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Findings from the 2010 Survey of Consumer Finances

In June, the Federal Reserve Board released the complete results from the 2010 Survey of Consumer Finances. The SCF is the Fed's triennial survey of how American households utilize financial services. The study examines consumer saving, borrowing, transacting, and investment behavior; and, because it is a longitudinal survey now in its eighth iteration, it allows comparison of trends across periods dating to 1989. A discussion of several of the most interesting and notable trends follows.

The wealth gap increased dramatically in recent years. In the 2001, 2004 and 2007 surveys, the median wealth of the top 10% of households was 15 times greater than the median wealth of all households. But in the 2010 survey, that gap accelerated to *(continued on page two)*

The most effective financial institutions employ a mix of service models with both freestanding and smaller branches.

Branch Service Models: A Comparison of Operating Costs

Financial institutions employ a variety of branch configurations, or service models, in their efforts to meet customer demands while maximizing operating efficiency. In an age where changing consumer preferences are driving the migration of transactions out of the branch and into electronic channels, the role of the branch is changing. As a result, institutions are increasingly considering smaller service models. With in-branch transaction volumes eroding and electronic media addressing records storage needs, bankers can embrace floor plans with less queuing and back office space, and can reorient the branch from transaction processing toward sales and advisory services.

The smaller format branches, often in leased space, can require significantly less capital and, more importantly, consume significantly less non-interest expense. The table on the page three compares standard operating costs under three service models: a traditional freestanding branch; an inline branch, i.e., a branch in a strip shopping center; and an in-store branch (in a grocery or retail store). The numbers shown represent industry averages, but actual figures can vary substantially based on market, finish levels, furnishing choices and internal equipment standards.

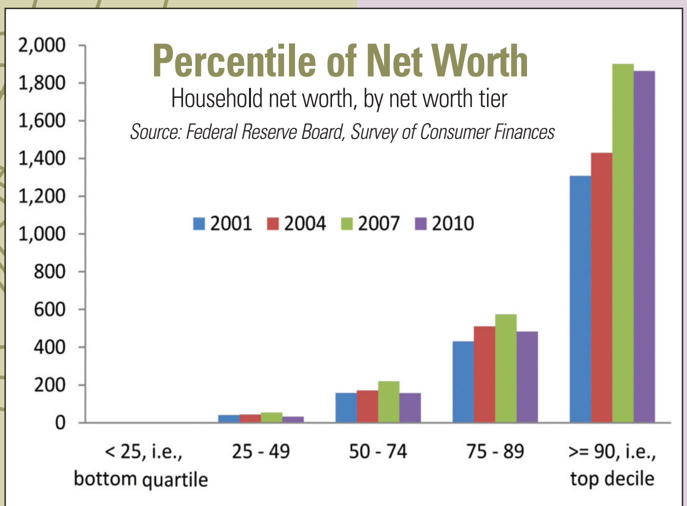
Without the expense of a land purchase, an inline branch can be outfitted for about one-third the cost of a traditional branch; and an in-store branch for slightly more than half the cost of an inline branch. Part of the land savings is consumed by rent, though, which the inline and in-store models require but the owned freestanding model bypasses. But the most significant difference lies in the staffing costs of the various models. Because staff costs consume about two-thirds of branch expenses, the primary objective of a smaller facility is not to reduce square footage for its own sake, but rather to facilitate operation with fewer employees.

Whereas a traditional branch may operate with three or four tellers and another three or four bankers on the platform side, a smaller branch can use cross-trained employees and leverage the short paths between critical workstations to operate with five or six full time equivalent employees. In-store branches may operate with only three employees at any given time, but part of that advantage is offset by the longer hours in-store branches typically operate, yielding a staff complement in the four to five FTE (full-time equivalent) range.

In aggregate, the combined occupancy and staffing costs give inline branches an annual advantage approaching $100,000 versus freestanding facilities, and in-store branches a $240,000 annual advantage.

While smaller format branches carry a benefit in terms of capital and operating costs, they face some drawbacks, too. Empirical studies show that inline branches capture nearly *(continued on page three)*

Findings from the 2010 ***Survey of Consumer Finances*** *continued from page one*



24 times. Since 2004, the median assets of every wealth tier (the bottom 25%, the second quartile, the third quartile, and the 75th through 90th percentiles) declined, but the median assets of the top decile increased by 30%.

The flight-to-quality phenomenon has increased banks' and credit unions' deposit wallet share. In the 2007 survey, the last version before the financial crisis, transaction accounts and CDs accounted for only 14.9% of consumer financial holdings (i.e., bank deposits, stocks, bonds, etc., but not non-financial assets such as homes, automobiles or the value of owned businesses). In 2010, the insured bank products accounted for 17.2% of consumer financial portfolios. This reflects the tendency of inherently risk averse consumers to migrate balances from uncertain, risky instruments such as stocks into the safe haven of federally insured bank deposits during times of economic uncertainty.

Most Americans maintain some level of non-revolving debt. Seventy-five percent of all American households carry some level of debt, with the two most frequent types being primary mortgages (held by 47% of all households) and installment loans (46%). Credit cards are also prominent, with 39% of households carrying credit card debt. The proportion of households with loans declined slightly, by two percentage points from the 2004 and 2007 surveys. Households in the middle age tiers are most likely to hold debt, with 85% of those in the 35 – 55 age tiers carrying loan balances. The proportion declines modestly in the 55 – 75 age tiers, and then precipitously in the 75+ tier, where only 38% of households hold loan debt.

Home equity borrowing is declining. In the 2004 and 2007 studies, 18% of households held home equity lines of credit and 12.5% held HELOCs with balances drawn; in the 2010 study, the proportion declined to 15% holding HELOCs and only 10.5% with balances drawn. This likely reflects multiple factors, including bank line contractions in response to declining home values and/or credit scores; and declining consumer confidence causing an aversion to borrowing, especially against a primary residence.

The Internet is becoming increasingly prominent in consumer search. In 2001, only 22% of consumers cited the Internet as a source they used for researching a borrowing need, and only 15% cited the Internet as a source they used for researching an investment need. In the 2010 survey, the proportion of consumers using the online channel for research rose to 42% for credit products and 33% for investment products. The Internet is supplanting the phone channel as a research avenue to some degree, but the decline in the proportion of consumers who use the phone for research was less than the gain of those using the Internet. Overall though, the Internet represents an additional research avenue rather than a replacement of preexisting avenues. Despite the ease of conducting online research from the home, "friends and relatives" remains the most widely cited source of information, and the use of that forum has actually trended upward in recent years.

The branch remains preeminent in the account opening decision. Over the past 20 years, "location of their offices" has been the most common response to the question "what is the most important reason for choosing your institution for your main checking account?" In every iteration of the SCF since 1992, the proportion of consumers citing "location" has hovered between 44% and the current 46% level. The next most frequently cited reasons, "able to obtain many services at one place" and "had the lowest fees/minimum balance requirement" were claimed by only 17% and 14% of respondents, respectively; and note that the former implies a location-based filter, too. Thus, despite the rise of the Internet as a transactional channel, there is little evidence of that channel replacing physical location convenience as a primary determinant of financial institution choice.

Future issues of Bancology will explore the SCF findings in more detail and will especially delve into the implications of the findings for financial institutions' distribution strategies.

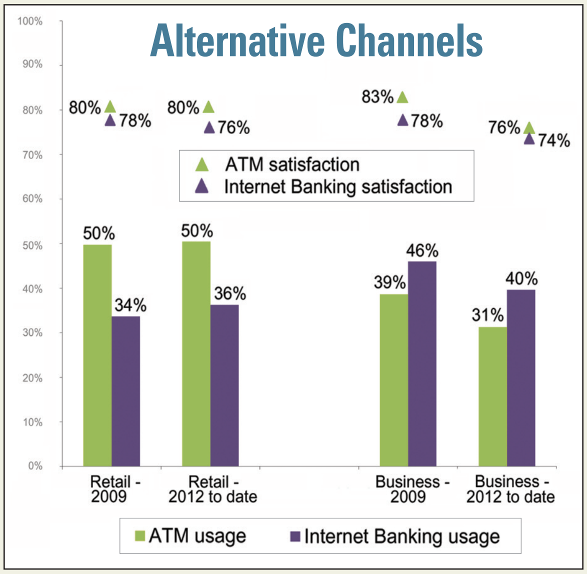
The Fed's triennial survey examines consumer saving, borrowing, transacting, and investment behavior; and, because it is a longitudinal survey now in its eighth iteration, it allows comparison of trends across periods dating to 1989.

Alternative Channel Usage and Satisfaction

The financial industry has done all that it can to move simple transactions away from the branch to alternative channels. Financial institutions have invested prodigiously in advanced-function ATMs and Internet Banking with Bill Pay. Admittedly, offering these channels was a necessary evil, simply because everyone else was doing it; thus the customer expected it.

Bancography's Customer Service, Satisfaction and Loyalty tracking studies have captured the usage and satisfaction across alternate channels. Bancography interviewed retail and businesses customers from banks and credit unions. There was no significant difference in the responses from the customers of the two types of institutions.

Respondents were asked whether they had used the channel in the past 30 days and if so what was their satisfaction with it. ATM usage and satisfaction among consumers has not varied at all since 2009. Businesses are using ATMs less and are less satisfied with the machines. Reasons for this discontent include that the machine was down or out of service, too slow, rejected or kept card, outdated abilities and fees. When respondents were asked whether they had experienced a bank-created problem or error, only one percent of retail customers and two percent of business customers reported problems or errors with ATMs.



Internet banking or bill pay slightly increased in usage for consumers but fell for businesses. Satisfaction of the channel has suffered. Platform conversions, antiquated log-in difficulties, down time and ease of use encompassed most of the complaints. Unlike the ATM, an Internet banking issue is beginning to surface as a driver for attrition. Eight percent of retail and six percent of business customers reportedly experienced a problem or issue related to this channel. This illuminates the growing importance or dependency of the channel by those who utilize it.

Usage of channels has not changed much overall because individuals have their preferences and are habitual. Sure cash can be had at a point-of-sale (POS) machine, but that's an additional venue rather than a replacement. Customers now are expecting more from ATMs and Internet banking due to their reliance on these channels for transactions.

Mobile banking is the latest alternative channel. Bancography has added this channel to its surveys and will share results after obtaining six months of data.

Branch Service Models: A Comparison of Operating Costs *continued from page one*

70% of the deposit volumes of freestanding facilities in the same trade area, and in-store branches about 35% of the balances of freestanding branches. However, empirical evidence also shows that large branch networks capture a disproportionate share of balances; that is, with greater overall awareness and perceived convenience, an eight branch network will capture more than twice the deposit gain of a four branch network, as consumers reward that perceived ubiquity by choosing the broader distribution network. Thus, while the smaller branches may capture smaller deposit bases in their own right, they bring benefit beyond that to the institution overall, by increasing the perception of convenience and thus influencing consumers' choices at branches across the institution's network. Ultimately, the most effective networks employ a mix of service models: freestanding branches to provide visibility, drive-in banking access, and space for non-retail lines of business such as mortgage, business banking, or wealth management; and smaller branches to extend the institution's share of branches and share of hours while not consuming excessive non-interest expense.

Notes about chart to the right:

Comparative branch deposit statistics based on June 2011 FDIC summary of deposits.

Operating costs estimates reflect 2012 industry averages.

Non-interest expense includes all expense items listed: occupancy, depreciation, cost of capital, utilities, miscellaneous, salaries and benefits.

Cash operating expenses include all non-interest expenses except non-cash items (depreciation and cost of capital).

Service Model Costs *(in $000s, except per sf items)*

	TRADITIONAL	INLINE	IN-STORE
Square footage	3,500	2,000	400
Land	800	—	—
Building	875	400	235
Depreciation term	30	15	15
Furniture	125	100	85
Equipment	175	150	55
Total capital cost	1,975	650	375
Rent per sf	$0.00	$24.00	$90.00
Occupancy	—	48	36
Depreciation	79	68	41
Cost of capital for land	32	—	—
Utilities per sf	$4.00	$4.00	$4.00
Utilities	14	8	—
Miscellaneous	36	24	18
Weekly hours of operation	45	45	60
FTEs	8	6	5
Salaries/benefits at maturity	395	319	223
Total non-interest expense	$556	$467	$318
Total cash operating expenses	$445	$399	$277

NEWS

Kimberly Clay will present ***Evaluating Your Brand's Effectiveness*** at the **American Bankers Association Marketing Conference** on September 25 in San Diego.

Steven Reider will present ***How & Why Customers Choose to Bank with Your Institution*** at the **American Bankers Association Annual Convention** on October 16 in San Diego.

Jamie Eads will participate in a panel discussion on ***The Branch of the Future*** during the **Virginia Association of Community Banks Annual Convention** on October 16 in Williamsburg.

Bancography will exhibit at the upcoming conferences:

ABA Bank Marketing Conference
September 23 – 25, San Diego, Booth 313

BAI Retail Delivery Conference & Expo
October 9 – 11, Washington, D.C., Booth 1143

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