' increased desire to pay down their debt.

Although the incidence of households with consumer credit may be declining, the amounts of debt carried by those households with consumer loans or credit-card debt are increasing. The overall median balance outstanding on consumer loans has risen by $1,000 for each of the past survey periods (between 1998 and 2000 and between 2000 and 2002). The median balance among credit-card revolvers has increased by 10% from two years ago (and 19% since 1998) to $3,200 in 2002. Among younger households, incidences and median debt are substantially higher. Despite improving economic conditions, household debt should raise a red flag among lenders (and financial institutions in general), especially when interest rates go up in the coming years.

Anecdotal evidence suggested that the events of September 11 served as a wake-up call to people's sense of mortality and resulted in more people's contacting insurance agents to obtain life insurance (especially in the New York and Washington, D.C., metro areas). The **MacroMonitor** data from about a year later, however, reflected no upsurge in the penetration of life insurance. In fact, the incidence of households with life insurance coverage declined, from 75% in 2000 down to 71% in 2002. Heightened terrorist threats and feelings of insecurity have not thwarted or reversed the decade-long downward trend in life insurance.

Meanwhile, acceptance of online financial services among mainstream consumers has solidified. Among the almost 70% of U.S. households having access to the Internet (from home, work, school, or other location), almost half (48%) now do some online banking, and more than one-third (36%) conduct online investment transactions. But, for the foreseeable future, most financial customers will rely on both online and offline channels to conduct transactions. Contrary to initial expectations, online financial services appear not to be displacing offline and other automated activities (such as automated phone systems). Rather, the Internet has become a value-added alternative delivery channel that benefits both financial institutions and consumers.

The greatest challenge facing the financial services industry in the immediate future is to regain the trust and confidence of the average financial customer, especially investors. In 1994 and 2002, the **MacroMonitor** questionnaire contained two series of questions that asked household financial decision makers how much they trust financial institutions and their intermediaries. At the time of the 2002 **MacroMonitor**'s fielding, indictments against Arthur Andersen and the Enron probe were under way, and charges of misleading reports by financial analysts of major brokerage firms were just heating up. Not surprisingly, financial institutions, most notably stockbrokerage firms, suffered a loss of trust among U.S. households. But interestingly, the decline in trust in financial institutions did not necessarily extend to the financial professionals who represent these institutions. In spite of the investment-industry scandals, the proportions of households that trust their full-service broker, discount broker, or mutual fund company advisor have all increased from 1994 to 2002.

A subsequent procession of financial scandals (the mutual fund industry scandal in particular), insider trading, and breaches of fiduciary trust has become clear since the collection of the 2002 **MacroMonitor** data. It is quite likely that household trust of financial institutions and financial professionals (such as mutual fund company advisors) has sunk to new lows. But the results of the **2002–03 MacroMonitor** survey suggest that the customer's one-to-one intermediary experience may be turned into the saving grace of financial institutions. Despite an

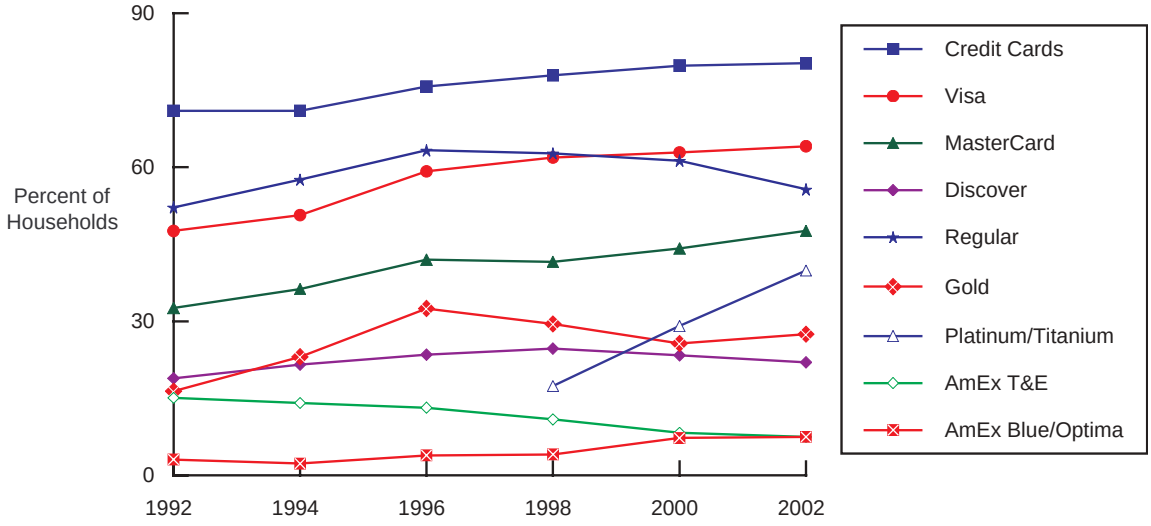
environment of negative publicity, consumers can be more forgiving and more understanding toward people they know. In other words, many untrustworthy brokers, analysts, and corporate executives may exist, but "My broker/advisor/representative is not one of them." Because many of the financial foundations that consumers rely on appear less certain, less solid, and less dependable, financial intermediaries—more importantly than ever before—must establish long-term personal relationships with their customers, perhaps even at the expense of short-term profit gains.

TRANSACTIONS

Asking consumers to forgo cash and checks (and monthly bills in the mail) may be asking too much too soon. Checks will continue to be the dominant type of retail noncash payment in the U.S. economy, probably through the next decade. But more households now use credit cards and debit cards as a transaction instrument than in the past—in 2002, half of all credit-card owners regularly paid their balance in full each month, compared to 42% in 2000. Moreover, three in ten households use automatic bill payment (up from 23% in 2000), and 22% now have automatic loan payment arrangements (from 18% in 2000). These noncash/noncheck transactions will likely accelerate in the coming years with the entry of Echo Boomers (sometimes, *Gen Y*) into adulthood. These children of Boomer parents constitute the first generation to grow up on the Internet. Their familiarity and high comfort level with technology assure the onward pace for these types of noncash/noncheck transactions.

Meanwhile, the total penetration of credit cards in U.S. households has plateaued at 80%. The introduction of Platinum and Titanium cards has caused the proportion of Gold cards to stay at roughly the same level and regular cards to decline. The maturity and saturation of this market suggest that any growth in market share must come at the expense of someone else's market—that is, the introduction of a new card tends to cannibalize an existing one.

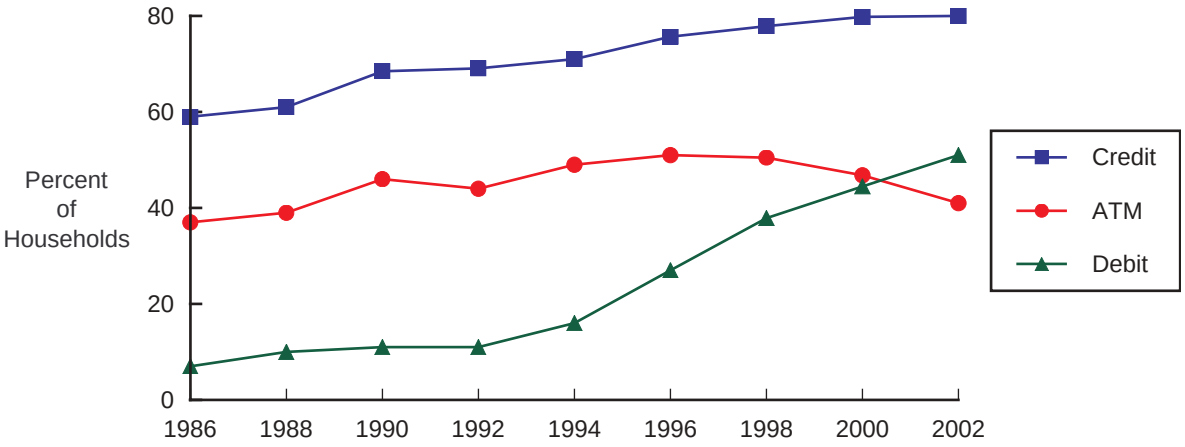
Figure 1
INCIDENCE OF OWNING CREDIT CARDS: IMPACT OF PLATINUM AND TITANIUM CARDS



Source: **The MacroMonitor**

Debit cards are successfully making inroads into the consumer lifestyle, with 51% of all households owning a debit card, compared to 45% in 2000 and 38% in 1998. Like the cannibalization occurring in the credit-card market, the increased market penetration of debit cards appears to be occurring at the expense of ATM cards. ATM cards are slowly losing market share and are down to 41% in 2002, compared to 47% in 2000 and 50% in 1998.

Figure 2
INCIDENCE OF OWNING CREDIT, ATM, AND DEBIT CARDS



Base: All U.S. Households

Use of online financial services is now nearing mainstream levels, given the widening availability of Internet access combined with the almost universal offering of online banking and investing services by financial providers. Although the significant increases in online banking and investing penetration (see Figure 3) may be overstated—2002 data include use from any device and any location; previous years' data include access from a PC at home only—other industry studies confirm the steady growth of online financial services.

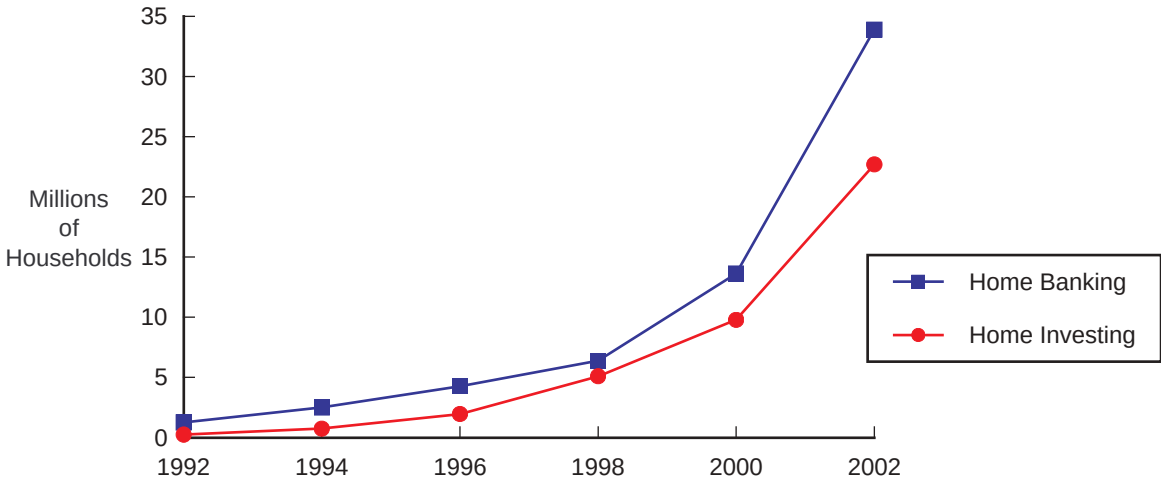
The rate of growth of online banking will likely decelerate as the market becomes more mature. Just a small proportion of wired households (14%) that currently do not use online banking expressed an interest in using the service in the future. And wired households that remain uninterested in using the service still constitute a sizable chunk of the wired household market (38%). Cost (some financial providers still charge for the service), ease of use, and security still tend to deter consumers from using online banking. On the other hand, increased availability of electronic bill presentment and payment (EBPP) should encourage more use from consumers who have tried online banking.

Close to 23 million households now use online investing services, accounting for 36% of all wired U.S. households. Although individual investor activity may have substantially declined since the historic bull-market days, many households will likely continue to view online investing as an integral part of the household's financial activity, regardless of the state of the financial markets. For households that have higher incomes, are highly comfortable with

technology, and—more important—prefer to be do-it-yourself investors, online investing is the ultimate empowerment tool.

The use of online financial services is not a zero-sum proposition for most consumers. They will likely rely on both online and offline channels to conduct transactions. Contrary to initial expectations, online financial services appear not to be displacing offline and other automated activities (such as automated phone systems). Rather, the Internet is developing into a value-added alternative delivery channel that financial institutions can use to deepen their relationship with their customers.

Figure 3
INCIDENCE OF USING ONLINE FINANCIAL SERVICES



Base: All U.S. Households

Note: 2002 includes access to the Internet via any electronic device from any location; 2000 and 1998 data are limited to Internet access using a computer at home.

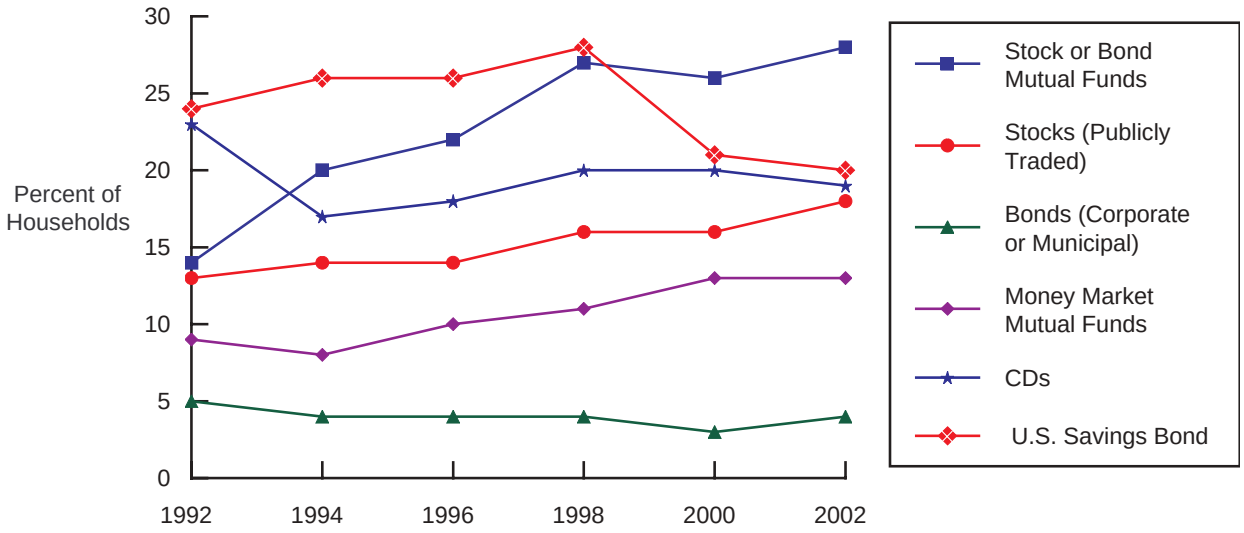
SAVINGS AND INVESTMENTS

Although the personal savings rate has been steadily declining (and the level of household debt has been increasing), the incidence and market penetration for savings products have been relatively stable. More than seven in ten U.S. households own at least one type of savings product. The majority of U.S. households own a regular or passbook savings account (57%), but the market penetration of other savings products is no more than one in five U.S. households.

The very low returns that savings products offer in this low-interest-rate environment have limited the market penetration of savings products outside the regular or passbook savings account. In 2002, a higher percentage of households own stock or bond mutual funds (28%) than own savings bonds (20%), CDs (19%), money market deposit accounts (18%), or money market mutual funds (13%).

The incidence of owning stocks, bonds, mutual funds, and other securities (outside retirement accounts) is generally up in spite of the market corrections that defined the 2000–02 period. The overall penetration of household exposure to any type of securities is now at 37% or 43.2 million U.S. households. Stock or bond mutual funds are the most likely type of investment product owned by the average household. Roughly three in ten households (28%) own at least one mutual fund product, and almost one in five own public stock (18%). Ownership of corporate and municipal bonds as well as other types of securities (such as REITs, Treasuries, zero coupon bonds, and so forth) remains below the 5% incidence level.

Figure 4
OWNERSHIP OF ASSET PRODUCTS OUTSIDE RETIREMENT ACCOUNTS

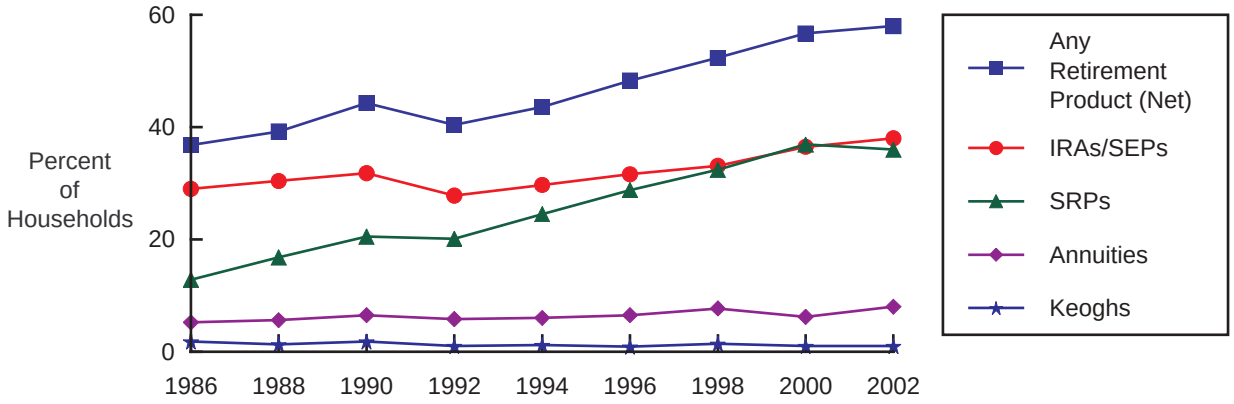


Source: **The MacroMonitor**

The **2002–03 MacroMonitor** data represent a snapshot of the economy in the summer of 2002, two years into the bear market. Although the median market value of all securities owned by households overall decreased by just 7%, from $43,000 in 2000 to $40,000 in 2002, some specific household segments—such as Younger Boomers, Younger Retirees, and Married No Child households—experienced significant losses. Not surprisingly, two subsequent years of negative returns have sapped consumers' risk tolerance. Almost half of all U.S. households now view the stock market as too risky, a 12% increase from two years ago.

In spite of the market declines, the overall penetration of retirement accounts continues to increase. However, in the past two years, the incidence of salary-reduction plans (SRPs: 401(k)s, 403(b)s, 457s) essentially stalled. The dismal economic environment may have hindered some households, particularly the younger ones, from participating in SRPs, especially if precipitated by employers' cutting back on matching contributions. Despite the markets' lackluster performance, however, total assets in retirement accounts continue to grow, with the median balance at $38,000 in 2002, $8,000 higher than four years previously. This increase was likely brought about by additional contributions by households to their retirement accounts, as opposed to positive market performance of existing assets.

Figure 5
INCIDENCE OF OWNING RETIREMENT PRODUCTS



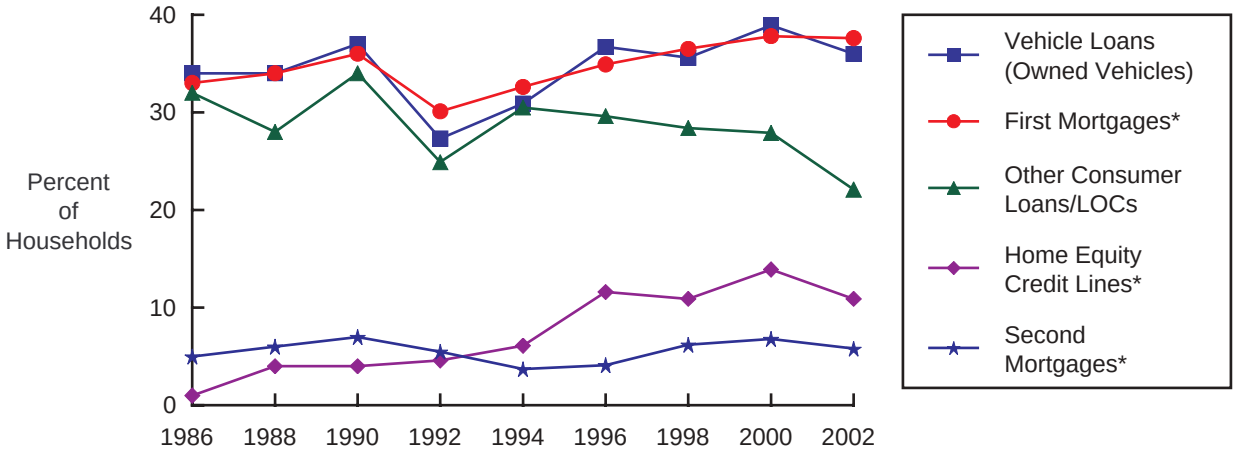
Base: All U.S. Households

CREDIT

In spite of historically low interest rates and increasing home values, the incidence of households with real estate loans has remained steady (although some growth has occurred as the total population has grown). And in spite of 0% (interest-free) financing offers, the incidence of households having at least one outstanding vehicle loan in 2002 is not markedly different from the proportion in 2000 (36% and 39%, respectively). However, the decline in the proportion of households having some form of consumer credit, from 28% in 2000 to 22% in 2002, is statistically significant. This change may partly result from the refinancing boom as households refinanced to pay off or consolidate higher-interest consumer loans.

With many homeowners taking advantage of tumbling interest rates to move up to bigger houses or refinancing and taking cash out for home improvements, vehicles, vacations, college costs, and so forth, the fact that the median balance outstanding on all mortgage loans in 2002 was up by 23% since 1998 to $74,000 is no surprise. Similarly, the level of debt carried by households that have consumer loans also continues to climb. The overall median balance outstanding on consumer credit has risen by $1,000 between 1998 and 2000 and by another $1,000 between 2000 and 2002. The increases partly reflect the significant increases in education loans, from $8,000 in 1998 to $13,000 in 2000 and $14,000 in 2002.

Figure 6
INCIDENCE OF OWNING CREDIT PRODUCTS



* On primary residence.

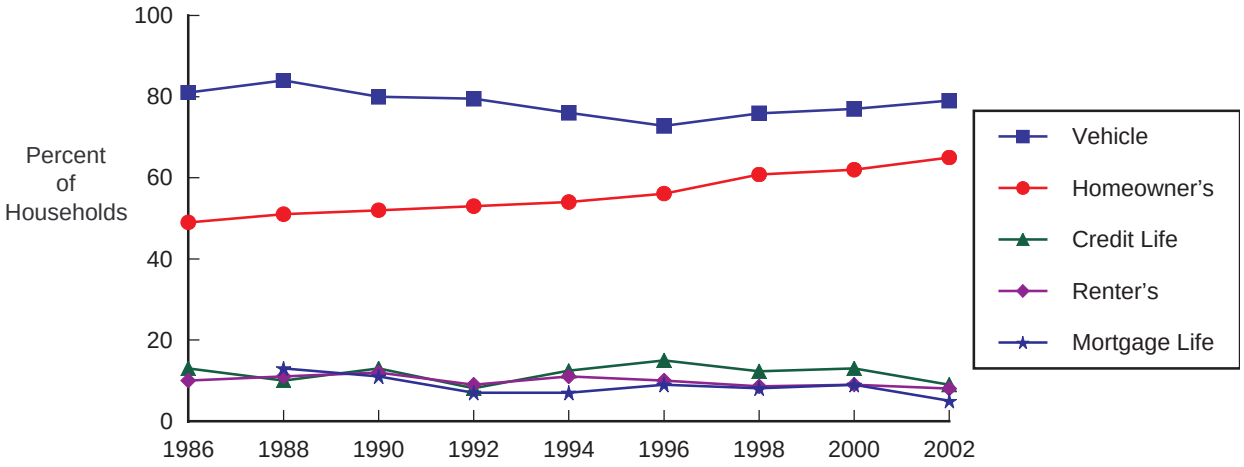
Base: All US Households

PROTECTION

Incidences of property and casualty insurance remain highly correlated with the underlying trends in consumer asset and credit acquisitions. The current low-interest-rate environment, in particular, has spurred consumers to make initial or step-up vehicle and home purchases, thus continuing the upward path of market penetration of vehicle and homeowner's insurance started in the mid-1990s. About eight in ten U.S. households have vehicle insurance, and 65% have homeowner's insurance in 2002.

Meanwhile, the incidence of households carrying mortgage insurance on their primary residence saw a sharp decline in 2002 and now stands at 5% from a 9% level in 2000. Similarly, the incidence of credit insurance experienced a dip from 13% in 2000 to 9% in 2002, reflecting the underlying decline in the proportion of households that report having some other form of consumer credit such as education loans, installment loans, other secured loans, personal loans, and so forth.

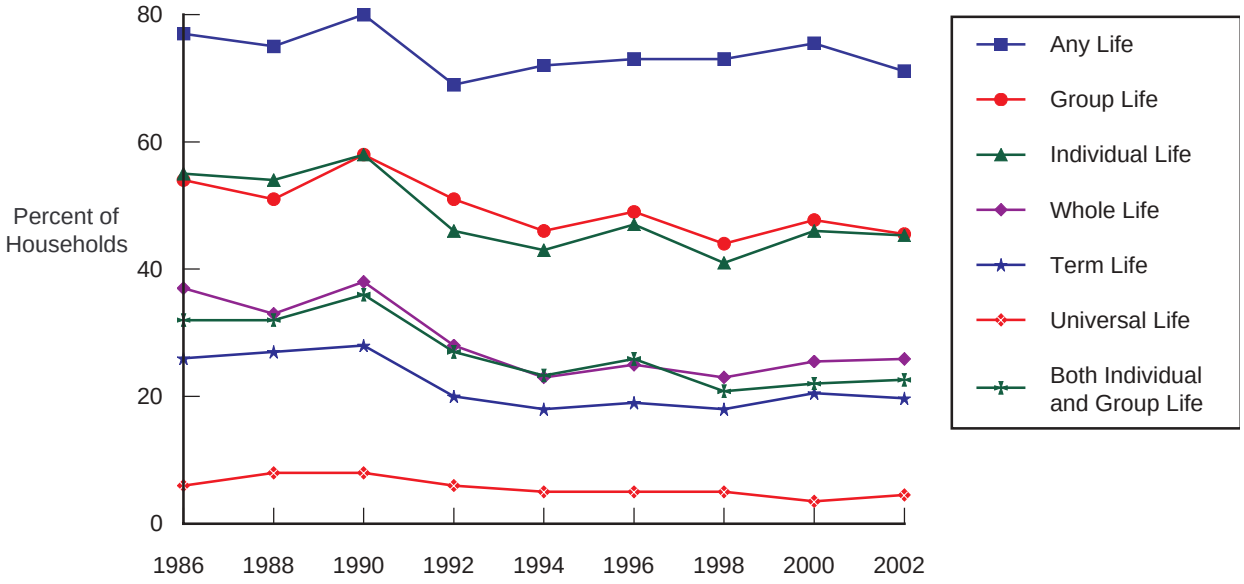
Figure 7
INCIDENCE OF OWNING PROPERTY OR CASUALTY INSURANCE PRODUCTS



Base: All U.S. Households

Heightened terrorist threats and security worries of the past two years, particularly the September 11 tragedy, purportedly served as a wake-up call to people's sense of mortality and demonstrated the continuing basic need for protection. But the **2002–03 MacroMonitor** data reflect no significant upsurge in numbers of households with life insurance. Slightly more than 83 million households (71% of all U.S. households) have some type of life insurance coverage in 2002, down from 87 million (75% of total households) in 2000.

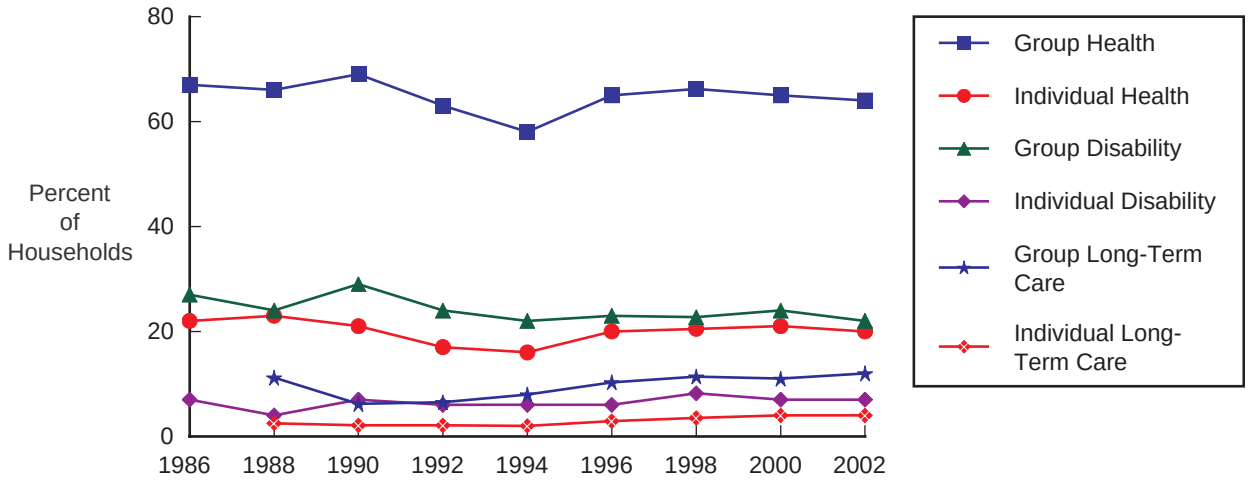
Figure 8
INCIDENCE OF OWNING LIFE INSURANCE PRODUCTS



Source: **The MacroMonitor**

The incidence for health insurance has remained flat in the past four years and even shows a slight decline from 76% in 2000 to 74% in 2002. This stasis is in line with the 2002 Census finding of an increased number of Americans who lack health insurance. Given that the majority of households obtain their health insurance through their jobs, increased layoffs and higher employee contributions toward premiums have resulted in more households without access to health insurance or choosing to forgo coverage because of cost. The increased percentage of households that pay health insurance premiums reflects the trend of more employers' passing more of the cost of health care to their employees. In 2002, 72% of households paid premiums, up by five percentage points from two years ago. Among households that pay premiums, the overall median premium for health and health-related insurance continues to increase, to $1,200 in 2002.

Figure 9
INCIDENCE OF HEALTH OR HEALTH-RELATED INSURANCE COVERAGE

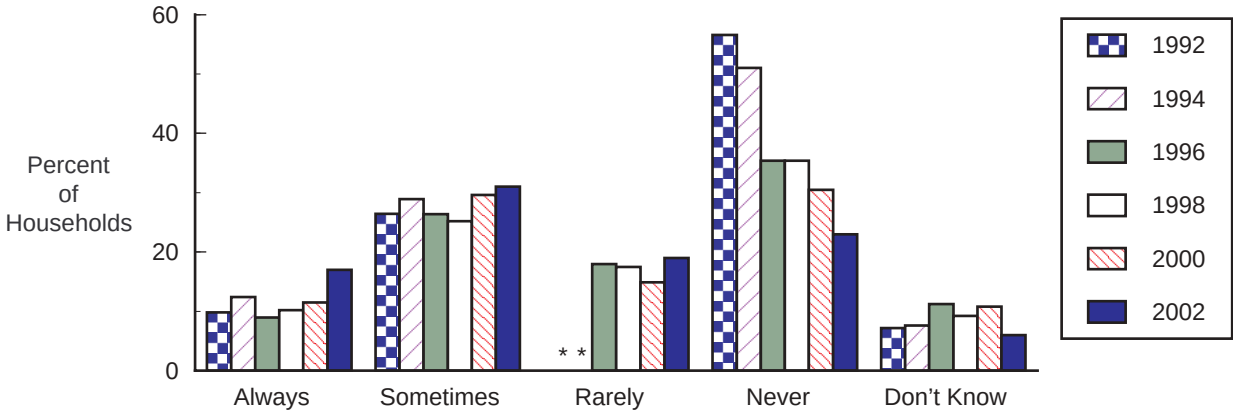


Base: All U.S. Households

INFORMATION AND ADVICE

More households than ever indicate that they regularly (always or sometimes) secure advice before making financial decisions for their households. The prolonged bear market and the overwhelming amount of available financial information—not to forget the unraveling issues of corporate mismanagement and Wall Street excesses—cannot but shake the consumers' confidence in navigating the financial waters on their own. The proportion of U.S. households that say they always or sometimes receive advice before making major household investment decisions increased by 17% between 2000 and 2002—from 41% to 48%.

Figure 10
INCIDENCE OF RECEIVING ADVICE BEFORE MAKING MAJOR FINANCIAL DECISIONS



* Category not included in 1992 and 1994.

Base: All U.S Households

Among households that receive advice before making a major investment decision, a bank or S&L officer or investment advisor continues to be the most likely type of professional advisor that a household will turn to for advice. However, the incidence of households using this type of advisor has been slowly eroding, from 24% in 1998 to 20% in 2002. Similarly, incidences for the next most frequently used types of adviser—full-service stockbroker and independent financial planner or consultant—have declined in the past two survey years.

Table 1
INTERMEDIARIES USED AS FINANCIAL ADVISOR IN LAST TWO YEARS
(Percent of Households)

Intermediaries	2002	2000	1998
— Bank or S&L officer or investment advisor	20	22	24
— Full-service stockbroker	17	19	23
— Independent financial planner or consultant	16	20	18
— Accountant or CPA	14	13	16
— Lawyer	13	10	11
— Mutual fund company investment advisor	10	11	14
— Certified financial planner	10	n.a.	n.a.
— Insurance company agent	8	} 13	} 19
— Independent insurance agent	9		
— Credit union officer/investment advisor	8	6	7
— Private banker/trust officer	5	2	3
— Discount stockbroker	3	4	4

Base: Receive advice (always or sometimes) before making major investment decisions.

In 1994, well before the market run-up of the late 1990s, the **MacroMonitor** questionnaire contained two series of questions that asked household financial decision makers how much they trust financial institutions and their intermediaries. In 2002, well after the market peaks of March 2000, we asked the same series of questions using the same methodology. By this time, the series of scandals involving corporate malfeasance, credibility issues of financial analysts, and other market excesses were well under way (but more scandals will rock the industry later on, including the biggest crisis in the history of the mutual fund industry).

The following are among the findings of the comparative analysis of the level of trust that U.S. households accord to financial institutions between 1994 and 2002:

- Depository institutions continue to be the most trustworthy in the eyes of consumers. That level of trust, however, has declined since the bursting of the investment bubble.
- A greater proportion of household financial decision makers have a great deal of trust in insurance companies now than they did in the past.
- The increase in the percentage of households that trust mutual fund companies is significant, although with the mutual fund scandal unraveling at the time of this writing, trust in mutual fund companies has likely suffered since the 2002 survey.
- The percentages of households that have hardly any trust in full-service and discount stockbrokerages have gone up significantly, a reflection of the scandals occupying the media during the fielding of the 2002 survey.

The decline in trust in financial institutions did not necessarily extend to the financial professionals that represent these institutions. In spite of the investment industry scandals, the proportions of households that trust their full-service broker, discount broker, or mutual fund company advisor have all increased from 1994 to 2002. The largest declines in trust from 1994 to 2002 are for bankers and credit union advisors. This decrease in trust may be the unanticipated outcome of the massive mergers-and-acquisitions activities of the past eight years wherein larger institutions replaced smaller, locally owned banks, increasing the impersonal nature of interactions at branches.

Household trust of financial institutions and financial professionals may have sunk to new lows, given the parade of additional financial scandals that have unraveled since the collection of the **MacroMonitor** data in 2002. Nonetheless, the results of the **2002–03 MacroMonitor** survey highlight the importance of the customer's one-to-one intermediary experience (that is, "many untrustworthy brokers, analysts, and corporate executives may exist but not my broker/advisor/representative"). As many of the financial foundations that consumers rely on appear less solid and less dependable, it becomes more important than ever for financial institutions and their representatives to establish long-term personal relationships with their customers, perhaps even at the cost of short-term financial gains.